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The P I A B A Quarterly

The Newsletter of the Public Investors Arbitration Bar Association

September 1998 Volume 5 Number 3

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Editor's Notes

This issue of the *Quarterly* contains the second half of an article by Tim O'Connor on the use of the NASD Notices to Members as precedent in arbitration proceedings. The first half appeared in the June issue of the *Quarterly*.

The deadline for receiving submissions for the December 1998 issue of the *Quarterly* is December 10, 1998. All submissions, regardless of length, should be accompanied by a computer disk of the submitted materials in either word perfect or as a text file.

Please send change of address information to Robin Ringo, 111 Wylie Road, #18, Norman, OK 73069. Phone (405) 360-8776. E-mail: PIABA@mindspring.com.

Please note the new mailing address for the *Quarterly*: 7910 Wrenwood Blvd., Suite B, Baton Rouge, LA 70809.

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

Diane A. Nygaard THE NYGAARD LAW FIRM Leawood, KS

Dear Colleagues:

During this last quarter, PIABA has been active in trying to improve the NASD arbitration system and in trying to give investors a choice of forum. In August, Mark Maddox, Robin Ringo and I met with Linda Fienberg, Exec. V.P. of the NASDR to discuss several matters of great importance to the investors we represent.

We explained that there has been no improvement in the dilatory "deficiency notices" that we continue to received from the New York office of the NASDR. Astoundingly, the NASDR conceded that over 70% of cases filed are not immediately served upon Respondents because an NASDR paralegal believes the filing is deficient in some respect. Mark and I specifically discussed the substantive evaluations made by paralegals

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of legal claims and Ms. Fienberg agreed that such determinations should not be made by paraprofessional staff. Additionally, as to the procedural deficiencies, such as requests for different notary seals, etc., Ms. Fienberg agreed that the staff was perhaps being overly zealous in its approach. She agreed that there was no good reason for delaying such a high percentage of cases. We expect that improvements will be forthcoming. Please let Robin Ringo at PIABA and Linda Fienberg at the NASDR know of continuing problems you have with your filings.

We also have signed off on the needed changes to the NASDR training materials, which I discussed at last year's meeting. The changes have been made and Ms. Fienberg stated that new training materials will be available to PIABA members at our Orlando meeting. No longer will arbitrators be instructed that punitive damages are seldom awarded or that claimants have a duty to mitigate damages.

Mark and I reiterated PIABA's position that investors should have a choice of forum. Given that stockbrokers will no longer be required to arbitrate their discrimination cases, it seems only logical that the SEC should similarly protect investors. It is odd that the SEC has eliminated mandatory arbitration where employment issues arise, and has not done so where securities fraud issues arise. The very mandate of the SEC is to protect investors. We look forward to having continuing discussions with the NASDR about this issue. We believe that the industry recognizes that choice of forum is of paramount importance. Given the number of investor claims against NASDAQ firms, it can be argued that the NASDR is not effective in protecting investors and should not be their exclusive forum for obtaining relief.

I look forward to seeing you in Orlando. Our program will be excellent and we will try a new program format, by simultaneously presenting speakers on different topics. This has created more work for the members of the annual meeting committee, and I extend my thanks to Joe Long, Bill Lapp, Mark Maddox, Pat Sadler, Ted Eppenstein, Cheryl Nichols, Rikki Ring, Mark Tepper, and Richard Burnstein. See you in Orlando!

Sincerely yours,

Diane A. Nygaard

News From New York

Seth Lipner DEUTSCH & LIPNER, Garden City, NY

PROCEDURAL ISSUES ON CONFIRMATION OF AWARDS IN NEW YORK

The good news is you just got a hefty award in an NASD arbitration. The bad news is the firm was a penny-stock firm which is now out of business, and you need to collect from the individual respondents. You face some legal hurdles, and some practical hurdles. The legal hurdles involve what is the best way to get from award to judgment to enforcement as fast and effectively as possible? The practical hurdle is how to collect from those who have for years profited from fraud, and are sufficiently sophisticated to have hidden most of those profits.

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The PIABA QUARTERLY, 7910 Wrenwood Blvd., Suite B, Baton Rouge, Louisiana 70809; FAX (225) 926-4348. E-mail: stanlaw@premier.net. All Copy is subject to the approval by the publisher. Any material accepted is subject to such revision as is deemed appropriate in the publisher's discretion.

The solution to the practical problem revolves around a combination of dogged perseverance and old-fashioned good luck; the solution to the legal hurdles is offered here in "question and answer" form.

Q. Should I move to confirm in my home state, or should I go straight to New York?

A. Moving to confirm in your home state provides an advantage because the respondent is less likely to oppose confirmation where you are because he will have to obtain local counsel. But gaining that advantage will cost you some time.

If the respondent defaults in your forum, you can then seek full faith and credit recognition in New York, but you will have to institute a legal proceeding. New York will not allow you simply to "register" a sister-state *default* judgment. A non-default judgment can be "registered" simply by filing an affidavit and giving the judgment debtor mail notice, but enforcement cannot begin for another 30 days. During that time, however, you can proceed to restrain the debtor's assets in the hands of others (e.g., bank accounts, clearing deposits, etc.), but you cannot commence turnover proceedings until the 30 days expires.

Q. If the respondent defaults in my home state, exactly what do I have to do in New York to obtain recognition?

A. You can take advantage of a procedure known as "Summary Judgment in Lieu of Complaint" based upon the sister-state judgment. You must serve a summons, a notice of motion, an affidavit of one with personal knowledge, a certified copy of the judgment, and a memorandum of law.

Under the full faith and credit clause, the only issue in this summary proceeding is whether your home state had jurisdiction over the Respondent. The jurisdictional issue has two components: basis and notice. Your home state has a jurisdictional basis if the arbitration took place there. If the arbitration took place in a different state from where you practice, you cannot confirm the award in your home state simply because your client lives there or because the broker transacted business there in the past.

