94-9246

In The

United States Court of Appeals

FOR THE SECOND CIRCUIT

PAINEWEBBER INCORPORATED,
Petitioner-Appellant,

-against-

MICHAEL J. BYBYK and JOYCE O. BYBYK,
Respondents-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR AMICUS CURIAE PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION

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TABLE OF CONTENTS

INTEREST OF AMICUS 1

POINT I: THE QUESTIONS RAISED IN THE PETITION ABOUT THE NASD'S ELIGIBILITY RULE SHOULD BE DECIDED BY THE ARBITRATORS AND NOT THE COURTS 3

POINT II: THE QUESTION OF WHETHER RESPONDENT-RESPONDENT MAY MAKE CLAIMS FOR ATTORNEYS FEES MUST BE REFERRED TO THE ARBITRATORS 9

CONCLUSION 11

TABLE OF AUTHORITIES

Cases

Barbier v. Shearson, 948 F.2d 1117 (1991) 2

First Options of Chicago Inc. v. Kaplan,
1995 WL 306184 (May 22, 1995) 8

Mastrobuono v. Shearson Lehman Hutton, Inc.,
115 S.Ct. 1212 (1995) 2

Smith Barney Shearson v. Luckie,
85 N.Y.2d 193, 623 N.Y.S.2d 800 (1995) 5

Smith Barney Shearson v. Luckie,
198 A.D.2d 87, 605 N.Y.S.2d 838 (1st Dept. 1993),
reversed on other grounds, 85 N.Y.2d 193,
623 N.Y.S.2d 800 (1995) 11

Smith Barney v. Boone,
47 F.3d 750 (5th Cir. 1995) 2

Todd Shipyards v. Christianson,
943 F.2d 1056 (9th Cir. 1991) 10

Statutes

CPLR 7513 9

Fla.Stat.812.014 (1995) 10

Ill.Rev.Stat. ch.5, sec. 13A(2)(1995) 9

Ind.Code sec.23-2-1-19 (1995) 10

Ind.Code sec.23-2-1-19(i) 10

Kan.Stat.Ann. 17-1268(d) 10

Kan.Stat.Ann. sec.17-1268(a)(1995) 10

Ky.Rev.Stat. 292.480(1)(1995) 10

La.Rev.Stat.Ann. sec. 51:714(a)(1995) 10

Statutes (cont.)

Mo.Rev.Stat. sec.409.411(a)(1995) 10

Mo.Rev.Stat. sec.409.411(g) 10

Neb.Rev.Stat. sec.8-1118(1) 10

Arbitration Rules

AMEX Rule 605 3

NASD Code of Arbitration Procedure, Section 6 . . . . . 5, 6, 8

NASD Code of Arbitration Procedure, Section 15 . . . . . 3, 5

NASD Code of Arbitration Procedure, Section 35 . . . . . 6, 8

NYSE Rule 603 3

Newspaper Articles

"SEC Is Investigating PaineWebber for Its Partnership Sales Methods," W.S.J., Nov. 22, 1994, Sec.C, p.1., col.3. 4

"SEC Widens Partnership Investigation," N.Y.T., Nov. 23, 1994, sec.D, p.1., col.1. 4

Administrative Agency Decisions

Securities Exchange Act of 1934 Rel.No.33082 (Oct. 21, 1993) . 4

Uniform Acts

Uniform Securities Act sec.410(g) 10

Uniform Securities Act, sec. 410(b) 10

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT
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PAINEWEBBER INCORPORATED,

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Respondents-Appellees.

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BRIEF OF THE PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION AS AMICUS CURIAE

INTEREST OF AMICUS

The Public Investors Arbitration Bar Association ("PIABA") was formed in the summer of 1990. A not-for-profit Texas corporation, PIABA was organized by prominent securities arbitration attorneys from thirteen states. PIABA currently has over 200 attorney-members from almost all the states, all of whom devote a significant portion of their practice to the arbitration of securities disputes, and all of whom represent public investors in arbitration. Collectively our members have represented and currently are representing tens of thousands of public investors in securities arbitrations around the country.

A large percentage of the clients represented by PIABA members purchased proprietary limited partnerships from major brokerage firms, including PaineWebber, Inc., the Petitioner-Appellant here. Many of these clients have been subjected to legal proceedings similar to that involved here, and these clients thus have an obvious interest in the outcome of this case.

The official Mission of PIABA is:

> To promote the interests of the public investor in securities arbitration by:
>
> (1) protecting public investors from abuses prevalent in the arbitration process;
>
> (2) making securities arbitration just and fair; and
>
> (3) creating a level playing field for the public investor in securities arbitration.

