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Turning Back the Clock: A Judicial Return to Caveat Emptor for U.S. Investors in Foreign Markets

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Cover Page Footnote
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NOTES

Turning Back the Clock: A Judicial Return to Caveat Emptor for U.S. Investors in Foreign Markets

I. Introduction

The past forty years has seen an expansion of American business into overseas commercial activities.\(^1\) The rise in multinational transactions has resulted in questions as to the appropriate forum for dispute resolution. Supreme Court decisions show a trend favoring the enforcement of forum selection and arbitration clauses included in such international contracts and agreements.\(^2\) The Court has described such clauses as an “indispensable element in international trade, commerce, and contracting.”\(^3\) For example, in Scherk v. Alberto-Culver Co.,\(^4\) the Court upheld an international arbitration clause in a securities agreement in the interests of certainty and international comity despite the public policy foundations of the Securities Act of 1933 and the Securities Exchange Act of 1934.\(^5\) The recent decision of the Court of Appeals for the Seventh Circuit in Bonny v. Society of Lloyd’s applied the rationale of the Supreme Court’s decisions favoring arbitration to uphold international forum selection and choice-of-law clauses in a securities transaction.\(^6\) This decision effectively deprived the plaintiffs of their statutory remedies under the 1933 Securities Act.\(^7\)

This Note will explore the facts and holding of Bonny in Part II. Part III will review the legislative intent behind the enactment of the

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\(^3\) Bremen, 407 U.S. at 13-14.
\(^5\) The Securities Act of 1933 and the Securities Exchange Act of 1934 (the 1933 and 1934 Acts) were enacted by Congress to protect U.S. investors by requiring “full and fair disclosure of the character of securities sold in interstate and foreign commerce and to prevent fraud in their sale.” Wilko v. Swan, 346 U.S. 427, 431 (1953). To this end, each of the Acts contains an anti-waiver provision, which makes void any “condition, stipulation, or provision” that results in a binding waiver of any rule or regulation of the Act. 15 U.S.C. §§ 77n and 78cc(a) (1988). See infra notes 44-47 and accompanying text.
\(^6\) Bonny v. Society of Lloyd’s, 3 F.3d 156, 162 (1993).
\(^7\) Id.; see infra notes 137-39 and accompanying text.
1933 and 1934 Acts and the rationale behind the decisions of the U.S. Supreme Court enforcing domestic and international arbitration clauses. Part IV will provide an analysis of the court's opinion in *Bonny*. This Note will conclude that the Supreme Court did not intend for its decisions enforcing international arbitration clauses to result in U.S. investors losing their statutory claims under the 1933 and 1934 Acts.

II. Statement of the Case: *Bonny v. Society of Lloyd's*

The Court of Appeals for the Seventh Circuit recently decided the case of *Bonny v. Society of Lloyd's*. In *Bonny*, the Seventh Circuit considered whether forum selection and choice-of-law clauses (designating that English law would apply to any disputes and conferring exclusive jurisdiction on the courts of England) included in various agreements between the parties should be enforced. The court upheld the "presumptive validity" of the clauses and dismissed plaintiffs' action based on the following factors: (1) the agreements involved were international in nature; (2) adequate remedies existed in the selected foreign forum; and (3) the available remedies sufficiently deterred the subversion of important American public policy.

The Seventh Circuit first found that the action involved an international agreement. The plaintiffs in the action were three U.S. investors who claimed they were "fraudulently, and in violation of various federal and state securities laws, induced to become members of the Society of Lloyd's. . .". The defendants were primarily British enti-
ties and individuals. Although the plaintiffs were solicited in the United States to invest in Lloyd’s, the court found it significant that they traveled to England to sign the “General Undertaking for Membership” and that Lloyd’s operations are worldwide. On this basis, the court concluded that “[t]here is no question that the transaction involved here is truly international.”

Having found an international agreement, the Seventh Circuit cited the U.S. Supreme Court’s holding in *M/S Bremen v. Zapata Off-Shore Co.* (a case not involving securities) that “forum selection clauses are ‘prima facie valid and should be enforced unless enforcement is shown by the resisting party to be unreasonable under the circumstances.’” The Seventh Circuit then noted that the Supreme Court’s interpretation of an unreasonable enforcement was limited to the following situations: (1) where the clauses were incorporated as a result of “fraud, undue influence or overweening bargaining power”; (2) where the forum selected is so “gravely difficult and inconvenient that [the complaining party] will for all practical purposes be deprived of its day in court”; or (3) where “enforcement of the clauses contravene a proportionate share of a syndicate’s losses (i.e., there is no joint and several liability); but, the liability for that share is unlimited. To protect against losses in excess of a Name’s investment, Names are required to issue an irrevocable letter of credit in favor of Lloyd’s. If such losses arise, a “cash call” will be made and if the Name does not pay the loss directly, Lloyd’s will draw against the letter of credit.

Names also must enter into several contractual arrangements. A Name must sign a General Undertaking for Membership with Lloyd’s, which includes forum selection and choice-of-law clauses designating that English law is to apply and that courts of England have exclusive jurisdiction over all disputes. Names must also enter into a Members’ Agent Agreement with their selected Member Agent which provides that any disputes will be arbitrated in England under English law. Names do not enter into any direct agreement with the Managing Agents, but the Member Agents’ Agreement gives the Member Agent the power to enter agreements with Managing Agents on the Name’s behalf.

