SECURITIES ARBITRATION COMMENTATOR

PUBLISHING SINCE 1988 (AUG '17) ISSN: 1041-3057

# *Tempus Fugit*: It's Been Thirty Years Since *McMahon* was Decided

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Hard to believe, but June 8th marked the 30th anniversary of SCOTUS deciding *Shearson/American Express v. McMahon*,[1] where a somewhat divided Supreme Court decided, in a case dealing with a securities brokerage pre-dispute arbitration agreement, to set a course that has elevated alternative dispute resolution to a position of prominence and visibility (and controversy) affecting interstate commerce generally and, most particularly, the employment and retail consumer sectors. This article offers look-backs at this ground-breaking decision, delving into the issues, the cast of characters, the decision, and the views of securities arbitration luminaries on the lasting impact of the case.

**The Issues**

The Court's 1953 decision in *Wilko v. Swan*,[2] had held unenforceable a predispute arbitration agreement ("PDAA") requiring arbitration of investor disputes arising out of the Securities Act of 1933, because it ran afoul of the Act's prohibition of a "stipulation" binding the customer to "waive compliance" with the Act's protections (here, the right to go to court). At issue in *McMahon, decided more than three decades later,* was whether claims arising out of both the Securities Exchange Act of 1934 (which in section 29(a) prohibits "any condition, stipulation, or provision binding any person to waive compliance with any provision of the Act") and the Racketeer Influenced and Corrupt Organizations Act, were arbitrable under the FAA. The issues, as framed by the Court: "The first is whether a claim brought under §10(b) of the [Act], 48 Stat. 891, 15 U.S.C. 78j(b), must be sent to arbitration in accordance with the terms of an arbitration agreement. The second is whether a claim brought under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. 1961 et seq., must be arbitrated in accordance with the terms of such an agreement." Although *Wilko* did not involve the 1934 Act, would the Supreme Court overrule *Wilko*?

**The Players**

Who were the key players arguing *McMahon*? The case featured "The Battle of the Teds," with **Theodore A. Krebsbach** arguing the case for Shearson/American Express (with him on

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***George H. Friedman,** *an* ADR consultant and *Chairman of the Board of Directors of* Arbitration Resolution Services, Inc.*, retired in 2013 as FINRA's Executive Vice President and Director of Arbitration, a position he held from 1998. In his extensive career, he previously held a variety of positions of responsibility at the American Arbitration Association, most recently as Senior Vice President from 1994 to 1998. He is an Adjunct Professor of Law at* Fordham Law School. *Mr. Friedman serves on the Board of Editors and is a Contributing Legal Editor of the* Securities Arbitration Commentator. *He is also a member of the AAA's national roster of arbitrators. He holds a B.A. from Queens College, a J.D. from Rutgers Law School, and is a Certified Regulatory and Compliance Professional.*

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the brief was **Jeffrey Friedman**), and **Theodore G. Eppenstein** arguing for the McMahons (with him on the brief was **Madelaine Eppenstein**). Urging reversal on behalf of the United States as *amicus curiae* was **Richard G. Taranto** (with him on the brief were **Solicitor General Fried**, **Deputy Solicitor General Cohen, Daniel L. Goelzer, Paul Gonson, Jacob H. Stillman,** and **David A. Sirignano**). There were several other *amicus* briefs. Urging reversal were the **American Arbitration Association** and the **Attorneys for Securities Industry Association, Inc**. (*today, this would be SIFMA's Compliance & Legal Society*). *Amicus* briefs urging affirmance were filed by several individual customers, including **Bruce Cordray** (*any relation to Consumer Financial Protection Bureau Director Richard Cordray?*). Many of the points made at the oral argument ring true today.[3]

**The Decision**

As we learned on June 8, 1987, a somewhat divided Court, replete with partial concurrences and dissents, held 5-4 that claims arising out of the Securities Exchange Act of 1934 were arbitrable under the FAA. SCOTUS also ruled 9-0 that Racketeer Influenced and Corrupt Organizations Act claims were arbitrable under a predispute arbitration agreement. Justice O'Connor wrote the Opinion, which had four parts, structured essentially as follows: I – Background; II – Burden is on the party resisting arbitration to show Congressional intent to bar arbitration; III – 1934 Act arbitration is permissible; and IV – RICO arbitration is permissible.

