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# COMMENT

## ***RICHARDS V. LLOYD'S OF LONDON: THE NINTH CIRCUIT DENIES ACCESS TO THE SECURITIES LAWS TO AMERICAN INVESTORS***<sup>†</sup>

### I. INTRODUCTION

Although 1990 might not be the most memorable year of the Twentieth Century, it certainly was for one of Great Britain's most recognized financial institutions, Lloyd's of London. In 1990, Lloyd's recorded an estimated loss of £2,910,000,000.<sup>1</sup> This capped off several previous years of massive losses. Even the most unsophisticated observer of the financial scene could see that many Lloyd's underwriters were going to suffer a financial disaster.

Although Lloyd's is an English institution, they have previously raised capital by allowing Americans to invest in Lloyd's. During the 1980s, Americans investing in Lloyd's of London were required to enter into a choice-of-law clause stipulating that all disputes be resolved in London. When these investors were later faced with the possibility of heavy losses, they wished to sue Lloyd's in the United States under the federal securities laws, which they believed made any foreign choice-of-law clause unenforceable. *Richards v. Lloyd's of London (Richards II)* was a Ninth circuit *en banc* decision that withdrew its prior holding (*Richards I*) that the anti-waiver provisions of the securities laws rendered the choice-of-law clause contained in Lloyd's contract with American investors unenforceable. The *Richards II* decision brings the Ninth Cir-

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<sup>†</sup> *Richards v. Lloyd's of London*, 135 F.3d 1289 (9th Cir. 1998).

1. Julian Barnes, *Deficit Millionaires*, THE NEW YORKER, Sept. 20, 1993, at 74, 75.

cuit into conformity with the other circuits that have looked into this matter.<sup>2</sup> Although the allegations by the American underwriters in the various federal circuits differed from case to case, the essential issue in all of them is the enforceability of both the forum selection and a choice-of-law clause in the original contract between American investors and Lloyd's of London.

In *Richards I*, the plaintiffs alleged, among other things, that Lloyd's violated various provisions of both the Securities Act of 1933 and the Securities Exchange Act of 1934 (the Acts). The investors, or underwriters, otherwise known as "Names," however, had entered into an agreement with Lloyd's of London ("Lloyd's Agreement") that stipulated English law would govern any disputes between the parties and that any disputes arising from the agreement would be resolved in London.<sup>3</sup> The consensus of all of the circuits before *Richards I* (and the Fifth Circuit shortly after *Richards I*) was that the Lloyd's Agreement was valid, based primarily upon the deference the Supreme Court has shown to forum selection clauses in the past.<sup>4</sup> In *Richards I*, however, the Ninth Circuit bucked the

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2. *Richards v. Lloyd's of London*, 135 F.3d 1289 (9th Cir. 1998) [hereinafter *Richards II* and distinguishing this case from the superseded decision in *Richards v. Lloyd's of London*, 107 F.3d 1422 (9th Cir. 1997) hereinafter "*Richards I*"]. Other Lloyd's cases relate to the choice-of-law issue. See *Allen v. Lloyd's of London*, 94 F.3d 923 (4th Cir. 1996); *Bonny v. Society of Lloyd's*, 3 F.3d 156 (7th Cir. 1993); *Roby v. Corporation of Lloyd's*, 996 F.2d 1353 (2d Cir. 1993); *Riley v. Kingsley Underwriting Agencies Ltd.*, 969 F.2d 953 (10th Cir. 1992); *Haynsworth v. Lloyd's of London*, 121 F.3d 956 (5th Cir. 1997), *cert. denied*, 140 L.Ed. 2d 666 (1998).

3. Paragraph 2.1 of this agreement reads as follows: "The rights and obligations of the parties arising out of or relating to the Member's membership of, and/or underwriting of insurance business at, Lloyd's and any other matter referred to in this Undertaking, shall be governed by and construed in accordance of the laws of England." Paragraph 2.2 of this agreement reads in relevant part as follows: "Each party irrevocably agrees that the courts of England shall have exclusive jurisdiction to settle any dispute and/or controversy of whatsoever nature arising out of or relating to the Member's membership and/or underwriting of insurance business at Lloyd's . . ." [hereinafter Lloyd's Agreement]. *Richards I*, 107 F.3d at 1425. These choice-of-law and forum selection clauses are contained in what Lloyd's calls the "General Undertaking, which all Names are required to enter into to become a Name . . ." *Allen v. Lloyd's of London*, No. 3:96cv522, slip op. at 28 n.2 (E.D. Va. Aug. 23, 1996).

4. The principal cases relied on by the courts include *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth*, 473 U.S. 614 (1985); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974); *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972). The applicability of these cases to the Lloyd's matter will be discussed at length

trend and determined that the Acts' anti-waiver provisions prohibit any private agreement to waive the protections of the Acts and the rules of the Securities Exchange Commission. Section 14 of the 1933 Securities Act provides 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 regulation of the Commission shall be void.<sup>5</sup>

In *Richards I*, the court held that this provision covers all contracts concerning sales of securities between United States citizens and foreign entities, such as the Lloyd's Agreement. The court saw nothing in the statute that distinguished between domestic and international transactions. Essentially the Ninth Circuit held that an act of Congress specifically prohibiting parties from contracting out of the securities laws precludes any judicial interpretation of the enforceability of such agreements. Under the *Richards I* analysis, the forum selection clause and choice-of-law clause are simply illegal, and therefore the plaintiffs have the right to sue under the United States securities laws. This decision by the Ninth Circuit, which contravened the findings of many other circuit courts, proved controversial enough to warrant a re-hearing of the entire matter *en banc*.

In *Richards II*, the court reversed the original decision, and held that various Supreme Court precedents (which will be discussed in detail later) allowed parties to enter into choice of law clauses in international dealings. The *en banc* decision then went on to take a leap of faith—similar to that of the other circuits—and held that the parties were able to contract for a choice of law clause in a securities transaction even though: 1) the choice clause would deprive the American party of a statutory right; and 2) Congress has specifically mandated that waiver of the securities laws is forbidden. This Comment will argue that the *Richards II* holding misapplied the relevant Supreme Court precedents, and, more importantly, gave a

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*infra* Part III.

5. 15 U.S.C. § 77n. See also Securities Exchange Act of 1934, 15 U.S.C. § 78cc(a), which reads: "[a]ny 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."

green light to unscrupulous securities dealers who can now, under firm authority, trade securities without the protections of the Acts by simply inserting a choice-of-law clause in their contract, and setting up shop off-shore.

The issue of whether or not to apply American securities laws to all international securities transactions involving American investors is, of course, important to the litigants themselves because of the large amounts of money involved. It is also significant because it represents a major policy choice on the part of the United States in regard to how the international community will approach dealing with American investors. The United States is known for having strict regulations regarding securities transactions, which represented a rejection of the common law rule of *caveat emptor*.<sup>6</sup> A determination that U.S. law will govern in all international transactions where securities are involved may inhibit foreign solicitation here, as international corporations fear what they may perceive as American parochialism.<sup>7</sup> By applying U.S. laws to agreements that specifically call for the application of laws of another sovereign state, as these agreements do, the United States may be accused of disturbing the norms of international financial dealings and of catering to parochial interests.<sup>8</sup> On the other hand, applying American law to these transactions guarantees that our citizens will not be subjected to *caveat emptor* simply because a foreign company has a choice-of-law provision in their contract.<sup>9</sup> Additionally, it may send a signal to the world that we believe our financial disclosure safeguards in securities transactions best protect the international market's integrity. Moreover, as the *Richards I* court held, there is a strong argument that Congress should determine this major policy choice, since Congress enacted the anti-waiver provisions. Until Congress exempts agreements in interna-

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6. See *Roby*, 996 F.2d at 1364 (citing *SEC v. Arthur Young & Co.*, 584 F.2d 1018, 1025 n.51 (D.C. Cir. 1978)), *cert. denied*, 439 U.S. 1071 (1979).

7. See *The Bremen*, 407 U.S. at 9.

8. See *id.* The Court states "[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 our courts." *Id.*

9. See Jennifer M. Eck, *Turning Back The Clock: A Judicial Return to Caveat Emptor for U.S. Investors in Foreign Markets*, 19 N.C. J. INT'L L. & COM. REG. 313 (1994) (advocating this position at length).

tional securities transactions from the Acts, the anti-waiver provisions should apply.<sup>10</sup>

This Comment will analyze how the Ninth Circuit reached its original controversial decision not to enforce the Lloyd's Agreement in *Richards I*, and how it was reversed by the *en banc* decision, *Richards II*. Part II of this Comment will give a brief background of Lloyd's the institution for those readers unfamiliar with their basic workings. To put in context the primary issues raised by the litigants, Part III of this Comment will trace the development of the Supreme Court's decisions regarding choice-of-law and forum selection clauses with an emphasis on those aspects of the cases that bear significantly on the Lloyd's situation. The most significant legal principle to be derived from this analysis is whether the Court's deference to honor choice of law and forum selection provisions in an effort to accommodate the realities of international commerce (as seen in cases such as *The Bremen*, *Scherk v. Alberto-Culver Co.*,<sup>11</sup> and *Mitsubishi*), eliminates the Acts' anti-waiver provisions<sup>12</sup> in international securities transactions.

Part IV of this Comment will focus on the controversial holding of *Richards I* that the anti-waiver provisions of the Acts preclude enforcement of the Lloyd's agreement. The decision will be broken down into its three main parts: 1) the courts can not contravene an express congressional policy decision, 2) the courts should not enforce a choice-of-law clause when it would deprive the citizen of the "substantive" protections of United States law, and 3) it would violate Ameri-

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10. The majority in *Richards I* put the issue as follows: "The fundamental issue dividing the majority and the minority [is] whether the courts or Congress determines our national policy after Congress has spoken," *Richards I*, 107 F.3d at 1429. The California Court of Appeals has come to the same conclusion in a related context: "Any new exception, such as 'promotion of international commerce' would have to come from the Legislature." *West v. Lloyd's of London*, No. B095440, slip. op. at 8 (Cal. Ct. App. Oct. 23, 1997). That suit was brought by American Names against Lloyd's for violations of state law. Lloyd's attempted to have it dismissed on the grounds the parties were bound by the Lloyd's Agreement. See *supra* note 3 (or in the alternative, grounds of *forum non conveniens*). The Names contended that the Agreement was unenforceable because the anti-waiver provisions of the state statute, Cal. Corp. Code § 25701 (West 1997) did not contain an exemption for this transaction. The court used in part the federal Lloyd's cases as a guideline, and concurred with the decision in *Richards I* in finding the Lloyd's Agreement unenforceable.

11. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

12. See Securities Exchange Act of 1934, 15 U.S.C. § 78cc(a).

can public policy to let the English courts decide this case because of deficiencies in their securities laws. These three aspects of *Richards I* will be measured against their outcome in *Richards II*, as well as in some of the other Lloyd's cases in the federal circuits. This comparison will include an analysis of how far American courts will go in enforcing choice-of-law and forum selection clauses in securities contracts between American citizens and foreign entities when, in the absence of fraud, they are freely bargained by competent parties. The *Richards II* decision has left open the question of whether *all* international securities transactions are subject to clauses like the Lloyd's Agreement, as have all of the circuit courts. In addition, unlike *Richards I*, *Richards II* did not find that a plain reading of the anti-waiver provisions prohibit enforcement of the Lloyd's agreement.<sup>13</sup>

The second issue to be analyzed is the so-called substance-procedure theory put forth by the American Names from the seminal Supreme Court securities arbitration cases and other relevant choice-of-law/forum selection cases.<sup>14</sup> The arbitration cases held that the anti-waiver provisions of the Acts do not prohibit disputes from being resolved in arbitration. In making that determination, the Supreme Court distinguished between substantive protections afforded by the Acts from the mere procedural forum used to resolve the dispute. The theory proposes that the Supreme Court has only recognized enforcement of *forum selection* clauses, not *choice of law* clauses. Basically, the Court supports parties contracting where the disputes will be settled, but not what law will be used.

Part IV will conclude by arguing that the *Richards I* decision was correct in its holding that Congress, not the courts, should decide if American citizens can contract out of the Acts. This is the logical result of a straightforward reading of the statutes' anti-waiver provisions. There are two additional reasons why *Richards I* was correct. First, the *Richards I* court properly followed the relevant Supreme Court decisions by rec-

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13. See *Roby v. Corporation of Lloyd's*, 996 F.2d 1353, 1362-1363 (2d Cir. 1993); *Allen v. Lloyd's of London*, 94 F.3d 923, 929 (4th Cir. 1996).

14. See *Roby*, 996 F.2d at 1362 (distinguishing *Scherk*); *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989). The American Names derived in part from the *McMahon* decision the theory of substance against procedure. *Shearson/American Express v. McMahon*, 482 U.S. 220 (1986).

ognizing that the Court has cautioned against enforcing choice-of-law and forum selection clauses when it would deprive the litigant of a statutory protection, despite the Court's overall approval of such clauses. In fact, the Court has never explicitly allowed Americans to waive their statutory protections in securities transactions. Secondly, *Richards I* respected the overall policy of the American securities laws by deferring to the legislature the job of determining whether American citizens can contract out of the Acts. Such a policy decision could potentially affect thousands of American investors. The courts are not the proper institution to take the initiative in enacting an optional waiver of the Acts. In regard to the "substance v. procedure" theory that arose in the Lloyd's matter, this comment argues that the theory as interpreted by the courts created confusion. When substantive laws afforded by a statute reflecting a strong public policy are lost due to a choice-of-law clause, then courts should be reluctant to enforce it. On the other hand, *Haynsworth v Lloyd's of London*<sup>15</sup> (the 5th circuit's Lloyd's decision) was correct in that it accurately follows the spirit of recent Supreme Court decisions. The Fifth Circuit held that a foreign forum is not inadequate simply because it does not identically reflect American "substantive" law.<sup>16</sup> *Haynsworth* was ultimately incorrect, however, in its substance-procedure analysis because it failed to distinguish that the substantive law in question in the Lloyd's matter was afforded by statute reflecting a strong public policy, and, therefore, may not be waived absent an express declaration by Congress.

Part V of this Comment will look at the final controversial aspect of the *Richards I* decision, which was its contention that British securities laws are insufficient to adequately protect American investors and therefore do not provide an adequate forum. Although the court did not need to go into this area since they had already decided that the anti-waiver provisions of the Acts precluded enforcement of the Lloyd's agreement,

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15. See generally *Haynsworth v. Lloyd's of London*, 121 F.3d 956 (5th Cir. 1997), cert. denied, 140 L.Ed. 2d 666, available in 1996 LEXIS 2533.

16. "It cannot be the case that, by virtue of a foreign forum selection clause standing alone, the domestic party to an international business agreement retains a 'substantive right' to assert the remedies and protections of American statutes in the contractually agreed-upon forum." *Id.* at 967.



they argued anyway that Lloyds' special situation in English law made it unfair to Americans to have to sue in English courts. In addition, the district court in the unreported *Allen* case made a detailed comparison of the United States securities laws and the remedies available in England and concluded that English forum is inadequate to decide this case. Moreover, when courts are faced in the future with issues similar to Lloyd's which involve dubious off-shore investment schemes armed with contracts containing choice-of-law clauses, the courts should not hesitate to strike the clauses down as against public policy. Under the *Richards II* holding, however, that may not be possible. It is time for the courts to remember, as the court did in *Richards I*, that justice sometimes requires more than the facilitation of international commerce.

## II. BACKGROUND OF THE LLOYD'S SITUATION: THE OPERATION, THE FINANCIAL DISASTER AND THE GROUNDS OF THE "RICHARDS" LAWSUIT

The legendary Lloyd's of London was developed in a coffee house in London in the late Seventeenth Century by a group of underwriters who shared risks insuring English commercial shipping.<sup>17</sup> Contrary to popular understanding, Lloyd's is not an insurance company; rather it is an insurance market.<sup>18</sup> The market is completely self-regulated under Lloyd's own rules<sup>19</sup> system known as the Lloyd's Acts.<sup>20</sup> The basic memberships in Lloyd's are the Names. The Names are the individual underwriters who are placed in syndicates by Members Agent's who are selected from among them. The syndicates are run by Managing Agents, and contain as few as two, and as many as hundreds of Names.<sup>21</sup> Prospective Names must clear

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17. *Allen v. Lloyd's of London*, No. 3:96cv522, slip op. at 4 (E.D. Va. Aug. 23, 1996). The District Court, in an exhaustive opinion, reached a similar position as the Ninth Circuit in *Richards I*. Although the decision was overruled by the Fourth Circuit, its comprehensive treatment of the Lloyd's matter is unsurpassed by other courts. See *Allen*, 94 F.3d at 926. The opinion also deals extensively with the inadequacy of English law in relation to American securities law. The opinion is not reported. *Id.*

18. See *Allen*, No. 3:96cv522, slip op. at 5.

19. 22 HALSBURY ch. 2, Part 1.

20. See *Allen*, 94 F.3d at 926. See also, A.C. PAGE & R.B. FERGUSON, INVESTOR PROTECTION 243-44 (1992).

21. See *Allen*, No. 3:96cv522, slip op. at 10.

several hurdles to become members in Lloyd's, such as a personal interview, an entrance fee, a "means test,"<sup>22</sup> and depositing a letter of credit.<sup>23</sup> The Name pledges his or her entire net worth (down to the "last button"), which means unlimited liability, to the amount of risk assigned to them.<sup>24</sup> Therefore the Names have unlimited liability for all claims made by the insured, no matter how substantial the losses.

Since Names sign on for unlimited liability, why would anyone want to become a Name? Although each individual Name had his or her own motivation to join Lloyd's, there are a few particular strong benefits that attract Names. In England, Lloyd's is a time-honored institution that has had members for generations. Lloyd's membership connotes prestige and affluence. That does not explain, however, why Americans would want to join. Some American Names have joined Lloyd's, in part, because they are Anglophiles. Lloyd's membership is the closest thing they can get to actual English citizenship.<sup>25</sup> In regard to the investment itself, Lloyd's could potentially provide a huge financial return. Lloyd's Names make profits from the insurance premiums paid into their syndicates. If there are little or no losses incurred by the syndicate (i.e., few claims are paid out), the premiums paid by the insured are returned to the Names as profits. Perhaps the greatest financial incentive for the Names is that they are not actually putting up their money to underwrite the insurance risk. They are merely "pledging" the money. Names only pay when losses are incurred by the syndicate. Therefore, the initial investment does not cost the Names any capital. Although the Names are required to place a letter of credit as collateral, it can consist of investment securities. Even the small amount placed with Lloyd's for good faith is actually making money on interest. Therefore, the prospect of high profits resulting from the investment of little capital is a strong incentive to become a Name.

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22. The test is described as follows: "Although the means test has varied through the years, currently an individual must prove individual wealth in excess of £250,000." Thomas W. Wilson, *How Lloyd's Functions: A Primer on Operations, in LLOYD'S AND THE LONDON INSURANCE MARKET* 11, 46 (1994).

23. See *Allen*, No. 3:96cv522, slip op. at 9.

24. See Wilson, *supra* note 22, at 44.

25. See ELIZABETH LUESSENHOP & MARTIN MAYER, *RISKY BUSINESS: AN INSIDERS ACCOUNT OF THE DISASTER AT LLOYD'S OF LONDON* 24 (1995).

Until 1969, Names were not recruited from the United States. Since then 3,159 Americans have become Names,<sup>26</sup> about 5% of Lloyd's membership. In this period Lloyd's raised over \$600,000,000 in letters of credit (security for future underwriting) from its American investors, and, of course their liability as underwriters.<sup>27</sup> In 1995, however, Lloyd's returned to its policy of denying eligibility to individual American citizens for membership.<sup>28</sup> In addition, since 1994 Lloyd's allowed corporations for the first time to join as "Corporate Names."<sup>29</sup>

Managing Agents, as the day-to-day managers of each syndicate, employ "active underwriters" who determine what risk the syndicate will take on. This takes place at the Lloyd's offices in London where the "active" underwriter takes a position at a "box" and entertains offers of risk from brokers.<sup>30</sup> Usually several syndicates combine to insure a risk, with most of the negotiation conducted between a "lead underwriter" and a broker, with other syndicates signing on to the risk later, based on the reputation of the "lead underwriter."<sup>31</sup> This process often results in many syndicates involved in one risk venture. In Lloyd's, brokers representing clients deal directly with the underwriters. The brokers are held to *uberrima fides* (the utmost good faith) when representing the nature of the risk to the underwriters.<sup>32</sup> The brokers shop their risk and find the best price for their clients. This bargaining illustrates why Lloyd's is in fact an insurance market, not a traditional American insurance company like Prudential or State Farm.

