Comments

INVESTOR PROTECTION AFTER McMAHON: THE ARBITRABILITY OF CLAIMS ARISING UNDER SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SEC RULE 10b-5

I. Introduction

The arbitrability of federal securities claims has been a controversial issue for decades. The increasing attention devoted to this issue is attributable in part to the recent Supreme Court case, Shearson/American Express, Inc. v. McMahon, which held that arbitration of securities claims is required where there exists a predispute agreement to arbitrate. The dispute over arbitrability arises from the apparent conflict between the Federal Arbitration Act, requiring enforcement of predispute agreements to arbitrate, and the federal securities laws, providing an investor with the right to a federal

1. See infra notes 41-137 and accompanying text.
4. McMahon, 107 S. Ct. at 2335. The issue in McMahon involved the arbitrability of securities claims where the party desiring to litigate these claims previously signed an agreement to arbitrate all potential claims.
forum. The plaintiff-investor may prefer a federal forum while the defendant, usually a brokerage firm, fights to enforce the arbitration agreement.

A prime example of this conflict is the McMahon case. The McMamons brought an action against Shearson/American Express, Inc. (Shearson) claiming that Shearson violated various securities laws. Shearson sought to compel arbitration of these claims based upon a predispute arbitration agreement previously signed by the McMamons. Arguing that the federal securities laws provide the investor with an absolute right to a federal forum, the McMamons sought to compel litigation of their claims. The Supreme Court found in favor of Shearson, holding that securities claims are arbitrable in situations where the investor has entered into a predispute arbitration agreement.

This comment will trace the historical developments leading to the Supreme Court's decision in McMahon, including the rise of arbitration and investor protection, and the effect of the dual enactment of the Arbitration Act and the federal securities laws. Next, relevant Supreme Court and circuit court opinions will be explored. Lastly, this comment will focus on McMahon, its impact, and its future.

II. The Predispute Arbitration Agreement

The catalyst of the controversy is the predispute arbitration agreement. Typically, when a brokerage firm obtains a new cus-

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8. See, e.g., Merrill Lynch, Pierce, Fenner & Smith v. Moore, 590 F.2d 823 (10th Cir. 1978), discussed infra notes 80-93 and accompanying text.
9. See, e.g., id.
11. Id. at 2335-37. See infra notes 138-92 and accompanying text (in-depth discussion of claims brought by investors).
15. An example of a typical predispute arbitration agreement is as follows: Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules, then in effect, of the National Association of
customer the firm asks the customer to sign an agreement stipulating that all potential disputes between the customer and the broker will go to arbitration, not to federal court. The investor, who may be unaware of what he is signing, too intimidated not to sign, or too optimistic to acknowledge that a controversy may arise, signs the agreement.

If a controversy between the investor and broker later arises, the broker will usually invoke the arbitration agreement. The investor, however, usually contends that the mandatory arbitration clause is invalid and that the proper forum for resolving such disputes is federal court. This debate between brokers and investors over the proper forum for resolving claims under the Securities Exchange Act of 1934 (Exchange Act) caused a split in the circuit courts, some upholding the arbitration clause and some invalidating it.


16. See supra note 15 (example of predispute arbitration agreement).

17. See T. Hazen, THE LAW OF SECURITIES REGULATION 7 (1985) (discussed Securities Act of 1933 and Exchange Act of 1934). See also L. Loss, SECURITIES REGULATION 1813-14, nn. 429, 430 (2d ed. 1961). The appearance of an arbitration clause in such circumstances might be viewed as an adhesion contract, i.e., a contract whereby one party with stronger bargaining power offers it to a weaker party who accepts it because all other parties who provide the same services use an identical form as their contract. Since the voluntariness of such agreements is questionable, courts will look at a variety of factors including the degree of adhesion, mutuality, and unconscionability of the arbitration clause. See generally Wright, Arbitration Clauses in Adhesion Contracts, ABA J., June 1978, at 41.

18. See, e.g., Moore, 590 F.2d at 823, discussed infra notes 80-93 and accompanying text.


The debate became increasingly pointed until the Supreme Court put the issue to rest in *McMahon*.

The battle centered on two conflicting congressional provisions. On the one hand, the Federal Arbitration Act provides for the enforcement of predispute agreements to arbitrate. On the other hand, the federal securities laws provide the investor with the right to a federal forum. To fully understand the impact of this conflict, it is important to first comprehend the importance of these provisions and the compelling forces which led Congress to enact them.

III. The Rise of Arbitration and Investor Protection

Arbitration was initially introduced in England where it was met with open hostility. English judges feared a loss of income resulting from the decreased number of disputes over which they would be presiding. Eventually, arbitration was introduced in

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22. See Note, supra note 6, at 525-26.

23. 9 U.S.C. §§ 1-14 (1982). The Act provided that a party to an arbitration agreement could seek a stay of federal court action pending arbitration as well as an order to compel arbitration. Id. §§ 3, 4.


[t]he need for the law arises from an anachronism of our American law. Some centuries ago, because of the jealousy of the English courts for their own jurisdiction, they refused to enforce specific agreements to arbitrate upon the ground that the courts were thereby ousted from their jurisdiction. This jealousy survived for so long a period that the principle became firmly embedded in the English common law and was adopted with it by the American courts. The courts have felt that the precedent was too strongly fixed to be overturned without legislative enactment, although they have frequently criticized the rule and recognized its illogical nature and the injustice which results from it. This bill declares simply that such agreements for arbitration shall be enforced, and provides a procedure in the Federal courts for their enforcement.

*Id.* at 1-2. See generally Insurance Co. v. Morse, 87 U.S. (20 Wall.) 445, 451 (1874) (English courts held arbitration agreements unenforceable).

27. See Kulukundis, 126 F.2d at 983 n.14.
America.28 The American judges were not supportive of arbitration and assumed the hostile attitude toward arbitration still displayed in the English courts.29 Congress, however, supported arbitration due to its speed and cost efficiency in resolving disputes.30 Thus, in 1925, Congress enacted the Federal Arbitration Act (the Act)31 to encourage judicial acceptance of arbitration.32 Essentially, the Act provides that courts must uphold all valid agreements to arbitrate statutory claims.33

Shortly thereafter, America experienced the stock market crash of 1929, giving Congress the impetus to provide investor protection.34 Congress passed the Securities Act of 1933 (Securities Act) to protect the investor and to improve the economy.35 In sum, the Securities Act protects the investor by assuring the public of sufficient and

28. See id. at 984.
29. See id. (although many businessmen were anxious to have a less costly form of dispute resolution, most judges were not); H.R. Rep. No. 96, 68th Cong., 1st Sess. 2 (1924) (noted that arbitration was not viewed with enthusiasm); Pitt & Schropp, Disputes Under the Federal Securities Laws: An Analysis of Shearson/American Express v. McMahon, 1 Insights: THE CORPORATE AND SECURITIES LAW ADVISOR 10, 11 (Sept. 1987).
30. See H.R. Rep. No. 96, 68th Cong., 1st Sess. 2 (1924). The report states: "It is practically appropriate that the action should be taken at this time when there is so much agitation against the costliness and delays of litigation. These matters can be largely eliminated by agreements for arbitration, if arbitration agreements are made valid and enforceable." Id.
32. H.R. Rep. No. 96, 68th Cong., 1st Sess. 2 (1924). See also Krause, Securities Litigation: The Unresolved Problem of Predispute Arbitration Agreements for Pendent Claims, 29 De Paul L. Rev. 693, 698 (1980) (discussed the resolution of a securities claim containing both arbitrable and nonarbitrable claims and noted that before Congress enacted the Arbitration Act, judicial acceptance of arbitration was minimal).
33. 9 U.S.C. § 2 (1982). The Act provides:
A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.
Id.
34. See HAZEN, supra note 17, at 6.
reliable information with which to make investment decisions.36 One year later, Congress enacted the Exchange Act.37 The Exchange Act regulates trading in securities which are already issued and outstanding and protects investors from fraud and lack of disclosure.38

The enactment of both the Federal Arbitration Act and the federal securities laws resulted in an unforeseen conflict which continues to be a source of controversy.39 Having created the conflict, Congress left the courts to determine which act should yield to the other.40

IV. THE EFFECT OF THE ENACTMENT OF THE FEDERAL ARBITRATION ACT AND THE SECURITIES LAWS

The enactment of the Arbitration Act was not met with judicial enthusiasm.41 Judicial hostility gradually diminished, however, after the Supreme Court’s decision in the 1960 case, United Steelworkers of America v. Warrior & Gulf Navigation Co.42 In one of its first endorsements of arbitration, the Supreme Court stated that “an order to arbitrate . . . should not be denied unless it may be said

36. See S. REP. NO. 47, 73d Cong., 1st Sess. 1 (1933). The report states that the policy of the 1933 Act is to inform the investor of facts regarding securities offered for sale in interstate commerce. Id. It further states: The aim is to prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation; . . . to protect . . . against the competition afforded by dishonest securities offered to the public through crooked promotion; to restore the confidence of the prospective investor . . . ; to bring into productive channels of industry . . . capital which has grown timid to the point of hoarding . . . .


38. See Hazen, supra note 17.


40. In McMahon, both the majority and dissent agreed that the question whether a claim brought under the Exchange Act should be subject to arbitration rather than litigation could be answered only by reference to congressional intent. See McMahon, 107 S. Ct. at 2350.

41. See S. REP. NO. 536, 68th Cong., 1st Sess. 2-3 (1924) (judges did not consider arbitration as a viable alternative to litigation). See, e.g., Western Air Lines v. Civil Aeronautics Bd., 194 F.2d 211 (9th Cir. 1952) (opining that arbitration fails to provide safeguards of an administrative hearing on the record.)

42. 363 U.S. 574 (1960).
with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute. Doubts should be resolved in favor of arbitration." Thus, Congress' effort to encourage arbitration as a statutory alternative to litigation was aided by the Supreme Court's fostering of a national policy favoring arbitration.44

Today, arbitration is widely recognized by many courts and commentators as a valuable and equitable alternative to litigation.45 The increasing popularity of arbitration stems from the expediency with which it resolves disputes.46 The national policy favoring arbitration as a salutary alternative to litigation continues to gain support.47

43. Id. at 582. In Steelworkers, a suit [was brought] under § 301(a) of the Labor Management Relations Act, [of] 1947, . . . by a labor union to compel arbitration of a grievance based upon the employer's practice of contracting out work while laying off employees who could have performed such work. The collective bargaining agreement between the parties contained "no strike" and "no lock-out" provisions and set up a grievance procedure culminating in arbitration. It provided that "matters which are strictly a function of management" shall not be subject to arbitration; but it also provided that "[s]hould differences arise . . . as to the meaning and application of the provisions of this Agreement, or should any local trouble of any kind arise," the grievance procedure should be followed. The Court of Appeals [of the Fifth Circuit] ruled that deciding whether to contract out work was "strictly a function of management" within the meaning of the agreement, and it sustained a judgment of the District Court dismissing the complaint.

