
Roslyn A. Quarto
George Boss

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

The United States Arbitration Act\(^1\) 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-

\(^2\) 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.

\(^3\) 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.

\(^4\) 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 556-60 (1959); Sayre, Development of Commercial Arbitration Law, 97 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. 5b, 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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Alternative to formal court litigation. 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. Second, arbitrators are not required to issue written opinions stating reasons for their awards. Third, decisions by arbitrators on the merits are not reviewable by the courts.

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

* 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 . . .").
* See Wilko v. Swan, 346 U.S. at 431-92 ("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: [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.

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.\footnote{1} One problem concerning the validity of arbitration arises in a context when there are countervailing public policy considerations inherent in another statute\footnote{2} — specifically, the Securities Exchange Act of 1934.\footnote{3}

The Act of 1934 was not meant to change or alter the basic purposes behind its predecessor, the Securities Act of 1933.\footnote{4} 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."\footnote{5}

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 . . ." 

\textit{Processing Time, Disposition Mode, and Cost in the American Arbitration Association and the Courts,} 8 \textit{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).

\footnote{2} 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). \textit{See also,} Burger, \textit{supra} note 5, at 277 (''[i]t is now clear that neither the federal nor the state court systems are capable of handling all the burdens placed upon them').

\footnote{3} 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 518, 519 (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).

\footnote{4} See \textit{generally} Note, \textit{Arbitration Agreements and Antitrust Claims: The Need For Enhanced Accomodation of Conflicting Public Policies,} 64 \textit{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).


The basic goals of the Exchange Act remains salutary 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. . . .

\textit{Id.}

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shall be void."

This article will trace the applicable case law beginning with the watershed case of Wilko v. Swan, invalidating an arbitration agreement under the Securities Act of 1933, to McMahon v. Shearson/American Express, Inc., now pending before the United States Supreme Court. In addition, this article will suggest that the Supreme Court, in the McMahon case should extend their decision in Wilko 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, the plaintiff, a purchaser of securities, entered a margin agreement with the defendant (broker). By this agreement, the parties were to submit all future disputes arising under the contract to arbitration. Alleging that the broker had induced him to purchase the securities by false representation,

18 788 F.2d 94 (2d Cir.), cert. granted, 107 S. Ct. 60 (1986).
19 Id.
21 346 U.S. 427.
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 damages\textsuperscript{26} for a violation of section 12(2) of the Securities Act of 1933.\textsuperscript{27}

Pursuant to section 3 of the Federal Arbitration Act,\textsuperscript{28} the broker moved to stay the action pending arbitration,\textsuperscript{29} but the district court denied the motion.\textsuperscript{30} The court of appeals held the Securities Act did not preclude arbitration and reversed the lower court,\textsuperscript{31} and the Supreme Court granted certiorari\textsuperscript{32} 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

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

\textsuperscript{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)).

\textsuperscript{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.


\textsuperscript{30} Id. 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.

\textsuperscript{31} 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)).

\textsuperscript{32} 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.

\textsuperscript{33} Wilko v. Swan, 345 U.S. 969 (1953).
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the Securities Act which Section 14 declares "void".\(^{38}\)

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,\(^{38}\) the Arbitration Act applied.\(^{38}\) 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.\(^{38}\) 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

\(^{32}\) 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.

\(^{36}\) 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).

\(^{38}\) 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.

\(^{39}\) 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).


\(^{40}\) 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, namely, the right to select a judicial forum. 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.

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 to the Securities Exchange Act of 1934, the Supreme Court in Scherk v. Alberto-Culver Co., held claims pursuant to Section 10(b) of the Securities Exchange Act of 1934, arising under an international agreement, arbitrable. In Scherk, 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.


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. 1949) (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).


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).

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mark rights. The purchase agreement called for arbitration of disputes arising out of the transaction. In a subsequent dispute, Alberto-Culver Co. filed suit in federal court alleging violations of section 10(b). Relying on Wilko, 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. Reversing the court of appeals affirmation, the Supreme Court held that "the provisions of the Arbitration Act cannot be ignored in this case." In distinguishing this case from Wilko, the Court focused on the "truly international" nature of the agreement in Scherk, as compared to the strictly domestic agreement in Wilko. The Court stated that when an

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46 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.

47 Id.

48 Scherk, 417 U.S. at 509. Approximately one year after closing the transaction in 1969, Alberto-Culver Co. discovered substantial encumberances 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.


80 Scherk, 417 U.S. at 510.

81 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 1935 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.


83 Scherk, 417 U.S. at 515.

agreement involves international transactions, selecting "in advance the forum in which disputes shall be litigated and the law to be applied is . . . an almost indispensible precondition to achievement of the orderliness and predictability essential to any international business transaction." 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, and held that the dispute be settled by arbitration.

It became apparent that Wilko still had life in regard to the 1934 Act in Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., when the Court of Appeals for the Third Circuit, applying the Wilko rule, held the buyer-employee's claims arising under the 1934 Act non-arbitrable. The court rejected defendant's con-
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tention that Scherk\(^6\) restricted application of Wilko\(^8\) to the 1933 Act.\(^9\) Indeed, the Ayres court noted that Congress appears to have accepted the view that the buyer's "special right," outlined in Wilko,\(^0\) also applies to the 1934 Act "in the 10(b) context."\(^1\)

The court also refused to distinguish Ayres\(^2\) because of "differences between the rights granted in the 1933 and 1934 Acts or any consideration of policy."\(^3\)

In its first opportunity after Ayres\(^4\) to extend the Wilko\(^5\) holding to the 1934 Act, the Supreme Court did not reach the specific issue; rather it held, in Dean Witter Reynolds, Inc. v. Byrd,\(^6\) that pendent state claims are arbitrable.\(^7\) However, the Court, in discussing Wilko,\(^5\) did conclude that the case still "retained considerable vitality."\(^7\)

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

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.


\(^8\) Ayres, 538 F.2d at 536.


\(^1\) 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.


\(^3\) Ayres, 538 F.2d at 536.


\(^6\) 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.

\(^7\) 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.

\(^8\) Wilko, 346 U.S. at 427.

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 Scherk85 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-

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 3355.
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.
88 Mitsubishi, 105 S. Ct. at 3355.
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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, as it is with the Securities Act of 1934.

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.

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

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

In McMahon, 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. In addition, appellants also alleged a RICO claim and state law claims for fraud and breach of fiduciary duties. The Court distinguished McMahon from Byrd on the facts, since Shearson, unlike Dean Witter in Byrd, sought to compel arbitration of the federal claims under the Securities Exchange Act of 1934.

Noting the similarities between the language of the non-waiver

91 Mitsubishi, 105 S. Ct. at 3355.
92 788 F.2d 94 (2d Cir.), cert. granted, 107 S. Ct. 60 (1986).
96 Id. at 96.
97 Id.
98 Id.
99 Id.
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" if Section 10(b) claims are held non-arbitrable under the 1934 Act.  

II. THE EXTENSION OF THE WILKO RULE

In granting certiorari in McMahon, 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. It is submitted that the decision in Wilko v. Swan, 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. 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 104.  105 See also Colonial Realty v. Bache & Co., 358 F.2d 178 (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).

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12 of the 1933 Act. 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.

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, 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. 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.

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


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).


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).


113 When amending the arbitration provisions of the 1934 Act, the Conference Committee stated “[i]t was the clear understanding of the conference 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, 542. 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,\textsuperscript{114} it should affirm the court of appeals decision, extending Wilko\textsuperscript{116} 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.

\textbf{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.

\textit{Roslyn A. Quarto \& George Boss}
