

# *Nova Law Review*

---

*Volume 12, Issue 3*

1988

*Article 18*

---

## Shearson/American Express v. McMahon: The Expanding Scope of Securities Arbitration

Patricia A. Shub\*

\*

Copyright ©1988 by the authors. *Nova Law Review* is produced by The Berkeley Electronic Press (bepress). <https://nsuworks.nova.edu/nlr>

# Shearson/American Express v. McMahon: The Expanding Scope of Securities Arbitration

Patricia A. Shub

## **Abstract**

Brokerage firms usually require that investors who open stock or commodities accounts execute a written customer agreement.

**KEYWORDS:** securities, arbitration, Wilko



# Shearson/American Express v. McMahon:<sup>1</sup> The Expanding Scope of Securities Arbitration

---

## TABLE OF CONTENTS

I. INTRODUCTION .....	1375
II. THE DEVELOPMENT OF SECURITIES ARBITRATION ...	1379
III. PROVISIONS OF THE SECURITIES LAWS .....	1382
IV. THE EVOLUTION OF THE <i>Wilko</i> DOCTRINE .....	1385
V. EXCEPTIONS TO THE <i>Wilko</i> DOCTRINE .....	1387
VI. THE CHANGE IN JUDICIAL ATTITUDES TOWARD ARBITRATION .....	1391
VII. THE BACKGROUND OF THE <i>McMahon</i> CASE .....	1394
VIII. THE <i>Shearson/American Express v. McMahon</i> DECISION .....	1397
IX. THE FUTURE OF THE <i>McMahon</i> DOCTRINE .....	1401
X. IMPROVING ARBITRATION .....	1402
XI. TRAINING ATTORNEYS FOR SECURITIES ARBITRATION	1404
XII. CONCLUSION .....	1406

### I. Introduction

Brokerage firms usually require that investors who open stock or commodities accounts execute a written customer agreement.<sup>3</sup> Since much of the agreement looks like legal boilerplate, many investors will not bother to read it.<sup>4</sup> Because they believe the government strictly reg-

---

1. 107 S. Ct. 2332, *reh'g denied*, 108 S. Ct. 31 (1987).

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

3. Note, *Arbitrability of Claims Arising Under the Securities Exchange Act of 1934*, 1986 DUKE L.J. 548, 549 (1986). If a client intends to trade options, he will be required to sign an option agreement which will contain an arbitration clause, even if he did not sign a customer agreement upon opening the account.

4. Robbins, *A Practitioner's Guide To Securities Dispute Resolution* RESOLVING SECURITIES DISPUTES-ARBITRATION AND LITIGATION 535 PRACTICING LAW INST. 11, 31 (1986) [hereinafter Robbins, *A Practitioner's Guide*]; See also Sterk, *Enforceability of Agreements to Arbitrate, An Examination of the Public Policy Defense*, 2 CARDOZO L. REV. 481, 517-18 (1981) (buyers do not pay attention to arbitration clauses because their exposure to them is so minimal that they do not understand what



ulates brokerage houses to insure consumer protection from fraud or unfair dealing, most will not take the agreement to an attorney. They also presume every other investor must and does sign similar agreements.

What the majority of investors probably do not realize<sup>5</sup> is that brokerage agreements may include an arbitration clause<sup>6</sup> that limits their recourse to courts<sup>7</sup> in actions like fraud,<sup>8</sup> suitability,<sup>9</sup> unauthorized trading,<sup>10</sup> or churning.<sup>11</sup> Unfortunately, the law does not require that brokers bring arbitration clauses to the attention of investors, or that the clause require separate signature,<sup>12</sup> or that it be in bold

the clause implicates).

5. Note, *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, 216 (1987) (investors may not be aware that the contract contains an arbitration clause or know what protections arbitration will provide).

6. A typical arbitration clause provides for arbitration of any controversy relating to accounts maintained by the customer with the brokerage house. One such clause reads in part:

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 Boards 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 (1985) (emphasis added), *rev'd*, 788 F.2d 94 (2d Cir. 1986), *rev'd*, *Shearson/American Express v. McMahon*, 107 S. Ct. 2332, *reh'g denied*, 108 S. Ct. 31 (1987).

7. The Supreme Court recently held that pre-dispute arbitration clauses bind customers to arbitrate securities disputes brought under the Securities Exchange Act of 1934 and the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. § 1961 *et seq.* *McMahon*, 107 S. Ct. at 2332.

8. See D. ROBBINS, AN INSIDER'S GUIDE TO SECURITIES ARBITRATION 8, 11 (1985). Fraud is defined as "[b]roker and/or firm engaged in conduct in violation of federal securities laws, particularly Section<sup>6</sup> 10(b)." *Id.*

9. *Id.* at 8, 10. (Suitability exists as a cause of action where an investment was inappropriate for the investor. The customer may not have known or understood the risks of loss in a particular investment, the customer could not financially bear the risk of that type of investment, or the customer's investment objective was contrary to the type of investment.)

10. *Id.* (Unauthorized trading occurs when a broker trades in a customer's account without the customer's prior approval.)

11. *Id.* at 8, 11. (Churning exists when the broker excessively trades the customer's account for the purpose of generating commissions, not for the customer's benefit.)

12. See Robbins, *A Practitioner's Guide*, *supra* note 4, at 98.



are not required to follow substantive rules of law,<sup>25</sup> and appeal of arbitration decisions is extremely limited.<sup>26</sup>

It is easy to understand why many investors believe they will not have a fair hearing in the arbitral forum, and have consistently tried to sue brokers and firms in court in spite of having signed an agreement containing an arbitration clause. What is more difficult to understand is why in *Shearson/American Express v. McMahon*<sup>27</sup> the Court held that predispute arbitration clauses should be enforceable in spite of statutory mandates and the ramifications of the decision. Prior to *McMahon*, predispute arbitration clauses in brokerage agreements had been considered void since they conflicted with the protective intent and provisions of the securities laws,<sup>28</sup> were not negotiated at arm's length,<sup>29</sup> and because arbitration itself did not provide the full and fair hearing dictated by the securities laws.<sup>30</sup> *McMahon* reversed the status quo<sup>31</sup>

25. *Wilko*, 346 U.S. at 434; Note, *supra* note 21, at 129.

26. *Wilko*, 346 U.S. at 436, 437. (Arbitration awards cannot be vacated for reasons other than the grounds enumerated in the FAA unless there is manifest disregard of the law.) However, it is difficult to understand how such grounds could be proved since transcripts are not standard in arbitration. *See also* 9 U.S.C. § 10 (1982). (The only grounds for vacating an award per the FAA are: (1) procurement of the award by corruption or fraud; (2) evident partiality of corruption in the arbitrators; (3) misconduct on the part of the arbitrators; and (4) where the arbitrators exceeded their powers.) *See also* Sanchez, *Should Claims Involving Public Customers Arising Under The Securities Exchange Act of 1934 Be Subject To Compulsory Arbitration?* 10 HARV. J.L. & PUB. POL'Y 173 at 184 (1987). (Even if the arbitrator finds for the claimant, the decision as to damages cannot be challenged by an appeal in the absence of fraud or an arbitrator's undisclosed conflict of interest.)

27. 107 S. Ct. 2332 (1987).

28. *Wilko*, 346 U.S. at 437.

29. *Id.* at 435.

30. *See* Robbins, *A Practitioner's Guide*, *supra* note 4, at 42 (suggesting that the absence of the factors listed above as well as the unavailability of depositions, mandatory document production, interrogatories, preclusion orders, motion practices and the limit on arbitrators' power to direct the appearance of witnesses should preclude giving collateral estoppel effect to a prior arbitration award). *See also* Artman v. Prudential-Bache Securities, Inc., [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 93,346 (S.D. Ohio August 26, 1987). (In Artman, the court held that an arbitration award that did not indicate its basis did not have a preclusive res judicata or collateral estoppel effect on federal securities claims retained when the state law claims were ordered to arbitration.)

31. *See Shearson/American Express*, 107 S. Ct. at 2348, 2349 (Blackmun J., Brennan J., and Marshall J., concurring in part, dissenting in part). (Until *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985) all the Courts of Appeals had presumed that the *Wilko* holding that § 12(2) claims could not be compelled to arbitration



and held predispute brokerage arbitration agreements for most causes of action enforceable.<sup>32</sup>

Since 1982 there have been at least 10 million new investors in the stock market and a 128% increase in complaints against brokers filed with the SEC, a total of 15,750 complaints in 1986.<sup>33</sup> The market crash of October 19, 1987 spawned scores of disputes about the suitability of investments, disclosure of risk and order execution. Thus, the mandatory enforcement of predispute arbitration agreements will have a significant impact on investors' efforts to recover for securities claims disputes and attorneys' efforts to help them do so.

This note reviews the history of securities arbitration and litigation from a statutory and case law perspective. It does not address those aspects of the *McMahon* decision that involve the arbitration of RICO claims. The article begins by discussing the growth of arbitration and the relevant aspects of the securities laws. It then traces the treatment of securities claims and arbitration in the courts. It outlines how the *McMahon* decision was reached and why it was to be expected. The article concludes with a compilation of suggested changes to arbitration procedures and the recommendation that law schools incorporate more arbitration courses into their curricula and continuing legal education programs.

## II. The Development Of Securities Arbitration

Arbitration is the submission of a dispute to a private proceeding where one or more impartial persons make a final and binding determination.<sup>34</sup> The parties either make the agreement in advance in an arbitration clause, or after the dispute has arisen in a separate agreement.<sup>35</sup>

---

was also applicable to § 10(b) claims. Subsequent to *Byrd*, the lower courts divided on the issue of arbitrability of § 10(b) claims.)