Id. at 574. The Supreme Court concluded that an order to arbitrate the particular grievance should not be denied "[i]n the absence of any express provision excluding a particular grievance from arbitration, [and] only the most forceful evidence of a purpose to exclude the claim from arbitration can prevail, particularly where, as here, the exclusion clause is vague and the arbitration clause quite broad." Id. at 584-85.

44. See Krause, supra note 32, at 698.

45. Id.


47. See Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983), which is illustrative of the Supreme Court's current attitude towards arbitration. In support of its encouragement of arbitration, the court opined that [the Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of
Prior to *McMahon*, however, many courts held that arbitration was an inappropriate method by which to resolve securities disputes.\(^{48}\) The concern of these courts involved a determination that because securities laws are public in nature, they should not be subject to private methods of dispute resolution.\(^{49}\) The courts concluded that Congress did not intend public matters to be resolved through nonjudicial methods.\(^{50}\) These courts reasoned that the resolution of a securities claim should include a complete record of the proceedings and findings involved in the claim.\(^{51}\) Since an arbitration proceeding does not include such a record,\(^{52}\) it was held to be an improper method by which to resolve a securities claim.\(^{53}\)

The courts also questioned an arbitrator’s ability to effectively handle securities issues due to their complex nature.\(^ {54}\) The proper

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the contract language itself, or an allegation of waiver, delay, or a like defense to arbitrability.

*Id.* at 24-25. After an analysis of the pros and cons of arbitration, the Supreme Court held the dispute arbitrable. *Id.* at 29. The strength of this statement has influenced many lower courts to reevaluate arbitration as a general form of dispute resolution.


49. See, e.g., Allegaert v. Perot, 548 F.2d 432 (2d Cir.), *cert. denied*, 432 U.S. 920 (1977). According to the court, “[T]he presence of the securities law claims further support the need for a judicial tribunal here.” *Id.* at 437. The court further noted that the security claim is “more than a mere internal brokerage industry squabble; it raises broad questions of policy which ordinarily should be handled by the judiciary . . . .” *Id.*


51. See, e.g., Allegaert, 548 F.2d at 438 (held that securities claims must be resolved in a federal court where complete records of proceedings and findings are maintained).

52. *Id.*

53. *Id.* See also Conover v. Dean Witter Reynolds, Inc., 794 F.2d 520, 527 (9th Cir. 1986); Greater Continental Corp. v. Schechter, 422 F.2d 1100, 1103 (2d Cir. 1970); Sterk, *supra* note 26, at 483 (discusses when the public policy doctrine should and should not be utilized with regard to agreements to arbitrate).

54. See Krause, *supra* note 32, at 706-07 (courts usually discuss an arbitrator’s
resolution of a securities dispute requires an arbitrator who possesses a thorough understanding of both state and federal securities law, as well as an understanding of the securities market. Many courts maintained that arbitrators lack the knowledge to resolve effectively complex securities issues. In addition, while arbitrators should act in an impartial manner, suppressing any personal, conflicting beliefs, some courts reasoned that arbitrators may lack the necessary detachment to decide the issues fairly. As a result, they viewed litigation as the only viable form of dispute resolution.

ability when holding securities claims nonarbitrable). See also Applied Digital Tech., Inc. v. Continental Casualty Co., 576 F.2d 116, 117 (7th Cir. 1978) (lengthy discussion of probable difficulty confronting arbitrator in separating antitrust claims from contract breach claims); Cobb v. Lewis, 488 F.2d 41, 47 (5th Cir. 1974) (noting the "questionable propriety" of entrusting the resolution of complex antitrust issues to commercial arbitrators who are businessmen generally regulated by such laws); Power Replacements, Inc. v. Air Preheater Co., 426 F.2d 980, 983-84 (9th Cir. 1970) (because commercial arbitrators are selected for their business expertise, it hardly seems proper for them to determine issues of great public interest); American Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821, 826-27 (2d Cir. 1968) (a claim under the arbitration laws is a public matter which should be resolved in the courts).

55. Hazen, supra note 17, at 7.
58. See, e.g., Lee v. Ply*Gem Indus., Inc., 593 F.2d 1266 (D.C. Cir.), cert. denied, 441 U.S. 967 (1979). In Lee, the court stated that "'it has been thought to be of 'questionable propriety' to entrust the decision of antitrust questions to commercial arbitrators when 'it is the business community generally that is regulated by the antitrust laws.'" Id. at 1275 (footnotes omitted).
59. Id. See also Allegaert, 543 F.2d at 438 (held that securities claims must be resolved in a federal court where a complete record is kept of the proceedings and findings); Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831, 834 (7th Cir. 1977) (held Wilko applicable to the Exchange Act because the Securities Act and Exchange Act are very similar); Sibley v. Tandy Corp., 543 F.2d 540, 543 (5th Cir.), cert. denied, 434 U.S. 824 (1977) (held that the federal claims are to be stayed pending the outcome of the arbitration proceedings for the state-law claims); Ayres v. Merrill Lynch, Pierce, Fenner & Smith, 538 F.2d 532, 536-37 (3d Cir.) (stated that Congress appears to have accepted the view that Rule 10b-5 claims must proceed to litigation), cert. denied, 429 U.S. 1010 (1976); Laupheimer v. McDonnell & Co., 500 F.2d 21, 26 (2d Cir. 1974) (held securities claims nonarbitrable); Axelrod & Co. v. Kordich, Victor & Newfield, 451 F.2d 838, 842-43 (2d Cir. 1971) (held Wilko applicable to the Exchange Act); Greater Continental Corp. v. Schechter, 422 F.2d 1100 (2d Cir. 1970) (noted the strong federal policy in favor of determining stock fraud issues in a federal court); Starkman v. Seroussi, 377 F. Supp. 518 (S.D.N.Y. 1974) (held securities claims nonarbitrable); Reader v. Hirsch & Co., 197 F. Supp. 111 (S.D.N.Y. 1961) (held that securities claims must be litigated in a federal forum).
In 1953, the issue of the arbitrability of securities claims was partially resolved in the Supreme Court case of Wilko v. Swan. In Wilko, the Supreme Court held that the Arbitration Act must yield to the Securities Act, thus creating an exception to the Arbitration Act. Although Wilko decided the issue for claims arising under the Securities Act, the issue for claims arising under the Exchange Act remained unresolved.

V. The Wilko Exception

In Wilko v. Swan, the Supreme Court held that agreements to arbitrate claims arising under the Securities Act are void. The

60. 346 U.S. 427 (1953). Wilko involved a § 12(2) claim of the Securities Act. Section 12 of the Securities Act provides:

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

15 U.S.C. § 771 (1982) (special rights provision). This claim was brought by an investor seeking to sue his brokerage firm in a judicial forum despite a predispute arbitration agreement signed by both parties. The Court held that the agreement was void. Wilko, 346 U.S. at 436-38.

61. Wilko, 346 U.S. at 438. The Supreme Court created the Wilko exception because "[w]hen the security buyer, prior to any violation of the Securities Act, waives his right to sue in courts, he gives up more than would a participant in other business transactions." Id. at 435.

The Court continued:

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

Even though the provisions of the Securities Act, advantageous to the buyer, apply, their effectiveness in application is lessened in arbitration as compared to judicial proceedings.

Id. Thus, the court held that because investors are in a weaker bargaining position than brokers, the arbitration agreements, which lessen investors' rights, are unenforceable.

62. Id.

63. See supra note 21 (courts of appeals divided over the arbitrability of claims arising under the Exchange Act).

64. 346 U.S. 427 (1953).

65. Id. at 438. "[W]e decide that the intention of Congress concerning the
basis for the court’s decision involved three interrelated statutory provisions of the Securities Act: (1) section 14 of the Act, which voids any “stipulation . . . binding any person acquiring any security to waive compliance with any provision” of the Act;65 (2) section 12(2) which provides a “special right to recover for misrepresentation”;67 and (3) section 22(a), which provides for concurrent state and federal jurisdiction.68

In Wilko, the Supreme Court considered the desirability of arbitration as an alternative to litigation.69 The Court acknowledged the strength of the policy behind arbitration as set forth in the Arbitration Act70 and further considered the increasing popularity of arbitration.71 The Court concluded, however, based on the purposes supporting the Securities Act,72 that the provisions of the Securities Act take priority over those of the Arbitration Act.73 The Court stated that since section 22(a) provides the aggrieved party with the right to select the forum, and section 14 states that any “stipulation” waiving compliance with any “provision” of the Securities Act is void, the predispute arbitration agreement must be void.74 The court viewed the agreement as a “stipulation,” and the sale of securities is better carried out by holding invalid such an agreement for arbitration of issues arising under the Act.” Id.

66. Id. at 430. Section 14 of the Securities Act provides: “Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.” 15 U.S.C. § 77n (1982).

67. Wilko, 346 U.S. at 431. See supra note 60 (text of § 12(2)).

68. Id. (§ 22(a) gives an aggrieved person the right to select a judicial forum).

69. Wilko, 346 U.S. at 431-36. See 9 U.S.C. §§ 1-14 (1947) (agreement to arbitrate should be given effect). The court reviewed § 3 of the United States Arbitration Act but stated that it “does not solve our question as to the validity of . . . [a] stipulation . . . to submit to arbitration controversies . . . .” Wilko, 346 U.S. at 432.

70. Wilko, 346 U.S. at 431. The Court conceded that the expedient nature of arbitration was a salutary objective underlying its policy. Id.

71. Id.

72. The Court recognized that “the Securities Act was drafted with an eye to the disadvantages under which buyers labor.” Id. at 435. See Dean Witter Reynolds, Inc. v. Byrd, 726 F.2d 552, 553 (9th Cir. 1984) (looks to “protective intent” of securities laws as a policy for its holding).

