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The Severability of Arbitrable and Nonarbitrable Securities Claims

THE SEVERABILITY OF ARBITRABLE AND NONARBITRABLE SECURITIES CLAIMS

Brokers and dealers generally require investors to enter into written agreements detailing the terms of the relationship between the broker or dealer and the investor prior to the establishment of a securities investment account.[1] These agreements usually contain clauses that require the arbitration of disputes arising from the relationship between the investor and the broker or dealer.[2] Notwithstanding the apparent scope of arbitration clauses, agreements to arbitrate potential future disputes are unenforceable with respect to investors' claims under the Securities Act of 1933[3] ('33 Act) and the Securities Exchange Act of 1934[4] ('34 Act).[5] Historically, brokers and dealers have been under no obligation to inform investors that predispute arbitration clauses are unenforceable with respect to federal securities claims.[6] Many investors, therefore, may have been unaware that, despite the apparent scope of arbitration clauses, they may litigate federal securities claims in court.[7] The Securities and Exchange

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1. *See* SEC Securities Exchange Act Release No. 34-15984 (July 2, 1979), *reprinted in* [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,122, at 81,976 (brokers and dealers routinely require customers to enter into written agreements prior to opening cash or margin accounts).

2. *See* H.R. DOC. No. 95, 88th Cong., 1st Sess. ch. 3, at 390-91 (1963) (major stock exchange firms generally use arbitration clauses); SEC Securities Exchange Act Release No. 34-15984 (July 2, 1979), *reprinted in* [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,122, at 81,976; *see also* Note, *Arbitration of Investor-Broker Disputes*, 65 CALIF. L. REV. 120, 121 (1977) [hereinafter cited as *Disputes*] (major stock brokerage firms include arbitration clauses in margin and cash account agreements). Arbitration clauses in security account agreements commonly purport to bind the investor to arbitration of all potential disputes that may arise between the investor and the broker or dealer. *See* 8A C. NICHOLS, CYCLOPEDIA OF LEGAL FORMS ANNOTATED § 8.5362, at 496 (1980) (text of standard arbitration clause requires settlement of any controversy by arbitration). Arbitration clauses also generally include procedures for selection of an arbitration forum. *See id.* (investor may choose to arbitrate disputes in accordance with rules of any one of several arbitration associations).

3. 15 U.S.C. §§ 77a-77aa (1982) (Securities Act of 1933 ('33 Act)).

4. 15 U.S.C. §§ 78a-78kk (1982) (Securities Exchange Act of 1934 ('34 Act)).

5. *See* Wilko v. Swan, 346 U.S. 427, 434-35 (1953) (predispute arbitration agreement is void and unenforceable with respect to claims arising under '33 Act); Reader v. Hirsch & Co., 197 F. Supp. 111, 116 (S.D.N.Y. 1961) (predispute arbitration agreements are void and unenforceable with respect to claims arising under '34 Act); *see also infra* notes 29-44 (discussion of *Wilko* doctrine); *infra* notes 45-47 (discussion of extension of *Wilko* doctrine to '34 Act claims).

6. *See* SEC Securities Act Release No. 34-20397 (Nov. 18, 1983), *reprinted in* [Current] FED. SEC. L. REP. (CCH) ¶83,452, at 86,357 (arbitration agreements historically have contained language purporting to bind investors to arbitration of all disputes); SEC Securities Exchange Release No. 34-15984 (July 2, 1979), *reprinted in* [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,122, at 81,975 (brokers and dealers commonly use arbitration clauses which imply that investors must submit future federal securities disputes to arbitration); *see also Disputes, supra* note 2, at 148-49 (securities industry continues to use boilerplate arbitration clauses purporting to bind investors to arbitration of all disputes despite unenforceability of clauses with respect to arbitration of federal securities claims).

7. *See* SEC Securities Exchange Act Release No. 34-15984 (July 2, 1979), *reprinted in*

Commission (SEC), however, recently adopted rule 15c2-2[8] prohibiting the use of predispute arbitration clauses that purport to bind investors to arbitrate federal securities claims.[9] Rule 15c2-2 requires brokers and dealers to inform potential and existing customers that arbitration clauses do not preclude judicial recourse for the resolution of federal securities disputes.[10] The enactment of rule 15c2-2 may result in the increased litigation of securities disputes as more investors pursue the resolution of federal securities claims in court.[11]

Securities claims based on state law generally are subject to arbitration pursuant to valid arbitration agreements.[12] For example, common-law claims

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[1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,122, at 81,975 (investors frequently are unaware of their right to pursue federal securities claims in court because brokers and dealers do not inform investors of enforceability limits of arbitration clauses).

8. 48 Fed. Reg. 53404 (1983) (to be codified at 17 C.F.R. § 240.15c2-2).

9. *See* SEC Securities Exchange Act Release No. 34-20397 (Nov. 18, 1983), *reprinted in* [Current] FED. SEC. L. REP. (CCH) ¶83,452, at 86,356 (announcing adoption of rule 15c2-2). Rule 15c2-2 declares that the use of arbitration agreements that purport to bind investors to the arbitration of future disputes arising under the federal securities laws is fraudulent. 48 Fed. Reg. 53404, 53406-07 (1983) (to be codified at 17 C.F.R. § 240.15c2-2). Rule 15c2-2 includes a provision that allows brokers and dealers to continue use of existing supplies of customer agreement forms containing objectionable clauses upon the condition that the brokers and dealers include a written disclosure that the customer is not bound to arbitrate federal securities disputes. *Id.* at 53407. As of January 1, 1985, however, rule 15c2-2 will prohibit brokers and dealers from executing customer agreements that purport to bind investors to arbitrate future federal securities disputes, irrespective of any disclosure of the limited effect of the agreement. *Id.; see* SEC Securities Exchange Act Release No. 34-20397 (Nov. 18, 1983), *reprinted in* [Current] FED. SEC. L. REP. (CCH) ¶83,452, at 86,358-59 (provision of proposed rule 15c2-2 allowing permanent use of disclosure language deleted as insufficient notice to investors).

10. 48 Fed. Reg. 53404, 53407 (1983) (to be codified at 17 C.F.R. § 240.15c2-2).

11. *See* SEC Securities Exchange Act Release No. 34-20397 (Nov. 18, 1983) *reprinted in* [Current] FED. SEC. L. REP. (CCH) ¶83,452, at 86,356 (purpose of rule 15c2-2 is to ensure that public customers are aware of availability of judicial recourse with respect to federal securities claims).

12. *See* Arbitration Act, Pub. L. No. 80-282, § 2, 61 Stat. 669 (1947) (codified at 9 U.S.C. § 2 (1982)) (written arbitration agreements constitute valid, irrevocable, and enforceable contracts); *see also infra* notes 81-91 and accompanying text (discussion of Arbitration Act).

Congress passed the Arbitration Act to overcome an anachronism of American common law. H.R. REP. No. 96, 68th Cong., 1st Sess. 1 (1924) [hereinafter cited as H.R. REP. No. 96]; S. REP. No. 536, 68th Cong., 1st Sess. 2 (1924) [hereinafter cited as S. REP. No. 536]. A common-law principle that courts would not enforce arbitration agreements upon the ground that arbitration agreements wrongly deprived courts of jurisdiction had evolved because of the jealousy of the English courts for their own jurisdiction. H.R. REP No. 96, *supra* at 1-2. Congress enacted the Arbitration Act to eliminate this common-law principle and place arbitration agreements on the same footing as other contracts. *Id.* at 1; *see* The Anaconda v. American Sugar Refining Co., 322 U.S. 42, 44 (1944) (by enactment of Arbitration Act, Congress overturned existing rule that courts of equity and admiralty could not compel performance of arbitration agreements). *See generally* Cohen & Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265 (1926) (discussion of Arbitration Act).

The Arbitration Act creates a body of federal substantive law applicable in both state and federal courts. *See* Southland Corp. v. Keating, 104 S.Ct. 852, 858-59 (1984) (California state courts must enforce valid arbitration agreement despite state statute to contrary); Georgia Power Co. v. Cimarron Coal Corp., 526 F.2d 101, 107 (6th Cir. 1975) (federal law under Arbitration Act controls determination of arbitrability of coal supply agreement between parties), *cert. denied*,

of breach of contract, fraud, breach of fiduciary duty, and other tort claims constitute arbitrable state-based claims.[13] Investors frequently assert state statutory and common-law claims in addition to federal securities claims in securities disputes.[14] The possibility of recovering punitive damages is a primary reason that investors plead state-based causes of action.[15] An investor may not recover punitive damages for violations of the federal securities acts, but may recover punitive damages under common-law claims.[16] Investors, therefore,

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425 U.S. 952 (1976). Section 2, the central provision of the Arbitration Act, states that written arbitration agreements are valid, irrevocable, and enforceable contracts. 9 U.S.C. § 2 (1982); *see* S. REP. No. 536, *supra*, at 2.

13. *See* Liskey v. Oppenheimer & Co., 717 F.2d 314, 320-21 (6th Cir. 1983) (investor's claims of breach of contract, breach of fiduciary duty, common-law negligence, and violations of state securities and consumer protection laws are subject to arbitration pursuant to valid predispute agreement); Dickinson v. Heinold Sec., Inc., 661 F.2d 638, 640 (7th Cir. 1981) (various state law tort and contract claims arbitrated); Kavit v. A.L. Stamm & Co., 491 F.2d 1176, 1181 (2d Cir. 1974) (common-law negligence and conversion claims are arbitrable); DeHart v. Moore, 424 F. Supp. 55, 56-57 (S.D. Fla. 1976) (common-law fraud and misrepresentation claims are subject to arbitration pursuant to agreement).

14. *See, e.g.*, Dickinson v. Heinold Sec., Inc., 661 F.2d 638, 640 (7th Cir. 1981) (tort and contract claims); Miley v. Oppenheimer & Co., 637 F.2d 318, 325 (5th Cir. 1981) (claims based on common-law breach of fiduciary duty and state consumer protection statute); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1021 (6th Cir. 1979) (claims of statutory fraud and common-law fraud); Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831, 832 (7th Cir. 1977) (allegations of breach of contract and common-law fraud and deceit); Cunningham v. Dean Witter Reynolds, Inc., 550 F. Supp. 578, 578-79 (E.D. Cal. 1982) (allegations of fraud, breach of fiduciary duties, negligent misrepresentation, and intentional infliction of emotional distress); Newman v. Shearson, Hammill & Co., 383 F. Supp. 265, 266 (W.D. Tex. 1974) (allegations of state securities act violations).

