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ENFORCEMENT OF ARBITRATION AGREEMENTS IN SECURITIES FRAUD DISPUTES

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I. INTRODUCTION

There is always a risk of conflict between an investor and his stockbroker. This conflict is particularly real when the investor has suffered a large loss, which he frequently believes to be the result of malfeasance or misfeasance on the part of the broker. Upon hearing the tale of the client-investor, an attorney may recognize a variety of potential claims against the broker and his firm. These claims may include violations of section 12(2) of the Securities Act of 1933;[1] section 10(b) of the Securities Exchange Act of 1934;[2] the Racketeer Influenced Corrupt Organizations Act

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1. 15 U.S.C. § 77l(2) (1982). Section 12(2) provides:

   Any person who—

   . . . .

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

2. 15 U.S.C. § 78j(b) (1982). Section 10(b) provides:

   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 Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

("RICO");[3] and state law blue sky, fraud and breach of contract claims.[4] On first glance the attorney may conclude that these claims should be joined in a single action to be filed in federal court. The claims under federal statutes have a clear jurisdictional base;[5] the state law claims may be swept into federal court under diversity jurisdiction,[6] or if that is unavailable, the state law claims may be brought under pendent jurisdiction.[7] Upon further examination, however, the attorney may discover that when the client-investor opened his account with the broker, he entered into a customer's agreement which provided that in the event of any controversy arising out of the broker-investor relationship, the matter was to be submitted to arbitration.[8]

Pursuant to this provision the Securities and Exchange Commission [SEC] adopted Rule 10b-5 which provides:

> 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.

17 C.F.R. § 240.10b-5 (1985). Under these provisions, courts have implied private rights of action ("Rule 10b-5 claims"). *E.g.*, Herman & MacLean v. Huddleston, 459 U.S. 375, 380 (1983); Superintendent of Ins. of New York v. Bankers Life and Casualty Co., 404 U.S. 6, 13 n.9 (1971). A brief history of the early development of the concept of implied rights is set out in L. Loss, FUNDAMENTALS OF SECURITIES REGULATION 1057-58 (1983).

3. 18 U.S.C. § 1962(c) (1982). Section 1962(c) provides:

> (c) it shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

Any person injured by a violation of this section may sue the person causing the injury in federal court for treble damages and attorney's fees. *Id.* § 1964(c).

4. *See, e.g.*, Uniform Securities Act § 101.

5. Under the Securities Act of 1933, jurisdiction is proper in state or federal court, and if the action is brought in state court it is not removable. 15 U.S.C. § 77v(a) (1982).

Under the Securities Exchange Act of 1934, there is exclusive jurisdiction in the federal district courts. *Id.* § 78aa.

Under RICO there is concurrent jurisdiction in the federal district court. 18 U.S.C. § 1964 (1982).

6. 28 U.S.C. § 1332 (1982).

7. *E.g.*, United Mine Workers v. Gibbs, 383 U.S. 715 (1966).

8. The Federal Arbitration Act, 9 U.S.C. §§ 1-14, 201-208 (1982), does not define the term "arbitration," but one district court defined it as follows:

The existence of such a pre-dispute arbitration clause,[9] notwithstanding its intent to avoid litigation, has led to extensive litigation to resolve whether the client-investor can be required to arbitrate claims that he may have against the broker.[10] The historical reluctance on the part of courts to enforce arbitration agreements[11] was changed by Congress when it adopted the Fed-

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> Arbitration is a creature of contract, a device of the parties rather than the judicial process. If the parties have agreed to submit a dispute for a decision by a third party, they have agreed to arbitration. The arbitrator's decision need not be binding in the same sense that a judicial decision needs to be to satisfy the constitutional requirement of a justiciable case or controversy.

AMF Inc. v. Brunswick Corp., 621 F. Supp. 456, 460 (E.D.N.Y. 1985).

9. The Securities Industry Association has adopted an arbitration clause which reads:

> It is understood that the following agreement to arbitrate does not constitute a waiver of the right to seek a judicial forum where such a waiver would be void under the federal securities law.
>
> The undersigned agrees, and by carrying an account for the undersigned you agree, that except as inconsistent with the foregoing sentence, all controversies which may arise between us concerning any transaction or the construction, performance or breach of this or any other agreement between us, whether entered into prior, on or subsequent to the date hereof, shall be determined by arbitration.

[July-Dec.] Sec. Reg. & L. Rep. (BNA) No. 41, at 1860 (Oct. 18, 1985).

Another example of a customer's arbitration agreement is set out in 5 A. SOMMER, SECURITIES LAW TECHNIQUES—TRANSACTIONS—LITIGATION ch. 118, app. A (1988) [hereinafter SOMMER].

It should be noted that not all customers sign these agreements. Some brokerage houses only require them for margin or option accounts and not for cash customers. SOMMER, *supra*, at § 118.02[4]. The SEC staff has reported to the Commission that a survey it had conducted of industry practices indicated that approximately 39 percent of cash accounts are covered by arbitration clauses, but that 99.5-99.6 percent of margin and option accounts are covered by such clauses. [Jan.-June] Sec. Reg. & L. Rep. (BNA) No. 27, at 1053 (July 8, 1988). Concern that brokerage firms may require the signing of an arbitration agreement as a condition of doing business has led to a bill being introduced in Congress which, among other things, would ban mandatory arbitration agreements. *Id.* at 838, 850, 1053-54 (referring to H.R. 4960, 100th Cong., 2d Sess. (1988)). The SEC has decided to oppose any legislation on this issue until it further studies the issue. *Id.* at 1053.

The Commonwealth of Massachusetts has adopted regulations effective January 1, 1989, that will ban mandatory arbitration between brokers and investors; other states are considering similar bans. [July-Dec.] Sec. Reg. & L. Rep. (BNA) No. 37, at 1436 (Sept. 23, 1988). The Massachusetts regulations were recently struck down by a federal district court. Wall St. J., Dec. 20, 1988, at B8, col. 3.

10. *E.g.*, Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213 (1985); Wilko v. Swan, 346 U.S. 427 (1953); Rush v. Oppenheimer & Co., 779 F.2d 885 (2d Cir. 1985). Of course, while my scenario suggests dealings between brokers and their clients, the same issues could arise in any setting in which there is a contract with a pre-dispute arbitration clause and a legal dispute arising out of the contract. *See, e.g.*, State Establishment for Agric. Product Trading v. Wesermunde, 770 F.2d 987 (11th Cir. 1985) (commercial shipping arbitration).

11. *Byrd*, 470 U.S. at 220 n.6 (citing the House Report on the Federal Arbitration Act, H.R. REP. No. 96, 68th Cong., 1st Sess. 102 (1924)).

eral Arbitration Act[12] ("Arbitration Act") in which it indicated a strong federal policy in favor of arbitration.[13] In some instances, however, courts have refused to enforce these agreements as to statutorily based causes of action when it is determined that Congress has indicated, implicitly or explicitly, that the plaintiff is entitled to a judicial determination of his or her rights.[14] The resolution of the question of the arbitrability of a claim has resulted in a balancing of competing interests to determine when an arbitration agreement should be enforced.[15]

In addressing the issue of the enforcement of arbitration agreements primary questions remain unanswered: first, which securities claims should be subject to pre-dispute arbitration agreements; and second, whether there exists a continuing justification for exempting any of these claims from arbitration. The United States Supreme Court has begun to address these questions in recent years, and it recently clarified its position in *Shearson/American Express, Inc. v. McMahon.*[16]

Initially, this article seeks to explain the context in which these disputes arise, and to suggest the reasons why plaintiffs strongly oppose the arbitration of claims in this area. It then reviews the Arbitration Act, and the rationale for establishing exceptions to the general policy of enforcing arbitration. Next, it considers the appropriateness of the analysis used in deciding whether to send cases to arbitration, and the problems which have arisen as a result of those decisions. Finally, it recommends changes in the arbitration process to resolve these problems and to better allow for the arbitration of securities disputes.

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12. 9 U.S.C. §§ 1-14, 201-208 (1982) (formerly the United States Arbitration Act).

13. H.R. REP. No. 96, 68th Cong. 1st Sess. (1924). ("The purpose of this bill is to make valid and enforceable agreements for arbitration . . . . Arbitration agreements are purely matters of contract and the effect of the bill is simply to make the contracting party live up to his agreement . . . . An arbitration agreement is placed upon the same footing as other contracts, where it belongs.").

14. *E.g., Wilko*, 346 U.S. at 434-38 (recognizing that Congress "has enacted the Securities Act to protect the rights of investors and has forbidden a waiver of any of those rights" and concluding that "the intention of Congress concerning the sale of securities is better carried out by holding invalid such an agreement for arbitration of issues arising under the [Securities] Act"); Allegaert v. Perot, 548 F.2d 432, 436-38 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977).

15. *See, e.g., Wilko*, 346 U.S. at 438; *Perot*, 548 F.2d at 438.

16. 107 S. Ct. 2332 (1987).

II. Opposition to Arbitration

In order to understand the issues raised concerning the arbitrability of securities disputes, it is appropriate to first consider the reasons for conflict between the parties as to whether a claim should be sent to arbitration. On its face it would seem that arbitration is a method of dispute resolution that benefits both parties, since it is a fast and relatively inexpensive means to resolve claims.[17] Plaintiffs, however, frequently oppose arbitration; in plaintiffs' view, the speed and low cost of arbitration is outweighed by the existence of several factors.

First, arbitration is viewed as being incapable of handling complex legal disputes because of the informal nature of the process, and because arbitrators are not as qualified as judges to handle the critical decisions required in a securities case.[18] Second, the absence of a significant discovery system in arbitration places a plaintiff at a disadvantage in attempting to ferret out the detailed information necessary to establish a claim.[19] Third, the informality of the arbitration process makes it difficult for the courts to supervise the propriety of the decision-making process; there is no requirement that a record be kept of the proceedings, or that the arbitrator's decision state the reasons for the decision.[20] Fourth, since the arbitration process is regulated by the securities industry, plaintiffs question the propriety of persons involved with the securities industry deciding cases which effectively operate to regulate that industry.[21] Finally, the arbitration of claims may limit the plaintiff's right to obtain punitive damages under state law.[22] At this stage, it is sufficient to accept these objections

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17. Meyerowitz, *The Arbitration Alternative*, 71 A.B.A. J. 78, 80 (1985).

18. *See, e.g.*, Wilko v. Swan, 346 U.S. 427, 436 (1953).

19. Katsoris, *Arbitration of a Public Securities Dispute*, 53 Fordham L. Rev. 279, 287 n.52 (1984) ("Generally, pre-trial discovery procedures, such as bills of particulars, interrogatories, depositions, and notices to produce documents for inspection . . . 'focus the dispute by bringing to light the pertinent differences before trial.'" (citing Goldstein, *Issue of Pretrial Discovery*, N.Y. Times, Jan. 5, 1979, at D4, col. 1)).

20. *See Wilko*, 346 U.S. at 436.

21. Katsoris, *supra* note 19, at 309-11. *See also* Richards v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 64 Cal. App. 3d 899, 903, 135 Cal. Rptr. 26, 28 (Ct. App. 1976); Krause, *Securities Litigation: The Unsolved Problem of Predispute Arbitration Agreements for Pendent Claims*, 29 De Paul L. Rev. 693, 720 (1980).

22. [July-Dec.] Sec. Reg. & L. Rep. (BNA) No. 48, at 1917 (Dec. 7, 1984) (reporting a colloquy between Justice Brennan and the attorney for the defendant during the oral argument in Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213 (1985), in which it was asserted that plaintiffs seek to avoid arbitration since arbitrators cannot award punitive

to arbitration. With these objections in mind, the development of the law concerning arbitration of securities disputes, and the recent judicial reconsideration of these principles can be examined.

III. THE FEDERAL ARBITRATION ACT

Congress adopted the Arbitration Act in 1925 with the specific purpose of overriding the reluctance of courts to enforce arbitration agreements.[23] Congress recognized that courts had historically viewed the arbitration process with hostility and suspicion. In an effort to reduce the delay and expense parties faced in the litigation process, Congress required the enforcement of arbitration agreements to the same extent as other contracts in matters that related to interstate commerce and admiralty.[24] Courts have enforced the requirements of the Arbitration Act as a matter of substantive law in both federal[25] and state courts.[26] While strong arguments have been made that the statute was only intended as a procedural device to require federal courts to enforce these agreements,[27] judicial interpretations of the statute have gone far

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damages under New York law). While New York law, which often controls state law claims in these cases, prohibits an arbitrator from granting punitive damages, Garrity v. Lyle Stuart, Inc., 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976), it has been argued that, under the Arbitration Act and recent Supreme Court decisions, a federal court enforcing an arbitration award should not apply the New York rule. Hirshman, *The Second Arbitration Trilogy: The Federalization of Arbitration Law*, 71 VA. L. REV. 1305, 1360-63 (1985); *see* Ehrich v. A.G. Edwards & Sons, Inc., 675 F. Supp. 559, 565 (D.S.D. 1987) (upholding an arbitration award of punitive damages and saying that *Garrity* was inapplicable because federal law applied).

The importance of punitive damages is illustrated by a recent case in Sioux Falls, South Dakota, in which a jury entered an award against a broker of $20,000 in compensatory damages and $2.25 million in punitive damages. Wall St. J., May 5, 1987, at 20, col. 2.

23. The House report stated the purpose of the Arbitration Act as follows:

> The need for the law arises from an anachronism of our American law. Some centuries ago, because of the jealousy of the English courts for their own jurisdiction, they refused to enforce specific agreements to arbitrate upon the ground that the courts were thereby ousted from their jurisdiction. This jealousy survived for so lon [sic] a period that the principle became firmly embedded in the English common law and was adopted with it by the American courts.

H.R. REP. No. 96, 68th Cong., 1st Sess. 1-2 (1924).

24. *Id.* at 1. The adoption of this statute ultimately led to a series of problems relating to Congress's power to legislate in this area. An interesting analysis of these problems is set out in Hirshman, *supra* note 22.

25. *E.g.*, Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967); Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402 (2d Cir. 1959).

26. *E.g.*, Southland Corp. v. Keating, 465 U.S. 1 (1984).

27. *Id.* at 25-30 (O'Connor, J., dissenting); Perry v. Thomas, 107 S. Ct. 2520, 2528 (1987) (O'Connor, J., dissenting).

beyond this, leading to the federalization of the law of arbitration.[28]

Given the strong federal policy established under the Arbitration Act, the issue arose as to whether there were any situations in which competing federal interests would restrict the enforcement of arbitration agreements. This issue of balancing competing federal interests presented itself clearly in the case of *Wilko v. Swan*.[29]

A. *The* Wilko *Decision*

In *Wilko*, the Supreme Court was faced with a claim pursuant to section 12(2) of the Securities Act of 1933 ("Securities Act").[30] A brokerage firm customer filed suit, alleging that he had lost money in a stock transaction due to misrepresentations by the firm.[31] The defendants moved for a stay pending arbitration in accordance with the parties' pre-dispute agreement.[32] The district court denied the application of the stay as a deprivation of the plaintiff's right to a judicial remedy under the Securities Act.[33] The court of appeals reversed and the stay was granted.[34]

The Supreme Court was faced with the problem of balancing the Arbitration Act's policy of enforcing arbitration agreements against the grant of a judicial remedy under the Securities Act. It was claimed that Congress specifically sought to protect this judicial remedy by the inclusion of a provision in section 14 of the Securities Act which states: "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or the rules and regu-

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28. Hirshman, *supra* note 22, at 1306-08. Professor Hirshman explains that "the Supreme Court established the Arbitration Act as the governing law in state courts and indicated that issues of arbitrability would be decided as a matter of federal law in accordance with the federal policy favoring arbitration." *Id.* at 1307.

29. 346 U.S. 427 (1953).

30. 15 U.S.C. § 77l(2) (1982). *See supra* note 1.

