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Securities—Arbitration—Agreements to Arbitrate Are Valid

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SECURITIES—ARBITRATION—AGREEMENTS TO ARBITRATE ARE VALID. *Shearson/American Express, Inc. v. McMahon*, 107 S. Ct. 2332 (1987).

Eugene and Julia McMahon were customers of Shearson/American Express, Inc. (Shearson), a brokerage firm registered with the Securities and Exchange Commission (SEC). Julia McMahon signed two customer agreements which provided for arbitration of any controversy relating to the accounts the McMahons maintained with Shearson.¹ The McMahons filed a complaint against Shearson and Mary Ann McNulty, the registered representative of Shearson who handled the McMahons' accounts. The complaint alleged that McNulty violated section 10(b) of the Securities Exchange Act of 1934 (Exchange Act)² and Rule 10b-5³ promulgated thereunder by engaging in churning⁴ and by making false statements and omitting material facts from the advice given to the McMahons. The complaint

1. The arbitration provision provided in relevant part as follows:

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

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

2. 15 U.S.C. § 78j(b) (1982). This section provides in relevant part as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . (b) To use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Id.

3. 17 C.F.R. § 240.10b-5 (1987) which provides in relevant part:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

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

Id.

4. "Churning" is the "fraudulent and wilful practice of trading extensively solely to max-

also alleged a claim under the Racketeer Influenced and Corrupt Organizations Act (RICO)⁵ and "state law claims for fraud and breach of fiduciary duties."⁶

Relying on the customer agreements, Shearson moved for an order compelling the McMahons to arbitrate their claims pursuant to section 3 of the Federal Arbitration Act.⁷ The United States District Court for the Southern District of New York granted the motion in part.⁸ The court held that the McMahons' section 10(b) and state law claims were arbitrable.⁹ The court concluded, however, that the RICO claim was not arbitrable because of the important federal policies inherent in the enforcement of RICO by the federal courts.¹⁰

The United States Court of Appeals for the Second Circuit affirmed the district court on the RICO and state law claims, but it reversed on the Exchange Act claims.¹¹ The Supreme Court granted certiorari and held that all of the McMahons' claims were arbitrable under the Federal Arbitration Act. *Shearson/American Express, Inc. v. McMahon*, 107 S. Ct. 2332 (1987).

The United States Supreme Court first dealt with the issue of the enforceability of an agreement to arbitrate claims arising under the federal securities laws in *Wilko v. Swan*,¹² decided in 1953. In *Wilko*

imize commissions." *McMahon v. Shearson/American Express, Inc.*, 618 F. Supp. 384, 386 (S.D.N.Y. 1985).

5. 18 U.S.C. § 1961 (1982).

6. 107 S. Ct. at 2336.

7. 9 U.S.C. §§ 1-14 (1982). Section 3 provides:

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

8. 618 F. Supp. at 389.

9. The district court held that the § 10(b) claims were arbitrable based on the Supreme Court's decision in *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985), and the "strong national policy favoring the enforcement of arbitration agreements." 618 F. Supp. at 388. The court also based its decision concerning the state law claims on *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985).

10. 618 F. Supp. at 387.

11. *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94 (1986), *rev'd*, 107 S. Ct. 2332 (1987). The court decided the Exchange Act claims were not arbitrable because of the Supreme Court's decision in *Wilko v. Swan*, 346 U.S. 427 (1953), coupled with the similarity of the nonwaiver provisions of the Exchange Act and the Securities Act of 1933. The court also relied on the "strong public policy concerns inherent in the securities laws." 788 F.2d at 98.

12. 346 U.S. 427 (1953).

a securities investor brought a claim against a brokerage firm under section 12(2) of the Securities Act of 1933 (Securities Act).¹³ The complaint alleged losses due to the firm's misrepresentations and omission of information concerning stock purchased by the investor. The investor signed an arbitration agreement similar to the one at issue in *McMahon*.¹⁴

Relying on the customer agreement, the brokerage firm moved to compel arbitration pursuant to section 3 of the Federal Arbitration Act.¹⁵ The Supreme Court held that the Securities Act claim was not arbitrable. The Court based its decision on the interaction of section 14 and section 22(a) of the Securities Act.¹⁶ Section 14 provides that "[a]ny 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 [SEC] shall be void."¹⁷ Section 22(a) confers jurisdiction on the district courts of the United States to hear suits brought for any violations of the Securities Act.¹⁸ The Supreme Court held that the arbitration agreement was a "stipulation," and "the right to select the judicial forum is the kind of 'provision' that cannot be waived under § 14 of the Securities Act."¹⁹ After reaching this conclusion, the Court examined some of the argu-

13. 15 U.S.C. § 77l(2) (1982). This section provides in relevant part as follows:

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

Id.

