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Securities Arbitration

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Securities Arbitration *vis a vis* Securities Litigation: To Be or Not To Be

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Introduction

It is March, 2006. Next year will mark the 20th anniversary of the U.S. Supreme Court's landmark decision in *Shearson/American Express, Inc. v. McMahon*,[1] and this year marks the six-year anniversary of the 2000 NASDAQ market correction. Arbitration before the SROs,[2] which for all intents and purposes became mandatory after the *Shearson* decision, has lurched along on a path towards something approximating actual court litigation for the past 19 years, but has evolved significantly in the past six. The volume of arbitrations filed before the various SROs ballooned after the tech-market bubble burst in 2000, and as the volume increased, so did their similarity to litigation.

In some respects arbitration remains significantly different than litigation, while in other areas the arbitration process has grown to emulate various litigation tactics and strategies. Arbitration still is a substantially streamlined process as compared with court litigation; depositions, bills of particulars, requests for admissions and the majority of foundational evidentiary objections simply do not occur in arbitrations before the various SROs. With that said, attorneys representing parties to such arbitrations often issue third-party subpoenas, submit both procedural and substantive pre-hearing motions, and the "amicable" exchange of documents and information (since its codification as the NASD's Discovery Guide in 1999[3]) increasingly leads to motions and cross motions to compel and for costs.

With the six-year anniversary of the NASDAQ market correction, NASD Rule 10304 (Time Limitation on Submission) and the corresponding rules of the other SROs now bar many claimants from bringing arbitrations based on losses sustained during 2000. This increases the number of motions to dismiss respondents' counsel will file, only increasing the need for clarity. Closing in on its own 20-year anniversary, securities arbitration is at a crossroads. When looking in the proverbial mirror, in what ways should arbitration be more akin to litigation, and in which respects should securities arbitrations be different than litigation – and truly be an alternative form of dispute resolution? With apologies to Hamlet: to be, or not to be?

While a comparative survey of each such aspect of arbitration would be an exhausting process, much can be gleaned from an examination of some of the most prominent examples. The following discussion will highlight two of the most contested areas of pre-hearing arbitration: dispositive motions and subpoenas.

Dispositive Motions

For many years, a claimant in arbitration before the SROs filed a Statement of Claim (for purposes of this discussion, the same as a Complaint) and the respondent(s) filed a responsive Answer(s). Unlike traditional court Answers, many respondents utilized the Answer to offer narrative responses – to tell their own side of the story – whereas in traditional litigation defendants will only admit or deny the allegations against them. Very scarce in SRO arbitrations were those respondents who filed a motion to dismiss in lieu of an Answer.

While inherently motions to dismiss are less common than Answers, this scarcity has never been the norm in court litigation. Under the Federal Rules of Civil Procedure, and similar corresponding state rules, the following defenses may be made by motion prior to, and in lieu of, filing an Answer: (1) lack of jurisdiction over the subject matter; (2) lack of jurisdiction over the person; (3) improper venue; (4) insufficiency of process; (5) insufficiency of service of process; (6) failure to state a claim upon which relief can be granted; and (7) failure to join a party.[4] In addition, many motions to dismiss are based on the grounds that the applicable statute of limitations has run.

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SRO Regulation

Arbitrator Training: Expungement

Article contributed by: Barbara Brady, Director of Neutral Management, NASD Inc.

In August 2004, NASD Dispute Resolution introduced a new mandatory online arbitrator training course on expungement. The course explains the role of the Central Registration Depository (CRD® or CRD system), gives a general overview of the expungement process and NASD Rule 2130, and discusses the specific findings arbitrators must make in order for NASD to waive its right to oppose the expungement request in court.

As it has been more than a year since many of our arbitrators participated in the training, the purpose of this article is to remind arbitrators of the standards outlined in Rule 2130 and the arbitrators' role in the expungement process.

What is Expungement?

Brokerage firms and their registered persons (sometimes referred to as "associated persons") are required initially to complete their respective applications for registration and to keep them current thereafter.[1] In addition to being required to report, among other things, certain criminal charges and convictions, regulatory actions, and bankruptcies, registered persons are required to report certain customer complaints and customer-initiated arbitration claims. When a registered person is named as a respondent in a customer-initiated arbitration proceeding, the arbitration claim and any allegations of wrongdoing contained therein are required to be reported on the registered person's Form U4. Once reported, that information is recorded on the registered person's CRD record and made available to the public upon request through NASD's Brokercheck program.

A registered person may seek to have any reference to the arbitration removed from his or her CRD record. The process of removing this information from the CRD system is called "expungement."

How Does the Expungement Process Work under Rule 2130?

Under NASD Rule 2130, a party may seek an expungement order either directly from a court or may ask the arbitrators, who are most familiar with the facts of the case, to order expungement as part of the award. If the arbitrators grant the request, the party must ask a court of competent jurisdiction to confirm the arbitration award. Before NASD will expunge information from a CRD record in these circumstances, the court must confirm the arbitrators' award.

If a party seeks expungement relief in arbitration, the arbitrators will determine whether to grant expungement on the basis of one or more of the standards identified in Rule 2130. Prior to seeking a court order for expungement, the parties must advise NASD of the grounds for expungement. NASD will then determine whether to require the parties to name NASD as a party to the court proceedings so that NASD can oppose the expungement in court, or waive the requirement to be named as a party.

What Are the Three Grounds upon which Arbitrators May Grant Expungement?

Under Rule 2130, NASD may waive the obligation to name NASD as a party if the arbitrators make an affirmative finding that expungement is granted under one or more of the following standards.

- The claim, allegation, or information is factually impossible or clearly erroneous.

  This standard could be the basis for expungement if, for example, the individual named in the arbitration was not employed by the member firm during the relevant time period.

- The registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds.

  This is an objective standard based on CRD reporting requirements. This standard would require an affirmative arbitral finding that the registered person was not involved in the alleged investment-related sales practice violation, forgery, theft, misappropriation, or conversion of funds. Dismissal of the claim alone would not be a sufficient basis for ordering expungement. For purposes of Rule 2130, the terms "sales practice violation," "investment-related," and "involved" have the same meaning as those terms are defined on the Form U4 (found on NASD's Web site).

- The claim, allegation, or information is false.

  This standard is self-explanatory. As described below, the arbitrators must have a reasonable basis for making this finding.

NASD will not consider waiving the requirement to be named as a party to the court proceedings unless the arbitrators have made an affirmative finding that one or more of the above standards has been met, and the arbitrators' written award clearly and expressly includes such a finding. The requisite finding (or findings) cannot merely be *implied* in the award—they must be clearly and expressly stated in the "Other Issues Decided" and/or "Award" sections.

Should Arbitrators Routinely Grant Requests for Expungement?

No. Arbitrators must remember that an order to expunge information from a CRD record is an extraordinary remedy. The mere fact that a complaint against a registered person

was dismissed would not provide a sufficient basis for ordering expungement. Arbitrators must make a specific finding that the expungement meets one or more of the prescribed standards in Rule 2130 before directing expungement of customer dispute information from the CRD system. Further, it is highly unlikely that one of the standards for granting expungement in Rule 2130 could be met if there is an adverse arbitration award rendered in favor of a customer and against the registered person. It is doubtful that an arbitrator could make one of the specific findings above unless the allegations were dismissed against the registered person who is requesting expungement.

As a "best practice," arbitrators should identify the circumstances that warrant the affirmative findings and include a brief explanation summarizing the circumstances underlying the finding either in the "Other Issues Decided…" section or in the section titled "Award."

Can Arbitrators Order Expungement in a Stipulated Award?

Yes. On occasion, parties may reach a settlement and ask the arbitrators to incorporate their settlement into a "stipulated award." Stipulated awards that request expungement relief are subject to the same requirements as contested claims (claims where the parties have not settled their differences). To satisfy these requirements, arbitrators should understand the terms of the settlement, and be comfortable that at least one of the standards of Rule 2130 has been met. The award must clearly and expressly contain one or more of the affirmative findings listed in Rule 2130.

In addition, arbitrators should consider whether expungement was a "quid pro quo" for settling the case, particularly where a monetary settlement is involved. A "quid pro quo" settlement may be contrary to NASD conduct rules. (See *Notice to Members 04-43*, "Members' Use of Affidavits in Connection with Stipulated Awards and Settlements to Obtain Expungement of Customer Dispute Information under Rule 2130" (June 2004)).

If expungement relief is to be included in a regular or stipulated award, the arbitrators must hear or review enough evidence to satisfy themselves that one of the three standards of Rule 2130 has been met.

The above direction is consistent with Canon V(d) of the *AAA/ABA Code of Ethics for Commercial Arbitrators*, which reads as follows:

> *"In the event that all parties agree upon a settlement of issues in dispute and request the arbitrator to embody that agreement in an award, the arbitrator may do so, but is not required to do so unless satisfied with the propriety of the terms of settlement. Whenever an arbitrator embodies a settlement by the parties in an award, the arbitrator should state in the award that it is based on an agreement of the parties."*

What if Arbitrators Do Not Believe They Have Enough Information to Order Expungement in a Stipulated Award?

Arbitrators who do not believe that they have enough information to make one of the three affirmative findings have several options:

1. They may ask the parties to submit additional information, including the terms of the settlement agreement;

2. They may conduct a telephonic or in-person hearing to obtain testimony; or

3. They may decline to sign the stipulated award.

An arbitrator who is uncomfortable with signing any stipulated award or who believes that he or she cannot make an affirmative finding based on the evidence presented is not required to do so and should not sign the stipulated award.

Can an Arbitrator Apply NASD Rule 2130 to Cases Filed before April 12, 2004?

No. NASD Rule 2130 applies only to cases filed on or after April 12, 2004. If you have any questions relating to the process for expungements on cases filed prior to April 12, 2004, please feel free to contact the case administrator assigned to the case.

Conclusion

If you have any concerns about your ability to handle an expungement request, or if you have additional questions after reading this article, we strongly recommend that you re-take NASD's expungement training for arbitrators. You have two options:

1. Completing the online course, free of charge, on NASD's Web site: http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&nodeId=813&ssSourceNodeId=12.

