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## Managing Securities Disputes after McMahon: A Call for Consolidation and Arbitration

Laura Ginger

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1988]

MANAGING SECURITIES DISPUTES AFTER *McMAHON*: A  
CALL FOR CONSOLIDATION AND ARBITRATION

LAURA GINGER\*

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I. INTRODUCTION

FOR SEVERAL YEARS, the lower federal courts were split on the issue of whether arbitration clauses included in investment contracts between securities brokers and their customers were enforceable.<sup>1</sup> This issue arose frequently because these contracts

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1. See Petition For Writ of Certiorari to the United States Court of Appeals For The Second Circuit at 5 & n.1, apps. E & F, *Shearson/Am. Express, Inc., v. McMahon*, 788 F.2d 94 (2d Cir. 1986), *rev'd*, 107 S. Ct. 2332 (1987) [hereinafter

typically call for submitting disputes to arbitration.<sup>2</sup> However, lawyers representing investors have generally favored going to court to settle disputes with brokers, while lawyers representing brokerage firms have preferred arbitration.<sup>3</sup> As a result, despite the existence of an arbitration clause, investors often insisted on a judicial forum for the resolution of these disputes, while attorneys for the brokers insisted that the clause be enforced and the dispute submitted to arbitration.

Section 10(b) is the major anti-fraud provision<sup>4</sup> of the Securities Exchange Act of 1934<sup>5</sup> and is the basis for the legal theory used most often in securities lawsuits filed by customers against their brokers.<sup>6</sup> Customers' securities fraud claims may also be alleged as predicate acts underlying a civil claim under the Racketeer Influenced and Corrupt Organizations Act (RICO),<sup>7</sup> which allows the customer to recover treble damages and attorneys' fees which are not available under conventional securities laws.<sup>8</sup> Given such an enticing incentive, the "thousands of legal disputes that ar[o]se each year between securities investors and their bro-

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Petition for Certiorari] (collecting lower federal court decisions holding both for and against the arbitrability of claims brought under Section 10(b) of the Securities Exchange Act of 1934 and RICO). See also *Shearson/Am. Express, Inc. v. McMahon*, 107 S. Ct. 2332, 2337 & nn.1-2 (1987) (collecting cases illustrating "the conflict among the Courts of Appeals regarding the arbitrability of § 10(b) and RICO claims," respectively).

2. See Note, *Investor-Broker Arbitration Agreements: Dean Witter Reynolds, Inc. v. Byrd*, 20 U.S.F. L. REV. 101, 108 (1985); Wermiel, *Supreme Court Orders Use of Arbitration For Claims Under Securities-Fraud Laws*, Wall St. J., June 9, 1987, at 2, col. 3 (Midwest ed.).

3. Wermiel, *supra* note 2.

4. Shell, *Keep Broker-Client Disputes Out of Court*, Wall St. J., Mar. 3, 1987, at 32, col. 3 (Midwest ed.).

5. 15 U.S.C. §§ 78a-78kk (1982).

6. Wermiel, *supra* note 2. See also Katsoris, *The Securities Arbitrators' Nightmare*, 14 FORDHAM URB. L.J. 3, 7 & nn.22-24 (1986) ("Most federal securities claims brought against brokers by the public, however, are brought under the Securities Exchange Act of 1934 (1934 Act). The reason for this is that, unlike the 1933 Act which is concerned with the initial distribution of securities, the 1934 Act deals principally with post-distribution trading.") (footnotes omitted).

7. 18 U.S.C. §§ 1961-1968 (1976).

8. Shell, *supra* note 4. However, two bills which are expected to be introduced in Congress seek to eliminate treble damages where state or federal securities laws provide a remedy for the type of conduct on which the RICO claim is based. The bill being developed by Rep. Frederick Boucher (D-Va.) would deny this securities law exemption if the predicate acts alleged involved illegal insider trading, while the version proposed by Sen. Howard Metzenbaum (D-Ohio) would disallow the treble damages exemption if illegal investor trading is involved or if the victim is a small investor. 3 Civ. RICO Rep. (BNA) No. 7, at 7 (July 14, 1987).

kers"<sup>9</sup> often included allegations of violations of RICO, the federal anti-racketeering law, as well as violations of the Securities Act of 1933<sup>10</sup> and Section 10(b) of the 1934 Act. Therefore, the dispute over arbitrability came to include the arbitrability *vel non* of both securities law and RICO claims, and the federal circuit courts were hopelessly split on both issues.<sup>11</sup>

On October 6, 1986, the Supreme Court of the United States granted certiorari in *Shearson/American Express, Inc. v. McMahon*<sup>12</sup> "to resolve the conflict among the Courts of Appeals regarding the arbitrability of § 10(b) and RICO claims."<sup>13</sup> On June 8, 1987, the Court ruled that both types of claims are arbitrable and that customers' agreements to arbitrate such claims must be enforced under the explicit provisions of the Federal Arbitration Act.<sup>14</sup> As a result, investors, " 'having made the bargain to arbitrate,' will be held to their bargain."<sup>15</sup>

It is unclear as yet whether the *McMahon* ruling will indeed mean that "almost all" securities lawsuits will be submitted to arbitration,<sup>16</sup> but the ruling will undoubtedly cause more securities-fraud disputes to be settled by arbitration than have been in the past.<sup>17</sup> Because civil RICO specifically permits a treble damages action for injury to business or property resulting from a pattern of predicate criminal offenses<sup>18</sup> including intentional violations of most of the antifraud provisions of the federal securities laws (like Section 10(b)),<sup>19</sup> civil RICO claims are often alleged as part of such securities disputes<sup>20</sup> and, after *McMahon*, will frequently be

9. Shell, *supra* note 4.

10. 15 U.S.C. §§ 77a-77m (1982).

11. For a discussion of this conflict among the circuits, see *supra* note 1.

12. 107 S. Ct. 60 (1986).

13. *Shearson/Am. Express, Inc. v. McMahon*, 107 S. Ct. 2332, 2336-37 (1987).

14. *Id.* at 2335; Federal Arbitration Act, 9 U.S.C. §§ 1-14 (1982) (formerly United States Arbitration Act).

15. 107 S. Ct. at 2346.

16. Wermiel, *Top Court To Rule Whether Arbitrators May Settle Fraud Suits Against Brokers*, Wall St. J., Oct. 7, 1986, at 2, col. 3 (Midwest ed.).

17. Wermiel, *supra* note 2.

18. 18 U.S.C. § 1964(c) (1976).

19. See 18 U.S.C. § 1961(1)(D) (1982) (includes within the definition of "racketeering activity" "any offense involving . . . fraud in the sale of securities . . .").

20. See Petition for Certiorari, *supra* note 1, at 18 & n.13 (" 'Racketeering' is becoming a basic claim in commercial disputes; ordinary customer complaints about their securities brokers are now RICO claims."). See also AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, *The Authority to Bring Private Treble-Damage Suits Under 'RICO' Should Be Reformed* 2 (AICPA White Paper on Civil RICO,

arbitrated in that context.

Several practical and legal issues confront those whose task it is to implement the mandate of *McMahon* in disputes involving both RICO and the securities laws. Among the most important of these issues are the proper collateral estoppel effect to be given to arbitral findings in simultaneous or subsequent litigation and the proper order in which to conduct arbitration and litigation in this context. Uniform rules regarding the collateral estoppel effect of arbitration awards and the proper timing of arbitration and litigation of related claims, as well as reforms in the arbitration process itself, must be forthcoming from the Securities and Exchange Commission (SEC) and Congress if the interests of investors, the courts, and the framers of RICO, the securities laws, and the Federal Arbitration Act are to be protected.

This article will explore the implications of the *McMahon* decision in securities law disputes which also involve RICO. In Section II, the history of the dispute over the arbitrability of securities law and RICO claims will be reviewed, including a discussion of the characteristics and suitability of arbitration as an alternative method of dispute resolution, the evolving view of the Supreme Court of the United States regarding the propriety of using arbitration to resolve federal statutory claims, and the Court's unanimous holding in *McMahon* that RICO and 10(b) claims are arbitrable. In Section III, questions of the proper collateral estoppel effect to be given to arbitral decisions in simultaneous or subsequent litigation of related but non-arbitrable securities law claims and the proper ordering of these arbitration and litigation proceedings will be addressed. Finally, several recommendations designed to deal with the collateral estoppel and ordering issues raised in Section III will be presented.

## II. THE HISTORY OF THE ARBITRABILITY DISPUTE

### A. *Arbitration as an Alternative Method of Dispute Resolution*

Arbitration is a process of dispute resolution in which an impartial trier of fact, or arbitrator, evaluates evidence and renders an opinion pursuant to general principles of law, culminating in a

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July 31, 1985), reprinted in *Oversight On Civil RICO Suits: Hearings On Oversight On Civil RICO Suits Brought Under 18 U.S.C. 1964(c) Before the Senate Committee On the Judiciary*, 99th Cong., 1st Sess. 251, 255 (1985) ("RICO claims are now added as a matter of course in virtually all cases challenging securities transactions.").

decision which will be final and binding on the parties.<sup>21</sup> Unlike judicial litigation, arbitration permits the parties to select their own trier of fact, to specify the rules of evidence and procedure to be observed during the arbitration process, to impose limitations on the arbitrator's power, and to determine the substantive legal rules which will govern the resolution of the dispute.<sup>22</sup>

As an alternative method of dispute resolution, arbitration has the potential to reduce court congestion, reduce the expense and delay of litigation, and improve compliance with decisions designed to resolve disputes.<sup>23</sup> Parties to an arbitration perceive the dispute resolution procedure to be fairer than do parties to litigation. This results in an increased willingness on the part of these parties to settle their disputes or, in the alternative, to abide by an arbitration decision if one is made. Parties to arbitration also cite the greater expertise of the "judges" and the more expeditious procedures as advantages of arbitration over litigation.<sup>24</sup>

The arbitrator who settles the dispute is selected by the parties themselves for his subject-matter expertise in the area of the dispute, not for his legal expertise. In fact, the arbitrator is not required to have any legal knowledge or training whatsoever.<sup>25</sup> The arbitrator need not justify or explain his decision, need not write any type of opinion beyond the resolution of the dispute, and is not bound to adhere to the principle of *stare decisis*.<sup>26</sup> Judicial review of an arbitration award is therefore severely limited, as are the grounds for reversal of an arbitrator's decision. An arbitrator's determination is binding on the parties and usually will not be overruled unless a court finds that he has abused his discretion or completely disregarded the contractual agreement which is the subject of the dispute. Even an incorrect application of the law will usually not be grounds for disputing an award.<sup>27</sup>

Arbitration forums and procedures have become increasingly

21. See F. ELKOURI & E. ELKOURI, *HOW ARBITRATION WORKS* 2 (4th ed. 1985).

22. *Id.* at 7-9.

23. Mobilia, *Offensive Use of Collateral Estoppel Arising Out of Non-Judicial Proceedings*, 50 ALB. L. REV. 305 (1986).

24. *Id.* at 307-08; Pearson, *An Evaluation of Alternatives to Court Adjudication*, 7 JUST. SYS. J. 420, 426 (1982).

25. Mobilia, *supra* note 23, at 309.

26. *Id.* at 309 & n.28.

