REVISED

OFFICIAL TRANSCRIPT
PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 86-44

TITLE SHEARSON/AMERICAN EXPRESS, INC., AND MARY ANN McNULTY, Petitioners V. EUGENE McMAHON, ET AL.

PLACE Washington, D. C.

DATE March 3, 1987

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IN THE SUPREME COURT OF THE UNITED STATES

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SHEARSON/AMERICAN EXPRESS, INC., :

AND MARY ANN MC NULTY, :

Petitioner, :

V. : No. 86-44

EUGENE MC MAHON, ET AL. :

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Washington, D.C.

Tuesday, March 3, 1987

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 11:52 o'clock a.m.

APPEARANCES:

THEODORE A. KREBSBACH, ESQ., New York, New York; on behalf of the petitioners.

RICHARD G. TARANTO, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D.C.; SEC, as amicus curiae, supporting the petitioners.

THEODORE GRANT EPPENSTEIN, ESQ., New York, New York; on behalf of the respondents.

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P R O C E E D I N G S

CHIEF JUSTICE REHNQUIST: We will hear arguments next in No. 86-44, Shearson/American Express, Inc., and Mary Ann McNulty versus Eugene McMahon, et al.

Mr. Krebsbach, you may proceed whenever you are ready.

ORAL ARGUMENT OF THEODORE A. KREBSBACH, ESQ.,
ON BEHALF OF THE PETITIONERS

MR. KREBSBACH: Mr. Chief Justice, and may it please the Court, the issue in this case is whether lower courts can refuse to enforce agreements to arbitrate claims under Section 10(b) of the Exchange Act and RICO, notwithstanding the clear Congressional directive in the Arbitration Act that agreements to arbitrate shall be valid, irrevocable, and enforceable.

The parties in this case contracted to arbitrate all of their disputes with respect to the handling of respondent's securities accounts. The Court of Appeals enforced that contract with respect to the parties' common law claims but refused to enforce that contract with respect to the claims pertaining to Section 10(b) and RICO, notwithstanding the fact that these claims arose from the same set of factual allegations pertaining to the common law claims.

Petitioners are here today on appeal from the decision of the Second Circuit, and ask this Court to enforce the contract of the parties with respect to all of their disputes. The parties' contracts should be enforced with respect to 10(b) claims because Congress did not intend to create an exception to the Federal Arbitration Act for claims under Section 10(b).

Congress enacted the Exchange Act in 1934, just nine years after it passed the Arbitration Act in 1925. If Congress had intended to create an exception to the Arbitration Act, Section 10(b), it simply had to state within the statute itself that such an exception was to be created and it simply could have prohibited within the statute itself arbitration of 10(b) claims.

This it did not do, and for this reason alone it is clear that the Arbitration Act contains no exception for 10(b) claims.

Despite the Congressional silence in the Exchange Act, the Exchange Act does contain an antiwaiver provision of the type that this Court in Wilko v. Swann found in 1953 prohibited arbitration of Section 12-2 claims under the 1933 Securities Act. Section 14 of that Act voided stipulations binding a person to waive compliance with a provision of the 1903 Securities Act.

The Wilko court held that because of the unique special 12-2 right created by Congress in the Securities Act, which was substantially different from common law fraud, and that it switched the burden of proof from the plaintiff buyer to the seller defendant in that case, as well as because of the Wilko court's concerns about the adequacy of the arbitral forum to enforce the special right and the adequacy of judicial review of the arbitrator's decision.

The Wilko court as a result of this analysis of Section 12-2 held that Congress must have intended the antiwaiver provision in Section 14 to prohibit waiver of judicial trial and review, notwithstanding the fact that nowhere in the statute or its legislative history did Congress indicate any evidence that it wanted to use that interpretation of an antiwaiver provision, which in fact was quite contrary to the interpretation of an antiwaiver provision at common law.

Petitioners believe that the Wilko court's interpretation of a antiwaiver provision must be limited to Section 12-2 of the Securities Act for two reasons. First, Wilko's interpretation of an antiwaiver provision with respect to Congressional intent cannot be mechanically applied to Section 10(b) claims as Justice White pointed out in his concurring opinion in the Byrd

case in 1985. It simply cannot be said that for an implied, judicially implied cause of action such as 10(b) that Congress intended an antiwaiver provision to prohibit judicial trial and review of the cause of action that it itself did not create.

Second, to the extent that the Wilko courts --

QUESTION: May I interrupt you there?

MR. KREBSBACH: Yes, Your Honor.

QUESTION: Who did create the 10(b)(5) private cause of action?

MR. KREBSBACH: The 10(b)(5) private cause of action was judicially implied by the courts, which held in effect that Congress impliedly intended to create an --

QUESTION: They held that Congress intended such a cause of action?

MR. KREBSBACH: That's true, Your Honor.

QUESTION: So that although it isn't expressed the source of the cause of action is nevertheless the statute.

MR. KREBSBACH: That is true, Your Honor, but that source is created by judicial implication and was not expressly created.

QUESTION: I though you said the courts interpreted the legislation as indicating that Congress

impliedly intended it.

MR. KREBSBACH: The action itself is created by judicial implication but the reports by doing that were saying that Congress intended to create --

QUESTION: So what is the ultimate source of the cause of action?

MR. KREBSBACH: Congressional intent, Your Honor. However, petitioners believe that to take it one step further would be illogical, and to say that Congress intended to exempt such an action from arbitration when it did not create that cause of action would just not make sense.

QUESTION: Why is there a difference between an express and implied cause of action? They both have been determined to exist.

MR. KREBSBACH: However, recently in a number of decisions this Court has stated, most recently in Mitsubishi, that in examining whether Congress intended to prohibit a certain statute from the Arbitration Act, you must look to the Congressional intent expressed in that statute or its legislative history.

Certainly with respect to implied cause of action it cannot be said that Congress intended to create an exception to the Arbitration Act when it did not expressly create that statute. Certainly when

Congress expressly created a statute and then evidenced its intent in the statute to prohibit arbitration of that statute, that would be a different story.

