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The PIABA Quarterly

The Newsletter of the Public Investors Arbitration Bar Association

March 1997 Volume 4 Number 1

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The Newsletter of the Public Investors Arbitration Bar Association

March, 1997

Volume 4 Number 1

Editor's Notes

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

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

Be reminded that you can take advantage of the Bulletin Board section of the *Quarterly* to request/share information with fellow PIABA members.

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

Letter From the President

Rosemary Schockman, SHOCKMAN & MCKEEGAN, P.C.
Scottsdale, Arizona

Dear Colleagues:

The PIABA Annual Meeting has been set for October 16-19, 1997 at the Hyatt at Gainey Ranch in Scottsdale, Arizona. While there was considerable interest in holding the meeting at the Broadmoor at Colorado Springs, the Board felt the possibility of bad weather for the November dates available at the Broadmoor made it a poor choice this year.

For the first time, a portion of the Annual Meeting will be open to members of the securities industry. The Board has weighed this issue on multiple occasions. We do not take lightly the tremendous

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camaraderie of the Annual Meeting. Part of the Annual Meeting will remain closed to the industry. We believe that opening some sessions to the industry will enhance the credibility of PIABA as a strong spokesperson for the public investor.

The Directors will be meeting in Chicago April 25-27 to work on plans for presentations at the Annual Meeting. If you have suggestions for topics or speakers for the Annual Meeting, please send them to me. Thanks to Phil Aidikoff, Mark Maddox, Cary Lapidus and others for suggestions already forwarded.

Brooke Geiger, our Administrative Assistant, has resigned to accept a new position. We wish Brooke well and thank her for the many contributions she has made to our organization. The new Administrative Assistant will be Robin Ringo. Robin comes to PIABA with many years of relevant experience. Hopefully, you will enjoy her enthusiasm as much as we have.

The PIABA office will be moved to Norman, Oklahoma. Joe Long has generously agreed to provide PIABA with office space. You may contact the PIABA office at:

1111 Wylie Road, #18
Norman, OK 73069
Phone: (405) 360-8776
E-mail: PIABA@mindspring.com

PIABA is monitoring the NASD rule changes. We will enlist your support, as needed, for comments. PIABA has provided comments to the SEC on the proposed amendments to record keeping rules for broker-dealers. Some of these rules should enhance investor protection and the availability of documents at local offices for discovery purposes. If the rules are enacted, we will provide you with details.

FROM THE PROFESSOR
Back To Basics, Part 1

by Joseph C. Long

This is the first of a two part Article, the second part of which will appear in the June issue of the Quarterly.

Many of us give little or no thought to two major questions when it comes to arbitration. Yes, we realize that we are arbitrating before the NASD, the NYSE, or the AAA. We understand as a result that the Arbitration Rules of that particular forum control. But we often don't think about under what law are we arbitrating and what law creates the substantive rights we are seeking to arbitrate. The answer to these questions often has a substantial part to play in the outcome of the arbitration.

In discussing these two major issues, it is important to distinguish between the substantive *right* to receive relief and the *power* of the arbitrators or the court to grant us such substantive relief. The state or federal law provide us, for the most part at least,[1] with the *right* to substantive relief. Thus, we sue to recover for violation of the federal or state securities acts, common law fraud, or breach of fiduciary duty. The substantive law in each case provides us with the right to relief and the general parameters of that relief. On the other hand, it is the substantive law of arbitration and the arbitration rules of the individual forums which determine whether the court or the arbitrators or both have the *authority or power* to provide us with that relief.

Certainly, most of us consider the rules of the arbitration forum when selecting whether to arbitrate with the NASD, the NYSE or other

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:
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Exchange, or AAA. Few of us, however, make a ·onscious decision as to what substantive law of arbitration will control. Further, if any thought is given to this issue, our assumption that *local state* law controls is, most often, incorrect.

It has long been held that an arbitration contract involving interstate commerce is governed by Federal arbitration act ("FAA")[2]. More recently, the Supreme Court has held that the FAA pre-empts any conflicting state law provision[3]. Since it is not well established that a securities dispute between a client and his broker or registered representative involves a matter within interstate commerce[4], at least initially, *all the arbitrations that we are engaged in are controlled by the FAA and not be the local arbitration act*[5]. Even the New York Court of Appeals in *Smith Barney, Harris, Upham & Co*[6], recognized in the absence of a choice of laws clause, the FAA would override conflicting state law. As will be seen below, this fact has a major impact up to the outcome of many arbitration issues.

