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

Patricia A. Shub*
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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
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I. Introduction

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

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 Arbitration and Litigation 535 PRACTICING LAW INST. 11, 31 (1988) [hereinafter Robbins, A Practitioner’s Guide]; See also Sierk, Enforceability of Agreements to Arbitrate, An Examination of the Public Policy Defense, 2 CARDOZO L. REV. 401, 515-16 (1981) (buyers do not pay attention to arbitration 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 is that brokerage agreements may include an arbitration clause that limits their recourse to courts in actions like fraud, suitability, unauthorized trading, or churning. Unfortunately, the law does not require that brokers bring arbitration clauses to the attention of investors, or that the clause require separate signature, 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 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 enforceable due to federal or state law, any controversy arising out of or relating to my accounts, 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.


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 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.)


print. Brokers need not explain that signing the customer agreements can preclude an investor from taking the brokerage firm or broker to court.

Even investors who know they are agreeing to arbitration may not be quite sure what it is. If they don't go out of their way to learn about arbitration, they won't understand how different arbitration procedures are from those that occur in a court of law or how those differences may affect their rights.

In arbitration proceedings, judges do not hear cases. Rather, individuals unfamiliar with securities law or, conversely, individuals affiliated with the industry hear the case. Few courtroom formalities apply in arbitration; the proceedings are not governed by the rules of evidence, there is limited discovery, no transcript is kept unless specifically requested, and the option of a jury decision is not available. Arbitrators need not explain awards nor give written opinions. They

13. Id. (Under the Commodity Exchange Act, 7 U.S.C. § 1-26 (1982), the arbitration agreement must be a separately signed clause or document and a customer must be put on notice by a bold face warning of the surrender of certain rights that could be asserted in court for a predispute arbitration agreement to be enforceable.)


15. See Sterk, supra note 4, at 517-18.


18. See Note, supra note 3, at 554.


21. See Note, supra note 5, at 216. See also Note, Arbitration of Investor-Broker Disputes, 65 CALIF. L. REV 120, 131 (1977). (Although subpoena is not usually available, full discovery rights are not. The latter allow investors to obtain otherwise unavailable information regarding their accounts that may be important in the volume of commissions generated by the account, the proceeded of claims, e.g. the volume of commissions generated by the account, the prosecution of claims, e.g. the volume of commissions generated by the account, the prosecution of claims.)

22. See SECURITIES ARBITRATION RULES, AM. ARB. ASSOC. (1987) at 12; CODE OF ARBITRATION PROCEDURE, NASD (1987) at 17; ARBITRATION PROCEDURES, UNIFORM CODE OF ARBITRATION, 209 SEC 12-84 at 8 (advising that a verbatim record will not be kept of the proceedings; if a party wants a record kept and a copy, they must request it and pay for it).

23. Note, supra note 21, at 131.

are not required to follow substantive rules of law, and appeal of arbitration decisions is extremely limited. 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 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, were not negotiated at arm's length, and because arbitration itself did not provide the full and fair hearing dictated by the securities laws. McMahon reversed the status quo.

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.)
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 practice 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. (CCCH) § 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 re judicata or collateral estoppel effect on federal securities claims retained when the state law claims were ordered to arbitration.)

and held predispute brokerage arbitration agreements for most causes of action enforceable. 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. 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. The parties either make the agreement in advance in an arbitration clause, or after the dispute has arisen in a separate agreement.

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 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.
35. Id.
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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/Amex v. McMahon, 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, but were not negotiated at arm's length and because arbitration itself did not provide the full and fair hearing dictated by the securities laws. McMahon reversed the status quo.

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31. See Shearson/Amex, 107 S. Ct. at 2348, 2349 (Blackmun, J., 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.)
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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. The parties either make the agreement in advance in an arbitration clause, or after the dispute has arisen in a separate agreement.
Advocates believe arbitration is preferable to formal litigation in some instances because it is expeditious, private and less expensive.\(^{36}\) 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.\(^{37}\) 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.\(^{38}\) Litigation, on the other hand, provides standards, which adhere to legal principles, *stare decisis*, and the right of appeal help to maintain.\(^{39}\) Also, the uniform rules and procedures of litigation may guarantee a more impartial decision.\(^{40}\)

