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Securities - Arbitration - Predispute Arbitration Agreements Enforceable against Investors Filing Claims under Section 10(b) of the Securities Exchange Act of 1934 Symposium - Business Tort Litigation - Case Note.

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CASENOTES

SECURITIES—Arbitration—Predispute Arbitration Agreements Enforceable Against Investors Filing Claims Under Section 10(b) Of The Securities Exchange Act Of 1934

Shearson/American Express, Inc. v. McMahon
__ U.S. __, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987)

Julia and Eugene McMahon held several profit-sharing and pension accounts with the brokerage firm Shearson/American Express, Inc. (Shearson).[1] Julia McMahon signed two customer agreements which required arbitration of disputes arising from these accounts.[2] Several years later, despite the arbitration agreements, the McMahons filed suit in federal district court against Shearson and its registered broker, Mary Ann McNulty, who managed the McMahons' accounts.[3] The McMahons contended that McNulty, in violation of Securities and Exchange Commission Rule 10b-5[4] and

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1. Shearson/American Express, Inc. v. McMahon, __ U.S. __, __, 107 S. Ct. 2332, 2335, 96 L. Ed. 2d 185, 191 (1987).

2. *Id.* The arbitration clause signed by Julia McMahon read as follows:

> Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules, then in effect, of the National Association of Securities Dealers, Inc. or the Board of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I may elect.

McMahon v. Shearson/American Express, Inc., 618 F. Supp. 384, 385 (S.D.N.Y. 1985), *aff'd in part, rev'd in part*, 788 F.2d 94 (2d Cir. 1986), *rev'd*, __ U.S. __, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987).

3. *McMahon*, __ U.S. at __, 107 S. Ct. at 2336, 96 L. Ed. 2d at 191 (suit filed in 1984).

4. 17 C.F.R § 240.10b-5 (1987). Rule 10b-5 states:

> 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,
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> a) To employ any device, scheme or artifice to defraud,
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> b) To make any untrue statement of a material fact or to omit to state a material fact

section 10(b) of the Securities Exchange Act of 1934 (Exchange Act),[5] had lied and suppressed important information when counseling the McMahons, and had unlawfully "churned"[6] their accounts.[7] Shearson, pursuant to the customer agreements and in accordance with the Federal Arbitration Act, sought to force arbitration of the dispute.[8] The district court agreed with Shearson, holding that the Exchange Act claim was arbitrable pursuant to both the customer agreement and the government's policy of support for arbitration.[9] The McMahons appealed the decision to the United States Court of Appeals for the Second Circuit, which reversed the district court's decision.[10] The United States Supreme Court granted Shearson's writ of

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necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id.

5. Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1982). Section 78j(b) provides:

It shall be unlawful for any person, directly or indirectly, by 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.

Id.

6. *McMahon*, 618 F. Supp. at 386. Churning is "the fraudulent and willful practice of trading extensively solely to maximize commissions." *Id.*

7. *McMahon*, __ U.S. at __, 107 S. Ct. at 2336, 96 L. Ed. 2d at 192. The McMahons brought additional claims, alleging violations of both the Racketeering Influenced and Corrupt Organizations Act (RICO) and state securities laws. *See id.*

8. *See id.* at __, 107 S. Ct. at 2336, 96 L. Ed. 2d at 192; *see also* Federal Arbitration Act, 9 U.S.C. §§ 1-14 (1982). Section 3 of the Act states:

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

Id. § 3.

9. *See McMahon*, 618 F. Supp. at 387-89 (district court found state securities claims arbitrable, but RICO claim not arbitrable because of strong governmental support for judicial enforcement of RICO).

10. *See* McMahon v. Shearson/American Express, Inc., 788 F.2d 94, 99-100 (2d Cir. 1986), *rev'd*, __ U.S. __, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987). Shearson concurrently appealed the district court's decision prohibiting arbitration of the RICO claim. *See id.* at 95.

certiorari to determine whether claims brought under section 10(b) of the Exchange Act are subject to arbitration based upon a predispute agreement.[11] HELD—*Reversed*. Predispute arbitration agreements are enforceable against investors making claims under section 10(b) of the Securities Exchange Act of 1934.[12]

Arbitration is a process for resolution of a dispute between parties by an impartial group of individuals called arbitrators.[13] Although arbitration was subject to judicial hostility at common law,[14] Congress statutorily advocated arbitration[15] in the Arbitration Act of 1925.[16] Through the enactment, Congress mandated enforcement of predispute agreements calling for arbitration.[17] The Act was further supported by the contention that arbitration

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The court of appeals affirmed the district court's decision regarding the state securities and RICO claims. *See id.* at 99-100.

11. *McMahon*, __ U.S. at __, 107 S. Ct. at 2336-37, 96 L. Ed. 2d at 193.

12. *Id.* at __, 107 S. Ct. at 2343, 96 L. Ed. 2d at 201 (no contrary Congressional intent opposing arbitration of RICO claim, thus, RICO claim arbitrable).

13. 1 BOUVIER'S LAW DICTIONARY 31 (1928)(quoted in Grand Rapids City Coach Lines v. Howlett, 137 F. Supp. 667, 672 (W.D. Mich. 1955). Arbitration has been defined as "the investigation and determination of a matter or matters of difference between contending parties, by one or more unofficial persons, chosen by the parties, and called arbitrators or referees." *Id.*; *see also* Comment, *The Arbitration Alternative: Its Time Has Come*, 46 MONT. L. REV. 199, 199 (1985)(arbitration is binding resolution of conflict by impartial persons). Judicial definitions of "arbitration" differ. *Compare* Stathos v. Arnold Bernstein S.S. Corp., 202 F.2d 525, 526 (2d Cir. 1953)(arbitration kind of trial replacing common law trial) *with* Zweig v. United States, 60 F. Supp. 785, 785 (N.D. Tex. 1945)(arbitration is non-litigious settlement).

14. *See* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 626-27 (1985)(courts originally suspicious of arbitration); *see also, e.g.*, Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 219-20 (1985)(longstanding opposition to arbitration); Southland Corp. v. Keating, 465 U.S. 1, 18 (1984)(Stevens, J., concurring in part, dissenting in part)(common law prohibited arbitration).

15. *See Mitsubishi*, 473 U.S. at 625 (Act promotes enforcement of arbitration agreements); *Keating*, 465 U.S. at 10 (federal policy favoring arbitration present in Act); *see also* Comment, *Section 10(b) and Rule 10b-5 Federal Securities Law Claims: The Need for the Uniform Disposition of the Arbitration Issue*, 24 SAN DIEGO L. REV. 199, 199 (1987)(discussing governmental policy favoring arbitration).

16. 9 U.S.C. §§ 1-14 (1982). Section two of the Act states in part:

> [A]n agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Id. § 2.

17. *See, e.g.*, *Mitsubishi*, 473 U.S. at 625-26 (Act passed to uphold arbitration agreements); *Byrd*, 470 U.S. at 221 (Congress favored enforcing predispute agreements); *Keating*, 465 U.S. at 15-16 (quoting H.R. REP. NO. 96, 68th Cong., 1st Sess. 1 (1924)). The House Report provides that Congress intended to place "an arbitration agreement . . . upon the same footing as other contracts, where it belongs." *See Keating*, 465 U.S. at 15-16; *see also* Comment, *Arbitrating Civil RICO And Implied Causes Of Action Arising Under Section 10(b) Of The Securities Exchange Act Of 1934*, 36 CATH. U. L. REV. 455, 468 (1987)(Arbitration Act passed to encourage upholding contractual agreements).

was beneficial to the parties by reducing both costs and time involved in litigation.[18]

Following enactment of the Arbitration Act, Congress passed the Securities Act of 1933 (Securities Act)[19] and the Securities Exchange Act of 1934 (Exchange Act)[20] to protect investors in the securities industry.[21] Specifically, the Securities Act sought to prevent fraudulent activities of brokers and to encourage fair and honest trading by requiring that investors receive "full disclosure of material information" regarding securities.[22] The Exchange Act was enacted to "protect investors against manipulation of stock prices."[23] Despite these Congressional efforts to protect securities investors, disputes arose between brokers and their customers, resulting in judicial examination of the arbitrability of securities claims brought under either Act.[24]

In 1953, the United States Supreme Court first addressed the issue of arbitrating securities claims in the landmark case of *Wilko v. Swan*.[25] The *Wilko*

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18. H.R. REP. NO. 96, 68th Cong., 1st Sess. 2 (1924). The report provides:

> It is practically [sic] appropriate that the action should be taken at this time when there is so much agitation against the costliness and delays of litigation. These matters can be largely eliminated by agreements for arbitration, if agreements are made valid and enforceable.

