BYU Law Review

Volume 1988 | Issue 2 Article 7

5-1-1988

Shearson/American Express v. McMahon: The Diminishing Role of Courts in Securities Disputes

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I. INTRODUCTION

The Supreme Court in *Wilko v. Swan*[1] held that a predispute arbitration agreement between a broker and an investor was unenforceable in a dispute which arose under section 12(2) of the Securities Act of 1933 [1933 Act].[2] Since then, many have speculated as to whether the *Wilko* doctrine applied to causes of action arising under section 10(b)[3] of the Securities and Exchange Act of 1934 [1934 Act].[4] In *Shearson/American Express v. McMahon*,[5] the Supreme Court, refusing to extend *Wilko*, required the enforcement of a predispute arbitration agreement in a section 10(b) action.

This decision recognized the current trend favoring arbitration and assailed *Wilko*'s skepticism of arbitration's ability to resolve the complex issues which arise in statutory causes of action. *McMahon* exposed many of the flaws in *Wilko*, but did not expressly overrule it. By refusing to put *Wilko* to its final rest, the Court left unresolved many of the problems inherent in bifurcated proceedings when claims arise under both sections 12(2) and 10(b).

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1. 346 U.S. 427 (1953).

2. 15 U.S.C. § 77l(2) (1982).

3. 15 U.S.C. § 77j(b) (1982).

4. *See, e.g.*, Malcolm & Segall, *The Arbitrability of Claims Arising Under Section 10(b) of the Securities Exchange Act: Should* Wilko *Be Extended?*, 50 ALB. L. REV. 725 (1986); 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 (1987); Brown, Shell & Tyson, *Arbitration of Customer-Broker Disputes Arising Under the Federal Securities Laws and RICO*, 15 SEC. REG. L.J. 3 (1987); Comment, *Predispute Arbitration Agreements Between Brokers and Investors: The Extension of* Wilko *to Section 10(b) Claims*, 46 MD. L. REV. 339 (1987); Comment, *Arbitrability of Implied Rights of Action Under Section 10(b) of the Securities Exchange Act*, 61 N.Y.U. L. REV. 506 (1986); Note, *Arbitrability of Claims Arising Under the Securities Exchange Act of 1934*, 1986 DUKE L.J. 548.

5. 107 S. Ct. 2332 (1987).

II. BACKGROUND

The Federal Arbitration Act,[6] enacted in 1925, ended centuries of judicial hostility toward arbitration.[7] Based upon the Congress' Commerce Clause powers,[8] the Act declares that a written agreement to arbitrate "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[9]

Despite the language of the Arbitration Act, courts have refused to enforce arbitration agreements where they felt that Congress intended, as a substantive portion of a statutory cause of action, to preclude waiver of the right to a judicial forum by agreement.[10] Whether Congress intended to restrict a cause of action arising under federal securities law to a judicial forum has been the subject of much controversy.

In *Wilko v. Swan*,[11] the Supreme Court in a 7-2 decision, held that arbitration agreements were unenforceable in actions arising under section 12(2) of the 1933 Act.[12] Although the Court

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6. 9 U.S.C. §§ 1-14 (1982).

7. The hostility toward arbitration had its roots in England, where in early days judges were paid by the case. Arbitration was viewed as a usurpation of the judges' role and a threat to their income. This hostility continued in America with the adoption of the common law. *See* Comment, *The Case for Domestic Arbitration of Federal Securities Claims: Is the* Wilko *Doctrine Still Valid?*, 16 SW. U.L. REV. 619 (1986).

8. *See* Southland Corp. v. Keating, 465 U.S. 1, 11 (1924).

9. 9 U.S.C. § 2 (1982). The Act established that any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem is the construction of the contract language involved or allegations of waiver, delay, or other defenses to arbitrability. *See* Moses H. Cone Hosp. v. Mercury Constr. Corp, 460 U.S. 1, 25 (1982). State courts have recognized that the provisions requiring a stay under section 3 apply to them. *Id.* at 26 n.34. The Court in *Moses H. Cone* felt that Congress could not have meant to allow a party to avoid arbitration by bringing suit in a state, rather than a federal forum. *Id.*; *see also* Prima Paint Corp. v. Flood & Conklin Mfg. Corp., 388 U.S. 395, 404 (1967).

