

September 1986

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Recommended Citation

Quarto, Roslyn A. and Boss, George (1986) "Arbitration and the Securities Exchange Act of 1934: The Prospect of Extending Wilko v. Swan," *Journal of Civil Rights and Economic Development*: Vol. 2: Iss. 1, Article 5.

Available at: <http://scholarship.law.stjohns.edu/jcred/vol2/iss1/5>

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ARBITRATION AND THE SECURITIES EXCHANGE ACT OF 1934: THE PROSPECT OF EXTENDING *WILKO v. SWAN*

The United States Arbitration Act¹ renders written provisions for arbitration of future disputes in any maritime transaction or a contract evidencing a transaction involving commerce "valid, irrevocable and enforceable."² Arbitration,³ although historically viewed with hostility,⁴ now enjoys a reputation as a valid and bind-

¹ 9 U.S.C. §§ 1-14 (1982).

² See *id.* at § 2:

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing contract, transaction, or refusal shall be valid, irrevocable and enforceable, save upon grounds that exist at law or in equity for the revocation of any contract.

Id.

³ Arbitration has been defined as:

[A] contractual proceeding whereby the parties to any controversy or dispute, in order to obtain an inexpensive and speedy final disposition of the matter involved, select judges of their own choice and by consent submit their controversy to such judge for determination, in the place of tribunals provided by the ordinary processes of law.

Gates v. Arizona Brewing Co., 4 Ariz. 266, 269, 95 P.2d 49, 50 (1939). See also M. DOMKE, *DOMKE ON COMMERCIAL ARBITRATION*, § 1:01 (rev. ed. 1983 & 1985 Supp.), at 1, defining arbitration as a voluntary process for settlement of disputes by which a third person of the parties choice hands down a final and binding award.

⁴ English Common Law courts were opposed to non-judicial forums, including arbitration, viewing such forums as contravening public policy by ousting courts of jurisdiction. See *Kulukundis Shipping Co., [S/A] v. Amtorg Trading Corp.*, 126 F.2d 978, 983-85 (2d Cir. 1942). See also L. FULLER & M. EISENBERG, *BASIC CONTRACT LAW* 432-33 (4th ed. 1981); 5 R. POUND, *JURISPRUDENCE* 356-60 (1959); Sayre, *Development of Commercial Arbitration Law*, 37 *YALE L.J.* 595, 610 (1928) (hostility originated "in context of the courts of ancient times for extension of jurisdiction"). This common law hostility can be traced back to the 15th Century. See *Y.B. Mich.* 8 Edw. 4, f. 9b,10a, pl. 9 (1468); *Y.B. Trin.* 5 Edw. 4, f. 3b, pl. 2 (1465); *Y.B. Pasch.* 28 Hen. 6, f. 6, pl. 4 (1449).

The early American courts also evinced a hostility towards arbitration. See *Red Cross Line v. Atlantic Fruit Co.*, 264 U.S. 109, 120-21 (1924) ("The Federal courts - like those of the states and of England - have, both in equity and at law, denied, in large measure, the aid of their processes to those seeking to enforce executory agreements to arbitrate disputes.")

For further discussion of the historical context of arbitration, see Emerson, *History of*

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ing alternative to formal court litigation.⁵

Although there are a few basic similarities between arbitration and formal court proceedings, arbitration differs in at least three significant aspects. First, arbitrators do not have to apply substantive or procedural rules of law.⁶ Second, arbitrators are not required to issue written opinions stating reasons for their awards.⁷ Third, decisions by arbitrators on the merits are not reviewable by the courts.⁸

It is generally agreed that the purposes of arbitration are to reduce cost,⁹ ease court congestion¹⁰ and expedite settlements of

Arbitration Practice and Law, 19 CLEV. ST. L. REV. 155 (1970); Wolaver, *The Historical Background of Commercial Arbitration*, 83 U. PA. L. REV. 132 (1934); Note, *Arbitrability of Disputes Under the Federal Arbitration Act*, 71 IOWA L. REV. 1137, 1139 (1986) (citing F. KELLOR, *AMERICAN ARBITRATION: ITS HISTORY, FUNCTIONS AND ACHIEVEMENTS* (1948)).

⁵ See generally *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984) ("Congress declared a national policy favoring arbitration by enacting the Arbitration Act"); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983) (enactment of Arbitration Act evidence of congressional declaration of federal policy favoring arbitration); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967) (in enacting Arbitration Act Congress' purpose was to make arbitration agreements as enforceable as other agreements); *Wilko v. Swan*, 346 U.S. 427, 431 (1953) (Act establishes desirability of arbitration as alternative to complications of litigation). See also M. DOMKE, *THE LAW AND PRACTICE OF COMMERCIAL ARBITRATION* 1-3 (1968); Burger, *Isn't There A Better Way*, 68 A.B.A. J. 274 (1982).

⁶ *Joseph P. Cuddigan, Inc. v. Dimes Constr. Co.*, 106 R.I. 583, 586, 261 A.2d 850, 852 (1970) (award will be upheld regardless of mistake of law by arbitrator); *Dane v. Aetna Cas. & Sur. Co.*, 369 Mass. 966, 967, 341 N.E.2d 254, 254 (1976) (in absence of fraud, arbitrator's award will not be vacated because of error of law).

⁷ See *Atkinson v. Sinclair Refining Co.*, 370 U.S. 238, 244, n.4 (1962) ("arbitrators have no obligation to give reasons for their award"); *United States Steelworkers of Am. v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 598 (1960) (record of proceeding need not be as complete as in trial court); *Wilko v. Swan*, 346 U.S. 427, 436 (1953) ("award may be made without explanation and without a complete record of [the] proceeding . . .").