Although arbitration may be preferable in situations where speedy resolution, privacy and finality are paramount and discovery is unimportant,\(^{41}\) it is not necessarily "a desirable substitute for trial in courts... [as] the parties must decide in each instance.\(^{3}\) [t]hey must be content with its informality... those procedural limitations which it is precisely its purpose to avoid."\(^{44}\) 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."\(^{45}\)

At its origin, arbitration was "an unwelcome stepchild in the courts."\(^{46}\) An agreement to arbitrate a dispute was unenforceable because courts viewed it as an attempt to deprive them of their natural jurisdiction.\(^{47}\) Therefore, in 1925 the federal government enacted the Federal Arbitration Act (FAA)\(^{48}\) "to allow parties to avoid the costliness and delays of litigation and to place arbitration agreements upon the same footing as other contracts."\(^{49}\) 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.\(^{50}\)

Subsequently, the securities industry integrated arbitration into the settlement of disputes on exchanges.\(^{51}\) Each Exchange or Self Regulatory Organization (SRO)\(^{52}\) developed its own rules to govern arbitration proceedings.\(^{53}\) In 1976, the SEC recommended that the members of the securities industry organize the Securities Industry Conference on Arbitration (SICA)\(^{54}\) to develop a Uniform Code of Arbitration\(^{55}\) to govern arbitration proceedings in securities disputes.\(^{56}\) 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.

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36. But see Krieger 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 JUS. SYR. 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).


38. See id. at 73.

39. Id. at 71.


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.
Advocates believe arbitration is preferable to formal litigation in some instances because it is expeditious, private and less expensive.\(^4^6\) 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.\(^4^7\) 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.\(^4^8\) Litigation, on the other hand, provides standards, which adhere to legal principles, stare decisis, and the right of appeal help to maintain.\(^4^9\) Also, the uniform rules and procedures of litigation may guarantee a more impartial decision.\(^5^0\) Although arbitration may be preferable in situations where speedy resolution, privacy and finality are paramount and discovery is unimportant,\(^5^1\) it is not necessarily "a desirable substitute for trial in court: . . . the parties must decide in each instance."\(^5^2\) "[T]hey must be content with its informalities . . . those procedural limitations which it is precisely its purpose to avoid."\(^5^3\) 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."\(^5^4\) At its origin, arbitration was "an unwelcome stepchild in the courts."\(^5^5\) An agreement to arbitrate a dispute was unenforceable because courts viewed it as an attempt to deprive them of their natural jurisdiction.\(^5^6\) Therefore, in 1925 the federal government enacted the Federal Arbitration Act (FAA)\(^5^7\) "to allow parties to avoid the costliness and delays of litigation and to place arbitration agreements 'upon the same footing as other contracts.'"\(^5^8\) 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.\(^5^9\) Subsequently, the securities industry integrated arbitration into the settlement of disputes on exchanges.\(^6^0\) Each Exchange or Self Regulatory Organization (SRO)\(^6^1\) developed its own rules to govern arbitration proceedings.\(^6^2\) In 1976, the SEC recommended that the members of the securities industry organize the Securities Industry Conference on Arbitration (SICA)\(^6^3\) to develop a Uniform Code of Arbitration\(^6^4\) to govern arbitration proceedings in securities disputes.\(^6^5\) 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 litigations.

46. 1 Widdiss, supra note 37, at 70 (citing Kill v. Hollister, 1 Wils 129 (1726)).
47. 57 Cal.2d 230 (1962) (current version of the California Court of Appeals, Second Appellate District).
52. Rev. 279, 280 n.7 (1984) (the SROs include the American Stock Exchange; Boston Stock Exchange; Chicago Board of Options Exchange; Cincinnati Stock Exchange; Midwest Stock Exchange; Municipal Securities Rulemaking Board; National Association of Securities Dealers, Inc.; New York Stock Exchange; Pacific Stock Exchange; and Philadelphia Stock Exchange).
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tion in the courts.** 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.** They also suggest that brokers dislike litigation because of jury awards, which are frequently more generous than arbitration awards** and punitive damages, which may be granted in litigation but are not frequently awarded in arbitration.**