27. *Id.* at 309-10. See generally F. ELKOURI & E. ELKOURI, *supra* note 21. See also Note, *Arbitrability of Claims Arising Under The Securities Exchange Act of 1934*, 1986 DUKE L.J. 548, 552-54 & nn.34-40; Shearson/Am. Express, Inc. v. McMahon, 107 S. Ct. 2332, 2353-55 & nn.14-18 (1987) (Blackmun, J., concurring in part and dissenting in part).

accessible and sophisticated, and the rules and procedures which govern arbitration have been refined with an eye to ensuring fair results. In addition, arbitration forums are more readily available to litigants. The American Arbitration Association has twenty-six branch offices in the major American cities.<sup>28</sup> Similarly, the NYSE has standing panels in thirty-five cities and the NASD in fifty cities. Each will conduct hearings elsewhere upon agreement of the parties.<sup>29</sup>

Extensive nationwide experience with arbitration in the last thirty-five years has demonstrated that it is a fair, efficient, and effective means to resolve commercial disputes. In 1950, the American Arbitration Association had a total of approximately 1750 arbitrations, fewer than 500 of which were commercial. In 1985 the total number of arbitrations had increased more than twenty-five times to 45,000, over 8,000 of which were commercial.<sup>30</sup> Moreover, the virtues and efficacy of arbitration have been widely recognized in recent years by courts and commentators.<sup>31</sup>

#### B. *The Use of Arbitration To Resolve Securities Disputes*

Arbitration is frequently used to settle securities-law disputes.<sup>32</sup> For the year ending March 31, 1984, more than 3000 securities and commodities cases were filed in federal district court.<sup>33</sup> During roughly the same period, however, almost 2000 securities cases were arbitrated under the auspices of the various self-regulatory organizations (SROs).<sup>34</sup> If one included the arbitration of securities disputes before non-SRO tribunals, such as the New York Chamber of Commerce Arbitration Department or the American Arbitration Association, the number would be even

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28. Meyerowitz, *The Arbitration Alternative*, 71 A.B.A. J. 78, 79 (1985); American Arbitration Association Commercial Arbitration Rule 11, reprinted in R. COULSON, *BUSINESS ARBITRATION—WHAT YOU NEED TO KNOW* 86 (2d ed. 1982) (fixing locale of arbitration).

29. Meyerowitz, *supra* note 28, at 79.

30. Hirshman, *The Second Arbitration Trilogy: The Federalization of Arbitration Law*, 71 VA. L. REV. 1305 & n.7 (1985); Furnish, *Commercial Arbitration Agreements and the Uniform Commercial Code*, 67 CALIF. L. REV. 317, 317-18 & n.1 (1979).

31. See, e.g., Burger, *Isn't There A Better Way?*, 68 A.B.A. J. 274 (1982); Meyerowitz, *supra* note 28.

32. Fletcher, *Privatizing Securities Disputes Through the Enforcement of Arbitration Agreements*, 71 MINN. L. REV. 393, 394 (1987).

33. *Id.* See Katsoris, *The Arbitration of a Public Securities Dispute*, 53 FORDHAM L. REV. 279 & n.5 (1984).

34. Katsoris, *supra* note 33, at 280 n.7 (showing that in 1983, 1,731 cases were submitted to various SROs for arbitration).

higher.<sup>35</sup> Moreover, the number of cases submitted to arbitration before the SROs has been increasing annually.<sup>36</sup>

The arbitration practices employed in securities disputes today manifest "a substantially more sophisticated and regulated system than was in place in 1953."<sup>37</sup> The 1975 amendments to the 1933 Securities Act and the 1934 Exchange Act<sup>38</sup> gave the Securities and Exchange Commission (SEC) authority to oversee the rules and procedures prescribed by the self-regulatory organizations, and to ensure that these procedures are adequate to enforce the rights of investors against SRO-member brokerage firms.<sup>39</sup> The regulated organizations include the national securities exchanges and the National Association of Securities Dealers, Inc. (NASD).

In 1977, the SEC exercised its authority under the 1975 amendments by promoting the formation of the Securities Industry Conference on Arbitration, which drafted the Uniform Code of Arbitration.<sup>40</sup> The Uniform Code, which has been adopted by virtually all SROs,<sup>41</sup> provides in most cases for arbitration panels of not less than three or more than five members "at least a majority of which shall not be from the securities industry, unless the public customer requests a panel consisting of at least a majority from the securities industry."<sup>42</sup> Arbitration under the Uniform Code is "a structured forum subject to a clear set of rules" which the SEC has expressly approved and found to be in the public interest and in furtherance of just and equitable principles of trade.<sup>43</sup> In fact, the SEC retains jurisdiction to correct any perceived abuses or unfairness in the arbitration rules pursuant to

35. Fletcher, *supra* note 32, at 395 & n.11.

36. In 1980, 830 cases were submitted for arbitration before the SROs; in 1981, 1042; in 1982, 1340; and in 1983, 1731. *Id.* at 395 n.12; Katsoris, *supra* note 33, at 280 n.7.

37. Brown, Shell, & Tyson, *Arbitration of Customer-Broker Disputes Arising Under the Federal Securities Laws and RICO*, 15 SEC. REC. L.J. 3, 13-14 (1987) [hereinafter Brown].

38. Securities Acts Amendments of 1975, Pub. L. No. 94-29, § 19, 89 Stat. 97, 146-55 (1975) (amending 15 U.S.C. § 78s (1934)).

39. Brown, *supra* note 37, at 14 & n.38 ("Pursuant to the 1975 amendments, the SEC now has authority over all SRO rules, including those of the exchanges."). See 15 U.S.C. §§ 78s(b)-(c) (1982). See also Shearson/Am. Express, Inc. v. McMahon, 107 S. Ct. 2332, 2340 (1987).

40. Brown, *supra* note 37, at 14; see also 42 Fed. Reg. 23, 892 (1977); Katsoris, *supra* note 33, at 283-84.

41. Brown, *supra* note 37, at 14.

42. Uniform Code of Arbitration Section 8(a)(1), reprinted in SECURITIES INDUSTRY CONFERENCE ON ARBITRATION, FIFTH REPORT (Exhibit C) (April 1986).

43. See Petition for Certiorari, *supra* note 1, at n.5.



Section 19 of the Securities Exchange Act of 1934.<sup>44</sup> Furthermore, arbitrators are bound to follow the law in adjudicating Section 10(b) claims.<sup>45</sup> Manifest disregard of the law is one ground to vacate an arbitration award in the securities law context.<sup>46</sup>

Arbitration practice pursuant to the Uniform Code of Arbitration seems to be operating impartially. In 1985, the Securities Industry Conference on Arbitration reported resolution of some 960 cases, over half of which resulted in awards for the claimant. There is evidence suggesting that these awards averaged approximately one-half of the amount demanded in the initial filing.<sup>47</sup>

### C. *The Evolving Judicial Attitude Toward Arbitration*

Although Congress explicitly sanctioned arbitration as an alternative method of dispute resolution in 1925, the courts were slow to enforce arbitration clauses. The Federal Arbitration Act (FAA)<sup>48</sup> governs agreements to arbitrate most commercial disputes, and states in relevant part:

A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.<sup>49</sup>

This legislation represented the first break from the English tradition in which the judiciary refused to enforce arbitration agreements on the basis that such agreements impinged upon the courts' jurisdiction,<sup>50</sup> and was designed to allow parties to avoid the costliness and delays of litigation "and to place arbitration agreements upon the same footing as other contracts."<sup>51</sup> Even though American courts criticized the anti-arbitration attitude as illogical and unjust, the notion was considered too deeply rooted

44. 15 U.S.C. § 78s (1982).

45. *Wilko v. Swan*, 346 U.S. 427, 436 (1953).

46. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,781 (S.D.N.Y. June 14, 1986) (Weinfeld, J.).

47. *Brown*, *supra* note 37, at 14-15 & n.41.

48. 9 U.S.C. §§ 1-14 (1982) (formerly United States Arbitration Act).

49. 9 U.S.C. § 2 (1982) (emphasis added).

50. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 510 & n.4 (1974).

51. *Id.* at 510-11 & n.4 and authorities cited therein.

to be overruled without legislative action.<sup>52</sup>

By its terms, the Federal Arbitration Act leaves no place for the exercise of discretion by a district court, but instead mandates that district courts "shall" direct the parties to proceed to arbitration on issues as to which an arbitration agreement has been signed.<sup>53</sup> Thus, the FAA requires that arbitration agreements be enforced absent a ground for revocation of the contractual agreement itself.<sup>54</sup>

However, even after the FAA was enacted, the courts frequently found arbitration to be an unsatisfactory method of dispute resolution, and generally refused to enforce arbitration agreements in the areas of securities, antitrust, bankruptcy, and RICO disputes.<sup>55</sup> The courts advanced several reasons for rejecting arbitration in these areas, but the most common rationale originated with the United States Supreme Court itself.

In 1953, in *Wilko v. Swan*,<sup>56</sup> the Supreme Court was forced to decide whether a customer who had executed a written agreement that any future controversy between him and his broker would be resolved by arbitration had thereby waived his statutory right to sue the broker in court under Section 12(2)<sup>57</sup> of the Securities Act of 1933. The 1933 Act specifies that any agreement waiving compliance with one of its provisions is void,<sup>58</sup> while the FAA states that written arbitration agreements are valid and enforceable and that a court must stay the trial of any action if the issue involved is referable to arbitration under such an agreement.<sup>59</sup> In deciding *Wilko*, the Court was confronted with "[t]wo policies, not easily reconcilable:"<sup>60</sup> the desire to provide "an opportunity generally to secure prompt, economical and adequate

52. *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 220 n.6 (1985) (citing H.R. REP. NO. 96, 68th Cong., 1st Sess. 1-2 (1924)).

53. 9 U.S.C. §§ 3-4 (1982); see also *Byrd*, 470 U.S. at 218.

54. *Byrd*, 470 U.S. at 218.

55. See, e.g., *S.A. Mineracao da Trindade-Samitri v. Utah Int'l, Inc.*, 576 F. Supp. 566 (S.D.N.Y. 1983), order certified for interlocutory appeal, 579 F. Supp. 1049 (S.D.N.Y. 1984), appealed and aff'd on other grounds, 745 F.2d 190 (2d Cir. 1984) (holding arbitration clauses unenforceable in areas of antitrust, bankruptcy, 10(b), and RICO claims respectively); *Applied Digital Technology v. Continental Casualty Co.*, 576 F.2d 116 (7th Cir. 1978); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore*, 590 F.2d 823 (10th Cir. 1978); *Allegaert v. Perot*, 548 F.2d 432 (2d Cir. 1977), cert. denied, 432 U.S. 910 (1977).

56. 346 U.S. 427 (1953).

57. 15 U.S.C. § 771(2) (1982).

58. 15 U.S.C. § 77n (1982).

59. 9 U.S.C. §§ 1-3 (1982).

60. *Wilko*, 346 U.S. at 438.

solution of controversies”<sup>61</sup> on the one hand, and the desire to protect the rights of investors on the other.<sup>62</sup>

The Court resolved the conflict in favor of the 1933 Securities Act’s policy of protecting investors vis-a-vis brokers, ruling that the statutory right to select a judicial forum was the kind of “‘provision’” that Congress “must have intended” to be nonwaivable, and that the customer’s agreement to arbitrate future disputes arising under the Securities Act was therefore void.<sup>63</sup> The Court’s *Wilko* decision seemed to bode ill for the arbitral resolution of disputes, especially those involving statutory claims such as RICO and the federal securities laws.

However, in the last thirteen years, culminating in *McMahon*, the Supreme Court of the United States has rendered six decisions that have created a favorable climate for commercial arbitration—including the arbitration of statutory rights—by dramatically expanding the scope and applicability of the FAA.<sup>64</sup> This series of decisions establishes a strong federal policy favoring arbitration and makes clear that the FAA (1) requires arbitration of statutory disputes in both international and domestic contexts, (2) creates a body of substantive federal law that is preemptive and binding on the states, (3) mandates arbitration of pendent arbitrable state law claims in federal statutory cases,<sup>65</sup> and (4) mandates the arbitration of federal statutory claims absent a clear Congressional intent to the contrary.