15. *See* Krause, *Securities Litigation: The Unsolved Problem of Predispute Arbitration Agreements for Pendent Claims*, 29 DE PAUL L. REV. 693, 709 (1980) (investors commonly assert state law claims with federal securities claims to recover punitive damages).

16. *See, e.g.*, Flaks v. Koegel, 504 F.2d 702, 707 (2d Cir. 1974) (damages recoverable on claim of common-law fraud); Coffee v. Permian Corp., 474 F.2d 1040, 1044-45 (5th Cir.) (damages recoverable for violation of state fraud statute), *cert. denied*, 412 U.S. 920 (1973); Young v. Taylor, 466 F.2d 1329, 1337-38 (10th Cir. 1972) (violation of state blue sky law and common-law fraud claim). The damages sections of the '33 Act, §§ 11(e) and 12(2), do not authorize recovery of punitive damages. *See* Avern Trust v. Clarke, 415 F.2d 1238, 1242 (7th Cir. 1969) (punitive damages are not recoverable under § 11(e) of '33 Act); Schaefer v. First Nat'l Bank, 326 F. Supp. 1186, 1193 (N.D. Ill. 1970) (§ 12(2) of '33 Act does not authorize recovery of punitive damages), *appeal dismissed*, 465 F.2d 234 (7th Cir. 1972); *see also* 15 U.S.C. § 77k(e) (1982) (§ 11(e) of '33 Act limits damages recovery to compensatory damages); *id.* § 77*l*(2) (§ 12(2) of '33 Act allows recovery of loss due to decline in security value plus interest only). Punitive damages also are not recoverable in an implied cause of action under § 17(a) of the '33 Act. *See* Globus v. Law Research Serv., Inc., 418 F.2d 1276, 1283-86 (2d Cir. 1969) (court may not award punitive damages for § 17(a) claim), *cert. denied*, 397 U.S. 913 (1970); *see also* 15 U.S.C. § 77q(a) (1982) (§ 17(a) of '33 Act prohibits fraud in offer and sale of securities). The '34 Act also does not authorize recovery of punitive damages. *See* Green v. Wolf Corp., 406 F.2d 291, 302-03 (2d Cir. 1968) (courts interpret § 28(a) of '34 Act to bar recovery of punitive damages although original aim of § 28(a) limitation to actual damages was prevention of double recovery under state and federal law), *cert. denied*, 395 U.S. 977 (1969); 15 U.S.C. § 78bb(a) (1982) (§ 28(a) of '34 Act expressly limits recovery to actual damages); *see also* Straub v. Vaismon & Co., 540 F.2d 591, 599 (3d Cir. 1976) (no punitive damages recoverable in actions arising under rule 10b-5). *See*

commonly combine state-based claims with federal securities claims.[17] Since federal securities claims are not subject to arbitration and state-based claims generally are arbitrable, securities disputes that present both state and federal claims require courts to determine the appropriate forum for the resolution of these disputes.[18]

The federal courts have not adopted a consistent approach for resolving securities disputes presenting both arbitrable state claims and nonarbitrable federal claims.[19] Some courts have decided to adopt a "sever and stay" approach.[20] Courts employing the sever and stay approach sever the state claims from the federal securities claims, adjudicate the federal claims, and submit the state claims to arbitration following judicial resolution of the federal claims.[21] Other courts have decided to exercise jurisdiction to adjudicate both the state and federal claims when the claims are sufficiently "intertwined."[22]

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generally Comment, *Punitive Damages and the Federal Securities Act: Recovery Via Pendent Jurisdiction* 47 MISS. L.J. 743 (1976) (discussion of propriety of punitive damages awards for pendent state claims); Comment, *The Reappearance of Punitive Damages in Private Actions for Securities Fraud*, 5 TEX. TECH. L. REV. 111 (1973) (discussion of punitive damages in securities disputes).

17. *See, e.g.*, Miley v. Oppenheimer & Co., 637 F.2d 318, 323 (5th Cir. 1981) (rule 10b-5 claim with common-law fiduciary duty and Texas consumer protection statute claims); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1021 (6th Cir. 1979) ('34 Act claim with statutory fraud and common-law fraud claims); Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831, 832 (7th Cir. 1977) (rule 10b-5 claim with fraud, deceit, and breach of contract claims); Sibley v. Tandy Corp., 543 F.2d 540, 542 (5th Cir. 1976) (rule 10b-5 claims with contract claims), *cert. denied*, 434 U.S. 824 (1977); Kavit v. A.L. Stamm & Co., 491 F.2d 1176, 1181 (2d Cir. 1974) ('34 Act claims with common-law negligence and conversion claims); Cunningham v. Dean Witter Reynolds, Inc., 550 F. Supp. 578, 578 (E.D. Cal. 1982) (claims under §§ 10(b) and 15(c) of '34 Act with state-based claims of fraud, breach of fiduciary duty, negligent misrepresentation, and intentional infliction of emotional distress); Newman v. Shearson, Hammill & Co., 383 F. Supp. 265, 266 (W.D. Tex. 1974) (various claims of '33 Act and '34 Act violations with claim of Texas securities act violation).

18. *See* Krause, *supra* note 15, at 709-10 (courts have developed guidelines for determining jurisdiction over mixed claim disputes).

19. *Compare infra* notes 92-104 and accompanying text (discussion of cases employing intertwining doctrine) *with infra* notes 105-126 and accompanying text (discussion of cases employing sever and stay approach).

20. *See* Liskey v. Oppenheimer & Co., 717 F.2d 314, 320 (6th Cir. 1983) (courts should sever state clams from federal securities claims and submit state claims to arbitration pursuant to valid arbitration clauses); Dickinson v. Heinold Sec., Inc., 661 F.2d 638, 644-46 (7th Cir. 1981) (practice of severance of state claims and stay of arbitration supports strong federal policy favoring arbitration without sacrificing goals of federal securities acts); *see also infra* notes 105-126 and accompanying text (discussion of sever and stay approach).

21. *See* Dickinson v. Heinold Sec., Inc., 661 F.2d 638, 643-44 (7th Cir. 1981) (stay of arbitration of state claims pending completion of litigation of federal claims preserves exclusive jurisdiction of courts over nonarbitrable federal claims).

22. *See* Belke v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 693 F.2d 1023, 1026-27 (11th Cir. 1982) (alleged violations of federal securities laws and common law of Florida based on mismanagement of investor's portfolio are inextricably intertwined); Miley v. Oppenheimer & Co., 637 F.2d 318, 335-36 (5th Cir. 1981) (courts should resolve entire dispute when investor alleges single legal wrong with alternate routes of recovery under state and federal claims); Sibley v. Tandy Corp., 543 F.2d 540, 543 (5th Cir. 1976) (courts should consolidate and hear state

Federal courts, however, have differed in their application of the intertwining doctrine.[23] Some courts have held that state and federal claims based on the same facts are intertwined.[24] Other courts have employed an intertwining test analogous to the test for the exercise of pendent federal subject matter jurisdiction.[25] Still other courts have held that federal and state securities claims are intertwined when the resolution of the federal claims requires the court to consider the same facts, legal issues, and evidence that support the state claims.[26] Courts invoking the intertwining doctrine have refused to submit the

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and federal claims when impractical or impossible to separate arbitrable state claims from nonarbitrable federal claims), *cert. denied*, 434 U.S. 824 (1977); Frogner v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [Current] FED. SEC. L. REP. (CCH) ¶99,504, at 96,927 (N.D. Cal. Sept. 26, 1983) (arbitration of state claims would be duplicative if state and federal claims rest on same factual and legal questions); Cunningham v. Dean Witter Reynolds, Inc., 550 F. Supp. 578, 584-85 (E.D. Cal. 1982) (Congress did not intend Arbitration Act to require arbitration of all arbitrable claims irrespective of joinder of arbitrable claims with nonarbitrable claims); Seymour v. Bache & Co., [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶95,402, at 99,058 (S.D.N.Y.) (common-law claim of breach of fiduciary duties intertwined with '34 Act claims), *aff'd mem.*, 538 F.2d 313 (2d Cir. 1976); Macchiavelli v. Shearson, Hammill & Co., 384 F. Supp. 21, 31 (E.D. Cal. 1974) (intertwining doctrine requires litigation of state claims not factually and legally severable from federal securities claims); Shapiro v. Jaslow, 320 F. Supp. 598, 600 (S.D.N.Y. 1970) (arbitration of common-law claims would render exclusive jurisdiction of federal courts over federal securities claims meaningless); *see also infra* notes 92-104 and accompanying text (discussion of intertwining doctrine).

23. *See infra* notes 24-27 and accompanying text (discussion of varying applications of intertwining doctrine).

24. *See* Belke v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 693 F.2d 1023, 1026-27 (11th Cir. 1982) (factual severability of state and federal claims is determinative of question of applicability of intertwining doctrine to litigate all claims); Seymour v. Bache & Co., [1975-76 Transfer Binder] FED. SEC. L. REP. (CCH) ¶95,402, at 99,058 (S.D.N.Y.) (presence of complex and factually intertwined issues requires consolidation of common-law and federal securities claims in one proceeding), *aff'd mem.*, 538 F.2d 313 (2d Cir. 1976); Macchiavelli v. Shearson, Hammill & Co., 384 F. Supp. 21, 31 (E.D. Cal. 1974) (invocation of intertwining doctrine requires finding that federal law issues and state law issues are inseparable).

25. *See* Sibley v. Tandy Corp., 543 F.2d 540, 543 (5th Cir. 1976) (courts should exercise jurisdiction to decide state claims that would be impractical to separate from federal securities claims), *cert. denied*, 434 U.S. 824 (1977); Shapiro v. Jaslow, 320 F. Supp. 598, 600 (S.D.N.Y. 1970) (court should decide pendent common-law claims).

Pendent subject matter jurisdiction allows a federal court exercising jurisdiction over a federal claim to decide a related state claim over which the federal court otherwise would not have had original jurisdiction. *See* United Mine Workers v. Gibbs, 383 U.S. 715, 725 (1966) (court properly exercised jurisdiction to decide both state claim of unlawful interference with contract and federal claim of violation of federal statute). Exercise of pendent jurisdiction requires that the federal claim be substantial, that the state and federal claims derive from a common nucleus of operative fact, and that a plaintiff ordinarily would expect to try all claims in a single proceeding. *Id.* While satisfaction of the three requirements for pendent jurisdiction establishes the constitutional power of a federal court to decide a pendent state claim, the exercise of that power by a federal court is discretionary. *Id.* at 726-28. A federal court should address the considerations of judicial economy and convenience and fairness to the litigants before exercising discretion to decide pendent claims. *Id.* at 726; *see* Liskey v. Oppenheimer & Co., 717 F.2d 314, 321 (6th Cir. 1982) (courts should exercise power to decide pendent claims sparingly).