2. Listening to a recording of an Arbitrator Call-in Workshop on Expungement, also located on NASD's Web site: http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_009530&ssSourceNodeId=813.

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Suggested Additional Reading

NASD Rule Filing SR-NASD-2002-168:
http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_001160
This document can also be found on the Bloomberg Professional® service using the function BBLS<GO> or by typing CITA S SR-NASD-2002-168<GO>.

NASD Press Release dated March 4, 2004: http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_002848

NASD *Notice to Members 04-16*: http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_003233
This document can also be found on the Bloomberg Professional® service using the function BBLS<GO> or by typing CITA S NASD 04-16<GO>.

Frequently Asked Questions regarding NASD Rule 2130:
http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_005224

NASD Rule 2130:
http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=1159000466
This document can also be found on the Bloomberg Professional® service using the function BBLS<GO> or by typing CITA S NASD Rule 2130<GO>.

NASD *Notice to Members 04-43***:**
http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_003014
This document can also be found on the Bloomberg Professional® service using the function BBLS<GO> or by typing CITA S NASD 04-43<GO>.

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[1] The application form for broker-dealers is the Uniform Application for Broker-Dealer Registration (Form BD); the application for registered persons is the Uniform Application for Securities Industry Registration or Transfer (Form U4).

In the News . . .

Ex-Salomon Smith Barney Broker Wins $1 Mln Defamation Verdict

By Bob Van Voris

Feb. 28 (Bloomberg) -- Former Salomon Smith Barney Inc. broker Philip Spartis won a $1 million defamation verdict against a lawyer who claimed Spartis conspired with former analyst Jack Grubman in biased recommendations of WorldCom Inc. stock.

A Phoenix jury decided, 7-2, that the lawyer, Stuart Goldberg, defamed Spartis on a Web site that claimed Spartis committed fraud while running a "boiler shop" in the Atlanta branch of Salomon, a unit of Citigroup Inc.

"There was nothing in the Web site that was truthful, at least to the degree that it dealt with Phil," said Jeffrey Liddle, Spartis's lawyer, in an interview.

Spartis, who provided information to regulators about improper brokerage practices, faces a disciplinary proceeding filed by the New York Stock Exchange's enforcement division, based on claims posted on Goldberg's Web site, Liddle said. Those claims are untrue, Liddle said.

Spartis administered several employee stock option plans, including WorldCom's. He has been sued by former WorldCom employees who lost money on the company's stock. He denies wrongdoing in those cases.

The jury deliberated four hours on Feb. 17 before announcing its verdict. Its decision was filed last week, court records show. Lawyers for both men say there will be no appeal because they expect to work out a confidential post-trial settlement.

In the 2003 suit, Spartis, 53, claimed Goldberg, 64, posted a 107-page "Special Study" and a two-page document titled "The Grubman Circle," on an Internet site. The documents falsely tied Spartis to biased research issued by Grubman, the complaint said.

Punitive Damages

Spartis claimed the statements were intended to drum up clients to file arbitration claims against him and Salomon, whose brokerage operations were later renamed Smith Barney. Spartis is working as a paralegal and hopes to clear his record and return to the securities industry, Liddle said.

The $1 million verdict included $600,000 in punitive damages, which may be awarded in Arizona if a jury finds a defendant acted with "hatred, ill will or spite," said David J. Bodney, a Phoenix lawyer who represents media companies in defamation cases. That standard may be met by proving a "conscious disregard for the truth," he said.

"That's a very generous verdict for defamation in this jurisdiction," Bodney said.

WorldCom lost more than $180 billion in market value before filing the biggest bankruptcy in history in July 2002. Grubman was fined $15 million and banned for life from the securities industry in 2003 for issuing biased stock recommendations.

The case is: Spartis v. Goldberg, 2003 Civ. 34252, Arizona Superior Court, Maricopa County.

--With reporting by George Stein in New York. Editors: Oster (ehs/adb)

Recent Cases

Arbitrator Bias

Allegation Based Solely on Arbitrator's Disclosures of Affiliations with Securities Industry Cannot Support a Finding of Evident Partiality

Bolick v. Merrill Lynch, Pierce, Fenner & Smith, No. 05-CV-4532 (E.D. Pa. Jan. 30, 2006)

On January 30, 2006, the United States District Court for the Eastern District of Pennsylvania denied an investor's petition to vacate an arbitration award finding that an allegation of arbitrator bias based solely on a public arbitrator's disclosures in his neutral profile of his affiliations with the securities industry and his son's employment in the securities industry were insufficient to support a finding of evident partiality.

Bolick Opens Account

In March 2001, Eileen Bolick (Bolick) opened an individual retirement account (IRA) with Merrill Lynch, Pierce, Fenner & Smith (Merrill Lynch), a broker-dealer and New York Stock Exchange, Inc. (NYSE) member. When she opened the account, Bolick signed an agreement, which contained an arbitration clause, requiring that the parties submit any dispute which may arise between them to arbitration.

Brett Freeman (Freeman) was the financial advisor assigned to Bolick's account. Based on Merrill Lynch's recommendation, Bolick invested her IRA in a managed account offered through the Merrill Lynch Consults Program (Consults Program). When Bolick opened the account, her IRA consisted of approximately $109,000. Due to losses suffered in her IRA, Bolick closed the account in July 2003.

During the time that Bolick's account was opened with Merrill Lynch, the stock market experienced a prolonged bear market that began in 2000 and continued into 2003 which affected almost all sectors of the market.

Simplified Arbitration

In June 2005, Bolick filed a Statement of Claim with the NYSE against Merrill Lynch and Freeman asserting claims for unsuitability, churning, misrepresentation, failure to supervise, and breach of fiduciary duty in regard to investments in her IRA. Initially, Bolick sought damages in the amount of $63,295 plus punitive damages.

After the initial filing of her Statement of Claim, however, Bolick elected to submit to Simplified Arbitration pursuant to NYSE Rule 601. To be eligible for Simplified Arbitration, Bolick had to agree to limit her damages claimed to $25,000. *See* NYSE Rule 601(a). Consequently, Bolick reduced the damages she sought to $24,910 plus interest and costs.

Rule 601 also provides that "the dispute, claim or controversy shall be submitted to a single public arbitrator knowledgeable in the securities industry selected by the Director of Arbitration. Unless the public customer demands or consents to a hearing, or the arbitrator(s) calls a hearing, the arbitrator shall decide the dispute, claim or controversy solely upon the pleadings and evidence filed by the parties." *See* NYSE Rule 601(f).

Securities Purchased Not Inappropriate

The NYSE assigned Bolick's arbitration to a public arbitrator, G. Rick O'Shea (O'Shea). On May 24, 2005, based on the pleadings and other supporting documents submitted by Bolick and Merrill Lynch, the arbitrator issued an award in favor of Bolick for $4,000. O'Shea found that "the losses suffered by [Bolick] were no greater, and perhaps less than those suffered by the overall market during the period of time in question."

O'Shea further found that "the securities purchased by the investment manager were *not* inappropriate for the risk tolerance and time horizon of [Bolick]." (emphasis added).

Unsuitable Investment Vehicle

However, O'Shea expressed concern about the Consults Program that Merrill Lynch recommended to Bolick. O'Shea stated that the Consults Program seemed "inappropriate for an investor whose only funds were $109,000 that were being held in a money market at the time she was placed in the Consults [P]rogram."

O'Shea found that the "Consults [P]rogram was an expensive and overly sophisticated vehicle for [an investor like Bolick] with somewhat limited funds which would be solely invested in her IRA." Therefore, O'Shea awarded Bolick $4,000 for the approximate fees she paid for what O'Shea concluded "was an unsuitable recommendation of investment vehicle."

Bolick Files Petition to Vacate in Federal Court

On August 25, 2005, Bolick filed a *pro se* Petition to Vacate the Arbitration Award in federal district court pursuant to Section 10 of the Federal Arbitration Act, 9 U.S.C. § 10. Bolick argued that the arbitration award was inappropriate and inadequate due to the arbitrator's bias.

Bolick claimed that O'Shea could not create an appearance of fairness because he had a direct financial and personal interest in the outcome of the arbitration proceeding based on his son's employment in the securities industry, and because he himself has "spent the better part of his career working closely with the securities industry."

Bolick argued that these factors demonstrated a "showing of bad faith" by O'Shea towards her. Bolick further argued that pursuant to NYSE Rule 607, these factors warranted the NYSE classifying O'Shea as an industry arbitrator, rather than a public arbitrator.

In response, Merrill Lynch filed a Cross-Petition to Confirm the Arbitration Award contending that Bolick waived all claims of arbitrator partiality by failing to object prior to the issuance of the arbitration award. Merrill Lynch argued that Bolick had the opportunity to object to the appointment of O'Shea, but rather she chose to confirm his appointment. Merrill Lynch argued that Bolick was aware of O'Shea's classification as a public arbitrator, his employment history and his disclosure regarding his son's employment in the securities industry.

In the alternative, Merrill Lynch asserted that Bolick failed to allege facts that met the evident partiality standard. Merrill Lynch argued that O'Shea was properly classified as a public arbitrator as he did not satisfy any of the criteria pursuant to NYSE Rule 607 to be classified as an industry arbitrator. Additionally, Merrill Lynch asserted that Bolick failed to meet the actual conflict requirement of evident partiality. Merrill Lynch noted that Bolick provided no evidence of any actual conflict or evidence that Bolick was partial to any party.

NYSE Rule 607 - Appointment of Arbitrators

NYSE Rule 607 provides that an arbitrator will be deemed as being from the securities industry if he or she: 1) is a person associated with a member, certain brokers, dealers or registered investment adviser; 2) has been associated with a person with any of the above within the past five years; 3) is retired from or spent a substantial part of his or her career in any of the above; or 4) is an attorney, accountant or other professional who devoted 20 percent or more of his or her professional work effort to securities industry clients within the last two years. *See* NYSE 607(a)(2).