⁸ See *University of Alaska v. Modern Constr. Inc.*, 522 P.2d 1132, 1139 (Alaska 1974) (award is presumed valid and will be upheld without court looking into merits of case); *Joseph P. Cuddigan Inc. v. Dimes Constr. Co.*, 106 R.I. 583, 586, 261 A.2d 850, 852 (1970) (ambiguities within an opinion is not reason in itself for court to invalidate award).

⁹ See *Wilko v. Swan*, 346 U.S. at 431-32 ("reports of Congress indicate the need for avoiding the expense of litigation"); *Conticommodity Services Inc. v. Philipp & Lion*, 613 F.2d 1222, 1224 (2d Cir. 1980) (Congress intended to provide relatively inexpensive alternative to trial). See also H.R. REP. NO. 96, 68th Cong., 1st Sess., at 2 (1923), stating that: [i]t 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.

But see Kronstein, *Business Arbitration-Instrument of Private Government*, 54 YALE L.J. 36, 39 n.10 (1944) (questioning the assumption that arbitration is less expensive than judicial settlement); Kritzer & Anderson, *The Arbitration Alternative: A Comparative Analysis of Case*

disputes.¹¹ One problem concerning the validity of arbitration arises in a context when there are countervailing public policy considerations inherent in another statute¹² — specifically, the Securities Exchange Act of 1934.¹³

The Act of 1934 was not meant to change or alter the basic purposes behind its predecessor, the Securities Act of 1933.¹⁴ More specifically, Congress intended to “eliminate deceptive and unfair practices in security trading to protect the public from inaccurate, incomplete and misleading information,” thus giving the investing public the opportunity “to make knowing and intelligent decisions regarding the purchase and sale of securities.”¹⁵

The actual conflict between the Federal Arbitration Act and the Securities Exchange Act of 1934 surfaces upon the reading of the non-waiver provision of the Securities Exchange Act, which provides “[a]ny condition, stipulation or provision binding any person to waive compliance with any provision of this chapter . . .

Processing Time, Disposition Mode, and Cost in the American Arbitration Association and the Courts, 8 JUST. SYS. J. 6 (1983) (arbitration is not always less expensive than litigation because arbitration is more likely than litigation to proceed to adjudicated conclusion).

¹⁰ See *Galt v. Libbey-Owens-Ford Glass Co.*, 376 F.2d 711, 714 (7th Cir. 1967) (policy underlying enactment of Arbitration Act is easing of court congestion). See also, *Burger*, *supra* note 5, at 277 (“[it] is now clear that neither the federal nor the state court systems are capable of handling all the burdens placed upon them”).

¹¹ See *Wilko v. Swan*, 346 U.S. at 431-32 (need for avoiding the delay associated with litigation); *Radiator Specialty Co. v. Cannon Mills Inc.*, 97 F.2d 318, 319 (4th Cir. 1938) (“arbitration laws are passed to expedite and facilitate settlement of disputes. . . .”); *Cargo Carriers Inc. v. Erie & St. Lawrence Corp.*, 105 F. Supp. 638, 639 (W.D.N.Y. 1952).

¹² See generally Note, *Arbitration Agreements and Antitrust Claims: The Need For Enhanced Accommodation of Conflicting Public Policies*, 64 N.C.L. REV. 219 (1986) (discussing conflicting purposes of arbitration as they relate to antitrust laws’ reliance on private enforcement as essential means to secure competitive markets).

¹³ Securities Exchange Act of 1934 (codified as amended in 15 U.S.C. §§ 78a-78kk (1982)).

¹⁴ See H.R. REP. NO. 94, 94th Cong., 1st Sess., at 91 (1975), *reprinted in* 1975 U.S. CODE CONG. & ADMIN. NEWS, Legislative History 97, 97, stating:

The basic goals of the Exchange Act remains salutatory and unchallenged: To provide fair and honest mechanisms for pricing of securities, to assure that dealing in securities is fair and without undue preferences or advantages among investors, to ensure that securities can be purchased and sold at economically efficient transaction costs, and to provide to the maximum degree practicable, markets that are open and orderly. . . .

Id.

¹⁵ *Ayres v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 538 F.2d 532, 539 (3d Cir. 1976) (Stern, J., dissenting) (citing *Kahan v. Rosenstiel*, 424 F.2d 161, 173 (3d Cir. 1970)), *cert. denied*, 429 U.S. 1010 (1976).

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shall be void."¹⁶

This article will trace the applicable case law beginning with the watershed case of *Wilko v. Swan*,¹⁷ invalidating an arbitration agreement under the Securities Act of 1933, to *McMahon v. Shearson/American Express, Inc.*,¹⁸ now pending before the United States Supreme Court. In addition, this article will suggest that the Supreme Court, in the *McMahon* case¹⁹ should extend their decision in *Wilko*²⁰ to cases arising under the 1934 Act and hold that fraud violations arising under the Act of 1934 are non-arbitrable.

I. DEVELOPMENT OF APPLICABLE CASE LAW

A. *Wilko v. Swan*

In *Wilko v. Swan*,²¹ the plaintiff, a purchaser of securities,²² entered a margin agreement with the defendant (broker).²³ By this agreement, the parties were to submit all future disputes arising under the contract to arbitration.²⁴ Alleging that the broker had induced him to purchase the securities by false representation,²⁵

¹⁶ Securities Exchange Act of 1934, ch. 404, § 29(a) (1934) (codified as amended in 15 U.S.C. § 78cc(a) (1982)).

¹⁷ 346 U.S. 427 (1953).

¹⁸ 788 F.2d 94 (2d Cir.), cert. granted, 107 S. Ct. 60 (1986).

¹⁹ *Id.*

²⁰ 346 U.S. 427, 438 (1953).