26. *See* Miley v. Oppenheimer & Co., 637 F.2d 318, 335-36 (5th Cir. 1981) (courts should decide state claims when resolutions of state and federal securities claims rely on drawing iden-

state claims to arbitration pursuant to existing arbitration agreements and have asserted jurisdiction over the state claims.[27] The intertwining doctrine and the sever and stay approach represent the differing approaches taken by federal courts in determining the appropriate forum for the resolution of disputes presenting both arbitrable state-based securities claims and nonarbitrable federal securities claims.[28]

In *Wilko v. Swan*,[29] the United States Supreme Court held that predispute arbitration agreements between brokers or dealers and investors are unenforceable with respect to federal securities claims arising under the '33 Act.[30] In *Wilko*, an investor brought suit in the United States District Court for the Southern District of New York against a securities brokerage firm to recover damages under the civil liability provisions of section 12(2) of the '33 Act.[31] The investor claimed that the investment firm had induced him to purchase shares of stock by falsely representing the value of the stock.[32] The investor, in *Wilko*, invoked federal jurisdiction under section 22(a) of the '33 Act.[33]

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tical factual and legal conclusions from common evidentiary facts); Frogner v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [Current] FED. SEC. L. REP. (CCH) ¶99,504, at 96,927 (N.D. Cal. Sept. 26, 1983) (claims based on same factual and legal issues requiring consideration of identical evidence are intertwined); Cunningham v. Dean Witter Reynolds, Inc., 550 F. Supp. 578, 582 (E.D. Cal. 1983) (arbitration that considers same evidence as court considers to decide identical legal and factual questions is inefficient).

27. *See* Belke v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 693 F.2d 1023, 1024-25 (11th Cir. 1982) (alleged violations of federal securities laws and state common-law principles based on mismanagement of investor's account); Miley v. Oppenheimer & Co., 637 F.2d 318, 323 (5th Cir. 1981) (excessive trading of account in violation of common-law fiduciary duty and '34 Act provisions); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1019-21 (6th Cir. 1979) (claims of '34 Act violations and state statutory and common-law fraud resulting from alleged mishandling of investor's account); Sibley v. Tandy Corp., 543 F.2d 540, 541-42 (5th Cir. 1976) (breach of contract and '34 Act claims), *cert. denied*, 434 U.S 824 (1977); Frogner v. Merrill Lynch, Pierce, Fenner & Smith, Inc. [Current] FED. SEC. L. REP. (CCH) ¶99,504, at 96,927 (N.D. Cal. Sept. 26, 1983) ('33 Act claims and alleged violations of state statutes based on fraud); Seymour v. Bache & Co., [1975-76 Transfer Binder] FED. SEC. L. REP. (CCH) ¶95,402, at 99,057 (S.D.N.Y.) (common-law fiduciary duty and '34 Act claims), *aff'd mem.*, 538 F.2d 313 (2d Cir. 1976); Shapiro v. Jaslow, 320 F. Supp. 598, 599-600 (S.D.N.Y. 1970) (general allegation of common-law violations combined with '33 Act and '34 Act claims).

28. *See infra* notes 92-126 and accompanying text (discussion of intertwining doctrine and sever and stay approach).

29. 346 U.S. 427 (1953).

30. *Id.* at 438.

31. Wilko v. Swan, 107 F. Supp. 75, 77 (S.D.N.Y. 1952), *rev'd*, 201 F.2d 439 (2d Cir.), *rev'd*, 346 U.S. 427 (1953); *see* Securities Act of 1933, § 12(2), 15 U.S.C. § 77*l*(2) (1982) (§ 12(2) of '33 Act creates civil liability for material misrepresentations by any person who offers or sells securities).

32. *See* Wilko v. Swan, 346 U.S. 427, 428-29 (1953). In *Wilko v. Swan*, an investor alleged that the investment firm of Hayden, Stone and Company had induced the investor to purchase 1,600 shares of the common stock of Air Associates, Inc. by falsely representing that the Air Associates stock would be valued at $6.00 per share over the then current market price upon the merger of Air Associates with the Borg Warner Corporation. *Id.* The investor sold the stock at a loss two weeks following the purchase. *Id.* at 429.

33. *Id.*; *see* 15 U.S.C. § 77v(a) (1982) (§ 22(a) of '33 Act creates concurrent jurisdiction

Section 22(a) creates concurrent jurisdiction in state and federal courts for adjudication of claims under the '33 Act and the rules and regulations promulgated thereunder.[34] The investment firm moved to stay the trial in the federal district court, pursuant to section 3 of the federal Arbitration Act,[35] pending arbitration in accordance with the terms of a written agreement between the investment firm and the investor.[36] The district court denied the investment firm's motion to stay the proceedings.[37] The Second Circuit held that the '33 Act did not prohibit the use of predispute arbitration agreements and reversed the district court.[38] The Supreme Court reversed the Second Circuit and held that a predispute arbitration agreement constitutes a waiver of an investor's right to select a judicial forum.[39] Section 14 of the '33 Act provides that any condition, stipulation, or provision that requires an investor to waive compliance with any provision of the '33 Act is void.[40] The *Wilko* Court reasoned that the right of an investor to bring suit in federal court,[41] and thereby to benefit from a wide choice of venue and broad service of process,[42] constituted a "provision" of the '33 Act that was not subject to waiver.[43] Since section 14 voids any stipulation waiving compliance with any provision of the '33 Act, the *Wilko* Court concluded that predispute arbitration agreements are void and unenforceable with respect to claims under the '33 Act.[44]

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in state and federal courts for adjudication of '33 Act claims).

34. 15 U.S.C. § 77v(a) (1982).

35. *See* 9 U.S.C. § 3 (1982) (§ 3 of Arbitration Act requires courts to stay litigation pending arbitration of claims pursuant to written agreements between parties).

36. *See Wilko*, 107 F. Supp. at 77. When the investor in *Wilko* established a margin account with Hayden, Stone and Company, the investor and the investment firm executed a written agreement providing for the arbitration of all future disputes between the investor and the investment firm. *Id.*

37. *See id.* at 79. The district court in *Wilko* held that the congressional policy of protecting investors required the litigation of the federal securities claims. *Id.*

38. *See* Wilko v. Swan, 201 F.2d 439, 445 (2d Cir.), *rev'd*, 346 U.S 427 (1953). In reversing the lower court's decision in *Wilko*, the Second Circuit held that the congressional policy favoring arbitration, as embodied in the Arbitration Act, overrides the '33 Act policy of investor protection. *Id.*

39. *Wilko*, 346 U.S. at 434-35.

40. 15 U.S.C. § 77n (1982) (§ 14 of '33 Act).

41. *Id.* § 77v(a).

42. *See id.* (§ 22(a) of '33 Act permits investors to bring suit in any district in which defendant can be found, transacts business, or made offer or sale, and permits service of process wherever defendant is inhabitant, or can be found).

43. *Wilko*, 346 U.S. at 434-35.

44. *Id.; see* 15 U.S.C. § 77n (1982) (§ 14 of '33 Act). The *Wilko* doctrine does not preclude enforcement of agreements to arbitrate existing disputes. *See Wilko*, 346 U.S. at 438-39 (Jackson, J., concurring) (parties may agree to arbitrate existing controversies); *see also* Kribs v. Bache, Halsey, Stuart, Shields, Inc., [1982-83 Transfer Binder] FED. SEC. L. REP. (CCH) ¶99,017 at 94,817 (S.D.N.Y. 1982) (investor's choice of arbitration tribunal and counterclaim alleging gross mismanagement of investor's securities account constituted agreement to submit existing federal securities claim to arbitration); Note, *Enforceability of Arbitration Agreements in Fraud Actions under the Securities Act*, 62 YALE L.J. 985, 994-96 (1953) (discussion of voluntary submission of existing federal securities claims to arbitration).

Although the Supreme Court has never decided whether predispute arbitration clauses are unenforceable with respect to claims arising under the '34 Act, federal courts have extended the *Wilko* doctrine to claims under the '34 Act.[45] Section 27 of the '34 Act provides that federal district courts shall have exclusive jurisdiction over claims arising under the '34 Act and the rules and regulations promulgated thereunder.[46] Section 29(a) of the '34 Act is a nonwaiver provision analogous to section 14 of the '33 Act.[47] Relying on the *Wilko* Court's interpretation of the nonwaiver provision of the '33 Act, courts have interpreted section 29(a) to render predispute arbitration agreements void with respect to claims based on the '34 Act.[48]

In *Scherk v. Alberto-Culver Co.*,[49] the United States Supreme Court addressed, but did not decide, whether to extend the *Wilko* doctrine to claims arising under the '34 Act.[50] In *Scherk*, Alberto-Culver, an American company, contracted for the purchase of businesses owned by Fritz Scherk, a German citizen.[51] The sales contract contained an agreement to arbitrate all disputes before the International Chamber of Commerce, in Paris, France.[52] Upon discovering the breach of certain express contract provisions, Alberto-Culver filed suit in the United States District Court for the Northern District of Illinois

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45. *See* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore, 590 F.2d 823, 827-29 (10th Cir. 1978) (policy of nonwaiver provision of '33 Act embodied in '34 Act nonwaiver provision), Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831, 835-36 (7th Cir. 1977) (*Wilko* doctrine applies to rule 10b-5 implied rights of action); Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532, 536-37 (3d Cir.) (prospective waiver of right to judicial resolution of any federal securities claim is inconsistent with investor protection policy of securities acts), *cert. denied*, 429 U.S. 1010 (1976); Newman v. Shearson, Hammill & Co., 383 F. Supp. 265, 268 (W.D. Tex. 1974) (reasoning of *Wilko* compels extension of doctrine to '34 Act claims); Maheu v. Reynolds & Co., 282 F. Supp. 423, 428-29 (S.D.N.Y. 1968) (neither '33 Act claims nor '34 Act claims of fraud are subject to arbitration); Stockwell v. Reynolds & Co., 252 F. Supp. 215, 219-21 (S.D.N.Y. 1965) (*Wilko* doctrine applies to preclude enforcement of predispute agreement to arbitrate fraud claims under '34 Act); Reader v. Hirsch & Co., 197 F. Supp. 111, 116 (S.D.N.Y. 1961) (congressional policy of protecting investors, as evidenced by implication of private rights of action, requires extension of *Wilko* doctrine to '34 Act claims). Congress also apparently has accepted the view that the *Wilko* doctrine applies to preclude enforcement of predispute arbitration agreements with respect to claims under rule 10b-5. *See* H.R. REP. No. 229, 94th Cong., 1st Sess. 111, *reprinted in* 1975 U.S. CODE CONG. & AD. NEWS 321, 342 (acknowledgement that 1975 amendments to '34 Act do not alter existing law under *Wilko* doctrine).