III. Provisions of the Securities Laws

During the early days of the New Deal, Congress enacted two landmark statutes regulating securities,** the Securities Act of 1933 (1933 Act)** and the Securities Exchange Act of 1934 (1934 Act)**. The 1933 Act's purpose is "to provide full and fair disclosure of the character of securities . . . and to prevent frauds in the sale . . ." *[55]* "[H]e was drafted with an eye to the disadvantages under which buyers labor," ** and "added to the ancient rule of caveat emptor*"** the further doctrine of "let the seller also beware."** The 1934 Act's purpose is to provide for the regulation of, and prevent unfair practices on, securities exchanges and over-the-counter markets.** It too is concerned with in-

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68. See Note, supra note 21, at 121 n.13 (citing Jacquin arbitration in Action on Wall Street, 1 ABA J. 261-62 (1946).
69. Id. at 113, citing R. NEY, THE WALL STREET GANG (1974); See also M. DOUCET, THE LAW AND PRACTICE OF COMMERCIAL ARBITRATION § 24.05 at 246 (1968 Supp. 1977) (Confidentiality in institutional arbitration is safeguarded by limiting access to the records and files of the proceedings to the parties involved.)
70. Note, Mixed Arbitrable and Non-Arbitrable Claims in Securities Litigation, Dow Witter Reynolds, Inc. v. Byrd, 94 Civil L. Rev. 525, 531 (1983). This author also cites Jacquin, Arbitration in Action on Wall Street, 1 ABA J. 261-62 (1946) to point out that arbitration as a means of securities dispute resolution was established on the N.Y.S.E. in 1871. 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."
71. Note, supra note 58, at 551.
75. Blue Chip Stamps, 422 U.S. at 727.
77. Id. at 430.
78. Id., citing H.R. REP. NO. 85, 73 Cong. 1st Sess. 2.
79. Blue Chip Stamps, 422 U.S. at 728.
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The text of both acts provides explicit jurisdictional and non-waiver stipulations, and both express 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. The jurisdictional provisions of the acts, on the other hand, are somewhat different.

The 1933 Act gives a choice of forum in "any court of competent jurisdiction."

56. See Note, supra note 21, at 121 n.13 (citing Jaqui Arbitration in Action on Wall Street, 1 A.A.A. J. 261-62 (1946).
57. Id. at n.13, citing R. Neil, 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.)
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59. Note, supra note 58, at 551.
63. Blue Chip Stamps, 421 U.S. at 727.
65. Id. at 430.
67. Blue Chip Stamps, 421 U.S. at 728.
jurisdiction—federal or state—while the 1934 Act restricts jurisdiction exclusively to the federal courts. 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. 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. The differences between the two are: 1) the action under 10(b) was judicially implied rather than expressly provided for by statute; 2) in an action for misrepresentation under section 12(2) the seller assumes the burden of proving lack of scienter; and 3) anyone who purchased or was offered securities can bring an action under 12(2) while only an actual purchaser can bring an action under 10(b).

Despite some differences, the Supreme Court views both statutes as "interrelated components of the federal regulatory scheme governing transactions in securities." The express-implied distinction has been found to have little meaning since "to say that a private cause of action is implied is to say that Congress intended such an action to exist." The policies of the two statutes overlap and are complementary, and the various remedies, whether express or implied, can be applied cumulatively to maximize investor protection since conduct that violates a provision of one Act can constitute a violation of the other. Based solely on a comparison of the regulatory and remedial policies of the two statutes, if there is a preclusion against arbitration for claims under one, it should apply to claims under the other as well. Moreover, it seems that if Congress did not trust arbitration of the relatively narrow rights created by the 1933 Act, it is not likely that it would trust arbitration of the broader, interrelated rights created by the 1934 Act.

IV. The Evolution of the Wilko Doctrine

Since the federal securities laws specify that any agreement waiving compliance with their provisions is void, while the FAA mandates that written arbitration agreements are valid and enforceable, a statutory conflict is created. The conflict was not formally resolved until 1953 when the Supreme Court decided Wilko v. Swan. Although Wilko recognized the importance of the policies underlying each Act, it held that the congressional intent to protect the purchasers of securities preempted the advantages of arbitration agreements.

