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ARBITRATION-ENFORCEABILITY OF ARBITRATION AGREEMENT IN ACTION BY INVESTOR UNDER THE SECURITIES ACT OF 1933

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RECENT DECISIONS

ARBITRATION—ENFORCEABILITY OF ARBITRATION AGREEMENT IN ACTION BY INVESTOR UNDER THE SECURITIES ACT OF 1933—Plaintiff sustained a severe loss in the resale of securities bought from the defendant. Alleging fraud he sued under section 12(2) of the Securities Act of 1933,[1] which provides for liability when prospectuses or oral communications sent through channels of interstate commerce falsely state or omit a material fact so as to render the statement misleading. Pursuant to the Federal Arbitration Act,[2] defendant moved for an order staying proceedings until arbitration had been had in accordance with an agreement between the parties. The district court denied the order,[3] saying that the non-waiver clause[4] of the Securities Act voided a waiver of remedies. The court of appeals reversed the decision, holding the non-waiver clause applicable only to mandatory provisions of the act.[5] On certiorari, the Supreme Court *held,* reversed, two justices dissenting. Arbitration, with its informal procedure, would not assure the plaintiff the benefit of being relieved from proving scienter. In view of the unequal positions of the parties in transactions involving securities, and the imposing array of remedies which the Securities Act specifically provides for the buyer, the policy of the statute is better served by avoiding an arbitration agreement under the non-waiver clause, despite the broad language of the Arbitration Act. *Wilko v. Swan,* 346 U.S. 427, 74 S.Ct. 182 (1953).

[1] 48 Stat. L. 84 (1933), 15 U.S.C. (1946) §77*l*(2).
[2] 43 Stat. L. 884 (1925), 9 U.S.C. (1946) §3.
[3] Wilko v. Swan, (D.C. N.Y. 1952) 107 F. Supp. 75.
[4] "Any condition, stipulation, or provision binding any person acquiring any securities to waive compliance with any provision of this title or of the rules and regulations of the Commission shall be void." 48 Stat. L. 84 (1933), 15 U.S.C. (1946) §14.
[5] Wilko v. Swan, (2d Cir. 1953) 201 F. (2d) 439.

Investors need not show reliance, causal relation, or scienter to recover under the Securities Act.[6] In shifting the burden of proof, the act may be found to simplify the procedure of the investor's action and to provide a pattern which conforms to the layman's notions of procedure to a considerable extent. Other federal statutes similarly aimed at controlling the issue and sale of securities as a means of protecting investors, such as the Securities Exchange Act of 1934,[7] the Public Utility Holding Company Act of 1935,[8] and the Investment Company Act of 1940,[9] contain non-waiver clauses almost identical to that of the Securities Act. In these acts additional sections invalidate "contracts," besides conditions and stipulations, "the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title . . . ," thus expanding on the meaning of the section which the Securities Act has in common with these acts. The similarity of the aims of these statutes and of the Securities Act warrants a presumption of affinity of operation. An arbitration agreement per se cannot be said to involve in its performance violation of any provision of the act. It seems that the terms of the agreement itself must be closely examined to ascertain whether a violation of the act is contemplated or not.[10] Since the word "compliance" is not qualified in the act, it could cover the purchaser's compliance in preserving the wide selection of remedies afforded him. But the latter part of section 14, voiding a waiver of compliance with the rules of the Commission in the same sentence which voids a waiver of compliance with the provisions of the act, seems to indicate that to be void a waiver must refer to the compliance of the seller, since the rules of the Commission are addressed solely to him, and the buyer could not possibly waive his own compliance with them. Likewise this compliance goes to substantive, mandatory provisions, rather than to

[6] If the view is taken that such drastic statutory liability is in substance a disguised criminal sanction, entrusted to private initiative for its enforcement, an interest of the state in preventing its waiver might be recognized on grounds of public policy, even without the help of the non-waiver clause. In the following cases right to arbitration was denied because of a public interest in the questions involved: Wise v. Johnson, 14 Ala. App. 396, 69 S. 986 (1915) (criminal prosecutions); Kingswood Management Corp. v. Salzman, 272 App. Div. 328, 70 N.Y.S. (2d) 692 (1947) (statute provided court should set attorney's fee); Hill v. Hill, 199 Misc. 1035, 104 N.Y.S. (2d) 755 (1951) (custody of children). But the presence of separate provisions for criminal liability for willful violations of the act, 48 Stat. L. 84 (1933), 15 U.S.C. (1946) §§17-24, and the availability of a defense showing an honest course of action seem to indicate the purely remedial rather than penal nature of the action, in substance as well as in form. The procedural modifications made by the statute may be aimed at relieving the buyer of securities from the disadvantages suffered on account of the necessity of proving the several elements of a common law action for fraud, and not only at extending special privileges to a certain class of suitors. On the general subject see Shulman, "Civil Liability and the Securities Act," 43 YALE L.J. 227 (1933).