Id. (quoted in *Byrd*, 470 U.S. at 220 (recognizing benefits of arbitration)); *see also* Scherk v. Alberto-Culver Co., 417 U.S. 506, 511 (1974)(acknowledging money and time saved by arbitration).

19. 15 U.S.C. § 77a-mm (1982).

20. *Id.* § 78a-kk.

21. *See, e.g.*, Ernst & Ernst v. Hockfelder, 425 U.S. 185, 194-95 (1976)(federal regulation of stock market needed); *Scherk*, 417 U.S. at 512 (Securities and Exchange Acts designed to protect investors); Wilko v. Swan, 246 U.S. 427, 431 (1953)(Securities Act provisions protect investors from broker misconduct); *see also* Comment, *Section 10(b) and Rule 10b-5 Federal Securities Law Claims: The Need for the Uniform Disposition of the Arbitration Issue*, 24 SAN DIEGO L. REV. 199, 204 (1987)(stock market crash resulted in enactment of Securities Acts).

22. *Hochfelder*, 425 U.S. at 195 (citing H.R. REP. NO. 85, 73d Cong., 1st Sess. 1-5 (1933)). *See generally* Comment, *Predispute Arbitration Agreements Between Brokers And Investors: The Extension of* Wilko *to Section 10(b) Claims*, 46 MD. L. REV. 339, 341 (1987)(discussing Congress' reasons for passing Securities Acts).

23. *See Hochfelder*, 425 U.S. at 195 (citing S. REP. NO. 792, 73d Cong., 2d Sess. 1-5 (1934)). For a discussion of the Congressional purpose behind the Exchange Act, see Comment, *Predispute Arbitration Agreements Between Brokers And Investors: The Extension of* Wilko *to Section 10(b) Claims*, 46 MD. L. REV. 339, 341 (1987).

24. *See, e.g.*, Shearson/American Express, Inc. v. McMahon, __ U.S. __, __, 107 S. Ct. 2332, 2335, 96 L. Ed. 2d 185, 191 (1987)(arbitrating claim under 1934 Exchange Act); *Wilko*, 346 U.S. at 430 (1953)(questioning arbitrability of 1933 Securities Act claim); Ayres v. Merrill, Lynch, Pierce, Fenner & Smith, 538 F.2d 532, 533 (3d Cir.)(reviewing validity of arbitrator's award in securities dispute), *cert. denied*, 429 U.S. 1010 (1976); Axelrod & Co. v. Kordich, Victor &Neufeld, 451 F.2d 838, 839 (2d Cir. 1971)(arbitration of security dispute between brokerage firms).

25. 346 U.S. 427 (1953).

case dealt with a broker's motion to enforce an arbitration agreement[26] which encompassed an investor's claim brought under the Securities Act.[27] The Supreme Court held that claims arising under section 12(2) of the Securities Act[28] were not subject to arbitration.[29] In reaching its decision in *Wilko*, the Court recognized that the Securities Act placed investors in an advantageous position over brokers[30] by providing investors with an express right of action against brokers under section 12(2)[31] and an expanded judicial forum in which to bring suit under section 22(a).[32] The Court further

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26. *See id.* at 430. The Arbitration Act allows a party to obtain judicial enforcement of a predispute agreement. *See* 9 U.S.C. § 3 (1982).

27. *See Wilko*, 346 U.S. at 431. Petitioner, Wilko, alleged that respondent broker, Swan, had misrepresented a merger involving Air Associates, Inc., and that Wilko had relied on those misrepresentations in purchasing stock. *See id.* at 428- 29. After Wilko sold the stock at a loss two weeks later, Wilko sued Swan, maintaining that the loss resulted from the broker's false statements and omissions. *See id.* at 429. The district court refused the broker's motion to compel arbitration, reasoning that the arbitration clause would waive the protections, such as a choice of forum, given to investors under the Securities Act and would conflict with legislative intent. *See* Wilko v. Swan, 107 F. Supp. 75, 78-79 (S.D.N.Y. 1952), *rev'd*, 201 F.2d 439 (2d Cir.), *rev'd*, 346 U.S. 427 (1953). However, the United States Court of Appeals for the Second Circuit reversed the district court, holding that arbitrators are bound to protect the investor by deciding the conflict based upon applicable provisions of the 1933 Securities Act. *See* Wilko v. Swan, 201 F.2d 439, 444-45 (2d Cir.), *rev'd*, 346 U.S. 427 (1953). Furthermore, the court of appeals reasoned that Congress would have explicitly stated its intent to create an exception to arbitration if it had desired to do so. *See id.* at 445.

28. Securities Act of 1933 § 12(2), 15 U.S.C. § 77l(2) (1982). Section 77l(2) states:

> Any person who—
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> (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.

Id.

29. *Wilko*, 346 U.S. at 438. *See generally* Note, *Arbitrability of Claims Arising Under the Securities and Exchange Act of 1934*, 1986 DUKE L.J. 548, 549-51 (1986)(discussing reasoning in *Wilko*).

30. *See Wilko*, 346 U.S. at 431-35; *see also* Comment, *Arbitrating Civil RICO and Implied Causes of Action Arising Under Section 10(b) of the Securities Exchange Act of 1934*, 36 CATH. U.L. REV. 455, 470 (1987)(Securities Act provides investor with advantageous remedies).

31. 15 U.S.C. § 77l(2) (1982); *see also Wilko*, 346 U.S. at 431 (noting express right of action requires broker to prove lack of intent and allows investor to sue in all courts with proper jurisdiction).

32. Securities Act of 1933 § 22(a), 15 U.S.C. § 77v (1982). Section 77v provides in part:

decided that because section 14 of the Securities Act[33] voided any "stipulation" which "waived compliance with any provision" of the Act.[34] Therefore, an arbitration agreement (the "stipulation") limiting the investor's judicial forum under section 22(a) (the "provision") was not enforceable.[35] The Court also found arbitration an inadequate method of handling customer disputes due to the restricted judicial examination of an arbitral decision, the lack of record-keeping in the arbitration process, and the want of explanations for an arbitral determination.[36] Thus, *Wilko* created an exception to compelled arbitration for Securities Act claims, despite Congressional efforts to promote arbitration.[37]

Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendants may be found.

Id. The Court found the Act's provision for expanded venue and wide service of process to be significant benefits for the investor. *See Wilko*, 346 U.S. at 431.

33. Securities Act of 1933 § 14, 15 U.S.C. § 77n (1982). Section 77n provides: "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void." *Id.*

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

35. *See id. See generally* Brown, Shell, & Tyson, *Arbitration of Customer-Broker Disputes Arising Under the Federal Securities Laws and RICO*, 15 SEC. REG. L.J. 3, 4, 17-19 (1987)(*Wilko* prohibited waiver of judicial forum); Moylan & Ukman, *Arbitration of Customer-Securities Broker Disputes*, 75 ILL. B.J. 374, 376 (1987)(arbitration of 1933 Act claim waived investor's right to bring suit).

36. *Wilko*, 346 U.S. at 432-35. The Court stated that arbitration insufficiently protected the investor because arbitrators lacked legal knowledge which would aid them in their decisions. *See id.* at 436. Moreover, according to the majority, the investor had limited access to judicial review of an arbitrator's award. *See id.* Section 10 of the Arbitration Act provides for vacating an award only:

(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.

9 U.S.C. § 10 (1982). *See generally* Brown, Shell, & Tyson, *Arbitration of Customer-Broker Disputes Arising Under the Federal Securities Laws and RICO*, 15 SEC. REG. L.J. 3, 15-17 (1987)(stating arbitration inadequate to protect investor bringing claim under either Securities Act or Exchange Act).

37. *See Wilko*, 346 U.S. at 438. For a discussion concerning exemption from arbitration for securities claims, see generally Katsoris, *The Arbitration of a Public Securities Dispute*, 53 FORDHAM L. REV. 279, 293-95 (1984); M. DOMKE, DOMKE ON COMMERCIAL ARBITRATION § 1901 (1986).