10. *See* Mitsubishi Motors v. Soler Chrysler-Plymouth, 473 U.S. 614, 628 (1985). Such an intention must be deduced from the statute's text or from the legislative history. *Id.*; *see also* Wilko v. Swan, 346 U.S. 427 (1953).

11. 346 U.S. 427 (1953).

12. Section 12(2) provides in relevant part:

> Any person who. . .
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> (2) offers or sells a security. . .by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in exercise of reasonable care could not have known, of such untruth or omission,

did not address the applicability of its holding to claims arising under section 10(b) of the 1934 Act, for the next 30 years all of the circuits which addressed the issue assumed that *Wilko* precluded the arbitration of 10(b) claims.[13] This assumption remained unquestioned until 1984 when Justice White, in a concurring opinion in *Dean Witter Reynolds v. Byrd*,[14] cast doubt upon it.

In that case, the parties presumed that *Wilko* precluded enforcement of a predispute arbitration agreement for the plaintiff's 1934 Act claims. Though the issue was not before the court, Justice White expressed the opinion that this presumption "was a matter of substantial doubt."[15] Since *Byrd*, the circuits had

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> shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction. . . .

15 U.S.C. § 77l (1982).

13. *See* Raiford v. Buslease Inc., 745 F.2d 1419 (11th Cir. 1984); Surman v. Merrill Lynch, Pierce, Fenner & Smith, 733 F.2d 59 (8th Cir. 1984); De Lancie v. Birr, Wilson & Co., 648 F.2d 1255 (9th Cir. 1981); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017 (6th Cir. 1979); Merrill Lynch, Pierce, Fenner & Smith v. Moore, 590 F.2d 823 (10th Cir. 1978); Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, 558 F.2d 831 (7th Cir. 1977); Allegaert v. Perot, 548 F.2d 432 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977); Sibley v. Tandy Corp., 543 F.2d 540 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977); Ayres v. Merrill Lynch, Pierce, Fenner & Smith, 538 F.2d 532 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976).

14. 470 U.S. 213 (1985).

15. *Id.* at 224 (White, J., Concurring). Justice White propounded the "colorable argument" dicta from the Court's opinion in Sherk v. Alberto-Culver Co., 417 U.S. 506, 513 (1974) ("a colorable argument could be made that even the semantic reasoning of the *Wilko* opinion does not control the [10(b)] case before us."). Justice White noted the differences between the 1933 Act and the 1934 Act as follows:

> *Wilko*'s reasoning cannot be mechanically transplanted to the 1934 Act. While § 29 of that Act, is equivalent to § 14 of the 1933 Act, counterparts of the other two provisions are imperfect or absent altogether. Jurisdiction under the 1934 Act is narrower, being restricted to the federal courts. More important, the cause of action under 10(b) and Rule 10b-5, involved here, is implied rather than express. The phrase "waive compliance with any provision of this chapter" is thus literally inapplicable. Moreover, *Wilko*'s solicitude for the federal cause of action—the "special right" established by Congress—is not necessarily appropriate where the cause of action is judicially implied and not so different from the common-law action.

Byrd, 470 U.S. at 224-25.

Justice White evidently felt that because the jurisdictional provision of the 1934 Act was narrower, it was not as important a provision as was the similar provision of the 1933 Act and therefore could be waived. The differences are, however, susceptible to differing interpretations.

