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## Arbitrating Civil RICO and Implied Causes of Action Arising Under Section 10(b) of the Securities Exchange Act of 1934

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## COMMENT

# ARBITRATING CIVIL RICO AND IMPLIED CAUSES OF ACTION ARISING UNDER SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934

The United States Arbitration Act<sup>1</sup> of 1925 mandates that courts enforce arbitration agreements<sup>2</sup> and recognizes arbitration<sup>3</sup> as a valid alternative to dispute resolution.<sup>4</sup> The United States Supreme Court, apparently attempting to reduce the case load of an overburdened federal court system,<sup>5</sup> also eventually recognized arbitration as a valid method of dispute resolution for

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1. 9 U.S.C §§ 1-14 (1982).

2. *See infra* note 101 and accompanying text.

3. Arbitration is an alternative to litigation. As such, it involves the resolution of disputes outside of the traditional judicial system. In arbitration, parties voluntarily and contractually agree to refer their disputes to an impartial arbitrator. The arbitrator will look at the evidence and listen to the arguments of the respective parties before making a determination or awarding damages. Because of the contractual nature of the arbitration agreement, the adversarial parties agree in advance that the arbitrator's findings and decisions will be accepted as final and binding upon them.

Arbitration is used in a wide variety of business transactions including sale and purchase of commodities, retailing, and manufactured goods. It is also used to resolve controversies in engineering contracts, patents, close corporation and partnership relations, franchise agreements, international business, government contracts, insurance, and medical malpractice. *See generally* M. DOMKE, DOMKE ON COMMERCIAL ARBITRATION § 1 (G. Wilner rev. ed. 1986); Lawyers' Arbitration Letters 1970-1979 (1981). For a brief analysis of the benefits and concerns facing an investor in the arbitration process, see Note, *Federal and State Securities Claims: Litigation or Arbitration?*—Dean Witter Reynolds, Inc. v. Byrd, 105 S. Ct. 1238 (1985), 61 WASH. L. REV. 245, 254-56 (1986).

4. Besides litigation, other methods of dispute resolution include legal negotiation and settlement, mediation and conciliation, collective bargaining, persuasion, and coercion. In mediation and conciliation, the third party involved assists the adversaries to reach a compromise or recommends an alternative for settlement. This recommendation is neither binding nor legally enforceable. The contractual nature of arbitration, however, binds the parties involved. *See* M. DOMKE, *supra* note 3, § 1, at 1.

5. Congress, jurists, and commentators have recognized that the federal court system is overloaded. *See State of the Judiciary and Access to Justice: Hearings Before the Subcomm. on Courts, Civil Liberties, and the Administration of Justice of the Comm. on the Judiciary House of Representatives*, 95th Cong., 1st Sess. (1977); Burger, *Isn't There a Better Way*, 68 A.B.A. J. 274 (1982); *see also* Clark, *A Commentary on Congestion in the Federal Courts*, 8 ST. MARY'S L.J. 407 (1976); Barton, *Behind the Legal Explosion*, 27 STAN. L. REV. 567 (1975).

commercial and securities transactions.<sup>6</sup> In *Wilko v. Swan*,<sup>7</sup> however, the United States Supreme Court created the first<sup>8</sup> exception to the Arbitration Act by holding that violations of the antifraud and express civil liability provisions found in section 12(2) of the Securities Act of 1933<sup>9</sup> were not arbitrable.

Since the *Wilko* decision in 1953, federal courts have expanded the *Wilko* exception to include violations of the antifraud provisions of the Securities Exchange Act of 1934.<sup>10</sup> Although recent Supreme Court decisions have strongly questioned the continued validity of judicially applying the *Wilko* exception to violations of section 10(b) of the Securities Exchange Act of 1934,<sup>11</sup> most federal circuit courts deciding the arbitrability of 10(b) claims have not favored arbitration. In fact, some circuits not only reaffirmed that violations of section 10(b) of the Exchange Act<sup>12</sup> and rule 10b-5<sup>13</sup> are not

6. As used in this Comment, commercial litigation involves issues arising under all types of contractual business relationships. See *infra* notes 110-40 and accompanying text.

7. 346 U.S. 427 (1953).

8. Federal courts have also created an exception to the Arbitration Act when antitrust issues are involved. This exception was created by the Second Circuit in *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968). There, the Second Circuit felt justified in creating the antitrust exception because of the public policy considerations in enforcing the federal antitrust laws and because of the complexity of the antitrust issues involved. The United States Supreme Court sharply criticized the *American Safety* exception to the Arbitration Act in an international antitrust arbitration dispute. Therefore, the continued validity of such an exception in domestic United States disputes has become highly questionable. See *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 105 S. Ct. 3346, 3351-60 (1985); see also *infra* notes 126-32 and accompanying text. For a discussion of the implications of *Mitsubishi*, particularly in international antitrust and other commercial arbitration disputes, see FOX, *Mitsubishi v. Soler and its Impact on International Commercial Arbitration*, 19 J. WORLD TRADE L. 579 (1985).

9. Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77m (1982)) [hereinafter Securities Act].

10. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a-78kk (1982)) [hereinafter Exchange Act].

11. See *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 513-18 (1974); see also *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 224-25 (1985) (White, J., concurring).

12. 15 U.S.C. § 78j(b) (1982). This section, covering manipulative or deceptive practices, states in relevant part that:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange-

...

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

*Id.* Throughout this Comment, references to section 10(b) will include issues raised under Securities Exchange Commission rule 10b-5. See *infra* note 13 for the language of rule 10b-5.

arbitrable,<sup>14</sup> but also began creating another exception to the Arbitration Act.

Acceptance of this second evolving, judicially created exception to the Arbitration Act is growing in acceptance. It provides that securities violations, which comprise the predicate acts required for jurisdiction under the Racketeer Influenced and Corrupt Organizations (RICO)<sup>15</sup> statute, are not arbitrable.<sup>16</sup> Civil actions arising under section 1964 of the statute, which have come to be known as civil RICO actions, allow for recovery of treble damages and litigation costs, including reasonable attorneys' fees.<sup>17</sup> Neither the RICO statute nor its legislative history address whether its civil provisions may be subject to an arbitration agreement.

In *Dean Witter Reynolds, Inc. v. Byrd*,<sup>18</sup> the Supreme Court rejected the

13. 17 C.F.R. § 240.10b-5 (1986). The 10b-5 rule states that:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

- a) To employ any device, scheme, or artifice to defraud,
- b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

*Id.*

14. See, e.g., *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197 (3d Cir. 1986); *Conover v. Dean Witter Reynolds, Inc.*, 794 F.2d 500 (9th Cir. 1986); *Miller v. Drexel Burnham Lambert, Inc.*, 791 F.2d 850 (11th Cir. 1986) (per curiam); *McMahon v. Shearson/Am. Express, Inc.*, 788 F.2d 94 (2d Cir.), cert. granted, 107 S. Ct. 60 (1986); *Smoky Greenhaw Cotton Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 785 F.2d 1274 (5th Cir.), vacated in part, No. 85-1310 (5th Cir. May 13, 1986) (per curiam) (en banc).

15. "RICO" is the commonly used acronym for the Racketeer Influenced and Corrupt Organizations Act, Pub. L. No. 91-452, tit. IX, 84 Stat. 922 (1970) (codified as amended at 18 U.S.C. §§ 1961-68 (1982)) [hereinafter RICO]. The legislative history of RICO is reviewed in *Blakey & Gettings, Racketeer Influenced and Corrupt Organizations (RICO): Basic Concepts-Criminal and Civil Remedies*, 53 TEMP. L.Q. 1009, 1014-21 (1980). See also *Bradley, Racketeers, Congress, and the Courts: An Analysis of RICO*, 65 IOWA L. REV. 837, 838-45 (1980); see *infra* notes 31-98 and accompanying text. Section 1962 provides the predicate acts of racketeering activity needed for jurisdiction under the RICO statute. The pleading requirements for RICO are easy to meet. In fact, "RICO is so broad based that virtually any person who is involved in a commercial dispute can become a subject of a RICO civil suit." *Boucher, Bill Curbing RICO's Use Advances*, Nat'l L.J., Sept. 1, 1986, at 15, col. 1.

16. See, e.g., *McMahon*, 788 F.2d at 98-99 (RICO is not arbitrable per se); *Jacobson*, 797 F.2d at 1202-03 (RICO not arbitrable if predicate acts are based on securities fraud, but arbitrable if based on violations of the mail and wire fraud laws); *Smoky Greenhaw*, 785 F.2d at 1281 (RICO not arbitrable per se); see also *infra* notes 159-82, 235, 270-71, and accompanying text.

17. See 18 U.S.C. § 1964(c) (1982); see also *infra* note 40 and accompanying text.

18. 470 U.S. 213 (1985).

"intertwining doctrine,"<sup>19</sup> a judicially created exception to the Arbitration Act that allowed federal courts to try all state securities and common law arbitrable issues together with nonarbitrable federal securities claims. In *Byrd*, a unanimous Supreme Court held that the Arbitration Act requires federal courts to sever or bifurcate the federal securities laws claims and compel arbitration of all pendent<sup>20</sup> state arbitrable issues. Further, the Court stated that the Arbitration Act requires bifurcation even where the controversies arise from a common nucleus of operative fact.<sup>21</sup> In a concurring opinion,<sup>22</sup> Justice White questioned the continued validity of expanding the *Wilko* exception to implied causes of action<sup>23</sup> arising under section 10(b) of the Securities Exchange Act of 1934.

While Justice White's concurring opinion in *Byrd* precipitated a split among the circuits on whether violations of section 10(b) of the Exchange Act are arbitrable,<sup>24</sup> the Third Circuit recently further complicated the split within the circuits on the securities arbitrability issue. In a divided opinion in *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,<sup>25</sup> the Court of Appeals for the Third Circuit held that civil RICO claims are not arbitrable when the predicate acts required for jurisdiction under RICO consist of section 10(b) violations, but are arbitrable when the predicate acts consist of mail and wire fraud.<sup>26</sup> The *Jacobson* dissent read the RICO statute differently and, recognizing more practical administrative policy considerations, argued that all civil RICO claims should be arbitrable.<sup>27</sup>

Whether civil RICO claims are arbitrable when those claims are closely intertwined with violations of the federal securities laws has not been resolved or considered by the Supreme Court. The issues have created splits among the federal courts.<sup>28</sup> On October 7, 1986, the Supreme Court granted

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19. *Id.* at 216-17. See *infra* notes 118-25 and accompanying text for the "intertwining doctrine" discussion.

20. See *infra* note 119 and accompanying text on pendent jurisdiction.

21. *Byrd*, 470 U.S. at 217.

22. *Id.* at 224-25 (White, J., concurring). See also *infra* notes 134, 143-46, and accompanying text.

23. See *infra* note 232.

24. See *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393, 1400 (8th Cir. 1986); see also *infra* note 195 and accompanying text.

25. 797 F.2d 1197 (3d Cir. 1986).

26. *Id.* at 1199. See also *infra* note 94 and accompanying text.

27. *Jacobson*, 797 F.2d at 1203, 1209-10 (Adams, J., concurring in part and dissenting in part).

28. See *Petition for a 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.), *cert. granted*, 107 S. Ct. 60 (1986) (appendices E & F provide an excellent breakdown of various federal courts decisions regarding the arbitrability of § 10(b) violations and RICO claims).

certiorari to resolve the issues.<sup>29</sup>

The Comment will first provide the background and development of the RICO statute in general, with specific discussion of the expansion of civil RICO's scope. Second, it will provide a brief background of the policy considerations that led to the enactment of the United States Arbitration Act, and discuss the development of the *Wilko* exception. Third, it will examine other Supreme Court decisions construing the Arbitration Act and, more importantly, limiting the *Wilko* exception. Accordingly, the Comment will highlight the Supreme Court's expansion of the Arbitration Act's scope and the Court's refusal to create a second judicial exception to that act. Fourth, a discussion of Justice White's concurring opinion in *Byrd* will set the stage for analyzing the two related circuit splits on whether implied rights of action arising under the Securities Exchange Act of 1934 and their ancillary<sup>30</sup> issues under RICO are arbitrable. In conclusion, this Comment will discuss the beneficial aspects of arbitration, the recent proliferation and abuse of civil RICO, and the likelihood that civil RICO claims and implied causes of action under the Securities Exchange Act of 1934 will be subject to arbitration.

## I. THE RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT

### A. *Background and Development of RICO*

Responding to a perceived "organized crime"<sup>31</sup> epidemic, Congress exercised its police power under the commerce clause<sup>32</sup> of the United States Constitution by enacting the Organized Crime Control Act of 1970.<sup>33</sup> Title

29. See *Shearson/Am. Express Inc. v. McMahon*, 788 F.2d 94 (2d Cir.), cert. granted, 107 S. Ct. 60 (1986).

30. See *infra* note 119 and accompanying text on ancillary jurisdiction.

31. The concept of "organized crime" is difficult to define. Depending on the definition or the source, organized crime is a "social system," a "conspiracy," a "criminal syndicate," or an "illegal enterprise" as those terms may in turn be defined. See *Blakey & Gettings, supra* note 15, at 1013 & n.15; see also Note, *Civil RICO: The Temptation and Impropriety of Judicial Restriction*, 95 HARV. L. REV. 1101, 1106-09 (1982).

32. U.S. CONST. art. I, § 8: "The Congress shall have power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

Congress has constitutionally exercised this police power as necessary and proper on numerous "national" as opposed to "local" matters affecting interstate commerce. See L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* §§ 6-3 to 6-5 (1978); see also Tarlow, *RICO Revisited*, 17 GA. L. REV. 291, 312 (1983).

33. Pub. L. No 91-452, 84 Stat. 922 (1970) (codified in scattered sections of 18, 28 U.S.C.). The Statement of Findings and Purpose for enactment of the Act is reprinted in 1970 U.S. CODE CONG. & ADMIN. NEWS 1073 and states that organized crime substantially burdens interstate commerce as follows:

The Congress finds that (1) organized crime in the United States is a highly sophisticated, diversified, and widespread activity that annually drains billions of dollars

IX of the Act, commonly known as the Racketeer Influenced and Corrupt Organizations (RICO) Act,<sup>34</sup> was designed primarily to fight organized crime's infiltration and influence over legitimate interstate businesses.<sup>35</sup> However, despite warnings that the statute may be overly broad,<sup>36</sup> Congress resisted attempts to limit RICO's applicability to organized crime. The resistance arose primarily from congressional concern over the constitutionality of criminalizing status or affiliation instead of conduct, and Congress' inability to precisely define "organized crime."<sup>37</sup>

As enacted, RICO provides new and innovative legal remedies for all types of organized criminal activities.<sup>38</sup> Without considering the statute's legislative history, a broad reading of these new provisions exposed defendants to either criminal<sup>39</sup> and/or civil<sup>40</sup> liability for violating RICO's provisions. Moreover, to encourage government and private party participation in the eradication of organized crime, the statute was intended to be liberally

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from America's economy by unlawful conduct and the illegal use of force, fraud, and corruption; . . . (4) *organized crime activities* in the United States weaken the stability of the Nation's economic system, *harm innocent investors and competing organizations, interfere with free competition, seriously burden interstate and foreign commerce . . . . It is the purpose of this Act to seek the eradication of organized crime in the United States . . . .*

*Id.* (emphasis added).