73. Wilko, 346 U.S. at 438. The Court held “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 437.

74. Id. at 430-35.
right to select a judicial forum as a "provision," which, under section 14 of the Securities Act, cannot be waived.75

A. The Wilko Extension

Wilko's impact has endured for three decades.76 Whether Wilko should be extended to determine the arbitrability of claims arising under section 10(b) of the Exchange Act77 and SEC Rule 10b-5 continues to be controversial.78 Although the circuit courts were split on the issue, the trend, prior to McMahon, was to hold section 10(b) and Rule 10b-5 claims arbitrable.79

For example, the Tenth Circuit extended Wilko to the Exchange Act in Merrill Lynch, Pierce, Fenner & Smith v. Moore,80 refusing to enforce an arbitration clause in an investment contract between investors and their broker.81 With regard to the claims arising out

75. Id. at 434-35.
76. However, in light of McMahon, the continuing vitality of Wilko is certain to come under attack from those courts faced with the arbitrability issue for claims arising under the Securities Act.
77. Section 10(b) of the Exchange Act states in pertinent part that: it [is] unlawful for any person, directly or indirectly, by the use of interstate commerce or the mails or any facility of any national securities exchange to use or employ, in connection with the purchase or sale of any security, whether or not listed on an exchange, any manipulative or deceptive device or contrivance in contravention of S.E.C. rules and regulations. 15 U.S.C. § 78j(b) (1982).
78. The genesis of Rule 10b-5 is as follows:
In 1942, the S.E.C., following the language of section 17 of the Securities Act of 1933, promulgated under section 10(b) of the 1934 Act Rule X-10B-5, later designated Rule 10b-5, and known as the "antifraud rule".

The S.E.C. and the courts have used Rule 10b-5 as a sanction against trading on "inside information"—private information intended to be available only for corporate purposes.
79. See supra note 21.
80. 590 F.2d 823 (10th Cir. 1978). The Moores brought suit in the United States district court alleging violations under the Securities Act of 1933, the Securities Exchange Act of 1934 and the SEC Rules. Id. at 825. After having been ordered to proceed to arbitration before a National Association of Securities Dealers tribunal, the Moores appealed to the Tenth Circuit asserting that "arbitration clauses such as [theirs] are not enforceable, but are void insofar as federal securities laws are concerned." Id.
81. Id. at 824.
of the Securities Act, the Wilko decision clearly controlled.\textsuperscript{62} The broker, however, argued that if Wilko had "any application it must be limited to the remedy under the Securities Act of 1933,"\textsuperscript{63} and not to claims arising out of the Exchange Act, thus concluding that the arbitration agreement should prevail.\textsuperscript{64} The Tenth Circuit disagreed with this distinction, holding the arbitration agreement void and the claims arising under section 10(b) and Rule 10b-5 nonarbitrable.\textsuperscript{65} The court reasoned that "it is impossible to distinguish the Wilko case [because] the parallel considerations applicable to the two Acts make it impossible to draw such a distinction."\textsuperscript{66} Further, the court stated that:

> the policy considerations in the two instances with respect to the two remedies are not different. The purpose of the Rule 10b-5 remedy is to protect the vulnerable purchasers of securities from the aggressive and more sophisticated seller (or buyer). Even though the arbitration proceeding may be faster and less costly to the public and, for that matter, to the violator of the contract, the desirability of non-waiver of the remedy would prevail.\textsuperscript{67}

The court concluded that the Securities Act and the Exchange Act have enough similarities to warrant the application of Wilko to both.\textsuperscript{68}

The Moore court also compared the language of the two Acts.\textsuperscript{69} According to the court, the section 14 nonwaiver provision of the Securities Act\textsuperscript{70} is undeniably similar to section 29 of the Exchange Act itself.

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\textsuperscript{62} Id. at 827. The court noted that "[t]he decision in Wilko is fully applicable to the § 12(2) remedy under the 1933 Act contained in the case before us, because there is no difference between Wilko and the § 12(2) remedy here." Id.

\textsuperscript{63} Id.

\textsuperscript{64} Id. The court stated that "[t]he remaining question is whether Wilko v. Swan, . . . also applies to the Securities Exchange Act of 1934, to §10(b) of that Act, and to Rule 10b-5 promulgated pursuant thereto." Id.

\textsuperscript{65} Id.

\textsuperscript{66} Id. at 826.

\textsuperscript{67} Id. at 826-27. In making the jump from the Act itself to include the regulations, the court noted that Rule 10b-5 is connected to the 1934 Act via the Act's nonwaiver provision, § 29(a), which expressly provides for a remedy under a regulation. Id. at 827.

\textsuperscript{68} Moore, 590 F.2d at 829.

\textsuperscript{69} Id.

Act.\textsuperscript{91} Both prohibit the waiver of any provisions or rules.\textsuperscript{92} Since \textit{Wilko} held securities claims nonarbitrable under the nonwaiver provision of the Securities Act, the Moore court found the nonwaiver provision of the Exchange Act similarly compelled a finding of the nonarbitrability of claims arising under the Exchange Act.\textsuperscript{93}

\textbf{B. Challenged: Wilko's Applicability to the Exchange Act}

The rationale utilized by the \textit{Moore} court in extending \textit{Wilko} to the Exchange Act was similarly utilized by many other circuit courts.\textsuperscript{94} The Supreme Court's decision in \textit{Scherk v. Alberto-Culver Co.},\textsuperscript{95} however, acknowledged but did not accept a "colorable argument" that the "semantic reasoning of the Wilko decision" applies to actions brought under the Exchange Act.\textsuperscript{96}

In \textit{Scherk}, a case brought under section 10(b) of the Exchange Act, the Supreme Court in dicta stressed important differences between the Securities Act and the Exchange Act and the effect those differences have on the applicability of \textit{Wilko} to the Exchange Act.\textsuperscript{97} The Court noted that the Exchange Act contains no analogue to section 12(2) of the Securities Act, which provides a special right of a private remedy to defrauded purchasers.\textsuperscript{98} As a result, the \textit{Scherk} Court upheld a predispute arbitration agreement entered into by parties involved in an international transaction.\textsuperscript{99} The Court's ra-

\textsuperscript{91} \textit{Moore}, 590 F.2d at 826. Section 29 of the Exchange Act provides: "(a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange thereby shall be void." 15 U.S.C. § 78(b) (1982).
\textsuperscript{92} \textit{Moore}, 590 F.2d at 827.
\textsuperscript{93} \textit{Id.} at 829.
\textsuperscript{94} See, e.g., Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831 (7th Cir. 1977); Sibley v. Tandy Corp., 543 F.2d 540 (5th Cir.), cert. denied, 424 U.S. 924 (1977); Greater Continental Corp. v. Schechter, 422 F.2d 1100 (2d Cir. 1970).
\textsuperscript{95} 417 U.S. 506 (1974).
\textsuperscript{96} \textit{Id.} at 513. Although Justice Stewart's statement was dictum and was rejected by the circuit courts, it was a harbinger of the \textit{McMahon} decision.
\textsuperscript{97} \textit{Id.} at 513-14.
\textsuperscript{98} \textit{Id.}
\textsuperscript{99} In \textit{Scherk}, Alberto-Culver, an American company, decided in the 1960s to expand abroad. It contacted the German Fritz Scherk in Europe to purchase his businesses organized under the laws of Germany and Liechtenstein. A contract was signed in Vienna which provided for a number of express warranties pertaining to sole and unencumbered ownership of the trademarks for his businesses. The contract also included an arbitration clause that "any controversy or claim [that] shall arise out of this agreement or breach thereof" would be referred to arbitration
tionale was based more upon the international system of commerce and arbitration than upon the interest of a litigant to his "day in court."103 Many of the federal appellate courts subsequently limited Scherk's holding to its facts and found it relevant only to a situation involving an international transaction.101 Nevertheless, the Scherk dicta concerning the differences between the 1933 and 1934 Acts undermined the applicability of Wilko to the Exchange Act.102

Following Scherk, the Supreme Court further indicated how it would rule on the applicability of Wilko to the Exchange Act in Dean Witter Reynolds, Inc. v. Byrd.103 In Byrd, Justice White, in a concurring opinion, expressed doubt about the extension of Wilko to the Exchange Act.104 An often quoted excerpt from Justice White's concurrence states, "Wilko's reasoning cannot be mechanically transplanted to the [Exchange] Act."105 Justice White acknowledged that although section 14 of the Securities Act and section 29 of the Exchange Act are similar in that both provide a private right of action, that alone is not enough to warrant the extension of Wilko to the Exchange Act.106 Regarding the investor's section 10(b) claim, Justice White stated that:

[t]he cause of action under § 10(b) . . . and Rule 10b-5 . . . is implied rather than express. Moreover, Wilko's

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102. See Byrd v. Intersport Ltd., 470 U.S. at 224-25.
solicitude for the federal cause of action—the "special right" established by Congress, 346 U.S. at 431—is not necessarily appropriate where the cause of action is judicially implied and not so different from the common law action.107

Justice White's concurrence seemed to be the most direct indication of how the Supreme Court might rule on the issue of the arbitrability of claims arising under section 10(b) and Rule 10b-5. After consideration of *Byrd*, many of the lower courts reevaluated their prior decisions and held Exchange Act claims arbitrable, despite precedent108 and despite *Wilko*.109

A later indication of how the Supreme Court might rule on this issue was derived from *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*110 The Court endorsed the two-step inquiry used by


110. 473 U.S. 614 (1985). In *Mitsubishi*, the petitioner was a Japanese corporation which manufactures automobiles and respondent was Soler Chrysler-Plymouth, Inc., a Puerto Rico-based corporation. Petitioner was a joint venture between a Swiss corporation, owned by Chrysler Corporation, and Mitsubishi Heavy Industries, Inc., a Japanese corporation. The goal of this joint venture was the distribution of Mitsubishi manufactured automobiles, bearing Chrysler and Mitsubishi trademarks, through Chrysler dealers outside the continental United States. *Id.* at 616-17.

The contract entered into by both parties provided for the sale of the automobiles within a designated area by Soler. Initially, Soler adhered to the contract. Two years later, however, Soler experienced substantial difficulties in meeting the expected sales volume and requested that Mitsubishi delay or cancel shipment of several orders. Mitsubishi refused to comply with any such diversion and then proceeded to withhold shipment of 966 vehicles. Shortly thereafter, Mitsubishi brought suit against Soler in the United States District Court for the District of Puerto Rico under the Federal Arbitration Act and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (Convention). Mitsubishi then sought to compel arbitration in accordance with the arbitration clause in the sales agreement. Soler denied the allegations and counterclaimed against Mitsubishi and the Swiss corporation, alleging numerous breaches by Mitsubishi of the sales agreement and also proceeded to assert Sherman Act claims. *Id.* at 617-20.