For example, the Ninth Circuit had a different view in Conover v. Dean Witter Reynolds, Inc., 794 F.2d 520 (9th Cir. 1986), *vacated*, 107 S. Ct. 3203 (1987). The court in that case upheld the district court's denial of a broker's motion to compel arbitration of section 10(b) claims finding that the distinction between the two acts was "an even more

been divided on whether section 10(b) claims are subject to predispute arbitration agreements.[16]

III. Analysis of *McMahon*

A. Facts

Eugene and Julia McMahon, acting individually and as trustees of pension and profit sharing plans, opened accounts with Shearson/American Express. Two of the customer agreements provided for arbitration of disputes relating to those accounts.[17]

A dispute arose between the McMahons and their broker at Shearson. The McMahons filed suit charging that their broker, with the knowledge and consent of Shearson, engaged in churning,[18] violating section 10(b) of the 1934 Act[19]. The complaint further charged that the broker and Shearson violated the Racketeer Influenced and Corrupt Organization Act of 1974 (RICO).[20] The defendants moved for an order to compel the plaintiffs to

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forceful indication of Congress' intent that federal courts oversee the interpretation and application of the 1934 Act." *Id.* at 527.

The American Law Institute, on the other hand, felt that the differences were due to "pure happenstance." *See infra* note 32 and accompanying text.

16. For courts holding that section 10(b) claims were not subject to predispute arbitration agreements, see Wolfe v. E.F. Hutton & Co., 800 F.2d 1032 (11th Cir. 1986), *vacated*, 107 S. Ct. 3205 (1987); Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, 797 F.2d 1197 (3d Cir. 1986), *vacated*, 107 S. Ct. 3204 (1987); King v. Drexel Burnham Lambert, 796 F.2d 59 (5th Cir. 1986), *vacated*, 107 S. Ct. 3203 (1987); McMahon v. Shearson/American Express, 788 F.2d 94 (2d Cir.), *rev'd*, 107 S. Ct. 2332 (1987). For courts holding that 10(b) claims were subject to predispute arbitration agreements, see Page v. Mosely, Hallgarten, Estabrook & Weeden, 806 F.2d 291 (1st Cir. 1986); Phillips v. Merrill Lynch, Pierce, Fenner & Smith, 795 F.2d 1393 (8th Cir. 1986), *cert. denied*, 107 S. Ct. 3218 (1987).

17. The provision of the agreement which related to the arbitration of disputes provided:

> 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.

Shearson/American Express v. McMahon, 107 S. Ct. 2332, 2335-36 (1987).

18. "Churning occurs when a broker, exercising control over the volume and frequency of trades abuses his customer's confidence for personal gain by initiating transactions that are excessive in view of the character of account and the customer's objectives as expressed to the broker." Blacks Law Dictionary 220 (5th ed. 1979).

19. 15 U.S.C. § 78j(b) (1982).

20. 18 U.S.C. § 1962(c) (1982).

arbitrate their state law claims as well as their claims under section 10(b) and RICO.[21]

The district court held that the RICO claims were nonarbitrable,[22] but ordered arbitration of the section 10(b) claims.[23] The court of appeals affirmed the district court's ruling that RICO claims were not arbitrable, but reversed the district court as to the section 10(b) claims.[24] The Supreme Court reversed, holding that both section 10(b) and RICO claims could be compelled to arbitration under a predispute agreement.

Reaffirming the present strong federal policy favoring arbitration agreements, the Court placed the burden on the party opposing arbitration to show that Congress intended to preclude a non-judicial forum.[25] The McMahons attempted to show this congressional intent by the language of the 1934 Act. They claimed that section 29(a),[26] (disallowing the waiver of compliance with any provision of the Act), prohibits waiver of section 27 (granting exclusive federal court jurisdiction to disputes arising under the Act).[27]

The Court dismissed this argument reasoning that section 29(a) prohibits only the waiver of the substantive obligations imposed by the Act, and since section 27 does not impose any affirmative duties, its waiver does not violate section 29(a). Basing its decision on this reasoning, the Court unsuccessfully at-

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

22. The district court reasoned that the RICO claims were nonarbitrable, "because of important federal policies inherent in the enforcement of RICO by the federal courts." McMahon v. Shearson/American Express, 618 F. Supp. 384, 387 (S.D.N.Y. 1985) (citing A. Mineracao de Trindade-Samitri v. Utah Int'l, 576 F. Supp. 566, 574-76 (S.D.N.Y. 1983)), *aff'd in part, rev'd in part*, 788 F.2d 94 (2d Cir. 1986), *rev'd*, 107 S. Ct. 2332 (1987).

