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Securities Arbitration Appeal: An Oxymoron No Longer?

BY C. EVAN STEWART*

INTRODUCTION

Appealing a tribunal's decision has been likened to putting "the dice into the box for another throw."¹ Although this notion conjures up a subjective image of the process, the right of appeal has been for centuries an essential element in ensuring the fairness of our civil litigation system.²

That system has been under an increasingly comprehensive attack by critics, who argue that it is too cumbersome, burdensome, time consuming, formalistic, and expensive.³ Many of those same critics aggressively promote the arbitration process in its place, hailing arbitration as having none of the aforementioned problems, while having many virtues.⁴ Recent U.S. Supreme Court decisions

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¹ A. BIERCE, *THE DEVIL'S DICTIONARY* 17 (1942). Justice Frankfurter put it a bit differently, characterizing the appellate process as a place where "[d]isappointed litigants and losing lawyers like to have another go at it." *Ferguson v. Moore-McCormack Lines*, 352 U.S. 521, 524 (1957). Previously, and in a jocular vein, he wrote about the alternative to the appellate process: "a practice familiar in the long history of Anglo-American litigation, whereby unsuccessful litigants and lawyers give vent to their disappointment in tavern or press." *United States v. Morgan*, 313 U.S. 409, 421 (1941).

² Although the U.S. federal circuit courts were established by the first Judiciary Act of September 24, 1784, the right to appeal a trial court verdict is a long established tradition in Anglo-American jurisprudence.

³ See, e.g., Alschuler, *Mediation with a Mugger: The Shortage of Adjudicative Services and the Need for a Two-Tier Trial System in Civil Cases*, 99 HARV. L. REV. 1808 (1986); Edward, *Alternative Dispute Resolution: Panacea or Anathema*, 99 HARV. L. REV. 668 (1986); see generally S. GOLDBERG, E. GREEN & F. SANDER, *DISPUTE RESOLUTION* (1985) [hereinafter GOLDBERG]. Courts also are critical of the system. See *Securities Indus. Ass'n v. Connolly*, 883 F.2d 1114 (1st Cir. 1989), cert. demed., U.S. , 110 S. Ct. 2559 (1990) (swollen judicial system defined as being in a state of hypertrophy—"the pathologic 'overgrowth' of an organ or part resulting from unusually steady to severe use. " (citation omitted)).

⁴ See, e.g., Edelman, *Institutionalizing Dispute Resolution Alternatives*, 9 JUST. SYS. J. 134 (1984); Faure, *The Arbitration Alternative: Its Time Has Come*, 46 MONT. L. REV. 199 (1985); Katsoris, *Securities Arbitration After McMahon*, 16 FORDHAM URBAN L.J. 361

upholding the arbitrability of claims under Section 10(b) (and Rule 10b-5 promulgated thereunder) of the Securities and Exchange Act of 1934⁵ and Section 12(2) of the Securities Act of 1933⁶ have provided a great deal of momentum for the shifting of a multitude of civil disputes into the forum of arbitration.⁷

(1988). The virtues trumpeted include the following: (i) disputes are resolved swiftly, informally and inexpensively, (ii) arbitrators are not bound to follow statutes, regulations or case law, (iii) the process provides finality, since there is virtually no right of appeal, and (iv) oftentimes specific industry arbitrations draw upon industry experts to sit as arbitrators, thereby ensuring that complicated claims will be understood and resolved easily. See 5 A. SOMMER, *SECURITIES LAW TECHNIQUES* § 118.01[1] (1987); see also 1 ARISTOTLE, *THE RHETORIC OF ARISTOTLE* ch. 13, 77-78 (1932) ("It is equitable to agree to arbitration [rather] than to go to court—for the umpire in an arbitration looks to equity, whereas the juryman sees only the law. Indeed, arbitration was devised to the end that equity might have full sway.").

⁵ Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987).

⁶ Rodriguez de Quijas v. Shearson/American Express, Inc., ___ U.S. ___, 109 S. Ct. 1917 (1989).

⁷ See Cain, *Commercial Dispute and Compulsory Arbitration*, 44 BUS. LAW. 65 (1988). Prior to *McMahon* and *Rodriguez*, the Court laid the groundwork to overturn *Wilko v. Swan*, 346 U.S. 427 (1953), overruled by *Rodriguez de Quijas*, ___ U.S. ___, 109 S. Ct. 1917 (1989) (rejecting the arbitrability of claims under Section 12(2) of the Securities Act of 1933) and embraced the strong policy favoring arbitration set forth in the Federal Arbitration Act, 9 U.S.C. §§ 1-14 (1982) [hereinafter FAA]. See *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626-27 (1985) ("[W]e are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution."); *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 220 (1985) ("[P]assage of the [FAA] was motivated first and foremost, by a congressional desire to enforce agreements into which parties had entered, and we must not overlook this principal objective when construing the statute. " (footnote omitted)); *Southland Corp. v. Keating*, 465 U.S. 1, 14 (1984) ("To confine the scope of the [FAA] to arbitrations sought to be enforced in federal courts could frustrate what we believe Congress intended to be a broad enactment. "); *Moses H. Cone Memorial Hosp. v. Mercury Constr.*, 460 U.S. 1, 24 (1983) ("[Q]uestions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration."); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519 (1974) quoting *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 9 (1972) ("The invalidation of [an arbitration agreement] would not only allow the respondent to repudiate its solemn promise but would, as well, reflect a 'parochial concept that all disputes must be resolved under our laws and in our courts.'").

Since *McMahon* and *Rodriguez de Quijas* there has been a tremendous amount of litigation in which securities firms have consistently moved to compel investors to seek redress only before industry arbitration panels. See, e.g., *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Georgiadis*, 724 F. Supp. 120 (S.D.N.Y. 1989); *Russo v. Simmons*, 723 F. Supp. 220 (S.D.N.Y. 1989); *Rubashkin v. Philips, Appel and Waldren Inc.*, 722 F. Supp. 1135 (S.D.N.Y. 1989). The securities industry's intense desire to litigate exclusively before arbitration panels is perhaps best illustrated by its response to Massachusetts' attempt to bar arbitration agreements between firms and customers: the industry trade association went to court and had the state's regulations ruled void because they conflicted with, and were thus preempted by, the FAA. See *Connolly*, 883 F.2d 1114.

This article does not attempt to evaluate or comment on the relative merits of this trend.⁸ Rather, it examines what would seem to be a logical outgrowth of it. With the arbitration process coming to be relied upon more and more, it is in fact becoming more like the civil litigation system it was designed to replace.⁹

⁸ For an examination of the author's view of this trend see Stewart, *Dissenting Voice on Securities Arbitration*, LEGAL TIMES, Aug. 21, 1989, at 23. The author is not the only one who prefers the civil litigation system to arbitration. "Adjudication is more likely to do justice than conversation, mediation, arbitration, settlement, rent-a-judge, mini-trials, community moots or any other contrivance of [Alternative Dispute Resolution], precisely because it vests the power of the state in officials who act as trustees for the public, who are highly visible, and who are committed to reason. What we need at the moment is not another assault on this form of public power, but a renewed appreciation of all that it promises." Fiss, *Out of Eden*, 94 YALE L.J. 1669, 1673 (1985); see also *Stroh Container Co. v. Delphi Indus., Inc.*, 783 F.2d 743, 751 n.12 (8th Cir. 1986), cert. denied, 476 U.S. 1141 (1986) ("Parties resorting to arbitration in commercial situations are finding not only that the arbitration process is complex, expensive and time consuming, but the results of arbitration by private and untrained 'judges' are distantly remote from the fair process procedurally followed and application of principled law found in the judicial process.").