Regarding "notice", you need to have gotten good service on the respondents in your home state proceeding. When you come to New York for recognition, you will learn that New York is hard on process servers and protective of defendants who claim no notice. Thus, make sure you have a good address, and try hard to get personal service on the respondent. If you can't get personal service and the process server uses "deliver and mail" or "nail and mail", be aware that New York requires a correct address, not simply a "last known address". While there is an argument (that we have won previously) that New York must apply the service of process rules of the sister-state, it is not an argument you want to have to make.

Our experience tells us that, at the time you make the application for recognition of the sister-state default, it pays to make a "belt and suspenders" application to confirm the award in the event the court finds there was no jurisdiction in the sister-state confirmation proceeding. The additional cost is nominal, and it might save some time later on.

The motion seeking recognition must be made on at least 20 days' notice if there was personal service, but 30 days if there was something other than personal service (in the New York proceeding). Even if there is a default in the New York action, you should expect some delay in getting a judgment entered. There is a 1-year statute of limitations on seeking confirmation of an award.

Q. Is there any danger in going straight to the New York court to seek confirmation?

A. There is no "danger", since New York courts are tough on vacatur applications, and they have now accepted Mastrobuono as governing the punitive damages issue.

The risk, however, is that by bringing the confirmation procedure in New York, the respondent may be more likely to oppose confirmation than if you start at home, because he already has the phone number of the usual crew of New York attorneys who defend pond scum. For that reason, despite the fact that starting the procedure

at home will delay you 60 days, some attorneys prefer that method. At bottom, of course, each case must be analyzed individually. But don't wait too long in doing something, or else the Respondent may be the one selecting the forum.

If there is complete diversity, you can instead go to federal court, but our sense tells us that the feds are more likely these days to be aggressive in reviewing awards. (See Montes v. Smith Barney and Halligan v. Piper Jaffray).

Q. What legal issues are you seeing in confirmation cases, and how can we deal with them?

A. The first legal issue is whether the respondent had notice of the arbitration hearing. The NASD is notoriously bad at serving these notices at the correct address, and they are even worse at keeping records of it. If the respondent didn't appear at that hearing, make sure you can prove he had notice. Write to the NASD for their paper trail. If you can anticipate such a default in advance of the hearing, it pays for you to send the respondent a notice of the time and place of the hearing. And if the Respondent didn't sign the USA, make sure the NASD served him with the claim.

Respondents trying to avoid confirmation still use "manifest disregard of the law" as their next favorite arrow. If you are in a jurisdiction that doesn't recognize that standard, by all means start at home. If, on the other hand, you are in Florida, beware of cases like Montes (and the 2d Circuit analog, Halligan). Some respondents are framing their opposition in terms of arbitrators exceeding their authority (they will probably be quoting Linda Feinberg), and others by arguing that they were denied an opportunity to be heard (e.g. denial of a request for a last-minute adjournment to get counsel, or through imposition of a discovery sanction). Evident partiality claims have also been made, one of which was even successful (Wages v. SB) because the arbitrator didn't disclose a conflict.

Q. What do I do if the respondent files bankruptcy?

A. Come to the PIABA Annual Meeting at Disneyworld in October!! We have a speaker who will address that very subject. SEE YOU THERE.

From the Professor

Joseph C. Long

CONFIRMATION AND VACATUR, PART I--POST-AWARD INTEREST

In this issue, we begin a series of articles dealing with issues after arbitration has been completed, dealing with confirmation or vacatur of the award. Confirmation or vacatur procedure, especially under the Federal Arbitration Act, is quite different from the filing of a normal civil complaint. For example, there are special time limits for filing and different service requirements. The general topic of the confirmation and vacatur process has been selected as a topic for one of the break-out sessions at the Annual Meeting. Hopefully, this installment will wet your curiosity so you will consider attending that break-out session.

Post-Award Interest

In connection with any arbitration award, there are three different types of interest that may be awarded. First, there is **pre-award** interest included in the initial award as payment for the use of the investment during the period of the investment.[1] The second type of interest which may be awarded is **post-award, pre-judgment** interest. As the name suggests, this interest is paid on the arbitrators' award from the date the award is rendered until the trial court enters its order of confirmation. Finally, there is **post-judgment** interest which runs after the date of confirmation until the judgment is actually paid. **Wiselogle v. Michigan Mutual Ins. Co.**[2], a non-securities arbitration case, has an excellent discussion of the way these three interest components are to be calculated. This column will deal only with the latter two components, post-award, pre-judgment interest and post-judgment interest.[3]

The calculation of both **post-award, pre-judgment** and **post-award** interest is governed by NASD Rule 10330(h).[4] This section is controlling because Rule 10331 of the NASD Code[5] provides that the NASD Code of Arbitration is incorporated by reference in, and therefore deemed a part of, every agreement to arbitrate under the Rules of NASD.[6]

The obvious starting point for the discussion of Rule 10330(h) is the language of the Rule itself, which provides in pertinent part:

> "(h) * * * **An award shall bear interest from the date of the award.... Interest shall be assessed** at the **legal rate, if any, then prevailing in the state where the award was rendered,** or at a rate set by the arbitrator(s)."[7]

A cursory reading of Section 10330(h) resolves three issues. First, it makes clear that an investor who has won an arbitration award is entitled to **post-award, pre-judgment** and **post-judgment** interest.[8] Rule 10330(h), not the local state[9] or federal[10] post-judgment interest statute, is the source of the claimant's entitlement to this interest award. Further, Section 10330(h) provides that the "**award shall** bear interest." The "**shall**" here makes clear that the awarding of post-award interest is **mandatory, not permissive.**[11]

Second, it also makes clear that the interest commences on the **date of the arbitrator's award** and **not** on the day when the court enters its judgment confirming the award.[12] Finally, it makes clear that the claimant is entitled to post-award interest **on the entire award.** The problem here is identifying what makes upon the entire award.

The word "**award**" as used in Rule 10330(h) means the **entire award** and not merely the compensatory damages.[13] The "entire" award should, therefore, encompass compensatory damages[14] and pre-judgment interest thereon[15] as provided for in Section 410(a)(2) of the Uniform Securities Act.[16] It should also include any punitive damages awarded,[17] attorney's fees,[18] and costs[19] awarded by the arbitrators.