²¹ 346 U.S. 427.

²² *Wilko v. Swan*, 346 U.S. 427, 428-29 (1953). On January 17, 1951, Anthony Wilko purchased from Hayden, Stone & Co., 1600 shares of Air Associates, Inc. for the sum of \$29,517.54. *Id.* at 429. See also *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 522 (Douglas, J., dissenting, joined by Brennan, White & Marshall, JJ.) (citing the Securities Exchange Act of 1934, § 3(a)(10)), (defining a security as including any "note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit sharing agreement . . ." 15 U.S.C. § 77(b)(1) (1982)).

²³ *Wilko*, 346 U.S. at 429. The margin agreement, or the contract for the purchase and sale of securities, provided in part that the parties' relationship was controlled by the terms of the agreements. *Id.*

²⁴ *Id.* at 432 n.15. "Any controversy arising between us under this contract shall be determined by arbitration." *Id.*

²⁵ *Wilko*, 107 F. Supp at 75 (S.D.N.Y. 1952). The plaintiff alleged that the defendants falsely represented to him that Air Associates Inc. had merged with Borg Warner Corp., that as a result the stock value would increase and as evidence of this lending institutions and large financial interests were purchasing the stocks. *Id.* Additionally, the plaintiff charged that defendant Haven B. Page, owner of a block of stock of the Air Associates Inc., was at that time selling his stock "including some or all of the stock sold to the plaintiff." *Id.*

Wilko filed suit in federal court to recover damages²⁶ for a violation of section 12(2) of the Securities Act of 1933.²⁷

Pursuant to section 3 of the Federal Arbitration Act,²⁸ the broker moved to stay the action pending arbitration,²⁹ but the district court denied the motion.³⁰ The court of appeals held the Securities Act did not preclude arbitration and reversed the lower court,³¹ and the Supreme Court granted certiorari³² to review the question of "whether an agreement to arbitrate a future controversy is a 'condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision' of

²⁶ *Id.* at 75. The plaintiff sought to recover \$3,888.88 in damages. *Id.* at 76.

²⁷ *Wilko*, 107 F. Supp. at 77. Section 12(2) of the Securities Act of 1933, 15 U.S.C. Section 77l provides in part that "[a]ny person who . . . sells a security . . . by means of a prospectus or oral communication, which includes an untrue statement of a material fact . . . shall be liable to the person purchasing such security from him . . ." Securities Act of 1933, ch. 38, § 12(2), 48 Stat. 74, 84 (codified as amended in 15 U.S.C. 77l (1982)).

²⁸ 9 U.S.C. § 3 (1982) states in pertinent part:

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.

Id.

See *Portland Constr. Co. v. Weiss Pollution Control Corp.*, 532 F.2d 1009, 1013 (5th Cir. 1976) (expedite arbitration and ease court congestion); *New Process Steel Corp. v. Titan Indus. Corp.*, 555 F. Supp. 1018 (S.D. Tex. 1983). The purpose of section 3 is to permit selection of an alternative to expensive litigation and to proceed in the alternative without court imposed delays. *Id.* See also *Parcel Tankers, Inc. v. Formosa Plastics Corp.*, 569 F. Supp. 1459 (D.C. Tex. 1983) (alternative to costly litigation without delay imposed on courts).

²⁹ *Wilko*, 346 U.S. at 429. Defendant moved to stay this action and all other actions until arbitration in accordance with the terms of the margin agreement could be had. *Id.*

³⁰ *Id.* at 430. In denying the defendant's motion to stay the action, the district court stated that congressional intent required the provisions of the Securities Act to be strictly complied with in order to protect the investor, and therefore the controversy was not "referable to arbitration." *Wilko v. Swan*, 107 F. Supp. 75, 77 (S.D.N.Y. 1952) (quoting Federal Arbitration Statute § 3, 9 U.S.C. § 3 (1982)).

³¹ *Wilko*, 346 U.S. at 430. The Court of Appeals for the Second Circuit stated that "[t]he purpose of that Act was deliberately to alter the judicial atmosphere previously existing," and "[i]n the light of the clear intention of Congress, it is our obligation to shake off the old judicial hostility to arbitration." *Wilko v. Swan*, 201 F.2d 439, 445 (2d Cir. 1953) (quoting *Kulukundis Shipping Co. v. Amtorg Trading Corp.*, 126 F.2d 978, 985 (2d Cir. 1942)). The Second Circuit could not find congressional intention to proscribe arbitration of a dispute arising under section 12(2) of the Securities Act of 1933. *Wilko*, 201 F.2d at 445.

³² *Wilko v. Swan*, 345 U.S. 969 (1953).

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the Securities Act which Section 14 declares 'void'.³³

Justice Reed, delivering the opinion of the Court, stated that because the margin agreement "evidenced a transaction in interstate commerce,"³⁴ and one of the policies of the Arbitration Act is the desire to avoid the delay and expense of litigation,³⁵ the Arbitration Act applied.³⁶ However, the Court also realized the countervailing provision of the Securities Act of 1933, § 12(2)³⁷, which granted a "special right" to the investor to recover for misrepresentation.³⁸ This "special right" to recover was enforceable in any federal or state court of competent jurisdiction.³⁹ The Court stated that this "special right" was granted to safeguard the securities purchaser from the "disadvantages under which buyers labor."⁴⁰ Applying the Securities Act of 1933, the Court held the

³³ *Id.* at 430. Securities Exchange Act of 1933, ch. 38 § 14, 48 Stat. 84 (codified as amended in 15 U.S.C. § 77n (1982)) 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." *Id.*

³⁴ 346 U.S. at 430.