The defendants included (1) The Society of Lloyd’s (Lloyd’s), Lime Street Underwriting Agencies Ltd. (Lime Street), Bankside Underwriting Agencies, Ltd., Robin C. Kingsley, Robert C. Hallam, Patrick M. Corbett (British entities, corporations or individuals; collectively the Members’ Agents); (2) Harris Bank Glencoe-Northbrook N.A., Harris Trust and Savings Bank, and Bank of Montreal (Bank defendants); and (3) Northfield Venture, Inc., Robert King, and Alan J. Hunken (U.S. corporation and its principals).
strong public policy of the forum in which the suit is brought, declared by statute or judicial decision.\textsuperscript{23}

After summarily dismissing the first two situations as not applicable to the case at bar,\textsuperscript{24} the Seventh Circuit discussed plaintiffs' contention that such clauses violate important American public policy embedded in the 1933 and 1934 Acts.\textsuperscript{25} The court acknowledged that allowing "Lloyd's to avoid liability for putative violations of the 1933 Act would contravene important American policies unless remedies available in the selected forum do not subvert the public policy of that Act."\textsuperscript{26} However, the court determined that adequate remedies existed under English law that would not subvert the policy of the 1933 and 1934 Acts.\textsuperscript{27}

As to the adequacy of the potential remedies, the Seventh Circuit noted that plaintiffs would have causes of action under English common law for fraud (which the court analogized to a Rule 10b-5 claim), rescission of contract, breach of contract, and breach of fiduciary duties.\textsuperscript{28} In addition, if defendants were found guilty under Section 47 of the Financial Services Act of 1986,\textsuperscript{29} then under Section 61 of such Act, the English court would be permitted, upon "application of the Secretary of State, to order injunctions to restrain violations of [Section] 47 and to make remedial orders."\textsuperscript{30} The court noted that this could "potentially" result in "some" compensation to plaintiffs for their injuries.\textsuperscript{31} Finally, the court noted that even though some of these claims would not be available because of certain immunities extended to Lloyd's under the Lloyd's Act of 1982, Lloyd's would not be immune for acts "done in bad faith."\textsuperscript{32}

As to the potential subversion of American public policy, the Seventh Circuit concluded that the "available remedies and potential damage recoveries [do not subvert American public policy because

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\textsuperscript{23} Id. at 160 (citing M/S Bremen, 407 U.S. at 15).
\textsuperscript{24} See supra notes 21-22.
\textsuperscript{25} Bonny, 3 F.3d at 160-62. See supra note 5.
\textsuperscript{26} Id.
\textsuperscript{27} Id. at 160 n.11.
\textsuperscript{28} Id. at 160-62. See supra note 5.
\textsuperscript{29} The Financial Services Act is the regulatory statute that governs the English securities industry. Bonny v. Society of Lloyd's, 784 F. Supp. 1350, 1355 (N.D. Ill. 1992). Section 47 provides criminal sanctions for misleading statements or omissions made knowingly or recklessly. Financial Services Act of 1986, ch. 6, § 47 (1986) (Eng.).
\textsuperscript{30} Id. at 161.
\textsuperscript{31} Id.
\textsuperscript{32} Id. Section 14(3) of the Lloyd's Act of 1982 reads in pertinent part: "[T]he Society shall not be liable for damages whether for negligence or other tort, breach of duty or otherwise . . . unless the act or omission complained of—(i) was done or omitted to be done in bad faith . . . ." Lloyd's Act of 1982, ch. xiv, § 14(3) (1982) (Eng.).
they] suffice to deter deception of American investors and to induce
the disclosure of material information to investors."\textsuperscript{33}

The Seventh Circuit concluded that "[g]iven the international na-
ture of the transactions involved here, and the availability of remedies
under British law that do not offend the policies behind the [U.S.] se-
curities laws, the parties' forum selection and choice-of-law provisions
contained in the agreements should be given effect."\textsuperscript{34}

III. Background Law

The Supreme Court has shown increasing tolerance toward arbi-
tration clauses in agreements involving securities transactions.\textsuperscript{35} This
part of the Note will track this controversial trend and point out the
significant issues raised by the dissents. The Part will start with the
Court's decision in \textit{Wilko v. Swan}, which held that the public policy
concerns behind the 1933 Securities Act outweighed the public policy
concerns of the United States Federal Arbitration Act.\textsuperscript{36} Subsequent
cases discussed will show the gradual erosion of the \textit{Wilko} decision until
it is squarely overruled in \textit{Rodriguez de Quijas v. Shearson/American
Express}.\textsuperscript{37}

A. Wilko v. Swan

The Supreme Court first addressed the importance of the public
policy concerns of the 1933 and 1934 Acts in \textit{Wilko v. Swan}.\textsuperscript{38} In \textit{Wilko},
a securities customer (petitioner) sued the partners in a securities bro-
kerage firm (respondents) for alleged misrepresentations under Sec-
tion 12(2) of the Securities Act of 1933,\textsuperscript{39} in connection with the sale
of securities.\textsuperscript{40} The respondents filed a motion to stay the proceedings
pending arbitration pursuant to Section 3 of the United States Arbitra-
tion Act,\textsuperscript{41} because the margin agreements between the parties pro-

\textsuperscript{33} \textit{Bonny}, 3 F.3d at 162.
\textsuperscript{34} Id.
\textsuperscript{35} See infra notes 60-68, 91-104 & 114-19 and accompanying text.
\textsuperscript{36} See infra part III.A.
\textsuperscript{37} See infra parts III.B, C, and D.
\textsuperscript{38} 346 U.S. 427 (1953).
\textsuperscript{39} See infra note 147.
\textsuperscript{40} Wilko, 346 U.S. at 428. The petitioner was a U.S. citizen and respondent was a U.S.
corporation. Id.
Act provides in pertinent part:
If any suit or proceeding be brought in any of the courts of the United States
upon any issue referable to arbitration under an agreement in writing for such
arbitration, the court in which such suit is pending, upon being satisfied that
the issue involved in such suit or proceeding is referable to arbitration under
such an agreement, shall on application of one of the parties stay the trial of
the action until such arbitration has been had in accordance with the terms of
the agreement, providing the applicant for the stay is not in default in proceed-
ing with such arbitration.
\textit{Id.} § 3 (1988).
vided that all future disputes between the parties be settled by arbitration.\textsuperscript{42} The Court denied the respondents' motion based on the policy behind the Securities Act of 1933 and its conclusion that enforcing the arbitration agreement would subvert such policy.\textsuperscript{43}