The first case in the series is *Scherk v. Alberto Culver Co.*,<sup>66</sup> which was decided in 1974. In *Scherk*, a U.S. company sued a German citizen for fraud in connection with the sale of the German’s business, alleging violations of Section 10(b) of the Securities Exchange Act of 1934. The contract for the sale of the business contained a clause calling for arbitration before the International Chamber of Commerce in Paris, France, and for the application of Illinois law. The U.S. company brought suit in federal court, hoping to defeat the arbitration clause pursuant to the Supreme Court’s *Wilko* decision.

The Court, despite *Wilko*, ruled that the arbitration clause should be enforced pursuant to the explicit provisions of the

61. *Id.*

62. *Id.*

63. *Id.* at 434-37.

64. Brown, *supra* note 37, at 7.

65. *Id.*

66. 417 U.S. 506 (1974).

FAA. The Court's decision was primarily based on international law considerations:

A contractual provision specifying in advance the forum in which disputes shall be litigated and the law to be applied is . . . an almost indispensable precondition to achievement of the orderliness and predictability essential to any international business transaction. . . . A parochial refusal by the courts of one country to enforce an international arbitration agreement would not only frustrate these purposes, but would invite unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages.<sup>67</sup>

Therefore, the Court concluded that "[t]he exception to the clear provisions of the Arbitration Act carved out by *Wilko* is simply inapposite to a case such as the one before us."<sup>68</sup> The Court also intimated in *Scherk* that perhaps *Wilko* should not be extended to prohibit the arbitration of claims made under Section 12(b) of the Securities Exchange Act of 1934, noting that "[a]t the outset, a colorable argument could be made that even the semantic reasoning of the *Wilko* opinion does not control the case before us."<sup>69</sup>

In the decisions following *Scherk*, the Court continued to reaffirm the applicability of the FAA and to disapprove of the judiciary's past hostility to the use of arbitration to settle disputes. In *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*,<sup>70</sup> the Court ruled that a federal court was required by the FAA to compel arbitration even when a prior suit was pending in a state court for a declaratory judgment that the dispute was not subject to arbitration. The Court asserted that the FAA established a liberal federal policy favoring arbitration agreements which was to be interpreted as a matter of substantive federal law, and that "[t]he Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration . . . ."<sup>71</sup>

The Court followed through on the broad language of *Moses*

67. *Id.* at 516-17.

68. *Id.* at 517.

69. *Id.* at 513. For an analysis of this "colorable argument," see *Shearson/Am. Express, Inc. v. McMahon*, 107 S. Ct. 2332, 2346-47 & nn.1-2 and authorities cited therein (1987) (Blackmun, J., concurring in part and dissenting in part).

70. 460 U.S. 1 (1983).

71. *Id.* at 24-25.

*H. Cone* during its next term. In *Southland Corp. v. Keating*,<sup>72</sup> the Court struck down a provision in a state franchise statute which prohibited the arbitration of claims filed under the statute on the ground that the FAA preempted any such attempt by a state to limit arbitration. The Court asserted that “[i]n enacting § 2 of the federal Act [Federal Arbitration Act], Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration. . . . Congress has thus mandated the enforcement of arbitration agreements.”<sup>73</sup> The Court also declared that “Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements.”<sup>74</sup> Therefore, only Congress, not the state legislatures, has the power to create exceptions to the federal rule requiring the arbitration of disputes.<sup>75</sup>

In the following year, the Court enunciated its test for determining when Congress has in fact created an exception to the FAA. The case arose in the context of an alleged violation of the Sherman Antitrust Act. In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,<sup>76</sup> in alleging that a Japanese manufacturer had violated the Sherman Act, a Puerto Rican car dealer objected to the enforcement of a contractual arbitration clause on the basis of a widely adopted exception to the FAA for domestic antitrust claims which the Second Circuit had developed in 1968 in *American Safety Equipment Corp. v. J.P. Maguire & Co.*<sup>77</sup> The Supreme Court refused to apply *American Safety* to the case at bar and, as in *Scherk*, held that the international context required enforcement of the parties’ arbitration agreement. Furthermore, the Court noted that statutory claims such as those under the Sherman Act were not presumptively exempt from arbitration under the FAA, and fashioned a broad test for precisely when a statutory right might be exempted from the policies of the FAA:

Just as it is the congressional policy manifested in the Federal Arbitration Act that requires courts liberally to construe the scope of arbitration agreements covered by the Act, it is the congressional intention expressed in

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72. 465 U.S. 1 (1984).

73. *Id.* at 10.

74. *Id.* at 16.

75. *Id.*; see also *Brown*, *supra* note 37, at 8.

76. 473 U.S. 614 (1985).

77. 391 F.2d 821 (2d Cir. 1968).

some other statute on which the courts must rely to identify any category of claims as to which agreements to arbitrate will be held unenforceable. . . . We must assume that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that intention will be deducible from text or legislative history. . . . Having made the bargain to arbitrate, the party should be held to it unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue.<sup>78</sup>

In applying this federal policy in favor of arbitration during the same term, the Court went so far as to require district courts to compel arbitration of arbitrable pendent state law claims which are intertwined with nonarbitrable federal claims, "even where the result would be the possibly inefficient maintenance of separate proceedings in different forums."<sup>79</sup> In *Dean Witter Reynolds Inc. v. Byrd*,<sup>80</sup> the Court addressed the issue whether, in cases involving a single transaction raising both nonarbitrable federal claims and arbitrable state common-law claims, all of the claims could be tried together in a federal court for reasons of judicial economy. Up to that time, a number of circuit courts of appeal had adopted a " 'doctrine of intertwining,' " under which district courts were free to consolidate for trial arbitrable and nonarbitrable claims arising from a single set of facts.<sup>81</sup> The Court struck down that doctrine, holding that the FAA requires arbitration of all arbitrable claims no matter what the effect on judicial economy: "The preeminent concern of Congress in passing the Act [FAA] was to enforce private agreements into which parties had entered, and that concern requires that we rigorously enforce agreements to arbitrate, even if the result is 'piecemeal' litigation, at least absent a countervailing policy manifested in another federal statute."<sup>82</sup>

Full recognition and implementation of this strong federal policy in favor of arbitration is made most clearly in the United States Supreme Court's decision in *Shearson/American Express, Inc.*

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78. *Mitsubishi Motors*, 473 U.S. at 627-28.

79. *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 217 (1985).

80. *Id.*

81. *Id.* at 216-17.

82. *Id.* at 221.

*v. McMahon*.<sup>83</sup> Between 1980 and 1982, the McMahons were customers of Shearson. Two customer agreements signed by Julia McMahon provided for arbitration of any controversy relating to the accounts the McMahons maintained with Shearson. In October 1984, the McMahons filed a complaint against Shearson and the broker who had handled their accounts, alleging that the broker had violated Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 by engaging in fraudulent and excessive trading on their accounts ("churning") and by making false statements and omitting material facts from the advice given to them. They also alleged a violation of RICO, and included state law claims for fraud and breach of fiduciary duties.<sup>84</sup>

Relying on the customer agreements, Shearson moved to compel arbitration of the McMahons' claims pursuant to Section 3 of the FAA. The District Court found that the McMahons' 10(b) claims were arbitrable under the terms of the customer agreement, and that their state law claims were also arbitrable. It held, however, that the McMahons' RICO claim was not arbitrable.<sup>85</sup> The United States Court of Appeals for the Second Circuit affirmed the District Court on the state law and RICO claims, but it reversed on the Exchange Act claims.<sup>86</sup> The Supreme Court of the United States granted certiorari<sup>87</sup> to resolve the conflict among the Courts of Appeals regarding the arbitrability of Section 10(b) and RICO claims.<sup>88</sup>

The Supreme Court held that both Section 10(b) and RICO claims are arbitrable and reversed and remanded the Second Circuit's decision.<sup>89</sup> Writing for the majority,<sup>90</sup> Justice O'Connor

83. 107 S. Ct. 2332 (1987).

84. *Id.* at 2334.

85. *McMahon v. Shearson/Am. Express, Inc.*, 618 F. Supp. 384, 387-88 (S.D.N.Y. 1985).

86. *McMahon v. Shearson/Am. Express, Inc.*, 788 F.2d 94, 97-98 (2d Cir. 1986).

87. *Shearson/Am. Express, Inc. v. McMahon*, 107 S. Ct. 60 (1986).

88. *Shearson/Am. Express, Inc. v. McMahon*, 107 S. Ct. 2332, 2336-37 (1987).

89. *Id.* at 2334-35.

90. Justices Rehnquist, White, Powell, and Scalia joined in Justice O'Connor's opinion. *Id.* at 2335. Justices Brennan, Blackmun, Marshall, and Stevens joined in the Court's decision with respect to the arbitrability of RICO claims but not in the Court's decision with respect to the arbitrability of Section 10(b) claims. *Id.* Justice Blackmun filed an opinion concurring in part and dissenting in part, which was joined by Justices Brennan and Marshall. *Id.* Justice Stevens also filed an opinion concurring in part and dissenting in part. *Id.* Thus, the Court ruled 5-4 that Section 10(b) claims are arbitrable, and 9-0 that RICO claims are arbitrable. *Id.*

noted at the outset that the FAA was the proper starting point for answering the questions raised in the case,<sup>91</sup> and observed that the Act “establishes a ‘federal policy favoring arbitration’<sup>92</sup> requiring that ‘we rigorously enforce agreements to arbitrate.’”<sup>93</sup> She immediately disposed of the argument that this policy is less compelling when statutes are involved, stating that:

[t]his duty to enforce arbitration agreements is not diminished when a party bound by an agreement raises a claim founded on statutory rights. As we observed in [*Mitsubishi*]. . . , ‘we are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals’ should inhibit enforcement of the Act “‘in controversies based on statutes’” [quoting *Wilko*]. . . . The Arbitration Act, standing alone, therefore mandates enforcement of agreements to arbitrate statutory claims. Like any statutory directive, the Arbitration Act’s mandate may be overridden by a contrary congressional command. *The burden is on the party opposing arbitration, however, to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue.* If Congress did intend to limit or prohibit waiver of a judicial forum for a particular claim, such an intent ‘will be deducible from [the statute’s] text or legislative history,’ or from an inherent conflict between arbitration and the statute’s underlying purposes.<sup>94</sup>

Therefore, it followed that in order “[t]o defeat application of the Arbitration Act,”<sup>95</sup> the McMahons would have to “demonstrate that Congress intended to make an exception to the Arbitration Act for claims arising under RICO and the Exchange Act, an intention discernible from the text, history, or purposes of the statute.”<sup>96</sup> This, the Court found, the McMahons had not done.

First, the Court had to contend with its previous holding in *Wilko v. Swan*<sup>97</sup> that claims arising under Section 12(2) of the Se-

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91. 107 S. Ct. at 2337.

92. *Id.* (quoting *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

93. *Id.* (quoting *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985)).

94. *Id.* (emphasis added) (citations omitted) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626-28, 632-37 (1985)).

95. *Id.* at 2338.

96. *Id.*

97. 346 U.S. 427 (1953).



curities Act of 1933 are not arbitrable. The McMahons argued that claims arising under the Securities Exchange Act of 1934 are nonarbitrable for an analogous reason,<sup>98</sup> and the Supreme Court either had to agree with them and extend *Wilko* to Exchange Act claims, overrule *Wilko* expressly, distinguish the 1933 Act from the 1934 Act for arbitrability purposes, or drastically limit the *Wilko* holding to its facts. The Court chose the last option.