Additionally, an arbitrator will be classified as an industry arbitrator if he or she is an individual registered under the Commodity Exchange Act or is a member of a registered futures association or any commodity exchange or is associated with any such person. *See id.*

NYSE Rule 607 further provides that an arbitrator who is not from the securities industry will be deemed a public arbitrator. *See* NYSE Rule 607(a)(3). Moreover, "a person will not be classified as a public arbitrator if he or she has a spouse or other member of the household who is a person associated with a registered broker, dealer, municipal securities dealer, government securities broker, government securities dealer or investment adviser." *Id.*

NYSE Guidelines for Classification of Arbitrators

The NYSE's Guidelines for Classification of Arbitrators (Guidelines) are used by the NYSE in applying Rule 607. The Guidelines state in part that "close family relationships with broker/dealers shall be disclosed and challenges for cause based on such relationships shall be honored." *See* NYSE Guidelines for Classification of Arbitrators, Section 1. The Guidelines further state that "individuals who spent a substantial part of their business careers in the securities industry shall always be classified as industry arbitrators." *Id*. at Section 2.

However, the Guidelines also provide that "individuals who spent a relatively minor portion of their career in the securities industry shall not be classified as public arbitrators until at least five years have elapsed from the date of their last industry affiliation. All such past affiliations shall be disclosed and challenges for cause based on upon past affiliations shall be sustained." *Id*. at Section 3.

No Evidence of Evident Partiality

In denying Bolick's petition, the district court noted that to vacate an arbitration award on the grounds of evident partiality, the moving party must establish specific facts which indicate improper motives on the part of the arbitrator, and which establish that the arbitrator's conduct was so biased and prejudiced as to destroy fundamental fairness. *See Forest Electric Corp. v. HCB Contractors*, No. 91-CV-1732 (E.D. Pa. Jan. 30, 1995).

The court found that in accordance with the NYSE's guidelines and rules, O'Shea's neutral profile disclosed his son's affiliation with the securities industry, as well as his own affiliations with the industry. The court further found that the substance of these disclosures alone did not support a finding of evident partiality. Furthermore, the court stated that O'Shea's profile and disclosure only served to underscore the fact that O'Shea was properly deemed a public arbitrator by the NYSE. By disclosing such information, the court stated that O'Shea was complying with the NYSE regulations, and neither his affiliations nor his son's affiliations were grounds for classifying O'Shea as an industry arbitrator.

Moreover, the court said a party to an arbitration may not sit idle through an arbitration proceeding and then collaterally attack that proceeding on grounds not raised before the arbitration when the result turns out to be adverse. *See Smith, Breslin & Associates v. Meridian Mortgage Corp.*, No. 96-CV-424 (E.D. Pa. March 31, 1997). The court noted that Bolick did not contest the fact that she received O'Shea's profile in advance of the arbitration proceeding, as required by the NYSE, and accepted him as the arbitrator. Nor did Bolick provide any other evidence in support of her claims of bias. Therefore, the court concluded that Bolick's claim of bias lacked merit.

Fraud and Manifest Disregard of Law

Lastly, Bolick alleged that the arbitrator's conduct was fraudulent and that he manifestly disregarded the law in awarding her the fees she paid for the Consults Program. Bolick asserted that the arbitrator "deviated from the applicable securities law" by awarding her the fees she paid for the Consults Program as such an award "is defined

as [a] restitution remedy while the law and the contract called for an award of [compensatory] damages to make the victim whole."

Merrill Lynch countered that Bolick's allegations of fraud were not stated with sufficient particularity, and noted that the allegations were nothing more than bare statements not based upon supporting evidence of any kind. Additionally, Merrill Lynch contended that the arbitrator's award of the Consult Program fees did not amount to manifest disregard of law. Moreover, Merrill Lynch pointed out that the arbitration award fully compensated Bolick for what O'Shea determined to be the only compensable act on the part of Merrill Lynch - an inappropriate investment vehicle.

The court noted that an allegation of fraud must be established by clear and convincing evidence, and must show that due diligence could not have resulted in discovery of the fraud prior to the arbitration. *See Foster v. Turley*, 808 F.2d 38, 42 (10th Cir. 1986). The court found that Bolick did not offer any specific facts indicating the nature of O'Shea's alleged fraud. Additionally, the court found no manifest disregard of the law by the arbitrator to justify vacating the award. Thus, the court stated that it would not vacate an arbitration award based on the "speculative allegations of a plaintiff dissatisfied with the amount of her award."

Compelling Arbitration

Ninth Circuit Holds Nonsignatory Participant of ERISA Plan Cannot be Compelled to Arbitrate ERISA Claim

Comer v. Micor Inc., No. 03-16560 (9th Cir. filed Feb. 1, 2006)

On February 1, 2006, the United States Court of Appeals for the Ninth Circuit affirmed a federal district court's decision which held that an Employment Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 *et seq*., plan participant cannot be compelled to arbitrate an ERISA claim brought on behalf of the plan where the plan, but not the participant, has signed an arbitration agreement.

Imprudent Investment Strategy

Kevin Comer (Comer) was an employee of Micor Inc. (Micor) from November 1994 to January 2003 and a participant in Micor's Employee Pension Plan and Employee Profit Sharing Plan (Plans). In or about 1999, the trustees of the Plans (Trustees) retained Salomon Smith Barney Inc. (Smith Barney), now known as Smith Barney Inc., to provide investment advice. The Trustees, on behalf of the Plans, entered into investment management agreements (Agreements) with Smith Barney which contained arbitration clauses, pursuant to which all claims or controversies between the Trustees, on behalf of the Plans, and Smith Barney concerning or arising from any of the Plans' accounts managed by Smith Barney had to be submitted to binding arbitration.

In February 2003, Comer filed a Complaint in the United States District Court for the Northern District of California against Micor as the plan administrator, the Trustees and Smith Barney. The Complaint stated an ERISA claim for breach of fiduciary duty against all defendants and an ERISA claim for equitable relief from interference with protected rights against Micor.

Comer alleged that in or about 1999, the defendants began investing most of the Plans' assets in large capitalization equities, with most of the Plans' holdings concentrated in high-tech and telecom stocks. Smith Barney allegedly maintained these concentrated positions, even after the "bubble burst" in 2000, until in or about June 2002. Comer asserted this was not a prudent investment strategy for the Plans and that the Plans incurred large investment losses. The Trustees terminated Smith Barney as investment advisor for the Plans in or about August 2002.

Additionally, Comer claimed that he urged Micor and the Trustees to take corrective action to bring the Plans into compliance with ERISA's fiduciary requirements, but they resisted his requests. Comer maintained that Micor and the Trustees also began retaliating against him by excluding him from conference calls and meetings regarding Micor's business operations, reducing his work assignments, and changing his compensation structure. Comer claimed that he was forced to leave his employment because of the purported retaliation.

Petition to Compel Arbitration

In April 2003, at the same time it filed its Answer to Comer's suit, Smith Barney filed a Petition to Compel Arbitration and a Motion to Stay Proceedings pending the arbitration. Smith Barney contended that Comer was bound by the arbitration clauses in the Agreements as a plan participant because his claims arose from the relationship between the Trustees and Smith Barney. In the alternative, Smith Barney argued that Comer was bound by the arbitration clauses as a third-party beneficiary.

In July 2003, the district court denied Smith Barney's Petition to Compel Arbitration and Motion to Stay the Proceedings finding that a then recent U.S. Supreme Court decision, in *Equal Employment Opportunity Commission (EEOC) v. Waffle House Inc.*, 534 U.S. 279 (2002), precluded Comer's ERISA claim for breach of fiduciary duty from being subject to the arbitration provisions of the Agreements as Comer was not a party to the Agreements and did not agree to arbitrate his claims. The court also found that there was insufficient evidence or legal authority for the court to conclude that Comer was a third-party beneficiary to the Agreements.

In August 2003, Smith Barney filed an appeal with the United States Court of Appeals for the Ninth Circuit.

Ordinary Contract & Agency Principles

In determining whether the arbitration provisions applied to Comer's ERISA claim against Smith Barney, the Ninth Circuit noted that nonsignatories of arbitration agreements may be bound by the agreement pursuant to ordinary contract and agency principles, such as estoppel, third-party beneficiary and agency. *See Letizia v. Prudential Bache Securities, Inc.*, 802 F.2d 1185 (9th Cir. 1986); *Thomson-CSF, S.A. v. American Arbitration Association*, 64 F.3d 773, 776 (2d Cir. 1995); and *E.I. DuPont de Nemours & Co. v. Rhone Poulenc Fiber & Resin Intermediates*, 269 F.3d 187, 195 (3d Cir. 2001).

Equitable Estoppel

On appeal, Smith Barney argued that Comer was bound by the arbitration clauses as a matter of equitable estoppel. "Equitable estoppel precludes a party from claiming the benefits of a contract while simultaneously attempting to avoid the burdens that contract imposes." *See Washington Mutual Financial Group, LLC v. Bailey*, 364 F.3d 260, 267 (5th Cir. 2004).

The court did note that nonsignatories have been held to arbitration clauses where the nonsignatory knowingly exploits the agreement containing the arbitration clause. *See E.I. DuPont de Nemours & Co.* at 199. However, the court found that Smith Barney did not provide any evidence that Comer knowingly exploited the Agreements. The court stated that prior to filing his Complaint, Comer did not seek to enforce the terms of the Agreements. More importantly, the court found that Comer did not exploit the Agreements by bringing his lawsuit as his claims were based entirely on ERISA and not on the Agreements.

Third-Party Beneficiary

The Ninth Circuit also rejected Smith Barney's contention that Comer was bound by the arbitration clauses as a third-party beneficiary. The court noted that "to sue as a third-party beneficiary of a contract, the third-party must show that the contract reflects the express or implied intention of the parties to the contract to benefit the third-party." *See Klamath Water Users Protective Association v. Patterson*, 204 F.3d 1206, 1211 (9th Cir. 2000).