31. *Wilko*, 346 U.S. at 428-29. The plaintiff claimed that his brokerage firm induced him to purchase shares in a corporation on speculation that it would be bought out at a price above the market price. The plaintiff alleged that he was not told that an insider of the corporation was selling shares of the corporation, and further alleged that he had purchased some or all of the insider's shares. When the merger did not occur the plaintiff sold his shares at a loss.

32. The arbitration clause was included in the margin agreement that had been executed by the parties. *Id.*

33. Wilko v. Swan, 107 F. Supp. 75 (S.D.N.Y. 1952).

34. Wilko v. Swan, 201 F.2d 439 (2d Cir. 1953).

lations of the Commission shall be void."[35] The plaintiff asserted that a pre-dispute agreement that provides for the arbitration of any disputes constitutes a "waiver" of the statutorily granted right to assert a restitution-like claim under section 12(2) of the Securities Act in a federal court.[36] The plaintiff argued that the arbitration provision should therefore be voided, and the case should continue in federal court, which would provide the plaintiff greater protection than would an informal arbitration proceeding.[37]

The Supreme Court concluded that "the right to select a judicial forum is the kind of 'provision' that cannot be waived under section 14 of the Securities Act."[38] The Court reasoned that purchasers of securities were at a substantial informational disadvantage in dealing with issuers and dealers in securities transactions, and that Congress therefore sought to give them some protection by providing them with a wider choice of forums to protect their interests.[39] In addition, the Court viewed arbitration as an inappropriate mechanism for the resolution of disputes involving complex "legal" questions that an arbitrator would be ill-prepared to decide.[40] This was of special concern to the Court because there was very limited judicial review of the arbitrator's decision,[41] and no requirement of a written record or decision.[42] The Court viewed this limited judicial review as inconsistent with the intention of Congress, as expressed in the Securities Act, to provide judicial supervision of the remedy provided to plaintiffs in this area.[43] In light of these concerns, the Court balanced what it perceived to be the conflicting policies of arbitration and investor protection, and concluded that arbitration agreements are invalid

35. 15 U.S.C. § 77n (1982).

36. *Wilko*, 346 U.S. at 432-33.

37. *Id.*

38. *Id.* at 435 ("The security buyer has a wider choice of courts and venue. He thus surrenders one of the advantages the Act gives him and surrenders it at a time when he is less able to judge the weight of the handicap the Securities Act places upon his adversary.").

39. *Id.*

40. *Id.* at 435-37.

41. *Id.* at 436-37 (stating that if the submission to the arbitrator was "unrestricted" the arbitrators' interpretation of the law would not be subject to judicial review under the Arbitration Act).

42. *Id.*

43. *Id.*

as a method to resolve issues arising under the Securities Act.[44]

In coming to its conclusion, the majority showed a substantial concern for the investor protections provided by Congress under the Securities Act, as well as an uneasiness about the use of arbitration in contexts other than the standard commercial transactions which involve the "quality of a commodity or the amount of money due under a contract."[45] This uneasiness was compounded by the Court's determination to narrowly view the role of the judiciary in the submission to arbitration and in the review of the arbitrator's decision under the Arbitration Act. The Court concluded that unless the parties' arbitration agreement provides otherwise, the Arbitration Act prohibits all judicial review of legal interpretations by the arbitrator, absent a "manifest disregard" of the law.[46] This restrictive view of judicial review, while not necessary to its holding,[47] was critical to its decision. The Court regarded judicial supervision as central to Congress's design in the adoption of the Securities Act. The limited nature of judicial supervision, as perceived by the Court in the context of arbitration

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44. *Id.* at 438 ("Recognizing the advantages that prior agreements for arbitration may provide for the solution of commercial controversies, we decide that the intention of Congress concerning the sale of securities is better carried out by holding invalid such an agreement for arbitration of issues arising under the [Securities] Act.").

45. *Id.* at 435 (footnote omitted).

46. *Id.* at 436-37. Specifically, section 10 of the Arbitration Act provides:

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

9 U.S.C. § 10 (1982).

47. Justice Jackson concurred in the majority opinion on the question of whether the Securities Act prohibited a pre-dispute agreement to arbitrate, but he thought it unnecessary to decide whether the Arbitration Act would prevent judicial review of an arbitrator's interpretation of the law. *Wilko*, 346 U.S. at 438-39 (Jackson, J., concurring).

agreements, tipped the balance in favor of non-waiveability.[48]

In his dissent, Justice Frankfurter focused on the question of judicial supervision and review of the arbitrator's decision.[49] He reasoned that an arbitrator is capable of and required to decide cases under section 12(2), and that it is proper for courts to review those decisions to insure compliance with the law.[50] Justice Frankfurter argued that, in order to encourage the speedy and economical resolution of disputes which Congress had intended under the Arbitration Act, the Court should imply the power to require sufficient formality in the proceedings so that a court could review the arbitration decision to insure compliance with the law in the substantive decision.[51] Based on this analysis, he saw no reason why the arbitration agreement should not be enforced, as long as it was freely agreed to by the parties.[52]

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48. *Id.* at 437.

49. *Id.* at 439-40 (Frankfurter, J., dissenting).

50. *Id.*

51. *Id.* Justice Frankfurter stated:

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

Id. at 440. *See infra* note 194 and accompanying text.

52. *Wilko*, 346 U.S. at 440 (Frankfurter, J., dissenting). The question of whether the contract was freely entered into or whether there was fraud involved in entering into the contract would go to arbitration, unless the parties had otherwise agreed. Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 402-04 (1967). The question of whether the clause providing for arbitration was freely given or obtained by fraud, would be resolved by the court. *Id.*; Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Haydu, 637 F.2d 391, 398 (5th Cir. 1981). If the claim of fraud relates both to the arbitration agreement and the entire agreement, it has been argued by at least one district court that the court must resolve the issue of fraud in entering the arbitration agreement. Rush v. Oppenheimer & Co., Inc., 681 F. Supp. 1045, 1048-53 (S.D.N.Y. 1988). *Contra* Schacht v. Beacon Ins. Co., 742 F.2d 386, 389-90 (7th Cir. 1984) (taking the position that a claim of fraud in the inducement should be decided by a court only when it goes solely to the arbitration clause, and not to the entire contract).

The basis for this distinction is section 4 of the Arbitration Act which provides that if a party refuses to arbitrate under an agreement, the other party may sue in the federal district court to compel arbitration. If the court is "satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement." 9 U.S.C. § 4 (1982). Under the statute, the agreement to arbitrate is to be enforced "save on such grounds as exist at law or in equity for the revocation of any con-

It is clear that *Wilko* was premised only in part on the special nature of the rights provided to investors under the Securities Act. Going beyond the special nature of those rights, the majority was strongly influenced by the perceived inability of the arbitration system to provide a consistently effective decision-making process for the resolution of these claims. The Court was concerned that once the matter was turned over to arbitration there was no effective means of judicial control to insure that the arbitrator was properly performing his job in resolving disputes.

Taking heed of the *Wilko* Court's concern about the arbitration system, lower federal courts determined that they would not enforce pre-dispute arbitration agreements in a number of situations.[53] In these cases, the courts focused less on the special elements of the claim created by Congress and the broad jurisdictional choices provided to plaintiffs, and instead looked at whether the arbitration clause would prevent the plaintiff from exercising an important right to a federal forum.[54] In no area of law was this more fully realized than in claims implied under Rule 10b-5.

B. *Rule 10b-5 Claims*

For the next twenty-two years courts took a broad view of *Wilko*, and uniformly decided not to send Rule 10b-5 claims to arbitration.[55] The primary focus of those opinions was the exis-

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tract." 9 U.S.C. § 2 (1982). More than an allegation of impropriety is necessary to raise an issue which a court will review since there is nothing inherently wrong with standardized contracts. Boyd v. Merrill Lynch, Pierce, Fenner & Smith, 611 F. Supp. 218, 220-21 (S.D. Fla. 1985). Moreover, it is clear that any questions concerning the scope of arbitration are to be resolved in favor of arbitrability. Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983); Austin Mun. Sec. v. Nat'l Ass'n of Sec. Dealers, Inc., 757 F.2d 676, 696 (5th Cir. 1985).

53. *E.g.*, Miley v. Oppenheimer & Co., 637 F.2d 318, 334-37 (5th Cir. 1981) (state claims which are intertwined with non-arbitrable federal claims); Allegaert v. Perot, 548 F.2d 432, 436-38 (2d Cir.) *cert. denied*, 432 U.S. 910 (1977) (Rule 10b-5 claim); American Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821, 825-28 (2d Cir. 1968) (antitrust claim); S.A. Mineracao de Trindade Samitri v. Utah Int'l, Inc., 576 F. Supp. 566, 574-76 (S.D.N.Y. 1983) (RICO).

54. Thus, in the antitrust area, the Court of Appeals for the Second Circuit was concerned about the public interest sought to be protected by the Sherman Act, and that Congress must have wanted those "private attorney-general" actions to be decided by a federal court. American Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968).

55. The uniform treatment of Rule 10b-5 claims is best shown by the number of cases prior to the Supreme Court's decision in Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213

tence of section 29(a) of the Securities Exchange Act of 1934 ("Exchange Act")[56] which, in a fashion similar to the language of section 14 of the Securities Act,[57] prohibits the enforcement of any provision which purports to waive compliance with the Act. Largely based on this provision, courts concluded that the *Wilko* analysis should be applied to these cases.[58] No strong attempt was made to evaluate the differences between the two categories of cases;[59] instead, the courts focused on the federal interest in pro-

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(1985), in which the defendants did not request arbitration of Rule 10b-5 claims when requesting arbitration of state law claims. In *Byrd*, itself, the Supreme Court declined to address the question of whether *Wilko* precluded arbitration agreements with regard to these federal claims because the defendant had failed to seek to compel arbitration of the Rule 10b-5 claim in the district court. *Byrd*, 470 U.S. at 215-16 n.1; Dimenstien v. Whiteman, 759 F.2d 1514, 1516 n.2 (11th Cir. 1985). *See supra* note 2.

56. 15 U.S.C. § 78cc (1982) ("Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.").

57. 15 U.S.C. § 77n (1982). *See supra* text accompanying note 35.

58. *E.g.*, Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017 (6th Cir. 1979). The court stated:

> As to the federal claims . . . *Wilko* . . . precludes compelling Mansbach to submit the matter to arbitration. The arbitration agreement is overridden by the anti-waiver provisions of the federal securities laws. While *Wilko* arose under the Securities Act of 1933, its holding and rationale are equally applicable to cases arising under the Securities Exchange Act of 1934.

Id. at 1030; Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore, 590 F.2d 823, 827 (10th Cir. 1979); Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532, 536 (3d Cir. 1976), *cert. denied*, 429 U.S. 1010 (1977).

59. As the Court of Appeals for the Third Circuit stated:

> We need not review here the fundamental and important differences between litigation in a court and arbitration. It is enough to say that the Supreme Court found prospective waivers of the right to judicial trial and review to be inconsistent with Congress' overriding concern for the protection of investors . . . . As Merrill Lynch points out, a "colorable argument" can be made that *Wilko v. Swan* should not apply to arbitration of judicially implied causes of action under the 1934 Act. We are not, however, persuaded that either the differences between the rights granted in the 1933 and 1934 Acts or any consideration of policy warrant such a distinction.

Ayres, 538 F.2d at 536 (footnotes omitted). It is interesting to note that while the courts were always very careful to avoid what was described as the "shrill cry against arbitration," Allegaert v. Perot, 548 F.2d 432, 437 (2d Cir. 1977), *cert. denied*, 432 U.S. 910 (1977), the bottom line of the decisions was that the courts viewed arbitration with a lingering suspicion that it was not capable of handling complex legal questions, and that it would therefore be inappropriate to apply the Arbitration Act as a matter of policy.

In *Ayres*, the court noted that Congress had at least suggested support for the view that *Wilko* applied to Rule 10b-5 claims. *Ayres*, 538 F.2d at 537. This view was based on a reference to the question in the legislative history to Securities Act Amendments of 1975. H.R. Rep. No. 229, 94th Cong., 1st Sess. 111, *reprinted in* 1975 U.S. CODE CONG. & ADMIN. NEWS 321, 342. That legislative history is susceptible to a variety of interpretations, *see*

tecting investors, which is present in all of the securities laws, and concluded that those interests would best be protected by providing a judicial forum.

In opposition to this position, it was suggested that a "colorable argument" could be made that the differences between claims under section 12(2) and Rule 10b-5 were significant enough to justify different results on the issue of arbitration.[60] This reasoning provided the basis for the one remaining argument that Rule 10b-5 claims were arbitrable.[61] Without evaluating the validity of this argument at this point,[62] there are a number of distinctions between section 12(2) claims and Rule 10b-5 claims which could provide a basis for different treatment. First, Rule 10b-5 actions have not been created by Congress as a provision of the Exchange Act, but have been implied by courts from the general prohibition language of the statute.[63] Since Congress did not create the cause of action, it can be argued that it never exempted this action from its general policy in favor of arbitration under the Arbritation Act.[64] Second, because neither the Exchange Act nor the rules thereunder create a right of action by their terms, it can be argued that a court cannot rely on the language of section 29, which voids agreements that waive compliance with the Exchange Act, or rules thereunder.[65] Third, because Rule 10b-5 actions are more

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infra text accompanying notes 111-13, and was specifically addressed by the Supreme Court in Shearson/American Express, Inc. v. McMahon, 107 S. Ct. 2332 (1987). *See infra* note 155.

60. Scherk v. Alberto-Culver Co., 417 U.S. 506, 513 (1974); Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 224 (1985) (White, J., concurring).

61. Shearson/American Express, Inc. v. McMahon, 107 S. Ct. 2332, 2346-47 (1987) (Blackmun, J., concurring in part and dissenting in part).

62. Justice Blackmun suggested in *McMahon* that the majority's failure to address this "colorable argument" relegated it "to its proper place in the graveyard of ideas." *Id.* at 2347 n.2 (Blackmun, J., concurring in part and dissenting in part). See *infra* text accompanying notes 120-43 for an analysis of the distinctions between the claims.

63. *See, e.g.*, Herman & MacLean v. Huddleston, 459 U.S. 375 (1983).

64. *See, e.g., Scherk*, 417 U.S. at 513-14. This dicta in *Scherk* was not followed by the lower courts, which felt bound by the strong federal policies protecting investors. *Scherk* was distinguished on the ground that the case was decided on the principles of international comity. *E.g.*, Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831, 833-35 (7th Cir. 1977); Sibley v. Tandy Corp., 543 F.2d 540, 543 n.3 (5th Cir. 1976).

65. *See, e.g., Byrd*, 470 U.S. at 224-25 (1985) (White, J., concurring). Contra Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore, 590 F.2d 823, 827 (10th Cir. 1978), where the court stated: "Thus through § 29(a), Congress carried the policy contained in § 14 of the 1933 Act into the Securities Exchange Act of 1934. True it is not a word for word replica, but it explicitly includes any *rule or regulation thereunder* which refers to 'any provision of this chapter.' " *Id.*

similar to common law actions in their elements than actions under section 12(2) and therefore more easily dealt with by an arbitrator, it can be argued that courts need not show as much concern for Rule 10b-5 actions as for actions under section 12(2).[66]

During the period following *Wilko*, the Securities and Exchange Commission ("SEC") supported the view in opposition to arbitration of securities claims.[67] In 1983, the SEC took the further step of attempting to regulate broker agreements concerning arbitration by adopting Rule 15c2-2.[68] Rule 15c2-2 declared it a fraudulent act for a broker or dealer to enter into a pre-dispute arbitration agreement with a public customer which purported to apply to disputes arising under the federal securities laws.

In adopting Rule 15c2-2, the SEC pointed out its long support for the concept of arbitration of securities disputes as an alternative to litigation, but not when it was based on an agreement between brokers and their customers to arbitrate future disputes.[69] The SEC took the position that *Wilko* must be read to bar all pre-dispute arbitration agreements for all federal claims arising under statutes that have anti-waiver provisions similar to that in the Securities Act.[70] While the language of Rule 15c2-2 gave the impression that it was a deceptive act to include an arbitration clause in a customer's agreement, the purpose of Rule 15c2-2 was to insure that public customers were not deceived into believing that they had waived their right to a judicial resolution of a federal securities claim, which would be invalid under the *Wilko*

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66. *See, e.g., Byrd*, 470 U.S. at 224-25.