Observing that “[i]t is difficult to reconcile *Wilko*’s mistrust of the arbitral process with this Court’s subsequent decisions involving the Arbitration Act,”<sup>99</sup> Justice O’Connor asserted that “*Wilko* must be understood . . . as holding that the plaintiff’s waiver of the ‘right to select the judicial forum’ . . . was unenforceable only because arbitration was judged inadequate to enforce the statutory rights created by § 12(2) [of the Securities Act of 1933].”<sup>100</sup> However, observed Justice O’Connor, that judgment is no longer valid:

[T]he mistrust of arbitration that formed the basis for the *Wilko* opinion in 1953 is difficult to square with the assessment of arbitration that has prevailed since that time. This is especially so in light of the intervening changes in the regulatory structure of the securities laws. Even if *Wilko*’s assumptions regarding arbitration were valid at the time *Wilko* was decided, most certainly they do not hold true today for arbitration procedures subject to the SEC’s oversight authority.<sup>101</sup>

Therefore, the Court “refuse[d] to extend *Wilko*’s reasoning to the Exchange Act in light of these intervening regulatory developments,” at the same time refusing to explicitly overrule *Wilko*.<sup>102</sup> “*Wilko*,” stated Justice O’Connor, “must be read as barring waiver of a judicial forum only where arbitration is inadequate to protect the substantive rights at issue.”<sup>103</sup> This drastic limitation on the precedential value of *Wilko*, based on the notion that times—and arbitration procedures—have changed, seriously

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98. 107 S. Ct. at 2338.

99. *Id.* at 2340 (citing as examples *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985); *Southland Corp. v. Keating*, 465 U.S. 1 (1984); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974)).

100. *Id.* at 2338.

101. *Id.* at 2341.

102. *Id.* at 2342.

103. *Id.* at 2339.

calls into question the continuing vitality of the *Wilko* exception to the FAA for claims arising under the Securities Act of 1933.

#### D. McMahon on the Arbitrability of RICO Claims

The *McMahon* Court was unanimous in its ruling that RICO claims are arbitrable and that predispute agreements to arbitrate them are therefore enforceable under the terms of the FAA.<sup>104</sup> Using its newly enunciated technique of inspecting the statute's text, legislative history, and purposes for evidence that Congress intended to make an exception to the Arbitration Act for claims arising under RICO,<sup>105</sup> the Court found "nothing in the text of the RICO statute that even arguably evinces congressional intent to exclude civil RICO claims from the dictates of the Arbitration Act," and found that "[t]his silence in the text is matched by silence in the statute's legislative history."<sup>106</sup>

The Court also found no conflict between arbitration and RICO's underlying purposes. The Court had already addressed many of the public policy arguments made by the *McMahons* in this regard in its opinion in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*,<sup>107</sup> and it did not find these assertions to be any more persuasive in the case at bar than it had in the previous case. The Court reiterated that neither potential complexity, the overlap between RICO's civil and criminal provisions, nor the private policing function of civil RICO make arbitration of civil RICO claims inappropriate.<sup>108</sup> Therefore, the Court concluded that "there is no inherent conflict between arbitration and the purposes underlying § 1964(c) [civil RICO]," and that "nothing in RICO's text or legislative history otherwise demonstrates congressional intent to make an exception to the Arbitration Act for RICO claims."<sup>109</sup> Hence, RICO claims were found to be arbitrable under the terms of the Arbitration Act.<sup>110</sup>

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104. *Id.* at 2345-46.

105. *Id.* at 2338.

106. *Id.* at 2343-44.

107. 473 U.S. 614 (1985).

108. 107 S. Ct. at 2345-46.

109. *Id.*

110. *Id.* at 2346.

### III. IMPLEMENTING *MCMAHON* IN CASES INVOLVING RICO AND THE SECURITIES LAWS: COLLATERAL ESTOPPEL AND THE PROBLEM OF ORDERING

#### A. *Concerns About Collateral Estoppel and Judicial Economy*

The Supreme Court's ruling in *McMahon*, that claims arising under RICO and Section 10(b) of the Securities Exchange Act of 1934 are arbitrable and that predispute agreements to arbitrate such claims must be enforced, forces the courts, the Congress, and the SEC to face two issues which they have never directly addressed before: the proper collateral estoppel effect to be given to arbitral decisions in simultaneous or subsequent litigation of securities law disputes, and the proper ordering of arbitration of the arbitrable claims and litigation of the nonarbitrable claims in such disputes.

Problems arise when a plaintiff includes in his complaint claims as to which arbitration can be compelled and claims as to which, under *Wilko*, arbitration cannot be compelled (principally, claims arising under the Securities Act of 1933).<sup>111</sup> The court can either permit the arbitration and court case to proceed simultaneously, or it can rule that one should conclude before the other commences. If the court decides that one proceeding should end before the other begins, it has the additional task of deciding the proper order of the proceedings.<sup>112</sup>

Several issues must be addressed as part of this ordering problem. The most important is the degree to which collateral estoppel<sup>113</sup> will affect the proceeding which goes last. If, for example, an arbitration proceeding results in a resolution of issues that then precludes retrying those issues in federal court, the

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111. Arguably, the majority's comments in *McMahon* that the mistrust of arbitration which formed the basis for the *Wilko* decision is no longer defensible, and that therefore "*Wilko* must be read as barring waiver of a judicial forum only where arbitration is inadequate to protect the substantive rights at issue," authorize courts to rule that *Wilko* no longer bars arbitration of claims brought under the Securities Act of 1933. *Id.* at 2339, 2341. This would obviate many ordering problems in securities disputes, at least those in which the only claims included were claims made under RICO, the 1933 Act, and the Securities Exchange Act of 1934. In the alternative, the *Wilko* exception could be legislatively abolished in order to avoid the problems caused when arbitrable federal securities claims are pleaded with nonarbitrable claims. See Katsoris, *supra* note 33, at 306 & n.206. If either of these eventualities comes to pass, much of the succeeding discussion about ordering will become moot.

112. See Fletcher, *supra* note 32, at 431-32.

113. The doctrine of collateral estoppel bars relitigation of an issue which has already been decided in a prior action. For an explanation of this concept, see *infra* notes 150-64 and accompanying text.

plaintiff's right to a federal judicial forum becomes meaningless. On the other hand, if resolution of certain issues in federal court precludes raising those issues again in arbitration, then the right to arbitration becomes meaningless. In either event, the proceeding which takes place last is inevitably short-changed in significance.<sup>114</sup> Yet, if the decision of the first forum to render an opinion has no preclusive effect whatsoever on the other forum, the arbitration and litigation proceedings will be totally unconnected. This *modus operandi* will likely "complicate, delay, and often thwart justice through conflicting and contradictory results."<sup>115</sup>

Preventing duplicative proceedings which seek twice to answer the same legal questions is another goal of proper ordering.<sup>116</sup> Now that *McMahon* has made clear that *Wilko* does not apply to claims brought under the Securities Exchange Act of 1934, more claims will surely be forced into arbitration and some duplication avoided since most federal securities claims arise under the 1934 Act.<sup>117</sup> However, although the *McMahon* ruling that these claims are arbitrable eliminates one reason for the maintenance of duplicative proceedings in separate forums, *Wilko* still requires that claims brought under the 1933 Act be litigated. Moreover, the Court's decision in *Dean Witter Reynolds Inc. v. Byrd*<sup>118</sup> requires federal courts to sever arbitrable claims from nonarbitrable ones and compel the arbitration of the arbitrable claims.

When a court severs similar claims, the arbitration proceeding and the federal trial cover similar ground, determining similar questions of fact. Under *Byrd*, a court cannot stay arbitration until the litigation of nonarbitrable federal claims is complete.<sup>119</sup> Such parallel proceedings defeat the federal policy of pendent jurisdiction, which promotes judicial economy by resolving related state, non-arbitrable federal, and arbitrable federal issues in a single forum.<sup>120</sup> Thus, the potential for duplication of effort in parallel

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114. See Fletcher, *supra* note 32, at 432.

115. Katsoris, *supra* note 6, at 11.

116. See Fletcher, *supra* note 32, at 434-35 & nn.269-72.

117. Katsoris, *supra* note 6, at 11 & n.45.

118. 470 U.S. 213 (1985). For a discussion of this case, see *supra* notes 80-82 and accompanying text.

119. 470 U.S. at 223.

120. Katsoris, *supra* note 33, at 305 n.201; Krause, *Securities Litigation: The Unsolved Problem of Predispute Arbitration Agreements for Pendent Claims*, 29 DEPAUL L. REV. 693, 704 (1980); Comment, *Enforcing Arbitration of Federal Securities Law*

and duplicative proceedings remains even after *McMahon*.<sup>121</sup>

B. *Judicial Economy and Mixed Claims: Intertwining  
v. "Sever and Stay"*

The Supreme Court's decisions in both *Wilko* and *Byrd* have contributed to the problem of inefficiency in disposing of related arbitrable and nonarbitrable claims. Another commentator has ably characterized the turmoil which followed those decisions:

The central problem presented in *Byrd* arose countless times in the lower courts after *Wilko* was decided.<sup>[122]</sup> The problem arose when a party combined clearly arbitrable state common-law or statutory claims<sup>[123]</sup> with nonarbitrable federal claims under the doctrine of pendent jurisdiction. Faced with this situation, the district courts had three possible choices: send the entire case to arbitration, send none of the case to arbitration, or send part of the case to arbitration.<sup>[124]</sup>

The most obvious solution would be to sever the arbitrable claims from the nonarbitrable claims and stay the court proceedings on the arbitrable claims pending arbitration. Such a "sever and stay" approach found favor with many courts<sup>[125]</sup> and commentators,<sup>[126]</sup> largely because the approach heeded the *Wilko* doctrine while enforcing the parties' contract, as required by the FAA, to the greatest extent possible.<sup>[127]</sup> Other courts,

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*Claims: The Effect of Dean Witter Reynolds, Inc. v. Byrd*, 28 WM. & MARY L. REV. 335, 353 & nn.99-100 (1987).

121. See Petition for Certiorari, *supra* note 1, at 17 n.12; Comment, *supra* note 120, at 353 & nn.97-100.

122. See *infra* notes 125-26 & 128-29.

123. Fletcher, *supra* note 32, at 414 & n.150.

124. *Id.*

125. See *id.* at 415 n.151; see also *Liskey v. Oppenheimer & Co.*, 717 F.2d 314, 320-21 (6th Cir. 1983); *Dickinson v. Heinold Sec., Inc.*, 661 F.2d 638, 643-46 (7th Cir. 1981); *Webb v. R. Rowland & Co.*, 613 F. Supp. 1123, 1124 (E.D. Mo. 1985); *Wilcox v. Ho-Wing Sit*, 586 F. Supp. 561, 567-68 (N.D. Cal. 1984); *S.A. Mineracao da Trindade-Samitri v. Utah Int'l Inc.*, 576 F. Supp. 566, 576 (S.D.N.Y.), *aff'd*, 745 F.2d 190, 196-97 (2d Cir. 1984); *Macchiavelli v. Shearson, Hammill & Co.*, 384 F. Supp. 21, 31 (E.D. Cal. 1974); *Davend Corp. v. Michael*, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,540 at 99,729 (S.D.N.Y. 1976).

