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The PIABA Quarterly

The Newsletter of the Public Investors Arbitration Bar Association

December 1998 Volume 5 Number 4

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Editor's Notes

This issue of the *Quarterly* contains an article on mediation from guest author E. Scott Douglas.

The deadline for receiving submissions for the March 1999 issue of the *Quarterly* is March 10, 1999. 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 at 1111 Wylie Road, #18, Norman, OK 73069. Toll Free: (888) 621-7484; Fax: (405) 360-2063; E-Mail: piabalaw@aol.com; Web site: www.piaba.org.

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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

Mark E. Maddox, MADDOX KOELLER HARGETT & CARUSO, Indianapolis, IN

Dear Friends:

During the last quarter of 1998, PIABA has continued the good work of out-going President Diane Nygaard and her predecessors.

The NASDR appears ready to give us some relief over the frustrating process of "deficiency notices" that plague about 70% of our case filings. Once the NASDR publishes its new and improved filing requirements, we will make them available to the membership.

Rumors out of Washington suggest that the NASDR's proposed

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rule capping punitive damages is about dead. Although nothing is ever guaranteed in the rule-making process, if it does come to pass that this rule is defeated, PIABA and its members deserve the lion's share of the credit for stepping up and protecting the public investor. We'll let you know the ultimate fate of the punitive rule proposal.

The NASDR's list selection method of selecting arbitrators went on line November 17, 1998. PIABA members have expressed concerns about not filling panels with the original lists and being forced to receive appointed arbitrators from the NASDR without a peremptory challenge. Please let me know if you are having any positive or negative experiences with the NASDR's new list selection process.

Best estimate: the NASDR's new and improved eligibility rule is unlikely to take effect before the summer of 1999. This is not set in stone as this rule has been a moving target ever since its creation.

The NASDR's new discovery guidelines discussed at the PIABA Annual Conference have been submitted to the SEC for approval. My current handicap for this rule is that it will be approved by the SEC and will be a very positive development for investors in arbitration.

PIABA's committees have been appointed and are starting to work on their goals for the coming year. If you have any ideas or information to be considered by one of the committees, please contact either the committee chairperson or myself.

After a long and drawn-out process, we have chosen the Mariott Desert Springs Resort and Spa in Palm Desert, California as the site for the 1999 Annual Meeting. Please mark your calendars for October 21 - 23 and I hope to see a record percentage of our membership in attendance.

Finally, as your PIABA President, please copy me or Robin Ringo on letters to the NASD, SEC, state regulators or the press relating to any of your concerns about securities arbitration.

Happy New Year !

Mark E. Maddox

1999 PIABA Committees

The PIABA Committees are beginning to plan their calendars. The following outlines the charges of the individual committees as well as the members of those committees. If you would like to participate on a committee, notify Robin Ringo and she will add you to the committee of your choice. If you have already indicated an interest but are not listed, notify Robin and she will correct the omission.

Annual Meeting Committee

Chairperson:	Seth Lipner
Vice Chairperson:	Open
Committee Members:	Steve Caruso
	Marcia Ford
	Steve Gard
	John Allen
	Ted Eppenstein
	Phil Aidikoff

The next Annual Meeting Committee is scheduled to convene on February 1, 1999 at 11:00 a.m. EST.

The PIABA QUARTERLY is published quarterly in the interest of the members of the Public Investors Arbitration Bar Association. Editor-in-Chief - Jerry Stanley; Associate Editor - Seth Lipner. The PIABA QUARTERLY welcomes information on cases or articles that would be of interest to PIABA members. Contributions should be mailed to:
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 Annual Meeting Committee shall have the following goals:

1. by March 15, 1999, the Committee shall file a report with the PIABA Board that shall address a preliminary outline for the 1999 Annual Meeting;

2. by June 15, 1999, the Committee shall submit a report to the PIABA Board addressing the final agenda for the 1999 Annual Meeting;

3. by July 15, 1999, the Committee shall contact and confirm all speakers for the 1999 Annual Meeting; and

4. by March 15, 1999, the Committee shall submit at least three (3) recommendations to the PIABA Board for the location of the year 2000 Annual Meeting.

NASDR Rule-Making and Federal Legislation Committee

Chairpersons:	Phil Aidikoff Scot Bernstein
Committee Members:	Gail Boliver Bob Dyer Jim Beckley Robert Banks Pat Huddleston William Little Rosemary Shockman

The primary charges of this Committee will be to monitor NASDR and NYSE arbitration rule-making proposals and proposed federal legislation that are of significant interest to our membership. The following are the primary goals of this Committee:

1. To file timely written responses to NASDR and NYSE securities arbitration rule-making proposals. These responses will be drafted by members of this Committee and approved by the PIABA president prior to filing;

2. To monitor all pending federal legislation of significant interest to PIABA and when appropriate to prepare written responses to such legislation. Again, this correspondence will be prepared by members of the Committee and approved by the PIABA President prior to filing; and

3. To champion proposed legislation that would modernize and update the Securities Investor Protection Act to include among other things increased insurance protection for unpaid arbitration awards.

Governance Committee

Chairperson:	Bill Lapp
Vice Chairperson :	Diane Nygaard
Committee Members:	Neal J. Blaher

This Committee will have the following goals and objectives:

1. To propose any needed modifications to the by-laws of the organization to the Board of Directors by June 15, 1999;

2. To create and implement a more formal process to review and accept/reject new members, by June 1, 1999; and

3. To create and implement a process for the continued review of existing members for compliance with membership guidelines by June 1, 1999.

Communications Committee

Chairperson:	Cary Lapidus
Vice Chairperson:	L. Jerome Stanley
Committee Members:	Allan Fedor Jeffrey Jones Tracy Pride Stoneman Rochelle Hall Jeffrey Sonn

The primary goals of this Committee will be as follows:

1. To continue to publish the *PIABA Quarterly* as a quality publication;

2. To work with our Executive Director to promote the 1999 Annual Meeting to the membership and other potential attendees;

3. To recommend to the Board any media and other opportunities to promote and enhance the reputation of PIABA; and

4. To oversee website and internet issues.

From the Professor

By: Joseph C. Long
Norman, OK

I want to devote this quarter's column to a recent decision, **Weston Securities Corp. v. Aykanian.**[1] This case raises at least two issues which are on the cutting edge of securities arbitration: (1) preemption of state law by the FAA; and (2) the six year rule of old Section 15.[2] The court's opinion provides new insights to these vexing issues which may be helpful to the membership.