The Court first addressed the policy behind the Securities Act of 1933 and noted that in passing the Act, Congress sought to protect investors by requiring issuers to provide "full and fair disclosure" to purchasers of securities.\textsuperscript{44} Moreover, the Court adopted petitioner's argument that Congress' purpose "was to assure that sellers could not maneuver buyers into a position that might weaken their ability to recover under the Securities Act."\textsuperscript{45} To ensure this protection,\textsuperscript{46} an explicit anti-waiver provision was included in Section 14 of the Act, which renders void any "condition, stipulation or provision" that results in a waiver of any rule or regulation of the Act.\textsuperscript{47}

The Court next addressed whether an arbitration clause violated the public policy of the 1933 Act.\textsuperscript{48} The Court found that the agreement to arbitrate limited the investor's right to select a judicial forum,\textsuperscript{49} which "is the kind of 'provision' that cannot be waived under Section 14 of the Securities Act."\textsuperscript{50} Although the Court acknowledged that the United States Arbitration Act established the "desirability of arbitration as an alternative to the complications of litigation,"\textsuperscript{51} it held that such policy was outweighed by the policy concerns of the 1933 Securities Act.\textsuperscript{52}

\textsuperscript{42} \textit{Wilko}, 346 U.S. at 429-30.
\textsuperscript{43} \textit{Id.} at 438. The Court refused to enforce the arbitration clause notwithstanding the fact that the arbitrators were bound to apply the provisions of the 1933 and 1934 Acts. \textit{Id.} The Court determined that the effectiveness of the securities laws would be lessened in an arbitration setting because the summary nature of arbitration awards is often difficult to subject to judicial review and the power to vacate an award is limited. \textit{Id.} at 435-37.
\textsuperscript{44} \textit{Id.} at 430-31 (citing S. Rep. No. 47, 73d Cong., 1st Sess. 1. (1933)).
\textsuperscript{45} \textit{Id.} at 432. The Court noted that "the Securities Act was drafted with an eye to the disadvantages under which buyers labor... [Therefore, it is] reasonable for Congress to put buyers of securities covered by the Act on a different basis from other purchasers." \textit{Id.} at 435.
\textsuperscript{46} \textit{Id.} at 434-35.
\textsuperscript{47} 15 U.S.C. § 77n (1988). Section 14 of the 1933 Act reads in full as follows: "Any condition, stipulation or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void." \textit{Id.}
\textsuperscript{48} \textit{Wilko}, 346 U.S. at 451-38.
\textsuperscript{49} Section 22 (a) of the 1933 Act provides in pertinent part: "The district courts of the United States... shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission... ." 15 U.S.C. § 77v(a) (1988).
\textsuperscript{50} \textit{Wilko}, 346 U.S. at 434-35.
\textsuperscript{51} \textit{Id.} at 431.
\textsuperscript{52} See \textit{id.} at 438 (stating that "two policies [that are] not easily reconcilable are involved in this case," but nonetheless holding that an arbitration clause was not valid under the Securities Act of 1933).
B. Scherk v. Alberto-Culver Co.

1. Justice Stewart for the Majority

Twenty years later the Court reconsidered the enforceability of an arbitration clause within a securities transaction from an international perspective in *Scherk v. Alberto-Culver Co.* *Scherk* involved a U.S. corporation (respondent) that entered into an agreement with a German citizen (petitioner) for the purchase of trademarks and stock of three German corporations. The agreement contained representations by petitioner that the trademarks were unencumbered and also contained an arbitration clause requiring that all disputes would be referred to arbitration before the International Chamber of Commerce in Paris applying Illinois law. Upon the alleged discovery that the trademarks were subject to substantial encumbrances, respondent filed suit in a Federal District Court in Illinois seeking damages pursuant to Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Petitioner moved to dismiss or, in the alternative, to stay the proceedings pending arbitration.

The district court denied petitioner’s motions, and the Court of Appeals for the Seventh Circuit affirmed based on the Supreme Court’s decision in *Wilko* holding that such arbitration clauses were unenforceable. Applying the international principles supporting its holding in *M/S Bremen v. Zapata Off-Shore Co.*, the Supreme Court in a 5-4 decision overruled the Court of Appeals for the Seventh Circuit by distinguishing *Wilko* on the basis that “a truly international” agree-

54 Id. at 508.
55 Id.
56 See infra notes 145-46 and accompanying text.
57 Scherk, 417 U.S. at 509.
58 Id. See supra note 41.
59 Scherk, 417 U.S. at 510. The Supreme Court in *Wilko* held that the choice of a judicial forum was the type of provision that was not waivable under Section 14 of the Securities Act of 1933. *Wilko v. Swan*, 346 U.S 427, 434-35 (1953). See supra notes 38-52 and accompanying text.
60 407 U.S. 1 (1972). *Bremen* involved the enforceability of a forum selection clause in a contract between Zapata Off-Shore Co. (Zapata), an American corporation, and Unterweser, a German corporation, for the towing of Zapata’s rig from Louisiana to Italy. *Id.* The agreement between the parties contained a forum selection clause, which the Court also presumed to encompass a choice-of-law provision, designating England as the forum for any dispute arising under the contract. *Id.* at 2, 13 n.15. In upholding the validity of the clause and dismissing the action brought in the United States, the Court stressed the international nature of the contract by noting that “[t]he expansion of American business and industry will hardly be encouraged if, notwithstanding solemn contracts, we insist on a parochial concept that all disputes must be resolved under our laws and in our courts.” *Id.* at 9.
61 The Court initially noted that *Wilko* was different because it was based on § 12(2) of the 1933 Act, which provides for a private right of redress. *Scherk*, 417 U.S. at 513. The action in *Scherk* was brought under § 10(b) of the 1934 Act, which does not explicitly provide for such private right of action. *Id.* The Court recognized that an implied private right of action has been upheld by the courts for actions under § 10(b), but noted that the 1934 “Act itself does not establish the ‘special right’ that the Court in *Wilko* found significant.” *Id.* at 514.
ment was involved in the Scherk case and thus it differed from Wilko in two respects.62