QUESTION: You are walking a bit of a tightrope walk, aren't you?

MR. KREBSBACH: Excuse me, Your Honor.

QUESTION: You are walking a tightrope.

MR. KREBSBACH: We don't believe so, Your Honor. We also believe that the Wilko court's analysis was limited to the unique 12-2 cause of action which the Wilko court termed as a special right.

QUESTION: Well, for a long time after Wilko the lower federal courts went right along with it. There was no disagreement below.

MR. KREBSBACH: That is correct, Your Honor.

QUESTION: Until we had a dictum.

MR. KREBSBACH: In the Byrd case.

QUESTION: Yes.

MR. KREBSBACH: That's right, Your Honor. It does appear that the --

QUESTION: And then they went off in all directions.

MR. KREBSBACH: Well, it seems from an analysis of those cases in the federal courts, Your Honor, that after the Wilko decision there was an

assumption on the part of the courts that the Wilko doctrine applied to 10(b) claims simply because it was a Securities Act claim.

However, the courts that have examined that particular concept of applying the Wilko analysis in 12-2 to Section 10(b) claims since the concurring opinion in the Byrd case, the majority of those courts have ruled in favor of petitioner and have held that these 10(b) claims should be arbitrated.

The second reason that petitioners feel that the Wilko analysis is limited to Section 12(b) is that the Wilko courts paid such deference to the special right in Section 12(b), the switching of the burden of proof to the seller.

The Wilko court felt that arbitrators could not understand the legal interpretations of the statute without judicial instruction on the law. Certainly they also felt that there was inadequate judicial review under the Arbitration Act with respect to Section 12-2.

However, as the Wilko court pointed out, their concerns were based on the fact that Section 12-2 is substantially different from common law fraud. As Justice White pointed out in his concurring opinion in Byrd, the 10(b) action, while different from common law fraud, is not that much different to create the type of

concerns that the Wilko court had in 1953.

CHIEF JUSTICE REHNQUIST: We will resume there at 1:00 o'clock.

(Whereupon, at 12:00 o'clock p.m., the Court was recessed, to reconvene at 1:00 o'clock p.m. of the same day.)

AFTERNOON SESSION

(1:00 P.M.)

CHIEF JUSTICE REHNQUIST: Mr. Krebsbach, you may resume where you left off.

ORAL ARGUMENT OF THEODORE A. KREBSBACH, ESQ.,

ON BEHALF OF THE PETITIONERS - RESUMED

MR. KREBSBACH: Thank you, Mr. Chief Justice.

Notwithstanding this Court's ability to rule in petitioner's favor by distinguishing the 12-2 action in Wilko from the 10(b) action in this case, the Wilko court's concerns in 1953 about arbitration in general can no longer be substantiated and Wilko is inapplicable today for that very reason alone.

In 1975, Congress enacted Section 19 of the Exchange Act, which gave the SEC supervisory authority --

QUESTION: (Inaudible) to overrule it.

MR. KREBSBACH: Not in a sense to overrule it, Your Honor, but to simply acknowledge --

QUESTION: To leave it as a derelict. Is that it?

MR. KREBSBACH: It is inapplicable today. In 1975 Congress gave --

QUESTION: I'm sorry --

MR. KREBSBACH: Excuse me.

QUESTION: What does that mean, it is

inapplicable today, if you don't overrule it?

MR. KREBSBACH: What we are saying in effect, Your Honor, is that although Wilko may have been correctly decided in 1953, the concerns of the Wilko court are no longer applicable today, so that Wilko's holding should no longer be applicable.

QUESTION: What does that mean? That means we should overrule it.

MR. KREBSBACH: As of today, yes.

QUESTION: All right.

MR. KREBSBACH: The SEC was given authorization by Congress in Section 19 of the Exchange Act to supervise arbitration procedures. Pursuant to that jurisdiction the Uniform Code of Arbitration was adopted, which provide rules of the various self-regulatory organizations such as the New York Stock Exchange, the American Stock Exchange, and the NESD, which were all included in the customer agreement in the case before the Court today.

QUESTION: Yes, but what if you have arbitration before some other organization? The Federal Arbitration Act doesn't just apply to arbitration before these organizations, does it?

MR. KREBSBACH: No, Your Honor. As a matter of fact --

MR. WRIGHT: So what if somebody comes in with you know, an arbitration agreement before some unheard of and not necessarily first rate organization? Would you want us to continue to apply Wilko in that case?

MR. KREBSBACH: In the first instance, Your Honor, to answer your question, in an examination of Congressional intent we do not believe it is proper to get into that question. We think that you simply look at the statute and determine as to that statute whether Congress expressed a general intention to prohibit statutory claims under that statute from arbitration or it did not. Once you determine --

QUESTION: Yes, but in Wilko we said it did, and we said the reason was that we weren't sure that arbitration could preserve the rights. You are now telling us it is now clear that arbitration can preserve the rights, but I am saying that isn't clear. It is just clear with respect to some of these organizations that you are telling us about, but what if the arbitration is conducted before some other organization?

MR. KREBSBACH: Certainly, Your Honor, petitioners feel that with respect to SRO arbitration under the SEC's jurisdiction arbitration is certainly proper today and the Wilko court's concerns are alleviated. To answer your question, however, recent

decisions of this Court such as the Court's decision in Mitsubishi, seem to indicate that perhaps a different test is being used today with respect to determining arbitrability of statutory disputes, but you must look at the Congressional intent contained in the statute or its legislative history and in the first instance determine whether the statute is arbitrable at all.

A secondary question which then would be asked is whether or not the arbitration forms themselves are competent once the Court has determined that the statutory claims under that statute are arbitrable.

QUESTION: I understand, but the first question whether it is arbitrable at all or not is not the point that you were raising.

MR. KREBSBACH: That is true, Your Honor.

QUESTION: You were raising the point that we should change our view in Wilko because arbitration is now better than it used to be. But the only evidence you are bringing out to prove that is certain arbitration organizations, which are admittedly good ones, but they are not all arbitration.

So therefore are you asking us to overrule Wilko entirely or just overrule Wilko when these stock exchange arbitration procedures are involved?