23. The district court based its decision to compel arbitration of the 10(b) claims upon the reservations as to the applicability of the *Wilko* doctrine to 10(b) claims expressed by the Court in *Scherk v. Alberto-Culver Co.* and Justice White in *Dean Witter Reynolds Inc. v. Byrd. See supra* note 15.

24. The court felt that despite speculation as to what may happen in the Supreme Court at a future date, the settled law in the Second Circuit was that such claims were not subject to arbitration. McMahon v. Shearson/American Express, 788 F.2d 94, 97 (2d Cir. 1986), *rev'd*, 107 S. Ct. 2332 (1987).

25. *Id.*

26. 15 U.S.C. § 78cc(a) (1982).

27. Section 27 provides in part: "The district courts of the United States. . .shall have exclusive jurisdiction of violation of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder." 15 U.S.C. § 78aa (1982).

tempted to distinguish its holding in *McMahon* from its holding in *Wilko*.

B. Distinguishing Wilko

1. Differences between the 1933 Act and the 1934 Act

In *Wilko*, the Court found that the right to select a judicial forum[28] was the kind of provision whose waiver was prohibited under section 14[29] of the 1933 Act.[30] Section 29 of the 1934 Act is virtually indistinguishable from section 14 of the 1933 Act.[31] While it is true the jurisdictional provisions of the two acts differ,[32] neither one expressly makes any allowance for a non-judicial forum.

In attempting to distinguish *Wilko*, the Court wisely choose not to accept the "colorable argument"[33] that a difference existed between the acts which affected their arbitrability.[34]

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28. Section 22(a) of the Act provides: "The district courts of the United States, and the United States courts of any Territory. . .shall have jurisdiction of offenses and violations. . .concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter." 15 U.S.C. § 77v(a) (1982).

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

30. Specifically, the Court felt that because the Act gives the investor a broad choice of forum and nationwide service of process, in giving up these rights prior to dispute, the investor "surrenders one of the advantages the Act gives him and surrenders it at a time when he is less able to judge the weight of the handicap the Securities Act places upon his adversary." Wilko v. Swan, 346 U.S. 427, 435 (1953). This reading of section 14 has been both lauded and attacked by commentators. The problem with the Court's interpretation is that the Court ignored the word "compliance" in section 14 which prohibits any stipulation which would require one "to waive compliance with any provision. . .of the Act". Though the rights of the plaintiff under section 22(a) may be a "provision" of the Securities Act, it is not one with which "compliance" must be made.

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

32. For the relevant text of the two provisions, see *supra* notes 28-29. Though federal jurisdiction is exclusive in cases arising under the 1934 Act and is concurrent under the 1933 Act, there appears to be no expressed legislative purpose for the difference. Note, *The Securities Exchange Act and the Rule of Exclusive Federal Jurisdiction*, 89 YALE L.J. 95, 109 n.58 (1979); *see also* Note, *Arbitrability of Claims Arising Under the Securities Exchange Act of 1934*, 1986 DUKE L.J. 548, 567. The American Law Institute noted that "[s]o far as the legislative history shows, this difference in these two related statutes is pure happenstance." AMERICAN LAW INSTITUTE, STUDY OF THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURTS 183 (1969).

33. *See supra* note 15.

34. The "colorable argument" has received much criticism by commentators. *See McMahon*, 107 S. Ct. at 2347 n.2.

Rather, the Court read *Wilko* as holding that the non-waiver provision of the 1933 Act bars waiver of a judicial forum "only where arbitration is inadequate to protect the substantive rights at issue."[35] Restating the grounds the *Wilko* court used in determining that arbitration weakens one's ability to recover,[36] the *McMahon* Court noted that most of those grounds had "been rejected subsequently by the Court as a basis for holding claims to be nonarbitrable."[37] The Court in *McMahon* thus attempted to distinguish its earlier holding by showing that *Wilko* was based upon erroneous assumptions.[38] Rather than distinguishing *McMahon*, this portion of the Court's opinion appears to implicitly overrule *Wilko*.