80. See the Securities Act of 1933, supra note 70, at § 12(2), and the Securities Exchange Act of 1934, supra note 70, at § 10(b).
81. Ernst & Ernst, 425 U.S. at 206.
84. Herman & MacLean, 459 U.S. at 387.
85. See Brown, supra note 71, at 16.
86. Id. at 16, 17.
89. 454 U.S. at 427 (1983).
90. Id. at 438.
In Wilko, an investor alleged that his stock purchase was induced by a broker's false representations and omission of information. He brought an action for misrepresentation in accordance with section 12(2) of the 1933 Act. The brokerage house moved to compel arbitration in accordance with a pre-dispute arbitration agreement the investor had signed. The Court found the pre-dispute arbitration clause in the customer agreement invalid because of the jurisdictional and non-waiver provisions of the 1933 Act. 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, pre-dispute arbitration agreements for such claims are void. 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'." 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.

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. Subsequently, courts have held that claims based on violations of sections 5 and 17 of the 1933 Act are not arbitrable. It was also generally assumed that the Wilko prohibition extends to claims based on violations of section 10(b) of the 1934 Act. The similarity of the non-waiver provisions, and the strong public policy concerns inherent in the action under section 10(b) and Rule 10b-5 support the compelling need for a judicial forum in the resolution of these securities disputes.

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. This exception was implied in the Wilko concurrence opinion for convincing policy reasons. An investor who agrees to arbitrate after the dispute arises is more likely to investigate


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

100. McMahon, 788 F.2d at 99. See also Conover, 749 F.2d at 530; supra note 3 at 570.

101. See supra note 3 at 570.

102. See supra note 3 at 570.

103. See supra note 3 at 570.

104. Wilko, 364 U.S. at 526 (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.)
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. The brokerage house moved to compel arbitration in accordance with a pre-dispute arbitration agreement the investor had signed. The Court found the predispute arbitration clause in the customer agreement invalid because of the jurisdictional and non-waiver provisions of the 1933 Act. 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.

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.'" 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.

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. Subsequently, courts have held that cases based on violations of Sections 5 and 17 of the 1933 Act are not arbitrable.

It was also generally assumed that the Wilko prohibition extends to claims based on violations of Section 10(b) of the 1934 Act. The similarity of the non-waiver provisions, and the strong public policy concerns inherent in the action under Section 10(b) and Rule 10b-5 support the compelling need for a judicial forum in the resolution of these securities disputes.

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. This exception was implied in the Wilko concurring opinion for convincing policy reasons.

An investor who agrees to arbitrate after the dispute arises is more likely to investigate

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the desirability of arbitration 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." The 1975 amendments to the securities laws amended section 28 of the 1934 Act to allow compulsory arbitration of claims between securities professionals. Courts had already compelled to arbitration disputes between stock exchange members pursuant to predates agreements as well as disputes between member and non-member firms at the instance of the nonmember. 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. 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. Dealers could fend for themselves; it was the investing public that was in need of protection.

In Scherk v. Alberto Culver, 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. In Scherk, a

105. Note, supra note 21, at 137.
106. I d. at 138.
107. See 15 U.S.C. § 78bb(b) 1982. See also Brown, supra note 31, 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 nonwaiver provision.)
109. Id. (Arbitration between a member and non-member firm was compelled in Andris & 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., 558 F.2d 532 (3d Cir. 1977)).
111. Id. Stock exchange members do not labor under the disadvantages borne by securities buyers as a class as enumerated in Wilko.
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,
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108. Stark, supra note 4, at 519, 520, and n.138 (citing the following courts:
(1972); In re Revenue Property Litigation Cases, 451 F.2d 310 (1st Cir. 1971);
109. Id. (Arbitration between a member and non-member firm was compelled in
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arbitration...is wholly independent of whether Congress made a right of action express or the courts inferred it.\footnote{232} 

Dean Witter Reynolds Inc. v. Byrd\footnote{232} further circumscribed the Wilko holding. In Byrd, the plaintiff brought suit in federal court under Rule 10b-5 and for violations of state law.\footnote{232} Dean Witter presumed the 10b-5 claims were non-arbitrable but moved to sever and stay proceedings on the state claims pending arbitration.\footnote{232} 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.\footnote{232} 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.\footnote{232} But the Byrd Court dismissed this argument and did away with intertwining.\footnote{232} 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.”\footnote{232}