However, as the last paragraph suggests, arbitration does not have to be controlled by the FAA. The Supreme Court, in *Volt Information Sciences, inc. V. Board of Trustees of Leland Stanford, Jr. University*[7], held that the parties are free to displace the FAA by making a conscious election to be bound by alternative state arbitration laws such as the New York arbitration statute or Uniform Arbitration Act. The key here is a *conscious* election to substitute the state substantive arbitration rules for the FAA. As the Supreme Court said in *First Options of Chicago v. Kaplan*[8] evidence of this election must be "clear and unmistakable".[9]

For a number of years, the brokers have been trying to replace both the FAA and local state arbitration acts with New York law by including a New York choice of laws clause. In *Mastrobuono v. Shearson Lehman Hutton, Inc.*,[10] the Court took most of the wind out of the brokers' sails by holding .hat the then typical choice of laws clause indicating that New York law would govern was not a conscious choice to apply local New York *arbitration as opposed to substantive law.*[11] The brokers' position was resurrected to a limited degree in *Smith Barney Harris Upham & Co., v. Luckie*[12]. It held that inclusion of the work "this contract and its enforcement" in the standard choice of laws clause would represent a conscious decision under *Volt* to apply New York arbitration law to the exclusion of the FAA or local state law where the arbitration was held.

However, other courts have question whether such language is the "clear and unmistakable" evidence of a conscious waiver required by *First Options* for *Volt* to apply. For example, in *Dean Witter Reynolds, Inc. v Espada*[13], the court held that an arbitration agreement providing: "The law of the State of New York will apply in all respects, including but not limited to determining of applicable statutes of limitation and available remedies" did not require the court to apply the New York state rule that courts rather than arbitrators will consider statute of limitations defenses. Further, the continued validity of choice of laws provisions similar to those found in both *Luckie* and *Espada* by the brokers is questionable under NASD Rule of Fair Practice 21(f)(4).[14]

Just because the brokers cannot include in pre-dispute arbitration clauses a provision requiring the application of New York arbitrative[15] does not mean that the client cannot elect to arbitrate under state arbitration law rather than the FAA. The standard NASD submission agreement contains a question asking under what law is the claim to be arbitrated. If the blank is not filled in, then the FAA will control in absence of any provision in the pre-dispute clause.[16] If you determine from the discussion below that your client would be better served by applying local state arbitration law rather than the FAA, then be sure to insert that the claim is to be arbitrated under the local arbitration act. The submission agreement becomes a binding arbitration agreement even though the broker does not sign.[17]

There are at least four major areas: (1) punitive damages; (2) statute of limitations; (3) attorneys' fees; and (4) pre- and post-judgment interest where the selection of whether to arbitrate under the FAA or state law can have a substantial impact upon the outcome of the arbitration. The first two of these areas are discussed below. Discussion of the latter two will be reserved until the June issue of the *Quarterly*.

Let us now examine some of the places that a federal or state law election will make a difference.

Punitive Damages

The *right* to receive punitive damages in securities arbitration cases arises from two difference sources. It has long been recognized that punitive damages are *not* recoverable under the federal securities acts.[18] However, this issue is still open under the state securities acts as they do not contain the language usually relied upon in the federal acts to prevent punitive damage awards. State common law fraud and, to a lesser degree, state violations of fiduciary duty, have been held to support such awards. Courts have long allowed the awarding of punitive damages under state pendent claims joined with actions under the federal securities acts.[19]

In arbitration, there may be a second basis for such awards completely independent of state or federal law. Arbitration proceedings are in the nature of equitable actions where the arbitrators are basically free to make whatever award they deem appropriate as long as it is not in direct disregard of the law.[20] The arbitration forums have generally acknowledged that the award of punitive damages by the arbitrators is appropriate. Thus, it can be argued that such awards may be made without authorization under state law and are not subject to the procedural findings or monetary caps imposed by state law.

This issue of the *power* of the arbitrators to award punitive damages is more complicated. While most state courts have not addressed the issue,[21] New York[22] followed by a handful of states[23] have long held on public policy grounds that arbitrators cannot award punitive damages.