Unlike American "generally accepted accounting principles," Lloyd's operates on a three year accounting system.<sup>33</sup> All of a Name's profits from their passive underwriting or "investment" are calculated three years after a syndicate has

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26. See Wilson, *supra* note 22, at 22.

27. See *id.* See also *Richards I*, 107 F.3d at 1424.

28. See *Allen*, No. 3:96cv522, slip op. at 7.

29. See Deborah A. Tompkinson, *Challenge at Lloyd's*, in *LLOYD'S AND THE LONDON INSURANCE MARKET* 123, 131-140 (1994) (explaining how the "Corporate Name" system operates).

30. See Wilson, *supra* note 22, at 22. The "box" is actually a real box-like object in the Lloyd's offices on Lime Street where the risks are bargained over. See Louis A. Chiafullo, *The Maelstrom at Lloyd's of London: Is it Sink or Swim for Policy Holders?*, 26 *SETON HALL L. REV.* 1392, 1397 (1996).

31. See Wilson, *supra* note 22, at 37.

32. *Id.* at 32-33.

33. *Id.* at 48-51.

closed. The syndicate itself, however, only has a life of one year. If the syndicate is to continue insuring the risk after the year is over, it must be re-formed. Lloyd's contends that this system, a holdover from the days of very long commercial sailing voyages, provides more accuracy in accounting. A Managing Agent, however, may choose not to close the syndicate at the end of a given year if he is unable to ascertain if there are any more potential claims arising from that syndicate.<sup>34</sup> Syndicates also may remain open if the Managing Agent can not close the account. As will be explained, this can happen when the syndicate contains many "long-tail" liabilities.<sup>35</sup> When a syndicate has to pay out a claim, the Name can be called upon to meet the liability. Therefore, the decision of what risks the syndicate is going to take on is the most critical to the Names' interest. Poor or negligent decisions by Managing Agents have led to the financial ruin of many Names.

The events which led to the massive losses at Lloyd's<sup>36</sup> are varied and complex, but there are some specific ones that can be briefly pointed out to help illustrate the situation. Lloyd's suffered badly from problems resulting from syndicates incorrectly gauging the reinsurance market which resulted in the London Market Excess of Loss Spiral, (LMX spiral).<sup>37</sup> The LMX spiral derived from a common practice known as "excess of loss reinsurance." Excess of loss is essential for catastrophic events "where the original coverage is granted for natural perils such as wind, storm, tempest, hurricane, earthquake, bush fires, etc."<sup>38</sup> Another way to look at the LMX plan is as "a layering of insurance risks." It is described as follows:

One underwriter will agree to pay claims on a particular risk

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34. See Chiafullo, *supra* note 30, at 1392, 1396.

35. Closing the syndicate when the syndicate has insured "long tail" risks is difficult. Closing is accomplished when they can establish approximately how much more liability the syndicate has, and then purchases reinsurance to cover it. Therefore, only when the syndicate has enough reinsurance to cover all liabilities can the syndicate be officially "closed." See *West v. Lloyd's of London*, No. B095440, slip. op. at 8 (Cal. Ct. App. Oct. 23, 1997). Of course, until the syndicate is closed, the Names are personally liable for all claims. *Id.*

36. From 1988-1991, Lloyd's of London sustained approximately \$12,600,000,000 in losses. See Stephen Lewis, *The "Names" Litigation, in LLOYD'S AND THE LONDON INSURANCE MARKET*, 173, 175 (1994).

37. See Chiafullo, *supra* note 30, at 1406.

38. *Id.*

of, say, more than \$1,000,000 and up to \$2,000,000. The second underwriter will underwrite another layer, paying claims, say, of \$1,000,000 in excess of the first \$2,000,000. The third underwriter might accept another \$1,000,000 in excess of \$3,000,000 and so on.<sup>39</sup>

The scheme was perhaps the most lucrative enterprise for the syndicates, because liabilities rarely got far up the ladder of reinsurance. The trouble with Lloyd's started when many syndicates reinsured with each other creating a complex situation that caused underwriters "to lose touch with the nature of the risks they were accepting," and, moreover, the syndicates often found that they had reinsured *themselves* at a certain point in the LMX spiral.<sup>40</sup> In other words, a syndicate may have taken on reinsurance which exposed them to risk at one level, and then again took on more reinsurance on the same risk exposing themselves for more risk further up the ladder. If the amount of the losses claimed were great enough to reach the entire reinsurance ladder, a syndicate could be responsible for many exposures in the ladder. A catastrophic event could result in one syndicate having the responsibilities of paying numerous times on the same risk. Therefore, instead of the LMX protecting syndicates from large losses by limiting their exposure, it created a false assurance that a syndicate could meet its liabilities without suffering huge losses. In addition, the reinsurers miscalculated the amount of time it would take for losses to be passed "up the line." In 1988, losses from natural disasters moved rapidly up the line, and "caught many reinsurers off guard."<sup>41</sup> In short, the LMX spiral drove many syndicates into ruin because the purpose of excess of loss reinsurance was defeated by unforeseen events such as natural disasters in the 1980's (like the windstorms of Piper Alpha) and early 1990's, and irresponsible behavior on the part of the

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39. See William Pitt, *Fear LMX Spiral May Be Rebuilt*, J. COM., Sept. 4, 1991, at 3C.

40. *Id.* It is important to remember that the LMX was one of the most lucrative sources of income for syndicates before the string of natural disasters in the late 1980's and early 1990's.

41. *Id.* See also Chiafullo, *supra* note 30, at 1407, (quoting LLOYD'S OF LONDON, AN INTRODUCTION TO LLOYD'S 1, 18, (Lloyd's Training Centre 1989) "Catastrophe excess of loss reinsurance is essential where the original coverage is granted for natural perils such as wind, storm, tempest, hurricane, earthquake, bush fires etc., in order to prevent too great an exposure to any one event/disaster.").

syndicates' Managing Agents.<sup>42</sup>

Another major source of financial trouble for Lloyd's (and, therefore, the Names) is the inability of agents to close out old accounts. The Names, as discussed earlier, are liable for all claims arising from their syndicate until it is closed. Unfortunately, Lloyd's was the underwriter for many businesses that encountered liabilities based on "asbestos, environmental pollution, Agent Orange, and toxic tort cases generally."<sup>43</sup> These types of situations create "long-tail" liabilities. "Long-tail" liabilities are claims that may not manifest themselves for a long period of time, perhaps years.<sup>44</sup> In Lloyd's, there are hundreds of syndicates that remain open from the early 1980's, resulting in a systematic bleeding dry of the underwriting Names with "no cap or end in sight."<sup>45</sup> The Names have unlimited liability until the syndicate is closed.

Not content to watch their entire fortunes be plunged into the unlimited liability abyss of Lloyd's, about 17,000 Names banded together to fight.<sup>46</sup> In England, the Names based their case primarily upon negligence and breach of fiduciary duties.<sup>47</sup> As discussed earlier, however, American Names were contractually bound to litigate in London, thereby losing access to American courts.<sup>48</sup> The problem with the Lloyd's agreement is that it prevents any litigation under the disclosure requirements of the Acts, which represents the harm done to the Names. Their grievance, according to one leading American Name, is that "[Lloyd's] did not say 'Do you understand that you have unlimited liability, and there are unquantifiable asbestos and pollution losses which we are concealing, . . . and the possibility of years you cannot ever get out' . . . ."<sup>49</sup>

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42. See LUESSENHOP & MAYER, *supra* note 25, at 43.

43. Lewis, *supra* note 36, at 175.

44. See Chiafullo, *supra* note 30, at 1409 n.60.

45. Lewis, *supra* note 36, at 176. Lloyd's plan to close these old syndicates is known as its "Equitase" scheme. It hopes to cap all unlimited liability incurred previously to 1992. See Chiafullo, *supra* note 30, at 1408.

46. Lewis, *supra* note 36, at 176.

47. See, e.g., *Deeny v. Gooda Walker Ltd.*, 4 All E.R. 289 (1995).

48. See Lloyd's Agreement, *supra* note 3.

49. See LUESSENHOP & MAYER, *supra* note 25, at 235 (quoting Richard Rosenblatt, member of the American Names Association). "[T]he possibility of years you can never get out" makes reference to the Lloyd's policy that a "year," which is the life of a syndicate, is not closed out (meaning the Name is off the hook) until the Name is able to do so by purchasing reinsurance to cover any future

The *Richards* case was filed on October 9, 1994 in the Southern District of California.<sup>50</sup> The Names alleged, *inter alia*, that Lloyd's violated the securities laws of this country by not meeting SEC standards for prospectuses, and not registering under the 1933 Act.<sup>51</sup> They also claimed that Lloyd's placed them in syndicates that were saddled with long-tail liabilities from asbestos and toxic waste, and vulnerable to the LMX spiral problems. These syndicates had very little chance of turning a profit. In addition, the plaintiffs also alleged that the extent of their potential liabilities were not disclosed to them.<sup>52</sup> In order to have these claims heard, however, the Lloyd's Agreement,<sup>53</sup> binding them to London courts had to be defeated. On April 28, 1995, the district court held that the Lloyd's Agreement should be enforced unless it would be "unreasonable" to do so. As will be discussed, this ruling relies heavily on the Supreme Court's holding in *The Bremen*.<sup>54</sup> Therefore, when approaching the Ninth Circuit on appeal, the Names were faced with the reality that all of the other federal circuits had faced essentially the same issue and found against them. From Lloyd's point of view, millions, perhaps billions of dollars, potentially hinged upon the enforcement of the Lloyd's Agreement.

### III. SUPREME COURT INTERPRETATION OF INTERNATIONAL CHOICE OF LAW AND FORUM SELECTION ISSUES

#### A. *The Bremen v. Zapata*<sup>55</sup>

As stated earlier, the Supreme Court has moved in the last twenty-five years from an aversion to choice-of-law and forum selection provisions, especially arbitration agreements,<sup>56</sup> to a general acceptance of them. The first significant

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losses. *Id.* The Names are liable for losses incurred in the syndicate until that time. *Id.*

50. See *Richards I*, 107 F.3d at 1424.

51. *Id.* at 1425.

52. *Id.*

53. See Lloyd's Agreement, *supra* note 3.

54. See *Richards I*, 107 F.3d at 1426.

55. *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972).