⁹ Arbitration now resembles the civil litigation system it was designed to replace. In the securities industry context, for example, many of the trappings of the civil litigation system now exist: (i) formal discovery procedures (including depositions), with sanctioning power given to arbitrators to enforce compliance with discovery obligations (e.g., New York Stock Exchange Rules [hereinafter NYSE Rules] § 619(a), 2 N.Y.S.E. Guide (CCH) ¶ 2619, at 4318 (Feb. 1989)), (ii) pre-arbitration conferences to resolve discovery disputes and other procedural and evidentiary questions (e.g., NYSE Rules § 619(d), 2 N.Y.S.E. Guide (CCH) ¶ 2619, at 4319 (May 1989)), (iii) greater utilization of the rules and procedures (evidentiary and otherwise) that exist in the civil litigation system (e.g., *id.*), (iv) the consolidation of individual cases into one arbitration (not unlike the class action procedure—indeed, there is already great pressure building up to permit class actions in arbitrations (see *infra* note 53 and accompanying text)), (v) complete transcriptions made of the hearings (e.g., NYSE Rules § 623, 2 N.Y.S.E. Guide (CCH) ¶ 2623, at 4320 (May 1989)), (vi) written arbitration awards that are published (e.g., NYSE Rules § 627, 2 N.Y.S.E. Guide (CCH) ¶ 2627, at 4321 (May 1989)), and (vii) increasing restrictions on industry—"tainted" individuals from serving on arbitration panels—thus having the process more closely resemble the civil jury system (e.g., NYSE Rules §§ 607, 2 N.Y.S.E. Guide (CCH) ¶ 2607, at 4313 (Nov. 1989), 608, 2 N.Y.S.E. Guide (CCH) ¶ 2608, at 4314 (Nov. 1989) & 610, 2 N.Y.S.E. Guide (CCH) ¶ 2610, at 4315 (Nov. 1989)). These changes significantly negate—if not eliminate—the advantages of arbitration. See *supra* note 4 and accompanying text.

The *McMahon* Court's ruling was in large measure based upon the Securities and Exchange Commission's *amicus curiae* brief, in which the SEC argued that its oversight jurisdiction over the self-regulatory organizations' arbitration procedures was strong enough to ensure that the arbitration process would be fair to all who brought claims against the members of that industry. *McMahon*, 482 U.S. at 233. On May 10, 1989, the SEC, making good on its pledge, approved the above noted wholesale changes in the arbitration process. See Securities Exchange Act Release No. 26,805, [1989-90 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,414 (May 10, 1989) [hereinafter Release No. 26,805]. Notwithstanding these changes, many small investors continue to believe that arbitrations under the jurisdiction of the self-regulatory organizations are heavily weighted in favor of the securities

Part I of this Article examines the statutory bases for judicial review of arbitration claims.¹⁰ Part II explores the common law development of the "manifest disregard" standard of review.¹¹ Part III then examines three reasons for active judicial review of securities arbitration decisions.¹²

I. THE STATUTORY BASES FOR SEEKING JUDICIAL REVIEW

Once an arbitration panel makes an award, the successful party must confirm the award by seeking and obtaining a judicial order.¹³ Under federal law, the appropriate court will grant the order unless there are grounds for vacation, modification or correction of the award.¹⁴

Section 10 of the Federal Arbitration Act provides that an award may be vacated for the following reasons: (a) the award was procured by corruption, fraud or undue means, (b) the arbitration panel was partial or corrupt, (c) the arbitration panel was guilty of misconduct, thereby prejudicing the rights of any party, or (d) the arbitration panel exceeded its powers, or so imperfectly

industry. See 21 Sec. Reg. & L. Rep. (BNA) 1805-06 (Dec. 8, 1989); Henriquez, *When Navvete Meets Wall Street*, N.Y. Times, December 3, 1989, § 3 (Business), at 1; N.Y. Times, December 21, 1989, § D (Business), at 8. For that reason, the SEC urged the securities industry to adopt a uniform rule mandating that securities firms provide customers with the right to use non-industry arbitration forums. See 22 Sec. Reg. & L. Rep. (BNA) 817-18 (June 1, 1990).

¹⁰ See *infra* notes 13-17 and accompanying text.

¹¹ See *infra* notes 18-39 and accompanying text.

¹² See *infra* notes 40-100 and accompanying text.

¹³ The federal process for confirmation is governed by the Federal Arbitration Act, 9 U.S.C. § 1-14 (1982); the process under New York law (N.Y. CIV. PRAC. L. & R. § 7510 (McKinney 1989)) is substantially similar. The party seeking confirmation in federal court has up to one year to file, although a court may waive the one year requirement. See *Kentucky River Mills v. Jackson*, 206 F.2d 111, 120 (6th Cir. 1953), *cert. denied*, 346 U.S. 887 (1953). The one year requirement in New York, however, is not discretionary and acts as a mandatory statute of limitations. See *Elliott v. Green Bus Lines, Inc.*, 459 N.Y.S.2d 419 (N.Y. 1983).

Alternatively, a party seeking to vacate an award has up to three months after the filing or delivery of the award to file an appropriate motion in court. 9 U.S.C. § 12 (1982). New York also has the three month period. N.Y. CIV. PRAC. L. & R. § 7511(a) (McKinney 1989). The only difference between the application of these laws is that New York permits a party to oppose a motion to confirm with a motion to vacate after the three months have passed; federal law does not allow that practice. Compare *Grayson-Robinson Stores v. Iris Constr. Corp.*, 202 N.Y.S.2d 303 (N.Y. 1960) with *Florasynth, Inc. v. Pickholz*, 750 F.2d 171 (2d Cir. 1984).

¹⁴ 9 U.S.C. § 9 (1982); see *Ottley v. Schwartzberg*, 819 F.2d 373, 376 (2d Cir. 1987); *Taylor v. Nelson*, 788 F.2d 220, 226 (4th Cir. 1986).

executed them that a mutual, final and definite award upon the subject matter submitted was not made.¹⁵

Section 11 of the Federal Arbitration Act provides that an award may be modified or corrected for these reasons: (a) there was a material miscalculation of figures or a material mistake in the description of any person, thing or property referred to in the award, (b) an award was made on a matter not submitted to arbitration, or (c) an award is imperfect in a matter of form that does not affect the merits of the controversy¹⁶

Courts traditionally have interpreted these statutory provisions narrowly, to limit judicial review of arbitration awards.¹⁷ And until thirty years ago these provisions were thought to provide the only basis for an appeal.

II. THE EMERGENCE OF THE "MANIFEST DISREGARD OF THE LAW" DOCTRINE

In *Wilko v Swan*,¹⁸ the Supreme Court first suggested a judicially created standard of judicial review called "manifest disregard of the law." Although it rejected the arbitrability of claims under Section 12(2) of the Securities Act of 1933,¹⁹ the Court recognized in *dictum* that,

¹⁵ 9 U.S.C. § 10 (1982). New York law allows vacation under similar circumstances. See N.Y. CIV. PRAC. L. & R. § 7511(b)(1) (McKinney 1989).

¹⁶ 9 U.S.C. § 11 (1982). Again, New York law provides virtually identical grounds for modification. See N.Y. CIV. PRAC. L. & R. § 7511(c) (McKinney 1989).

¹⁷ See, e.g., *Bernhardt v. Polygraphic Co.*, 350 U.S. 198, 203 n.4 (1956); *Saxix S.S. Co. v. Multifacs Int'l Traders, Inc.*, 375 F.2d 577, 582 (2d Cir. 1976).

¹⁸ 346 U.S. 427 (1953), *overruled by* *Rodriguez de Quijas v. Shearson/American Express, Inc.*, U.S. , 109 S. Ct. 1917 (1989).

¹⁹ The Court's rejection of the arbitration process as a proper forum to resolve disputes under the securities laws was based upon four perceived problems: (i) the arbitration process seemed at odds with established case law requiring "subjective findings on the purpose and knowledge of an alleged [securities laws] violator," (ii) the Court believed that non-judicial arbitrators would make errors when confronted with the complexity of the securities laws, (iii) the Court feared that there would be awards that were unfair and inconsistent with the law because there were no requirements of published opinions or complete records of proceedings, and (iv) the difficulty of meeting the standards of sections 10 and 11 of the FAA meant that the other problems could not be remedied on appeal or through judicial review. *Wilko*, 346 U.S. at 435-36. Although Justice Blackmun in his dissent in *McMahon* wrote at length that these problems had not gone away since *Wilko*, see *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 258-59 (1987) (Blackmun, J., dissenting), his views by that time were in the minority. See also *Rodriguez de Quijas v. Shearson/American Express, Inc.*, U.S. , 109 S. Ct. 1917, 1923 (1989) (Stevens, J., dissenting).

