Broom v. Morgan Stanley DW, Inc.[*]

I. INTRODUCTION

The grounds for vacating an arbitration award, particularly based on the ground of "facial legal error," tend to be narrow,[1] and to vacate an award based on such grounds is rare.[2] In *Broom v. Morgan Stanley DW, Inc.*, Washington's Supreme Court narrowly held that an arbitral panel's decision to dismiss claims based on the state's statutes of limitations, in instances where the parties to the dispute had not explicitly agreed that the statutes of limitations would apply, was a facial legal error that provides a basis for vacating an arbitral award.[3]

II. FACTUAL AND PROCEDURAL BACKGROUND

Dick Broom maintained a retirement investment account with Paine Webber from the late 1990s into mid-2000.[4] When Broom's former broker retired, a new broker took over his account.[5] While the new broker was managing Broom's account, the account decreased in value by 25%.[6] However, when his broker moved to Morgan Stanley, Broom transferred his accounts with the broker.[7] Broom's account continued to decline in worth after this time.[8]

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[*] Broom v. Morgan Stanley DW, Inc., 236 P.3d 182 (Wash. 2010).

[1] *See id.* at 185–86 (discussing that Washington will only vacate an arbitration award based on facial legal error in four narrow instances). For examples of other states that have established narrow grounds for vacating arbitration awards on the basis of facial legal error, see Anthony v. Kaplan, 918 S.W.2d 174, 178 (Ark. 1996); First Health Group Corp. v. Ruddick, 911 N.E.2d 1201, 1213 (Ill. App. Ct. 2009); Parr Constr. Co. v. Pomer, 144 A.2d 69, 72 (Md. 1958); Washington v. Washington, 770 N.W.2d 908, 912 (Mich. 2009); Tiberghein v. B.R. Jones Roofing Co., 856 A.2d 21, 24 (N.H. 2004); State of New Jersey, Office of Employee Relations v. Commc'ns Workers of Am., 711 A.2d 300, 307 (N.J. 1998); and Welty v. Brady, 123 P.3d 920, 924 (Wyo. 2005).

[2] Lane Powell Attorneys and Counselors, *Washington Supreme Court Holds Statutes of Limitations do not apply to Arbitration Proceedings*, Aug. 2, 2010, http://www.lanepowell.com/10270/statutes-of-limitations-do-not-apply-to-arbitration-proceedings/ [hereinafter Lane Powell].

[3] *Broom*, 236 P.3d at 188.

[4] *Id.* at 183.

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] *Id.*

After Broom's death, Broom's children, who were the beneficiaries of his account, "filed a notice of claim with Morgan Stanley" in September 2005.[9] The claim alleged that Morgan Stanley was guilty of "negligence, failure to make suitable investment recommendations, violation of state and federal securities law, breach of fiduciary duty, misrepresentation and omissions, failure to supervise, breach of contract," and violating the state of Washington's Consumer Protection Act (CPA).[10]

The dispute between Broom's beneficiaries and Morgan Stanley was submitted to an arbitration panel pursuant to a previous arbitration agreement.[11] Morgan Stanley moved to dismiss the Brooms' claims, making various assertions, including that the state statutes of limitations barred consideration of all claims.[12] The arbitration panel ruled the statutes of limitations barred consideration of all Broom's claims except for the claim alleging a violation of the Washington CPA.[13] The Brooms filed a motion asking the arbitration panel to reconsider their ruling and Morgan Stanley moved for a dismissal of the CPA claim.[14] The panel granted Morgan Stanley's request for dismissal.[15]

After the arbitration panel's ruling, Broom's beneficiaries filed a complaint in a Washington trial court and filed a motion to vacate the arbitration award, arguing the award contained a "facial legal error because state statutes of limitations do not apply to arbitration."[16] The trial court agreed, and vacated the arbitration award.[17]

After the Court of Appeals affirmed the trial court's holding, Morgan Stanley successfully petitioned the Supreme Court of Washington for review.[18] The Supreme Court of Washington considered two questions on review. First, "[i]s 'legal error on the face of the award' a valid ground for a court to vacate an arbitration award?"[19] Second, "[i]f so, may arbitrators apply state statutes of limitations to bar the claims presented?"[20]

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[9] *Broom*, 236 P.3d at 183.

[10] *Id.*

[11] *Id.*

[12] *Id.*

[13] *Id.* at 183–84.

[14] *Id.* at 184.

[15] *Broom*, 236 P.3d at 184.