First, unlike Wilko, the parties in Scherk faced considerable uncertainty as to the international conflict of laws—which laws would govern any disputes.63 In light of such uncertainty, the Court noted that such an agreement is "an almost indispensable precondition to achievement of the orderliness and predictability essential to any international business transaction."64

Second, the Court found that the reasoning of the Wilko Court that the buyer surrenders the advantage of choosing the court and venue was not applicable in this case.65 The Court noted that in an international contract, if the party opposing litigation in the United States anticipates such litigation, that party could seek an order in a foreign court to enjoin the other party from proceeding with the litigation.66 Regardless of whether or not the foreign order would be upheld in a U.S. court, the Supreme Court held that "the dicey atmosphere of such a legal no-man's-land would surely damage the fabric of international commerce and trade...."67 The majority therefore concluded that the arbitration clause should be upheld.68

2. Justice Douglas for the Dissent

Justice Douglas wrote the dissenting opinion in Scherk in which Justices White, Brennan and Marshall joined.69 The dissenters agreed with the Seventh Circuit and held that Section 29 of the 1934 Act rendered the arbitration provision unenforceable.70 The dissent set forth two basic arguments for this conclusion. First, the dissent argued that the Securities Act provisions constitute an exception to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Second, the dissent pointed to Section 29(b) of the 1934 Act, which states that "'[e]very contract' made in violation of the Act 'shall be void'" noting that "[n]o exception is made for contracts

However, the Court acknowledged this was a "colorable" argument and reversed on other grounds. Id. at 515-15.

62 Id. at 515.
63 Id. at 515-16. The petitioner was a German citizen and the respondent was an American corporation; the signing of the contract took place in Austria; the closing took place in Switzerland; and negotiations were conducted in America, Germany and England. Id. at 515.
64 Id. at 516.
65 Id. at 518.
66 Id. at 517.
67 Id.
68 Id. at 519-20.
69 Id. at 521-34.
70 15 U.S.C. § 78cc(a) (1988). Section 29 of the 1934 Act is similar to § 14 of the 1933 Act (see supra note 47) and provides the following: "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void." 15 U.S.C. § 78cc(a) (1988).
71 Scherk, 417 U.S. at 525 (Douglas, J., dissenting).
which have an international character." Finally, the dissent argued that, if such a change is to be made, Congress, not the courts, should be the forum for changing the rules.73

In its first argument, the dissent recognized that Congress' decision to implement the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards reflected an important public policy in favor of dispute settlement.74 However, the dissent pointed to provisions of that Act that lead to the conclusion that it "does not substitute an arbiter for the settlement of disputes under the 1933 and 1934 Acts."75 For example, Article II(3) of the Convention states that if a written agreement for arbitration exists, "[t]he court . . . shall . . . refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed."76 The dissent reasoned that Section 29(a) rendered the agreement in question "void" and "inoperative,"77 noting that "Congress has specified a precise way whereby big and small investors will be protected and the rules under which the Alberto-Culvers of this Nation shall operate. . . . [F]or our corporate giants are not principalities of power but guardians of a host of wards unable to care for themselves."78 The dissent further noted that "[w]hen a foreign corporation undertakes fraudulent action which subjects it to the jurisdiction of our federal securities laws, nothing justifies the conclusion that only a diluted version of those laws protects American investors."79

Second, the dissent disagreed with the majority's reasoning that this case was distinguishable from Wilko on the grounds that an international agreement was involved.80 The dissent was concerned that the majority's analysis and focus on the international aspect of the contract could preclude an unsophisticated American investor in a foreign company or mutual fund, who invested on the basis of fraudulent mis-

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72 Id. at 524 (Douglas, J., dissenting). The dissent also dismissed the possibility that Wilko could be distinguished on the basis that this case involved a sophisticated business as opposed to an individual investor. Id. at 526-27 (Douglas, J., dissenting). The dissent noted that "[t]he Act does not speak in terms of 'sophisticated' as opposed to 'unsophisticated' people dealing in securities" and rightly so since the "victims" of the type of fraud alleged here are the "thousands of investors" of Alberto-Culver Co. Id. at 526 (Douglas, J., dissenting).

73 Id. at 533 (Douglas, J., dissenting).
74 Id. at 526-27 (Douglas, J., dissenting).
75 Id. at 526-27 (Douglas, J., dissenting).
76 Id. at 527 (Douglas, J., dissenting) (citing the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 3 U.S.T. 2517, 2519, T.I.A.S. No. 6997 (1970)). In addition, Article V(2)(b) also permits nonenforcement of an arbitration award if it "would be contrary to the public policy of that country." Id. at 527 n.5 (Douglas, J., dissenting) (citing the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 3 U.S.T. 2517, 2520, T.I.A.S. No. 6997 (1970)).
77 Scherk, 471 U.S. at 527 (Douglas, J., dissenting).
78 Id. (Douglas, J., dissenting).
79 Id. at 530-31 (Douglas, J., dissenting).
80 Id. at 528-34 (Douglas, J., dissenting).
representations in the United States, from seeking redress in the American court system. The majority responded to the dissent's concern by conceding that "situations may arise where the contacts with foreign countries are so insignificant or attenuated that the holding in Wilko would meaningfully apply." The dissent criticized this concession, however, in light of the majority's reasoning that order and predictability were "essential" to any international business transaction. Presumably under the majority's analysis, if enough contacts with the United States could be shown, the foreign arbitration clause would not be upheld, which in effect leads to more uncertainty.

Finally, the dissent stressed that Congress enacted the 1933 and 1934 Acts to protect investors, and if such protection is to be removed, it should be done by legislative enactment, not by the courts. The dissent noted that "[i]t is important that American standards of fairness in security dealings govern the destinies of American investors until Congress changes these standards."

