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The P I A B A Quarterly

The Newsletter of the Public Investors Arbitration Bar Association

December 1996 Volume 3 Number 4

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December, 1996

Volume 3 Number 4

Editor's Notes

Our members can send notices and other regular correspondence to the *Quarterly* via E-Mail. The address is stanlaw@premier.net.

We welcome your questions, comments and suggestions.

The deadline for receiving submissions for the March 1997 issue of the *Quarterly* is March 5, 1997. All submissions, regardless of length, should be accompanied by a computer disk of the submitted material.

The PIABA Quarterly is a publication of The Public Investors Arbitration Bar Association (PIABA) and is intended for the use of its members. Statements and opinions expressed are not necessarily those of PIABA or its Board of Directors. Information is from sources deemed reliable, but should be used subject to verification.

Letter From the President

Rosemary J. Shockman, SHOCKMAN & MCKEEGAN, P.C., Tuscon, AZ

Dear Colleagues:

As always, the Board of Directors departed the annual meeting with renewed enthusiasm for the cause.

At the meeting, Jerry Stanley reported to you on the effort he initiated to curtail industry abuses of choice of law clauses in customer agreements. His letter to SEC Chairman Levitt was referred to NASDR. PIABA was contacted by NASDR and asked to provide evidence of misuse of the choice of law provisions. PIABA members submitted many examples to Jerry, including examples from all of the major broker/dealers. We compiled a large, indexed volume of the evidence and forwarded it to NASDR.

On December 11, several members of the Board of Directors held a conference call with NASDR representatives to discuss the abuses and suggested action. We are hopeful that these efforts will be productive. A follow-up, face-to-face, meeting is anticipated with the NASDR people.

Thanks to all of you who forwarded documents.

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We have started planning for the 1997 annual meeting and hope to have the location established by ime the next edition goes to press.

To each of you, a prosperous and happy 1997.

Rosemary J. Shockman

FROM THE PROFESSOR

Joseph C. Long, Professor of Law – OU Law School, Norman, OK

In this issue, I want to focus on the changing face of securities arbitration. As most readers are aware, in 1995, we saw three significant decisions issued which were destined to have major impact on the way arbitration cases would be litigated in the future.

The first of this trilogy to come down was **S[illegible]th Barney Harris Upham & Co. v. Luckie**, 85 N.Y.2d 193, 623 N.Y.S.2d 800, cert. denied, ___U.S.___, 166 S.Ct. 59 (1995). **Luckie** involved the issue of whether, when a contract contained a New York conflict-of-laws clause, such clause required the application of both the New York substantive law of arbitration and arbitration procedure.

Technically, the issue before the court in **Luckie** was very narrow. The court had to decide whether under a New York conflict of laws clause the New York substantive arbitration rule that the courts, rather, than the arbitrators, were to decide a statute of limitations affirmative defense applied. The court held that it did. Thus, the court rather than the arbitrators, would decide the statute of limitations issue.

While the decision technically only covered the statute of limitations issue, the language used has lead many observers to believe that the Court of Appeals was stating a much broader rule. They feel that **Luckie** indicated that whenever an arbitration agreement contained a New York conflict-of-laws clause that New York general and arbitration law would control to the exclusion of the FAA or the law of another state.

Two weeks after the **Luckie** decision, the Supreme Court decided **Mastrobuono v. Shearson Lehman Hutton, Inc.**, ___U.S.___, 115 S.Ct. 1212 (1995). **Mastrobuono** raised serious questions as to the continued validity of **Luckie** in cases governed by the FAA, with or without a New York conflict clause. Again, the holding in **Mastrobuono**, like in **Luckie**, technically was a rather narrow one. It only held that when read singly, or together, the particular arbitration and conflicts clause contained in the contract in question did not require the application of the New York substantive arbitrative law provision prohibiting the awarding of punitive damages by the arbitrators.

Again, however, substantial question has been raised as to the intent of the Court in reaching its conclusion. Was **Mastrobuono** intended to create a new rule that, in cases under the FAA, federal law would pre-empt inconsistent state law provision? Or was the Supreme Court merely giving its interpretation of the two clauses in light of New York contract law?

If **Mastrobuono** represents only the Supreme Court's interpretation of New York law, such interpretation would not be binding on the New York courts. The New York of Appeals decision in **Luckie** would continue to be valid and control as an interpretation of New York law by New York's highest court. If, on the other hand, **Mastrobuono** is intended to state a rule of pre-

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emption, then Luckie whether broadly, or narrowly, interpreted is dead as to cases covered by the FAA. Since there are a number of places where New York substantive arbitration law appears to run contrary to the federal common law under the FAA, solving this issue may have wide national impact.