The district court ordered Mitsubishi and Soler to arbitrate all of the issues raised in the complaint and most of the issues raised in the counterclaims including
the antitrust issues. The court held that due to the international nature of the contract, the antitrust claims should proceed to arbitration. Id. at 638-40.

The appellate court read the arbitration clause to include almost all the claims arising under the various statutes, including those arising under the Sherman Act. The appellate court, however, reversed the district court's order to compel arbitration of the antitrust claims. In doing so, the court concluded that "neither...Scherk nor the Convention required abandonment of that doctrine [that rights conferred by the antitrust laws were not appropriately enforced by arbitration] in the face of an international transaction." Id. at 621-23 (citing Mitsubishi Motor Corp. v. Soler Chrysler-Plymouth, 723 F.2d 155, 164-68 (1st Cir. 1983).

Finally, the Supreme Court proceeded to affirm in part and reverse in part the judgment of the court of appeals. The Supreme Court concluded that considering the strong federal policy favoring arbitration, there is no reason not to enforce a previously existing, valid arbitration agreement. With regard to the antitrust issues, the court held that based on Scherk, issues arising from an international transaction are arbitrable. Id. at 638-40.

111. Id. at 636. The Court held that claims arising under the Sherman Act are arbitrable when a valid arbitration agreement is contained in the contract for an international transaction. Id.

112. Id. at 628.


concerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes require that we enforce the parties' agreement, even assuming that a contrary result would be forthcoming in a domestic context.

Mitsubishi, 473 U.S. at 629.
transaction. The Court's intentional failure to rule on the arbitrability of antitrust claims in a domestic transaction left the lower courts to deal with the dilemma of whether Mitsubishi, like Scherk, should apply solely in the context of an international transaction, or whether it should be extended to include domestic transactions as well. Those courts holding that section 10(b) and Rule 10b-5 claims were arbitrable utilized Mitsubishi, thus resolving the dilemma in favor of extension.

In Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc., for example, the First Circuit turned to Mitsubishi as support for Supreme Court approval of the arbitrability of section 10(b) and Rule 10b-5 claims. The court interpreted Mitsubishi as dictating that:

[g]iven the existence of a valid agreement to arbitrate, and even where a federal statutory right is involved, the Supreme Court has made clear that it is our obligation to enforce the agreement (unless we find that the congressional intent, enacting the statute was to preclude the waiver of judicial remedies).

The court then referred to the central justifications for the holding in Wilko, namely that Congress has provided an express right of action under the Securities Act, and that the determination of rights under the Act is an area of vital federal concern which is properly entrusted to the federal courts. Using Justice White's analysis from Byrd, the court concluded that an "automatic" extension of

114. Id. at 635-40. The Supreme Court noted traditional reasons why antitrust controversies were not considered suitable for arbitration. Id. at 632-37.

115. See, e.g., Phillips v. Merrill Lynch, Pierce, Fenner & Smith, 795 F.2d 1393 (8th Cir. 1986) (held § 10(b) and Rule 10b-5 claims arbitrable, distinguishing Wilko); Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc., 806 F.2d 291 (1st Cir. 1986).

116. 806 F.2d 291 (1st Cir. 1986). Plaintiffs alleged excessive trading or "churning" of their accounts by defendants. Hence, plaintiffs sought to recover damages under § 10(b) of the Exchange Act and Rule 10b-5. The defendants then filed a motion to compel arbitration of all claims. The district court denied defendants' motion to compel arbitration and the appellate court remanded the case with instructions that the district court order arbitration of the 10b-5 claim. Id.

117. Id. at 295 (citing Mitsubishi, 473 U.S. at 632-33).

118. Id.

119. Id. at 295-96.
Wilko to the Exchange Act is without merit. The court stated that if Congress intended the Exchange Act to preclude the waiver of the right to a judicial forum, it would have expressly so stated as it did in the Securities Act. In addition, the court noted the strong federal policy favoring arbitration, which, according to the court, dictates that all predispute arbitration agreements must be upheld. Thus, the court concluded that unless the plaintiffs can show that a defendant intentionally delayed seeking arbitration, and that such delay caused a plaintiff prejudice, defendants have not waived their right to arbitration.

Conversely, other circuit courts interpreted congressional intent to mandate that an investor has a right to a judicial forum, irrespective of the Arbitration Act. For example, in Conover v. Dean Witter Reynolds, a customer brought claims arising under section 10(b) and Rule 10b-5, alleging that his broker churned and manipulated his account to generate sales commissions. The broker filed a motion to compel arbitration of the customer’s claims. The Ninth Circuit affirmed the district court’s denial, looking beyond the Wilko analysis to three historical developments on which it

120. Id. at 296. The Court utilized two prongs of the Wilko analysis. The first prong is “whether the right to a judicial forum can be regarded as a non-waivable provision of the Exchange Act subject to its similar anti-waiver clause.” Id. The second is whether, due to the legislative history of the Exchange Act, it can be inferred that “Congress regarded the securities laws as an area of critical federal import” which can only be entrusted to the federal judiciary. Id.

121. Id. at 297.

122. Id. at 293 (court referred to the Supreme Court’s endorsement of arbitration in Moses).

123. Id. at 295.

124. Id. at 294-95.

125. 794 F.2d 520 (9th Cir. 1986).


127. Conover, 794 F.2d at 521.

128. Id.

129. Id. at 520.

130. Id. at 521-22. The court noted that several circuits have relied on the similarity between the antiwaiver provisions of the Exchange Act and the Securities Act to hold § 10(b) claims nonarbitrable. See, e.g., Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore, 590 F.2d 823, 827 (10th Cir. 1978); Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532, 536 (3d Cir.), cert. denied, 429 U.S. 1010 (1976).
based its ultimate conclusion.\textsuperscript{131}

First, the court reaffirmed the historical acceptance of an implied cause of action in federal court under section 10(b) and Rule 10b-5. Second, the court noted that Congress could have eliminated the federal cause of action for section 10(b) in 1975 when it revised both the Securities Act and the Exchange Act. Third, the court stated that in 1975 Congress expressly recognized the nonarbitrable nature of securities disputes. These factors led the court to hold the securities claims nonarbitrable.\textsuperscript{135}

Page and Conover exemplify the stalemate that plagued lower courts dealing with this issue. These courts sought to resolve the issue by interpreting prior case law and utilizing dicta contained in relevant Supreme Court decisions. The fact that the circuits were divided on the issue heightened the eagerness with which the McMahon decision was awaited.\textsuperscript{137}

VI. Shearson/American Express, Inc. v. McMahon

In McMahon, Eugene and Julia McMahon brought an action against their brokerage firm, Shearson. Their complaint alleged, in pertinent part, that Shearson’s representative violated section 10(b) of the Exchange Act and Rule 10b-5 by engaging in fraudulent, excessive trading on the Mahons’ accounts, and by making false statements and omitting material facts from the advice given to the

\textsuperscript{131} Conover, 794 F.2d at 524.
\textsuperscript{132} Id.
\textsuperscript{133} Id.
\textsuperscript{134} Id. In support, the court stated that:
\[\text{[i]n the conference report to the Securities Act Amendment of 1975, Congress emphasized that its amendment to section 28 of the Securities Exchange Act of 1934, which permitted arbitration agreements between brokers and exchanges, did not extend to arbitration agreements between brokers and customers:}\]
\[\text{It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in Wilko v. Swan concerning the effect of arbitration proceeding provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations.}\]
\textsuperscript{id. (citation omitted).}
\textsuperscript{135} Id. at 524.
\textsuperscript{136} See, e.g., id. at 520-21 (discussing the nonenforceability of an arbitration agreement, and the background cases for so holding); Page, 806 F.2d at 291 (same).
\textsuperscript{137} See supra note 21.
\textsuperscript{138} McMahon, 107 S. Ct. at 2334.
McMahons. The McMahons also claimed that the firm had full knowledge of the representative’s actions.

Shearson countered by filing a motion to compel arbitration of the securities claims pursuant to the Federal Arbitration Act. Shearson based its motion upon an arbitration provision contained in two customer agreements which the McMahons had signed prior to the dispute. The district court held the section 10(b) claims arbitrable based upon the strong national policy favoring arbitration and the Supreme Court’s decision in Byrd. The Second Circuit, however, reversed, holding the section 10(b) claims nonarbitrable.

The court based its holding on Wilko, noting that despite Scherk and Byrd, which “cast some doubt on the applicability of Wilko to claims under § 10(b),” the Wilko extension existed as precedent in the Second Circuit and thus bound the court to hold the section 10(b)

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139. Id. at 2336.
140. Id.
141. Id.
142. Id. at 2335-36. See supra note 15 (contains arbitration agreement).
143. McMahon, 618 F. Supp. at 384. The district court held that the securities broker’s customers would be required to arbitrate their securities claims, that the broker excessively “churned” their accounts and made certain misrepresentations concerning the status of those accounts under terms of an arbitration provision in the customers’ agreements, which required arbitration of any controversy arising out of or relating to the securities or any of the transactions. Id.

The district court based its holding on: (1) the fact that the United States Arbitration Act “was designed to allow parties to avoid ‘the costliness and delays of litigation,’ and to place arbitration agreements ‘upon the same footing as other contracts . . .’ ” Id. at 386. The district court stated that the strong national policy favoring the enforcement of arbitration agreements was articulated in Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983). McMahon, 618 F. Supp. at 388. The Court in Moses stated that:

section 2 [of the Arbitration Act] is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary. The effect of the section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act . . . . The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.

Moses, 460 U.S. at 24-25. The district court in McMahon further relied on Dean Witter Reynolds, Inc. v. Byrd, 105 S. Ct. 1238 (1985), in which “the Supreme Court held that a district court is required to compel arbitration of state law fraud claims where the parties entered into an arbitration agreement similar to the one presented here.” McMahon, 618 F. Supp. at 387 n.10.

