NEW YORK COUNTY
NYCLA
LAWYERS' ASSOCIATION

**TASK FORCE ON JUDICIAL BUDGET CUTS**
**Co-Chairs: Hon. Stephen G. Crane and Michael Miller**
**Report on Public Hearing Conducted on December 2, 2013**

**This report was approved by the Executive Committee of the New York County Lawyers' Association on January 3, 2014.**

# COURTS IN CRISIS

***The budget remains the single most important issue facing the courts.***

Chief Justice John Roberts, December 31, 2013.[1]

## INTRODUCTION

In his Year-End Report on the federal judiciary, released on New Year's Eve 2013, Chief Justice Roberts noted that Congress has set a target date of January 15, 2014 to complete the appropriations process for fiscal 2014. He then warned that absent significant relief from the brutal and indiscriminate budget cuts mandated by sequestration, "The future would be bleak." Court staff would be further reduced, civil and criminal cases would be delayed, and the consequences would include "a genuine threat to public safety," as well as "commercial uncertainty, lost opportunities, and unvindicated rights."[2]

The New York County Lawyers' Association (NYCLA) has been tracking the real-world effects of budget cuts on our courts—both federal and state—for the past two and a half years. On December 2, 2013, NYCLA's Task Force on Judicial Budget Cuts (Task Force) held its second all-day public hearing on the continuing judicial budget crisis. Seven hours of testimony from 23 witnesses—including court administrators, judges, prosecutors, defense attorneys and bar leaders—dramatically illustrated both the breadth and depth of the problem.[3] These witnesses provided detailed and compelling evidence that the

[1] 2013 Year-End Report on the Federal Judiciary, Dec. 31, 2013 (hereinafter Year-End Report), p.1, available at http://www.supremecourt.gov/publicinfo/year-end/2013year-endreport.pdf.

[2] Id., pp. 8-9.

[3] Witnesses included New York State Court administrators; the Chief Judges of the United States Court of Appeals for the Second Circuit, the Eastern District of New York, the Southern District of New York and the Bankruptcy Courts for the Eastern and Southern Districts of New York; the United States Attorneys for both the Southern and Eastern Districts of New York; the Executive Director of the Federal Defenders of New York; the Presidents of the American Bar Association, the New York State Bar Association, the Federal Bar Council, and the Federal Bar Association; attorneys; and representatives of public interest groups. See Appendix A for the hearing schedule with the list of witnesses.

cumulative impact of judicial budget cuts over the past several years has pushed both the New York and federal courts into crisis, and the hearing received substantial coverage in the press.[4]

Witnesses detailed the continuing corrosive effect that budget cuts have had on the justice system over the past several years. Delays at every stage of every matter before the courts are now common: delays in getting into the courthouses, delays in processing documents, delays in the public's ability to obtain archived documents, delays in trial proceedings, delays in decisions. The decimation of court staff has also reduced security for both the courts and the public, and, ironically, forced the dismantling or reduction of a range of programs that actually generate revenue or save money, from prosecution of economic crimes to drug treatment programs that cut recidivism rates. Although there were some bright spots—and there is hope for limited budget relief from both Washington and Albany—the testimony concerning both the New York and the federal courts reflected a judicial system in deep crisis.

Regarding the federal courts, we heard that a series of budget cuts over the past several years, followed by the across-the-board ax of sequestration earlier this year—has damaged the courts in very meaningful ways. Cuts have created untenable management issues for all decision-makers, damaged morale and, as the testimony consistently reflected, compromised the courts' ability to meet their constitutional and statutorily mandated responsibilities and duties. Moreover, many of the cost reductions seemingly achieved are illusory. United States Attorneys Preet Bharara and Loretta Lynch—who head the federal prosecutors' offices in the Southern and Eastern Districts of New York, respectively—pointed out that their offices generate enormous amounts of money from fines, fees and restitution that go into the United States Treasury. Yet because of hiring freezes, the headcount for both Assistant United States Attorneys and staff positions has been significantly reduced, forcing those offices to curtail or scale back investigations or prosecutions that could pay for themselves many times over.

Additionally, the witnesses testified that the across-the-board cuts have caused serious public safety issues, not just for courthouse staff but for the public as well. There have been more threats to federal judges than ever before, yet there has been a mandatory reduction in the number of court officers. Moreover, essential training, such as for firearms safety, has been reduced or eliminated. The caseload for federal Probation Officers has increased due to the cutbacks and hiring freeze and, as a result, presentence

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[4] *See, e.g., New York Times*, December 2, 2013, p. A23 (available at http://www.nytimes.com/2013/12/03/nyregion/prosecutor-sees-danger-in-budget-cuts.html?_r=2&); *New York Post*, December 2, 2013 (available at http://nypost.com/2013/12/02/us-attorney-preet-sequestration-cuts-put-safety-at-risk/); *New York Daily News*, December 2, 2013 (available at http://www.nydailynews.com/new-york/cuts-turn-ny-unsafe-chicago-u-s-attorney-article-1.1535466); *New York Law Journal*, December 4, 2013 (available at http://www.newyorklawjournal.com/PubArticleNY.jsp?id=1202630403051&Judiciarys_Request_for_Increase_in_Funds_Receives_Early_Support&slreturn=20131130153218); *Wall Street Journal*, December 2, 2013 (available at http://blogs.wsj.com/law/2013/12/02/us-attorney-chief-judge-decry-budget-cuts/?KEYWORDS=preska); *Law360*, December 2, 2013 (available at http://www.law360.com/legalindustry/articles/491818/prosecutors-say-budget-woes-imperil-ny-criminal-recoveries); *Brooklyn Daily Eagle*, November 27, 2013 (available at http://www.brooklyneagle.com/articles/hearing-judicial-budget-cuts-has-focus-brooklyns-court-2013-11-27-183000); *Courthouse News Service*, December 3, 2013 (available at http://www.courthousenews.com/2013/12/03/63394.htm); *The Jewish Voice*, December 4, 2013 (available at http://jewishvoiceny.com/index.php?option=com_content&view=article&id=5989:budget-cuts-may-leave-nyc-office-of-us-attorney-in-peril&catid=112:new-york&Itemid=295).

reports are necessarily less thorough, and field work and probation services to and monitoring of offenders have been reduced.

Regarding the New York State courts, we heard that the $170 million in cuts to the judiciary budget three years ago, followed by "flat" funding since (in the face of rising costs), has produced a hiring freeze, reduced court hours and greater delays at every stage of court proceedings. New Yorkers now face routine delays and often long lines simply getting into the courthouses (sometimes resulting in default judgments and then orders to show cause to set aside the judgments), delays in obtaining files (up to 14 weeks to obtain an archived file), delays in trials, delays in motion practice, delays in obtaining decisions, and delays in the processing of papers. Not surprisingly, the morale of court personnel has declined dramatically.

As Chief Justice Roberts noted in his Year-End Report, the impact of budget cuts is more severe in the judicial system than in other parts of the federal government, as "virtually all of [the courts'] core functions are constitutionally and statutorily required."[5] The same is true, of course, for the courts of New York State. Moreover, as the Chief Justice pointed out: "The five percent cut that was intended [by sequestration] to apply 'across-the-board' translated into even larger cuts in discretionary components of the Judiciary's budget." The combined effects of cuts and sequestration have resulted in "the lowest staffing level since 1997, despite significant workload increases over the same period," have reduced federal defender offices by 11 percent in fiscal 2013 alone, have "postponed trials and delayed justice for the innocent and guilty alike," and have significantly reduced security, "placing judges, court personnel, and the public at greater risk of harm."[6]

Since its establishment in June 2011, NYCLA's Task Force has issued five substantive reports and held two all-day hearings on the impact of budget cuts on the administration of justice.[7] NYCLA recognizes the difficult economic and political realities facing court administrators and appreciates their efforts to provide the best service possible under increasingly challenging circumstances. However, even the best efforts of dedicated and gifted administrators and court personnel cannot change the reality that our courts are perilously straining as a result of budget cuts and sequestration and that the quality of justice has been impaired.

On December 2, 2011—exactly two years before the most recent public hearing—the Task Force held its first hearing on the brewing budget crisis. The testimony at that time was deeply troubling, as we heard of

[5] Year-End Report, p. 5.

[6] Year-End Report, pp. 5-7.

[7] Preliminary Report on the Effect of Judicial Budget Cuts on New York State Courts, August 15, 2011, http://www.nycla.org/siteFiles/Publications/Publications1475_0.pdf; Preliminary Report on the Effect of Judicial Budget Cuts on the U. S. District Court for the Southern District of New York, August 26, 2011; http://www.nycla.org/siteFiles/Publications/Publications1476_0.pdf; Electronic Survey Report, December 12, 2011, http://www.nycla.org/siteFiles/Publications/Publications1507_0.pdf; Public Hearing Report on the Effects of Judicial Budget Cuts on the New York State and Federal Courts, January 18, 2012, http://www.nycla.org/siteFiles/Publications/Publications1516_0.pdf; Report on Budget Cuts in the Federal Courts, September 4, 2013, http://www.nycla.org/siteFiles/Publications/Publications1637_0.pdf.

increased delays, deterioration of morale and a general decline in the ability of the courts to maintain the quality of service delivery. The testimony at the 2013 hearing was even more troubling, although there are a few positive notes.

We are heartened that the United States Congress has averted another government shutdown and has approved a budget for the next two years. However, the House and Senate Appropriations Committees have yet to determine how the proverbial budget pie will be sliced. Earlier in 2013, the House Appropriations Committee proposed a 5.4% increase and the Senate Appropriations Committee proposed a 7.4% increase in the judiciary budget. On December 6, 2013, the judiciary made its budget request, which is slightly below the amount recommended by the House Appropriations Committee. We note that the federal judiciary's budget, in total, represents 0.2% of the federal budget—two-tenths of one percent. We urge the respective Appropriations Committees to follow through on the recommendations they made earlier in the year and fund the federal judiciary's budget request in its entirety.

For the New York State courts, the hopeful aspect was the fact that on December 1, 2013, court administration released a proposed budget that called for a small (3.6%) increase over the flat budget of the preceding year, together with funding for 20 new Family Court judges. Additionally, if the proposed budget is adopted, we were told that courthouses would once again remain open to 5:00 p.m., regaining the half-hour that they lost as a result of funding shortfalls over the past several years.

However, the state judicial budget request remained significantly lower than the budget of two years earlier, which itself was slashed by $170 million from the year before. Additionally, there have been significant salary increases that were contractually mandated, as well as an increased allocation to civil legal services, resulting in a further decline in the court's effective operations budget. The budget proposed just before our public hearing was also notable for a couple of items not included. For example, it would not restore child care facilities to the courts from which they had been removed or reduced (removed from Housing Court and reduced significantly in Criminal Court and Family Court). Nor would it restore Small Claims Court to four nights per week.

Wrapping up the public hearing, American Bar Association President James R. Silkenat stated, "We are well past the diagnosis stage." As he and other bar leaders pointed out, our courts are an equal branch of government, and should not be treated as though they are merely an administrative agency with discretionary programs to cut. NYCLA concurs. It is incumbent upon the organized bar to use its extraordinary powers of advocacy and persuasion to convey to Washington and Albany that our courts must be adequately funded in order to meet their constitutional obligations and, indeed, for the integrity of our system to survive.

## SUMMARY OF HEARING TESTIMONY

**Panel 1: Impact of Budget Cuts on the State Courts—Office of Court Administration**

> "…there is a point beyond which the Judiciary cannot be pushed if we are to continue to meet our constitutional responsibilities. We have reached that point…." Written testimony of Hon. Lawrence Marks, First Deputy Chief Administrative Judge, and Ronald Younkins, Executive Director, New York State Office of Court Administration

Hon. Lawrence Marks and Ronald Younkins provided an overview of the budget the Office of Court Administration (OCA) had submitted to the Governor and legislative leaders on November 29 for the fiscal year beginning April 1, 2014.

The proposed budget would provide the first increase in court system funding in five years. In that period of time, the state judiciary has absorbed $300 million in increased costs and no additional funding. To accommodate the significant decline in resources, OCA has tried, wherever possible, to find savings in areas that do not affect the public by streamlining administration and reorganizing and consolidating offices and programs. Examples include expansion of electronic filing of court papers, using internet-protocol telephones, shifting from print to on-line legal materials, using technology for a record repository and an enhanced website, and upgrading case-management systems. Layoffs, early retirement programs and a hiring freeze have reduced court system non-judicial personnel by 1,900 employees over the past five years. Despite burgeoning caseloads, current staffing is the lowest in a decade.

The effects of the reductions in the workforce are evident. Depleted back-office staffing has resulted in delays in processing documents and disposing of cases. Managers have been diverted from their duties to cover front-line positions. The 4:30 p.m. courtroom closing time, adopted by some courts to control overtime, has produced complaints from the public and the bar. Reduced numbers of court officers have affected the timely delivery of prisoners to courtrooms and raise serious public safety concerns.

The proposed budget seeks increased appropriations of $63 million or a 3.6% increase in funding. This budget provides funding for judicial salary increases, mandated increases for indigent criminal defense and incremental salary adjustments for non-judicial employees. It would allow OCA to maintain current staffing levels and fill a limited number of critical positions. Courtrooms would remain open to the public until 5:00 p.m. each day. Civil legal services would receive an additional $15 million, which would provide for more legal representation in eviction, domestic violence, consumer debt and foreclosure cases.

Perhaps most significantly, the proposed budget would fund 20 new Family Court judgeships to be established in January 2015. Over the past 30 years as filings increased by 90%, the number of Family Court judgeships has increased by only 8.8%, with no new judgeships created in New York City since 1991. Increasing the number of Family Court judgeships will require legislative action; it cannot be accomplished by OCA alone.