The last of this trilogy is **First Options of Chicago v. Kaplan**, ___U.S. ___, 115 S. Ct. 1212 (1995). In **Kaplan**, the Supreme Court recognized that the duty arbitrate is strictly contractual. Therefore, in spite of the strong federal public policy favoring arbitration, there is a rebuttable presumption **against** finding an agreement to arbitrate. Or stated another way, a person should not be forced to arbitrate unless there is clear evidence that he agreed to do so. Determining whether this consent has been given and whether the presumption has been overcome is for the courts, rather than the arbitrators, to determine. The Court referred to this as the basic threshold issue of "arbitrability." However, once it has been determined that there is a general agreement to arbitrate, then **Kaplan** affirms the Court's long-standing position that there is a presumption which arises that the parties intended to submit all substantive issues and defenses to arbitration.

These three decisions appear to express broad policy decisions, which in the case of **Mastrobuono** and **Luckie**, appear to be conflicting. It has been left to the state and lower federal courts to resolve this apparent conflict and to determine to what extent that **Kaplan** requires a change in pre-existing law. To date there are two trends which appear to be emerging. First, the federal and lower New York courts seem to be concluding that **Mastrobuono** does state a rule of federal pre-emption. Second, there appears to be a trend to re-think which, if any, of a number of affirmative defenses really involve "arbitrability" issues for the courts and which are merely merit defenses properly left to the arbitrators. The trend, especially by the Second Circuit, appears toward holding that the affirmative defenses are not "arbitrability" issues, but rather merit-type defenses for the arbitrators to consider. Several manifestations of each of these trends will be discussed briefly below.

I. Federal Pre-emption.

A. Statute of Limitations.

Under New York law, statute of limitations issues are to be decided by the courts rather than the arbitrators. Thus, when the parties include a New York choice-of-laws clause, the **Luckie** case held that statute of limitations issues are to be considered by the court. The federal rule under the FAA, on the other hand, is that statute of limitation issues are to be considered by the arbitrators.

Did the Supreme Court in **Mastrobuono** overrule **Luckie**, saying in effect that the federal common law rule under the FAA pre-empted the contrary New York state rule? Not surprisingly the early post-**Mastrobuono** New York lower courts decision did not read **Mastrobuono** as stating a rule of pre-emption. They, therefore, continued to apply **Luckie** as controlling on the issue of who considers the statute of limitation defense. See e.g., **Merrill Lynch Pierce Fenner & Smith, Inc. v. Ohnuma**, 630 N.Y.S.2d 724 (A.D., 1st Dept. 1995); **Prudential Sec. Inc. v. Pesce**, 1996 WL 250321, 642 N.Y.S.2d 466 (N.Y. Sup., N.Y County, 1996); and **Merrill Lynch Pierce Fenner & Smith, Inc. v. Levine**, 7/5/1995 N.Y.L.J. 26 (col.2) (N.Y. Sup., N.Y. County, 1995). But see **Lester, Schwab, Katz & Dwyer v. Yukevich**, 167 Misc.2d 1004, 641 N.Y.S.2d 505 (N.Y. Sup., N.Y. County, 1996).

Initially, the federal District Courts in New York did not read **Mastrobuono** as providing a rule of pre-emption. **PaineWebber Inc. v. Richardson**, 1995 WL 236722, 1995 U.S. Dist. LEXIS 5317 (S.D.N.Y. 1995). The Second Circuit recently affirmed this conclusion in **PaineWebber v. Bybyk**, 81 F.2d 1193 (2d Cir. 1996).3 Therefore, according to the Second Circuit at least, federal law rather than Luckie will control who reviews statute of limitations issues, absent an express agreement by the parties that New York law would replace federal law.

This holding means, at least in the Second Circuit, that **Luckie** is dead as far as the statute of limitations issue for all cases under the FAA except where the parties have expressly indicated that New

York substantive and arbitration law is to control. Inclusion of such a clause in an arbitration agreement fc y brokerage customer other than one living in New York would be a clear violation of Section 21(f) of the NASD Rules of Fair Practice and be void as against public policy. Cf. **Thomas James Assoc., Inc. v. Jameson**, 1996 U.S.App. LEXIS 32634 (2d Cir., Dec. 12, 1996).