[w]hile it may be true that a failure of the arbitrators to decide in accordance with [applicable law] would 'constitute grounds for vacating the award pursuant to section 10 of the Federal Arbitration Act,' that failure would need to be made clearly to appear. [T]he interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation.²⁰

Lower courts were slow to adopt the "manifest disregard" standard; the few that did interpreted the language to mean that, although an arbitrator's interpretation of the law was not reviewable, an arbitrator's conscious disregard of the law was.²¹ That standard, as interpreted, initially may have seemed workable. It did little to assist the losing parties in arbitration, however, because there were few if any tangible ways to demonstrate manifest disregard of the law.²²

As the arbitration process has become more widely utilized over the past decade, the U.S. Supreme Court has taken the lead in stressing that arbitrators must look to and follow the law.²³ This

²⁰ *Wilko*, 346 U.S. at 436-37 (footnote omitted). In his dissent, Justice Frankfurter wrote, "Arbitrators may not disregard the law. On this we are all agreed." *Id.* at 440 (Frankfurter, J., dissenting).

²¹ *See, e.g.*, *Office of Supply, Gov't of Republic of South Korea v. New York Navigation Co.*, 469 F.2d 377, 379-80 (2d Cir. 1972); *San Martine Compania de Navegacion v. Saguenay Terminals, Ltd.*, 293 F.2d 796, 801 (9th Cir. 1961) (manifest disregard standard met "when arbitrators understand and correctly state the law, but proceed to disregard the same"). One commentator has designated this an "extreme view" of the "manifest disregard" standard. H. BLOOMENTHAL, *SECURITIES LAW HANDBOOK* § 25.12[7] (1989). Subsequent courts, *see infra* notes 24, 25, 31-38 and accompanying text, and the SEC have taken a somewhat more flexible view of the "manifest disregard" standard: "The error must have been obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator. Moreover, the term 'disregard' implies that the arbitrator appreciates the existence of a clearly governing legal principle but decides to pay no attention to it." Release No. 26,805, *supra* note 9, at 80,109 n.45 (citations omitted).

²² As noted by one commentator,

courts will not vacate an arbitral award for mistakes of law made by the arbitrators unless, as a general rule, there is some indication that the arbitrators knew what the applicable law was and simply ignored it or refused to apply it. Because arbitrators are not required to give reasons for their decisions some commentators question how a dissatisfied arbitrant can challenge the award on the basis of a manifest disregard of the law.

Fletcher, *Privatizing Securities Disputes Through the Enforcement of Arbitration Agreements*, 71 MINN. L. REV. 393, 456-57 (1981) (footnotes omitted).

²³ As the Supreme Court moved toward overturning *Wilko*, *see supra* note 7, it also made clear that arbitrators were responsible for applying applicable law. In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), for example, the Court ruled that an agreement to arbitrate disputes under U.S. antitrust laws required even

requirement appears to have had at least two effects on the "manifest disregard of the law" standard. First, more courts now embrace it and openly look for ways in which to review arbitration awards that appear to be clearly contrary to law²⁴ Indeed, in the courts of the Southern District of New York, which have jurisdiction over the nation's busiest commercial center, such review is becoming relatively routine.²⁵ Second, courts are beginning to acknowledge other non-statutory bases for reviewing arbitration awards on the grounds of irrationality,²⁶ public policy,²⁷ ambiguity or indefiniteness,²⁸ arbitrariness or capriciousness,²⁹ and lack of

a foreign arbitration panel to apply the appropriate law. The Court stressed that "the national courts of the United States will have the opportunity at the award enforcement stage to ensure that the legitimate interest in the enforcement of the antitrust laws has been addressed." *Id.* at 638. Subsequently, in *McMahon*, the majority wrote, "we have indicated that there is no reason to assume at the outset that arbitrators will not follow the law; although judicial scrutiny of arbitration awards necessarily is limited, such review is sufficient to ensure that arbitrators comply with the requirements of the statute." *McMahon*, 482 U.S. at 232 (citations omitted).

²⁴ Courts in at least six circuits have utilized the "manifest disregard" standard. *See, e.g.,* O. R. Sec., Inc. v. Professional Planning Assoc., 857 F.2d 742 (11th Cir. 1988); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker, 808 F.2d 930 (2d Cir. 1986); Stroh Container Co. v. Delphi Indus., Inc., 783 F.2d 743 (8th Cir. 1986), *cert. denied*, 476 U.S. 1141 (1986); *San Martine Compania de Navagacion*, 293 F.2d at 796; Bechtel Constructors Corp. v. Detroit Carpenters Dist. Council, 610 F Supp. 1550 (E.D. Mich. 1985). Circuits that have rejected this standard are the Seventh in *Mosely, Hallgarten, Estabrook & Wesden, Inc. v. Ellis*, 899 F.2d 264 (7th Cir. 1988), and the Tenth in *Jenkins v. Prudential-Bache Sec., Inc.*, 847 F.2d 631 (10th Cir. 1988).

²⁵ *See, e.g.,* *In re Southwind Shipping Co., S.A.*, 709 F Supp. 79 (S.D.N.Y. 1989); *Concourse Beauty School, Inc. v. Polakov*, 685 F Supp. 1311 (S.D.N.Y. 1988); *Fried, Krupp, GmbH v. Solidarity Carriers, Inc.*, 674 F Supp. 1022 (S.D.N.Y. 1987), *aff'd*, 838 F.2d 1202 (2d Cir. 1988); *Svoboda v. Negey Associates, Inc.*, 655 F Supp. 1329 (S.D.N.Y. 1987); *Sea Dragon, Inc. v. Gebr. Van Weelde Scheepvaast-Kantoor B.V.*, 574 F Supp. 367 (S.D.N.Y. 1983). Simultaneously, courts in the southern district of New York have made clear that frivolous challenges to arbitration awards will not be dealt with lightly. *See Quick & Reilly Inc. v. Jacobson*, 126 F.R.D. 24 (S.D.N.Y. 1989) (sanctions imposed for appeal of award that was not subject to valid legal challenge).

²⁶ *See, e.g.,* *French v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 784 F.2d 902, 906 (9th Cir. 1986); *Industrial Mut. Ass'n v. Amalgamated Workers*, 725 F.2d 406, 412 (6th Cir. 1984); *McLaughlin, Piven, Vogel, Inc. v. Gross*, 699 F Supp. 55 (E.D. Pa. 1988), *aff'd*, 862 F.2d 308 (3d Cir. 1988); *Prudential-Bache Sec., Inc. v. Caporale*, 664 F Supp. 72 (S.D.N.Y. 1987); *Sargent v. Paine Webber, Jackson & Curtis, Inc.*, 674 F Supp. 920 (D.D.C. 1987).

²⁷ *See, e.g.,* *Revere Copper & Brass, Inc. v. Overseas Private Inv. Corp.*, 628 F.2d 81, 83 (D.C. Cir. 1980); *Diapulse Corp. of America v. Carba, Ltd.*, 626 F.2d 1108, 1110 (2d Cir. 1980).

²⁸ *See, e.g.,* *Americas Ins. Co. v. Seagull Compania Naviera, S.A.*, 774 F.2d 64 (2d Cir. 1985); *Sargent*, 674 F Supp. at 920.

²⁹ *See, e.g.,* *United States Postal Serv. v. National Ass'n of Letter Carriers*, 847 F.2d 775 (11th Cir. 1988); *Local 657 Int'l. Bhd. of Teamsters v. Stanley Structures, Inc.*, 735 F.2d 903 (5th Cir. 1984).

factual support.³⁰

Notwithstanding this trend, a recent decision by the Second Circuit, *Merrill Lynch, Pierce, Fenner & Smith, Inc. v Bobker*,³¹ illustrates the great difficulty courts have had in reviewing arbitration awards and applying the "manifest disregard" standard. In *Bobker*, a company in which the arbitration claimant (Bobker) owned stock made a self-tender for more than a majority of its outstanding shares. Just after instructing his brokerage firm (Merrill Lynch) to tender all of his stock (4,000 shares), Bobker directed the firm to sell 2,000 shares short at the then market price and to buy an equal amount back after the tender was completed, at a lower price per share. The firm did so, but then voided the short sale two days later, prior to the tender's completion.