56. The Court in *Mitsubishi* explained that arbitration provisions were previously treated with "anachronistic judicial hostility . . . which American courts borrowed from the English common law." *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth*, 473 U.S. at 625 n.14 (1985).

change in policy came in the decision *The Bremen v. Zapata*, where forum selection clauses in international transactions were presumed valid and enforceable. Prior to *The Bremen*, American courts viewed such clauses with mistrust. The presumption was that they were contrary to public policy and therefore unenforceable.<sup>57</sup> *The Bremen*, therefore, marked a radical shift in judicial policy at the time.

*The Bremen* involved a sale of an oil rig from an American corporation, Zapata, to an Italian concern. The American corporation contracted with a German company, Unterweser, to tow the rig to Italy. The parties had previously agreed as part of the original contract to settle disputes in England, under English law.<sup>58</sup> When problems arose, however, and the rig was damaged and towed to Tampa, Florida, Zapata sued in U.S. court. The district court ruled in favor of Zapata, as did the Fifth Circuit Court of Appeals, in an 8-6 *en banc* decision. The Court of Appeals determined that the clause could not be enforced because of precedent and American courts were constrained to honor such clauses when one of the parties was an American citizen.<sup>59</sup> In essence, the pre-*The Bremen* position of the Fifth Circuit was that American courts could honor such agreements between an American and non-American party only when the selected forum site would be more convenient to the particulars of the litigation.

The Court's change in policy in *The Bremen* can be attributed, in part, to economic realities. Specifically, the Court held that "[I]n the light of present-day commercial realities and expanding international trade we conclude that the forum clause should control absent a strong showing that it should be set aside."<sup>60</sup> Therefore, the burden in attempting to avoid a contractual forum provision is on the party seeking avoidance. In addition, the showing that must be made in order to avoid the contractual provision is extremely high. The party must "clearly show that enforcement would be unreasonable and unjust, or that the clause was invalid for such reasons as fraud or overreaching."<sup>61</sup> The Court also determined that "a contrac-

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57. *The Bremen*, 407 U.S. at 13.

58. *Id.* at nn.2-3.

59. *Id.* at n.10.

60. *Id.* at 15.

61. *Id.*



tual choice-of-forum clause should be held unenforceable if enforcement would contravene a strong public policy of the forum in which the suit is being brought."<sup>62</sup> The Court gave no test to determine what exactly constitutes a "strong public policy."

*B. Mitsubishi v. Soler*<sup>63</sup>

In *Mitsubishi v. Soler* the Supreme Court further reinforced its commitment to honoring contractual choice of law selections in international agreements. The *Mitsubishi* case concerned the enforceability of an arbitration agreement between a car manufacturer, Mitsubishi, and an American car dealer.<sup>64</sup> The First Circuit Court of Appeals found that the counter claims invoking antitrust laws were unarbitrable as a matter of public policy. Therefore the United States Courts could not hear the antitrust claims despite the agreement between the parties.<sup>65</sup> The Supreme Court reversed on the grounds that there should be no presumption that the antitrust laws are not eligible to be settled by a private agreement to arbitrate.<sup>66</sup> The Court emphasized that there should no longer be a presumption "that international arbitration will not provide an adequate mechanism,"<sup>67</sup> in effect placing the burden on the party who wishes to get out of the arbitration

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62. *Id.*

63. *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth*, 473 U.S. 614 (1985).

64. The sales contract between the parties contained the following clause: "All disputes, controversies of differences between [Mitsubishi and [Soler] out of or in relation to Articles I-B through V of this Agreement or for the breach thereof, shall be finally settled by arbitration in Japan in accordance with the rules and regulations of the Japan Commercial Arbitration Association." *Id.* at 617.

65. The Court of Appeals followed the rationale of *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968) (holding that rights stemming from the antitrust laws were not appropriate for arbitration). See also *Mitsubishi*, 473 U.S. at 620-21.

66. "[W]e find no warrant in the Arbitration Act for implying in every contract within its ken a presumption against arbitration of statutory claims." *Mitsubishi*, 473 U.S. at 625. The Federal Arbitration Act, 9 U.S.C. §§ 1-16, provides for the courts to compel parties to arbitration pursuant to an agreement. The United States has also signed and ratified the major international agreement on international arbitration awards. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T 2519, 330 U.N.T.S. 3. This treaty commits the United States to honoring international arbitration agreements unless it finds that the agreement "is null and void, inoperative or incapable of being performed." *Id.*

67. *Mitsubishi*, 473 U.S. at 636.

agreement to make a showing of why the foreign arbitration system will not protect his rights. In conclusion, the Court reasoned that old judicial hostilities towards arbitration, including hostility directed towards international arbitration have to be discarded in order to test how fair and effective the new system will be.

Similar to the holding in *The Bremen*, however, the Supreme Court did *not* shut the door completely on those parties wishing to litigate rather than arbitrate pursuant to a contractual agreement. The Court stated that if the choice-of-law clause would preclude a statutory remedy for antitrust violations, "we would have little hesitation in condemning the agreement as against public policy."<sup>68</sup> The *Mitsubishi* decision in fact laid out a clear guideline as to the judicial policy in determining whether to honor arbitration agreements, and recognized that Congress can evidence an intent to prohibit waiver of judicial remedies. The Court stated:

By agreeing to arbitrate a statutory claim, a party does not forgo substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial forum. It trades the procedures and opportunity for review of the court-room for the simplicity, informality, and expedition of arbitration. We must assume that if Congress intended the substantive protection against waiver of the right to a judicial forum, that intention will be deductible from the text or legislative history.<sup>69</sup>

The Court made a distinction between procedure and substance to be considered by a court faced with determining whether to release a party from a contractual agreement to arbitrate. This analysis would be a factor in the *Richards I* decision, although it was also a source for confusion.<sup>70</sup>

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68. *Id.* at n.19.

69. *Id.* at 628.

70. See, e.g., Darrel Hall, Note, *No Way Out: An Argument Against Permitting Parties to Opt Out of U.S. Securities Laws In International Transactions* 97 COLUM. L. REV. 57 (1997) [hereinafter *No Way Out*] (criticizing the Second, Fourth, and Tenth Circuits' analysis in the Lloyd's litigation). The author argues that in finding for Lloyd's and enforcing the choice-of-law and forum selection agreements, the circuits either neglected to follow the Supreme Court's substantive-procedural distinction, or, as in *Roby*, misapplied it. The substance-procedure distinction is also used for support of the American Names position in *Richards I* by the Securities and Exchange Commission. See Brief of the Securities Exchange

In the aftermath of the *Mitsubishi* decision, the status of the enforceability of foreign arbitration agreements can be summed up as follows: 1) courts should give great weight to agreements freely entered into by private parties; 2) there is no presumption that foreign arbitration is inherently incapable of adequately adjudicating the conflict before it; and 3) when faced with a statutory claim, the court must look to congressional intent to see if there is evidence that waiver of traditional judicial forum was contemplated. The Court also articulated a test for this issue: First, the court should consider "whether the parties' agreement to arbitrate reached [statutory] issues . . . and then . . . [consider] whether legal constraints external to the parties' agreement foreclosed the arbitration of those claims."<sup>71</sup>

Recently, the Supreme Court revisited the issue of a foreign arbitration clause potentially denying an American litigant a statutory protection in *Vimar Seguros*.<sup>72</sup> In *Vimar*, the Court reiterated its position in *Mitsubishi* that it would strike down a choice clause in an international agreement if it deprived the litigants of a statutory remedy.

### C. *Scherk v. Alberto-Culver Co.*<sup>73</sup>

In *Scherk v. Alberto-Culver Co.*, the Supreme Court addressed the issue of the anti-waiver provisions in the context of

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Commission, Amicus Curiae at 18-19 [hereinafter SEC Brief]; *Richards I*, 107 F.3d at 1422. However, the distinction between procedure and substance is exaggerated in *Richards I*, and the better argument for the plaintiffs is the anti-waiver provisions themselves. The substance-procedure argument is vague, and if applied could defeat the whole purpose of the direction honoring of contractual choice clauses that the Court is moving in. See section IV, *infra*. Perhaps the key factor in determining enforceability of the choice-of-law and selection clauses is the substantive law derived from a statutory right of a United States citizen. That statutory right should not be waived unless the significance of the public policy is adequately reflected by the foreign arbitrators. In the Lloyd's situation, this would require a comprehensive comparative securities law analysis of the type conducted by the District Court. See *Allen v. Lloyd's of London*, No. 3:96cv522 (E.D. Va. Aug. 23, 1996).

71. *Mitsubishi*, 473 U.S. at 628.

72. *Vimar Seguros Y Reaseguros S.A. v. M/V Sky Reefer*, 515 U.S. 528 (1995) (holding that the statutory provisions of the Carriage of Goods Sea Act (COGSA), 46 U.S.C. § 1300 prevented, *inter alia*, any agreement from lessening the liability of a carrier could be opted out of in this instance because the litigants had provided for an American court to review the foreign arbitration).

73. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

an international securities transaction. The issue of whether the Acts can be waived by American citizens, however, was not reached. The Court ruled on the enforceability of an arbitration clause in an international transaction where the plaintiff charged violations of section 10b of the 1934 Exchange Act. The transactions concerned the sale of property sold in Germany and Liechtenstein, and the contract was signed in Austria.<sup>74</sup> The Court held in a 5-4 decision that the parties would be bound to their prior agreement to arbitrate all discrepancies in Paris, under the laws of the State of Illinois, once again reinforcing its policy of honoring international agreements.

Although *Scherk* involved enforcement of a choice-of-law/forum selection clause in an international securities transaction, the case does not make clear the Court's position on waiving the statutory provisions of the Acts themselves. While following generally *The Bremen* and the line of favoring international choice/forum clauses in the interest of commerce,<sup>75</sup> the Court enforced the clause knowing that in fact the substantive provisions of the securities laws would be available to the parties due to the choice-of-law clause stipulating Illinois law. While the majority leans towards a general approval of acknowledging both forum and choice-of-law clauses, it specifically leaves open the question of the waiving of the securities laws in cases involving transactions between American investors and foreign companies. The majority acknowledges that its holding does not address the anti-waiver provisions:

The dissent opinion raises the specter that our holding today will leave American investors at the mercy of multinational corporations with 'vast operations around the world' . . . Our decision, of course, *has no bearing on the scope of the substantive provisions of the federal securities laws for the simple reason that the question is not presented in this case.*<sup>76</sup>

The *Scherk* decision, as well as *McMahon*,<sup>77</sup> are seminal

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74. *Id.* at 515.