32. In *McMahon*, the investors brought an action under § 10(b) of the 1934 Act and Rule 10b-5, court created remedy for fraud in connection with the purchase or sale of a security. In *Wilko*, the investor brought the action under § 12(2) of the 1933 Act, which provides an express private remedy for the offer, sale or delivery of a security by means of a prospectus with a material misstatement or omission or in violation of the registration and prospectus requirements of the act. Although the *McMahon* holding only addressed actions brought under the 1934 Act, courts have begun to direct arbitration of 1933 Act claims as well.

33. Meyer, *Why Stockbrokers Sleep at Night*, 16 MONEY MAGAZINE 107 (1987).

34. See Meyerowitz, *The Arbitration Alternative*, 71 A.B.A. J. 78 (1985).

35. *Id.*



Advocates believe arbitration is preferable to formal litigation in some instances because it is expeditious, private and less expensive.<sup>36</sup> In arbitration, parties may choose counsel as they please regardless of the jurisdiction, and the restrictions of the rules of evidence will not apply in the hearing.<sup>37</sup> However, the quality and efficiency of an arbitration depends almost entirely on the qualifications of the arbitrators and the manner in which they administer the arbitration.<sup>38</sup> Litigation, on the other hand, provides standards, which adherence to legal principles, *stare decisis*, and the right of appeal help to maintain.<sup>39</sup> Also, the uniform rules and procedures of litigation may guarantee a more impartial decision.<sup>40</sup>

Although arbitration may be preferable in situations where speedy resolution, privacy and finality are paramount and discovery is unimportant,<sup>41</sup> it is not necessarily "a desirable substitute for trial in courts . . . the parties must decide in each instance."<sup>42</sup> "[T]hey must be content with its informalities . . . those procedural limitations which it is precisely its purpose to avoid."<sup>43</sup> They must know what to expect when they agree to arbitrate and must be willing to accept "looser approximations to the enforcement of their rights than those the law affords them."<sup>44</sup>

At its origin, arbitration was "an unwelcome stepchild in the courts."<sup>45</sup> An agreement to arbitrate a dispute was unenforceable be-

---

36. *But see* Kritzer and Anderson, *The Arbitration Alternative: A Comparative Analysis of Case Processing Time, Disposition Mode, and Cost in the American Arbitration Association and the Courts*, 8 JUST. SYS. J. 6 (1983). (On the whole, suits heard in arbitration as opposed to litigation have a greater chance of being adjudicated rather than settled or terminated by a ruling on a motion. Additionally, cases are generally processed more quickly through arbitration than through the federal or state courts. However, lawyers fees, the most costly item in either forum, were higher in arbitration for any claim greater than \$5,000.) *See also* Note, *Arbitration and Mediation—Alternatives or Opposites*, 4 J. INT'L ARB. 69, 69-70 (1987).

37. I. WIDISS, *ARBITRATION, COMMERCIAL DISPUTES, INSURANCE AND TORT CLAIMS* 72 (1979).

38. *See id.* at 73.

39. *Id.* at 71.

40. *See* McDonald and Bivens, *Alternative Dispute Resolution and The Court*, 42 ARB. J. 58, 60 (1987).

41. *See id.* at 60.

42. *American Almond Prod. Co. v. Consolidated Pecan S. Co.*, 144 F.2d 448, 451 (2d Cir. 1944).

43. *Id.*

44. *Id.*

45. Sterk, *supra* note 4, at 481.



cause courts viewed it as an attempt to deprive them of their natural jurisdiction.<sup>46</sup> Therefore, in 1925 the federal government enacted the Federal Arbitration Act (FAA)<sup>47</sup> "to allow parties to avoid the costliness and delays of litigation" and to place arbitration agreements "upon the same footing as other contracts."<sup>48</sup> The FAA made written agreements to arbitrate commercial disputes enforceable and required a court to stay the trial of a dispute if it is referable to arbitration under any such agreement.<sup>49</sup>

Subsequently, the securities industry integrated arbitration into the settlement of disputes on exchanges.<sup>50</sup> Each Exchange or Self Regulatory Organization (SRO)<sup>51</sup> developed its own rules to govern arbitration proceedings.<sup>52</sup> In 1976, the SEC recommended that the members of the securities industry organize the Securities Industry Conference on Arbitration (SICA)<sup>53</sup> to develop a Uniform Code of Arbitration<sup>54</sup> to govern arbitration proceedings in securities disputes.<sup>55</sup> The supposed justification for the industry's easy acceptance of arbitration was that since the volume of transactions on the exchanges could generate so many disputes, they had to utilize a private form of resolution to avoid tying up vast sums of working capital in protracted litigation.

46. I. WIDISS, *supra* note 37, at 70 (citing *Kill v. Hollister*, 1 Wils 129 (1726)).

47. See 9 U.S.C. §§ 1-14 (1982) (currently the United States Arbitration Act).

48. *Scherk v. Alberto Culver Co.*, 417 U.S. 506, 510-11 (1974) (citing H.R. REP. NO. 96, 68TH CONG. 1st Sess. 1, 2 (1924)).

49. 9 U.S.C. § 2. In pertinent part, section 2 states that "a written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." *Id.*

50. See Note *supra* note 21, at 122 (citing *Stone*, *Justice Weighs Bulls and Bears*, 7 ARB. J. 79 (1952)).

51. Katsoris, *The Arbitration of a Public Securities Dispute*, 53 FORDHAM L. REV. 279, 280 n.7 (1984) (the SROs include the American Stock Exch.; Boston Stock Exch.; Chicago Bd. Options Exch.; Cincinnati Stock Exch.; Midwest Stock Exch.; Municipal Sec. Rulemaking Bd.; National Ass'n of Securities Dealers, Inc.; New York Stock Exch.; Pacific Stock Exch.; and Philadelphia Stock Exch.).

52. See Note, *supra* note 5, at 205.

53. *Id.* See also Katsoris, *supra* note 51, at 283. (The SICA consists of various SRO's, a trade Association for the Securities Industry and four public members.)

54. UNIF. CODE ARB., reprinted in the Fourth Report of the Securities Industry Conference on Arbitration to the Securities and Exchange Commission (Nov. 1984).

55. See Securities Exchange Act Release No. 34-13470 (April 26, 1977), 42 Fed. Reg. 23,892 (1977) (the recommendation was made because the SEC had become aware of investors' suspicion of partiality of the officials associated with SRO arbitration).



tion in the courts.<sup>56</sup> However, critics speculate that, since arbitration hearings and decisions are not made public, the securities industry adopted arbitration to prevent public disclosure of questionable industry practices.<sup>57</sup> They also suggest that brokers dislike litigation because of jury awards, which are frequently more generous than arbitration awards<sup>58</sup> and punitive damages, which may be granted in litigation but are not frequently awarded in arbitration.<sup>59</sup>

### III. Provisions of the Securities Laws

During the early days of the New Deal, Congress enacted two landmark statutes regulating securities,<sup>60</sup> the Securities Act of 1933 (1933 Act)<sup>61</sup> and the Securities Exchange Act of 1934 (1934 Act).<sup>62</sup> The 1933 Act's purpose is "to provide full and fair disclosure of the character of securities . . . and to prevent frauds in the sale. . . ."<sup>63</sup> "[It] was drafted with an eye to the disadvantages under which buyers labor,"<sup>64</sup> and "added to the ancient rule of *caveat emptor*<sup>65</sup> the further doctrine of 'let the seller also beware.'"<sup>66</sup> The 1934 Act's purpose is to provide for the regulation of, and prevent unfair practices on, securities exchanges and over-the-counter markets.<sup>67</sup> It too is concerned with in-

56. See Note, *supra* note 21, at 121 n.13 (citing Jacquin *Arbitration in Action on Wall Street*, 1 *ARB. J.* 261-62 (1946)).

57. *Id.* at n.13, citing R. NEY, *THE WALL STREET GANG* (1974); See also M. DOMKE, *THE LAW AND PRACTICE OF COMMERCIAL ARBITRATION* § 24.05 at 248 (1968 Supp. 1977) (Confidentiality in institutional arbitration is safeguarded by limiting access to the records and files of the proceedings to the parties involved.)

58. Note, *Mixed Arbitrable and Non-Arbitrable Claims in Securities Litigation: Dean Witter Reynolds, Inc. v. Byrd*, 34 *CATH. U.L. REV.* 525, 551 (1985). This author also cites Jacquin, *Arbitration in Action on Wall Street*, 1 *ARB. J.* 261, 261-62 (1946) to point out that arbitration as a method of securities dispute resolution was established on the N.Y.S.E. in 1817, *id.* at 525 n.7. See also Note, *supra* note 21, at 148-49. "The New York Stock Exchange began as a private club, and its system of arbitration reflects that beginning."

59. Note, *supra* note 58, at 551.

60. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

61. Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1982 & Supp. II 1984).

62. Securities Exchange Act of 1934, ch. 202, 48 Stat. 881, 15 U.S.C. §§ 78a-78kk (1982).

63. *Blue Chip Stamps*, 421 U.S. at 727.

64. *Wilko v. Swan*, 346 U.S. 427, 435 (1953).

65. *Id.* at 430.

66. *Id.*, citing H.R. REP. NO. 85, 73 Cong. 1st Sess. 2.