67. Exchange Act Release No. 15,984, [1979] Fed. Sec. L. Rep. (CCH) ¶ 82,122 (July 2, 1979).

68. Rule 15c2-2 provided in pertinent part:

> (a) It shall be a fraudulent, manipulative or deceptive act or practice for a broker or dealer to enter into an agreement with any public customer which purports to bind the customer to the arbitration of future disputes between them arising under the federal securities laws or to have in effect such an agreement, pursuant to which it effects transactions with or for a customer.

17 C.F.R. § 240.15C2-2 (1985). This rule was rescinded after the Supreme Court's decision in Shearson/American Express, Inc. v. McMahon, 107 S. Ct. 2332 (1987). Exchange Act Release No. 25,035, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,163 (Oct. 15, 1987).

69. Exchange Act Release No. 19,813, [1982-1983] Fed. Sec. L. Rep. (CCH) ¶ 83,356 (May 26, 1983) (setting forth the SEC's history of support for arbitration as an economical alternative); Exchange Act Release No. 20,397, [1983-1984] Fed. Sec. L. Rep. (CCH) ¶ 83,452 (Nov. 18, 1983).

70. Exchange Act Release No. 20,397, *supra* note 68, ¶ 83,452 at 86,357 & n.6.

principles.[71]

Thus, in the years after *Wilko*, both the SEC and the courts seemed fairly confident of the view that claims asserted under the federal securities laws, primarily the Securities Act and the Exchange Act, were clear exceptions to the Arbitration Act; therefore, pre-dispute arbitration agreements between the broker and customer were not enforced with regard to these claims.[72]

IV. JUDICIAL RECONSIDERATION

The question of the arbitrability of Rule 10b-5 claims, while seemingly settled by the lower courts, had not been decided by the Supreme Court. In 1985, the question was opened for new consideration by the Supreme Court's decision in *Dean Witter Reynolds, Inc. v. Byrd.*[73] After the lower courts had come to conflicting decisions in reexamining this question, the Court ultimately concluded in *Shearson/American Express, Inc. v. McMahon*,[74] that Rule 10b-5 claims are arbitrable. In order to understand the basis for the *McMahon* decision and to consider whether it provides a satisfactory resolution of the issue, it is necessary to first consider *Byrd*, and the conflicts to which it led.

A. *The* Byrd *Decision*

In *Byrd*, the Supreme Court did not address the issue of arbi-

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71. *Id.* at 86,356-58. In fact, the SEC's Division of Market Regulation subsequently indicated it would not recommend that action be taken under Rule 15c2-2 for a clause drafted by the Securities Industry Association for inclusion in its member's customer agreements which provided in pertinent part: "It is understood that the following agreement to arbitrate does not constitute a waiver of the right to seek a judicial forum where such a waiver would be void under the federal securities laws." [July-Dec.] Sec. Reg. & L. Rep. (BNA) No. 41, at 1860 (Oct. 18, 1985).

72. The SEC showed this confidence that the law on this question was settled when it stated:

> In sum, the judicial decisions involving the applicability of Section 14 of the Act and Section 29 of the Exchange Act to customer arbitration agreements have delineated a set of investor-broker disputes for which arbitration may not be compelled pursuant to the arbitration clause of a customer agreement entered into at the time of opening an account or at any time prior to the dispute.

Exchange Act Release No. 15,984, *supra* note 67, ¶ 82,122, at 81,977; Exchange Act Release No. 20,397, [1983-1984] Fed. Sec. L. Rep. ¶ 83,452. The Supreme Court noted that this language only stated what the SEC thought courts of appeals were deciding in this area and did not show the "independent analysis" that would shed light on the issue. Shearson/American Express, Inc. v. McMahon, 107 S. Ct. 2332, 2341 n.3 (1987).

73. 470 U.S. 213 (1985).

74. 107 S. Ct. 2332 (1987).

trability of a Rule 10b-5 claim, but rather the related problem of determining the treatment of state law claims that are filed with federal securities claims when there is a request for arbitration under a pre-dispute arbitration agreement. Under the Arbitration Act, the state law claims would normally be sent to arbitration since there was no federal concern that would implicate *Wilko*.[75] Some federal courts, however, were concerned about the consequences of such a procedure in the event the state law claim arose out of the same transaction as the federal claim. To send such state law claims to arbitration raised questions of economy, since many of the same issues would be addressed in both forums. In addition, there was concern that an arbitrator's resolution of issues might estop the federal court from considering those issues, thus depriving the plaintiff of his or her right to a federal forum. As a result, a number of courts concluded that the claims were so "intertwined" that the state claims should also be retained in federal court and not submitted to arbitration.[76]

In *Byrd*, a federal claim was asserted under Rule 10b-5, and the defendant asked the district court to submit the state law claims to arbitration. The defendant assumed that the arbitration clause could not be used to force the Rule 10b-5 claim into arbitration, and therefore did not request arbitration of the federal claim.[77] As a result, the Supreme Court refused to consider whether a Rule 10b-5 claim would be subject to arbitration.[78] The Court did hold, however, that if state and federal claims are brought in a single complaint when a pre-dispute arbitration agreement exists, the state law claims must be sent to arbitration even if it creates bifurcated proceedings.[79] The closest the majority came to ad-

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75. It is clear today that the Arbitration Act applies to state law claims if they involve transactions involving commerce or maritime matters. 9 U.S.C. §§ 1, 2 & 3 (1982); Prima Paint Corp. v. Flood & Conklin, 388 U.S. 395, 400-01 (1967); Bernhardt v. Polygraphic Company of America, Inc., 350 U.S. 198, 201-02 (1956). This is so, even if the claims are asserted in state court. Southland Corp. v. Keating, 465 U.S. 1, 11-17 (1984); Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 25 n.32 (1983) (dicta). The Arbitration Act, however, apparently does not create federal question jurisdiction. *Moses H. Cone Memorial Hospital*, 460 U.S. at 25 n.32 (dicta); Hirshman, *supra* note 22, at 1341.

76. The Fifth, Ninth and Eleventh Circuits adopted this position while the Sixth, Seventh and Eighth Circuits rejected the intertwining doctrine. *Byrd*, 470 U.S. at 270 & nn.3, 4 (citing cases).

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

78. *Id.* at 215-16 n.1.

79. The Court concluded that the delay inherent in a bifurcated proceeding was not a

dressing the issue of the arbitrability of the Rule 10b-5 claims was a footnote which traced the history of the non-arbitrability principle.[80] In that discussion, the Court referred to its decision in *Scherk v. Alberto Culver Co.*[81] which had questioned the applicability of *Wilko* to Rule 10b-5 claims.[82]

In a concurring opinion, Justice White pointed out that there was substantial doubt as to whether *Wilko* would apply to claims under the Exchange Act.[83] In his view, the three interconnecting factors which led to the *Wilko* decision—the waiver language of section 14 of the Securities Act; the differences between the elements of a section 12(2) claim and a common law claim; and the expanded jurisdictional provisions of the Securities Act—were not present in a Rule 10b-5 claim. In support of this view, Justice White also cited *Scherk*.[84] While agreeing that the question was not before the Court, Justice White asked lower courts to reconsider the question.

The *Byrd* decision, especially Justice White's concurring opinion, precipitated a reconsideration of the coverage of *Wilko*.[85] This reconsideration was also suggested by the Court's decision in *Scherk* and in *Mitsubishi Motors Corp. v. Soler Chrysler-Plym-*

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strong enough federal interest, absent "a countervailing policy manifested in another federal statute," to overcome the strong congressional interest, evidenced in the Arbitration Act, to enforce private agreements to arbitrate. *Id.* at 221. This analysis by the Court is analogous to the approach that it has taken with respect to pendent and ancillary jurisdiction, where the Court has refused to allow lower federal courts to assert jurisdiction over a "common nucleus of operative facts" for reasons of judicial economy where Congress has negated the assertion of jurisdiction. Owen Equipment & Erection Co. v. Kroger, 437 U.S. 365 (1978); Aldinger v. Howard, 427 U.S. 1, 14-18 (1976). Similarly, the Arbitration Act effectively negates any attempt by the federal courts to assert control over the state law claims on grounds of economy.

The Court in *Byrd* also rejected the argument that the state law claims should be retained to avoid a situation in which the federal court might be collaterally estopped from reconsidering an issue previously decided in arbitration. The Court suggested, without deciding, that preclusion might not be appropriate, and that the courts should fashion rules to protect federal interests. *Byrd*, 470 U.S. at 221-23 (citing McDonald v. City of West Branch, 466 U.S. 284, 287-88 (1984)); *see infra* note 174.

80. *Byrd*, 470 U.S. at 215-16 n.1.

81. 417 U.S. 506 (1974); *see infra* note 87.

82. *Scherk*, 417 U.S. at 513-14.

83. *Byrd*, 470 U.S. at 224-25 (White, J., concurring). A criticism of Justice White's reasoning is set out in Comment, *Arbitrability of Claims Arising Under the Securities Exchange Act of 1934*, 1986 DUKE L.J. 548, 565-71.

84. *Byrd*, 470 U.S. at 225.

85. *McMahon*, 107 S. Ct. at 2348-49 (Blackmun, J., concurring in part and dissenting in part).

outh, Inc.[86] In both of these cases the Supreme Court sent claims asserted under federal law to arbitration pursuant to pre-dispute agreements. Each case involved an international transaction: the *Scherk* claim was asserted under Rule 10b-5, and the *Mitsubishi Motors* claim involved allegations of antitrust violations under the Sherman Act.[87] In each case, the plaintiff argued that, under the reasoning of *Wilko*, the claim should not be consigned to the arbitration process. The Supreme Court held in both cases that the claims should be sent to arbitration because an international transaction was involved, and because principles of comity required enforcement of international arbitration provisions.[88] The Court questioned, however, whether the claims asserted would have been non-arbitrable if they had been domestic claims.

In *Scherk*, the Court first made its "colorable argument" that *Wilko* did not apply to Rule 10b-5 claims. The Court reasoned that because Congress did not provide an express private remedy

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86. 473 U.S. 614 (1985).

87. In *Scherk*, the plaintiff, an American corporation, purchased certain foreign businesses from a German citizen. The contract contained a provision providing for the arbitration of disputes. When the plaintiff discovered that the trademark rights purchased under the contract had encumbrances which affected their value, it brought suit to rescind the contract claiming fraudulent misrepresentations in violation of Rule 10b-5. The district court rejected a motion for a stay pending arbitration and enjoined the defendant from proceeding with the arbitration. The Court of Appeals for the Seventh Circuit affirmed. Both lower courts relied on *Wilko* in deciding the case, Scherk v. Alberto Culver Co., 417 U.S. 506, 508-10 (1974).

In *Mitsubishi Motors*, a Puerto Rico corporation entered into a distribution agreement to sell vehicles built by Mitsubishi, a Japanese manufacturer of automobiles. As part of this arrangement, the parties entered into a sales agreement which included an arbitration clause. When problems arose concerning the distribution of vehicles, Mitsubishi filed suit in the Federal District Court for the District of Puerto Rico seeking an order to compel arbitration pursuant to 9 U.S.C. § 4 (1982). Jurisdiction in the case was based on 9 U.S.C. § 201 (1982), which authorizes district courts to enforce arbitration agreements under "The Convention on the Recognition and Enforcement of Foreign Arbitration Awards of June 10, 1958." The defendant counterclaimed based upon various grounds, including a Sherman Act claim. The district court refused to send several of the claims, including the antitrust claim, to arbitration. The Court of Appeals for the First Circuit reversed and ordered the antitrust claim to arbitration on the grounds that it involved an international transaction. *Mitsubishi Motors*, 473 U.S. at 616-24.

88. *Scherk*, 417 U.S. at 515-20; *Mitsubishi Motors*, 473 U.S. at 629. In *Mitsubishi Motors* the Court stated:

> As in *Scherk v. Alberto-Culver Co.*, we conclude that concerns of international comity, respect for the capacity of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes require that we enforce the parties' agreement, even assuming that a contrary result would be forthcoming in a domestic context.

Id. (citations omitted).

as it did under section 12(2) of the Securities Act, Rule 10b-5 claims did not evince a congressional concern by the establishment of a "special right" which required a judicial forum.[89] Moreover, the Court noted that while there were anti-waiver provisions in both statutes, the Exchange Act lacked the type of provisions that the court in *Wilko* was concerned with.[90]

In *Mitsubishi Motors*, the Court sought to clarify its position in response to the argument that, under the Arbitration Act, the Court should not construe arbitration agreements to cover any federal statutory claim unless the agreement specifically refers to that claim.[91] The Court rejected this presumption against arbitration and indicated that each statute had to be examined to determine whether its text or legislative history evinced a congressional intent to preclude waiver of a judicial remedy.[92]

In balancing the various arguments in opposition to the arbitra-

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89. *Scherk*, 417 U.S. at 513-14; *see supra* text accompanying notes 60-66.

90. *Scherk*, 417 U.S. at 514. Specifically, the Court stated:

> Furthermore, while both the Securities Act of 1933 and the Securities Exchange Act of 1934 contain sections barring waiver of compliance with any "provision" of the respective Acts, certain of the "provisions" of the 1933 Act that the Court held could not be waived by Wilko's agreement to arbitrate find no counterpart in the 1934 Act. In particular, the Court in *Wilko* noted that the jurisdictional provision of the 1933 Act . . . allowed a plaintiff to bring suit "in any court of competent jurisdiction—federal or state—and removal from a state court is prohibited." . . . The analogous provision of the 1934 Act, by contrast, provides for suit only in the federal district courts that have "exclusive jurisdiction," . . . thus significantly restricting the plaintiff's choice of forum.

Id. (citations and footnotes omitted).

91. *Mitsubishi Motors*, 473 U.S. at 624-25. While the basis for this argument is not clear, it is arguable that the existence of a statutory claim showed Congress's intent to reserve the matter to the courts, and therefore only an express waiver should be enforced. Moreover, the dissent argued that "[n]othing in the text of the [Arbitration] Act, nor its legislative history, suggests that Congress intended to authorize the arbitration of any statutory claims." *Id.* at 646 (Stevens, J., dissenting) (citing Justice Black's dissent in Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 418 (1967) and Cohen & Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265, 281 (1926)).

92. *Id.* at 625-28. The Court concluded that, in light of the federal policy favoring arbitration, issues concerning the scope of the agreement should be resolved in favor of arbitration. Once it is decided that the agreement requires arbitration, it is appropriate to examine the statute which creates the claim to determine if Congress has taken a negative position toward arbitration of the claim. As the Court stated:

> Just as it is the congressional policy manifested in the Federal Arbitration Act that requires courts liberally to construe the scope of arbitration agreements covered by that Act, it is the congressional intention expressed in some other statute on which the courts must rely to identify any category of claims as to which agreements to arbitrate will be held unenforceable.