I. Extent of Preemption of State Law By the Federal Arbitration Act.

We all should be aware that securities arbitrations are controlled by the Federal Arbitration Act ("FAA"). The FAA applies to all "contracts evidencing a transaction involving commerce."[3] Brokerage contracts have been held to be contracts "involving commerce".[4] Therefore, the FAA will control unless the parties in their arbitration agreement, at the time of submission[5], or during the arbitration itself agree that state arbitration law will apply.[6] Further, the FAA preempts any state law which is inconsistent with it.[7]

We should also know that the FAA gives the federal court the power, but not the jurisdiction, to entertain actions to enforce or enjoin arbitration or to confirm or vacate arbitration awards. As a result, if the federal court has an independent basis for asserting jurisdiction[8], then the FAA will control these actions. Further, to the extent that the FAA proves a procedural process which is different from the Federal Rules of Civil Procedure, the federal rules do not apply and the FAA procedure is controlling.[9] Finally, we should know that the state courts have concurrent jurisdiction over actions brought under the FAA.[10]

From this knowledge, we often **assume** that the FAA will control in such state court actions. **Is this assumption completely justified?** This is the issue addressed by the court in **Weston Securities Corp. v. Aykanian.**[11]

In **Weston** the Court faced this issue in the context of whether an order to arbitrate is appealable. By a special provision in Section 16 of the FAA, orders **denying arbitration** are immediately appealable even though they are interlocutory orders. On the other hand, orders **granting arbitration** are generally not appealable because usually they are intermediate interlocutory orders. However, under case law, if the only issue before the court is arbitrability, then an order granting arbitration is a final order and an appeal can be taken.[12]

On the other hand, Section 19 of the Uniform Arbitration Act, the section dealing with appeals, is silent on the appealability of orders **granting arbitration.**[13] This silence has been held by the Massachusetts[14] and most other courts[15] to mean that orders granting arbitration are not immediately appealable.[16]

Weston Securities argued that Section 16 of the FAA preempted Section 19 of the Uniform Act. Therefore, the order to grant arbitration, which was in this case a final order, it argued was appealable. The Appellate Court disagreed. It held that Section 16 of the FAA did **not** preempt Section 19 of the Uniform Act.[17] It concluded that the **substantive** parts of the FAA are binding upon the state courts, but not the **procedural** provisions.

Citing **Felder v. Casey**,[18] the court first concluded that the states have the right to establish **procedural** rules governing litigation in their own courts.[19] It then held that these state rules should control in an arbitration context unless they "would undermine the goals and policies of the FAA."[20] Finally, the court found that making the granting of arbitration, even when a final order, non-appealable did not undermine the goals of the FAA.

There is ample support for the position that the procedural provisions of the FAA are not controlling in state court actions. In **Southland Corp. v. Keating**, the Court said:

> In holding that the [FAA] preempts a state law that withdraws the power to enforce arbitration agreements, **we do not hold that §§ 3 and 4** of the Arbitration Act apply to proceedings in state courts. Section 4, for example, provides that the Rules of Civil Procedure apply in proceedings to compel arbitration. **The Federal Rules do not apply in such state court proceedings.**[21]

From the **Weston** and **Keating** cases, we now know that Sections 3, 4, and 16 of the FAA do not preempt inconsistent state procedural provisions. Are there others, such as Sections 9 and 12 dealing with the time for filing confirmation or vacatur and the mode of service[22], or Section 6 providing that all proceeding under the FAA have to be instituted by the filing of a motion rather than the normal filing of a complaint, which also should not apply? An increasing number of recent state cases have also held other procedural provisions of the FAA not applicable in state actions.[23]

Members need to be aware that there are important reasons for selecting either a federal or state court to seek relief either in the form of compelling arbitration or confirming or vacating an award already granted. The rules are not necessarily the same. One forum may be better suited to the client's claim than another. A member must make a rational decision as to which forum is best for the client. Further, members need to consider whether other provisions of the FAA are binding in state court, and not blindly **assume** that they are.

II. Arbitrability, For the Court or For the Arbitrators?

The second issue visited in **Weston** is the continuing question of determining who should decide old Section 15[24] arbitrability issues. As is well documented, the federal courts of appeals are about evenly split on this issue.[25] However, I discern a trend among the more recent federal and state court cases to determine that these issues are for the arbitrators, abandoning the older federal position. **Weston** is one such case.[26]

The trend in itself, I think, is significant. It may cause some of the federal appeals courts to re-examine their original holdings in light of the increasing weigh of authority for sending such issues to the arbitrators.

The trend is also significant to the determine whether to present the issue to a state or federal court. If the federal courts in a member's jurisdiction have spoken and follow the older "for the court" rule, the member may want to test the issue in the local state courts. Many have not yet addressed the problem and may be more willing to follow the trend toward sending these issues to the arbitrators. The **Weston** court was.

Also remember that the state courts are not bound by the decisions of the federal District or Courts of Appeal in which the state is located. Nor are their decisions reviewable by any federal court, short of the Supreme Court. While the **Weston** court happened to adopt the First Circuit rule, it made clear that it had a choice in the matter and selected the "for the arbitrators" rule based upon the arguments for that position rather than the geographical fact that Massachusetts is located in the First Circuit.