Judge Marks noted the important role of the bar in advocating for sufficient funding for the judiciary and called on the bar to continue to document problems faced by litigants and attorneys as they navigate the state court system.

**Panel 2: Impact of State Court Budget Cuts on Children, Families and the Public**

> "...the Family Court system cannot fulfill the functions it was designed to do without additional Family Court Judges….with a caseload of 1,533 cases per year, a Family Court Judge can only spend **52 minutes per case per year."** Written testimony of Stephanie Gendell, Associate Executive Director, Policy and Government Relations, Citizens' Committee for Children of New York

> "…young children in particular have a vastly different sense of time, and delay can be very traumatic in the life of a child who has been removed from his/her home." Oral testimony of Susan B. Lindenauer, Co-Chair, New York State Bar Association Task Force on the Family Court

In her testimony, Briana Denney, Esq., partner at Newman & Denney P.C. and co-chair of the NYCLA Matrimonial Law Section, noted that since she had testified at a similar NYCLA hearing two years ago, the "situation has become more dire with parties and children's day-to-day lives hanging in the balance." She attributed a list of problems in Supreme and Family Court to the budget cuts, including shortened courthouse hours, increased backlogs of cases on judges' and referees' calendars, delayed trials creating injustices for non-monied parties and difficulties for children whose lives are in flux, decreased availability of interpreters, and inadequate time for judges to understand complex cases, particularly when immediate court intervention is needed. Matrimonial judges often refer financial issues to referees and JHOs, with the result that the parties must bear the burden of conducting two trials of related matters. Additionally, delays in obtaining judgments of divorce have tax consequences and create problems with enforcement of agreements, including enforcement of child support.

Dora Galacatos, Esq., Executive Director of the Feerick Center for Social Justice at Fordham University School of Law, described the impact of judiciary budget cuts on both lawyers and the more than 97% of defendants who are unrepresented in consumer debt collection cases. She testified that "delays are so significant that they truly implicate due process concerns." One advocate who was preparing for a hearing was told it would take 45 days for the clerk to take the request for a file and another 14 weeks to obtain the court file. In another case, an attorney assisting a client with mental illness waited ten months for a file to be retrieved from the archives. By then, the client was institutionalized. While the rate of default judgments is going down, it remains very high—52% in 2012. Despite this high rate, notice of default judgments is often untimely; sometimes judgment debtors do not learn about such judgments until their wages are garnished. Without access to court files for records, such as affidavits of service, claimants are hindered from fully asserting their claims for relief. Children's Centers have closed, affecting single-parent families and working families who are pressured to settle cases when their children are in the courtroom instead of a child care center.

Representing Citizens' Committee for Children of New York Inc., Stephanie Gendell, Esq., presented the context for the budget cuts in the Family Courts, noting that the statutory limit on Family Court judges in New York City has not changed since 1991 when the New York State Legislature authorized 47, while new and amended statutes have increased the role and workload of the Family Court without adding resources. Years of advocacy to increase both the number of judges and budget resources have not proved fruitful. The $9.2 million in cuts in the last two years have translated into tangible losses in non-judicial staff, court officers, overtime and services such as child care and mediation programs. The impact on children and families is dramatic—delays in the resolution of juvenile delinquency cases, longer adjournments in support, custody and visitation cases, and longer stays for children in foster care as fewer permanency hearings are conducted. Notably, New York ranks 50$^{th}$ out of 52 jurisdictions in the length of foster care. Ms. Gendell called for a restoration of funding as "…otherwise the same children who missed this Thanksgiving might still be in foster care next Thanksgiving."

Janet Ray Kalson, Esq., Associate, Himmelstein, McConnell, Gribben Donoghue & Joseph, focused on the impact of the budget cuts on the Housing Court, where the overwhelming majority of tenants are

unrepresented. There are now fewer court attorneys, impeding the resolution of cases, fewer attorneys providing information to unrepresented tenants and more discontinuous trials as the trial parts do not have full-time clerks and enough court officers. With 20% of the translators gone, translators are often unavailable, requiring tenants and their attorneys to return to court several times. As Ms. Kalson noted: "These staff cuts matter. They result in endless delays, inefficiencies and hardships for tenants in Housing Court. The Housing Court is in crisis, and it is *pro se* tenants who are suffering the most."

In her written and oral testimony, Susan B. Lindenauer, Esq., representing the New York State Bar Association Task Force on the Family Court, advised that she would address two of the five priority areas and briefly touch on a third priority identified in the Task Force Report, approved by the New York State Bar Association House of Delegates in January 2013. First, she advocated for an increase in the number of Family Court judges to hear the approximately 700,000 cases filed each year, describing the Family Courts as akin to "hospital emergency rooms." Next she emphasized that legislative authorization of more judges without sufficient funding for the judicial positions and ancillary support for staff and security "would serve no purpose." The third issue needing attention is the delays in hearings, often delays of months, and the lack of continuous trials. These are "systemic problems that result in large measure from too few judges."

In written testimony not presented in person at the hearing, Alan M. Moss, Chair of the Small Claims Improvement Committee created by Hon. A. Gail Prudenti, Chief Administrative Judge of the New York State Unified Court System, noted that the severe reduction in evening hours in Small Claims Court from four nights a week to one night in most boroughs and to only one or two nights a month in Richmond County makes the Small Claims Court basically unavailable to claimants who cannot take time off during the day to appear. In Brooklyn and Manhattan, it may now take up to several years to get a judgment. Defendants who know how to "play" the system request adjournments or allow default judgments to be entered against them and then easily get the matters restored to the calendar.

**Panel 3: Impact of Budget Cuts on the Federal Courts Part 1: Court Operations, Criminal Defense and Public Safety**

> "If sufficient funding is not provided to our courts in the next year, the federal judiciary will be unable to execute its core constitutional and statutory duties with the quality the public has come to expect." Written testimony of Hon. Carol Bagley Amon, Chief Judge, United States District Court, Eastern District of New York
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> "We will continue to prioritize the most serious crimes, but the thought of other crimes leading to tragedy is one that keeps me and my colleagues up at night." Written testimony of Loretta E. Lynch, United States Attorney for the Eastern District of New York
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> "I worry that we're suffering from budget fatigue." Oral testimony of David Patton, Executive Director and Attorney-in-Chief for the Federal Defenders of New York

Judge Amon began by noting that when she testified at the NYCLA hearing two years ago, she said "we would plan for the worst and hope for the best." What the court got was the worst. Funding allocations for the current fiscal year were 10% below fiscal year 2012 levels, including a cut of $731,770 for the Eastern District because of sequestration. Sequestration cuts on one of the largest federal districts, which

had 6,500 civil cases and 736 criminal cases filed last year, have affected every aspect of the court's operations. The Clerk's Office, which is the administrative arm for all court operations, lacks funding for 27 employees and has 17 fewer employees than two years ago. Understaffing has created delays in processing victim restitution payments, docketing cases and responding to queries from the public; there are no longer dedicated staff for various critical tasks leading to inefficiencies and high staff stress levels. Layoffs in the Clerk's Office were averted by diverting about $971,000 from expense and IT accounts to staff salaries; now the court has no ability to maintain or purchase equipment and limited ability to service and maintain the state-of-the-art technology so beneficial to litigants.

"The impact of sequestration-related funding cuts on the Eastern District's Probation Department cannot be overstated," advised Judge Amon. Probation officers now take an extra month to complete Presentence Reports for judges and cannot do all the field work necessary to verify material in the reports. Fewer officers are available to conduct home searches, monitor sex offenders' computer use and conduct 24-hour location monitoring of defendants. Treatment services for defendants have also been cut by 20%; funds for emergency housing and other services for offenders were eliminated entirely. The Pretrial Services Agency, currently responsible for supervising over 1,000 defendants, experienced cuts in salaries of 14% and in treatment funds of 20%, resulting in less intensive supervision.

Judge Amon discussed the additional risks to the safety of the public, judges, employees, jurors and litigants created by sequestration cuts of 30% to funding for court security systems and equipment. The Eastern District, which has eight national security cases currently pending, received 42 threats in the past year against judges and court officials, including a plot to assassinate a judge on Long Island.

Eileen Kelly, Chief Probation Officer for the Eastern District of New York, amplified Judge Amon's testimony about the effects of budget cuts on her department, noting that her administrative office needs 148 people, has 120, but only has funding for 117. Furloughs were narrowly avoided by transferring funds from other accounts to salaries. Essential training, such as for firearms safety, is either non-existent or postponed. All of these cuts have adversely affected morale.

In her testimony, Loretta E. Lynch, United States Attorney for the Eastern District of New York, noted that her office has prosecuted more terrorism cases since 9/11 than any other United States Attorney's office, foiling plots to blow up the subway system and the Federal Reserve Bank building and putting together cases on international cybercrime and corporate fraud. She described the mandatory cuts caused by sequestration as taking a "meat cleaver" to the budget, with no consideration for how the government can carry out its mission. With cuts allocated based on size, the Eastern and Southern Districts both took 8% cuts to their non-personnel budgets, affecting training, travel in the line of duty and IT. Since a hiring freeze was invoked in early 2011, few new hires have been permitted. Early retirement options for senior staff have further depleted personnel; 25 attorney positions are now "empty chairs." Resources are needed to continue to bring terrorism and national security cases and to investigate complex fraud cases to find assets and justice for victims. One of the true costs of sequestration emerges in the area of making sure "that crime does not pay." In the last year, Ms. Lynch's office was credited with over $2.2 billion in fines, restitution, penalties, forfeiture and civil settlements, vastly surpassing the office budget of $38 million. If sequestration continues and people are furloughed, these and other law enforcement efforts will be jeopardized. And, ironically, revenue to the federal government will be diminished. Ms. Lynch

concluded by noting: "While some may say we're shrinking government, what will shrink is the blanket of protection we provide for the American people and the recoveries we provide to the Treasury."

David Patton, Esq., Executive Director and Attorney-in-Chief for the Federal Defenders of New York, reiterated his office's constitutional mandate—to provide a lawyer to defendants who are charged with a serious crime and cannot afford an attorney. Ninety percent of defendants in federal court qualify for court-appointed lawyers; 200,000 cases a year are assigned to Federal Defenders or Criminal Justice Act (CJA) Panel attorneys. His office represents 40% of all federal criminal defendants in the Eastern and Southern Districts. In Fiscal Year 2013, Federal Defenders staff nationally was cut by 10% and forced to take 12,500 unpaid furlough days. Federal Defenders of New York required each attorney to take 12 days of unpaid leave. Further cuts are expected in Fiscal Year 2014; ironically, these cuts will increase costs for taxpayers because if Defenders cannot handle cases, they will be shifted to the private attorneys on the CJA panel at higher costs. Mr. Patton characterized the cuts as "not just short-sighted but blind." A recent Congressional appropriation of $26 million included $5 million for Federal Defenders, which reduced cuts from 9.5% to 9%. Mr. Patton presented a vivid example of a case where complex and extensive investigations by Federal Defenders enabled a defendant to win his case instead of spending many years in prison. Reduced funds will affect resource-intensive cases that Defenders will have to turn away, costing the public more money. Mr. Patton urged the Task Force not to suffer from "budget fatigue" but to keep advocating for adequate funding for quality representation that promotes the rule of law and safeguards constitutional rights.

**Panel 4: Impact of Budget Cuts on the Federal Courts Part 2: Court Operations and the Administration of Justice**

> "The Judiciary must adjudicate all civil and criminal cases that are filed in our Courts. We do not have the luxury of choosing our cases or controlling the growth of our dockets." Written testimony by Hon. Robert A. Katzmann, Chief Judge, United States Court of Appeals for the Second Circuit
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> "In addition to significant delays of justice, budget cuts to the United States District Court for the Southern District of New York have impeded access to information, jeopardized public safety, and potentially impacted the nation's economy." Written testimony of Hon. Loretta A. Preska, Chief Judge, United States District Court for the Southern District of New York
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> "The bottom line is this. At the end of the day, justice cannot be done on the cheap, and public safety does not come free." Written testimony of Preet Bharara, United States Attorney for the Southern District of New York

Chief Circuit Judge Robert A. Katzmann emphasized in his testimony that deep funding cuts mean the federal judiciary—the Third Branch of government—will not be able to carry out its constitutionally and statutorily mandated responsibilities. To date, the court system has coped with reduced funding but it "cannot continue to operate in this way." Between Fiscal Year 2011 and 2013, the Courts of Appeal nationally reduced personnel by 10.9%, at the same time filings fell by less than 2%. The Second Circuit Clerk's Office lost 23% of its staff, while filings fell by 6%, translating into the departure of 17 employees with a cumulative history of more than 210 years of knowledge and experience. Continued budget reductions will affect the court's ability to keep apace of technology developments and will lead to

increased caseload backlogs and additional time to process civil cases and bankruptcy petitions. Judge Katzmann noted that budget cuts and sequestration have had the most significant impact on the Defenders Service and reaffirmed David Patton's prior testimony. Additionally, shortfalls in the Juror Fee Account could affect the diversity of jurors reporting for duty and have an impact on the "Courts' ability to ensure a fair representation of citizens serving as jurors." Inadequate funding will further reduce the number of hours for each Court Security Officer and leave courthouses with security vulnerabilities. In conclusion, Judge Katzmann stated: "We have no programs to cut, only people and when we cut our staff and reduce our operations deep into the bone, we will be forced to curtail our ability for our citizens to access justice…."