MR. KREBSBACH: With respect to that

particular point we believe that Wilko's concerns about the adequacy of arbitration were improper. In light of the Congressional policy in the Federal Arbitration Act which clearly created a strong policy favoring arbitration, we believe that the Wilko court's concerns with respect to the competency of arbitrators in general were improper.

With respect to any particular forum today we think in the first instance the Court should determine whether the statute is arbitrable. We think under the Act Congress has provided bases on a motion to vacate or a motion to confirm to overturn the decision of an arbitrator if the arbitrator's decision is improper.

It does not seem that Congress is saying in the Act itself that there is any reason that there should be a presumption that arbitrators are not competent. Quite to the contrary, in light of the clear policy in the Federal Arbitration Act, its seems that the presumption should be that arbitrators are competent, and this Court seemed to take that approach in the Mitsubishi case in 1985.

Certainly, however, as to SRO arbitration, which are the three arbitration forums before the Court today, under the jurisdiction of the SEC, the government agency given the power to enforce the

securities laws, these laws have been set up to protect both the public and the securities industry, and there is always going to be a majority of arbitrators --

QUESTION: What requirements have been placed by the SEC on your arbitration proceedings if they were to go forward?

MR. KREBSBACH: There is an entire Uniform Code of Arbitration which has been enacted after public hearings and approval by the SEC which basically provides all the guidelines and rules under which arbitration is held.

It provides for discovery in certain instances. It provides for document production. It provides, for example, for arbitrators to have subpoena power to direct the appearance at the arbitration of different parties and witnesses that are needed by the parties in the case. It also provides for a majority --

QUESTION: And how are the arbitrators selected under those regulations?

MR. KREBSBACH: The arbitrators are selected by panels of arbitrators at the various SROs which are taken from the general public and from the industry and from business and from all walks of life. But specifically, I think importantly, with respect to SRO arbitration the rules specifically provide that a

majority of the panelists will always be from outside the securities industry. I think that is important because it ensures that the individual investors' concerns about receiving a fair hearing at these forums will always be protected.

QUESTION: Does the claimant get to select an arbitrator?

MR. KREBSBACH: The way it is done, Justice O'Connor, is that a number of panelists are picked from the common pool by the arbitration forum itself, by the arbitration department. Then under the rules which have been passed and enforced by the SEC the individual parties have a right to make challenges for cause or peremptory challenges, just as they would in federal or state court litigation.

Certainly whatever the common reasons are for objecting for cause, such as bias or perhaps a relationship with the parties, are also in arbitration of the SROs a basis for removing an arbitrator who might be partial in a particular case. And the individuals also have peremptory challenges.

QUESTION: These procedures now enable an arbitration to last as long as a lawsuit?

(General laughter.)

MR. KREBSBACH: I understand the point you are

making, Your Honor. However, it has been our experience that arbitration proceedings are usually completed within one year of when they are instituted.

Finally, although obviously the Court is not required to do so to find in petitioner's favor in this case, we think the best approach in this case would be to acknowledge that Wilko should be decided differently today in light of these changes in arbitration as well as recent decisions of this Court which emphasize the examination of Congressional intent with whether or not Congress -- with respect to whether Congress has created an exception to the Federal Arbitration Act.

The Wilko court's antiwaiver analysis seems to be focused more on public policy concerns of the Wilko court than on an analysis of Congressional intent. Certainly nowhere in the Exchange Act or its legislative history did Congress ever state that it intended an antiwaiver provision to be applicable to a judicial forum selection.

The true meaning of the antiwaiver provision as developed in common law was to void waiver of substantive compliance with the statute, and certainly in arbitration proceedings an individual does not waive substantive compliance with the law. The individual simply switches the forum where those rights will be

adjudicated.

The parties' agreement should also be enforced with respect to the arbitration of RICO claims because again Congress did not intend to exempt RICO claims from the Arbitration Act. Once again, Congress could simply have prohibited arbitration of RICO claims within the statute itself, which it did not.

Furthermore, there is nothing in the legislative history which evidences any Congressional intent to prohibit arbitration of RICO claims, nor is there an antiwaiver provision of the type which the Wilko court relied upon.

The Court of Appeals' concern with the public nature of RICO claims is also misplaced, because while RICO has an incidental public deterrent function, the legislative history indicates that its primary function is to compensate victims of organized crime.

By ruling that either 10(b) or RICO claims are not arbitrable, this Court would have to decide that Congress intended to repeal the Arbitration Act by implication when it enacted the Securities Act and RICO.

Such repeals by implication have always been disfavored by this Court, and are inapplicable here where the statutes can coexist without conflict since the statutory rights of the individuals can be enforced

by arbitrators subject to review as limited by Congress in the Arbitration Act.

In conclusion, the case before the Court today involves allegations that an investor's account was mishandled by his stockbroker. Petitioners feel that arbitrators are better equipped than juries to handle these primarily factual disputes and have done so for years, and there is no reason to burden the federal courts with these types of cases.

Furthermore, the SRO arbitration forums in this case have experienced arbitrators, including former judges and securities attorneys, always have a majority of panelists from the public, and operate pursuant to rules approved by the SEC after public hearing. Petitioners feel that the continued SEC supervision and rulemaking authority ensure that statutory rights will be enforced through arbitration.

By enforcing contracts to arbitrate 10(b) and RICO claims the Court will allow these claims to be heard by the same arbitrators who hear the parties' state and common law claims arising from the same factual patterns. This will avoid the bifurcating proceedings and duplicative proceedings which otherwise result in the very type of delay which Congress hoped to avoid when it passed the Arbitration Act.

I will reserves my remaining time for rebuttal unless there are questions.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Krebsbach.

We will hear now from you, Mr. Taranto.

ORAL ARGUMENT OF RICHARD G. TARANTO, ESQ.,
ON BEHALF OF THE SEC, AS AMICUS CURIAE,
SUPPORTING PETITIONERS

MR. TARANTO: Mr. Chief Justice, and may it please the Court, the Securities and Exchange Commission agrees with petitioners that the arbitration agreement at issue in this case should be enforced. Our argument is in three steps.