Following the Supreme Court's decision in *Wilko*, federal appeals courts extended the applicability of *Wilko*'s analysis of Securities Act claims to securities claims brought under the 1934 Exchange Act.[38] Courts prohibiting arbitration of section 10(b) claims reasoned that the waiver provision in the Exchange Act,[39] which barred waiver of the purchaser's right to sue in court, was comparable to the section 14 waiver provision in the Securities Act.[40] These courts considered both Acts to provide the investor with an advantageous choice of jurisdictions in which to bring suit.[41] Although the United States Supreme Court had not specifically prohibited the extension of *Wilko's* reasoning to section 10(b) claims,[42] one of the Court's later decisions expressed reservations about the lower courts' extension of the *Wilko* decision to section 10(b) claims.[43]

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38. *See, e.g.*, Cancanon v. Smith Barney, Harris, Upham & Co., 805 F.2d 998, 998-99 (11th Cir. 1986)(relying on *Wilko* as precluding arbitration of section 10(b) claims); Wolfe v. E.F. Hutton & Co., 800 F.2d 1032, 1038 (11th Cir. 1986)(refusing to compel arbitration of section 10(b) claim), *vacated*, __ U.S. __, 107 S. Ct. 3205, 96 L. Ed. 2d 692 (1987); Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532, 537-38 (3d Cir.)(supporting *Wilko*'s extension to section 10(b) claims), *cert. denied*, 429 U.S. 1010 (1976); *see also* Leone v. Advest, Inc., 624 F. Supp. 297, 302 (S.D.N.Y. 1985)(holding claims brought under section 10(b) non-arbitrable). *But see* Brief for Petitioner at A-32, Shearson/American Express, Inc. v. McMahon, __ U.S. __, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987), *reprinted in* D. ROBBINS, RESOLVING SECURITIES DISPUTES: ARBITRATION AND LITIGATION 406-416 (1986)(appendix listing cases which support and which oppose arbitration of section 10(b) claims).

39. 15 U.S.C. § 78cc(a) (1982). Section 78cc(a) (previously identified and still commonly referred to as section 29(a)) provides that "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void." *Id.*

40. *See, e.g.*, *Wolfe*, 800 F.2d at 1039 (Tjoflat, J., concurring); Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, 797 F.2d 1197, 1201 (3d Cir. 1986), *vacated*, __ U.S. __, 107 S. Ct. 3204, 96 L. Ed. 2d 691 (1987); *Ayres*, 538 F.2d at 536. *See generally* Comment, *Section 10(b) And Rule 10b-5 Federal Securities Law Claims: The Need for the Uniform Disposition of the Arbitration Issue*, 24 SAN DIEGO L. REV. 199, 209 (1987)(similarities in waiver provisions warrant *Wilko*'s extension).

41. *See Wolfe*, 800 F.2d at 1032, 1036-37 (Exchange Act provides federal forum for dispute resolution); Conover v. Dean Witter Reynolds, Inc., 794 F.2d 520, 526-27 (9th Cir. 1986)(1934 Act ensures judicial remedy), *vacated*, __ U.S. __, 107 S. Ct. 3203, 96 L. Ed. 2d 691 (1987); *see also* Scherk v. Alberto-Culver Company, 417 U.S. 506, 532 (1974)(Douglas, J., dissenting)(right to sue in federal court under 1934 Act). *But see Scherk*, 417 U.S. at 515 (restricted forum in 1934 Act).

42. *See* Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 215 n.1 (1985)(*Wilko*'s extension not before Court); Scherk v. Alberto-Culver Co., 417 U.S. 506, 514 n.8 (1974)(refusing to consider *Wilko*'s extension); *see also* Note, *The Enforceability of Predispute Arbitration Agreements Under 10(b) and 10b-5 Claims*, 43 WASH. & LEE L. REV. 923, 925 (1986)(arbitrability of section 10(b) claims still in doubt).

43. *See Scherk*, 417 U.S. at 513-15 (*Wilko* reasoning inapplicable to Exchange Act suit); *see also Byrd*, 470 U.S. at 224-25 (White, J., concurring)(*Wilko*'s decision not mechanically transplanted to section 10(b) claims). *See generally* Katsoris, *The Arbitration of a Public Se-*

In *Scherk v. Alberto-Culver Co.*,[44] the Supreme Court expressed doubt regarding the applicability of the *Wilko* reasoning to section 10(b) claims.[45] Writing for the majority, Justice Stewart stated, "a colorable argument could be made that even the semantic reasoning of the *Wilko* opinion does not control the case before us."[46] The Court's skepticism arose from the absence of any provision in section 10(b) of the 1934 Act[47] which would afford the investor with the right to a "private remedy to redress violations."[48] Moreover, the Court noted that the jurisdictional provisions within the two Acts differed[49] in that the Securities Act permitted the purchaser to sue in either state or federal courts having "competent jurisdiction," while the Exchange Act permitted suit to be brought only in federal courts.[50]

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curities Dispute, 53 FORDHAM L. REV. 279, 299-300 (1984)(noting lower court's failure to examine all factors in *Wilko*).

44. 417 U.S. 506 (1974).

45. *See id.* at 513-14. Alberto-Culver was an United States company which had negotiated with Scherk, a German citizen, to purchase three of his enterprises. *Id.* at 509. Despite a predispute agreement signed by both parties, Alberto-Culver brought suit in a United States District Court after learning that the company trademarks had several encumbrances. *See id.* at 509-10. On appeal to the Supreme Court, Scherk sought to compel arbitration of the section 10(b) claim and the Court ruled in his favor. *See id.* at 519-20. The Court based its holding on the need for arbitration in an international arena to prevent disputes over the location of the judicial forum and the law which would apply. *See id.* at 515-16. Although the Court's decision was based on the international nature of the dispute, Justice Stewart questioned the applicability of *Wilko*'s reasoning to stop arbitration of section 10(b) claims. *See id.* at 513-16. Justice Douglas, dissenting, contended that *Wilko*'s reasoning applied in this case because the waiver provision in the 1934 Act protects investors and voids arbitration of section 10(b) claims. *See id.* at 527-28 (Douglas, J., dissenting).

46. *See Scherk*, 417 U.S. at 513. For a discussion of Justice Stewart's "colorable argument" opposing *Wilko*'s extension to the 1934 Act see generally Comment, *Predispute Arbitration Agreements Between Brokers and Investors: The Extension of* Wilko *to Section 10(b) Claims*, 46 MD. L. REV. 339, 346-53 (1987).

47. *See Scherk*, 417 U.S. at 513-14 (1974)(federal courts implied exception to compelled arbitration in Exchange Act claims). *Compare* 15 U.S.C. § 78j (1982)(no express provision in section 10(b) to bring suit) *with* 15 U.S.C. § 77*l* (1982)(express right to sue in section 12(2) provision).

48. *Scherk*, 417 U.S. at 513; *accord* Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc., 806 F.2d 291, 296 (1st Cir. 1986)(1933 Act specifically provides right to sue); Phillips v. Merrill Lynch, Pierce, Fenner & Smith, 795 F.2d 1393, 1397 (8th Cir. 1986)(express right to sue under Securities Act), *cert. denied*, __ U.S. __, 107 S. Ct. 3218, 96 L. Ed. 2d 705 (1987).

49. *See Scherk*, 417 U.S. at 514; *accord Phillips*, 795 F.2d at 1397. For a discussion of the differences between provisions within the 1933 and 1934 Securities Acts, see generally Note, *Arbitrability of Implied Rights of Action Under Section 10(b) of the Securities Exchange Act*, 61 N.Y.U. L. REV. 506, 520 (1986).

50. *Scherk*, 417 U.S. at 514 (citing Wilko v. Swan, 346 U.S. 427, 431 (1953)); *see also* 15 U.S.C. § 77v (1982)(may institute suit in federal or state court). The Exchange Act limits the buyer's choice of venue to federal courts. *See Scherk*, 417 U.S. at 514; *see also* 15 U.S.C. § 78aa (1982)(suit must be brought in federal court). In addition to permitting suit in both federal and state courts, section 22(a) of the Securities Act also allows a purchaser to prevent

Ten years after *Scherk*, in *Dean Witter Reynolds, Inc v. Byrd*,[51] Justice White questioned the validity of *Wilko*'s extension to Exchange Act claims.[52] Justice White noted that lower court decisions holding claims brought under section 10(b) of the Exchange Act nonarbitrable "must be viewed with some doubt."[53] Justice White observed that although the waiver provisions of both Acts were "equivalent,"[54] the "counterparts of the [cause of action and jurisdictional] provisions [were] imperfect or absent altogether."[55] Justice White based his reasoning on two distinctions. The Justice first noted section 10(b) did not provide an express cause of action but judicially implied a private remedy, while section 12(2) stated an express cause of action.[56] In addition, section 27 limited jurisdiction to the federal courts, while section 22(a) extended jurisdiction to both federal and state courts, with removal from the state courts prohibited.[57] Because the cause of action and jurisdictional provisions were unique to each Act, Justice White concluded that the waiver provision in the Exchange Act would not void arbitration of a section 10(b) claim and that *Wilko*'s consideration for an express cause of action under section 12(2) of the Securities Act was unfitting for the "judicially implied" right of action within section 10(b) of the

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removal of his case from a state court. *See Scherk*, 417 U.S. at 514; *accord Phillips*, 795 F.2d at 1397; 15 U.S.C. § 77v (1982)(may prevent removal to federal court).