In her testimony, Hon. Loretta Preska, Chief Judge of the Southern District of New York, reviewed the dramatic cuts in operations forced by reduced funding over the last several years. The Clerk's Office staff has been cut from 229 to 173 employees, leading to delays in docketing civil filings and responses to requests for records. The docketing delays can affect orders and other decisions having an impact on financial markets or a litigant's financial viability, on civil contempt orders informing a party when to report to prison, and on civil complaints and criminal indictments of high public interest. Delays in receiving archival records affect released prisoners who need files for employment applications and civil litigants who need documents from prior cases.

As in the Eastern District, cuts to the Probation Office have compromised public safety as fewer officers manage increased caseloads. Since January 2009, Probation Office staffing has been reduced from 155 to 126 employees, with average caseloads increasing from 52 to 66. Funding for substance abuse treatment, location monitoring and mental health treatment has decreased; fewer court-ordered searches mean more weapons, drugs, child pornography and contraband remain in the community. Pretrial Services has been similarly affected, with 16 vacant positions, an increase in average caseloads and delays in processing new arrests, which creates problems for judges, attorneys, defendants and their families. Because of high-profile proceedings, the Southern District also attracts and must process large jury pools and crowds of visitors; lines now wrap around the block as fewer Court Security Officers operate the magnetometers at the entrance to the courthouse. The Southern District is also facing a 34% cut in non-salary funds, threatening maintenance, equipment upgrades, purchase of supplies and reduction in hours that lights and HVAC are used. Court reporters, previously considered essential staff, have been cut, leaving nine vacancies and causing delays in trials and in transcription. Judge Preska concluded by stating: "The effects of sequestration go far beyond an inconvenience to judges or to the court's litigants; budget cuts have created a ripple effect that impacts New York City and beyond."

Edward Friedland, Southern District Executive, reported that staff had not received a cost-of-living increase in three years, with resulting demoralization and turnover. Even worse, the SDNY's non-salary budget had been slashed 34%, with drastic cuts in technology, office supplies and maintenance. Only two audiovisual employees cover over 60 courtrooms.

Preet Bharara, United States Attorney for the Southern District of New York, noted at the outset of his testimony that "no topic weighs more heavily on my mind" than the effects of budget cuts imposed by sequestration on his office. He added that "the impact of a prolonged hiring freeze and continuing budget cuts could ultimately work irrevocable harm to the fundamental mission of my office—which is to keep our homeland secure, our streets safe, our markets fair, and our government honest." He particularly

emphasized the impact of the freeze on headcount. There are 20 fewer Assistant United States Attorneys (AUSA) now than in 2011, creating a 13% vacancy rate for AUSA's and a 26% vacancy rate for other staff, the highest in the country. A complete and indefinite hiring freeze and a traditional annual attrition rate of 22 AUSA's mean that by January 2015, a quarter of the allocated prosecutor positions will be vacant. Mr. Bharara added that, ironically, every dollar spent on his office generates much more money; last month, for example, a plea agreement with SAC Capital, a hedge fund, will lead to a $1.2 billion payment, 24 times his office's annual budget. Lost revenue is not the only impact; the longer term impact is on communities as cases will take longer to make and potentially fruitful but labor-intensive investigations will be foregone.

Blanket budget cuts will force painful, supremely difficult choices in the future. He ticked off a list of choices he might have to confront, including should he settle civil cases because going to trial is too resource intensive, should he plead out criminal cases for the same reason, should he stop pursuing some smaller but important cases involving guns on the street or child pornography, should he ease up on financial fraud investigations or the prosecution of violent gangs, should he moderate his commitment to confronting cyber threats? He concluded: "In a sane world, we should have to do none of these things."

**Panel 5: Impact of Budget Cuts on the Federal Courts Part 3: Bankruptcy, Business and Consumers**

> "In short, we are cut to the bone." Written testimony of Hon. Carla E. Craig, Chief Judge, United States Bankruptcy Court for the Eastern District of New York
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> "Often the relief requested from the bankruptcy court can mean the loss or gain of millions of dollars and thousands of jobs, or even the very ability of the debtor or other enterprises to survive." Written testimony of Hon. Cecelia Morris, Chief Judge, United States Bankruptcy Court for the Southern District of New York
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> "I hope there is never another Lehman. But what would happen under sequestration if there were?" Written testimony of James B. Kobak Jr., NYCLA Past President and Partner, Hughes Hubbard & Reed LLP
>
> "Every petition we file transforms people's lives." Written testimony of William Z. Kransdorf, Director, New York City Bankruptcy Assistance Project, Legal Services NYC

Chief Judge Craig noted the importance of the bankruptcy courts to the national economy and then identified two principal areas where the cumulative impact of funding cutbacks has affected the Bankruptcy Court in the Eastern District: personnel and technology. In the last 15 months, the court reduced staff by 16 positions, representing a 23% loss of personnel. At current funding levels, three additional employees may be laid off, which may require the court to restrict or stagger courtroom hours. Staff have been required to perform multiple jobs, affecting morale and prompting some employees to seek jobs elsewhere. Bankruptcy courts, more than other courts, are highly dependent on technology, particularly the electronic filing system. In the past, the court maintained a reserve fund for emergencies and unexpected technology needs; now, the court is analyzing whether it can renew IT maintenance contracts. Library support funds, for both books and electronic research, have been cut, threatening to limit access to critical research needed on a daily basis.

Vito Genna, Clerk of the Court, United States Bankruptcy Court for the Southern District of New York, presented Chief Judge Morris's written testimony. Judge Morris described her court as experiencing a "crisis of staffing." Over the past three years, the court has absorbed the loss of 39% of its administrative staff, as well as the loss of support staff upon the retirement of a judge. These losses pose serious problems for one of the most active commercial courts in the world, where both complex, mega Chapter 11 cases, as well as thousands of consumer bankruptcy cases, are handled. With the mega Chapter 11 cases, the filing, review and disposition of hundreds of motions per month and the resolution of complex issues require substantial service by the court, including maintaining the status quo while the debtor formulates a path to reorganization, utilizing bankruptcy tools to broaden the pool of assets and build consensus among creditors, and employing the judicial process to liquidate estate property for the benefit of creditors. And some of these cases last several years. While consumer cases have a smaller dollar amount of claims, they operate on the same statutory scheme and require substantial attention. In 2009, the court launched its Loss Mitigation Program Procedures to assist the thousands of debtors trying to prevent the loss of their homes to foreclosure. This program is also resource intensive, with regular conferences and the enforcement of the loss mitigation scheduling order. As Judge Morris stated: "The diligence and excellence required for a federal body on the scale found in the three divisions of this court can only be achieved by the work of committed judges and their meticulous staff."

In his testimony, James B. Kobak Jr., Esq., discussed his role as lead counsel to the Lehman Brothers Inc. and MF Global Inc. trustees, two of the mega Chapter 11 cases discussed by Judge Morris in her testimony. He noted that more than 1,250 business commercial cases were filed in the Southern and Eastern Districts last year, over and above 22,000 non-commercial cases. The business cases often have "far-reaching consequences for not only tens of thousands of creditors and employees immediately involved but for the U.S. and worldwide financial system and the communities where businesses are located." Judges, courtrooms, support staff and systems need to be available on an emergency basis as filings often take place after hours and on weekends. Because of the superb response of the court in the *Lehman* case, 110,000 customer accounts involving $90 billion in assets were available to customers the Monday after the filing, rather than being removed from the financial markets. In the *MF Global* case, with the court's help after an emergency filing and hearing, 3,000,000 open commodity contracts continued to be traded, amounting to 40% of the entire futures market. For both these cases, the filings and initial hearings were only the beginning of a long and complicated process. In terms of adequate resources for the Bankruptcy Courts, Mr. Kobak concluded: "The cost is small in terms of the national budget. To fail to provide that modest funding creates enormous and unacceptable risk for an always uncertain economic future."

The NYCLA Bankruptcy Committee, co-chaired by James P. Pagano, Esq., and David Wiltenburg, Esq., submitted written testimony that was not presented in person. The Committee expressed serious concerns that "if the downward spiral of financial support continues, the ability of our Bankruptcy Courts to respond to the next crisis… will be put at risk." Budget cuts and sequestration have led to reduced hours and the loss of more experienced personnel, burdens for both the judicial and support staff.

In his testimony, William Kransdorf, Esq., of Legal Services NYC, whose project provides assistance to low-income consumers, painted a poignant picture of how transformational filing for bankruptcy is in his clients' lives: they can stop a garnishment and harassing calls, they can get a job again and they can move into better housing. They get a "fresh start" and move onto a more sustainable financial path. His

project provides assistance through volunteer attorneys and law students to low-income New Yorkers in preparing their petitions; after that, the clients navigate the system on their own, most very successfully. Of the 1,000 petitions filed since 2006, fewer than ten have been dismissed. Mr. Kransdorf attributed this success, not only to the volunteer lawyers and law students, but to the case-management expertise and "humanism" of the court clerks and courtroom deputies. Judges also play an important role by identifying litigants who need attorney guidance. Layoffs in the Bankruptcy Courts may actually cost money in the long run as experienced staff foster efficient operations.

**Panel 6: Courts in Crisis—The View from the Bar**

> "Budget cutbacks are corroding the efficient administration of justice and threatening our justice system, perhaps as in no other time in our country's history." Written testimony of James R. Silkenat, President of the American Bar Association (ABA)
>
> "Additional costs for litigants due to funding-related delays…serve as disincentives for the international community to choose New York as the forum for dispute resolution." Written testimony of David M. Schraver, President of the New York State Bar Association (NYSBA)
>
> "The sequester already has severely compromised the courts' ability to fulfill their constitutional duties…." Written testimony of Robert J. Anello, President of the Federal Bar Council
>
> "The judges and their staff are not in ivory towers; they jump into the trenches every day and help bring resolution to critical disputes." Written testimony of William F. Dahill, President of the Southern District of New York Chapter of the Federal Bar Association (FBA)

ABA President James R. Silkenat noted that adequate funding for state and federal courts has long been a priority for the ABA, which conducted hearings around the country over the last several years to determine the status of state court funding. The theme that emerged: "State court systems were in worse shape than first thought and faced the most severe funding crisis in U.S. history." Mr. Silkenat indicated that in the short term, state court funding appears to be "stabilizing" but that states like New York are far behind because of previous funding cuts. The ABA is working closely with state and local bar associations and other partners to encourage legislators to allocate more funding for state courts. On the federal side, Mr. Silkenat recently testified before the House of Representatives about the huge negative impact of the government shutdown on the federal courts, with special emphasis on how sequestration devastated the Federal Defenders Service. He concluded by stating: "I can assure you that the ABA will continue to work to guarantee the promise for all Americans of equal justice under law."

In his testimony, NYSBA President David M. Schraver reviewed NYSBA's efforts to address both the impact of funding cuts on the state level and also on the federal side. He noted that "inadequate funding from sequestration poses a threat to New York's status as a top choice for businesses engaged in international transactions…."

Federal Bar Council President Robert J. Anello highlighted the effects of the federal budget cuts and sequestration on the federal criminal justice system, including the insufficient funds for the Federal Defenders Service to represent all needy defendants and for the Probation Departments to prepare pre-sentencing reports and monitor criminal defendants. Courthouse security and physical facilities have also been affected. Both the Southern and Eastern Districts cannot make needed upgrades for security

cameras and ancillary computer systems and have had to reduce staffing by the United States Marshals. Routine building upkeep and maintenance of computer systems are compromised. Mr. Anello also noted the effect of budget cuts on staffing in both the Bankruptcy Courts and Second Circuit.

In his testimony, FBA Chapter President William F. Dahill presented examples from his own practice of federal judges, magistrate judges, clerks, other non-judicial staff and U.S. Marshals going above and beyond their normal responsibilities to assist him and his clients. He then commented on how budget cuts have led to delays in same-day docketing and processing requests for archived files, creating delays in filing and resolving cases. He concluded by noting his chapter's involvement in lobbying on funding issues on behalf of the federal judiciary.

## CONCLUSION

The compelling testimony at the public hearing held on December 2, 2013 dramatically demonstrated that as a result of the severe budget cuts over the past several years, both the New York State courts and the federal courts in New York City are struggling to provide access to justice and that they are dangerously close to the point where they cannot meet their constitutional and statutory duties.

We are encouraged that the New York State Office of Court Administration has requested a budget increase for Fiscal Year 2014, albeit a very modest one, to $1.81 billion and initially there seems to be a good deal of support for it in Albany. We note that this amount represents a tiny 1.27% of the $142.6 billion New York State budget proposed by Governor Cuomo. We urge the New York State Legislature and Governor Cuomo to approve the court's budget request in its entirety and to fund the judiciary at a level sufficient to allow the New York State courts to meet their obligations under the New York State Constitution and relevant case law.

As noted above, we are also pleased that Congress has approved a budget for the next two years. However, now the appropriations process is underway and the various federal agencies and departments are competing for the same budget dollars. We urge the respective Appropriations Committees to follow through on the recommendations they made earlier in the year and grant the federal judiciary budget request in its entirety. As Chief Justice Roberts noted, there are profound issues in the balance: "It takes no imagination to see that failing to meet the Judiciary's essential requirements undermines the public's confidence in all three branches of government."[8]

America's judiciary is the envy of the world. "Through over two hundred years of committed effort, our federal court system has become a model for justice throughout the world."[9] Though they are respectively co-equal branches of government with profound constitutional and statutory obligations, both the New York and the federal judiciary have budgets representing only tiny fractions of the New York State and United States budgets. Our courts are struggling to meet their vitally important duties with diminished and shrinking resources. The Task Force on Judicial Budget Cuts urges that the courts receive sufficient

[8] Year-End Report, p. 10.