67. *Blue Chip Stamps*, 421 U.S. at 728.



vestor protection, although it is aimed at trading in the secondary securities market.<sup>68</sup> Congress designed both statutes to protect the public, particularly the less sophisticated investor.<sup>69</sup>

The text of both acts provides explicit jurisdictional and non-waiver stipulations, and both express and implied causes of action. The non-waiver stipulations are essentially identical; both provide that any stipulation, condition or provision to waive compliance with the provisions of the chapter itself, rules or regulations thereunder or rules of the Commission or an exchange shall be void.<sup>70</sup> The jurisdictional provisions of the acts, on the other hand, are somewhat different.<sup>71</sup>

The 1933 Act gives a choice of forum<sup>72</sup> "in any court of competent

68. *Shearson/American Express v. McMahon*, 107 S. Ct. 2332, 2353 (Blackmun J., Brennan J., and Marshall J., concurring in part and dissenting in part), *reh'g denied*, 108 S. Ct. 31 (1987).

69. *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94, 98 (2d Cir. 1986), *rev'd*, *Shearson/American Express v. McMahon*, 107 S. Ct. 2332, *reh'g denied*, 108 S. Ct. 31 (1987).

70. See the Securities Act of 1933, § 14, 15 U.S.C. § 77n (1982) and the Securities Exchange Act of 1934, § 29(a), 15 U.S.C. § 78cc(a) (1982).

71. See *Conover v. Dean Witter Reynolds, Inc.*, 794 F.2d 520, 527 (9th Cir. 1986), *vacated*, 107 S. Ct. 3203 (1987). As compared to the 1933 Act's grant of concurrent jurisdiction to state and federal courts, the 1934 Act's exclusive jurisdiction provision is "an even more forceful indication of Congress' intent that federal courts oversee the interpretation and application of the 1934 Act." *Id.* See also Brown, Shell and Tyson, *Arbitration of Customer-Broker Disputes Arising Under the Federal Securities Laws and RICO*, 15 SEC. REG. L.J. 3, 19 (1987) [hereinafter Brown]. The distinction between these provisions is irrelevant insofar as whether or not action brought under either act is arbitrable. "The fact that the customer has fewer forum choices under the 1934 Act does not mean that he has waived less by agreeing to arbitrate." *Id.* See also *Wolfe v. E.F. Hutton & Co. Inc.*, 800 F.2d 1032, 1037 (11th Cir. 1986). (The 1934 Act's jurisdictional provision may indicate an intent to confer a benefit on plaintiffs since they can obtain the federal forum without having to meet diversity jurisdiction.) See also Hazen, *Allocation of Jurisdiction between the State and Federal Courts For Private Remedies Under the Federal Securities Law*, 60 N.C.L. REV. 707, 712 (1982). The absence of concurrent jurisdiction "is most significant." *Id.* "The supposed advantages of federal court jurisdiction of federal securities laws violation are: (1) promotion of uniform interpretation, (2) greater expertise of federal judges, (3) avoidance of state courts' hostility to unfamiliar federal claims arising in familiar state law contract actions and (4) the 'disparate impact' of state and federal discovery provisions." *Id.* at 720.

72. Section 22 provides, among other things:

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 . . . and process in such cases may be served . . . wherever the defendants may be found . . . No case arising



jurisdiction — federal or state<sup>73</sup> while the 1934 Act restricts jurisdiction exclusively to the federal courts.<sup>74</sup> In a securities fraud action, the 1933 Act's express liability provision, section 12(2), imposes civil liability on any person who offers or sells a security by means of a prospectus or oral communication that contains an untrue statement or omission of a material fact.<sup>75</sup> The 1934 Act has a broader anti-fraud provision. Section 10(b) outlaws the use of any manipulative or deceptive devices or contrivances in contravention of rules promulgated by the SEC in connection with the purchase or sale of a security.<sup>76</sup> The differences between the two are: 1) the action under 10(b) was judicially implied rather than expressly provided for by statute;<sup>77</sup> 2) in an action for misrepresentation under section 12(2) the seller assumes the burden of proving lack of scienter,<sup>78</sup> while in an action under section 10(b) and Rule 10(b)5, the plaintiff bears the burden of proving scienter;<sup>79</sup> and 3) anyone who purchased or was offered securities can bring an action under 12(2) while only an actual purchaser can bring an ac-

---

under this title 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).

73. *Wilko v. Swan*, 346 U.S. 427, 431 (1953).

74. Section 27 provides:

The district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any Territory or any other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title and 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 title or the rules and regulations thereunder.

15 U.S.C. § 78aa (1982).

75. *See* Securities Act of 1933, § 12(2), 15 U.S.C.A. § 77 l(2).

76. *See* Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) (1982) and Rule 10b-5 promulgated thereunder, 17 C.F.R. 240.10b-5.

77. *But see* *Herman & MacLean v. Huddleston*, 459 U.S. 375, (1983). Pursuant to the statutory enabling provision, the SEC adopted Rule 10b-5 under which an implied private right of action has since been consistently recognized. *Id.* at 380-81 n.10. Note that an action has also been implied under section 17 of the 1933 Act. Section 17 is a general provision under which a private cause of action can be brought for fraud without scienter in offers or sales by both investors and brokers or transfer agents. In addition, the SEC can bring an action. Moreover, remedies under sections 10(b) and 17 can be cumulative.

78. *Wilko*, 346 U.S. at 431.

79. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 190, 193, *reh'g. denied*, 425 U.S. 986 (1976).



In *Wilko*, an investor alleged that his stock purchase was induced by a brokers' false representations and omission of information. He brought an action for misrepresentation under section 12(2) of the 1933 Act.<sup>91</sup> The brokerage house moved to compel arbitration in accordance with a pre-dispute arbitration agreement the investor had signed.<sup>92</sup> The Court found the predispute arbitration clause in the customer agreement invalid because of the jurisdictional and non-waiver provisions of the 1933 Act.<sup>93</sup> It held that since arbitration may be less effective at insuring the protective provisions of the Securities Act, and the typical buyer may be unable to judge the differences at the time he signs, predispute arbitration agreements for such claims are void.<sup>94</sup> The *Wilko* Court also enumerated reasons why arbitration is an inadequate forum for deciding securities disputes. These include: the absence of judicial instruction on the law; the absence of judicial review of errors in interpretation; and the absence of records of proceedings or review of arbitrators' conceptions of the legal meaning of such "statutory requirements as 'burden of proof,' 'reasonable care' or 'material fact.'"<sup>95</sup> The Court reasoned that, since the protective provisions of the laws require judicial direction, Congress must have intended the non-waiver provisions of the Securities Act to apply to the judicial trial and review provisions.<sup>96</sup>

Since the investor in *Wilko* brought his claim under section 12(2) of the 1933 Act, the *Wilko* holding was limited to actions under that section.<sup>97</sup> Subsequently, courts have held that claims based on violations of sections 5 and 17 of the 1933 Act are not arbitrable.<sup>98</sup> It was also generally assumed that the *Wilko* prohibition extends to claims

---

91. *Id.* at 429.

92. *Id.*

93. *Id.*

94. *Id.* at 435, 438.

95. *Id.* at 436.

96. *Id.* at 437.

97. *Id.* at 427.

98. See Katsoris, *supra* note 51, at 293. The following courts have held that claims based on violations of sections 5 and 17 of the 1933 Act are not arbitrable: *Laupheimer v. McDonnell & Co.*, 500 F.2d 21, 25 (2d Cir. 1974) (section 5 claims are nonarbitrable); *Maheu v. Reynolds & Co.*, 282 F. Supp. 423, 426 (S.D.N.Y. 1968) (section 5 claims are nonarbitrable); *Davend Corp v. Michael*, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 95,540, at 99,730 (S.D.N.Y. Apr. 14, 1976) (section 17 claims are nonarbitrable); *Frier Indus., Inc. v. Glickman*, [1974-75 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 94,845 at 96,848 (S.D.N.Y. Oct. 22, 1974) (section 17 claims are nonarbitrable).



based on violations of section 10(b) of the 1934 Act.<sup>99</sup> The similarity of the nonwaiver provisions,<sup>100</sup> and the strong public policy concerns inherent in the action under section 10(b) and Rule 10b-5<sup>101</sup> support the compelling need for a judicial forum in the resolution of these securities disputes.<sup>102</sup>

## V. Exceptions to the *Wilko* Doctrine

Gradually, exceptions have been carved out of the *Wilko* doctrine. If parties make an agreement to arbitrate after a dispute arises, the agreement is enforceable.<sup>103</sup> This exception was implied in the *Wilko* concurring opinion for convincing policy reasons.<sup>104</sup> An investor who agrees to arbitrate after the dispute arises is more likely to investigate

99. Courts holding that § 10(b) claims could not be compelled to arbitration include *Kehr v. Smith Barney, Harris, Upham & Co.*, 736 F.2d 1327 (9th Cir. 1984); *Kershaw v. Dean Witter Reynolds, Inc.*, 734 F.2d 1327 (9th Cir. 1984); *De Lancie v. Birr, Wilson & Co.* 648 F.2d 1255 (9th Cir. 1981); *Sawyer v. Raymond James & Associates, Inc.*, 642 F.2d 791 (5th Cir. 1981); *Allegaert v. Perot*, 548 F.2d 432 (2d Cir. 1977); *Greater Continental Corp. v. Schechter*, 422 F.2d 1100 (2d Cir. 1970); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831 (7th Cir. 1977); *Hammerman v. Peacock*, Fed. Sec. L. Rep. (CCH) § 92,239 (D.D.C. 1985); *AFP Imaging Corp. v. Ross*, 780 F.2d 202 (2d Cir. 1985), *cert. denied*, 106 S. Ct. 3295 (1986).