First, the agreement at issue is a valid contract, and the Federal Arbitration Act requires that it be enforced unless that Act is superseded by another federal statute.

Second, the antiwaiver provision of the Securities Exchange Act, which is alleged to be the superseding statute, only invalidates waivers of the substantive protections of the securities laws.

Third, there is no waiver of substantive protection where there is an adequate remedy for violations of the Act, and arbitration is an adequate remedy when it takes place in a forum that is subject to

the SEC's regulatory oversight. The contract in this case provides for arbitration in such a forum, and should therefore be enforced.

QUESTION: Are you taking a position on the RICO claims?

MR. TARANTO: No, the SEC has no position on the RICO claims

QUESTION: Why not?

MR. TARANTO: The SEC has no supervisory or enforcement responsibilities specifically for RICO.

Our argument --

QUESTION: Now --

QUESTION: The SEC's position, of course, has not been consistent over the years.

MR. TARANTO: That's right. The SEC has changed its position.

QUESTION: They have seen the light? Is that it, or what?

(General laughter.)

MR. TARANTO: Well, they have seen this particular light this time. That is right.

QUESTION: That was my question also.

MR. TARANTO: Yes, the SEC took a different position in a Third Circuit case in 1975.

Our argument today begins with the Federal

Arbitration Act.

QUESTION: May I just ask one other thing? Is it your position that -- I think the logic of your argument suggests that you would overrule -- you think we should overrule Wilko.

MR. TARANTO: If overruling means that under the current statute which is different from the statute as it existed in 1953, the results should be different, yes, we do think that Wilko should be overruled. That is not strictly speaking necessary for a decision in this case, but --

QUESTION: I understand. It seems to me that is the thrust of the argument.

MR. TARANTO: That's right, the rationale we advance would --

QUESTION: So both '33 Act and '34 Act claims would be subject to arbitration.

MR. TARANTO: That's right. We read the antiwaiver provisions of both of those Acts to be concerned with waivers of substantive protections.

QUESTION: Substantive, right.

MR. TARANTO: And as long --

QUESTION: And really you are saying it was incorrectly decided in the first instance, too, I take it.

MR. TARANTO: Well, in 1953 the securities laws were not what they are today. In particular --

QUESTION: I understand, but the same argument could have been made under the different statutory language then, I think.

MR. TARANTO: There could have been no argument at the time that the SEC had a clear oversight authority over self-regulating agencies.

QUESTION: No, I understand, but the substantive argument, the point about only substantive protections of the Act are not waivable.

MR. TARANTO: That's right.

QUESTION: So that would have come to a different conclusion.

MR. TARANTO: That's right. That's right, but there might have been a different assessment about the adequacy of arbitration to enforce substantive protections.

QUESTION: You are not really urging an overruling of Wilko entirely. Presumably we would continue to apply Wilko where the arbitration was not provided to be before one of these arbitration institutions that are within the control of the SEC.

MR. TARANTO: That is right, although the --

QUESTION: So there would be something left to

Wilko.

MR. TARANTO: Absolutely, although I believe that the agreement to arbitrate in Wilko itself did give the customer a right to go to an SRO it's just that the authority that the SEC now has over SRO arbitrations did not exist at the time.

QUESTION: I understand. Which approach leaves less of Wilko, your approach or the approach that the petitioner takes here?

MR. TARANTO: Less in terms of numbers of cases, I am not sure. I would expect that --

QUESTION: The petitioners' approach as I understand it would eliminate any application of Wilko to 10(b). But full application to 12-2 would continue, right?

MR. TARANTO: I believe that that is part of it.

QUESTION: Yours would leave it applicable to both 12 and 10(b), arguably 10(b), anyway, although we would have to decide the point, I presume, but it would only be applicable to them where you are not using an SRO, right?

MR. TARANTO: Yes, that's right.

QUESTION: Now, which one of those two would leave more of this litigation in the federal courts?

MR. TARANTO: I would expect that -- I guess I am again not sure of the numbers. Certainly most securities law claims are 10(b), involve some kind of 10(b) claim. On the other hand, the arbitration agreements that members of stock exchanges are, as far as I know, typically use do in fact lead to an SRO arbitration. In short, I am not sure how the numbers would actually work out.

QUESTION: Has there been a significant increase in claims against people affected by this, members of the exchange since Wilko was decided?

MR. TARANTO: I think that there has. There has been -- as far as I know that increase is commensurate with the general increase in litigation in the federal courts. I believe there are extensive statistics in one of the amicus briefs that detail the increase in claims both in the federal courts and in arbitrations.

If one begins with the Arbitration Act and its command that Arbitration agreements be enforced the question then becomes whether there is some overriding federal statute, and the only statutory provision that is alleged to furnish that kind of overriding command is the antiwaiver provision of the Exchange Act.

Now, as I have suggested, that provision does

not concern itself with all waivers of procedural rights or rights to particular forums, because any such reading would presumably invalidate settlements of lawsuits, post-dispute arbitration agreements, and even predispute arbitration agreements in the international context which this Court approved in Scherk.

Rather, the concern of that provision is with, as its language concerning compliance suggests, is with the substantive protections of the Acts, of the securities laws. If a customer waived any adequate remedy for violations of the Act that would be prohibited by the antiwaiver provision.

But where a customer agrees to arbitrate any future disputes and the arbitral forum is an adequate remedy for valid complaints, there has been no waiver of compliance with the duties under the Act. That is precisely what we believe to be the case with agreements to arbitrate under a self-regulatory organization, and there are two reasons.

One of them is that this Court in numerous cases in recent years has come to a quite different assessment of the adequacy of arbitration in the commercial area generally. In Mitsubishi, Southland, the Byrd case, this Court has said that there is in general no good reason to question the adequacy of

arbitration as an effective remedy for resolving commercial disputes.