Weston is also significant for another reason. While most, if not all, plaintiffs in **Weston** were subject to arbitration clauses in their brokerage agreement, the Court did not base its decision on these agreements. Instead, it emphasized that its holding rested **solely** upon the brokers membership in the NASD. It first pointed out that such membership carries with it a duty, independent of the

individual brokerage agreement, to arbitrate any dispute with a customer.[27] It found persuasive this independent duty to arbitrate imposed by the NASD, coupled with what it believed was the proper interpretation of the language of Old Rule 35.[28]

By using this approach the Court indicated that its job was not to determine the "mutual consent" of the parties (i.e. the broker and his customer) as would be the case under the brokerage agreement. Instead, it felt its job was to determine the purpose of the NASD Code in general and Section 35 in specific since these provisions controlled the relationship between the NASD and the broker, the customer being the third party beneficiary of this relationship. The court said: "[O]ur task is to determine the appropriate construction to be put on §35 of the NASD code, not to calculate the "manifestations of mutual assent of the parties."[29]

By taking this approach, the Court avoided[30] the problem that has caused many federal courts to reject Section 35 as controlling. The Supreme Court in **First Options of Chicago, Inc. v. Kaplan**, indicated that in the absence of a specific agreement to have arbitrability decided by the arbitrators there must be clear showing that the person opposing such arbitration "clearly agreed to have the arbitrators decide the question of arbitrability."[31] The courts that have rejected Section 35 in the context of the brokerage agreement arbitration provision have held that Section 35 does not show this clear agreement by the broker and his customer to arbitrate arbitrability.

From the stand point of the broker and the NASD, the **Weston** Court held that the manifest purpose of the NASD Arbitration Code reflected "that the interests of securities dealers are best served by eschewing litigation in favor of arbitration."[32] The court then concluded:

> The text of §35 points directly in favor of the arbitrator deciding arbitrability in the first instance. That section empowers the arbitrators to "interpret and determine the applicability of all provisions under this Code..." "Applicability has to do with "the quality or state of being applicable" Webster's Third New Int'l Dictionary 105 (1993). Thus, the arbitrator is empowered to determine whether the NASD Code--the arbitral process--is applicable to the facts before him. Under the NASD Code it is the arbitrator--not the court--who first determines whether the code can be applied to the claims asserted.[33]

Members faced with Section 15 issues may want to shift their reliance upon the traditional brokerage agreement to a reliance upon the member's independent obligation to arbitrate. As noted above, such reliance makes much stronger the argument that Section 35 should be controlling. Further, this analysis presented to a "for the court" court might be sufficient to persuade the court to reconsider its position.

FOOTNOTES:

[1] 1998 Mass. App. LEXIS 1352 (Dec. 30, 1998). The author argued this case on appeal. However, the ideas which persuaded the Court clearly were those briefed by my co-counsels Laura S. Nadolski and Sidney Gorovitz of the Massachusetts law firm of Dropkin, Perlman, Leavitt & Rubin.

[2] This Section is now NASD Code of Arbitration §10304.

[3] 9 U.S.C. §2. See e.g., Smith Barney, Inc. v. Bardolph, 1998 N.C. App. 1561 at *5 (Dec. 29, 1998), citing Porter Hayden Co. v. Century Indem. Co., 136 F.3d 380, 382 (4th Cir. 1998). "Section 2 [of the FAA] created a body of federal substantive law applicable in both state and federal courts...." Id., citing Glass v. Kidder Peabody & Co., 114 F.3d 446, 452 (4th Cir. 1997).

[4] See e.g., PaineWebber Inc. v. Elahi, 87 F.3d 589, 593 (1st Cir. 1996).

[5] Such agreement constitutes a new contract to arbitrate.

[6] Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Jr, Univ., 489 U.S. 477 (1989).

[7] Southland Corp. v. Keating, 465 U.S. 1 (1984).

[8] The only basis in most cases will be diversity of citizenship as the federal courts have held that the interpretation of a federal statute which supports the arbitrated claim does **not** trigger federal statutory question jurisdiction.

[9] Fed. R. Civ. Proc., Rule 81(a)(3). For example, 9 U.S.C. §6 indicates that all proceeding under the Act will be instituted by the filing of a motion rather than the normal filing of a complaint. Further, 9 U.S.C. §§ 9 and 12 outline special provisions controlling the time for filing such motions and how they are to be served.

[10] Moses H. Cone Mem. Hosp. v. Mercury Constr., 460 U.S. 1, 25 (1983). This concurrent jurisdiction is necessary in those cases where there is no independent basis for federal jurisdiction as in the case where both parties are citizens of the same state.

[11] 1998 Mass. App. LEXIS 1352 (Dec. 30, 1998).

[12] Weston at *5, n. 6, citing Apollo Computer, Inc. v. Berg, 886 F.2d 469, 471-472 (1st Cir. 1989) and Thomson McKinnon Sec. Inc. v. Salter, 873 F.2d 1397, 1399 (11th Cir. 1989).

[13] Sections 19(a)(1) and (2) specifically make orders denying arbitration or granting a stay to arbitration to be appealable as under federal law.

[14] Weston at *5, citing Coughlan Constr. Co. v. Town of Rockport, 23 Mass. App. 994, 995, 505 N.E.2d 203, 205 (1987); Old Rochester Regional Teacher's Club v. Old Rochester Regional Sch. Dist., 18 Mass. App. 117, 463 N.E.2d 581 (1984), rev. denied, 392 Mass. 1103, 465 N.E.2d 262.

[15] See e.g., Hodes v. Comprehensive Health Associates P.A., 9 Kan App.2d 36, 670 P.2d 76 (1983); J.M. Huber Corp. v. Main-Erbauer, Inc., 493 A.2d 1048 (Me. 1985); and Heffner v. Destiny, Inc., 321 S.C. 536, 471 S.E.2d 135 (1995). But see Grane v. Grane, 130 Ill. App.3d 332, 473 N.E.2d 1366 (1985).

[16] Of course, the issue of granting arbitration may be reviewed when an action is brought either to confirm or vacate the arbitration award after arbitration has taken place.

[17] It is interesting that the court did not address the question of whether the Uniform Arbitration Act or other statutory or common law was the appropriate body of law to look to once it was decided that the FAA did not pre-empt state law. The court **assumed** it was. Again, such assumption is not a foregone conclusion.

[18] 487 U.S. 131, 138 (1988).

[19] Weston at *8.

[20] Id., quoting Volt Inf. Sciences, Inc. v. Board of Trustees of Leland Stanford, Jr. Univ., 489 U.S. at 477-478 (1989).

[21] 465 U.S. 1, 16, n.10 (1984).

[22] See Manson v. Dain Bosworth Inc., 1998 WL 422192 (Minn. App. July 28, 1998).