³⁵ *See Wilko*, 346 U.S. at 431-32 (need for avoiding delay associated with litigation); *Commodity Services, Inc. v. Philipp & Lion*, 613 F.2d 1222, 1224 (2d Cir. 1980) (Congress intended to provide inexpensive alternative to trial); *Radiator Specialty Co. v. Cannon Mills, Inc.*, 97 F.2d 318, 319 (4th Cir. 1938) (arbitration laws are passed to expedite and facilitate settlement of disputes). *See also* H.R. REP. No. 96, 68th Cong., 1st Sess., at 2 (1923) (arbitration can eliminate the costliness and delays of litigation).

³⁶ *Wilko*, 346 U.S. at 430.

³⁷ Securities Act of 1933, ch. 38, § 12, 48 Stat. 84 (1933) (codified as amended in 15 U.S.C. § 77l(2) (1982)). Section 77l(2) provides:

Any person who -

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 truth or omission, shall be liable to the person purchasing such security from him, who may sue either in law or in equity . . .

Id.

³⁸ *Wilko*, 346 U.S. at 430-31. The Securities Act demands that issuers and dealers make full and fair disclosure of the character of the securities to the investor. *Id.* at 431. Section 12(2) places the burden of proof of lack of scienter on the seller. *Id.*; H.R. REP. No. 85, 73rd Cong., 1st Sess. at 9-10 (1933).

³⁹ *Wilko*, 346 U.S. at 431; *see Wilko*, 107 F. Supp. at 77 (S.D.N.Y. 1952) (quoting Securities Exchange Act of 1933, ch. 38, § 12, 48 Stat. 84 (1933) (codified as amended in 15 U.S.C. § 77l(2) (1982))).

⁴⁰ *Wilko*, 346 U.S. at 435; *see Otis & Co. v. SEC*, 106 F.2d 579 (6th Cir. 1939) noting that

agreement to arbitrate was a "stipulation" waiving compliance with a "provision" of the Act,⁴¹ namely, the right to select a judicial forum.⁴² The majority stated that although the policies of the Securities and Arbitration Acts were not easily reconcilable, congressional intention was best served by invalidation of the agreement to arbitrate future claims arising under the Act.⁴³

It is submitted that the decision in *Wilko v. Swan* should be extended to the Securities Exchange Act of 1934 to hold that fraud violations are non-arbitrable.

B. *Treatment of Wilko v. Swan*

In what first appeared to preclude an extension of the holding in *Wilko*⁴⁴ to the Securities Exchange Act of 1934, the Supreme Court in *Scherk v. Alberto-Culver Co.*,⁴⁵ held claims pursuant to Section 10(b) of the Securities Exchange Act of 1934,⁴⁶ arising under an international agreement, arbitrable.⁴⁷ In *Scherk*,⁴⁸ an American firm purchased a German citizen's related businesses and trade-

"[t]his statute should be so construed as to achieve the purpose of its enactment if its language is susceptible of such a construction. The obvious purpose of the Congress in its enactment was protection of the investing public." *Id.* See also *Oklahoma Texas Trust v. SEC*, 100 F.2d 888, 891 (10th Cir. 1939) (purpose of Act is to protect investor from fraud in sale of securities).

⁴¹ *Wilko*, 346 U.S. at 434-35.

⁴² *Id.* See Note, *Enforceability of Arbitration Agreements in Fraud Actions Under the Securities Act*, 62 YALE L.J. 985, 987 (1953); *Securities Acts — Federal Securities Act — Arbitration Clause in Brokerage Agreement Precludes Purchaser's Statutory Suit for Misrepresentation*, 66 HARV. L. REV. 1326, 1327 (1953). Cf. *Boyd v. Grand Trunk W. R. Co.*, 338 U.S. 263 (1949) (holding that an agreement limiting choice of venue void as in direct conflict with Employer's Liability Act).

⁴³ *Wilko*, 346 U.S. at 438; see *Wilko v. Swan*, 107 F. Supp. 75, 77 (S.D.N.Y. 1952) (intent of Congress that Securities Act provisions should be strictly complied with); *Otis & Co. v. SEC*, 106 F.2d 579, 583 (6th Cir. 1939) (Congress' intention was to protect public and statute should be construed to achieve this purpose); see also S. REP. NO. 47, 73rd Cong., 1st Sess. 2 (1933); H.R. REP. NO. 85, 73rd Cong. 1st Sess., 9-10 (1933).

⁴⁴ *Wilko v. Swan*, 346 U.S. 427 (1953).

⁴⁵ *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

⁴⁶ Securities Exchange Act of 1934, ch. 404, § 10(b), 48 Stat. 891 (1934) (codified as amended in 15 U.S.C. § 78j(b) (1982)).

⁴⁷ *Scherk*, 417 U.S. at 519-20; see *Bernhardt v. Polygraphic Co. of Am. Inc.*, 350 U.S. 198 (1956). The United States Arbitration Act, 9 U.S.C. §§ 1-3, pursuant to § 2, makes "valid, irrevocable and enforceable" contracts relating to a maritime transaction and those involving commerce. *Bernhardt*, 350 U.S. at 200; see also *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 12-13 (1972) (international contract clause stipulating forum in which to litigate should be given "full effect" when both parties voluntarily entered into agreement).