145. Id. at 97.
claims nonarbitrable. The Supreme Court granted certiorari to settle the heightened controversy among the circuit courts with regard to the arbitrability of section 10(b) claims.\textsuperscript{146}

\textit{A. The Majority}

In a 5-4 decision,\textsuperscript{147} the Supreme Court held that an agreement to arbitrate claims arising under section 10(b) of the Exchange Act is valid, and thus an investor has no right to litigate his claim in federal court.\textsuperscript{148} The majority determined that in light of the strong federal policy favoring arbitration,\textsuperscript{149} as established by the Arbitration Act, courts must "rigorously enforce arbitration agreements"\textsuperscript{150} despite the existence of a claim based on a statutory right.\textsuperscript{151} Thus, the Court emphasized that the "Arbitration Act, standing alone, ... mandates enforcement of agreements to arbitrate claims."\textsuperscript{152}

The Court, however, further determined that the requirement to enforce a predispute arbitration agreement may be overridden where the party seeking to void the agreement shows a "contrary congressional command"\textsuperscript{153} based upon the "statute's text, history, or purposes."\textsuperscript{154} Thus, the success of the McMahons' attempt to litigate their securities claim was predicated upon their ability to demonstrate that Congress intended such claims to be litigated.\textsuperscript{155}

Initially, the McMahons attempted to prove the requisite congressional intent by showing that although Congress did not specifically address the nonarbitrability of securities claims, Congress implied it through the creation of section 29(a) of the Exchange Act "which declares void '[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of [the

\textsuperscript{147} Justice O'Connor authored the majority opinion, which Chief Justice Rehnquist and Justices White, Scalia, and Powell joined. Justice Blackmun wrote a dissenting opinion, which Justices Brennan and Marshall joined. Justice Stevens wrote a separate dissenting opinion.
\textsuperscript{148} McMahon, 107 S. Ct. at 2346.
\textsuperscript{149} Id. at 2337.
\textsuperscript{150} Id.
\textsuperscript{151} Id.
\textsuperscript{152} Id.
\textsuperscript{153} Id.
\textsuperscript{154} Id.
\textsuperscript{155} Id. at 2338.
Act]." 156  The McMahan's contended that section 29(a) forbids the enforcement of an arbitration agreement because the agreement constitutes an impermissible waiver of section 27 of the Exchange Act, which states in pertinent part: "The district courts of the United States . . . shall have exclusive jurisdiction of violations of this title 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 title or the rules and regulations thereunder." 157

The Court responded to this contention by stating that section 29(a) does not reach so far as to void the waiver of "any provision" of the Exchange Act. 158 Instead, the court found that what the nonwaiver provision in section 29(a) forbids is the "enforcement of agreements to waive 'compliance' with the provisions of the statute." 159 Further, since section 27 does not create any statutory duty with which brokers must comply, its waiver is not "a waiver of 'compliance with any provision' of the Exchange Act under § 29(a)." 159

In an attempt to distinguish the statutory interpretation in Wilko, the majority stated that Wilko turned on the insufficiency of the arbitration process to enforce statutory rights which, the Court concluded, no longer mandates judicial concern. 161

The McMahan's second attempt to prove the requisite congressional intent involved the argument that the arbitration agreement constitutes an impermissible waiver of their substantive rights

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156. McMahan, 107 S. Ct. at 2338 (quoting 15 U.S.C. § 78cc(a)).
158. Id.
159. Id.
160. Id.
161. The Court stated, in pertinent part, that:
The conclusion in Wilko was expressly based on the Court's belief that a judicial forum was needed to protect the substantive rights created by the Securities Act: "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." 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 § 12(2).
McMahan, 107 S. Ct. at 2338 (citations omitted). Further, the Court stated that Scherk demonstrated the increased judicial approval of the arbitration process as it "turned on the Court's judgment that under the circumstances of that case, arbitration was an adequate substitute for adjudication as a means of enforcing the parties' statutory rights." Id. at 2339.
as provided by the Exchange Act.\textsuperscript{162} In support of this argument, the McMahan's asserted that section 29(a) of the Act voids predispute arbitration agreements because they "tend to result from broker overreaching."\textsuperscript{163} The Court, however, disagreed with the McMahan's interpretation of section 29(a) and stated that the section "is concerned, not with whether brokers 'maneuver[ed customers] into'\textsuperscript{164} an agreement, but with whether the agreement 'weaken[s] their ability to recover under the [Exchange] Act.' "\textsuperscript{165}

The McMahan's, however, countered that arbitration does "weaken their ability to recover under the [Exchange] Act."\textsuperscript{166} In response, the Court noted that although this argument constituted the "heart" of the Wilko decision,\textsuperscript{167} most of the reasons for the Wilko Court's conclusion that arbitration was an inadequate method

\textsuperscript{162} Id.

\textsuperscript{163} Id. The McMahan's argued that since securities sales agreements are not freely negotiated, the predispute arbitration agreement should be voided.

\textsuperscript{164} Wilko, 346 U.S. at 432, quoted in McMahon, 107 S. Ct. at 2339.

\textsuperscript{165} Id. The Court stated that maneuvering customers into an agreement is grounds for revoking the contract under contract law. If the agreement weakens the McMahan's ability to recover under the Exchange Act, this would be grounds for voiding the agreement under § 29(a).

\textsuperscript{166} McMahon, 107 S. Ct. at 2340 (citing Wilko, 346 U.S. at 432).

\textsuperscript{167} Id. The Court stated that among these prior inadequacies was the Wilko Court's belief that "arbitration proceedings were not suited to cases requiring 'subjective findings on the purpose and knowledge of an alleged violator'"; that "arbitrators must make legal determinations 'without judicial instruction on the law', and that an arbitration award 'may be made without explanation of [the arbitrator's] reasons and without a complete record of their proceedings'"; and finally that 'the power to vacate an award is limited' and that absent manifest disregard, interpretations of the law by arbitrators are not subject to judicial review. Id. (quoting Wilko, 346 U.S. at 435-37).

The McMahon Court further stated that:
[a]s Justice Frankfurter noted in his dissent in Wilko, the Court's opinion 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." . . . Instead, the reasons given in Wilko reflect a general suspicion of the desirability of arbitration and the competence of arbitral tribunals—most apply with no greater force to the arbitration of securities disputes than to the arbitration of legal disputes generally. It is difficult to reconcile Wilko's mistrust of the arbitral process with this Court's subsequent decisions involving the Arbitration Act. See, e.g., Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc., supra; Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 (1985); Southland Corp. v. Keating, 465 U.S. 1 (1984); Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1 (1983); Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974). McMahon, 107 S. Ct. at 2340 (Wilko citations omitted).
of dispute resolution have been rejected in later Supreme Court cases.168

The Court reasoned that judicial suspicion of the arbitration process no longer exists,169 citing Mitsubishi, which held that arbitration is a proper forum for dispute resolution of antitrust claims despite the absence of judicial supervision and instruction.170 Moreover, the Court stated that Mitsubishi provided that, despite the limitations for judicial review of an arbitration award, there exists sufficient review of these awards.171 Additionally, the arbitration process does not deprive investors of their substantive rights.172 Thus, according to the Court, the argument set forth by the McMahons is no longer appropriate.173 The Court stated that "the mistrust of arbitration that formed the basis for the Wilko opinion in 1953 is difficult to square with the assessment of arbitration that has prevailed since that time."174

The Court continued by explaining the reasons for the Supreme Court's current approval of the arbitration process.175 One reason for the Supreme Court's change in attitude since Wilko is the increased degree of authority delegated to the Securities and Exchange

168. Id. at 2340. More recent Supreme Court cases have indicated that the underlying assumption in Wilko, that arbitration tribunals are unable to handle legally and factually complex cases, does not exist today. Id.

169. Id.


171. Id. at 2340 (citing Mitsubishi, 473 U.S. at 628-34). The Supreme Court in Mitsubishi stated that:

[w]here the parties have agreed that the arbitral body is to decide a defined set of claims which includes, as in these cases, those arising from the application of American antitrust law, the tribunal therefore should be bound to decide that dispute in accord with the national law giving rise to the claim.

Mitsubishi, 473 U.S. at 636-37. The Court further stated that it need not "consider now the effect of an arbitral tribunal's failure to take cognizance of the statutory cause of action on the claimant's capacity to reinstate suit in federal court." Id. at 637 n.19.

Additionally, the Court observed that the "Convention reserves to each signatory country the right to refuse enforcement of an award where the 'recognition of enforcement of the award would be contrary to the public policy of that country.'" Id. at 638 (citation omitted). Thus, "the national courts of the United States will have the opportunity at the award-enforcement stage to ensure that the legitimate interest in the enforcement of the antitrust laws has been addressed." Id.

172. Id.


174. Id.

175. Id.
Commission (SEC) to ensure that the rules regulating arbitration are consistent with the requirements of the Exchange Act.\footnote{176} The Court stated that the SEC, pursuant to the 1975 amendments to section 19 of the Exchange Act, now has the power to “ensure the adequacy of the arbitration procedures employed by the SROs self-regulatory organizations.”\footnote{177} The Supreme Court considered this increased SEC power sufficient to overcome the prior fears associated with the arbitration process expressed in Wilko.\footnote{178} In light of these regulatory developments, the Court refused to extend Wilko, concluding instead that an agreement to arbitrate a section 10(b) claim is not tantamount to an impermissible waiver, and thus is not void under section 29(a).\footnote{179}

The McMahons’ final argument was that Congress intended section 29(a) to void predispute arbitration agreements even if section 29(a), by its own terms, does not so provide.\footnote{180} The McMahons argued that Congress’ failure to make more extensive changes to section 28(b)\footnote{181} in the 1975 amendments to the Exchange Act indicated its desire that section 29(a) should be interpreted as voiding all predispute agreements to arbitrate.\footnote{182}

In response, the Court stated that before section 28(b) was amended, its purpose “was to preserve the self-regulatory role of the securities exchanges, by giving the exchanges a means of enforcing their rules against their members.”\footnote{183} Further, the congressional amendments of 1975 were meant only to “clarify the scope of the self-regulatory responsibilities of national securities exchanges and registered securities associations . . . and the manner in which they are to exercise those responsibilities.”\footnote{184} Additionally, the Court noted that this amendment does not mention the words “customers”\footnote{185}.

\footnote{176} Id. The Court stated that “[i]n 1953, when Wilko was decided, the Commission had only limited authority over the rules governing (SROs)—the national securities exchanges and registered securities associations—and this authority appears not to have included any authority at all over their arbitration rules.” Id.

\footnote{177} Id.

\footnote{178} Id.

\footnote{179} Id. at 2341-42.

\footnote{180} Id. at 2342.

\footnote{181} Id. at 2342 (citing 15 U.S.C. § 78bb(b)).

\footnote{182} McMahon, 107 S. Ct. at 2342.

\footnote{183} Id.

\footnote{184} Id. at 2342 (citing S. Rep. No. 94-75, at 22 (1975)).
nor "arbitration" and is in no way geared toward the issue of the arbitrability of securities claims.185

The McMahons, however, focused on a statement from the 1975 conference report addressing the Wilko issue which provides:

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.186

According to the McMahons, this statement illustrates implicit Congressional approval of Wilko's extension to the Exchange Act.