In its amicus brief, the SEC urged the Court to hold predispute arbitration agreements enforceable, but not to rely on distinctions between the implied and express causes of action. The SEC felt that in order to effectuate the policies of the securities laws, no distinction should be made between express and implied causes of action in determining the enforceability of arbitration agreements. Brief for the Securities and Exchange Commission as *Amicus Curiae*, Shearson/American Express v. McMahon, 107 S. Ct. 2332 (1987) (No. 86-44).

35. *McMahon*, 107 S. Ct. at 2339 (citations omitted). The Court quoted the following passage as its basis for distinguishing *Wilko*: "As the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness, it seems to us that Congress must have intended § 14. . .to apply to waiver of judicial trial and review." *Id.* at 2338 (quoting Wilko v. Swan, 346 U.S. 427, 437 (1953)).

36. According to the Court in *McMahon*, the *Wilko* Court was concerned that arbitrators must make legal determinations without judicial instruction on the law; that arbitration awards may not be accompanied by written legal opinions and may be made absent a complete record of the proceedings; and that judicial review of awards is severely limited. *Id.* at 2340.

37. The Court noted that arbitral tribunals are capable of handling complex statutory causes of action, such as antitrust cases without any judicial instruction or supervision. *Id.* at 2340 (citing Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc., 473 U.S. 614 (1985)). The Court in *Mitsubishi* stated that it "recognized that arbitral tribunals are readily capable of handling the factual and legal complexities of antitrust claims, notwithstanding the absence of judicial instruction and supervision." *Mitsubishi*, 473 U.S. at 633-34.

The Court further noted that there was no reason to assume at the outset that arbitrators will not follow the law, that though judicial scrutiny of arbitration awards was limited, it was sufficient to ensure that arbitrators follow substantive statutory law. The Court concluded that arbitration did not represent any restriction on substantive rights. *McMahon*, 107 S. Ct. at 2340.

38. The Court appears to adopt Justice Frankfurter's dissent in *Wilko* which pointed out that the Court's decision "did not rest on any evidence, either 'in the record. . .[or] in the facts of which [it could] take judicial notice' that 'the arbitral system. . .would not afford the plaintiff the rights to which he is entitled.' " *McMahon*, 107 S. Ct. at 2340.

2. *Developments Since* Wilko

The *Wilko* Court felt that the effectiveness of the 1933 Act would be lessened when enforced in an arbitral, rather than a judicial forum. The inadequacies complained of by the Court included arbitration's lack of judicial instruction, the lack of published opinions, and the limited nature of judicial review[39] in arbitration proceedings.[40]

In attempting to further distinguish *Wilko*, The Court in *McMahon* stated that even if arbitration were an inadequate remedy in *Wilko*'s day, such would not be the case today due to the 1975 amendments to section 19 of the 1934 Act[41] expanding the authority of the SEC to control the rules governing self-regulatory organizations (SROs).[42] The SEC can approve or disapprove proposed rule changes and require the addition or deletion of any SRO rule deemed necessary to effectuate the protection of rights under the 1934 Act.[43] The Court held that where the procedures of the arbitral forum are subject to the SEC's section 19 authority,[44] a predispute arbitration agreement does not ef-

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39. The limited grounds for vacating an award are as follows:

(a) Where the award was procured by corruption, fraud, or undue means.

(b) Where there was evident partiality or corruption in the arbitrators, or either of them.

(c) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(d) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

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9 U.S.C. § 10 (1982)(in relevant part).