Federal law under the FAA is entirely different as a result in *Mastrobuono*.[24] There are four important holdings in *Mastrobuono*. First, the Court held that under the FAA, the arbitrators could award punitive damages *if the parties agreed*. Second, it recognized that the "all disputes" language in the standard arbitration clause showed sufficient agreement by the parties to allow the arbitrators to award such damages.[25] Third, the Court held that the FAA would pre-empt any state law provision to the contrary *unless there is a clear state law arbitration selection* as authorized by the *Volt* case.[26] Finally, it held that the standard New York choice of laws clause was not a conscious waiver of the FAA in favor of the New York state arbitration law prohibition on the award of such damages by arbitrators.

As a result, a claimant can avoid either a New York choice of law imposed New York, or local state law, restriction on punitive damages by the simple election to arbitrate under the FAA. To the extent that the New York choice of laws provisions does not have a clear election of New York arbitration law[27], under *Mastrobuono*, it is not controlling. Likewise, to the extent that the punitive damages restriction is imposed by local state law, election to be governed by the FAA will pre-empt this inconsistent state law provision.

This result should be reached whether the case is heard by either the federal or state courts. The state courts are bound to apply the FAA to the exclusion of state law, if the arbitration contract falls within the terms of the FAA.[28] However, it is always a sound practice to remind the state court that its decisions are controlled by the FAA and not state arbitration rules, State courts, like ourselves, often forget that the FAA rather than state law is controlling.

Statute of Limitations

A similar analysis applies in the case of statute of limitations. New York state law requires the court rather than the arbitrators to determine whether a particular cause of action is barred by the statute of limitations.[29] Federal law under the FAA indicates such decisions are to be made by the arbitrators, rather than the courts.[30] Recently, in *Prudential Sec. Inc. v. Laurita*,[31] the Southern District of New York followed by the lead of the New York Appellate Division in *Hamershlag v. Oestrich*[32] and acknowledged that the FAA will control over the New York state provision. Both courts correctly interpreted *Smith Barney Harris*

Upham & Co. v. Luckie[33], as holding that New York rovision will supersede the FAA only when there is a choice of law clause which specifically incorporating New York arbitration law.[34] Again by specifically stating that the arbitration is to be under the FAA the client can avoid the statute of limitations issue going to the court.

ENDNOTES

[1] The one exception to this rule may be violations of the Rules of the various self-regulator bodies. It is clear that in a court action that a violation of the NASD Rule of Fair Practice do not give rise to a cause of action. Such rules may establish the appropriate standard of conduct to measure whether the defendant has been guilty of common law fraud, negligence, or securities fraud. An argument can be made that in arbitration relief can be granted for direct violation of the NASD Rules of Fair Practice.

[2] 9 U.S.C. § 2 (1988). *Bernhardt v. Polygraphic Co.*, 350 U.S. 198 (1956); *Ex Parte Costa and Head (Atrium), Ltd.*, 486 So.2d 1272, 1275 (Ala. 1986).

[3] *See, e.g., Southland v. Keating*, 465 U.S. 1 (1964).

[4] *See e.g., Wilkinson v. Dean Witter Reynolds, Inc.*, 1997 Okla. Lexis 21 (Mar. 4, 1997).

[5] Usually the Uniform Arbitration Act, *see, e.g.*, 15 Okla. Stat. §§ 701-713.

[6] 85 N.Y.2d 193, 202, 623 N.Y.S.2d 800,_____, 647 N.E.2d 1308,_____(1995). The court said:
"Undeniably, the absence of an explicit choice of law provision, governing Federal law would have precluded the courts in the appeal before us from addressing the Statute of Limitations issue . . . or from issuing stays under our arbitration act." See also Dean Witter Reynolds, Inc v. Espada, 1997 WL 117716 (D.P.R. Feb. 22, 1997).

[7] 489 U.S. 468 (1989).

[8] 514 U.S._____,____,115 S.Ct. 1920, 1925 (1995).

[9] *Dean Witter Reynolds, Inc. v. Espada*, 1997 WL 117716 (D.P.R. Feb. 22, 1997).

[10] 514 U.S. 265 (1995).

[11] As to the ability of the brokers to replace local law with New York law as to substantive causes of action, see From the Professor in the December 1996 issue of the Quarterly. There has been a recent development in that area in *Rogers v. Lloyd's of London*, 1997 U.S. App. LEXIS 3889 (9th Cir. March 6, 1997), discussed elsewhere in this issue. *Rogers* held that a substantive choice of laws clause could not stand in the face of a specific non-waiver provision such as found in both the state and federal securities acts.