100. *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94, 99 (2d Cir. 1986), *rev'd*, *Shearson/American Express v. McMahon*, 107 S. Ct. 2332, *reh'g denied*, 108 S. Ct. 31 (1987). *See also* *Conover v. Dean Witter Reynolds, Inc.*, 749 F.2d 520, 523 (9th Cir.), *vacated*, 107 S. Ct. 2303 (1986). Several circuits have relied on the similarity of the anti-waiver provisions to refuse to compel arbitration of section 10(b) claims. *See e.g.* *Merrill Lynch Pierce, Fenner & Smith, Inc. v. Moore*, 590 F.2d 823, 827 (10th Cir. 1978); *Weissbuch v. Merrill Lynch Pierce Fenner & Smith, Inc.*, 558 F.2d 831, 836 (7th Cir. 1977); *Ayres v. Merrill Lynch Pierce, Fenner & Smith, Inc.*, 538 F.2d 532, 536 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976).

101. *McMahon*, 788 F.2d at 99. *See also* Note, *supra* note 3, at 570.

102. *McMahon*, 788 F.2d at 99. *See also* *Conover*, 749 F.2d at 524; Note, *supra* note 3, at 570.

103. *See* *Shearson/American Express, Inc. v. McMahon*, 107 S. Ct. 2332, 2341 (1987) (noting the following courts who have compelled arbitration under agreement made after the dispute has arisen: *Gardner v. Shearson, Hammill & Co.*, 433 F.2d 367 (5th Cir. 1970); *Moran v. Paine Webber, Jackson & Curtis*, 389 F.2d 242 (3d Cir. 1968)), *reh'g denied*, 108 S. Ct. 31 (1987).

104. *Wilko*, 346 U.S. at 438 (Jackson, J. concurring). *See also* Note, *supra* note 19, at 137. (This commentator noted both the concurring opinion and the SEC's support of this distinction in an amicus brief.)



the desirability of arbitration<sup>105</sup> and to make a willful waiver of the judicial forum. The whole purpose of the nonwaiver provisions and the *Wilko* preclusion "is to allow investors to make an intelligent choice of forums, and not wholly to foreclose voluntary arbitration."<sup>106</sup>

The 1975 amendments to the securities laws amended section 28 of the 1934 Act to allow compulsory arbitration of claims between securities professionals.<sup>107</sup> Courts had already compelled to arbitration disputes between stock exchange members pursuant to predispute agreements<sup>108</sup> as well as disputes between member and non-member firms at the instance of the nonmember.<sup>109</sup> Intra-exchange arbitration does not prejudice the investing public and allows the exchanges to fulfill their disciplinary and dispute resolving functions in an efficient manner.<sup>110</sup> Moreover, Congress presumed exchange members were not under the disadvantages borne by securities buyers as a class because they are sophisticated enough to protect their own interests.<sup>111</sup> "Dealers could fend for themselves; it was the investing public that was in need of protection."<sup>112</sup>

In *Scherk v. Alberto Culver*,<sup>113</sup> the Court made an exception to the *Wilko* doctrine for international transactions, where providing a forum for dispute resolution is a carefully negotiated part of the agreement and not the product of unequal bargaining power.<sup>114</sup> In *Scherk*, a

105. Note, *supra* note 21, at 137.

106. *Id.* at 138.

107. See 15 U.S.C. § 78bb(b) 1982. See also Brown, *supra* note 71, at 20. (In the Conference report accompanying this legislation, Congress endorsed *Wilko* and those cases that extended *Wilko* to 10(b) claims. In addition, the amendment to section 15B of the 1934 Act permitted municipal securities broker-dealers to arbitrate claims, but insisted that a customer could not be mandated to arbitration except at his instance and in accordance with section 29, the non-waiver provision.)

108. Sterk, *supra* note 4, at 519, 520, and n.138 (listing the following courts: Coenan v. R.W. Pressprich & Co., 453 F.2d 1209 (2d Cir.), cert. denied, 406 U.S. 949 (1972); *In re* Revenue Properties Litigation Cases, 451 F.2d 310 (1st Cir. 1971); Brown v. Gillian, Will & Co., 287 F. Supp. 766 (S.D. N.Y. 1968)).

109. *Id.* (Arbitration between a member and non-member firm was compelled in *Axelrod & Co. v. Kordich, Victor & Neufeld*, 451 F.2d 838 (2d Cir. 1971)).

110. See Note, *supra* note 21, at 140 (citing *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532 (3d Cir. 1976)).

111. *Id.* Stock exchange members do not labor under the disadvantages borne by securities buyers as a class as enumerated in *Wilko*.

112. Brown, 287 F. Supp. at 771-72.

113. 417 U.S. 506 (1974).

114. *Id.* at 515. The "critical" basis of the decision to compel arbitration was that the contract in issue was "a truly international agreement." *Id.* In fact,



U.S. company and a German citizen contracted for a stock purchase.<sup>115</sup> The purchase agreement provided that future disputes would be arbitrated in an international forum.<sup>116</sup> Accordingly, when Alberto Culver brought suit alleging violations of section 10(b) and Rule 10b-5 in federal court, Scherk moved for a stay pending arbitration.<sup>117</sup> On appeal, the Supreme Court held the arbitration agreement enforceable because of "crucial differences between the agreement involved in *Wilko* and the one signed by the parties here."<sup>118</sup> This contract was an international agreement concerning the sale of businesses organized under the laws and situated in European countries, "each with its own substantive laws and conflict of laws rules."<sup>119</sup> "[R]efusal by the courts of one country to enforce an international arbitration agreement would . . . imperil the willingness and ability of businessmen to enter into international commercial agreements."<sup>120</sup>

Although in dicta the *Scherk* Court made a "colorable argument" distinguishing suits brought under section 12(2) of the 1933 Act from suits brought under section 10(b) of the 1934 Act,<sup>121</sup> commentators have almost uniformly rejected its premises.<sup>122</sup> The SEC, for instance, emphatically noted that "Section 10(b) is just as much a 'provision' of the 1934 Act, with which persons trading in securities are required to 'comply,' as Section 12(2) is of the 1933 Act."<sup>123</sup> "The adequacy of

---

"[c]oncededly, situations may arise where the contacts with foreign countries are so insignificant or attenuated that the holding in *Wilko* would meaningfully apply." *Id.* at 517 n.11.

115. *Id.* at 508.

116. *Id.*

117. *Id.*

118. *Id.* at 515.

119. *Id.* at 516.

120. *Id.* at 516, 517.

121. The *Scherk* Court suggested that there was a "colorable argument" that the *Wilko* holding which applied to suits under section 12 of the 1933 Act may not apply to suits brought under section 10(b) of the 1934 Act or Rule 10b-5. The former expressly provides defrauded purchasers with special rights of private remedy for civil liability while there is no statutory counterpart for the latter; the 10(b) cause of action has been judicially created. *Id.* at 513-14. Since the 1934 "Act does not establish the 'special right' that the court in *Wilko* found significant . . . the nonwaiver provision of the Act does not apply." *Id.* at 514.

122. *Shearson/American Express Inc. v. McMahon*, 107 S. Ct. 2332, 2347 n.2 (Blackmun J., Brennan J., and Marshall J., concurring in part and dissenting in part), *reh'g denied*, 108 S. Ct. 31 (1987).

123. See Brief of the Securities Exchange Commission as Amicus Curiae Supporting Petitioners at 24, *Shearson/American Express, Inc. v. McMahon*, 107 S. Ct.



arbitration . . . is wholly independent of whether Congress made a right of action express or the courts inferred it."<sup>124</sup>

*Dean Witter Reynolds Inc. v. Byrd*<sup>125</sup> further circumscribed the *Wilko* holding. In *Byrd*, the plaintiff brought suit in federal court under Rule 10b-5 and for violations of state law.<sup>126</sup> Dean Witter presumed the 10b-5 claims were non-arbitrable but moved to sever and stay proceedings on the state claims pending arbitration.<sup>127</sup> The issue was whether the court could try the arbitrable state claims with the non-arbitrable federal claim under pendant jurisdiction for reasons of judicial economy.<sup>128</sup> *Byrd* argued that severing the claims would result in inefficient bifurcated proceedings and would frustrate the FAA's primary purpose, providing for quick and efficient resolution of disputes.<sup>129</sup> But the *Byrd* Court dismissed this argument and did away with intertwining.<sup>130</sup> It held that the FAA requires arbitration of all arbitrable claims, "even if the result is 'piecemeal' litigation . . ." and "inefficient maintenance of separate proceedings in different forums."<sup>131</sup>

The majority opinion in *Byrd* did not address the arbitration of 10(b) claims.<sup>132</sup> In fact, although the petitioner and *amici* from the securities industry had urged the Court to resolve this question, it declined to do so because the question was not properly before it.<sup>133</sup> But the *Scherk* dicta was repeated in the *Byrd* concurring opinion,<sup>134</sup> and it led some subsequent courts to hold 10(b) claims arbitrable.<sup>135</sup> Al-

2332 (No.86-44), *reh'g denied*, 108 S. Ct. 31 (1987) [hereinafter Amicus Brief].

124. *Id.*

125. 470 U.S. 213 (1985).

126. *Id.* at 214-15.

127. *Id.* at 215.

128. *Id.* Until then, courts had either severed the arbitrable from the non-arbitrable claims or intertwined the claims if they arose from a single set of facts, and adjudicated the entire case in federal court. *Id.* at 216-17. *See also* Krause, *Securities Litigation: The Unsolved Problem of Predispute Arbitration Agreements for Pendant Claims*, 29 DEPAUL L. REV. 693, 709 (1980). (Plaintiffs in federal court often pled pendant state common law or statutory claims since punitive damages could be recovered under state claims but not for claims under the federal securities statutes.)