34. 18 U.S.C. §§ 1961-1968 (1982).

35. *See supra* note 33.

36. The American Civil Liberties Union (ACLU) recognized that RICO may be overly broad and argued that the civil liberties of businessmen, political activists, and private citizens were being jeopardized by the statute. *See Blakey & Gettings, supra* note 15, at 1018 & n.55. *But cf. infra* notes 40, 49, and accompanying text.

37. "[The] concept of organized criminal activity is broader in scope than the concept of organized crime; it is meant to include any criminal activity collectively undertaken . . ." 116 CONG. REC. 35, 293 (1970) (statement of Rep. Poff). *See also Blakey & Gettings, supra* note 15, at 1017-19 & nn.45-56; Tarlow, *supra* note 32, at 312-15.

38. *See Blakey & Gettings, supra* note 15, at 1013. The Senate Judiciary Committee on RICO indicated that:

Obviously, the time has come for a frontal attack on the subversion of our economic system by organized criminal activities. That attack must begin, however with the frank recognition that our present laws are inadequate to remove criminal influences from legitimate endeavor organizations. . . . [N]ot a single one of the "families" of La Cosa Nostra has been destroyed through criminal prosecution . . . What is needed here . . . are new approaches . . . . In short, an attack must be made on the source of economic power itself, and the attack must take place on all available fronts.

S. REP. NO. 617, 91st Cong., 1st Sess. 78-79 (1969).

39. *See* 18 U.S.C. § 1963 (1982).

40. 18 U.S.C. § 1964. In relevant part, § 1964(c) provides the following civil remedies: "(c) Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefore in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee." *Id.*

construed.<sup>41</sup>

Civil RICO actions arising under section 1964<sup>42</sup> of the statute allow for recovery of treble damages and court costs, including reasonable attorneys' fees.<sup>43</sup> Arguably, these punitive remedies are not allowed in arbitration or commercial contract disputes.<sup>44</sup> Not surprisingly, the allure of such attractive civil remedies has rapidly expanded the use of civil RICO in commercial litigation,<sup>45</sup> and made it a very popular legal instrument for fighting a variety of fraudulent activities.<sup>46</sup> Indeed, the list of legitimate businesses affected by civil RICO claims is extensive,<sup>47</sup> limited only by an attorney's inability to frame complaints in a RICO fashion.<sup>48</sup> As a result, the expansion of civil RICO has affected legitimate businesses and persons<sup>49</sup> which Congress did

41. "The provisions of this [Act] shall be liberally construed to effectuate its remedial purposes." Pub. L. No 91-452, 84 Stat. 922, 947 (1970). See also Blakey & Gettings, *supra* note 15, at 1032-33; Tarlow, *supra* note 32, at 308-11.

42. 18 U.S.C. § 1964; see *supra* note 40.

43. *Id.*

44. See *Wilko v. Swan*, 346 U.S. 427, 439-40 (1953) (Frankfurter, J., dissenting). But see M. DOMKE, *supra* note 3, § 25:01, at 390-92.

45. Courts and commentators have recognized the "explosion" of civil RICO claims. See, e.g., *Sedima, S.P.R.L. v. Imrex Co.*, 741 F.2d 482, 486 (1984), *rev'd*, 105 S. Ct. 3275 (1985); see also Rivois, *Civil RICO—The Supreme Court Opens the Door to Commercial Litigation*, COMM. L.J. 621 (1985); Boucher, *Bill Curbing RICO's Use Advances*, Nat'l L.J., Sept. 1, 1986, at 15, col. 1. But see Strafer, Masumi & Skolnik, *Civil RICO in the Public Interest: "Everybody's Darling"*, 19 AM. CRIM. L. REV. 655 (1982); Long, *Treble Damages for Violations of the Federal Securities Laws: A Suggested Analysis and Application of the RICO Civil Cause of Action*, 85 DICK. L. REV. 201 (1981).

46. "Fraud" is difficult to define with precision but falls within the proverbial "I know it when I see it" definition. See *Knauer v. United States*, 328 U.S. 654, 657 (1946) ("fraud" connotes perjury, concealment, falsification, misrepresentation, or the like); *Illinois Minerals Co. v. McCarty*, 318 Ill. App. 423, 428, 48 N.E.2d 424, 429 (1943) ("fraud" comprises all acts, of omission and commission, including breach of legal or equitable duty, trust, or confidence, resulting in injury to another); *First State Bank of Canute v. Thomas*, 201 Okl. 325, 328, 205 P.2d 866, 869 (1949) ("fraud" is a generic term embracing all unfair ways by which another is cheated or unlawfully imposed upon, including elements of duress, undue influence, threats, and intimidation). The collective use of mail, wire and securities fraud is known as "garden variety fraud." See, e.g., *Hulse v. Halle Farms Dev.*, 586 F. Supp. 120, 122 (D. Conn. 1984); see also *infra* notes 91-95 and accompanying text.

47. Instead of limiting RICO to traditional elements of organized crime, RICO has also been used against banks, insurance companies, brokerage firms, government departments and agencies, state governors, judges, state senators and countless other persons not connected with organized crime. See generally Project, *White-Collar Crime: Second Annual Survey of Law*, 19 AM. CRIM. L. REV. 173, 351-70 & nn.1406-24 (1981).

48. In pleading fraud, rule 9(b) of the Federal Rules of Civil Procedure requires that "[t]he circumstance construing fraud . . . be stated with particularity." FED. R. CIV. PROC. 9. See generally Bertz, *Pursuing a Business Fraud RICO Claim*, 21 CAL. W.L. REV. 246 (1985) (demonstrating the proper way to plead RICO); see also *supra* note 15.

49. But see *Furman v. Cirrito*, 741 F.2d 524, 529 (2d Cir. 1984) ("It seems almost too obvious to require statement but fraud is fraud, whether it is committed by a hit man for organized crime or by the President of a Wall Street brokerage firm.").



not intend to reach when it first enacted the statute.

To fall within the ambit of RICO, an enterprise<sup>50</sup> involved in interstate or foreign commerce must have committed two or more predicate acts<sup>51</sup> through a pattern<sup>52</sup> of racketeering activity<sup>53</sup> within a ten year period.<sup>54</sup> Because application of civil RICO appeared unrestricted, potentially affecting legitimate businesses more than the originally intended "organized crime associations,"<sup>55</sup> some courts began to impose "standing" obstacles to civil RICO claims.<sup>56</sup> As part of the standing requirements limiting civil RICO's

50. 18 U.S.C. § 1961(4) (1982) provides: An "[e]nterprise" includes *any individual, partnership, corporation, association, or other legal entity*, and any union or group of individuals associated in fact although not a legal entity." *Id.* (emphasis added). See also *United States v. Turkette*, 452 U.S. 576 (1981) (in which the Supreme Court decided that "enterprise" included both legitimate and illegitimate businesses).

51. 18 U.S.C. § 1962 (1982). Section 1962 provides the predicate acts for jurisdiction under the RICO statute. This section states in relevant part that:

(a) It shall be *unlawful for any person* who has received *any income . . . from a pattern of racketeering activity* or through collection of an unlawful debt . . . to use or invest . . . *any part of such income*, or the proceeds of such income in acquisition of *any interest in, . . . any enterprise* which is engaged in, or . . . affect[s], interstate or foreign commerce. . . .

(b) It shall be *unlawful for any person through a pattern of racketeering activity* or through collection of an unlawful debt to acquire or maintain . . . *any interest in or control of any enterprise* which is engaged in, or . . . affect[s], interstate or foreign commerce.

(c) It shall be *unlawful for any person* employed by or associated with *any enterprise engaged in, or . . . affect[ing], interstate or foreign commerce*, to conduct or participate . . . in the conduct of such enterprise's affairs *through a pattern of racketeering activity . . . .*

(d) It shall be *unlawful for any person* to conspire to violate *any* of the provisions of subsections (a), (b), or (c) of this section.

*Id.* (citations omitted) (emphasis added).

52. 18 U.S.C. § 1961(s) (1982) provides in relevant part that: "As used in this chapter—'pattern of racketeering activity' requires at least two acts of racketeering activity, . . . which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity." *Id.* See also *Sedima, S.P.R.L. v. Imrex Co.*, 105 S. Ct. 3275, 3285 & n.14 (1985).

53. Section 1961(1) provides in relevant part that:

As used in this chapter—

(1) "racketeering activity" means (A) *any act or threat . . . which is chargeable under State law and punishable by imprisonment for more than one year; (B) any act which is indictable under any of the following provisions of title 18, United States Code; . . . section 1341 (relating to mail fraud), section 1343 (relating to wire fraud), . . . section 1951 (relating to interference with commerce), . . . or (D) any offense involving . . . fraud in the sale of securities . . . .*

18 U.S.C. § 1961(1) (1982) (emphasis added).

54. 18 U.S.C. § 1961(5) (1982).

55. See *supra* notes 31, 36-37, and accompanying text.

56. See generally Comment, *Civil RICO: The Resolution of the Racketeering Enterprise Injury Requirement*, 21 CAL. W.L. REV. 364, 366 (1985); Note, *RICO's New Community of*

scope, these courts required that plaintiffs prove a racketeering enterprise injury,<sup>57</sup> and permitted a private RICO action only against a defendant who had already been convicted of a predicate act or of a RICO violation.<sup>58</sup>

This background of judicially created obstacles to standing under civil RICO, from courts which recognized the potential for abuse of the statute,<sup>59</sup> created a split within the circuits. On the one hand, in *Sedima, S.P.R.L. v. Imrex Co.*,<sup>60</sup> a divided Court of Appeals for the Second Circuit affirmed the district court's<sup>61</sup> dismissal of a civil RICO claim, noting that the predicate acts required for jurisdiction under the statute must have consisted of prior criminal convictions. The court also found that the plaintiff had not shown "injury different in kind from that occurring as a result of the predicate acts themselves, or not simply caused by the predicate acts, but also caused by an

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*Racketeers: The Need for a Prior Criminal Conviction Requirement*, 64 WASH. U.L.Q. 229, 236-41 (1986).

57. See Comment, *supra* note 56, at 367-68 & n.26. Other standing requirements demand that plaintiffs prove an organized crime connection, a competitive injury, or an infiltration injury.

Prior to *Sedima*, plaintiffs had to show an injury caused by a defendant connected with organized crime to meet the "organized crime connection" requirement. See, e.g., *Moss v. Morgan Stanley, Inc.*, 719 F.2d 5, 21 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984); *Schacht v. Brown*, 711 F.2d 1343, 1353 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983); *Bunker Ramo Corp. v. United Business Forms, Inc.*, 713 F.2d 1272, 1287-88 & n.6 (7th Cir. 1983); *Bennett v. Berg*, 685 F.2d 1053, 1063 (8th Cir. 1982), *cert. denied*, 464 U.S. 1008 (1983); *In re Catanella & E.F. Hutton & Co. Sec. Litig.*, 583 F. Supp. 1388, 1430 (E.D. Pa. 1984). *But see*, e.g., *Hokama v. E.F. Hutton & Co.*, 566 F. Supp. 636, 643 (C.D. Cal. 1983); *Waterman S.S. Corp. v. Avondale Shipyards, Inc.*, 527 F. Supp. 256, 258 (E.D. La. 1981).

The "competitive injury" requirement, eventually rejected by most courts, asked that plaintiffs show a competitive injury. The practical effect of this requirement was to deny standing to those directly injured from the predicate crimes, but grant standing to competitors indirectly affected. See, e.g., *Bunker Ramo Corp. v. United Business Forms, Inc.*, 713 F.2d 1272, 1288 (7th Cir. 1983); *Schacht v. Brown*, 711 F.2d 1343, 1357 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983); *Mauriber v. Shearson/Am. Express, Inc.*, 567 F. Supp. 1231, 1240-41 (S.D.N.Y. 1983); *Bankers Trust Co. v. Feldesman*, 566 F. Supp. 1235 (S.D.N.Y. 1983) ("competitive injury" must be shown); *Crocker Nat'l. Bank v. Rockwell Int'l. Corp.*, 555 F. Supp. 47, 49 (N.D. Cal. 1982).

The "infiltration injury" required that plaintiffs demonstrate that legitimate business entities were infiltrated by criminal elements through the required pattern of racketeering activity. This requirement is perhaps the only judicial requirement that complied with original congressional intent. See, e.g., *Spencer Co. v. Agency Rent-A-Car, Inc.*, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,361 (D. Mass. Nov. 17, 1981). See also Comment, *supra* note 56, at 366-81 & nn.22-28.

58. See, e.g., *Sedima, S.P.R.L. v. Imrex Co.*, 741 F.2d 482, 486-88 (2d Cir. 1984), *rev'd*, 105 S. Ct. 3275 (1985); *Landmark Sav. & Loan v. Rhoades*, 527 F. Supp. 206, 208-09 (E.D. Mich. 1981). The prior RICO conviction requirement was rejected in *Bunker Ramo Corp. v. United Business Forms, Inc.*, 713 F.2d at 1286-87.

59. See *supra* notes 56-58 and accompanying text.

60. 741 F.2d 482 (2d Cir. 1984).

61. *Sedima, S.P.R.L. v. Imrex Co.*, 574 F. Supp. 963 (E.D.N.Y. 1983).

activity which RICO was designed to deter."<sup>62</sup>

On the other hand, in *Haroco, Inc. v. American National Bank & Trust Co.*,<sup>63</sup> a unanimous Court of Appeals for the Seventh Circuit criticized Second Circuit precedent and refused to limit civil RICO's scope. There, the Seventh Circuit concluded that civil RICO claims only required proof of causation of injury, either directly or indirectly, by the predicate acts.<sup>64</sup>

In the first case, *Sedima*, a Belgian importing-exporting corporation, had entered into a joint venture with *Imrex, Co.*, an American exporter of aircraft and electronic aircraft-related components.<sup>65</sup> After becoming convinced that *Imrex* was presenting inflated bills for orders filled, *Sedima* filed a complaint setting forth various common law claims traditionally alleged in disputes involving contractual business relationships. In addition, however, *Sedima* alleged RICO claims under the civil remedies of section 1964(c) against *Imrex*.<sup>66</sup> *Sedima* asserted that *Imrex* had been involved in an international pattern of racketeering activity in violation of section 1962(c) of the RICO statute.<sup>67</sup> *Sedima* also maintained that this pattern of racketeering activity was based on predicate acts of mail and wire fraud.<sup>68</sup> A third RICO count alleged a conspiracy to violate section 1962(c). Asserting injury of at least \$175,000 from *Imrex's* overbilling, *Sedima* sought treble damages and attorneys' fees.<sup>69</sup> The Second Circuit affirmed the district court's dismissal of the action.<sup>70</sup> In so doing, the Second Circuit required that a racketeering injury and a prior conviction of a predicate act or a RICO violation be shown before a civil RICO action could proceed.

In *Haroco*, several businesses, including *Haroco*, had borrowed several million dollars from the American National Bank of Chicago. Each loan agreement stipulated that the interest rate would be "one percent over the bank's prime rate."<sup>71</sup> The prime rate was subsequently defined as the "rate of interest charged by the bank to its largest and most creditworthy commer-

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62. *Sedima*, 741 F.2d at 494-96 & n.41. This was a "competitive injury" analogous to antitrust laws. See generally Brown, *RICO Repercussions: Sedima and Haroco*, 21 CAL. W.L. REV. 282 (1985).