46. 15 U.S.C. § 78aa (1982) (§ 27 of '34 Act).

47. *Id.* § 78cc(a) (§ 29(a) of '34 Act voids any condition, stipulation, or provision binding any person to waive compliance with any provision of '34 Act).

48. *See supra* note 45 and accompanying text (cases extending *Wilko* doctrine to '34 Act claims).

49. 417 U.S. 506 (1974).

50. *Id.* at 513-14.

51. *Id.* at 508. In *Scherk v. Alberto-Culver Co.*, Alberto-Culver contracted to purchase three business entities owned by Scherk operating in Germany and Liechtenstein. *Id.* The sales contract contained express warranties in which Scherk guaranteed the transfer of complete and unencumbered ownership of trademarks in cosmetic goods. *Id.*

52. *Id.* The contract for the sale of the business entities owned by Scherk stipulated that the laws of the state of Illinois, Alberto-Culver's principal place of business, would apply in any arbitration proceedings. *Id.*

alleging that Scherk had made fraudulent representations in violation of section 10(b) of the '34 Act[53] and rule 10b-5[54] promulgated thereunder.[55] Scherk moved to stay the district court proceedings pending arbitration pursuant to the terms of the sales contract.[56] Relying on the *Wilko* doctrine, the district court denied Scherk's motion and granted a preliminary injunction to prevent Scherk from proceeding with arbitration.[57] The Seventh Circuit affirmed the district court's decision.[58] The Supreme Court, however, reversed the judgment of the Seventh Circuit and held that the arbitration agreement between the parties was enforceable.[59]

In *Scherk*, the Supreme Court acknowledged an argument that the *Wilko* doctrine should not apply to claims under the '34 Act.[60] The argument that the *Wilko* doctrine does not apply to '34 Act claims recognizes that section 12(2) of the '33 Act provides investors with a private remedy for civil liability.[61] No analogous provision exists in the '34 Act.[62] Neither section 10(b) of the '34 Act nor rule 10b-5 creates an express private remedy.[63] Furthermore, unlike the provision of the '33 Act creating concurrent jurisdiction in state and federal courts, the jurisdictional provision of the '34 Act provides exclusive jurisdiction in the federal courts.[64] The *Scherk* Court acknowledged that the lack of an express private remedy and the restriction of an investor's choice of forum

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53. 15 U.S.C. § 78j(b) (1982) (§ 10(b) of '34 Act prohibits use of manipulative and deceptive devices in purchase or sale of securities).

54. 17 C.F.R. § 240.10b-5 (1983). Pursuant to its rulemaking authority under § 10(b) of the '34 Act, the SEC promulgated rule 10b-5, a general antifraud provision, to identify practices that violate § 10(b). *See id.* Rule 10b-5 proscribes the employment of all manipulative and deceptive devices in the purchase and sale of securities. *See id.*

55. *Scherk*, 417 U.S. at 509. In *Scherk*, Alberto-Culver discovered that trademark rights in cosmetic goods which Alberto-Culver had purchased from Scherk were subject to substantial encumbrances in violation of the contract for sale of Scherk's business entities to Alberto-Culver. *Id.*

56. *Id.* Alberto-Culver opposed Scherk's motion for a stay and sought a preliminary injunction restraining the prosecution of arbitration proceedings. *Id.* at 510. The memorandum opinion of the district court in *Scherk* is unreported. *See id.* at 510 n.3.

57. *Id.* at 510.

58. *See* Alberto-Culver Co. v. Scherk, 484 F.2d 611, 615 (7th Cir. 1973), *rev'd*, 417 U.S. 506 (1974). The Seventh Circuit upheld the district court's grant of an injunction in *Scherk*, reasoning that the *Wilko* doctrine requires the litigation of all federal securities claims, irrespective of the international nature of the dispute. *Id.*

59. *See Scherk*, 417 U.S. at 520-21. The Supreme Court distinguished *Scherk* from *Wilko* on the grounds that *Scherk* involved an international agreement and, therefore, raised different policy considerations. *Id.*

60. *Id.* at 513-14.

61. *Id.* at 513; *see supra* note 31 and accompanying text (discussion of § 12(2) of '33 Act).

62. *Scherk*, 417 U.S. at 513.

63. *Id.* at 513-14. An implied right of action exists under rule 10b-5. Superintendent of Ins. v. Bankers Life & Casualty Co., 404 U.S. 6, 11-12 (1971); *see infra* note 79 (discussion of implied rights of action under '34 Act). The Supreme Court, however, has indicated that courts should be restrictive in their implication of private rights of action under the '34 Act to avoid vexatious litigation. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 739 (1975).

64. *Compare* 15 U.S.C. § 77v(a) (1982) (§ 22(a) of '33 Act creates concurrent jurisdiction in state and federal courts over '33 Act claims) *with id.* § 78aa (federal courts have exclusive jurisdiction over '34 Act claims).

under the '34 Act may imply that the *Wilko* doctrine should not control the question of the enforceability of predispute arbitration agreements with respect to claims under the '34 Act.[65] The *Scherk* Court, however, did not decide whether the *Wilko* doctrine applies to '34 Act claims, but upheld the enforceability of the arbitration clause by distinguishing the facts of the *Scherk* case from the facts of the *Wilko* case.[66] The *Scherk* Court reasoned that the international nature of the agreement between Scherk and Alberto-Culver raised considerations and policies significantly different from those present in *Wilko*.[67] The *Scherk* Court explained that arbitration agreements between parties to an international agreement are necessary to maintain the orderliness and predictability essential to efficient international business transactions.[68] The Supreme Court concluded that policy considerations favoring facilitation of international commerce require the enforcement of valid arbitration agreements.[69] Subsequent lower court cases have limited the *Scherk* holding to its facts, and, absent a significant international character to the agreement, have continued to apply the *Wilko* doctrine to prohibit enforcement of predispute arbitration agreements with respect to '34 Act claims.[70] The lower courts have recognized that neither the differences between the rights granted by the '33 and '34 Acts nor any policy considerations warrant a distinction between '33 and '34 Act claims with respect to the enforceability of predispute arbitration agreements.[71]

The *Wilko* doctrine's preclusion of the enforcement of predispute arbitration agreements effectuates the policy of the '33 Act.[72] The main purpose of the '33 Act is to protect investors from fraud and misrepresentation in the sale of securities.[73] The *Wilko* Court recognized that arbitration lacks many

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65. *Scherk*, 417 U.S. at 514.

66. *Id.* at 515-18.

67. *Id.* The *Scherk* Court reasoned that contractual provisions specifying the forum for the resolution of future disputes are essential to the orderliness and predictability of international business transactions. *Id.* at 516. In particular, enforcement of predispute arbitration agreements between parties to an international agreement allows courts to avoid confronting difficult conflicts of law questions in the resolution of international disputes. *Id.* at 516-17.

68. *Id.*

69. *Id.* at 519-20.

70. *See* Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1030 (6th Cir. 1979) (*Wilko* doctrine applies to rule 10b-5 claim for mishandling of investor's account); Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 558 F.2d 831, 834-36 (7th Cir. 1977) (same policy considerations underlie '33 and '34 Acts and, therefore, *Wilko* doctrine applies equally to '34 Act claims); Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 538 F.2d 532, 538-39 (3d Cir.) (§ 28(b) of '34 Act prohibits predispute waiver of '34 Act provisions), *cert. denied*, 429 U.S. 1010 (1976); Newman v. Shearson, Hammill & Co., 383 F. Supp. 265, 268 (W.D. Tex. 1974) (*Scherk* does not overrule *Wilko*, but creates limited exception applicable only to international transactions); *see also* SEC Securities Exchange Act Release No. 34-15984 (July 2, 1979), *reprinted in* [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,122, at 81,977 (SEC recognizes that *Wilko* doctrine is applicable to '34 Act claims).

71. *See supra* notes 45 & 70 and accompanying text (discussion of extension of *Wilko* doctrine to '34 Act claims).

72. *See infra* notes 73-77 (discussion of policy of '33 Act).

73. S. REP. No. 47, 73d Cong., 1st Sess. 1 (1933). Congress enacted the '33 Act to prevent

of the procedural safeguards of litigation in court.[74] Arbitrators generally do not issue opinions explaining the reasons for arbitration awards, and no requirement exists for arbitrators to keep complete records of arbitration proceedings.[75] Moreover, arbitrators' interpretations of law are not subject to judicial review in the federal courts.[76] The *Wilko* Court concluded that the lack of procedural safeguards and the limited availability of review rendered arbitration inconsistent with the '33 Act's policy of providing protection to securities investors.[77]

The *Wilko* doctrine is also consistent with the '34 Act's provision creating exclusive jurisdiction in the federal courts over claims arising under the '34 Act.[78] Similarly, the implication of various private rights of action indicates that the courts construe a congressional intent that the '34 Act provide additional investor protections.[79] Therefore, federal courts have maintained that

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exploitation of the public through the sale of unsound, fraudulent, and worthless securities. *Id.* The '33 Act established a federally supervised scheme for the registration of publicly traded securities. *See id.* at 2-3. The '33 Act also created remedies for fraud and misrepresentation in the sale of securities. *See id.* at 6.

74. *Wilko*, 346 U.S. at 436-37.

75. *See* United Steelworkers of Am. v. Enterprise Wheel & Car Corp., 363 U.S. 593, 598 (1960) (arbitrators are under no obligation to courts to give reasons for awards); Bernhardt v. Polygraphic Co. of Am., 350 U.S. 198, 203 (1956) (courts cannot require arbitrators to disclose facts or reasons supporting award); Sobel v. Hertz, Warner & Co., 469 F.2d 1211, 1214-15 (2d Cir. 1972) (no general requirement exists that arbitrators explain reasons for awards); M. DOMKE, THE LAW AND PRACTICE OF COMMERCIAL ARBITRATION § 29.06 (1968) (written opinions rarely accompany commercial arbitration awards).