The two recent New York lower court opinions have accepted the Second Circuit interpretation in **Bybyk** that **Mastrobuono** states a rule of federal pre-emption. **Mulder v. Donaldson, Lufkin & Jenrette**, 648 N.Y.S.2d 535 (A.D., 1st Dept., 1996); and **Merrill Lynch Pierce Fenner & Smith, Inc. v. Driessens**, 10/24/96 N.Y.L.J. 27 (col.5) (N.Y. Sup., N.Y. County, 1996). This conclusion has a far reaching effect beyond New York. In cases outside the Second Circuit, the courts are not required to follow **Bybyk**. They may conclude that there is no federal pre-emption and that under a New York conflict-of-laws clause that New York law controls. The post-**Luckie** New York cases suggest that as a **matter of N York law Luckie** has been pre-empted by **M..robuono**. This means even under **present** New York law statute of limitations issues are for the arbitrators.

B. Punitive Damages.

A similar dispute is taking place over the award of punitive damages. Again New York law makes clear that punitive damages can not be awarded by arbitrators **regardless of whether the parties agree that the arbitrators may do so. Garrity v. Lyle Stewart**, 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976), **Garrity** concluded that only the state has authority to impose such damages and to contract otherwise is against public policy. Id. The **Garrity** rule has been adopted by a number of states. However, the courts in many states have not yet addressed the issue. See generally, Annot., 83 A.L.R.3d 1024.

The federal position prior to **Mastrobuono** ap rs to have been that punitive damages could be awarded by the arbitrators under the FAA. **Lee v. Chica**, 983 F.2d 883 (8th Cir.), cert. denied, ___U.S___, 114 S.Ct. 287 (1993); **Todd Shipyards Corp. v. Cunard Line, Ltd.**, 943 F.2d 1056 (9th Cir. 1991); **Raytheon Co. v. Automated Business Systems, Inc.**, 882 F.2d 6 (1st Cir. 1989); and **Bonar v. Dean Witter Reynolds, Inc.**, 835 F.2d 1378 (11th Cir. 1988).

The Second Circuit, however, allowed the **Garrity** rule to apply in those cases involving a New York conflict of laws clause. **Barbier v. Shearson Lehman Hutton, Inc.**, 948 F.2d 117 (2d Cir. 1991). This last summer, the Second Circuit in **Bybyk** re-considered its position in light of **Mastrobuono**. Concluding that **Mastrobuono** stated a rule of federal pre-emption, it held that the arbitrators under the FAA could award punitive damages in spite of a New York conflict-of-laws clause.

There is some indication that the lower New York courts will also recognize Mastrobuono as controlling. In **Dean Witter Reynolds Inc. v. Trimble**, 631 N.Y.S.2d 215 (N.Y. Sup. 1995), the court adhered to **Luckie**. However, more recently in **Lester Schwab Katz & Dwyer v. Yukevich**, 641 N.Y.S.2d (N.Y. Sup. 1996), the court applied the federal rule and allowed the arbitrators to award punitive damages.

C. Attorneys' fees.

In contrast to the New York position on the award of punitive damages by the arbitrators, there is no absolute prohibition under New York against the arbitrators awarding attorneys' fees. The New York rule is that the arbitrator may award attorneys' fees only if the parties agree to the arbitrators making such award. However, there must be a clear intent shown to allow the arbitrators to award attorneys' fees. Such intent may be shown by conduct at the arbitration hearing either by failing to object to the plaintiff's demand for attorneys' fees or by the defendant seeking such an award. **Berman v. Stratton Oakmont**, 10/18/96 N.Y.L.J. 34 (col. 4) (Sup. Ct. Oct. 18, 1996).

This position is that found in most states. Section 10 of the Uniform Arbitration Act also

prevents arbitrators from making such award unless there is a specific agreement. By way of contrast, the federal courts have generally determined that the "any and all controversies" language is sufficient to allow the arbitrators to award punitive damages under the FAA.

The initial reaction of the federal district court in New York was that **Mastrobuono** had no application when considering the arbitrators' ability to award attorneys' fees. As a result, under a New York conflict clause, the New York rather than the federal rule would apply. **PaineWebber v. Richardson**, 1995 WL 236722, 1995 U.S. Dist. LEXIS (S.D.N.Y. 1995). However, the Second Circuit also considered this issue in **Bybyk**. Again, it concluded that **Mastrobuono** stated a the broad rule of federal pre-emption and that the arbitrators could award attorneys' fees under the FAA in spite of the New York conflicts clause. This position has been followed by one New York federal district court. **A.S. Goldmen & Co., Inc. v. Bochner**, 1996 WL 413676 (S.D.N.Y. June 24, 1996).