*1934 Act Claims*

Driven in large part by the SEC's oversight of SRO arbitration, Justice O'Connor's majority Opinion, joined by Chief Justice Rehnquist and Justices Powell, Scalia, and White stated: "We conclude, therefore, that Congress did not intend for § 29(a) to bar enforcement of all predispute arbitration agreements. In this case, where the SEC has sufficient statutory authority to ensure that arbitration is adequate to vindicate Exchange Act rights, enforcement does not effect a waiver of 'compliance with any provision' of the Exchange Act under § 29(a)." Justices Blackmun, Brennan, Marshall, and Stevens joined in parts I, II, and IV, but had problems not applying *Wilko* to the 1934 Act. Justice Blackmun filed an Opinion, joined by Justices Brennan and Marshall, concurring in parts I, II, and IV and dissenting with part III. Finally, Justice Stevens filed a separate Opinion similarly concurring in part and dissenting in part.

*RICO Claims*

While there was a split on the 1934 Act issue, there was unanimity that RICO claims were resolvable by PDAAs. Said the Court: "Unlike the Exchange Act, there is nothing in the text of the RICO statute that even arguably evinces congressional intent to exclude civil RICO claims from the dictates of the Arbitration Act. This silence in the text is matched by silence in the statute's legislative history… In sum, we find no basis for concluding that Congress intended to prevent enforcement of agreements to arbitrate RICO claims. The McMahons

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**SECURITIES ARBITRATION COMMENTATOR**

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**SUBSCRIPTION INFORMATION:**

The Securities Arbitration Commentator is published 8 times per year and sells by annual subscription. Regular Subscription: $290; Preferred Subscription (with weekly e-mail Alerts): $590. Back issues of SAC are archived at www.sacarbitration.com > SBI-SAC (Search Back Issues-SAC). At SBI-SAC, subscribers may search and download PDF copies of past issues for free. Non-subscribers may search this database for $25 per download.

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may effectively vindicate their RICO claim in an arbitral forum… Moreover, nothing in RICO's text or legislative history otherwise demonstrates congressional intent to make an exception to the Arbitration Act for RICO claims. Accordingly, the McMahons, 'having made the bargain to arbitrate,' will be held to their bargain."

**The *McMahon* Legacy**

SAC reached out to individuals who were either involved in the *McMahon* case or were active in the securities arbitration field, seeking their views on the case's legacy. Their comments appear below, starting with counsel for the parties and then segueing to others involved with securities arbitration back in 1987. The bulk of the commentary is from counsel for the parties.

**Theodore G. Eppenstein** argued the case for the McMahons: "The opportunity to argue the McMahon's case before the Supreme Court, in effect representing the public's interest in seeking an alternative to mandatory arbitration, was a watershed moment in the next phase of my professional career. Although the 5-4 decision was a blow to the rights of securities customers, as was the about-face of the SEC in backing the industry in an unexpected *amicus* brief, it led to my congressional trifecta appearances on behalf of investors and invitations to the lecture circuit in the U.S. and at symposia in Moscow and Cairo. The highlight has been my work as a public member of the Securities Industry Conference on Arbitration, where I've successfully advocated for numerous improvements to SRO arbitration procedures that continue to benefit public investors. Some additional thoughts:

*"Customer Success in Arbitration:* A few years after the *McMahon* decision, the General Accounting Office (now the Government Accountability Office) in 1992 reported that customers won almost 60 percent of the time and were awarded about 61 percent of their losses. This became a benchmark high point.... FINRA's figures in 2014, which do not factor in an 'expected recovery percentage,' show a so-called win rate of only 38 percent for customers whose cases are decided by arbitrators....

*"Perceptions of Fairness:* Concerning fairness to industry customers, FINRA in 2011 adopted a proposal I made over many years as a member of SICA that parties to SRO arbitration may choose to have only public arbitrators adjudicate their cases and not individuals from the industry. The 'win rate' appears to have increased a few percentage points for public investors since this initiative was adopted.