Arbitrators generally do not keep records of commercial arbitration proceedings. *See* M. DOMKE, *supra*, § 24.07 (parties generally do not require taking of records due to expenses involved and limited usefulness since courts will not review merits of case). Parties' concern for speed and finality of controversy settlement constitutes the main policy underlying arbitrators' practice of not issuing written opinions. *Id.* § 29.06. A detailed written opinion might expose the reasoning behind an arbitration award to challenge in the courts and, thereby, jeopardize both the speed and finality of arbitration proceedings. *Id.*

76. *Wilko*, 346 U.S. at 436-37; *see* Sobel v. Hertz, Warner & Co., 469 F.2d 1211, 1213 (2d Cir. 1972) (court cannot vacate arbitration award for mistaken interpretation of law, but only for manifest disregard of law); *see also* M. DOMKE, *supra* note 75, § 33.02 (discussion of restrictions on judicial challenge of arbitrators' awards); *Disputes, supra* note 2, at 146-48 (discussion of limited methods for attack of arbitration awards). Section 10 of the Arbitration Act specifies several permissible grounds for vacating arbitrator's awards including fraud, corruption or undue means in procuring award, partiality or corruption on the part of an arbitrator, misconduct by an arbitrator in refusing to postpone a hearing upon the showing of sufficient cause, an arbitrator's refusal to hear pertinent evidence, and an arbitrator's actions in excess of powers. 9 U.S.C. § 10 (1982).

77. *Wilko*, 346 U.S. at 438.

78. *See* 15 U.S.C. § 78aa (1982) (§ 27 of '34 Act creates exclusive federal jurisdiction); *see also* Sibley v. Tandy Corp., 543 F.2d 540, 543 (5th Cir. 1976) (preservation of exclusive federal jurisdiction over '34 Act claims requires denial of enforcement of predispute arbitration agreements), *cert. denied*, 434 U.S. 824 (1977); Shapiro v. Jaslow, 320 F. Supp. 598, 600 (S.D.N.Y. 1970) (enforcement of arbitration agreements could render federal courts' exclusive jurisdiction over '34 Act claims meaningless).

79. *See* Reader v. Hirsch & Co., 197 F. Supp. 111, 114-15 (S.D.N.Y. 1961) (implication of private rights of action under various '34 Act sections evidences congressional intent to protect

the policy reasons for denying enforcement of predispute arbitration agreements under the '33 Act are equally applicable to claims under the '34 Act.[80]

The *Wilko* doctrine, however, creates an exception to the provisions of the federal Arbitration Act.[81] The Arbitration Act, enacted under the authority of the commerce clause,[82] creates a body of federal substantive law applicable in state and federal courts.[83] Section 2 of the Arbitration Act declares that, except for the limitations on enforcement of any contract, written arbitration agreements are valid, irrevocable, and enforceable.[84] The *Wilko* doctrine, while recognizing the general contractual validity of predispute arbitration clauses, declares predispute arbitration agreements void and unenforceable with respect to federal securities claims.[85] Congress enacted the Arbitration Act to overcome a common-law principle that traditionally denied specific enforcement of written arbitration agreements.[86] The Arbitration Act placed arbitration agreements on equal footing with other contracts.[87] Congress passed the Arbitration Act to allow parties to contract to avoid the expense and delay of litigating future disputes.[88] Courts consistently have construed the scope of arbitration agreements liberally to give full effect to the congressional policy underlying the Arbitration Act.[89] The *Wilko* doctrine represents an exception

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investors). In *J.I. Case Co. v. Borak*, the Supreme Court implied a private right of action to sue for damages caused by a misleading proxy solicitation in violation of § 14(a) of the '34 Act. 377 U.S. 426, 433-35 (1964); *see* 15 U.S.C. § 78n(a) (1982) (§ 14(a) of '34 Act). The *Borak* Court reasoned that the '34 Act's policy of protecting investors implies the availability of judicial relief where necessary to protect investors. 317 U.S. at 431-33. Similarly, the Supreme Court acknowledged the availability of a private right of action under § 10(b) of the '34 Act and rule 10b-5 in *Superintendent of Ins. v. Bankers Life & Casualty Co.* 404 U.S. 6, 11-12 (1971); *see* 15 U.S.C. § 78j(b) (1982) (§ 10(b) of '34 Act); 17 C.F.R. § 240.10b-5 (1983) (rule 10b-5). Recently, however, the Supreme Court has taken a more restrictive approach toward implying private rights of action under the provisions of the '34 Act. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 729-30 (1975) (absent clear indication that Congress intended statute to provide private remedy, courts should hesitate to imply private remedy); *see also* Cannon v. University of Chicago, 441 U.S. 677, 735-36 (1979) (Powell, J., dissenting) (implication of private rights of action constitutes aberrant interpretation of the '34 Act).

80. *See supra* notes 73-79 (discussion of policies of '33 and '34 Acts).

81. 9 U.S.C. §§ 1-14 (1982).

82. U.S. CONST. art. I, § 8, cl. 3.

83. *See* Southland Corp. v. Keating, 104 S.Ct. 852, 858-59 (1984) (Arbitration Act requires that California state court enforce predispute arbitration agreement despite state statute mandating judicial resolution of franchise dispute).

84. 9 U.S.C. § 2 (1982).

85. *See supra* notes 29-44 and accompanying text (discussion of *Wilko* doctrine). The *Wilko* Court assumed the contractual validity of the arbitration agreement between the parties. *See* 346 U.S. at 429-30.

86. S. REP. No. 536, *supra* note 12, at 2; H.R. REP. No. 96, *supra* note 12, at 1-2.

87. H.R. REP. No. 96, *supra* note 12, at 1.

88. S. REP. No. 536, *supra* note 12, at 3; H.R. REP. No. 96, *supra* note 12, at 2.

89. *See* Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402, 411 (2d Cir. 1959) (court held that arbitration clause covering contract controversies included charge of fraud in inducement); Janmort Leasing, Inc. v. EconoCan Int'l, Inc., 475 F. Supp. 1282, 1291-92 (E.D.N.Y. 1979) (court held that clause requiring arbitration of any controversy or claim arising out of, or relating to, contract applied to claims of breach of fiduciary duty, tortious interference with

to the enforcement of the provisions of the Arbitration Act to the extent that the doctrine precludes the enforcement of contractually valid predispute agreements to arbitrate federal securities claims.[90] Since securities disputes often contain both state and federal claims, courts must determine whether state-based securities claims are subject to arbitration pursuant to valid arbitration agreements or whether the *Wilko* doctrine requires the parties to litigate state claims concurrently with related nonarbitrable federal securities claims.[91]

The Fifth Circuit has decided that, despite the existence of a valid agreement to arbitrate future claims, courts should exercise jurisdiction to review both the state and federal claims presented in a securities dispute when the state claims are intertwined with the federal claims.[92] In *Miley v. Oppenheimer & Co.*,[93] an investor alleged that the defendant investment company had "churned"[94] the investor's account in violation of the investment company's common-law fiduciary duty to the investor, section 10(b) of the '34 Act, and rule 10b-5.[95] The *Miley* court refused to enforce a valid predispute arbitration

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contractual relationships, common-law unconscionability, and unjust enrichment). Federal courts recognize a strong federal policy to encourage the arbitration of disputes. *See* Seaboard Coast Line R.R. v. Trailer Train Co., 690 F.2d 1343, 1348 (11th Cir. 1982) (federal policy favoring arbitration over litigation requires courts to construe arbitration clauses to resolve all doubts in favor of arbitration); Stateside Mach. Co. v. Alperin, 591 F.2d 234, 240 (3d Cir. 1979) (Arbitration Act embodies federal policy of promoting arbitration); Southwest Indus. Import & Export, Inc. v. Wilmod Co., 524 F.2d 468, 470 (5th Cir. 1975) (courts should give full effect to arbitration agreements to effectuate intent of parties and ease court congestion); DeCosta v. Columbia Broadcasting Sys., Inc., 520 F.2d 499, 505 (1st Cir. 1975) (adoption of Arbitration Act transformed judicial hostility toward arbitration to general approval of arbitration), *cert. denied*, 423 U.S. 1073 (1976). Courts, therefore, have construed a strong federal policy favoring the liberal enforcement of arbitration agreements. *See* Galt v. Libbey-Owens-Ford Glass Co., 376 F.2d 711, 714 (7th Cir. 1967) (courts should construe arbitration clauses by resolving every doubt in favor of arbitration); Lundgren v. Freeman, 307 F.2d 104, 111 (9th Cir. 1962) (Arbitration Act's policy of promoting arbitration requires liberal interpretation of arbitration agreements).

90. *See supra* notes 29-44 and accompanying text (discussion of *Wilko* doctrine).

91. *See infra* notes 92-126 and accompanying text (discussion of differing approaches of courts to determine jurisdiction over mixed claims disputes).

92. *See* Miley v. Oppenheimer & Co., 637 F.2d 318, 335-36 (5th Cir. 1981) (common-law claim of breach of fiduciary duty litigated with rule 10b-5 claim).

93. 637 F.2d 318 (5th Cir. 1981).

94. *Id.* at 324. To prove a claim of churning in violation of § 10(b) of the '34 Act and rule 10b-5 an investor must show that the trading of the investor's account was excessive in light of the investor's objectives, that the defendant broker exercised control over the trading of the investor's account, and that the broker acted with the intent to defraud the investor or with reckless disregard for the investor's interests. *Id.; see* 15 U.S.C. § 78j(b) (1982); 17 C.F.R. § 240.10b-5 (1983). *See generally* Note, *Churning By Securities Dealers*, 80 HARV. L. REV. 869 (1967) (discussion of churning of securities investment accounts).