Interest on Interest

The major objection raised by defendants to the payment of post-award, pre-judgment or post-judgment interest on pre-award interest is that this practice allows interest to be paid on interest, and such practice is prohibited. The problem with this approach is that when the pre-award interest is included in the arbitrators' award it loses its character as interest and simple becomes an element of the award. As the court said in **Britz, Inc. v. Alfa-Laval Food & Dairy Co.**:

> The arbitration award itself resulted in a new fixed liability [Citation omitted]. Regardless of the individual elements that comprised that liability, respondents were entitled to payment of the fixed sum upon issuance of the award.
>
> The arbitration award was the contractual equivalent of a judgment in respondents' favor. In the context of a judicial judgment, it is clear that interest after judgment accrues as to the entire award, including attorney fees. [Citation omitted.] The prejudgment interest awarded respondents served the same purpose here. Although the interest was pre-"judicial judgment," it was post-"contractual judgment." Any result that denied respondents this post-award interest would punish them for using arbitration instead of the court system to resolve their dispute with appellants [20]

This rejection of the interest on interest argument in arbitration is consistent with the treatment of interest by both the state[21] and federal courts[22] under the post-judgment interest statute. Thus, for example, in **North Drive-In Theatre Corp. v. Park-In Theatres, Inc.**,[23] the Tenth Circuit said:

> It is the general rule that a judgment bears interest on the whole amount thereof, although such amount is made up partly of interest on the original obligation, and even though the interest is separately stated in the judgment."

Interest on Attorney's Fee and Costs[24]

The federal courts are virtually unanimous in holding that costs and attorney's fees contained in a judgment bear post-judgment interest under 28 U.S.C. §1961, the federal post-judgment interest statute. The First Circuit in **Foley v. City of Lowel** stated:

> Insofar as we can determine virtually every circuit to confront the question has concluded that if an attorney's fee award is incorporated in a final judgment, as here, interest will

> thereafter accrue on the amount of the award.[25]

The Ninth Circuit was even more specific in **Perkins v. Standard Oil Co.,**[26] where the court said:

> [A]ttorney's fees, being unliquidated until they are determined by a court, are not entitled to prejudgment interest...[b]ut once a judgment is obtained, interest thereon is mandatory without regard to the elements of which that judgment is composed.

The Tenth Circuit in **Wheeler v. John Deere Co.**[27] extended post-judgment interest coverage to costs. The court first said: "An award of costs, which partially reimburses the prevailing party for the out-of-pocket expenses of litigation, is obviously any money judgment'." It then continued saying:

> For purposes of interest under §1961, we see no practical difference between an award of costs, an award of attorney's fees, or an award of damages. Indeed, in **Transpower**[28] we noted that "there exists no real distinction between judgments for attorney's fees and judgments for... damages.... `[O]nce a judgment is obtained interest thereon is mandatory without regard to the elements of which that judgment is composed.'" **Id.**

The same treatment has been accorded attorney's fees and costs in arbitration. As the quoted language above indicates, the court in **Britz, Inc. v. Alfa-Laval Food & Dairy Co.,**[29] specifically held that interest would run on the entire arbitration award, including attorney's fees. Thus, the conclusion is the same under both federal law and arbitration in general as well as under NASD Rule 10330(h), attorney's fees and costs are part of the award and bear both post-award, pre-judgment and post-judgment interest like any other part of the award.[30]

Interest on Punitive Damages

For post-judgment interest purposes,[31] punitive damages have been treated much the same way as interest or attorney's fees. Both the state[32] and federal[33] courts have held that post-judgment interest will be allowed on punitive damages like any other part of the original judgment. Research has not revealed any case where the issue has been discussed in connection with punitive damages in arbitration. However, the rationale should be the same here. Punitive damages loose their character when they are incorporated in an arbitration award. As a result, the arbitration award should not be broken into its component parts when post-award, pre-judgment and post-judgment interest is awarded. The entire award, including punitive damages, is entitled to bear interest. This appears to be what was done in **Ehrich v. A.G. Edwards & Sons, Inc.**[34] The plaintiff sought post-award, pre-judgment interest where the arbitration award included punitive damages. Without discussion, the court included the punitive damages within the total award upon which interest was granted.

Interest Rate

Having determined that both post-award, pre-judgment and post-judgment interest runs on the entire award, including pre-award interest, punitive damages, attorney's fees, and costs, the next step is to determine the rate at which the interest is to be awarded. Again, Rule 10330(h) is controlling, not the state or federal post-judgment rate. Rule 10330(h) provides alternative methods for calculating post-award interest. First, the arbitrators themselves may select a rate. Second, if the arbitrators do not select a rate then the legal rate prevailing in the state where the Panel sits is to be applied.

Alternative One

Under the first alternative the arbitrators are free to set what ever rate they desire for post-award, prejudgment and post-judgment interest. Certainly the claimant should urge the panel to adopt a rate that fairly compensates the claimant for the loss of the use of the money during confirmation or vacatur. Normally, this rate would be much higher than the post-judgment interest rate under either the state or federal post-judgment interest statutes. If the claimant feels compelled to base claim on a statutory rate, then as discussed below, the rate contained in Section 410(a)(2) of the Uniform Securities Act is the best choice. This section is appealing as a post-award rate because it is clearly the rate at which the claimant is entitled to pre-award interest on his investment. A strong argument can be made that the rate

for pre- and post-award interest should be the same. There is no prejudgment interest statute at the federal level. However, the federal courts will often use 28 U.S.C. §1961, the post-judgment interest statute, as a guide for awarding pre-judgment interest.