The court concurred with the district court's findings that Smith Barney did not produce any evidence that the Trustees and Smith Barney intended to give every beneficiary of the plans the right to sue under the Agreements. Therefore, the court found that Comer could not be bound to the terms of a contract that he did not sign and is not entitled to enforce.

Third Circuit Approach

In support of its contention that Comer was bound by the arbitration clauses in the Agreements as a plan participant because his claims arose from the relationship between the Trustees and Smith Barney, Smith Barney solely relied on a New Jersey district court decision, *Bevere v. Oppenheimer & Co.*, 862 F. Supp. 1243 (D.N.J. 1994). In *Bevere*, the court held that a plan participant can be compelled to arbitrate an ERISA claim subject to an arbitration clause of a customer agreement that he or she did not sign where the plan administrator had the authority to bind the plan and there was no issue of fact regarding the formation of the customer agreement, and the arbitration clause in particular. *Id*. at 1250.

However, in rejecting the *Bevere* court's holding, the district court noted that the *Bevere* court did not rely on agency principles to conclude that the plaintiffs were bound by the arbitration agreements signed by the plan administrator. The district court also found that the *Bevere* court did not rely on any third-party beneficiary theory in reaching its decision, but rather on "the law in this circuit" and focused on the nature of the relationship between the parties to the contract and the fact that the plaintiffs' claims were derivative of that relationship. *Id*. at 1240.

The Ninth Circuit concurred with the district court's findings that the Third Circuit's approach was not grounded in ordinary contract and agency principles and that the principles of equitable estoppel and third-party beneficiary did not apply in this case. The court stated that the Trustees did not act as Comer's agents in entering into the Agreements. *See* Restatement (Second) of Trusts § 8 ("An agency is not a trust."). Therefore, the court concluded that it was precluded by *Letizia* from adopting the Third Circuit's approach.

EEOC v. Waffle House

Moreover, the Ninth Circuit found that even if the *Bevere* court's holding was grounded in ordinary principles of contract or agency law, it would be superseded by *Waffle House*. In *Waffle House*, the U.S. Supreme Court held that an employee's signing of an arbitration agreement with the employer did not bar the EEOC from seeking victim-specific relief in an American with Disabilities Act enforcement action because the EEOC had independent statutory authority to bring the suit and it never agreed to arbitrate its claim against the defendant.

The Ninth Circuit also concurred with the district court's finding that Comer's cause of action was "materially indistinguishable" from the EEOC's cause of action in *Waffle House*. The court rejected Smith Barney's assertion that the cases were distinct because in *Waffle House* the EEOC was suing in a non-derivative capacity, whereas Comer was suing in an entirely derivative capacity.

While the court agreed that the EEOC was not suing in a wholly derivative capacity, it held that based on its own precedent that an ERISA claimant also sues in a non-derivative capacity. *See Landwehr v. DuPree*, 72 F.3d 726, 732-33 (9th Cir. 1995). In *Landwehr,* the court held that the statute of limitations began when the individual plaintiff had actual knowledge of an ERISA claim as the cause of action belonged to the individual plaintiff even though the money recovered on the ERISA claim would go to the plan.

Vacating Arbitration Award

Fifth Circuit Affirms $2.9 Million Punitive Damages Arbitration Award Against Investment Firm

Sarofim v. Trust Company of the West, No. 05-20309 (5th Cir. Feb. 8, 2006)

On February 8, 2006, the United States Court of Appeals for the Fifth Circuit affirmed a federal district court's decision which confirmed an arbitration panel's award including $2.9 million in punitive damages to an individual investor against an investment firm finding that the arbitration panel did not manifestly disregard applicable law or violate public policy in granting the award.

$12.7 Million Investment Account

In 2000, Valerie Biggs Sarofim (Sarofim) opened an investment account with Trust Company of the West (TCW) in the amount of $12.7 million. The majority of the money was invested in TCW's Concentrated Core Portfolio, which consisted of stocks selected for an emphasis on growth. The balance of the funds, $2.2 million, was invested in TCW's Galileo High Yield Bond Fund, a mutual fund which invested in "admitted" junk bonds. When Sarofim opened the account she signed an agreement which contained mandatory arbitration provisions. Additionally, the agreement provided that it was governed by California law.

From 2000 to 2003, Sarofim's account suffered $6 million in losses. Additionally, during this time Sarofim made withdrawals for personal expenses. When Sarofim closed her account on May 22, 2003, it contained approximately $2.4 million.

On May 20, 2003, Sarofim initiated arbitration proceedings against TCW by filing a Statement of Claim with the American Arbitration Association, which she later amended in December 2003. *Sarofim v. Trust Company of the West*, No. 70 Y 181 00364 03 (American Arbitration Association Aug. 19, 2004) (Craig, J., Elston, J. and Wilk, M.). Sarofim asserted claims against TCW for breach of fiduciary duty, fraud, unconscionability, constructive fraud, negligent misrepresentation, negligence, and breach of contract.

"Wholly and Negligently Unsuitable" Investments

On or about August 25, 2004, after a five-day hearing a three-member arbitration panel, at the parties' request, issued a "reasoned award." "[A] reasoned award is something short of findings and conclusions but more than a simple result." *Holden v. Deloitte & Touche LLP,* 390 F. Supp. 2d 752, 780 (N.D. Ill. 2005). The panel held that TCW breached its fiduciary duties to Sarofim by placing her assets in "wholly and negligently unsuitable" investments. The panel further found that TCW failed to diversify her investments and failed to educate Sarofim about the risks of investing. Additionally, the panel found that TCW failed to educate itself about Sarofim's needs as an investor. The panel rejected TCW's argument that it served merely as a broker, finding that TCW served as Sarofim's financial consultant and advisor.

The arbitration panel awarded Sarofim $6.3 million in actual damages and $2.9 million in punitive damages. The panel found TCW's breach of fiduciary duties justified an award of punitive damages to Sarofim. The panel denied Sarofim's request for attorney's fees, finding that it was precluded from awarding attorney's fees pursuant to the arbitration agreement and California law.

Motion to Vacate Punitive Damages Award

On August 27, 2004, pursuant to Section 9 of the Federal Arbitration Act, 9 U.S.C. § 9, Sarofim filed a Motion to Confirm the Arbitration Award with the United States District Court for the Southern District of Texas. In response, TCW filed a Motion to Vacate the Punitive Damages Award contending that the arbitration panel manifestly disregarded the applicable law and that the punitive damages award violated public policy. TCW did not challenge the factual findings or the actual damages award. In March 2005, the district court granted Sarofim's motion to confirm and denied TCW's motion to vacate.

In April 2005, TCW filed an appeal with the United States Court of Appeals for the Fifth Circuit.

Manifest Disregard

On appeal, TCW argued that the arbitrators manifestly disregarded applicable law in awarding Sarofim $2.9 million in punitive damages, asserting that the panel awarded her attorney's fees *disguised* as punitive damages as the amount awarded was approximately the same as the attorney's fees Sarofim requested, but was denied. TCW further argued that its culpability did not exceed simple negligence. Therefore, TCW contended that the arbitration panel could not have found by clear and convincing evidence that it was guilty of oppression, fraud, or malice as required under California law for an award of punitive damages. *See* Cal. Civ. Code § 3294(a).

In rejecting TCW's argument, the Fifth Circuit noted that review of an arbitration award is deferential, with vacatur allowed only on narrow grounds. *See Brabham v. A.G. Edwards & Sons Inc.*, 376 F.3d 377, 380 (5th Cir. 2004); *First Options of Chicago v. Kaplan*, 514 U.S. 938, 942 (1995). The court explained the fact that the arbitrators

acted contrary to the applicable law does not amount to manifest disregard of the law. *See Williams v. Cigna Financial Advisors Inc.*, 197 F.3d 752 (5th Cir. 1999). Moreover, the court stated that "TCW, as a party to the arbitration, agreed to [a reasoned award] rather than requesting specific findings of fact and conclusions of law. [Therefore,] TCW cannot now seek vacatur based on the award's lack of specificity."

The court found that the arbitration panel did not act contrary to the applicable law. Although the arbitration panel did not use the exact language of Section 3294(a), the court found that sufficient evidence existed to support the determination that the award satisfied Section 3294, as the arbitration decision explained that the action of the parties justified the punitive damages award. The court further found that the arbitration decision contained enough information to infer that TCW committed "despicable conduct" with "willful and conscious disregard of the rights" of others. *See* Cal. Civ. Code § 3294(c) (defining malice). Additionally, the court found the decision contained sufficient information for a finding of "intentional misrepresentation, deceit, or concealment of a material fact" that "deprive[d] a person of property." *Id*. (defining fraud).

In support of its findings, the Fifth Circuit recounted that the arbitration panel found that TCW's attempts to educate Sarofim consisted of one or two undocumented telephone calls and one face-to-face meeting at which a TCW representative showed her a graph comparing the Concentrated Core Portfolio with a fund operated by her father-in-law. The court noted that the arbitration panel found the graph to be "incomplete, misleading and inflammatory." The court also found relevant that the arbitration panel noted that "a TCW vice president, Sarofim's primary contact with TCW, testified that he believed her portfolio was inappropriate from the beginning." Lastly, the court noted that "the panel also considered the investment strategy unsuitable because of its lack of diversification and failure to address Sarofim's liquidity needs."

Public Policy

The court also rejected TCW's argument that the punitive damages award violated California public policy finding that the award satisfied California's goals of "punishing" the wrongdoer and "deterring" others from engaging in similar conduct. *See PPG Industries, Inc. v. Transamerica Insurance Co.*, 975 P.2d 652, 657 (Cal. 1999). The court stated that "[r]equiring TCW to pay $2.9 million punishes the company, and the award has the potential to deter entities from engaging in similar behavior." Additionally, the court found that the award was specific enough to put financial advisors on notice that they should not operate in the same manner that TCW did in handling Sarofim's account.