126. See Fletcher, *supra* note 32, at 415 n.152; see also, Bell & Fitzgerald, *Mixed Arbitrable/Nonarbitrable Disputes*, 16 REV. SEC. REG. 849, 853 (1983); Note, *The Severability of Arbitrable and Nonarbitrable Securities Claims*, 41 WASH. & LEE L. REV. 1165, 1184-86 (1984).

127. Fletcher, *supra* note 32, at 415.

expressing a variety of concerns, adopted the "intertwining doctrine," holding that when arbitrable claims are intimately related factually to the nonarbitrable claims, the entire intertwined package should be adjudicated in federal court without arbitration.<sup>[128]</sup> Still others acknowledged the appropriateness of the sever and stay approach but, after ordering certain claims to arbitration, enjoined the arbitration proceedings pending resolution of the federal court action.<sup>[129]</sup>

In *Dean Witter Reynolds Inc. v. Byrd*,<sup>130</sup> the Supreme Court rejected the intertwining doctrine in favor of the sever and stay approach, and admonished courts not to stay or enjoin arbitration pending the outcome of the federal court action.<sup>131</sup> The Court unanimously held that the intertwining doctrine was inconsistent with the FAA.<sup>132</sup>

The Court's decision two years earlier in *Moses H. Cone Memo-*

128. See Fletcher, *supra* note 32, at 415 n.153; see also, *Belke v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 693 F.2d 1023, 1026-27 (11th Cir. 1982) (claims were inextricably intertwined); *Sawyer v. Raymond, James & Assocs.*, 642 F.2d 791, 792-93 (5th Cir. 1981) (bifurcation would lead to duplicate review of same facts); *Miley v. Oppenheimer & Co.*, 637 F.2d 318, 335-36 (5th Cir. 1981) (claims were for single legal wrong); *Sibley v. Tandy Corp.*, 543 F.2d 540, 543 (5th Cir. 1976) (claims were inextricably intertwined), *cert. denied*, 434 U.S. 824 (1977); *Wise v. Kidder Peabody & Co.*, 596 F. Supp. 1391, 1397-98 (D. Del. 1984) (all claims should be heard in one proceeding to effectuate purposes of FAA); *Cunningham v. Dean Witter Reynolds, Inc.*, 550 F. Supp. 578, 584-85 (E.D. Cal. 1982) (bifurcation would frustrate FAA purpose to make dispute resolution faster and simpler); *Shapiro v. Jaslow*, 320 F. Supp. 598, 600 (S.D.N.Y. 1970) (due to collateral estoppel effect of arbitration, allowing arbitration of issues involved in nonarbitrable 1934 Act claims would frustrate exclusive jurisdiction provisions of 1934 Act); *Frogner v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [1983-84 Transfer Binder] Fed. Sec. L. Rep. (CCH), ¶ 99,504, at 96,927 (N.D. Cal. Sept. 26, 1983) (bifurcation would result in duplication of proof); *Seymour v. Bache & Co.*, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,402, at 99,058 (S.D.N.Y. Jan. 14, 1976) (judicial economy requires litigation of entire matter in one forum).

129. Fletcher, *supra* note 32, at 414-15 (footnotes omitted); see also *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831, 833-36 (7th Cir. 1977); *Stockwell v. Reynolds & Co.*, 252 F. Supp. 215, 220 (S.D.N.Y. 1965); *Sennett v. Oppenheimer & Co.*, [1979-80 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,378, at 97,502-03 (N.D. Ill. Apr. 22, 1980); *Peacock v. Oppenheimer & Co.*, [1979-80 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,201, at 96,586-87 (N.D. Ill. Sept. 17, 1979).

130. 470 U.S. 213 (1985). For a discussion of *Dean Witter Reynolds*, see *supra* notes 80-82 and accompanying text.

131. See *infra* notes 136-37 and accompanying text.

132. 470 U.S. at 217.

*rial Hospital v. Mercury Construction Corp.*<sup>133</sup> foreshadowed the Court's holding on the issue of intertwining in *Byrd*. In *Moses H. Cone*, the Court insisted that the FAA "requires piecemeal resolution when necessary to give effect to an arbitration agreement."<sup>134</sup> The *Byrd* Court relied heavily on *Moses H. Cone* in rejecting the intertwining doctrine.<sup>135</sup> The Court accepted instead the reasoning of those courts adopting the sever and stay approach,<sup>136</sup> stating that the FAA requires the arbitration of pendent claims even if that would result in inefficiencies due to the maintenance of proceedings in two forums.<sup>137</sup>

The death of the intertwining doctrine also marked the end of the practice of enjoining the arbitration of severed claims pending the outcome of the federal court suit.<sup>138</sup> The *Byrd* Court undercut the judicial economy justification for adopting such an approach, explicitly rejecting the notion that considerations of judicial economy are a legitimate reason for forestalling arbitration.<sup>139</sup> Under *Byrd*, therefore, a court presented with arbitrable state claims and nonarbitrable federal claims must, on the motion of a party, sever and stay the arbitrable claims and direct that arbitration proceed without delay.<sup>140</sup>

This approach is fraught with difficulty. Because federal courts and arbitrators follow different rules of procedure, evidence, and law, these separate proceedings may produce conflicting conclusions even though both actions arose out of the same securities transaction.<sup>141</sup> The principle of automatic bifurca-

133. 460 U.S. 1 (1983). For a discussion of *Moses H. Cone Memorial Hosp.*, see *supra* notes 70-71 and accompanying text.

134. *Id.* at 20 (footnote omitted) (emphasis in original). The Seventh Circuit had previously expressed the same sentiment in 1981 in *Dickinson v. Heihold Sec. Inc.*, 661 F.2d 638, 643 (7th Cir. 1981) ("A requirement to arbitrate may, in a particular instance, result in some duplication of effort, but this prospect cannot vitiate the agreement of the parties.").

135. See *Byrd*, 470 U.S. at 220-21.

136. See *supra* notes 125 & 129 and accompanying text.

137. 470 U.S. at 220-21.

138. See *supra* note 129 and accompanying text.

139. See *Byrd*, 470 U.S. at 220.

140. Some courts have stayed litigation of the nonarbitrable federal claims pending the outcome of the arbitration. See, e.g., *Webb v. R. Rowland & Co.*, 613 F. Supp. 1123, 1124 (E.D. Mo. 1985); *Adams v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,328, at 92,175 (W.D. Okla. Sept. 20, 1985). The wisdom and propriety of this and other ordering techniques are discussed *infra* notes 218-30 and accompanying text.

141. Comment, *supra* note 120, at 353 n.101.

tion<sup>142</sup> therefore makes possible the disposition of arbitrable and nonarbitrable claims separately *and simultaneously*,<sup>143</sup> putting the judge and the arbitrator "on a collision course."<sup>144</sup> Such a state of affairs creates especially severe headaches for the arbitrator, who is usually not a lawyer.<sup>145</sup> Moreover, at a time in our judicial history when the courts are already overburdened, creating even more delay and duplication is unwise.<sup>146</sup>

### C. *The Collateral Estoppel Effect of Arbitration Decisions Generally*

Another crucial issue which must be resolved before *McMahon* can be efficiently applied to securities disputes is the question of what preclusive effect an arbitrator's findings of fact will have in a simultaneous or subsequent judicial proceeding which seeks to resolve the same factual issues. The mandatory severance and arbitration of pendent arbitrable claims required by *Byrd* raises the possibility that these arbitration findings of fact will have a collateral estoppel effect on the simultaneous or subsequent litigation of federal claims.

Currently, the collateral estoppel effect of arbitration on the litigation of federal securities claims is unclear because the Supreme Court of the United States has not ruled on the issue.<sup>147</sup> Until the *Byrd* decision, courts and commentators seemed to assume without deciding that issues resolved in an arbitration proceeding were to be given full collateral estoppel effect in court.<sup>148</sup> *Byrd* muddied the water with regard to the collateral estoppel effect of arbitration awards, and courts forced to rule on the issue since *Byrd* have gone both ways.<sup>149</sup>

Like arbitration, collateral estoppel, or "issue preclusion," is a device employed to promote efficiency in dispute resolution

142. Katsoris, *supra* note 6, at 8 & n.30; Pitt, 'Byrd': *First Step to Heighten Role of Arbitration*, *Legal Times*, Mar. 11, 1985, at 15, col. 1.

143. Some courts have taken this approach. *See, e.g.*, *Hughes v. Paine, Webber, Jackson & Curtis, Inc.*, No. 81-5075 (N.D. Ill. Nov. 15, 1985) (LEXIS, Genfed library, Courts file); *Barr v. Illinois Co.*, No. 84 C 2076 (N.D. Ill. Oct. 29, 1985) (LEXIS, Genfed library, Courts file).

144. Katsoris, *supra* note 6, at 8.

145. *Id.*

146. *Id.* at 10 n.38.

147. *Id.*, *passim*; *see* *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 223 (1985) ("The question of what preclusive effect, if any, the arbitration proceedings might have is not yet before us, however, and we do not decide it."); *see also infra* notes 170-81 and accompanying text.

148. Fletcher, *supra* note 32, at 432 & n.256 and authorities cited therein; *see also infra* notes 168-69 and accompanying text.

149. *See infra* note 199 and accompanying text.



by simplifying the nature of the controversy.<sup>150</sup> The doctrine of collateral estoppel prohibits a party who has had an issue actually and necessarily decided in a prior proceeding from relitigating the same issue in a subsequent action.<sup>151</sup> It is based on the principle that such relitigation is unfair to the parties who have already litigated the issue and wastes precious judicial resources.<sup>152</sup> In order for collateral estoppel to bar relitigation of an issue, the issue must be identical to the one already litigated, must have been actually litigated by the parties in the earlier proceeding, and the determination of the issue in the prior proceeding must have been essential to the decision in that proceeding.<sup>153</sup>

There are several major policy reasons typically offered in favor of collateral estoppel. It prevents parties who have already litigated their actions from being required to litigate them again<sup>154</sup> and promotes judicial economy by disposing of an issue on the basis of the prior litigation.<sup>155</sup> Collateral estoppel also orders extra-judicial relationships by establishing finality of the litigation<sup>156</sup> and encouraging parties to act in accordance with the prior decision.<sup>157</sup>

In appropriate circumstances, collateral estoppel may also be invoked by a stranger to the initial action to preclude relitigation of an issue that was previously fully and fairly litigated by others.<sup>158</sup> The availability of collateral estoppel formerly hinged on the "mutuality doctrine," which prevented a party from using a prior judgment as an estoppel against the other party unless both parties were bound by the prior judgment.<sup>159</sup> This required that the parties in the second proceeding be identical to or in privity with those in the first proceeding.<sup>160</sup> In its 1979 *Parklane*

150. *Mobilia*, *supra* note 23, at 305 & 340; *see also* RESTATEMENT (SECOND) OF JUDGMENTS § 27 (1982).

151. RESTATEMENT (SECOND) OF JUDGMENTS §§ 27-29 (1982); Ginger, *The Use of Collateral Estoppel in Private Civil RICO Actions*, 54 TENN. L. REV. 31, 33 & n.4 (1986); *Mobilia*, *supra* note 23, at 305 & n.6.

152. *Mobilia*, *supra* note 23, at 312.

153. *See* Fletcher, *supra* note 32, at 432 n.255; Ginger, *supra* note 151, at 33 & n.8; *Mobilia*, *supra* note 23, at 305-06 & n.7.

154. RESTATEMENT (SECOND) OF JUDGMENTS § 27 (1982); *see also* *Mobilia*, *supra* note 23, at 321.

155. *Mobilia*, *supra* note 23, at 321 & n.103.

156. *Id.* at 321 & nn.104-06.

157. *Id.* at 321.

158. *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 326-28 (1979).