A closing word of caution. The dispute over the holding in **Mastrobuono** will not be concluded until the New York Court of Appeals accepts the concept of federal pre-emption or the Supreme Court adopts **Bybyk** making clear pre-emption is the law of the land.

II. Re-Thinking Eligibility Issues.

A. The Six-Year Rule.

The most significant area of re-consideration involving "eligibility to arbitrate" question is the Six Year Rule. Before **Kaplan**, the federal courts of appeal were badly divided over who should determine claims to be stale under the Six Year Rule.

On the theory that this was a basic question of "arbitrability", the Third, Sixth, Seventh, and Eleventh Circuits held that this issue was one for the courts. **PaineWebber v. Hofmann**, 984 F.2d 1372 (3d Cir.1993); **Dean Witter Reynolds, Inc v. McCoy**, 995 F.2d 649 (6th Cir. 1993); **Smith Barney v. Schell**, 53 F.3d 807 (7th Cir. 1995); **Edward D. Jones v. Sorrell**, 957 509 (7th Cir. 1992); and **Merrill Lynch Pierce Fenner & Smith v. Cohen**, 62 F.3d 381 (llth Cir. 1995). Conversely, the Fifth and the Eighth Circuits held that Six Year Rule problems should be decided by the arbitrators. **Smith Barney Shearson, Inc. v. Boone**, 47 F.2d 750 (5th Cir. 1995); **FSC Sec. Corp. v. Freel**, 14 F.3d 1310 (8th Cir. 1994). Since **Kaplan**, the division of opinion has continued. The Sixth Circuit in **The Ohio Company v. Nemecek**, 98 F.3d 234 (6th Cir. 1996), without citing or discussing Kaplan, has re-affirmed its belief that Six Year Rule controversies are to be settled by the courts. The Tenth Circuit in **Cogswell v. Merrill Lynch Pierce Fenner & Smith**, 78 F.3d 474 (lOth Cir. 1996), also joined the ranks of those circuits treating the issue as one of basic "arbitrability". Having made this determination, it applied the **Kaplan**-created presumption against arbitration of the issue without specific agreement of the parties that the arbitrators should decide "arbitrability" issues.

On the other hand, the First and Second Circuits examining the question for the first time, re-thought the issue and concluded that Six-Year Rule problems are not substantive arbitration issues. Instead the courts held that the Six-Year Rule is simply another merits-type affirmative defense. As such, the **Kaplan** presumption requires arbitration of these issues unless there is a clear indication that the parties did not intend to have the arbitrators address this issue. **PaineWebber v. Elahi**, 87 F.3d 589 (1st. Cir. 1996); **PaineWebber v. Bybyk**, 81 F.3d 1193 (2d Cir. 1996).

B. Issue Preclusion or Collateral Estoppel.

The second area of reconsideration involves the problem of issue preclusion or collateral estoppel. Prior to **Kaplan**, the Eleventh Circuit in **Kelly v. Merrill Lynch Pierce Fenner & Smith, Inc.**, 985 F.2d 1067, 1069 (11th Cir.), cert. denied, ___ U.S. ___, 14 S.Ct. 600 (1993), held that the courts would decide the preclusive effect of prior judgments. However, in two recent decisions, the

Second Circuit has re-visited this issue and held that in ligh^ of Kaplan such preclusion issues are for the arb .tors.

First, in **National Union Fire Ins. Co. v. Belco Pet. Corp.**, 88 F.3d 129 (2d Cir. 1996), the court held that the issue-preclusive effect of a prior arbitration is to be determined by the arbitrators. More recently, in **United States Fire Ins. Co. v. National Gypsum Co.**, 1996 U.S. App. LEXIS 29159 (2d Cir. Nov. 4, 1996), the Second Circuit extended the **Belco** holding to allow the arbitrators to consider the collateral estoppel effect of a prior **court judgment.**

REPORT FROM NEW YORK

Seth Lipner, DEUTSCH & LIPNER, Garden City, N.Y.

As you probably know by now, New York (finally) appears ready to join the rest of the world on punitive damages. The fight, however, isn't quite over, and ~ur old friend Larry Fenster will have one last gas.