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

130. *Id.*

131. *Id.* at 221.

132. *Id.*

133. *Id.* at 215 n.1.

134. *Id.* at 224-25 (White, J. concurring).

135. *McMahon*, 107 S. Ct. at 2349 n.8 (Blackmun J., Brennan J., and Marshall



though little was added to the points that had been made in *Scherk* and no further reasoning was given,<sup>136</sup> the "colorable argument" was taken up by many lower courts, often without any analysis.<sup>137</sup> Subsequently, although all the courts of appeals had presumed since the time of *Wilko* that 10(b) claims as well as 12(2) claims could not be compelled to arbitration, after *Byrd*, some held to the contrary.<sup>138</sup> The conflict awaited resolution by a Supreme Court decision.<sup>139</sup>

## VI. The Change in Judicial Attitudes Toward Arbitration

Decisions in areas other than securities law also evidenced a changing federal attitude toward arbitration and precipitated disparate holdings in the lower courts.<sup>140</sup> *Mitsubishi Motors Corp. v. Solar Chrysler-Plymouth, Inc.*<sup>141</sup> upheld the validity of an international arbitration agreement in an antitrust claim based on the possibility of harm to international trade. Although *Mitsubishi* did not decide the enforcement of arbitration clauses in domestic antitrust disputes, the Court mandated that the policies of the FAA be liberally construed, that any doubts as to the arbitrability of an issue be resolved in favor of arbitration, and that arbitration agreements be enforced against claims implicating statutory rights in the absence of a countervailing congressional intent.<sup>142</sup> In *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*,<sup>143</sup> the Court similarly held that, because of the liberal federal policy favoring arbitration agreements, courts should resolve "any doubts concerning . . . an allegation of waiver, delay, or a like defense to arbitrability" in favor of arbitration.<sup>144</sup> Additionally, in *Southland*

---

J., concurring in part and dissenting in part). Courts that followed the *Byrd* concurrence include *Page v. Mosley, Hallgarten, Estabrook & Weeden*, 806 F.2d 291, 296-98 (1st Cir. 1986); *Phillips v. Merrill Lynch Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393, 1397-98 (8th Cir. 1986). See also Note, *supra* note 5, at 212 n.116. (listing additional courts).

136. *McMahon*, 107 S. Ct. at 2349 n.8.

137. *Id.*

138. *Id.*

139. *Id.* at 2336-37. The Court granted certiorari in *McMahon* to resolve the conflict among the courts of appeals.

140. See *Brown*, *supra* note 71, at 7-11.

141. 105 S. Ct. 3346 (1985).

142. *Id.*

143. 460 U.S. 1 (1983).

144. *Id.* at 24-25.



*Corp. v. Keating*,<sup>145</sup> the Court held that the FAA preempted state attempts to limit arbitration, even if the state statute under which a claim was brought attempted to preclude arbitration of such claims.<sup>146</sup>

The change in judicial attitude toward arbitration is to an extent attributable to a concern over the rising number of federal court cases and the explosion of litigation costs.<sup>147</sup> Former Chief Justice Warren Burger and Justice Sandra Day O'Connor have both taken the position that there is a litigation explosion that will bury our court systems unless we develop new and innovative methods of dealing with the resolution of civil disputes.<sup>148</sup> Although practical concerns should be irrelevant in the face of congressional intent,<sup>149</sup> "the general posture of many federal judges has not been to look kindly upon legal principles which increase the volume of their case load,"<sup>150</sup> and thus the *Wilko* holding "[w]hile technically justifiable . . . has proved troublesome. . . ."<sup>151</sup>

Problems of court congestion have drastically increased in the last few years.<sup>152</sup> It is not surprising that the transplant of *Wilko* to the section 10(b) arena could not "withstand the onslaught of the evolving federal recognition of arbitration as an . . . alternative dispute resolution mechanism."<sup>153</sup> "[T]he Supreme Court consider[ed] the issue open

145. 465 U.S. 1 (1984).

146. See Brown, *supra* note 71, at 8.

147. Fisher v. Prudential-Bache Securities Inc., 635 F. Supp. 234, 236 (D. Md. 1986). See also Hazen, *supra* note 71, at 744-45. (Observers have long decried the overburdened federal judiciary. Commentators agree that federal courts should not be shackled with cases that belong elsewhere. This will provide for more efficient processing of private claims and help relieve some of the pressure on overcrowded federal dockets.)

148. Spatt, *Res Judicata and Collateral Estoppel*, 42 ARB. J. 61 (1987). See also Dickinson, *Exclusive Federal Jurisdiction and the Role of the States in Securities Regulation*, 65 IOWA L. REV. 1201 (1980). (Under Burger, the Supreme Court attempted to reduce the federal judiciary's workload in the area of securities litigation.)

149. Fisher, 635 F. Supp. at 236. See also Brown, *supra* note 71, at 11. "[T]he text structure and policies of the 1934 Act, legislative developments since *Wilko*, and principles of judicial self restraint and *stare decisis* should constrain the Court to hold these [section 10b and RICO] claims are not subject to arbitration." *Id.*

150. S. JAFFEE, *BROKER-DEALERS AND SECURITIES MARKETS, A GUIDE TO THE REGULATORY PROCESS* 341 (1977).

151. *Id.*

152. See Spatt, *supra* note 148, at 61.

153. *Woodyard v. Merrill Lynch, Pierce Fenner & Smith, Inc.*, 640 F. Supp. 760, 763 (S.D. Tex. 1986). (This court anticipated *McMahon* but felt bound to follow Supreme Court precedent at that time. It is interesting to note that the motion to compel arbitration was denied by the court because, even if the agreement was enforce-



and [would] at some point expressly limit or overrule *Wilko*."<sup>154</sup> It was simply a matter of time. Five sitting Justices were on record opposing the extension of *Wilko* to claims under the 1934 Act.<sup>155</sup> Justices Powell, Rehnquist and Blackmun had voted with the *Scherk* majority and differentiated the enforceability of arbitration clauses for implied causes of action under the 1934 Act and express causes under the 1933 Act.<sup>156</sup> Justice Stevens, who replaced Justice Douglas, had dissented and argued against extending *Wilko* to implied actions under the 1934 Act in the *Scherk* court of appeals decision.<sup>157</sup> In the *Byrd* concurrence, Justice White, who dissented in *Scherk*, expressed his agreement that *Wilko* could not be mechanically extended to 1934 Act actions.<sup>158</sup> The two new members of the Court, Justices O'Connor and Scalia, were noted conservatives and had previously held against extending judicial doctrines where Congress had not provided an express basis for doing so.<sup>159</sup>

Thus, some courts began to compel section 10(b) claims to arbitration in anticipation that the Supreme Court would eventually mandate they do so.<sup>160</sup> One court did not agree with the trend but went along with it and explained "[a]lthough the differences between the 1933 and

---

able under the securities laws, the customer did not knowingly enter the contract to arbitrate or knowingly waive her right to a judicial forum. The parties had not discussed the arbitration clause contained in the cash management account agreement, and the plaintiff claimed she was unaware of the arbitration provisions prior to filing the lawsuit. *Id.* at 761.)

154. *Wolfe v. E.F. Hutton & Co., Inc.*, 800 F.2d 1032, 1038 (11th Cir. 1986).

155. Fletcher, *Privatizing Securities Disputes Through the Enforcement of Arbitration Claims*, 71 MINN. L. REV. 393, 411-12 (1987).

156. *Id.*

157. *Id.* (citing *Alberto Culver Co. v. Scherk*, 484 F.2d 611, 616-18 (Stevens, J. dissenting), *rev'd*, 417 U.S. 506 (1974)).

158. *Id.*

159. *Id.* (citing *Randall v. Loftsgarrden*, 106 S. Ct. 3143, 3150 (1986) (O'Connor, J.) (observing that "if the language of a provision of the securities laws is sufficiently clear in its context and not at odds with the legislative history, it is unnecessary to examine the additional considerations of policy.") (also citing *Gott v. Walters*, 756 F.2d 902, 906 (D.C. Cir. 1985)).

160. Courts which have so held include *Prawer v. Dean Witter Reynolds, Inc.*, 626 F. Supp. 642 (D.C. Mass. 1985); *Tullis v. Kohlmeyer & Co.*, 551 F.2d 632 (5th Cir. 1977); and *Halliburton & Assocs. v. Henderson Few & Co.*, 774 F.2d 441, 445 (11th Cir. 1985). Other courts acknowledging the growing trend are *Moncrieff v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 623 F. Supp. 1005 (E.D. Mich. 1985); *Phillips v. Merrill Lynch, Pierce, Fenner & Smith*, 795 F.2d 1393 (8th Cir. 1986); and *Fisher v. Prudential-Bache Securities, Inc.*, 635 F. Supp. 234 (D. Md. 1986).



1934 Securities Acts noted by the Supreme Court are truly distinctions without a difference, the Court is convinced that the dicta in *Dean Witter* reflects a determination on the part of the Supreme Court to undermine, and eventually overturn, lower courts precedent extending *Wilko* to 1934 Act claims."<sup>161</sup> Therefore, this court enforced a predispute arbitration agreement for a plaintiff's section 10(b) claims.<sup>162</sup>

## VII. The Background of The *McMahon* Case

*Shearson/American Express v McMahon*<sup>163</sup> provided the opportunity for the Supreme Court to settle the issue of whether investors could be compelled to arbitration of claims under section 10(b) and RICO if they had signed a predispute arbitration agreement. Both the American Arbitration Association (AAA) and the SEC, under whose authority the majority of securities dispute arbitrations are currently conducted,<sup>164</sup> filed *amicus curiae* briefs in favor of Shearson. The AAA's strong support of increasing the scope of securities arbitration was to be expected; it promotes commercial arbitration of disputes in fields as diverse as divorce, construction, automobile injury and criminal complaints.<sup>165</sup> Their brief stressed the strong federal policy toward arbitration created by the FAA and that the *Wilko* holding was based on a clearly outdated improper suspicion of arbitration rather than on evidence of congressional intent to preclude arbitration.<sup>166</sup> It urged the Court to reexamine the *Wilko* holding since, subsequent to *Wilko*, the Court's decisions had overcome judicial hostility toward arbitration and had reflected the intent of Congress as expressed in the Arbitration Act.<sup>167</sup>

161. *Fisher*, 635 F. Supp. at 236.