But there is also a second point, and that second reason has to do with the limitation of our argument to arbitrations that take place under the SRO. The SEC since 1975 has had a very broad authority to review the rules that govern arbitrations under SROs and to modify them where appropriate. It is that authority which led to the Uniform Code of Arbitration, and that authority can be used in the future to effect further improvements as the need becomes apparent.

That oversight authority, which did not exist at the time of Wilko, we think should lead to a different assessment of the adequacy of arbitration because it in effect provides a statutory basis for assuring the adequacy of that remedy.

That difference means the factual underpinning of Wilko is no longer appropriate today. We think therefore that an agreement providing for SRO arbitration does not waive the protections of the securities laws, and that for such an agreement there is today no basis in the Exchange Act for overriding the command of the Arbitration Act.

We therefore think that insofar as the judgment below concerns a securities law claim, that the

judgment of the Court of Appeals should be reversed. Thank you.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Taranto.

We will hear now from you, Mr. Eppenstein.

ORAL ARGUMENT OF THEODORE GRANT EPPENSTEIN, ESQ.,
ON BEHALF OF THE RESPONDENTS

MR. EPPENSTEIN: Mr. Chief Justice, and may it please this Court, I am here representing the respondents in this case, Eugene McMahon, Julia McMahon, and the four pension trusts.

I am also here representing all of the other individual investors who have pre-dispute arbitration agreements in place. The concerns that they have are the same concerns that are placed before this Court, and that is namely that the pre-dispute arbitration agreement be found to be unenforceable in two contexts, one, in connection with Section 10, and two, in connection with RICO claims.

We have heard earlier this morning and this afternoon about the fact that arbitration at the SROs is something that the government now considers to be okay. They didn't before.

Of course, the securities industry always felt that arbitration is beneficial. However, what is the

reason that we have the securities industry coming into this Court and coming into almost every other District Court and Circuit Court in this country trying to get everything into arbitration?

I think it is simple. The reason is, they feel they have a leg up when they go to arbitration and the reason for that mainly is because they have a member of their industry sitting on each panel. Typically there are three members on an arbitration panel. We feel if one member is represented by the securities industry the public customer is at a disadvantage from the start.

Now, Mr. Krebsbach mentioned that there are peremptory challenges available in arbitration. I propose to you according to the Uniform Act there is one. Furthermore, Mr. Krebsbach stated that there were members of the public who sit as other members on the panel. I present to you the people who sit who are not industry members are sophisticated businessmen.

I have looked at the panel list of the American Stock Exchange, which is included in one of the amicus briefs. And I note that there are a number of people who are securities litigators, but those people come from the large firms, the firms who typically represent the brokerage companies.

I think having the public customer believes that having an industry representative on the panel is very damaging. We believe that --

QUESTION: Excuse me. Sophistication is damaging? That means the rights wouldn't be sufficiently preserved if we allowed waiver of a jury trial and allowed it to be tried to a District Judge unless we have unsophisticated District Judges?

MR. EPPENSTEIN: No, Justice Scalia. If there was a situation where the parties agreed to waive a jury trial and go before a judge that would be fine.

QUESTION: We would say that is okay Sophistication wouldn't make any difference, right?

MR. EPPENSTEIN: That is correct.

QUESTION: If the parties want to go for sophistication, so if they sign this agreement and they are willing to go for a sophisticated panel, it is all right then.

MR. EPPENSTEIN: Well, I am saying -- I am saying that when they signed this agreement they didn't know what they were agreeing to. They didn't know that they were agreeing to have all their grievances, no matter how terrible they may be, under Section 10(b) or under RICO sent to arbitration. They are not aware of that.

QUESTION: That is a different argument.

MR. EPPENSTEIN: It is. I feel that the non-industry members on the arbitration panel are not drawn from the general public as Mr. Krebsbach argued. They are not drawn from a pool of the community as we have in federal court, people who sit on the jury. They are drawn from businessmen.

They are drawn from people who are typically knowledgeable about the workings of the marketplace. They are not the type of individual who comes into federal court with a Section 10(b) claim alleging to be an unsophisticated investor.

I think we have a disparity there. I don't think it is as great as the bias of having an industry member sit on the panel.

QUESTION: But isn't that inherent in the system of arbitration and Congress surely knew that and understood it when Congress chose to enact the arbitration law, which said we will give effect to contracts to arbitrate?

Now, if you have a claim that in a particular contract one of the parties didn't understand it or has -- or that it is a contract of adhesion, or there is some reason to get out of it, that is a defense to the contract itself, a defense that says there wasn't a

binding contract on this, but once you agree that there isn a binding contract, and I guess we have to assume that for purposes of deciding this case, then we have to look to what Congress intended, don't we?

MR. EPPENSTEIN: I would like to answer that first with your latter premise. I wouldn't assume that there is a binding contract in this case. The point was raised down below and it was litigated and the record has affidavits in it in connection with the fact that it is an unenforceable contract --

QUESTION: Should we not assume it for the purpose of deciding the effect of the Arbitration Act on the Securities Exchange Act?

MR. EPPENSTEIN: If we assume that it is --

QUESTION: Shouldn't we do it just for that purpose?

MR. EPPENSTEIN: Sure. If we assume that it is a good contract, Your Honor, we believe the Arbitration Act, which was devised in 1925, did not take into account the fact that an arbitration panel may be composed of panel members as we find now in the SROs. We are bound -- if we take this contract as binding, we are bound to go to either the American Stock Exchange, the NASD, or the New York Stock Exchange with all our claims, nowhere else.

QUESTION: No, but Justice O'Connor's point is that the composition of the arbitration panels in these SROs is not much different from the ordinary arbitration panel. When Congress was thinking of arbitration it was not -- it was probably thinking of the ordinary case where one side picks one sophisticated person, the other side picks another sophisticated person, and the two of them get together and pick a third sophisticated person. Nobody picks somebody off the street the way we select juries.

MR. EPPENSTEIN: True, but we don't have that here, do we, Justice Scalia?

QUESTION: But isn't that what Congress had in mind, Justice O'Connor was asking, when they were talking about arbitration? They were talking about just this kind of thing.