C. Shearson/American Express Inc. v. McMahon

1. Justice O'Connor for the Majority

The Supreme Court was again presented with the opportunity to address the Wilko issue in Shearson/American Express Inc. v. McMahon. Unlike Scherk, decided just ten years earlier, this case was even closer to Wilko because it did not involve international issues. McMahon involved two individual purchasers of securities (respondents), suing a security brokerage firm (petitioner) in district court alleging violations of Section 10(b) of the Securities Act of 1934, Rule 10b-5, and RICO. The petitioner moved to compel arbitration pursuant to a clause contained in the standard customer agreement that any disputes arising out of the contract would be settled by arbitration.

The Court held that both the securities and RICO claims were arbitrable and set forth the following reasons for its decision: (1) the federal policy of enforcing arbitration agreements is not diminished merely by a claim founded on statutory grounds; (2) Section 27 of the Securities Exchange Act of 1934 is not a substantive provision of

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81 Id. (Douglas, J., dissenting).
82 Id. at 517 n.11 (Douglas, J., dissenting).
83 Id. at 529 n.7 (Douglas, J., dissenting).
84 Id. at 533 (Douglas, J., dissenting).
85 Id. at 528 (Douglas, J., dissenting).
87 Id. at 252-33. It differed from Wilko only in that it involved allegations of violations of the 1934 Act while Wilko involved similar violations of the 1933 Act. Id.
88 Id. at 222.
89 Id. at 223-24.
90 This Note will not address the correctness of the Court's decision with respect to the arbitrability of the petitioner's RICO allegations.
91 McMahon, 482 U.S. at 226.
that Act for purposes of the anti-waiver provision of Section 29 contained therein; and (3) the traditional judicial mistrust of arbitration proceedings should be dissuaded by changes in the securities regulations that give greater oversight authority to the Securities Exchange Commission.

The Court first noted that the Federal Arbitration Act essentially established a federal policy in favor of arbitration and that the duty to enforce arbitration clauses is not diminished solely on the basis that statutory claims are involved. However, the Court recognized that this duty to enforce an arbitration clause can be rebutted by a showing of contrary congressional intent. In this case, the respondents argued that the public policy of the Securities Exchange Act of 1934 established such a contrary intent by Congress.

The Court, however, disagreed with respondents' contention that Section 29(a) (the anti-waiver provision of the 1934 Act) precluded their waiving a judicial forum. The Court held that Section 29(a) is too narrow to forbid waiver of "any provision" of the Act. Instead, the Court held that it forbids only "waiver of the substantive obligations imposed by the Exchange Act." The Court then reasoned that Section 27 of the 1934 Act is not such a substantive provision of the Act.

Finally, the Court addressed the holding in Wilko that arbitration could "weaken [the investor's] ability to recover under the [1933] Act." The Court noted that even if there were a proper reason for the Wilko Court to be suspicious of arbitration at the time of its decision, changes in the securities regulations giving greater oversight to the Securities Exchange Commission over arbitration procedures

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92 Id. at 227-31.
93 Id. at 231-34.
94 Id. at 226 (citing Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983)).
95 Id.
96 Id. at 226-27. "The burden is on the party opposing arbitration . . . to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue." Id. at 227.
97 Id. at 227. See supra note 5.
98 McMahon, 482 U.S. at 227. Plaintiffs contended that § 27, which provides that "[t]he district courts of the United States . . . shall have exclusive jurisdiction of violations of this title . . .," is a "condition, stipulation or provision" of the Act that cannot be waived under § 29(a). Id. (citing 15 U.S.C. § 78aa (1988)).
99 Id. at 227-29.
100 Id. at 228.
101 Id. Although this appears to be in direct conflict with Wilko, which held that the right to select the judicial forum is the type of provision covered by the similar anti-waiver provision of the 1933 Act, the Court reasoned that Wilko must be read as barring waiver of a judicial forum only where the arbitration is inadequate to protect the substantive rights at issue. Id. at 228-29. See infra notes 102-04 and accompanying text.
should alleviate such concerns. The Court therefore concluded that "Congress did not intend for Section 29(a) to bar enforcement of all predispute arbitration agreements."

2. Justice Blackmun for the Dissent

The dissent argued that the Section 10(b) claims were not arbitrable for three reasons. First, Congress substantially revised the Securities Exchange Act of 1934 in 1975, but did not disturb the Wilko decision or the extended application of that decision by the lower courts to Section 10(b) claims. The dissent felt that this inaction should be interpreted as favoring the Wilko decision and its extension to Section 10(b) claims, particularly since the revisions were intended to further investor protection.

Second, the Wilko decision was not limited to determining whether arbitration was sufficient to enforce the "substantive" provisions of the 1933 Act. The dissent felt the majority gave an "unduly narrow reading of Wilko that ignore[d] the Court's determination [in Wilko] that the Securities Act was an exception to the Arbitration Act." The dissent noted that "[t]he Court in Wilko recognized the policy of investor protection in the Securities Act" and specifically referred to this policy when it reasoned that a predispute agreement would constitute a waiver of a provision under Section 29(a) of the Act.