The Court responded that unless Congress actually legislated the nonarbitrability of securities claims, Congress could not have intended Wilko to be extended to the Exchange Act.187 In addition, the Court stated that Congress may have merely mentioned Wilko to clarify that the amendment to section 28(b) was not meant to disrupt the holding of Wilko.188 Further, the Court stated that Congress' desire not to change "existing law" may have referred either to its desire not to have Wilko extended to the Exchange Act189 or to its desire to express approval of the Supreme Court's doubts as expressed in Scherk as to whether Wilko should be extended to claims under the Exchange Act.190 In any event, the Court concluded that Congress intended the Wilko issue to be left to judicial interpretation.191 Thus, the Court held that since the McMahons did not prove contrary congressional intent, the arbitration agreement previously signed by the McMahons must be upheld.192

186. Id. at 2343 (citing H.R. Conf. Rep. No. 94-229, at 111 (1975)).
187. Id.
188. Id.
189. Id.
190. Id.
191. Id.
192. Id.
B. The Dissent

A dissenting opinion, written by Justice Blackmun and joined by Justices Brennan and Marshall, argued that the section 10(b) claims should be held nonarbitrable. Justice Blackmun adamantly argued that Congress approved of Wilko's extension to the Exchange Act. He concluded that the reasoning applied by the Wilko Court should still be utilized today, despite any improvements made to the arbitration process.

With regard to congressional intent, Justice Blackmun argued that the 1975 amendments illustrate Congress' implied endorsement of Wilko's extension to the Exchange Act. He cited the committee statement relied upon by the McMahons as evidence that Congress was aware of the Wilko extension and was "not concerned with arresting" the trend.

193. Id. at 2346. In a separate dissent, Justice Stevens opined that the long-standing interpretation of Wilko's application to the Exchange Act creates a presumption of correctness which should be remedied only by congressional action. Id. at 2359 (Stevens, J., dissenting).

194. Id. at 2346.

195. Id. The dissent stated that following the decision in Wilko v. Swan, 346 U.S. 427 (1953), "lower courts extended Wilko's reasoning to claims brought under § 10(b) of the Exchange Act, and Congress approved of this extension." McMahon, 107 S. Ct. at 2346.

196. Id.

197. Id. at 2347.

198. Id. at 2348. In a footnote, Justice Blackmun stated:

Although I agree that the [excerpt of legislative history] does not state expressly Congress' approval of Wilko's extension to Exchange Act claims, I do not believe that there are "difficulties," as the Court suggests, in interpreting that remark to suggest such approval. Certainly, by the 1975 amendments dealing with exceptions to § 29(a) of the Exchange Act, Congress was enacting provisions directly related to the general subject of Wilko and its extension to Exchange Act claims—the scope of the nonwaiver provision—contrary to the Court's flat statement that these provisions were not "remotely addressing that subject." . . . Moreover, understanding the remark to imply Congress' affirmation of Wilko and an awareness of Wilko's extension to § 10(b) claims is not incompatible with several of the concerns at the center of the Court's "difficulties." Thus, Congress' concern that a possible misreading of § 28(b) might affect Wilko's actual holding as to § 12(2) claims, is consistent with this understanding. In addition, the mention of "existing law" could very well have referred both to the Court's decision in Schenk, where the Court assumed that Wilko could be applied to § 10(b) claims, see 417 U.S., at 515, 94 S. Ct. at 2455, and to holdings by the lower courts. I disagree with the Court's assertion that Congress left the Wilko issue to the courts by way of its statement that it did not change existing law. Ante at 2342.
Next, the dissent stated that although it agreed with the majority's determination that congressional intent is a prerequisite for holding section 10(b) claims nonarbitrable as an exception to the Federal Arbitration Act,\textsuperscript{199} the majority was mistaken in failing "to acknowledge that the Exchange Act, like the Securities Act, constitutes such an exception."\textsuperscript{200} Moreover, if the majority had not conducted an "unduly narrow" reading of \textit{Wilko}, it would have discovered the \textit{Wilko} Court's determination "that the Securities Act was an exception to the Arbitration Act."\textsuperscript{201} This, the dissent concluded, constituted a direct contradiction to the Supreme Court's prior acknowledgment in \textit{Mitsubishi}, which involved the determination that \textit{Wilko} held claims arising under the Securities Act to constitute an exception to the Arbitration Act.\textsuperscript{202}

Further, \textit{Wilko}, according to Justice Blackmun, dictates that the Securities Act constitutes an exception to the Arbitration Act in light of the fact that it was passed after the enactment of the Arbitration Act and was created to promote investor protection.\textsuperscript{203} In addition, the dissent noted that \textit{Wilko} acknowledged that Congress enhanced investor protection by providing investors with "a 'special right' of suit under § 12(2); they could bring the suit in federal or state court pursuant to § 22(a); and, if brought in federal court, there were numerous procedural advantages, such as nation-wide service of process."\textsuperscript{204} Thus, the dissent concluded that, contrary to the majority's view, \textit{Wilko} turned on more than just the policy considerations regarding the inadequacy of the arbitration process.\textsuperscript{205}

\textsuperscript{199} \textit{Id.} at 2348 n.5 (citations omitted).
\textsuperscript{200} \textit{Id.} at 2350.
\textsuperscript{201} \textit{Id.}
\textsuperscript{202} \textit{Id.}
\textsuperscript{203} \textit{Id.} According to the dissent, this result directly contradicts the goal of both securities acts, which is to free the investor from control of the market professional. \textit{Id.}
\textsuperscript{204} \textit{Id.} at 2351 (citing \textit{Wilko}, 346 U.S. at 431).
\textsuperscript{205} \textit{McMahon}, 107 S. Ct. at 2352. The dissent stated that "the Court seriously errs when it states that the result in \textit{Wilko} turned only on the perceived inadequacy of arbitration for the enforcement of § 12(2) claims." \textit{Id.} The dissent explained that this discussion was preceded by the Court's conclusion that the language, legislative history, and purposes of the Securities Act mandated an exception to the Arbitration Act. \textit{Id.}
The dissent also rejected the majority’s interpretation of Scherk, stating that Scherk turned on the special nature of agreements to arbitrate in the international commercial context, not on the adequacy of the arbitration process. Justice Blackmun then wrote, "In light of a proper reading of Wilko, the pertinent question then becomes whether the language, legislative history, and purposes of the Exchange Act call for an exception to the Arbitration Act for § 10(b) [Exchange Act] claims." To answer this question, he focused on the Wilko extension and determined that the similarities between the antiwaiver provisions and the underlying policies concerning investor protection in both the Securities Act and the Exchange Act warranted extension of Wilko to the Exchange Act.

Irrespective of any subsequent improvements in the process, the dissent concluded that the Wilko Court’s mistrust of arbitration is still appropriate. Certain concerns associated with the arbitration process, as acknowledged in Wilko, are not outdated. Among these concerns is the difficulty of judicial review of an arbitrator’s decision where typically no record nor reasoning behind the decision exists, the high standard for review of an arbitrator’s decision, and the fact that arbitrators are not bound by precedent. Thus, the dissent concluded that despite the improvements made to the arbitration process, such as the development of a code of arbitration by the SEC, the procedure has not changed so dramatically since Wilko as

206. McMahon, 107 S. Ct. at 2352. In a footnote, Justice Blackmun stated that:

\[\text{[This reading of Scherk is entirely consistent with our explanation of that decision in Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U. S. 614 (1985), a case that also involved an agreement to arbitrate in the international business context. There, citing Scherk, we concluded that \"concerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes require that we enforce the parties’ agreement, even assuming that a contrary result would be forthcoming in a domestic context.\" In discussing that case at length, we expressed our agreement with the remark in Scherk that such arbitration agreements constituted \"a specialized kind of forum-selection clause.\"]}

207. Id. at 2352-53 n.11 (citations omitted).
208. Id. at 2353.
210. Id.
211. Id. at 2354.
to negate a significant amount of the previous judicial skepticism associated with arbitration.\textsuperscript{212}

Moreover, the dissent stated that "there remains the danger that, at worst, compelling an investor to arbitrate securities claims puts him in a forum controlled by the securities industry."\textsuperscript{213} This may result in a forum composed of biased individuals before whom an investor must bring a securities claim.\textsuperscript{214} The dissent also viewed with skepticism the Commission's actual ability to control and review the arbitration process.\textsuperscript{215} Justice Blackmun stated that "[t]he Commission does not pretend that its oversight consists of anything other than a general review of SRO rules and the ability to require that a SRO adopt or delete a particular rule. It does not contend that its 'sweeping authority' . . . includes a review of specific arbitration proceedings."\textsuperscript{216} Thus, the dissent concluded that the Commission "neither polices nor monitors"\textsuperscript{217} the results of these arbitrations for possible misapplications of securities laws or for indications of how investors fare in these proceedings, especially in view of the abuses associated with the arbitration process.\textsuperscript{218}

\textbf{C. Analysis of McMahon}

Despite the assertion that resolution of the arbitrability issue turns on congressional intent, the heart of the majority opinion focuses on the arbitration process and the substantial improvements

\begin{itemize}
\item \textsuperscript{212} Id.
\item \textsuperscript{213} Id.
\item \textsuperscript{214} Id.
\item \textsuperscript{215} Id. at 2357.
\item \textsuperscript{216} Id. Justice Blackmun further stated: Even those who would agree with the Commission that its general oversight of SRO arbitration procedures has bettered the adequacy of arbitration recognize that improvements in this oversight still are needed. For example, commentators have suggested that the Commission should revise the Uniform Code of Arbitration in order to ensure that predispute arbitration agreements are displayed prominently, that the reference to a person drawn from "outside the securities industry" be more specifically defined, and that arbitrators be required to give a more detailed statement of their reasoning. Congress could give to the Commission specific rule-making authority in the area of arbitration with the goal of preventing abuses in the process that have surfaced in recent years.
\item \textsuperscript{217} Id. at 2358 n.25 (citations omitted).
\item \textsuperscript{218} Id.
\end{itemize}
made to it since the Wilko decision in 1953.\textsuperscript{219} The majority stated that based upon these improvements and the reasoning underlying Wilko, that case no longer exemplifies "good law."\textsuperscript{220} The dissent, however, stated that Wilko rested on more than the inadequacies of arbitration and that even if Wilko's primary concern was the inadequacy of arbitration, the improvements made to the arbitration process are not substantial enough to warrant dismissal of the skepticism associated with the arbitration process.\textsuperscript{221} The only improvement actually mentioned by the majority is the SEC's increased authority over the rules governing SROs to "ensure the adequacy of the arbitration procedures employed by the SROs."\textsuperscript{222} Moreover, the dissent stated that many judicial concerns regarding the arbitration process persist, even in light of the subsequent improvements to the process.\textsuperscript{223}

It is suggested that the dissent's argument is the more compelling and pragmatic one.\textsuperscript{224} If the majority's holding is based upon the existence of substantial improvements to the arbitration process resulting in Wilko's virtual inapplicability to the issue of arbitrability

\textsuperscript{219} In McMahon, the Court stated that "the mistrust of arbitration that formed the basis for the Wilko opinion in 1953 is difficult to square with the assessment of arbitration that has prevailed since that time." McMahon, 107 S. Ct. at 2341.