63. 747 F.2d 384 (7th Cir. 1984).

64. *Id.* at 392.

65. *Sedima*, 741 F.2d at 484. The agreement called for *Imrex* to supply parts to a Belgian corporation.

66. See *supra* note 40 for text of § 1964(c).

67. See *supra* note 51 and accompanying text.

68. See *supra* notes 50-54 and accompanying text; see also *infra* note 94 and accompanying text.

69. *Sedima*, 105 S. Ct. 3275, 3279 (1985).

70. See *supra* notes 60-61 and accompanying text.

71. *Haroco*, 747 F.2d at 385.

cial borrowers."<sup>72</sup> Haroco, for itself and on behalf of the other borrowers, later sued alleging that the bank had defrauded them "by setting the interest rate for the loans at one percent over the prime rate and then actively concealing [the bank's] actual prime rate, which, presumably, was measurably less than [the bank had] represented it to be to the plaintiffs."<sup>73</sup> Haroco alleged three state law causes of action and two RICO counts under section 1964(c).<sup>74</sup> On the RICO charges, Haroco claimed that the bank had injured the borrowers by charging them excessive interest in a pattern of racketeering activity and had violated the federal mail fraud laws by billing the borrowers for the excessive interest.<sup>75</sup> Haroco sought damages in the amount of three times the excessive interest paid. The district court dismissed the RICO action for failure to state a claim upon which relief could be granted. The court of appeals reversed.<sup>76</sup> Unlike the Second Circuit, the Seventh Circuit found the RICO language not ambiguous, but deliberately broad to reach the racketeering evil sought.<sup>77</sup> Thus, the United States Supreme Court granted certiorari to resolve the *Sedima-Haroco* conflict.

### B. Expansion of Civil RICO's Scope

The expansion of civil RICO's scope received approval of the United States Supreme Court in *Sedima*<sup>78</sup> and *Haroco*.<sup>79</sup> The cases were decided the same day by a sharply divided Court. Both cases involved business fraud between legitimate corporations whose affiliation with, or infiltration by, organized crime elements was nonexistent.

For all practical purposes, the Supreme Court decided the *Sedima-Haroco* dilemma with the *Sedima* opinion. After conducting its own analysis of RICO's history, language, and policy considerations, a five-Justice majority of the Supreme Court held that judicially created "standing" requirements for private actions brought under section 1964(c) of the statute were unwarranted. As such, the Supreme Court reversed the Second Circuit opinions requiring that civil RICO actions proceed only against defendants who had already been criminally convicted.<sup>80</sup> In addition, the Supreme Court criti-

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72. *Id.*

73. *Haroco, Inc. v. American Nat'l. Bank & Trust Co.*, 577 F. Supp. 111, 112 (N.D. Ill. 1983).

74. *See supra* note 40 for text of § 1964(c).

75. The RICO claims were based on violations of § 1962(c) and on predicate acts of mail fraud. *See infra* note 94 and accompanying text.

76. *See supra* note 63 and accompanying text.

77. *Haroco*, 747 F.2d at 390.

78. 105 S. Ct. 3275 (1985).

79. 105 S. Ct. 3291 (1985).

80. *Sedima*, 105 S. Ct. at 3284. The other Second Circuit precedents were *Bankers Trust*

cized other "competitive injury" or "organized crime nexus" standing requirements and dismissed the Second Circuit's racketeering injury requirement.<sup>81</sup> Writing for the majority, Justice White recognized the Second Circuit's concern over the misuse of civil RICO by private plaintiffs,<sup>82</sup> but stated that the Second Circuit was not alone in struggling to define "racketeering enterprise injury," particularly as a standing requirement to limit civil RICO's scope. Therefore, the "difficulty of that task itself caution[ed] against imposing such a requirement."<sup>83</sup> Finally, the opinion invited lower courts to develop a narrower definition for the "pattern"<sup>84</sup> component of racketeering activity to slow the expansion of civil RICO claims.<sup>85</sup>

Justice Powell, dissenting separately<sup>86</sup> and concurring with Justice Marshall's dissent,<sup>87</sup> emphatically disagreed that RICO authorized the types of private civil actions being brought against legitimate and respected businesses in ordinary fraud and breach of contract cases.<sup>88</sup> For Justice Powell, RICO's title and legislative history clearly prevented the statute from applying to "garden variety fraud", breach of contract cases, and "innocent businessmen" whom Congress did not intend to reach with the statute.<sup>89</sup> Furthermore, he warned that the majority's opinion would encourage expansion of ancillary civil RICO claims in federal courts, bypassing the traditional remedies available in state courts for alleged fraud or contract violations.<sup>90</sup>

Justice Marshall, writing for the *Sedima* and *Haroco* dissenters,<sup>91</sup> recognized the practical implications of the majority's opinion stating that civil

Co. v. Rhoades, 741 F.2d 511 (2d Cir. 1984), *vacated mem.*, 105 S. Ct. 3550 (1985); Furman v. Cirrito, 741 F.2d 524 (2d Cir. 1984), *vacated sub nom.* Joel v. Cirrito, 105 S. Ct. 3550 (1985).

81. *Sedima*, 105 S. Ct. at 3284. See also *supra* notes 56-58 and accompanying text.

82. *Sedima*, 105 S. Ct. at 3278.

83. *Id.* at 3284-85 & nn.12-13 (citations omitted).

84. See *id.* at 3285 & n.14 (for the crucial importance ascribed to the word "pattern" within the RICO statute in "pattern of racketeering activity").

85. *Sedima*, 105 S. Ct. at 3285 & n.14 and part II of Justice Powell's dissent at 3289-91. However, the *Sedima* majority failed to recognize that despite any possible attempts to narrow the "pattern" definition, the ease with which two RICO predicate acts are committed will do little to slow the expansion of those RICO claims. See Taylor & Smith, *Pleading and Proving Patterns of Racketeering After Sedima*, Nat'l L.J., Sept. 1, 1986, at 15, col. 2 (discussing the post-*Sedima* developments to the "pattern" definition); see also *infra* notes 91-97 and accompanying text.

86. *Sedima*, 105 S. Ct. at 3288 (Powell, J., dissenting).

87. *Id.* at 3292 (Marshall, J., dissenting in *Sedima* and *Haroco*).

88. *Id.* at 3288 (Powell, J., dissenting)

89. *Id.* See also *supra* note 46 and accompanying text. But see *supra* note 49 and accompanying text.

90. *Sedima*, 105 S. Ct. at 3291.

91. Joining in the dissent were Justices Brennan, Blackmun, and Powell.

RICO's expansion will revolutionize private litigation.<sup>92</sup> The dissent argued that the majority's overly broad reading of the statute had validated the federalization of extensive areas of state common law fraud and displaced established federal and state remedial provisions to deal with that fraud.<sup>93</sup> The dissent strongly criticized the majority because prior to RICO, no federal statute expressly provided a private remedy for violating the federal mail and wire fraud laws.<sup>94</sup> Moreover, in the securities litigation area, Justice Marshall argued that the majority's decision practically eliminated "decades of legislative and judicial development of private civil remedies under the federal securities laws."<sup>95</sup> Despite *Sedima's* invitation for the courts to narrowly define the "pattern" component of racketeering activity, the dissent observed that civil RICO was prone to abuse. For instance, Justice Marshall observed that although commodities fraud is not a predicate act within RICO's reach, private damages provided for under the Commodities Exchange Act<sup>96</sup> could be circumvented in a commodities case by alleging mail or wire fraud.<sup>97</sup>

Whether the Supreme Court correctly interpreted the RICO statute in deciding *Sedima* is open for debate.<sup>98</sup> What is definite, however, is that a

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92. *Sedima*, 105 S. Ct. at 3293; see also Rivois, *supra* note 45, at 621.

93. *Sedima*, 105 S. Ct. at 3293.

94. *Id.* See Note, *supra* note 31, at 1104-05 (warning of RICO's potential breadth by pleading a violation of the federal mail and wire fraud laws). Mail fraud (18 U.S.C. § 1341 (1982)) and wire fraud (18 U.S.C. § 1343 (1982)) provide that any fraudulent scheme in which either a mailing (mail fraud) or an interstate communication (wire fraud) is used shall constitute a violation of the statutes. Since almost every business transaction involves a mailing, a telephone call, or a wire transfer, particularly in the securities exchange industry, the scope of civil RICO is virtually unlimited. See, e.g., *Pereira v. United States*, 347 U.S. 1 (1954) (only knowledge or reasonable foreseeability that the mails or interstate wires would be used in a fraudulent scheme required to violate the statutes); *United States v. Siegel*, 717 F.2d 9 (2d Cir. 1983) (expansively interpreting the statutes); see also *Rakoff, The Federal Mail Fraud Statute* (Part 1), 18 DUQ. L. REV. 771 (1980) (Congress and the Supreme Court have approved the expansive use of the statutes); Note, *A Survey of the Mail Fraud Act*, 8 MEM. ST. U.L. REV. 673 (1978) (commentators and courts have liberally interpreted the mail fraud statute). Thus, in the securities exchange markets, a securities trade by a dishonest broker, followed by a periodic letter or telephone confirmation of the executed trade would sufficiently provide the two predicate acts required for RICO jurisdiction.

95. *Sedima*, 105 S. Ct. at 3295 (Marshall, J., dissenting).

96. Commodities Exchange Act of 1936, ch. 545, 49 Stat. 1491 (1936) (codified as amended at 7 U.S.C. §§ 1-26 (1982)) [hereinafter the Commodities Act]. Congress has made at least six major revisions to the Commodities Act. For a discussion of the history of the Commodities Act see *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982). See *supra* notes 51, 53 for a partial list of predicate acts and racketeering activities prohibited by RICO.

97. *Sedima*, 105 S. Ct. at 3295. See *supra* note 94 and accompanying text.

98. See, e.g., Boucher, *Bill Curbing RICO's Use Advances*, Nat'l L.J., Sept. 1, 1986, at 15, col. 1.

majority of the Supreme Court refused to allow judicially created standing requirements to prevent private parties from obtaining the benefits of the RICO statute. In doing so, the *Sedima* decision expanded civil RICO's scope and revolutionized commercial litigation. Whether *Sedima* will eventually create a second Supreme Court exception to the Arbitration Act is also an open question, particularly after considering the compelling public interest in enforcing the racketeering laws.

## II. THE ARBITRATION ACT, THE *WILKO* EXCEPTION, AND EXPANDING THE SCOPE OF ARBITRABILITY

### A. *Background of the Act and Creation of the Wilko Exception*

Congress enacted the United States Arbitration Act<sup>99</sup> in 1925 to overcome decades of judicial hostility towards arbitration.<sup>100</sup> Congress statutorily, and without exception, recognized arbitration as a valid method of dispute resolution for contracting parties.<sup>101</sup> Within the securities exchange industry it-

99. 9 U.S.C. §§ 1-14 (1982).

100. Judicial hostility towards arbitration has existed for various reasons since at least the 1700's. For instance, erroneously assuming that contracting parties could not resolve their disputes without court intervention, early English and American courts refused to enforce arbitration agreements partly because parties could not, by contract, oust courts of jurisdiction. See Note, *Mixed Arbitrable and Nonarbitrable Claims in Securities Litigation*: Dean Witter Reynolds, Inc. v. Byrd, 34 CATH. U.L. REV. 525, 528-31 & nn.25-31 (1985). Financial reasons were also involved. Since judicial salaries came largely from fees, English judges wished to avoid loss of income. Finally, competitive and monopolistic judicial attitudes may also explain the judicial hostility towards arbitration. See generally F. ELKOURI & E. ELKOURI, HOW ARBITRATION WORKS (4th Ed. 1985); Cohen & Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265 (1926); Jones, *Historical Development of Commercial Arbitration in the United States*, 12 MINN. L. REV. 240 (1928); Lippman, *Arbitration as an Alternative to Judicial Settlement: Some Selected Perspectives*, 24 MAINE L. REV. 215 (1972); Sayre, *Development of Commercial Arbitration Law*, 37 YALE L.J. 595 (1928).

101. 9 U.S.C. § 2 (1982). In relevant part, § 2 of the Arbitration Act mandates without exception that:

A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, . . . or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, *shall be valid, irrevocable, and enforceable*, save upon such grounds as exist at law or in equity for the revocation of any contract.

*Id.* (emphasis added). Furthermore, there should not be much judicial hesitance in enforcing an arbitration agreement. To prevail on a motion to compel arbitration, a contracting party need only show (i) the existence of a written agreement to arbitrate, (ii) that the claims are arbitrable, and (iii) that the right to arbitrate has not been waived. *McMahon v. Shearson/Am. Express, Inc.*, 618 F. Supp. 384, 386 (S.D.N.Y. 1985), *aff'd in part & rev'd in part*, 788 F.2d 94 (2d Cir.), *cert. granted*, 107 S. Ct. 60 (1986). Any doubts as to the arbitrability of a given issue should be settled in favor of arbitration. See *infra* notes 111-17 and accompanying text.

self, arbitration was established in the early 1800's and remains an important part of the industry's self-regulation.<sup>102</sup>

The United States Supreme Court created the first exception to the mandates of the Arbitration Act in *Wilko v. Swan*.<sup>103</sup> In that case, a customer who had signed a predispute arbitration agreement<sup>104</sup> sued partners in a securities brokerage firm for misrepresentations in the sale of securities. While the customer sued to recover damages for violations of section 12(2) of the Securities Act of 1933,<sup>105</sup> the brokerage firm sought to compel arbitration as per the customer's arbitration agreement and section 3 of the Arbitration Act.<sup>106</sup> The conflict addressed by the Supreme Court arose, however, be-

102. See Note, *supra* note 100, at 525 & n.7; see also Note, *Arbitration of Investor-Broker Disputes*, 65 CALIF. L. REV. 120, 122 & nn.12-13 (1977). In fact, stock exchange member firms and brokers are required to arbitrate any existing disputes among themselves. See *id.* at 122; see also *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 414 U.S. 117, 135 (1973) (stock exchange rules requiring arbitration of disputes among member firms and their employees are not subject to Securities & Exchange Commission oversight). For a discussion and background of the industry's "self-regulatory organizations" and securities market regulation see N. WOLFSON, R. PHILLIPS, & T. RUSSO, *REGULATION OF BROKERS, DEALERS AND SECURITIES MARKETS* §§ 12.01-12.22 (1977 & Cumm. Supp. 1985); Moylan, *The Place of Self-Regulation in the Securities Industry*, 6 SEC. REG. L.J. 49 (1978); Wallison, *Self-Regulation of the Municipal Securities Industry*, 6 SEC. REG. L.J. 291 (1978). For a study suggesting possible improvements in the securities industry dispute resolution system see Lipton, *Arbitration in the Securities Industry: Too Much of a Good Thing?*, 1985 MISS. J. DISP. RESOL. 151; see also *infra* notes 226-34, 248-66 (addressing congressional acceptance and support of the securities industry self-regulatory organizations).

103. 346 U.S. 427 (1953).

104. A typical predispute arbitration agreement used in the securities industry, very similar to the one used in *Wilko*, is provided below. See *infra* note 148 and accompanying text. Written in very general terms, the arbitration clause may cover all controversies arising between the customer-investor and the broker-firm. Courts have interpreted arbitration agreements liberally. See Note, *Arbitration of Investor-Broker Disputes*, *supra* note 102, at 125 & nn.29-31.