51. 470 U.S. 213 (1985). Byrd brought a claim against his broker, an agent of Dean Witter, after his investment account significantly declined in value. *See id.* at 214. Byrd alleged that the broker made misrepresentations regarding the investments, excessively traded on his account, and made transactions on the account without Byrd's permission in violation of state securities laws and section 10(b) of the 1934 Exchange Act. Pursuant to a predispute agreement with Byrd, the broker sought to sever the state claims and compel their arbitration. *See id.* at 215. The Court, emphasizing the Arbitration Act language which mandates enforcement of predispute agreements, held that the state claims should be severed for arbitration. Having assumed that the section 10(b) claims could not be arbitrated, the broker failed to demand their arbitration in the district court. *See id.* at 215-16 n.1. Therefore, the Justices declined to answer the question of *Wilko*'s applicability to these claims, as it was not properly before the Court. *See id.* at 216 n.2. Although the Court refused to discuss *Wilko*'s application to section 10(b) claims, Justice White addressed this issue in a concurring opinion. *See id.* at 224-25 (White, J., concurring).

52. *See id.* at 224-25 (White, J., concurring).

53. *Id.* at 225; *accord Scherk*, 417 U.S. at 513-14.

54. *Byrd*, 470 U.S. at 224 (White, J., concurring); *see also* 15 U.S.C. § 78cc (1982) (preventing waiver of 1934 Act provisions); 15 U.S.C. § 77n (1982)(prohibiting waiver of 1933 Act provisions).

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

56. *See id. Compare* 15 U.S.C. § 78j (1982)(judicially implied right of action) *with* 15 U.S.C. § 77*l* (1982)(express cause of action).

57. *See Byrd*, 470 U.S. at 225 (White, J., concurring). *Compare* 15 U.S.C. § 78aa (1982)(may only sue in federal court) *with* 15 U.S.C. § 77v (1982)(suit may be brought in federal or state court).

Exchange Act.[58]

After the Supreme Court's apparent reluctance in *Scherk* and *Byrd* to extend *Wilko* to 10(b) claims, decisions of the courts of appeals began to conflict.[59] Those courts allowing arbitration of section 10(b) claims refused to equate the Securities Act, which expressed a distinct right of action for investors, with the Exchange Act, wherein a right of action for investors had been judicially implied.[60] Courts noted that section 10(b) of the Exchange Act differed from section 12(2) of the Securities Act in that the customer had the burden in a section 10(b) action of proving intent on the part of the broker, in contrast to section 12(2) which required the broker to prove his lack of intent.[61] To settle the dispute among the circuits, the Supreme Court agreed to hear *McMahon*.[62]

In *Shearson/American Express, Inc. v. McMahon,*[63] the United States Supreme Court determined that predispute arbitration agreements were enforceable against brokerage customers who had filed claims pursuant to section 10(b) of the Exchange Act.[64] Justice O'Connor, writing for the ma-

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58. *See Byrd*, 470 U.S. at 224-25 (White, J., concurring). *See generally* Katsoris, *The Arbitration of a Public Securities Dispute*, 53 FORDHAM L. REV. 279, 300-01 (discussing *Wilko*'s applicability to section 10(b) claims).

59. *Compare* Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc., 806 F.2d 291, 296-98 (1st Cir. 1986)(section 10(b) claims arbitrable) *and* Phillips v. Merrill Lynch, Pierce, Fenner & Smith, 795 F.2d 1393, 1399 (8th Cir. 1986)(section 10(b) claims arbitrable), *cert. denied*, __ U.S. __, 107 S. Ct. 3218, 96 L. Ed. 2d 705 (1987) *with* Wolfe v. E.F. Hutton & Co., 800 F.2d 1032, 1038 (11th Cir. 1986)(refusing to compel arbitration of section 10(b) claim) *and* Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, 797 F.2d 1197, 1202 (3d Cir. 1986)(denying motion to compel arbitration of section 10(b) claims), *vacated*, __ U.S. __, 107 S. Ct. 3205, 96 L. Ed. 2d 692 (1987) *and* King v. Drexel Burnham Lambert, Inc., 796 F.2d 59, 60 (5th Cir. 1986)(affirming denial of motion to compel arbitration of section 10(b) claim), *vacated*, __ U.S. __, 107 S. Ct. 3203, 96 L. Ed. 2d 691 (1987). *See also* Brief for Petitioner at 6-17, A-32, Shearson/American Express, Inc. v. McMahon, __ U.S. __, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987), *reprinted in* D. ROBBINS, RESOLVING SECURITIES DISPUTES: ARBITRATION AND LITIGATION 406-16 (1986)(listing cases supporting and opposing arbitration of section 10(b) claims).

60. *See Phillips*, 795 F.2d at 1397 (differing provisions require *Wilko* to be limited); *see also Byrd*, 470 U.S. at 224 (White, J., concurring)(*Wilko* doctrine should not be extended to 1934 Act). *But see Wolfe*, 800 F.2d at 1038 (similarities in Acts' provisions permit *Wilko*'s application).

61. *See Phillips*, 795 F.2d at 1398 (section 10(b) action requires buyer's proof of broker's scienter while action under section 12(2) does not). *Compare* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 190-93 (1976)(section 10(b) claim requires purchaser to prove broker's intent) *with* Wilko v. Swan, 346 U.S. 427, 431 (1953)(broker must prove lack of intent in section 12(2) action).

62. Shearson/American Express, Inc. v. McMahon, __ U.S. __, __, 107 S. Ct. 2232, 2336-37, 96 L. Ed. 2d 185, 193 (1987).

63. __ U.S. __, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987).

64. *See id.* at __, 107 S. Ct. at 2343, 96 L. Ed. 2d at 201. A 5-4 majority supported the decision to enforce the arbitration agreements as to the section 10(b) claims. *See id.* at __, 107

jority, found support within the Arbitration Act for upholding predispute arbitration agreements.[65] Rejecting the contention that Congress intended section 10(b) dispute resolution to occur in a judicial forum, the Court maintained that section 27 of the Exchange Act was purely a jurisdictional provision prescribing no statutory duties necessitating a broker's compliance.[66] Therefore, the Court concluded that waiver of section 27 would not result in a waiver under section 29(a) of compliance with any section in the 1934 Exchange Act.[67] Additionally, the Court refused to extend *Wilko v. Swan* to 10(b) claims since the *Wilko* decision rested upon congressional intent to provide a judicial forum, rather than an arbitral forum, to protect investor rights.[68] The Court failed to find similar legislative intent for the Exchange Act's requirement that section 10(b) claims be resolved in court rather than through arbitration.[69] Moreover, the Court maintained that arbitration would not result in an illegal relinquishment of an investor's "substantive protections," as these substantive rights would merely be resolved by an arbitrator rather than a court.[70] The Court noted that arbitration procedures improved significantly after the *Wilko* decision[71] and had become a compe-

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S. Ct. at 2335, 2346, 2359, 96 L. Ed. 2d at 191, 204, 220. In agreeing on this particular point, the majority and dissenters found no public interest or congressional intent which would warrant prohibiting the arbitration of RICO claims. *Id.* at __, 107 S. Ct. at 2343-46, 96 L. Ed. 2d at 201-04.

65. *Id.* at __, 107 S. Ct. at 2337, 96 L. Ed. 2d at 193-94. The Court maintained that the Arbitration Act evidenced federal support for alternate dispute resolution. *Id.* (citing to Moses H. Cone Memorial Hosp. v. Mercury Const. Corp., 460 U.S. 1, 24 (1983)). Moreover, the Court stated that any exception to arbitration would have to be supported by the Act, its history, or its purpose. *See id.* at __, 107 S. Ct. at 2338, 96 L. Ed. 2d at 194.

66. *See id.* at __, 107 S. Ct. at 2338-39, 96 L. Ed. 2d at 194-95.