Id. at 627.

tion of antitrust cases[93] against the "strong belief in the efficacy of arbitral procedures for the resolution of international commercial disputes,"[94] the Court in *Mitsubishi Motors*, reviewed the concerns which led the federal courts of appeals which had addressed the issue to unanimously reject arbitration in antitrust cases.[95] In the course of its decision, the Court showed strong support for the arbitration process. In addressing the argument that antitrust cases were too complex for the arbitral process, the Court pointed out that, with the proper selection of arbitrators based on the nature of the claim and the effective use of experts, arbitration is capable of effectively handling antitrust claims, while at the same time limiting the costs and time involved in the process.[96] Moreover, the Court was unwilling to accept the proposition that arbitrators would be inherently hostile to business restraints since it assumed that the process of selection would protect against such a bias.[97] Finally, the Court reasoned that the availability of court review of the arbitration decision at the time of enforcement would insure that the arbitration process furthered the public interest in the enforcement of the antitrust laws.[98]

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93. The Court summarized the arguments against arbitration as follows:

> First, private parties play a pivotal role in aiding governmental enforcement of the antitrust laws by means of the private action for treble damages. Second, "the strong possibility that contracts which generate antitrust disputes may be contracts of adhesion militates against automatic forum determination by contract." Third, antitrust issues, prone to complication, require sophisticated legal and economic analysis, and thus are "ill-adapted to strengths of the arbitral process, i.e., expedition, minimal requirements of written rationale, simplicity, resort to basic concepts of common sense and simple equity." Finally, just as "issues of war and peace are too important to be vested in the generals, . . . decisions as to antitrust regulation of business are too important to be lodged in arbitrators chosen from the business community—particularly those from a foreign community that has had no experience with or exposure to our law and values."

Id. at 632 (quoting the opinion below, 723 F.2d 155, 162 (1st Cir. 1983) as having "distilled" the doctrines against arbitration of antitrust regulations from American Safety Equipment Corp. v. J.P. Maguire & Co., 391 F.2d 821, 826-27 (2d Cir. 1968)).

94. *Mitsubishi Motors*, 473 U.S. at 631.

95. *Id.* at 628-40. The view that antitrust claims were non-arbitrable had been accepted by the First, Second, Fifth, Seventh, Eighth and Ninth Circuits. *Id.* at 655-57 (Stevens, J., dissenting) (citing cases).

96. *Id.* at 633-34.

97. *Id.* at 634.

98. *Id.* at 636-38. While this conclusion was based on the enforcement provisions of "The Convention on the Recognition and Enforcement of Foreign Arbitral Awards of June 10, 1958," *id.* at 638 (citing art. V(2)(b), 21 U.S.T. 2517, 2520), the general tenor of the

The decision in *Scherk*, standing alone, did not have much impact on the lower federal courts' denial of arbitration of federal statutory claims, particularly in the Rule 10b-5 area.[99] The addition, however, of the decisions in *Mitsubishi Motors* and *Byrd*—especially *Byrd*, with its concurring opinion by Justice White—caused many lower federal courts to reevaluate earlier decisions on this question.[100] The lower courts split on the issue; some relied on *Wilko* to limit the use of arbitration, while others supported the use of the arbitration process as a means of dealing with these claims. In order to appreciate the differences between these two approaches, it is appropriate to examine some of the judicial responses to these Supreme Court decisions.

B. *Conflicting Circuit Views*

The courts of appeals that considered the question after *Byrd* divided on the question of the arbitrability of Rule 10b-5 claims. In some cases, the courts felt bound by earlier circuit decisions[101] concluding that since the question had not been specifically addressed by the Supreme Court in the period since *Wilko*, they would not find that these claims were arbitrable.[102]

Court's analysis suggested a greater willingness to inquire into an arbitration decision than shown in *Wilko*. *See supra* text accompanying notes 39-44; *see infra* note 194.

99. For example, in Allegaert v. Perot, 548 F.2d 432, 437-38 (2d Cir.) *cert. denied*, 432 U.S. 910 (1977), the Court of Appeals for the Second Circuit concluded that "significant policies reflected in the securities laws and the Bankruptcy Act" required that a motion to compel arbitration be denied, despite the fact that *Scherk* had been decided and that the defendants cited to it. *Id.*

100. At the time that Shearson/American Express Inc. petitioned for *certiorari*, it stated that 118 cases on this point had been decided since *Byrd*, with 76 decisions to send claims to arbitration and 42 cases refusing to do so. Petition for Certiorari at n.1 and Appendix E, Shearson/American Express, Inc. v. McMahon, 107 S. Ct. 2332 (1987).

101. *See, e.g.*, Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, 797 F.2d 1197, 1201 (3d Cir. 1986); King v. Drexel Burnham Lambert, Inc., 796 F.2d 59, 60 (5th Cir. 1986).

102. In *Jacobson*, the Court of Appeals for the Third Circuit pointed out that an earlier decision rejected *Scherk* as limiting *Wilko*, and concluded that the existence of similar anti-waiver provisions in the Securities Act and Exchange Act warranted treating them the same. *Jacobson*, 797 F.2d at 1201 (citing Ayres v. Merrill Lynch, Pierce, Fenner & Smith, 538 F.2d 532, 536-37 (3d Cir. 1976)). The court stated that the majority in *Byrd* had expressly declined to consider the question of the applicability of *Wilko* in this area. *Id.* at 1201. Finally, the court concluded that the only concern in *Mitsubishi Motors* was the interpretation of an arbitration agreement, and therefore *Mitsubishi Motors* did not provide contrary precedent. *Id.* at 1201-02. Parenthetically, it should be noted that the court sent the RICO claims to arbitration since there is no anti-waiver provision in that statute, except in those cases where the predicate acts were violations of Rule 10b-5. *Id.* at 1202-03.

While continuing to prohibit the arbitration of Rule 10b-5 claims, some courts found it appropriate to consider the area more fully before making a determination.[103] In some cases, despite the existence of circuit precedent in support of non-arbitrability,[104] the courts chose to consider whether *Scherk*'s "colorable argument" and Justice White's concurring opinion in *Byrd* required a different result.[105] These courts focused on the similarity between the anti-waiver provisions of the two securities statutes involved,[106] and the fact that plaintiffs in each case were seeking special rights which required a judicial forum.[107] While it was argued that *Mitsubishi Motors* suggested that the development of arbitration made the need for a judicial forum less important, the courts did not consider such a possibility as a sufficient reason for treating Rule 10b-5 claims differently from section 12(2) claims.[108] In addition, the courts viewed the special jurisdictional provisions of the Exchange Act as evidence of a

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The *King* opinion was much briefer than *Jacobson*. It simply pointed out that since *Byrd* had not addressed the question, the court would follow its prior decisions. *King*, 796 F.2d at 60.

103. The opinion of the court of appeals in Sterne v. Dean Witter Reynolds, Inc., 808 F.2d 480 (6th Cir. 1987), is a hybrid that relied on circuit precedent for its decision, *id.* at 482-83 (citing Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017 (6th Cir. 1979)), but also analyzed *Wilko*. The court stated:

> *Wilko* weighed the policy favoring arbitration against the policy inherent in the anti-fraud protection of the securities laws involved, and felt that the latter policies were weightier and should prevail. Although there are differences between the 1933 and 1934 Acts, the rationale of *Wilko* persuades us that, despite his agreement to do so, Sterne should not be compelled to arbitrate.

Id. at 483.

104. *See, e.g.*, Wolfe v. E.F. Hutton & Co., 800 F.2d 1032, 1034 (11th Cir. 1986); McMahon v. Shearson/American Express, Inc., 788 F.2d 94, 96-97 (2d Cir. 1986), *rev'd*, 107 S. Ct. 2332 (1987).

105. *See, e.g.*, *Wolfe*, 800 F.2d at 1035 (recognizing that *Wilko* is distinguishable, and so not controlling, but stating that the question is whether the similarities are such that the court should follow *Wilko*'s reasoning); Conover v. Dean Witter Reynolds, Inc., 794 F.2d 520, 521-22 (9th Cir. 1986) (stating that it would consider the matter "in light of the questions raised by Justice White") *vacated*, 107 S. Ct. 3202 (1987), *rev'd per curium*, 837 F.2d 867 (9th Cir. 1988); *McMahon*, 788 F.2d at 97-98 (considering the *Scherk* and *Byrd* arguments but stating that it would be "improvident" to disregard clear judicial precedent).

106. *See, e.g.*, *Wolfe*, 800 F.2d at 1036; *Conover*, 794 F.2d at 523; *McMahon*, 788 F.2d at 96-97.

107. *See, e.g.*, *Wolfe*, 800 F.2d at 1035; *Conover*, 794 F.2d at 524; *McMahon*, 788 F.2d at 98.

108. *See, e.g.*, *Wolfe*, 800 F.2d at 1037 (suggesting that even if the need for a judicial forum was "less compelling" because of improvements in arbitration, it had not changed the result in section 12(2) cases and there was no legitimate basis for treating claims under Rule 10b-5 and section 12(2) differently for purposes of arbitration).

strong congressional concern with providing a judicial forum in the same manner as the Securities Act provisions.[109]

Having considered these points, two of the courts looked to support their position against arbitration of Rule 10b-5 claims by considering Congress's 1975 amendments to the Exchange Act.[110] One provision of those amendments specifically authorized compulsory arbitration of securities claims between securities professionals.[111] In reference to this amendment, the Conference Report stated:

> The 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. The House amendment contained no comparable provision. The House receded to the Senate. It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in *Wilko v. Swan*, 346 U.S. 427 (1953), concerning the effect of arbitration proceeding provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations.[112]

An examination of this language shows its ambiguity, since it is unclear whether Congress was endorsing *Wilko* for section 12(2) cases, the extension of *Wilko* to Rule 10b-5 cases, or the use of *Wilko* limited by the "colorable argument" language of *Scherk*, which had been decided in 1974.[113] The two courts of appeals

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109. *See, e.g., Wolfe*, 800 F.2d at 1036; *Conover*, 794 F.2d at 523.

110. *Wolfe*, 800 F.2d at 1037-38; *Conover*, 794 F.2d at 524.

111. Section 28(b) of the Securities Exchange Act of 1934 was amended to read:

> (b) Nothing in this Chapter shall be construed to modify existing law with regard to the binding effect (1) on any member of or participant in any self-regulatory organization of any action taken by the authorities of such organization to settle disputes between its members or participants, (2) on any municipal securities dealer or municipal securities broker of any action taken pursuant to a procedure established by the Municipal Securities Rulemaking Board to settle disputes between municipal securities dealers and municipal securities brokers, or (3) of any action described in paragraph (1) or (2) on any person who has agreed to be bound thereby.

15 U.S.C. § 78bb(b) (1982).

112. H.R. CONF. REP. No. 229, 94th Cong., 1st Sess. 111, *reprinted in* 1975 U.S. CODE CONG. & ADMIN. NEWS 179, 321, 342.

113. To illustrate this point, the court in *Wolfe* noted that each side had cited this language as supporting its position. *Wolfe*, 800 F.2d at 1037. The Supreme Court emphasized the ambiguity of this language in discounting its significance in deciding *McMahon*, 107 S. Ct. at 2343. *See infra* note 155.

which ruled in favor of non-arbitrability, however, gave this language some weight as supporting their position.[114]

The two courts of appeals which decided in favor of arbitration of Rule 10b-5 claims during this period considered the same arguments but came to a different conclusion.[115] These courts found persuasive the distinctions noted by the Supreme Court between claims arising under Rule 10b-5 and claims to which *Wilko* was applicable; reference was made to the narrower jurisdictional provision of the Exchange Act, and the difference between express and implied remedies. The decisions, however, lacked a clear analysis of why these distinctions should lead to different results, other than to state that the distinctions indicated that Congress did not intend to override the strong federal policy favoring enforcement of arbitration agreements embodied in the Arbitration Act.[116] Both courts agreed that the rule permitting arbitration of

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114. Although the Eleventh Circuit in *Wolfe* recognized that the language of the Conference Report could be taken as nothing more than an "endorsement of *Wilko*," the court viewed the failure of Congress to disavow the application of *Wilko* to Rule 10b-5 claims as supportive of its position. *Wolfe*, 800 F.2d at 1037-38.

The Ninth Circuit went further and found the legislative history "compelling" on the question of the application of *Wilko* to Rule 10b-5 claims. *Conover*, 794 F.2d at 524 (citing Ayres v. Merrill Lynch, Pierce, Fenner & Smith, 538 F.2d 532, 537 (3d Cir. 1976). It found additional support in the fact that Congress had ratified the judicial remedy under Rule 10b-5 by not acting to eliminate it. *Id.* at 524 (citing Herman & MacLean v. Huddleston, 459 U.S. 375, 384-86 (1983)). The *Conover* court also noted that the SEC asserted that brokers had to make customers aware of their rights to a judicial forum under the Securities Act and Exchange Act, notwithstanding any prior agreements to arbitrate. *Id.* at 524 (citing Exchange Act Release No. 15,984, *supra* note 67); *see supra* text accompanying notes 67-72. *But see* Sterne v. Dean Witter Reynolds, Inc., 808 F.2d 480, 481 (6th Cir. 1987) (The court indicated that the Securities Exchange Association, Inc. had filed an *amicus curiae* brief supporting the defendant's position that the Rule 10b-5 claim should be sent to arbitration pursuant to the pre-dispute agreement.).

115. Page v. Moseley, Hallgarten, Estabrook & Weeden, 806 F.2d 291 (1st Cir. 1986); Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 795 F.2d 1393 (8th Cir. 1986).

116. As the First Circuit stated:

> [T]he 1934 Act, unlike the 1933 Act, does not expressly provide individuals a right to a judicial forum. Because of the absence of any *express* "provision" for a judicial forum under the 1934 Act, we conclude that the 1934 Act's anti-waiver clause, by itself, does not suffice to indicate a Congressional intent to preclude arbitration.

Page, 806 F.2d at 296 (footnote omitted).

The Eighth Circuit went somewhat further in *Phillips* and pointed out not only the express/implied distinction, but that the Securities Act provides a choice of forum, not exclusive jurisdiction as the Exchange Act does. The court also pointed out that the Securities Act, unlike the Exchange Act and common-law securities actions, does not require a plaintiff to prove scienter in order to recover, thus creating a special right. *Phillips*, 795 F.2d at 1397-98. Interestingly, the First Circuit thought that the exclusive jurisdiction "ar-

Rule 10b-5 claims was not changed by the 1975 amendments to the Exchange Act since it was not clear what Congress had meant by its statement concerning *Wilko*.[117] The Court of Appeals for the First Circuit explicitly relied on the Supreme Court's view in *Mitsubishi Motors* that the modern process of arbitration was capable of handling complex federal statutory rights.[118] Therefore, the court concluded that it was inappropriate to consider "the alleged ineffectiveness of the arbitral forum in deciding the arbitrability of a federal statutory right."[119]

C. *Analysis of Conflicting Views*

The conflict which arose among the courts of appeals in analyzing the arbitrability of Rule 10b-5 claims in the period after *Byrd* was primarily centered around two main points. The first point arose out of the suggestion in *Scherk* that Rule 10b-5 claims were distinguishable from section 12(2) claims and therefore the *Wilko* analysis should not apply. Much of the discussion of questions such as the distinction between express and implied remedies, for example, centered on this aspect of the analysis. The second point of dispute was whether Rule 10b-5 claims standing alone warranted an exception to the Arbitration Act's principle of arbitrability. This analysis moved away from the "colorable argument" questions, and instead sought to examine Congress's intentions in this area. Each of these points will be analyzed more fully in order to judge the merits of the positions taken.

The arguments concerning the distinction between the Rule 10b-5 and section 12(2) claims centered around the three main elements which led to the *Wilko* decision:[120] (1) the existence of the anti-waiver provision in section 14 of the Securities Act;[121] (2) the special nature of the right under section 12(2) of the Securi-

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guably" indicated the importance of a federal court forum. *Page*, 806 F.2d at 296.

117. *Page*, 806 F.2d at 296-97 n.10; *Phillips*, 795 F.2d at 1398 n.17. The Eighth Circuit in *Phillips* also disposed of the plaintiffs' argument that Rule 15c2-2 supported their position by pointing out that the rule was promulgated after the contracts involved in the case had been executed, and also that it did nothing more than state the SEC's interpretation of the present law. The court stated that it disagreed with the SEC analysis. *Id.*; *see supra* note 72.

118. *Page*, 806 F.2d at 297 (citing Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, 473 U.S. 614 (1985)); *see supra* text accompanying notes 93-98.

119. *Page*, 806 F.2d at 297.

120. *See supra* text accompanying notes 30-44.