105. 15 U.S.C. § 77f(2) (1982). Section 12(2) provides in relevant part the following remedies for fraudulent misrepresentations in an initial public offering:

Any person who-

- 2) offers or sells a security (whether or not exempted . . . ), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, . . . not misleading . . . , and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

*Id.*

106. 9 U.S.C. § 3 (1982). Section 3 provides for stay of proceedings where issues are referred to arbitration as follows:



cause of the Securities Act's nonwaiver provision, which provides that any condition, or provision that purports to bind any securities customer to waive compliance with any provision of the Act or of the rules and regulations of the Securities and Exchange Commission, is void.<sup>107</sup> Thus, nearly twenty-five years after Congress enacted the Arbitration Act, the stage was set for the Supreme Court to determine whether agreements to arbitrate future securities disputes were permitted in light of the anti-waiver provision of the Securities Act of 1933. Reasoning that agreements to arbitrate future disputes deprived investors of the advantageous court remedies allowed under the Securities Act,<sup>108</sup> the *Wilko* Court concluded that predispute arbitration agreements were not enforceable under the Securities Act of 1933 because such agreements violated the Act's nonwaiver provision. The Court reasoned that the conflicting provision of the Arbitration Act that mandated enforcement of arbitration agreements had to yield to the established public policy considerations of protecting the investor as required by the Securities Act of 1933.<sup>109</sup>

*B. Expanding the Arbitration Act's Scope and Limiting the Wilko Exception*

After *Wilko*, the Supreme Court consistently resisted creating another ex-

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If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

*Id.*

107. See *infra* notes 169-70 and accompanying text for the nonwaiver provisions under the Securities Act of 1933, and the Securities Exchange Act of 1934, respectively.

108. See *supra* note 105 and accompanying text. However, at least two dissenting justices disagreed with the majority's view. Arbitration did not preclude investor protection, and the courts were not precluded from exercising their prerogative to judicial review of an arbitrator's determination. After all, "[a]rbitrators may not disregard the law." See *Wilko v. Swan*, 346 U.S. 427, 439-40 (1953) (Frankfurter, J., dissenting).

109. It should be noted, however, that the *Wilko* exception involved an investor seeking to recover damages under the express civil liability provisions of section 12(2) of the Securities Act of 1933. Although federal courts subsequently applied the *Wilko* exception to implied causes of action arising under the Securities Exchange Act of 1934, the Supreme Court has yet to decide whether the exception applies to those implied actions in domestic American securities exchange disputes. The nonarbitrability of implied causes of action arising under the Exchange Act has become highly questionable considering recent Supreme Court decisions construing the Arbitration Act and limiting the *Wilko* exception. See *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 224-25 (1985) (White, J., concurring) ("*Wilko's* reasoning cannot be mechanically transplanted to the 1934 Act."); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 513-18 (1974) (international disputes arising under § 10(b) are arbitrable).

ception to the Arbitration Act when interstate commerce was involved.<sup>110</sup> The Supreme Court recognized the Arbitration Act as national substantive law<sup>111</sup> and accepted arbitration as a valid method of settling disputes including issues dealing with fraud.<sup>112</sup> Because the Arbitration Act created national substantive law, constitutionally enacted by Congress under the commerce clause, the Arbitration Act preempted state laws prohibiting arbitration or in any way limiting the strong federal policy in favor of arbitration.<sup>113</sup>

In *Moses H. Cone Memorial Hospital v. Mercury Construction Co.*,<sup>114</sup> the Supreme Court determined that federal courts could decline to exercise jurisdiction of Arbitration Act claims only in exceptional circumstances.<sup>115</sup> The Court determined that the question of whether specific disputes should be arbitrated is to be determined by federal law.<sup>116</sup> Moreover, because the Act created a duty to honor arbitration agreements, the Court concluded that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability."<sup>117</sup>

In *Dean Witter Reynolds, Inc. v. Byrd*,<sup>118</sup> a unanimous Supreme Court held that the Arbitration Act required federal courts to compel arbitration of pendent<sup>119</sup> state arbitrable claims if a motion to compel arbitration under

110. Cf. *Bernhardt v. Polygraph Co.*, 350 U.S. 198 (1956) (upheld state law allowing arbitration agreements to be revoked any time prior to arbitrator's award determination in case involving intrastate employment contract).

111. See, e.g., *Southland Corp. v. Keating*, 465 U.S. 1, 11-13 (1984); *Moses H. Cone Memorial Hosp. v. Mercury Const. Corp.*, 460 U.S. 1, 23-26 (1983); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404-05 (1967).

112. See *Prima Paint Corp.*, 388 U.S. at 400-05.

113. See, e.g., *Southland Corp.*, 465 U.S. at 16-17; *Oppenheimer & Co. v. Young*, 456 So. 2d 1175 (Fla. 1984); *H.E. Garmo v. Dean Witter Reynolds, Inc.*, 101 Wash. 2d 585, 681 P.2d 253 (1984); see generally M. DOMKE, *supra* note 3, § 4.03.

114. 460 U.S. 1 (1983).

115. *Id.* at 13-19.

116. *Id.* at 24.

117. *Id.* at 24-25.

118. 470 U.S. 213 (1985).

119. The concepts of pendent and ancillary jurisdiction are court-developed concepts giving federal courts subject matter jurisdiction. For more complete discussion and background of the jurisdictional concepts, see, e.g., Baker, *Toward a Relaxed View of Federal Ancillary and Pendent Jurisdiction*, 33 U. PITT. L. REV. 759 (1972); Minahan, *Pendent and Ancillary Jurisdiction of United States Federal District Courts*, 10 CREIGHTON L. REV. 279 (1976); Schenkier, *Ensuring Access to Federal Courts: A Revised Rationale for Pendent Jurisdiction*, 75 NW. U.L. REV. 245 (1980); Note, *Federal Pendent Party Jurisdiction and United Mine Workers v. Gibbs—Federal Question and Diversity Cases*, 62 VA. L. REV. 194 (1976); Note, *Federal Civil*

sections 3 and 4 of the Act was made by one of the parties.<sup>120</sup> With *Byrd*, the Supreme Court indicated that it strongly favors arbitration as a method of settling disputes, including state securities violations. Further, the Court eliminated the "intertwining doctrine,"<sup>121</sup> a judicially developed obstacle preventing enforcement of the Arbitration Act mandates. The Court also concluded that the Arbitration Act required compelling arbitration of pendent state law claims even if it resulted in "the possibly inefficient maintenance of separate proceedings in different forums,"<sup>122</sup> and nearly abandoned earlier court suggestions that the Arbitration Act was enacted to avoid the delay and expense of litigation.<sup>123</sup> The *Byrd* Court required bifurcation because of the anomalous effect that the *Wilko* exception has on federal securities laws violations. Essentially, the Court reasoned that arbitrable state securities laws and common law violations could be decided in the arbitration forum, while nonarbitrable federal securities issues would continue to be tried in federal court.<sup>124</sup> In other words, the Supreme Court required that arbitrable state law claims be severed from the nonarbitrable federal securities claims even if state and federal claims arose from a common nucleus of operative fact.<sup>125</sup>

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*Procedure: Limiting Ancillary Jurisdiction*, 31 U. FLA. L. REV. 442 (1979); Comment, *Limiting Federal Ancillary and Pendent Jurisdiction in Diversity Cases*, 64 IOWA L. REV. 930 (1979).

120. 9 U.S.C. § 4 (1982). Section 4 of the Arbitration Act provides, in relevant part, that courts compel arbitration as follows: "A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court . . . for an order directing that such arbitration proceed in the manner provided for in such agreement." *Id.* See *supra* note 106 for text of § 3 of the Arbitration Act providing for stay of proceedings.

121. *Byrd*, 470 U.S. at 216-17. The "intertwining doctrine" may be defined as "a judicially created exception to the application of the Arbitration Act which instructs that when arbitrable and nonarbitrable claims are sufficiently intertwined factually and legally, a court should deny arbitration of the arbitrable claims and try all the claims together in federal court." *Liskey v. Oppenheimer & Co.*, 717 F.2d 314, 317 (6th Cir. 1983) (citations omitted) (emphasis added). At least two reasons were asserted for justifying this judicially created exception. First, courts sought to preserve exclusive jurisdiction over the arbitrable and nonarbitrable securities claims. Second, because arbitrable and nonarbitrable securities claims arose from a common nucleus of operative fact, courts sought to mitigate inefficiency and expense. *Id.* at 317. See generally Comment, *Dean Witter Reynolds, Inc. v. Byrd: The Unraveling of the Intertwining Doctrine*, 62 DEN. U.L. REV. 789 (1985); see also Note, *supra* note 100, at 541-47.

122. *Byrd*, 470 U.S. at 216-17.

123. See, e.g., *Southland Corp. v. Keating*, 465 U.S. 1, 7 (1984); *Wilko v. Swan*, 346 U.S. 427, 431 & n.12 (1953); *Miley v. Oppenheimer & Co.*, 637 F.2d 318, 336 (5th Cir. 1981); *Cunningham v. Dean Witter Reynolds, Inc.*, 550 F. Supp. 578, 585 (E.D. Cal. 1982).

124. See *Byrd*, 470 U.S. at 217; see also *supra* notes 18-21 and accompanying text on bifurcated proceedings.

125. The Supreme Court had first indicated that bifurcated proceedings may be required by the Arbitration Act in *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 20 (1983).

On July 2, 1985, the Supreme Court decided *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*<sup>126</sup> There, the Court concluded that the Arbitration Act required that even ancillary federal claims be arbitrated unless otherwise expressly mandated by Congress.<sup>127</sup> In so doing, the Supreme Court decided that complicated international antitrust disputes are subject to contract arbitration and eliminated another judicially created obstacle preventing the effective enforcement of the Arbitration Act mandates.<sup>128</sup> In 1968, the Second Circuit had decided that complicated federal antitrust disputes were not arbitrable because of the important public policy considerations in enforcing the federal antitrust laws.<sup>129</sup>

This antitrust exception to the Arbitration Act was subsequently followed by other federal courts.<sup>130</sup> By holding that federal statutory rights may be arbitrated unless Congress expressly indicated to the contrary, *Mitsubishi* is one of the most important cases since *Wilko* construing the Arbitration Act. For the lawyers involved in securities arbitration/litigation, *Mitsubishi's* significance lies in its broad language indicating that even implied causes of action arising under section 10(b) of the Exchange Act may be arbitrable.<sup>131</sup> Furthermore, the arbitrability of federal statutory actions may also apply to civil RICO claims.<sup>132</sup> *Mitsubishi* was decided one day after the Supreme Court refused to uphold the standing limitations to civil RICO's scope in *Sedima* and nearly four months after a unanimous *Byrd* Court eliminated the intertwining doctrine. These latest Supreme Court decisions affecting commercial or securities exchange transactions appear to establish that judicially created limitations or exceptions to duly enacted federal statutes will not pass constitutional muster.

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126. 105 S. Ct. 3346 (1985). *Mitsubishi* involved disputes between a Japanese-American automobile manufacturing joint venture and a Puerto Rican car dealership/franchisee. Attempting to resolve disputes between the joint venture and the franchisee, Mitsubishi sought arbitration pursuant to arbitration clauses in the existing distributorship agreements and sales agreements. The franchisee refused to participate in the arbitration proceedings and argued that federal antitrust issues were not arbitrable despite the existence of a valid predispute arbitration agreement. See *Mitsubishi*, 105 S. Ct. at 3349-53 & nn.9-13; see also Fox, *supra* note 8, at 584-85.

127. 105 S. Ct. at 3353-55. See *supra* note 119 and accompanying text for a discussion of ancillary jurisdiction.

128. *Mitsubishi*, 105 S. Ct. at 3357-60. See *supra* note 8 and accompanying text for a discussion of the "antitrust exception" to the Arbitration Act; see also *infra* notes 177-84 and accompanying text.

129. *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821, 826-27 (2d Cir. 1968). See also *supra* note 8.

130. See, e.g., *Applied Digital Technology, Inc. v. Continental Casualty Co.*, 576 F.2d 116, 117 (7th Cir. 1978); *Cobb v. Lewis*, 488 F.2d 41, 47 (5th Cir. 1974).

131. See Fox, *supra* note 8, at 585-87.

132. *Id.* at 585-89.

While federal courts expanded the *Wilko* exception to other securities laws violations, the Supreme Court itself did not question the validity of expanding the *Wilko* exception to implied causes of action arising under the securities laws for nearly twenty years even though *Wilko* was based on an express statutory right to sue accompanied by a nonwaiver provision. Then, in *Scherk v. Alberto-Culver Co.*,<sup>133</sup> the Supreme Court again considered arbitration agreements, nonwaiver provisions, and investor protection.

In *Scherk*,<sup>134</sup> a five-Justice majority of the Court criticized *Wilko*'s "semantic reasoning."<sup>135</sup> Although the Court declined to eliminate the *Wilko* exception, it limited that exception to the Arbitration Act and held that international predispute arbitration agreements would be enforced if violations of section 10(b) of the Securities Exchange Act of 1934 were involved.<sup>136</sup> Unlike *Wilko*, where the parties were investors and brokers, the parties in *Scherk* were corporate entities involved in an international contract dispute.<sup>137</sup> Questioning the continued validity of expanding the *Wilko* exception to violations of section 10(b), the Court, for the first time, observed that there was no statutory counterpart to the express cause of action provided by section 12(2) of the Securities Act in the Exchange Act. Further, the Court observed that neither section 10(b) nor rule 10b-5 provided an express private remedy to redress fraudulent violations of the Exchange Act.<sup>138</sup> In other words, while federal case law had established that an implied civil action existed for violations of section 10(b)<sup>139</sup> and rule 10b-5, the Exchange Act did not expressly contain that right. Whether violations of section 10(b) were subject to contract arbitration in domestic American securities disputes was left an open question.<sup>140</sup> Undoubtedly, an important motivating factor

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133. 417 U.S. 506 (1974).

134. *Id.* The *Scherk* dissenters were Justices Douglas, Brennan, Marshall, and White. *But see infra* notes 143-46 and accompanying text (indicating that Justice White has changed his mind on the nonarbitrability of § 10(b) claims).

135. *Scherk*, 417 U.S. at 513; *see also supra* note 109.

136. *Scherk*, 417 U.S. at 509, 519-20. *See supra* notes 12-13 and accompanying text.

137. *Scherk*, 417 U.S. at 515-19. The five-Justice majority also recognized international business practicalities. As such, voluntary contractual agreements, selecting in advance the forum in which controversies are to be settled, and the law which is to be applied, were indispensable preconditions necessary to the orderliness and predictability of international business transactions. Furthermore, a "parochial refusal by the courts of one Country to enforce an international business agreement" would obviate those commercial realities. *Id.* at 516-17.

138. *Id.* at 513.

139. *See, e.g.*, *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa. 1946) (initially recognizing that an implied cause of action arising under § 10(b) exists).