The court further stated that California public policy contained an "exceedingly deferential standard" for punitive damages awarded in arbitration. The court noted that "California policy does not limit punitive damages in arbitration, even if those awards are contrary to 'procedural or substantive law imposed by statute and judicial interpretations.'" *See Rifkind & Sterling, Inc. v. Rifkind*, 33 Cal. Rptr. 2d 828, 833 (Ct. App. 1994). Moreover, the court stated that unless otherwise constricted by rules of law, arbitrators could base their rulings on broad principles of justice and equity, thereby in some instances rejecting a claim that a party may have successfully asserted in a judicial proceeding. *See Moncharsh v. Heily & Blase*, 832 P.2d 899, 904 (Cal. 1992).

Contract Validity

U.S. Supreme Court Holds Challenge to Validity of a Contract Containing an Arbitration Clause Must be Determined by Arbitrator

Buckeye Check Cashing Inc. v. Cardegna, No. 04-1264 (U.S. Feb. 21, 2006)

On February 21, 2006, the Supreme Court of the United States, in a 7-1 vote, reversed a Florida Supreme Court decision which held that a *court* should resolve the issue of whether a contract, which contains an arbitration clause, is illegal and void *ab initio*. Rather, the U.S. Supreme Court held that whether the challenge is brought in federal or state court, a challenge to the validity of a contract as a whole, and not specifically to the arbitration clause, should be determined by an arbitral body.

Usurious Rates of Interest

John Cardegna and Donna Reuter (collectively, Respondents) entered into various deferred-payment transactions with Buckeye Check Cashing Inc. (Buckeye) in which they received cash in exchange for a personal check in the amount of the cash plus a finance charge.

For each separate transaction Respondents signed a Deferred Deposit and Disclosure Agreement (Agreement) which contained an arbitration provision requiring the parties to submit any claim or dispute arising from or related to the Agreement to binding arbitration pursuant to the Federal Arbitration Act (FAA), 9 U.S.C. § 1 *et seq.* The arbitration provision further provided that any claim or dispute relating to the validity, enforceability, or scope of the arbitration provision or the entire agreement would also be resolved by binding arbitration.

In February 2001, Respondents filed a putative class action against Buckeye in a Florida state trial court. The Respondents alleged that the fees that Buckeye charged for its check cashing services were usurious in violation of various Florida statutes. The Respondents further argued that this rendered the contract as a whole null and void.

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Motion to Compel Arbitration

In response, Buckeye moved to compel arbitration of the Respondents' claims and stay all proceedings contending that, based on the U.S. Supreme Court's holding in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), an arbitrator should resolve the question of whether the underlying contract was *void* for illegality.

In *Prima Paint*, the Court held that pursuant to the FAA, unless there was a claim that the arbitration agreement itself was procured by fraud, an arbitrator should resolve the question of whether the underlying contract is *voidable*. The Court further held that the issue of whether the arbitration agreement was severable from the underlying contract was governed by federal law under the FAA.

The Respondents countered that *Prima Paint* did not apply in the state court context.

The state trial court denied Buckeye's motion finding that although the Respondents' claims fell within the broad language of the parties' arbitration agreement, the rule of law in the state of Florida provided that a court, not an arbitrator should resolve a challenge to the legality of the underlying contract. *See Party Yards, Inc. v. Templeton,* 751 So. 2d 121 (Fla. Dist. Ct. App. 2000); *FastFunding The Company, Inc. v. Betts*, 758 So. 2d 1143 (Fla. Dist. Ct. App. 2000).

Buckeye appealed to a Florida district court of appeals, which reversed the trial court. The district court of appeals noted that while the Respondents argued that the contract was void *ab initio* because it was criminally usurious, they did not challenge the legality of the arbitration provision. Therefore, in reliance on *Prima Paint* the district court of appeals held that the arbitration agreement was enforceable and the challenge to the legality of the underlying contract had to be resolved by an arbitrator and not a court.

Respondents appealed the district court of appeals' decision to the Florida Supreme Court.

Florida Supreme Court

In January 2005, the Florida Supreme Court reversed the appellate court's decision holding that "where a party sufficiently alleges that a contract is void for violation of Florida usury laws, the Florida courts, and not an arbitrator must first determine the contract's legality before a party may be required to submit to arbitration under a provision of the contract."

The court stated "if the underlying contract is held entirely void as a matter of law, all of its provisions, including the arbitration clause, would be nullified as well." The court further stated that "there are no severable, or salvageable, parts of a contract found illegal and void under Florida law."

Furthermore, the Florida Supreme Court found that this case was distinguishable from the U.S. Supreme Court's decision in *Prima Paint*. Specifically, the Florida Supreme Court found relevant that the issue in *Prima Paint* was whether the contract was *voidable*, whereas, the claim before the court in Buckeye was whether the contract was *entirely void as a matter of law*.

Buckeye filed an appeal with the U.S. Supreme Court. The U.S. Supreme Court granted *certiorari* on June 20, 2005.

FAA Preempts State Law

On appeal, Buckeye asserted that the state law applied by the Florida Supreme Court conflicted with the FAA and U.S. Supreme Court's decision in *Prima Paint*. Buckeye argued that the Court's decision in *Prima Paint* established that pursuant to the FAA, any challenge to the validity of an underlying contract is severable from a challenge to validity of an arbitration clause. Therefore, Buckeye contended that the state law applied by the Florida Supreme Court was preempted by *Prima Paint* and the FAA.

The Respondents on the other hand, asserted that *Prima Paint's* rule of severability did not apply in state court as *Prima Paint* was based only on Sections 3 and 4 of the FAA, which are procedural provisions that are only applicable in federal courts. The Respondents contended that only Section 2 of the FAA has been applied in state court. The Respondents further argued that since Section 2 only applies to arbitration agreements that involve a contract, that section did not apply to this case because under Florida state law an agreement void *ab initio* is not a contract. Therefore, the Respondents asserted there was no contract in this matter to which Section 2 could be applied.

Prima Paint Applicable in State Court

In reversing the Florida Supreme Court's decision, the U.S. Supreme Court found the Florida court's distinction of this case from *Prima Paint* irrelevant. The court noted that in *Prima Paint*, it rejected "the application of state severability rules to the arbitration agreement *without discussing* whether the challenge at issue would have rendered the contract void or voidable." Therefore, the Court found that the Florida Supreme Court erred in not applying *Prima Paint's* rule of severability to this case.

The Court also rejected the Respondents' contention that *Prima Paint* did not apply in state court. The Court found that the Respondents misinterpreted *Prima Paint* in arguing that the Court only relied on Sections 3 and 4 of the FAA in establishing the rule of severability. The Court stated that "although § 4, in particular, had much to do with *Prima Paint's* understanding of the rule of severability, [] this rule ultimately arises out of § 2, the FAA's substantive command that arbitration agreements be treated like all other contracts." The Court further stated that "the rule of

severability establishes how this equal footing guarantee [] is to be implemented."

Lastly, the Court rejected the Respondents' contention that Section 2 did not apply to an agreement that was void *ab initio* under state law stating that it did not read the term "contract" so narrowly. Rather, the Court found that "contract" as used in the final clause of Section 2 which provides for a challenge to an arbitration clause at law or in equity for the revocation of *any* contract, includes contracts that may later prove to be void. The Court reasoned that to determine otherwise would mean the grounds for revocation of a contract would be limited to those that rendered a contract voidable and therefore, contracts could only be challenged as voidable and not void.

Arbitration Awards

Former Goldman Sachs Broker Awarded $2.5 Million by NASD Arbitration Panel
Katz v. Goldman Sachs & Co., NASD Decision No. 03-08283 (Jan. 13, 2006)

On January 13, 2006, a panel of NASD arbitrators, sitting in California, awarded Sanford Katz (Katz) $2,524,935 against his former employer, Goldman Sachs & Co. (Goldman or Firm), a broker-dealer and NASD member firm. Goldman is a subsidiary of The Goldman Sachs Group Inc.

Downsizing Efforts

Katz began his employment with Goldman on June 30, 1986, in the Firm's New York office in the Municipal Bond Trading Department. In 1995, Katz was transferred to the Firm's San Francisco office.

On or about November 13, 2002, Goldman terminated Katz's employment approximately two weeks before he would have been entitled to a 2002 equity award under Goldman's Stock Incentive Plan (SIP). Katz was informed that his termination was part of the Firm's downsizing efforts. At the time that he was terminated, Katz was over 40 years old.

Shortly after his termination, Katz found employment with UBS PaineWebber Inc. (UBS PaineWebber), now known as UBS Financial Services Inc., a broker-dealer and NASD member. Goldman would eventually assert that soon after Katz joined UBS PaineWebber, it became aware that Katz had chosen to solicit Firm clients with whom he had previously worked. Goldman would also later maintain that, as a result of Katz's decision to solicit clients from the Firm, it informed him that he had foregone his vested equity awards.

Equity Awards

In 1999, Goldman's parent, The Goldman Sachs Group Inc., launched an initial public offering (IPO) and became a publicly traded company. In connection with the IPO, Goldman made conditional equity awards to all of its employees through its SIP. At the end of each fiscal year since 1999, Goldman had also paid compensation in the form of conditional equity awards to certain employees, including employees at Katz's level. The conditional equity awards were governed by individual award agreements. Katz executed his award agreement in 1999.

According to Goldman, the SIP provided, in part, that an administrative committee had the sole discretion to determine the extent to which eligible employees would receive equity awards and that the committee's determinations under the SIP, which included whether or not an individual forfeited his or her equity awards, would be "final, binding and conclusive." The SIP also provided that any unvested awards would lapse upon a participant's departure from the Firm, and that participants agreed that they would not receive vested awards if they chose to solicit clients with whom they dealt with while at the Firm after leaving the Firm.

Further, the SIP and award agreements provided that New York law governed all rights and obligations under the SIP and award agreements, and that further ground for forfeiture of vested awards would exist if a participant tried to bring any dispute other than in arbitration before the New York Stock Exchange Inc. (NYSE) in New York.

Statement of Claim Filed With NASD

In November 2003, Katz filed a Statement of Claim with NASD, in California, against Goldman, which he later amended in January 2004 (Amended Statement of Claim). He claimed, among other things, that he was wrongfully terminated and that Goldman illegally withheld compensation from him. Katz also claimed that certain provisions of the SIP and award agreements were unconscionable.