MR. EPPENSTEIN: I think the response is yes, Congress did probably have that in mind. I think the answer is no, we don't have that here, and also, we have to look at the 1934 Act and its purposes to determine what the tension is between the Federal Arbitration Act and the '34 Act.

And I say, and it has been found by eight Circuit Courts, who have followed the Second Circuit reasoning here, that there is a great protective policy

written into the federal securities laws, and I am not just talking about the '34 Act.

I am talking about the '33 Act also. And in order to pursue that protective policy Congress created an antiwaiver provision in Section 29A of the '34 Act which we put forth is something that requires that this case and the claims in this case not be sent to arbitration. There is a grant of federal jurisdiction in Section 27.

QUESTION: Well, of course, the Solicitor General makes the argument on behalf of the SEC that the antiwaiver provision extends only to substantive provisions of the Securities Exchange Act.

MR. EPPENSTEIN: We disagree. We believe -- the only way the antiwaiver provision makes any sense is if it pertains to the grant of federal jurisdiction. An antiwaiver provision in my mind is something that isn't passed very often in many Acts, and it was particularly passed in both the '33 Act and the '34 Act.

QUESTION: Is there any legislative history specifically that would guide us on the intention of the antiwaiver provision that has come to your attention?

MR. EPPENSTEIN: I believe we have to look at the Act itself and if we can't find the answer in the Act itself then we have to look at what the legislature has

done, and I can run down for you, Justice O'Connor, what has occurred subsequent to the enactment of the '34 Act, and I think we have our answer there. In 1975 the '34 Act was extensively revised, and in that revision there were several instances in which Congress amended Section 28, for example, which gave the rights of members of the securities industries to have arbitrations between themselves.

So what Congress did there was, they carved out an exception to what they perceived to be the rule of nonarbitrability. Otherwise they wouldn't have had to pass that amendment to Section 28. Furthermore, Congress enacted in 1975 the Municipal Rulemaking Board, and as part of that section which is Section 15 -- well, it is found within Section 15, Your Honor. It is a subdivision of it.

That section specifically provided for an individual to bring an arbitration in connection with a municipal security dispute. However, Congress stated in particular that Section 29(a) should be abided by in all respects, which means you cannot enforce a pre-dispute arbitration agreement in connection with municipal securities.

Again, this is an exception that Congress would not have had to make if they didn't believe the

unenforceability of the provisions of the '34 Act.

Getting back to arbitration for a second, since the government has stepped in here and taken some of us for a loop and come forward on behalf of the securities industry, I would like to point out that this is a marked departure from their previous positions. In 1979 -- actually our brief goes back to 1953 where they started criticizing the usage of the so-called pre-dispute arbitration provision that we find in the McMahon case.

We have had an Exchange Act release that the government has promulgated in 1979, and it is Release 15984, which criticized the use of that provision. They found that the pre-dispute provision was something that was confusing, it was something that was not fully disclosing the situation to the public customer, and it was something that they frowned upon.

In 1983 they went a step further by promulgating Release 20397. In that release they said, well, the security industry hasn't been listening to us, so we are not going to promulgate a rule, and they promulgated Rule 15C2-2 which made it a violation for the brokerage industries to contain a pre-dispute arbitration clause in their customer contracts.

And the reasons that they came out with that

is because they felt it was misleading. They felt that the public customer was not being protected as he should be under the 1934 Acts. In fact --

QUESTION: Is that rule still in effect?

MR. EPPENSTEIN: As far as I know it is still on the books.

QUESTION: It has never been withdrawn?

MR. EPPENSTEIN: Justice Blackmun, the government seems to want to repeal it by filing their amicus brief in this case, but I haven't seen anything other than that.

QUESTION: Neither have I, and that is why I asked whether it is still outstanding.

MR. EPPENSTEIN: Getting back to Rule 15C2-2 for a second --

QUESTION: Well, you have established that they were either wrong then or they are wrong now. Do you want to tell us why they are wrong now instead of then?

MR. EPPENSTEIN: They are wrong now because of the purposes behind the federal securities statutes and that is to protect the public customer from abuses in the marketplace. For years dating back to the early fifties they took the position that this was an abuse.

In fact, the said in these releases that the

mere printing of the form is in and of itself a Section 10 violation.

QUESTION: That really doesn't go to the basis of our decision. Our decision -- it goes more to your concern about proper notice to the customer. And our decision wasn't based on that, it was based on the fact that arbitration, no matter how good the notice you gave may have been, arbitration cannot serve to give the kind of justice that is needed under this Act.

Now, maybe the SEC continues to take the same view as to whether these particular forms give the customer enough notice about what he is letting himself in for. But that is not really what we have before us. We just have before us the question whether, assuming adequate notice is given, and you can fight that out some other day, is arbitration a proper way to get these matters settled?

MR. EPPENSTEIN: We don't believe it is, and I started giving the Number One reason, and that is having the industry representative appear on the panel of the SROs. Additionally, of course, you lose your federal procedural protections to broad discovery, which is of extreme importance in a securities fraud case where the brokerage firm is in possession of all of the documents and the customer is not.

The right to judicial review is severely limited in arbitration, and since the arbitrators are told not to give reasons for their awards, it is very unlikely that someone can go into court and say, well, they had manifest disregard for the law. As a matter of fact, the president of the American Arbitration Association has been quoted as saying don't write reasons that can't be criticized.

Again, I believe that if we look to the other rights that a customer is entitled to when he goes to court and examine what he loses when he goes to arbitration, in the context of the federal securities laws and the RICO statute we believe that a customer is not fully protected.

I am not suggesting that arbitration is inappropriate in every case, nor am I suggesting that you find that arbitration is no good at all for securities cases, because I find in the Uniform Act that arbitration will be something that a customer might want to utilize for a small claim of $2,500 or $5,000 where he can't hire a lawyer to help him, where there are simplified procedures under the Uniform Act in order to have this thing figured out by letters coming back and forth by the claimant and the brokerage firm has some purpose there.

But for the big case, Justice Scalia, the 10(b) cases, it really has no useful purpose, and we believe the customer is behind the eight-ball when he goes into arbitration.