40. Wilko v. Swan, 346 U.S. 427, 435-36 (1953). The problem with this portion of the *Wilko* opinion is the assumption that for an arbitration clause to be enforced, arbitration must not be less effective in enforcing a plaintiff's rights. The shortcomings mentioned by the Court are present whenever a claim is arbitrated rather than tried in court; if they were fatal to the enforcement of predispute arbitration agreements, the Arbitration Act would be without force altogether.

41. 15 U.S.C. § 77s (1982).

42. SROs include the national securities exchanges and registered securities associations.

43. The Court noted that the arbitration procedures of the New York Stock Exchange, the American Stock Exchange, and the National Association of Securities Dealers were all subject to SEC scrutiny. *McMahon*, 107 S. Ct. at 2341.

44. 15 U.S.C. § 78s (1982). Under the revised law, each SRO is required to file proposed rule changes with the SEC. 15 U.S.C. § 78s(b)(1). When filed, the Commission must publish notice of the change and provide interested parties with an opportunity to be heard. *Id.* The Commission must approve each proposed change and may, on its own

fect a waiver of the protections of the Act and is not void on that basis under § 29(a).[45] The Court did not pass on whether arbitration governed by a body not subject to SEC oversight would effect a waiver of the protections of the Act.

In reality, SEC oversight over SROs and their arbitration procedures offer little in the way of safeguards. The weaknesses in arbitration claimed by the Court in *Wilko*[46] are not addressed by the 1975 changes. The broader section 19 powers granted to the SEC apply only to rule-making.[47]

In sum, *McMahon* cannot really be reconciled with *Wilko*. A close reading of the *McMahon* opinion leads one to conclude that *Wilko* was indeed based more upon suspicion of arbitration than on any demonstrable congressional intent to limit securities disputes to a judicial forum. In light of the effort expended in the Court's opinion to explain why the *Wilko* rationale no longer applys today, it is puzzling why the court added the following statement: "While *stare decisis* concerns may counsel against upsetting *Wilko*'s contrary conclusion under the 1933 Act, we refuse to extend *Wilko*'s reasoning to the 1934 Act in light of these intervening regulatory developments."[48] Had the Court not included this particular reference to *Wilko*, lower courts would likely have considered the *Wilko* doctrine disapproved.[49]

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initiative, "abrogate, add to, and delete from" any rule if changes are necessary to further the purposes of the Act. 15 U.S.C. § 78s(c).

45. *McMahon*, 107 S. Ct. at 2341-42.

46. *See supra* note 36.

47. *See McMahon*, 107 S. Ct at 2357. Recently, the SEC conceded that it lacked oversight authority over actual SRO arbitration proceedings: "The Commission has no authority to review a specific arbitration to assure either compliance with the procedural requirements of the [Uniform Code of Arbitration] or accurate interpretations of underlying federal securities law or other claims by the arbitrators." Brief for the Respondents, Shearson/American Express v. McMahon, 107 S. Ct. 2332 (1987) (quoting SEC REP. OF THE DIVISION OF MARKET REGULATION (Aug. 28, 1986) (in response to an inquiry by the Honorable John D. Dingell, Chairman of the Committee on Energy and Commerce concerning a complaint by Joan Hunt Smith).

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

49. It is difficult to understand what this disclaimer adds to the current state of the law. Though the Court mentioned "*stare decisis*," it is hard to believe that the reason for the courts reluctance to expressly overrule *Wilko* could be based on a concern for upsetting established law. As Justice Stevens stated in his dissent in *McMahon*, for 32 years following *Wilko* until Justice White's concurrence in Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 (1985), each of the eight circuits that had addressed the issue has held that the *Wilko* decision applied to 10(b) causes of action. *McMahon*, 107 S. Ct. at 2359 (Stevens, J., dissenting).