Alternative Two

If the arbitrators do not set out in their award a special rate, then the default provision is to apply the legal rate in the state where the panel sits. Unfortunately, Rule 10330(h) does not further define "legal rate". Under Oklahoma law, as is the case in most states, there are different "legal rates" for different purposes. For example, most states have a "legal rate" for contracts when the contract is silent as to the rate of interest.[35] This statute would seem inappropriate for calculating post-award interest for two reasons. First, in most cases, the provision applies only to contracts. Second, the provision often only covers pre-judgment interest. In the arbitration setting, such limitation would seem to restrict its application to pre-award interest rather than post-award, pre-judgment interest or post-judgment interest.

At first glance, the appropriate legal rate would seem to be that contained in the local post-judgment interest statute.[36] Closer examination, however, suggests this may not be true. Most of these statutes by their own language deal only with **post-judgment** interest awarded by a **court**.[37] Arguably, the limitation to post-judgment interest might make these sections inappropriate, at least, for the calculation of post-award, pre-judgment interest. However, these statutes appear a likely choice unless a better statute is found.

There is, in fact, a better statute, the securities act itself. Section 410(a)(2) of the Uniform Securities Act provides that the purchaser of a security in violation of the Act is entitled to recover the amount of his investment **plus ten percent (10%) interest.** The statute is open ended. It merely states that the purchaser of the securities is entitled to recover a fixed percentage of interest[38] beginning when he paid for his securities, but is silent as to when this interest is to cease.[39]

Compound Rather Than Simple Interest

Again when addressing the question of whether interest is to be simple or compound, it is important to recognize and to stress to the judge hearing the case that the issue of simple or compound post-judgment interest is governed by Rule 10330 and not the post-judgment interest statute normally controlling the court.[40] Rule 10330(h) also does not specify whether post-award, pre-judgment or post-judgment interest is to be simple or compound. Again, the tendency is to assume that in absence of specific language in the Rule, simple interest should apply. However, such assumption turns out not to be a foregone conclusion. An equity reasonable interpretation is that the silence of Rule 10330(h) means that reference should made to state or federal law to determine whether post-award, pre-judgment or post-judgment interest should be simple or compound. If reference is made, it is clear that the reference should be to federal post-judgment statute, 28 U.S.C. §1961 rather than state post-judgment statutes.

All securities transactions between brokers and their customers have been held to involve interstate commerce. As a result, they are governed by the Federal Arbitration Act rather than state arbitration law. The FAA creates a body of federal substantive law, applicable to any arbitration agreement within the coverage of the Act. This is true, notwithstanding any state substantive or procedural policies to the contrary.[41] Further, this body of federal substantive law applies in both state and federal court actions involving the FAA.[42] Therefore, the compounding issue, in absence of specific direction in Rule 10330(h), in both state and federal courts, should be resolved by reference to federal rather than state law. This means that 28 U.S.C. §1961, the federal post-judgment interest statute, is the controlling provision. Section 1961 makes clear that compounding is not only appropriate, but mandatory when it provides: "(b) **Interest** shall be computed daily to the date of payment..:, and **shall be compounded annually.**"[43]

The majority of state post-judgment interest statutes, unlike Section 1961, do not allow compounding. As a result, any brokers may argue that state law should apply to the compounding issue. They base this assertion on the fact that Rule 10330(h) makes reference to state law to determine the **rate** of post-award interest. The fallacy with this approach is that the reference to state law in Section 10330(h) is for the

purpose of determining the **rate**, not whether the interest is to be simple or compound. Since Rule 10330(h) does not address the compounding issue, it could hardly incorporate by reference state law on the compounding issue. In the absence of controlling language in Rule 10330(h), the gap must be filled by either state or federal law. In the absence of any express provision or express incorporation of state law in Rule 10330(h), the FAA commands that the default provision come from federal, not state, law.

Public policy also indicates that the award of compound post-award, prejudgment and post-judgment interest is equitable and appropriate. Two of the purposes for awarding interest are: (1) to compensate the party for the delay in receiving his money and (2) to compensate him for the loss of the use of his principal.

In modern society, the only way these goals can be accomplished is through the award of compound interest. It is standard practice of every bank, savings and loan association, credit union, or other financial institution to compound interest. It is clear that the brokerage house has had the use of the award money during the confirmation process and had the opportunity to invest it. No doubt such investment would have paid compound interest. At the moment of the award, the amount of the award becomes the claimants rather than the broker. He rather than the broker should have the opportunity to earn the compound interest. It was the broker's decision, not claimant's, whether or not to pay the award and seek vacatur. In such case, the only fair thing to do is for the court to award compound interest. This treats him in the same way that he would have been treated if his money had been invested throughout the vacatur period.[44]

1. Section 410(a)(2) of the Uniform Securities Act specifically includes this type of interest within the recovery entitlement. Even without specific statutory authority, the arbitrators have the authority to award pre-award interest. See Wiselogle v. Michigan Mutual Ins. Co., 212 Mich. App. 612, 538 N.W.2d 98 (1995).

2. 212 Mich App. 612, 538 N.W.2d 98 (1995).
3. As will be seen below, because of the language of NASD Rule 1033(h), in most cases, there should be no difference in the calculation of these interest components.

4. This Rule is old Rule 41(h), the language has not been changed.

5. This is old Rule 42, the language of which has not been changed.

6. Haynes, Miller, & Farni, Inc. v. W. Flume, D.D.S., S.C., 888 F. Supp. 949, 954 (E.D. Wis. 1995).
7. [Emphasis added]. NASD Manual ¶ 3741 (1994). This Section reads in full:

(h) All monetary awards shall be paid within thirty (30) days of receipt unless a motion to vacate has been filed with a court of competent jurisdiction. An award shall bear interest from the date of award: (i) if not paid within thirty (30) days or receipt, (ii) if the award is the subject of a motion to vacate which is denied, or (iii) as specified by the arbitrators in the award. Interest shall be assessed at the legal rate, if any, than prevailing in the state where the award was rendered, or at a rate set by the arbitrators.

8. Card v. Stratton Oakmont, Inc., 933 F. Supp. 806, 816 (D. Minn. 1996); Haynes, Miller, & Farni, Inc. v. W. Flume, D.D.S., S.C., supra at 954; FSC Securities Corp. v. Freel, 811 F. Supp. 439, 446 (D. Minn. 1993), aff'd 14 F.3d 1310 (8th Cir. 1994).