14. See 346 U.S. at 432 n.15.

15. 9 U.S.C. §§ 1-14 (1982). See *supra* note 7.

16. 346 U.S. at 434-35.

17. 15 U.S.C. § 77n (1982).

18. 15 U.S.C. § 77v(a) (1982). This section provides, in relevant part:

The district courts of the United States . . . shall have jurisdiction of offenses and violations under [the Securities Act] and under the rules and regulations promulgated by the [Securities and Exchange] Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by [the Securities Act].

19. 346 U.S. at 434-35.

ments against arbitration.²⁰ Noting that arbitrators' awards "may be made without explanation of [the arbitrator's] reasons and without a complete record of their proceedings"²¹ and that "[p]ower to vacate an award is limited,"²² the Court stated that "the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness."²³ After *Wilko*, lower courts extended the holding to claims under the Exchange Act and refused to enforce predispute agreements to arbitrate claims under section 10(b) of that Act.²⁴

In 1974, the Supreme Court first addressed the enforceability of a predispute agreement to arbitrate claims under section 10(b) of the Exchange Act in *Scherk v. Alberto-Culver Co.*²⁵ *Scherk* involved an international business transaction between an American company and a German citizen. The German citizen agreed to transfer the ownership of three business entities along with certain trademarks.²⁶ The contract contained a clause referring any controversy to arbitration before the International Chamber of Commerce in Paris, France.²⁷ When the American plaintiff brought suit under section 10(b) of the Exchange Act based on alleged fraudulent representations and encumbrances on the trademarks, the German defendant moved to compel arbitration in accordance with the contract.²⁸

The Supreme Court held the arbitration agreement enforceable.²⁹ However, the Court based its decision on the international business policies involved and *not* on the Exchange Act.³⁰ The Court characterized the arbitration clause as "an almost indispensable precondition to achievement of the orderliness and predictability essential to any international business transaction."³¹ *Wilko* was distinguished as a purely domestic dispute.³²

20. *Id.* at 435-37.

21. *Id.* at 436.

22. *Id.*

23. *Id.* at 437.

24. *See, e.g.,* *Greater Continental Corp. v. Schechter*, 422 F.2d 1100 (2d Cir. 1970) (dicta); *Moran v. Paine, Webber, Jackson & Curtis*, 389 F.2d 242 (3d Cir. 1968).

25. 417 U.S. 506 (1974).

26. *Id.* at 508.

27. *Id.*

28. *Id.* at 509.

29. *Id.* at 519-20.

30. *Id.* at 515-21. The Court did not decide whether the business acquisition was a security transaction within the meaning of the Exchange Act because the question was not properly before the Court. *Id.* at 514-15 n.8.

31. *Id.* at 516.

32. *Id.* at 515-16.

Although the Court decided *Scherk* entirely upon international business grounds, the majority of the Court, in dictum, suggested that a “colorable argument could be made that even the semantic reasoning of the *Wilko* opinion does not control the case before us.”³³ The “colorable argument,” as stated by the Court, consisted of two parts. First, the Court drew a distinction between section 12(2)³⁴ of the Securities Act and section 10(b) of the Exchange Act. Whereas section 12(2) provides a “‘special right’ of a private remedy for civil liability . . . neither § 10(b) . . . nor Rule 10b-5 speaks of a private remedy to redress violations of the kind alleged [in *Scherk*].”³⁵ Rather, private plaintiffs may bring suit for violations of section 10(b) and Rule 10b-5 only because federal case law has established an implied private cause of action under this section.³⁶

Second, the *Scherk* majority found distinctions between the two jurisdictional provisions of the Securities Act and the Exchange Act.³⁷ Section 22(a), the jurisdictional provision of the Securities Act, allows suit in any court of competent jurisdiction (federal or state), whereas the jurisdictional provision of the Exchange Act, section 27, provides for exclusive federal jurisdiction.³⁸ Thus, jurisdiction under the Exchange Act is more restrictive.³⁹ Notwithstanding the “colorable argument” set forth in the *Scherk* decision, lower federal courts continued to deny enforcement of arbitration agreements involving Exchange Act claims on the authority of *Wilko*.⁴⁰

33. *Id.* at 513.