Finally, the suspicions of the Wilko Court against arbitration were not outdated despite the majority's contrary suggestion. In fact, the dissent stated that the need for investor protection was even greater "when the industry's abuses towards investors are more apparent than ever." Although the dissent acknowledged improvements to the arbitration process, it noted that many of the same problems identified

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103 McMahon, 482 U.S. at 233. This SEC oversight protection would not be available to the plaintiffs in Bonny because English laws would govern any arbitration process. See supra note 9 and accompanying text.
104 McMahon, 482 U.S. at 238.
105 Justices Blackmun, Brennan and Marshall concurred in part and dissented in part [hereinafter the dissent]. The dissent related entirely to the majority's analysis of the arbitrability of the securities violations. Id. at 243 (Blackmun, J., dissenting). Justice Stevens filed a separate opinion concurring in part and dissenting in part; his disagreement also related to the securities violations. Id. at 268-69 (Stevens, J., dissenting). Justice Stevens noted that the courts have interpreted the Wilko decision to be applicable to the 1934 Act for thirty-two years, and any mistake in this interpretation should be left to the legislature for correction. Id. at 268-69 (Blackmun, J., dissenting).
106 Id. at 246-47 (Blackmun, J., dissenting).
107 Id. at 249-57 (Blackmun, J., dissenting).
108 Id. at 250 (Blackmun, J., dissenting).
109 Id. at 252 (Blackmun, J., dissenting).
110 Id. at 257-66 (Blackmun, J., dissenting). See supra note 103 and accompanying text.
111 Id. at 257-66 (Blackmun, J., dissenting). See supra note 103 and accompanying text.
112 McMahon, 482 U.S. at 243 (Blackmun, J., dissenting).
by the Wilko Court still remain.\(^{113}\)

**D. Rodriguez de Quijas v. Shearson/American Express, Inc.**

In another 5-4 decision, the Court finally attempted to set the issue of the arbitrability of Securities Act violations to rest in *Rodriguez de Quijas v. Shearson/American Express, Inc.*\(^{114}\) by overruling *Wilko.*\(^{115}\) The action was based on violations of both the 1933 and 1934 Acts.\(^{116}\) In overruling *Wilko*, the Court noted that the *Wilko* holding was based on the “outmoded presumption of disfavoring arbitration proceedings” and that for the reasons set out in *McMahon*,\(^ {117}\) “[t]here is no sound basis for construing the prohibition in [Section] 14 on waive[ing] ‘compliance with any provision’ of the Securities Act to apply to these procedural provisions.”\(^ {118}\)

The Court also held that it would be inconsistent to require the 1933 Act claims to proceed in court while the 1934 Act claims would be submitted to arbitration pursuant to its decision in *McMahon* because the Acts are meant to be “construed harmoniously because they ‘constitute interrelated components of the federal regulatory scheme governing transactions in securities.’”\(^ {119}\) The dissent in *Rodriguez de Quijas* would have held that the judicial interpretation of *Wilko* should not be disturbed except by an act of Congress.\(^ {120}\)

**IV. Analysis**

The Seventh Circuit’s analysis in *Bonny* relied heavily on the Supreme Court’s trend (discussed in Part III) toward enforcing arbitra-

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\(^{113}\) *Id.* at 257 (Blackmun, J., dissenting). For example, the difficulty of judicial review due to the summary nature of the arbiters’ findings and limited review of arbitration awards were specifically noted as continuing problems with the arbitration process. *Id.* at 257-58 (Blackmun, J., dissenting).

\(^{114}\) 490 U.S. 477 (1989).

\(^{115}\) *Id.*

\(^{116}\) *Petitioners*, securities investors, brought suit in district court against respondent, brokerage firm, for violations of the 1933 and 1934 Acts “alleging that their money was lost in unauthorized and fraudulent transactions.” *Id.* at 478-79. The standard customer agreement signed by petitioners included an arbitration clause. *Id.* at 478. The district court ordered all of the claims to be submitted to arbitration except for the 1933 Act claims pursuant to the Supreme Court’s ruling in *Wilko*. *Id.* at 479. The Court of Appeals for the Fifth Circuit reversed and held that the 1933 Act claims should have been submitted to arbitration as well, noting that *Wilko* had been effectively rendered obsolete by subsequent decisions. *Id.* at 479.

\(^{117}\) *Rodriguez de Quijas*, 490 U.S. at 481. See supra notes 86-104 and accompanying text.

\(^{118}\) *Rodriguez de Quijas*, 490 U.S. at 482. The Court here refers to the statute’s broad federal venue provisions, availability of nationwide service of process, extinction of the amount in controversy requirement for diversity jurisdiction and the grant of concurrent jurisdiction. *Id.*

\(^{119}\) *Id.* at 484-85 (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 206 (1976)).

\(^{120}\) *Id.* at 486-87 (Stevens, J., dissenting). The dissent commented that a statutory interpretation by an earlier opinion that has not been amended by Congress for over thirty years deserves the Court’s respect as if it “had been drafted by the Congress itself.” *Id.* at 486 n.2 (quoting Shearson/American Express v. McMahon, 482 U.S. 220, 268 (1987) (Stevens, J., concurring in part and dissenting in part)).
tion clauses in international agreements. This reliance, however, is misplaced for three important reasons. First, the Seventh Circuit appears to have ignored the distinction between waiving substantive versus procedural statutory rights. Second, the court incorrectly found that remedies available in England are substantially the same as the U.S. securities remedies and therefore adequate to vindicate plaintiffs' rights. Third, the court did not address whether sufficient contacts in the United States existed such that the principles of Wilko should still be applied. This misplaced reliance has effectively resulted in the deprivation of the Bonny investors' statutory rights under the 1933 and 1934 Acts.

A. Procedural v. Substantive Rights

As the background material suggests, the Supreme Court has shown increasing tolerance toward arbitration clauses in agreements involving securities transactions. The Court has reasoned that such clauses do not prospectively waive a party's securities act remedies because giving up a judicial forum is only a procedural, not a substantive right under the Acts. Even if this logic is accepted, the rights involved in Bonny v. Society of Lloyd's do not fit within this category of "procedural" rights.