67. *See id.*

68. *Id.* at __, 107 S. Ct. at 2338-39, 96 L. Ed. 2d at 194-95 (citing Wilko v. Swan, 346 U.S. 427 (1953)). Justice O'Connor stated that a contrary interpretation of *Wilko* would conflict with the Court's prior decision in *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974). The *Scherk* decision resulted from the acceptance of arbitration as an adequate alternative for enforcing the Exchange Act. Thus, only where a complainant's substantive rights go unprotected will arbitration be prohibited. *See id.*; *see also* Scherk v. Alberto-Culver Co., 417 U.S. 506, 513-15 (1974)(arbitration adequate means of enforcement).

69. *See McMahon*, __ U.S. at __, 107 S. Ct. at 2338-39, 96 L. Ed. 2d at 194-96.

70. *Id.* at __, 107 S. Ct. at 2339, 96 L. Ed. 2d at 196. The McMahons argued that the arbitration agreement was invalid because it resulted from overreaching by the broker. *See id.* The Court stated that contract law would invalidate a predispute agreement resulting from broker manipulation, but that section 29(a) was inapplicable to this situation and would only void agreements which weakened the buyer's remedies under the Act. *See id.*

71. *See id.* at __, 107 S. Ct. at 2340, 96 L. Ed. 2d at 197-98. The *Wilko* Court was suspicious of an arbitrator's unsupervised capacity to subjectively find wrongful intent on the part of a broker. *See* Wilko v. Swan, 346 U.S. 427, 435-36 (1953). Furthermore, that Court distrusted arbitration because no record was needed, arbitrators were not required to provide reasons for their decisions, and review of arbitration was limited. *See id.* The *Shearson* Court, in rejecting this suspicion, cited *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 473

tent method of enforcing the Exchange Act.[72] Finally, the Court held that the 1975 Amendments to the Exchange Act did not indicate a clear congressional intent in support of *Wilko*'s extension to section 10(b) claims.[73]

Justice Blackmun disagreed with the majority's position that *Wilko* dealt solely with the inadequacies of arbitration as an enforcement mechanism for the Securities Act; that arbitration had improved significantly since *Wilko*; and that, because of these improvements, *Wilko* was outdated.[74] The dissent pointed out that such a narrow reading overlooked *Wilko*'s importance in creating an exception to arbitration of securities claims.[75] Justice Blackmun, finding congressional approval of *Wilko*'s extension in the 1975 amendments to the Exchange Act, disapproved of the Court's failure to protect investors.[76] Because congressional intent favored exemption of Securities Act claims from arbitration, Justice Blackmun contended that the legislative intent behind the Exchange Act also compelled the Court to cre-

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U.S. 614, 636-37 (1985) and acknowledged that arbitrators, though lacking judicial supervision, were able to handle the facts and issues involved in a claim. *See McMahon*, __ U.S. at __, 107 S. Ct. at 2340, 96 L. Ed. 2d at 196-97. Additionally, the customer's legal rights would be protected since judicial review of awards, though limited, would ensure that arbitrators follow the Exchange Act. *See id.*

72. *See id.* at __, 107 S. Ct. at 2340-41, 96 L. Ed. 2d at 197-99. The Court noted that arbitration would guarantee protection of Exchange Act rights since the Securities and Exchange Commission had increased its regulatory authority over arbitration proceedings. *See id.*

73. *See id.* at __, 107 S. Ct. at 2342-43, 96 L. Ed. 2d at 199-201. Although the House Conference Report accompanying the amendments evidenced Congress' awareness of the existing law stated in *Wilko*, the majority maintained that the report failed to indicate whether Congress ratified *Wilko* as applied to section 12(2) only, or whether Congress approved of the extension of *Wilko* to section 10(b) claims. *See id.*

74. *See id.* at __, 107 S. Ct. at 2349-50, 96 L. Ed. 2d at 208-09 (Blackmun, J., concurring in part, dissenting in part).

75. *See id.* at __, 107 S. Ct. at 2350, 96 L. Ed. 2d at 208-09. Justice Blackmun stated that the majority's constricted interpretation of *Wilko* was not supported in the Court's later decision in *Mitsubishi*, and that Congress' policy and intent behind the Act was to protect investors' rights in court rather than in arbitration proceedings. *See id.* at __, 107 S. Ct. at 2350-52, 96 L. Ed. 2d at 208-12. Finally, the dissent found *Wilko*'s extension to be in accord with *Scherk v. Alberto-Culver Co.*, since that Court found the international nature of the case to be the deciding factor for compelling arbitration. *Id.* at __, 107 S. Ct. at 2352, 96 L. Ed. 2d at 211-12.

76. *Id.* at __, 107 S. Ct. at 2347, 96 L. Ed. 2d at 206. Justice Blackmun found that, though legislative history superficially showed Congress' approval of *Wilko*, the lack of any opposition to *Wilko* in the amendments indicated that Congress favored *Wilko*'s extension. *See id.* at __, 107 S. Ct. at 2347-49 L. Ed. 2d at 206-08. The dissent also acknowledged the lower court's extension of *Wilko* as supporting congressional desire to protect the investor. *See id.* at __, 107 S. Ct. at 2346, 96 L. Ed. 2d at 204-05. Justice Blackmun further stated that the lower court's extension of *Wilko* has continued despite the Court's suggestive opposition to this extension found in *Scherk v. Alberto-Culver Co.* and *Dean Witter Reynolds, Inc. v. Byrd*. *See id.* at __, 107 S. Ct. at 2348-49, 96 L. Ed. 2d at 207-08.

ate a second exception to arbitration.[77] Moreover, Justice Blackmun disagreed with the majority's view that arbitration procedures had greatly improved since *Wilko*.[78] The dissent maintained that arbitration continued to be an inadequate method of protecting investors because arbitrators typically did not keep records or provide reasons for their awards, and because judicial review of those awards was infrequent.[79] Justice Blackmun criticized the majority's failure to provide protection for investors at a time when broker abuse was increasing and the securities industry was undergoing congressional investigation.[80]

By compelling arbitration of Exchange Act claims, the majority in *McMahon* followed recent United States Supreme Court precedent upholding predispute arbitration agreements pursuant to congressional policy reflected in the Arbitration Act.[81] The Court erred, however, in refusing to recognize that the similarities between the choice of forum provisions in the Exchange Act and the Securities Act warrant the creation of an exception to arbitration for Exchange Act claims, as had been done for Securities Act claims in *Wilko*.[82] The majority misconstrued *Wilko* as prohibiting waiver of the sub-

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77. *See id.* at __, 107 S. Ct. at 2353, 96 L. Ed. 2d at 212-13. Justice Blackmun found *Wilko*'s application to section 10(b) claims possible because both the Securities Act and Exchange Act exemplified Congress' intent to protect investors and provided similar waiver provisions. *See id.*

78. *See id.* at __, 107 S. Ct. 2350, 2353-54, 96 L. Ed. 2d 185, 213-14.

79. *Id.* at __, 107 S. Ct. at 2353-56, 2355, 96 L. Ed. 2d at 213-16. Justice Blackmun noted that the limitations on judicial review of arbitration decisions found in *Wilko* are still present today. *See id.* at __, 107 S. Ct. at 2354-55, 96 L. Ed. 2d at 214-15. Arbitral awards could only be vacated where fraud occurred in making the decision, arbitrators were partial to one party, arbitrators acted with gross misconduct, a final decision was not rendered, or there was a manifest disregard of the law by an arbitrator. *See id.* Having compared the reasons for the Court's mistrust of arbitration in *Wilko v. Swan* to the majority's approval of arbitration in the present case, Justice Blackmun faulted the majority's opinion for failing to recognize that many of the problems with arbitration present when *Wilko* was decided are still present in arbitration today. *See id.* The dissent further questioned the Securities and Exchange Commission's support for arbitration, as indicated by the Commission's amicus curiae brief supporting Shearson, since prior to the filing of its brief the Commission had opposed arbitration of both section 12(2) and section 10(b) customer claims. *See id.*

80. *See id.* at __, 107 S. Ct. at 2358-59, 96 L. Ed. 2d at 218-19. Justice Stevens wrote a short opinion in which he noted that the consistent extension of *Wilko* to Securities Act claims by eight of the circuit courts of appeals created a strong presumption that Congress, not the Court, should correct any error on the part of the judiciary in making this extension. *See id.* at __, 107 S. Ct. at 2359-60, 96 L. Ed. 2d at 220-21 (Stevens, J., concurring in part, dissenting in part).

81. *See, e.g., McMahon*, __ U.S. __, __, 107 S. Ct. at 2337-39, 96 L. Ed. 2d at 193-96, 201 (majority opinion)(upholding arbitration agreement covering Exchange Act claims); Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 218-21 (1985)(arbitration of state securities claims upheld); Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 625-28 (1985)(upholding arbitration of antitrust claims).