34. The plaintiff in *Wilko* brought his claim under this section. 346 U.S. 427, 428 (1953).

35. 417 U.S. at 513. While the court did not clearly articulate the significance of this distinction, it seemed to suggest that while courts might be loath to enforce an agreement to arbitrate a dispute for which Congress expressly made a judicial forum available, there is no good reason to deny effect to section 3 of the Arbitration Act when the judicial forum is available to the plaintiff only because the courts have decreed that it shall be.

36. *Id.* at 513-14.

37. *Id.* at 514.

38. *Id.*

39. *Id.* The Court noted this difference in the jurisdictional provisions of the two Acts but did not explain its significance. Logic would seem to suggest that Congress was *more* concerned with investor's rights under the Exchange Act because of the exclusive jurisdiction given to the federal courts. The federal courts are in a better position to interpret important federal law questions. Nevertheless, one commentator suggests that the reasoning of this distinction drawn by the *Scherk* Court and later reiterated in a concurring opinion by Justice White, see *infra* notes 46-47 and accompanying text, is that since the Exchange Act does not give the investor a choice of forum, the investor has not waived any provision of the Act by agreeing to arbitrate. See Note, *Arbitrability of Claims Arising Under the Securities Exchange Act of 1934*, 1986 DUKE L.J. 548, 566.

40. See *Raiford v. Buslease Inc.*, 745 F.2d 1419, 1421 (11th Cir. 1984); *Surman v. Merrill Lynch, Pierce, Fenner & Smith*, 733 F.2d 59, 61 (8th Cir. 1984); *Ingbar v. Drexel Burnham Lambert Inc.*, 683 F.2d 603, 605 (1st Cir. 1982); *De Lancie v. Birr, Wilson & Co.*, 648 F.2d

The arbitration issue surfaced again in 1985 in *Dean Witter Reynolds, Inc. v. Byrd*.⁴¹ In *Byrd* an investor filed a complaint against a securities dealer alleging, *inter alia*, a violation of section 10(b) of the Exchange Act and various state law claims.⁴² The investor previously signed an arbitration agreement.⁴³ Because the securities dealer did not raise the issue of the arbitrability of the section 10(b) claim, the Court did not address it.⁴⁴ The only issue presented was whether the pendent state claims had to be severed and sent to arbitration. A unanimous Court held such pendent state law claims must be sent to arbitration.⁴⁵

Justice White, in a concurring opinion, reiterated the *Scherk* majority's "colorable argument."⁴⁶ He restated the reasoning of this "colorable argument" but did not specifically indicate why these differences in the Securities Act and the Exchange Act should compel the arbitration of section 10(b) claims.⁴⁷

After Justice White's concurrence in *Byrd*, the unanimity among lower federal courts denying the arbitration of section 10(b) claims disappeared. A number of federal district courts held agreements to arbitrate Exchange Act claims enforceable.⁴⁸ Two federal courts of

1255, 1257-59 (9th Cir. 1981); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1030 (6th Cir. 1979); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore*, 590 F.2d 823, 827-29 (10th Cir. 1978); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831, 833-36 (7th Cir. 1977); *Allegaert v. Perot*, 548 F.2d 432, 437-38 (2d Cir. 1977), *cert. denied*, 432 U.S. 910 (1977); *Sibley v. Tandy Corp.*, 543 F.2d 540, 543 & n.3 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977); *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532, 536-37 (3d Cir. 1976), *cert. denied*, 429 U.S. 1010 (1976).

41. 470 U.S. 213 (1985).

42. *Id.* at 214.

43. *Id.* at 215.

44. *Id.* at 215-16 n.1.

45. *Id.* at 223-24. The same year, in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), the Court decided "whether an American court should enforce an agreement to resolve antitrust claims by arbitration when that agreement arises from an international transaction." *Id.* at 624. The Court found that the "potential complexity" and the "fundamental importance" of antitrust matters does not preclude arbitration. *Id.* at 633-35. Relying heavily on *Scherk*, the Court 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." *Id.* at 629.