[9] Year-End Report, p. 2.

resources to meet their constitutional and statutory duties lest we jeopardize the most basic and essential values of due process and access to justice that have been the hallmark of the American judicial system.

# NYCLA Task Force on Judicial Budget Cuts

Co-Chairs: Hon. Stephen G. Crane and Michael Miller

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Alison Wilkey

Marilyn J. Flood, NYCLA Counsel

NEW YORK COUNTY NYCLA LAWYERS' ASSOCIATION

**TASK FORCE ON JUDICIAL BUDGET CUTS**
**Co-Chairs: Hon. Stephen G. Crane and Michael Miller**

**PUBLIC HEARING – COURTS IN CRISIS**

**DECEMBER 2, 2013**

**NEW YORK COUNTY LAWYERS' ASSOCIATION**
**14 VESEY STREET**

**9:00 A.M. TO 4:30 P.M.**

| | |
|---|---|
| 9:00 a.m. | Welcome and Introductions |
| 9:15-9:45 a.m. | **Panel 1: Impact of Budget Cuts on the State Courts – Office of Court Administration** |
| | Presenters: |
| | Hon. Lawrence Marks, First Deputy Chief Administrative Judge, New York State Office of Court Administration |
| | Ronald Younkins, Executive Director, New York State Office of Court Administration |
| 10:00-11:00 a.m. | **Panel 2: Impact of State Court Budget Cuts on Children, Families and the Public** |
| | Presenters: |
| | Briana Denney, Co-Chair, NYCLA Matrimonial Law Section |
| | Dora F. Galacatos, Executive Director, Feerick Center for Social Justice, Fordham University School of Law |
| | Stephanie Gendell, Associate Executive Director, Policy and Government Relations, Citizens Committee for Children of New York |
| | Janet Ray Kalson, Associate, Himmelstein, McConnell, Gribben, Donoghue & Joseph |
| | Susan B. Lindenauer, Co-Chair, New York State Bar Association Task Force on the Family Court |

| | |
|---|---|
| 11:15-12:15 p.m. | **Panel 3: Impact of Budget Cuts on the Federal Courts – Part 1**<br>**Court Operations, Criminal Defense and Public Safety** |
| | Presenters: |
| | Hon. Carol Bagley Amon, Chief Judge, United States District Court, Eastern District of New York |
| | Eileen Kelly, Chief Probation Officer, United States Probation Department, Eastern District of New York |
| | Loretta E. Lynch, United States Attorney, Eastern District of New York |
| | David Patton, Executive Director and Attorney-in Chief, Federal Defenders of New York |
| 12:15-12:45 p.m. | **Break** |
| 1:00-2:00 p.m. | **Panel 4: Impact of Budget Cuts on the Federal Courts – Part 2**<br>**Court Operations, the Administration of Justice** |
| | Presenters: |
| | Hon. Robert Katzmann, Chief Judge, United States Court of Appeals for the Second Circuit |
| | Hon. Loretta A. Preska, Chief Judge, United States District Court, Southern District of New York |
| | Edward Friedland, District Executive, Southern District of New York |
| | Preet Bharara, United States Attorney, Southern District of New York |
| 2:15-3:15 p.m. | **Panel 5: Impact of Budget Cuts on the Federal Courts – Part 3**<br>**Bankruptcy, Business and Consumers** |
| | Presenters: |
| | Hon. Carla E. Craig, Chief Bankruptcy Judge, Eastern District of New York |
| | Hon. Cecelia Morris, Chief Bankruptcy Judge, Southern District of New York |
| | James B. Kobak Jr., NYCLA Past President, Partner, Hughes Hubbard & Reed |
| | William Z. Kransdorf, Director, New York City Bankruptcy Assistance Project, Legal Services NYC |

3:30-4:30 p.m. **Panel 6: Courts in Crisis – the View from the Bar**

Presenters:

James R. Silkenat, President, American Bar Association

David M. Schraver, President, New York State Bar Association

Robert J. Anello, President, Federal Bar Council

William F. Dahill, President, Southern District of New York Chapter of the Federal Bar Association

**BENEFITS OF ARBITRATION FOR COMMERCIAL DISPUTES**

**by Edna Sussman and John Wilkinson**

The Arbitration Committee of the ABA Section of Dispute Resolution is preparing a brochure for broad dissemination to educate users on the benefits of arbitration for commercial disputes. You will find below the text of the current draft of the brochure. We welcome your comments, edits and additions. Please contact us at esussman@sussmanadr.com and JohnHWilkinson@msn.com or **submit your comments online.** You can help us make it better, so please do take the time to review this draft.

# BENEFITS OF ARBITRATION FOR COMMERCIAL DISPUTES

Arbitration has been part of the dispute resolution landscape for centuries: (i) some commentators date arbitration back to the time of the Phoenician merchants; (ii) Alexander the Great's father, Phillip the Second, used arbitration as a means for resolving border disputes; (iii) George Washington had an arbitration clause in his will; and (iv) the English used arbitration for commercial disputes as early as 1224.

Arbitration is preferred by many as a way to resolve commercial disputes. It has significant advantages over litigation in court, such as party control of the process, typically lower cost and shorter time to resolution, flexibility, privacy, awards which are fair, final and enforceable, decision makers who are selected by the parties on the basis of desired characteristics and experience, and broad user satisfaction. Thus, for example, did you know that:

## Party Control

- Because arbitration is a creature of contract, parties can by agreement design the process to accommodate their respective needs and can continue to do so as the proceeding moves forward. For example, the nature and scope of discovery (including whether to allow depositions), the conduct of the hearing (including testimony by live video), the length of time for the entire process, as well as pre-screening the arbitrators for disclosure issues and availability can all be determined by the parties, both at the contractual stage and after the arbitration has commenced.

## Length of Time

- According to statistics of the American Arbitration Association ("AAA") for the year 2008, the median length of time from the filing of an arbitration demand to the final award in domestic, commercial cases was just **7.9** months.

- By contrast, in 2010, the median length of time from filing through trial of civil cases in the U.S. District Court for the Southern District of New York was **33.2** months.[1]

- The median length of time in 2010 from filing of a civil case in lower court to disposition of appeal by the Second Circuit Court of Appeals was **40.8** months.[2]

## Expense

- Attorneys' fees and expenses are by far the most significant cost of litigation, and they increase in direct proportion to the time to resolution of the case. Attorneys' fees and expenses are minimized in arbitration because arbitrations are generally concluded in far less time than cases in court.

- Although it is true that there are no arbitrator or institutional charges in court cases, the International Chamber of Commerce reports that those charges represent only 18% of the cost of arbitration.[3] This 18% (and substantially more) can be recouped quickly because of the increased speed and efficiency of arbitration and the ability to tailor the arbitration to the specific needs of the parties.

- Court cases generally require more counsel time and, thus, more expense for preparation and trial than is needed in arbitration. For example, trial-related matters which consume time and money in court but which are usually not part of arbitration include extensive evidentiary issues, *voir dire*, jury charges, broad motion practice, proposed findings of fact, endless authentication of documents, qualification of experts, cumulative witnesses and, finally, appeals, which are far more limited in arbitration than in court.

## Flexible Process

- In arbitration, parties can schedule hearings and deadlines to meet their objectives and convenience. The flexibility of arbitration and the opportunities it allows parties to save time and money are apparent in common arbitration practices such as: choosing a location for the hearing that will minimize costs; taking witnesses out of order or interrupting a witness to accommodate individual needs; continuing a hearing after normal business hours (e.g., during the night or over a weekend) in order to complete a witness or finish the hearing; taking testimony of distant witnesses by video conference or by telephone; ordering testimony so that all experts on a topic testify directly after one another or even all at the same time (a procedure known as "hot tubbing"); and using written witness statements for some or all of the witnesses in lieu of time-consuming, oral direct testimony.

- When negotiating their underlying commercial contract, parties often utilize the flexibility of arbitration to include provisions in the arbitration clause which will enhance the efficient conduct of any arbitration that might arise thereafter. Most commonly, such clauses set time limitations for concluding the entire arbitration, as well as limitations on interim phases such as discovery and commencement of the hearing. A primary benefit of this common approach is it is far easier for the parties to agree on such matters when they

negotiate their commercial contract than when a dispute has actually arisen and the parties are in an adversarial relationship.

- The flexibility of arbitration fosters a relatively informal atmosphere. Together with the privacy of the arbitration proceeding, this serves to reduce the stress on the witnesses and on what are often continuing business relationships between the parties.

**Confidentiality**

- Arbitral hearings are held in private settings and are attended only by those designated by the parties and their counsel. This is in contrast to trial proceedings held at the court house, which are open to the public. In addition, maintaining the confidentiality of the arbitration proceeding can be agreed to by the parties, unlike in court, where requests to seal the record are seldom granted. Most arbitral institutions have specific rules regarding the confidentiality of proceedings and awards.

- Confidentiality is an important feature for many corporations, particularly when dealing with disputes involving intellectual property and trade secrets or when there are concerns about publicity or damage to reputation or position in the marketplace.

**Arbitrator Selection**

- A great benefit of arbitration is that the parties can select their arbitrators, both under the party appointed system and the list system, and thereby choose arbitrators with qualifications tailored to the needs of the arbitration in question. These desired qualifications can include attributes such as subject matter expertise; reputation for competence; temperament; number of years of experience; number of arbitrations chaired; availability; and commitment and ability to conduct an efficient, cost-effective arbitration.

- The ability of parties to select arbitrators with desired expertise and competence contrasts with most court cases where judges are assigned randomly without regard to whether they possess qualifications particularly suited to the dispute in question.

- An additional benefit is the parties' ability to provide for a panel of three arbitrators to hear complex and/or high-dollar disputes.

**Discovery and Related Matters**

- In court litigation in the United States, the governing Federal Rules of Civil Procedure or parallel state court rules often allow for broad, burdensome and expensive discovery, including lengthy depositions and the extensive production of electronic data.

- Unless specifically agreed otherwise by the parties, discovery and related procedures are considerably more limited in arbitration than in litigation. See, e.g., the New York State Bar Association's *Guidelines for the Arbitrator's Conduct of the Pre-Hearing Phase of Domestic Commercial Arbitrations and International Arbitrations.*[4] These Guidelines,

among others, contain significant suggested limits on processes including document discovery, e-discovery, depositions, discovery motions and dispositive motions. Guidelines like these are binding when adopted by the parties. But even if they are not adopted, arbitrators often rely on these Guidelines as a framework for the efficient conduct of the pre-hearing phase of arbitration.

- Arbitrators, in contrast to harried federal and state court judges, are actively involved in the management of the case and can promptly conduct a telephonic or in person supervised session to assure expeditious proceedings.

## Finality

- In many cases it is important that commercial disputes be resolved quickly and finally because drawn-out indecision significantly increases costs and may cause business paralysis. Arbitration provides finality and does so quickly and economically because lengthy, expensive appeals like those encountered in court are not available under the Federal Arbitration Act ("FAA") and state arbitration statutes. These statutes severely limit a court's ability to vacate arbitration awards except on narrow grounds such as corruption, fraud and evident partiality, which are difficult to prove and rarely succeed.

- In some cases, parties to a large dispute may want a more comprehensive appeal than is permitted under the FAA and state arbitration statutes. They can accomplish this (without sacrificing the efficiency of arbitration) by providing for an appeal to a second arbitrator or panel of arbitrators on traditional legal grounds. An appeal within the arbitration framework can be conducted quickly and cost effectively, without significantly delaying the final resolution of the case.

## International Commercial Disputes

- Arbitration permits the parties to choose adjudicators with the necessary special expertise to decide a cross-border dispute, which is not possible with the luck of the draw in court. This special expertise can include knowledge of more than one legal tradition (e.g., common law and civil law), experience, understanding and ability in harmonizing cross-border cultural differences between parties and fluency in more than one language.

- In the international context, arbitration provides what in some cases may be the only possible neutral forum for dispute resolution and enables the parties to select decision makers of neutral nationalities or of recognized neutrality who are detached from the parties and their respective home state governments and courts. Thus arbitration allows the parties to avoid concerns that may arise with respect to some judicial systems, and it assures an adjudicative setting in which bias is avoided and the rule of law is observed. Arbitration also avoids delays in court which, in some jurisdictions, can exceed five or even ten years.

- In the international context, a critical feature of arbitration is the existence and effective operation of the New York Convention to which over 140 nations are parties. The

Convention enables the enforcement of international arbitration agreements and awards across borders. In contrast, judgments of national courts are more difficult and often impossible to enforce in other countries.