75. "A contractual provision specifying in advance the forum in which disputes shall be litigated and the law to be applied is . . . an almost indispensable precondition to achievement of the orderliness and predictability essential to any international business transaction." *Id.* at 516.

76. *Id.* at 518 n.12. The Court had made no determination if the transaction concerned a security; *id.* at 514 n.8 (emphasis added).

77. *Shearson/American Express v. McMahon*, 482 U.S. 220 (1987).

securities law cases because they overturned prior holdings that arbitration was not allowed in resolving claims brought under the Acts. Although the majority left no doubt about their enthusiasm for enforcing choice clauses, they do not appear, however, to have mustered enough support to endorse the waiver of the securities laws in international transactions. Although Lloyd's relies in part on *Scherk* to bar its American Names from access to American courts, it is not clear if it is applicable to their situation because of the ambiguity in the Court's holding. The Court left open the substantive-procedural issue in the securities laws context that later would become an issue in the *McMahon* decision. In addition, the Court did not overturn its statements in *Mitsubishi* about not enforcing choice-of-law agreements that operate to deny statutory rights. *Scherk* is only relevant to the Lloyd's Agreement<sup>78</sup> if the Court meant that Americans are free to contract out of the protection of the Acts in international agreements.<sup>79</sup> The argument for this interpretation is based simply on the great lengths the Court has gone in expressing their unequivocal support for freedom of contracting both choice and forum clauses in the interest of international trade and commerce. There is no doubt that the Court recognizes ascertaining the choice-of-law ahead of time is a benefit to our economy. Still, the Court did not reach the issue. It may be that *Scherk* stands for enforcement of choice-of-law clauses in general international agreements involving securities only when the contacts with the United States are not substantial.<sup>80</sup> In that case, the courts may have to conduct a "contacts" type analysis when confronted with the issue.

*D. Summary of the Supreme Court Position on Choice-Of-Law and Forum Selection Provisions In International Agreements*

The Supreme Court has clearly spoken in favor of upholding forum selection and choice of law provisions in internation-

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78. See Lloyd's Agreement, *supra* note 3.

79. In *Richards I*, the court also raised other problems with Lloyd's reliance on *Scherk*, such as the nature of the transactions in *Scherk* were almost exclusively European, and that the Court also had to deal with the Federal Arbitration Act. See 9 U.S.C. § 1.

80. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 517 n.11 (1974).

al agreements. Prior judicial prejudices against these clauses were overturned in favor of a general acceptance of them primarily because of their affect on growing international commerce. The policy of the Court is illustrated in an excerpt from *Scherk*:

A parochial refusal by the courts of one country to enforce an international arbitration agreement would not only frustrate these purposes, but would invite unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages . . . [It would] damage the fabric of international commerce and trade, and imperil the willingness and ability of businessmen to enter into international commercial agreements.<sup>81</sup>

The presumption of the validity of choice-of-law and forum selection clauses has limitations. Generally, the provisions will not be enforced if they are not reasonable. Clauses can be "unreasonable" in three ways:<sup>82</sup>

1) The clause was entered into by fraud or overreaching.<sup>83</sup>

2) The complaining party will for all practical purposes be deprived of his day in court because of the unfairness or inconvenience of the selected forum.<sup>84</sup>

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81. *Id.* at 516-17.

82. *See, e.g.,* *Roby v. Corporation of Lloyd's*, 996 F.2d 1353, 1363 (2d Cir. 1993); *Allen v. Lloyd's of London*, 94 F.3d 923, 928 (4th Cir. 1996).

83. This was not applicable to *Richards I* because the court found fraud was not present in the actual signing of the agreement itself. *See Richards I*, 107 F.3d at 1426.

84. American Names have claimed that British courts have been unfair. *See American Names Association, U.K. Court Denies Investors' Right To Sue For Fraud; U.S. Lloyd's Investors Allegations Confirmed*, Press Release, Apr. 24, 1997. In the wake of the *Society of Lloyd's v. Wilkinson & Others*, the British Courts are accused of abandoning investor protection in what is characterized as the "pay now, sue later" decision. *Id.* The Wilkinson decision and its effect on the American courts' analysis of the adequacy of the British forum will be discussed *infra*. It is agreed by observers, however, that British law does contain remedies somewhat similar to those in the United States in securities transactions. *See* NORMAN S. POSER, *INTERNATIONAL SECURITIES REGULATION* 293-298 (1991) (comparing § 62 of the British Financial Services Act, which provides a private right of action, with civil liability under the American securities law). *Lloyd's*, however, is exempt from the English securities laws. *Id.*

3) The fundamental unfairness of the chosen law may deprive the plaintiff of a remedy.<sup>85</sup>

More importantly to the Lloyd's agreement problem, however, is that the Supreme Court has clearly been more hesitant in approving enforcement of choice-of-law clauses when it would result in the loss of a statutory remedy. The *Mitsubishi* decision specifically stated that it would strike down a choice-of-law agreement if it would deprive a litigant of protections of the antitrust laws.<sup>86</sup> Although the Court did not mention any other specific statutory provisions, like the securities laws, it is clear that waiver of statutory rights is an issue that the Court finds problematic. Moreover, the Court's concern for waiver of statutory rights was again seen recently in *Vimar Seguros*. Therefore, the Supreme Court's position on enforceability of choice-of-law clauses in international agreements has two aspects: 1) if the clause simply agrees on which substantive law to apply to resolve disputes, it will be upheld as long as it is not unreasonable, but 2) if the choice-of-law clause would deprive a party of a statutory protection, it should not be enforced unless the foreign forum contains a suitable alternative substantive protection.

#### IV. THE ENFORCEABILITY OF THE CHOICE OF LAW AND FORUM SELECTION CLAUSES IN THE LLOYD'S AGREEMENT: THE ANTI-WAIVER PROVISIONS OF THE ACTS AND THE SUBSTANCE-PROCEDURE DISTINCTION IN SUPREME COURT PRECEDENTS

##### A. *The Plain Meaning Interpretation of the Anti-waiver Provisions in Richards v. Lloyd's of London*

The *Richards I* court held that the anti-waiver provisions of the Acts<sup>87</sup> prohibit enforcement of the Lloyd's Agreement.

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85. This "public policy" argument is the most important to the Lloyd's situation. The issue is whether the disclosure provisions of Rule 10b (or the anti-fraud provision of the proxy rules) would give plaintiffs a cause of action unavailable in England, and having found that they would, do those provisions of the American securities laws represent a strong public policy that opting out of them would render them unenforceable. *Id.*

86. See *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth*, 473 U.S. 636 n.19 (1985).

87. See Securities Exchange Act of 1934, 15 U.S.C. § 78cc(a).

According to *Richards I*, "Congress has already determined such clauses were void."<sup>88</sup> The decision continues, when discussing the "reasonableness" of the clauses under the established *The Bremen* test, "In our view . . . the reasonableness of the Choice Clauses is not determinative of their enforceability. The Securities Acts' anti-waiver provisions themselves render the Choice Clauses void, making it unnecessary to examine whether enforcement of the clauses would be reasonable under the test set forth in *The Bremen*. . . ." <sup>89</sup> Therefore, the analysis of the reasonableness of the clauses, determined under the Supreme Court cases discussed above, is not applicable to the Lloyd's cases.<sup>90</sup>

In contrast, the *Richards II* court found that the enforceability of the Lloyd's Agreement must come under a *The Bremen* analysis.<sup>91</sup> The court gave the following reasons for this: 1) the court deciding *The Bremen* specifically made reference to enforcing a forum selection clause when it conflicts with a relevant statute.<sup>92</sup> 2) the *Scherk* decision relied on *The Bremen* to resolve an international securities question<sup>93</sup> and 3) if they found that *The Bremen* did not apply, the "reach of the United States securities laws would be unbounded."<sup>94</sup> All three of the courts reasons to apply a *The Bremen* test are incorrect. First, *The Bremen* only contemplated a forum-selection clause to take precedent over a conflicting statute, not a choice-of-law clause. In addition, as the court admits, there was no statute involved in *The Bremen*. There is no argument about the enforceability of forum selection clauses. Therefore, the court's reasoning does not support their position. Second,

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88. *Richards I*, 107 F.3d at 1426.

89. *Id.* at 1428-29.

90. See SEC Brief, *supra* note 70, at 15 (stating that "[t]he anti-waiver provisions, however, are not simply an expression of public policy that favors United States securities laws unless other comparative laws are available. Rather, they are an express and unequivocal directive that the rights and obligations under the securities laws cannot be waived. This determination has been made by Congress, and the courts are not free to substitute their own public policy determinations").

91. "We analyze the validity of the choice clause under *The Bremen* . . . , where the Supreme Court stated that courts should enforce choice of law clauses in cases of 'freely negotiated private international agreements.'" *Richards II*, 135 F.3d at 1293 (quoting *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 12-13 (1972)).

92. *Id.*

93. *Id.*

94. *Id.*



the *Scherk* court's reliance on *The Bremen* is not applicable to the Lloyd's Agreement because the *Scherk* decision did not consider the waiver of the securities laws. Furthermore, the contacts with the United States were minimal. As for the third reason given by *Richards II*, the securities laws are not unbounded when applied to this situation, where the parties were solicited in the United States and the syndicates insured United States interests. Considering the totality of the American contacts in this case, the *Richards II* warning of the overreaching of the American securities laws is clearly unwarranted. Lloyd's did not have a peripheral contact with the United States. In fact, Lloyd's was heavily committed to the American market.

In distinguishing *Scherk*, the *Richards I* court argued that the circumstances of the case made it almost entirely international in character, thus less likely a transaction the securities laws were meant to protect.<sup>95</sup> The transaction in *Scherk* had minimal contacts with the United States. The American party was an institution, not a private individual. In contrast, in the Lloyd's situation, the Names were *solicited in the United States*. The Names are individual investors, not part of a large corporation with experience in international dispute resolution. It also distinguished *Scherk* from the Lloyd's situation because in *Scherk*, the Court was confronted with two statutes, the Exchange Act and the Federal Arbitration Act. In such a situation when confronted by two statutes, the Court's consideration of international commerce "tipped the balance" in favor of upholding the arbitration.<sup>96</sup> Finally, the *Richards I* court essentially agreed with the Securities Exchange Commission (SEC) in their analysis of *Scherk*. The SEC argued that the Court allowed the arbitration to take place in Paris since there was no question of not applying American law because the parties' agreement specified that disputes would be resolved in accordance with Illinois law.<sup>97</sup> In other words, there has never been a Supreme Court precedent for allowing an exception to

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95. *Richards I*, 107 F.3d at 1427.