⁴⁸ *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

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mark rights.⁴⁹ The purchase agreement called for arbitration of disputes arising out of the transaction.⁵⁰ In a subsequent dispute, Alberto-Culver Co. filed suit in federal court alleging violations of section 10(b).⁵¹ Relying on *Wilko*,⁵² the district court denied Scherk's motion to stay the action pending arbitration, and granted plaintiff's motion to enjoin the defendant from proceeding with arbitration.⁵³ Reversing the court of appeals affirmation, the Supreme Court held that "the provisions of the Arbitration Act cannot be ignored in this case."⁵⁴ In distinguishing this case from *Wilko*,⁵⁵ the Court focused on the "truly international" nature of the agreement in *Scherk*,⁵⁶ as compared to the strictly domestic agreement in *Wilko*.⁵⁷ The Court stated that when an

⁴⁹ *Scherk*, 417 U.S. at 508. The plaintiff, Alberto-Culver Co., incorporated in Delaware, manufactured and distributed toiletries; the defendant, Scherk, a German citizen, was the owner of three interrelated businesses which manufactured toiletries and licensed trademarks for these products. *Id.* Scherk's businesses were organized under the laws of Germany and Liechtenstein. *Id.* In 1969 an agreement was signed providing for the transfer of ownership of Scherk's business together with all rights to trademarks in cosmetics. Scherk warranted that the trademarks were solely owned by him and unencumbered. *Id.*

⁵⁰ *Id.*

⁵¹ *Scherk*, 417 U.S. at 509. Approximately one year after closing the transaction in 1969, Alberto-Culver Co. discovered substantial encumbrances on the trademark rights it had purchased from Scherk. *Id.* After Scherk refused to rescind the contract, Alberto-Culver Co. instituted an action in Federal District Court. *Id.* The plaintiff alleged that Scherk made fraudulent misrepresentations in the sale of the trademark rights and that this was a violation of § 10(b) of the Securities Exchange Act of 1934. *Id.*

⁵² *Wilko v. Swan*, 346 U.S. 427 (1953).

⁵³ *Scherk*, 417 U.S. at 510.

⁵⁴ *Scherk*, 417 U.S. at 513. The Court stated that a "colorable argument" could be made that the reasoning of *Wilko* did not hold in *Scherk*, noting that the 1933 Act established an express private remedy for civil liability while the remedy of the 1934 Act is implied. *Id.* Additionally, the 1934 Act narrows selection of venue and provides for an action only in federal district court. *Id.* at 513-14.

⁵⁵ *Wilko v. Swan*, 346 U.S. 427 (1953).

⁵⁶ *Scherk*, 417 U.S. at 515.

⁵⁷ *Id.* at 515-16. "A parochial refusal by the courts of one country to enforce an international arbitration agreement would not only frustrate these purposes, but would invite unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages." *Id.* at 516-17. See also Quigley, *Accession By the United States to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 70 YALE L.J. 1049, 1059-60 (1961) (the United Nations Economic and Social Council adopted Convention on Recognition and Enforcement of Foreign Arbitral Awards in 1958). In 1970 the United States acceded to the treaty. Convention on Recognition and Enforcement of Foreign Arbitral Awards in 1958, 1970, 3 U.S.T. 2517, T.I.A.S. No. 6997. Subsequently, Congress passed Chapter 2 of the United States Arbitration Act, 9 U.S.C. § 201 *et seq.*, to implement the provision of the Convention. Chapter 1 of 7 U.S.C. § 201 provides that the Convention "shall be enforced in United States courts in accordance with this chapter." See *Scherk*, 417 U.S. at 520 n.15. The purpose of the Convention and primary purpose of the United States

agreement involves international transactions, selecting "in advance the forum in which disputes shall be litigated and the law to be applied is . . . an almost indispensable precondition to achievement of the orderliness and predictability essential to any international business transaction."⁶⁸ Therefore, because of a need to promote international trade and foster a willingness on the part of businessmen to enter international agreements, the Court distinguished this case on its facts from *Wilko*,⁶⁹ and held that the dispute be settled by arbitration.⁶⁰

It became apparent that *Wilko*⁶¹ still had life in regard to the 1934 Act⁶² in *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,⁶³ when the Court of Appeals for the Third Circuit, applying the *Wilko* rule,⁶⁴ held the buyer-employee's claims arising under the 1934 Act⁶⁵ non-arbitrable.⁶⁶ The court rejected defendant's con-

adopting it was to "encourage the recognition and enforcement of commercial arbitration agreements in international contracts and to unify the standards by which agreements to arbitrate are observed and arbitral awards are enforced in the signatory countries." *Id. Cf. Wilko v. Swan*, 346 U.S. 427 (1953). The dispute in *Wilko* arose under a purely domestic transaction, and no international conflict of laws problem could have arisen. *Scherk*, 417 U.S. at 515-16.

⁶⁸ *Scherk*, 417 U.S. at 516. "The elimination of all such uncertainties by agreeing in advance on a forum acceptable to both parties is an indispensable element in international trade, commerce, and contracting." *Id.* at 518 (quoting *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 13-14 (1972)).

⁶⁹ *Wilko v. Swan*, 346 U.S. 427 (1953).

⁶⁰ *Scherk*, 417 U.S. at 519-20.

⁶¹ *Wilko v. Swan*, 346 U.S. 427 (1953).

⁶² 15 U.S.C. § 78a *et seq.*

⁶³ *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976). The plaintiff (Ayres) was an employee of the defendant. *Id.* at 533. He had a stock option agreement with Merrill Lynch which provided a cash out upon retirement. *Id.* The defendant did not disclose to Ayres its intention of going public with its stock. *Id.* at 533-34. Ayres decided to retire and cash out his stock with defendant, a total value of \$209,064. *Id.* at 534. Subsequently, defendant corporation went public, and plaintiff sought rescission of the sale or damages based on a § 10(b) violation – non-disclosure of a material fact. *Id.* The plaintiff alleged that had this information been disclosed to him, he would not have retired and cashed out, and would have realized a gain from the corporation going public. *Id.*

⁶⁴ *Ayres*, 538 F.2d at 536. "The Supreme Court held that the anti-waiver provision of the Securities Act of 1933, 15 U.S.C. Section 77n, . . . rendered void a prospective agreement between a brokerage firm and a customer which would have required arbitration of the customer's claim under Section 72(2) of the 1933 Act." *Id.*

⁶⁵ Securities Exchange Act of 1934, ch. 404 § 29(a), 48 Stat. 881, 903 (1934) (codified as amended in 15 U.S.C. § 78(c)(a) (1982)).