162. *Id.*

163. 107 S. Ct. 2332 (1987).

164. Robbins, *Securities Arbitration: Preparation and Presentation*, 42 *ARB. J.* 3, 4 (1987) [hereinafter Robbins, *Securities Arbitration*]. (The choice of either an AAA or SRO forum is often provided for in customer agreement arbitration clauses. While the procedures in an AAA or SRO arbitration are generally similar, the differences will have an effect on the way the case is to be presented.)

165. R. COULSON, *BUSINESS ARBITRATION—WHAT YOU NEED TO KNOW* 8-9 (1980).

166. See *Amicus Brief* at 4. The FAA requires enforcement of arbitration clauses for commercial disputes between contracting parties, unless Congress has specifically decided to preclude arbitration. *Id.*

167. *Id.* at 12. (The AAA also observed that there was no evidence of congressional intent to preclude arbitration of RICO claims whereas the SEC's brief only ad-



The SEC's brief, on the other hand, was an unexpected reversal of its prior position that "arbitration could not be used to settle fraud claims under Section 10(b) of the 1934 Act."<sup>168</sup> In a 1979 release, the SEC had issued a warning to broker-dealers that they must inform customers that predispute arbitration clauses did not waive the customer's right to a judicial forum for claims arising under the federal securities laws.<sup>169</sup> After broker-dealers did not provide such explanation and continued to use the clauses, a 1983 release adopted a rule requiring a printed disclosure of investors' recourse to the courts.<sup>170</sup> "[L]egislative history, a thirty year line of case law and Commission releases"<sup>171</sup> precluded the deceptive use of arbitration clauses.<sup>172</sup>

In contrast, in the *McMahon* brief, the SEC tried to distinguish *Wilko* since, in the 1975 amendments to the 1934 Act, the SEC obtained sufficient regulatory authority over the arbitration procedures used by stock exchanges and other SROs to ensure that arbitration is adequate to protect the statutory rights of customers against broker-

---

dressed the arbitrability of the Exchange Act Claims.)

168. See Letter from John D. Dingell, Chairman of the Subcommittee on Oversight and Investigations, U.S. House of Representatives, (Feb. 11, 1987). (The letter discussed the Committees' concern with the increased number of investor complaints about brokers and problems in arbitration. The letter also expressed concern with the SEC's unexpected reversal of position with regard to the arbitration of complaints brought under section 10(b) in light of their previous position and a General Accounting Office report on the SRO's inability to police violations.)

169. See Securities Exchange Act Release No. 34-15984 (July 2 1979), 44 Fed. Reg. 40,462 (1979). In pertinent part the release required that "[c]ustomers should not be led to believe, either before or after the occurrence of disputes, that a predispute arbitration agreement constitutes a waiver of the right to a judicial forum."

170. REGULATION § 240.15C-2-2 OF THE SECURITIES EXCHANGE ACT OF 1934, adopted in Securities Exchange Act Release no. 34-20397, 48 Fed. Reg. 53,404 (Nov. 18, 1983, effective December 28, 1983) states in 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.

171. Securities Exchange Act Release No. 19813 at 85,967 (May 23, 1983).

172. See Securities Exchange Act Release No. 15984 (July 2, 1979). (In this and similar releases, the Commission indicated that, since investors are unaware of their rights and may submit to arbitration or choose not to pursue a dispute believing that arbitration is their only alternative, the use of arbitration clauses without providing information about the judicial alternative is an inequitable, unjust trade practice and may itself violate the anti-fraud provisions of the securities laws.)



dealers.<sup>173</sup> Yet as recently as August 1986, the SEC had indicated concern that there were serious limitations on its authority and shortcomings in the arbitration process itself.<sup>174</sup> A report prepared by the staff of the Commission's Division of Market Regulation had explained that "[t]he Commission has no authority to review a specific arbitration to assure either compliance with the procedural requirements of the Code or accurate interpretations of underlying federal securities law or other claims by the arbitrators . . . [and] no authority to overturn an arbitration award."<sup>175</sup>

Thus far, there has been no public explanation of the inconsistency of the SEC's position.<sup>176</sup> It is clear, however, that although the stated "major purpose" of its brief was to urge the Court not to compel 10(b) claims to arbitration because of any "supposed" distinction between express actions under section 12(2) and implied actions under section 10(b),<sup>177</sup> what the SEC was actually interested in was emphasizing the

---

173. See Amicus Brief at 6-7, 21. (In its brief, the SEC urged the court to limit its holding to enforcing arbitration agreements that prescribe procedures subject to its oversight. The SEC wanted the Court to refrain from ruling on the adequacy of arbitration that was not subject to SEC oversight. *Id.*) But see *McMahon*, 107 S. Ct. at 2341. (The Court's ruling did not differentiate the adequacy of arbitration in forums subject to the SEC's oversight (SRO forums) from the adequacy of arbitration in other forums.) However, many securities arbitrations are conducted in AAA or independent forums. How will their adequacy be insured?

174. Letter from John D. Dingell, Chairman Subcommittee on Oversight and Investigations, U.S. House of Representatives to John D.R. Shad, Chairman Securities and Exchange Commission (Feb. 11, 1987) at 3.

175. *Id.*, citing an August 1986 report prepared by the SEC's Department of Market Regulation (emphasis added by the committee deleted).

176. Letter from John D.R. Shad, Chairman Securities and Exchange Commission to John D. Dingell, Chairman Subcommittee on Oversight and Investigations, U.S. House of Representatives (June 9, 1987). (This letter provided a response to the Committee's request for documents related to the Commission in *McMahon*. However, with the exception of one letter, the materials were noted to involve confidential, non-public memoranda to the Commission from OGC and the Division of Market regulation and it was requested that they not be made public.) They were not made available to the author.

177. See Amicus Brief at 6-7, 21. The SEC urged that this distinction might prove destructive of investors' protections under the securities laws. Section 10(b) is as much a provision with which people trading in securities are required to comply as section 12(2) is. *Id.* at 24. It is interesting that this point of view was adopted by both the *McMahon* majority and minority in direct contravention of the "colorable argument" as it had appeared in *Scherk* and *Byrd*. But see Reply Brief for the Petitioners at 7, 8, *Shearson/American Express v. McMahon*, 107 S. Ct. 2332 (1987) (no. 86-44) (The argument that Congress could not have intended the anti-waiver provision to ap-



adequacy of arbitration to ensure compliance with the provisions of the securities laws for both express and implied causes of action.<sup>178</sup>

### VIII. The *Shearson/American Express v. McMahon*<sup>179</sup> Decision

In *McMahon*, Eugene and Julia McMahon opened an account with Shearson Lehman Brothers individually and as trustees for the employee pension and profit sharing plan of the funeral home they operated.<sup>180</sup> In 1984 they filed suit in federal court charging Shearson and the broker with securities fraud under section 10(b) of the 1934 Act, Rule 10b-5, state law torts and a RICO charge.<sup>181</sup> Their account value decreased \$500,000.00, of which \$200,000.00 was commissions.<sup>182</sup>

When the case reached the Supreme Court, it had yet to be heard on the merits. Shearson had moved to stay the action pending arbitration in accordance with customer agreements signed upon opening the account.<sup>183</sup> The district court rejected the McMahon's contention that the agreements were unenforceable as adhesion contracts and held the churning and state law fraud counts arbitrable. It stayed the RICO charge for resolution in the courts pending the outcome of arbitration.<sup>184</sup> The court of appeals upheld arbitration of the state law claim, but held that both the securities claim and RICO claim were non-arbi-

---

ply to waiver of the judicial forum for an action it did not create was one of the petitioner's primary points), *reh'g denied*, 108 S. Ct. 31 (1987).

178. See Amicus Brief at 13-21.

179. 107 S. Ct. 2332 (1987).

180. Meyer, *Why Stockbrokers Sleep at Night*, 16 MONEY MAGAZINE 105 (1987). The McMahons ran a funeral home in New York for 21 years. Their employees and their pension funds, and their personal saving totalled over \$1 million. The money had been invested in CDs, municipal bonds and treasury bills when they turned their investments over to a broker who was a fellow parishioner in their church. She had been speaking with them for some time to convince them that she could boost their income 25%.

181. *McMahon*, 107 S. Ct. at 2336.

182. Meyer, *supra* note 180. Although the McMahons allege that they had specifically instructed the broker to avoid risky investments, Shearson lawyers argue that they should have been aware of the risks the broker was taking since the couple had received confirmations for all trades and monthly statements, and because Mr. McMahon was a successful businessman.

183. *McMahon*, 107 S. Ct. at 2336.