In contrast with the arbitration clause cases, Bonny involved forum selection and choice-of-law clauses. The Seventh Circuit did not specifically address whether such clauses related to substantive or procedural rights under the securities laws. Instead, the court focused on the international nature of the transaction and applied the principles behind the Supreme Court's holding in M/S Bremen v. Zapata Off-Shore Co. that international forum selection clauses are presumptively valid. In so doing, however, the Seventh Circuit appears to have ignored important discussions in Supreme Court cases subsequent to M/S Bremen that suggest that the presumptive validity of the

121 See supra part III.
122 See infra notes 125-40 and accompanying text.
123 See infra text accompanying notes 141-58.
124 See infra text accompanying notes 159-63.
125 See supra notes 60-68, 90-104, 114-19 and accompanying text.
126 See supra notes 98-104 and accompanying text.
127 See supra notes 69-85, 105-13 for a discussion of the dissenting opinions, which disagreed with this contention.
128 Bonny v. Society of Lloyd's, 3 F.3d 156 (1993).
130 Bonny, 3 F.3d 156.
132 Bonny, 3 F.3d at 159-60. See supra notes 19-23 and accompanying text.
forum selection clause would be overcome if the substantive provisions of the securities acts were prospectively waived.

For example, the Supreme Court in Rodriguez de Quijas v. Shearson/American Express\textsuperscript{133} stated that "[t]here is no sound basis for construing the prohibition in [Section 14] waiving 'compliance with any provision' of the Securities Act to apply to . . . procedural provisions."\textsuperscript{134} In clarifying its decision that arbitration clauses were only procedural, the Court contrasted procedural provisions such as choice of venue, extinction of amount in controversy, etc.\textsuperscript{135} with the "substantive" provision "placing on the seller the burden of proof proving lack of scienter when a buyer alleges fraud."\textsuperscript{136} An analogous "substantive" provision is found in Section 12(2) of the Securities Act of 1933, the violation of which is the most important allegation of plaintiffs' complaint in Bonny.\textsuperscript{137} Although the Seventh Circuit in Bonny acknowledged that enforcement of the forum selection and choice-of-law clauses "will deprive plaintiffs of their specific rights under [Section] 12(1) and [Section] 12(2) of the Securities and Exchange Act of 1933,"\textsuperscript{138} it nonetheless held that the clauses were valid.\textsuperscript{139} The Supreme Court's discussion in Rodriguez seems to preclude this conclusion because, by its own definition, substantive rights were being waived in Bonny.\textsuperscript{140}

\textbf{B. Adequacy of English Law Remedies}

Although it is unclear from the court's opinion in Bonny, it is conceivable that the Seventh Circuit did evaluate the substantive/procedural dichotomy by focusing its analysis on the adequacy of remedies in England to protect the plaintiffs' substantive statutory rights.\textsuperscript{141} Assuming this, the Seventh Circuit still failed to adequately address the issue of whether plaintiffs were prospectively waiving their Securities Act remedies because the court's analysis ignored the fact that remedies available in England are not substantially similar to U.S. statutory remedies. The laws of England and the United States are substantially different in the following important respects: (1) U.S. securities laws provide lighter scienter and causation requirements; (2) U.S. securities laws provide a private right of action; (3) U.S. securities laws shift the burden of proof to the seller to show lack of reasonable care when the

\textsuperscript{133} 490 U.S. 477 (1989).
\textsuperscript{134} Id. at 482.
\textsuperscript{135} See supra note 118.
\textsuperscript{136} Rodriguez de Quijas, 490 U.S. at 481.
\textsuperscript{137} Bonny v. Society of Lloyd's, 3 F.3d 156, 157 (1993).
\textsuperscript{138} Id. at 162.
\textsuperscript{139} Id.
\textsuperscript{140} See supra notes 135-36 and accompanying text.
\textsuperscript{141} Bonny, 3 F.3d at 160-62. The Court of Appeals for the Seventh Circuit noted that allowing Lloyd's to avoid liability would contravene American public policy unless remedies that do not subvert that policy were available in the selected forum. Id. at 160.
buyer alleges fraud; and (4) U.S. RICO laws provide an opportunity to recover treble damages.

First, the U.S. securities laws provide more easily established scienter and causation requirements than remedies available under English law because of the "special position of Lloyd's and its underwriters under English law." Lloyd's operations are governed by the Lloyd's Act of 1982. This Act exempts the Society of Lloyd's (but not the underwriters or other members of the Lloyd's community) from damages from any suit "whether for negligence or other tort, breach of duty or otherwise . . . unless the act or omission complained of—(i) was done or omitted to be done in bad faith . . . ." Although this Act arguably may preserve the plaintiffs' Section 10(b) claims under the 1934 Act and Rule 10b-5 claims, it precludes recovery under Section 12(2) of the 1933 Act, which clearly has no such bad faith requirement.

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144 15 U.S.C. § 78j(b) (1988). Section 10(b) provides in pertinent part:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails . . .

To use or employ, in connection with the purchase or sale of any security registered . . . or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . . in the public interest or for the protection of investors.

145 Id.

146 17 C.F.R. § 240.10b-5 (1993). Rule 10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id. The Lloyd’s Act may not preserve the plaintiffs’ Rule 10b-5 claim because the majority of circuit and district courts, including the Seventh Circuit, have held that a good faith reckless disregard standard satisfies the scienter requirement for such a claim. See Van Dyke v. Coburn Enterprises, 873 F.2d 1054, 1100 (8th Cir. 1989). The Lloyd’s Act, on the other hand, requires a showing of “bad faith” to establish a claim. See supra note 32.


Any person who— . . . offers or sells a security (whether or not exempted by the provisions of section 77c of this title . . . ), by the use of any means . . . in interstate commerce . . . by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact . . . (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known . . . shall be liable to the person purchasing . . . .
In addition, Lloyd's and its underwriters are “exempt” persons under the English Financial Services Act of 1986 (FSA),\(^ {148}\) except for limited sections of the Act.\(^ {149}\) One section applicable to Lloyd's, Section 47, provides "criminal penalties for misleading statements made knowingly or recklessly."\(^ {150}\) Because this is a criminal penalty only, it is not available to compensate plaintiffs for the damages they suffered.\(^ {151}\)

The Seventh Circuit also noted that plaintiffs have possible causes of action under English common law for misrepresentation, breach of contract, and breach of fiduciary duty.\(^ {152}\) Although the misrepresentation action has less rigorous scienter requirements than the English statutory provisions under the Lloyd’s Act or FSA, none of the available common law actions shift the burden of proof or provide for treble damages.