It appears that the SEC also felt that the law applying *Wilko* to 1934 Act claims was well settled. This was evidenced by the 1983 promulgation of Rule 15c2-2, which made it

Though some may read the Court's opinion as overruling *Wilko*,[50] many will read the opinion as expressly keeping section 12(2) claims nonarbitrable.[51]

C. *Split Causes of Action*

Prior to the decision in *McMahon*, confusion existed on how to handle combined state law and federal law securities claims. Courts were initially in a quandary on whether to split the arbitrable and non-arbitrable claims.[52] With the death of intertwining,[53] the issue of the preclusive effect of arbitral awards on the

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a fraudulent act, for the purposes of section 15(c)(2), for a broker to purport to bind a customer to an agreement to arbitrate 1934 Act claims. 17 C.F.R. §240.15c2-2 (1986).

There is evidence that Congress likewise accepted the extension of *Wilko* to 1934 act claims, evidenced by the following passage of the House Conference Report in relation to proposed changes to section 28:

> 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.

McMahon, 107 S. Ct. at 2343 (quoting H.R. Conf. Rep. No. 229, 94th Cong. 111 (1975)).

Though the McMahons were unsuccessful in persuading the Court that the report expressed an awareness and approval by Congress of the extension of *Wilko* to 1934 Act claims, it is not difficult to so read. *See* Malcolm & Segall, *supra* note 4 at 753-54; *see also* Brown, Shell & Tyson, *supra* note 4 at 17-18 (feeling that arguably ambiguous, the most sensible reading of the report was that Congress was endorsing *Wilko* and those cases that had extended *Wilko* to claims brought under section 10(b)); *McMahon*, 107 S. Ct. at 2348 n.5 (Blackmun, J., dissenting) ("Although I agree that the remark from the legislative history does not state expressly Congress' approval of Wilko's extension to the Exchange Act claims, I do not believe that there are 'difficulties', as the Court suggests, in interpreting that remark to suggest such approval.").

50. *See, McMahon*, 107 S. Ct. at 2346 (Blackmun, J., dissenting) ("In today's decision. . .the Court effectively overrules *Wilko*. . . ."); Noble v. Drexel, Burnham, Lambert, Inc., 823 F.2d 849, 850 n.3 (5th Cir. 1987) ("*McMahon* undercuts every aspect of *Wilko v. Swan*; a formal overruling of *Wilko* appears inevitable—or, perhaps, superfluous.") (citations omitted).

51. *See, e.g.*, Continental Serv. Life & Health Ins. Co. v. A. Edwards & Sons, Inc., 664 F. Supp. 997 (M.D. La. 1987) (despite *McMahon*, *Wilko* still applies to make 1933 act claims nonarbitrable); Schultz v. Robinson-Humphrey/American Express, Inc., 666 F. Supp. 219 (M.D. Ga. 1987).

52. *See, e.g.*, Comment, *The Severability of Arbitrable and Nonarbitrable Securities Claims*, 41 WASH. & LEE L. REV. 1165 (1984); W. Bell and K. Fitzgerald, *Mixed Arbitrable/Nonarbitrable Disputes*, 16 REV. SEC. REG. 849 (1983).

53. After the decision in *Wilko*, courts were unsure how to handle arbitrable and nonarbitrable claims. Some courts (Sixth, Seventh, and Eighth circuits) adopted the sever and stay approach, severing the arbitrable issues and staying the judicial proceed-

continuing or subsequent federal court actions became critical.[54] Courts were split on whether to allow both the arbitration and the court action to proceed simultaneously.[55] With the decision in *McMahon*, these issues were resolved with respect to combined 1934 Act and state law claims. The Court's reluctance to expressly overrule *Wilko* left unresolved the above issues with respect to claims arising under section 12(2) of the 1933 Act and those under the 1934 Act.[56]

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ings pending arbitration. Other courts (Ninth, Fifth, and Eleventh Circuits) adopted the intertwining doctrine, holding that in cases where arbitrable claims are so factually related to nonarbitrable claims, the entire action was to be decided in a judicial forum. Fletcher, *supra* note 4 at 414-15. In Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 (1985), the Supreme Court struck down intertwining and held that the Arbitration Act required the arbitration of pendent arbitrable claims even where the result would be the "possibly inefficient maintenance of separate proceedings in different forums." *Id.* at 217.