*"Further Improvements:* Also to FINRA's credit, it has expanded the amount of information it gives to all parties regarding the background of potential arbitrators. There are still some procedures, however, that overwhelmingly favor the industry.... FINRA seems open to ideas from the public to make its arbitrations fair for all. But the low percentage of customers who win is an indicator that FINRA dispute resolution does not yet afford an equal footing for all...."

**Theodore A. Krebsbach** argued the case for Shearson/American Express: "Back in the mid-1980's, Jeffrey Friedman and I were Shearson in-house lawyers who, based upon our personal experience, were certain that SRO arbitration was the fairest and most cost-effective and efficient forum for resolving investor disputes with stockbrokerage firms. Due to SEC oversight and other factors, we were also convinced that pre-dispute agreements to arbitrate federal securities claims at SROs should be enforced despite the United States Supreme Court's *Wilko v. Swan* precedent to the contrary. Encouraged by Shearson's General Counsel, the late Philip J. Hoblin, Jr., we began filing and arguing motions to compel arbitration of such claims in federal district and circuit courts throughout the country.

"When the Second Circuit refused to enforce predispute agreements with respect to the '34 Act (as well as RICO claims) in *Shearson v. McMahon*,[4] we

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### Additional Comments Solicited By SAC

**Barbara Black**
Professor, University of Cincinnati College of Law (Retired)
Chair, FINRA Dispute Resolution Task Force (2014-2015)

When *McMahon* was decided, I was a professor at Pace Law School in White Plains, NY, teaching securities regulation. At that time the academic consensus on *McMahon* was that it was an anti-investor rights opinion and that the SEC had betrayed its investor protection mission when it filed an *amicus* brief in support of arbitration.

Fast forward to March 1997. I received a telephone call from SEC Chairman Arthur Levitt's office. Mr. Levitt had held a series of investors' town meetings where a frequently voiced complaint was that customers felt outmatched when they were compelled to arbitrate their claims in the NASD and NYSE forums. The firms had experienced, well-paid attorneys to argue their positions, and many investors, particularly small investors, could not, as a practical matter, obtain legal representation. Chairman Levitt wanted to help out these investors. Would Pace Law School be interested in establishing a securities arbitration clinic?

I was intrigued. I thought this could be an opportunity to provide assistance to *pro se* investors, give law students valuable hands-on experience in an interesting practice setting, and (selfishly, I admit) provide me with new fields to research and write about.

Later that spring, I, along with professors who ran clinics at other NYC-area law schools, attended a meeting with staff from the SEC's market regulation division. I was the only law professor present with expertise in securities regulation and an understanding of the plight of small investors. For me the highlight was meeting Deborah Masucci, then the head of NASD's arbitration program, who supported my enthusiasm for a clinic.

The securities arbitration clinic at Pace Law School opened for business in fall 1997. This fall it will celebrate its 20th anniversary. Since its inception, over 175 law students have worked on clinic matters. They have handled inquiries from hundreds of investors and recovered about $700,000 for clinic clients.

Thirty years after *McMahon*, we continue to debate its legal analysis and impact on investors. The debate over mandatory

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filed a Petition for review[5] with the United States Supreme Court. After the Petition was granted, we briefed and successfully argued *McMahon* before the Supreme Court in 1987.

"I will always be grateful to my former Fordham Law School professor, Constantine ("Gus") Katsoris, for sponsoring my admission to the Court in time for the oral argument! Just two years later we successfully petitioned, briefed and argued *Rodriguez v. Shearson/American Express, Inc.*,[6] in which the Supreme Court not only enforced predispute agreements to arbitrate '33 Act claims, it also took the rare action of reversing its own *Wilko v. Swan* precedent. As they say, the rest is history.

"Almost all investor disputes since then have been resolved in arbitration. Countless professionals at FINRA and elsewhere have worked tirelessly over the past 30 years to ensure that securities arbitration remains the best forum for resolution of these disputes, and that the process continuously evolves to meet the ever-changing needs of investors and the securities industry."