121. *Wilko*, 346 U.S. at 434-35.

ties Act which was substantively complex and therefore not to be entrusted to other than a judicial forum;[122] and (3) the special jurisdictional provisions which allowed plaintiffs to choose a state or federal forum, and to refuse removal if a state forum was chosen—thus showing a clear preference for a judicial determination of the issues raised.[123] By critically reviewing these factors in light of the cases already considered, it is possible to evaluate their appropriateness as a basis for decision.

1. Statutory Anti-Waiver Provision

This first element requires the court to consider the applicable statutory claim to determine whether Congress intended to override the basic federal policy set forth in the Arbitration Act.[124] The policy of the Arbitration Act is to encourage arbitration by directing courts to enforce arbitration contracts in the same manner as they would any other contract.[125] In considering the section 12(2) claim under the Securities Act, the *Wilko* Court found the congressional intent to override that policy in the language of section 14 of the Securities Act. Section 14 prohibits the enforcement of any pre-dispute provision which purports to "waive compliance with any provision of this title or of the rules and regulations of the Commission."[126] While the language of section 29 of the Exchange Act is essentially the same, a different result may be warranted.[127] As stated in *Scherk*[128] and by Justice White in *Byrd*,[129] the investor is not "waiving compliance with any provision of this title" with respect to the Exchange Act, because no

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122. *Id.* at 436-38.

123. *Id.* at 435.

124. *Id.* The decisions examined focus on this concern with regard to congressional intent. As the Supreme Court stated in *Mitsubishi Motors*:

> Just as it is the congressional policy manifested in the Federal Arbitration Act that requires courts liberally to construe the scope of arbitration agreements covered by that Act, it is the congressional intention expressed in some other statute on which the courts must rely to identify any category of claims as to which agreements to arbitrate will be held unenforceable.

Mitsubishi Motors, 473 U.S. at 627.

125. *See supra* notes 23-24 and accompanying text.

126. 15 U.S.C. § 77n (*see supra* text accompanying note 35 for the text of section 14); *Wilko*, 346 U.S. at 434-35 ("This arrangement to arbitrate is a 'stipulation,' and we think the right to select the judicial forum is the kind of 'provision' that cannot be waived under § 14 of the Securities Act.").

127. *See supra* note 65.

128. 417 U.S. at 513-14.

129. 470 U.S. at 224-25 (White, J., concurring).

provision of the statute authorizes a private right of action under Rule 10b-5; therefore, the non-waiver provision is arguably inapplicable. If this position is accepted, there is no evidence of a congressional intent to override the general federal policy in favor of arbitration.

Taken at face value, it is clear that there is a distinction between section 12(2) actions under the Securities Act, and implied actions under Rule 10b-5 of the Exchange Act. It is not clear, however, whether that distinction should make a difference in the treatment of the waiver provision in the two cases. In recent years, the Supreme Court has made it clear that it will not imply a private right of action under a federal statute unless it finds evidence of congressional intent in the statutory language or legislative history to authorize such action.[130] Once that intent is established and the court implies the private right of action, the right of action is subject to the express jurisdictional provision of the statute, which requires the federal court to hear the case.[131] Applying this reasoning to the *Wilko* analysis, once an implied claim is established it is required to be heard in federal court; enforcement of an arbitration agreement would therefore permit a waiver of the jurisdictional provision of the statute. If the *Wilko* Court was concerned about protecting the plaintiff's choice of forum, which Congress had granted through the jurisdictional provisions of the Securities Act, it is arguable that a court should also be careful to preserve the Exchange Act jurisdictional provision, which indicates that Congress wanted these claims heard exclusively in federal court. Thus, this element of the *Wilko* analysis does not present a compelling reason for a different treatment of these two types of claims on the issue of arbitrability.

2. Special Nature of the Right

Even if the anti-waiver provision, standing alone, does not present a compelling reason for treating these claims differently, it

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130. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 15-16 (1979) ("[W]hat must ultimately be determined is whether Congress intended to create the private remedy asserted . . . ."); Touche Ross & Co. v. Redington, 442 U.S. 560 (1979). The Court stated that "our task is limited solely to determining whether Congress intended to create the private right of action," *id.* at 568, and further stated that "[t]he central inquiry remains whether Congress intended to create, either expressly or by implication, a private cause of action," *id.* at 575.

131. R. JENNINGS & J. MARSH, JR., SECURITIES REGULATION 811 (5th ed. 1982).

can be argued that it does so when reviewed in light of the special nature of the section 12(2) claim. In *Wilko*, the Court pointed out that since section 12(2) claims create special rights intended to protect investors, whom Congress viewed as operating at a disadvantage in dealing with issuers and dealers, it was important to determine if that protection would be lessened by allowing arbitration.[132] The Court was concerned that the arbitration process was not equipped to decide the numerous complex legal questions of vital federal concern which section 12(2) raises.[133] In its view, arbitration was best suited for the resolution of simple questions, and nothing more.[134] This was particularly troubling for the Court because the arbitrators' decision would only be subject to limited review.[135] To the extent that this presents a strong reason for denying arbitration, it equally applies to Rule 10b-5 cases. While the issues raised are different from those under section 12(2), there is an ever increasing number of complex legal issues which must be resolved in many Rule 10b-5 cases.[136] If, as the Court suggested, arbitrators are ill-prepared to deal with legal questions under section 12(2), it would seem that the same concerns would be present under Rule 10b-5, which has been used extensively for the protection of investors over the past thirty years.[137]

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132. *Wilko*, 346 U.S. at 435-37; Page v. Moseley, Hallgarten, Estabrook & Weeden, 806 F.2d 291, 296 (1st Cir. 1986).

133. *Wilko*, 346 U.S. at 436; *Page*, 806 F.2d at 296. The *Wilko* Court focused on issues of "burden of proof," "reasonable care," and "material fact." A full discussion of the elements of section 12(2) is set out in L. Loss, *supra* note 2, at 1021-29.

134. *Wilko*, 346 U.S. at 435-36 (footnotes omitted), where the Court stated:

> Even though the provisions of the Securities Act, advantageous to the buyer, apply, their effectiveness in application is lessened in arbitration as compared to judicial proceedings. Determination of the quality of a commodity or the amount of money due under a contract is not the type of issue here involved. This case requires subjective findings on the purpose and knowledge of an alleged violator of the Act.

135. *Id.*

136. *E.g.*, Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) ("scienter" requirement); Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972), *reh'g denied*, 407 U.S. 916 (reliance and causation); TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976) (materiality raised in the context of a proxy context, but relevant to Rule 10b-5 claims); Moss v. Morgan Stanley, 719 F.2d 5 (2d Cir. 1983) (standing to bring a private action under Rule 10b-5).

137. A detailed analysis of the development of Rule 10b-5 is set out in L. Loss, *supra* note 2, at 820-944.

3. Special Jurisdictional Provisions

The concern with respect to the special jurisdictional provisions relates to the previously discussed waiver issue. Under the Securities Act, Congress provided investors with an advantage in that they have the power to choose a federal or a non-removable state forum. The Court in *Wilko* was reluctant to take away this advantage by enforcing an arbitration provision.[138] The Exchange Act does not provide the same advantage since it does not give the investor plaintiff a jurisdictional choice, but it does give the federal courts exclusive jurisdiction over Exchange Act claims.[139] If the Court is reluctant to enforce a waiver of an expansive jurisdictional right given to investors by Congress, the Court should also be reluctant to do so in a statutory setting in which Congress felt so strongly about the claims that it provided exclusive jurisdiction to the federal courts.[140] The arbitration provision would

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138. *Wilko*, 346 U.S. at 435. The jurisdictional provision of the Securities Act of 1933 states:

> Sec. 22. (a) The district courts of the United States, and United States courts of any Territory, shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. . . . No case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States.

15 U.S.C. § 77v(a) (1982).

139. Section 27 of the Securities Act of 1934 provides:

> The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder . . . .

15 U.S.C. § 78aa (1982).

140. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 654-57 (1985) (Stevens, J., dissenting); Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc., 806 F.2d 291, 296 (1st Cir. 1986) (stating that the existence of exclusive federal jurisdiction arguably allows "for the inference that Congress regarded the federal court forum to be an important one"); Conover v. Dean Witter Reynolds, Inc., 794 F.2d 520, 527 (9th Cir. 1986) (comparing the jurisdictional provisions under the Securities Act and the Exchange Act and stating that the exclusive jurisdiction provision is "an even more forceful indication of Congress' intent that the federal courts oversee the interpretation and application of the 1934 Act"), *vacated*, 107 S. Ct. 3203 (1987), *rev'd per curiam*, 837 F.2d 867 (9th Cir. 1988). An expansive discussion of exclusive jurisdiction under the securities laws, and possible limits thereon, is set out in Dickinson, *Exclusive Federal Jurisdiction and the Role of States in Securities Regulation*, 65 IOWA L. REV. 1201 (1980).

allow an arbitrator to decide a case which Congress has prohibited a state court from deciding. It would be incongruous to distinguish the treatment of section 12(2) claims and Rule 10b-5 claims based on the difference in these jurisdictional provisions.

After examining the factors considered by the Court in *Wilko*, the only distinction between the two claims which has any merit is that implied rights of actions are different from specifically granted statutory causes of action. Arguably the specifically granted statutory right evidences a clear Congressional intent to override the Arbitration Act's policy in favor of arbitration, and, in a technical sense, the implied right of action does not fit within the statutory waiver language of the statutes.[141] In a real sense, however, this seems to be an argument in favor of formalism as the basis for decision-making. As such, there appears to be no principled reason for distinguishing cases under Rule 10b-5 and section 12(2) on the issue of arbitrability.

Perhaps because of the lack of a basis for distinguishing the claims, the Supreme Court, in considering the question of the arbitrability of Rule 10b-5 claims in *Shearson/American Express, Inc. v. McMahon*,[142] chose to focus on the second point of dispute: whether Congress had intended to exempt Rule 10b-5 claims from the Arbitration Act. While the Court considered *Wilko* relevant in analyzing this question, the Court declined to distinguish the results in the two situations.[143] Thus, in considering the second point of dispute, it is appropriate to examine *McMahon*.

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141. *See supra* text accompanying notes 124-31.

142. 107 S. Ct. 2332 (1987).

143. Justice O'Connor made this clear when she stated: "While *stare decisis* concerns may counsel against upsetting *Wilko*'s contrary conclusion under the Securities Act, we refuse to extend *Wilko*'s reasoning to the Exchange Act in light of the intervening regulatory developments." *Id.* at 2341. Justice Blackmun emphasized the majority's failure to address this distinction when he stated:

> There is no need to discuss in any detail that "colorable argument" which rests on alleged distinctions between pertinent provisions of the Securities Act and those of the Exchange Act, because the court does not rely upon it today. In fact, the "argument" is important not so much for its substance as it is for its litigation role. It simply constituted a way of keeping the issue of arbitrability of § 10(b) claims alive for those opposed to the result in *Wilko*.

Id. at 2346-47 (footnotes omitted) (Blackmun, J., concurring in part and dissenting in part). The refusal to attempt to distinguish the two Acts was supported by the SEC in its *amicus curiae* brief, Brief for SEC as *Amicus Curiae* at 18-26, which was also cited by Justice Blackmun in *McMahon*, 107 S. Ct. at 2347 n.2.

D. *The* McMahon *Decision*

In *McMahon*, the Supreme Court reviewed the decision by the Court of Appeals for the Second Circuit which refused to allow arbitration of both a Rule 10b-5 claim and a RICO claim under a pre-dispute arbitration agreement.[144] The court of appeals declined to follow the defendants' suggestion that the court should revise its view that Rule 10b-5 claims are not arbitrable on the basis of the *Scherk* opinion and Justice White's concurrence in *Byrd*. The court concluded that the public interest in deterrence of misconduct in the securities industry necessitated judicial control.[145] The court stated:

> [T]he similarity of the non-waiver provisions, § 14 of the 1933 Act and § 29(a) of the 1934 Act, as well as the strong public policy concerns inherent in the securities laws and the legislative history that preceded their enactment, support the compelling need for a judicial forum in the resolution of securities law disputes. Although *Scherk* and *Byrd* may cast some doubt on whether the Supreme Court, if presented with the issue, would hold claims under § 10(b) and Rule 10b-5 to be non-arbitrable, it would be improvident for us to disregard clear judicial precedent in this Circuit based on mere speculation. We think that the orderly administration of justice will be best served if we as one of the inferior courts follow Supreme Court precedent and adhere to the settled law of this Circuit, and a fortiori the district courts should do likewise.[146]

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144. McMahon v. Shearson/American Express, Inc., 788 F.2d 94 (2d Cir. 1986). The Second Circuit reversed a district court decision to send the Rule 10b-5 claim to arbitration, but upheld the decision not to send the RICO claim to arbitration. *Id.* The district court relied on *Scherk* and Justice White's concurring opinion in *Byrd* in allowing arbitration of the Rule 10b-5 claim. McMahon v. Shearson/American Express, Inc., 618 F. Supp. 384, 388 (S.D.N.Y. 1985).

The district court's decision not to send the RICO claim to arbitration was based on what it viewed as "important federal policies inherent in the enforcement of RICO by the federal courts." *Id.* at 387. In affirming this decision, the court of appeals stated that RICO claims, like antitrust claims, fall into a special category of strong public interest which requires a judicial determination to develop a record and to insure "judicial clarification and resulting consistency in resolving disputes under this relatively new statute." *McMahon*, 788 F.2d at 98-99.

The Supreme Court unanimously decided that RICO claims were arbitrable under a pre-dispute agreement because there was no basis for concluding that Congress intended to exempt these claims from the Arbitration Act, nor that arbitration could not effectively handle these claims. Shearson/American Express, Inc. v. McMahon, 107 S. Ct. 2332, 2343-46 (1987).

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

146. *Id.*

The Supreme Court began by pointing out that it was the plaintiff's burden to establish, through "the text, history, or purposes of the statute"[147] which was the basis of the suit, that Congress had intended to mandate an exception to the Arbitration Act's general policy of enforcing arbitration agreements.[148] To meet this burden the plaintiff made three arguments, all of which were rejected by the Court.

The plaintiff argued that the anti-waiver provision of section 29 of the Exchange Act evidenced a congressional intent to override the mandate of the Arbitration Act.[149] This intent was clear because section 29 prohibits a waiver of the exclusive jurisdiction provision of the Exchange Act. This argument presented an opportunity for the Court to establish a position consistent with the earlier statements of Justice White by pointing out the distinction between express and implied rights of action, as well as other distinctions between the Securities Act and the Exchange Act. Instead, the Court addressed what it deemed to be the meaning of section 29 in light of its reading of *Wilko*.[150] It rejected the view that section 29 prohibits the waiver of a judicial forum *per se*, and instead read *Wilko* "as barring waiver of a judicial forum only where arbitration is inadequate to protect the substantive rights at issue."[151] Having focused on section 29 as the primary source of congressional intent to negate the policies of the Arbitration Act, and having limited that section's significance to the question of the adequacy of arbitration, the Court addressed the issue of whether arbitration was adequate for Rule 10b-5 claims.[152]

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147. *McMahon*, 107 S. Ct. at 2338.

148. *Id.* at 2337-38.

149. *Id.* at 2338-39. See *supra* note 56 for the text of section 29.

150. The Court may have been influenced by the SEC's *amicus curiae* brief which supported arbitration of the Rule 10b-5 claim. In its brief, the SEC urged the Court not to distinguish between Securities Act and Exchange Act claims in deciding to arbitrate Rule 10b-5 claims. Brief for SEC as *Amicus Curiae* at 21-26.

151. *McMahon*, 107 S. Ct. at 2338-39 (citing *Scherk* and concluding that its decision in that case had turned on its determination that arbitration was adequate to protect the parties' statutory rights).

152. The plaintiff's second argument was that section 29 prohibits pre-dispute arbitration agreements because of the unequal bargaining positions of the parties. The Court rejected this argument, stating that the only issue was whether the agreement would waive a statutory duty by limiting the plaintiff's ability to recover under the Act. If the answer to this was in the affirmative, then it would be irrelevant whether the agreement was voluntary or involuntary. *Id.* at 2339.