Katz maintained that at some point during his employment with Goldman, the Firm made promises of continued employment and that he was terminated without cause. Additionally, Katz asserted that he was "terminated because he complained about certain purported illegal practices and fraudulent treatment of clients at Goldman." Katz also alleged that Goldman had a policy of "reducing star employees" which evidenced a discriminatory intent against employees 40 years of age and older. Katz also asserted that the Firm's downsizing efforts had an adverse impact on older workers.

Katz contended that the equity award "forfeiture for cause" provisions were unconscionable because they were vaguely defined and unlawfully broad. He also asserted that the degree of discretion afforded the administrative committee and the advance waiver of the right to contest the Firm's decisions under the SIP made the agreements unconscionable.

Katz Sought Over $15 Million in Damages

Katz sought damages that "[could] not presently be ascertained, but which exceed[ed] $15,000,000." The monetary damage claim was comprised, in part, of withheld earned compensation and options, lost income from Goldman clients whose business Katz lost upon his termination, and lost income during the transition phase of rebuilding his client base.

He also sought disgorgement of Goldman's profits from the use of his earned compensation, delivery of securities purchased with his earned but unpaid compensation, and interest on damages from the date of termination or earlier date on which the damages accrued.

Goldman's Response

In response to Katz's Amended Statement of Claim, Goldman filed a Motion to Decline Jurisdiction in April 2004 contending that pursuant to the terms of the award agreement that he signed Katz was barred from proceeding with his Amended Statement of Claim before NASD. Goldman filed its Answer to the Amended Statement of Claim in June 2004 in which it denied all of Katz's claims and asserted various affirmative defenses. On or about December 2, 2004, NASD denied Goldman's Motion to Decline Jurisdiction.

Goldman contended that Katz was an at-will employee who was terminated as part of the Firm's downsizing efforts for poor performance. The Firm denied that anyone made assurances of continued employment to Katz. Goldman also denied Katz's claims of discrimination. The Firm noted that Katz contradicted certain of his own allegations by stating in his Amended Statement of Claim that Goldman "generally selects candidates for downsizing based on seniority" thereby terminating the least senior employees first. Goldman argued that its downsizing policy based on seniority, as evidenced by Katz's statements, benefits older workers rather than harming them. Moreover, Goldman also noted that Katz stated that "not a single other vice president was actually selected for termination."

Goldman also asserted that the forfeiture provisions and other provisions of the SIP were not unconscionable under the laws of New York or California. The Firm stated that its decision to forfeit Katz's vested awards was based on Katz's decision to solicit Firm clients as provided for in the contract that Katz signed and not based merely on his competition. Moreover, in applying the "employee choice doctrine" Goldman argued that "New York courts have *repeatedly rejected* the argument that conditioning incentive compensation awards on not injuring the employer after termination is unconscionable." (emphasis added.)

The Firm noted that under California law a contract provision must be procedurally and substantively unconscionable to be void. Goldman argued that the SIP and award agreements were not procedurally unconscionable because Katz had the meaningful choice to reject them. Goldman maintained that if Katz was dissatisfied with the terms of the SIP he could have easily sought employment elsewhere.

Furthermore, Goldman argued that the SIP and award agreements were not substantively unconscionable because, "[l]ike New York courts, California courts have enforced employment contracts for the forfeiture of an employee's incentive compensation awards if he engages in competitive activity." Therefore, Goldman asserted that if California law allowed the forfeiture of incentive compensation based on an employee's competition with an employer, it would also allow the forfeiture of Katz's compensation at issue here because it was based on his actual solicitation of Firm clients and not on his mere competition with the Firm.

Goldman also asserted that it did not withhold earned but unpaid compensation from Katz. The Firm contended that it did not withdraw money from Katz's compensation, nor was there any compensation plan that called for such withdrawals.

Furthermore, Goldman argued that under New York and California law, the SIP constituted a discretionary bonus plan under which Katz had no contractual right to payment as the SIP and award agreements vested sole discretion as to the determination of the extent of the equity awards to the administrative committee.

Damages Awarded

On January 13, 2005, the panel, comprised of Robert M. Lubin, Esq., the non-public arbitrator, and William J. Pretzel, J.D. and Anthony G. Sousa, J.D., the public arbitrators, found Goldman liable to Katz for $2,524,935 million. The panel denied Katz's claims for punitive damages and attorney fees.

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Legislative Activity Summary

Date Introduced	Bill No.	Short Title	Purpose	Most Recent Action
9/06/05	H.R. 3651	Arbitration Choice	To amend Title 9, United States Code, to allow employees the right to accept or reject the use of arbitration to resolve an employment controversy.	Referred to Subcommittee on Commercial and Administrative Law on 9/19/05
6/23/05	S. 1307	Dominican Republic-Central America-United States Free Trade Agreement Implementation Act	To approve and implement the Free Trade Agreement between the United States, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua entered into under the authority of section 2103(b) of the Bipartisan Trade Promotion Authority Act of 2002. (19 U.S.C. 3803(b)). Establishes at Chapters 10 and 20 arbitration procedures for Investor-State disputes.	Signed by President Bush on 8/02/05
3/03/05	H.R. 1077	Realtime Investor Protection Act	To improve the access of investors to regulatory records with respect to securities brokers, dealers, and investment advisers.	Received in the Senate and referred to the Committee on Banking, Housing, and Urban Affairs on 4/07/05
2/01/05	H.R. 458	Military Personnel Financial Services Protection Act	To prevent the sale of abusive insurance and investment products to military personnel.	Received in the Senate and referred to the Committee on Banking, Housing, and Urban Affairs on 6/28/05
2/01/05	H.R. 461	Military Personnel Financial Services Protection Act	To prevent the sale of abusive insurance and investment products to military personnel.	Referred to the House Committee on Financial Services on 2/01/05
2/17/05	S.418	Military Personnel Financial Services Protection Act	To prevent the sale of abusive insurance and investment products to military personnel.	Read twice and referred to the Committee on Banking, Housing, and Urban Affairs on 2/17/05

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Regulatory Activity Summary

Final Rules

Regulator	Action	Topic	Purpose	History	Relevant Dates
SEC	**Final Rule** - Release No. 34-52958 - File No. SR-NYSE-2005-73	Waiver of California Ethical Standards	Rescinds NYSE Rule 600(g), a pilot rule permitting waiver of California Ethical Standards.	Final Rule, Release No. 34-46816; Final Rule, Release No. 34-47836 (extended pilot rule's effectiveness until 9/30/03); Final Rule, Release No. 34-48552 (extended pilot rule's effectiveness until 3/31/04); Final Rule, Release No. 34-49521 (extended pilot rule's effectiveness until 9/30/04); Final Rule, Release No. 34-50449 (extended pilot rule's effectiveness until 3/31/05); Final Rule, Release No. 34-51395 (extended pilot rule's effectiveness until 9/30/05)	**Release Date:** December 15, 2005
SEC	**Final Rule** - Release No. 34-52822 - File No. SR-NYSE-2005-02	Arbitrator Selection	Amends NYSE Rule 607 by modifying and making permanent the Random List Selection Method and eliminating the Enhanced List Selection Method under the Pilot Rule.	Proposed Rule, Release No. 34-51863 - File No. SR-NYSE-2005-02; Pilot Program 34-43214 - File No. SR-NYSE-2000-34; 34-46372 - File No. SR-NYSE-2002-30 (extended pilot rule's effectiveness to 7/31/04); 34-49915 (extended pilot rule's effectiveness to 1/31/05); 34-51085 (extended pilot rule's effectiveness to 7/31/05); 34-52155 (extended pilot rule's effectiveness to 11/30/05)	**Release Date:** November 22, 2005
SEC	**Final Rule** - Release No. 34-52705 - File No. SR-NASD-2004-013	Mediation	Simplifies the language of the mediation portion of the NASD Code of Arbitration using plain English and reorganizes them into a separate code for mediations.	Proposed Rule, Release No. 34-51855 - File No. SR-NASD-2004-013	**Release Date:** October 31, 2005
SEC	**Final Rule** - Release No. 34-52658 - File No. SR-NASD-2005-046	Arbitration Fees	Limits arbitration filing fees applicable to certain statutory employment discrimination claims.	Proposed Rule, Release No. 34-51921 - File No. SR-NASD-2005-046	**Release Date:** October 24, 2005
SEC	**Final Rule** - Release No. 34-52513 - File No. SR-PCX-2005-106 * *See also* PCX Weekly Bulletin 05-39	Waiver of California Ethical Standards	Amends PCX Options and PCX Equities, Inc. arbitration rules to rescind the pilot rules regarding waiver of the California Ethical Standards and California Code of Civil procedure Section 1281.92.	Final Rule, Release No. 34-46881; Final Rule, Release No. 34-47872 (extended pilot rules' effectiveness until 11/22/03); Final Rule, Release No. 34-48806 (extended pilot rules' effectiveness until 5/23/04); Final Rule, Release No. 34-49758 (extended pilot rules' effectiveness until 11/24/04); Final Rule, Release No. 34-50731 (extended pilot rules' effectiveness until 5/25/05); Final Rule, Release No. 34-51696 (extended pilot rules' effectiveness until 11/26/05).	**Effective Date:** September 20, 2005
SEC	**Final Rule** - Release No. 34-52316 - File No. SR-NYSE-2005-56 * *See also* NYSE Information Memo 05-60	Arbitration Fees	Amends NYSE Rule 629 to establish arbitration processing fees for members, member organizations and allied members where dispute involves over $25,000.		**Effective Date:** August 10, 2005
SEC	**Final Rule** - Release No. 34-52016 - File No. SR-NYSE-2005-29	Failure to Honor an Arbitration Award	Removes incorrect reference in rule relating to failure to honor arbitration awards.	Proposed Rule, Release No. 34-51622 - File No. SR-NYSE-2005-29.	**Release Date:** July 12, 2005

Regulatory Activity Summary (cont'd)