[16] *Id.*

[17] *Id.*

[18] *Id.*

[19] *Id.*

[20] *Id.*

III. HOLDING AND REASONING

In addressing the above two questions, the Supreme Court of Washington ultimately held, in a 5-4 decision, that under the Washington Arbitration Act (WAA), facial legal error provides grounds for vacating an arbitration award and arbitration is not considered an "action" that is subject to the statutes of limitations set by the state.[21]

A. *Arbitration Awards Displaying Facial Legal Error*

The Supreme Court of Washington has consistently held that the WAA allows courts to vacate arbitration awards when they find that the award contains a facial legal error.[22] A WAA provision permits a court to vacate an arbitration award when "the arbitrators exceeded their powers, or so imperfectly executed them that a final and definite award upon the subject matter submitted was not made."[23] In construing this provision, the Supreme Court of Washington has stated that "facial legal error constitutes an instance in which arbitrators 'exceeded their powers.'"[24]

While the current WAA does not explicitly include facial legal error as a ground that justifies vacating an arbitration determination, the previous state arbitration statute directly stated that facial legal error was grounds for vacating arbitration decisions.[25] In 1995, the Supreme Court of Washington stated in *Boyd v. Davis* that facial legal errors were grounds for vacating arbitration decisions under the current state arbitration act.[26] In *Broom*, the Supreme Court of Washington stated that there was no reason to alter the *Boyd* decision, as the state presumes that the legislature is aware of judicial interpretations of statutory law and thus when there is no change in statutory language "after a court decision the court will not overrule clear precedent interpreting the same statutory language."[27]

Despite state precedent that prevents the re-interpretation of statutory language by a court, Morgan Stanley and two amici argued the interpretation of the WAA viewing facial legal error as a grounds for vacating an arbitration award "is harmful" and should be reversed "because it

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[21] *Broom*, 236 P.3d at 186, 188.

[22] *Id.* at 184–85.

[23] *Id.* at 184 (referencing the former RCW 7.04.160(4)).

[24] *Id.* at 185.

[25] *Id.*

[26] *Id.*; *see also* Boyd v. Davis, 897 P.2d 1239, 1241 (Wash. 1995).

[27] *Broom*, 236 P.3d at 185.

undermines the purposes of arbitration: finality and efficiency."[28] The Court refused to accept this argument, however, stating the defendant's argument painted an overly broad characterization of the legal error standard.[29] Rather, the Court stated that "the facial legal error standard is a very narrow ground for vacating an arbitral award" that furthers the objectives of arbitration—not one that permits a court to "search . . . arbitral proceedings for *any* legal error[,] look to the merits of [a] case[, or] reexamine evidence."[30]

B. *Applicability of State Statutes of Limitations to Arbitration Proceedings*

In *Broom*, the parties had agreed that National Association of Securities Dealers Code of Arbitration Procedure (NASD Code) would govern their arbitration proceedings; however, no provision of the arbitration agreement explicitly stated whether the a party could assert defenses to claims based on the state statutes of limitations.[31] Thus, the determination of whether or not the state statutes of limitations could act as a bar to Broom's arbitration claims was an issue for the court to decide.[32]

Morgan Stanley argued that even if facial legal error is considered to be a legitimate reason for vacating arbitration awards, the arbitration panel did not make a facial legal error in this case.[33] Specifically, Morgan Stanley asserted it was not a facial legal error for the arbitration panel to apply the state statutes of limitations to the Brooms' claims for two reasons.[34] First, Morgan Stanley argued that the NASD Code the parties agreed would apply to the arbitration proceedings allows "arbitration panels to apply state statutes of limitations" at their discretion.[35] Second, Morgan Stanley argued that previous cases decided by the Supreme Court of Washington considered

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[28] *Id.*

[29] *Id.*

[30] *Id.* at 185–86. The Supreme Court of Washington also noted that "the facial legal error standard does not permit courts to conduct a trial de novo in reviewing an arbitration award." *Id.*

[31] *Id.* at 186.

[32] *Id.*

[33] *Broom*, 236 P.3d at 186.