In order to explore this issue, the Court had to address the underlying rationale of *Wilko*: the concern that the arbitration process was not capable of dealing with these issues.[153] Recognizing that the *Wilko* decision reflected judicial mistrust of arbitration, the Court stated that such mistrust was inconsistent with its subsequent decisions, which had concluded that arbitration was capable of handling complex matters.[154]

The Court found additional support for its view that there was no longer any basis for mistrusting arbitration in the 1975 amendments to the Exchange Act. While the Court found the reference to *Wilko* in the legislative history of the amendments unhelpful, the Court gave great weight to the amendment to section 19, which provided the SEC with extensive power to regulate the arbitration procedures approved by the various stock exchanges and registered securities associations.[155] The grant of broad regulatory power satisfied the Court that, at least where arbitration procedures were "subject to the Commission's section 19 authority, an arbitration agreement does not effect a waiver of the protections

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153. *Id.* at 2339-41. The Court noted three concerns of *Wilko*: (1) that arbitration was not suited for cases which required subjective findings; (2) that arbitrators were making legal determinations without judicial instructions, without stating the reasons for their decisions, and without having to establish a record; and (3) that courts had limited power to review an arbitrator's interpretation of law or to vacate an award. *Id.* at 2340.

154. *McMahon*, 107 S. Ct. at 2340 (citing *Mitsubishi Motors*, *Byrd*, *Scherk*, Southland Corp. v. Keating, 465 U.S. 1 (1984), and Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1 (1983)). The Court placed particular emphasis on *Mitsubishi Motors*' endorsement of the arbitration process as a streamlined method for satisfactorily resolving claims with only limited supervision by the courts. *Id.*

The Court also pointed out that *Wilko* had not been extended to securities disputes between member firms, nor to post-dispute arbitration agreements. The Court stated that this was further support for its decision to allow arbitration based on pre-dispute agreements, since the underlying assumption must be that arbitration can effectively handle such matters. *Id.* at 2340-41.

155. In considering the additional power given to the SEC, the Court pointed specifically to section 19(b)(2), 15 U.S.C. § 78s(b)(2) (1982), which prohibits rule changes unless the SEC finds that they are consistent with the requirements of the Act, and to section 19(c), 15 U.S.C. § 78s(c) (1982), which gives the SEC broad powers to "abrogate, add to, and delete from" any such rule if it would further the objectives of the Act. *McMahon*, 107 S. Ct. at 2341.

The Court rejected the language of the Conference Report as support for the application of *Wilko* to the Exchange Act, because the legislative history relating to the amendments did not address this subject. The Court also stated that it was unclear from the language of the Conference Report whether the reference was only to *Wilko* or its application to the Exchange Act, and exactly what the committee members thought "existing law" provided. *McMahon*, 107 S. Ct. at 2343. See *supra* text accompanying notes 110-14 for the reference to *Wilko* in the legislative history of the amendments.

of the Act."[156] Thus, the Court concluded that SEC supervision of arbitration procedures ensured an acceptable forum for the resolution of claims under the Exchange Act.[157]

The difficulty with the Court's opinion in *McMahon* is that having decided that the key question was the adequacy of arbitration procedures, it then assumed that they were adequate, or at least that SEC regulation would insure their adequacy. In many ways this is the same approach that led the Court to the opposite conclusion in *Wilko*.[158] Indeed, in *McMahon*, Justice Blackmun criticized the majority for accepting the adequacy of arbitration for securities disputes without a careful analysis to determine the accuracy of that assumption.[159]

In light of the *McMahon* decision, the arbitration process should be examined to determine whether it is adequate to deal with Rule 10b-5 claims. To the extent that problems are found, it is necessary to determine whether they can be solved by revisions of the procedures for arbitration under the supervision of the SEC and the various self-regulatory organizations ("SRO's"). Finally, if it is found that arbitration is adequate, it will be necessary to consider whether the Court should reexamine *Wilko* and apply a single standard to the question of arbitrability of section 12(2) and Rule 10b-5 claims.

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156. *McMahon*, 107 S. Ct. at 2341.

157. The Court's language suggests that it might not validate an arbitration agreement which purports to set up the arbitration under the procedures of an organization not subject to SEC regulation, such as the American Arbitration Association. *See* Brief for SEC as *Amicus Curiae* at 20. But see *infra* note 211, which refers to an SEC staff letter suggesting that groups such as the American Arbitration Association might be used for securities arbitrations.

158. In *Wilko*, Justice Frankfurter criticized the majority for its failure to consider the adequacy of the arbitration procedures. He stated:

> There is nothing in the record before us, nor in the facts of which we can take judicial notice, to indicate that the arbitral system as practiced in the City of New York, and as enforceable under the supervisory authority of the District Court for the Southern District of New York, would not afford the plaintiff the rights to which he is entitled.

Wilko, 346 U.S. at 439 (Frankfurter, J., dissenting). *See supra* note 51.

159. *McMahon*, 107 S. Ct. at 2349-50 (Blackmun, J., concurring in part and dissenting in part). Justice Blackmun dissented from the majority's view that Rule 10b-5 claims are arbitrable, but agreed that the RICO claim should be sent to arbitration. Justices Brennan and Marshall joined this opinion. Justice Stevens wrote separately, dissenting from the portion of the majority's opinion that held *Wilko* inapplicable to the Exchange Act. *Id.* at 2359-60 (Stevens, J., concurring in part and dissenting in part).

V. The Arbitration Process

A. *Adequacy of Arbitration*

The Supreme Court, having defined the issue of the arbitrability of Rule 10b-5 claims as primarily a question of whether arbitration can effectively deal with these claims, has left several issues unresolved. What the Court has done is to place the primary responsibility on the SEC and the sponsoring SRO's to take action that will encourage public investor support while retaining the benefits of arbitration. In order to meet this responsibility and to evaluate the adequacy of the arbitration system for handling Rule 10b-5 claims, it is necessary to consider the reasons for opposition.[160] The primary arguments against arbitration of these types of claims are: (1) arbitrators are not well suited to deciding complex legal questions;[161] (2) the absence of discovery places investors at a significant disadvantage in trying to establish a claim;[162] (3) the informality of the arbitration process makes it difficult for courts to control the decision-making process;[163] and (4) arbitration involves industry people deciding cases in place of the courts, which have been charged with the duty of enforcing the statutes regulating the securities industry in order to protect investors.[164]

The belief that arbitration is incapable of handling complex legal issues is grounded in the very nature of the system: in arbitration, the parties agree to give up the security that a court judgment is more likely to be "correct," in return for the savings in time and money that the arbitration process provides.[165] If the issue to be decided is whether a shipment of goods was defective, the parties may feel that an arbitrator is fully capable of resolving that question, and that even if it is decided incorrectly, both parties have been better served by a speedy and low cost determination. It is argued that the risk of a potentially incorrect decision made by an arbitrator in a securities fraud case is simply too great to be justified by the reduction in costs. That risk is consid-

160. *See supra* text accompanying notes 17-22.

161. *See supra* note 18.

162. *See supra* note 19.

163. *See supra* note 20.

164. *See supra* note 21.

165. Mitsubishi Motors Inc. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 657 (1985) (Stevens, J., dissenting).

ered especially great in securities fraud cases for two reasons. First, there is a national interest in enforcement of the securities laws which must be carefully guarded by having courts decide this type of case.[166] Second, the issues are too important to the individual investor, who may have lost his or her life savings in the transaction, and will now have to rely on the industry, rather than a judge, to protect those interests.[167]

This argument, that the risk in securities law cases is too great, assumes that arbitration forces us to pay a heavy price in return for cost and time savings—to wit, inferior decision-making. It has become increasingly evident, however, that the arbitration system which has developed in the securities industry provides a forum for arbitrators to carefully analyze and decide complex cases. In *McMahon*, the Supreme Court rejected the view that complexity of the issues was a deterrent to arbitration and found support for this in *Mitsubishi Motors*.[168] In *Mitsubishi Motors*, the Court characterized the nature of arbitration by stating that "adaptability and access to expertise are hallmarks of arbitration. The anticipated subject matter of the dispute may be taken into account when the arbitrators are appointed, and arbitral rules typically provide for the participation of experts either employed by the parties or appointed by the tribunal."[169] Moreover, it would be incongruous for the Court to conclude that an arbitration based on a pre-dispute agreement was incapable of dealing with the issues involved in a securities fraud case, in light of the fact that courts have routinely permitted arbitration based on post-dispute agreements, or when the parties to the agreement are members of securities self-regulatory organizations.[170] Courts have increasingly accepted the proposition that the arbitral decision-making process is reasoned and expert.[171] While there may be problems

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166. *See* Allegaert v. Perot, 548 F.2d 432, 437-38 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977).

167. Shearson/American Express, Inc. v. McMahon, 107 S. Ct. 2332, 2355 (1987) (Blackmun, J., concurring in part and dissenting in part).

168. *Id.* at 2340 (citing *Mitsubishi Motors*, 473 U.S. at 633-34).

169. *Mitsubishi Motors*, 473 U.S. at 633 (footnote omitted).

170. *McMahon*, 107 S. Ct. at 2340-41; *Mitsubishi Motors*, 473 U.S. at 633 (the Court's comment was limited to post-dispute agreements to arbitrate antitrust claims); Fletcher, *Privatizing Securities Disputes Through the Enforcement of Arbitration Agreements*, 71 MINN. L. REV. 393, 421-27 (1987).

171. Brener v. Becker Paribas, Inc., 628 F. Supp. 442 (S.D.N.Y. 1985). After pointing out the *Wilko* concern that arbitration could not effectively resolve these claims, the *Brener* court went on to say:

with the system, the lack of reasoned and expert decision-making is not one of them. This argument, therefore, should not prevent us from taking advantage of the speed and economy provided by arbitration.

The concern about time and cost has become even more focused since the decision in *Byrd*, in which the Court rejected the so-called "intertwining doctrine" by which lower federal courts resolved state law claims along with the non-arbitrable federal claims for reasons of economy.[172] In so ruling, the Court opted for enforcement of private agreements to arbitrate state claims, even when to do so creates piecemeal litigation.[173] Thus, if state law claims are involved (as they usually are), plaintiffs are placed in the unenviable position of having to litigate their claims in two separate forums, either simultaneously or *seriatim*.[174] Neither op-

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> Arbitration procedures, however, have become increasingly sophisticated since *Wilko* was decided, and the number of securities disputes being channeled into arbitration has risen significantly.
>
> A carefully developed structure has been established by the securities industry for arbitrating disputes, and the arbitrators available to consider disputes are generally knowledgeable individuals who have had experience working with the federal securities laws.

Id. at 448 (footnote omitted) (citing Katsoris, *supra* note 18, at 283-87).

172. *See supra* text accompanying notes 75-79.

173. Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 221 (1985).

174. The majority in *Byrd* did not address the question of whether, in sending the state law claims to arbitration, a court should stay either proceeding or allow each to proceed at its own pace. In rejecting the argument that claims should not be sent to arbitration because they will be decided more quickly and thus have preclusive effect in the federal proceeding, the Court did state:

> Suffice it to say that in framing preclusion rules in this context, courts shall take into account the federal interests warranting protection. As a result, there is no reason to require that district courts decline to compel arbitration, or manipulate the ordering of the resulting bifurcated proceedings, simply to avoid an infringement of federal interests.

Id. at 223. A full discussion of the preclusive effect of arbitration decisions is set out in Shell, *Res Judicata and Collateral Estoppel Effects of Commercial Arbitration*, 35 UCLA L. REV. 623 (1988), in which the author states that lower courts have not followed *Byrd*'s view on preclusion, and arguing for the use of preclusion in appropriate circumstances. *Id.* at 655, 669-73.

In his concurring opinion in *Byrd*, Justice White took the position that the two proceedings should go forward without reference to each other. He stated:

> The Court's opinion makes clear that a district court should not stay arbitration, or refuse to compel it at all, for fear of its preclusive effect. And I can perceive few, if any, other possible reasons for staying the arbitration pending the outcome of the lawsuit. Belated enforcement of the arbitration clause, though a less substantial interference than a refusal to enforce it at all, nonetheless significantly disappoints the expectations of the parties and frustrates the clear purpose of their agreement. In addition, once it is decided that the two

tion is beneficial to the plaintiff, usually an individual, who must decide how to allocate resources in that situation. The plaintiff will have to decide whether to accept the piecemeal litigation, or whether to take other action to avoid it, such as agreeing to arbitrate all of the claims, or voluntarily dismissing the state law claims.[175] It is also an inefficient option for the federal courts which must continue to hold or consider the federal claims while another tribunal, the arbitrator, is considering the same transaction in another context.[176]

The second argument against arbitration—lack of discovery procedures—may present a more serious problem.[177] In order for

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> proceedings are to go forward independently, the concern for speedy resolution suggests that neither should be delayed. While the impossibility of the lawyers being in two places at once may require some accommodation in scheduling, it seems to me that the heavy presumption should be that the arbitration and the lawsuit will each proceed in its normal course. And while the matter remains to be determined by the District Court, I see nothing in the record before us to indicate that arbitration in the present case should be stayed.

Byrd, 470 U.S. at 225 (White, J., concurring). Notwithstanding this statement, some courts have stayed federal proceeding pending resolution of the arbitration. *See, e.g.*, NPS Communications, Inc. v. Continental Group, Inc., 760 F.2d 463 (2d Cir. 1985) (in an antitrust suit, the district court did not abuse its discretion in staying the federal claims pending the arbitration of contract claims); Brener v. Becker Paribas, Inc., 628 F. Supp. 442, 453 (S.D.N.Y. 1985) (staying the federal proceeding on the grounds that the arbitration "may well clarify and perhaps even simplify the issues that must be litigated"); Webb v. R. Rowland & Co., 613 F. Supp. 1123 (E.D. Mo. 1985) (in a securities law case, the court stayed the federal proceeding pending resolution of the securities arbitration since *Byrd* only stated that a stay of arbitration proceedings is not necessary). Other courts have questioned or rejected any stay of these proceedings. *See, e.g.*, Chang v. Lin, 824 F.2d 219, 222-23 (2d Cir. 1987) (stating that at least where Securities Act claims are before the court, the cases should proceed simultaneously unless there are "compelling reasons" to stay the proceedings); Shihadeh v. Dean Witter Reynolds, Inc., 766 F.2d 461 (11th Cir. 1985) (remanding the case to the district court to decide if it was correct in staying the federal proceedings in light of Justice White's opinion); Dimenstien v. Whiteman, 759 F.2d 1514, 1517 (11th Cir. 1985) (emphasizing that since there is no preclusive effect, there is no point in ordering the time of the cases). Presumably, a district court which stays the proceedings is hoping that the matter will be resolved in whole or in part in arbitration, and that the federal proceedings will therefore benefit from the delay, while those opposing a stay feel a plaintiff is entitled to resolution of federal rights without delay.

175. McMahon v. Shearson/American Express, Inc., 788 F.2d 94, 99 n.7 (2d Cir. 1986), *rev'd on other grounds*, 107 S. Ct. 2332 (1987) (suggesting that if plaintiffs withdrew their pendent state law claims there would be no claims available for arbitration and bifurcated proceedings would be unnecessary).

176. The Court in *Byrd* made no attempt to defend the efficiency of the bifurcated process which it set up, but simply stated that it was obliged to do so in light of the congressional policies evidenced in the Arbitration Act. 470 U.S. at 220-21.