96. *See id.* at 1427. The *Scherk* court had to make a choice between applying one of two statutes which were in conflict. Therefore, faced with that choice the Court looked to the policy of favoring international commerce as sort of a "tie-breaker." *Id.*

97. *See* SEC Brief, *supra* note 70, at 17.

the anti-waiver provisions for "fostering international commerce."

The *Richards II* interpretation of *Scherk*, in contrast, goes too far beyond the holding of the Supreme Court. The *Richards II* decision asserts that "[t]he Supreme Court repeatedly recognized in *Scherk* that parties to an international securities transaction may choose law other than that of the United States."<sup>98</sup> They cite to two footnotes within the *Scherk* opinion for support of their position. The first, footnote eleven in *Scherk*, points out that the greater part of the securities transaction in *Scherk* took place outside of the United States, so applying the United States laws would be overreaching. The second cite, footnote thirteen, comments that some forum selection clauses can be read to encompass a choice-of-law selection. This is irrelevant to the enforceability of the Lloyd's Agreement because the issue is whether choice-of-law is allowed at all in securities transactions. The expectations of the parties are subservient to the dictates of the statute. The sweeping *Richards II* generalization that parties are free to pre-determine the law governing potential disputes in international securities transactions regarding Americans misreads the relevant precedents, except, perhaps, to the extent that the contacts with the United States are minimal or peripheral.

#### B. *Richards I Contrasted With the Other Circuit Opinions on the Lloyd's Agreement*

The *Richards I* position on the anti-waiver provisions was a radical departure from the other circuit cases<sup>99</sup> on the same matter. The *Riley*<sup>100</sup> and *Allen*<sup>101</sup> decisions did not consider

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98. *Richards II*, 135 F.3d at 1295.

99. See *Allen v. Lloyd's of London*, 94 F.3d 923 (4th Cir. 1996); *Bonny v. Society of Lloyd's*, 3 F.3d 156 (7th Cir. 1993); *Roby v. Corporation of Lloyd's*, 996 F.2d 1353 (2d Cir. 1993); *Riley v. Kingsley Underwriting Agencies Ltd.*, 969 F.2d 953 (10th Cir. 1992); *Haynsworth v. Lloyd's of London*, 121 F.3d 956 (5th Cir. 1997), *cert. denied*, 140 L.Ed. 2d 666 (1998).

100. See *Riley v. Kingsley Underwriting Agencies, Ltd.*, 969 F.2d 953 (10th Cir. 1992) (the 10th Circuit's *Lloyd's* decision).

101. See *Allen v. Lloyd's of London*, 94 F.3d 923 (4th Cir. 1996). Although most of the various *Lloyd's* cases are basically similar, the *Allen* case was unique in that it involved the American Names attempting to sue to receive more information from *Lloyd's* about their attempt to implement a reinsurance scheme ("Plan for Reconstruction and Renewal"). See *Allen*, 94 F.3d at 927. *Lloyd's* successfully argued that the reinsurance scheme was not a "security," and therefore not subject

the anti-waiver provisions as highly relevant. In *Roby*,<sup>102</sup> the Second Circuit came closer to *Richards I* when it considered the anti-waiver provisions significant as a showing that the Congress had weighed in on the idea that the American securities laws are important public policy and found that in determining to enforce the Lloyd's Agreement it had to first conduct an analysis based on a *The Bremen* reasonableness test. Put another way, the *Roby* court used the anti-waiver provisions as a *factor* in measuring how significant to public policy are the American securities laws and then balanced them against the Supreme Court deference to private choice-of-law or forum selection agreements. The *Roby* court did not consider the anti-waiver provisions a complete prohibition to parties choosing to have their potential conflicts adjudicated under other laws than American. It is not clear why the *Roby* court would look to a clear, unambiguous anti-waiver statute as an element in a balancing test.

The Fifth Circuit did, however, face the issue of the anti-waiver provisions squarely in *Haynsworth*, (a decision rendered shortly after *Richards I*) and arrived at a conclusion that the provisions do not prohibit parties from contracting out of American securities laws.<sup>103</sup> The *Haynsworth* court relied primarily on *Scherk* for this position, and argued that the fact the parties in that case had their claims adjudicated under American law was not relevant: ". . . for *Scherk* involved a foreign forum selection clause accompanied by a choice-of-law clause selecting the law of Illinois. Presumably, this meant that the parties could rely on the protections of the federal securities laws as well, *but the decision did not rest on this assumption*."<sup>104</sup> Instead the Court roundly rejected the notion that a forum selection clause can be circumvented by a party's asserting the unavailability of American remedies. The Fifth Circuit interpretation of *Scherk*, means that the anti-waiver provisions of the Acts do not apply to international transactions despite no direct language by the court directly on that partic-

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to the Acts. *Id.* The other circuits, as well as the SEC, have not made a determination if the actual investment itself constitutes a security under the Acts. *Richards I*, ruling on an appeal from a dismissal of the Names' complaint, assumed that the Lloyd's investment was a security. See *Richards I*, 107 F.3d at 1425.

102. *Roby v. Corporation of Lloyd's*, 996 F.2d 1353 (2d Cir. 1993).

103. See *Haynsworth v. Lloyd's of London*, 121 F.3d 956 (5th Cir. 1970).

104. *Id.* at 967. (emphasis added).

ular point.

The interpretation of the anti-waiver provisions by the various circuits in the Lloyd's cases reveals that only three circuits have addressed the issue in any significance.<sup>105</sup> Of the three, the *Roby* court used the anti-waiver provisions only as a factor in discussing the policy considerations under *The Bremen*. The *Roby* court did not determine whether or not the provisions directly bear on the Lloyd's Agreement itself. The *Roby* decision, by using the anti-waiver provisions as a factor in measuring the weight of public policy, did not adequately address the issue of the statute directly. Therefore only two circuits, the Fifth and the Ninth, have looked at the choice clauses turning principally on the interpretation of the anti-waiver provisions, and have come to different results. When looked at in this light, in regard to the anti-waiver provisions, the *Richards I* decision is not as isolated as it might otherwise appear. In addition, *Richards I* was also correct in its analysis that in determining whether to enforce the Lloyd's Agreement, the courts should first deal with the anti-waiver statutes<sup>106</sup> before moving on to a balancing of public policy interests.<sup>107</sup> As discussed above, *Richards II* immediately went into a *The Bremen* test of public interest.

### C. The "Substance-Procedure" Theory

Some of the circuit courts in the Lloyd's matter have construed the line of cases following *The Bremen* as differentiating between upholding enforcement of choice and forum selection clauses when the clauses merely imposed a "procedural" basis

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105. See *Roby*, 996 F.3d at 1353; *Richards I*, 107 F.3d at 1422; *Haynsworth*, 121 F.3d at 956.

106. See Securities and Exchange Act of 1934, 15 U.S.C. § 78cc(a).

107. See *Richards I*, 107 F.3d at 1428-29. In addition, *Roby* is distinguishable from *Richards I* and *Haynsworth* because *Roby* actually concedes that "[i]n a sense, the securities laws somewhat resemble the antitrust laws at issue in *Mitsubishi*." See *Roby*, 996 F.2d at 1634. If that were true, the *Mitsubishi* decision advises that it would strike the choice clause if it prevented a party from pursuing statutory remedies (it does not mention weighing public policy when faced with a claim based on a statute). *Id.* The *Mitsubishi* decision reads closer to the proposition that when Congress has enacted a provision to void non-compliance with the statute, congressional intent will trump *The Bremen* prodigy. The *Roby* decision recognizes this distinction, but fails to analyze it. *Haynsworth*, however, reads *Scherk* as holding the anti-waiver provisions do not reach international transactions.

for adjudication, but considered the loss of "substantive" rights as a result of choice-of-law clauses more troublesome.<sup>108</sup> Another way of looking at this substance-procedure theory is that the Supreme Court has in reality only upheld *forum selection* clauses, but has not upheld choice-of-law cases. In *Richards I*, the court argued that the relevant Supreme Courts precedents,<sup>109</sup> especially *McMahon*, establish that "substantive rights" can not be waived, even in the face of the Arbitration Act, and "[b]y this test, [since] the Choice Clauses require the waiver of substantive provisions of the 1933 and 1934 Acts [they] are consequently void."<sup>110</sup>

This substantive-procedural theory, however, potentially can lead to confusion regarding the arguments of the American Names. If applied, the substance-procedure argument discussed in *Richards I* would be at direct odds with the purposes of *The Bremen* and subsequent Supreme Court cases that advocate the expanding freedom to choose forums to foster international business transactions. The *Haynsworth*<sup>111</sup> decision cor-

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108. See *Roby*, 996 F.2d at 1362 (distinguishes the situation in the Lloyd's cases based upon the substance-procedure concept from the seminal securities arbitration cases of *Rodriguez* and *McMahon*). See *id.* See also *No Way Out*, *supra* note 70, at 74-76 (criticizing the Bonny, Riley and *Roby* courts for enforcing the choice clauses despite the resulting loss to the American Names of the substantive protections of the Acts). The author also argues that the Supreme Court has in fact only ruled on forum selection clauses, not choice of law clauses, which pertain to "substantive" rights.

109. See *infra*, part III.

110. *Richards I*, 107 F.3d at 1428. The court went on to state: "*The Bremen* did not apply the reasonableness test in the face of a statute purporting to decide the question of the choice-of-forum's enforceability." *Id.* But see *Allen*, 923 F.3d at 929 (argument of the court that "[W]e do not believe that Congress intended that the disclosure requirements of the United States securities law be exported and imposed as governing principles on markets conducted entirely in other countries simply because membership in such markets is solicited in the United States." *Allen*, 923 F.3d at 929, (citing *Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326, 1334 (2d. Cir 1992)) (emphasis added). The *Leasco* case, however, concerned an American company, not individual investors. Moreover, the *Allen* court downplays the extent of the contacts with the United States in the Lloyd's matter by alluding that the Names were participating in a predominantly foreign market because they travelled to London to have a personal interview and sign their agreement. See *Allen*, 94 F.3d at 929. Not only were the Names solicited in the United States, many of the syndicates they belonged to were destroyed by huge financial losses because of "long-tail" risks from asbestos and toxic waste in the United States.