Bobker subsequently brought an arbitration claim against Merrill Lynch, seeking money damages equal to the amount of profits he would have gained if the short sale had gone through. Merrill Lynch defended on the ground that allowing the sale would have violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-4, promulgated thereunder by the SEC.³² There was extensive briefing, testimony, and argument at the arbitration about the appropriateness and proper application of Rule 10b-4,³³ which ultimately left one arbitrator shaking his head about this complicated area of the law.³⁴

³⁰ See, e.g., *Public Serv. Co. of Colorado v. Local 111 Intl. Bhd. of Elec. Workers*, 709 F. Supp. 212 (D. Colo. 1989); *Clemons v. Dean Witter Reynolds, Inc.*, 708 F. Supp. 62 (S.D.N.Y. 1989).

³¹ 808 F.2d 930 (2d Cir. 1986).

³² Rule 10b-4 provides in relevant part that,

It shall constitute a 'manipulative or deceptive device or contrivance' and a 'fraudulent, deceptive, or manipulative act or practice' as those terms are used in sections 10(b) and 14(e) of the Act, respectively, for any person to tender any subject security in a partial offer: (1) For his own account unless at the time of tender, and at the end of the proration period or period during which securities are accepted by lot (including any extensions thereof), he owns: (i) The subject security or (ii) [a]n equivalent security. 17 C.F.R. § 240.10b-4 (1990).

Rule 10b-4 also provides that "a person shall be deemed to own a security for the purposes of [Rule 10b-4] only to the extent that he has a net long position in such security." *Id.*

³³ *Bobker*, 808 F.2d at 932-33.

³⁴ The arbitrator's questions and comments are quoted at length throughout the Second Circuit's opinion. His remarks at the conclusion of the hearing were, "we now hopefully have to come up with the right answer on this law, and it is a very gray area. I think this is just going to be a deliberation we are going to have to go through." *Id.* at 933. He is later quoted as saying, "I read that law and I cannot interpret it." *Id.* at 937. The arbitrator's confusion mirrors Justice Jackson's famous comment: "I give up.

On the final day of the hearing, the arbitration panel awarded Bobker one half of his lost profits damages, without a written decision. Two months later, Merrill Lynch filed a petition in the Southern District of New York to vacate the award. Judge Weinfeld, upon briefing by the parties and the SEC—whose brief supported Merrill Lynch's position,³⁵ vacated the award, ruling that as a matter of law the short sale would have violated Rule 10b-4 and that the panel had acted in manifest disregard of the law.³⁶

On appeal, the Second Circuit reversed the district court's decision. Although the appellate court acknowledged that "[a]t first blush" Judge Weinfeld seemed correct that there has been "manifest disregard of the law,"³⁷ it concluded that the standard for reversing the award had not been met:

The sole issue before us is whether the arbitrators, in not strictly enforcing the "net long" provision, acted in "manifest disregard of the law." We cannot agree that they did. On the contrary, their long colloquy with counsel, after being informed of the provisions of Rule 10b-4, reveals that as a result of careful and conscientious analysis they had serious doubts about the rationality and interpretation of the "net long" proviso and how it serves the Rule's avowed purpose of preventing a stockholder such as Bobker from increasing his *pro rata* share of stock tendered and accepted over the *pro rata* share of that tendered by other stockholders.³⁸

In its decision, the court reaffirmed the view that, where the governing legal principle is complex and arguably subject to varying interpretations, an arbitration award may not be vacated so long as it can be demonstrated that the arbitrators did not avoid coming to grips with that legal principle, but rather attempted to apply it—even if demonstrably incorrectly.³⁹

Now I realize fully what Mark Twain meant when he said, "The more you explain it, the more I don't understand it." SEC v. Chenery, 332 U.S. 194, 214 (1947).

³⁵ *Bobker*, 808 F.2d at 934.

³⁶ *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 636 F. Supp. 444, 447-48 (S.D.N.Y. 1986). ("Permitting this award to stand would have the unacceptable result of penalizing Merrill Lynch for acting in accordance with the law.")

³⁷ *Bobker*, 808 F.2d at 935.

³⁸ *Id.* at 936-37. The court also ruled that the arbitrators' "arbitrarily" splitting of Bobker's lost profits damage claim was not further evidence of "manifest disregard of the law." *Id.* at 937.

³⁹ See *supra* note 21 and accompanying text.

III. SHOULD THERE BE AN EXPANSION OF JUDICIAL REVIEW?

In his *Wilko* dissent, Justice Frankfurter argued that, commensurate with the arbitration of complex securities law claims, the courts would be able to devise "appropriate means for judicial scrutiny in the form of some record or opinion, however informal, whereby compliance will appear, or want of it will upset the award."⁴⁰ Today, with the sweeping procedural changes affecting the arbitration process in the securities industry,⁴¹ such records and opinions are now being created.⁴² Nevertheless, and notwithstanding the aforementioned willingness of some courts to review arbitration awards on certain grounds,⁴³ there does not exist an appellate review process in any way comparable to that in the civil litigation system;⁴⁴ the *Bobker* decision makes that evident.⁴⁵ For at least three reasons, arbitrants need a broadened right of appeal—at minimum, one in which an arbitrator's interpretation of governing law is reviewable.

A. *The Protection of Complex Substantive Rights*

In *Shearson/American Express v McMahon*,⁴⁶ besides ruling that fraud claims under Rule 10b-5 are arbitrable, the Supreme

⁴⁰ *Wilko v. Swan*, 346 U.S. at 440 (1953) (Frankfurter, J., dissenting).

⁴¹ See *supra* note 9 and accompanying text; see also *Selected Summary Award Statements*, 21 Sec. Reg. & L. Rep. (BNA) 995-1003 (July 7, 1989) (first publication of New York Stock Exchange arbitration awards); "Summaries of National Association of Securities Dealers Arbitration Awards", 21 Sec. Reg. & L. Rep. (BNA) 1252-55 (August 11, 1989) (first publication of National Association of Securities Dealers arbitration awards).

⁴² Even though it has been urged to do so by several groups, to date the SEC has not mandated that written decisions be included as part of the award process. See Release No. 26,805, *supra* note 9, at 80,109. However, the Commission has taken the position that, "[t]he data already included in the awards under this proposal together with the pleadings and the verbatim record of the case ought to be sufficient in making determinations under the current manifest disregard standard." *Id.* at n.45. Notwithstanding the SEC's position, it has been reported that securities industry groups are planning to change arbitration procedures to encourage the issuance of written findings of fact and conclusions of law in large and complex cases; such changes, as currently contemplated, would not require SEC approval. See Rules Changed to Make Written Findings Easier to Obtain in Larger Arbitrations, 22 Sec. Reg. & L. Rep. (BNA) 816-17 (June 1, 1990).

⁴³ See *supra* notes 24-38 and accompanying text.

⁴⁴ See *supra* notes 21 & 22, 31-38 and accompanying text; see also *supra* note 8. As the Chairman of the NASD's arbitration review panel noted, the nature of the current arbitration process, which hinders appeals, "is somewhat contrary to the American notion of justice." Henriques, *supra* note 9, at 6.

⁴⁵ See *supra* notes 31-38 and accompanying text.

⁴⁶ 482 U.S. 220 (1987).

Court also addressed the arbitrability of a claim brought under the Racketeer Influenced and Corrupt Organizations Act (RICO).⁴⁷ Notwithstanding the complexity of the statute whose "extraordinary" breadth it had explicitly criticized,⁴⁸ the Court held that RICO claims are arbitrable.⁴⁹ Besides RICO, claims under virtually all federal statutes, including the antitrust laws⁵⁰ and the Employee Retirement Income Security Act (ERISA),⁵¹ are now arbitrable.⁵² Additionally, strong pressures are being exerted to have class actions handled by arbitrators.⁵³ The true teaching of *McMahon* and

⁴⁷ 18 U.S.C. §§ 1961-68 (1990).

⁴⁸ Courts have tremendous difficulty interpreting various RICO provisions. See *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 500 (1985); Goldsmith, *RICO and "Pattern: The Search For "Continuity Plus Relationship"*, 73 CORNELL L. REV 971 (1988) (detailing at length the difficulties lower courts have had in interpreting the RICO statute).