140. After the *Scherk* decision, federal courts reaffirmed earlier post-*Wilko* precedent and continued to hold that violations of § 10(b) and rule 10b-5 were not arbitrable. *See, e.g.* *De Lancie v. Birr, Wilson & Co.*, 648 F.2d 1255, 1258-59 (9th Cir. 1981); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1030 (6th Cir. 1979); *Merrill Lynch, Pierce, Fenner & Smith*,

in the Supreme Court's expansion of the Arbitration Act's scope has been the Court's attempt to reduce the case load on an overburdened federal court system.<sup>141</sup>

### III. CREATING UNNECESSARY CONFUSION: ARBITRATING CIVIL RICO CLAIMS AND IMPLIED CAUSES OF ACTION ARISING UNDER SECTION 10(B) OF THE SECURITIES EXCHANGE ACT OF 1934

#### A. Dean Witter Reynolds, Inc. v. Byrd: *The Concurring Opinion*

The concerns first expressed in *Scherk* regarding the continued validity of expanding the *Wilko* exception to violations of section 10(b) of the Securities Exchange Act of 1934,<sup>142</sup> were raised again in *Byrd*. Indeed, despite a unanimous Supreme Court decision, *Byrd's* original holdings on bifurcated proceedings and pendent claims will probably be given little emphasis by courts. Instead, the courts will focus on Justice White's concurring opinion<sup>143</sup> because it became the catalyst for the latest circuit split on the arbitrability of section 10(b) claims.

Although joining the Court's opinion, Justice White questioned the continued validity of judicially expanding the *Wilko* exception to implied claims arising under section 10(b) of the Securities Exchange Act of 1934. Noting that such expansion was of "substantial doubt," he delineated the major differences between express causes of action arising under the Securities Act of 1933 and those arising under the Securities Exchange Act of 1934.<sup>144</sup> Most significantly, Justice White observed that the *Wilko* exception applied to express causes of action rather than implied private actions under section 10(b) and rule 10b-5 of the Securities Exchange Act of 1934.<sup>145</sup> As such, Justice White concurred in *Byrd* only to emphasize that the nonarbitrability of 10(b) claims question remained open and that the continued validity of expanding

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Inc. v. Moore, 590 F.2d 823, 827-29 (10th Cir. 1978); Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831, 833-36 (7th Cir. 1977); Sibley v. Tandy Corp., 543 F.2d 540, 542-43 (5th Cir. 1976), cert. denied, 434 U.S. 824 (1977); Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532, 536 (3d Cir.), cert. denied, 429 U.S. 1010 (1976).

141. See generally Brennan, *Some Thoughts on the Supreme Court's Workload*, 66 JUDICATURE 230 (1983); Address by Chief Justice Warren Burger, Annual Meeting of American Law Institute (May 13, 1986), reprinted in 54 U.S.L.W. 2593 (May 27, 1986); Burger, *Annual Report on the State of the Judiciary*, 69 A.B.A. J. 442 (1983); Edwards, *The Rising Workload and Perceived "Bureaucracy" of the Federal Courts: A Causation-Based Approach to the Search for Appropriate Remedies*, 68 IOWA L. REV. 871 (1983); Powell, *Are the Federal Courts Becoming Bureaucracies?*, 68 A.B.A. J. 1370 (1982).

142. See *supra* notes 133-40 and accompanying text.

143. Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 224 (1985) (White, J., concurring).

144. *Id.* at 224-25.

145. *Id.*

the *Wilko* exception was doubtful.<sup>146</sup>

*B. The Recalcitrant Circuits and the Circuit Splits: Will the Supreme Court Allow More Judicially Created Exceptions to the Arbitration Act?*

In *Byrd*, the Supreme Court eliminated judicially created obstacles preventing enforcement of the Arbitration Act. Furthermore, Justice White's concurring opinion in *Byrd* strongly questioned the continued validity of expanding the *Wilko* exception to implied causes of action arising under section 10(b) of the Securities Exchange Act of 1934.<sup>147</sup> In *Sedima*, the Supreme Court eliminated standing obstacles preventing private parties from receiving the benefits of civil RICO remedies or provisions.<sup>148</sup> And in *Mitsubishi*, the Supreme Court not only eliminated another judicially created obstacle preventing enforcement of Arbitration Act mandates, but also indicated that federal antitrust, securities, or other statutory rights may be subject to arbitration if not expressly indicated to the contrary by Congress.<sup>149</sup> The Supreme Court's decisions indicate that judicially created limitations or exceptions to enacted federal statutes are unwarranted and will not be upheld by the Court. However, even after Justice White's concurring opinion in *Byrd*, and the Supreme Court's decision in *Mitsubishi*, two circuit splits have developed in the area of securities arbitrability. These circuit splits would not exist but for two other judicially created exceptions to the Arbitration Act.

Since *Byrd*, the Second,<sup>150</sup> Third,<sup>151</sup> Fifth,<sup>152</sup> Eighth,<sup>153</sup> Ninth,<sup>154</sup> and Eleventh<sup>155</sup> Circuits have reconsidered the arbitrability of section 10(b) claims in the presence of valid predispute arbitration agreements.<sup>156</sup> Except

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146. *Id.* at 225.

147. *See supra* notes 144-46 and accompanying text.

148. *See supra* notes 80-83 and accompanying text.

149. *See supra* notes 126-32 and accompanying text.

150. *McMahon v. Shearson/Am. Express, Inc.*, 788 F.2d 94 (2d Cir.), *cert. granted*, 107 S. Ct. 60 (1986).

151. *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197 (3d Cir. 1986).

152. *Smoky Greenhaw Cotton Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 785 F.2d 1274 (5th Cir.), *vacated in part*, No. 85-1310 (5th Cir. May 13, 1986) (per curiam) (en banc).

153. *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393 (8th Cir. 1986).

154. *Conover v. Dean Witter Reynolds, Inc.*, 794 F.2d 520 (9th Cir. 1986).

155. *Miller v. Drexel Burnham Lambert, Inc.*, 791 F.2d 850 (11th Cir. 1986) (per curiam).

156. A typical predispute arbitration clause in an investor-customer arbitration agreement used in the securities industry states:

It is agreed that *any* controversy between us arising out of your business or this

for the Eighth Circuit, all of these circuits ignored the Supreme Court's endorsement of arbitration as a valid method of dispute resolution, the Supreme Court's expansion of the Arbitration Act's scope, the broad language of *Mitsubishi*, and Justice White's concerns in *Byrd*.<sup>157</sup> In so doing, the circuits reaffirmed their post-*Scherk*, pre-*Byrd* positions that the *Wilko* exception should be extended to implied causes of action under the Exchange Act.<sup>158</sup> The Eighth Circuit created a split within the circuits when it reconsidered the issue and declined to follow the decisions of other circuits by holding that implied causes of actions arising under section 10(b) of the Exchange Act are arbitrable.<sup>159</sup>

Although numerous district courts have considered the related RICO issue after *Sedima* and *Mitsubishi*, only the Second,<sup>160</sup> Third,<sup>161</sup> and Fifth,<sup>162</sup> Circuits have decided, in the same cases deciding the arbitrability of section 10(b) claims, whether ancillary civil RICO claims are arbitrable. Despite the Supreme Court's decision in *Mitsubishi*, which allowed ancillary statutory claims to be arbitrated, the Second and Fifth Circuits concluded that civil RICO claims are not arbitrable.<sup>163</sup> Although the Second and Fifth Circuit decisions were made in the context of securities exchange violations, the

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agreement, shall be submitted to arbitration conducted under the provisions of the Constitution and rules of the Board of Governors of the [respective] Exchange, . . . or pursuant to the Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., as the undersigned may elect. If, the controversy involves any security or commodity transaction or contract related thereto executed on an exchange located outside the United States, then such controversy shall, at the election of the undersigned, be submitted to arbitration conducted under the Constitution of such exchange or under the provisions of the Constitution and Rules of the Board of Governors of the [respective] Exchange, . . . or the Code of Arbitration Procedure of the National Association of Securities Dealers, Inc. . . .

*Phillips*, 795 F.2d at 1394 nn.2-3 (emphasis added); see also *supra* note 104 and accompanying text.

157. With little variation, all the cases decided present the same factual and legal issues. All the plaintiffs were investors-customers with trading accounts in brokerage houses, and all executed the standard arbitration agreement. All the plaintiffs sued their broker-brokerage firm claiming that losses in their investment accounts resulted from violations of the federal securities laws, state statutory and common laws, and various securities industry rules. In the cases in the Second, Third, and Fifth Circuits, the plaintiffs also alleged violations of the RICO statute. See *McMahon*, 788 F.2d at 95-99; *Jacobson*, 797 F.2d at 1199-1203; *Smoky-Greenhaw*, 785 F.2d at 1275-76, 1278-82; *Phillips*, 795 F.2d at 1394; *Conover*, 794 F.2d at 521-23; *Miller*, 791 F.2d at 852-54.

158. See *supra* note 140.

159. *Phillips*, 795 F.2d at 1399-1400. This is the first time since *Wilko* that a circuit split has existed on the issue.

160. *McMahon*, 788 F.2d at 94.

161. *Jacobson*, 797 F.2d at 1197-98.

162. *Smoky Greenhaw*, 785 F.2d at 1274.

163. *McMahon*, 788 F.2d at 98-99; *Smoky Greenhaw*, 785 F.2d at 1280-82.



decisions apply to any civil RICO claims. Meanwhile, a divided panel of the Third Circuit further confused the securities and RICO arbitrability issues. The Third Circuit concluded that civil RICO claims are not arbitrable if intertwined with violations of section 10(b) of the Exchange Act, but are arbitrable if intertwined with violations of the federal mail and wire fraud laws.<sup>164</sup> The Third Circuit dissent agreed that section 10(b) claims are not arbitrable, but argued that all civil RICO claims should be arbitrable.<sup>165</sup> Neither the RICO statute nor its legislative history contain any discussion of the arbitrability issue. The Third Circuit's decision on the arbitrability of civil RICO claims created a split within the circuits on the issue.

### 1. *The Second, Fifth, and Eleventh Circuits*

Although the Fifth Circuit was first to consider the interrelationship<sup>166</sup> between the arbitrability of section 10(b) claims closely intertwined with ancillary civil RICO claims, the Court of Appeals for the Second Circuit is the most influential court to consider these issues.<sup>167</sup> In *McMahon v. Shearson/American Express, Inc.*,<sup>168</sup> the Second Circuit concluded that the nonwaiver provision of section 14 of the Securities Act<sup>169</sup> had an almost identical counterpart in section 29(a) of the Exchange Act.<sup>170</sup> In view of *Wilko*, and the similarity of the nonwaiver provisions of the federal securities laws, the *McMahon* court reaffirmed its post-*Scherk*, pre-*Byrd* position that violations of section 10(b) and rule 10b-5 are not arbitrable.<sup>171</sup>

The Second Circuit recognized that the Supreme Court declined to reach the issue of arbitrating 10(b) claims in *Byrd* and that Justice White's concur-

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164. *Jacobson*, 797 F.2d at 1202-03. See also *supra* note 94 and accompanying text for a discussion on the federal mail and wire fraud laws.

165. See *Jacobson*, 797 F.2d at 1203, 1206 (Adams, J., concurring in part and dissenting in part).

166. The Fifth Circuit initially held that civil RICO claims were not arbitrable. Upon reconsideration, the court remanded the case to the district court after noting that the Supreme Court's decision in *Mitsubishi* may require the enforcement of agreements to arbitrate civil RICO claims. See *Smoky Greenhaw*, 785 F.2d at 1282.

167. The Supreme Court has recognized the Second Circuit's expertise in the securities litigation area. See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting) (referring to the Second Circuit as the "Mother Court" of securities law).

168. 788 F.2d 94, 96 (2d Cir.), cert. granted, 107 S. Ct. 60 (1986).

169. 15 U.S.C. § 77n (1982). Section 14 provides: "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void." *Id.*

170. 15 U.S.C. § 78cc(a) (1982). Section 29(a) provides: "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void." *Id.*

171. *McMahon*, 788 F.2d at 96.

ring opinion cast doubt on the applicability of the *Wilko* exception to implied causes of action under the Exchange Act.<sup>172</sup> However, because the Supreme Court had not specifically overruled Second Circuit precedent, the *McMahon* court held that 10(b) claims are not arbitrable.<sup>173</sup> Yet, the *McMahon* court made its nonarbitrability determination without any analysis of the differences between implied causes of action under the Exchange Act and expressly legislated private rights under the securities laws.<sup>174</sup> Had it done so, the *McMahon* court may have concluded that the express anti-waiver provision of the Exchange Act should not apply to implied causes of action arising under section 10(b) of the Exchange Act. Moreover, the Second Circuit supported its view of nonarbitrability on public policy grounds. The court concluded that the securities laws and the implied causes of action, which the courts have consistently recognized, are designed to protect the public, and particularly the unsophisticated investor.<sup>175</sup> Despite the latter contention, the Second Circuit ignored the fact that the customers in *McMahon* were sophisticated investors, who sued both in their individual capacities and as trustees controlling various pensions and profit sharing plans.<sup>176</sup>

On the RICO issue, the Second Circuit concluded that the important federal policies inherent in the enforcement of RICO by federal courts prevented RICO from being an arbitrable issue.<sup>177</sup> The court observed that enforcement of the Arbitration Act was inappropriate when strong public policy considerations warranted otherwise.<sup>178</sup> The Second Circuit relied on its own precedent in *American Safety Equipment Corp. v. J.P. Maguire & Co.*<sup>179</sup> to support its position that civil RICO claims are not arbitrable.<sup>180</sup>

*American Safety* involved an exception to the Arbitration Act in antitrust

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172. *Id.* at 97-98.

173. *Id.* at 98.

174. *Id.* at 97-98. Each of the federal securities laws enacted between 1933 and 1940 have express liability provisions. See generally III L. LOSS, SECURITIES REGULATION 1683, 1683-1757 (2d ed. 1961); see also 1 A. BROMBERG & L. LOWENFELS, SECURITIES FRAUD & COMMODITIES FRAUD §§ 2.1-2.7 (1985).

175. *McMahon*, 788 F.2d at 98. Although the federal securities laws may have been created to protect the public and the less sophisticated investors, a deregulation of the securities industry and a reexamination of the basic purposes of the securities laws appears warranted at this time. Small and unsophisticated investors still play a significant role in the securities markets, but the major players in those markets presently are the big, resourceful, and sophisticated institutional investors. See generally R. BARBER, THE AMERICAN CORPORATION: ITS POWER, ITS MONEY, ITS POLITICS 54-58 (1970).

176. See *McMahon v. Shearson/Am. Express, Inc.*, 618 F. Supp. 384, 385 (S.D.N.Y. 1985).

177. *McMahon*, 788 F.2d at 98-99.

178. *Id.*

179. 391 F.2d 821 (2d Cir. 1968).

180. *McMahon*, 788 F.2d at 98.

disputes.<sup>181</sup> Analogizing to its previous *American Safety* exception to the Arbitration Act, the *McMahon* court concluded that RICO was designed to promote the national interest in fighting organized crime and racketeering activities and that plaintiffs asserting their rights under the RICO statute are like private attorneys-general protecting the public interest.<sup>182</sup> Based on this analogy, the Second Circuit limited the Supreme Court's *Mitsubishi* decision to its own facts and undermined *Mitsubishi*'s broader holding that ancillary federal claims may be arbitrated.<sup>183</sup> In *Mitsubishi*, the Supreme Court not only strongly criticized the *American Safety* exception to the Arbitration Act, but held that all federal statutory rights may be arbitrable unless expressly indicated to the contrary by Congress.<sup>184</sup>

After the Second and Fifth Circuit decisions, the Court of Appeals for the Eleventh Circuit considered the arbitrability of 10(b) claims in *Miller v. Drexel Burnham Lambert, Inc.*<sup>185</sup> Undoubtedly influenced by the Second Circuit, the Eleventh Circuit followed its own pre-*Byrd* precedent and decided that violations of the federal securities laws are not arbitrable.<sup>186</sup> Neither *Miller*, nor the opinions upon which it relied, analyzed the difference between implied causes of action and expressly legislated private rights under the Securities Act and the Exchange Act. Furthermore, the court did not consider the implications of *Mitsubishi* in making its nonarbitrability decision.