The majority opinion in Byrd did not address the arbitration of 10(b) claims.\footnote{232} 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.\footnote{232} But the Scherk dicta was repeated in the Byrd concurring opinion,\footnote{232} and it led some subsequent courts to hold 10(b) claims arbitrable.\footnote{232} All


124. Id.
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 interwove 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 Kressman, Securities Litigation: The Unresolved Problem of Predicature Arbitration Agreements for Pendent Claims, 29 DePaul L. Rev. 693, 709 (1980). (Plaintiffs in federal court often pled pendable common law or statutory claims since punitive damages could be recovered under state claims but not for claims under the federal securities statutes.)
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

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though little was added to the points that had been made in Scherk and no further reasoning was given,\footnote{232} the “colorable argument” was taken up by many lower courts, often without any analysis.\footnote{232} Subsequently, although all the courts of appeals had presumed since the time of Wilko that 10(b) claims as well as 2(2) claims could not be compelled to arbitration, after Byrd, some held to the contrary.\footnote{232} The conflict awaited resolution by a Supreme Court decision.\footnote{232}

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.\footnote{232} Mitsubishi Motors Corp. v. Solar Chrysler-Plymouth, Inc.\footnote{232} 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.\footnote{232} In Moses H. Cone Memorial Hospital v. Mercury Construction Corp.,\footnote{232} 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.\footnote{232} Additionally, in Southland

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.
142. Id.
144. Id. at 24-25.
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Dean Witter Reynolds Inc. \textit{v.} Byrd\textsuperscript{1137} further circumscribed the Wilko holding. In Byrd, the plaintiff brought suit in federal court under Rule 10b-5 and for violations of state law.\textsuperscript{1138} Dean Witter presumed the 10b-5 claims were non-arbitrable but moved to sever and stay proceedings on the state claims pending arbitration.\textsuperscript{1139} The issue was whether the court could try the arbitrable state claims with the non-arbitrable federal claims under pendant jurisdiction for reasons of judicial economy.\textsuperscript{1140} 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.\textsuperscript{1141} But the Byrd Court dismissed this argument and did away with intertwine.\textsuperscript{1142} 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."\textsuperscript{1143}

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\textsuperscript{233} 15

\textit{Shub: Shearson/American Express v. McMahon: The Expanding Scope of Secu

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Corp. v. Keating.\textsuperscript{145} 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.\textsuperscript{146}

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.\textsuperscript{147} 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.\textsuperscript{148} Although practical concerns should be irrelevant in the face of congressional intent,\textsuperscript{149} "the general posture of many federal judges has not been to look kindly upon legal principles which increase the volume of their case load,"\textsuperscript{150} and thus the Wilko holding "[i]n terms of being justifiable...has proved troublesome...."\textsuperscript{151}

Problems of court congestion have drastically increased in the last few years.\textsuperscript{152} 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."\textsuperscript{153} [The Supreme Court considered] the issue open