PIABA is dedicated to advancing the rights of public investors through a variety of activities, including the submission of briefs as amicus curiae. PIABA has submitted amicus briefs in a variety of cases, including Smith Barney v. Boone, 47 F.3d 750 (5th Cir. 1995), which presented issues similar to those presented here. PIABA also submitted an amicus brief in Mastrobuono v. Shearson Lehman Hutton, Inc., 115 S.Ct. 1212 (1995), and another to this Court in Barbier v. Shearson, 948 F.2d 1117 (1991).

Because of the importance of the issues raised on this appeal, PIABA files the following brief as amicus curiae.

POINT I: THE QUESTIONS RAISED IN THE PETITION ABOUT THE NASD'S ELIGIBILITY RULE SHOULD BE DECIDED BY THE ARBITRATORS AND NOT THE COURTS

The Petition herein seeks relief under Section 15 of the NASD's Code of Arbitration Procedure. That rule states that:

> "No dispute, claim or controversy shall be eligible for submission to arbitration under this Code where six (6) years have elapsed from the occurrence or event giving rise to the act or dispute, claim, or controversy. . . .[1]

Petitioner-Appellant argues that this rule (hereinafter referred to as the "eligibility rule") bars the claims because the "purchase date" of the investment at issue is more than six years before the date on which the Respondents filed their claim with the NASD. Petitioner-Appellant has conceded that Respondents filed a Uniform Submission Agreement in an timely manner, but they assert that an additional document, a Statement of Claim, must also have been filed within the eligibility period. [2]

Aside from this arcane dispute about NASD filing requirements, Petitioner-Appellant argue that the question of eligibility, including the important question of what "occurrence or event" triggers the running of time under the rule (i.e. "purchase date," date of accrual of the claim, or date of

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[1] Identical rules exist at New York Stock Exchange and the American Stock Exchange. See NYSE Rule 603; AMEX Rule 605.

[2] In cases where an initial filing is judged incomplete, the NASD's practice is to accept the filing of the Uniform Submission Agreement, subject to submission of the Statement of Claim within thirty days. In this case the "deficiency" was apparently cured even before the NASD could send out its "deficiency" letter.

discovery) is a matter to be decided by the courts rather than the arbitrators.[3]

PIABA believes that the arbitrators should decide these "eligibility" issues. PIABA is concerned that investors around the country, almost all of whom have pre-dispute arbitration agreements similar in form and substance to that involved here, are being forced to defend the timeliness of their arbitration claims in

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[3] The question presented on this appeal is made especially important because the case involves allegations of the fraudulent sale of proprietary limited partnerships by securities brokerage firms. PaineWebber, like several other brokerages firms, is currently being investigated by the SEC for its limited partnership sales practices. See "SEC Is Investigating PaineWebber for Its Partnership Sales Methods," W.S.J., Nov. 22, 1994, Sec.C, p.1., col.3.; "SEC Widens Partnership Investigation," N.Y.T., Nov. 23, 1994, sec.D, p.1., col.1. Of course, Prudential Securities partnership sales practices were the subject of an SEC Complaint, a finding of fraud, and an elaborate and unprecedented remedial order. Securities Exchange Act of 1934 Rel.No.33082 (Oct. 21, 1993).

Although this case concerns PaineWebber, it is noteworthy that, in its order in the Prudential case, the SEC not only condemned Prudential's partnership sales practices as fraudulent, but also found that "[Prudential's] practice of reflecting limited partnerships on account statements at cost in many instances provided investors with a false sense of safety about their investments and failed to reflect the current market value, if any, of their investments." See Order, at p.9. Among the relief agreed to by Prudential was a waiver of all timeliness defenses in connection with the "Expedited Arbitration" process created by the SEC.

The limited record in this case does not reveal whether PaineWebber engaged in pricing practices that were similar to those of Prudential. Nevertheless, this Court should be wary of barring arbitration of partnership cases until it is satisfied that PaineWebber will not thereby extinguish its liability to investors, regardless of whether PaineWebber, like Prudential, concealed its wrongdoing. In this regard, it must be remembered that (a) PaineWebber requires customers to sign arbitration agreements restricting them to arbitration at either the NASD or the NYSE, and (b) that both of these organizations have 6-year eligibility rules, which the brokerage industry argues cannot be extended even in cases of non-discovery and willful concealment.

court, and, only if they are successful there do they get an opportunity to arbitrate the merits of their dispute. Thus, many arbitrations now seem to be derailed into court, making the process of arbitration more costly and more time-consuming. The result, as Chief Judge Judith Kaye pointed in her separate concurring opinion in Smith Barney Shearson v. Luckie, 85 N.Y.2d 193, 623 N.Y.S.2d 800 (1995) creates the troubling "practical effect" of requiring an aggrieved investor to litigate timeliness defenses in court "before ever reaching the arbitrators' door." Chief Judge Kaye wrote separately in that case because of her "fear [for] what may be the continuing erosion of the pro-arbitration policy originally expressed by Congress in the [FAA]." This Court can signal a halt to this perception of erosion by affirming the decision below.