[34] *Id.*

[35] *Id.* at 186–87. In making this argument, Morgan Stanley referenced section 10304 of the NASD Code. *Id.*

arbitral proceedings "actions" for purposes of the state statutes of limitations.[36]

With regard to Morgan Stanley's arguments, the Supreme Court of Washington stated that the correct interpretation of the NASD Code relevant to the importation of state statutes of limitations was not dispositive in the case.[37] Rather, the Court stated that it needed to "determine independently whether [Washington] statutes of limitations may apply to arbitral proceedings."[38] The rationale for this analysis lies in the Court's statement that "[a]lthough arbitrators are empowered to interpret the NASD Code, their interpretations [are] bounded by Washington's case law and statutes."[39]

In *Broom*, the Court stated it is the statute at issue that determines whether or not arbitral proceedings are considered "actions."[40] The Court established that Revised Code of Washington's catch-all statutes of limitations provision, as well as the code's "general rule governing statutes of limitations" "refer only to 'actions' and make no mention of arbitrations."[41] In addition, the WAA and the Revised Uniform Arbitration Act (RUAA), which has been enacted in the state of Washington,[42] use language that explicitly distinguishes arbitrations from judicial proceedings.[43] The Court pointed out neither the WAA nor the RUAA referred to arbitration as an "action."[44] This distinction, as well as the legislature's "apparent approval of the [Court's previous] statutory interpretation" distinguishing the two, weigh in favor of distinguishing arbitrations from "actions" under the Washington law relevant in *Broom*.[45] As a result, the Court concluded that the arbitration panel's application of the

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[36] *Id.* at 186–88.

[37] *Id.* at 187.

[38] *Id.*

[39] *Broom*, 236 P.3d at 188. This is where the dissent differed in opinion from the rest of the court. *Id.* at 189 (Madsen, C.J., dissenting). In her dissent, Chief Justice Madsen stated that the majority decision "fails to give effect to the parties' contractual agreement to arbitration under the" NASD Code. *Id.* (Madsen, C.J., dissenting).

[40] *Id.* at 187.

[41] *Id.* at 187–88.

[42] *See, e.g.*, American Arbitration Association, *RUAA and UMA Legislation from Coast to Coast*, DISP. RESOL. TIMES, Aug. 31, 2005, http://www.adr.org/sp.asp?id=26600.

[43] *Broom*, 236 P.3d at 188.

[44] *Id.*

[45] *Id.*

state statutes of limitations to dismiss the Brooms' claims was a facial legal error that warranted vacating the panel's decision.[46]

However, the *Broom* decision does not leave parties without recourse against "stale and untimely claims."[47] The Court noted that parties can contractually agree to apply state statutes of limitations to their arbitration agreements.[48] In this case, however, the parties failed to include a contractual provision pertaining to the applicability of state statutes of limitations, and the Court did not view the NASD Code provision that granted arbitrators the discretion to interpret limitations provisions as sufficiently explicit.[49]

IV. POTENTIAL IMPACT OF THE COURT'S DECISION

A concern exists that *Broom* allows claims that would be time-barred in court to be brought before arbitral panels—in effect providing an arena where state statutes of limitations may be nullified. As one Seattle-based firm stated: "Thousands of businesses[, ranging from construction to securities,] operating in the state of Washington today utilize form contracts which contain arbitration clauses. . . . [N]one [of the arbitration contracts that the firm was] aware of affirmatively adopt[ed] a statutory limitations provision" pre-*Broom*.[50] Thus, arbitration agreements need to be reviewed, and form agreements will likely need to be revised in order to prevent plaintiffs from asserting time-barred claims.[51]

In constructing future arbitration agreements, parties need to be more explicit in asserting that state statutes of limitations provisions apply if they want to prevent the consideration of claims that would otherwise be time-barred. When arbitration agreements apply state law, "the agreement should articulate whether state law extends to both procedural and substantive aspects of state law."[52] One firm has reported it had begun "adding the phrase 'to be governed by the applicable Washington statute of limitations' to all new arbitration . . . contracts."[53] In addition, international business

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[46] *Id.*

[47] *Id.*

[48] *Id.*

[49] *Broom*, 236 P.3d at 186–88.

[50] Smyth & Mason Attorneys at Law, *Arbitration Oh-O!*, Sept. 8, 2010, http://www.smythlaw.com/news/arbitration-oh-o/ [hereinafter Smyth & Mason].

[51] Schwabe, Williamson, & Wyatt Attorneys at Law, *Washington Supreme Court Statutes of Limitation do not Apply in Arbitration*, Aug. 12, 2010, http://www.schwabe.com/showarticle.aspx?Show=12023.

[52] Lane Powell, *supra* note 2.

[53] Smyth & Mason, *supra* note 50.

agreements containing dispute resolution clauses should also take Washington's ruling into consideration and establish statutes of limitations provisions if they are attempting to prevent the assertion of stale claims.[54]

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[54] Cutler, Nylander & Hayton Professional Service Corporation, *Intricacies of Dispute Resolution Clauses within International Business Agreements—Key Drafting Considerations*, Aug. 5, 2011, http://cnhlaw.com/phil-cutler/intricacies-of-dispute-resolution-clauses-within-international-business-agreements-key-drafting-considerations-2/.