[12] 85 N.Y.2d 193, 623 N.Y.S.2d 800, 647 N.E.2d 1308 (1995).

[13] 1997 WL 117716 (D.P.R. Feb. 22, 1997).

[14] This Section makes it an unfair practice by a broker to include in an arbitration clause which includes "any condition which limits or contradicts the rules of any self-regulatory organization or limits the ability of a party to file any claim in arbitration or limits the ability of the arbitrators to make any award." When this rule was adopted, the SEC made clear that it was intended to prevent brokers from using choice of law provisions to prohibit the award of punitive damages and attorneys' fees. Items that can not be arbitrated under the New York statute. *Mastrobuono* discussed this Rule, but did not decide its application because the case under review arose before the adoption of the Rule.

[15] Whether, under NASD Rule 21(f) (4), the brokers could include a clause requiring the application of the state arbitration law of the state in which the client lived or entered into the transactions in question rather than the FAA is a much closer question. This would be especially true where the language of the clause made clear that a conscious choice of state arbitration law was being made.

[16] Good practice would suggest that this blank

should always be filled in indicating that the case is to be governed by the FAA rather than state law unless a conscious decision is made upon the discussion below that the state law is more favorable. There are two reasons for this. First, where there is no choice of laws clause, this makes clear the FAA will apply. Second, if there is a choice of laws clause, the client can argue that the submission agreement is a new arbitration contract which supersedes the predispute agreement. The new selection in the arbitration submission, therefore, supersedes the old selection in the predispute agreement.

[17] Under the NASD Rules as a condition to membership, the member must arbitrate all customer claims. See NASD Arbitration Rule 12(a) indicating that arbitration may be had on the basis of a signed arbitration agreement or upon demand of the customer. This provision should be kept in mind when it appears that your client has not signed an arbitration agreement, and you wish to arbitrate rather than litigate.

[18] *See, e.g., Petrites v. J.C. Bradford & Co.*, 646 F.2d 1033 (5th Cir. 1981).

[19] Id.

[20] For example, it is a manifest disregard of the law or arbitrary and capricious conduct for the arbitrators to find a violation of the state securities act and then not to award recovery in accordance with the statutory formula provided therein. *Skurnick v. Ainsworth*, 591 So.2d 904 (Fla. 1991). Of course, if there are several causes of action, the claimant is entitled to recover the largest recovery available under any of the various causes. Further, it is possible to recover compensatory damages under one statute, punitive damages under another, and attorneys' fees, interest, and costs under a third. *See Bateman v. Petro Atlas Co.*, [1971-1978 Transfer Binder] Blue Sky L. Rep. (CCH) ¶ 71,463 (S.D. Tex. 1977).

[21] *See* Annot., Arbitrator's Power to Award Punitive Damages, 83 A.L.R.3d 1037 (1996).

[22] *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 554, 386 N.Y.S.2d 831, 353 N.E.2d 793 (1976).

[23] Annot., Arbitrator's Power to Award Punitive Damages, 83 A.L.R.3d 1037 (1996).

[24] *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995).

[25] As an alternative position, it can be argued that agreement to arbitrate under the NASD rules supplies the necessary agreement because the NASD rules as interpreted contemplate the award of such punitive damages.

[26] *Prudential Sec. Inc. v. Laurita*, 1997 U.S. Dist. LEXIS 2654 (S.D.N.Y Mar 11, 1997), where the court said of *Mastrobuono* and other recent Supreme Court cases:

> This string of recent cases reaffirms the principle that courts must enforce the terms of agreements to arbitrate -- including choice-of-law provisions -- even if those terms limit or bar claims which would otherwise be available under federal law.
>
> Id. At *11.

[27] *See Prudential Sec. Inc. v. Laurita*, 1997 U.S. Dist. LEXIS 2654 (S.D.N.Y Mar 11, 1997), quoted in the last note.

[28] *Southland Corp. v. Keating*, 465 U.S. 1 (1984); *Smith Barney Harris Upham & Co. v. Luckie*, 85 N.Y.2d 193, 623 N.Y.S.2d 800, 647 N.E.2d 1308 (1995), *quoted in* note 6 supra.

[29] *Smith Barney Harris Upham & Co. v. Luckie*, 85 N.Y.2d 193, 623 N.Y.S.2d 800, 647 N.E.2d 1308 (1995).