\textsuperscript{220} The majority in McMahon stated, "Even if Wilko's assumptions regarding arbitration were valid at the time Wilko was decided, most certainly they do not hold true today . . . ." McMahon, 107 S. Ct. at 2341.

\textsuperscript{221} Id. at 2353.

\textsuperscript{222} Id. at 2341. However, even the majority opinion acknowledged that the SEC has not been given the authority by Congress to review any specific arbitration decision that might be rendered in accordance with any SRO arbitration procedure. Id. at 2346.

\textsuperscript{223} Id. at 2353-54. Among these concerns are that the preparation of a record of the proceeding is not required; that judicial review of these proceedings is limited due to the high standard of review and the difficulty of meeting this standard without a record of the proceeding to indicate why judicial review is necessary; and that "arbitrators are not bound by precedent and are actually discouraged by their associations from giving reasons for a decision." In addition, the dissent noted the widespread perception among investors that the arbitration panels are composed of individuals sympathetic to the securities industry and not from the general public. According to the dissent, this perception is "frequently justified." Id. at 2354-55.

\textsuperscript{224} Despite improvements to the arbitration process, many inadequacies still remain. See infra notes 245-75 and accompanying text. See also McMahon, 107 S. Ct. at 2354 (dissent states that the inadequacies of the arbitration process still exist).
of claims arising under section 10(b) of the Exchange Act, the holding seems unsubstantiated and unwarranted.225

The majority, however, initially relies on congressional intent.226 Congressional intent may be derived from prior judicial interpretation of congressional acts.227 In Wilko, the Court first noted that Congress created the Securities Act to protect the investor.228 Congress must therefore have intended section 14 of this Act to prohibit the waiver of an investor’s right to select a forum for dispute resolution because judicial direction is an important element in ensuring investor protection.229 Therefore, when Congress incorporated a strikingly similar antiwaiver provision in the Exchange Act, it logically follows that Congress intended this provision to prohibit the waiver of a judicial forum as well.230 To find otherwise is to ignore congressional directives,231 especially where the improvements to the arbitration process since Wilko have not been so significant as to moot the court’s concerns.232 In reality, the arbitration process itself has not changed as dramatically as has the judicial perception of arbitration.233

A possible indication of congressional intent with regard to the “Wilko extension” may be derived from the 1975 amendments to the Exchange Act. The majority concluded that absent either a direct indication of congressional intent to approve the “Wilko extension” or “the enactment into law of a provision remotely addressing the subject,”234 the 1975 amendments do not indicate congressional approval of the “Wilko extension.”235 In response to

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225. See infra notes 245-75 and accompanying text (discussion of reasons why arbitration should not be a viable determination to litigation).
228. Wilko, 346 U.S. at 431.
229. Id.
230. This is especially true considering that the Exchange Act was also created to ensure investor protection. See supra notes 41-44 and accompanying text.
232. See infra notes 244-65 and accompanying text.
233. See Scherk, 417 U.S. at 518; Mitsubishi, 473 U.S. at 627; Byrd, 470 U.S. at 221 (discussions of the shortcomings of arbitration).
235. See supra notes 76-137 and accompanying text (detailed analysis of Wilko extension).
the majority, Justice Blackmun stated that these amendments are a direct indication of Congress' desire not to overrule Wilko.\(^{236}\) Further, "the fact that this statement was made in an amendment to the Exchange Act suggests that Congress was aware of the extension of Wilko to § 10(b) claims."\(^{237}\)

After a review of the conference report, it seems that Congress did directly address the issue when it stated, "It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in Wilko v. Swan, concerning the effect of arbitration proceedings provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations."\(^{238}\) Whether this statement referred strictly to Wilko as applied to the Securities Act, or also included the "Wilko extension" theory, appears to be the dispositive issue.

To resolve this issue, one must first determine what constitutes "existing law."\(^{239}\) "Existing law" may refer only to the Wilko holding that claims arising under the Securities Act are nonarbitrable.\(^{240}\) It seems reasonable, however, to assume that Congress was aware of the extension of Wilko to the Exchange Act, considering the vast amount of case law on the issue and its controversial nature.\(^{241}\) Thus, the term "existing law" may have included the "Wilko extension" argument. Conversely, the phrase states that the amendment does "not change existing law as articulated in Wilko,"\(^{242}\) which may serve to limit the phrase to what was specifically articulated in Wilko. Justice Blackmun's argument seems to be the more reasonable one considering Congress' probable awareness of the extensive case law substantiating the Wilko extension. Thus, as stated by the dissent in McMahon, congressional intent, with regard to the 1975 Amendment, does appear to encompass congressional approval of Wilko's extension to the Exchange Act.

In sum, both congressional intent arguments offered by the McMahons and supported by the dissent, namely that the anti-

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237. Id. at 2348.
239. Id.
241. Since Wilko, there has been a dramatic split in the circuits regarding the arbitrability of claims arising under the Exchange Act. See supra note 21.
waiver provision of the Exchange Act invalidates predispute arbitration agreements with regard to section 10(b) claims, and that Congress expressed its approval of the Wilko extension in its 1975 amendments to the Exchange Act, seem to be compelling and logically correct. It is, therefore, suggested that the majority in McMahon was unwise to hold that predispute arbitration agreements are not void under the Exchange Act.

To fully understand the necessity of the extension of Wilko to the Exchange Act, it is essential to compare litigation to arbitration and attempt to determine which better protects the investor.

VII. THE CURRENT STATE OF SECURITIES ARBITRATION: FAILING TO PROTECT THE INVESTOR

Arbitration of securities claims takes place in a private forum\textsuperscript{243} not bound by precedent.\textsuperscript{244} The purpose of arbitration "is to do justice between the parties."\textsuperscript{245} It is questionable, however, whether that purpose is consistently achieved in light of industry practices.\textsuperscript{246}

First, since arbitrators are not currently required to maintain a formal record, there is no reliable judicial review of factual errors.\textsuperscript{247}


\textsuperscript{244} Sterk, supra note 26, at 483; See M. Domke, Commercial Arbitration § 25:01 (rev. ed. 1984) (arbitrators not bound to follow applicable law unless set forth in arbitration agreement).

\textsuperscript{245} Sterk, supra note 26, at 483. The author defines "justice between the parties" as treating the contracting parties fairly, and not as accounting for other social goals, even if such goals would be better served by permitting the breaching party to escape liability.

\textsuperscript{246} The conduct of securities industry arbitration proceedings is governed by a Uniform Code of Arbitration which has been adopted by the National Association of Securities Dealers, Inc., the Municipal Securities Rulemaking Board, the New York Stock Exchange, and each of the other national securities exchanges that administers an arbitration system for the resolution of disputes between investors and broker-dealers. Collectively, these organizations are referred to as self-regulatory organizations (SROs).

\textsuperscript{247} 9 U.S.C. §§ 1-14; R. Coulson, Business Arbitration—What You Need to Know 29 (3d ed. 1986); Domke, supra note 244, § 29:06 (arbitrators not required to state reasons for their award, make separate findings on issues or make express findings of fact); Katsoris, supra note 243, at 286.
nor any way to assess the overall fairness of any given proceeding.\textsuperscript{248} Second, it is difficult at best for an investor to successfully appeal an arbitrator’s decision\textsuperscript{249} because judicial review is limited\textsuperscript{250} to a showing of ‘‘pervasive misconstruction or positive misconduct on the part of the arbitrator.’’\textsuperscript{251} Thus, even if an arbitrator has made

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\item[\textsuperscript{248}] The arbitration process contains no requirement of keeping complete records of the proceedings. See supra note 247. Without complete records, it is virtually impossible to determine the fairness of an arbitration proceeding. The court in Wilko v. Swan, 346 U.S. 427 (1953), indicated that without complete records of the proceeding, it is very difficult to show an error as being clearly erroneous, and that absent ‘‘manifest disregard’’ in interpreting the law, an arbitrator’s award will not be vacated. Id. at 436.
\item[\textsuperscript{249}] Sterk, supra note 26, at 483-87. Judicial review of an arbitration award is severely limited. The appealing party has the burden of proof, but has no record on which to base his allegations. See Coulson, supra note 247, at 29-31 (Since there is no written record explaining reason for award, an undisclosed error of judgment is virtually immune from attack, and thus ‘‘an occasional mistake by an arbitrator left uncorrected by courts, is the price that must be paid for a healthy system of arbitration.’’); Elkouri & Elkouri, supra note 46, at 30; Swift Indus., Inc. v. Botany Indus., Inc., 466 F.2d 1125, 1131 (3d Cir. 1971) (arbitrator’s decision will be affirmed unless shown to be ‘‘completely irrational’’). But see Sargent v. Paine Webber, Jackson & Curtis, 674 F. Supp. 920 (D.D.C. 1987). Although judicial review of arbitrator’s decision is narrowly limited, courts should not attempt to enforce an award that is ambiguous, indefinite, or irrational. For judicial review to be meaningful, an arbitrator’s award cannot be absolutely immune from scrutiny.
\item[\textsuperscript{250}] Generally speaking, courts will not inquire into the basis of the award unless they believe that the arbitrators rendered it in ‘‘manifest disregard’’ of the law or the facts of the case. Under the ‘‘manifest disregard’’ doctrine, the mere failure on the part of the arbitrator to understand or apply the law will not be sufficient to overturn the award. See generally Merrill Lynch, Pierce, Fenner & Smith v. Bobker, 808 F.2d 930 (2d Cir. 1987).
\item[\textsuperscript{251}] Domke, supra note 244, § 34.00. The Arbitration Act sets forth four grounds for vacating an arbitrator’s award. The standards for review as set out in 9 U.S.C. § 10 (Supp. V. 1952) are:
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\item[\textsuperscript{\textit{§}} 10. Same; vacation; grounds; rehearing]
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\item[\textit{(a)}] Where the award was procured by corruption, fraud, or undue means.
\item[\textit{(b)}] Where there was evident partiality or corruption in the arbitrators, or either of them.
\item[\textit{(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.
\item[\textit{(d)}] Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject
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erroneous findings of fact or law, the investor will be hard pressed to get the arbitrator’s decision vacated.