In September, the Appellate Division First Department decided Mulder v. Donaldson Lufkin & Jenrette. Justice Peter Tom (who had sided with us on the jurisdictional issue when he was a lower court judge) ruled that Mastrobuono controlled over Garrity. Mulder was an unusual case because it was an employment case brought by an alleged whistleblower. They went to arbitration, and received about $100,000 in compensatory damages; the award said nothing about punitives. The employee went to court seeking a judicial determination of his claim to punitives, on the theory that if its not arbitrable the punitives claim can go to court. At first the Appellate Division agreed. But, after Mastrobuono, the case made its way back up to the Appellate Division, who this time compelled the case back to arbitration. The great irony is that it was DLJ's motion to compel arbitration of the punitives. I guess somebody forgot to tell them what the industry line is.

The decision in Mulder is very broad in its language, but the facts aren't terribly helpful. Mulder was a no agreement case. Under Luckie, New York would apply the FAA, and there is dicta in Mastrobuono that makes the "no agreement" cases more compelling.

It was thus heartening to see, in late October, Justice Solomon's decision in Merrill Lynch v. Dreissen. (NOTE: Ted Eppenstein will take credit, but John Rich of his office argued the case). Dreissen was an agreement case, with a New York choice-of-law. Justice Solomon nevertheless read Mulder as dispositive, and she declined to stay the claims for punitive damages and attorneys fees. Merrill will almost certainly appeal. The case has another interesting side concerning the issue of whether certain foreign subsidiaries of Merrill were subject to the arbitration; Judge Solomon ruled against the investors on that point.

Judge Solomon, however, has not entirely turned over a new leaf. She ruled against a New York investor in a no-agreement eligibility rule case, ignoring Goldberg v. Parker. See Kidder Peabody v. Berger. She has, however rule otherwise for a non-New Yorker (there was a New York jurisdictional contact). See Prudential v. Nelson.

The only other decision of note is a ruling in Nassau County that the AMEX 6-year rule applies to an AMEX Window arbitration. Kidder Peabody v. Denmark. The decision has no reasoning whatsoever. An appeal will follow.

As you can see, things have quieted down substantially in New York on the arbitration front. But you should also be aware of the fact that New York has shortened its statute of limitations on professional misconduct from 6 years to 3 years (this presumably applies to brokers). Fraud is still six years. Thus, be sure to frame your suitability claims in terms of fraud as well as breach of implied contract in cases more than 3 years old. Be aware, also, that the statute is ambiguous as to retroactivity, but cases already filed should be safe (no guarantee).

SECOND CIRCUIT RAISES 'SSUE OF SETTLEMENT ADMISSIBILITY

Recently, the Second Circuit in Manko v. United States, 87 F.3d 50 (2d Cir. 1996), re-visited the issue of admission of civil settlements. Rule 408 of the Federal Rules of Evidence indicates that such prior settlements are not admissible. Such settlement information may be probative evidence and extremely relevant to the present case. However, Rule 408 excludes the introduction of such settlement information in subsequent suits as a matter of public policy to encourage settlements. The Second Circuit, citing its earlier decision in United States v. Gonzalez, 748 F.2d 74 (2d Cir. 1984), concluded that such rationale does not apply to a criminal case. The Second Circuit said:

> "The policy favoring the encouragement of civil settlements, sufficient to bar their admission in civil actions, is insufficient, in our view to outweigh the need for accurate determinations in criminal cases where the stakes are higher."
> 87 F.3d at 54.

Therefore, either government or the defendant under certain circumstances can introduce prior civil settlements.

Can a similar argument be made in the case of arbitration proceedings? Assuming the basic conclusion that such prior settlements are both probative and relevant in a subsequent arbitration, why should the arbitrators not be given the opportunity consider them? Rule 408, like the other Federal Rules of Evidence, is not applicable to arbitration proceedings.

NASDR PROPOSES ARBITRATION RULES CHANGES

The NASDR has proposed several rules changes to the Board of the NASD for the Board to consider at its January meeting.

The proposed rule changes involve punitive damages and the eligibility rule.

As to punitive damages, the rule change would allow for punitive damages if a court of the state in which the party is a citizen at the time the claim is filed could award punitive damages for the same type of claim. The party requesting punitive damages must specify in its claim the amount of punitive damages it is requesting.

The standard of conduct for the award of punitive damages will be the standard of the state of residence regardless of any choice-of-law agreement between the parties.

The amount of punitive damages allowable shall be two times compensatory damages or $750,000, whichever is less. Compensatory damages do not include attorney's fees, costs of arbitration or post-award interest. The proposed rules require that, if an award includes punitive damages, it should specify the amounts awarded for compensatory and punitive damages.