159. *See* Ginger, *supra* note 151, at 34 & n.11; *Mobilia*, *supra* note 23, at 313 & nn.46-47.

160. *See* Ginger, *supra* note 151, at 34 & n.12; Note, *Use of Collateral Estoppel*

*Hosiery Co. v. Shore*<sup>161</sup> decision, the Supreme Court of the United States abolished this strict "mutuality of parties" rule as a prerequisite to the invocation of collateral estoppel.<sup>162</sup> In *Parklane*, the Court liberalized the collateral estoppel doctrine by permitting a plaintiff to preclude a defendant from relitigating an issue that was decided in a prior suit between the same defendant and a different plaintiff.<sup>163</sup> Theoretically at least, a person not a party to the previous proceeding could use the determination in that proceeding to estop the relitigation of issues decided therein.<sup>164</sup>

The principles enunciated in the *Parklane* decision are easily applied to non-judicial contexts such as the arbitral arena.<sup>165</sup> Collateral estoppel has the potential to promote efficiency when it arises out of non-judicial proceedings, such as arbitration,<sup>166</sup> though the question whether it may be asserted based on an arbitration proceeding has seldom been directly addressed.<sup>167</sup> For many years, courts held arbitration to be akin to a judicial inquiry, carrying the same force as an adjudication and thereby precluding relitigation of an issue in the same way as a judicial decision would preclude its relitigation.<sup>168</sup> Courts and commentators seemed to assume that issues decided in an arbitration proceeding would be given full collateral estoppel effect in court.<sup>169</sup> Then the Supreme Court "cast a shadow of doubt over the matter"<sup>170</sup> in its decision in *Dean Witter Reynolds Inc. v. Byrd*.<sup>171</sup> In

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*In Private Civil Actions Under RICO: The Procedural Benefits of Parklane Hosiery Co. v. Shore*, 52 U. CIN. L. REV. 490, 490 (1983); *see, e.g.*, *Bigelow v. Old Dominion Copper Mining & Smelting Co.*, 225 U.S. 111, 127 (1912).

161. 439 U.S. 322 (1979).

162. *Id.* at 326-28.

163. *Id.* at 326-33.

164. *Cf.* Ginger, *supra* note 151, at 34.

165. *See* *Mobilia*, *supra* note 23, at 321.

166. *Id.* at 307. ("[T]o the extent that an identifiable issue is fully and fairly resolved in a prior arbitration proceeding, the use of collateral estoppel in a subsequent judicial proceeding is conceptually sound.")

167. *See infra* note 199.

168. *Mobilia*, *supra* note 23, at 310 & n.33; *see also infra* note 169.

169. *See, e.g.*, *Davis v. Chevy Chase Fin. Ltd.*, 667 F.2d 160, 172 (D.C. Cir. 1981); *City of Gainesville v. Island Creek Coal Sales Co.*, 618 F. Supp. 513 (N.D. Fla. 1974); *Sports Factory, Inc. v. Chanoff*, 586 F. Supp. 342, 346 (E.D. Pa. 1984); *Wilcox v. Ho-Wing Sit*, 586 F. Supp. 561, 567-68 (N.D. Cal. 1984); *Maidman v. O'Brien*, 473 F. Supp. 25, 29-34 (S.D.N.Y. 1979); *Shapiro v. Jaslow*, 320 F. Supp. 598, 600 (S.D.N.Y. 1970); *Saphier Agency v. Green*, 190 F. Supp. 713, 718-21 (S.D.N.Y.), *aff'd*, 293 F.2d 769, 774 (2d Cir. 1961); *see also* 18 C. WRIGHT, A. MILLER & E. COOPER, FEDERAL PRACTICE & PROCEDURE § 4475 (1981).

170. *See* *Fletcher*, *supra* note 32, at 432.

171. 470 U.S. 213 (1985).

*Byrd*, the Court referred to its previous rulings in the area of individual rights and held that employees represented by unions in grievance arbitration need not fear issue preclusion when those employees later sue in court under Section 1983 of Title VII of the Civil Rights Act or under the Fair Labor Standards Act.<sup>172</sup>

In these rulings, however, the Supreme Court had rejected granting collateral estoppel effect to the previous arbitral findings because of its "conclusion that Congress intended the statutes at issue in those cases to be judicially enforceable and that arbitration could not provide an adequate substitute for judicial proceedings in adjudicating claims under those statutes."<sup>173</sup> This rationale clearly does not apply to securities law disputes involving RICO after *McMahon*, in which the Court concluded that Congress intended that the FAA apply to compel the arbitral resolution of disputes under RICO and the Securities Exchange Act of 1934, cast great doubt upon the vitality of the *Wilko* exemption of the Securities Act of 1933 from the FAA, and asserted that "the mistrust of arbitration that formed the basis for the *Wilko* opinion in 1953 is difficult to square with the assessment of arbitration that has prevailed since that time . . . [and] do[es] not hold true today for arbitration procedures subject to the SEC's oversight authority."<sup>174</sup>

While the Court referred to the previous collateral estoppel rulings in its *Byrd* opinion,<sup>175</sup> it left open the possibility that collateral estoppel *would* make an arbitration proceeding one in which nonarbitrable claims were effectively adjudicated, and ordered the arbitration to take place nonetheless.<sup>176</sup> The Court asserted that "the preclusive effect of arbitration proceedings is significantly less well settled than the lower court opinions might suggest," and that "arbitration proceedings will not necessarily have a preclusive effect on subsequent federal-court proceedings."<sup>177</sup> Moreover, the Court declined to decide the issue, stating that "[t]he question of what preclusive effect, if any, the

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172. See *McDonald v. City of West Branch*, 466 U.S. 284 (1984) (Section 1983); *Barrentine v. Arkansas-Best Freight Sys., Inc.*, 450 U.S. 728 (1981) (Fair Labor Standards Act); *Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974) (Title VII); see also *Byrd*, 470 U.S. at 222-23.

173. *McDonald v. City of West Branch*, 466 U.S. 284, 289 (1984).

174. *Shearson/Am. Express, Inc. v. McMahon*, 107 S. Ct. 2332, 2341 (1987); see also *supra* notes 89-103 and accompanying text.

175. See *Byrd*, 470 U.S. at 221-24.

176. See *id.* at 223-24; *Fletcher*, *supra* note 32, at 433 & n.260; *Ginger*, *supra* note 151, at 56 n.201.

177. *Byrd*, 470 U.S. at 222-23.

arbitration proceedings might have is not yet before us . . . and we do not decide it.”<sup>178</sup> The Court did hint at what it thought was the appropriate course to take, however, noting that “courts may directly and effectively protect federal interests by determining the preclusive effect to be given to an arbitration proceeding. . . . Suffice it to say that in framing preclusion rules in this context, courts shall take into account the federal interests warranting protection.”<sup>179</sup>

In ordering arbitration to take place despite the risk of preclusion,<sup>180</sup> the Court apparently agreed with those courts that had taken the position that the threat of collateral estoppel “does not justify denying arbitration of otherwise arbitrable intertwined state law claims.”<sup>181</sup> In his concurrence, Justice White made this point explicitly, stating that fears of collateral estoppel should not cause a district court to stay or refuse to compel the arbitration of arbitrable claims.<sup>182</sup>

Cases decided after *Byrd* have re-examined the presumption that collateral estoppel applies in the arbitration context.<sup>183</sup> However, having rethought the issue, most courts (and commentators) have come down on the side of granting collateral estoppel effect to these arbitration decisions. For example, in a thoughtful decision rendered shortly after *Byrd*, the United States Court of Appeals for the Eleventh Circuit ruled in *Greenblatt v. Drexel Burnham Lambert, Inc.*<sup>184</sup> that the application of collateral estoppel is within the sound discretion of the judge.<sup>185</sup> Though the court cautioned that federal courts should be hesitant to give collateral estoppel effect to an arbitration decision if it would result in the nonlitigation of claims that cannot be arbitrated,<sup>186</sup> it nonetheless gave the arbitration proceeding full collateral estoppel effect in the case before it on the ground that arbitration had resolved the issues that were crucial to the litigation of the nonarbitrable claims.<sup>187</sup>

The *Greenblatt* case involved a customer who sued his broker-

178. *Id.* at 223.

179. *Id.*

180. *Id.* at 223-24.

181. *Dickinson v. Heinold Sec., Inc.*, 661 F.2d 638, 644 (7th Cir. 1981).

182. *Byrd*, 470 U.S. at 225 (White, J., concurring).

183. See Fletcher, *supra* note 32, at 433.

184. 763 F.2d 1352 (11th Cir. 1985).

185. *Id.* at 1360.

186. *Id.* at 1361.

187. *Id.*

age firm over a margin account balance and was collaterally estopped from litigating his RICO claim due to a previous arbitration award in the firm's favor.<sup>188</sup> Greenblatt's account was governed by an agreement containing an arbitration clause.<sup>189</sup> When a decline in the stock market prompted a margin call and he refused to pay,<sup>190</sup> an arbitration panel ruled in favor of Drexel Burnham, finding that the brokerage firm was legally entitled to the debit balance and all of the interest charged thereon.<sup>191</sup>

Meanwhile, Greenblatt had filed a civil RICO action against Drexel Burnham in federal district court after the arbitration proceedings were initiated, but before the arbitration hearing took place.<sup>192</sup> After the arbitration panel ruled in its favor, Drexel Burnham moved for summary judgment and the district court granted its motion, finding that plaintiff was collaterally estopped from litigating his RICO claim by the arbitrators' adverse determination of the facts underlying the claim.<sup>193</sup> Plaintiff Greenblatt appealed.

On appeal, the court held that collateral estoppel can properly result from determinations made during arbitration. The court found that "[w]hen an arbitration proceeding affords basic elements of adjudicatory procedure . . . , the determination of issues in an arbitration proceeding should generally be treated as conclusive in subsequent proceedings, just as determinations of a court would be treated."<sup>194</sup> The court found that the nature of the RICO claim which had been asserted by Greenblatt favored the application of collateral estoppel to the arbitration panel's factfinding, and that the arbitration procedure had adequately protected the rights of the parties.<sup>195</sup> As the court observed: "[A] RICO claim is unusual in that it must be based on underlying, independently unlawful acts. We do not think it improper to grant collateral estoppel effect to an arbitration panel's factual findings regarding these underlying acts, particularly if such findings are within the panel's authority and expertise."<sup>196</sup> As a result, the Eleventh Circuit held that Greenblatt was collaterally

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188. See *Ginger*, *supra* note 151, at nn.192-201 and accompanying text.

189. *Greenblatt*, 763 F.2d at 1354.

190. *Id.* at 1355.

191. *Id.* at 1356.

192. *Id.* at 1355.

193. *Id.* at 1356.

194. *Id.* at 1360.

195. *Id.* at 1361.

