Difficult, Duplicative and Wasteful?: The NASD's Prohibition of Class Action Arbitration in the Post-*Bazzle* Era

*By Matthew Eisler**

Editor's Note

Each year, the Section of Business Law sponsors the Mendes Hershman Student Writing Contest to encourage and reward law student writings on business law subjects of general and current interest. Essays submitted for consideration must be the work of the submitting student without substantial editorial input from others. The papers are judged on research and analysis, choice of topic, writing style, originality, and contribution to the literature available on the topic. Depending on the topic, whether the paper has been previously published, and other factors, the winning essay is considered for publication in The Business Lawyer.

The winning essay for the 2005–2006 contest was submitted by Matthew Eisler. However, Mr. Eisler's paper had previously been published in the Cardozo Law Review, Volume 28 so it is not being republished here. Mr. Eisler was awarded the Mendes Hershman Student Writing Contest Prize at the Section's luncheon at the Annual Meeting in August 2006.

An abstract of Mr. Eisler's paper is set forth below.

As a general rule, the National Association of Securities Dealers (NASD) requires arbitration of *any* disputes arising in connection with the business of its members. Prior to 1992, in the event of a class action claim against an NASD member firm, the defense bar would avail this general rule and compel arbitration of each individual customer claim thereby forcing automatic class decertification. In 1992, as a reaction to the unfairness of this practice, the NASD promulgated Rule 10301(d) (Exclusionary Rule), which prohibits arbitration against putative members of class action claims. By carving out a narrow exception to its mandatory arbitration policy, the NASD chose litigation as the sole mechanism for resolving securities class action claims against member firms and thereby denied class claimants the right to a class action arbitration. This sharp retreat from the policy of mandatory arbitration was based on a suggestion of then SEC Chairman David S. Ruder, who believed that arbitration of class action claims by the NASD would be "difficult, duplicative and wasteful." This note argues that the NASD should abrogate the Exclusionary Rule and provide an arbitral forum for the resolution of class claims.

* The author received his J.D. from Benjamin N. Cardozo School of Law in June of 2007. He was the Submissions Editor for Cardozo Law Review, and will start as a full time associate in the Private Equity Group at Weil, Gotshal & Manges LLP in New York, NY in September of 2007.

Part I of the note describes arbitration generally, distinguishes arbitration from litigation, and discusses arbitration practice involving NASD member firms. Part II traces the jurisprudential policy regarding arbitration over time, as it evolved from judicial hostility in the early 1900's to a modest embrace following the adoption of the Federal Arbitration Act (FAA), and ultimately to the emphatic endorsement of arbitration the Supreme Court displays today. Part III of the note focuses specifically on class actions. First, it establishes the importance of the class action device as a mechanism of dispute resolution. Second, it describes how the lower courts failed to uniformly interpret the FAA with respect to the availability of arbitration in the context of class actions. Finally, it highlights the Supreme Court's 2003 decision in *Green Tree Financial Corp. v. Bazzle,* which resolved the dissension among lower courts by finding class action arbitration legally viable under the FAA, and, as a result, leading to the creation of a class action docket at other leading arbitral fora. Part IV sets forth two fundamental reasons why the NASD should abrogate Rule 10301(d). First, it proposes that the NASD's class action arbitration prohibition is contrary to the prevailing jurisprudence regarding the FAA. Second, it rejects the NASD's reasoning that class action arbitration would be "difficult, duplicative and wasteful". The note argues that the current paradigm of securities arbitration is materially different than that which the NASD faced when promulgating its Exclusionary Rule. Specifically, the note addresses certain changes in the law, a proven history of class action arbitration in other contexts, current positive empirical evidence favoring arbitration, and improvements in the NASD's procedural competence over the last decade, which, taken together, support the proposition that the NASD should abrogate its Exclusionary Rule and provide a forum for the arbitration of class action claims.

This note was previously published at *28 Cardozo L. Rev. 1891 (2007).*