**Professor Constantine N. ("Gus") Katsoris,** Educator, Arbitrator, Securities Industry Conference on Arbitration ("SICA") Founding Member: "*McMahon* vastly broadened the use of arbitration for the resolution of disputes between the investing public and the securities industry. In reaching its decision the Court emphasized the great strides that had been achieved in legitimatizing the process and removing much of the mistrust it had previously expressed in *Wilko v. Swan* some 34 years earlier.

Among the intervening events the Court referred to was the establishment of SICA in 1977 and its enactment of its *Uniform Code of Arbitration* which added stability and clarity to the process. Counsel before the *McMahon* Court are both friends, i.e., Ted Eppenstein was a co-Public Member with Peter Cella and me at SICA for many years; and, Ted Krebsbach was a student of mine whom I had the privilege of sponsoring for admission to the Supreme Court in a Fordham Admission Ceremony just months before the case was argued. Congratulations to both of them, as they both made excellent presentations before the Court."

**Deb Masucci** was NASD's Director of Arbitration: "At the time *McMahon* was argued and decided, all of the staff at the NASD were committed to a fair arbitration process for broker/dealer customers, broker/dealer employees, and the broker/dealer industry but the program was not very well known or understood.

The *McMahon* decision took the voluntary program out of the shadows into sunshine, a double-edged sword. Since the *McMahon* decision, the staff continued its commitment to fairness and the securities dispute resolution program has been a leader of changes to the field. Publicly available awards, the expansion of mediation to resolve disputes, expansive disclosures for arbitrators, required education for arbitrators and then mediators, and the establishment of law school securities clinics to help small investors resolve disputes have their roots in the securities area. We should all be proud of the advancements and accomplishments of the program throughout the many years of change, criticism, and growth."

**George Friedman** was AAA's Vice President for Case Administration, and was responsible for the securities book of business: "Bob Coulson, AAA's president at the time, was prescient. He saw the decision coming and had me start working on specialized rules before the Court ruled. AAA eventually formed a task force that developed the Association's *Securities Arbitration Rules*. I served as staff liaison to both the Task Force and SICA, getting to know very well everyone offering comments here.

*McMahon* was a very significant, seminal case. It paved the way for a series of Supreme Court decisions holding that federal statutory right cases could be

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### Additional Comments Solicited By SAC

**Edward W. Morris, Jr.**
Former Director of Arbitration
New York Stock Exchange

When the Supreme Court decided *Dean Witter Reynolds v. Byrd*, the New York Stock Exchange led by John Phelan, the Exchange's Chairman and one of the Securities Industry's all-time great leaders (remember his calming influence during the October 1987 market break), started preparations for a dramatically increasing caseload. With Jim Buck, Secretary of the Exchange, guiding its effors, the staff met with regulators and industry leaders to ensure the Exchange had adequate personnel, facilities and panels of qualified arbitrators to deal with an anticipated heavy caseload. As I remember, for a while it looked as if we had over-prepared, Then the deluge.

In 1987 I was Arbitration Director at the Exchange. Here are some of my specific recollections of *Mc Mahon* and its impact:

A persistent problem at that time, one that continues to this day, is the public perception of arbitration as a forum that favors the industry. I especially remember a New York Times article in March, 1987 that questioned the industry's ability to administer a fair forum. I believe this article or information from it was alluded to in the *Mc Mahon* dissent.

I also recall a meeting with the SEC staff when it was announced that the Commission would file an *amicus* brief and the shocked reaction of some observers from the plaintiff's bar.

A special memory was attending the oral argument before SCOTUS and hearing Ted Krebsbach talking to the court about my job.

Others include the resultant expansion of the Exchange's arbitrator training program to ensure we had qualified arbitrators in many new hearing securities arbitration is to a large extent a philosophical or policy question about which thoughtful, informed individuals disagree. Yet there is no doubt that *McMahon* was the impetus for establishing securities arbitration clinics at law schools. Clinics can never be the panacea for investors' wrongs, but they can provide meaningful assistance for at least some investors who are fortunate enough to take advantage of their services.