9. See e.g., 12 O.S. (1991) §727.

10. 28 U.S.C. §1961(b).

11. This conclusion is in agreement with the federal position that post-judgement interest is mandatory. 28 U.S.C. §1961. Wheeler v. John Deere Co., 966 F.2d 413 (10th Cir. 1993); Transpower Constructors v. Grand River Dam Auth., 905 F.2d 1413, 1423-1424 (10th Cir. 1988).

Since this award is mandatory, failure to award this interest would be grounds for setting the arbitration award aside because the arbitrators have exceeded their powers. 9 U.S.C. §10(a)(4).

12. As the court said in Card v. Stratton Oakmont, Inc.,

933 F. Supp. 806, 816 (D. Minn. 1996):

> "Rule [1033(h)] specifically provides that all awards that are subject of a motion to vacate, which is denied, shall include interest at the legal rate from the date of the award."

Accord: Haynes, Miller, & Farni, Inc. v. W. Flume, D.D.S., S.C., supra at 954. Roubik v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 285 Ill. App. 3d 217, 223, 674 N.E.2d 35, 38 (1996). See also Parsons & Whittemore Ala. Mach. and Serv. Corp., 744 F.2d 1482 (11th Cir. 1984); Sun Ship, Inc. v. Matson Nav. Co., 785 F.2d 59 (3rd Cir. 1986); Lundgren v. Freeman, 307 F.2d 104 (9th Cir. 1962); United States ex rel. J. Farmer & Co., Inc. v. Praught Const. Corp., 607 F. Supp. 1309 (D.Mass. 1985); Aegean (Shipbrokers) Ltd. v. Henriksen's Rederi A/S, 165 F. Supp. 939 (D. Mass. 1958); Hackman v. American Mutual Liability Ins. Co., 110 N.H. 87, 261 A.2d 433, 438 (1970).

3. Failure to award compensatory damages when a violation of the securities act has been established is a manifest disregard of the law which would be grounds for having the award vacated, if the fact had been brought to the attention of the arbitrators. Ainsworth v. Skurnick, 591 So.2d 904 (Fla. 1991). See also Ainsworth v. Skurnick, 960 F.2d 939 (11th Cir. 1992).

14. This amount includes more than the money actually paid for the securities. For example, in Bradley v. Hullander, 272 S.C. 6, 249 S.E.2d 486 (1978), buyer was entitled to recover brokerage commissions paid in addition to the consideration paid the seller, both initially and in subsequent payments after the sale.

15. Cases are in conflict as to whether the award of interest is discretionary or mandatory. Compare Merchant v. Oppenheimer & Co., Inc., 568 F. Supp. 639 (E.D. Va. 1983), aff'd in part, reversed in part on other grounds, 739 F.2d 165 (4th Cir. 1984) and Jersild v. Acker, 775 F. Supp. 198 (E.D. Wis. 1991) (mandatory) with Burgess v. Premier Corp., 727 F.2d 826 (9th Cir. 1984)(discretionary).

16. This section provides: The purchaser may "recover the consideration paid for the security, together with interest at six percent per year from the **date of payment...**"

17. It is generally believed that punitive damages may not be awarded under the Uniform Act. See e.g., Woods v. Homes and Structures of Pittsburg, Kansas, 489 F. Supp. 1270 (D.Kan. 1980); Kirkland v. E.F. Hutton and Co., Inc., 564 F. Supp. 427 (E.D. Mich. 1983); and Scheve v. Clark, 596 F. Supp. 592 (E.D.Mo. 1984). These decisions are all federal court decisions. The language of Section 28 of the Securities Exchange Act of 1934, 15 U.S.C.§78bb has been interpreted to prohibit the award of punitive damages under the federal securities acts. This section reads: "[N]o person...hall recover, through satisfaction of judgement in one or more actions, a total amount in excess of his actual damages on account of the act complained of." The Uniform Securities Act §410 does not contain similar language. Therefore, the rationale for not awarding punitive damages under the federal acts does not exist under the Uniform Act.

It has long been recognized that punitive damages may be awarded under other alternative causes of action such as common law fraud and breach of fiduciary duty. See e.g., Lucas v. Lucas, 946 F.2d 1318 (8th Cir. 1991)(conversion); State ex rel. Vranish v. District Court, 741 P.2d 412 (Mont 1987).

18. Attorney's fees are specifically authorized by Section 410(a)(2) of the Uniform Act. While authority is split as to whether the award of such fees are mandatory or discretionary, the better reasoned cases, see e.g., Golub v. J.W. Gant & Assoc., 863 F.2d 1516, 1521 (11th Cir. 1989); Kelsey v. Nagy, 410 N.E.2d 1333 (Ind. App. 1980), rev. denied, 471 N.W.2d 509, hold that such award is mandatory. But see MidAmerica Fed. Sav. and L. Assoc., 962 F.2d 1470, 1476 (10th Cir. 1992) and Andrews v. Blue, 489 F.2d 367, 377 (10th Cir. 1973).

19. Award of costs is specifically allowed by Section 410(a)(2) of the Uniform Act. It is an open question as to what is included within the category of "costs". For

example, do costs include expert witness fees and travel, or are costs limited to "court" costs as defined in most states by the costs statute? Florczak v. United Jersey Bank, 248 N.J. Super. 651, 591 A.2d 1023 (1991) and Bradley v. Hullander 277 S.C. 327, 287 S.E.2d (1982), appear to hold that "costs" means only those costs allowed under the costs statute. Such a holding, however, runs contrary to the philosophy embraced by the securities acts of making the investor whole. Not to allow him to recovery out-of-pocket expenses incurred in winning his award penalizes him and does not make him whole.

20. 34 Cal. App. 4th 1085, 1107, 40 Cal. Rptr.2d 700, 713-714 (1995).