[30] *See, e.g., PaineWebber Inc. v. Elahi*, 87 F.3d 589 (1st Cir. 1996); *PaineWebber, Inc. v. Bybyk*, 81 F.3d 1193 (2d Cir. 1996); *Shearson Lehman Hutton v. Wagoner*, 944 F.2d 144 (2d Cir. 1991); *Prudential Sec. Inc. v. Laurita*, 1997 U.S. Dist. LEXIS 2654 (S.D.N.Y. March 11, 1997). This conclusion is based upon the idea that statute of limitation issues are not issues of "arbitrability".

First Options of Chicago v. Kaplan, 514 U.S. ,
, 115 S.Ct. 1920, 1924-1925 (1995).

[31] 1997 U.S. Dist. LEXIS 2654 (S.D.N.Y. March 11, 1997). *See also Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Shaddock*, 822 F. Supp. 125 (S.D.N.Y. 1993). *But see PaineWebber, Inc. v. Richardson*, 1995 WL 236722 (S.D.N.Y. Apr. 21, 1995).

[32] 651 N.Y.S.2d 489 (A.D. 1996).

[33] 85 N.Y.2d 193, 623 N.Y.S.2d 800, 647 N.E.2d 1308 (1995).

[34] The *Luckie* court itself recognized this result in the absence of a choice of laws clause. *See* note 6 *supra*.

REPORT FROM NEW YORK

Seth Lipner, DEUTSCH & LIPNER, Garden City, NY

As we indicated last time, things have quieted down in the New York courts - even Larry Fenster seems to have surrendered on punitive damages. We are still awaiting definitive word on how NY will view eligibility cases without an explicit New York choice of law clause in the agreement.

The Appellate Division, First Department continues to state that unless there is a New York choice-of-law with the "and its enforcement" language, "all timeliness are for the arbitrators." The "all timeliness questions" language is sufficiently ambiguous that Judge Solomon is (as best we can tell) sticking to the 'court decides' approach. There are appeals pending that should clarify it, but . . . . One is more than a year sub judice.

The whole thing led to an interesting fiasco last month. The First Department issued another two-line "all timeliness - to the arbitrators" decision. It cited Goldberg v. Parker, which was their first decision on the subject. When I read the decision, I noted that, after the citation, the court wrote "permission to appeal granted sub nom. Goldberg v. Harwood. " I was stunned; the Court of Appeals was taking up the issue? That would be strange, since I speak to regularly to Mrs. Parker's attorneys (Larry Steckman, Dave Robbins and Joe Keenan), and they hadn't said anything.

I called Steckman. "Who is Harwood?" I asked. "Good question," he answered, "I don't know." He had called Goldberg's attorney. He had never heard of Harwood either. Their arbitration was going forward. What's going on?

I was curious. I called the Court of Appeals. The clerk was very nice. I asked her to look in the computer and tell me who represents Harwood. She said he was pro se. Uh oh! Then she said there had been a decision. And he lost. Oh no!!! She had a cite. I looked it up. I couldn't stop laughing. It was a different Goldberg; he was a surveyor. Harwood was his partner. The partnership was breaking up, and they were arguing about who was liable under the lease. The case had nothing to do with arbitration, nothing to do with the eligibility rule. The Appellate Division's cross-reference was an error.

I called Judge Solomon. She saw it too. She also wanted to know who Harwood was. I told her. She seemed upset that the Appellate Division had made an error. I said, well, its just a wrong cross-reference. She said "not that error, they are wrong on who decides eligibility. They keep citing Luckie, but that dealt with limitations." My response: "Did you ever think you're wrong? I've been trying tell you that for years."

* * *

The only significant decision to note was our victory in Kidder Peabody v. Sanders. The Appellate Division agreed with Justice Solomon that the AMEX Window doesn't have a trap door - the AMEX's eligibility rule. The Court ruled that the plain language of the Window excludes application of the AMEX's arbitration rules. Kidder had argued that the Window only excepts the AMEX's arbitration "procedures", and that the eligibility rule is "a substantive limit on arbitrability." The Court rejected the argument as having "no merit". Kidder Peabody, undaunted, has sought leave to appeal to the Court of Appeals.