As to eligibility, the six year rule is phased out. All claims filed within six years of the effective date of the adoption of the rule, will remain eligible. For example, if the rule were to be adopted on June 1, 1997, then all claims would be eligible for arbitration which are based on an event or occurrence which transpired on or after June 1, 1991. The proposed rule specifically states that the fact that a claim is ineligible for arbitration shall not act as an election of remedy.

Any party may file, within 20 days of service, to request that the Director or Arbitration determine whether the claim is eligible. The date of the claim is defined as the date of the transaction. The rule would prohibit any party from going to court for an eligibility ruling prior to the Director's determination.

As a trade off for phasing out six-year eligibility, the proposed rules specifically direct that "in de ining statute of limitations issues the arbitratons shall apply the applicable federal or state statute of limitations."

Lastly, the proposed rule would allow that all ineligible claims may be filed in a court of competent jurisdiction.

CALIFORNIA U.S. DISTRICT COURT ESTABLISHES STRICTER STANDARD FOR PLEADING SCIENTER

A U.S. District Court has held that The Private Securities Litigation Reform Act of 1995 established a stricter standard for pleading scienter in securities fraud cases. Instead of allowing scienter to be pleaded with particularity by allegations tending to show motive and opportunity for fraud, or conscious or reckless behavior, which was the prevailing standard before the 1995 Act, the Court found congressional intent in the legislative history to adopt a stricter standard, which requires the allegations of facts giving rise to a strong inference of conscious behavior. In so holding, the Court found that Congress intended to eliminate motive and opportunity, and recklessness-type pleading.

The allegations, as plead, coupled the issuer's insiders' alleged awareness of negative internal reports and their allegedly misleading optimistic statements, and coupled this with the insiders' allegedly suspicious stock trading. The court found that these allegations were not enough. If it were, the Court said, any corporation using internal reports could be pulled into securities litigation anytime its stock price dropped. The Court remarked that the investor should have specifically identified the internal reports, and provided names and dates. Silicon Graphics, Inc. Securities Litigation, (N.D.Cal) CCH ¶ 99,325.

FLORIDA STATE COURT ALLOWS INVESTORS' APPEAL BASED ON "EVIDENT PARTIALITY" ... BUT ...

In World Invest Corporation v. Breen, 1996 WL 670056 (Fla. App. 4 Dist.), the investor filed a petition in circuit court to vacate the arbitration award alleging that the panel's decision was "arbitrary and capricious" and that there was "evident partiality" on the part of the arbitrators. The investor alleged that there was no support at all in the record for the arbitration panel's decision and that only through bias could the panel have reached its conclusions. The lower court had denied the investor's petition as failing to state a claim for which relief could be granted without reviewing the transcript of the arbitration.

The appeals court reversed, holding that the claim stated a basis upon which relief could be granted:

> We hold that the trial court erred in dismissing the petition to vacate the arbitration award. When a petition to vacate an arbitration award alleges facially sufficient grounds for relief, the trial court must, at least, hold a limited evidentiary hearing to allow the movant to submit evidence to establish its claim.

The Breen Court went on to relate that, although arbitration awards are accorded great deference, there are several statutory and nonstatutory grounds upon which an arbitration award may be vacated. For example, arbitration award may be vacated on the non-statutory ground that it is arbitrary and capricious. In Ainsworth v. Skurnick, 960 F.2d 939, 941 (11th Cir. 1992), the court stated that "an award that is arbitrary and capricious is not required to be enforced. An award is arbitrary and capricious only if a ground for the arbitrator's decision cannot be inferred from the facts of the case." The burden is on the party requesting the vacatur to refute every rational basis

on which the arbitrator could have relied. See Brown v. Rauscher Pierce Refsnes, Inc., 994 F.2d 775, 779 (11th Cir. 1993).

The Court went on to address the trial court's refusal to consult the hearing transcript:

> If requested to do so by Breen, the trial court will, at least, be required to scan the transcript of the arbitration hearing to determine whether any rational basis exists to support the panel's decision.

Having said this, the Court specifically found that Breen had failed to allege any facts which could support a finding of "evident partiality."

> The federal courts have required the party challenging an arbitration award on this basis to allege specific facts indicating improper motives on the part of the arbitrator[s], or at least, specific facts which create a reasonable impression of partiality. See Toyota of Berkeley v. Local 1095, 834 F.2d 751 (9th Cir. 1987); Park v. First Union Brokerage Servs., 926 F.Supp. 1085, 1088 (M.D. Fla. 1996). Breen's only support for her claim of evident partiality is her belief that bias must have existed because the arbitrators did not find in her favor.