46. 470 U.S. 213, 224 (White, J., concurring).

47. *Id.* at 224-25.

48. *See, e.g.*, *Fisher v. Prudential-Bache Securities, Inc.*, 635 F. Supp. 234, 236-37 (D. Md. 1986); *Schriner v. Bear, Stearns & Co.*, 635 F. Supp. 373, 375-76 (N.D. Cal. 1986); *Brener v. Becker Paribas, Inc.*, 628 F. Supp. 442, 447-49 (S.D.N.Y. 1985); *Prawer v. Dean Witter Reynolds, Inc.*, 626 F. Supp. 642, 646 (D. Mass. 1985); *Moncrieff v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 623 F. Supp. 1005, 1006 (E.D. Mich. 1985); *Peele v. Kidder, Peabody & Co.*, 620 F. Supp. 61, 63 (W.D. Mo. 1985).

appeals held likewise.⁴⁹ The Supreme Court granted certiorari⁵⁰ in *McMahon v. Shearson/American Express, Inc.*⁵¹ to resolve this conflict.

Justice O'Connor, writing for the *McMahon* majority, began her analysis with the Federal Arbitration Act.⁵² Noting that "[t]he Arbitration Act . . . establishes a 'federal policy favoring arbitration,'"⁵³ the Court concluded that "[t]he Arbitration Act, standing alone, . . . mandates enforcement of agreements to arbitrate statutory claims."⁵⁴ The Court then stated that, in order for the *McMahons* to prevail, Congress must have intended for the Exchange Act and RICO⁵⁵ to be exceptions to the Arbitration Act.⁵⁶

The Court then addressed the Exchange Act issue. The *McMahons* argued that the nonwaiver provision⁵⁷ forbade waiver of the jurisdictional provision.⁵⁸ In rejecting this argument, the Court reasoned that the nonwaiver provision prohibits only waiver of the substantive obligations of the Exchange Act. Since the jurisdictional provision operates upon the power of the court to hear the case and

49. See *Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc.*, 806 F.2d 291, 296-98 (1st Cir. 1986); *Phillips v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 795 F.2d 1393, 1397-98 (8th Cir. 1986).

50. *Shearson/American Express, Inc. v. McMahon*, 107 S. Ct. 60 (1986).

51. 788 F.2d 94 (2d Cir. 1986), *rev'd*, 107 S. Ct. 2332 (1987).

52. 9 U.S.C. §§ 1-14 (1982).

53. 107 S. Ct. 2332, 2337 (1987) (quoting *Moses H. Cone Memorial Hosp. v. Mercury Constr.*, 460 U.S. 1, 24 (1983)).

54. *Id.*

55. Prior to the *McMahon* decision, there was a split among the courts of appeals on the issue of whether RICO claims were arbitrable. See, e.g., *Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc.*, 806 F.2d 291 (1st Cir. 1986) (RICO claims not arbitrable because Congress provided for an express private right of action coupled with the public policy reasons of the RICO statute); *Mayaja, Inc. v. Bodkin*, 803 F.2d 157 (5th Cir. 1986) (RICO claims are arbitrable because no congressional intent to preclude arbitration); *Tashea v. Bache, Halsey, Stuart, Shields, Inc.*, 802 F.2d 1337 (11th Cir. 1986) (RICO claims based on alleged violations of the federal securities laws are not arbitrable); *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197 (3d Cir. 1986) (RICO claims based on alleged violations of the Exchange Act are not arbitrable whereas RICO claims based on violations of federal mail fraud and wire-fraud statutes are arbitrable).

56. 107 S. Ct. at 2338.

57. 15 U.S.C. § 78cc(a) (1982), which provides: "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of [the Exchange Act] or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void."