95. *Miley*, 637 F.2d at 324. In *Miley v. Oppenheimer & Co.*, an investor alleged that the defendant investment firm had engaged in excessive trading of the investor's assets in light of the investor's stated goals of conservative income and growth. *Id.* at 325. The defendant investment firm defended on the grounds that the investor had expressed a desire for a high rate of return through aggressive trading of the investor's discretionary account. *Id.* Both the investor and the investment firm presented expert testimony concerning the transactions in the investor's account. *Id.* The investor had an expert testify that the transactions in the investor's account were excessive in size and frequency in light of the conservative investment objectives of the in-

agreement, and held that the parties should resolve the entire dispute in court because the investor's state-based claim of violation of a fiduciary duty and the federal securities claims were sufficiently intertwined.[96] The *Miley* court reasoned that when the same ultimate facts underlie both the state and federal claims, federal courts should resolve the entire dispute to protect the exclusive jurisdiction of the federal courts over '34 Act claims.[97] The Fifth Circuit concluded that state and federal securities claims rest on the same ultimate facts when the resolution of each claim requires a court to draw the same legal and factual conclusions from common evidentiary facts.[98]

As the *Miley* court reasoned, the intertwining doctrine protects the exclusive jurisdiction of the federal courts over claims arising under the '34 Act.[99] Allowing the arbitration of state claims based on the same ultimate facts as federal securities claims threatens the exclusive jurisdiction of the federal courts through the potential application of collateral estoppel to bind federal courts to an arbitrator's prior resolution of a central issue of the federal securities claims.[100]

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vestor. *Id.* The investment firm presented expert testimony that the transactions in the investor's account were reasonable in light of the speculative objectives of the investor. *Id.* A jury determined that the investment company had churned the investor's account in violation of both the federal securities law and the Texas common-law fiduciary duty of investment brokers. *Id.*

96. *Id.* at 335-37. The *Miley* court concluded that resolutions of the investor's churning claim under rule 10b-5 and breach of fiduciary duty claim under common law both relied on the same ultimate issues. *Id.* at 336. The ultimate issues underlying both the state and federal claims were whether the trading of the investor's account was excessive, whether the investment company controlled the account, and whether any excessive trading was willful or reckless. *Id.*

97. *Id.* at 335-36. The *Miley* court reasoned that arbitration of the investor's state-based claim of breach of fiduciary duty would threaten the exclusive jurisdiction of the federal courts over the investor's rule 10b-5 claim because the resolution of each claim relies on the same ultimate issues, and a federal court would be bound, through collateral estoppel, by an arbitrator's prior resolution of those issues. *Id.* at 336. The investment firm argued that the investor had alleged distinct causes of action and that courts should apply the intertwining doctrine only to "legally intertwined" claims. *Id.* at 335. The investment firm asserted that claims are legally intertwined only when the legal issues are so inseparable as to constitute a single cause of action. *Id.* The *Miley* court rejected the concept of legal intertwining as unduly restrictive and, therefore, not consistent with the intertwining doctrine's policy of promoting judicial efficiency *Id.*

98. *Id.* at 335-36.

99. *See id.* at 336. The Fifth Circuit reasoned that the use of collateral estoppel to bind federal courts to arbitrators' decisions of issues common to nonarbitrable federal claims and arbitrable state claims effectively destroys the exclusive jurisdiction of the federal courts over federal securities claims. *Id.; see* 15 U.S.C. § 78aa (1982) (§ 27 of the '34 Act creates exclusive jurisdiction in federal courts over claims arising under '34 Act); *see also supra* note 78 (discussion of rationale of courts employing intertwining doctrine).

100. *See* Behrens v. Skelly, 173 F.2d 715, 719-20 (3d Cir. 1949) (arbitration award disallowing plaintiff's claim for breach of contract bars subsequent court proceeding for damages due to breach of contract); Goldstein v. Doft, 236 F. Supp. 730, 734 (S.D.N.Y. 1964) (court claim for commissions on product sales allegedly due plaintiff disallowed because prior arbitration of issues is binding as res judicata on court); Livingston v. Shreveport-Texas League Baseball Corp., 128 F. Supp. 191, 202 (W.D. La. 1955) (execution of arbitration clause in baseball manager's employment contract yields binding award having force of res judicata); *see also* RESTATEMENT (SECOND) OF JUDGMENTS § 84 (1982) (valid and final award by arbitration has same effect under rules of res judicata as judgment by court); 18 C. WRIGHT, A. MILLER & E. COOPER, FEDERAL

Arguably, the intertwining doctrine also promotes judicial efficiency.[101] Since the intertwining doctrine enables federal courts to resolve a securities dispute in its entirety, parties to the litigation may avoid the needless repetition of

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PRACTICE AND PROCEDURE § 4475 (1981) (principles of issue and claim preclusion generally are applicable to arbitration decisions); M. DOMKE, *supra* note 75, § 39.04 (rules of res judicata and collateral estoppel apply to judgments rendered upon arbitration award).

Prior court decisions bind arbitrators through collateral estoppel. *See* Buffalo Forge Co. v. United Steelworkers of Am., 428 U.S. 397, 412 (1976) (Court refused to issue injunction against striking union workers because labor contract contained arbitration clause and Court's interpretation of legal and factual issues in injunction proceeding would bind arbitrators in subsequent proceedings); Dickinson v. Heinold Sec., Inc., 661 F.2d 638, 644 (7th Cir. 1981) (federal court's determination of issues in federal securities suit binds arbitrators); New York State Ass'n for Retarded Children, Inc. v. Carey, 456 F. Supp. 85, 96 (E.D.N.Y. 1978) (court denied declaratory judgment in ancillary proceeding arising out of civil rights suit by mentally retarded state residents against New York State Department of Mental Health officials because some claims were referable to arbitration and court's decisions would bind arbitrators in subsequent proceedings); Stockwell v. Reynolds & Co., 252 F. Supp. 215, 220 (S.D.N.Y. 1965) (outcome of subsequent arbitration is dependent on court's determination of federal securities issues).

101. *See* Cunningham v. Dean Witter Reynolds, Inc., 550 F. Supp. 578, 582 (E.D. Cal. 1982) (severance of related claims would create inefficiencies by requiring duplication of presentation of evidence). In *Cunningham v. Dean Witter Reynolds, Inc.* an investor brought suit in the United States District Court for the Eastern District of California alleging that the brokerage firm of Dean Witter Reynolds, Inc. and two of the firm's employees had made deceptive and misleading statements concerning the risk and expected return of a particular investment scheme to induce the investor to open a securities investment account. *Id.* at 578-79. The investor asserted federal securities claims based on §§ 10(b) and 15(c) of the '34 Act and state-based tort claims of fraud, breach of fiduciary duty, negligent misrepresentation, and intentional infliction of emotional distress. *Id.* at 578. The investment firm moved for an order to sever the state tort claims and stay judicial proceedings on the federal claims pending the completion of arbitration proceedings pursuant to a predispute arbitration agreement between the parties. *Id.* at 578-79. The district court invoked the intertwining doctrine to establish federal jurisdiction over the state-based claims and accordingly denied the investment firm's motion to compel arbitration of the tort claims. *Id.* at 585.

The *Cunningham* court adopted the Fifth Circuit's intertwining doctrine and explicitly rejected the sever and stay approach of the Seventh Circuit. *Id.* at 584-85; *see* Dickinson v. Heinold Sec., Inc., 661 F.2d 638, 645-46 (7th Cir. 1981) (Seventh Circuit rejected intertwining doctrine, severed state-based claims from federal securities claims, and submitted state claims to arbitration following judicial resolution of federal claims); Miley v. Oppenheimer, 637 F.2d 318, 335-36 (5th Cir. 1981) (Fifth Circuit adopted intertwining doctrine); *see also supra* notes 92-98 and accompanying text (discussion of *Miley* decision); *infra* notes 105-115 and accompanying text (discussion of *Dickinson* decision). The *Cunningham* court held that the Arbitration Act does not require the enforcement of arbitration agreements when arbitrable state-based securities claims are intertwined with nonarbitrable federal securities claims. 550 F. Supp. at 583. The district court maintained that Congress intended § 3 of the Arbitration Act, which allows a stay of court proceedings on arbitrable claims, to apply to suits upon solely arbitrable issues. *Id.* at 583 & n.4; *see* 9 U.S.C. § 3 (1982) (§ 3 of Arbitration Act permits courts to stay proceedings on arbitrable issues). The *Cunningham* court accordingly concluded that § 3 of the Arbitration Act does not compel bifurcation of securities disputes presenting both arbitrable state-based claims and nonarbitrable federal claims. 550 F. Supp. at 583. Furthermore, the *Cunningham* court reasoned that the sever and stay approach is inconsistent with the Arbitration Act's policy of encouraging the quick and inexpensive resolution of disputes because application of the sever and stay approach would require parties to present identical evidence to prove the same legal and factual claims in two separate proceedings. *Id.* at 584.

the presentation of identical evidence in arbitration proceedings.[102] Moreover, the intertwining doctrine eliminates the possibility that federal courts and arbitrators may render inconsistent decisions on identical or similar claims.[103] Courts employing the intertwining doctrine recognize that the litigation of state-based securities claims with related federal securities claims furthers the policies of judicial efficiency, protection of exclusive federal jurisdiction over '34 Act claims, and avoidance of inconsistent decisions.[104]

Not all courts, however, have adopted the intertwining doctrine.[105] In *Dickinson v. Heinold Securities, Inc.*,[106] the Seventh Circuit rejected the intertwining doctrine.[107] The *Dickinson* court held that district courts should enforce valid arbitration agreements by requiring the arbitration of state-based securities claims, irrespective of the joinder of those claims with nonarbitrable federal claims.[108] In *Dickinson*, an investor brought suit in the United States District Court for the Northern District of Illinois against a broker claiming that the broker had failed to trade the investor's account in accordance with certain preselected strategies contained in a written agreement between the broker and the investor.[109] The investor alleged damages based on the broker's violation of section 10(b) of the '34 Act and rule 10b-5.[110] The investor also alleged various state law tort and contract claims based upon essentially the same facts as the federal securities claims.[111] The *Dickinson* court reasoned that an application of the intertwining doctrine would frustrate the strong federal policy favoring arbitration because the doctrine would preclude the arbitration of the state claims pursuant to a valid predispute arbitration agreement between the parties.[112] Accordingly, the Seventh Circuit severed the state law contract and tort claims from the federal securities claims and ordered

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102. 550 F. Supp. at 584.

103. *Id.*

104. *See id.* at 582; *Miley*, 637 F.2d at 336.

105. *See infra* notes 106-126 and accompanying text (discussion of courts adopting sever and stay approach).

106. 661 F.2d 638 (7th Cir. 1981).

107. *Id.* at 643-44.

108. *Id.* at 646.

109. *Id.* at 639-40.