**Arbitration Does Not Face the Budgetary Cutbacks Being Imposed on the Courts**

- Arbitration is not affected by the current massive cutbacks in judicial budgets in states across the United States or by the increase in the criminal docket in the federal courts, all of which are increasing the already significant delays in the time to get to trial in civil cases in state and federal courts. [5]

**Studies Prove that Arbitration is in Many Ways a Better Process**

- **Satisfaction -** Studies have shown that a majority of users believe arbitration is better, cheaper and faster than litigation.[6]

- **Fairness** - Studies have shown that arbitration is perceived to be "a more just process" with 80 per cent of attorneys and 83 percent of business people reporting that arbitration is a fair and just process.[7]

- **International** - Studies have shown that 86% of corporate counsel are satisfied with international arbitration. [8]

- **Expertise**- Studies have shown that the majority of parties find arbitrators to be more likely to understand the subject of the arbitration than judges.[9]

- **Predictability** - Studies have shown that counsel make fewer errors in predicting case results in arbitration versus not only jury trials but also cases tried to a judge, demonstrating that outcomes in arbitration are more predictable than in litigation.[10]

- **Arbitrators Do Not Split the Baby –** Studies have repeatedly and conclusively shown that arbitrators do not split the baby. For example, a 2007 study showed that in only 7% of the cases were damages awarded in the midrange of 41-60% of the amount claimed, results almost identical to a similar study conducted six years earlier. [11]

- **Lack of bias -** Studies have concluded that three arbitrators are less likely to be influenced by unconscious biases than is a single judge in a bench trial.[12]

- **Compliance with awards** - Studies have shown that the rate of voluntary compliance with arbitral awards is over 90%**.**[13]

* * * *

**Edna Sussman** *is the chair of the Arbitration Committees of the ABA Section of Dispute Resolution and of the Section of International Law and serves on the boards of the American Arbitration Association and the College of Commercial Arbitrators. She is a member of the large complex case,*

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**John Wilkinson** *is a member of various arbitration and mediation panels of the AAA and CPR as well as the panels of the Hong Kong and Kuala Lumpur arbitration centres. He is Chair-Elect of the Dispute Resolution Section of the New York State Bar Association and Vice Chair of the Arbitration Committee of the ABA's Dispute Resolution Section. He is on the board of the College of Commercial Arbitrators and has authored numerous articles and materials on means of attaining arbitration efficiency. He has served as arbitrator (often as chair) in hundreds of complex, commercial arbitrations. Contact information is available at www.johnwilkinsonlaw.com.*

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[1] *Judicial Business of the U.S. Courts, U.S. District Courts—Median Time Intervals From Filing to Disposition of Civil Cases Terminated, by District and Method of Disposition, at* http://www.uscourts.gov/uscourts/Statistics/JudicialBusiness/2010/appendices/C05Sep10.pdf

[2] *Judicial Business of the U.S. Courts, Table B-4A.U.S. Courts of Appeals—Median Time Intervals in Months for Merit Terminations of Appeals Arising From the U.S. District Courts, by Circuit* at http://www.uscourts.gov/uscourts/Statistics/JudicialBusiness/2010/appendices/B04ASep10.pdf

[3] International Chamber of Commerce Commission on Arbitration, *Techniques for Controlling Time and Costs for Arbitration, available at* http://www.iccwbo.org/uploadedFiles/TimeCost_E.pdf.

[4] *Guidelines for the Arbitrator's Conduct of the Pre-Hearing Phase of Domestic Commercial Arbitrations and International Arbitrations*, available at http://www.nysba.org/ArbitrationGuidelinesBooklet.

[5] National Center for State Courts, statistics and information on state court budget cuts available at www.NCSC.org; Wall Street Journal, *Budget Woes Squeeze Federal Courts in NYC*, DECEMBER 27, 2011; Wall Street Journal, *Criminal Case Glut Impedes Civil Suits*, November 10, 2011.

[6] Rand Institute for Civil Justice, *Business to Business Arbitration in the United States, Perceptions of Corporate Counsel ("Rand")*, p. 1, 30 (2011).

[7] Id.

[8] PriceWaterhouseCoopers, *International Arbitration, Corporate Attitudes and Practices*, ("PWC"), p. 8 (2008).

[9] Rand, *supra* note vi at p. 32

[10] Randall Kiser, *Beyond Right and Wrong*, p. 63 (publ. Springer) 2010.

[11] American Arbitration Association, *Splitting the Baby: a New AAA Study*, available at http://www.adr.org/sp.asp?id=32004

[12] Chris Guthrie *Misjudging*, 7 Nev. L.J. 420, 451-453 (2007).

[13] PWC *supra* note viii at p. 8.

109 S.Ct. 1917
Supreme Court of the United States

Ofelia RODRIGUEZ DE QUIJAS, et al., Petitioners
v.
SHEARSON/AMERICAN EXPRESS, INC., etc.

No. 88-385.
|
Argued March 27, 1989.
|
Decided May 15, 1989.

Securities investors brought actions against brokerage firm and others for violations of Securities Act of 1933 and Securities Exchange Act of 1934. The United States District Court for the Southern District of Texas, Filemon B. Vela, J., ordered all but Securities Act claims to be submitted to arbitration, and securities firm appealed. The Fifth Circuit Court of Appeals, 845 F.2d 1296, reversed, and investors petitioned for certiorari. The Supreme Court, Justice Kennedy, held that predispute agreement to arbitrate claims under the Securities Act was enforceable.

Court of Appeals affirmed.

Justice Stevens filed dissenting opinion, in which Justices Brennan, Marshall, and Blackmun joined.

West Headnotes (4)

[1] **Alternative Dispute Resolution**
Agreements to Arbitrate

Predispute agreement to arbitrate claims under the Securities Act of 1933 was enforceable; overruling *Wilko v. Swan*, 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168. Securities Act of 1933, §§ 12(2), 14, 15 U.S.C.A. §§ 77*l* (2), 77n.

231 Cases that cite this headnote

[2] **Alternative Dispute Resolution**
Agreements to Arbitrate

Investors seeking to avoid arbitration of Securities Act claims under predispute arbitration agreement failed to establish that agreement to arbitrate resulted from sort of fraud or overwhelming economic power that would provide grounds for revocation of any contract. 9 U.S.C.A. § 2; Securities Act of 1933, §§ 12(2), 14, 15 U.S.C.A. §§ 77*l* (2), 77n.

253 Cases that cite this headnote

[3] **Courts**
Highest Appellate Court

Court of Appeals should follow case which directly controls, leaving to Supreme Court prerogative of overruling its own decisions, if precedent of Supreme Court has direct application in case, yet appears to rest on reasons rejected in some other line of decisions.

624 Cases that cite this headnote

[4] **Courts**
In General; Retroactive or Prospective Operation

Determination that predispute agreement to arbitrate claims under the Securities Act of 1933 was enforceable applied retroactively to case at bar, although decision established new principle of law, in that ruling furthered purposes and effect of Arbitration Act without undermining those of Securities Act, did not produce substantial inequitable results, and did not inherently undermine any substantive right afforded under Securities Act. 9 U.S.C.A. § 1 et seq.; Securities Act of 1933, § 1 et seq., 15 U.S.C.A. § 77a et seq.

303 Cases that cite this headnote

  

****1917** *Syllabus*[*]

[*] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

***477** Petitioners, securities investors, signed a standard customer agreement which included ****1918** an agreement to settle account disputes through binding arbitration unless the agreement was found unenforceable under federal or state law. When the investments turned sour, petitioners brought suit in the District Court against, *inter alias*, respondent brokerage firm, alleging that their money was lost in unauthorized and fraudulent transactions in violation of, among other things, the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. The District Court ordered all but the Securities Act claims to be submitted to arbitration, holding that those claims must proceed in the court action pursuant to the ruling in *Wilko v. Swan*, 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168, that an agreement to arbitrate Securities Act claims is void under § 14 of the Act, which prohibits a binding stipulation "to waive compliance with any provision" of the Act. The Court of Appeals reversed, concluding that the arbitration agreement is enforceable because this Court's subsequent decisions have reduced *Wilko* to "obsolescence."

*Held:* A predispute agreement to arbitrate claims under the Securities Act of 1933 is enforceable and resolution of the claims only in a judicial forum is not required. Pp. 1919-1922.

(a) *Wilko* is overruled. It was incorrectly decided and is inconsistent with the prevailing uniform construction of other federal statutes governing arbitration agreements in the setting of business transactions. See, particularly, *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220, 107 S.Ct. 2332, 96 L.Ed.2d 185 which declined to read § 29(a) of the 1934 Act, which is identical to § 14 of the 1933 Act, to prohibit enforcement of predispute agreements to arbitrate, and which stressed the strong language of the Arbitration Act declaring a federal policy favoring arbitration. It would be undesirable for *Wilko* and *McMahon* to exist side by side because their inconsistency is at odds with the principle that the 1933 and 1934 Acts be construed harmoniously in order to discourage litigants from manipulating their allegations merely to cast their claims under one rather than the other securities law. Pp. 1919-1922.

(b) The customary rule of retroactive application-that the law announced in the Court's decision controls the case at bar-is appropriate ***478** here. Although the decision to overrule *Wilko* establishes a new principle of law, the ruling furthers the purpose and effect of the Arbitration Act without undermining those of the Securities Act; it does not produce substantial inequitable results; and resort to arbitration does not inherently undermine any of petitioners' substantive rights under the Securities Act. P. 1922.

845 F.2d 1296 (CA5 1988) affirmed.

KENNEDY, J., delivered the opinion of the Court, in which REHNQUIST, C.J., and WHITE, O'CONNOR, and SCALIA, JJ., joined. STEVENS, J., filed a dissenting opinion, in which BRENNAN, MARSHALL, and BLACKMUN, JJ., joined, *post*, p. ----.

**Attorneys and Law Firms**

*Denis A. Downey* argued the cause and filed briefs for petitioners.

*Theodore A. Krebsbach* argued the cause for respondent. With him on the brief was *Jeffrey L. Friedman.**

* *Paul Windels III* filed a brief for the Securities Industry Association et al. as *amici curiae* urging affirmance.

**Opinion**

Justice KENNEDY delivered the opinion of the Court.

The question here is whether a predispute agreement to arbitrate claims under the Securities Act of 1933 is unenforceable, requiring resolution of the claims only in a judicial forum.

I

Petitioners are individuals who invested about $400,000 in securities. They signed a standard customer agreement with the broker, which included a clause stating that the parties agreed to settle any controversies "relating to [the] accounts" through ****1919** binding arbitration that

  

complies with specified procedures. The agreement to arbitrate these controversies is unqualified, unless it is found to be unenforceable under federal or state law. Customer's Agreement ¶ 13. The investments turned sour, and petitioners eventually sued respondent and its broker-agent in charge of the accounts, alleging that their money was lost in unauthorized and fraudulent transactions. In their complaint they ***479** pleaded various violations of federal and state law, including claims under § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77 *l* (2), and claims under three sections of the Securities Exchange Act of 1934.

The District Court ordered all the claims to be submitted to arbitration except for those raised under § 12(2) of the Securities Act. It held that the latter claims must proceed in the court action under our clear holding on the point in *Wilko v. Swan,* 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168 (1953). The District Court reaffirmed its ruling upon reconsideration and also entered a default judgment against the broker, who is no longer in the case. The Court of Appeals reversed, concluding that the arbitration agreement is enforceable because this Court's subsequent decisions have reduced *Wilko* to "obsolescence." *Rodriguez de Quijas v. Shearson/Lehman Bros., Inc.*, 845 F.2d 1296, 1299 (CA5 1988). We granted certiorari, 488 U.S. 954, 109 S.Ct. 389, 102 L.Ed.2d 379 (1988).

II

**[1]** The *Wilko* case, decided in 1953, required the Court to determine whether an agreement to arbitrate future controversies constitutes a binding stipulation "to waive compliance with any provision" of the Securities Act, which is nullified by § 14 of the Act. 15 U.S.C. § 77n. The Court considered the language, purposes, and legislative history of the Securities Act and concluded that the agreement to arbitrate was void under § 14.[*] But the decision was a difficult one in view of the competing legislative policy embodied in the Arbitration Act, which the Court described as "not easily reconcilable," and which strongly favors the enforcement of agreements to arbitrate as a means of securing "prompt, economical ***480** and adequate solution of controversies." 346 U.S., at 438, 74 S.Ct., at 188.

[*] The Court carefully limited its holding to apply only to arbitration agreements which are made "prior to the existence of a controversy." 346 U.S., at 438, 74 S.Ct., at 188; see *id.,* at 438-439, 74 S.Ct., at 188-189 (JACKSON, J., concurring). In contrast, "courts uniformly have concluded that *Wilko* does not apply to the submission to arbitration of existing disputes." *Shearson/American Express Inc. v. McMahon,* 482 U.S. 220, 233, 107 S.Ct. 2332, 2341, 96 L.Ed.2d 185 (1987).

It has been recognized that *Wilko* was not obviously correct, for "the language prohibiting waiver of 'compliance with any provision of this title' could easily have been read to relate to substantive provisions of the Act without including the remedy provisions." *Alberto-Culver Co. v. Scherk,* 484 F.2d 611, 618, n. 7 (CA7 1973) (Stevens, J., dissenting), rev'd, 417 U.S. 506, 94 S.Ct. 2449, 41 L.Ed.2d 270 (1974). The Court did not read the language this way in *Wilko,* however, and gave two reasons. First, the Court rejected the argument that "arbitration is merely a form of trial to be used in lieu of a trial at law." 346 U.S., at 433, 74 S.Ct., at 186. The Court found instead that § 14 does not permit waiver of "the right to select the judicial forum" in favor of arbitration, *id.,* at 435, 74 S.Ct., at 186, because "arbitration lacks the certainty of a suit at law under the Act to enforce [the buyer's] rights," *id.,* at 432, 74 S.Ct., at 185. Second, the Court concluded that the Securities Act was intended to protect buyers of securities, who often do not deal at arm's length and on equal terms with sellers, by offering them "a wider choice of courts and venue" than is enjoyed by participants in other business transactions, making "the right to select the judicial forum" a particularly ****1920** valuable feature of the Securities Act. *Id.,* at 435, 74 S.Ct., at 186.