In arguing that the eligibility question should be left to the arbitrators, PIABA wishes the Court to note that Petitioner-Appellant's Petition to the courts under Section 15 on the NASD Code of Arbitration Procedure is itself a violation of two (2) other provisions of the NASD Code of Arbitration Procedure:[4]

VIOLATION # 1

Section 6 of the NASD Code of Arbitration Procedure states that:

No party shall, during the arbitration of any

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[4] Section 12 of the NASD Code of Arbitration Procedure states that "any dispute, claim or controversy eligible for submission under . . . this Code between a customer and a member . . . shall be arbitrated under this Code . . . upon the demand of the customer."

> matter, prosecute or commence any suit, action or proceeding against any other party touching upon any of the matters referred to arbitration pursuant to this Code.

The commencement of this suit was a violation of the letter and spirit of the NASD rule. Petitioner-Appellant evidently finds Section 6 to be contrary to their interests, and they have thus chosen to disregard it.

But Section 6 exists for a reason: it makes the arbitral less subject to procedural whipsaws, and guarantees expeditious and unfettered access to the arbitral forum. The purpose which Section 6 serves would be vitiated if Petitioner-Respondent were permitted to commence a legal proceeding on "matters referred to arbitration. . . ."

VIOLATION # 2

Petitioner-Appellant is also ignoring another NASD rule. Importantly, under the rules of the NASD, all questions of interpretation and applicability of the rules are matters for the arbitrators. Specifically, the NASD Code of Arbitration Procedure, Section 35, provides that:

> The arbitrators shall be empowered to interpret and determine the applicability of all provisions of this Code which interpretation shall be final and binding upon the parties.

Notwithstanding this clear and unambiguous rule, Petitioner-Appellant wants this Court to determine the interpretation and applicability of the eligibility rule. Petitioner-Appellant advances this argument notwithstanding the

fact that this case raises complex questions not only about the rule itself, but also about what type of filing satisfies other NASD rules about tolling (Section 18) and commencement of an action (Section 25). Petitioner-Appellant apparently fears the NASD's (or the arbitrators') interpretation of these rules so, again, they ignore the rule that the arbitrators shall "interpret and determine the applicability of all provisions" of the NASD Code of Arbitration Procedure] and instead shop for a forum they hope will be more accommodating.[5]

In contrast to the two above-quoted NASD rules, Petitioner-Appellant evidently finds that judicial determination of the 6-year eligibility rule is in their interest, so that is the one rule they bring before this Court. For Petitioner-Appellant, the other rules, evidently, aren't supposed to count.

This Court should not permit Petitioner-Appellant to cherry-pick among the NASD rules, seeking out the ones that are favorable to it, and ignoring the ones that are contrary to its legal interests.

PIABA wishes to draw the Court's attention to the fact that Petitioner-Appellant is the party who insisted on arbitration at the NASD, by placing the arbitration agreement in all of its

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[5] It should be noted that, in addition to being contractually obligated to do so (the arbitration agreement expressly provides that the arbitration "shall be governed the rules of the organization convening the panel"), Petitioner-Appellant is also a member of the NASD. It is thus bound, by its membership in that organization, to live up to and abide by all of the NASD's rules, including Section 6 and Section 35 of the Code of Arbitration Procedure.

standard form contracts. Having agreed broadly to arbitrate "any and all controversies," and (1) having committed the question of interpretation and enforcement of the eligibility rule to the arbitrators, and (2) having promised not to "prosecute or commence any suit, action or proceeding against any other party touching upon any of the matters referred to arbitration pursuant to this Code," Petitioner-Appellant should be required to live up to its bargain - not just part of the bargain, but all of it. See generally the time-honored case of Goose v. Gander.

These arguments are wholly supported by the U.S. Supreme Court's recent decision in First Options of Chicago Inc. v. Kaplan, 1995 WL 306184 (May 22, 1995). It is submitted that the two arbitration Code sections referenced here (Sections 35 and 6) constitute, under the doctrine of First Options, an indication of an "objective[] intent to submit the arbitrability issue to arbitration." Id. at 4.

In First Options, the Court ruled that the Kaplan's had not demonstrated a "willingness to be effectively bound by the arbitrator's decision" on arbitrability, and it was thus proper for the courts to intervene in the arbitration. Id. at 5. But it is submitted that in this case, Petitioner-Appellant has demonstrated such a willingness to be bound by the arbitrators decisions on eligibility by agreeing to bound by all the NASD rules, including Section 6 and 35 of the Code of Arbitration Procedure.