111. See *Haynsworth v. Lloyd's of London*, 121 F.3d 956 (5th Cir. 1997), *cert. denied*, 140 L. Ed. 2d 666 (1998).

rectly deals with the substance-procedure, (or "waiver of substantive rights" theory) by arguing that when parties agree to a forum selection clause, the assumption is that the substantive law used to resolve the disputes will be the law of the forum selected.<sup>112</sup> Furthermore, the substantive-procedural theory is analytically flawed because the distinction could potentially render all choice-of-law clauses void unless the forum state contained an exact substitute substantive law that would be enjoyed if the parties were in American courts. That result, absent a clear congressional showing as discussed above, certainly defeats the spirit of *The Bremen* and subsequent decisions. In the words of the Fifth Circuit "[t]he view that every foreign forum's remedies must duplicate those available under American law would render all forum selection clauses worthless and severely hinder Americans' ability to participate in international commerce."<sup>113</sup> The *Roby* court, in raising the substance-procedure distinction, concluded that the *Shearson/American Express v. McMahon* case<sup>114</sup> was not applicable to the Lloyd's cases because it only stood for granting arbitration in cases involving the securities laws when the substantive protections of the securities laws will be used as the basis for resolving the dispute.<sup>115</sup> The court correctly pointed out that if the American Names had argued "merely to the judicial choice of an arbitral forum, we would reject their claim immediately . . ."<sup>116</sup> Since, however, the Names had argued that the enforcement of the Lloyd's Agreement<sup>117</sup> would deprive them of the *substantive* rights of the securities

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112. "The sophisticated individuals entering into these agreements are hardly so naive as to believe that by choosing only a foreign forum and not the law to be applied therein, they thereby retain some inalienable privilege of litigating their disputes under American law." *Id.* at 967-968.

113. *Id.* The court goes on to say it accepts the Second Circuit's position on the substance-procedure theory. It is referring to the *Roby* court's statement that "[i]t defies reason to suggest that a plaintiff may circumvent forum selection and arbitration clauses merely by stating claims under laws not recognized by the forum selected in the agreement. A plaintiff simply would have to allege violations of *his country's* tort law or *his country's* statutory law or *his country's* property law in order to render nugatory any forum selection clause . . ." *See Roby*, 996 F.2d at 1360.

114. *See McMahon*, 482 U.S. 220 (1986).

115. *See Roby*, 996 F.2d at 1362.

116. *Id.*

117. *See Lloyd's Agreement*, *supra* note 3.

laws, the *Roby* court concluded that both *Rodriguez* and *McMahon* did *not* apply because this was an *international* agreement.<sup>118</sup> The court instead conducted the following analysis if a) whether there is a Supreme Court precedent that stands for when parties can waive their *substantive* rights in international agreements and b) whether British laws would adequately reflect the substantive provisions of American securities laws if the American litigants have to sue in Britain.<sup>119</sup> The court concluded that *The Bremen* did allow for the waiver of substantive laws, and that British law does provide adequate remedies for the Americans. This holding shows the problems for the American Names in relying on the substance-procedure theory because the courts can find precedent for waiving substantive rights from *The Bremen* line of cases easily. As discussed earlier, the Court has endorsed choice-of-law and forum selection clauses in international agreements in the interests of promoting commerce. The ability of private parties in international business transactions to pre-determine which substantive law will be used to resolve disputes is the core of the Supreme Court's rulings. Therefore, the substance-procedure argument can lead a court, like in the *Roby* decision, to conclude that the Lloyd's Agreement should be enforced since choice-of-law determinations in international agreements are presumed valid. In other words, the substantive law pre-determined in the choice-of-law clause would have to contravene public policy to rise to the level where the court would not enforce it.<sup>120</sup> In addition, by framing the argument in terms of substance-procedure (or sometimes substance v. procedure), the courts may look to the substantive law of the foreign country to ascertain if the foreign forum will adequately protect the American citizen. Again, if the court is conducting this type of analysis, the precedents all point to allowing the choice clause to stand because the courts realize that it cannot be expected that foreign courts will reflect precisely American substantive law. Moreover, it is evident that the theory is susceptible to the allegations made against it by the *Haynsworth* court that all a party need to do to get out of their commitment is to claim the foreign forum does not replicate American substan-

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118. See *Roby*, 996 F.2d at 1362.

119. See *id.*, at 1362 (Part II, A and B).

120. *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 15 (1972).

tive law. To illustrate the point, the *Haynsworth* court said: "We refuse to accept the notion . . . that the sheer scope of the U.S. securities law automatically renders [the securities laws] of other countries inferior or should provide American investors a means to escape their contractual obligations when they begin to prove too costly."<sup>121</sup>

The American Name's position that only Congress can determine whether the securities laws can be waived by American citizens is clouded by the substance-procedure argument. It is not compelling enough to overcome the Supreme Court's clear preference in favor of a party's right in contracting a pre-determined specific forum, including a pre-determined substantive law. In order to correctly state the issue, it should be pointed out that the Supreme Court has not recognized choice-of-law clauses when they would deprive a party a "substantive" right *conferred by a statute*. In other words, "substantive" law can, of course, be pre-determined by private parties by a choice-of-law clause, but substantive rights conferred by statute explicitly denying waiver of those rights can not be waived through the mechanism of a choice clause. In this regard the *McMahon*<sup>122</sup> holding that the means of adjudicating a securities claim can be arbitrated, as long as the securities laws themselves will be used in the arbitration, is a substantial factor in the Lloyd's litigation. If the transaction between Lloyd's and the Names is determined to be covered by the Acts, then as Justice O'Connor wrote in *McMahon*: "What the anti-waiver provision of section 29(a) forbids is enforcement of agreements to waive 'compliance' with the provisions of the statute. . . By its terms section 29(a) only prohibits waiver of the substantive obligations imposed by the Exchange Act"<sup>123</sup> (Another way of looking at this is substantive law derived from a statute). Although *McMahon* was decided in the domestic context, the Court was clear in its determination that Congress' intentions in protecting American investors would be

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121. *Haynsworth*, 121 F.3d at 969.

122. *McMahon* overturned, in part, *Wilco v. Swan*, 316 U.S. 427 (1953), by allowing arbitration in 10b-5 claims. *Wilco* previously held, *inter alia*, that the anti-waiver provisions of the Acts barred arbitration. In *Rodriguez de Qujas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989), the Court followed the lead of *McMahon* and allowed arbitration in all securities claims.

123. *McMahon*, 482 U.S. at 229.



consistent with allowing alternative dispute resolutions as long as the dispute was governed by the statute itself. The caution displayed by the majority in *McMahon* in assuring that its holding did not threaten waiver of the substantive statutory provisions of the Acts clearly illustrates that the Court's views those protections as unwaivable. Therefore, under this reading the Lloyd's Agreement is illegal.

#### D. CONCLUSION

There are two reasons why the *Richards I* decision should not have been withdrawn in its holding that the anti-waiver provisions of the Acts preclude enforcement of the Lloyd's Agreement. The first is that it recognized that *Scherk* never held outright that the securities laws could be waived. *Richards I* correctly pointed out that the international nature of *Scherk* did not raise the same issues as the Lloyd's situation where Lloyd's solicited membership from United States citizens in the United States. Moreover, the court recognized that simply because the Court speaks of enhancing international commerce by allowing parties to contract pre-determined forums etc., that does not mean that the circuit courts can go further than the Supreme Court has ever gone and allow an American party to waive out of what Congress has declared unwaivable. There is simply no precedent to waive out of the Acts. *Richards II* went down the wrong path of surrendering national sovereignty because of a misperceived fear of the courts hindering international commerce. This is not a rationale that should deprive the Names of their day in an American court. As stated earlier, the amount of contact Lloyd's has in the United States does not make applying the securities laws an act of "overreaching."

The second reason that *Richards I* should not have been withdrawn was that it reserved for Congress the policy of determining whether American investors can waive their rights under the Acts. By emphasizing the advantages to international commerce, *Richards II* overlooked that they may have opened the door for foreign entities to sell securities in the United States to small investors who do not possess the financial sophistication and background of the Names. The dissenting judges in the 5-4 *Scherk* decision voiced similar concerns. Justice Douglas' dissent contained this warning:

This invocation of the 'international contract' talisman might be applied to a situation where . . . an interest in a foreign company or mutual fund was sold to an utterly unsophisticated American citizen, with material fraudulent misrepresentations made in this country. The arbitration clause could appear in fine print of a form contract, and still be sufficient to preclude recourse to our courts . . . .<sup>124</sup>

One of the primary purposes of the American securities laws is to give the defrauded investor strong protections.<sup>125</sup> In this important policy decision "[i]t is important that American standards of fairness in security dealings govern the destinies of investors until Congress changes these standards."<sup>126</sup> Implicit in this statement is a prudent deferral to the legislature. The *Richards I* court refused to enter into a policy making role where it would be overstepping its bounds.

#### V. THE *RICHARDS I* ASSERTION THAT ENGLAND DOES NOT PROVIDE A PROPER FORUM FOR THE AMERICAN NAMES

The *Richards I* decision held that the Lloyd's Agreement was unenforceable due to the anti-waiver provisions of the Acts. Therefore, the court did not have to reach the question of whether the application of English law would violate a strong public policy of the United States.<sup>127</sup> The court did argue, however, in response to the decisions of the other circuits that the remedies available in England "are not adequate substitutes for the firm shields and the finely honed swords provided by the American securities laws."<sup>128</sup> The discussion of whether the remedies in England would contravene public policy of the United States requires, at least, two inquiries: 1) what are the remedies provided for the Names in England, and 2) what

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124. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 528 (1974) (Douglas, J., dissenting).

125. See *Herman & MacClain v. Huddleston*, 459 U.S. 375, 390 (1983).

126. *Scherk*, 417 U.S. at 528 (Douglas, J. dissenting). It is important to remember that the dissent in *Scherk* was responding only to the possibility that future cases may deprive Americans from the protections of the Acts. *Id.* As pointed out in the discussion of *Scherk*, *infra*, the majority argues the contacts in *Scherk* are largely foreign, and leaves to another day a ruling when the factual situation is different. See *Scherk*, 417 U.S. at 517 n.11.

127. *Richards I*, 107 F.3d at 1428-29.

128. *Id.* at 1430.

is the legal standard to determine if the remedies are insufficient.