We do not think these reasons justify an interpretation of § 14 that prohibits agreements to arbitrate future disputes relating to the purchase of securities. The Court's characterization of the arbitration process in *Wilko* is pervaded by what Judge Jerome Frank called "the old judicial hostility to arbitration." *Kulukundis Shipping Co. v. Amtorg Trading Corp.,* 126 F.2d 978, 985 (CA2 1942). That view has been steadily eroded over the years, beginning in the lower courts. See *Scherk, supra,* at 616 (Stevens, J., dissenting) (citing cases). The erosion intensified in our most recent decisions upholding agreements to arbitrate federal claims raised under the Securities Exchange Act of 1934, see *Shearson/American* ***481** *Express Inc. v. McMahon,* 482 U.S. 220, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987), under the Racketeer Influenced and Corrupt Organizations (RICO) statutes, see *ibid.,* and under the antitrust laws, see *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.,* 473 U.S. 614, 105 S.Ct. 3346, 87 L.Ed.2d 444 (1985). See also *Dean Witter Reynolds Inc. v. Byrd,* 470 U.S. 213, 221, 105 S.Ct. 1238, 1242, 84 L.Ed.2d 158 (1985) (federal arbitration statute "requires that we rigorously enforce agreements to arbitrate"); *Moses H. Cone Memorial*

  

*Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24, 103 S.Ct. 927, 941, 74 L.Ed.2d 765 (1983) ("[Q]uestions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration"). The shift in the Court's views on arbitration away from those adopted in *Wilko* is shown by the flat statement in *Mitsubishi:* "By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum." 473 U.S., at 628, 105 S.Ct., at 3354. To the extent that *Wilko* rested on suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants, it has fallen far out of step with our current strong endorsement of the federal statutes favoring this method of resolving disputes.

Once the outmoded presumption of disfavoring arbitration proceedings is set to one side, it becomes clear that the right to select the judicial forum and the wider choice of courts are not such essential features of the Securities Act that § 14 is properly construed to bar any waiver of these provisions. Nor are they so critical that they cannot be waived under the rationale that the Securities Act was intended to place buyers of securities on an equal footing with sellers. *Wilko* identified two different kinds of provisions in the Securities Act that would advance this objective. Some are substantive, such as the provision placing on the seller the burden of proving lack of scienter when a buyer alleges fraud. See 346 U.S., at 431, 74 S.Ct., at 184, citing 15 U.S.C. § 77*l* (2). Others are procedural. The specific procedural improvements highlighted in ***482** *Wilko* are the statute's broad venue provisions in the federal courts; the existence of nationwide service of process in the federal courts; the extinction of the amount-in-controversy requirement that had applied to fraud suits when they were brought in federal courts under diversity jurisdiction rather than as a federal cause of action; and the grant of concurrent jurisdiction in the state and federal courts without possibility of removal. See 346 U.S., at 431, 74 S.Ct., at 184, citing 15 U.S.C. § 77v(a).

There is no sound basis for construing the prohibition in § 14 on waiving "compliance with any provision" of the Securities Act to apply to these procedural provisions. Although the first three measures do facilitate suits by buyers of securities, the grant of concurrent jurisdiction constitutes explicit authorization for complainants to waive those protections by filing suit in state court without possibility of removal to federal court. These measures, moreover, are present in other federal statutes which have not been interpreted to prohibit ****1921** enforcement of predispute agreements to arbitrate. See *Shearson/American Express Inc. v. McMahon*, *supra* (construing the Securities Exchange Act of 1934; see 15 U.S.C. § 78aa); *ibid.* (construing the RICO statutes; see 18 U.S.C. § 1965); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, *supra* (construing the antitrust laws; see 15 U.S.C. § 15).

Indeed, in *McMahon* the Court declined to read § 29(a) of the Securities Exchange Act of 1934, the language of which is in every respect the same as that in § 14 of the 1933 Act, compare 15 U.S.C. § 77v(a) with § 78aa, to prohibit enforcement of predispute agreements to arbitrate. The only conceivable distinction in this regard between the Securities Act and the Securities Exchange Act is that the former statute allows concurrent federal-state jurisdiction over causes of action and the latter statute provides for exclusive federal jurisdiction. But even if this distinction were thought to make any difference at all, it would suggest that arbitration agreements, ***483** which are "in effect, a specialized kind of forum-selection clause," *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519, 94 S.Ct. 2449, 2457, 41 L.Ed.2d 270 (1974), should not be prohibited under the Securities Act, since they, like the provision for concurrent jurisdiction, serve to advance the objective of allowing buyers of securities a broader right to select the forum for resolving disputes, whether it be judicial or otherwise. And in *McMahon* we explained at length why we rejected the *Wilko* Court's aversion to arbitration as a forum for resolving disputes over securities transactions, especially in light of the relatively recent expansion of the Securities and Exchange Commission's authority to oversee and to regulate those arbitration procedures. 482 U.S., at 231-234, 107 S.Ct., at 2340-2342. We need not repeat those arguments here.

Finally, in *McMahon* we stressed the strong language of the Arbitration Act, which declares as a matter of federal law that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Under that statute, the party opposing arbitration carries the burden of showing that Congress intended in a separate statute to preclude a waiver of judicial remedies, or that such a waiver of judicial remedies inherently conflicts with the underlying purposes of that other statute. 482 U.S., at 226-227, 107 S.Ct., at 2337-2338. But as Justice Frankfurter said in dissent in *Wilko*, so it is true in this case: "There is nothing in the record before us, nor in the facts of which we can take judicial notice, to indicate that the arbitral system ... would not afford the plaintiff the rights to which he is entitled." 346 U.S., at 439, 74 S.Ct., at 189. Petitioners have not carried their burden of showing that

  

arbitration agreements are not enforceable under the Securities Act.

[2] The language quoted above from § 2 of the Arbitration Act also allows the courts to give relief where the party opposing arbitration presents "well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming ***484** economic power that would provide grounds 'for the revocation of any contract.' " *Mitsubishi,* 473 U.S., at 627, 105 S.Ct., at 3354. This avenue of relief is in harmony with the Securities Act's concern to protect buyers of securities by removing "the disadvantages under which buyers labor" in their dealings with sellers. *Wilko, supra,* 346 U.S., at 435, 74 S.Ct., at 187. Although petitioners suggest that the agreement to arbitrate here was adhesive in nature, the record contains no factual showing sufficient to support that suggestion.

III

[3] We do not suggest that the Court of Appeals on its own authority should have taken the step of renouncing *Wilko.* If a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, the Court of Appeals should follow the case which directly controls, leaving to ****1922** this Court the prerogative of overruling its own decisions. We now conclude that *Wilko* was incorrectly decided and is inconsistent with the prevailing uniform construction of other federal statutes governing arbitration agreements in the setting of business transactions. Although we are normally and properly reluctant to overturn our decisions construing statutes, we have done so to achieve a uniform interpretation of similar statutory language, *Commissioner v. Estate of Church,* 335 U.S. 632, 649-650, 69 S.Ct. 322, 330-331, 93 L.Ed. 288 (1949), and to correct a seriously erroneous interpretation of statutory language that would undermine congressional policy as expressed in other legislation, see, *e.g., Boys Markets, Inc. v. Retail Clerks,* 398 U.S. 235, 240-241, 90 S.Ct. 1583, 1586-1587, 26 L.Ed.2d 199 (1970) (overruling *Sinclair Refining Co. v. Atkinson,* 370 U.S. 195, 82 S.Ct. 1328, 8 L.Ed.2d 440 (1962)). Both purposes would be served here by overruling the *Wilko* decision.

It also would be undesirable for the decisions in *Wilko* and *McMahon* to continue to exist side by side. Their inconsistency is at odds with the principle that the 1933 and 1934 Acts should be construed harmoniously because they "constitute ***485** interrelated components of the federal regulatory scheme governing transactions in securities." *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 206, 96 S.Ct. 1375, 1387, 47 L.Ed.2d 668 (1976). In this case, for example, petitioners' claims under the 1934 Act were subjected to arbitration, while their claim under the 1933 Act was not permitted to go to arbitration, but was required to proceed in court. That result makes little sense for similar claims, based on similar facts, which are supposed to arise within a single federal regulatory scheme. In addition, the inconsistency between *Wilko* and *McMahon* undermines the essential rationale for a harmonious construction of the two statutes, which is to discourage litigants from manipulating their allegations merely to cast their claims under one of the securities laws rather than another. For all of these reasons, therefore, we overrule the decision in *Wilko.*

[4] Petitioners argue finally that if the Court overrules *Wilko,* it should not apply its ruling retroactively to the facts of this case. We disagree. The general rule of long standing is that the law announced in the Court's decision controls the case at bar. See, *e.g., Saint Francis College v. Al-Khazraji,* 481 U.S. 604, 608, 107 S.Ct. 2022, 2025, 95 L.Ed.2d 582 (1987); *United States v. Schooner Peggy,* 5 U.S. (1 Cranch) 103, 109, 2 L.Ed. 49 (1801). In some civil cases, the Court has restricted its rulings to have prospective application only, where specific circumstances are present. *Chevron Oil v. Huson,* 404 U.S. 97, 106-107, 92 S.Ct. 349, 355-356, 30 L.Ed.2d 296 (1971). Under the *Chevron* approach, the customary rule of retroactive application is appropriate here. Although our decision to overrule *Wilko* establishes a new principle of law for arbitration agreements under the Securities Act, this ruling furthers the purposes and effect of the Arbitration Act without undermining those of the Securities Act. Today's ruling, moreover, does not produce "substantial inequitable results," 404 U.S., at 107, 92 S.Ct., at 355, for petitioners do not make any serious allegation that they agreed to arbitrate future disputes relating to their investment contracts in reliance on *Wilko*'s holding that such agreements would be held unenforceable by the courts. Our ***486** conclusion is reinforced by our assessment that resort to the arbitration process does not inherently undermine any of the substantive rights afforded to petitioners under the Securities Act.

The judgment of the Court of Appeals is

*Affirmed.*

Justice STEVENS, with whom Justice BRENNAN, Justice MARSHALL, and Justice BLACKMUN join, dissenting.

  

The Court of Appeals refused to follow *Wilko v. Swan*, 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168 (1953), a controlling precedent of this Court. As the majority correctly ****1923** acknowledges, *ante*, at 1921, the Court of Appeals therefore engaged in an indefensible brand of judicial activism.[1] We, of course, are not subject to the same restraint when asked to upset one of our own precedents. But when our earlier opinion gives a statutory provision concrete meaning, which Congress elects not to amend during the ensuing 3½ decades, our duty to respect Congress' work product is strikingly similar to the duty of other federal courts to respect our work product.[2]

1 After the Court decided *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987), numerous District Courts also deviated from the rule established in *Wilko v. Swan*, and enforced predispute arbitration clauses in suits brought pursuant to the Securities Act of 1933. *E.g., Reed v. Bear, Stearns & Co.*, 698 F.Supp. 835 (Kan.1988); *Ryan v. Liss, Tenner & Goldberg Securities Corp.*, 683 F.Supp. 480 (NJ 1988); *Kavouras v. Visual Products Systems, Inc.*, 680 F.Supp. 205 (WD Pa.1988); *Aronson v. Dean Witter Reynolds, Inc.*, 675 F.Supp. 1324 (SD Fla.1987); *DeKuyper v. A.G. Edwards & Sons, Inc.*, 695 F.Supp. 1367 (Conn.1987); *Rosenblum v. Drexel Burnham Lambert Inc.*, 700 F.Supp. 874 (ED La.1987); *Staiman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 673 F.Supp. 1009 (CD Cal.1987).

2 Cf. *McMahon*, 482 U.S., at 268, 107 S.Ct., at 2359 (STEVENS, J., concurring in part and dissenting in part) ("[A]fter a statute has been construed ... by this Court ... it acquires a meaning that should be as clear as if the judicial gloss had been drafted by the Congress itself. This position reflects both respect for Congress' role, see *Boys Market, Inc. v. Retail Clerks*, 398 U.S. 235, 257-258, 90 S.Ct. 1583, 1595-1596, 26 L.Ed.2d 199 (1970) (BLACK, J., dissenting), and the compelling need to preserve the courts' limited resources, see B. Cardozo, The Nature of the Judicial Process 149 (1921)").

***487** In the final analysis, a Justice's vote in a case like this depends more on his or her views about the respective lawmaking responsibilities of Congress and this Court than on conflicting policy interests. Judges who have confidence in their own ability to fashion public policy are less hesitant to change the law than those of us who are inclined to give wide latitude to the views of the voters' representatives on nonconstitutional matters. Cf. *Boyle v. United Technologies Corp.*, 487 U.S. 500, 108 S.Ct. 2510, 101 L.Ed.2d 442 (1988). As I pointed out years ago, *Alberto-Culver Co. v. Scherk*, 484 F.2d 611, 615-620 (CA7 1973) (dissenting opinion), rev'd, 417 U.S. 506, 94 S.Ct. 2449, 41 L.Ed.2d 270 (1974), there are valid policy and textual arguments on both sides regarding the interrelation of federal securities and arbitration Acts.[3] See *ante*, at 1919-1921. None of these arguments, however, carries sufficient weight to tip the balance between judicial and legislative authority and overturn an interpretation of an Act of Congress that has been settled for many years.

3 Indeed the Court first debated some of these arguments in the precedent-setting opinion that the majority now overrules. Compare *Wilko*, 346 U.S., at 432-438, 74 S.Ct., at 185-189, with *id.*, at 439-440, 74 S.Ct., at 189-190 (Frankfurter, J., dissenting). Most recently they were revisited in *McMahon*, *supra*, an action based upon the Securities Exchange Act of 1934. Compare 482 U.S., at 225-238, 107 S.Ct., at 2336-2344, with *id.*, at 243-266, 107 S.Ct., at 2346-2358 (BLACKMUN, J., concurring in part and dissenting in part).

I respectfully dissent.

**All Citations**

490 U.S. 477, 109 S.Ct. 1917, 104 L.Ed.2d 526, 57 USLW 4539, Fed. Sec. L. Rep. P 94,407

**End of Document**

74 S.Ct. 182
Supreme Court of the United States
WILKO

v.
SWAN et al.