110. *Id.* at 640. In *Dickinson v. Heinold Sec., Inc.*, an investor opened a stock options investment account with the defendant, Heinold Securities, Inc. *Id.* at 639. The investor and Heinold executed a written agreement giving Heinold a limited discretionary power to trade the investor's account on the Chicago Board Options Exchange. *Id.* Approximately one year after opening the account, the investor withdrew the bulk of his funds and informed Heinold that he believed that Heinold had not traded the account in accordance with the investment strategies specified in the written agreement between the parties. *Id.* at 640. The investor subsequently filed suit in the United States District Court for the Northern District of Illinois. *Id.* at 640. The investor alleged that Heinold's conduct had violated the agreement between the parties. *Id.* The investor also alleged that Heinold had violated § 10(b) of the '34 Act and rule 10b-5 by making misrepresentations in soliciting and trading the investor's account to maximize Heinold's profits from commissions. *Id.*

111. *Id.*

112. *Id.* at 644.

a stay of arbitration of the state claims pending judicial resolution of the federal claims.[113] The *Dickinson* court noted that the "sever and stay" approach preserves the federal courts' exclusive jurisdiction over '34 Act claims because a stay of the arbitration proceedings eliminates the possibility that an arbitrator's decisions would bind a federal court through collateral estoppel.[114] Furthermore, the *Dickinson* court claimed that the availability of detailed findings of fact, special verdicts, and the use of collateral estoppel to avoid duplication of efforts could minimize any inefficiencies attributable to bifurcation of a securities dispute.[115]

The Sixth Circuit recently adopted the sever and stay approach of the *Dickinson* court.[116] In *Liskey v. Oppenheimer & Co.*,[117] an investor alleged that the defendant investment firm had churned the investor's account in violation of various provisions of the '34 Act, stock exchange and association rules, state statutes, and common law.[118] The investment firm moved to sever the state-based claims and compel arbitration of those claims.[119] The United States District Court for the Western District of Michigan denied the defendant's motion.[120] The Sixth Circuit, however, reversed and compelled severance and

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113. *Id.* at 646.

114. *Id.* at 644.

115. *Id.; see supra* note 100 (application of doctrine of collateral estoppel to arbitration awards). The *Dickinson* court asserted that the alleged inefficiencies of a bifurcated securities dispute resolution system are speculative. 661 F.2d at 644. The Seventh Circuit reasoned that, in addition to the application of collateral estoppel to limit inefficiencies, plaintiffs who prevail in federal court on federal securities claims may have no need to pursue the resolution of arbitrable state claims because they would have previously recovered their damages. *Id. But see supra* notes 15-17 and accompanying text (plaintiffs may pursue state-based claims to recover punitive damages). Furthermore, the *Dickinson* court commented that the determination of issues of fact in a federal trial may facilitate the settlement of state-based claims prior to arbitration. 661 F.2d at 644.

116. *See infra* notes 117-126 and accompanying text (discussion of *Liskey* case).

117. 717 F.2d 314 (6th Cir. 1983).

118. *Id.* at 315. In *Liskey v. Oppenheimer & Co.*, an investor opened several types of investment accounts with the defendant investment firm, Oppenheimer & Co., Inc. *Id.* The investor signed a margin agreement and a "Client's Option Agreement" upon opening the accounts. *Id.* The terms of each of these agreements included a provision whereby the investor agreed to arbitrate any dispute pertaining to Oppenheimer's handling of the investor's account. *Id.* at 315 & nn. 1 & 2. The investor alleged that one of Oppenheimer's brokers had induced the investor to invest more than $100,000 in a bond option program by giving specific assurances of the investment's low-risk nature. *Id.* at 315. Within one year, the investor's account was worth approximately $30,000. *Id.* The investor filed suit in the United States District Court for the Western District of Michigan alleging fraudulent misrepresentation of material facts by Oppenheimer and the broker in violation of various provisions of the '34 Act, stock exchange and association rules, state statutes, and common law. Liskey v. Oppenheimer & Co., [1981-82 Transfer Binder] FED. SEC. L. REP. (CCH) ¶98,419, at 92,507-08 (W.D. Mich. 1982), *rev'd*, 717 F.2d 314 (6th Cir. 1983).

119. Liskey v. Oppenheimer & Co., [1981-82 Transfer Binder] FED. SEC. L. REP. (CCH) ¶98,419, at 92,508-09 (W.D. Mich. 1982), *rev'd*, 717 F.2d 314 (6th Cir. 1983).

120. *Id.* at 92,512. The district court in *Liskey* relied on the Sixth Circuit's decision in *Mansbach v. Prescott, Ball & Turben* to decide that the court should consolidate the investor's state and federal claims and try all claims in one proceeding. *Id.* at 92,508-09; *see* Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1030-31 (6th Cir. 1979) (court consolidated and tried '34 Act

arbitration of the state-based claims following judicial resolution of the federal securities claims.[121] The *Liskey* court concluded that the sever and stay approach maintains the proper balance between the competing policies of the Arbitration Act and the '34 Act.[122] Noting that section 3 of the Arbitration Act provides for a stay of court proceedings on issues referable to arbitration pursuant to a valid written agreement, the *Liskey* court concluded that severance and arbitration of state claims accomplishes the Arbitration Act's policy of providing an efficient and inexpensive dispute resolution process.[123] The *Liskey* court acknowledged that a stay of arbitration pending the completion of litigation of federal claims protects the exclusive jurisdiction of the federal courts over '34 Act claims.[124] The Sixth Circuit further asserted that the alleged inefficiencies of bifurcated proceedings are speculative.[125] For example, plaintiffs

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claims, state statutory fraud claim, and common-law fraud claim because all based on alleged mishandling of investor's option account by broker's purchase of incorrect number of options on wrong day). In *Mansbach,* the Sixth Circuit consolidated and tried state and federal securities claims resulting from a broker's mishandling of an investor's option account. 598 F.2d at 1030-31. The *Mansbach* court held that courts should decide state and federal securities claims containing substantially the same elements because arbitration of the state claims based on the same facts as the federal claims would be duplicative. *Id.* at 1030.

121. *Liskey,* 717 F.2d at 321.

122. *Id.* at 320. The Sixth Circuit in *Liskey* effectively discarded the intertwining approach of *Mansbach* in favor of the sever and stay approach. *Id.* at 320 & n.8a.; *see supra* note 120 (discussion of *Mansbach* decision).

123. 717 F.2d at 320. *But see* Cunningham v. Dean Witter Reynolds, Inc., 550 F. Supp. 578, 583 & n.4 (E.D. Cal. 1982) (§ 3 of Arbitration Act applies only to court proceedings on solely arbitrable claims); *supra* note 101 (discussion of *Cunningham* decision).

124. 717 F.2d at 320.

125. *Id.* In *Liskey,* the Sixth Circuit maintained that, even if the sever and stay approach results in some duplication of proof, the Supreme Court's decision in *Moses H. Cone Memorial Hosp. v. Mercury Constr. Co.* recognized that the Arbitration Act requires piecemeal litigation when necessary to give effect to an arbitration agreement. *Id.; see* Moses H. Cone Memorial Hosp. v. Mercury Constr. Co., 103 S.Ct. 927 (1983). In *Moses H. Cone,* a hospital contracted with Mercury Construction Company for the construction of additions to the hospital building. 103 S.Ct. at 931. The contract contained a provision whereby the parties agreed to refer all disputes involving interpretation of the contract or performance of the construction work to an independent architectural firm that the hospital had employed to design and oversee the construction project. *Id.* According to the terms of the contract, the parties could submit disputes to binding arbitration upon demand of either party following the architectural firm's resolution of the dispute or the architectural firm's failure to decide the dispute within 10 days. *Id.* at 931 & n.2. During construction, Mercury submitted claims to the architectural firm for increased costs caused by delays and inaction by the hospital. *Id.* at 932. The architectural firm never resolved the claims. *Id.* The hospital filed suit in state court against Mercury and the architectural firm alleging that Mercury's claims were without factual or legal basis. *Id.* The hospital also alleged that Mercury had lost its right to arbitration because of waiver, laches, estoppel, and failure to make a timely demand for arbitration. *Id.* The hospital's complaint also alleged various delinquencies on the part of the architectural firm. *Id.* As relief, the hospital sought declarations that Mercury had no right to demand arbitration, that the hospital bore no liability to Mercury, and that, if the court should find the hospital liable, the hospital would be entitled to indemnification from the architectural firm. *Id.*

The hospital obtained an injunction from the state court prohibiting Mercury from arbitrating its claims against the hospital. *Id.* Mercury filed suit in the United States District Court for the

who recover damages in court may have no need to pursue the arbitration of related claims.[126]

As a result of the SEC's recent enactment of rule 15c2-2, the possibility of increased litigation of securities disputes threatens to highlight the inconsistent approaches that federal courts have taken in considering the severability of arbitrable state-based securities claims and nonarbitrable federal securities claims.[127] Rule 15c2-2 requires brokers and dealers to inform investors that predispute arbitration clauses are unenforceable with respect to federal securities claims.[128] Since rule 15c2-2 effectively encourages the litigation of securities disputes presenting state-based claims arising out of the same transactions as federal securities claims, the consistent application of either the intertwining doctrine or the sever and stay approach would enable courts to resolve the potentially large number of future securities suits in a uniform manner.[129]

The intertwining doctrine and the sever and stay approach represent different balancings of the policies of the Arbitration Act and the federal securities acts.[130] The chief purpose of the Arbitration Act is to require the enforcement of agreements to submit disputes to arbitration.[131] The Arbitration Act thereby evidences congressional support of arbitration as an economical and expeditious alternative to litigation.[132] The '33 and '34 Acts embody a policy of protection of investors from fraudulent and misleading practices in the sale and trading of securities.[133] The *Wilko* doctrine creates an exception to the provisions of the Arbitration Act by rendering predispute arbitration agreements

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Middle District of North Carolina to compel arbitration under § 4 of the Arbitration Act. *Id.; see* 9 U.S.C. § 4 (1982) (§ 4 of the Arbitration Act permits party aggrieved by failure to arbitrate in accordance with written agreement to petition any federal district court to compel arbitration). The district court stayed Mercury's federal court suit pending completion of the state court suit on the same issue of arbitrability of Mercury's claims. 103 S.Ct. at 933. The Fourth Circuit reversed the district court's stay order and remanded the case to the district court with instructions for entry of an order to arbitrate. Mercury Constr. Corp. v. Moses H. Cone Memorial Hosp., 656 F.2d 933, 946 (4th Cir. 1981). The Supreme Court affirmed. 103 S.Ct. at 944.

The Supreme Court held that, even though the hospital's claim for indemnity from the architectural firm was not subject to an arbitration agreement between the parties, Mercury's claim against the hospital was subject to arbitration pursuant to the terms of the written agreement between the parties. *Id.* at 939. The Supreme Court recognized that compelling arbitration of the claim between the parties would require the hospital to resolve related disputes in different forums. *Id.* The Supreme Court reasoned that the Arbitration Act "*requires* piecemeal resolution when necessary to give effect to an arbitration agreement." *Id.* (emphasis in original).

126. *Liskey*, 717 F.2d at 320.

127. *See supra* notes 8-11 and accompanying text (discussion of rule 15c2-2).

128. 48 Fed. Reg. 53404 (1983) (to be codified at 17 C.F.R. § 240.15c2-2); *see supra* notes 8-11 and accompanying text (discussion of rule 15c2-2).