[23] See. e.g., Siegel v. Prudential Ins. Co., 67 Cal App.4th 1270, 79 Cal. Rptr.2d 726 (1998), discussed elsewhere in this issue, holding that "manifest disregard of the law" standard for vacatur recognized under the FAA does not preempt a California statutory provision which does not recognize this basis; Manson v. Dain Bosworth Inc., 1998 WL 422191 (Minn. App. July 28, 1998), holding that Section 12 service of process requirements do not preempt state service requirements. These and other similar cases will be the subject of a future column.

[24] This Section is now NASD Code of Arbitration §10304.

[25] See e.g., Smith Barney Inc. v. Bardolph, 1998 N.C. App. LEXIS 1561 (Dec. 29, 1998), for a very recent discussion of the positions of the various federal circuits.

[26] Smith Barney Inc. v. Bardolph, 1998 N.C. App. LEXIS 1561 (Dec. 29, 1998) is another.

[27] Weston at *13, citing both Form U-4 and Section 12(a)

(now Section 10301) of the NASD Code of Arbitration.

[28] Now Section 10324.

[29] Weston at *14.

[30] See Weston *15-*17.

[31] 514 U.S. 938, 945-950 (1995).

[32] Weston at *15,

[33] Weston at *17. The Court went on to point out that the arbitrator's decision is reviewable under either FAA or the Uniform Arbitration Act. Weston at *17, n. 10. However, this review is severely restricted in scope under Section 10 of the FAA and Section 12 of the Uniform Arbitration Act as are all reviews of arbitrator decisions.

NASD Lists of Arbitrators' Closed Cases Exclude Cases Resolved by Granting "Dismissal Motions"

Submitted by: Scot Bernstein, Esq.
Sacramento, California

Many attorneys who represent public customers may believe that the list of closed cases that accompanies an NASD arbitrator biography is exhaustive. That turns out not to be the case.

I have in my possession several examples of arbitration panel awards (titled "orders") in which arbitrators granted securities industry respondents' "dismissal motions." Those awards came into my possession as exhibits to dismissal motions filed by respondents in cases in which I represented public customers. The respondents attached the exhibits to their "motions" in an unsuccessful attempt to convince a panel that, because another panel had deprived a customer of his or her right to a hearing, the instant panel should do so as well.

I contend that "dismissal motions" are impermissible under the NASD Code of Arbitration Procedure and under state and federal arbitration law. Whatever one may think about the permissibility of such motions, however, there is no justification for excluding awards or "orders" granting such motions from the list of closed cases that accompanies an arbitrator's biography.

An attorney who is analyzing an arbitrator's award history should not be forced to do so in an environment in which the most anti-customer of the awards are being hidden from view. By hiding those awards, the NASD may be violating its duty to make awards public. Further, it is depriving parties of information in a way that works disproportionately (and perhaps exclusively) to the disadvantage of public customers who are making claims against the NASD's members.

PIABA members need to be aware of this problem. Making our views regarding this matter known to the NASD would be desirable as well. Finally, I would propose that copies of all such dispositive orders or awards that come into our possession be sent to PIABA, where a complete set can be maintained. If the NASD will not provide copies of those documents, we should do so ourselves.

Applicability of Statutes of Limitation in AAA Arbitration

Submitted by: Kenneth R. Jones, Jr., Esq.
Nashville, TN

Rule 42(c) of the AAA Securities Arbitration Rules states that "[t]he arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties...." Technical procedural defenses that ignore the merits of a claimant's claim, such as statute of limitations defenses, have no place in arbitration. Since a AAA arbitration award is not required to state the reasons for a panel's decision, arbitrators may deny relief for reasons that only they know,

but only so long as none of the recognized grounds for vacatur are present. The timeliness of filing a claim may justify denying relief if a claimant has so unreasonably delayed in asserting the claim that he has somehow prejudiced the ability of the respondent to assert a defense or led the respondent to detrimentally rely on the claimant's failure to take action, *i.e.* if the facts are similar to the common law requirements for laches. It is not appropriate, however, to subject an arbitration claim to the same rigorous statutes of limitation requirements that would apply to a court action.

The courts have recognized that statute of limitations defenses need not be allowed in arbitration. Skidmore, Owings and Merrill v. Connecticut General Life Insurance Co., 25 Conn. Supp. 76, 197 A.2d 83, 86-87 (1963), holds that a Connecticut statute of limitations applicable to negligence "actions," could not be applied to a claim made in arbitration involving an architect's alleged negligent building design, describing its result as follows:

> An arbitration proceeding is not the bringing of an action within the meaning of the phrase as used in the Statute of Limitations cited above. .... "In a general sense the word 'action' means the lawful demand of one's right in a court of justice ...".
>
> Arbitration is not a common-law action, and the institution of arbitration proceedings is not the bringing of an action under any of our statutes of limitation.

(citations omitted)

Skidmore goes on to explain that "[t]he parties to an arbitration set up their own tribunal and rules of procedure." 197 A.2d at 88.

Har-Mar, Inc. v. Thorsen and Thorshov, Inc., 300 Minn. 149, 218 N.W.2d 751, 755 (1974), follows Skidmore to reach the same result under Minnesota law, holding as follows:

> Based on the special nature of arbitration proceedings and both the statutory and common-law meaning of the term "action," we feel compelled to hold that [the statute of limitations] was not intended to bar arbitration of [the claimant's claim] solely because such claim would be barred if asserted in an action in court.

Har-Mar notes, however, that statutes of limitations may be made expressly applicable to arbitration claims, citing New York authority. Id.

The same result was reached in Lewiston Firefighters Assoc. v. City of Lewiston, 354 A.2d 154, 167 (Me. 1976), where the court held as follows:

> We do not agree with the Justice's conclusion that the six-year statute of limitations must be applied to the Union's claim to its right to back pay under the contractual parity pay provisions. Arbitration is not an action at law and the statute is not, therefore, an automatic bar to the Firefighters' recovery.