## 2. The Eighth Circuit

Nearly three months after the influential *McMahon* decision, a majority of the Court of Appeals for the Eighth Circuit decided *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,<sup>187</sup> and held that implied causes of action arising under section 10(b) of the Exchange Act are arbitrable.<sup>188</sup> In doing so, the Eighth Circuit declined to follow established federal court precedents<sup>189</sup> and created a split within the circuits on the arbitrability of securities claims. In creating the split, the Eighth Circuit considered the Arbitration Act mandates,<sup>190</sup> post-*Wilko* and post-*Scherk* Supreme Court

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181. See *supra* notes 8, 126-32 and accompanying text.

182. *McMahon*, 788 F.2d at 98 (quoting *American Safety*, 391 F.2d at 826).

183. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346, 3356-59 (1985). See *supra* notes 8, 126-32 and accompanying text.

184. See Fox, *supra* note 8, at 586-88.

185. 791 F.2d 850 (11th Cir. 1986) (per curiam).

186. *Id.* at 854.

187. 795 F.2d 1393 (8th Cir. 1986).

188. *Id.* at 1399.

189. See *supra* note 140 and accompanying text.

190. *Phillips*, 795 F.2d at 1396-98.

decisions expanding the Arbitration Act's scope,<sup>191</sup> and the differences between implied causes of action and express private rights under the federal securities laws.<sup>192</sup>

More importantly, however, the Eighth Circuit declined to limit *Mitsubishi's* holdings and recognized that any doubts as to the arbitrability of any issue, including ancillary federal statutory rights, should be resolved in favor of arbitration.<sup>193</sup> Further, despite the Exchange Act's nonwaiver provision,<sup>194</sup> the Eighth Circuit concluded that the strong federal policy favoring enforcement of arbitration agreements overrode any judicial inclination to extend the *Wilko* exception to implied causes of action under the Exchange Act.<sup>195</sup> No RICO issues were involved in the *Phillips* opinion. Thus, *Phillips* pitted the Eighth Circuit against the Second Circuit's *McMahon* decision on the arbitrability of section 10(b) claims issue.

### 3. The Ninth Circuit

Shortly after the Eighth Circuit created the split within the circuits on the arbitrability of 10(b) claims, the Court of Appeals for the Ninth Circuit decided *Conover v. Dean Witter Reynolds, Inc.*<sup>196</sup> There, the Ninth Circuit either ignored the split created by the Eighth Circuit in *Phillips* or was not aware that a split existed because no mention of the existing circuit split was made in the opinion. In either case, apparently influenced by the Second Circuit's *McMahon* decision,<sup>197</sup> a unanimous Ninth Circuit court reaffirmed its post-*Wilko*, pre-*Byrd* position and held that 10(b) claims are not arbitrable.<sup>198</sup> In making that determination, the *Conover* court summarily dis-

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191. This Supreme Court expansion of the Arbitration Act's scope also constitutes the Court's consistent refusal to create another judicial exception to the Arbitration Act. See, e.g., *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346 (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).

192. *Phillips*, 795 F.2d at 1397-99.

193. *Id.* at 1395; see *Mitsubishi*, 105 S. Ct. at 3353-54.

194. See *supra* notes 169-70 and accompanying text.

195. Indeed, the Eighth Circuit court stated in no uncertain terms that the recent Supreme Court decisions in *Scherk* and *Byrd* "have invited a reexamination of the applicability of *Wilko* to claims arising under section 10(b) of the 1934 Act and Rule 10b-5 . . . . We have made that assessment, and now create a conflict within the circuits. We assume the Supreme Court will eventually decide this question." *Phillips*, 795 F.2d at 1400. The Eighth Circuit prediction has been fulfilled. On October 7, 1986, on the first day of the Supreme Court's 1986 term, the Court granted certiorari to resolve whether section 10(b) violations and their ancillary RICO claims are arbitrable. See *Shearson/Am. Express, Inc. v. McMahon*, 788 F.2d 94 (2d Cir.), *cert. granted*, 107 S. Ct. 60 (1986).

196. 794 F.2d 520 (9th Cir. 1986).

197. *Id.* at 522.

198. *Id.* at 527.

cussed the applicability of *Mitsubishi* to the issue only to reiterate the strong federal policy in favor of arbitration. After limiting *Mitsubishi* to its own facts, the court relied on *Mitsubishi* primarily to establish that in that case, the Supreme Court indicated that not all statutory rights are subject to arbitration.<sup>199</sup>

The *Conover* court then gave two reasons for holding that 10(b) claims are not arbitrable. First, the Ninth Circuit concluded that *Wilko* controlled when deciding whether federal securities laws violations are arbitrable, particularly because of the similarity of the anti-waiver provisions found in the Securities Act of 1933 and the Securities Exchange Act of 1934.<sup>200</sup> Second, the court considered the legislative and judicial history of section 10(b) claims and concluded that implied causes of action arising under section 10(b) have a nonwaivable character that the Securities and Exchange Commission, the courts of appeals, and Congress have all accepted.<sup>201</sup> Therefore, 10(b) claims are not arbitrable in the Ninth Circuit.<sup>202</sup>

Aside from the brief reference to the Second Circuit precedent, all other authorities and commentators relied on by the *Conover* court holding that 10(b) claims are not arbitrable predated *Byrd* and *Mitsubishi*.<sup>203</sup> For additional support of its nonarbitrability holding, the *Conover* court relied on the interrelationship of the federal securities laws and its own precedent in *Fratt v. Robinson*.<sup>204</sup> In *Fratt*, the Ninth Circuit recognized that an implied cause of action arising under section 10(b) existed and was necessary to accomplish the Exchange Act's general purpose of establishing federal control over securities transactions.<sup>205</sup> Further, the court concluded that because the Securities Act and the Exchange Act are part of a comprehensive federal securities regulatory scheme, violations of section 10(b) would be addressed in court.<sup>206</sup>

There are at least three problems with the above argument. First, the issue is not whether an implied cause of action arising under section 10(b) exists. Rather, the issue is whether an implied cause of action should be protected by the express anti-waiver provisions of the securities laws. The Supreme Court's decisions in *Scherk*, *Byrd*, and *Mitsubishi* cast doubt on whether such protection exists. Second, it is true that federal courts have

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199. *Id.* at 522.

200. *Id.* at 523. *See supra* notes 169-70.

201. *Conover*, 794 F.2d at 523-24.

202. *Id.* at 523-25, 527.

203. *See id.* at 523-25.

204. 203 F.2d 627 (9th Cir. 1953).

205. *Id.* at 631-33.

206. *Id.* at 631-32; *Conover*, 794 F.2d at 525.

long recognized the existence of an implied cause of action under section 10(b) of the Securities Exchange Act of 1934.<sup>207</sup> However, by judicially extending the *Wilko* exception to section 10(b) claims, federal courts are, perhaps without recognizing it, overstepping their bounds. First, the courts determined that an implied cause of action exists for section 10(b) claims.<sup>208</sup> Then, the courts determined that the Arbitration Act did not apply to those implied causes of action.<sup>209</sup> The overall effect of those two judicial determinations for section 10(b) claims is to enact two remedies that the legislature never provided for, or, arguably, intended. Third, to assert that implied causes of action may only be addressed in federal court is conclusory: neither the Arbitration Act nor the securities laws provide that implied action disputes be limited to the federal forum.

Next, the *Conover* court concluded that the *Wilko* holding that the non-waiver provision of the Securities Act precluded enforcement of the arbitration agreement relied on three bases. First, the parties were of unequal bargaining power.<sup>210</sup> Second, the Ninth Circuit observed that, because judicial oversight was needed to ensure the effectiveness of the Securities Act provisions, arbitration was not the equivalent of judicial proceedings.<sup>211</sup> Third, because of the special jurisdictional and procedural provisions of the Securities Act,<sup>212</sup> the *Conover* court concluded that investors surrender more by arbitration than similarly situated persons arbitrating normal business transaction claims.<sup>213</sup> Thus, the court reasoned that these considerations of nonarbitrability equally apply to 10(b) claims.<sup>214</sup> There are problems with this argument as well.

First, although unconscionability is one basis for arguing against contracts of adhesion,<sup>215</sup> the argument that an arbitration clause is unconscionable and should not apply to parties of unequal bargaining power carries little weight. Courts regularly enforce arbitration clauses between contracting

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207. See, e.g., *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983); *Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353 (1982); *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946).

208. See *supra* note 207 and accompanying text.

209. See, e.g., *McMahon v. Shearson/Am. Express, Inc.*, 788 F.2d 94 (2d Cir.), cert. granted, 107 S. Ct. 60 (1986); *Conover v. Dean Witter Reynolds, Inc.*, 794 F.2d 520 (9th Cir. 1986); *Miller v. Drexel Burnham Lambert, Inc.*, 791 F.2d 850 (11th Cir. 1986) (per curiam).

210. *Conover*, 794 F.2d at 525.

211. *Id.*

212. See, e.g., *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 728-30 & n.4 (1975), *reh'g denied*, 423 U.S. 884 (1975); see also *infra* notes 218-21 and accompanying text.

213. *Conover*, 794 F.2d at 525. These are the typical judicial arguments to undermine the enforcement of the Arbitration Act. See *Fox, supra* note 8, at 589-90.

214. *Conover*, 794 F.2d at 525.

215. See *Fox, supra* note 8, at 587-89.

parties. Contracts between investors and brokers are no exception.<sup>216</sup> Second, arbitration is generally not viewed as the equivalent of a judicial proceeding. To the contrary, Congress and the Supreme Court recognize that arbitration is a valid alternative for dispute resolution.<sup>217</sup> Third, Justice White's concurrence in *Byrd*<sup>218</sup> specifically distinguished the jurisdictional and procedural provisions of the Securities Act with their counterparts in the Exchange Act. In *Byrd*, Justice White agreed that the nonwaiver provisions are similar in both acts.<sup>219</sup> However, while jurisdictional provisions under the Securities Act allow jurisdiction under federal or state courts, jurisdiction under the Exchange Act is limited to the federal courts.<sup>220</sup> Finally, while section 12(2) of the Securities Act provides an express remedy for its violation, section 10(b) of the Exchange Act does not.<sup>221</sup> These differences among the federal securities laws apparently were not determinative for the *Conover* court. Like the other circuit courts deciding that 10(b) claims are not arbitrable, the Ninth Circuit decided the nonarbitrability issue without thoroughly considering the differences between those implied causes of action and the express private rights provided by the federal securities laws.<sup>222</sup>

The Ninth Circuit observed that the Securities and Exchange Commission accepted the nonarbitrability of 10(b) claims in a 1979 Commission release.<sup>223</sup> The release warned broker-dealers that customers must be informed that despite their predispute arbitration agreement, customers have a right to a judicial forum to pursue violations of the federal securities laws. The *Conover* court ignored the fact that the Commission release predated *Byrd* and *Mitsubishi*.<sup>224</sup> Therefore, because of the court's earlier summary

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216. See, e.g., *Baker v. Paine, Webber, Jackson & Curtis, Inc.* [Current Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,757, at 93,687 (D.N.J. Apr. 10, 1986).

217. See, e.g., *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 105 S. Ct. 3346 (1985); *Moses H. Cone Memorial Hosp. v. Mercury Const. Co.*, 460 U.S. 1 (1983); H.R. REP. NO. 229, 94th Cong., 1st Sess. 111, reprinted in 1975 U.S. CODE CONG. & ADMIN. NEWS 321, 342. See also *supra* notes 3-4 and accompanying text.

218. *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 224 (1985) (White, J., concurring).

219. *Id.*

220. *Id.*

221. *Id.* at 224-25. See also *Scherk*, 417 U.S. at 514-16; cf. *Wilko*, 346 U.S. at 430-43.

222. See *supra* note 109 and accompanying text.

223. Securities Exchange Act Release No. 15,984, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,122, at 81,975 (1979).

224. One Commissioner strongly criticized the Commission's release as follows:

I object to the issuance of the Commission's release because . . . *it improperly casts doubt on the efficacy and fairness of arbitration* . . . . Further, I do not believe that there is sufficient evidence of overreaching of customers by broker-dealers using arbitration clauses in standard customer agreements to justify the issuance of the release. To the contrary, *arbitration is an effective and worthwhile alternative to litigation for*

disposal of *Mitsubishi*, the continued validity of the Commission's release is also questionable.

The Ninth Circuit's strongest argument for holding that section 10(b) claims are not arbitrable is the apparent acceptance by Congress of the idea that the *Wilko* exception could be judicially expanded to implied causes of action under the Exchange Act.<sup>225</sup> This apparent congressional acceptance was first observed by the Third Circuit in *Ayres v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*<sup>226</sup> Referring to the substantial congressional revisions to the federal securities laws in 1975, the *Ayres* court observed that Congress had apparently accepted the view that *Wilko* applied to section 10(b) because that section remained intact after the amendments.<sup>227</sup> Furthermore, the *Conover* court argued that by amending section 28 of the Securities Exchange Act of 1934 to permit arbitration between brokers and exchanges, Congress "expressly" declined to extend the arbitration agreements to include broker-customer disputes.<sup>228</sup> To strengthen its position that Congress' silence indicated its acceptance of the judicial expansion of the *Wilko* exception to implied causes of action, the Ninth Circuit observed that the Supreme Court stated in related contexts "that Congress' decision to leave section 10(b) intact suggests ratification of a judicial remedy under section 10(b)."<sup>229</sup>

As persuasive and strong as the congressional acceptance argument is, it is not conclusive. First, the Ninth Circuit ignored the fact that the Supreme Court strongly questioned the continued validity of judicially expanding the *Wilko* exception<sup>230</sup> to implied causes of action almost one year before the securities amendments became effective. It seems unlikely that Congress would have ignored the concerns raised by a divided Court in *Scherk* about the nonarbitrability of section 10(b) claims.<sup>231</sup> Second, the view that Con-

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*resolving disputes which reduces the costs to both the customer and the broker-dealer.*

In my opinion the use of arbitration clauses in customer agreements does not violate or raise questions under the antifraud provisions of the federal securities laws.

*Id.* at 81,978 (emphasis added).

225. *Conover v. Dean Witter Reynolds, Inc.*, 794 F.2d 520, 523-24 (9th Cir. 1986).

226. 538 F.2d 532, 536-37 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976).

227. *Id.* at 537. *See Conover*, 794 F.2d at 524.

228. *Conover*, 794 F.2d at 524.

229. *Id.* The "related contexts" language refers primarily to the issue of whether an implied cause of action existed under section 10(b) of the Exchange Act. *See, e.g.*, *Herman & MacLean v. Huddleston*, 459 U.S. 375, 384-86 (1983); *Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353, 379, 381-82 (1982). However, the issue is not whether an implied cause of action exists; rather, the issue is whether an implied cause of action is subject to the express prohibitions of the nonwaiver provisions of the federal securities laws.