\textsuperscript{146} See Brown, supra note 71, at 8.
\textsuperscript{147} Fisher v. Prudential-Bache Securities Inc., 635 F. Supp. 234, 236 (D. Md. 1986). See also Haren, 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.)
\textsuperscript{148} Spatt, Res Judicata and Collateral Estoppel, 42 AM. J. 61 (1987). See also Dickinson, Exclusive Federal Jurisdiction and the Role of the States in Securities Regulation, 65 IOWA L. REV. 120 (1980). (Under Burger, the Supreme Court attempted to reduce the federal judiciary's workload in the area of securities litigation.)
\textsuperscript{149} Fisher, 635 F. Supp. at 236. See also Brown, supra note 71, at 11. ["The clear 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.]
\textsuperscript{150} S. JAFFEI, BROKERS-DEALERS AND SECURITIES MARKETS, A GUIDE TO THE REGULATORY PROCESS 341 (1977).
\textsuperscript{151} Id.
\textsuperscript{152} See Spatt, supra note 148, at 61.
\textsuperscript{153} Woodward v. Merrill Lynch, Pierce Fenner & Smith, Inc., 640 F. Supp. 760, 763 (S.D. Tex. 1986). (This court anticipated Met-Mar and 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 enforceable 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 did not dispute the arbitration clause contained in the cash management account agreement, and the plaintiff claimed she was unaware of the arbitration provisions prior to signing the contract. Id. at 76.)
\textsuperscript{154} Wolfe v. E.F. Hutton & Co., Inc., 800 F.2d 1032, 1038 (11th Cir. 1986).
\textsuperscript{156} Id.
\textsuperscript{157} Id. (citing Alberto Culver Co. v. Scherk, 484 F.2d 611, 616-18 (Stevens, J. dissenting), rev'd, 477 U.S. 214 (1984).
\textsuperscript{158} Id.
\textsuperscript{159} Id. (citing Randell v. Luftgarten, 106 S. Ct. 3143, 3150 (1986) ("[t]he arbitration clause was inserted as a matter of policy."") (citing Gen. Motors Corp. v. DeWitt, 756 F.2d 902, 906 (D.C. Cir. 1985)).
\textsuperscript{160} Courts which have so held include Prawer v. Dean Witter Reynolds, Inc., 760 F.2d 871 (2d Cir. 1985); Salomon v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 551 F.2d 622 (5th Cir. 1977); and D'Amico v. Morgan Guaranty Trust Co., 584 F.2d 61 (2d Cir. 1978) and Wood v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 800 F.2d 1032 (11th Cir. 1986). Other courts acknowledging the growing trend are Moncrieff v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 760 F.2d 871 (2d Cir. 1985); and Salomon v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 551 F.2d 622 (5th Cir. 1977).
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151. Id.
152. See Spatz, supra note 148, at 61.
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. Therefore, this court enforced a predispute arbitration agreement for a plaintiff's section 10(b) claim.

VII. The Background of The McMahon Case

Shearson/American Express v. McMahon 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, 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. 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. 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.

162. Id.
164. Robbins, Securities Arbitration: Preparation and Presentation, 42 AM. 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. COUGHLIN, 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. 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 addressed the arbitrability of the Exchange Act Claims.)

168. See Letter from John D. Dangel, Chairman of the Subcommittee on Oversight and Investigations, U.S. House of Representatives, Feb. 11, 1987. (The letter discussed the Committees' concerns 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, 46 Fed. Reg. 35,404 (Nov. 18, 1983), effective December 28, 1983 states in part: (a) It shall be a fraudulenct, manipulative or deceptive act or practice for a broker or dealer to enter into an agreement with any public customer or person to bind the customer to the arbitration of future disputes 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 25, 1983). 172. See Securities Exchange Act Release No. 1984 (July 2, 1979). On this and similar releases, the Commission indicated that, since investors are unaware of their rights and may submit to arbitration or choose not to present a dispute believing that arbitration is their only alternative, the use of arbitration clauses without providing information about the judicial alternative is an impermissible, unjust trade practice and may itself violate the anti-fraud provisions of the securities laws.)

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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." In 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. 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. Legislative history, a thirty-year line of case law and Commission releases precluded the deceptive use of arbitration clauses.

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-dealer fraud.
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adequacy of arbitration to ensure compliance with the provisions of the securities laws for both express and implied causes of action.  

VIII. The Shearsen/American Express v. McMahon Decision  

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

When the case reached the Supreme Court, it had yet to be heard on the merits. Shearsen had moved to stay the action pending arbitration in accordance with customer agreements signed upon opening the account. 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. The court of appeals upheld arbitration of the state law claim, but held that both the securities claim and RICO claim were non-arbitrable to waiver of the judicial forum for an action it did not create was one of the petitioner's primary points), rel'g denied, 108 S. Ct. 31 (1987).

178. See Amicus Brief at 13-21.
180. Meyer, Why Stockbrokers Sleep at Night, 16 MONEY MAGAZINE 105 (1987). The McMahon ran a funeral home in New York for 21 years. Their employees and their pension funds, and their personal savings 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 pensioner in their church. She had been speaking with them for some time to convince them that she could boost their income 25%.
182. Meyer, supra note 180. Although the McMahons allege that they had specifically instructed the broker to avoid risky investments, Shearsen 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. McMa-

184. Id.
dealers. 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. 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." Thus far, there has been no public explanation of the inconsistency of the SEC's position. 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), what the SEC was actually interested in was emphasizing the adequacy of arbitration to ensure compliance with the provisions of the securities laws for both express and implied causes of action.