Now, this Court has balanced the tension between the Federal Arbitration Act and other federal statutes before. We discussed Wilko versus Swann in 1953. And then we have McDonald in 1984, Barrentine in 1981, and Alexander in 1974. In those cases, this Court found that the claimant was entitled to a federal forum, despite the fact that he had gone through arbitration.

A point that was brought out, if I may refer to the form of customer agreements that we have in this case, which, as I said before, the SEC has found for some 30 years to be an improper notification to the customer, the customer who comes into the brokerage relationship is coming in thinking that the broker is going to make money for him.

Otherwise he wouldn't go there in the first place. He is at a position where he is trusting the broker with his dollars or her dollars, as the case may be.

The customer, unsophisticated as he may be, isn't aware that he has to read the customer agreement with a fine tooth comb. The agreement that we have in

front of us is a multipage document.

Somewhere found on the second page in the middle of Paragraph 13, which starts, by the way, stating that this agreement shall innure to the benefit of your heirs and assigns, we find the sentence which states that all grievances are going to be decided in arbitration.

Well, if you were to uphold that, I think you have to say to the customer, you had better get a lawyer in order to open up a brokerage account, in order to review that agreement.

QUESTION: Well, that isn't really the basis of our prior holdings, is it, or the Court of Appeals' holding in this case?

MR. EPPENSTEIN: No, the Court of Appeals did not hold that, Your Honor. I pointed it out to the Court because I think --

QUESTION: Nor Wilko?

MR. EPPENSTEIN: That's correct, Your Honor. I point it out to the Court because I think that the SEC was right for those 30 years when they found that this was not full disclosure to the customer.

QUESTION: But don't you think, as has been suggested by some of the questions from the bench, that that really is another question? If the Second Circuit

had said this particular agreement didn't give enough notice to the customer to be fair and binding, you know, very likely we wouldn't have granted certiorari.

What they said is, arbitration, no matter how fair or under what kind of an arbitration agreement, cannot be had in this case.

MR. EPPENSTEIN: Your Honor, this Court can put aside this portion of my argument and rule in favor of the Second Circuit's opinion down the line and I would be perfectly happy. What concerns me is this practice which no one is doing anything about.

We have --

QUESTION: Do you want to spend your 30 minutes arguing about it?

MR. EPPENSTEIN: No, I didn't mean to do that, Mr. Chief Justice. I would like to point out, moving on to what Congress has done about this situation that I termed unfair to the customer when he is forced to go into arbitration, I believe just today there was a letter distributed from Chairman John Dingell which was sent to Chairman Shadd at the SEC.

And in Congressman Dingell's letter, dated February 11, 1987, is stated that there is a conflict of interest that Congress perceives in this type of arrangement where there is a broker sitting on the

panel.

Congressman Dingell goes on to cite the admission of the SEC of limited authority that they have in order to ensure that the federal securities laws are correctly applied in arbitration. And lastly, if you will permit me, I would just like to quote you one portion of that letter which appears on Page 3 and which Congressman Dingell sought to underscore on his own, and here he quotes from an August, 1986, report of the staff of Division and Marketing of the SEC, who said, "The Commission has no authority to review a specific arbitration to assure either compliance with procedural requirements of the Code," the Uniform Code of Arbitration, "or accurate interpretations of underlying federal securities law or other claims by the arbitrators. The Commission has no authority to overturn an arbitration award."

Well, then, what is the government telling us they are doing?

QUESTION: With the understanding that it is not in the record, any of this.

MR. EPPENSTEIN: Your Honor, this was a --

QUESTION: It is not in the record, and nothing you say can put it in the record.

MR. EPPENSTEIN: I believe, Your Honor, that

if you would permit us to make a supplemental filing, I would be happy to add it to the --

QUESTION: It wouldn't be in the record.

MR. EPPENSTEIN: We have made provisions with the clerk of this Court --

QUESTION: I don't see what you can do to bring before us what was said on 60 Minutes, a television program.

MR. EPPENSTEIN: I would respectfully request that Congressman Dingell's -- the import of Congressman Dingell's letter --

QUESTION: You may make your request to the Chief Justice, but not assume that it is going to be done. I think I am right.

MR. EPPENSTEIN: I am sure you are.

QUESTION: Mr. Eppenstein, while you are interrupted, may I back up and ask a factual question that has come to mind as a result of Justice Blackmun's question about Rule 15(c)(2), which I guess was promulgated in 1983?

Your agreements were signed in '80 and '82, so they preceded that rule, but is it the fact that, A, that rule remains in effect as I guess you indicated, and B, does that mean there are no such agreements, no agreements like the one in this case that have been

executed after '83 if they would have been in violation --

MR. EPPENSTEIN: I wish that were so, Justice Stevens. Unfortunately, we still find that they are prevalent in the industry, especially for margin agreements.

QUESTION: Under your reading of that rule, of course, we don't have the whole text of it in front of us, would the agreement that your client signed have been prohibited if it had been executed after 1983?

MR. EPPENSTEIN: Yes, we believe so. We believe that that rule states it would have been in itself a violation of Section 10(b) for the brokerage firm to give that form of agreement to the customer without a legend that says you have the right to go to federal court to sue on your federal security claims despite what is contained in this agreement.

QUESTION: And it is your contention that the Commission's position in this case is not merely that they have changed their view, but that the rule they promulgated in '83 probably is an invalid rule. If you buy their argument completely, that is what they are now contending, their own rule is invalid.

MR. EPPENSTEIN: I think they are fighting an inconsistent position without any justification for

doing it. I mean, in essence their argument is, because we have oversight authority it has to be right because Congress gave us this right in 1975, then the arbitration procedure is fair. However, all of these rules, the Rule 15(c)(2)-2 and each of the releases came after Congress gave them the power.

Additionally, they had the Uniform Code of Arbitration in front of them, and they still came out with these rules and these releases.

Another issue I would like to address briefly which the securities industry has brought up in their amicus brief in support of certiorari is the table that they append in connection with the amount of cases that are before the District Courts, and I would like to point out that statistics can be read in many ways.