Nevertheless, the Court reversed the lower court's ruling dismissing the petition to vacate, based on its finding that the investor was not given an opportunity to present her evidence. The Court directing a rehearing to allow the investor to "state a proper claim", and instructed the lower court to conduct a review of the arbitration transcript.

SIXTH CIRCUIT HOLDS THAT NEW YORK STOCK EXCHANGE RULE 603 IS NOT SUBJECT TO TOLLING

In The Ohio Company v. Nemecek, 1996 WL 590822 (6th Cir. (Mich.)) Oct. 16, 1996, the U.S. Sixth Circuit held that the eligibility section (603) of the NYSE arbitration rules was not subject to tolling and that fraudulent concealment did not extend the six year period for filing an arbitration claim.

The Court's decision reversed several lower court rulings which, based on the dicta from prior Sixth Circuit rulings, had allowed tolling to extend the time period for filing.

In Roney and Co. v. Kassab, 981 F.2d 894 (6th Cir. 1992) the investor had argued fraudulent concealment and the Sixth Circuit found that, because the claimants had not stated a sufficient claim for fraudulent concealment, the allegations of concealment did not extend the time period of 603. Based on Roney, several district courts in the 6th circuit, notably Davis v. Keyes, 859 F.Supp. 290 (E.D.Mich. 1994), had held that properly pleaded fraudulent concealment could toll 603.

The Nemecek decision left no doubt that the Sixth Circuit stands for proposition that Section 603 is not subject to tolling but is rather "a substantive temporal limitation on the parties agreement" to arbitrate and therefore a jurisdictional limitation on the claims subject to arbitration.

The Nemecek Court also left no doubt that the Sixth Circuit also sides with those circuits which require that issues regarding the eligibility period be decided by the courts rather than the arbitrators.

NEW YORK STATE APPEALS C)URT FOLLOWS MASTROBUONO ON ATTORNEY'S FEES AND PUNITIVE DAMAGES

The New York Appeals Court, First Department in Merrill Lynch v. Allen Adler 1996 WL 723030 (N.Y.A.D. 1 Dept.), reversed a prior ruling by the lower court (Judge J. Solomon) which had stayed the Claimant's arbitration claim for punitive damages and attorney's fees.

The Appellate Court overturned the decision, stating that the lower court had "erred" in not following the precedent of Mastrobuono v. Shearson.

The relevant arbitration clause spoke in terms of an agreement to arbitrate "all controversies" at a chosen SRO "in accordance with its arbitration rules the 'n force." The Adler court then cited the NASD Cc ˏ of Arbitration Procedure, Section 41 (e) for the proposition that the NASD rules contemplate a broad range of relief, i.e., "damages and other relief", and also the NASD Rules of Fair Practice, Rule 21(f)(4) which states that no agreement shall "limit the ability of a party to file any claim" or limits "the ability of an arbitrator to make any award."

The Adler court dutifully recited the basis of the Mastrobuono court, that the ambiguity in the arbitration agreement between the NASD rules on the one hand and the arbitration rules under New York law on the other, would be construed against the party that drafted it, and allowed the inclusion of the attorneys fees and punitive damage claims in the arbitration.

This case is very significant in that the Adler Court cited Rule 21(f)(4) and gave the rule deference in deciding the issues of the case in favor of a public investor. Since 21(f)(4) is placed in the Rules of Fair Pr ce instead of the Code of Arbitration Procedure, other courts have routinely held that 21(f)(4) is an internal rule of the NASD which involves only the conduct of its members, and therefore, a violation of that rule does not give rise to rights for the individual investor -- e.g., giving the investor the right to bring an action for vacatur on the grounds that the arbitrators exceeded their authority by not hearing all claims. See, Kopman v. Stratton Oakmont, Inc. 1995 WL 110355 (N.D.Ga. 1995), Cantella & Co. v. Goodwin, 924 S.W.2d 943 (Tex.1996), Eureka Homestead v. Howard Weil, LaBouisse, Fredericks, Inc., 1994 WL 583274 (E.D.La.1994).