No. 39.
|
Argued Oct. 21, 1953.
|
Decided Dec. 7, 1953.

Buyer's suit to recover, under Securities Act, for misrepresentation. The United States District Court for the Southern District of New York, 107 F.Supp. 75, denied the defendant-brokers' motion for stay of proceeding until an arbitration could be had in accordance with agreement between parties, and the defendants appealed. The United States Court of Appeals for the Second Circuit, 201 F.2d 439, reversed, and the plaintiff brought certiorari. The United States Supreme Court, Mr. Justice Reed, held that right to select judicial forum is kind of 'provision' which cannot validly be waived, and that an agreement to arbitrate future controversies between securities brokers and buyer constitutes a 'stipulation' binding buyer to waive compliance with such Securities Act provision, and held that such an agreement is therefore invalidated by the act's express prohibitions against waiver.

Reversed.

Mr. Justice Frankfurter and Mr. Justice Minton, dissented.

West Headnotes (7)

[1] **Federal Courts**
Particular Cases, Contexts, and Questions

Federal Supreme Court would grant certiorari to review important and novel federal question, affecting both Securities Act and United States Arbitration Act, presented by purchaser's action, against brokers, involving issue as to whether an agreement to arbitrate future controversy was the sort of "condition, stipulation, or provision" for waiver of compliance with any "provision" of the Securities Act which said act itself declares "void." Securities Act of 1933, § 14, 15 U.S.C.A. § 77n; 9 U.S.C.A. § 2.

251 Cases that cite this headnote

[2] **Securities Regulation**
Registration Requirement in General

The Securities Act of 1933 was passed in response to a presidential message urging that there be added to the ancient rule of caveat emptor the further doctrine of "let the seller also beware," and such act was designed to protect investors. Securities Act of 1933, §§ 1 et seq., 12(2), 15 U.S.C.A. §§ 77a et seq., 77*l* (2).

23 Cases that cite this headnote

[3] **Federal Courts**
Actions arising under federal constitution and laws in general
**Removal of Cases**
Restrictions by federal or state statutes
**Securities Regulation**
Jurisdiction and venue

The special right given by Securities Act, to recover for misrepresentation, is enforceable in any court of competent jurisdiction, federal or state, and removal from state court is prohibited, but if suit is brought in federal court purchaser has wide choice of venue and privilege of nation-wide service of process, and jurisdictional $3,000 requirement of diversity cases is inapplicable. Securities Act of 1933, §§ 4, 12(2), 16, and § 22(a), as amended, 15 U.S.C.A. §§ 77d, 77*l* (2), 77p, 77v(a); 9 U.S.C.A. § 10.

35 Cases that cite this headnote

  

[4] **Alternative Dispute Resolution**
Award

Where arbitration agreement between buyer and brokers was made subject to provisions of Securities Act, provisions of Securities Act would control, in so far as award in arbitration might be affected by legal requirements, statutes or common law, even if proposed agreement had no requirement that arbitrators follow the law. 9 U.S.C.A. §§ 1 et seq., 3.

344 Cases that cite this headnote

[5] **Alternative Dispute Resolution**
Questions of law or fact

In unrestricted submissions, interpretations of law by arbitrators, in contrast to manifest disregard thereof, are not subject, in federal courts, to judicial review for error in interpretation. 9 U.S.C.A. § 10.

503 Cases that cite this headnote

[6] **Alternative Dispute Resolution**
Constitutional and statutory provisions and rules of court

By Federal Arbitration Act, Congress has afforded participants in transactions subject to its legislative power an opportunity generally to secure prompt, economical and adequate solution of controversies through arbitration, if parties are willing to accept less certainty of legally correct adjustment. 9 U.S.C.A. § 1 et seq.

85 Cases that cite this headnote

[7] **Alternative Dispute Resolution**
Agreements to arbitrate
**Contracts**
Approval or Decision of Architects, Engineers, or Others

Right to select judicial forum is kind of "provision" which cannot by express terms of Securities Act, validly be waived; and an agreement to arbitrate future controversy between securities brokers and buyer constitutes a "stipulation" binding buyer to waive compliance with such Securities Act provision. 9 U.S.C.A. § 10.

375 Cases that cite this headnote

**Attorneys and Law Firms**

****183*427** Mr. Richard H. Wels, New York City, for petitioner.

Mr. Horace G. Hitchcock, New York City, for respondents.

Mr. William H. Timbers, New York City, for S.E.C., ***428** amicus curiae, by special leave of Court.

**Opinion**

Mr. Justice REED delivered the opinion of the Court.

This action by petitioner,[*] a customer, against respondents, partners in a securities brokerage firm, was brought in the United States District Court for the Southern District of New York, to recover damages under s 12(2) of the Securities Act of 1933.[1] The complaint alleged that on or about January 17, 1951, through the instrumentalities of interstate commerce, petitioner was induced by Hayden, Stone and Company to purchase ***429** 1,600 shares of the common stock of Air Associates, Incorporated, by false representations that pursuant to a merger contract with the Borg Warner Corporation, Air Associates' stock would be valued at $6.00 per share over the then current market price, and that financial interests were buying up the stock for the speculative profit. It was alleged that he was not told that Haven B. Page (also named as a defendant but not involved in this review[2] ), a director of, and counsel for, Air Associates was then

  

selling his own Air Associates' stock, including some or all that petitioner purchased. Two weeks after the purchase, petitioner disposed of the stock at a loss. Claiming that the loss was due to the firm's misrepresentations and omission of information concerning Mr. Page, he sought damages.

* The Securities and Exchange Commission participated as amicus curiae throughout this case and has shared petitioner's burden in presenting the case to the Court.

1 48 Stat. 74, 15 U.S.C. s 77a et seq., 15 U.S.C.A. s 77a et seq., s 12(2), 48 Stat. 84, 15 U.S.C. s 77*l*(2), 15 U.S.C.A. s 77*l*(2), provides: 'Any person who—* * *
'(2) sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of section 77c of this title), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.'

2 See Wilko v. Swan, 2 Cir., 201 F.2d 439, 445.

Without answering the complaint, the respondent moved to stay the trial of the action pursuant to s 3 of the United States Arbitration Act[3] until an arbitration ****184** in accordance with the terms of identical margin agreements was had. An affidavit accompanied the motion stating that the parties' relationship was controlled by the terms of the agreements and that while the firm was willing to arbitrate petitioner had failed to seek or proceed with any arbitration of the controversy.

3 9 U.S.C. s 1 et seq. (Supp. V, 1952), 9 U.S.C.A. s 1 et seq. Section 3 provides:
'If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.'

Finding that the margin agreements provide that arbitration should be the method of settling all future ***430** controversies, the District Court held that the agreement to arbitrate deprived petitioner of the advantageous court remedy afforded by the Securities Act, and denied the stay.[4] A divided Court of Appeals concluded that the Act did not prohibit the agreement to refer future controversies to arbitration, and reversed.[5]

4 Wilko v. Swan, D.C.N.Y., 107 F.Supp. 75.

5 Wilko v. Swan, 2 Cir., 201 F.2d 439.

**[1]** The question is whether an agreement to arbitrate a future controversy is a 'condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision' of the Securities Act which s 14[6] declares 'void.' We granted certiorari, 345 U.S. 969,73 S.Ct. 73 S.Ct. 1112, to review this important and novel federal question affecting both the Securities Act and the United States Arbitration Act. Cf. Frost & Co. v. Coeur D'Alene Mines Corp., 312 U.S. 38, 40, 61 S.Ct. 414, 415, 85 L.Ed. 500.

6 48 Stat. 84, 15 U.S.C. s 77n, 15 U.S.C.A. s 77n. Section 14 provides:
'Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.'

As the margin agreement in the light of the complaint evidenced a transaction in interstate commerce, no issue arises as to the applicability of the provisions of the United States Arbitration Act to this suit, based upon the Securities Act. 9 U.S.C. (Supp. V, 1952) s 2, 9 U.S.C.A. s 2. Cf. Tejas Development Co. v. McGough Bros., 5 Cir., 165 F.2d 276, 278, with Agostini Bros. Bldg. Corp. v. United States, 4 Cir., 142 F.2d 854. See Sturges and

  

Murphy, Some Confusing Matters Relating to Arbitration, 17 Law & Contemp. Prob. 580.

[2][3] In response to a Presidential message urging that there be added to the ancient rule of caveat emptor the further doctrine of 'let the seller also beware,'[7] Congress passed ***431** the Securities Act of 1933. Designed to protect investors,[8] the Act requires issuers, underwriters, and dealers to make full and fair disclosure of the character of securities sold in interstate and foreign commerce and to prevent fraud in their sale.[9] To effectuate this policy, s 12(2) created a special right to recover for misrepresentation which differs substantially from the common-law action in that the seller is made to assume the burden of proving lack of scienter.[10] The Act's special right is enforceable in any court of competent jurisdiction—federal or state—and removal from a ****185** state court is prohibited. If suit be brought in a federal court, the purchaser has a wide choice of venue, the privilege of nation-wide service of process and the jurisdictional $3,000 requirement of diversity cases is inapplicable.[11]

7 H.R.Rep.No.85, 73d Cong., 1st Sess. 2.

8 S.Rep.No.47, 73d Cong., 1st Sess. 1. See Oklahoma-Texas Trust v. S.E.C., 10 Cir., 100 F.2d 888, 891.

9 48 Stat. 74, Preamble; 48 Stat. 77, 15 U.S.C. s 77d, 15 U.S.C.A. s 77d. See Frost & Co. v. Coeur D'Alene Mines Corp., 312 U.S. 38, 40, 61 S.Ct. 414, 415, 85 L.Ed. 500.

10 See note 1, supra. 'Unless responsibility is to involve merely paper liability it is necessary to throw the burden of disproving responsibility for reprehensible acts of omission or commission on those who purport to issue statements for the public's reliance. * * * To impose a lesser responsibility would nullify the purposes of this legislation.' H.R.Rep.No.85, 73d Cong., 1st Sess. 9—10.

11 s 22(a), 48 Stat. 86, as amended 49 Stat. 1921, 15 U.S.C. s 77v(a), 15 U.S.C.A. s 77v(a). See Deckert v. Independence Shares Corp., 311 U.S. 282, 289, 61 S.Ct. 229, 233, 85 L.Ed. 189. Existing remedies at law and equity are retained. s 16, 48 Stat. 84, 15 U.S.C. s 77p, 15 U.S.C.A. s 77p.

The United States Arbitration Act establishes by statute the desirability of arbitration as an alternative to the complications of litigation. The reports of both Houses on that Act stress the need for avoiding the delay and expense of litigation,[12] and practice under its terms raises ***432** hope for its usefulness both in controversies based on statutes[13] or on standards otherwise created.[14] This hospitable attitude of legislatures and courts toward arbitration, however, does not solve our question as to the validity of petitioner's stipulation by the margin agreements, set out below, to submit to arbitration controversies that might arise from the transactions.[15]

12 H.R.Rep.No.96, 68th Cong., 1st Sess. 1—2; S.Rep.No.536, 68th Cong., 1st Sess. 3. See Marine Transit Corp. v. Dreyfus, 284 U.S. 263, 52 S.Ct. 166, 76 L.Ed. 282.

13 Agostini Bros. Bldg. Corp. v. United States, 4 Cir., 142 F.2d 854;Watkins v. Hudson Coal Co., 3 Cir., 151 F.2d 311;Donahue v. Susquehanna Collieries Co., 3 Cir., 138 F.2d 3;Donahue v. Susquehanna Collieries Co., 3 Cir., 160 F.2d 661;Evans v. Hudson Coal Co., 3 Cir., 165 F.2d 970.

14 Marine Transit Corp. v. Dreyfus, 284 U.S. 263, 52 S.Ct. 166, 76 L.Ed. 282;Kentucky River Mills v. Jackson, 6 Cir., 206 F.2d 111;Campbell v. American Fabrics Co., 2 Cir., 168 F.2d 959;Columbian Fuel Corp. v. United Fuel Gas Co., D.C.W.Va., 72 F.Supp. 843, affirmed, 4 Cir., 165 F.2d 746;Matter of Springs Cotton Mills v. Buster Boy Suit Co., 275 App.Div. 196, 88 N.Y.S.2d 295, affirmed 300 N.Y. 586, 89 N.E.2d 877;White Star Mining Co. v. Hultberg, 220 Ill. 578, 77 N.E. 327;Oregon-Washington R. & N. Co. v. Spokane, P. & S.R. Co., 83 Or. 528, 163 P. 600; Sturges, Commercial Arbitrations and Awards, pp. 502, 793—798.

15 'Any controversy arising between us under this contract shall be determined by arbitration pursuant to the Arbitration Law of the State of New York, and under the rules of either the Arbitration Committee of the Chamber of Commerce of the State of New York, or of the American Arbitration Association, or of the Arbitration Committee of the New York Stock Exchange or such other Exchange as may have jurisdiction over the matter in dispute, as I may elect. Any arbitration hereunder shall be before at least three arbitrators.'

  

Petitioner argues that s 14, note 6, supra, shows that the purpose of Congress was to assure that sellers could not maneuver buyers into a position that might weaken their ability to recover under the Securities Act. He contends that arbitration lacks the certainty of a suit at law under the Act to enforce his rights. He reasons that the arbitration paragraph of the margin agreement is a stipulation that waives 'compliance with' the provision ***433** of the Securities Act, set out in the margin, conferring jurisdiction of suits and special powers.[16]

16 48 Stat. 86, as amended, 49 Stat. 1921, 15 U.S.C. s 77v(a), 15 U.S.C.A. s 77v(a). Section 22(a) provides:
'The district courts of the United States * * * shall have jurisdiction * * * concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections (1292—93) and (1254) of Title 28. No case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States. * * *' See note 11, supra.