82. *See McMahon*, __ U.S. at __, 107 S. Ct. at 2353, 96 L. Ed. 2d at 211-13 (Blackmun,

stantive rights provision, rather than as preventing waiver of the judicial forum provision.[83] Moreover, the majority failed to give credence to the Securities and Exchange Commission's acknowledgement of the inadequacies of an arbitral forum through its enactment of rules prohibiting brokers from binding customers to arbitration of federal securities law claims.[84] The decision also overrides congressional policy present in both the Exchange Act and its 1975 amendments, which substantially support investor protection by extending *Wilko* to Exchange Act claims.[85]

The *McMahon* decision disregards the affinity between the choice of forum provisions in both Acts.[86] Although the forum provision in the Securities Act allows suit to be brought in either federal or state court, the analogous provision in the Exchange Act provides investors with an equally

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J., concurring in part, dissenting in part)(waiver provisions in Securities Act and Exchange Act virtually identical); Wilko v. Swan, 346 U.S. 427, 438 (1953)(ability to select forum cannot be waived). *Compare* 15 U.S.C. § 77v (1982)(suit may be filed in various federal and state courts) *with* 15 U.S.C. § 78aa (1982)(may choose to bring suit in one of many federal court districts).

83. *See McMahon*, __ U.S. at __, 107 S. Ct. at 2338, 96 L. Ed. 2d at 194-95 (*Wilko* prevented waiver of section 12(2) statutory rights). *But see Wilko*, 346 U.S. at 432-35 (decision prohibits waiver of judicial forum under section 22(a)); *McMahon*, __ U.S. at __, 107 S. Ct. at 2351-52, 96 L. Ed. 2d at 210-11 (Blackmun, J., concurring in part, dissenting in part)(arbitration waives section 22(a) judicial forum provision).

84. *See McMahon*, __ U.S. at __, nn.21-24, 107 S. Ct. at 2353, 2356-57 nn.21-24, 96 L. Ed. 2d at 213-18 nn.21-24 (Blackmun, J., concurring in part, dissenting in part)(serious doubts regarding Securities and Exchange Commission's ability to protect investor in arbitration proceedings); *see also Wilko*, 346 U.S. at 435-36 (discussing shortcomings involved in arbitrating securities disputes); 17 C.F.R. § 240.15c2-2 (1987)(fraud for broker to bind customer to arbitration agreement). For a discussion of the disadvantages realized by investors who must arbitrate securities claims, see generally Comment, *Predispute Arbitration Agreements Between Brokers and Investors: The Extension of* Wilko *to Section 10(b) Claims*, 46 MD. L. REV. 339, 375-76 (1987).

85. *See McMahon*, __ U.S. at __, 107 S. Ct. at 2346-48, 96 L. Ed. 2d at 204-07 (Blackmun, J., concurring in part, dissenting in part)(noting congressional support for *Wilko*'s extension to Exchange Act). In support of the nonarbitrability of section 10(b) claims, several courts of appeals have relied upon the legislative history behind the Exchange Act and its 1975 amendment. *See, e.g.*, Conover v. Dean Witter Reynolds, Inc., 794 F.2d 520, 524 (9th Cir. 1986)(legislative history shows congressional disapproval of arbitration of securities claims), *vacated*, __ U.S. __, 107 S. Ct. 3203, 96 L. Ed. 2d 691 (1987); Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831, 836 (7th Cir. 1977)(Congress accepts nonarbitrability of section 10(b) claims); Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532, 536-37 (3d Cir.)(Congress supports *Wilko*'s extension), *cert. denied*, 429 U.S. 1010 (1976).

86. *See, e.g.*, Wolfe v. E.F. Hutton & Co., 800 F.2d 1032, 1036 (11th Cir. 1986)(investor may sue in court under both Acts), *vacated*, __ U.S. __, 107 S. Ct. 3205, 96 L. Ed. 2d 692 (1987); *Conover*, 794 F.2d 520, 523 (9th Cir. 1986)(Acts provide for federal court remedy); *see also* Brown, Shell & Tyson, *Arbitration of Customer-Broker Disputes Arising Under the Federal Securities Laws and RICO*, 15 SEC. REG. L.J. 3, 4 (1987)(*Wilko* Court prevented waiver of right to choose judicial forum).

significant advantage in that they may choose to file suit in any district where the broker is located or transacts business.[87] The majority in *McMahon* failed to recognize that compelling arbitration of Exchange Act claims avoids the judicial forum guarantee of section 27, that is comparable to the judicial forum provision within the Securities Act and which the *Wilko* Court sought to protect from waiver.[88] Rather, the Court misconstrued *Wilko*, interpreting it as prohibiting waiver of the substantive rights stated in section 12(2) of the Securities Act.[89] Since the jurisdictional provision under section 27 of the Exchange Act fails to prescribe statutory duties as imposed by section 12(2), the majority in *McMahon* concluded that section 27 is not

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87. *Compare* Securities Act of 1934 § 27, 15 U.S.C. § 78aa (1982)(permits suit to be filed in district court where seller located or transacts business) *with* Securities Act of 1933 § 22, 15 U.S.C. § 77v (1982). Under section 22(a), suit may be filed in the federal district or state court of the state where the seller began or consummated the sale, where the seller is located, or where the seller transacts business. *See* Securities Act of 1933 § 22, 15 U.S.C. § 77v (1982). Removal of the suit from state court is prohibited. *Id.* Despite the differences between the jurisdictional provisions, section 27 confers significant jurisdictional advantages which investors should not be forced to surrender. *See Wolfe*, 800 F.2d at 1036-37. Under section 27, suit may be instituted in any federal district where the broker is located, where the broker is an inhabitant, or where the broker transacts business. *See* Securities Exchange Act of 1934 § 27, 15 U.S.C. § 78aa (1982). In bringing suit in federal court, an investor does not need to meet the diversity jurisdiction requirements under section 27. *See* § 27, 15 U.S.C. § 78 (1982); *see also Wolfe*, 800 F.2d at 1037; *Conover*, 794 F.2d at 526. In *Conover*, after comparing the concurrent jurisdiction given to state and federal courts under the Securities Act with the exclusive jurisdiction in federal court prescribed under the Exchange Act, the court of appeals reasoned that this similarity strongly indicated legislative intent to provide judicial oversight of 1934 Act claims. *See id.* at 527.

88. *See* Shearson/American Express, Inc. v. McMahon, __ U.S. __, __ n.9, 107 S. Ct. 2332, 2351 n.9, 96 L. Ed. 2d 185, 211 n.9 (1987)(Blackmun, J., concurring in part, dissenting in part)(*Wilko* Court interpreted nonwaiver provision as prohibiting waiver of section 22(a) which provides a judicial forum for resolution of his claim); *see also* Wilko v. Swan, 346 U.S. 427, 432-34 (1953). Wilko opposed compelled arbitration since the arbitration agreement was a "stipulation that waived compliance" with the section 22(a) jurisdictional provision. *Id.* at 432-35. The *Wilko* Court agreed, stating that the arbitration agreement would waive, according to section 14, the judicial forum provided in section 22(a) of the Securities Act. *Id.* at 434-35. The Court stated that selection of the judicial forum is a substantial right and an arbitration agreement limiting that choice defeats the express purpose of the Securities Act in protecting the investor. *See id.* at 438; *see also* Phillips v. Merrill Lynch, Pierce, Fenner & Smith, 795 F.2d 1393, 1400 (8th Cir. 1986)(Ross, J., dissenting)(nonwaiver provisions are key to *Wilko*'s analysis), *cert. denied*, __ U.S. __, 107 S. Ct. 3218, 96 L. Ed. 2d 705 (1987).