196. *Id.*

estopped by the arbitration panel's prior findings of fact from litigating or proving any of the predicate acts necessary to support a RICO violation. The court affirmed the district court's grant of summary judgment in favor of Drexel Burnham on the RICO claim.<sup>197</sup>

Most instructive, however, is the *Greenblatt* court's discussion of the Supreme Court decisions in *Byrd* and *McDonald* and what these decisions mean to courts trying to decide whether to give collateral estoppel effect to arbitral decisions. The Eleventh Circuit asserted that,

[t]he *Byrd* and *McDonald* cases indicate that, at least with respect to an important, nonarbitrable federal claim, a federal court should be hesitant to preclude the litigation of the federal claim based on the collateral estoppel effects of a prior arbitration award. These cases indicate a case-by-case approach to determining the collateral estoppel effects of arbitration on federal claims, focusing on the federal interests in insuring a federal court determination of the federal claim, the expertise of the arbitrator and his scope of authority under the arbitration agreement, and the procedural adequacy of the arbitration proceeding.<sup>198</sup>

The *Greenblatt* decision represents a sensible approach to the problem of the proper collateral estoppel effect to be given to arbitration awards. Collateral estoppel is a common-law doctrine and as such must undergo judicial modification and qualification over time to meet changing circumstances. It should not be construed to be so inflexible as to flout the will of Congress that certain claims must receive a judicial hearing. It is also reasonable, however, to leave open the possibility that a collateral estoppel effect should be given to arbitration decisions when, as in *Greenblatt*, the court determines that the issues received a fair and complete hearing in the arbitration proceeding and that litigation in federal court would simply be a waste of time and resources for all concerned.<sup>199</sup> In fact, several cases decided after *Byrd* and *Greenblatt* have followed *Greenblatt* and held that a previous arbitration decision has collateral estoppel effect in a subsequent federal

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197. *Id.* at 1362.

198. *Id.* at 1361. See also, Comment, *supra* note 120, at 353-54 n.101.

199. See Fletcher, *supra* note 32, at 434.

judicial proceeding.<sup>200</sup>

One problem unique to the issue of granting collateral estoppel effect to arbitration decisions must be addressed at this point: most arbitration awards do not make separate and clear findings as to each issue of fact.<sup>201</sup> This means that a subsequent court trying to give collateral estoppel effect to the arbitration award cannot be sure which specific issues were addressed and decided by the arbitrator.<sup>202</sup> In single-issue disputes, the problem is less likely to occur because a discussion or explanation of the award is generally unnecessary to identify the issue and the outcome. When the arbitration proceeding covers several issues, it may be more difficult to give a particular issue collateral estoppel effect because the arbitrator usually does not deliver an opinion as to each issue being contested in the dispute.<sup>203</sup> Moreover, even when identical claims are at stake, there is often no clear decision on a disputed issue.<sup>204</sup> This has caused at least one commentator to argue that the usefulness of collateral estoppel in the arbitration context may thus be limited to cases where a single issue is submitted to arbitration and that same issue arises in a later action.<sup>205</sup>

However, this problem can successfully be resolved simply by requiring that arbitrators make separate and specific findings of fact as to each factual issue presented, and by placing the burden on the party seeking estoppel to establish that the particular is-

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200. See, e.g., *Sevinor v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 807 F.2d 16 (5th Cir. 1986); *J.D. Marshall Int'l, Inc. v. Redstart, Inc.*, 656 F. Supp. 830 (N.D. Ill. 1987); *O'Neill v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 654 F. Supp. 347 (N.D. Ill. 1987); *Timberlake v. Oppenheimer & Co., Inc.*, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,336 (Sept. 4, 1985) (Arbitrator's single-sentence findings were too ambiguous to be given collateral estoppel effect). See also 1 Civ. RICO Rep. (BNA) No. 38, at 4 (Mar. 5, 1986). At least one court has even ruled that the failure to raise a matter as a defense during an arbitration proceeding forecloses the party from raising the matter in a later judicial proceeding on the ground that to permit the party to later raise the claim would serve to undermine the arbitration award. *Rudell v. Comprehensive Accounting Corp.*, 802 F.2d 926, 931-32 (7th Cir. 1986). But see *Katsoris*, *supra* note 6, at 9 ("[i]t is somewhat doubtful that a prior arbitration award would have a preclusive effect upon subsequent litigation of a federal securities claim."); *Brown*, *supra* note 37, at 28 ("The [Supreme] Court has expressed doubt regarding the collateral estoppel effects of arbitration in subsequent litigation involving statutory rights . . .").

201. See *Mobilia*, *supra* note 23, at 309 & n.28; see also *Wilko v. Swan*, 346 U.S. 427, 436 (1953).

202. *Mobilia*, *supra* note 23, at 323.

203. *Id.* at 323 & n.117.

204. *Id.* at 323 & n.120.

205. *Id.* at 324.

sues involved in the arbitration were each specifically and finally decided and are identical to issues arising in the litigation.<sup>206</sup>

D. *The Collateral Estoppel Effect of the Arbitration of RICO Claims in the Subsequent Litigation of Related Securities Law Claims*

The preclusive effect to be given a previous arbitration award is a particularly significant issue in the context of securities litigation where RICO claims are coupled with nonarbitrable securities claims arising under the 1933 Act. Now that RICO claims are subject to compelled arbitration under *McMahon*, a court might choose to stay its own consideration of a related securities claim pending arbitration of the RICO claim. If the arbitration decision is then given preclusive effect by the court, an adverse decision on the RICO claim may significantly affect a plaintiff's nonarbitrable securities law claims.<sup>207</sup>

The crucial question concerning the arbitration of RICO claims which are based on both arbitrable and nonarbitrable securities offenses is whether the arbitration precludes a later independent resolution of the nonarbitrable claims by a court.<sup>208</sup> With reference to nonarbitrable federal securities law claims in particular, the statutory nonwaiver provision of the 1933 Act which so concerned the Supreme Court in *Wilko* is offended only if prior arbitration of the RICO claim results in the foreclosure of the customer's right to bring an action in court under the 1933 Act.<sup>209</sup>

However, such foreclosure is unlikely. RICO is a complex statute requiring proof of more than predicate offenses to establish liability. Plaintiffs must also show a "pattern of racketeering activity" and the existence of an "enterprise" in order to recover.<sup>210</sup> Failure to prove either of these prerequisites results in judgment for the defendant. Because arbitration awards typically do not involve detailed findings on particular issues or opinions regarding liability on specific claims,<sup>211</sup> a decision for the defendant in a RICO arbitration simply indicates that the plaintiff failed to establish liability under RICO and says nothing about the viability of the predicate offenses as independent claims.<sup>212</sup>

206. *Id.* at 323.

207. *See* 2 Civ. RICO Rep. (BNA) No. 39, Part 2, at 1 (Mar. 17, 1987).

208. Brown, *supra* note 37, at 27.

209. *Id.* at 27-28.

210. 18 U.S.C. § 1962 (1982).

211. *See supra* note 200 and accompanying text.

212. In fact, in a very recent case alleging facts similar to those alleged in



Therefore, because findings regarding predicate offenses are not necessary to a judgment for the defendant in a RICO arbitration, collateral estoppel would not bar later adjudication of the claims stemming from these predicate acts. If the plaintiff loses a RICO arbitration, collateral estoppel will not apply to the predicate offenses. If the plaintiff wins the RICO arbitration, collateral estoppel will not harm, and might even help, the plaintiff in a subsequent action.<sup>213</sup>

Moreover, even if conventional preclusion analysis would put a nonarbitrable claim at risk after a RICO arbitration, the Supreme Court has observed that federal courts have it within their power to protect nonarbitrable federal statutory rights.<sup>214</sup> The Court noted that it is possible to do this in the context of giving some collateral estoppel effect to arbitration proceedings, pointing out that

courts may directly and effectively protect federal interests by determining the preclusive effect to be given to an arbitration proceeding. . . . Suffice it to say that in framing preclusion rules in this context, courts shall take into account the federal interests warranting protection. As a result, there is no reason to require that district courts decline to compel arbitration, or manipulate the ordering of the resulting bifurcated proceedings, simply to avoid an infringement of federal interests.<sup>215</sup>

Thus, the most sensible solution to the problem seems to be to fashion a general rule that arbitration awards shall be given collateral estoppel effect in related litigation of securities law dis-

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*McMahon*, an investor's claim that his broker engaged in "churning" in that he made numerous excessive trades in the investor's account was held to allege only one "'racketeering activity'" for purposes of RICO on the ground that such "'churning'" is a "unified offense" rather than the requisite "'pattern of racketeering activity'" required for RICO liability. *Winer v. Patterson*, 663 F. Supp. 723, 723-24 (1987). Therefore, the court ruled for the defendant and dismissed the RICO count from the suit while letting stand the securities and wire fraud allegations. *Id.* at 726. Thus, it is clear that a court's judgment that the plaintiff failed to establish the liability of the defendant under RICO says nothing about the viability of the predicate offense, here churning, as an independent claim.

213. See *Parklane Hosiery Co. v. Shore*, 439 U.S. 322 (1979); *Brown*, *supra* note 37, at 28 & n.82; *Ginger*, *supra* note 151 *passim*. For further discussion of collateral estoppel in this context see *supra* notes 194-95 and accompanying text.

214. *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 223 (1985); *Brown*, *supra* note 37, at 28 & n.83. For further discussion of these federal interests see *supra* note 179 and accompanying text.

215. *Byrd*, 470 U.S. at 223.

putes, no matter whether the arbitral findings concern RICO claims or other arbitrable pendent claims. The district courts should deny preclusive effect to arbitration awards only in situations where such denial is necessary to protect the federal interests at stake.

#### E. *Collateral Estoppel and the Problem of Ordering*

Giving collateral estoppel effect to arbitration decisions can maximize judicial economy and minimize potential inefficiency and duplication of effort. The use of collateral estoppel in this context can simplify or even make unnecessary the judicial resolution of related issues. In the words of one court:

[f]ederal courts, through the judicious use of collateral estoppel, can preserve the effectiveness of arbitration; by giving the arbitration decision some preclusive effect in the federal action, the arbitrator's fact-finding efforts are not needlessly duplicated. At the same time, the federal court's review of the arbitration hearing and decision—a review that must be undertaken to determine if the circumstances of the case warrant the application of collateral estoppel—ensures the investor's legislatively-created right to a federal forum for his securities claim.<sup>216</sup>

Several other courts seeking to manage the resolution of securities disputes involving both arbitrable and nonarbitrable pendent claims have noted that “[t]he results of the arbitration proceedings may simplify or even resolve the proceedings [in the district court],”<sup>217</sup> in that the arbitral decision could make unnecessary any further district court action, be given evidentiary weight in any district court action, or simplify the issues remaining to be litigated.<sup>218</sup>

Therefore, though *Byrd* and *McMahon* tell us that arbitration is not to be denied due to concerns about judicial economy, these concerns do argue strongly against letting the arbitration and the

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216. *O'Neill v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 654 F. Supp. 347, 351 (N.D. Ill. 1987).

217. *J.D. Marshall Int'l, Inc., v. Redstart, Inc.*, 656 F. Supp. 830, 834 (N.D. Ill. 1987).

218. *Sevinor v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 807 F.2d 16, 20 (1st Cir. 1986) (citations omitted). See also *Wilcox v. Ho-Wing Sit*, 586 F. Supp. 561, 567-68 (N.D. Cal. 1984).

judicial proceeding go forward simultaneously.<sup>219</sup> Such simultaneous bifurcated proceedings would cause many problems, including “annoying issues of adjournment and/or harassment due to the fact that discovery and depositions in the litigation are being conducted at the same time as the arbitration proceeding [and] [c]omplicated issues of collateral estoppel and res judicata . . . .”<sup>220</sup> In addition, differences in evidence, procedure, and substantive law between arbitration and litigation could easily cause different findings of fact and conflicting and contradictory ultimate results.<sup>221</sup>

That being the case, some commentators have argued that “the only reasonable solution to the problem of ordering is to stay the judicial resolution of nonarbitrable claims pending the outcome of the arbitration proceeding.”<sup>222</sup> This is what most courts that have faced the issue since *Byrd* have done.<sup>223</sup> This solution to the problem of ordering may well be “an ideal one, given the competing interests at stake.”<sup>224</sup> On the one hand, requiring the parties both to arbitrate and to litigate is worse than requiring them to litigate all their claims because it destroys all the advantages of arbitration. The parties are not spared the expense of litigation, the court docket is not any less crowded, and the time involved is even greater. “In other words, to require the parties simultaneously to litigate and to arbitrate robs the parties of the benefit of the bargain they made.”<sup>225</sup>

On the other hand, staying the court proceeding pending the completion of arbitration prevents the plaintiff and defendant

219. Fletcher, *supra* note 32, at 434.

220. Katsoris, *supra* note 6, at 9.

221. *Id.* at 11.