Son Shipping Co. v. De Fosse & Tanghe, 199 F.2d 687, 689 (2d Cir. 1952), explained its similar holding as follows:

> It is true that the demand for arbitration was not made within the one year limitation upon suits, contained in § 1303(6) of the [Carriage of Goods by Sea Act], but there is, nevertheless, no time bar because arbitration is not within the term "suit" as used in that statute. Instead, it is the performance of a contract providing for the resolution of controversy without suit. We are aware that the time within which arbitration may be demanded may be of great importance to the parties who have by contract agreed to have their differences so determined, especially to a shipowner. But unless they see fit to condition their agreement by an express time limitation, a demand within a reasonable time, as here, is not barred.

The statute of limitations applicable to federal securities fraud claims, refers to the filing of an "action." Under the sound reasoning of the above-discussed authorities, it thus cannot bar arbitration claims, regardless of the timeliness of their filing.

NASD Arbitrators Are Not Bound To Apply Statutes of Limitation

Submitted by: Martin H. Aussenberg, Esq.
Memphis, TN

Arbitrators are not bound to the application of statutory limitations periods in a matter where fundamental fairness is the purpose of the proceeding. Indeed, there is some question about whether statutes of limitation apply at all to arbitration, since all statutes of limitations apply to "actions" which are generally understood (if not explicitly defined) as lawsuits. Indeed, under Tennessee law, the general provisions applicable to all statutes of limitations explicitly state:

> The word "action" in this title [statutes of limitation] includes motions, garnishments, petitions, and other legal proceedings in judicial tribunals for the redress of civil injuries.(emphasis supplied)

T.C.A. §28-1-101.[1] And, while there may be the perception that to argue the inapplicability of statutes of limitation is wanting to have it "both ways," there is some compelling logic in such a position.[2]

As most arbitrators are aware, arbitration was the forum of choice selected by the securities industry years ago, and strenuously defended (and eventually successfully established) as the exclusive forum for the resolution of disputes both within the industry, but more importantly between customers and members of the industry. The reasonable assumption is that when that choice (more appropriately, imposition) was made (and eventually enforced by the courts), it was with the knowledge that statutes of limitation did not (and would not) apply to arbitration. Thus, it is suggested, the industry made a trade-off in the process of choosing arbitration, namely that in exchange for quicker, more cost-efficient resolution of disputes, they would lose the benefit of excluding older claims. Indeed, since arbitrations in securities industry forums are, arguably, another form of regulating and policing the securities industry, a salutary purpose is served by allowing claims to be brought that might be considered stale in a judicial forum. Perhaps this is the reason that the eligibility rule is as chronologically permissive as it is.

Since the Securities Industry has required its public customers to arbitrate their disputes, it is inherently unfair to allow it to import technical legalisms that do not belong in arbitration. To allow the Securities Industry Respondent to do so, in essence, allows it to have two bites at the apple: one, depriving the public customer of a judicial forum, and the other, picking the judicial standards it wished to have applied, to the extent it benefits them, and deprives the public customer. And, in the process, the Securities Industry Respondent not only breaches its agreement with the public customer to abide by arbitration standards, in the process it tilts this regulatory/enforcement forum improperly in favor of the very industry being regulated.

FOOTNOTES:

[1] Admittedly, if statutes of limitation don't apply to claims in arbitration, an argument can be made that neither do the substantive statutes that claimants typically rely on to provide the right to bring an "action" in arbitration. This reverts to the arbitrators' equitable jurisdiction, and their power to make determinations not so much because they are empowered to do so by specific statutory causes of action, but in their capacity as equitable arbiters of fact and law.

[2] The inapplicability of statutes of limitation to arbitration, at least under Tennessee law thus dovetails into the language in the NASD's eligibility rule (Rule 10304) about not extending "applicable statutes of limitations." That is, since the statutes of limitation are not "applicable," to begin with the six year eligibility rule does not extend them.

NASD Policy of Granting Certain Casual Challenges by Security Industry Respondents

Submitted by: Scot Bernstein, Esq.
Sacramento, California

An attorney representing a public customer recently sent me a copy of a memorandum from an NASD staff attorney. The memorandum was in response to the attorney's inquiries regarding why a securities industry respondent's causal challenge to an arbitrator was granted. The memorandum states in relevant part as follows:

> "Please be advised that the NASD granted Respondents' causal challenge to arbitrator [name] due to the fact that Mr. [name] had previously sat on an arbitration which involved the same respondent firm, the same investments and contained similar allegations in the statement of claim as the above-referenced matter. As a general policy, the NASD in an abundance of caution and in order to insure that a panel member will not prejudge or predetermine a case due to any conclusions drawn from a previous, unrelated matter, will grant a causal challenge made on these grounds."

This policy and its explanation sound logical enough in theory. In practice, however, the impact of the policy will be asymmetrical, working to the disadvantage of public customers. The problem arises from the fact that arbitration awards virtually never identify the securities at issue. Thus, if an arbitrator sat on a case involving "the same respondent firm" and "the same investments," only the respondent firm is likely to know about it. The public customer's counsel is unlikely to know about it except through luck and/or effective communications with other practitioners.

Of course, a respondent firm will not exercise a causal challenge if it won the prior case. Thus, the NASD's policy is likely to have the effect of selectively removing from arbitration panels a particular class of arbitrators who might resolve a case in favor of a public customer, and of retaining a class of arbitrators who would resolve that case adversely.

Unless the NASD can eliminate this asymmetry, the policy should be abandoned. I encourage PIABA members to make their views regarding this matter known to the NASD.

Representing Multiple Claimants at Mediation

Submitted by: E. Scott Douglas, Esq.
Long Beach, CA

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Envision a situation in which you have been selected to represent a group of claimants in a securities investment dispute. Each member of the group had purchased a particular stock after attending a seminar put on by a local investment advisor/CPA team. Part of your pitch to the group was that your good relationship with the broker-dealer and its counsel leads you to believe that Respondents will agree to an early mediation. This is attractive to your new clients because many of them do not have a stomach for protracted litigation, and all of them would like to get whatever amount of compensation is rightfully coming to them and get on with their lives.

All of the claimants had executed standard customer agreements and are therefore required to arbitrate their claims. All had invested in the same stock touted by the same broker, which had lost a substantial portion of its value in a short period of time. The broker-dealer made a market in the particular stock, and your preliminary investigation indicates there might be a valid claim for negligence against both the broker and the firm.