89. *See McMahon*, __ U.S. at __, 107 S. Ct. at 2338, 96 L. Ed. 2d at 195. The majority in *McMahon* understood *Wilko* as holding that, under section 14, waiver of an investor's right to choose a judicial forum was prohibited only because the statutory rights expressed in section 12(2) would be inadequately enforced by arbitration. *See id.* For a discussion regarding the *Wilko* decision as hinging on waiver of a judicial forum rather than the type of cause of action, see generally Malcolm & Segall, *The Arbitrability of Claims Arising Under Section 10(b) of the Securities Act: Should* Wilko *be Extended*?, 50 ALBANY L. REV. 725, 745-50 (1986).

the type of provision which *Wilko* sought to protect from waiver.[90] Without acknowledging that section 10(b) of the Exchange Act affords the investor with judicially implied rights under which a broker may not waive compliance,[91] the Court asserted that arbitration would not result in an illegal waiver of the McMahon's rights under section 10(b).[92] In accepting this premise the majority in *McMahon* effectively prohibited waiver of the investor's right to sue a broker for violations of section 12(2) of the Securities Act, while concurrently sacrificing the implied rights given investors under section 10(b), which prior federal case law had supported for more than thirty years.[93]

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90. *See McMahon*, __ U.S. at __, 107 S. Ct. at 2338-39, 96 L. Ed. 2d at 194-95; *see also id.* at __ n.9, 107 S. Ct. at 2351-52 n.9, 96 L. Ed. 2d at 211 n.9 (Blackmun, J., concurring in part, dissenting in part)(*Wilko* misinterpreted by majority to mean purchaser cannot waive broker's compliance with duties imposed under section 12(2) of Securities Act).

91. *See, e.g.*, Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 224-25 (1985)(White, J., concurring)(investor's right under section 10(b) implied); Herman & McLean v. Huddleston, 459 U.S. 375, 380 (1983)(section 10(b)(implied cause of action); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196-97 (1976)(cause of action under section 10(b) implicit).

92. *See McMahon*, __ U.S. at __, 107 S. Ct. at 2341-42, 96 L. Ed. 2d at 199.

93. *See id.* at __, 107 S. Ct. at 2338-39, 96 L. Ed. 2d at 194-96; *see also Byrd*, 470 U.S. at 225 (White, J., concurring)(*Wilko*'s consideration for express right in Securities Act did not apply to judicially implied right); Scherk v. Alberto-Culver Co., 417 U.S. 506, 513-14 (1974). In *Scherk*, Justice Stewart stated that section 12(2) provided an express private remedy while section 10(b) provided only a judicially implied remedy. *See id.* Therefore, Justice Stewart reasoned, arbitration of section 10(b) claims may be permissible despite *Wilko*. *See id.* He based his reasoning on section 10(b)'s distinction in not providing the "special right that the Court in *Wilko* found significant." *Id.* Lower courts which have applied *Wilko*'s reasoning to prevent arbitration of section 10(b) claims have specifically noted the similarities between the express and implied causes of action which prevent waiver of either provision. *See* Wolfe v. E.F. Hutton & Co., 800 F.2d 1032, 1035-36 (11th Cir. 1986), *vacated*, __ U.S. __, 107 S. Ct. 3205, 96 L. Ed. 2d 692 (1987); Conover v. Dean Witter Reynolds, Inc., 794 F.2d 520, 523 (9th Cir. 1986), *vacated*, __ U.S. __, 107 S. Ct. 3203, 96 L. Ed. 2d 691 (1987). Additionally, this implied cause of action has been recognized by other Supreme Court decisions. *See Huddleston*, 459 U.S. at 380-81, 384-87 (private right of action under section 10(b) undoubtedly exists); *Hochfelder*, 425 U.S. at 196 (private right of action under section 10(b) well established). *But see* Wilko v. Swan, 346 U.S. 427, 435 (1953)(judicial forum selection is unwaivable). In *Cort v. Ash*, the United States Supreme Court set forth four relevant inquiries for determining whether a private cause of action is to be implied in a statute which fails to expressly provide a remedy: 1) Is the person bringing suit "one of the class for whose benefit the statute was enacted?" 2) Does the legislative history explicitly or impliedly show an intent to deny or create such a remedy? 3) Will implying a remedy be consistent with the act and its underlying purposes? and 4) Will implying a federal cause of action interfere in an area of state concern where a cause of action has historically come from state law? Cort v. Ash, 422 U.S. 66, 78 (1975). In utilizing these factors to imply a cause of action, the Supreme Court has taken a strict approach. *See* Touche Ross & Co. v. Redington, 442 U.S. 560, 575-76 (1979). In *Redington*, the Court refused to imply a private cause of action under section 17(a) of the 1934 Exchange Act. *See id.* at 579. The Court considered the four *Cort* factors, but recognized that the weight given each factor varied and the central inquiry was Congress' intention to create a

The majority's acceptance of arbitration as a sufficient substitute for litigation and its reliance upon the Securities and Exchange Commission's regulatory authority[94] leaves investors unprotected.[95] The Court overlooked the Commission's pre-*McMahon* opposition to arbitration, which had continued to thrive despite the Commission's expanded oversight role granted in the 1975 amendments to the Exchange Act.[96] In 1983, the Commission for-

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remedy as shown by the language of the statute. *See id.* at 568, 575-77. In analyzing the language of section 17(a), the *Redington* Court was able to distinguish prior cases recognizing implicit private causes of action, since the statutes in those cases either created federal rights for a private party or prohibited specific conduct. *See id.* at 568-69. However, the *Redington* Court, unlike the *Shearson* majority, recognized that section 10(b) created a private cause of action because its statutory language proscribed certain conduct. *See id.* at 569 (citing Superintendent of Ins. of State of N.Y. v. Bankers Life & Casualty Co., 404 U.S. 6 (1971)). Both the analysis used in *Redington* and past Supreme Court cases recognizing an implied action in section 10(b) support the implication of a private action for section 10(b) in the *McMahon* case. *See, e.g., Redington*, 442 U.S. at 569 (recognizing private action from language in section 10(b)); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 729-30 (1975)(implied action in section 10(b)); Affiliated Ute Citizens v. United States, 406 U.S. 128, 150-54 (1972)(private action recognized in section 19(b)); Superintendent of Ins. of State of N.Y. v. Bankers Life & Casualty Co., 404 U.S. 6, 13 n.9 (1971)(established implied right of action under section 10(b)).

94. *See McMahon*, __ U.S. at __, 107 S. Ct. at 2341, 96 L. Ed. 2d at 199.

95. *See id.* at __, 107 S. Ct. at 2353-58, 96 L. Ed. 2d at 213-19 (Blackmun, J., concurring in part, dissenting in part). The dissent reasoned that since many of the arbitral problems found in *Wilko* still exist and since the Securities and Exchange Commission's ability to correct these problems is questionable, the investor could only derive protection from a judicial forum. *See id.* at __, 107 S. Ct. at 2346-58, 96 L. Ed. 2d at 214-16. Justice Blackmun pointed to the illegalities proliferating on Wall Street as evidence of the lack of confidence in the Security and Exchange Commission's ability to regulate the industry. *See id.* at __, 107 S. Ct. at 2358-59, 96 L. Ed. 2d at 218-19. These securities violations typically result in investor complaints, many of which will eventually be arbitrated in a system full of conflicts of interest between defendant brokerage firms and arbitrators. *See id.* at __, 107 S. Ct. at 2355-59, 96 L. Ed. 2d at 215-19. Justice Blackmun concluded that investors could not find protection in a system governed by the securities industry, whose arbitral forums are staffed by persons who may be either sympathetic to the securities firms or aligned with the industry through past business associations with brokerage firms. *See id.* at __, 107 S. Ct. at 2355, 96 L. Ed. 2d at 215-16. *See generally* Note, *Arbitrability of Claims Arising Under the Securities Exchange Act of 1934*, 1986 DUKE L.J. 548, 552-53 (1986)(discussing advantages derived for investors in litigating securities claims).

96. *See Wilko*, 346 U.S. at 428; *Conover*, 794 F.2d at 524. This opposition was evidenced by the Securities Exchange Commission's filing of amicus curiae briefs opposing arbitration in both the 1953 *Wilko* case and the 1976 *Ayres* case. *See Wilko*, 346 U.S. at 428; Ayres v. Merrill Lynch, Pierce, Fenner & Smith, 538 F.2d 532, 533 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976). In 1979, the Commission further opposed arbitration of securities claims in a letter to brokers, warning them to make customers aware of the customers' right to a judicial forum for resolving 1933 and 1934 Act claims, despite their signing predispute agreements. *See Conover*, 794 F.2d at 524; *see also McMahon*, __ U.S. at __ n.22, 107 S. Ct. at 2356 n.22, 96 L. Ed. 2d at 217 n.22 (Blackmun, J., concurring in part, dissenting in part)(noting that prior to *Wilko*, Commission consistently opposed use of arbitration agreements which waived inves-

mally expressed opposition to arbitration agreements in rule 15c2-2.[97] Rule 15c2-2 holds brokers liable for fraud for entering binding predispute agreements which remove investors' right to a judicial forum.[98] Finally, the administrative history behind the promulgation of rule 15c2-2 reveals the Commission's awareness of and adherence to *Wilko*'s extension, and blatant recognition by the Commission of the rule's connection with the waiver and cause of action provisions in the Exchange Act.[99] This approval demonstrates the Commission's acquiescence to judicial resolution of securities disputes, casting doubt upon the *McMahon* Court's reliance on the Commission's oversight role as a method of regulating arbitral proceedings and protecting investors.[100]

The majority's decision to uphold arbitration of Exchange Act claims is also unsound in view of congressional policy favoring an exception to arbitration for Securities and Exchange Act claims.[101] The *Wilko* Court recog-

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tors' rights). For an analysis of the Securities Exchange Commission's consistent stance against arbitrating Exchange or Securities Act claims see generally Brown, Shell, & Tyson *Arbitration of Customer-Broker Disputes Arising Under the Federal Securities Laws and RICO*, 15 SEC. REG. L.J. 3, 20-21 (1987).