SEC	**Final Rule** - Release No. 34-51931 - File No. SR-NASD-2005-052	Arbitrator Compensation	Adopts a new rule to provide $200 payment to arbitrators for deciding discovery-related motions without a hearing session.	Proposed Rule, Release No. 34-51693 - File No. SR-NASD-2005-052.	**Release Date:** June 28, 2005
SEC	**Final Rule** - Release No. 34-51825 - File No. SR-NASD-2005-070	Waiver of California Ethical Standards	Rescinds pilot rule in IM 10100(f) of NASD Code of Arbitration relating to the waiver of California Ethical Standards.	Final Rule, Release No. 34-46562; Final Rule, Release No. 34-50447 (extended pilot rule's effectiveness until 3/31/05); Proposed Rule, Release No. 34-50971 (sought extension of pilot until 9/30/05); Final Rule, Release No. 34-51213 (extended pilot rule's effectiveness until 9/30/05).	**Release Date:** June 13, 2005

Proposed Rules

Regulator	Action	Topic	Purpose	History	Relevant Dates
SEC	**Proposed Rule -** Release No. 34-53431 - File No. SR-CBOE-2004-65	Restrictions on Arbitrators	Would codify policy restricting Arbitration Committee members from representing parties in cases submitted to CBOE and provide greater safeguards for disqualifying arbitrators.		**Comments Due:** 21 days after publication in the Federal Register
SEC	**Proposed Rule -** Release No. 34-52468 - File No. SR-NYSE-2005-48	Subpoenas	Would provide for a 10-Day notice requirement before party issues a subpoena to a non-party for pre-hearing discovery.		**Comments Due:** closed on October 17, 2005
SEC	**Proposed Rule** - Release No. 34-52314 - File No. SR-NYSE-2005-43	Classification of Arbitrators	Would amend NYSE Rule 607 to clarify rules for classifying arbitrators as public or industry.		**Comments Due:** closed on September 19, 2005
SEC	**Proposed Rule** - Release No. 34-52332 - File No. SR-NASD-2005-094	Classification of Arbitrators	Would amend NASD Rule 10308 to clarify rules for classifying arbitrators as public or non-public.		**Comments Due:** closed on September 20, 2005
SEC	**Proposed Rule** - Release No. 34-52045 - File No. SR-NASD-2005-023	Representation in Arbitration and Mediation Proceedings	Would amend Rule 10316 and adopt Rule 10408 of the NASD Code of Arbitration to allow admitted attorneys to represent clients in arbitration or mediation proceedings.		**Comments Due:** closed on August 11, 2005
SEC	**Proposed Rule** - Release No. 34-51857 - File No. SR-NASD-2004-011	Amendments to NASD Code of Arbitration	Would amend NASD Code of Arbitration for industry disputes to reorganize current rules, simplify language, codify current practices and implement substantive changes.		**Comments Due:** closed on July 14, 2005
SEC	**Proposed Rule** - Release No. 34-51856 - File No. SR-NASD-2003-158	Amendments to NASD Code of Arbitration	Would amend NASD Code of Arbitration for customer disputes to reorganize current rules, simplify language, codify current practices and implement substantive changes.		**Comments Due:** closed on July 14, 2005

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Presumably because no such rule existed in the various arbitration codes of the SROs, initially such motions were rarely brought by respondents. It is impossible to determine whether in recent years claimants began to bring more cases on a percentage basis that fall under one of the motion to dismiss categories above, or the volume of arbitrations filed in the past six years simply increased the raw number of such instances. Whatever the reason, more and more respondents' representatives appear to now be utilizing motions to dismiss in lieu of Answers.

Partly, this is because simple knowledge of the six-year eligibility rule[5] does not seem to inhibit claimants from bringing untimely claims as much as one would imagine it would. Accordingly, respondents' representatives have increasingly responded to untimely claims with motions to dismiss based on Rule 10304. Another common tactic is for claimants' counsel to name as respondents the owners and executive officers of a brokerage firm in addition to the actual broker and firm with whom they actually invested. Typically, the Statement of Claim in such instances will mention the executive or owner in the "Description of Parties" section, and describe them merely as the Owner, President, CEO, etc., as the case may be, and then never specifically mention that individual again. While the potential strategic value to a claimant is clear, what is at best unclear is whether the claimant has an absolute right to force such an individual to provide private, personal documents in discovery and then physically show up and sit through what can occasionally be lengthy arbitration hearings.

Generally, claimants in such situations rely on claims of "control person liability" and "failure to supervise" in an attempt to explain why the brokerage firm's Executive Officers (who have never met nor spoken to or otherwise dealt with the claimant) should be forced to defend themselves throughout the entire arbitration process. Often, the attorney representing such an Executive Officer will submit a motion to dismiss these particular respondents at inception, while submitting an Answer on behalf of the broker and/or firm itself. Sometimes the claimant will be able to make a *prima facie* showing that the Executive Officer in question actually knew about the alleged wrongdoing and either did nothing to stop it or otherwise participated in it. If so, the motion to dismiss should not be brought, or if it is, not granted.

Yet in the circumstance described above, it appears that the law is on the Executive Officers' side, and what most holds them back is that the case is in arbitration and not court. If such a case were brought in court, a judge would very likely dismiss the case as against the unfairly named brokerage firm owner for failure to properly plead "control person liability," and because no private right of action exists for a claim sounding in "failure to supervise" the broker in question.

Specifically, with regard to control person liability, a claimant must allege in the Statement of Claim that the "control persons" exercised "*actual control* over the wrongdoer and the transactions in question."[6] (emphasis added). Significantly, mere "officer or director status alone does not constitute control."[7] *Cromer Finance Ltd. v. Berger,* requires plaintiffs to "state with particularity facts giving rise to a strong inference that [the controlling person] in some meaningful sense *culpably participated* in [the controlled person's] primary violation."[8] (emphasis added). With respect to claims for failure to supervise, the Supreme Court has consistently sided with the arguments raised by respondents' representatives on this issue.[9] No one argues that brokers should not be supervised; rather the argument is that the responsibility for enforcing such laws falls to the government, the SEC and SROs, and not to individual investors. The reason claimants may not raise a claim based on these rules is simple – Congress did not intend these rules to permit private rights of action. The legislative history of NYSE Rule 405 and NASD Rule 3010 (through the enactment of the Securities and Exchange Act of 1934) fails to mention private remedies.[10]

Furthermore, the 1934 Act creates private remedies under some circumstances, indicating that Congress intended to exclude them in unlisted circumstances.[11] "When Congress wished to provide a private damages remedy, it knew how to do so and did so expressly."[12] Moreover, the self-regulation and self-enforcement procedures in the 1934 Act suggest that no other remedies were intended. "In view of these express provisions for enforcing the duties imposed by § 204 [of the Investment Advisors Act], it is highly improbable that 'Congress absentmindedly forgot to mention an intended private action.'"[13]

For the very good reason that it is never a particularly viable litigation strategy to face off squarely with settled Supreme Court precedent, claimants' counsel wisely do not do so.[14] Rather, they argue (among other things) that even if the claims should be dismissed on such grounds, the arbitrators may only dismiss those claims after the full-blown arbitration hearing – evidence, testimony, opening and closing arguments, etc. – has concluded. Which is the same defense claimants' counsel overwhelmingly uses (often successfully) in defending motions to dismiss on control person liability, the six-year eligibility rule, and just about everything else.

Essentially, claimants' counsel argue that regardless of the viability of the claims they allege, each and every respondent they choose to name in an arbitration proceeding should be forced to participate in a full-blown, in-person, evidentiary and trial-like arbitration hearing before they may be dismissed. Arbitration panels tend to side with claimants' counsel on this issue. In the past, this could be attributed in large part to the fact that the various codes of arbitration procedure did not contain any language at all pertaining to dispositive motions. Now that the NASD has proposed to amend its Code to include a new rule addressing the issue,[15] arbitrators will be able to easily decide not to grant

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motions to dismiss because of the plain language of the rule, which provides in relevant part that: "(a) Except as provided in Rule 12206, motions to decide a claim before a hearing are discouraged, and may only be granted in extraordinary circumstances"; and "(d) The panel may issue sanctions under Rule 12211 if it determines that a party filed a motion under this Rule in bad faith." The New York Stock Exchange is, if anything, even more hostile than the NASD is in encouraging arbitrators to deny dispositive pre-trial motions.

Clearly, respondents faced with what amount to frivolous claims will have to consider the very good chance that filing a motion to dismiss under the new NASD rule, if adopted, will be at best a waste of several thousand dollars in legal fees, given that the new NASD rule obviously frowns on such motions. Given that Federal Rule of Civil Procedure 12(b) and the corresponding state rules regarding responsive dispositive motions do not contain the same chilling language discouraging the filing of dispositive motions while encouraging the denial of such motions, it is apparent that respondents facing such claims would be far better off resolving the dispute in court than by submitting to arbitration.

Subpoena Practice

In litigation before various courts, subpoenas are commonplace. Counsel issue subpoenas, as do judges, and while litigation certainly also includes a fair number of motions to quash subpoenas, rarely is the argument over the intrinsic power to issue the subpoena. In court, motions to quash usually argue that the subpoena at issue seeks too much information, or seeks documents which for other reasons the party which received the subpoena wishes to not produce.

Not so in arbitration before the SROs. Many claimants' counsel argue that counsel to parties in arbitrations may not issue subpoenas, because the Federal Arbitration Act does not permit counsel to do so. Some go so far as to argue that even arbitrators may not issue such subpoenas. The NASD Code, meanwhile, provides in Rule 10322(a) that: "The arbitrators and any counsel of record to the proceeding shall have the power of the subpoena process as provided by law. All parties shall be given a copy of a subpoena upon its issuance. Parties shall produce witnesses and present proofs to the fullest extent possible without resort to the subpoena process."