Further, the arbitration system provides minimal assurance that an arbitrator will act properly and fairly when deciding a securities issue. By contrast, in litigation the investor has an established procedure and right to challenge judicial actions and decisions. This ensures that the twin objectives of justice and investor protection are consistently being accomplished. The protection afforded to investors in litigation, which provides a certain assurance of judicial expertise regarding securities issues, should be extended to the arbitration process where the likelihood of encountering an arbitrator not fully versed on securities law issues is far greater.

Further, without records to ensure justice through appellate review, the degree of judicial control over the arbitration process is limited. Such limitation may serve to destroy Congress’ primary objective in enacting the laws regarding securities regulation: to protect the investor. The end result of allowing arbitration of securities claims is the virtual impossibility of providing assurance of investor protection.

matter submitted was not made.

(c) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators.

252. See supra note 251.

253. If the proceedings and decisions made by an arbitrator are not thoroughly reviewed, the arbitrator may not follow the proper arbitration procedure as set forth in the Arbitration Act. The Act draws narrow limits for a court’s authority to review awards, thereby resulting in relatively few motions to vacate, modify, or overturn awards. Coulson, supra note 247, at 300.

254. Domke, supra note 244, § 19.03. See Greater Continental Corp. v. Schechter, 422 F.2d 1100, 1103 (2d Cir. 1970) (a question concerning fraud within the meaning of 10b-5 is “properly litigated in the courts where a complete record is kept of the proceedings and findings and conclusions are made”).


256. It seems an appropriate conclusion that if the judicial system provides methods of assuring fairness, such as the ability to secure appellate review, these methods should also be available in an arbitration proceeding.

257. See Sterk, supra note 26, at 483-84.

258. See generally Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). See also Wilko, 346 U.S. at 431; Loss, supra note 17, at 36.

259. See Wilko v. Swan, 346 U.S. 427 (1953) (litigation provides greater investor protection than arbitration because unlike arbitration, litigation provides the parties with a chance for appellate review for errors in interpreting the law).
Moreover, with an increasing number of securities claims being channeled into arbitration,\textsuperscript{260} the development of securities case law may stagnate. This may result in two negative consequences to investors. First, without the publicity which often stems from important securities issues being subjected to litigation,\textsuperscript{261} economically injured investors may remain ignorant of potential remedies for injuries incurred from fraudulent and negligent acts committed by unscrupulous brokers.\textsuperscript{262} Second, if the number of investors instituting litigation against fraudulent and negligent brokers increased, the amount of fraud and negligence experienced by investors would probably be reduced, since these lawsuits would forewarn potentially deceitful brokers.\textsuperscript{263} If, however, the number of injured investors bringing viable claims against their brokers decreases, the amount of fraud and negligence committed by brokers may increase.\textsuperscript{264} This result is clearly in direct conflict with Congress’ attempt to protect

\textsuperscript{260} In 1986, there were 2,838 securities arbitration disputes, compared with 838 in 1982. See SEC Staff to Urge Revisions to Industry Arbitration System, 19 Sec. Reg. & L. Rep. (BNA) 1387, 1388 (Sept. 18, 1987). That number has increased dramatically in light of \textit{McMahon}:

The New York Stock Exchange estimates that since October about 120 cases have been filed every month—a 60% increase from year-earlier levels. The National Association of Securities Dealers says that 1987 cases grew 82% over the 1986 level and that this year’s pace is running an annualized 45% higher.


\textsuperscript{261} \textit{See}, e.g., Dean Witter Reynolds, Inc. v. Byrd, 726 F.2d 552 (9th Cir. 1984), \textit{rev’d}, 105 S. Ct. 1238 (1985) (lower courts were able to utilize this and other lower court decisions to supplement their rationale and provide additional information to investors regarding current Supreme Court trends when deciding the arbitrability of securities issues).

\textsuperscript{262} Unless these decisions are published for investors to review, investors will remain ignorant as to possible remedies for violations of the Securities Acts of 1933 and 1934. Since investors are perceived to be in a weaker bargaining position than brokers, \textit{Hazen, supra} note 17, it would be in the best interest of investors to make them aware of possible remedies for possible illegal activity by brokers.

\textsuperscript{263} One of the objectives of the judicial system is to act as a deterrent for future illegal acts. This deterrent effect is achieved through the punishment of wrongdoers which acts as a warning against committing similar illegal acts. See Andenaes, \textit{The General Preventive Effects of Punishment}, 114 U. Pa. L. Rev. 949, 953 (1966) (sufferings of the criminal for the crime he has committed are supposed to deter others from committing similar crimes).

\textsuperscript{264} If the wrongful acts of brokers go unpunished, there will be little incentive for other brokers not to commit similar acts. J. TAPPAN, CRIME, JUSTICE AND CORRECTION 248 (1960).
VIII. Arbitration After McMahon

Contrary to the majority's conclusion in McMahon, the arbitration process has not changed so radically as to provide the investor with the same degree of protection as is afforded by the litigation process. The preceding discussion indicated that the current checks on the arbitration system lack specificity and thoroughness. Furthermore, serious questions have been raised about the system's procedural fairness. Thus, the Supreme Court's ruling in McMahon must be followed up with some revision of the arbitration process to provide the investor with the protections envisioned by Congress.

265. See supra notes 243-54 and accompanying text.
266. McMahon, 107 S. Ct. at 2358.

A staff letter drafted by the Securities and Exchange Commission's Division of Market Regulation to the Security Industry Conference on Arbitration (SICA), dated September 10, 1987, contained numerous recommendations. The recommendations, compiled after an 18-month review of the securities industry-sponsored arbitration program, are designed to enhance the perception that industry-sponsored arbitration is fair to the investing public. SEC Staff to Urge Revisions, supra.

Specifically, the SEC recommended that the SICA, which includes the American, Boston, Cincinnati, Midwest, New York, Pacific, and Philadelphia Stock Exchanges, as well as the National Association of Securities Dealers, the Chicago Board Options Exchange, and the Securities Industry Association, revise the Uniform Code to establish eligibility standards for public arbitrators on arbitration panels involving public customers. Id. The Commission suggested that the roster of public arbitrators maintained by the SROs should exclude all persons having significant professional ties to the industry. Id. Currently, under arbitration disputes of more than $5,000, the dispute is heard by a three-person panel, consisting of two "public" arbitrators and one "industry" arbitrator. Included on the roster of "public" arbitrators are security industry retirees, security industry lawyers, and spouses of security industry employees. The Commission recommended that these persons be moved from the "public" roster to the "industry" roster. Id.

Other recommendations include: maintenance of summary data for all SRO arbitration forums; expansion of discovery proceedings; revised disclosure provisions aimed at informing investors of arbitrator relationships with the industry; educational programs for arbitrators; improved evaluation systems; amending broker-

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when it promulgated the Exchange Act. 269

When such a change is implemented, however, care must be taken not to diminish the positive attributes of speed and cost efficiency associated with the current arbitration process. 270 Changes in the current process should be made carefully so as to avoid losing these useful characteristics. 271 One possible change may be to liberalize the standard of review of an arbitrator's decision 272 to allow the investor increased protection against irrational arbitration decisions. 273 The problem with this change, however, is that it may merely add an additional tier to the dispute resolution process, increasing the expense and time required to resolve a securities claim. In the end, however, this change may be necessary to ensure that arbitrators are acting in an impartial manner.

Another approach to achieving this objective is to require arbitrators to draft written opinions to support their decisions and to

customer predispute agreements to give customers a wider choice of forums; consideration of other than alternative dispute resolution groups; and public release of written opinions. Id.

The staff letter is part of an ongoing SEC review of the arbitration process. The next phase of the review includes a review of customer agreements with emphasis on the wording of the predispute agreements and whether the customer is free to negotiate the terms of the agreement. Id.

Recommendations from securities lawyers mirror many of the Commission's recommendations, but some go further than what the Commission proposes. For example, one attorney suggests that more information should be available on the backgrounds of nonindustry panelists and that SRO arbitration procedures provide for prehearing document exchange which would include depositions and interrogatories. See SEC Staffer Predicts Arbitrations Will Improve as a Result of McMahon, 19 Sec. Reg. & L. Rep. (BNA) 1405, 1406 (Sept. 18, 1987). Furthermore, the attorney suggests that all hearings should be transcribed and forwarded to the Commission, and arbitrators should be required to document their ruling. Id.


270. See Hardin, supra note 2.

271. See Shell, supra note 2. The author, after listing several possible changes which could be made to the arbitration process, stated:

Private arbitration holds out great promise as a means of processing many antitrust cases now clogging the courts. The challenge is to preserve the efficiencies that make arbitration attractive, while introducing a measure of accountability among private arbitrators, who will be implementing fundamental economic and social policy.

Id.

272. McMahon, 107 S. Ct. at 2354 (dissent stated that the Court recognized that the grounds for vacating an arbitration award were too limited).

273. Id. at 2354-55. Dissent stated that the current standard of review associated with arbitration may not be adequate to protect an investor's rights under the securities acts.
strictly comply with legal rules. This would enable the arbitrator's actions to be subjected to heightened judicial scrutiny and review. This change may also create precedent in the arbitration process which would aid investors and arbitrators in their search for justice by providing uniform results in similar factual situations.

All of these changes are tenable, but may have some impact on the speed and cost efficiency currently attributable to arbitration. Nevertheless, these changes are necessary to achieve both the congressional goal of providing investor protection and the Supreme Court's desire to provide investors and brokerage firms with an inexpensive and relatively efficient method by which to resolve their disputes. Clearly, there is no easy solution to the potential problems which may arise as a result of the McMahon decision.

IX. Conclusion

The issue of the arbitrability of claims arising under section 10(b) of the Exchange Act has not been fully laid to rest. The McMahon decision has left many unanswered questions in its wake, such as whether the arbitration process will be revised and, if so, what the impact of those revisions will be?

Although the Supreme Court did not intend the McMahon decision to deny the investor any statutory rights, some commentators have labeled the decision as "a victory for the securities industry." Possibly, like the Supreme Court's interpretation of Wilko, McMahon is merely a product of the times. Nevertheless, the impact of McMahon may cause a slow trickle of various changes and developments in policies, rules, and attitudes for which investors will merely have to watch and wait.

Cristy B. Bell


275. See supra note 251.