****186** Respondent asserts that arbitration is merely a form of trial to be used in lieu of a trial at law,[17] and therefore no conflict exists between the Securities Act and the United States Arbitration Act either in their language or in the congressional purposes in their enactment. Each may function within its own scope, the former to protect investors and the latter to simplify recovery for actionable violations of law by issuers or dealers in securities.

17 See Murray Oil Products v. Mitsui & Co., 2 Cir., 146 F.2d 381, 383;American Locomotive Co., v. Chemical Research Corp., 6 Cir., 171 F.2d 115, 120.

**[4]** Respondent is in agreement with the Court of Appeals that the margin agreement arbitration paragraph, note 15, supra, does not relieve the seller from either liability or burden of proof, note 1, supra, imposed by the Securities Act.[18] We agree that in so far as the award in arbitration ***434** may be affected by legal requirements, statutes or common law, rather than by considerations of fairness, the provisions of the Securities Act control.[19] This is true even though this proposed agreement has no requirement that the arbitrators follow the law. This agreement of the parties as to the effect of the Securities Act includes also acceptance of the invalidity of the paragraph of the margin agreement that relieves the respondent sellers of liability for all 'representation or advice by you or your employees or agents regarding the purchase or sale by me of any property. * * *'

18 'Paragraph 3 of the margin agreement provides that all transactions 'shall be subject to the provisions of the Securities Exchange Act of 1934 and present and future acts amendatory thereto (15 U.S.C.A. s 78a et seq.).' It contains no express mention of the Securities Act of 1933. If reference to the 1934 Act were construed as excluding the 1933 Act, it might be argued that the agreement did not provide for arbitration of a controversy as to the liability of Hayden, Stone & Co. under section 12(2) of the 1933 Act. But we do not think the principle of expressio unius est exclusio alterius is here applicable. It may well be that the phrase 'present * * * acts * * * supplemental' to the 1934 Act should be construed to include the 1933 Act. In any event the sale transaction would necessarily be subject to that Act. Therefore the amicus does not regard it as material whether or not the agreement purports to make that statute applicable. We agree, and shall proceed to a consideration of the question decided below, namely, whether the 1933 Act evidences a public policy which forbids referring the controversy to arbitration.' 201 F.2d at page 443.
The paragraph of the agreement referred to by the Court of Appeals as '3' reads as follows:
'All transactions made by you or your agents for me are to be subject to the constitutions, rules, customs and practices of the exchanges or markets where executed and of their respective clearing houses and shall be subject to the provisions of the Securities Exchange Act of 1934 and present and future acts amendatory thereof or supplemental thereto, and to the rules and regulations of the Federal Securities and Exchange Commission and of the Federal Reserve Board insofar as they may be applicable * * *.'

19 See Sturges, Commercial Arbitrations and Awards, 500.

**[5][6][7]** The words of s 14, note 6, supra, void and 'stipulation' waiving compliance with any 'provision' of the Securities Act. This arrangement to arbitrate is a 'stipulation,' ***435** and we think the right to select the judicial forum is the kind of 'provision' that cannot be waived under s 14 of the Securities Act. That conclusion is reached for the reasons set out above in the statement of petitioner's contention on this review. While a buyer and seller of securities, under some circumstances, may deal at ****187** arm's length on equal terms, it is clear that the

  

Securities Act was drafted with an eye to the disadvantages under which buyers labor. Issuers of and dealers in securities have better opportunities to investigate and appraise the prospective earnings and business plans affecting securities than buyers. It is therefore reasonable for Congress to put buyers of securities covered by that Act on a different basis from other purchasers.

When the security buyer, prior to any violation of the Securities Act, waives his right to sue in courts, he gives up more than would a participant in other business transactions. The security buyer has a wider choice of courts and venue. He thus surrenders one of the advantages the Act gives him and surrenders it at a time when he is less able to judge the weight of the handicap the Securities Act places upon his adversary.

Even though the provisions of the Securities Act, advantageous to the buyer, apply, their effectiveness in application is lessened in arbitration as compared to judicial proceedings. Determination of the quality of a commodity[20] or the amount of money due under a contract is not the type of issue here involved.[21] This case requires subjective findings on the purpose and knowledge ***436** of an alleged violator of the Act. They must be not only determined but applied by the arbitrators without judicial instruction on the law. As their award may be made without explanation of their reasons and without a complete record of their proceedings, the arbitrators' conception of the legal meaning of such statutory requirements as 'burden of proof,' 'reasonable care' or 'material fact,' see, note 1, supra, cannot be examined. Power to vacate an award is limited.[22] While it may be true, as the Court of Appeals thought, that a failure of the arbitrators to decide in accordance with the provisions of the Securities Act would 'constitute grounds for vacating the award pursuant to section 10 of the Federal Arbitration Act,'[23] that failure would need to be made clearly to appear. In unrestricted submission, such as the present margin agreements envisage, the interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error ***437** in ****188** interpretation.[24] The United States Arbitration Act contains no provision for judicial determination of legal issues such as is found in the English law.[25] As the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness, it seems to us that Congress must have intended s 14, note 6, supra, to apply to waiver of judicial trial and review.[26]

20 Campe Corp. v. Pacific Mills, Sup., 87 N.Y.S.2d 16, reversed 275 App.Div. 634, 92 N.Y.S.2d 347.

21 Evans v. Hudson Coal Co., 3 Cir., 165 F.2d 970;Donahue v. Susquehanna Collieries Co., 3 Cir., 160 F.2d 661;Watkins v. Hudson Coal Co., 3 Cir., 151 F.2d 311;Donahue v. Susquehanna Collieries Co., 3 Cir., 138 F.2d 3;Agostini Bros. Bldg. Corp. v. United States, 4 Cir., 142 F.2d 854;American Almond Prod. Co. v. Consolidated Pecan S. Co., 2 Cir., 144 F.2d 448.

22 9 U.S.C. (Supp. V, 1952) s 10, 9 U.S.C.A. s 10:
'In either of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—
'(a) Where the award was procured by corruption, fraud, or undue means.
'(b) Where there was evident partiality or corruption in the arbitrators, or either of them.
'(c) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.
'(d) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.
'(e) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators.'

23 Wilko v. Swan, 2 Cir., 201 F.2d 439, 445.

24 Burchell v. Marsh, 17 How. 344, 349, 15 L.Ed. 96;United States v. Farragut, 22 Wall. 406, 413, 419—421, 22 L.Ed. 879 (note the right of review); Kleine v. Catara, 14 Fed.Cas. page 732, No. 7, 869; Texas & P. Ry. Co. v. St. Louis Southwestern Ry. Co., 8 Cir., 158 F.2d 251, 256;The Hartbridge (North England S.S. Co. v. Munson S.S. Line), 2 Cir., 62 F.2d 72, 73. In Mutual Benefit Health & Acc. Ass'n v. United Cas. C., 1 Cir., 142 F.2d 390, 393, the problem was dealt with on the basis of the Massachusetts law. See Sturges, note 19, supra; Note, Judicial Review of Arbitration Awards on the Merits, 63 Harv.L.Rev. 681, 685, Award Based on Erroneous Rule; Cox, The Place of Law in Labor Arbitration, XXXIV Chicago Bar Rec. 205.

25 Arbitration Act, 1950, 14 Geo VI, c. 27, s 21, 29

  

Halsbury's Statutes of England 2d ed.) p. 106.

[26] Cf. notes 66 Harv.L.Rev. 1326; 53 Col.L.Rev. 735; 41 Georgetown L.J. 565; 62 Yale L.J. 985.

This accords with Boyd v. Grand Trunk Western R. Co., 338 U.S. 263, 70 S.Ct. 26, 94 L.Ed. 55.[27] We there held invalid a stipulation restricting an employee's choice of venue in an action under the Federal Employers' Liability Act, 45 U.S.C.A. s 51 et seq. Section 6 of that Act permitted suit in any one of several localities and s 5 forbade a common carrier's exempting itself from any liability under the Act.[28] Section 5 had been adopted to avoid contracts waiving employers' liability.[29] It is ***438** to be noted that in words it forbade exemption only from 'liability.' We said the right to select the 'forum' even after the creation of a liability is a 'substantial right' and that the agreement, restricting that choice, would thwart the express purpose of the statute. We need not and do not go so far in this present case. By the terms of the agreement to arbitrate, petitioner is restricted in his choice of forum prior to the existence of a controversy. While the Securities Act does not require petitioner to sue,[30] a waiver in advance of a controversy stands upon a different footing.[31]

[27] See also, Krenger v. Pennsylvania R. Co., 2 Cir., 174 F.2d 556;Akerly v. New York Cent. R. Co., 6 Cir., 168 F.2d 812.

[28] s 5 of the Federal Employers' Liability Act, 35 Stat. 66, 45 U.S.C. s 55, 45 U.S.C.A. s 55, provides: 'Any contract, rule, regulation, or device whatsoever, the purpose or intent of which shall be to enable any common carrier to exempt itself from any liability created by this chapter, shall to that extent be void * * *.'

[29] See H.R.Rep.No.1386, 60th Cong., 1st Sess. 6. Compare Baltimore & O.S.R. Co. v. Voigt, 176 U.S. 498, 20 S.Ct. 385, 44 L.Ed. 560.

[30] Cf. Callen v. Pennsylvania R. Co., 332 U.S. 625, 631, 68 S.Ct. 296, 298, 92 L.Ed. 242.

[31] Brooklyn Savings Bank v. O'Neil, 324 U.S. 697, 707, 714, 65 S.Ct. 895, 905, 89 L.Ed. 1296.

Two policies, not easily reconcilable, are involved in this case. Congress has afforded participants in transactions subject to its legislative power an opportunity generally to secure prompt, economical and adequate solution of controversies through arbitration if the parties are willing to accept less certainty of legally correct adjustment.[32] On the other hand, it has enacted the Securities Act to protect the rights of investors and has forbidden a waiver of any of those rights. Recognizing the advantages that prior agreements for arbitration may provide for the solution of commercial controversies, we decide that the intention of Congress concerning the sale of securities is better carried out by holding invalid such an ****189** agreement for arbitration of issues arising under the Act.

[32] Cf. Wilko v. Swan, 2 Cir., 201 F.2d at page 444.

Reversed.

Mr. Justice JACKSON, concurring.

I agree with the Court's opinion insofar as it construes the Securities Act to prohibit waiver of a judicial remedy in favor of arbitration by agreement made before any controversy arose. I think thereafter the parties could agree upon arbitration. However, I find it unnecessary ***439** in this case, where there has not been and could not be any arbitration, to decide that the Arbitration Act precludes any judicial remedy for the arbitrators' error of interpretation of a relevant statute.

Mr. Justice FRANKFURTER, whom Mr. Justice MINTON joins, dissenting.

If arbitration inherently precluded full protection of the rights s 12(2) of the Securities Act affords to a purchaser of securities, or if there were no effective means of ensuring judicial review of the legal basis of the arbitration, then, of course, an agreement to settle the controversy by arbitration would be barred by s 14, the anti-waiver provision, of that Act.
There is nothing in the record before us, nor in the facts of which we can take judicial notice, to indicate that the arbitral system as practiced in the City of New York, and as enforceable under the supervisory authority of the

  

District Court for the Southern District of New York, would not afford the plaintiff the rights to which he is entitled.*

* Under the rules of the American Arbitration Association, available to the plaintiff under his contract, the procedure for selection of arbitrators is as follows:
The Association submits a list of potential arbitrators qualified by experience to adjudicate the particular controversy. In the City of New York, the list would be drawn from a panel of 4,400 persons, 1,275 of whom are lawyers. Each party may strike off the names of any unacceptable persons and number the remaining in order of preference. The Association then designates the arbitrators on the basis of the preferences expressed by both parties. See 'Questions and Answers,' Pamphlet of American Arbitration Association. In short, those who are charged to enforce the rights are selected by the parties themselves from among those qualified to decide.

The impelling considerations that led to the enactment of the Federal Arbitration Act are the advantages of providing a speedier, more economical and more effective ***440** enforcement of rights by way of arbitration than can be had by the tortuous course of litigation, especially in the City of New York. These advantages should not be assumed to be denied in controversies like that before us arising under the Securities Act, in the absence of any showing that settlement by arbitration would jeopardize the rights of the plaintiff.

Arbitrators may not disregard the law. Specifically they are, as Chief Judge Swan pointed out, 'bound to decide in accordance with the provisions of section 12(2).' On this we are all agreed. It is suggested, however, that there is no effective way of assuring obedience by the arbitrators to the governing law. But since their failure to observe this law 'would * * * constitute grounds for vacating the award pursuant to section 10 of the Federal Arbitration Act,' 201 F.2d 439, 445, appropriate means for judicial scrutiny must be implied, in the form of some record or opinion, however informal, whereby such compliance will appear, or want of it will upset the award.

We have not before us a case in which the record shows that the plaintiff in opening an account had no choice but to accept the arbitration stipulation, thereby making the stipulation an unconscionable and unenforceable provision in a business transaction. The Securities and Exchange Commission, as amicus curiae, does not contend that the stipulation ****190** which the Court of Appeals respected, under the appropriate safeguards defined by it, was a coercive practice by financial houses against customers incapable of self-protection. It is one thing to make out a case of overreaching as between parties bargaining not at arm's length. It is quite a different thing to find in the anti-waiver provision of the Securities Act a general limitation on the Federal Arbitration Act.

On the state of the record before us, I would affirm the decision of the Court of Appeals.

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346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168