⁶⁶ *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976). The *Ayres* court rejected the dictum in *Scherk* that mentioned a "colorable argument can be made" that *Wilko* would not be applicable to the 1934 Act.

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tention that *Scherk*⁶⁷ restricted application of *Wilko*⁶⁸ to the 1933 Act.⁶⁹ Indeed, the *Ayres* court noted that Congress appears to have accepted the view that the buyer's "special right," outlined in *Wilko*,⁷⁰ also applies to the 1934 Act "in the 10(b) context."⁷¹ The court also refused to distinguish *Ayres*⁷² because of "differences between the rights granted in the 1933 and 1934 Acts or any consideration of policy."⁷³

In its first opportunity after *Ayres*⁷⁴ to extend the *Wilko*⁷⁵ holding to the 1934 Act, the Supreme Court did not reach the specific issue; rather it held, in *Dean Witter Reynolds, Inc. v. Byrd*,⁷⁶ that pendent state claims are arbitrable.⁷⁷ However, the Court, in discussing *Wilko*,⁷⁸ did conclude that the case still "retained considerable vitality."⁷⁹

In 1985 the Court dealt with an analogous issue of enforceabil-

Ayres, 538 F.2d at 536 (citing *Scherk*, 417 U.S. at 513-14). A Section 10(b) cause of action under the 1934 Act is judicially implied whereas a Section 12(2) cause of action under the 1933 Act is express. *Ayres*, 538 F.2d at 536 n.12.

⁶⁷ *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

⁶⁸ *Wilko v. Swan*, 346 U.S. 427 (1953).

⁶⁹ *Ayres*, 538 F.2d at 536.

⁷⁰ *Wilko v. Swan*, 346 U.S. 427.

⁷¹ *Ayres*, 538 F.2d at 536. See H.R. CONF. REP. NO. 229, 94th Cong., 1st Sess. 111, reprinted in 1975 U.S. CODE & ADMIN. NEWS 331, 342. When amending section 28 of the 1934 Act, which deals with arbitration proceedings between self-regulatory organizations and their members, Congress recognized that this amendment did not, and should not, "change existing law, as articulated in *Wilko v. Swan*, 346 U.S. 427 (1953), concerning the effect of arbitration proceeding provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations." *Id.* In effect, the arbitration agreements are binding on the member firms, but not on the individual investors.

⁷² *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532 (3d Cir.), cert. denied, 429 U.S. 1010 (1976).

⁷³ *Ayres*, 538 F.2d at 536.

⁷⁴ *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532 (3d Cir. 1976).

⁷⁵ *Wilko v. Swan*, 346 U.S. 427 (1953).

⁷⁶ 470 U.S. 213 (1985). Byrd invested \$160,000 in securities through Dean Witter Reynolds, Inc. In a one year period the account declined more than \$100,000. In his suit, Byrd alleged that Dean Witter traded in his account without consent, churned the account, and made misrepresentations to him about the status of his account. *Id.* at 214. Since the securities broker only sought to compel arbitration of the pendent state claims, and not the federal claims, the Court declined to reach the issue of whether or not Section 10(b) claims are arbitrable under the 1934 Act. *Id.* at 216, n.1.

⁷⁷ *Id.* at 217. The Court stated that the "[a]rbitration Act requires district courts to compel arbitration of pendent arbitrable claims when one of the parties files a motion to compel. . . ." *Id.*

⁷⁸ *Wilko*, 346 U.S. at 427.

⁷⁹ *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 216 n.1 (1985).

ity of arbitration agreements relating to disputes arising under the Sherman Anti-Trust Act.⁸⁰ In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,⁸¹ the Court held that the arbitration clause in the agreement between the parties included claims arising under the Sherman Anti-Trust Act.⁸² These claims were held to be arbitrable despite the court of appeals uniform characterization of the claims as "inappropriate for enforcement by arbitration."⁸³ Due to the international transaction involved in *Mitsubishi*,⁸⁴ the Court relied on *Scherk*⁸⁵ in reaching its decision to arbitrate the anti-trust claim.⁸⁶ Although the Court upheld the provisions and policies of the Arbitration Act,⁸⁷ it stated that "it is the Congressional intention expressed in some other statute on which the courts must rely to identify any category of claims as to which agreements to arbitrate will be held unenforceable."⁸⁸ The Court, citing *Wilko*,⁸⁹ also noted that if Congress intended the pro-

⁸⁰ 15 U.S.C. § 15a *et seq.* (1986).

⁸¹ *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 473 U.S. 614, 105 S. Ct. 3346 (1985). Soler Chrysler-Plymouth, a Puerto Rican corporation, entered into a sales agreement with Mitsubishi as a distributor of the firm's automobiles. The sales agreement provided for arbitration by the Japan Commercial Arbitration Association of disputes arising under the agreement. The Court did not address the validity of the American Safety doctrine as applied to domestic transactions, but instead focused on the international nature of the transaction, concluding that as in *Scherk*, the "need for predictability in the resolution of disputes" arising under an international transaction required enforcement, even if under a domestic transaction the Court would hold arbitration clauses unenforceable. 105 S. Ct. at 3355.

⁸² *Mitsubishi*, 105 S. Ct. at 3353-54. The Arbitration Act does require that claims arising under statutes be expressly included with the arbitration clause of the agreement. 105 S. Ct. at 3353.