230. *See Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

231. *See infra notes 256-62* for a discussion of the *Scherk*-Congress connection.



gress' silence subsequently ratified a judicial remedy under section 10(b) as the Supreme Court has indicated is not determinative of the arbitrability issue. The well-established policy that an implied cause of action exists under section 10(b) of the Exchange Act has not been challenged.<sup>232</sup> However, the Supreme Court first questioned the continued validity of expanding the *Wilko* exception to implied causes of action in *Scherk*, shortly before the 1975 securities amendments were passed.<sup>233</sup> In *Scherk*, a majority of the Supreme Court criticized the *Wilko* exception and ruled that implied causes of action arising under section 10(b) of the Exchange Act were arbitrable in an international commercial setting.<sup>234</sup> Again, it seems unlikely that Congress would have ignored the concerns of a sharply divided *Scherk* court and the possibility that investors may have to submit their federal securities disputes to arbitration. If Congress had wanted to provide for express protection of investors in 10(b) actions, it would have done so explicitly. Moreover, by holding that section 10(b) violations are not arbitrable, the *Conover* court ignored the Supreme Court's decision in *Mitsubishi*, and Justice White's concurrence in *Byrd*.<sup>235</sup>

#### 4. *The Third Circuit*

##### a. *Arbitrability of Section 10(b) Claims*

One month after the circuit split created by *Phillips*, the Court of Appeals for the Third Circuit decided *Jacobson v. Merrill Lynch, Pierce, Fenner &*

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232. In *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa. 1946), an implied cause of action under § 10(b) of the Securities Exchange Act of 1934 was initially recognized. It was not until 1983, nine years after *Scherk*, that the Supreme Court recognized the existence of an implied cause of action under § 10(b) of the Exchange Act. See *Herman & MacLean v. Huddleston*, 459 U.S. 375, 384-86 (1983).

233. *Scherk*, 417 U.S. at 513-21.

234. *Id.*

235. Although Justice White was one of the four dissenters in *Scherk*, he has apparently changed his mind on the nonarbitrability of section 10(b) claims. See *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393, 1397 & n.11 (8th Cir. 1986). Justice White formed part of the *Mitsubishi* majority which decided that federal statutory claims in commercial disputes may be subject to arbitration. Chief Justice Burger, and Justices Blackmun, O'Connor, and Rehnquist also joined Justice White to form the *Mitsubishi* majority. Justice Powell did not participate in the consideration of *Mitsubishi*. Justice Powell was, however, part of the *Scherk* majority which allowed the arbitration of § 10(b) claims in an international commercial transaction. As such, Justice Powell may now be ready to allow the arbitration of 10(b) claims in domestic securities exchange transactions. Considering Justice White's change of position regarding the arbitrability of § 10(b) claims, a majority of the Supreme Court is apparently in favor of arbitrating all implied causes of action arising under the Securities Exchange Act of 1934. The majority would probably consist of newly appointed Chief Justice Rehnquist, and Justices Blackmun, O'Connor, Powell, and White. Assuming newly appointed Justice Scalia votes with the conservative block, a six-Justice majority in favor of arbitrating implied causes of action may now be in place on the Court.

*Smith, Inc.*<sup>236</sup> In *Jacobson*, the Third Circuit considered whether implied causes of action under the Exchange Act and their ancillary civil RICO claims are arbitrable.<sup>237</sup> The *Jacobson* opinion is divided into three parts. First, a full panel of the court reaffirmed its post-*Scherk*, pre-*Byrd* position that violations of section 10(b) are not arbitrable.<sup>238</sup> Second, a two-member majority concluded that ancillary civil RICO claims are not arbitrable if intertwined with 10(b) violations,<sup>239</sup> but are arbitrable when intertwined with violations of the federal mail and wire fraud laws.<sup>240</sup> Finally, Judge Adams, concurring and dissenting in part, argued that all RICO actions may be subject to arbitration pursuant to a valid predispute arbitration agreement.<sup>241</sup> The last part of the *Jacobson* majority's holding, that civil RICO claims are arbitrable when the predicate racketeering acts involve violations of the mail and wire fraud laws, created a split within the circuits on the arbitrability of RICO claims. Thus, *Jacobson* pitted the Third Circuit against the Second Circuit's *McMahon* decision on this issue.

To decide that section 10(b) claims are not arbitrable, the *Jacobson* court relied extensively on its own precedent in *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*<sup>242</sup> To date, of all the circuit court opinions deciding the issue, the *Jacobson* majority and concurring opinions together constitute the most persuasive and analytical authorities on the nonarbitrability of section 10(b) claims.

When the *Ayres* court judicially expanded the *Wilko* exception to implied actions under section 10(b) of the Exchange Act, it did so on two grounds. First, the *Ayres* court relied on the similarity of the anti-waiver provisions of section 14 of the Securities Act and its counterpart in section 29(a) of the Exchange Act.<sup>243</sup> In so doing, the *Ayres* court considered the federal securities laws as being part of a comprehensive federal scheme to regulate the securities markets.<sup>244</sup> Therefore, if violations of the Securities Act were not arbitrable as established in *Wilko*, it reasonably followed that violations of the Exchange Act, having a similar nonwaiver provision as the Securities Act, were not arbitrable either.<sup>245</sup> Second, the *Ayres* court relied on Con-

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236. 797 F.2d 1197 (3d Cir. 1986).

237. *Id.* at 1199.

238. *Id.* at 1202.

239. *Id.* at 1203.

240. *Id.*

241. *Id.* at 1203, 1209 (Adams, J., concurring in part and dissenting in part).

242. 538 F.2d 532 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976).

243. *See id.* at 536; *see also supra* notes 169-75.

244. 538 F.2d at 536-37; *see also* *Conovers v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 794 F.2d 520, 525 (9th Cir. 1986).

245. *Ayres*, 538 F.2d at 536-37.

gress' apparent acceptance of the judicial expansion of the *Wilko* exception to implied causes of action under section 10(b) of the Securities Exchange Act of 1934.<sup>246</sup> This apparent congressional acquiescence, first relied on by the *Ayres* court, considered by the Ninth Circuit in *Conover*, and again relied on by the *Jacobson* court, is based on the conference committee statement of the 94th Congress accompanying the substantial amendments to the federal securities laws in 1975.<sup>247</sup>

To analyze the conference committee statement and its apparent acceptance of the judicial expansion of the *Wilko* exception, the *Jacobson* panel, and the concurring opinion, first relied on a *Mitsubishi* tenet which established that in determining the applicability of the Arbitration Act to a federal statutory cause of action, the primary consideration is the intent of Congress.<sup>248</sup> The *Jacobson* concurrence, relying on *Ayres*, observed that Congress amended section 28(b) of the Exchange Act to provide that "disputes between members or participants in self-regulatory organizations, or between municipal securities dealers and brokers, may be arbitrated."<sup>249</sup> The concurrence also noted that "[i]t was the clear understanding of the conferees that this amendment did not change existing law, as articulated in *Wilko v. Swan* . . . concerning the effect of arbitration proceeding provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations."<sup>250</sup> Moreover, according to the concurrence, the *Ayres* court concluded "[t]hat the committee included this statement in amending the 1934 Act . . . suggests [the] belief that *Wilko* applies to [implied] causes of action under that Act."<sup>251</sup>

In addition, although the Third Circuit in *Jacobson* tentatively recognized that *Mitsubishi* controlled when determining the arbitrability of a statutory cause of action, the *Jacobson* court limited *Mitsubishi* to its own international antitrust facts. As a result, according to the Third Circuit, "[t]he issue presented in *Mitsubishi* was entirely different from that presented in *Ayres* [sic] and in *Wilko*. *Ayres* [sic] and *Wilko* did not involve interpreta-

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246. *Id.* See *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197, 1201 (3d Cir. 1986).

247. The amendments became effective on June 4, 1975, nearly twelve months after the Supreme Court's *Scherk* decision, and nearly a year before *Ayres*. See generally Moylan, *supra* note 102; Wallison, *supra* note 102 and accompanying text.

248. *Jacobson*, 797 F.2d at 1202; *id.* at 1205 (Adams, J., concurring in part and dissenting in part). See *Mitsubishi Motors Cor. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346, 3355 (1985).

249. *Jacobson*, 797 F.2d at 1205 (Adams, J., concurring in part and dissenting in part).

250. *Id.* (quoting H.R. REP. NO. 229, 94th Cong., 1st Sess. 111, reprinted in 1975 U.S. CODE CONG. & ADMIN. NEWS 321, 342 (1975)) (emphasis in original).

251. *Jacobson*, 797 F.2d at 1205 (Adams, J., concurring in part and dissenting in part).

tions of arbitration agreements; rather they involved interpretations of federal statutes that prohibit the application of forum-selection clauses.<sup>252</sup> The *Jacobson* court, following the *Ayres* precedent, identified the anti-waiver provision of section 29(a) of the Exchange Act as negating the enforceability of such forum selection clauses.<sup>253</sup> In making the latter conclusion, however, the Third Circuit panel misinterpreted the broad language in *Mitsubishi* that courts must look to the express congressional intent in a statute when determining whether “any category of claims” are arbitrable.<sup>254</sup> Finally, because *Ayres* had not been undermined by subsequent Supreme Court decisions, the *Ayres* precedent controlled in the Third Circuit: implied causes of action arising under section 10(b) of the Exchange Act are not arbitrable.

Although artfully expressed, the *Jacobson* majority and concurring opinions are not convincing. First, the conference committee language relied on by the *Jacobson* panel is taken out of context, is too limited in scope, and does not give enough consideration to the full conference committee statement on arbitration proceedings. In fact,

[t]he Senate bill amended section 28 of the Securities Exchange Act of 1934 with respect to arbitration proceedings between self-regulatory organizations and their participants, members, or persons dealing with members or participants. . . . It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in *Wilko v. Swan*, . . . concerning the effect of arbitration proceeding provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations.<sup>255</sup>

Contrary to the *Jacobson* analysis, the conference committee’s inclusion of this statement when it amended the Exchange Act does not suggest congressional acceptance of the judicial expansion of the *Wilko* exception to implied causes of action under section 10(b).<sup>256</sup> Instead, the conference committee and Congress referred first to the Exchange Act, and then to *Wilko*.<sup>257</sup> In doing so, Congress separated, and apparently recognized, the difference between an implied cause of action under the Exchange Act and expressly leg-

252. *Id.* at 1202. See also *supra* note 126.

253. *Jacobson*, 797 F.2d at 1202. The forum selection clause language of section 29(a) refers to a party’s preference for an arbitration determination as opposed to a judicial settlement of disputes.

254. *Id.* at 1202 (quoting *Mitsubishi*, 105 S. Ct. at 3355). See *supra* notes 126-32 and accompanying text for discussion of *Mitsubishi*.

255. H.R. REP. NO. 229, 94th Cong., 1st Sess. 111, reprinted in 1975 U.S. CODE CONG. & ADMIN. NEWS 321, 342 (emphasis added).

256. *Id.*

257. *Id.*

olated private rights under the Securities Act. The statement by the conference committee amending the securities laws indicates that Congress did not want to expand the *Wilko* exception to implied causes of action under the Exchange Act.<sup>258</sup> Further, by amending the securities laws to provide for arbitration and self-regulatory agencies, Congress reiterated its support for arbitration and recognized the significant role played in the securities industry by the self-regulatory agencies.<sup>259</sup> If Congress had wanted to expand the *Wilko* exception to section 10(b) claims, it would have made such an intention explicit in the language of that provision. Therefore, because section 10(b) claims are implied causes of action, it does not necessarily follow that these claims are protected by the express anti-waiver provision of section 29(a) of the Exchange Act.<sup>260</sup>

Second, Congress could not have ignored the concerns raised by the *Scherk* Court when amending the federal securities laws. The Supreme Court has stated that “[w]e 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 [would] be deducible from text or legislative history.”<sup>261</sup> No such intention of nonarbitrability of 10(b) claims exists, or could exist, based on the implied nature of the 10(b) claims. Moreover, it is even questionable whether Congress intended to provide for a private cause of action at all for violations of section 10(b) of the Exchange Act. Despite making substantial amendments to the federal securities laws in 1975, and having an opportunity to clarify the issues, Congress did not amend section 10(b) to expressly preclude arbitration or provide for a private cause of action.<sup>262</sup>

Third, the *Ayres* court, and subsequently the *Jacobson* court, in holding that 10(b) claims are not arbitrable because of “apparent congressional acquiescence” to judicial expansion of the *Wilko* exception, completely ignored Justice Rehnquist’s concerns in *Blue Chip Stamps v. Manor Drug Stores*<sup>263</sup> regarding the expansion of those claims. In that case, Justice Rehnquist, writing for the majority in a 10(b) “standing” case, thoroughly analyzed implied causes of action under section 10(b) and express private rights provided

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258. *Id.*

259. See generally Moylan, *supra* note 102 and Wallison, *supra* note 102 and accompanying text.

260. See *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 225 (1985) (White, J., concurring).

261. *Mitsubishi*, 105 S. Ct. at 3355.

262. See *supra* notes 225-35 and accompanying text.

263. 421 U.S. 723 (1975). *Blue Chip Stamps* was decided immediately after the federal securities amendments became effective.

by Congress in both the Exchange Act and the Securities Act.<sup>264</sup> Strongly criticizing the vexatiousness of 10(b) claims litigation, he observed that “[w]hen we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn.”<sup>265</sup> While such growth may be consistent with congressional enactments, “it would be disingenuous to suggest that . . . Congress . . . foreordained the present state of the law with respect to [10(b) violations].”<sup>266</sup> That Congress neglected to clarify section 10(b) of the Exchange Act in 1975, despite the above mentioned *Scherk* concerns, militates against holding that 10(b) claims should be protected by the Exchange Act’s nonwaiver provision and not be arbitrable.

*b. Arbitrability of Civil RICO Claims*

On the RICO arbitrability issue, a majority of the *Jacobson* panel argued that civil RICO may be arbitrable in some circumstances, but not in others. Before making that determination, the *Jacobson* majority declined to follow Second Circuit precedent which held that because of the important public policy considerations in enforcing the racketeering laws, RICO claims are not arbitrable per se.<sup>267</sup> Further, the Third Circuit majority criticized the *McMahon* opinion for not giving enough deference to the Supreme Court’s *Mitsubishi* decision.<sup>268</sup> In fact, despite the complexity of most RICO claims, which support the public policy exception to nonarbitrability, the *Jacobson* court decided that complexity alone is not sufficient to prevent arbitration.<sup>269</sup> As a result, the *Jacobson* court concluded that with the Supreme Court’s opinion in *Mitsubishi*, determining the nonarbitrability of statutory claims on judicially recognized public policy grounds instead of as a matter of statutory interpretation is no longer permissible.<sup>270</sup>

To decide the RICO arbitrability issue, the Third Circuit again relied on *Mitsubishi*.<sup>271</sup> However, the *Jacobson* majority observed that the expansive reach of civil RICO’S scope has been achieved largely by the courts, evol-

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264. *Id.* at 735-36.

265. *Id.* at 737.

266. *Id.*

267. *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197, 1202-03 (3d Cir. 1986).

268. *Id.* at 1202.

269. *Id.* at 1202. See *Mitsubishi*, 105 S. Ct. at 3357. The *Mitsubishi* Court specifically stated that “we are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited . . . arbitration as an alternative means of dispute resolution.” *Mitsubishi*, 105 S. Ct. at 3354.