58. 15 U.S.C. § 78aa (1982), which provides, in relevant part:

The district courts of the United States . . . shall have exclusive jurisdiction of violations of [the Exchange Act] 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 [the Exchange Act] or the rules and regulations thereunder.

does not impose any statutory duties, its waiver is not a waiver of "compliance with any provision" of the Exchange Act.⁵⁹

Since the nonwaiver and jurisdictional provisions of the Exchange Act are virtually identical to the corresponding provisions of the Securities Act, the Court felt obligated to address its earlier decision in *Wilko v. Swan*.⁶⁰ The Court distinguished *Wilko* as a decision based on the idea that "arbitration [in 1953] was judged inadequate to enforce the statutory rights [of the Securities Act]."⁶¹ The Court also relied on its decision in *Scherk*⁶² to distinguish *Wilko*. According to the *McMahon* majority, *Scherk* upheld arbitration because under the circumstances of that case, arbitration was an adequate means of enforcing the parties' statutory rights.⁶³ The *McMahon* Court concluded that "*Scherk* supports our understanding that *Wilko* must be read as barring waiver of a judicial forum only where arbitration is inadequate to protect the substantive rights at issue."⁶⁴

The *McMahons* further argued that the arbitration agreement was a waiver of their section 10(b) rights because arbitration would weaken their ability to recover under the Exchange Act.⁶⁵ The majority believed that this weakening was "the heart of the Court's decision in *Wilko*."⁶⁶ In rejecting this argument, the Court relied heavily on the SEC's oversight authority of arbitration procedures. The Court noted that at the time of the *Wilko* decision, the SEC had "limited authority over the rules governing . . . securities exchanges . . . and this authority appears not to have included any authority at all over their arbitration rules."⁶⁷ This situation changed with the 1975 amendments to section 19⁶⁸ of the Exchange Act, which increased the oversight authority of the SEC in arbitration procedures.⁶⁹ The Court

59. 107 S. Ct. at 2338.

60. 346 U.S. 427 (1953).

61. 107 S. Ct. at 2338.

62. 417 U.S. 506 (1974).

63. 107 S. Ct. at 2339.

64. *Id.*

65. The *McMahon* Court reviewed the criticism of arbitration put forth by the *Wilko* Court. The Court noted that *Wilko* "was concerned 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.'" 107 S. Ct. at 2340 (quoting *Wilko v. Swan*, 346 U.S. 427, 436 (1953)).

66. *Id.*

67. *Id.* at 2341. The Court received this information from a brief submitted by the SEC as *amicus curiae*.

68. 15 U.S.C. § 78s (1982).

69. 107 S. Ct. at 2341.

summarized the changes that it found significant⁷⁰ and concluded “that where, as in this case, the prescribed procedures are subject to the [SEC’s] § 19 authority, an arbitration agreement does not effect a waiver of the protections of the [Exchange] Act.”⁷¹ Therefore, the Court held that the McMahons’ section 10(b) claim was arbitrable.⁷²

The Court also addressed the issue of the arbitrability of the RICO claim. The majority quickly rejected all of the McMahons’ arguments,⁷³ reasoning that since “nothing in RICO’s text or legislative history otherwise demonstrates congressional intent to make an exception to the Arbitration Act for RICO claims,”⁷⁴ the McMahons’ RICO claim was arbitrable.⁷⁵

Justice Blackmun, joined by Justices Brennan and Marshall, concurred in the Court’s holding that RICO claims were arbitrable.⁷⁶ However, he dissented from the Court’s conclusion that section 10(b) claims were subject to arbitration.⁷⁷ Justice Blackmun found two problems with the Court’s reasoning. First, he argued that the majority erred in stating that the *Wilko* decision was based only on the “perceived inadequacy of arbitration.”⁷⁸ Although Blackmun admitted that the inadequacies of arbitration constituted one ground for the *Wilko* decision, he pointed out that this discussion came after the Court concluded that the “language, legislative history, and purposes of the Securities Act” made it an exception to the Arbitration Act.⁷⁹ Citing a statement made by the Court in *Mitsubishi Motors Corp. v.*

70. The Court noted that

“[n]o proposed rule change may take effect unless the SEC finds that the proposed rule is consistent with the requirements of the Exchange Act, 15 U.S.C. § 78s(b)(2); and the [SEC] has the power, on its own initiative, to ‘abrogate, add to, and delete from’ any [self-regulatory organization] rule if it finds such changes necessary or appropriate to further the objectives of the Act, 15 U.S.C. § 78s(c).”

107 S. Ct. at 2341 (quoting Brief for the Securities and Exchange Commission as Amicus Curiae at 18).

71. 107 S. Ct. at 2341.

72. *Id.* at 2343.

73. The McMahons offered the following arguments to support their contention that RICO claims are not arbitrable: the complexity of such claims; the overlap between RICO’s civil and criminal provisions; and the public interest in the enforcement of RICO. The Court relied heavily on its decision in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), in rejecting these arguments. 107 S. Ct. at 2344-45.