⁴⁹ The Court, finding no legislative history evidencing congressional intent to bar the arbitration of RICO claims, rejected the claimants' arguments that (i) arbitration was irreconcilably at odds with the underlying purposes of RICO, (ii) the overlap between civil and criminal RICO provisions rendered the civil claim nonarbitrable, and (iii) public interest in RICO enforcement bars arbitration of the civil claim because the treble damage deterrent was abolished. The Court noted that it analyzed and rejected each of these arguments in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 633-37 (1985), where the arbitrability of antitrust claims arising out of international transactions was at issue. *Shearson/American Express v. McMahon*, 482 U.S. 220, 232 (1987).

⁵⁰ *Mitsubishi*, 473 U.S. 614. *But see* *American Safety Equip. Corp. v. J. P. Maguire & Co.*, 391 F.2d 821, 828 (2d Cir. 1968) (domestic antitrust disputes are "inappropriate for arbitration"), criticized in *Mitsubishi*, 473 U.S. at 632-36. Lower courts now have extended *Mitsubishi* to domestic antitrust cases. See *GKG Caribe, Inc. v. Nokia-Mobira, Inc.*, 725 F. Supp. 109 (1989).

⁵¹ *Annulfo P. Sulit, Inc. v. Dean Witter Reynolds, Inc.*, 847 F.2d 475 (8th Cir. 1988); *Rosenblum v. Drexel Burnham Lambert*, 700 F. Supp. 874 (E.D. La. 1987). Although the Second Circuit held that ERISA claims are not arbitrable, the Supreme Court recently vacated and remanded that decision in light of its decision in *Rodriguez de Quijas v. Shearson/American Express, U.S.*, 109 S. Ct. 1917 (1989). *Shearson Lehman/American Express, Inc. v. Bird*, 871 F.2d 292 (2d Cir. 1989), *vacated*, U.S., 110 S. Ct. 225 (1989).

⁵² Prior to *McMahon*, the Supreme Court held that employee claims under Title VII of the Civil Rights Act of 1964 were not arbitrable. *Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1973). *But see* *Roe v. Kidder Peabody & Co., Inc.*, No. 88 Civ. 8507 (S.D.N.Y. April 19, 1990) (Court granted employer a stay of Title VII judicial proceedings pending arbitration pursuant to prior agreement). Notwithstanding the important issues at stake under Title VII, the *Alexander* decision makes little sense in light of *McMahon* and *Rodriguez*. Moreover, virtually all other employee-employer disputes may be arbitrated. See, e.g., NYSE Rule 347, 2 N.Y.S.E. Guide (CCH) ¶ 2347, at 3596 (Oct. 1989) (arbitration between registered representatives and member firms mandated with respect to any employment controversies); see also *Fleck v. E. F. Hutton Group, Inc.*, 891 F.2d 1047 (2d Cir. 1989) (broker's post employment tort dispute held arbitrable under NYSE Rule 347); *Gilmer v. Interstate/Johnson Lane Corp.*, 895 F.2d 195 (4th Cir. 1990) (age discrimination claims held arbitrable).

⁵³ A subcommittee of the Securities Industry Conference on Arbitration (SICA) recommended that the self-regulatory organizations propose rule changes that would have class

Rodriguez thus seems to be that any legal right created by Congress can and should be adjudicated before an arbitrator or arbitration panel.

While this approach may be attractive, should not there be some way to ensure that arbitrators get it right? As Oliver Wendell Holmes once opined, individuals and institutions have a right to understand what is acceptable conduct (commercial or otherwise), and to be sure that such conduct will be protected.⁵⁴ Yet, under the current standard of review, with complex federal statutes being argued before arbitration panels,⁵⁵ there is no way to guarantee that parties' substantive rights will be fairly heard and properly adjudged.⁵⁶ Equally disturbing is the fact that, while the number

actions directed first to the courts, which would resolve issues concerning representation and certification, and then send the cases back to arbitration; the SEC staff is studying that proposal and is seeking a uniform industry position. See *SEC Approves Arbitration Summaries, Other Revisions to Industry Programs*, 21 Sec. Rep. & L. Rep. (BNA) 683 (May 12, 1989) [hereinafter *SEC Approves Arbitration Summaries*]. For a view of how courts have thus far addressed this matter, see *Keating v. Superior Court*, 645 P.2d 1192 (Cal. 1982), *rev'd on other grounds sub nom.*, *Southland Corp. v. Keating*, 465 U.S. 1 (1984). See also *Lewis v. Prudential-Bache Sec., Inc.*, 225 Cal. Rptr. 69 (1986) (petition to compel arbitration in class action against broker discussed); *Izzy v. Mesquite Country Club*, 231 Cal. Rptr. 315 (1986) (case remanded for determination of whether class action arbitration could proceed). For a view of how commentators have thus far addressed this matter, see H. BLOOMENTAL, *supra* note 21, at § 25.12[5]; Note, *Classwide Arbitration and 10b-5 Claims in the Wake of Shearson/American Express, Inc. v. McMahon*, 74 CORNELL L. REV. 380 (1989).

According to at least one case, *Champ v. Siegal Trading Co.*, No. 89 Civ. 7148 (N.D. Ill. Nov. 2, 1990), the trend is toward requiring an express provision in an arbitration agreement before allowing consolidation of claims. By analogy, the court held that class certification must be denied absent express provisions in an arbitration agreement. *Id.*

⁵⁴ Holmes wrote:

"[A]ny legal standard must be one which would apply to all men under the same circumstances. It is not intended that the public force should fall upon an individual accidentally, or at the whim of any body of men. The standard must be fixed.

Finally, any legal standard must be capable of being known. When a man has to pay damages, he is supposed to have broken the law, and he is further supposed to have known what the law was."

O. HOLMES, *THE COMMON LAW* 110-11 (1881).

⁵⁵ It is not just federal statutes that are argued in arbitrations. Different state statutes are often in dispute; similarly, and as recently noted by the SEC, "legal issues are often dispositive in employment cases between broker-dealers and registered representatives, and these issues differ from state to state." Release No. 26,805, *supra* note 9, at 80,109.

⁵⁶ The history of the *Bobker* arbitration clearly demonstrates that there is no such guarantee. See *supra* notes 31-38 and accompanying text; see also *supra* note 8. Furthermore, there are no procedural methods for the hearing of dispositive legal issues in the arbitration process. See *infra* notes 61-74 and accompanying text.

of arbitrations has increased exponentially, the number of arbitrators has decreased, and those who act as arbitrators are often poorly qualified and/or trained.⁵⁷

The SEC acknowledges this problem. When it approved the sweeping procedural changes for arbitrations conducted by the self-regulatory organizations, the Commission noted that "[i]t may be appropriate to provide for written opinions for [large and complex] cases."⁵⁸ Although it is not hard to identify significant disadvantages to having laymen write legal decisions on complicated securities issues,⁵⁹ this acknowledgement clearly envisions greater judicial

⁵⁷ The number of new securities arbitrations before self-regulatory organizations went from 830 in 1980 to 6,101 in 1988. Masucci & Morris, *Arbitration at the National Association of Securities Dealers and the New York Stock Exchange*, SECURITIES ARBITRATION 1989 437, 442 (P.L.I. 1989). The number of securities arbitrations before the American Arbitration Association went from 119 in 1986 to 495 in 1988, with the money damages claimed correspondingly rising from \$15 million in 1986 to \$266 million in 1989. Friedman, *Securities: The Latest Developments*, N.Y. L.J. Mar. 9, 1989 at 3, 4; see also *infra* note 92 (increasing punitive damage awards).