After you sign up the individual claimants, you contact the broker-dealer's counsel. He checks with his people. They will agree to an early mediation. In fact, he even encourages you to hold off filing the Statement of Claim until after the mediation. You smell blood, speculating that he wants to avoid

regulatory inquiry. Neither statutes of limitation nor eligibility deadlines are an issue, so you do away with the tolling agreement. You start to make arrangements for the mediation.

Setting the Stage for Mediation

You have now agreed on a mediator, and have booked two consecutive days for the mediation. Your damage analysis is complete, with separate calculations for each of your clients. One of the main issues is suitability, and your expert has recommended that you prepare a suitability summary for each individual. This turns out to be a very useful tool, because you immediately realize that their suitability profiles are quite different. Some are sophisticated investors, others are novices. A few are wealthy and have substantial assets outside the account in question. Within the account itself, some are well diversified, others have serious over-concentration claims.

Representing multiple claimants has an obvious advantage in cost saving and sharing of information. However, a number of other considerations should be considered. Here are some thoughts on issues to consider, including tips from some leading securities practitioners:

Prepare client fee agreements which are tailored to the multi-party case. A veteran of a number of successful multi-claimant mediations, Michael Donahue of Donahue, Mesereau & Leids finds that a detailed retention agreement is crucial to resolving multi-claimant cases. "You have concerns in these types of matters not found in single-claimant actions," says Donahue. "For instance, we have the clients expressly waive the attorney-client privilege as to information we may wish to obtain or share among others in the group. Second, we insist on an agreement up front as to how any lump-sum settlement or award will be split up. If you don't take care of this at the outset, what was an easy issue to resolve in the abstract becomes a very difficult issue when actual dollars are at stake."

Be prepared to settle claims individually, rather than as a group. A lump sum settlement may not always be appropriate or forthcoming from the respondents. Significantly, unless your clients have agreed in advance to a formula for allocation, serious conflict of interest issues arise. According to claimants' counsel William F. Davis, splitting up money can raise nettlesome problems and conflicts, particularly when there is not enough to go around. "With firms that are not financially solid, this can be a tremendous problem. Settling early may get you money from a firm that has gone out of business by the time you would have received an arbitration award. The unfortunate reality is that there may not be enough money to get what your client's deserve, and you may have conflicts in making recommendations with respect to clients in differing circumstances and with respect to allocations."

Prepare a mediation brief with the intent it be provided to the opposition along with your damage analyses well in advance of the mediation hearing. A detailed Statement of Claim may do. The objective: They must know you are to be taken seriously. It is important to both your clients and the opposition that you appear well prepared and serious about your case. Whether or not you have filed a Statement of Claim, this is your opportunity to demonstrate that you have conducted an initial investigation and will be a formidable opponent if the case doesn't settle immediately. In addition, mutual exchange of P & Ls often allows the parties to reach agreement on the numbers, saving valuable mediation time. Claimants' counsel Philip Aidikoff advises to do your homework at the outset. "We prepare a Statement of Claim in every case, along with a P & L. We have the clients review it for accuracy. I'll then send the Statement of Claim to my opposition before filing it, to see if there is any interest in discussing settlement before we even incur a filing fee. Sometimes it works, sometimes it doesn't."

Work with, rather than against, opposing counsel. If you are to settle the multi-claimant case in mediation, you need your opponent to work with you, rather than against you. Mediation is one place where the old saying, "You get more ants with honey than vinegar" generally holds true. The logistics of a multi-party

mediation require cooperation and a degree of trust. One method is to have everyone together initially for the opening joint session and initial caucus. Then, depending on the agreed protocol, keep only a few claimants at the mediation and allow the rest to be on phone standby. Enlist the mediator's assistance in making the best assessment at the mediation of how to most effectively structure the conference.

Agree to a voluntary exchange of documents. Both sides, if they are truly motivated to resolve their differences early, should be willing to make a reasonable exchange of documents whose production would be required in any event. Try to anticipate issues and avoid impediments caused by the lack of necessary information. Neither side wants the mediation to stall because of the perceived need for additional discovery. Because of the potential volume of discovery in multi-party cases, cooperation is again the key to short-cutting the normal process. Everen Securities' in-house counsel Bruce Lewitas says that he often agrees to an informal document production as a prelude to early mediation. "It saves us time and money in the long run. We have no motive to run the other side around on documents to which they are clearly entitled, and which they would get anyway. In most cases, if the mediation is to succeed, everyone needs to have a comfort level that they have enough information to resolve the claim.

Avoid excessive posturing before the mediation begins. Accept on faith that the opposition is here to do business. Otherwise, they probably would not have agreed to pay half of the mediator's fee. Attempts to create "floors" or "ceilings" for settlement negotiations in advance of mediation generally do more harm than good and may kill the mediation altogether.

Prepare your clients. Not only should you fully explain the mediation process to them, you must also prepare them for their respective roles at the hearing. If you mean for them to be seen and not heard, make this clear to them, and explain that at least in joint session, you will do the talking. If you anticipate that the mediator will want to ask questions of your clients in the individual caucus sessions, prepare them for the issues they may be asked to address. Assess your strongest and weakest witnesses and plan your strategy accordingly.

Avoid creating unreasonable expectations of recovery. Your clients must understand that one of the important aspects of early mediation is compromise. According to attorney Mark R. Wietstock of Rogers, Sheffield & Herman, a firm which frequently represents claimants in securities litigation, there is a *quid pro quo* for the cost savings and sharing of resources when representing a group: That is, the group must often sacrifice something individually for the whole. This can raise problems, even where the group is comprised of family or close friends. In small damage cases, the consolidated claim may be the only practical way to seek redress, requiring some give and take on the part of the individuals. The clients must understand these principles going in to mediation if the process is to succeed.