Proposed Legislation of Interest to PIABA Members

Contributed by: Diane A. Nygaard
The Nygaard Law Firm, Overland Park, Kansas

H.R. 983 and S. 63 intorduced by Senator Feingold (D-Wisconsin) in the Senate and Rep. Edward Markey (D-Massachusetts) in the House:

These bills would "amend certain Federal civil rights statutes to prevent the involuntary application of arbitration to claims that arise from unlawful employment discrimination based on race, color, religion, sex, national origin, age or disabilities."

New York U.S. District Court Affirms Timeliness Questions Are Arbitrable

In Prudential Securities v. Laurita, 1997 WL 109438 (S.D.N.Y.), the District Court affirmed in Second Circuits' Wagoner decision (944 F2d 114 (2d Cir. 1991)) holding that all limitations issues -- whether stemming from the arbitration agreement, arbitration association rule or state statute-- should be addressed by the arbitrators.

The Laurita court examined the issue in light of Luckie (623 N.Y.S. 2d 800) and the U.S. Supreme Court's holding in Volt Information Services (109 S.Ct. 1248) but found that the contract provisions in the instant case differed from Luckie in that the customer agreement did not contain the language "and its enforcement" as was found in Luckie.

The Laurita court found that, absent an express agreement between the parties that New York arbitration law would apply, that choice of law provision applied only substantive law.

Lastly, the court rejected Prudential's claim that, based on the New York Choice of Law provision in the arbitration agreement, punitive damages are not available.

Florida Appeals Court Opens The AMEX Window The AMEX Window -- One Pane at a Time

By Robert Dyer

Until March 12th, the Second Circuit was the only appellate court "interpreting" the Amex Window phrase "in the City of New York." In a short magisterial decision Florida's Fourth DCA held in Fahnestock v. Dean Witter that venue should be decided by arbitrators not the court. The court refused to embrace the logic of Bear, Stearns & Co., v. Bennett, 938 F. 2d 31 (2d Cir. 1991) and PaineWebber v. Rutherford, 903 F. 2d 106 (2d Cir. 1990): those courts refused to allow extrinsic evidence on the meaning of "in the City of New York," even though they knew that both the AAA and the Amex took the position that this phrase was not a venue-setting provision.

In contrast, the Fahnestock court relied on Boudreau v. L.F. Rothschild & Co., 1990 WL 81861 (M.D. Fla. Feb 23, 1990), which held that procedural issues such as venue were the province of arbitrators. The Florida court agreed with the reasoning in Prudential Sec., Inc. v. Thomas, 793 F.Supp. 764 (W.D. Tenn. 1992), viz., that both interpretations of "in the City of New York" (home office or venue site) were reasonable and therefore the phrase must be ambiguous -- meaning that under an "any controversy" arbitration agreement, the arbitrators should make the decision. Since Dean Witter could find no arbitration agreement in Fahnestock, the only issue before the Court was whether the arbitration site would be decided by a trial judge or the AAA.

Another issue Wall Street firms occasionally raise in these Amex Window cases is what arbitration rules should be used, those of the Amex or of the AAA? As you might guess, the brokers want to use the Amex rules in order to take advantage of the six-year eligibility rule. The

AAA rules have no such limitation. The "whose rules to use" was argued and decided in the customers' favor in Lee v. Smith Barney at the Florida trial court level back in 1991. The most recent trial court decision seems to be Seth Lipner's Kidder Peabody v. Sanders (NY S.Ct. 1 Dept., Jan. 14, 1997), where Judge Solomon in effect said that there was "no merit to petitioner's contention ..." that the Amex rules were contemplated by the Window.

For those who may not be current on the Amex Window -- the only way to get before a neutral forum -- Article VIII §2(c) provides as follows:

> "Arbitration shall be conducted under the arbitration procedures of this Exchange, except as follows:
>
> * * *
>
> "(c) if any of the parties to a controversy is a customer, the customer may elect to arbitrate before the American Arbitration Association in the City of New York, unless the customer has expressly agreed, in writing, to submit only to the arbitration procedure of the Exchange."

Both the Second and the Eleventh Circuits, Bennett and Rutherford, supra, and Luckie v. Smith Barney, 999 F. 2d 509 (11th Cir. 1993), unambiguously held that the Amex Window right to AAA arbitration is overridden by an arbitration agreement; but none of those decisions supply a rationale to support this conclusion. Therefore the issue is again ripe for a judicial determination in other jurisdictions. For a longer discussion of the Amex Window cases -- and there are several in favor of the customer -- see R. Dyer, the AMEX WINDOW -- The SEC Won't Let It Be Shut!, 7 Sec. Arb. Comm. (Sept. 1995). It al. [Ed. Note: Neal Blaher and Stuart Goldberg filed an Amicus Brief in Fahmestock on behalf of PIABA.]