Second, U.S. securities laws provide plaintiffs with a private right of action\(^ {153}\) to enforce their rights as investors. Although Lloyd's is not exempt from Section 61 of the FSA, and, as the Seventh Circuit noted, plaintiffs could “potentially” receive “some compensation” for their damages under this section, Section 61 only applies following a guilty verdict under Section 47 and requires the Secretary of State to apply to the court, which is then “permitted” to make remedial orders for past violations.\(^ {154}\) This procedure is very different from that applied in the United States, where the private right of action has been considered to be a very important means of “deterring the exploitation of American investors.”\(^ {155}\)

Third, Section 12(2) of the 1933 Act shifts the burden to the seller of securities to show that he did not know, or could not have known through the exercise of reasonable care, of the alleged misstatement or omission.\(^ {156}\) This reasonable care standard is a lower threshold than scienter, and no similar shift in the burden requirements are


\(^{149}\) Id. at 1355-56. The sections of the FSA applicable to Lloyd's are sections 47, 56, 59, and 61. Id.

\(^{150}\) Id. at 1356. It appears that there are geographical limitations included in this section that would preclude Lloyd's from being held liable, because it essentially only covers misrepresentations “made in or from the United Kingdom or that the affected person be in the United Kingdom.” Id.

\(^{151}\) See infra note 154 and accompanying text regarding the applicability of § 61 of the Financial Services Act and potential for compensation to plaintiffs, barring the geographical barriers discussed supra note 150 and accompanying text.

\(^{152}\) Bonny v. Society of Lloyd's, 3 F.3d 156, 161 (1993).

\(^{153}\) A private right of action is explicit for §§ 12(1) and 12(2) of the 1933 Securities Act and an implied right of action has long been recognized for § 10(b) of the Securities Exchange Act of 1934. See supra note 61.


\(^{155}\) Roby v. Corporation of Lloyd’s, 996 F.2d 1353, 1364 (2d Cir. 1993), cert. denied, 114 S.Ct. 385 (1993).

\(^{156}\) See supra note 147.

Fourth, the potential availability of treble damages and payment of the plaintiffs’ attorney fees under RICO upon finding of violations of the U.S. securities laws serves not only as compensation to the plaintiff but also as an additional deterrence for issuers and dealers in securities to defraud American investors. Again, no similar provision is found in the Financial Services Act of 1986, The Lloyd’s Act of 1982, or English common law.

In summary, the significant substantive protections afforded by the U.S. securities laws are unmatched by their English counterparts. It therefore appears that the Seventh Circuit’s analysis fails to satisfactorily address the issue that plaintiffs have effectively waived their substantive statutory remedies under the 1933 and 1934 Acts.

C. Sufficient Contacts Analysis

A final issue not adequately addressed by the Seventh Circuit in Bonny is the possibility that the solicitation of the plaintiffs in the United States to invest in Lloyd’s would constitute sufficient contacts to overcome the presumptive validity of the forum selection and choice-of-law clauses. The majority in Scherk v. Alberto-Culver Co. conceded that there may be some situations where the foreign contacts are so “insignificant or attenuated” that the principles of Wilko should still apply. This concession was in response to the dissent’s concern in Scherk that the majority’s analysis could result in American investors being forced to arbitrate their claims in a foreign country despite the fact that material misrepresentations inducing them to invest in a foreign corporation took place in the United States; a fact pattern very similar to Bonny. The Seventh Circuit in Bonny did not address these comments made in this cautionary dictum by the Supreme Court, but instead found that there was no question that an international agreement was involved in the case.

V. Conclusion

Principles of international comity are reflected in the trend of Supreme Court cases enforcing international arbitration and forum se-

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158 See Roly, 996 F.2d at 1366 (stating that RICO “seeks to deter persistent misconduct”).
160 Id. at 517 n.11.
161 Id. at 529-33 (Douglas, J., dissenting).
162 "Kenneth Bonny was solicited by [Robert] King [(principal of Northfield Venture, Inc., an agent of Lloyd’s)] in Illinois to invest in Lloyd’s." Bonny v. Society of Lloyd’s, 3 F.3d 156, 162 n.14 (1993). The other plaintiffs were also solicited to invest in Lloyd’s in the United States. Id. at 158.
163 Id. at 159 n.9.
lection clauses. In *M/S Bremen*, the Court stated that we cannot “insist on a parochial concept that all disputes must be resolved under our laws and in our courts.”\(^{164}\) Regardless of the cogency of such arguments, they should have no applicability in the securities area when “substantive” provisions of the 1933 and 1934 Acts are prospectively waived. Congress passed the Securities Act of 1933 and the Securities Exchange Act of 1934 to protect U.S. investors,\(^{165}\) and such protections should not be thwarted by principles of international comity. The Seventh Circuit’s reliance in *Bonny* on the trend of Supreme Court decisions favoring enforcement of international arbitration and forum selection clauses is therefore misplaced.

Moreover, the Seventh Circuit’s determination that remedies available in England were sufficient to vindicate the plaintiffs’ statutory rights and to deter deception of U.S. investors ignores the argument that “[w]hen a foreign corporation undertakes fraudulent action which subjects it to the jurisdiction of our federal securities laws, nothing justifies the conclusion that only a diluted version of those laws protects American investors.”\(^{166}\) The U.S. Securities laws offer better protection for U.S. investors than their English counterparts.\(^{167}\)

Finally, if the protections of the U.S. Securities Acts are to be taken away, it should be done only by act of Congress. The discretion of the courts should not be permitted to return U.S. investors in foreign markets to the principle of caveat emptor.

**Jennifer M. Eck**

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\(^{165}\) See supra note 5.


\(^{167}\) See supra notes 141-58 and accompanying text.