74. 107 S. Ct. at 2346.

75. *Id.*

76. *Id.* at 2346 (Blackmun, J., concurring in part & dissenting in part).

77. *Id.*

78. *Id.* at 2352.

79. *Id.*

Soler Chrysler-Plymouth, Inc.,⁸⁰ Justice Blackmun stated that this "language clearly suggests that, in *Mitsubishi*, we viewed *Wilko* as holding that the text and legislative history of the Securities Act—not general problems with arbitration—established that the Securities Act constituted an exception to the Arbitration Act."⁸¹

Justice Blackmun then noted the Court's acceptance of the present adequacy of arbitration. After pointing out problems he saw with arbitration,⁸² Justice Blackmun questioned the Court's acceptance of the SEC's oversight authority in ensuring adequate arbitration procedures.⁸³ He noted that until it filed an *amicus curiae* brief in *McMahon*, the SEC consistently held the position that section 10(b) claims are not arbitrable.⁸⁴ Even after the 1975 amendments to the Exchange Act, the SEC issued a release explaining its opposition to arbitration agreements.⁸⁵ In addition, Justice Blackmun noted the existence of an SEC rule stating that use of arbitration agreements constitute fraud.⁸⁶

The *McMahon* Court based its decision on the nature of arbitration proceedings today along with the SEC's oversight authority in this area. The problem with the *McMahon* opinion is the Court's misreading of the *Wilko* decision. As Justice Blackmun points out, the Court decided *Wilko* on the language of the Securities Act. Subsequent Supreme Court cases support this proposition.⁸⁷ The colorable

80. 473 U.S. 614 (1985). The Court stated, "we must assume that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that intention will be deducible from text or legislative history." *Id.* at 628.

81. 107 S. Ct. at 2350.

82. Justice Blackmun noted that arbitrators are not required to prepare a record of the proceedings and are not bound by precedent. He also pointed out that judicial review is substantially limited to the four grounds listed in § 10 of the Federal Arbitration Act. *Id.* at 2354-55.

83. *Id.* at 2356.

84. *Id.*

85. *Id.* at 2356-57 n.22.

86. 17 C.F.R. § 240.15c2-2(a), *rescinded* by SEC Exchange Act Release No. 25034 (Oct. 15, 1987), 52 Fed. Reg. 39,216 (1987). The SEC issued this release in response to the *McMahon* decision. Prior to this, section 240.15c2-2(a) provided:

It shall be a fraudulent, manipulative or deceptive act or practice for a broker or dealer to enter into an agreement with any public customer which purports to bind the customer to the arbitration of future disputes between them arising under the Federal securities laws, or to have in effect such an agreement, pursuant to which it effects transactions with or for a customer.

87. In *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974), the Court noted that the *Wilko* Court based its decision on the Securities Act. *Id.* at 512-13. After discussing the *Wilko* reasoning, the *Scherk* Court stated, "[t]hus, *Wilko*'s advance agreement to arbitrate any disputes subsequently arising out of his contract to purchase the securities was unenforceable

argument that first appeared in *Scherk*,⁸⁸ and later, in Justice White's concurrence in *Dean Witter Reynolds Inc. v. Byrd*,⁸⁹ lends support to the proposition that the Court based *Wilko* on the language of the Securities Act. The "colorable argument" is based entirely on the Securities Act and the Exchange Act. There is no mention in this argument of the inadequacies of arbitration. This lends support to the view that *Wilko* was decided on the language of the Securities Act. This is probably one of the reasons the *McMahon* majority did not address the colorable argument.

McMahon sends a clear directive that a predispute arbitration agreement can be enforced when section 10(b) and RICO claims are involved. Although the Court did not expressly overrule *Wilko*, it is clear that the Court does not accept what it perceives to be the reasoning of that opinion. Thus, when and if the issue is ever properly before the Court, the Court will probably hold claims based on section 12(2) of the Securities Act to be arbitrable. It is apparent that investors who sign customer agreements containing arbitration agreements will have to resolve any future claims in an arbitral forum.

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under the terms of § 14 [the nonwaiver provision] of the Securities Act of 1933." *Id.* at 513 (emphasis added).

88. *Id.* at 513-14.

89. 470 U.S. 213, 224 (1985) (White, J., concurring).