21. See e.g., MaGee v. Ford Motor Co., 132 N.J. Super. 565, 334 A.2d 382 (1975); Huff v. State, 764 P.2d 183, 188 (Okla. 1988); McFarlane v. Winters, 114 Utah 502, 201 P.2d 494 (1949).

22. See e.g., United States v. Michael Schiavone & Sons, Inc., 450 F.2d 875, 876 (1st Cir. 1971); Mill Pond Assoc. Inc. v. E&B Giftware, Inc., 751 F. Supp. 299 (D. Mass. 1990). In Schiavone the court specifically rejected the argument that a judgement should be parceled into component parts of which only would be entitled to post judgement interest.

23. 248 F.2d 232, 240 (10th Cir. 1957).

24. The attorneys' fees and costs discussed here are those incurred in bringing the original arbitration action. These fees and costs were included in the original arbitration award. Attorney's fees and cost incurred in the confirmation or vacatur process are not included here. The ability to recover these fees and costs is not as straight forward as might first appear. Recovery of these fees will be the subject of a subsequent column.

25. 948 F.2d 10, 21 (1st Cir. 1991).

26. 487 F.2d 672, 675 (9th Cir. 1973).

27. 966 F.2d 413, 415 (10th Cir. 1993).

28. [Author's note] Transpower Constructors v. Grand River Dam Auth., 905 F.2d 1413, 1423-1424 (10th C 1988).

29. Britz, Inc. v. Alfa-Laval Food & Dairy Co. 34 Cal. App. 4th 1085, 1107, 40 Cal. Rptr.2d 700, 713-714 (1995); Marion Manf'g Co. v. Long, 588 F.2d 538 (6th Cir. 1978); FDIC v. Air Florida Sys., Inc., 822 F.2d 833 (9th Cir. 1986); and Lundgren v. Freeman, 307 F.2d 104 (9th Cir. 1962). See also, Sun Ship, Inc. v. Matson Nav. Co., 785 F.2d 59 (3d Cir. 1986); United States ex rel. J. Farmer & Co., Inc. v. Praught Const. Corp., 607 F. Supp. 1309 (D.Mass. 1985); Aegean (Shipbrokers) Ltd. v. Henriksen's Rederi A/S, 165 F. Supp. 939 (D.Mass. 1958); Hackman v. American Mutual Liability Ins. Co., 110 N.H. 87, 261 A.2d 433, 438 (1970).

30. Traditionally, post-judgement interest accrues only when a monetary award is expressed in the form of a sum certain. Wheeler v. John Deere Co., supra at 415. In both cases, however, payment of post-award interest is consistent with the idea that at the time of award judgement the money is ue. If the defendant is allowed to keep the money pending confirmation or appeal, then the defendant should compensate the plaintiff for the use of **his** money.

31. For a discussion of the right to prejudgement interest on punitive damages, see Annot. "Right to Prejudgement Interest on Punitive or Multiple Damages Awards", 9 A.L.R. 5th 63 (1993).

32. Hall v. Montgomery Ward & Co., 252 N.W.2d 421 (Iowa).

33. See e.g., Bank South Leasing, Inc. v. Williams, 778 F.2d 704 (11th Cir. 1985); Dorsey v. Honda Motor Co., Inc., 673 F.2d 911 (5th Cir. 1982); United States v. Michael Schiavone & Sons, Inc., 450 F.2d 875 (1st Cir. 1971); Mill Pond Assoc., Inc. v. E&B Giftware, Inc., 751 F. Supp. 299 (D. Mass. (1990).

34. 675 F. Supp. 559 (D.S.D. 1987).

35. In Oklahoma, this statute is 15 O.S. (1991) §266

provides a general "legal rate" of six percent. See e.g., Heiman v. Atlantic Richfield Co., 891 P.2d 1252 (Okla. 1995).

36. In Oklahoma, this is 12 O.S. (1991) §727.

37. The use of the work "court" in these statutes means that technically they do not apply to arbitration. However, they can be incorporated by reference by Rule 10330(h).

38. In Oklahoma that rate is 10 percent. This is substantially higher than the other legal rate provisions.
39. If this position is not accepted to apply to the entire arbitration award, a strong argument can be made that the Uniform Act provision should at least control over Rule 10330(h) as to the actual damages portion of the arbitration award. The securities act rate, after all, is a part of the investor's right of recovery.

40. As will be seen below, in the case of the federal courts, the proper answer to the compounding issues comes from 28 U.S.C. §1961. However, Section 1961 does not apply because the confirmation action was brought in federal court, but rather because the compounding rule in that section is incorporated through Rule 10330(h).

41. Moss H. Cone Mem. Hospital v. Mercury Const. Corp., 460 U.S. 1, 24 (1983).

42. Southland Corp. v. Keating, 465 U.S. 1 (1984).

43. [Emphasis added]. The courts have held this provision to be mandatory rather than discretionary. Wheeler v. John Deere Co., 966 F.2d 413 (10th Cir. 1993); Transpower Constructors v. Grand River Dam Auth., 905 F.2d 1413, 1423-1424 (10th Cir. 1988).

44. Because of the high return on investments and low legal rates of interests many brokers will seek vacatur simply to be able to invest the award during the period it takes to resolve the vacatur motion. They make a substantial profit on the award after paying the claimant simple interest at the legal rate.

NASD Arbitration Panel Finds Bear Stearns Liable as a Clearing Firm for a Second-Tier Broker Dealer

In NASD Arbitration No. 97-02167, the Arbitration Panel held Bear Stearns jointly and severally liable with Hillcrest Financial Corporation, the introducing broker. This was in spite of the fact that Bear Stearns was acting only as the clearing broker on a fully disclosed basis, and had noticed the Claimant at the opening of the account that Hillcrest would be responsible for supervising all account activity.

The claim involved suitability and market manipulation on a newly formed company which had little or no assets and operating history. Claimant alleged that Bear Stearns committed fraud by inducing them to sign a customer agreement with Bear Stearns without any disclosure of the thin capitalization of the introducing broker.