97. 17 C.F.R. § 240.15c2-2 (1987).

98. *See id.* Rule 15c2-2 states 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.

Id.; *see also McMahon*, __ U.S. at __ nn.22-24, 107 S. Ct. at 2356-57 nn.22-24, 96 L. Ed. 2d at 217-18 nn.22-24 (Blackmun, J., concurring in part, dissenting in part)(recognizing Commission's opposition to predispute agreements evidenced by rule 15c2-2); Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, 797 F.2d 1197, 1200-01 (3d Cir. 1986)(discussing applicability of arbitration agreements in light of rule 15c2-2), *vacated*, __ U.S. __, 107 S. Ct. 3204, 96 L. Ed. 2d 691 (1987).

99. *See* Administrative History to Rule 15c2-2, 48 Fed. Reg. 53404, 53406 (1983). Under the "Statutory Authority and Competitive Considerations" section, the Commission stated: "The Securities and Exchange Commission, acting pursuant to the [Exchange] Act, and particularly sections . . . 10 . . . and 29 thereof (15 U.S.C. . . . 78j . . . and 78cc), hereby adopts the amendment to § 240.15c2-2." *Id.* at 53407.

100. *See McMahon*, __ U.S. at __, 107 S. Ct. at 2356, 2358, 96 L. Ed. 2d at 216, 218-19 (Blackmun, J., concurring in part, dissenting in part)(Court influenced by Commission's regulatory authority despite Commission's consistent opposition to arbitration). *See generally* Ingersoll, *SEC Proposes New Rules For Arbitration*, Wall St. J., Sept. 11, 1987, at 23, col. 3 (discussing need for new rules to make arbitration of investor disputes more fair).

101. *See McMahon*, __ U.S. at __, 107 S. Ct. at 2350, 96 L. Ed. 2d at 209 (Blackmun, J., concurring in part, dissenting in part). Congress passed the Act after the 1929 stock market crash to protect investors from broker abuse. By providing investors with a judicial forum, the Act "place[d] investors on an equal footing with" securities brokers. To guarantee this investor protection, the Securities Act prohibited waiver of the right to a judicial forum for resolving investors' claims. *See id.* at 2350-51.

nized that the text of and purpose behind the Securities Act mandated exclusion of securities claims from arbitration.[102] Courts dealing with the arbitrability of Exchange Act claims recognized the purpose behind the Exchange Act is the same as for the Securities Act,[103] and construed the Securities and Exchange Acts together as prohibiting arbitration of claims based upon either Act.[104] *McMahon*'s reasoning is further attenuated by the majority's unwillingness to accept Congress' approval of *Wilko* as extended to Exchange Act claims.[105] Yet, in the 1975 amendments to the Exchange Act, Congress expressly maintained that the Amendments in no way changed "existing law, as articulated in *Wilko*," which dealt with the arbitrability of securities claims.[106] By rebuffing Congressional sanction of *Wilko*'s extension, the Court encroached upon the legislative branch, stripping investors of protections afforded them under the Exchange Act.[107]

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102. *See* Wilko v. Swan, 346 U.S. 427, 434-35 (1953)(Securities Act claims exempt from arbitration); *see also* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 627-28 (1985)(arbitration exception will be evidenced in statute and its history).

103. *See, e.g.*, Herman & McLean v. Huddleston, 459 U.S. 375, 380 (1983)(Exchange and Securities Acts are interrelated components); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194-97 (1976)(both Acts passed to remedy problems caused by 1929 stock market crash); Conover v. Dean Witter Reynolds, Inc., 794 F.2d 520, 525-26 (9th Cir. 1986)(Exchange and Securities Acts are related legislation), *vacated*, __ U.S. __, 107 S. Ct. 3203, 96 L. Ed. 2d 691 (1987); Axelrod & Co. v. Kordich, Victor & Neufeld, 451 F.2d 838, 842-43 (2d Cir. 1971)(both Acts construed together).

104. *See, e.g.*, Sterne v. Dean Witter Reynolds, Inc., 808 F.2d 480, 482-83 (6th Cir. 1987)(policies behind both Acts prevent arbitration); Mayaja, Inc. v. Bodkin, 803 F.2d 157, 162 (5th Cir. 1986)(Exchange and Securities Act claims non-arbitrable), *vacated*, __ U.S. __, 107 S. Ct. 3205, 96 L. Ed. 2d 692 (1987); Bustamante v. Rotan Mosle, Inc., 802 F.2d 815, 816 (5th Cir. 1986)(arbitration agreements invalid under Securities and Exchange Act); *Conover*, 794 F.2d at 525-27 (relation of 1933 and 1934 Acts prevents arbitration of securities claims under those Acts); *Axelrod*, 451 F.2d at 843 (both Acts are construed together to prohibit arbitration of claims brought under either).

105. *See McMahon* __ U.S. at __, 107 S. Ct. at 2342-43, 96 L. Ed. 2d at 199-201 (Congressional approval of *Wilko* not apparent).

106. H.R. REP. NO. 29, 94th Cong., 1st Sess. 111, *reprinted in* 1975 U.S. CODE CONG. & ADMIN. NEWS 179, 321, 342 (1975 amendments to Exchange Act acknowledging *Wilko* doctrine). The Supreme Court previously recognized that, after considering judicial interpretation of section 10(b) at the time of the 1975 amendments which approved of an implied action, Congress' leaving section 10(b) intact indicated a ratification of the implied action in section 10(b) and furthered the remedial purposes behind the Exchange Act. *See* Herman & McLean v. Huddleston, 459 U.S. 375, 384-87 (1983); *see also McMahon*, __ U.S. at __, 107 S. Ct. at 2348, 96 L. Ed. 2d at 206-07 (Blackmun, J., concurring in part, dissenting in part); *Conover*, 794 F.2d at 524. *See generally* Brown, Shell & Tyson, *Arbitration of Customer-Broker Disputes Arising Under the Federal Securities Laws and RICO*, 15 SEC. REG. L.J. 3, 19-21 (1987)(discussing 1975 Exchange Act Amendments).

107. *See McMahon*, __ U.S. at __, __, 107 S. Ct. at 2348, 2359, 96 L. Ed. 2d at 206-07, 219 (Blackmun, J., concurring in part, dissenting in part) (Court removes judicially implied remedy that Congress had tacitly approved); *see also* Comment, *Predispute Arbitration Agree-*

The *McMahon* decision supports upholding predispute agreements pursuant to the strong policy considerations evidenced in the Federal Arbitration Act and manifested in recent Supreme Court precedent. However, the Court achieved this result through misinterpretation of *Wilko* and disregard of prior federal case law which had, by means of assimilating provisions within both the Securities and Exchange Acts, created an exception to arbitration, affording investors a judicial forum for adjudicating their Exchange Act claims. In removing this judicial protection, the majority entrusts the oversight of these claims to a Commission that has expressed its opposition to arbitrating securities claims for more than thirty years. Finally, the Court refused to accept Congress' approval of adjudicating Exchange Act claims, thereby abrogating any judicial remedy given the investor with a cause of action under section 10(b) of the Exchange Act. The ramifications of this decision will not reduce the litigation in federal courts, but rather, will result in parties challenging the adequacy of the arbitration of their claims under section 10 of the Arbitration Act to regain the judicial forum eliminated by the Supreme Court for Exchange Act claims.

A. Robert Lamb, Jr.

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ments Between Brokers and Investors: The Extension of Wilko *to Section 10(b) Claims*, 46 MD. L. REV. 339, 376-77 (1987)(change in Exchange Act protections should be initiated by Congress); Note, *The Supreme Court—Leading Cases*, 101 HARV. L. REV. 119, 285-89 (1987)(Congress' silence in light of lower courts' decisions expressly ratifies *Wilko* extention).