⁸³ *American Safety Equipment Corp. v. J. P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968) (specific anti-trust claims held inappropriate for arbitration).

⁸⁴ *Mitsubishi*, 105 S. Ct. at 3349. Mitsubishi, a manufacturer of automobiles, is incorporated in Tokyo, Japan. Soler is a Puerto Rican Corporation. Soler agreed, as a distributor, to sell Mitsubishi automobiles in a designated area of Puerto Rico. *Id.*

⁸⁵ *Scherk v. Alberto Culver Co.*, 417 U.S. 506 (1974).

⁸⁶ *Mitsubishi*, 105 S. Ct. at 3355-56. See *Scherk v. Alberto-Culver Co.*, 417 U.S. at 515-20. See also *The Bremen v. Zapato Off-Shore Co.*, 407 U.S. 1, 13 (1972) (parochial view of international trade will discourage commerce with American companies).

⁸⁷ *Mitsubishi*, 105 S. Ct. at 3361. See also *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984) (Arbitration Act evinces national policy favoring arbitration); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983) (enactment of Arbitration Act evidence of a congressional declaration of federal policy favoring arbitration); *Wilko v. Swan*, 346 U.S. 427, 431 (1953) (Act establishes desirability of arbitration as a viable alternative to litigation).

⁸⁸ *Mitsubishi*, 105 S. Ct. at 3355.

⁸⁹ *Wilko v. Swan*, 346 U.S. 427.

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tection afforded by a statute to include non-waiver of a judicial forum, it would be either express, or deducible from the text or the legislative history,⁹⁰ as it is with the Securities Act of 1934.⁹¹

Although upholding the arbitrability of the claims, the Court indicated that when congressional intention expresses that a claim be litigated only in a judicial forum, the arbitration agreement should not be enforced.⁹²

Acting on this suggestion by the Supreme Court, the Court of Appeals for the Second Circuit, in *McMahon v. Shearson/American Express, Inc.*,⁹³ applied the *Wilko*⁹⁴ holding to the 1934 Act, thereby reaffirming the Second Circuit's continued belief in its validity.⁹⁵

C. *McMahon v. Shearson/American Express, Inc.*

In *McMahon*,⁹⁶ the appellants alleged that Shearson had violated Section 10(b) of the 1934 Act by "churning [their] accounts, making false statements and omitting material facts" when advising them.⁹⁷ In addition, appellants also alleged a RICO claim and state law claims for fraud and breach of fiduciary duties.⁹⁸ The Court distinguished *McMahon*⁹⁹ from *Byrd*¹⁰⁰ on the facts, since Shearson, unlike Dean Witter in *Byrd*,¹⁰¹ sought to compel arbitration of the federal claims under the Securities Exchange Act of 1934.¹⁰²

Noting the similarities between the language of the non-waiver

⁹⁰ *Mitsubishi*, 105 S. Ct. at 3355. See *Wilko v. Swan*, 346 U.S. at 430, 435.

⁹¹ *Mitsubishi*, 105 S. Ct. at 3355.

⁹² 788 F.2d 94 (2d Cir.), cert. granted, 107 S. Ct. 60 (1986).

⁹³ *Wilko v. Swan*, 346 U.S. 427 (1953).

⁹⁴ *McMahon*, 788 F.2d at 96-97 (2d Cir. 1986); see *AFP Imaging Corp. v. Rosa*, 780 F.2d 202, 205 (2d Cir. 1985); *Allegaert v. Perot*, 548 F.2d 432, 436-37 (2d Cir.), cert. denied, 432 U.S. 910 (1977); *Greater Continental Corp. v. Schechter*, 422 F.2d 1100, 1103 (2d Cir. 1970); *Colonial Realty Corp. v. Bache & Co.*, 358 F.2d 178, 183 (2d Cir.), cert. denied, 385 U.S. 817 (1966).

⁹⁵ *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir.), cert. granted, 107 S. Ct. 60 (1986).

⁹⁶ 107 S. Ct. at 96.

⁹⁷ *Id.*

⁹⁸ *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. 1986).

⁹⁹ *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985).

¹⁰⁰ *Id.*

¹⁰¹ *McMahon*, 788 F.2d at 96-98.

¹⁰² *Id.* at 98.

provisions of both the 1933 and 1934 Acts, the public policy concerns as indicated by the legislative history of the Acts, and the clear judicial precedent, the court held that "the orderly administration of justice will best be served"¹⁰³ if Section 10(b) claims are held non-arbitrable under the 1934 Act.¹⁰⁴

II. THE EXTENSION OF THE *Wilko* RULE

In granting certiorari in *McMahon*,¹⁰⁵ the Supreme Court has acknowledged the disparity in the lower federal court holdings in regard to the arbitrability of fraud violations of the Securities Exchange Act of 1934.¹⁰⁶ It is submitted that the decision in *Wilko v. Swan*,¹⁰⁷ holding fraud violations of the Securities Act of 1933 non-arbitrable, should be extended to the 1934 Act because of the strong federal policy in favor of determining such claims in federal court as demonstrated by the non-waiver provisions of the 1934 Act and by congressional intent.

In examining the statutes, the logical provisions with which to begin the query are the non-waiver provisions.¹⁰⁸ One distinction between the two acts that could affect the outcome of the decision is the right to a private cause of action found explicitly in Section

¹⁰³ *Id.*

¹⁰⁴ 788 F.2d 94 (2d Cir.), *cert. granted*, 107 S. Ct. 60 (1986).