[7] 48 Stat. L. 903 (1934), 52 Stat. L. 1076 (1938), 15 U.S.C. (1946) §78cc.

[8] 49 Stat. L. 835 (1935), 15 U.S.C. (1946) §79z.

[9] 54 Stat. L. 845 (1940), 15 U.S.C. (1946) §80a-46.

[10] An investor may well find arbitration desirable. He can only assure this right for himself by a binding contract.

matters connected with the remedial process. It would seem that conflicts between statutes should be avoided if possible in the interpretative process. It is one thing to say that it is desirable that the statutory action be tried in a court of law, and another to say that the Securities Act allows no alternative, no matter how enlightened the choice. Existing remedies at law and in equity are retained by the act.[11] While arbitration perhaps cannot technically be called a remedy, it is a form of trial[12] favored in clear, broad language by Congress in the Arbitration Act, and is therefore open to a suitor under the retaining clause of the Securities Act. The time of the making of the stipulation seems immaterial, since it is in essence an exercise of the right to choose a remedy and as such is in harmony with the policy of the Securities Act. The broad sweep of the Federal Arbitration Act, making arbitration clauses in contracts involving interstate and foreign commerce "valid, irrevocable and enforceable," has been recognized by the courts.[13] Avoidance of arbitration agreements by operation of the non-waiver clause may induce buyers to seek a speedy adjudication of their claims with mental reservations of disregarding an award if dissatisfied.[14] It would seem that an arbitration agreement should stand even though not expressly incorporating the liability standard of the Securities Act, at least if a repugnant standard is not substituted. Since the seller must comply with the act in sustaining the burden of proof of lack of scienter, it could be said that by virtue of section 14 the statutory standard is attached to an arbitration agreement by operation of law. However, against this view it might be argued that since under the retaining clause a buyer may not avail himself of the statutory action and so may renounce the benefit of it as to the burden of proof, an arbitration agreement would be valid even if it denied him any procedural advantage. Courts are generally reluctant to review an arbitration award on the merits;[15] but this is not so if a legal standard for the decision is set by law or by stipulation.[16]

[11] 48 Stat. L. 84, §16 (1933), 15 U.S.C. (1946) §77p.

[12] Murray Oil Products v. Mitsui & Co., (2d Cir. 1944) 146 F. (2d) 381.

[13] Kulukundis Shipping Co. v. Amtorg Trading Corp., (2d Cir. 1942) 126 F. (2d) 978; Agostini Bros. Bldg. Corp. v. United States, (4th Cir. 1944) 142 F. (2d) 854.

[14] The Securities and Exchange Commission, appearing in the case as amicus curiae in favor of investor, declined to express an opinion as to the enforceability of an arbitration agreement entered into after a §12(2) cause of action has been asserted. Wilko v. Swan, (2d Cir. 1953) 201 F. (2d) 439 at 443. Thus, the Commission avoided the practical difficulty a party seeking to void an arbitration agreement would find himself in by taking either position. If the agreement is enforceable after the assertion of the statutory cause of action, the supposed voiding effect of the non-waiver clause seems to depend on a question of time or of convenience to the buyer. If not enforceable, one may submit to arbitration with mental reservations with impunity. Justice Jackson, concurring, seems to have felt this danger, as he affirms that such agreement after the controversy arises is valid.

[15] Karppinen v. Karl Kiefer Machine Co., (2d Cir. 1951) 187 F. (2d) 32; Western Canada S.S. Co. v. Cia. De Nav. San Leonardo, (D.C. N.Y. 1952) 105 F. Supp. 452.

[16] The majority opinion that the federal courts cannot review awards on the merits except in limited cases is effectively rebutted in the dissent. Justice Frankfurter argues that if it is true that failure to apply the statutory standard of liability is ground for vacation of the award, as the majority says, jurisdiction to review the award must be inferred. More-

Arbitration has a long history of use in the securities market.[17] It seems reasonable to presume that Congress was aware of such widespread practice. The total absence of more explicit language in the Securities Act to bar arbitration would seem to refute a legislative intent to that end.

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over, he implies, want of a record stating the reasons for award, formal or informal, is itself ground for vacation, since the burden of proof requirement is not under such circumstances satisfied by the seller. Campbell v. American Fabrics Co., (2d Cir. 1948) 168 F. (2d) 959; Western Union Tel. Co. v. American Communications Assn., 299 N.Y. 177, 86 N.E. (2d) 162 (1949).

[17] On the subject see Jacquin, "Arbitration in Action in Wall Street," 1 ARB. J. (n.s.) 261 (1946).