184. *Id.*



trable.<sup>185</sup> Finally, in June 1987, the Supreme Court, in a five to four decision, held all three claims subject to arbitration.<sup>186</sup>

The *McMahon* majority built the foundation of their holding on the strong federal policy and the duty to uphold arbitration agreements created by the FAA.<sup>187</sup> As in *Mitsubishi*,<sup>188</sup> Justice O'Connor explained that the duty to uphold agreements preempts claims founded on statutory rights unless the party opposing arbitration could show, from text or legislative history, that Congress intended to "preclude a waiver of judicial remedies."<sup>189</sup> The Court then individually dismissed the McMahon's attempts to show such congressional intent.

In response to the McMahon's first argument that section 29(a), the nonwaiver provision of the 1934 Act, forbids waiver of section 27's guarantee of jurisdiction in the federal forum, the Court explained that section 29 only prohibits waiver of the substantive obligations of the Act.<sup>190</sup> Because the jurisdictional provision does not impose any statutory duty, "its waiver does not constitute a waiver of 'compliance with any provision' of the Exchange Act under § 29(a)."<sup>191</sup> "*Wilko* must be understood, therefore, as holding that the plaintiff's waiver of the 'right to select the judicial forum' . . . was unenforceable only because arbitration was judged inadequate to enforce the statutory rights created by Section 12(2)."<sup>192</sup> *Scherk* was similarly interpreted. The *McMahon* Court explained that just as the *Scherk* agreement was upheld because, under the circumstances of the international contract, arbitration was an adequate substitute for adjudication as a means of enforcing the parties' statutory rights, arbitration is now adequate to resolve 10(b) domestic claims.<sup>193</sup>

In response to the McMahons' second argument that arbitration would weaken their ability to recover under the 1934 Act, the Court

185. *Id.*

186. *Id.* at 2334-35.

187. *Id.* at 2337.

188. *Mitsubishi Motors Corp. v. Solar Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346 (1985).

189. *McMahon*, 107 S. Ct. at 2337.

190. *Id.* at 2338.

191. *Id.*

192. *Id.* (citations omitted).

193. *Id.* at 2339-41. However, this likening of the two cases is difficult to reconcile with the *Scherk* text stating that the Court upheld the arbitration agreement in the international contract because it "involve[d] considerations and policies significantly different from those found controlling in *Wilko*." *Scherk*, 417 U.S. at 515.



explained that although the presumption that the effectiveness of the Act's provisions required the exercise of judicial discretion may have been true at the time *Wilko* was decided, "most of the reasons given in *Wilko* have been rejected subsequently by the Court as a basis for holding claims to be nonarbitrable."<sup>194</sup> The Court strongly endorsed the SEC's newly found position that although it had no authority over the SRO's arbitration rules at the time *Wilko* was decided, the 1975 amendments to section 19 of the Exchange Act gave it expansive power to make SRO arbitration adequate to protect statutory rights.<sup>195</sup>

The McMahon's final argument was that even if the text of section 29(a), the nonwaiver provision, could be read not to void predispute waivers of the judicial forum, Congress has subsequently indicated that it desires this interpretation.<sup>196</sup> Congress expressed this intent because, although it significantly amended the 1934 Act in 1975 to permit mandatory arbitration between the members of exchanges, it did not provide for arbitrability of 1934 Act claims, but rather explained in a conference report that the amendments were not meant to effect law under *Wilko*.<sup>197</sup> The conference report states:

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 proceedings provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations.*<sup>198</sup>

The Court had an alternative to the McMahon's interpretation. Although the McMahons contended that the Conferees would not have acknowledged *Wilko* in a revision of the Exchange Act unless they were aware of lower court decisions extending the *Wilko* holding to section 10(b) claims and intended to approve them, the Court ex-

194. *McMahon*, 107 S. Ct. at 2339-40.

195. *Id.* at 2341.

196. *Id.* at 2342.

197. *Id.*

198. *Id.* at 2343 (emphasis added).



plained that there were other possible interpretations of the report.<sup>199</sup> Moreover, if Congress wanted to extend *Wilko*, it would have enacted into law a provision doing so.<sup>200</sup>

The *McMahon* dissent agreed with the majority's *Mitsubishi* analysis of the FAA, but found shortcomings in almost all of the rest of the majority's analysis.<sup>201</sup> First, the statement in the congressional report was made during a wholesale revision of the securities laws that was intended to further investor protection, which suggests that Congress was aware of the extension of the *Wilko* doctrine to actions under section 10(b), and was not concerned with arresting this trend.<sup>202</sup> Second, the majority's failure to recognize that both the 1933 and 1934 Acts manifest congressional intent to exclude their provisions from the dictates of the Arbitration Act was the result of the majority's "unduly narrow reading of *Wilko*."<sup>203</sup> In fact, the Court had previously understood *Wilko* to have the opposite meaning in *Mitsubishi*. There, it explained *Wilko* as showing how a statute manifested clear congressional intent to preclude waiver of the right to a judicial forum.<sup>204</sup> Finally, although the majority was extolling the policies of the Arbitration Act, it was insensitive to and disregarded the policies of the Securities Act.<sup>205</sup> The Securities Act was passed eight years after the Arbitration Act, in response to the market crash of 1929 and as a remedy to industry abuses. The *Wilko* Court clearly recognized the Act's policy of investor protection and based its holding on precluding waiver of the jurisdictional advantage the Act gives.<sup>206</sup> The *Wilko* Court's discussion of the inadequacies of arbitration did not occur until "after the Court had concluded that the language, legislative history, and purposes of the Securities Act mandated an exception to the Arbitration Act."<sup>207</sup>

The dissent also illustrated how the majority's interpretation of *Scherk* and their overall perception of arbitration are incorrect. They pointed out that *Scherk* was not a case about the adequacy of arbitra-

---

199. *Id.*

200. *Id.*

201. *Id.* at 2346 (Blackmun J., Brennan J., and Marshall J., concurring in part and dissenting in part).

202. *Id.* at 2348.

203. *Id.* at 2350.

204. *Id.*

205. *Id.*

206. *Id.* at 2350-51.

207. *Id.* at 2352.



tion.<sup>208</sup> *Scherk* relied upon the crucial difference between an international business situation and the *Wilko* dispute, which was clearly governed by the securities laws of the U.S. The *Scherk* Court had assumed that the *Wilko* prohibition would extend to 10(b) claims.<sup>209</sup> Second, arbitration has not significantly changed since the time of *Wilko*, although the Court implied it has.<sup>210</sup> Records are still not required; arbitrators are still not bound by precedent; they are still discouraged from giving reasons for their decisions, and there is still limited judicial review.<sup>211</sup> Moreover, the SEC's newly adopted position that its supervision can insure the adequacy of SRO arbitration is questionable, since the SEC admits that it only makes rules; it does not review proceedings nor does it have the manpower to do so.<sup>212</sup> Finally, the increasing volume of Wall Street illegality suggests that the industry's self regulation as a whole, of which SRO arbitration is a part, is not adequately functioning.<sup>213</sup>

### IX. The Future of the *McMahon* Doctrine

Because their basis for distinguishing *Wilko* was the new adequacy of arbitration to insure investors' protection under the securities law, although the *McMahon* Court limited its holding to actions under the 1934 Act, lower courts have already begun to direct arbitration of 1933 Act claims.<sup>214</sup> This trend can be expected to increase since arguments for extending the *McMahon* holding flow naturally from the Court's reasoning.<sup>215</sup> One court reasoned that, since the antiwaiver provisions in the 1933 and 1934 Acts are nearly identical, *McMahon* restricted *Wilko* to barring waiver only when arbitration is inadequate to protect substantive rights.<sup>216</sup> Because of the expanded oversight author-

208. *Id.* at 2352.

209. *Id.*

210. *Id.* at 2354.

211. *Id.* at 2354-55.

212. *Id.* at 2356-58.

213. *Id.* at 2358.

214. See *Nobel v. Drexel, Burnham, Lambert Inc.*, 823 F.2d 849 (5th Cir. 1987); *Staiman v. Merrill Lynch, Pierce Fenner & Smith, Inc.*, C.D. Cal. 1251 Fed. Sec. L. Rep. (CCH) § 93,381 (Fed. Sec. L. Rep. Oct. 1, 1987).

215. See *Nobel*, 823 F.2d at 850 n.3. "*McMahon* undercuts every aspect of *Wilko*; a formal overruling of *Wilko* appears inevitable—or perhaps, superfluous." (citation omitted).

216. See *Staiman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, C.D. Cal. 1251 Fed. Sec. L. Rep. (CCH) § 93,381 (Fed. Sec. L. Rep. Oct. 1, 1987).



ity of the SEC over securities exchanges, if an investor makes no showing that his Securities Acts claims would be inadequately protected in arbitration, it is no longer true that his rights could not be vindicated through arbitration.<sup>217</sup> In another instance a court compelled a claim under section 17(a) of the 1933 Act to arbitration "because the safeguards of having oversight of arbitration by a securities exchange or association" apply to this claim the same way they did in *McMahon*.<sup>218</sup> This action is implied as is the action under 10(b) and the substantive rights are substantially similar to those under 10(b); it is irrelevant that the claim is under the 1933 Act rather than the 1934 Act.<sup>219</sup>

## X. Improving Arbitration

Whether they endorse or oppose the extension of the *Wilko* doctrine to claims under section 10(b), almost all commentators agree that securities arbitration needs changing.<sup>220</sup> Prior to *McMahon*, they had suggested more extensive judicial review,<sup>221</sup> increased discovery,<sup>222</sup> mandatory hearing records in the form of transcripts or recordings,<sup>223</sup> and written opinions of arbitration awards.<sup>224</sup> Probably the most vehe-

217. *Id.*

218. *See Rocz v. Drexel Burnham Lambert, Inc.*, 743 P.2d 971, 974 (Ariz. App. 1987).