U.S. Fifth Circuit Holds Title VII Discrimination Claims Must be Arbitrated

In Mouton v. Metropolitan Life Insurance Co., 1998 U.S. App. LEXIS 17612, the Fifth Circuit ruled than an NASD licensed insurance agent was required to arbitrate his Title VII claim against Metropolitan. The Court rejected the Plaintiff's arguments that Section 1 of the NASD Code in effect in 1988 (when Mouton signed his U-4) did not encompass employment related controversies. The Court also considered and rejected the argument that the claim was not subject to compulsory arbitration because it fell within the exception for disputes involving the insurance business of an NASD member which is also an insurance company.

The Use of NASD Notice to Members Bulletins as Precedent in Arbitration Proceedings--Part II

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[This is the second part of a two part article, the first part of which appeared in the June 1998 issue of the Quarterly.]

VII. Customer Complaints, NASD Notice to Members 93-73 (October 1993)

Reports of NASD Members to the Central Registration Depository (the CRD) relative to customer complaints and other required disclosures has been fraught, until recently, with uncertainty and unclarity with the result that the investing public has been deprived of vital information which would bear upon a choice of brokers. Patterns of customer abuse and questionable trade practices were hidden from the public eye as broker dealers were able to claim that certain gray area matters were simply not reportable to the CRD under NASD Guidelines.

The SEC approved NASD(R) Rule 3070 (formerly Article III, Section 50 of the NASD Rules of Fair Practice) on September 8, 1995, to clarify the requirements of reporting customer complaint information and other specified events to NASD Regulation, Inc., and ultimately, to the Central Registration Depository. The rules requires NASD member firms to disclose to NASD Regulation any occurrence which fit within ten (10) separately specified categories of events enumerated in NASD(R) Rule 3070. The rule requires the reporting by member firms of quarterly summary statistical information pertaining to written customer complaints. NASD(R) Rules 3070 became effective on October 15, 1995, and the first series of quarterly statistical electronic submissions were required to be filed with NASD Regulation by January 15, 1996.

As could be expected, even though NASD Regulation sought to specify the reporting obligation of member firms under NASD(R) Rule 3070, NASD Regulation was met with numerous inquiries by member firms regarding their customer complaint reporting obligation culminating in NASD Notice to Members No. 96-85 (December 1996).

This Notice to Members is very specific as to the mechanics in which reportable information must be forwarded to NASD Regulation in a timely fashion, including the specification of the use of certain communications software (NASDnet) to communicate with the NASD together with the use of member firm coding requirements with the further requirement that "[t]he...members should maintain a systematic method (e.g. date stamping) for recording the dates that customer complaints are first received by the member".

The clarification of the reporting requirements in this Notice only requires that "the members should report the most egregious problem code allowed (e.g. fraud, misrepresentation, unauthorized transaction), the security associated with the most egregious problem code, and the highest alleged damage amount: even though the customer complaint may contain numerous allegations involving a variety of securities or multiple damage amounts. It would appear that this clarification, however, still leaves considerable lee-way for member firm to engage in considerable selective reporting of complaints and reportable events.

The clarification in this notice also requires separate reports in circumstances under which more than one associated person is named in a customer complaint. Subsequent letters from the same customers must also be reported separately to NASD Regulation if it includes any new allegations.

The notice went on to direct that in circumstances under which a member and an associated person or persons are named as defendants or respondents or are subject to any claim for damages

by a customer and, as a result of a judgment, award or settlement, the parties have joint and several liability over $25,000.00, two separate disclosure reports are required to be filed with NASD Regulation and reports for each event must be made under the rule, noting that:

> Any judgment, award or settlement in an amount over $15,000.00 for an associated person and over $25,000.00 for a firm, respectively, must be submitted to NASD Regulation...[s]ince the liability is joint and several, the amount for each named party must be aggregated and reported as if the member and associated person(s) are separately liable for the specified amount.

These guidelines appear to delegate a practice engaged by some firms wherein reports either went unfired or were filed as against one party.

It is the total amount claimed by the customer that is taken into consideration whether to file with NASD Regulation, regardless of whether or not the firm rescinds the transaction complained of in favor of the customer. The same also applies to arbitration or civil litigation claims filed by customers after October 1, 1995, which settle in an amount in excess of the threshold amounts for a matter commenced prior to October 1, 1995.

Notice to Members 96-85 also covers the reporting responsibilities of a broker dealer in circumstances in which any registered person has been terminated as a result of an internal investigation. Under such circumstances, notwithstanding a timely filing of a form U-5 through the CRD system, the member must also submit a specified event item under number 10 [section (a)(10)], filing through the customer complaint reporting system at NASD Regulation. In circumstances wherein the customer complaint is forwarded to NASD Regulation and not the member firm, upon forwarding the same to the member firm by NASD Regulation, the member is obligated to report the complaint through the customer complaint reporting system.

Certain types of complaints have more stringent and accelerated submission requirements to NASD Regulation. For example, if a member receives a customer complaint alleging theft, misappropriation of funds or securities or forgery the member firm must not only file the appropriate specified event filing under Section (a)(2) with NASD Regulation within ten (10) days, the member must also submit a quarterly customer complaint filing with NASD Regulation regarding the same event.

Ironically, when a member receives notification that it or an associated person was named in an arbitration or civil litigation regarding a customer dispute, the member is not obligated to file either a specified event filing or a customer complaint filing with NASD Regulation. NASD Notice to Members 96-85 simply directs that "[u]nder the rule, a member is obligated to report only settled or completed arbitrations or civil litigation matters and only where the award, judgment or settlement exceeds a certain specified dollar amount". This notice also pointed out, however, that the member firm still may be required to report these matters to the NASD through the CRD system on forms U-4, U-5 and BD.

Given the heightened reporting requirements of NASD member firms and their affiliated persons as required by NASD(R) Rule 3070 and as further clarified in NASD Notice to Members 96-85, practitioners representing parties to arbitration proceedings should consider obtaining specified event and quarterly summary statistical information filings filed with NASD Regulation in addition to discovery requests such as U-4, U-5, RE-3's and CRD filings. Discovery requests in this regard should be all inclusive and not afford member firm any lee-way to not disclose all relevant customer complaints.