Because claimants are not required to maintain documents by the NASD (as brokerage firms are), it is usually a respondent's counsel who needs to use subpoenas to acquire documents about the claimant's investment history, like account statements from the claimant's accounts with other brokers, via subpoena. These documents should be produced under the Discovery Guide, but often are simply not available because claimants do not keep their monthly statements. This tends to mean respondents' counsel gain more from using subpoenas, and as such claimants' representatives are opposed. Claimants' counsel collectively urged the adoption of the proposed subpoena rule that the NASD filed as a separate rule change with the SEC last June.[16]

The disagreement between claimants' and respondents' counsel stems from the role played by the Code. Respondents' position is that the Code takes precedence over the FAA. In situations where the Code is silent, the parties *then* would turn to the FAA for the applicable rule. Here, the Code is not silent; rather, it is explicit. Rule 10322(a) – in addition to providing the panel the power of the subpoena process as provided by law – also explicitly gives the same power to "any counsel of record." Accordingly, with regard to the issuance of subpoenas, the FAA ceases to apply and Rule 10322(a) applies instead.

Claimants' representatives tend to argue that the words "as provided by law" act to negate the words "any counsel of record." They reach this inconsistent result by interpreting the phrase "as provided by law" to reinstate the FAA rule as opposed to that of the Code. As noted above, the FAA does not grant attorneys the right to issue subpoenas directly, whereas the Code does. By this logic, Rule 10322(a) in the last four words of its first sentence completely negates all of the previous eighteen words, as well as the remainder of the rule itself. In short, claimants' counsel often read Rule 10322(a) to say that, in an NASD arbitration proceeding, both the arbitrators and any counsel of record are granted the power to issue subpoenas, except when they are not permitted to do so, which is always. This is an absurd result. It cannot have been the intent of the Code's drafters to write a rule which negates itself.

Yet as with dispositive motions, claimants often succeed in convincing arbitration panels of the limitations on their power, because they are not judges and juries. With respect to the issue of subpoenas, the battle is sometimes actually waged in court anyway, because motions to quash can be filed in court, and have been decided by judges (although a number of judges have sensibly determined that the issue is best left to the discretion of the arbitrators). To confuse matters somewhat further, if you represent a brokerage firm that is not a party to the arbitration proceeding, but you receive a subpoena for one of your client's brokerage records, you are caught between the wish to comply with the subpoena and the new rules regarding privacy of the client's personal information.

The subpoena issue remains in flux, with many arbitrators mistakenly confusing third-party subpoenas with discovery, and ruling based on the Discovery Guide. Many arbitrators are not even lawyers, much less judges, and as such do not feel entirely comfortable with the idea of wielding subpoena power. When claimants' counsel argue that they do not have such power, many arbitrators are inclined to agree. So in the case where a claimant has simply misplaced his other brokerage firm's monthly statements and confirmations of

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trades, counsel for the brokerage firm being sued actually has far more recourse to obtain those documents in court than in arbitration. If the case was not in arbitration, the FAA would not apply, and the claimant would be subject to traditional discovery methods. Counsel for broker-dealers would have the largely unfettered right to issue subpoenas at their whim.

Conclusion

As the foregoing discussion has attempted to demonstrate, the securities industry's victory in *Shearson*, has at least in part been an example of the old adage: be careful what you wish for – you just might get it. It was not the investors' attorneys who were clamoring for mandatory arbitration 20 years ago. The primary reason the securities industry wanted to force their clients into mandatory arbitration was because defending cases in court was far too expensive, and securities plaintiffs essentially had the ability to extort cost of defense settlements quite easily.

Yet as we approach both the 20-year anniversary of *Shearson*, and the end of the high volume period fueled by the 2000 market correction, it is increasingly the securities industry that finds itself wishing aspects of arbitration were more like traditional litigation. At least in the areas of both dispositive motions and subpoenas – both of which are critical to the defense of a securities claim – it appears that if anything, the Supreme Court's decision in *Shearson* to uphold mandatory arbitration clauses was at best a pyrrhic victory for the securities industry. Many would argue that claimants have actually done better in the past 20 years than they would have had *Shearson* been decided the other way.

Still, the prevailing sentiment apparently remains otherwise, as, for example, Massachusetts Secretary of the Commonwealth William Galvin indicated in his public testimony concerning securities arbitration: "The system is run by the industry and for the industry, and it is unfair."

Thus, at least in part, it appears both claimants and respondents in securities arbitrations believe the current system is unfair, and should more reflect – or perhaps revert entirely back to – traditional court litigation. Perhaps this is merely reflective of a successfully negotiated dispute resolved through settlement – both parties walk away unhappy. Or perhaps securities arbitration, at least in certain key areas, should in fact, be more akin to traditional securities litigation. To be, or not to be: that is the question.

Jonathan C. Uretsky is a founding partner of Phillipson & Uretsky, LLP, a full-service law firm with offices in New York and New Jersey, and an Adjunct Professor at Fordham University School of Law.

His practice is focused on securities litigation, including the resolution of civil disputes in federal and state courts, as well as in various dispute resolution forums. Mr. Uretsky also has extensive experience representing financial institutions in arbitration proceedings, in a number of forums including the NASD, NYSE and the CBOE. Mr. Uretsky's practice also concentrates on the defense of hedge funds, public companies, stock promoters, investor relations firms and broker-dealers in regulatory matters before the SEC and applicable SROs, and in the white-collar context before the U.S. Attorney's Office and F.B.I.

Mr. Uretsky is admitted to practice before the New York and New Jersey State Bars, as well as the U.S. District Courts for the Southern District of New York, Eastern District of New York, and the District of New Jersey.

Mr. Uretsky has spoken on Securities Arbitration at the American Conference Institute's annual forum on customer claims, and writes a regular column for TraderDaily about legal issues that affect the securities industry.

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[*] Thank you to Jeremy Cohen, a second-year law student and law clerk for Phillipson & Uretsky, LLP, for his assistance.

[1] 482 U.S. 220 (1987).

[2] Self-Regulatory Organizations, include but are not limited to the NYSE, NASD and CBOE.

[3] *See* NASD Notice to Members 99-90.

[4] *See* F.R.C.P. 12(b).

[5] *See* NASD Rule 10304.

[6] *Cromer Finance Ltd. v. Berger*, 137 F. Supp. 2d 452, 484 (S.D.N.Y. 2001)

[7] *Id*.

[8] *Id*.

[9] *See Cent. Bank v. First Interstate Bank*, 511 U.S. 164 (1994); *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979); *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979).

[10] *See Touche Ross & Co. v. Redington*, 442 U.S. 560, 571 (1979) (omitting provision for private right of action in section 17(a) of the 1934 Act reinforced Supreme Court's decision not to find such a right).

[11] *See id*.

[12] *Id*. at 572.

[13] *See Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 20 (1979) (quoting *Cannon v. University of Chicago*, 441 U.S. 677, 742, 99 S.Ct. 1946, (1979) (Powell, J. dissenting)).

[14] For a far more in depth discussion of private rights of action in the securities litigation and arbitration context, see the detailed analysis in: *See No Evil, Hear No Evil, Don't Get Sued: Should a Private Cause of Action Exist For A Violation of NASD Conduct Rule 3010?* Wenger, Amnon, 74 Fordham L.Rev. 303.

[15] *See* NASD Proposed Rule 12504; NASD Dispute Resolution, Inc., File No. SR-NASD-2003-158, Proposed Rule Change for Reorganization and Revision of NASD Rules Relating to Customer Disputes (Oct. 15, 2003) and amended on Jan. 3, 2005, Jan. 19, 2005, April 8, 2005 and June 10, 2005. As of the time of this writing, the Proposed Rule has not been approved.

[16] NASD Dispute Resolution, Inc., File No. SR-NASD-2005-079, Proposed Rule Change to Provide for a 10-day Notice Requirement Before a Party Issues a Subpoena to a Non-Party for Pre-Hearing Discovery (June 17, 2005). As of the time of this writing, the Proposed Rule has not been approved.

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In Brief

- On February 3, **NASD** announced that during its Annual Meeting **John J. Brennan**, Chairman and CEO of The Vanguard Group, **John S. Simmers**, CEO of ING Advisors Network, **Brian J. Kovack**, President of Kovack Securities Inc., and **Tyler F. Dedman**, Rear Admiral (retired) of the U.S. Navy, were elected to the **NASD Board of Governors**. Simmers was elected to a second term of three years. The NASD Board consists of 18 Governors who are eligible to serve up to two consecutive terms on the Board. NASD also announced that in January 2006, **Judith R. MacDonald**, Managing Director of Rothschild Inc., commenced a one-year term on the Board as Chair of the National Adjudicatory Council.

- The SEC approved a proposed rule change, on February 27, that was filed by the NYSE to effect its merger with Archipelago Holdings Inc. (SEC Release No. 34-53382; File No. SR-NYSE-2005-77). The merger was completed on March 7 and the combined company, the **NYSE Group Inc.**, began trading on the NYSE under the ticker NYX on March 8.

- NASD released its **Dispute Resolution Statistics** report for January 2006 on February 28. The report revealed that new case filings during January 2006 (423) dropped 13 percent from new case filings during January 2005 (486). The report also disclosed that 6,074 arbitration cases were filed in 2005, in contrast to the 8,201 cases that were filed in 2004. To view the report visit NASD's website at http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&nodeId=516.

- On March 7, **NYSE Regulation** announced that **Regina C. Mysliwiec,** senior vice president and senior advisor to **Richard Ketchum**, NYSE Chief Regulatory Officer, will retire in April 2006. Mysliwiec joined the NYSE in 1988. During her tenure with the NYSE she held senior positions in various Regulatory divisions, including Enforcement, Market Surveillance, and Risk Assessment. Prior to joining the NYSE, Mysliwiec was the Regional Counsel in the Enforcement Division of the SEC.

- NASD will be hosting its **15th Annual Spring Securities Conference** on May 17-19, at the Westin Diplomat Resort & Spa in Hollywood, Florida. The conference will explore the latest updates in securities regulation and compliance, including such topics as disaster recovery, ethics, insurance products, regulatory form filing and associated systems, advertising regulation, research analyst issues and others. For more information about the conference visit NASD's website at www.nasd.com.

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