222. Fletcher, *supra* note 32, at 434-35. See also Brief for Appellants at 23-26; *Girard v. Drexel Burnham Lambert, Inc.*, 805 F.2d 607 (5th Cir. 1986).

223. Fletcher, *supra* note 32, at 435 & n.271. See also, *Sevinor v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 807 F.2d 16, 20-21 (1st Cir. 1986); *Mediterranean Enters., Inc. v. Ssangyong Corp.*, 708 F.2d 1458, 1465 (9th Cir. 1983); *J.D. Marshall Int'l, Inc. v. Redstart, Inc.*, 665 F. Supp. 830, 833-34 (N.D. Ill. 1987); *Becker v. Silverman*, 638 F. Supp. 193, 196-97, 198 (S.D.N.Y. 1986); *Bale v. Dean Witter Reynolds, Inc.*, 627 F. Supp. 650, 655 (D. Minn. 1986); *Webb v. R. Rowland & Co.*, 613 F. Supp. 1123, 1124 (E.D. Mo. 1985); *Mullis v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 492 F. Supp. 1345, 1358-61 (D. Nev. 1980); *Adams v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,328, at 92,175 (W.D. Okla. Sept. 20, 1985). *But see Cummings v. A.G. Edwards & Sons, Inc.*, 637 F. Supp. 132, 133 (M.D. La. 1986) (refusing to stay federal action pending arbitration of state claims). See also *supra* note 125 and accompanying text.

224. Fletcher, *supra* note 32, at 435.

225. *Id.*

from having to be in two places at once. It also makes a settlement short of federal litigation more likely because a party may rethink his stance in light of an impartial arbitrator's view of the case. In addition, courts need not be concerned about the collateral estoppel effect of the arbitration on the stayed judicial proceeding, because application of that doctrine is within their discretion. Thus, "sever and stay" seem to some an ideal solution to the problem of ordering.<sup>226</sup>

Other commentators, however, advocate the consolidation of all securities-related claims in a single proceeding,<sup>227</sup> preferably in an arbitration forum.<sup>228</sup> From the standpoint of pure efficiency, arbitration of both federal and state claims in a single proceeding is probably the best method of dispute resolution.<sup>229</sup> However, when nonarbitrable securities claims are joined with arbitrable securities or RICO claims, *Byrd* seems to require simultaneous arbitration and litigation. Therefore, even the simplest customer complaint could well result in multiforum and/or duplicative litigation.<sup>230</sup>

Because disputes between investors and brokers arise frequently but often involve modest sums, a uniform and efficient alternative to the present system of resolving securities claims is desirable. Instead of handling the problem of resolving these disputes by ordering immediate arbitration and staying litigation of the nonarbitrable claims until after the arbitration concludes, perhaps all securities-related claims should be consolidated in an arbitration proceeding in the first place.<sup>231</sup>

#### F. Recommendations

Congress and the SEC should join the debate on securities arbitration and work together toward the goal of creating a unified and economical system of arbitration which promotes the policies underlying the securities laws.<sup>232</sup>

It has been said that "it is not merely of some importance but is of fundamental importance that justice should not only be done, but should manifestly and undoubtedly be seen to be

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226. *Id.*

227. Comment, *supra* note 120, at 354.

228. Brown, *supra* note 37, at 33; Shell, *supra* note 4.

229. See Comment, *supra* note 120, at 354 & n.105.

230. Brown, *supra* note 37, at 33.

231. *Id.*

232. *Id.* at 33-34.

done."<sup>233</sup> Therefore, if all securities disputes are to be resolved in the arbitration forum, arbitration procedures must be fair both in fact and in appearance.<sup>234</sup> The process must inspire public confidence if it is to be entrusted with important federal statutory rights.<sup>235</sup> To this end, prompt legislative and regulatory action is needed to establish an effective and unified securities arbitration system.<sup>236</sup>

First of all, Congress should overturn the *Wilko* exemption<sup>237</sup> and make all securities claims subject to voluntary, contractual arbitration under the Federal Arbitration Act,<sup>238</sup> perhaps even in a specialized independent forum governed by a separate organization in which the public participates.<sup>239</sup> Congress and the SEC should then devise uniform arbitration procedures and practices for use in the securities industry which eliminate adhesion contracts and conflicts of interest on the part of arbitrators, and which ensure that arbitrators will faithfully apply the securities laws.<sup>240</sup>

These objectives can be accomplished by requiring that all securities arbitrations be conducted pursuant to an amended Uniform Code of Arbitration under the jurisdiction of the SEC, and by a specific delegation of rulemaking authority by Congress to the SEC that explicitly states these goals.<sup>241</sup>

Next, the SEC should conduct a thorough review of current practices used in securities arbitrations, including the Uniform Code of Arbitration, and formulate an amended version of the Code. At a minimum, this amended Code should guarantee "free choice" to investors who do not wish to sign "take it or leave it" arbitration clauses<sup>242</sup> and inform those who do sign that all disputes will be settled by arbitration for reasons of economy. Investors should be told that they are not required to consent to

233. *King v. Sussex Justices*, [1924] 1 K.B. 256, 259.

234. Katsoris, *supra* note 6, at 3, 14 & nn.58-59.

235. *See Shell, supra* note 4.

236. *Id.*

237. The legislative abolition of the *Wilko* exemption is advocated by several commentators. *See Brown, supra* note 37, at 34; *Fletcher, supra* note 32, at 459; *Shell, supra* note 4.

238. *See Brown, supra* note 37, at 34; Katsoris, *supra* note 6, at 14 & nn.60-64; *Shell, supra* note 4.

239. *See Katsoris, supra* note 6, at 14 & nn.60-64; Katsoris, *supra* note 33, at 306 & n.206, 312-13 & nn.259-63.

240. *Brown, supra* note 37, at 34.

241. *Id.*

242. *Shell, supra* note 4.

arbitration in order to do business with the broker or exchange, and they should sign separately any arbitration clauses to which they do consent.<sup>243</sup>

In addition, the arbitration clause itself should warn investors that by signing the clause, they are giving up their rights to jury trial and to judicial review of the arbitrator's decision.<sup>244</sup> Arbitrators should be drawn from outside the securities industry,<sup>245</sup> and the Code's term "public arbitrator" should be redefined to exclude lawyers and others who work for firms that serve the securities industry as advisers.<sup>246</sup> Also, to the extent possible, the Uniform Code of Arbitration should be amended to give customers a role in selecting their arbitrators, and information regarding the dispositions of securities arbitrations in which each arbitrator has participated in the past should be made available to both sides prior to the selection process.<sup>247</sup>

Finally, the Code should explicitly state that arbitrators are to follow federal securities law in rendering their decisions, and the arbitrators should be required to sign an affidavit to this effect which is to accompany their final decision.<sup>248</sup> This affidavit should list the federal statutory rights, if any, that were raised, considered, and decided by the arbitrator, which side won with respect to each statutory claim, and should state that, to the best of his or her ability, the arbitrator followed the law regarding these claims.<sup>249</sup>

#### IV. CONCLUSION

The number of legal claims made against brokers by disgruntled customers is on the rise, as is the number of complaints about brokers filed with the SEC.<sup>250</sup> In addition, these customers

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243. Brown, *supra* note 37, at 35.

244. *Id.* at 35 & n.93.

245. *Id.* at 35 & n.94.

246. Shell, *supra* note 4.

247. *Id.*; see also Brown, *supra* note 37, at 35-36 & n.95.

248. Shell, *supra* note 4.

249. Brown, *supra* note 37, at 36.

250. Ingersoll, *Sleepy Watchdogs: Regulation of Brokers by Securities Industry Seems To Be Faltering*, Wall St. J., July 21, 1987, at 1, col. 6 (Midwest ed.) ("More and more disgruntled customers are suing wayward brokers or filing arbitration cases with stock exchanges. And in record numbers, they are complaining to the SEC. The agency received 10,392 complaints last year, up 121% from 1982. The National Association of Securities Dealers recorded a startling 171% increase. The biggest surge in complaints to the SEC involves unauthorized trading, high-pressure sales pitches and 'churning'—excessive trading in customer accounts to generate commissions.").

have become increasingly aggressive in their use of federal statutes, including RICO, to sue brokers and dealers.<sup>251</sup> It is by no means clear that RICO's drafters intended that RICO should apply to securities disputes. Nonetheless, about forty percent of all RICO cases are brought against brokers who have no connection with racketeering.<sup>252</sup> Because brokers could be required to pay treble damages under RICO, they are more in favor than ever of arbitration of customer claims.<sup>253</sup>

Now that *McMahon* has made RICO claims as well as the majority of federal securities claims brought against brokers by the public arbitrable, more securities-fraud disputes will be forced into arbitration, while the number of court battles in this area is sure to decrease dramatically. While the courts, Congress, and the SEC could seek to streamline this process by mandating the "sever and stay" approach and by granting collateral estoppel effect to arbitrators' findings in subsequent court contests, the consolidation of all securities-related claims in the arbitration forum is a more efficient way to resolve securities disputes.

It is clear that the securities industry needs some alternative to formal litigation, and that the present system of industry-sponsored arbitration of investors' claims is both practical and economical. Statistics from the Securities Industry Conference on Arbitration show that most cases are disposed of the same year they are filed, that roughly half of all customers who arbitrate their securities complaints are awarded damages, and that the awards equal about half the amount requested.<sup>254</sup>

However fair the present system may be, several legislative and regulatory reforms are necessary before a truly effective and unified securities arbitration system will exist which can serve as the court of last resort for important federal statutory rights. Congress should require that all securities claims be settled by voluntary contractual arbitration under the Federal Arbitration Act, and then, in cooperation with the SEC, take steps to assure that the arbitration practices and procedures used are uniform and adequately protective of both investors and the federal interest in the effective enforcement of the securities laws.

Any RICO claims included in securities disputes should be required to be arbitrated as well, preferably in conjunction with

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251. See Shell, *supra* note 4.

252. *Id.*

253. *Id.*

254. *Id.*

the securities-law claims themselves. If for some reason the RICO claims are arbitrated in a separate proceeding, the arbitration decision on the RICO matters should be given full collateral estoppel effect by the arbitrators handling the securities-law claims.

This consolidation of securities disputes in the arbitral forum is beneficial to both investors and brokers.<sup>255</sup> The parties can avoid crowded court dockets and expect a resolution of their dispute in, on the average, four to six months.<sup>256</sup> Arbitration is also much cheaper than litigation—usually about one-third the cost, even if both parties are represented by attorneys.<sup>257</sup> Thus, small claims that an investor might choose not to assert in court due to the expense of litigation are more likely be pursued in arbitration.<sup>258</sup> Obviously, the resulting likelihood that an increased number of securities claims will be redressed inures to the benefit of society as well. Therefore, Congress and the SEC should take advantage of the opening provided by the Supreme Court of the United States in *McMahon* and see to it that all securities disputes are resolved in their entirety in the arbitral forum.

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255. See Fletcher, *supra* note 32, at 458 & nn.421-24.

256. See Meyerowitz, *supra* note 28, at 80.

257. *Id.*

258. See Fletcher, *supra* note 32, at 458.