¹⁰⁵ *Compare* DeLancie v. Birr, Wilson & Co., 648 F.2d 1255 (9th Cir. 1981) (decided in favor of judicial proceeding to settle dispute); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017 (6th Cir. 1979) (same); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore*, 590 F.2d 823 (10th Cir. 1978) (same); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* 558 F.2d 831 (7th Cir. 1977) (same); *and Colonial Realty v. Bache & Co.*, 358 F.2d 178 (2d Cir.) (same), *cert. denied*, 385 U.S. 817 (1966) *with* *Jarvis v. Dean Witter Reynolds, Inc.*, 614 F. Supp. 1146 (D. Vt. 1985) (decided in favor of arbitration); *Finkle & Ross v. A.G. Becker Paribas Inc.*, 622 F. Supp. 1505 (S.D.N.Y. 1985) (same); *Intre Sport Ltd. v. Kidder, Peabody & Co., Inc.*, 625 F. Supp. 1303 (S.D.N.Y. 1985) (same); *Hanes Corp. v. Millard*, 531 F.2d 585 (D.C. Cir. 1976) (same); *Kulukundis Shipping Co. v. Amtorg Trading Corp.*, 126 F.2d 978 (2d Cir. 1942) (same).

¹⁰⁶ 346 U.S. 427 (1953).

¹⁰⁷ *See* Securities Exchange Act of 1933, ch. 38, § 14, 48 (1933) Stat. 74, 84 (codified as amended in 15 U.S.C. § 77n (1982)) which provides that "[a]ny condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this sub-chapter or of the rules and regulations of the Commission shall be void." *Id.* *See also* *Colonial Realty v. Bache & Co.*, 358 F.2d 178, 183 n.5 (2d Cir.) ("the non-waiver provision of the 1933 Act has an almost identical counterpart in Section 29(a) of the 1934 Act"), *cert. denied*, 385 U.S. 817 (1966).

¹⁰⁸ Securities Act of 1933, ch. 38 § 12, 48 Stat. 74, 84 (1933) (codified as amended in 15 U.S.C. § 77(n) (1982)).

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12 of the 1933 Act.¹⁰⁹ Although this right is not expressly found in the 1934 Act, it has been consistently recognized as implied under Section 10(b) of the 1934 Act.¹¹⁰

With the existence of this "special right" in the 1934 Act firmly established, it is now necessary to look into the purposes of the statutes involved. Although it is recognized that the purposes underlying the enactment of the Arbitration Act are important,¹¹¹ it is suggested that the countervailing policy of protecting the investor inherent in the Securities Exchange Act of 1934 prevail. From this basic purpose, found in both the 1933 and 1934 Acts, it may be inferred that Congress intended the protective non-waiver provision of the 1933 Act to apply to both Acts with respect to the availability of a judicial forum for aggrieved investors.¹¹² In addition to any congressional intent that may be inferred from the purpose of the Acts, Congress has expressly refused to disrupt the existing law as expounded in *Wilko v. Swan*, in the context of amending portions of the 1934 Act.¹¹³

In addition to the legislative intent of Congress, it is submitted that the nature of arbitration proceedings themselves leads to the

¹⁰⁹ See *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983) ("The existence of this implied remedy is simply beyond peradventure."); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196 (1976) (existence of private cause of action now well established).

This implied private right of action was recognized for the first time in *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946). The Supreme Court accepted this implied right the first time it was brought before the Court, and did so with barely a discussion. See *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971).

¹¹⁰ See *Wilko v. Swan*, 346 U.S. 427, 431-32 (1953) (discussing the positive aspects of arbitration).

¹¹¹ See *Wilko*, 346 U.S. at 431 (Securities Act enacted to protect individual investor, and as such, statute should be construed to achieve that purpose); *Otis and Co. v. SEC*, 106 F.2d 579, 583 (6th Cir. 1939) (same); *Oklahoma Texas Trust v. SEC*, 100 F.2d 888, 891 (10th Cir. 1939).

¹¹² See *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 525 (1974) (Douglas, J., dissenting), in which Justice Douglas, citing *Wilko*, 346 U.S. at 437, stated that "[a]s the protective provisions of the Securities Act require the exercise of judicial direction, it seems to us that Congress must have intended Section 14 . . . to apply to waiver of judicial trial and review." *Scherk*, 417 U.S. at 525.

¹¹³ When amending the arbitration provisions of the 1934 Act, the Conference Committee stated "[i]t 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 proceeding provisions in agreements entered into by persons dealing with members . . . of self-regulatory organizations." H.R. CONF. REP. NO. 229, 94th Cong., 1st Sess. III, reprinted in 1975 U.S. CODE CONG. & ADMIN. NEWS 321, 342. Congress thereby clearly indicated it believed that the investor's right to avoid arbitration extended to the 1934 Act as well. *Id.*

conclusion that claims of fraud violations of the Securities Exchange Act of 1934 made by investors against brokers are more properly litigated in federal courts than by arbitrators. Therefore, it is suggested that when the Supreme Court hears *McMahon*,¹¹⁴ it should affirm the court of appeals decision, extending *Wilko*¹¹⁵ to the Securities Exchange Act of 1934, holding federal securities claims by investors against brokers non-arbitrable unless the investor agrees to arbitration after the claim arises.

CONCLUSION

The question of whether or not to extend the *Wilko* rule to the Securities Exchange Act of 1934 has led to disparity within the lower federal courts. The Supreme Court, in granting certiorari in *McMahon*, has an opportunity to extend the *Wilko* rule to the 1934 Act. Based on the similarities in the language and purpose of both Acts, legislative intent and public policy, *Wilko* should be extended.

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¹¹⁴ *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir.), cert. granted, 107 S. Ct. 60 (1986).

¹¹⁵ *Wilko v. Swan*, 346 U.S. 427 (1953).