VIII. Selling Away - NASD Notice to Members 86-65 Compliance with the NASD Rules of Fair Practice in the Employment and Supervision of Off-Site Personnel

NASD Notice to Members 86-65 (9/12/86), noted

that:

> [b]ecause of their location and other circumstances of their employment, off-site personnel have a greater opportunity than on-site personnel to engage in undetected selling away...[c]onsequently, firms that employ such persons are responsible for monitoring their activities in a manner reasonable intended to detect violations.

Referring to former Article III, Section 40 of the NASD Rules of Fair Practice regarding Private Securities Transactions Notice to Members 86-65 imposes specific requirements on noted firms noting that:

> The rule requires that a member approves an associated persons involvement in private securities transactions for compensation to record the transactions on its books and records and supervised individuals participation "as if the transactions were executed on behalf of the member" and went on to recommend that the firm obtain ten separate categories of information including the following:
>
> A. The individual and the security involved;
> B. The amount and source of compensation;
> C. The names of the investors and the amounts and dates of the investments;
> D. The issuer, syndicator or any other broker/dealer involved; and
> E. The manner in which the firm undertook to supervise the associated persons participation.

And the Notice went on to note that "...firms must approve any materials referencing that securities are sold by the off-site representative through the member, even though such materials may be intended to promote the non-securities businesses of the off-site personnel". Given such stringent and burdensome requirements, query whether any broker dealer would even consider permitting an associated person to engage in private securities transactions - the reasons would have to be compelling. Further yet, it would appear that the Joint Regulatory Sales Practice Sweep - Heightened Supervisor Procedures discussed in NASD Notice to Members 97-19 (April 1997) (see Point III in this article) imposes the most stringent and constant supervision of any affiliated member having any prior involvement with undisclosed private securities transactions or selling away activity.

IX. Collateralized Mortgage Obligations NASD Notice to Members 93-85 (December 1993)

In NASD Notice to Members 93-73 (October 1993), the NASD reminded the members of the need to "be conversant in all of the characteristics of CMO's to assess adequately the suitability of CMO's for their customers" and to assure that "members must insure that their customers understand their characteristics and risks associated with CMO's". This Notice to Members followed up on Notice to Members 93-18 (Guidelines Regarding Communications with the Public About Collateralized Mortgage Obligations) and Notice to Member 92-59 imposing a pre-use filing requirement for CMO advertising.

1992 Amendments to the NASD Guidelines Regarding Communications With the Public About Collateralize Mortgage Obligations of Article III, Section 35 of the Rules of Fair Practice addressed in Notice to Members 93-85 (December 1993) highlighted the need for member firms to engage in a more affirmative obligation to clearly identify collateralized mortgage obligations to customers defining the term "Collateralized Mortgage Obligations (CMO) as a multi-class bond backed by a pool of mortgage pass-through securities or mortgage loans and interchangeably used the term "Real Estate Mortgage Investment Conduits" (REMICs) when referring to CMO's.

Member firms are directed in this notice to refrain from using proprietary names for CMO's with the further admonition "[t]o prevent confusion and the

possibility of misleading the reader, communications should not contain comparisons between CMO's and any other investment vehicle, including Certificates of Deposit". Thus, the abuses sought to be remedied and addressed in Notice to Members 93-85 are obvious.

The Notice also advised members that "...members are required to offer to customers educational material which covers the following matters:

A. A discussion of CMO characteristics as investments and their attendant risks;
B. An explanation of the structure of a CMO, including the various types of tranches;
C. A discussion of mortgage loans and mortgage securities;
D. Features of CMO's, including credit quality, prepayment rates and average lives, interest rates (including effect on values and prepayment rates, tax considerations, minimum investments, transactions, costs and liquidity.
E. Questions an investor should ask before investing, and a glossary of terms that may be helpful to an investor considering an investment".

Given the concise directives to broker dealers in Notice to Members 93-85 regarding their obligation to the investing public when selling CMO's it would appear that the days of comparing CMO's to government backed or corporate bonds without any explanation of attendant risks are a distant memory.

X. The Applicability of the NASD Rules of Fair Practice to Direct Participation Programs. Notice to Members 91-69 (November 1991)

Notice to Members 91-69 noted that the investing public purchased over 90 billion dollars worth of direct participation program securities in the 1970's and 80's by more than 10 million investors in industries including real estate, oil and gas, cable television, commodities and equipment leasing. Many broker dealers try to skirt the applicability of the suitability requirements of the NASD by structuring direct participation program investment products so as not to constitute a security as defined by the Federal Securities Law in order to avoid civil liability not only for the unsuitable sale of securities but also for the unregistered sale of securities.

In addressing the topic of suitability of recommendations relative to direct participation programs, Notice to Members 91-69 (November 1991) noted that:

> NASD members and associated persons are required pursuant to Article III, Section 2 and appendix F to Article III, Section 34 of the Rules of Fair Practice, when recommending to an investor the purchase, sale or exchange of a DPP Security, to have reasonable grounds to believe that the recommendation is suitable for the customer based on the customer's investment objectives, other investments, financial situation and needs, tax status, and any other information known by the member or associated person... [a]dditionally, the member and associated person must determine that the investor has the appropriate investment objectives, is in a position to fully understand the risks and benefits of the transaction and has a net worth sufficient to sustain the risks involved in an investment in a DPP Security.

These heightened suitability requirements applicable to direct participation might very well explain the proliferation of telemarketing firms selling oil and gas, computer, product marketing and telecommunications direct investments which firms have no affiliation with the NASD, thereby avoiding self-regulatory scrutiny. (See also NASD Notice to Members No. 73-50 (7/13193) - "SEC release on NASD Proposed Tax Shelter Rules" page 57-60, 85-101-111).

On the heels of the explosion of limited partnership related arbitration filings, the NASD, in March of 1997 in Notice to Members 97-8, made known the approval by the