Simultaneously, new procedures approved by the SEC have limited the number of industry-"tainted" individuals who can serve on arbitration panels. See *supra* note 9 and accompanying text. This has resulted in the Director of Arbitration for the N.A.S.D. publicly announcing that there are fewer available arbitrators. Henriques, *supra* note 9, at 6. Finally, the training and qualifications of arbitrators have been an articulated concern of the SEC for years. See September 10, 1987 letter from the SEC's Director of Market Regulation to the Securities Industry Conference on Arbitration (there is "virtually no formal training for arbitrators on matters relating to either arbitration law, relevant state law or securities law."), reprinted in J. SCHROPP, SECURITIES ARBITRATION, NEW APPROACHES TO SECURITIES COUNSELING & LITIGATION AFTER McMAHON 141-53 (1988); see also Henriques, *supra* note 9, at 6. The preparatory materials available to arbitrators underscore the SEC's concern, especially with regard to an arbitrator's ability to deal with complex disputes in which difficult and complex statutes are at issue. See, e.g., *The Arbitrator's Manual* (prepared by the Securities Industry Conference on Arbitration) reprinted in SECURITIES ARBITRATION 1989 at 477-90 (P.L.I. 1989) [hereinafter *Arbitrator's Manual*]; *Guidelines for Expediting Larger, Complex Commercial Arbitrations* (prepared by the American Arbitration Association) reprinted in *Arbitrator's Manual*, at 807-11; see also Poppleton, *The Arbitrator's Role in Expediting the Large and Complex Commercial Case*, 36 ARB. J. 1, 6 (Dec. 1981); Barrett, *Arbitration of a Complex Commercial Case: Practical Guidelines for Arbitrators and Counsel*, 41 ARB. J. 1, 15 (Dec. 1986). The securities industry also recently acknowledged the problem, calling for a larger pool of trained and knowledgeable arbitrators to handle complex cases. See SIA Calls for Single Agency to Administer Arbitration System, 22 Sec. Reg. & Law Rep. (BNA) 13-14 (January 5, 1990).

⁵⁸ Release No. 26,805, *supra* note 9, at 80,110 n.46. In subsequent remarks to reporters, staff members of the SEC emphasized that further arbitration reform is needed in the areas of complex litigation and class actions. See *SEC Approves Arbitration Summaries*, *supra* note 53, at 684. The securities industry, independent of the SEC, is taking steps in this direction. See *supra* note 42 and accompanying text.

⁵⁹ See Katsoris, *supra* note 4, at 382-83. The disadvantages of written opinions by laymen include the following: (i) opinions would, or should, not constitute binding precedent, (ii) opinions might not be tightly reasoned or set forth well-expressed legal analysis,

involvement in arbitrations, to ensure that parties' substantive rights under a variety of complex laws are fully protected. In any event, a broader standard for judicial review of awards made under such laws does not require a judge-like, scholarly decision.⁶⁰

B. *Ensuring that Absolute Defenses To Suit Are Upheld*

In the civil litigation system, there are well established procedures for avoiding a trial if one party is entitled to a judgment as a matter of law and there are no genuine factual disputes with respect to the application of that law.⁶¹ In contrast, there are no procedural methods for the hearing and resolution of dispositive legal issues (e.g., discharge in bankruptcy, *res judicata*, statute of limitations) in the arbitration process. Thus, even where there is such a dispositive defense, a party's sole remedy is to argue the applicability of the defense to the arbitrators, with little or no hope that a court will be in a position to ensure that the defense is honored.

The statute of limitations is a paradigm of this problem. The securities industry's self-regulatory organizations have a general six-year rule, without regard to the substantive nature of the claim.⁶² However, the states usually have varying statutory periods for different substantive claims,⁶³ and many federal statutes have their

(iii) the extra work might discourage potential arbitrators from serving, and (iv) the writing of opinions would further slow down the rendering of awards. *Id.* Nonetheless, even Katsoris stated that "awards should clearly state the result, e.g., if it includes relief for punitive damages or a RICO claim, it should state this separately." *Id.* at 383. Even this minimal type of award form, however, is not strictly required by the new procedures mandated by the SEC. *See supra* note 9.

⁶⁰ *See supra* note 42.

⁶¹ Rule 12 of the Federal Rules of Civil Procedure allows a party to move to dismiss on the ground that there is a failure to state a claim upon which legal relief can be granted. FED. R. CIV. P. 12(b)(6). Should there be any need to look beyond the pleadings themselves, such a motion can be amended under FED. R. CIV. P. 56. Rule 56, which provides that summary judgment should be entered when "pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." *Id.* The U.S. Supreme Court, in three recent cases, has strongly endorsed such dispositive motions in complex litigation. *See* Stewart, *Rulings Make Summary Judgment Possible in Complex Litigation*, NATL. L.J., Dec. 1, 1989, at 22.

⁶² NYSE Rules 603, 2 N.Y.S.E. Guide (CCH) ¶ 2603, at 4313 (Feb. 1989); AMEX Arbitration Rule 605(a); NASD Code of Arbitration Procedure § 15.

⁶³ *See, e.g.*, N.Y. CIV. PRAC. L. & R. § 213 (McKinney 1989) (six-year statute for contract claims); *id.* at § 214 (three-year statute for tort claims); *id.* at § 215 (one-year statute for defamation claims).

own specific limitations periods.⁶⁴ Thus, should a substantive claim that is governed by a limitation period shorter than six years be asserted in arbitration, the arbitrators must address a complicated situation.

If the arbitration is governed by New York law, then the defending party is in luck because New York has a statute permitting a party to go to court at the outset to bar the action "if the claim sought to be arbitrated would have been barred by limitation of time had it been asserted in a court of the state."⁶⁵ Failure to seek court dismissal does not bar a party from asserting the statute of limitations at the arbitration;⁶⁶ however, at that point the decision to apply the statute of limitations rests within the arbitrators' sole discretion, and that discretion is, for all practical purposes, unchallengeable.⁶⁷

The New York statute regrettably appears to be unique, both as to procedure and as to the specific dispositive legal issues on which a party may seek to bar an arbitration from taking place.⁶⁸

⁶⁴ See, e.g., *In re Data Access Sys. Sec. Litig.*, 843 F.2d 1537 (3d Cir. 1988) (*en banc*), *cert. denied sub. nom.*, *Vitiello v. I. Kahlowsky & Co.*, 488 U.S. 984 (1988) (claim under § 10(b) of the Securities Exchange Act of 1934 barred if not brought within one year from the time of discovery and within three years from the time the violations occurred). Unfortunately, the limitation period for § 10(b) claims is not uniform among the states, or the federal circuit courts. See H. BLOOMENTHAL, *EMERGING TRENDS IN SECURITIES LAWS* §§ 6.01-.14 (1989). Although the SEC urged the Supreme Court to set a uniform five-year limitation on such claims, see *SEC Says its FEA Limitations Period Should Be Applied to Rule 10b-5 Claims*, 21 Sec. Reg. & L. Rep. 875 (June 16, 1989), the Court has thus far refused to do so. See *High Court Declines to Review Ruling on Limitations Period for '34 Act*, 21 Sec. Reg. & L. Rep. 935 (June 30, 1989).

⁶⁵ N.Y. CIV. PRAC. L. & R. § 7502(b) (McKinney 1989). All other affirmative defenses that are more fact specific are left to the arbitrators. See *Apuzzo v. County of Ulster*, 479 N.Y.S.2d 191 (N.Y. 1984) (laches); *cf.* *Corbo v. Les Chateau Assoc.*, 511 N.Y.S.2d 883 (N.Y. App. Div. 1987) (factual issues concerning statute of limitations were so intermeshed with the ultimate substantive issues governed by arbitration clause that court held arbitrator must make determination).

⁶⁶ *In Re Guetta*, 510 N.Y.S.2d 576, 578 (N.Y. App. Div. 1987). If the issue is not raised at that stage, however, it is deemed to be waived and cannot be asserted later when challenging the arbitration award. See *Tilbury Fabrics, Inc. v. Stillwater, Inc.*, 450 N.Y.S.2d 478 (N.Y. 1982).

⁶⁷ See *In re Guetta*, 510 N.Y.S.2d at 579.

⁶⁸ It is unclear why only the statute of limitations defense may be used in court to bar an arbitration. The legislature could have selected other affirmative defenses. Courts are now called on at the outset of arbitrations to decide key matters. For example, 12(b)(6) motions are frequently used to compel claims into arbitration. See *supra* note 7. One defense where this type of judicial intervention would make sense is collateral estoppel. It is well established that an arbitration award may be used to invoke the doctrine of collateral estoppel on a Rule 56 summary judgment motion to bar relitigation of the same issue in a court. See, e.g., *Pallante v. Paine Webber, Jackson & Curtis, Inc.*, 1985 WL 1360 (S.D.N.Y.