VIII. The Shearson/American Express v. McMahon 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. 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 violation. Their account value decreased $500,000.00, of which $200,000.00 was commissions, $300,000.00 in rendered services, and $20,000 in managerial services.

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. 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. The court of appeals upheld arbitration of the state law claim, but held that both the securities claim and RICO claim were non-arbitrable to waiver of the judicial forum for an action it did not create was one of the petitioner's primary points.

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 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?


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.B. Shad, Chairman Securities and Exchange Commission to John D. Dingell, Chairman of the House Committee 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 argued 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 in direct contravention of the "colorable argument" as it had appeared in Scheinkman and Byrd, but see Reply Brief for the Petitioners at 7, 8, Shearson/American Express v. McMahon, 107 S. Ct. 2332 (1987) (no. 66-44) (The argument that Congress could not have intended the anti-waiver provision to apply to waiver of the judicial forum for an action it did not create was one of the petitioner's primary points).

178. See Amicus Brief at 13-21.


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 managed their investments in CD's, municipal bonds and treasury bills when they turned their investments over to a broker who was a fellow parishioner in their church. Shearson attorneys pointed to an opinion this court had recently received in which the SEC had changed its position on an issue concerning whether a seller of securities had violated the anti-waiver provision of the securities laws.


184. Id.

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trable. Finally, in June 1987, the Supreme Court, in a five to four decision, held all three claims subject to arbitration.865

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.866 As in Mitsubishi,867 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."868 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, fords 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.869 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)."870 "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)."871 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.872

In response to the McMahons' second argument that arbitration would weaken their ability to recover under the 1934 Act, the Court 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."873 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.874

The McMahon's final argument was that even if the text of section 29(a), the nonwaiver provision, could be read not to void protective waivers of the judicial forum, Congress has subsequently indicated that it desires this interpretation.875 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 affect law under Wilko.876 The conference report states:

The Senate bill amended section 28 of the Securities Exchange Act of 1934 with respect to arbitration proceedings between self-regula
dory organizations and their participants, members or persons deal-
ing with members or participants. The House amendment con-
tained no comparable provision. The House receded to the Senate. It was the clear understanding of the senators that this amend
ment did not change existing law, as articulated in Wilko v. Swan, 346 U.S. 427 (1953), concerning the effect of arbitration proced-
ings provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations.877

The Court had an alternative to the McMahon's interpretation. Although the McMahons contended that the Conference 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-

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185. Id.
186. Id. at 2334-35.
187. Id. at 2337.
190. Id. at 2338.
191. Id.
192. Id. (citations omitted).
193. Id. at 2339-41. However, this likeness 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 "involved[e] considerations and policies significantly different from those found controlling in Wilko." Scherk, 417 U.S. at 315.
195. Id. at 2341.
196. Id. at 2342.
197. Id.
198. Id. at 2343 (emphasis added).
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plained that there were other possible interpretations of the report.\footnote{199} Moreover, if Congress wanted to extend Wilko, it would have enacted into law a provision doing so.\footnote{200}

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.\footnote{201} 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.\footnote{202} 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."\footnote{203} 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.\footnote{204} Finally, although the majority was extolling the policies of the Arbitration Act, it was insensitive to and disregarded the policies of the Securities Act.\footnote{205} 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.\footnote{206} 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."\footnote{207}

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-

tion.\footnote{208} 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.\footnote{209} Secondly, arbitration has not significantly changed since the time of Wilko, although the Court implied it has.\footnote{210} 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.\footnote{211} 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.\footnote{212} 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.\footnote{213}

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.\footnote{214} This trend can be expected to increase since arguments for extending the McMahon holding flow naturally from the Court's reasoning.\footnote{215} 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.\footnote{216} Because of the expanded oversight author-