Ascertain your clients' needs as well as your own. Remember that this may be the individuals' only chance to tell their story to a neutral party if the case settles at mediation. Some may need to vent. Others may approach this as purely a business decision. Knowing one from the other in advance of the mediation may be critical to achieving a settlement. If you have the client who needs badly to vent, have him do so in front of the mediator only, in individual caucus. Echoing a common concern, claimants' counsel Michael Friedman of Pasadena says a balance must be reached. "If the case doesn't settle, I don't want this to be their opportunity for free discovery." From your perspective, determine as best you can if client control may be an issue. If so, try to make sure those you perceive as potential problem clients attend the mediation in person. There is often no substitute for hearing a dose of reality from a mediator in order to bring the difficult client aboard.

Make sure your clients understand that each of their cases constitutes a separate claim for settlement purposes. Each person must

separately be prepared to decide at the mediation if the claim should be settled at the price offered. If certain individuals want to stick together for settlement purposes, that is their decision. Not yours.

Anticipate that by the very nature of their claims, certain individuals will present higher priority settlement figures than others. Be prepared for the fact that Respondents may attempt to pick off the strongest claimants, leaving the weaker claims to resolve later. This process may in and of itself lessen the value of the remaining claims. If you have elderly or physically ailing clients, both sides may choose to make those individuals a priority.

Foresee issues of confidentiality. Most broker-dealers routinely insist on confidentiality clauses in their settlement agreements. Consider that if all your clients don't settle, you may wish to have some of those who did settle testify as witnesses. Anticipate how this will play out and discuss the ramifications with your clients.

Rather than try to ascertain in advance the settlement value of each claim, instruct your clients that they should approach mediation with an open mind. Avoid the temptation to establish the dollar value of your clients' claims before getting to the mediation. Instead, participate with the mediator in the valuation and negotiation process. Once you and the mediator are convinced that the opponent has put forth their best and last offer, ***only then and not before*** should you and your clients decide whether to accept the figure or reject it and go forward. In this fashion, you take pressure off of yourself to evaluate individual and group claims, and let the mediator assist in placing the ultimate decision where it belongs: with each individual claimant.

[*E. Scott Douglas is a former partner of Keesal, Young & Logan in Long Beach, CA, who now serves as a full-time private mediator and arbitrator for the National Association of Securities Dealers, LA Superior Courts, US District Courts, and other organizations.*]

NASD Finally Takes Action on New York Choice of Law Arbitration Agreements

More than two years ago, PIABA sent correspondence to the SEC advising it that many securities firms were using New York choice of law clauses in arbitration agreements to argue that arbitrators, under New York law, lacked the authority to award attorney's fees and punitive damages. After the SEC referred the matter to the NASD, the NASD met with members of PIABA's board of directors and promised corrective action. Finally, two years later, the NASD has taken action against the firms. Both Bear Stearns and Merrill Lynch have submitted Letters of Acceptance, Waiver and Consent and accepted fines of $15,000 and $25,000, respectively, based on findings by the NASD that each asserted that New York choice of law provisions in customer agreements precluded an award of punitive damages or attorney's fees. The NASD proclaimed that such action by the firms violated I.M.-3110 (f)(4).

U.S. First Circuit Court of Appeals Overrules Rosenberg v. Merrill Lynch

The Federal Appeals Court in Boston reversed a lower court ruling in which the District Court had held that a former financial consultant for Merrill Lynch didn't have to arbitrate a sex discrimination claim because Rosenberg had contended that the securities industry's system for resolving arbitration disputes is inherently unfair. The First Circuit threw out the broad legal challenge that had been the basis of the lower court ruling--that the New York Stock Exchange arbitration system is unfair because it is dominated by the securities industry.

The appeals panel also rejected the lower court's

finding that congress meant to preclude private arbitration of sex and race discrimination claims in the work place when it passed amendments to Title VII of the Civil Rights Act in 1991 that specifically provide for public jury trials of such claims. The First Circuit thereby joined nine other Federal Courts that have found no such congressional intent in the 1991 amendments. Only one Federal Appeals Court, the 9th Circuit Court of Appeals in San Francisco, has interpreted the amendments as precluding arbitration.

The Court allowed Rosenberg's case to proceed to trial because, although Merrill Lynch's employment contract agreement made reference to arbitration, the company did not explain the rule to Rosenberg or provide her with a copy of it. The panel ruled that "had Merrill taken the modest effort to make relevant information regarding the arbitrability of employment disputes available to Rosenberg, it would have been able to compel Rosenberg to arbitration."

U.S. Fourth Circuit Court of Appeals Affirms Arbitration Award After Defendant Was Forced to Appear Pro Se at the Hearing

In Fogelman v. Testerman, 1998 U.S. App. LEXIS 29359, the U.S. Fourth Circuit Court of Appeals affirmed an arbitration award even though the Respondent appeared at the second scheduled hearing without counsel.

At an initial hearing in July of 1997 scheduled for two days, the Plaintiff presented evidence supporting his claim. However, the session concluded before the hearing was complete, necessitating a second session. The arbitration panel selected a second set of hearing dates for November 5-7 or November 12-14. Respondent's counsel asserted that he was not available for the first set of dates and scheduled for jury duty for the second set of dates, although the jury duty schedule could have been postponed.

The Respondent appeared at the second hearing without counsel and informed the panel that his counsel could not appear and requested a postponement. The panel refused to grant a postponement, noting that Testerman's counsel had suggested that the hearing be postponed for another six months. The hearing proceeded with Testerman as pro se and the panel entered a unanimous decision finding Testerman liable to the Claimant. Quoting Scott v. Prudential Securities, Inc., 141 F. 3d. 1007 (11th Cir. 1998), the Court stated "if there is any reasonable basis for the arbitrators' decision not to postpone a hearing, including a desire to expedite the proceedings even in the face of counsel's competing scheduling obligations, the Court should not intervene."

Texas State Court of Appeals Affirms Punitive Damage Award

In Prudential Securities, Inc. v. Shoemaker, 1998 WL 723815 (Tex. App.-Hous. (1 Dist.)), a Texas Appeals Court confirmed an award of punitive damages in the face of the Respondent's claim that the arbitrators exceeded their authority by deciding a matter not submitted for arbitration since the Claimant did not plead a claim for punitive damages.

The Statement of Claim alleged state and federal securities fraud, common law fraud, statutory fraud, violations of the Texas Deceptive Trade Practices Act, breach of contract, and sought actual damages of not less than $400,000.00. The claim further stated that the nature of violations of Texas and federal laws dictate that there should be an award of treble damages.