129. *See supra* notes 8-11 and accompanying text (discussion of rule 15c2-2).

130. *See supra* notes 92-126 and accompanying text (discussion of intertwining doctrine and sever and stay approach).

131. H.R. REP. No. 96, *supra* note 12, at 1-2; *supra* note 12 (discussion of Arbitration Act).

132. S. REP. No. 536, *supra* note 12, at 3. Businesses and individuals support the resolution of disputes through arbitration. *Id.* Arbitration allows parties to avoid the delay and expense of litigation. *Id.*

133. S. REP. No. 47, 73d Cong., 1st Sess. 1 (1933).

void and unenforceable with respect to claims arising under the federal securities acts.[134] The Supreme Court's concern with furthering the policy of investor protection constitutes the basis for the *Wilko* doctrine's exception to the Arbitration Act's policy of enforcement of valid arbitration agreements.[135] In determining the appropriate forum for deciding state claims based on the same facts as federal securities claims, courts must consider the policies of the Arbitration Act and the federal securities acts.[136] Courts adopting the intertwining doctrine have concluded that maintenance of exclusive federal jurisdiction over '34 Act claims, furtherance of the *Wilko* doctrine's protection of investors, and judicial efficiency arguments support the extension of federal court jurisdiction to decide state claims based on the same facts as federal securities claims despite the existence of valid arbitration agreements.[137] In contrast, courts adopting the sever and stay approach limit the application of the *Wilko* doctrine to federal securities claims and accordingly further the policy of the Arbitration Act by requiring arbitration of state-based claims pursuant to valid arbitration agreements.[138]

To the extent that the sever and stay approach gives effect to the policies underlying both the federal securities acts and the Arbitration Act, the sever and stay approach is preferable to the intertwining doctrine, which protects only the policies underlying the federal securities acts.[139] The sever and stay approach gives general effect to the right of parties to contract for the

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134. *See supra* notes 92-104 and accompanying text (discussion of intertwining doctrine).

135. *See Wilko*, 346 U.S. at 438.

136. *See supra* notes 92-126 and accompanying text (discussion of intertwining doctrine and sever and stay approach).

137. *See supra* notes 92-104 and accompanying text (discussion of intertwining doctrine)

138. *See supra* notes 105-126 and accompanying text (discussion of sever and stay approach).

139. *See infra* notes 140-157 and accompanying text (discussion of advantages of sever and stay approach over intertwining doctrine). Recent Supreme Court decisions favoring the enforcement of arbitration agreements lend indirect support to the conclusion that the sever and stay approach represents a proper balancing of the policies underlying the federal securities acts and the Arbitration Act. *See* Southland Corp. v. Keating, 104 S.Ct. 852, 858-59 (1984) (Arbitration Act requires enforcement of predispute arbitration agreement despite state statute mandating judicial resolution of dispute); Moses H. Cone Memorial Hosp. v. Mercury Constr. Co., 103 S.Ct. 927, 941-42 (1983) (parties should arbitrate construction contract dispute pursuant to predispute agreement); *see also supra* note 125 (discussion of *Moses H. Cone Memorial Hosp.*). In *Southland Corp. v. Keating*, Keating, a franchisee of The Southland Corporation, filed a class action suit against Southland, owner and franchiser of 7-Eleven convenience stores, on behalf of approximately 800 California franchisees of Southland. *Southland Corp.*, 104 S.Ct. at 855. Keating filed suit in California Superior Court alleging fraud, oral misrepresentation, breach of contract, breach of fiduciary duty, and violation of the disclosure requirements of the California Franchise Investment Law (franchise law). *Id.; see* CAL. CORP. CODE §§ 31000-31516. (West 1977). Southland petitioned to compel arbitration of all claims pursuant to the terms of Southland's standard franchise agreement whereby each franchisee had agreed to the arbitration of any future dispute arising out of the franchise agreement. 104 S.Ct. at 855. The superior court ordered arbitration of all claims except those claims arising under the franchise law. *Id.* The California Court of Appeal reversed the trial court's refusal to compel arbitration of the franchise law claims. Keating v. Superior Court, 109 Cal. App. 3d 784, ____, 167 Cal. Rptr. 481, 493-94 (1980). The California Supreme Court reversed and held that claims under the franchise law are not arbitrable. Keating v. Superior Court, 31 Cal. 3d 584, 614, 645 P.2d 1192, 1210, 183 Cal. Rptr. 360, 378 (1982).

arbitration of potential future disputes, while it requires courts to recognize a limited exception regarding the nonarbitrability of federal securities claims.[140] Moreover, the SEC generally endorses arbitration as an efficient and economical securities dispute resolution procedure.[141] The goals of the *Wilko* doctrine are the maintenance of exclusive federal jurisdiction over '34 Act claims and the protection of investors through disallowance of predispute waivers of forum choice provisions of the '33 Act.[142] Application of the intertwining doctrine is unnecessary to accomplish the goals of the *Wilko* doctrine, and, therefore, constitutes an unwarranted extension of the *Wilko* doctrine.[143] A stay of arbitration proceedings pending judicial resolution of federal securities claims protects the exclusive jurisdiction of the federal courts over '34 Act claims.[144] Furthermore, application of the sever and stay approach does not affect an investor's right to select a forum for litigation of '33 Act claims because only the investor's state-based claims are subject to arbitration.[145] Arguably, severance of state claims from related federal claims encourages inefficient and inconsistent dispute resolutions.[146] However, the application of collateral estoppel could reduce the potential inefficiencies attributable to a bifurcated system of securities dispute resolution.[147]

The California Supreme Court held that predispute arbitration agreements are void with respect to the franchise law because § 31512 of the franchise law voids any condition, stipulation, or provision purporting to bind any franchisee to waive compliance with any provision of the franchise law. *Id.* at 599-600, 645 P.2d at 1200-01, 183 Cal. Rptr. at 368-69; *see* CAL. CORP. CODE § 31512 (West 1977) (nonwaiver provision). The United States Supreme Court reversed. 104 S.Ct. at 861. The Supreme Court held that the California Supreme Court's interpretation of § 31512 of the franchise law directly conflicts with § 2 of the Arbitration Act and, therefore, violates the supremacy clause of the United States Constitution. *Id.* at 858-59; *see* 9 U.S.C. § 2 (1982) (§ 2 of the Arbitration Act declares written arbitration agreements to be valid, irrevocable, and enforceable); *see also* U.S. CONST. art. VI, cl.2 (supremacy clause allows federal law to preempt conflicting state laws). The Supreme Court held that the Arbitration Act constitutes substantive federal law applicable in both state and federal courts. 104 S.Ct. at 861. The Supreme Court, therefore, reasoned that congressional enactment of the Arbitration Act withdrew the power of the states to require the judicial resolution of claims that parties have contracted to arbitrate. *Id.* at 858-59.

140. *See supra* notes 105-126 and accompanying text (discussion of sever and stay approach).

141. *See* SEC Securities Exchange Act Release No. 34-15984 (July 2, 1979), *reprinted in* [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,122, at 81,976 (SEC generally believes that arbitration is an economical and efficient means of resolving existing securities disputes). In 1977, the SEC established the Securities Industry Conference on Arbitration (SICA) to develop and implement uniform, fair, and efficient procedures for the resolution of securities disputes. *See* SEC Securities Exchange Act Release No. 34-13470 (April 26, 1977), *reprinted in* [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶81,136, at 87,905. The SICA has developed an arbitration procedure for resolving investor claims of $2500 or less. *See Third Report of the Securities Industry Conference on Arbitration to the Securities and Exchange Commission* (January 31, 1980). Additionally, the SICA has drafted a Uniform Code of Arbitration. *See id.*

142. *See supra* notes 29-48 and accompanying text (discussion of *Wilko* doctrine).

143. *See Disputes, supra* note 2, at 145-46 (discussion of intertwining doctrine).

144. *See supra* notes 105-126 and accompanying text (discussion of sever and stay approach).

145. *See id.*

146. *See id.*

147. *See supra* note 100 and accompanying test (discussion of application of collateral estoppel to arbitration decisions).

The sever and stay approach is easy to apply.[148] Courts merely must distinguish the federal securities claims from the state-based claims and proceed to litigate the federal claims.[149] In contrast, application of the intertwining doctrine requires courts to determine whether state and federal claims are sufficiently intertwined to merit the exercise of jurisdiction to decide all claims.[150] The federal courts have not been consistent in their determination of what constitutes sufficient intertwining.[151] Furthermore, the use of court time to determine the preliminary question of the degree of intertwining undercuts the efficiency arguments in favor of application of the intertwining doctrine.[152]

The sever and stay approach serves the policies of the federal securities acts by preserving the exclusive jurisdiction of the federal courts over '34 Act claims and protecting investors by upholding the *Wilko* doctrine's requirement that predispute arbitration agreements shall not bind investors to arbitrate federal securities claims.[153] The sever and stay approach also gives effect to the policies of the Arbitration Act by requiring arbitration of valid state securities claims.[154] Moreover, courts may apply the sever and stay approach easily and consistently to resolve securities disputes involving both state and federal claims.[155] Since the effect of the SEC's rule 15c2-2 may be to increase the volume of future securities litigation involving both arbitrable and nonarbitrable claims, courts now should establish a consistent approach for determining the proper forum for resolution of arbitrable state-based securities claims.[156] To the extent that the sever and stay approach represents a proper balancing of federal policies underlying the federal securities acts and the Arbitration Act, courts uniformly should reject the intertwining doctrine and adopt the sever and stay approach.[157]

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148. *See supra* notes 105-126 and accompanying text (discussion of sever and stay approach).

149. *See id.*

150. *See supra* notes 24-26 and accompanying text (discussion of varying applications of intertwining doctrine).

151. *See id.* Skillful pleading should produce enough intertwining between state law fraud and misrepresentation claims and federal securities claims to preclude arbitration. Dickinson v. Heinold Sec., Inc., 661 F.2d 638, 646 (7th Cir. 1981).

152. *See supra* notes 24-26 and accompanying text (discussion of varying applications of intertwining doctrine). Arguably, the intertwining doctrine is inefficient because it requires federal courts to decide state law issues. *See supra* notes 92-104 and accompanying text (discussion of intertwining doctrine).

153. *See supra* notes 105-126 and accompanying text (discussion of sever and stay approach).

154. *See id.*

155. *See id.*

156. *See supra* notes 8-11 and accompanying text (discussion of rule 15c2-2).

157. *See supra* text accompanying notes 139-156 (discussion of advantages of sever and stay approach over intertwining doctrine).