THE SIX YEAR RULE AND OTHER ESOTERICA

C. Thomas Mason III, Tucson, AZ.

Prudential v. Kucinski (M.D. Fla) 1996 WL 673092 (M.D. Fla., Nov. 1, 1996). seems to be a natural outgrowth of *Merrill Lynch v. Cohen*, 62 F.3d 381 (11th Cir. 1996). However, the court effectively decides that the six year period runs from the date of the wrongdoing, not from the date the claim accrued. Thus, suitability-based claims -- including torts of negligence, fraud, breach of fiduciary duty -- are barred if not filed within six years from date of purchase. Claims of wrongdoing after the purchase -- misrepresentations of value, continuing breach of duty -- arise at the time of that subsequent wrongdoing. Allegations of wrongdoing older than six years cannot be arbitrated even if the legal claim did not become justiciable within the six year period.

Kucinski coincides with Judge Kovachevich's decision in *Smith Barney v. Hyland*, 1996 WL 420836 (M.D. Fla. 1996), which went so far as to split churning claims into transactions occurring within and without the six year period. J. Kovachevich apparently never learned that churning is a "unified offense." *Miley v. Oppenheimer & Co.*, 637 F.2d 318, 327 (5th Cir. 1981) ("[A] finding of churning, by the very nature of the offense, can only be based on a hindsight analysis of the entire history of a broker's management of an account and of his pattern of trading that portfolio, in comparison to the needs

and desires of an investor."). But then, she has also ruled that variable insurance -- a security -- solicited by a Prudential Securities broker (who undoubtedly shared in the Pruco agent's commissions) is not arbitrable because it is part of Prudential's insurance business. *Prudential Securities v. Emerson*, 905 F.Supp. 415 (1996). Mme. Kovachevich agreed with Prudential Securities that even though it is not an insurance company, "if it did sell the insurance policies to the Plaintiff then it is in the business of selling insurance and the claims must be excluded from arbitration in accordance with section 1 of the NASD Code." Circular? Never mind that the policies were securities.

Shahan v. Staley (Ariz.App.) 2 CA-CV 96-0245, Nov. 2, 1996, holds: (a) a trust's beneficiary is the broker's "customer" and third-party beneficiary of the broker's contract with the NASD to arbitrate all disputes; (b) the six-year rule is for the arbitrators to apply, following *Freel* and *Bybyk*; and (c) taking the defendant's deposition but not otherwise pursuing the litigation does not waive plaintiff's right subsequently to demand arbitration. The court awarded attorney's fees to appellant/plaintiff! The case was brought in court, not as a six-year rule gambit, but because one of the original defendants was not an NASD-associated person. When he went bankrupt and was dropped from the case, plaintiff moved to compel arbitration against the broker. The decision has not yet been published. It is the first opinion by an Arizona appellate court regarding the six-year rule.

Shahan's ruling on "customer" status is consistent with several other important decisions. See *Spear, Leeds v. Central Life*, 85 F.3d 21 (2nd Cir. 1996) (insurance company which paid death benefits to broker's customers is third-party beneficiary of broker's agreement to arbitrate); *Lehman Brothers, Inc. v. Certified Reporting Co.*, 1996 WL 531805 (N.D. Ill., Sept. 5, 1996) (Lehman's misleading statements to people who eventually bought the securities elsewhere were sufficient to create "customer" status for purpose of arbitration; claimant need not have done transactions with the broker in order to be considered a "customer").

BULLETIN BOARD

STATUS OF PENNY STOCK FIRMS

On December 5th, the NASD Regulation National Business Conduct Committee suspended Stratton Oakmont. The NASDR announced its ruling on an appeal by Stratton Oakmont of the April 1996 decision of the NEW York (District 10) Business Conduct Committee. The order expelled Stratton Oakmont from the securities industry and permanently barred Daniel Porush, Stratton Oakmont's President and Steven Sanders, its trading department head. They requested a stay from the SEC, which was denied.

Cases currently pending are still being set for hearing, according to John Barlow in the NASD's Chicago office, but Stratton Oakmont's outside counsel are withdrawing and requesting postponements.

Ken Andrichik of the New York NASD Mediation office has reported that there are no funds currently in the account from which settlements and awards were being paid in the NASD's Stratton Oakmont's mediation program.

As to cases that have gone to award or been settled but not yet paid in full, several attorneys are joining forces to try to urge the SEC and NASD to threaten sufficiently strong sanctions against Stratton Oakmont principles to "encourage" payment, and to hire an asset locator to assist in locating assets of individual respondents.

Kensington Wells' continued existence is also in serious doubt, as it was recently reported that it is terminating its retail brokerage business.

For more information, call Diane Nygaard at (913) 469-5544.