\footnotesize{\bibitem{199} Id.}
\footnotesize{\bibitem{200} Id.}
\footnotesize{\bibitem{201} Id. at 2346 (Blackmun J., Brennan J., and Marshall J., concurring in part and dissenting in part).}
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\footnotesize{\bibitem{204} Id.}
\footnotesize{\bibitem{205} Id.}
\footnotesize{\bibitem{206} Id. at 2350-51.}
\footnotesize{\bibitem{207} Id. at 2352.}
\footnotesize{\bibitem{208} Id. at 2352.}
\footnotesize{\bibitem{209} Id.}
\footnotesize{\bibitem{210} Id. at 2354.}
\footnotesize{\bibitem{211} Id. at 2354-55.}
\footnotesize{\bibitem{212} Id. at 2356-58.}
\footnotesize{\bibitem{213} Id. at 2358.}
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  \item 207. Id. at 2352.
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ity of the SEC over securities exchanges, if an investor makes no showing that his Securities Act claims were inadequately protected in arbitration, it is no longer true that his rights could not be vindicated through arbitration. 227 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. 228 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. 229

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. 230 Prior to McMahon, they had suggested more extensive judicial review, 231 increased discovery, 232 mandatory hearing records in the form of transcripts or recordings, 233 and written opinions of arbitration awards. 234 Probably the most vehem

217. Id.
219. Id.
220. See, e.g., Note, supra note 5, at 213-18; Brown, supra note 71, at 34-36; Kavan, supra note 128, at 718-21; Note, supra note 5, at 552-54. But see Note, The Arbitrability of Federal Securities Claims: Wilko's Swan Song, 42 U. Miam. L. Rev. 203, 222-23 (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 Kasor, 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 Baer 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.
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225. Brown, supra note 71, at 35. See also Robbins, Securities Arbitration, supra note 164, at 3, 4. (Although note of the members of an AAA 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 SCA members.
229. Id.
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231. Id. at 4. (Currently, SOs administer virtually no training on matters relating to arbitration law, the scope of arbitrators' authority, relevant state law or securities law.)
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217. Id.
219. Id.
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evaluation,\textsuperscript{228} that all SRO forums make publicly available summary data on the results of arbitration,\textsuperscript{229} and that the SROs instruct arbitrators that they can refer "particularly egregious" broker or dealer conduct to appropriate disciplinary SRO authorities.\textsuperscript{230} Although the SEC's recommendations will become operative only if the SROs file implementing rules that the SEC approves of,\textsuperscript{231} 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, 5,000 cases were filed in federal court or arbitrated in an SRO or AAA forum.\textsuperscript{232} In the first half of fiscal 1987 the SEC received 13,267 complaints.\textsuperscript{233} The stock market drop of October 1987 spawned scores of lawsuits for improper order execution, unsuitability of stocks and failure to properly explain options.\textsuperscript{234}

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.\textsuperscript{235} 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 "war[ing] poetic about a client's tale of woe" will lose their interest and cause them to become impatient.\textsuperscript{236} So will boilerplate, complaint

222. 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.

223. Id. at 6.

224. Id. at 12.


226. See Fletcher, supra note 155, at 394.


231. 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.\textsuperscript{232} 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.\textsuperscript{233} Lawyers must also know what to expect as a brokerage firms' defense and be familiar with the rules that govern the hearings and the limited grounds that are available to modify or vacate an award.\textsuperscript{234} 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.\textsuperscript{235} 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.\textsuperscript{236} 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.\textsuperscript{237}

The AAA has created a Task Force on Law and Business Schools to promote the development of new materials and courses on Arbitration.\textsuperscript{238} 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.


233. 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.)

234. Id. at 175-76.

235. Id. at 177.
evaluation, that all SRO forums make publicly available summary data on the results of arbitration, and that the SROs instruct arbitrators that they can refer "particularly egregious" broker or dealer conduct to appropriate disciplinary SRO authorities. Although the SEC’s recommendations will become operative only if the SROs file implementing rules that the SEC approves of, they are an indication that arbitration may truly become a forum that adequately ensures compliance with the protective intent of the securities laws.

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233. Id. at 8.

234. Id. at 12.


236. See Fletcher, supra note 135, at 394.


240. See Robbins, Securities Arbitration, supra note 164, at 11.
in the securities industry.\textsuperscript{249}

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. \textit{Shearson/American Express v. McMahon}\textsuperscript{250} 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.

\textit{Patricia A. Shub}

\textsuperscript{249} See Special Bibliography on Dispute Resolution and the Securities Industry, 42 \textit{Ark. J.} 15 (1987).

\textsuperscript{250} 107 S. Ct. 2332 (1987).