The far more common situation finds a party in arbitration attempting to assert a dispositive defense, like the statute of limitations, for the first time. A recent decision of the Fourth Circuit, *Miller v Prudential Bache Securities, Inc.*,⁶⁹ is illustrative of this situation, and parallels the *Bobker* decision in analysis and outcome.

In *Miller*, more than five and one half years after losing over one million dollars as a result of trading in naked options, Miller filed an arbitration claim against her brokerage firm, Prudential Bache. At the hearing, the defendant moved to dismiss the claims on the ground that they were barred by the Maryland three-year statute of limitations. The arbitrators, rather than applying the NASD's six-year limitations period, "apparently" looked to the pre-dispute choice of law provision, which stated that New York law applied.⁷⁰ They applied New York's "borrowing statute" to determine that the Maryland statute of limitations barred the claim.⁷¹ Miller subsequently sought to vacate the award in the District Court of Maryland, but that court ruled that the arbitrators' decision was not subject to judicial review

On appeal to the Fourth Circuit, Miller made alternative arguments, contending that the panel had either,

(i) misinterpreted the customer agreement by holding that the choice of law provision (providing for New York substantive law to be applied) incorporated New York's borrowing statute (which is procedural),

(ii) misapplied New York's borrowing statute, or

1985) (attorneys' fees granted to party defending against claim already decided in arbitration). There is no policy reason for not allowing the converse: permit a party to an arbitration to invoke collateral estoppel in court to bar the arbitration of a claim already arbitrated or litigated in court. See RESTATEMENT (SECOND) OF JUDGMENTS § 84 (1982).

⁶⁹ 884 F.2d 128 (4th Cir. 1989), cert. denied, 22 Sec. Reg. & L. Rep. 985 (June 29, 1990).

⁷⁰ The Fourth Circuit concluded that the arbitrators had "apparently" followed this line of reasoning, since "their decision did not specifically say so." *Miller v. Prudential Bache Sec., Inc.*, 884 F.2d 128.

⁷¹ The New York borrowing statute applies in situations where a plaintiff is a non-resident of New York and the cause of action accrued outside of New York. The statute provides,

an action based upon a cause of action accruing without the state cannot be commenced after the expiration of the time limited by the laws of either the state or the place without the state where the cause of action accrued, except that where the cause of action accrued in favor of a resident of the state the time limited by the laws of the state shall apply.

N.Y. CIV. PRAC. L. & R. § 202 (McKinney 1989).

(iii) misinterpreted and/or misapplied the six year statute of limitations provisions governing NASD proceedings.⁷²

Consistent with the Second Circuit's reasoning in *Bobker*,⁷³ the court refused to overturn the arbitration award, even though misinterpretations, misapplications and errors of law were evident.⁷⁴ Thus, although the dispositive defense was applied by the arbitrators, the acknowledged error of its application was unreviewable.

C. *The Prevention of Impermissible Damage Recoveries*

Generally, disputed damage awards made by arbitrators are governed by the "manifest disregard of the law" standard.⁷⁵ Thus, an arbitration award unaccompanied by a written opinion is difficult to challenge in court.⁷⁶ Nonetheless, there are two specific damage claims for which judicial review is clearly warranted—punitive damages and attorney's fees.

A controversial issue in arbitration is the recoverability of punitive damages.⁷⁷ At one time, a plaintiff could not recover punitive damages in arbitration,⁷⁸ because such damages were disallowed in civil litigation under the federal securities laws.⁷⁹ This may no longer be the case.

⁷² *Miller*, 884 F.2d 128.

⁷³ See *supra* note 38 and accompanying text.

⁷⁴ *Miller*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH), at 93,579-80. Of the three arguments pressed by Miller, it is likely that the second would not have prevailed under current case law, even had there been judicial review of the award. See *McMahan & Co. v. Donaldson, Lufkin & Jenrette Sec. Corp.*, 727 F. Supp. 833 (S.D.N.Y. 1989) (investor's fraud claims under the 1934 Act were barred under Connecticut's two year statute of limitations; court applied New York's borrowing statute because investor's residence was in, and the loss occurred in, Connecticut).

⁷⁵ See, e.g., *Koch Oil, S.A. v. Transocean Gulf Oil Co.*, 751 F.2d 551, 554 (2d Cir. 1985) ("[a]rbitrators may render a lump sum award without disclosing their rationale for it").

⁷⁶ See, e.g., *Sargent v. Paine, Webber, Jackson & Curtis, Inc.*, 882 F.2d 529 (D.C. Cir. 1989) (arbitration award will not be remanded for explanation absent evidence of error justifying vacation of the award).

⁷⁷ Compare Note, *An Argument Against the Availability of Punitive Damages in Commercial Arbitration*, 62 ST. JOHN'S L. REV. 270 (1988) with Note, *Punitive Damages in Securities Arbitration: The Unresolved Question of Pendent State Claims*, 37 CATH. U. L. REV. 1113 (1988). See also Report on Punitive Damages in Commercial Arbitrations, New York State Bar Association (1989) (committee issuing report evenly divided on permitting arbitrators to award punitive damages).

⁷⁸ See Smiley, *Stockbroker-Customer Disputes: Making a Case for Arbitration*, 23 GA. ST. B.J. 195, 199 (1987).

⁷⁹ See, e.g., *Grogan v. Garner*, 806 F.2d 829 (8th Cir. 1986) (punitive damages not recoverable under § 10(b) of 1934 Securities Exchange Act); *Hill York Corp. v. American*

Nowhere is this uncertainty more evident than in New York. Fifteen years ago the state's highest court, in *Garrity v Lyle Stuart, Inc.*,⁸⁰ ruled that public policy forbids private punishment and that under no circumstances could an arbitrator award punitive damages. Dutifully applying that clear statement of New York law, Chief Judge Motley of the Southern District of New York subsequently determined that such damages were not available in arbitration.⁸¹ Nevertheless, two years later Judge Cannella refused to apply *Garrity* in *Duggal Int'l, Inc. v Sallmetall, B.V.*,⁸² Judge Cannella ruled that the Federal Arbitration Act, not state law, applied and that there was no public policy expressed in that statute against punitive damages.⁸³ The only other possible bar to recovery the judge envisaged was an express or implied contractual limitation on the power of the arbitrator to award punitive damages,⁸⁴ and because there was none in that case, he held that the arbitrator had the authority to grant such a recovery.

Courts nationwide have gone both ways: some apply the appropriate state law,⁸⁵ and some look to the federal arbitration

Int'l Franchises, Inc., 448 F.2d 680 (5th Cir. 1971) (punitive damages not recoverable under 1933 Securities Act); *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276 (2d Cir. 1969), cert. denied, 397 U.S. 913 (1970) (punitive damages not recoverable under 1933 Securities Act); see generally 5C A. JACOBS, LITIGATION AND PRACTICE UNDER RULE 10B-5 § 260.03[e] (2d ed. 1986).

⁸⁰ 386 N.Y.S.2d 831 (N.Y. 1976). Underlying the Court of Appeals' ruling was a stated concern about the lack of judicial oversight of arbitration awards. See *id.* at 834 (if punitive damages were to be available, arbitration "would become a trap for the unwary given the freedom from judicial overview of law and facts. It would mean that the scope of determination by arbitrators, by the license to award punitive damages, would be both unpredictable and uncontrollable.').

⁸¹ *O'Driscoll v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 83 Civ. 0616 (S.D.N.Y. Oct. 26, 1984) (available at 1984 WL 1196).

⁸² No. 84 Civ. 7170, slip op. (S.D.N.Y. May 8, 1986).

⁸³ *Duggal Int'l, Inc. v Sallmetall, B.V.*, No. 84 Civ. 7170, slip op. at 2-3 (S.D.N.Y. May 8, 1986); see also *infra* note 88 and accompanying text.

⁸⁴ *Duggal*, No. 84 Civ. 7170, slip op. at 4. Courts in the Southern District of New York continue to be divided on this issue. Compare *Fahnestock & Co., Inc. v. Waltman*, No. 90 Civ. 1792 (S.D.N.Y. Aug. 22, 1990) (*Duggal* decision not followed; deemed inconsistent with the law), with *Barbier v. Shearson Lehman Hutton, Inc.*, 752 F. Supp. 151 (S.D.N.Y. 1990) (*Fahnestock* not followed; *Duggal* decision considered applicable precedent).