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locations and the development of a cottage industry of CLE programs on Securities Arbitration. And finally the SEC inspired reforms which rightly or wrongly endeavored to make arbitration more closely resemble civil litigation.

arbitrated under a predispute arbitration agreement. It gets cited all the time, such as by SCOTUS in *American Express Co. v. Italian Colors Restaurant*.[7] And I suppose it led indirectly to me becoming NASD's Director of Arbitration 11 years later."

**Rick Ryder,** Founder and President of the Securities Arbitration Commentator, Inc.: "Arbitration had been a key aspect of our litigation strategy during my time at PaineWebber. I left my position as PWI's Litigation Manager in late 1987 with the idea of starting SAC. With the Supreme Court's decision in June, the September SEC (Ketchum) letter recommending an SRO Code overhaul to SICA, and the claims avalanche of the October Crash, *McMahon* kicked off a set of events that combined to spark a seismic shift in securities arbitration. I wanted to be there to record it!

One of the first things we reported was a 54% jump in the SRO caseload from 2,828 in 1986 to 4,364 in 1987 (SAC, Vol. 1, No. 4)!"

**Conclusion**

That *McMahon* was a watershed case with lasting impact is beyond question. To this day, the case is cited by courts and attorneys, and it formed the foundation for later Supreme Court decisions permitting predispute arbitration agreements to resolve an array of federal statutory rights cases. In the ensuing years, SRO arbitration mushroomed, and the SROs shifted very quickly to making their programs fairer in fact and perception. To borrow a phrase from the late, great baseball philosopher Casey Stengel, "who wuddah thunk" back in 1987 that the mandatory "industry" arbitrator would eventually go the way of the telegram in customer cases and that *McMahon* would spawn three decades of unwavering support for arbitration from the Supreme Court?

## Endnotes

1 482 U.S. 220 (1987).

2 346 U.S. 427 (1953).

3 An audio file of the oral argument and a searchable transcript can be found at https://www.oyez.org/cases/1986/86-44.

4 788 F.2d 94 (1986).

5 My thanks to Ted Krebsbach, now with Murphy & McGonigle, for providing a free copy of the Petition for *Certiorari*. Readers can obtain a copy by emailing Help@SACArbitration.com.)

6 490 U.S. 77 (1989).

## Additional Comments Solicited By SAC

**Matthew Farley**
Drinker Biddle & Reath LLP (Retired)

Here's a minor footnote to the *McMahon* 30-year history story.

Based upon a few decisions, the names of which I cannot recall, the industry thought it had a shot at getting the FAA upgraded vis a vis the securities laws.

Bill Fitzpatrick (then head of the then SIA, remember?) likened the opportunity to the Oklahoma Land Rush, because everyone wanted to get their case to the Supremes. Law firms and BD's were vying to position their cases.

I was then representing in private practice my old firm Kidder Peabody, whose general counsel, Robert Krantz (a now deceased and dear friend and mentor), understood the issues -- could not care less about who got it done -- but ultimately gave me the right Kidder case and we had the word: go for it.

The customer, a corporate customer, had defeated Kidder (ok me !) at the trial level and we moved for summary affirmance at the court of appeals so we had standing to seek the holy grail of *cert*. Brian McDonough (then an associate, later my partner and always my friend) crafted the certiorari petition. As was usually, the case I didn't change much. The client was with us all the way.

We knew Ted Krebsbach at Shearson probably had more than a few cases to use and I think we had some idea which one would be his choice.

By counting the days from the appellate rulings from his and our decisions, we knew the SCOTUS filing deadlines. The deadline could be met by the mailing date. We figured that Ted would mail. So I sent Brian on a plane to Washington to file our petition ASAP and not lose the time in US mail.

If my and Brian memory's serve we were number 40 on the SCOTUS docket and Ted/Shearson/*McMahon* was 44. Hallelujah ! We were beaming !

And then my adversary in the matter called to tell me that they had had enough of this nonsense and expense and would NOT OPPOSE OUR PETITION; they'd consent to arbitration ! "What the F???" I said, "you can't do that!" and he said, "Oh yes we can!" and the number on the docket we had lower than Ted's evaporated and Ted ultimately won the day !

(Ted's still a great friend BTW.)