An NASD panel of arbitrators awarded the Claimants $126,300.00 in actual damages and $100,000.00 in punitive damages together with attorney's fees. The Appeals Court based its opinion on Texas law which allows that pleadings are to be liberally construed absent special exceptions. It also noted that once it has been determined

that the parties are obligated to submit the subject matter of a dispute to arbitration, procedural questions which grow out of the dispute and bear on its final disposition should be left to the arbitrators, quoting Wiley and Sons v. Livingston, 376 U.S. 543, 84 S. Ct. 909 (1964). The Court concluded that whether Prudential had proper notice of a punitive damage claim was a procedural issue for the arbitrators and that judicial review of arbitration awards is "very deferential". The Court further noted that the Claimants had plead a fraud claim under the Texas Deceptive Trade Practices Act which expressly provides for exemplary damages and that Black's Law Dictionary lists exemplary damages and punitive damages as synonyms and that Miley v. Oppenheimer, 637 F. 2d. 318, uses the terms exemplary and punitive interchangeably.

California Appeals Court Holds That Sections 10 and 12 of the U.S. Arbitration Act Do Not Impose on California a Manifest Disregard for the Law Standard of Review of the Merits of an Arbitration Award

In Siegel v. Prudential Insurance Co., 1998 Cal. App. LEXIS 961, Prudential appealed from a judgment denying their petition to vacate an arbitration award. Prudential argued that the manifest disregard for the law standard of review of the merits of an arbitration award must be applied even if the confirmation proceeding was in California state court because Sections 10 and 12 of the United States Arbitration Act would preempt California provisions which do not allow for the vacatur of an arbitration award under the manifest disregard for the law standard of review.

The Court noted that the manifest disregard of the law ground was a judicially created remedy which had as its genesis dictum in the decision of Wilkow v. Swann, 74 S. Ct. 182 (1953). Various civil courts of appeal then picked up on the dictum and articulated a rule that allowed for a limited right to review the merits of an arbitration award for a manifest disregard of the law.

The Court noted that it is established California law that under that state's arbitration act, the merits of an arbitration act are not subject to a judicial review. The Court further noted that the authority applying the manifest disregard of the law rule has arisen only in the context of litigation in Federal Courts and that Federal Courts have never addressed the issue of whether Sections 10 and 12 of the U.S.A.A. applies when the award is filed in state court.

The Court noted that Section 10 of the U.S.A.A., by its very terms, applies only in Federal Court. Section 10 (a) states in pertinent part: "in any of the following cases, the United States Court in and for the district in which the award was made may make an order vacating the award upon the application of any party of the arbitration." The Siegel Court concluded that this statutory language weighs materially against the application of Sections 10 and 12 to a forum other than the United States District Court of the district in which the award was made.

The Siegel Court further concluded that the California law limiting the review of arbitration awards did not run a foul of the underlying principals of the U.S.A.A. The Court noted that it is a general and unassailable position that states may establish the rules of procedure governing litigation in their own courts even when the controversy is governed by substitive federal law. The Court further noted that a state procedural rule must give way if it impedes the uniform application of the federal statute essential to effectuate its purpose. The state rule will be preempted, if it would stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.

In making its analysis, the Siegel Court noted that California's rule as to the inapplicability of the manifest disregard of the law standard of review shows no hostility toward arbitration and, in fact, the California rule furthers the use of arbitration by more

strictly limiting judicial review of the merits of an award. Lastly, the Court noted that the U.S.A.A. contains no express preemptive provision, nor does it reflect the Congressional intent to occupy the entire field of arbitration.

[*Ed. note: This case demonstrates that it may be preferable to confirm a favorable Claimant's arbitration award in state court rather than federal court. It also may give Claimant's counsel reason to name a non-diverse broker as Respondent to keep the confirmation of the arbitration award from being removed to federal court.*]

NASD "Streamlining" of the Arbitrator Pool

Submitted by: Scot Bernstein, Esq.
Sacramento, California

How the NASD selected arbitrators to fill arbitration panels traditionally has been the grand mystery of securities arbitration. The change to list selection will change that and will, for the most part, divest the NASD of its power to select arbitrators on a case-by-case basis. Instead, arbitrators generally will be drawn from the arbitrator pool using a system of rotation.

A non-attorney representative who has provided services to public customers with claims against securities industry participants recently sent me a copy of a letter that he received from the NASD. It turns out that the individual has served as an arbitrator on a number of occasions over the years. The NASD's letter states that, as a part of the NASD's conversion to list selection of arbitrators, the NASD has "completed a comprehensive review and evaluation of [its] arbitration roster." The letter goes on to state that the NASD has "streamlined the arbitration roster and determined which arbitrators will be on the new ... roster." Finally, the letter advises the addressee that his name will not be on the new roster. The letter provides no explanation for that decision.

I have requested that the NASD explain the basis for the ejection of this individual from the arbitrator roster. The NASD has refused to provide me with any information regarding what standards form the basis for its decisions about whom to include and whom to exclude as arbitrators.

My concern is that, having been deprived of the power to select arbitrators on a case-by-case basis, the NASD now will attempt to stack the entire arbitrator roster in favor of the industry. Even if the NASD's reasons for excluding arbitrators appear facially reasonable, they may lead to the same unacceptable result. For example, suppose the NASD's reason for ejecting or rejecting an arbitrator is that the arbitrator has been the subject of complaints by parties to arbitrations. Such a standard could tip the scales in favor of the securities industry if it turned out that public customers' representatives complain to PIABA and their fellow claimants' counsel, while securities industry participants complain to the NASD. It also could tip the scales if the NASD listens to its members' complaints but not to ours.

Thus, the NASD's "streamlining" of its arbitrator roster may have an adverse impact on public customers, even if the NASD is able to come up with an explanation that appears neutral at first glance.

This is an issue that deserves our attention. If anyone reading this announcement is aware of similar letters ejecting or rejecting arbitrators, please provide copies and all other relevant information to Robin Ringo by e-mail (PIABALAW@aol.com) or facsimile (405)360-2063.