177. *McMahon*, 107 S. Ct. at 2355 n.18 (Blackmun, J., concurring in part and dissenting in part) (citing Katsoris, *supra* note 19, at 287 n.52). Meyerowitz, *The Arbitration Alternative*, *supra* note 16, at 80; SOMMER, *supra* note 9, § 118.01[1].

a plaintiff-investor to recover under a Rule 10b-5 claim, it may be necessary to have access to internal documents of the defendants, to have questions answered, or to depose witnesses prior to the time of the arbitration. Normally, this type of discovery is not permitted in the arbitration process because it would mire the case in complicated preliminary matters that would effectively dissipate the speed and economy which are the hallmarks of arbitration decision-making.[178] Moreover, the presence of a formal discovery system may have a coercive effect on the attorneys involved and cause them to use the system to its full extent, whether or not it is necessary. To avoid this, and the expense and delay that would inevitably result, it would be better to use techniques currently available to insure informational equality without an elaborate discovery system. For example, under the Uniform Code of Arbitration,[179] the parties are directed to "cooperate in the voluntary exchange of such documents and information as will serve to expedite the arbitration."[180] Moreover, the arbitrator

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178. Katsoris, *supra* note 19, at 287 n.52; *cf.* SOMMER, *supra* note 9, § 118.05[9]. While courts normally deny requests for discovery concerning a matter to be arbitrated, they will allow it in exceptional circumstances where it will aid the arbitration. Koch Fuel Intern., Inc. v. M/V South Star, 118 F.R.D. 318, 320-21 (E.D.N.Y. 1987) (allowing deposition of only witnesses with first-hand knowledge of the events who were about to leave the country and would be unavailable for arbitration); Willenken, *The Often Overlooked Use of Discovery in Aid of Arbitration and the Spread of the New York Rule to Federal Common Law*, 35 BUS. LAW. 173, 181-82 (1979) (setting out the facts that have been cited by courts as a basis for allowing discovery).

179. Uniform Code of Arbitration (as amended), *reprinted in* Fifth Report of the Securities Industry Conference on Arbitration (Apr. 1986) (Exhibit C) [hereinafter Uniform Code of Arbitration]. The Securities Industry Conference on Arbitration [SICA] developed a Uniform Code of Arbitration which was adopted by participating SRO's in 1979 and 1980. As discussed earlier, *see supra* text accompanying notes 154-56, the Supreme Court in *McMahon* emphasized that the 1975 Amendments to section 19 of the Exchange Act gave the SEC power to regulate the arbitration procedures of SRO's, which it has exercised by the approval of the Uniform Code of Arbitration. Participating SRO's include: American Stock Exchange, Inc.; Boston Stock Exchange, Inc.; Chicago Board of Options Exchange, Inc.; Cincinnati Stock Exchange, Inc.; Midwest Stock Exchange Inc.; Municipal Securities Rulemaking Board; National Association of Securities Dealers, Inc.; New York Stock Exchange, Inc.; Pacific Stock Exchange, Inc.; and Philadelphia Stock Exchange, Inc. *See* Fifth Report of the Securities Industry Conference on Arbitration (Apr. 1986) [hereinafter Fifth Report]. These SRO's utilize the Uniform Code of Arbitration which they have adopted. SOMMER, *supra* note 9, § 118.05[1].

180. Uniform Code of Arbitration, *supra* note 179, § 20(b). The New York Stock Exchange has taken this one step further, and mandated that the documents intended to be used at a hearing must be exchanged at least ten days before the hearing. Arbitrators "may" exclude from the hearing documents not so presented. N.Y.S.E. Arbitration Rule 638, 2 N.Y.S.E. Guide (CCH) ¶ 2638 (1988).

has the power "to direct the appearance of any person employed or associated with any member . . . and/or the production of any records in the possession or control of such persons, members or member organization."[181] In addition to these rules, arbitrators have the discretionary power to adjourn any hearing.[182] This rule would permit an adjournment if one of the parties is placed at a significant informational disadvantage that might require further time for preparation.[183] Properly used, these mechanisms can insure a full opportunity for each side to present its position without resort to the development of an elaborate discovery process which would provide more information, but which would also cause the increased costs and delay that arbitration was intended to avoid.[184] Although it has been suggested that, in light of *McMahon*, the SEC and the SRO's should revise arbitration procedures to increase discovery,[185] the more appropriate response is to take no action until it can be determined whether the current procedures may be used effectively to meet the concerns of plaintiff-investors while maintaining the cost efficiency of arbitration. If arbitrators, the SRO's, and the SEC are sensitive to the problems which may arise in this area, an appropriate balance may be struck without dramatically changing the arbitration procedures or making them less efficient.

The third argument against arbitration—that the informality of the proceedings makes it difficult to have judicial supervision of

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181. Uniform Code of Arbitration, *supra* note 179, § 21.

182. Uniform Code of Arbitration, *supra* note 179, § 18. If the adjournment is granted, the requesting party is to be charged a fee, not to exceed $100, but the arbitrators may waive the fee. *Id.*

183. Thus, for example, if a document is not voluntarily produced the arbitrators may subpoena a person to bring the document to the hearing, 9 U.S.C. § 7 (1982), and, since a full review of the document has not been had before the hearing, matters relating to that document may be pursued at a subsequent hearing. *See* SOMMER, *supra* note 9, § 118.05[9]. While the power to subpoena is limited to hearings, the arbitrator may ask the parties to agree to pre-hearing disclosure. Willenken, *supra* note 179, at 182.

184. SOMMER, *supra* note 9, § 118.01. At least one district court, in concluding that arbitration rights had not been waived, has suggested that because rules concerning discovery in arbitration are flexible, they might result in the same type of discovery which had taken place in federal court. Brener v. Becker Paribas, Inc., 628 F. Supp. 442, 452 n.16 (S.D.N.Y. 1985). The abuse of discovery in the federal courts is well documented. *E.g.*, Brazil, *The Adversary Character of Civil Discovery: A Critique and Proposal for Change*, 31 VAND. L. REV. 1295, 1320-331 (1978); Sofaer, *Sanctioning Attorneys for Discovery Abuse Under the New Federal Rules: On the Limited Utility of Punishment*, 57 ST. JOHN'S L. REV. 680, 696-98 (1983).

185. Burrough, *Exchanges Mull Changing Rules for Arbitration*, Wall St. J., July 24, 1987, at 19, col. 2; *see infra* note 211.

the decision-making process—arises both because of the lack of a record of the proceedings, and because an arbitrator's decision does not necessarily include the reasons for that decision.[186] These absences can create a situation in which it is difficult or impossible for a court to review the propriety of the arbitrator's decision.[187] The Uniform Code of Arbitration does provide some protection against these problems. For example, while no record of the arbitration proceedings is ordinarily kept, any party may request a verbatim record, and the requesting party or parties must bear the expense of that transcript.[188] For an arbitration involving a significant sum of money or multiple hearings, the parties are likely to want such a record in any event.[189] While the availability of this option may solve the problem, the SEC should mandate that a written record of every arbitration proceeding must be kept, the cost of which will be paid either by the losing party or by the brokerage firm defending the action, which has the resources and an institutional interest in insuring an acceptable arbitration process.

A more fundamental problem is that, while the award must be in writing,[190] the arbitrator cannot be required to state the reasons for the award, and as a general rule is not encouraged to do so.[191] In addition, there is limited judicial review of the arbitra-

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186. Wilko v. Swan, 346 U.S. 427, 436 (1953) ("As [the arbitrators'] award may be made without explanation of their reasons and without a complete record of their proceedings, the arbitrators' conception of the legal meaning of . . . statutory requirements . . . cannot be examined."). Justice Blackmun emphasized this point in his dissent in *McMahon* when he stated that records of proceedings are not invariably kept and that arbitrators are "not bound by precedent" and are advised not to give reasons for their decisions. *McMahon*, 107 S. Ct. at 2354 (Blackmun, J., concurring in part and dissenting in part).

187. *Wilko*, 346 U.S. at 436. The position of some advocates of arbitration is that a lack of judicial review is fully appropriate since the parties have agreed to binding arbitration and, to make the system work, the parties must live with "[a]n occasional mistake by an arbitrator." R. COULSON, BUSINESS ARBITRATION—WHAT YOU NEED TO KNOW 25 (3d ed. 1986). The *McMahon* Court was not willing to go so far, and cited *Mitsubishi Motors* as reserving the question of whether claimants have the capacity to reinstate a federal court action if an arbitrator fails "to take cognizance of the statutory cause of action." *McMahon*, 107 S. Ct. at 2340 (citing *Mitsubishi Motors*, 473 U.S. at 636-37 & n.19); *see infra* note 194.

188. Uniform Code of Arbitration, *supra* note 179, § 25.

189. *See* SOMMER, *supra* note 9, § 118.05[13].

190. Uniform Code of Arbitration, *supra* note 179, § 29(a).

191. Courts cannot require arbitrators to give the reasons for their awards. United Steel Workers v. Enterprise Wheel and Car Corp., 363 U.S. 593, 598 (1960); Wilko v. Swan, 346 U.S. 427, 436 (1953); Shearson Hayden Stone, Inc. v. Liang, 653 F.2d 310, 312 (7th Cir. 1981). The general practice of advising arbitrators not to give the reasons for their deci-

tion award. Under the Arbitration Act, an arbitrator's award can be vacated if, among other reasons, "the arbitrators exceeded their powers, or so imperfectly execute them that a mutual, final, and definite award upon the subject matter submitted was not made."[192] While courts have read this language narrowly in order to limit the review of arbitration awards,[193] they have considered whether there was a manifest disregard of the law, and whether there was a rational basis for the decision.[194] This review, how-

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sions was pointed out by Justice Blackmun in *McMahon*, 107 S. Ct. at 2354 (Blackmun, J., concurring in part and dissenting in part) (citing R. COULSON, BUSINESS ARBITRATION—WHAT YOU NEED TO KNOW 29 (3d ed. 1986)).

192. 9 U.S.C. § 10(d) (1982). Section 10 reads in full:

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

193. *E.g.*, Shearson Hayden Stone, Inc. v. Liang, 653 F.2d 310, 312 (7th Cir. 1981); National Bulk Carriers, Inc. v. Princess Management Co., Ltd., 597 F.2d 819 (2d Cir. 1979).

194. *E.g.*, Merrill Lynch, Pierce, Fenner & Smith v. Bobker, 808 F.2d 930, 933 (2d Cir. 1986) (citing *Wilko* as the source of the manifest disregard standard); Storer Broadcasting Co. v. American Fed'n of Tel., 600 F.2d 45, 47 (6th Cir. 1979) (rational basis required).

The exact meaning of the standard of review is somewhat unclear because of the generalities of the statements courts make in rendering their decisions. Professor David A. Lipton has suggested that there is uncertainty among arbitrators about whether "manifest disregard" means that arbitrators must apply applicable legal standards, or whether they can use their "commercial judgment, a sense of equity, and/or common sense as a basis for resolving the dispute." Lipton, *The Standard on Which Arbitrators Base Their Decisions: The SROs Must Decide*, 16 SEC. REG. L.J. 3, 6 (1988). Professor Lipton suggests that this has not been sufficiently addressed by the SRO's because the system was not set up to deal with complex cases, and now that it is faced with such cases it must directly address the issue. *Id.* at 5. It is clear, however, that the Supreme Court's view is that arbitrators are to apply the applicable legal standards in rendering their decisions, and that this is an underlying basis for the Court's series of decisions which have moved away from *Wilko*'s distrust of arbitration. *McMahon*, 107 S. Ct. at 2338-41. As the court has stated: "Finally, we have indicated that there is no reason to assume at the outset that arbitration will not follow the law; although judicial scrutiny of arbitration awards necessarily is limited, such review is sufficient to ensure that arbitrators comply with the requirements of the stat-

ever, is of little benefit if the arbitrator has not provided the reasons for the decision. The purpose in not providing reasons for the decision and in narrowly limiting judicial review is to streamline the proceedings by reaching final results without a lengthy appeals process.[195] While such a purpose is certainly valid, it must be balanced against legitimate concerns for investor protection under the securities laws. In order to insure this protection, and to provide a system which permits investors to have confidence in the arbitrator's decision, it would be appropriate for the SEC to exercise its supervisory power over the arbitration process to strike a balance between the competing interests involved. It should mandate that the arbitrators state the reasons for the decision so that the parties and a reviewing court will be able to assess, in a manner consistent with the Arbitration Act, whether there was a disregard of the law, and whether there was a rational basis for the decision.[196] Such a change would permit an openness that will encourage better decision-making and confidence in the arbitral process. It should be recognized that as a result, there will be some loss in efficiency since arbitrators will have to prepare a written explanation of the reasons for their decisions, and the availability of such a written record will make it easier to raise challenges on appeal. This loss in efficiency, however, is an appropriate price to pay since the arbitration process is being used to resolve claims establishing federally created protections for the investing public.

The fourth argument against arbitration is that the system is controlled by the securities industry, albeit under SEC supervi-

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ute." *Id.* at 2340; *Wilko*, 346 U.S. at 440 (Frankfurter, J., dissenting) ("Arbitrators may not disregard the law. . . . On this we all agree.").

195. *See* National Bulk Carriers, Inc. v. Princess Management Co., Ltd., 597 F.2d at 825.

196. *See supra* text accompanying notes 46, 47 & 51. Courts have recognized the need for arbitration awards to be explained in order to to insure adequate judicial review. *E.g.*, Sargent v. Paine Webber, Jackson & Curtis, Inc., 674 F. Supp. 920, 922-23 (D.D.C. 1987) (vacating an award and remanding to the arbitration panel for an explanation of their award, so that the court could "engage in meaningful judicial review of the plaintiff's award").

One provision of a bill introduced in Congress to reform the securities arbitration system would require arbitrators to state briefly, in writing, the reasons for the decision, and the elements of the award. H.R. 4960, 100th Cong., 2d Sess. (1988); [July-Dec.] Sec. Reg. L. Rep. (BNA) No. 27, at 1054 (July 8, 1988).

In the analogous field of labor arbitration, written decisions stating the reasons for the award are common, and there is strong support for this practice. F. ELKOURI & E. ELKOURI, HOW ARBITRATION WORKS 281 (4th ed. 1985).

sion, and that such control operates to the disadvantage of the investor.[197] The legitimacy of this concern is unclear. The securities fraud claims involved are not cases that question the underlying financial structure of the industry; they usually consist of individual cases claiming misconduct on a limited scale, such as an individual investor whose life savings has been lost by alleged misconduct. Arguably, the securities industry has a strong interest in rooting out this misconduct as part of its self-regulating process. Moreover, the investors benefit by having knowledgeable arbitrators resolve securities law claims because the arbitrator's expertise in the securities area will allow for speedier and more expert resolutions of these cases.

Notwithstanding this argument, it is true that investors, or at least investors' attorneys, are concerned about the propriety of the securities industry's control of the arbitration process.[198] The basis for this concern is difficult to ascertain. It may be that arbitrators with a connection to the industry may be perceived as less sympathetic to investors than a judge who only sees these matters occasionally, and so may be perceived as more "objective." There may also be a concern that a connection to the industry may cause arbitrators to have a "there but for the grace of God go I" attitude towards the claims of investors. While these may be legitimate concerns, the limited statistical evidence available is at best inconclusive as to whether the percentage of successful litigants and the size of the awards accurately reflects the amount of harm incurred.[199] To the extent, however, that there exists a lack of public confidence in the fairness and impartiality of the process, difficulties will arise with respect to the effective use of arbi-

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197. *McMahon*, 107 S. Ct. at 2355-56 (Blackmun, J., concurring in part and dissenting in part).

198. As Justice Blackmun stated in his opinion in *McMahon*: "The uniform opposition of investors to compelled arbitration and the overwhelming support of the securities industry for the process suggest that there must be *some* truth to the investors' belief that the securities industry has an advantage in a forum under its own control." *Id.* at 2355.