The way I read these statistics is that for each of the five years that the SIA has compiled the amount of cases brought under all of the securities laws, not just 10(b), but the '33 Act, the '34 Act, and the Commodities Act, taking all of those cases together, they amounted to less than 2 percent of the total cases in the federal docket.

Now, they did not go into the most recent figures of 1986, which I did, and was advised that in fact the amount of -- the amount of cases under all the

securities laws have decreased in 1986 to a point beyond the 1984 level, again, less than 2 percent of all the cases that are in this Court.

QUESTION: (Inaudible.)

MR. EPPENSTEIN: I don't believe so, Your Honor.

QUESTION: Volume decrease, or just the percentage? I mean, the percentage could -

MR. EPPENSTEIN: The volume decrease.

QUESTION: Volume.

MR. EPPENSTEIN: Unfortunately, the SIA didn't break out the amount of cases that were just under 10(b). And I don't have those figures, either. They have called --

QUESTION: A billion dollars here, a billion dollars there, pretty soon it adds up to real money.

MR. EPPENSTEIN: Yes. That brings up a point about the equal bargaining rights that the parties have when they go into a contract that I would like to address for just one second.

I know I don't want to take 30 minutes to discuss it, but here we have a firm such as Shearson who the New York Times reported last week had revenues of $4.6 billion and income of $316 million, and they are saying that there was equal bargaining in connection

with the standard, so-called standard form of agreement.

I don't think so, and I think this is what Justice Frankfurter pointed out as an overwhelming bargaining power which would vitiate a contract.

QUESTION: You mean because they had all that money, an individual could not have said, I won't sign this agreement?

MR. EPPENSTEIN: The individual, when this agreement was presented to him, had no choice.

QUESTION: He could have said, I won't sign it.

MR. EPPENSTEIN: Because it was common practice at the firms to have this type of agreement.

QUESTION: Yes, but the fact they had $400 million didn't make them sign that agreement. I don't find that argument very persuasive. An individual can still say, I don't like this agreement and I won't sign it.

MR. EPPENSTEIN: I would then say that there is no room for them to go elsewhere.

QUESTION: And some of your clients are not individuals.

MR. EPPENSTEIN: That's correct. Four of them are profit and pension sharing plans, which makes the facts of this case even worse if we get to them some

day. I would like --

QUESTION: And the individuals who have large claims, you say. You are not worried about those that have, what, $10,000 claims are presumably not very unsophisticated individuals either.

MR. EPPENSTEIN: No, I wouldn't agree with that. I would say that there might be decent businessmen if they have a decent salary, but I wouldn't say that they are sophisticated in the workings of the marketplace. I mean, it is common knowledge, for example, that doctors are not.

(General laughter.)

MR. EPPENSTEIN: I won't imply on attorneys.

QUESTION: Can we take judicial notice of that?

(General laughter.)

MR. EPPENSTEIN: No, Your Honor.

Lastly, I would say with respect to RICO we have the same concerns that we have in connection with a 10(b) claimant.

QUESTION: How do you suggest that we identify those statutes that have such a strong public policy behind them that arbitration agreements should not be enforced at all?

MR. EPPENSTEIN: I think, Justice White, you

will have to look at the statute and you will have to look at the legislative history and you will have to look at the judicial interpretations, and I submit that over --

QUESTION: Congress doesn't say anything at all about it. They just regulate, and there are hundreds of regulatory statutes.

MR. EPPENSTEIN: Well, Your Honor --

QUESTION: Arbitration is allowable in some of them, and not in others.

MR. EPPENSTEIN: Yes, I believe so, but I think that the antiwaiver provision in this case governs the fact that they are not to be enforced.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Eppenstein.

Mr. Krebsbach, you have one minute remaining.

ORAL ARGUMENT OF THEODORE A. KREBSBACH, ESQ.,

ON BEHALF OF THE PETITIONERS

MR. KREBSBACH: Thank you, Mr. Chief Justice.

Just one brief point with respect to the SEC rule 15(c)(2)-2, since the SEC will have no rebuttal time. The SEC's position on this has always been that that particular rule is simply a notice provision which says no more than whatever the courts happen to interpret the law to be with respect to arbitrability,

that is what we want investors to be apprised of.

QUESTION: Well, but that law, that rule is still in effect. Isn't that right?

MR. KREBSBACH: That is true, Your Honor, and I presume that rule will continue to be in effect pending this Court's clarification of the issue.

QUESTION: You say it doesn't -- the language of the rule is correct, it just means something else? I don't understand you. It says it is a misleading statement of the customer's rights to include this kind of provision in the --

MR. KREBSBACH: Under the current interpretation of the law as we --

QUESTION: Does it says in the rule itself under our present view of the law it would be misleading but if we change our mind it will no longer be misleading?

MR. KREBSBACH: It doesn't say that specifically, Your Honor.

QUESTION: But that is in effect what you think it was meant to say?

MR. KREBSBACH: That is the essence of it.

QUESTION: It is not their view of the law that they are talking about, it is the court's view of the law, as I understand the rule.

MR. KREBSBACH: Exactly. Exactly, Your Honor.

QUESTION: What they are saying is that given Wilko, this statement is misleading. But if Wilko were to be changed, this statement wouldn't be misleading. Is that what you mean?

MR. KREBSBACH: That is exactly true, Your Honor.

QUESTION: But Wilko thus far has not been changed.

MR. KREBSBACH: That is also true, Your Honor.

QUESTION: And therefore the rule is correct as it now stands.

QUESTION: Therefore the rule is misleading.

(General laughter.)

CHIEF JUSTICE REHNQUIST: The case is submitted.

(Whereupon, at 1:51 o'clock p.m., the case in the above-entitled matter was submitted.)

CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represents an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of The United States in the Matter of:

#86-44 - SHEARSON/AMERICAN EXPRESS, INC. AND MARY ANN McNULTY, Petitioners

V. EUGENE McMAHON, ET AL.

and that these attached pages constitutes the original transcript of the proceedings for the records of the court.

BY Paul A. Richardson

(REPORTER)