In the *Richards I* decision, the court relied on the SEC's analysis of the deficiencies of the English remedies.<sup>129</sup> According to the SEC, English remedies provide no cause of action for failing to register as a security.<sup>130</sup> The English remedies for misrepresentation fall short of the American securities laws standards.<sup>131</sup> In addition, the 1982 Lloyd's Acts specifically insulate Lloyd's itself for any damages resulting from their negligence or breach of fiduciary duty unless the actions causing the damage were done "in bad faith."<sup>132</sup> That provision resulted in lawsuits being directed at the Managing Agents, who did not have the "deep pockets" of Lloyd's itself. Moreover, the American securities law's general policy of full and complete disclosure is not adequately reflected in English law.<sup>133</sup> For all of those reasons the *Richards I* court determined that the English remedies do not adequately support the Names, and therefore, to enforcement of the Lloyd's Agreement would violate a public policy of the United States.

In England, the American Names would not be protected by the English securities laws. Lloyd's is specifically exempted from the Financial Services Act (FSA).<sup>134</sup> The comparisons between American and English securities laws are, however, not irrelevant.<sup>135</sup> In regard to misrepresentation, the dissent in *Richards I* argues that section 47 of the FSA provides for penalties for "misleading statements or omissions made know-

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129. *Id.* at 1429.

130. See SEC Brief, *supra* note 70, at 20. Registration requirements are found under § 12(1) of the 1933 Securities Act.

131. *Id.*

132. *Richards I*, 107 F.3d at 1429.

133. See *Allen v. Lloyd's of London*, No. 3:96cv522, slip op. at 49-52 (E.D. Va. Aug. 23, 1995).

134. See Financial Services Act of 1986, ch. IV, § 42 (stating "[t]he Society of Lloyd's and persons permitted by the Council of Lloyd's Act to act as underwriting agents at Lloyd's are exempted persons as respects investment business carried on in connection with the purpose of insurance business at Lloyd's.>").

135. The District Court in the *Allen* case, after holding that the common law remedies available to the American Names do not adequately reflect American securities laws, argues that the English disclosure requirements of the FSA § 61 do not adequately reflect American public policy because it provides for no private right of action. Parties must sue to obtain injunctive relief. *Allen v. Lloyd's of London*, No. 3:96cv522, slip op. at 53-54 (E.D. Va. Aug. 23, 1995).

ingly or recklessly."<sup>136</sup> Since Lloyd's itself is not exempt for acts done in "bad faith" it could be liable under this section. This analysis, however, turns on the question of whether reckless conduct reaches the level of bad faith. Moreover, even if section 47 was available to the Names, it would only be a small segment of the FSA. The dissent argues further that the Names have adequate protections available to them because English law provides compensation for "fraudulent, negligent, and even innocent misrepresentation."<sup>137</sup> The *Roby* and *Allen* courts are in agreement that English common law provides perhaps even a greater forum for the Names because their misrepresentation law has a low scienter requirement.<sup>138</sup>

*Richards II*, and the other circuits which are at odds with the *Richards I* opinion also argue that the disclosure requirements in England, although not up to American standards, are sufficient enough to protect the American Names. In *Roby*, for example, the court pointed out that the Member's Agent Agreement requires timely notice of relevant information to each Name.<sup>139</sup> This disclosure provides for information to the Name "which could reasonably be expected to influence the Name in deciding to become or remain a member . . ."<sup>140</sup> Therefore, although the Names are not protected by substantive English disclosure laws, they have a contract claim to sue under.

There are strong arguments supporting both sides of the issue of whether the English laws provide an adequate forum for the Names. The decision rests on what legal standard should be applied by a court when making this determination. The dissent in *Richards I* argues that the criteria for a *forum non conveniens* case should apply when determining if a foreign forum contravenes a strong American public policy: "While English and American remedies are not identical, 'the possibility of an unfavorable change in law' should not be dispositive unless the 'remedy provided by the alternate forum is so clearly inadequate or unsatisfactory that it is no remedy at all."<sup>141</sup> In applying the *forum non conveniens* standard, the

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136. *Richards I*, 107 F.3d at 1435.

137. *See Id.*

138. *See Roby*, 996 F.3d at 1353.

139. *Id.* at 1366.

140. *Id.*

141. *Richards I*, 107 F.3d at 1434, (quoting *Piper Aircraft Co. v. Reyno*, 454

dissent seems to echo the *Roby* and *Allen* courts who thought English law is adequate, although it does not provide as great a remedy as the American courts.

The majority opinion in *Richards I* looks at particulars of the public policy, in this case the policy of the securities laws, and evaluates how these policies are carried out in the foreign forum. As discussed, the court looked at the overall policy in regard to disclosure, misrepresentation, and private right of action. The court gave more weight to public policy than did the dissent's *forum non conveniens* analysis. The dissent would have erroneously held that American public policy would be violated only if there is absolutely no credible remedy. This analysis does not comport with the concern the Supreme Court has shown in protecting such interests, and is certainly not consistent with United States securities laws. The dissent's analysis is even more troubling in that it would allow private parties to contract out of the securities laws despite the anti-waiver provisions provided only that the substitute forum provided practically any remedy. Therefore, the *forum non conveniens* approach does not provide a decent legal standard to determine whether a substitute forum violates the public policies embodied in the securities laws. Instead, a court should conduct a fact-based analysis similar to the approach in *Richards I*.

In conclusion, the position of the *Richards II* decision is that even though the Names, or any future investor who enters into a choice-of-law agreement, do not have recourse to any securities laws, either in America or in the chosen forum, access to American courts will be denied as long as there is some remedy available to them. Assuming that even if the Names can prove that participation in Lloyd's involves securities, they in essence have waived their rights to sue under the securities laws. In short, the congressional policy of providing heightened protection for investors is vitiated by the fact that the choice-of-law clause was entered into with a foreign company. As pointed out by the dissent in *Richards II*, "[t]he majority espouses a reasonable foreign policy, but one which emanates from the wrong branch of government."<sup>142</sup> Allowing Ameri-

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U.S. 235, 254-55 (1981)).

142. *Richards II*, 135 F.3d at 1297.

cans investors to re-enter the world of *caveat emptor* when dealing with securities is certainly a debatable issue; in light of the growing dominance of global markets, that road may be the correct one taken. The decision to proceed down that road can not be made, however, by the judicial branch of government, but only by the Congress.

## VI. CONCLUSION

Faced with a difficult issue, the *Richards I* court choose the more difficult path in nullifying the Lloyd's Agreement. In doing so they struck down a freely contracted provision that has been used by Lloyd's for years. The case seems easy when one looks at the fact the Names flew to London to sign the agreement, and as wealthy individuals they had every opportunity to examine the situation in detail before signing. The Lloyd's Agreement helped give certainty to the Society of Lloyd's, an operation with members in over eighty countries.<sup>143</sup> In addition, the weight of case law favored Lloyd's. The other circuits saw the Names anti-waiver argument as a desperate attempt to back out of a bad deal.<sup>144</sup> Despite all of these compelling reasons given by the other circuits ruling in the Lloyd's matter, the *Richards I* opinion kept its head and correctly diagnosed the real issue: Congress has not allowed for American citizens to lose the protections of the most efficient and trustworthy securities laws in the world simply because of a choice-of-law clause. *Richards I* was not over-reaching in coming to this conclusion; the decision was endorsed by the Chairman of the House Judiciary Committee, Henry Hyde:

I am heartened . . . by the recent appeals court ruling in *Richards v. Lloyds of London (Richards I)* and strong pro-

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143. See *Roby*, 996 F.2d at 1364. See also *Allen v. Lloyd's of London*, 94 F.3d 923, 930 (4th Cir. 1996) (stating that "[i]mposing United States securities laws on this foreign market would directly contravene the very rules and regulations adopted by Britain for the creation and operation of the Lloyd's market to which the Names subscribed").

144. *Id.* at 1360. "We refuse to allow a party's solemn promise to be defeated by artful pleading." *Id.* But see Roberta S. Karmel, *Sex, Lloyd's and Pre-Dispute Waivers*, N.Y.L.J., June 18, 1998, at 3. (stating that "unarticulated financial exigencies are not a good basis for judicial decision making that subjects the plaintiffs in these cases to enormous personal financial losses. Whether the plaintiffs were free to waive their procedural and substantive rights under the federal securities laws is a question of statutory interpretation and public policy.").

nouncements by the SEC in that appeal, which recognize the statutory bar against agreements which waive compliance with the Federal Securities laws . . . When foreign promoters come into [the] states to raise capital, they cannot effectuate waivers of substantive rights under the securities laws that belong to those from whom they solicit capital.<sup>145</sup>

In addition, the reasons for enforcing the Lloyd's Agreement do not sound as compelling when looked at in a different light. For example, Lloyd's broke with long tradition to allow American Names only when it was faced with financial difficulty. Although *Richards II* and the other circuits looking at this issue have pointed out how the American Names knew full well what they were doing when they signed the Lloyd's Agreement, they do not point out that Lloyd's was well represented when it solicited members in the United States, and presumably they knew the purpose of the American securities laws. The fact that the Names knew the consequences of their actions does not seem to be as significant as Lloyd's knowledge of the securities laws. Lloyd's was in a better position to know the law than the individual Names. Regarding the argument that Lloyd's desired predictability and certainty in being certain about which forum to bring litigation, Lloyd's could be satisfied by knowing that when they solicit American citizens in the United States, they will abide by the American securities laws. The amount of contact the Lloyd's transaction had with the United States belies the argument that applying the American securities laws to this agreement is somehow an artificial "overreaching or overextension." The Names were solicited in America, there is a Lloyd's Trust Fund in America, and many of the risks insured by Lloyd's were in America. The idea that the American securities laws should not apply to such a situation because international comity fails when looking at the weight of the contacts in the United States. Finally, the *Richards II* Circuit decision reopens the prospect of potential mischief coming from foreign companies emboldened by the courts refusal to enforce the securities laws. Without those protections, off-shore companies are free to solicit American

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145. United States Investors in Lloyd's of London Deserve Their Day in United States Court, 143 CONG. REC. E1608 (daily ed. Aug. 1, 1997) (statement of Rep. Hyde).

investors and could enforce a choice-of-law clause resulting in minimal protection to the investors. This is an admittedly parental outlook on the capabilities of investors. This outlook, however, is our financial policy, has served investors well since 1933, and should not be changed until debated in the legislature.

*James Gange*