U.S. District Court Denies Stay Request Based On Limitations

The U.S. District court in Puerto Rico denied a request to stay a NYSE arbitration based on the defendant firm's assertion of a statute of limitation defense. Dean Witter Reynolds v. Espada, 1997 WL 117716 (D. Puerto Rico).

In Espada, Dean Witter had asked the court to stay the arbitration based on the statute of limitations. The court declined, noting that, although courts should not assume that the parties agreed to arbitrate arbitrarily unless there is clear and unmistakable evidence that they do so, timeless questions, including statute of limitations defenses, do not normally present questions of arbitrability.

Dean Witter argued that the choice-of-law provisions in the customer agreement specifically incorporate New York's arbitration rules as it pertained to limitations issues being decided by the courts, citing Luckie and Volt. The Espada court rejected this argument, noting that the Luckie court had relied on the Seventh Circuit's ruling in Mastrobuono v. Shearson Lehman Hutton, 20 F3d 713 (1994), in making its decision, and that the Luckie decision was flawed because of the U.S. Supreme Court's reversai of Mastrobuono.

Recent Developments

Submitted by: Joseph C. Long

In the December 1996 *Quarterly* "From the Professor" column, there was a discussion of the ability to cut off claims under the local securities act by inclusion of a choice of laws clause making the laws of a particular state, usually New York, apply. Since that article was published, the Ninth circuit considered this issue in connection with the English forum and choice of laws provisions in the Lloyd's of London membership agreements in Rogers v. Lloyd's of London, 1997 U.S. App. LEXIS 3889 (9th Cir., Mar. 6, 1997). In this case, the Ninth Circuit broke with the Second, Fourth, and Sixth Circuits, which held the English choice of laws clause to control over the federal securities acts. The decisions in these Circuits have been criticized in Note, "No Way Out: An Argument Against Permitting Parties to Opt Out of U.S. Securities Law in International Transactions," 97 Column L. Rev. 57 (1997).

In doing so, the Ninth Circuit indicated that such selection clause could not control in the face of the specific non-waiver provision adopted by Congress is Section 14 of the Securities Act of 1933, 15 U.S.C. §77n. Section 14 makes any attempt to waive compliance with the 1933 Act void. The Ninth Circuit~ pointed out that the other Circuits had examined the issue under the standard set out in The Bremen v. Zapata Off-Shore Co., 407 U. S. 1 (1972) of whether the plaintiff has shown that " enforcement of the clause would be unreasonable or unjust." The other Circuits concluded that enforcement of the choice of law clause would not be unjust because English law, they felt, provided a similar remedy and therefore, its application would not subvert the "public policy" position that the anit-waiver clause of Section 14 voided the choice of laws provision and that the reasonable test simply had no application. Congress through Section 14 has determined the policy issue and left no room for the Courts to apply a reasonableness test.

Interestingly, the Ninth Circuit opinion, at first glance would seem to be authority that the same analysis is not available under state law because it upheld the trial court's dismissal of the plaintiffs' state securities law claims. However, such conclusion is not warranted when the opinion is read carefully. The Ninth Circuit upheld the trial court on the basis that the plaintiffs' did allege a specific state law and thee that law contained an anti-waiver. In fact, Section 410(g) of the Uniform Securities Act (1957) has an anti-waiver clause virtually identical to Section 14 of the 1933 Act. Had this provision been called to the Ninth Circuit's attention, there is no reason to believe that they would not have upheld the state law claims as well.

In Fleet Enterprises Inc. v. Velinsky, NYLJ p.27, Col. 1 (Jan. 29, 1997), Justice Solomon issued another opinion in series of New York cases eroding the application of New York substantive arbitration law in brokerage cases. Solomon held that in the absence of a New York choice of laws clause, that the FAA governs such arbitration agreement "regardless of New York policy or precedent". As a result all doubts as to whether a particular issue is within the purview of the court or the arbitrators must be settled in favor of arbitration. She, therefore, concluded that whether defamatory statements contained in a U-5 where either defamatory or privileged was a matter for the arbitrators and not the court to decide.