For these reasons, the decision below should be affirmed.

POINT II: THE QUESTION OF WHETHER RESPONDENT-RESPONDENT MAY MAKE CLAIMS FOR ATTORNEYS FEES MUST BE REFERRED TO THE ARBITRATORS

Petitioner-Appellant herein appeals from a determination that the question of whether Respondents may obtain an award of attorneys fees was for the arbitrators rather than the court. Petitioner-Appellant relies on the "American Rule," that attorneys are ordinarily not recoverable by a prevailing litigant in the absence of a an agreement or a statutory authorization. Petitioner-Appellant argues that this rule governs the arbitration, especially in view of the fact that the agreement between the parties contains a New York choice-of-law clause.[6]

Placing to the side the existence of the choice-of-law clause, it must be observed that many states have statutes providing that a party who prevails in a securities arbitration can recover attorneys fees. See e.g. Ill.Rev.Stat. ch.5, sec. 13A(2)(1995)("If the purchaser shall prevail in action to enforce any of the remedies provided in this subsection, the court shall assess costs together with reasonable fees and expenses of the

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[6] Petitioner-Appellant disingenuously cites NY CPLR 7513 as authority that, under New York law, arbitrators may not award attorneys fees unless there is an express agreement to that effect. CPLR 7513, however, does not go that far - it merely provides that attorneys fees are not, in the usual case, part of a party's arbitration "expenses." The statute undoubtedly exists to make clear that where the arbitration agreement provides that the prevailing party can recover "expenses," those "expenses" do not include attorneys fees unless the agreement specifically so states. The statute does not state that arbitrators may not award attorneys fees absent an express agreement. If a **statute** permits a court to award attorneys fees, nothing in CPLR 7513 precludes an arbitrator from acting in a like manner.

purchaser's attorney against the defendant. . . ."); Ind.Code sec.23-2-1-19 (1995)("A person who offers or sells a security in violation of this chapter . . . is liable to any other party to the transaction, . . . who may sue either at law or in equity to rescind the transaction or to recover the consideration paid, together in either case, with interest . . . plus costs and reasonable attorneys fees. . . ."). See also Fla.Stat.812.014 (1995); Kan.Stat.Ann. sec.17-1268(a)(1995); Ky.Rev.Stat. 292.480(1)(1995); La.Rev.Stat.Ann. sec. 51:714(a)(1995); Hawaii Rev.Stat. sec.485-20(a); Mo.Rev.Stat. sec.409.411(a)(1995); Neb.Rev.Stat. sec.8-1118(1).[7] And under California law (the jurisdiction with the predominance of contacts to the Bybyk's case), an arbitrator has the power to award attorneys fees as a sanction for frivolous or bad faith conduct. See Todd Shipyards v. Christianson, 943 F.2d 1056 (9th Cir. 1991).

Yet Petitioner-Appellant seeks to bar the claims for attorneys fees notwithstanding the law of California, arguing that

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[7] Many of these state statutes are based on the Uniform Securities Act, sec. 410(b).

It is also important to note that the Uniform Securities Act (sec.410(g)), and the securities laws of many states, further provide that the provisions of the state's securities laws may not be waived. See e.g. Ind.Code sec.23-2-1-19(i)("A condition, stipulation or provision binding a person acquiring a security to waive compliance with this chapter or any rule or order under this chapter is void.") See also Kan.Stat.Ann. 17-1268(d); Mo.Rev.Stat. sec.409.411(g). Were this Court to hold that, in cases of this kind, attorneys fees claims are always barred in securities arbitration, the legislatures of these states would be disenfranchised, and the brokerage firm would have accomplished through the back door (the New York choice-of-law) what it could not accomplish through the front door because of the no-waiver provisions.

the New York choice-of-law clause effectively excludes any consideration of the law of California. In order for this Court to rule for Petitioner-Appellant on this point, this Court would be required to analyze and decide this choice-of-law question. Such a ruling by this Court, however, would constitute an infringement on the arbitrators' powers, and thus would violate both the arbitration agreement between the parties ("all controversies which may arise between me and PaineWebber concerning any . . . transaction shall be determined by arbitration") and the Federal Arbitration Act. See Smith Barney v. Luckie, 198 A.D.2d 87, 605 N.Y.S.2d 838 (1st Dept. 1993), reversed on other grounds, 85 N.Y.2d 193, 623 N.Y.S.2d 800 (1995).

For this reason, to the extent that the instant Petition raises issues concerning the arbitration claim for attorneys fees, the Petition should be denied.

CONCLUSION

For the reasons here stated, the instant appeal should be denied.

Dated: July 7, 1995
Garden City, New York

Respectfully submitted,

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