54. In Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 222 (1985), the Supreme Court noted that "it is far from certain that arbitration proceedings will have any preclusive effect on the litigation of nonarbitrable federal claims." Whether arbitration of a securities dispute will have any preclusive effect on a later judicial proceeding may well depend upon the individual circumstances of each case. *See* Comment, *The Preclusive Effect of Arbitral Determinations in Subsequent Federal Securities Litigation*, 55 FORDHAM L. REV. 655 (1987).

In Greenblatt v. Drexel Burnham Lambert, Inc, 763 F.2d 1352 (11th Cir. 1985), the Eleventh Circuit reasoned that the preclusive effect of arbitral decisions is within the discretion of a judge. The court stated:

> [A]t least with respect to an important, nonarbitrable federal claim, a federal court should be hesitant to preclude the litigation of the federal claim based on the collateral estoppel effects of a prior arbitration award. These cases indicate a case-by-case approach to determining the collateral estoppel effects of arbitration on federal claims, focusing on the federal interests in insuring a federal court determination of the federal claim, the expertise of the arbitrator and his scope of authority under the arbitration agreement, and the procedural adequacy of the arbitration proceeding.

Id. at 1361.

55. This issue as to whether to stay the judicial proceeding pending the outcome of arbitration is referred to as the problem of ordering. *See* Fletcher, *Privatizing Securities Disputes Through The Enforcement of Arbitration Agreements*, 71 MINN. L. REV. 393, 431-35 (1987).

56. This confusion is illustrated by a pair of post-*McMahon* cases involving both 1933 Act and 1934 Act claims. In Schultz V. Robinson-Humphrey/American Express, Inc., 666 F. Supp 219 (M.D. Ga. 1987), the court found the plaintiff's § 12(2) claims insubstantial when compared with her § 10(b) claims. Because of this, the court ordered her § 12(2) claims stayed pending the outcome of arbitration.

In contrast, the second circuit in Chang v. Lin, 824 F.2d 219 (2d Cir. 1987), reversed a district court's stay of 1933 Act claims pending arbitration of the plaintiffs' 1934 Act claims. The court stated:

> A plaintiff has the right to litigate a '33 Act claim in a federal court notwithstanding any arbitration agreement with the defendant. This right is substantially diminished if such claims must lay dormant until other claims arising out of the same series of events have been arbitrated. Evidence supporting the federal claims may become stale or unavailable prior to the conclusion of the arbi-

IV. CONCLUSION

The *Wilko* decision embodied the traditional judicial mistrust of arbitration. It pointed out the shortcomings of the arbitral tribunal and sought Congressional intent to exclude 1933 Act claims from the process. *McMahon* exposed the flaws in the rationale underlying the *Wilko* decision, clarified some issues and left others clouded. It remains to be seen whether the Court will ever formally overrule *Wilko*. In the meantime, however, lower courts will struggle with ordering[57] and preclusion problems associated with claims arising under both section 12(2) and 10(b).

While congressional intent on the non-arbitrability of securities claims may be unclear, the mandate of the Congress to give arbitration agreements the dignity of other contracts is clear. The Arbitration Act requires the stay of judicial proceedings where predispute agreements to arbitrate are present. While there are shortcomings associated with the arbitral process as compared to a judicial forum, parties have the right to choose whether they will avail themselves of such an agreement or not. If securities customers are unaware of such clauses embodied in broker agreements, it is within Congress' power to make disclosure requirements.

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tration. Moreover, delay generally works to the advantage of defendants who may well be inclined to prolong the arbitration unnecessarily in the hope that plaintiffs ultimately will be forced to abandon their nonarbitrable claims. If nonarbitrable federal claims are stayed pending the arbitration of other federal or state claims, plaintiffs alleging fraud in securities transactions face the unhappy choice of either foregoing arbitrable claims in order to obtain prompt consideration of the other claims or waiting months, if not years, before their nonarbitrable claims will be heard by a federal court.

Id. at 222.

57. *See supra* note 54.