199. In its *amicus curiae* brief to the Supreme Court in *McMahon*, the American Arbitration Association cited statistics on the fairness of arbitration. It stated that in the cases surveyed the claimant was successful in 68% of the cases with an average award of $26,000, and punitive damages were awarded in four cases. Brief for American Arbitration Association as *Amicus Curiae* at 17. Of course such statistics are of limited value since they do not tell us whether the parties thought the resolutions were fair and accurately reflected what had happened in the cases. *Id.* at 2355-56 n.20 (Blackmun, J., concurring in part and dissenting in part). Moreover, as long as arbitrators are free to decide cases without explaining their decisions, it will be difficult to assess this concern.

tration in the resolution of securities fraud cases.[200]

While some of this difficulty may be solved by a more open process of decision-making,[201] confidence in the system will ultimately depend on confidence in the impartiality of the decision-makers. In order to achieve this goal arbitrators must be viewed as being independent of the industry. The Uniform Code of Arbitration has attempted to deal with this by requiring that a majority of an arbitration panel "not be from the securities industry."[202] The individuals who will serve as arbitrators are selected by the Director of Arbitration of the sponsoring organization.[203] The Securities Industry Conference on Arbitration has set out guidelines for the classification of persons as "public arbitrators." Those guidelines state:

> No one may serve as a public arbitrator who has been an employee or partner of a member organization or subsidiary thereof, or a shareholder of a non-publicly owned member organization or subsidiary thereof for a period of three years immediately preceding his or her appointment as a public arbitrator.
>
> Additional information concerning a particular arbitrator may be obtained by a party or the party's attorney upon request directed to the Director of Arbitration prior to the commencement of the hearing or a submission to the arbitrator without a hearing.[204]

In addition, each party is entitled to one peremptory challenge, and an unlimited number of challenges for cause.[205]

While these provisions should help to encourage public confidence, they do not fully solve the problem. The definition of a public arbitrator is broadly drawn, and may lead to some persons being qualified as "public" who have significant ties to the securi-

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200. Katsoris, *supra* note 19, at 310.

201. *See supra* text accompanying notes 185-95.

202. Uniform Code of Arbitration, *supra* note 179, § 8(a). Claims for under $500,000 are to be heard by panels of three to five arbitrators, and claims over $500,000 are to have panels of five arbitrators, unless the parties agree in writing to have panels of three arbitrators. In both cases a majority of the panel are not to be from the securities industry unless otherwise requested by the public customer. *Id.* For claims under $5,000, there is a voluntary option to use a simplified arbitration procedure with a single arbitrator who is to be from the public, if possible, and otherwise from the securities industry. Fifth Report, *supra* note 179, Exhibit D [Simplified Arbitration].

203. Uniform Code of Arbitration, *supra* note 179, § 8(b).

204. Fifth Report, *supra* note 179, Exhibit B at 17.

205. Uniform Code of Arbitration, *supra* note 179, § 10.

ties industry. For example, in *McMahon*, Justice Blackmun pointed out that this definition would permit attorneys for exchange members or for SRO's to serve as public arbitrators, which in his view is unsatisfactory.[206] While due regard must be given to insure that the panel considering the question has the requisite expertise, the definition of public arbitrator should be narrowed to encourage public confidence.[207] In addition, the Director of Arbitration should be sensitive to any appearance of a lack of impartiality in the persons selected for a panel.[208] Beyond this, however, the arbitration code should be amended to require that detailed information as to the background of each arbitrator must be provided as a matter of course prior to the arbitration.[209] A short waiting period should be created to enable the Director of Arbitration of the sponsoring organization to resolve any questions or challenges concerning the arbitrators.

In addition, SRO's should be required to prepare periodic reports on the selection process. These reports should be filed with the SEC and made available to the public.[210] The disclosure of this type of information will help develop the public confidence in arbitration which is needed to establish the arbitration of securities law claims as an appropriate method of dispute resolution. The reports will also provide the SEC with a formal reporting system to monitor the arbitration process in order to determine whether it is operating fairly, and if it is not, what additional steps should be taken to insure impartial decision-making.[211] If

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206. *McMahon*, 107 S. Ct. at 2355 (citing to Panel of Arbitrators 1987-1988, 1987 American Stock Exchange Guide (CCH) at 159-60, which indicated that 53 out of 70 "public" arbitrators are lawyers).

207. Katsoris, *supra* note 19, at 311 (arguing that SICA's definition of a "public arbitrator" had taken these competing interests into consideration). The New York Stock Exchange has revised its guidelines for public arbitrators to eliminate from the definition professionals who represent the industry, or those who spent a substantial part of their business careers in the industry. Also, close family ties with broker-dealers will be grounds for a challenge for cause. [Jan.-June] Sec. Reg. & L. Rep. (BNA) No. 9, at 325 (Mar. 4, 1988).

208. Katsoris, *supra* note 19, at 311-12.

209. The New York Stock Exchange has begun providing biographical information on arbitrators to assist with peremptory challenges. [Jan.-June] Sec. Reg. & L. Rep. (BNA) No. 9, at 325 (Mar. 4, 1988).

210. These reports should include information concerning the background of "public" arbitrators that are selected; challenges that have been made; the resolution of the challenges; and other appropriate information.

211. The SEC is reviewing the arbitration process with the goal of revising the rules to make arbitration more effective. The SEC's Division of Market Regulation has sent to

adopted, these procedures will result in a formal, structured process which will give investors greater confidence in the system, while encouraging a careful analysis in the selection process.

B. *The* Wilko *Rule*

A second question left open by the *McMahon* decision, which the Supreme Court has recently agreed to consider,[212] is whether the *Wilko* rule will continue to operate in the area of claims under section 12(2) of the Securities Act. Although the majority avoided this question since a section 12(2) claim was not before the Court, the Court noted that "*stare decisis* concerns may counsel against upsetting *Wilko*'s contrary conclusion under the Securities Act."[213] The Court's statement that *stare decisis* "may" protect *Wilko* suggests a willingness to consider the question. Moreover, application of the Court's reasoning in *McMahon* with respect to Rule 10b-5 claims should lead to the same conclusion with respect to section 12(2) claims. The basis for the Court's analysis in *McMahon* was its interpretation that *Wilko* provides only that the anti-waiver provision of the statute prohibits waiver of a judicial forum where arbitration is an inadequate process for protecting the statutory rights involved.[214] Since the Court in *McMahon* concluded that arbitration was adequate to deal with Rule 10b-5 claims, it should also be adequate to deal with section 12(2) claims. Arbitration, therefore, should not be prohibited by the

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SICA a staff letter, approved by the Commission, which made a number of recommendations for consideration by the member SRO's. Among the recommendations were: (1) establishing a more restrictive definition of "public arbitrator"; (2) having SRO's publish summary data concerning the results of arbitration; (3) developing the discovery process more fully, especially in large cases, and allowing for depositions when witnesses are unavailable; (4) having greater disclosure by arbitrators of their personal and professional relationships, and making this available to the parties; (5) establishing an arbitrator education program; (6) considering special rules for large and complex cases, which might include written opinions in some cases; (7) increasing the choice of arbitration forums in agreements since most currently provide for New York Stock Exchange or National Association of Securities Dealers sponsored arbitration; and (8) considering other sponsoring groups, such as the American Arbitration Association, for handling these arbitrations. These recommendations will now be considered by the SRO's which will work with the SEC to consider all possible options before revisions to the process are made. [July-Dec.] Sec. Reg. & L. Rep. (BNA) No. 37, at 1387-88 (Sept. 18, 1987).

212. Rodriguez De Quijas v. Shearson/Lehman Bros., Inc., 845 F.2d 1296 (5th Cir.), *cert. granted sub nom.* Rodriguez De Quijas v. Shearson/American Express, Inc., 57 U.S.L.W. 3343 (Nov. 15, 1988).

213. *McMahon*, 107 S. Ct. at 2341.

214. *See supra* text accompanying notes 151-52.

anti-waiver provision of the Securities Act, unless there is some significant difference between the two claims for purposes of arbitration. As previously discussed, these provisions are not distinguishable for purposes of arbitration.[215] The fact that the *McMahon* Court chose to ignore the "colorable argument" for differentiating these types of claims further supports this position.[216]

Thus, in reexamining *Wilko*, the Court should conclude that section 12(2) claims are subject to pre-dispute arbitration agreements. This result is necessary as a matter of consistency, and because the reasoning of its recent decisions suggests that these claims would be better handled by arbitration, provided that the SEC appropriately regulates the process.[217] In fact, Justice Blackmun's opinion in *McMahon* flatly stated that the Court's decision "effectively overrules *Wilko*,"[218] and since *McMahon*, courts have divided on the question of the continued vitality of *Wilko*. The courts which have concluded that claims under the Securities Act are not arbitrable have relied on the argument that *McMahon* chose not to overrule *Wilko*, and therefore it should continue to apply.[219] On the other hand, a number of courts have concluded

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215. *See supra* text accompanying notes 120-41.

216. *See supra* text accompanying notes 142-43.

217. In his dissent, Justice Stevens expressed concern about the majority's overturning such a long line of precedents denying arbitration. *McMahon*, 107 S. Ct. at 2359 (Stevens, J., dissenting) (citing Justice Black's dissent in Boys Market, Inc. v. Retail Clerks, 398 U.S. 235, 257-58 (1970) (Black, J., dissenting)). The basis for concluding that *Wilko* should be reconsidered, is that the underlying considerations which motivated that result are no longer present, and therefore arbitration agreements relating to these claims should be enforced.

218. *Id.* at 2346; *see infra* notes 219-20. In a separate dissent, Justice Stevens was concerned that the long standing application of *Wilko* to the Exchange Act created a presumption of interpretation that should be dealt with by the legislature and not the courts. *Id.* at 2359-60 (Stevens, J., dissenting).

219. A panel of the Court of Appeals for the Second Circuit came to this conclusion by merely stating that *McMahon* questioned, but did not overrule *Wilko*. Chang v. Lin, 824 F.2d 219, 222 (2d Cir. 1987); McCowan v. Dean Witter Reynolds, Inc., 682 F. Supp. 741, 744 (S.D.N.Y. 1987) (since *Wilko* had not been overruled, Securities Act claims would not be sent to arbitration); Continental Serv. Life & Health Ins. v. A.G. Edwards & Sons, 664 F. Supp. 997, 1001 (M.D. La. 1987) (while *Wilko* has been questioned, it has not been overruled, so Securities Act claims would not be sent to arbitration); Johnson v. O'Brien, 420 N.W.2d 264, 267-68 (Minn. App. 1988) (a divided three-judge panel said that *Wilko* had been questioned, but not overruled).

The same result was reached by a district court in Schultz v. Robinson-Humphrey/American Express, Inc., 666 F. Supp. 219 (M.D. Ga. 1987), but with a more detailed analysis. That court also relied on the fact that *McMahon* had not overruled *Wilko*, but acknowledged that the Supreme Court may have wanted to avoid giving an advisory opinion.

that the *McMahon* decision has "so undercut" the *Wilko* analysis that it was proper to order a section 12(2) claim to arbitration.[220]

In light of this movement away from *Wilko*, it is legitimate to ask whether plaintiff-investors would be better served by arbitrating their section 12(2) claims. It has already been pointed out that a plaintiff will be placed at a disadvantage by having to proceed in two forums, judicial and arbitral, if some claims remain in

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Id. at 220. However, it gave weight to two other factors in distinguishing the cases. First, it referred to the legislative history of the 1975 amendments to the Exchange Act, *see supra* text accompanying notes 110-14, and stated that the *McMahon* Court concluded that this showed a clearer legislative intent to affirm *Wilko*'s ruling as to section 12(2) claims, than it did as to Rule 10b-5 claims. *Id.* While this may appear to be a legitimate position, its weakness lies in the fact that the *McMahon* Court recognized that this legislative history was unclear as to what Congress thought existing law was. *See supra* note 155. For example, since the Supreme Court concluded that *Wilko* only prohibited arbitration where arbitration was inadequate, then Congress's support for *Wilko* would only bring us back to the question of the adequacy of arbitration. *See supra* text accompanying notes 149-54. Second, the *Schultz* court asserted that the Supreme Court had not specifically rejected the "colorable argument" for differentiating between Securities and Exchange Act claims, and so *Wilko* should be followed until it is specifically overruled. *Schultz*, 666 F. Supp. at 220. The weaknesses in the "colorable argument" which make it unhelpful in analyzing this problem have been discussed. *See supra* text accompanying notes 120-41. The same reasoning used by the *Schultz* court was also used by another district court in Ketchum v. Almahurst Bloodstock IV, Nos. 86-2498, 86-2523, 86-2535 (D. Kan. Feb. 12, 1988) (WESTLAW, 1988 WL 42552).

220. In Rodriguez De Quijas v. Shearson/Lehman Bros., Inc., 845 F.2d 1296 (5th Cir.), *cert. granted sub nom.* Rodriguez De Quijas v. Shearson/American Express Inc., 57 U.S.L.W. 3343 (Nov. 15, 1988), the Court of Appeals for the Fifth Circuit concluded that section 12(2) claims were arbitrable. In its view, *McMahon* had completely undermined *Wilko* since it limited that case to situations where arbitration was inadequate to protect substantive rights, and concluded that arbitration was adequate for Exchange Act claims. *Id.* at 1298-99. In the Fifth Circuit's view, the similarities between the Securities Act and the Exchange Act justified the conclusion that it should follow *McMahon* "which lead[s] directly to the obsolescence of *Wilko* and the arbitrability of Securities Act § 12(2) claims." *Id.* at 1299. Moreover, the court rejected the argument that the legislative history to the 1975 amendments meant that Congress intended that section 12(2) claims were non-arbitrable. It found "implausible" the view that the two statutes were to be treated differently, and instead thought *McMahon* viewed the legislative history as leaving the *Wilko* issue to the courts. *Id.* & n.7. Similar reasoning has been used by a number of other courts in deciding to permit arbitration of Securities Act claims. Ryan v. Liss, Tenner & Goldberg Securities Corp., 683 F. Supp. 480 (D.N.J. 1988) (claim under section 17(a) of the Securities Act sent to arbitration); Staiman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 673 F. Supp. 1009 (C.D. Cal. 1987); Aronson v. Dean Witter Reynolds, Inc., 675 F. Supp. 1324 (S.D. Fla. 1987); Rocz v. Drexel Burnham Lambert, Inc., 743 P.2d 971 (Ariz. App. 1987) (section 17(a) claim ruled arbitrable).

In another case decided by the Fifth Circuit which gave the *McMahon* decision retroactive effect, the court, in dicta, commented on *Wilko*, stating: "*McMahon* undercuts every aspect of *Wilko v. Swan*; a formal overruling of *Wilko* appears inevitable—or, perhaps, superfluous." Noble v. Drexel Burnham Lambert, Inc., 823 F.2d 849, 850 n.3 (5th Cir. 1987) (citation omitted).

federal court, while others are sent to arbitration.[221] In many cases this will result in the plaintiff being burdened with additional time and expense of simultaneously challenging a large corporate defendant on two different fronts, or having the federal court proceedings delayed until the arbitration is resolved. When the disadvantage of proceeding in two forums is coupled with the reality that the arbitration is a quicker and less expensive method of proceeding, little benefit accrues to plaintiffs' opposition to arbitration of their section 12(2) claims. This, of course, assumes that adjustments are made to the arbitration process as have been suggested earlier. The only factors that can be weighed in favor of retaining section 12(2) claims in federal court is the potential "discovery" benefits in preparation of a case, and the hope that a judicial forum will be more sympathetic to the investor's claim. These benefits are hypothetical at best, and do not justify a plaintiff's decision to litigate a section 12(2) claim, when arbitration is available, and will nonetheless be utilized to resolve the other claims between the parties.

VI. CONCLUSION

The Supreme Court has shown an increasing willingness in recent years to rely on the arbitral process for the resolution of securities disputes, and has been more willing to enforce pre-dispute arbitration agreements under the Arbitration Act. In so doing the Court has assumed that the process is more capable of dealing with these matters than it once was, and that SEC supervision of the rules of arbitration will insure the satisfactory use of this system in dealing with claims under the Exchange Act. As a result of these developments, it is important that the SEC carefully review the legitimate concerns of the public investor, and direct changes in the system that will increase public confidence. Assuming that this is done, there are substantial reasons for the Court to also enforce pre-dispute arbitration agreements with regard to claims which arise under the Securities Act.

221. *See supra* text accompanying notes 174-75.