Bespeaks Caution

Submitted by: C. Thomas Mason

The Fourth Circuit has joined the rest in adopting and applying the judicially created doctrine of "bespeaks caution". *Gasner v. Board of Supervisors of the County of Dinwiddie, Virginia,* ____ F.3d _____, 1996 WL741803 (4th Cir., Dec. 31, 1996). What makes the opinion interesting is its lengthy and well-argued dissent.

The decision turns on materiality, rather than disclosure. The majority determined that whatever facts may have been omitted or misrepresented in the offering materials, they were not material. "There is not a substantial likelihood here that the disclosure of the allegedly false facts or omitted fact would have been viewed by a reasonable investor as having significantly altered the total mix of information made available.

The dissent strongly (and to my mind, convincingly) disagreed. He claimed that the majority had erroneously applied the "bespeaks caution" doctrine. He reminded the court that on summary judgment the nonmoving party is entitled

to have the credibility of his evidence as forecast assumed, his

> version of all that is in dispute accepted, all internal conflicts in it resolved favorably to him, the most favorable of possible alternative inferences from it drawn in his behalf; and finally, to be given the benefit of all favorable legal theories invoked by the evidence so considered. *Charbonnages de France v. Smith*, 597 F.2d 406,414 (4th Cir. 1979). In the instant case, the Appellants at least raised a genuine issue fact as to whether the statements that they relied upon misrepresented the nature of the technology in the proposed investment...A substantial likelihood exists that a prospective investor would have viewed the “total mix” of information to have been significantly altered if the investor knew that the technology was experimental and had not been proved.

The dissent argued that the facts in dispute were not “forward looking” at all, but instead were misstatements of “Known, historical facts” to which the “bespeaks caution” doctrine simply does not apply.

What is significant, and potentially worrisome, about this decision is the court's willingness to decide as a matter of law that disputed facts and actual misstatements are not material, and thereby dismiss the case on summary judgment. Without the benefit of an evidentiary hearing, the Fourth Circuit determines that certain misrepresentations of known or historical facts simply ought not matter to a reasonable investor. “It is not necessary for this Court to decide if a genuine issue of fact exists as to whether the statements relied upon by the appellants were false or misleading.” In other words, some lies to prospective investors are OK.

A federal court in New York recently reached a similar conclusion regarding a Stratton Oakmont offering: The offering materials disclosed that certain individuals would be selling their holdings at the offering, but failed to state that those sellers were Stratton Oakmont employees who had been given pre-IPO shares as part of the underwriting process. *Geiger v. Solomon-Page, Inc.*, 933 F.Supp. 1180 (S.D.N.Y. 1996). The judge determined that the omission was immaterial as a matter of law.

A misrepresentation or omission is material if there is substantial likelihood that a reasonably prudent investor would consider it important in making a decision. *Basic Inc.v.Levinson*, 485 U.S. 224, 231, 108 S.Ct. 978,983 (1988). The question of materiality may be decided as a matter of law if the alleged omission is “so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of [its] importance.” *Feinman v. Dean Witter Reynolds*, 84 F.3d 539, 541 (2nd Cir. 1996). Obviously, those of us who would want to know about Stratton Oakmont's employees' involvement in the offering are not “reasonable investors”, much less “reasonably prudent investors”. And the fact that we differ with the judge's conclusion must make us “unreasonable minds”.

Ceaveat emptor!

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NASDR Proposed Rules Changes

As most of you know, the NASDR has proposed certain amendments to the NASD Code of Arbitration Procedure. The common name of the Rule affected the new code provision number and the estimated date of forwarding the change to the SEC for notice and comments are as follows:

1. List selection: 10308:April 97;
2. Raising the ceiling: 10202, 10203, 10302, & 10308: April 97;
3. Eligibility: 10304:May, 1997; and
4. Punitive damages: 10335:May, 1997.

The proposed discovery rule is still a work in progress. If satisfactory consensus is obtained, it is estimated that the discovery rule will be sent to the SEC about July 1997.

The comment period, once the Rules are noticed is 60 days.

It is court understanding that the goal of NASDR is to have all these proposed rules take effect simultaneously on January 1, 1998.

BULLETIN BOARD

PIABA member Randall H. Steinmayer is representing clients in arbitration against Tuschner & Company involving its broker selling rare coins to its clients. If anyone has any information regarding claims against Tuschner & Company for its brokers selling away; and information or evidence regaring Tuschner's supervision of its branches/brokers, please contact Randall H. Steinmeyer at (612) 941-4005.

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