270. *Jacobson*, 797 F.2d at 1202.

271. *Id.*

ing it “‘into something quite different from the original conception of its [congressional] enactors.’”<sup>272</sup> The court ignored the fact that the unambiguous language of RICO itself controlled, without any judicial intervention or impetus. The Third Circuit then recognized that *Mitsubishi* required any exceptions to the enforceability of predispute arbitration agreements pursuant to the Arbitration Act to be found, if at all, in the statutes themselves.<sup>273</sup> With that observation, the Third Circuit, in *Jacobson*, became the first circuit to formally accept and establish that *Mitsubishi* controls in deciding whether a federal statutory claim should be arbitrable. *Jacobson* accepted the Court’s holding in *Mitsubishi* without limiting the *Mitsubishi* decision to its own facts. Moreover, the *Jacobson* court accurately observed that unlike the Securities Act and the Exchange Act, “RICO contains no anti-waiver provision.”<sup>274</sup> Thus, because of the extensive reach of civil RICO, and because neither the RICO language itself nor its legislative history suggest that Congress ever considered the arbitrability of civil RICO claims, it logically follows that, based on *Mitsubishi*, the Third Circuit would hold civil RICO claims to be subject to contract arbitration. But this did not occur.

To decide whether RICO claims are arbitrable, the *Jacobson* majority considered the RICO statute itself and the predicate federal statutes that it cross-references.<sup>275</sup> The Third Circuit majority concluded that since 10(b) claims have been “definitively construed” as precluding arbitration based upon the nonwaiver provision found in the Exchange Act, ancillary civil RICO claims inextricably intertwined with those Exchange Act violations are not arbitrable.<sup>276</sup> However, ancillary civil RICO claims predicated on violations of the federal mail and wire fraud laws are arbitrable.<sup>277</sup> The federal mail and wire fraud laws, like RICO, do not contain any nonwaiver provisions.<sup>278</sup> In other words, presumably any federal statute containing what could be considered an anti-waiver provision would preclude arbitration of civil RICO. If the federal statute contains no anti-waiver provision, civil RICO claims would be arbitrable.

The inconsistent reasoning of the Third Circuit panel deciding the arbi-

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272. *Id.* (quoting *Sedima, S.P.R.L. v. Imrex Co.*, 105 S. Ct. 3275, 3287 (1985)).

273. *Jacobson*, 797 F.2d at 1202; *Mitsubishi*, 105 S. Ct. at 3355.

274. *Jacobson*, 797 F.2d at 1202.

275. *Id.* at 1202-03. In cross-referencing to predicate federal statutes rather than predicate acts, the court unnecessarily limited the civil RICO provisions to federal statutory claims, ignoring the common law claims also provided for under RICO. See 18 U.S.C. § 1961(1) for a list of predicate crimes and statutes that comprise the required “racketeering activities” under RICO; see also *supra* notes 51-53 and accompanying text.

276. *Jacobson*, 797 F.2d at 1203.

277. *Id.* at 1202-03.

278. *Id.* at 1203.

trability of 10(b) violations and their ancillary civil RICO claims apparently escaped the *Jacobson* majority. First, the Third Circuit had limited *Mitsubishi* to its facts when holding that 10(b) claims are not arbitrable.<sup>279</sup> Then, the court criticized the Second Circuit for not giving *Mitsubishi* enough deference and recognized that *Mitsubishi* controlled when determining whether civil RICO should be arbitrable.<sup>280</sup> However, *Jacobson* established that, despite the absence of a nonwaiver provision in the RICO language or its legislative history, the arbitrability of civil RICO claims depended on the arbitrability of the cross-referenced statutes.<sup>281</sup> In doing so, the Third Circuit majority ignored the fact that neither RICO nor *Mitsubishi* required an inter-dependency among the statutes to determine whether arbitrable issues exist. In fact, the opposite is true: each statute or its legislative history is to provide expressly for the arbitrability of its provisions. Moreover, the court's circular reasoning ignored the fact that with regard to statutorily implied causes of action, any statutorily express nonwaiver provisions could not literally or logically apply.<sup>282</sup>

The *Jacobson* dissent recognized the inconsistency of the majority's reasoning on the RICO arbitrability issue.<sup>283</sup> The dissent recognized that *Mitsubishi* indicated that federal statutory claims may be subject to arbitration agreements absent express congressional intent.<sup>284</sup> The dissent further acknowledged that neither RICO, nor its legislative history, barred arbitration of civil RICO claims.<sup>285</sup> Thus, after criticizing the Second Circuit's *McMahon* decision and questioning the continued validity of that circuit's *American Safety* exception, the dissent concluded that all civil RICO claims should be subject to arbitration.<sup>286</sup> The dissent disagreed with the majority's interdependency requirement for determining the arbitrability of civil RICO claims.<sup>287</sup> Moreover, the dissent concluded that "[a] private right of action under RICO is a unique and separate claim to which the Arbitration Act logically applies."<sup>288</sup>

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279. *Id.* at 1201-02.

280. *Id.* at 1202-03.

281. *Id.*

282. *See* *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 225 (1975) (White, J., concurring).

283. *Jacobson*, 797 F.2d at 1203 (Adams, J., concurring in part and dissenting in part). Judge Adams concurred in the nonarbitrability of 10(b) claims. *Id.* at 1206.

284. *Id.* at 1207-09.

285. *Id.* at 1207-08.

286. *Id.* at 1208-10.

287. *Id.* at 1209-10.

288. *Id.* at 1209.



## IV. THE CASE FOR ARBITRABILITY

In *Wilko v. Swan*, two statutes and two conflicting statutory provisions reached the Supreme Court.<sup>289</sup> First, the Arbitration Act mandated without exception that arbitration agreements be enforced like other contracts.<sup>290</sup> Second, the Securities Act of 1933 voided any provision or stipulation binding customers to waive compliance with express provisions of the Act.<sup>291</sup> Considering that the Supreme Court has twice questioned the continued validity of judicially expanding the *Wilko* exception to implied causes of action,<sup>292</sup> there is little doubt that 10(b) claims will be subject to contract arbitration soon.

As to the arbitrability of civil RICO, one must consider that three conflicting statutory provisions have reached the Supreme Court. First, there is the significantly expanded scope of the Arbitration Act requiring that courts enforce arbitration agreements.<sup>293</sup> Second, the anti-waiver provision of the Exchange Act was expanded to preclude arbitration of highly criticized implied causes of action arising under section 10(b).<sup>294</sup> Third, there exists the significantly expanded scope of the RICO statute that has no anti-waiver provision and allows private parties to act as private attorneys-general in enforcing the racketeering laws.<sup>295</sup> However, unlike the Arbitration Act or the Exchange Act, the RICO statute contains an express requirement that it is to be liberally construed to effectuate its provisions.<sup>296</sup> Thus, the issue appears to be whether the "liberally construed" provision of the RICO statute, when intertwined with implied causes of action under section 10(b) of the Exchange Act, sufficiently combine to permit creating a second judicial exception to the Arbitration Act.

The nonarbitrability of civil RICO claims is subject to serious doubt. In *Sedima*, a majority of the Supreme Court recognized that RICO has grown far beyond the original intent of its enactment.<sup>297</sup> Based upon the unambiguous statutory language, however, the Court felt compelled to eliminate judicially created obstacles preventing RICO's enforcement.<sup>298</sup> It can be argued that the reluctant expansion of civil RICO's scope, an overloaded federal court docket, and the vexatious RICO litigation that resulted after

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

290. *Id.* at 429. See *supra* note 101 for relevant text of the Arbitration Act.

291. *Wilko*, 346 U.S. at 430.

292. See *supra* notes 133-40, 143-46 and accompanying text.

293. See *supra* notes 110-41 and accompanying text.

294. See *supra* notes 166-76, 185-86, 196-98 and accompanying text.

295. See *supra* notes 78-98 and accompanying text.

296. See *supra* note 41 and accompanying text.

297. *Sedima, S.P.R.L. v. Imrex Co.*, 105 S. Ct. 3275, 3287 (1985).

298. *Id.*

enactment of the RICO statute and the *Sedima* decision, would suffice to convince a majority of the Supreme Court to arbitrate civil RICO claims.

There are, however, at least four reasons strongly supporting the conclusion that civil RICO claims are not arbitrable. First, RICO's liberal construction clause requires that the RICO statute be broadly interpreted to effectuate its provisions.<sup>299</sup> The concern with allowing civil RICO claims to be settled by arbitration is that arbitrators may not "liberally" construe the RICO statute, thereby undermining the statute's remedial purposes. Second, as in *Wilko*, section 1964(c) of the RICO statute provides an express cause of action to plaintiffs suffering a legally cognizable RICO injury.<sup>300</sup> Third, an important public policy interest exists in enforcing the racketeering laws. To allow arbitration of civil RICO claims may undermine private enforcement of those laws.<sup>301</sup> Finally, because of the complexity of RICO claims, a fear arises that arbitrators may ignore the civil provisions of the RICO statute when making their arbitration determinations.<sup>302</sup>

The concerns supporting the arguments against arbitrability of civil RICO claims do not suffice to create a judicial exception to the clear mandates of the Arbitration Act. First, RICO's liberal construction clause does not expressly indicate that only federal courts are capable of broadly interpreting the RICO statute.<sup>303</sup> As a result, arbitrators may also properly consider the issue. Second, although the *Wilko* plaintiff relied on the express cause of action provided by section 12(2) of the Securities Act to address his concerns, a majority of the Supreme Court decided to create the *Wilko* exception to the Arbitration Act because of the emphasis the Court placed on the nonwaiver provision found in section 14 of the Securities Act of 1933.<sup>304</sup> The RICO statute also provides for an express cause of action for private plaintiffs.<sup>305</sup> Unlike *Wilko*, however, the RICO statute contains no anti-waiver provision.<sup>306</sup> Further, *Mitsubishi* established that all federal statutory rights may be arbitrable absent an express statement to the contrary by Congress.<sup>307</sup> Neither the RICO statute nor its legislative history address the

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299. See *supra* note 41.

300. See *supra* note 40.

301. See *supra* note 98 and accompanying text; see also *McMahon v. Shearson/Am. Express Co.*, 788 F.2d 94, 98-99 (2d Cir. 1986).

302. See *M. DOMKE*, *supra* note 3, §§ 12:00-12:02, at 151-59.

303. See *supra* note 41.

304. See *supra* note 169 and accompanying text.

305. See *supra* note 40.

306. See *Jacobsen v. Merrill Lynch, Pierce, Fenner & Smith*, 797 F.2d 1197, 1207-08 (3d Cir. 1986) (Adams, J., concurring in part and dissenting in part) ("[n]o indication that Congress intended to exempt RICO actions from the provisions of the Arbitration Act").

307. See *supra* notes 126-32 and accompanying text.

arbitrability of its civil provision. Thus, it may be argued that under *Mitsubishi* civil RICO expressly permits arbitration.

Third, the Supreme Court has indicated that judicial limitations or exceptions to duly enacted federal statutes are unwarranted. In *Sedima*, the Supreme Court criticized and eliminated judicially created standing obstacles preventing private plaintiffs from gaining access to the RICO statute.<sup>308</sup> To conclude that civil RICO claims are not arbitrable would create an inconsistent judicial exception to the Arbitration Act. Further, the overall impact of determining that civil RICO claims are not arbitrable would undermine the practical effects of the *Mitsubishi* decision and the other Supreme Court cases favoring arbitration of commercial disputes. Fourth, *Mitsubishi* criticized the *American Safety* exception to the Arbitration Act.<sup>309</sup> In so doing, the Supreme Court impliedly established that neither complexity nor public policy considerations in enforcing the racketeering laws suffice to create a second Supreme Court exception to the Arbitration Act.

The important public interest in battling organized crime will continue to be served if civil RICO claims are arbitrated. First, arbitration will not preclude private plaintiffs from continuing to bring RICO actions against dishonest brokers or businessmen following arbitration proceedings. Second, because arbitrators may not disregard the law,<sup>310</sup> arbitrators may award treble damages and attorneys' fees in appropriate commercial or securities cases involving civil RICO claims. Courts are not precluded from reviewing arbitration awards at the time of enforcement. The Supreme Court recognized that arbitration awards should not be given collateral estoppel or preclusive effect on federal statutory rights.<sup>311</sup> As a result, neither the liberal construction provision of RICO, nor the anti-waiver provision of the Exchange Act justify undermining the established Arbitration Act mandates. Ancillary civil RICO claims should be arbitrable issues.

## V. CONCLUSION

If used properly, arbitration provides a quick and relatively inexpensive

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308. See *supra* notes 56-58, 80-81.

309. *Mitsubishi Motor Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346, 3355-59 (1985).

310. See *Wilko v. Swan*, 346 U.S. 427, 440 (1953) (Frankfurter, J., dissenting); see also *supra* note 108 and accompanying text. But see *M. DOMKE, supra* note 3, § 25:01, at 390-92.

311. See *McDonald v. City of West Branch*, 466 U.S. 284, 287-91 (1984) (federal courts not required to give res judicata or collateral estoppel effect to arbitration awards, particularly when a federal statutory cause of action is involved in a noncommercial dispute). *McDonald* involved arbitration of civil rights issues.

alternative to dispute resolution. Further, considering the overloaded federal court system, the Supreme Court and Congress have accepted arbitration not only as a method of settling disputes, but also as a promising tool for reducing the federal courts' work load. Undoubtedly, one of the motivating factors in requiring the arbitrability of pendent and ancillary claims is the Supreme Court's attempt to relieve the pressure from that congested federal court docket.

Any benefits derived from *Byrd* and *Mitsubishi* in reducing the federal courts' work load by requiring pendent and ancillary claims to be arbitrated may be entirely undermined by *Sedima*; particularly if the Supreme Court decides that civil RICO claims are not arbitrable. In *Sedima*, the Supreme Court felt compelled by the unambiguous RICO language to eliminate judicially created obstacles preventing enforcement of that federal statute. In so doing, the Supreme Court revolutionized commercial litigation and permitted the continued growth of vexatious civil RICO litigation. However, the Supreme Court probably did not intend to undermine the Arbitration Act as well.

With the exception of the Eighth Circuit, the circuits that have decided the nonarbitrability of implied causes of action arising under section 10(b), and those that have decided the nonarbitrability of civil RICO claims, have disregarded the Supreme Court's expansion of the Arbitration Act's scope. Those courts also have given little weight to the practical policy and administrative considerations behind the Supreme Court arbitration decisions. With the Third Circuit decision in *Jacobson*, the securities and RICO arbitrability issues were further confused and complicated.

The Supreme Court is soon to decide these complicated arbitration issues. The Court will probably decide that implied causes of action arising under section 10(b) of the Securities Exchange Act of 1934 should be arbitrable. To make that determination, the Court will consider the following factors. First, when Congress wished to provide a remedy for violations of the federal securities laws it did so expressly. Second, Congress recognizes and supports the role of the self-regulatory organizations in the securities exchange markets. Arbitration would promote that role. Finally, the Court will consider its own expansion of the Arbitration Act in cases such as *Scherk*, *Byrd*, and *Mitsubishi*. And, unless the Supreme Court retracts some of the broad language of *Mitsubishi*, ancillary civil RICO claims may be arbitrable as well.

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