219. *Id.*

220. *See, e.g.*, Note, *supra* note 5, at 213-18; Brown, *supra* note 71, at 34-36; Krause, *supra* note 128, at 718-21; Note, *supra* note 3, at 552-54. *But see* Note, *The Arbitrability of Federal Securities Claims: Wilko's Swan Song*, 42 U. MIAMI L. REV. 203, 222-25 (1987). This commentator incorrectly asserts that it is not true that arbitration agreements may be adhesion contracts, that the arbitration forum may be biased in favor of the securities industry, or that adequate discovery, evidentiary procedures, records and judicial review are lacking and provides explanations to dispel each of these "myths." *Id.* at 222-23.

221. Note, *supra* note 5, at 214-15. (Judicial review will protect the parties if arbitrators disregard the law.)

222. *Id.* at 215-17. *See also* Katsoris, *supra* note 51, at 286-87. Currently, the extent of discovery is limited to the voluntary disclosure of documents.

223. *See* Note, *supra* note 5, at 214-15. *See also* Bayer and Abrahams, *The Trouble with Arbitration*, 11 LITIGATION 30, 31 (1985). The AAA suggests that selecting the arbitrator after investigating background and reputation is the most critical step in an arbitration. However, they do not recommend contact with the individual and, since there is no record, there is no way to investigate the potential arbitrator's reasoning or thoughtfulness.

224. Note, *supra* note 5, at 217-18. (Written opinions or a record will help courts determine whether the arbitrator's decision should be reviewed, modified or



ment recommendation was elimination of partiality in the composition of the arbitration panel itself. Arbitrators from "outside the securities industry" should not be persons who have been employed by, represented as counsel, or acted as consultant to any SRO or SRO affiliate, and the majority of any panel, or any single arbitrator, should be drawn from this pool so that investors do not feel trapped in an industry controlled forum.<sup>225</sup>

Just four months after *McMahon*, the Division of Market Regulation of the SEC sent a letter to the members of the SICA recommending changes to the Uniform Code.<sup>226</sup> Currently, each member and prominent industry figures are responding to the letter with their own suggestions.<sup>227</sup> The letter was the result of an eighteen month review of Securities Industry sponsored arbitration<sup>228</sup> but the SEC made its recommendations on the basis that, since as a result of *McMahon*, SRO arbitration will become the primary forum for resolving securities disputes, the same degree of informality as had previously existed will no longer be available to the system.<sup>229</sup> Many of the SEC's suggestions were similar to those above. In addition, it suggested disciplinary checks on arbitrators' backgrounds through a central registration system,<sup>230</sup> formal training for arbitrators,<sup>231</sup> a system of written arbitrator

---

vacated.)

225. Brown, *supra* note 71, at 35. See also Robbins, *Securities Arbitration*, *supra* note 164, at 3, 4. (Although none of the members of an AAA arbitration panel are from the securities industry, at least one individual on an SRO arbitration panel is from a member organization.)

226. See Letter from United States Securities and Exchange Commission, Division Of Market Regulation (September 10, 1987), sent to all SICA members.

227. Letter from the SICA to the Securities and Exchange Commission, Division of Market Regulation (December 14, 1987); Letter from The Pacific Stock Exchange to Securities and Exchange Commission, Division of Market Regulation (January 7, 1988); Letter from the Municipal Securities Rulemaking Board to Securities and Exchange Commission, Division of Market Regulation (December 8, 1987); Letter from Fidelity Brokerage Services to Securities and Exchange Commission, Division of Market Regulation (1987); Letter from Eppenstein and Eppenstein, Attorneys at Law to Securities and Exchange Commission, Division of Market Regulation (December 23, 1987).

228. Letter from U.S. SEC, *supra* note 226, at 1.

229. *Id.*

230. *Id.* at 3.

231. *Id.* at 4. (Currently, SROs administer virtually no training on matters relating to arbitration law, the scope of arbitrators' authority, relevant state law or securities law.)



evaluation,<sup>232</sup> that all SRO forums make publicly available summary data on the results of arbitration,<sup>233</sup> and that the SROs instruct arbitrators that they can refer "particularly egregious" broker or dealer conduct to appropriate disciplinary SRO authorities.<sup>234</sup> Although the SEC's recommendations will become operative only if the SROs file implementing rules that the SEC approves of,<sup>235</sup> they are an indication that arbitration may truly become a forum that adequately ensures compliance with the protective intent of the securities laws.

## XI. Training Attorneys for Securities Arbitration

The *McMahon* decision will have a substantial impact on lawyers whose clients have stock or commodities related disputes. The number of securities claims brought by investors is increasing rapidly. In 1984, 5000 cases were filed in federal court or arbitrated in an SRO or AAA forum.<sup>236</sup> In the first half of fiscal 1987 the SEC received 13,267 complaints.<sup>237</sup> The stock market drop of October 1987 spawned scores of lawsuits for improper order execution, unsuitability of stocks and failure to properly explain options.<sup>238</sup>

Lawyers who are traditionally litigators may have a difficult time adjusting to the practice and procedures of arbitration. Even an experienced trial lawyer does not necessarily understand the specialized practice of securities arbitration.<sup>239</sup> Because most arbitrators are sophisticated business executives, educators or professionals, talking to them like a jury and explaining the basics of stocks or options, or "wax[ing] poetic about a client's tale of woe" will lose their interest and cause them to become impatient.<sup>240</sup> So will boilerplate, complaint

---

232. *Id.* at 5. (The letter suggests that this information should be used exclusively for the administration of arbitration departments and potentially should be shared among SROs. The letter recommends that the information not be available to parties in subsequent litigation.) This suggestion, if implemented, may increase rather than decrease the perception of arbitration as an industry controlled forum.

233. *Id.* at 8.

234. *Id.* at 12.

235. 1249 Fed. Sec. L. Rep. (CCH) (Fed. Sec. L. Rep. Sept. 16, 1987) at 4, 5.

236. See Fletcher, *supra* note 155, at 394.

237. Telephone interview with John Heine, Securities and Exchange Commission Office of Consumer Affairs and Information Services (March 16, 1988).

238. N.Y. Times, Oct. 26, 1987, § 2, at 22, col. 1.

239. See Robbins, *A Practitioner's Guide*, *supra* note 4, at 51.

240. See Robbins, *Securities Arbitration*, *supra* note 164, at 11.



type drafting.<sup>241</sup> In summary, treating an arbitration proceeding with the formality of a federal case rather than the less formal proceeding it is intended to be is likely to antagonize arbitrators.<sup>242</sup>

It is important for lawyers who will be involved in securities arbitration to become familiar and keep current with arbitration procedures in both AAA and SRO forums. While they are generally similar, the differences are substantial enough that the practitioner's choice of forum will have a considerable effect on the presentation of the customer's case.<sup>243</sup> Lawyers must also know what to expect as a brokerage firm's defense and be familiar with the rules that govern the hearings and the limited grounds that are available to modify or vacate an award.<sup>244</sup>

Law schools must take a more active role in providing classes and continuing education in arbitration procedures. "Law schools have traditionally viewed their role as to train students in the skills of litigation," not arbitration.<sup>245</sup> As recently as the early 1980's, most law school curriculums did not include courses in arbitration or other alternative dispute resolution (ADR) procedures and practice, and many beginning attorneys had little or no exposure to arbitration.<sup>246</sup> Recently, however, some law schools have established special curricula and centers, publishers have devoted legal textbooks solely to arbitration and ADR, and legal education journals have begun including materials on teaching ADR.<sup>247</sup>

The AAA has created a Task Force on Law and Business Schools to promote the development of new materials and courses on Arbitration.<sup>248</sup> The AAA can make arrangements for attorneys or students to observe arbitration hearings at any one of their regional offices, and the Eastman Arbitration Library of the AAA has approximately one hundred published and unpublished materials relating to dispute resolution

241. *Id.* at 7.

242. *Id.* at 11.

243. *Id.* at 4.

244. *Id.* at 14.

245. Buchheit, *Teaching Alternative Dispute Resolution in Law Schools*, 1985 *ARB. & THE LAW*, AAA GENERAL COUNSEL'S REP. 174, 177 (1985).

246. *Id.* at 174-75. (Students were not exposed to other forms of alternative dispute resolution (ADR) such as negotiation and mediation and other related settlement techniques.)

247. *Id.* at 175-76.

248. *Id.* at 178.



in the securities industry.<sup>249</sup>

## XII. Conclusion

A conflict between two federal statutes presents a particularly complex problem for courts. Through the FAA, Congress had afforded parties to transactions who had agreed to arbitration the opportunity for prompt economical resolution of disputes. Through the Securities Laws, Congress intended to protect the rights of investors by providing a judicial forum for the resolution of disputes, and had forbidden a waiver of any of those rights. *Shearson/American Express v. McMahon*<sup>250</sup> held that compelling investors who sign predispute arbitration agreements to resolve their securities disputes in arbitration does not constitute a waiver of their rights to protection under the securities laws. Until Congress speaks otherwise, most investors will probably be sent to arbitration.

Presently, arbitration lacks many of the preferred features of the judicial forum for the resolution of securities disputes. It does, however, provide for speedier settlement of disputes and helps relieve court congestion problems. Moreover, if the safeguards of the SEC's and commentators' recommendations are implemented, and attorneys become proficient at the practice and procedures of arbitration, it may evolve into the better forum for fair resolution of securities disputes.

Patricia A. Shub

---

249. See *Special Bibliography on Dispute Resolution and the Securities Industry*, 42 *ARB. J.* 15 (1987).

250. 107 S. Ct. 2332 (1987).