⁸⁵ See, e.g., *Appel v. Kidder, Peabody & Co.*, 628 F. Supp. 153 (S.D.N.Y. 1986) (request for punitive damages, although not awardable in arbitration, does not prevent arbitration); *Shahmirzadi v. Smith Barney, Harris Upham & Co.*, 636 F. Supp. 49 (D.D.C. 1985) (arbitration clause governed by New York law, which does not allow recovery of punitive damages); *Baselski v. Paine, Webber, Jackson & Curtis, Inc.*, 514 F. Supp. 535 (N.D. Ill. 1981) (contractual waiver of punitive damage recovery because it was stipulated

statute.⁸⁶ To further confuse the issue, there have been two recent developments. First, the procedures approved by the SEC preclude pre-dispute arbitration agreements that attempt to limit the power of arbitrators to make awards.⁸⁷ Second, a decision by the U.S. Supreme Court undermined those cases holding that federal law is applicable where a contractual arrangement dictates otherwise.⁸⁸

Given the above developments and the enormous monetary risks posed by punitive damages,⁸⁹ the jurisdiction in which an arbitration takes place and/or the choice of law provisions agreed to by the parties take on great significance, as does the arbitration panel's ability to sort through the laws' status as it now exists. Presently, securities arbitrators are informed—without regard to

that New York law governed); *Baker v. Sadick*, 208 Cal. Rptr. 676 (Cal. Ct. App. 1984) (agreement to arbitrate medical malpractice claim under California law authorized arbitrator's award of punitive damages); *United States Fidelity & Guar. Co. v. DeFluiter*, 456 N.E. 429 (Ind. 1983) (punitive damages not recoverable in arbitration proceeding under Indiana law); *Shaw v. Kuhnel & Assoc.*, 698 P.2d 880 (N.M. 1985) (punitive damages not recoverable under contract).

⁸⁶ See, e.g., *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378 (11th Cir. 1988) (arbitrators have power to award punitive damages even though the parties' contract specified that New York law would be applied); *Singer v. E. F. Hutton & Co.*, 699 F. Supp. 276 (S.D. Fla. 1988) (federal law favoring arbitration applied even though contract stated that New York law applied); *Willis v. Shearson/American Express, Inc.*, 569 F. Supp. 821 (M.D.N.C. 1983) (even though New York law governed, demand for punitive damages did not make arbitration improper).

⁸⁷ See, e.g., NYSE Rules 637(4), 2 N.Y.S.E. Guide (CCH) ¶ 2637, at 4325 (Feb. 1989) ("No agreement shall include any condition which limits the ability of the arbitrators to make any award.").

⁸⁸ Although the Court ruled in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), that the federal substantive arbitration law pre-empts state arbitration law—this was Judge Cannella's basis in *Duggal* for not looking to New York law—the Court more recently held in *Volt Information Sciences, Inc. v. Board of Trustees, U.S.*, 109 S. Ct. 1248 (1989), that state law controls where, under contract, there is a choice of law clause specifying that a state's law should apply, and the Federal Arbitration Act is silent on the substantive matter at issue.

⁸⁹ Although the Supreme Court recently held that the eighth amendment does not apply to punitive damage awards, it specifically reserved decision on the question of whether the due process requirements of the fourteenth amendment bar such awards. *Browning-Ferris, Inc. v. Kelco Disposal, Inc.*, U.S., 109 S. Ct. 2909 (1989). A district court recently applied this rationale in a massive tort case. *Juzwin v. Amtorg Trading Corp.*, 705 F. Supp. 1053 (D.N.J. 1989), *vacated*, 718 F. Supp. 1233 (D.N.J. 1989). This term the Court will decide that issue. *Pacific Mut. Life Ins. Co. v. Haslip*, 553 So. 2d 537 (Ala. 1989), *cert. granted*, 110 S. Ct. 1780 (1990) (No. 1279, 1989 Term, argued October 3, 1990). Literature debating the constitutionality of such damage recoveries is voluminous. See, e.g., Fein & Reynolds, *High Court May End Judicial Sweepstakes*, MANHATTAN LAW., June 1990, at 26; Grags, *The Penal Dimensions of Punitive Damages*, 12 HASTINGS CONST. L.Q. 241 (1985); Jeffries, *A Comment on the Constitutionality of Punitive Damages*, 72 VA. L. REV. 139 (1986).

jurisdiction—that they “can consider punitive damages”⁹⁰ and are further instructed that, if punitive damages are awarded, the decision of the arbitrators should clearly specify what portion of the award is intended as punitive damages, and the arbitrators should consider referring to the authority upon which they relied.⁹¹ Unfortunately, those directives are neither consistent with the status of the law, nor sufficient to ensure that an aggrieved party will receive judicial review of a big dollar mistake, under the “manifest disregard” standard.⁹²

The recovery of attorneys’ fees also is a form of damages frequently sought by arbitration claimants. This is not surprising when one considers that the directives given to arbitrators regarding attorney’s fees are very similar to the directives governing punitive damages.⁹³ And yet the law in virtually every state, barring explicit agreement by the parties, prohibits recovery of attorneys’ fees.⁹⁴

⁹⁰ *Arbitrator’s Manual*, *supra* note 57, at 487.

⁹¹ *Id.* The new award form put in use by the NYSE prominently displays areas for punitive damage recoveries. See *Selected Summary Award Statements*, *supra* note 41, at 999-1003.

⁹² The Arbitration Director of the New York Stock Exchange has written that he is “unaware of any securities arbitration award that has been vacated because arbitrators awarded punitive damages.” Morris, *Punitive Damages in Securities Arbitration*, 21 SEC. & COM. REG., Sept. 21, 1988, at 167, 168. From May of 1989 to May of 1990, arbitrators granted 21 punitive damage awards totaling \$4.5 million; for the prior one year period, there were nine awards totaling \$1.7 million. See Siconolfi, *Blow to Brokers: Stock Investors Win More Punitive Damage Awards in Arbitration Cases*, Wall St. J., June 11, 1990, at A1, col. 1.

⁹³ *Arbitrator’s Manual*, *supra* note 57, at 487.

Generally, parties to an arbitration are responsible for their personal costs associated with bringing or defending an arbitration action. Exceptions to that rule do exist. For instance, if there is an agreement that provides for an award of attorneys’ fees, it is within the discretion of the panel to do so. Parties should be prepared to argue the statutory or contractual basis that permits the award of attorneys’ fees. The arbitrators should consider referring to the authority relied upon if attorneys’ fees are awarded.

Id. Furthermore, the new award form used by the NYSE prominently displays areas of attorneys’ fees recoveries. See *Selected Summary Award Statements*, *supra* note 41, at 999-1003.

⁹⁴ See M. DOMKE, *DOMKE ON COMMERCIAL ARBITRATION* § 43.01 (rev. ed. 1987). For a sampling of states that follow this practice, see *Cueras v. Potamkin Dodge, Inc.*, 455 So. 2d 398 (Fla. 1984) (attorney’s fees allowed where expressly agreed to in contract); *Bingham County Comm’n v. Interstate Elec. Co.*, 665 P.2d 1046 (Idaho 1983) (absent contractual agreement to award attorney’s fees, an arbitrator may not do so); *School Comm. v. Dever*, 395 N.E.2d 900 (Mass. 1979) (recovery of attorney’s fees not allowed absent express agreement to the contrary). Michigan is one of the few states that allows an arbitrator to award attorneys’ fees even if the parties’ arbitration agreement did not provide for such a recovery. See *J. R. Synder Co. v. Soble*, 226 N.W.2d 276 (Mich. 1975).

New York is illustrative. According to New York statutory⁹⁵ and case⁹⁶ law, attorneys fees are not recoverable in an arbitration absent an express agreement to the contrary.⁹⁷ Notwithstanding this well-articulated law, courts reviewing attorneys' fees awards have not utilized the "manifest disregard" standard; rather they have either looked to whether the arbitrators exceeded their power,⁹⁸ or whether the matter was properly before the arbitrators in the first place.⁹⁹ Courts outside of New York, whose states have similar statutes, also seem to share this reluctance to employ the "manifest disregard" standard on attorneys' fees claims.¹⁰⁰ The reason for the judicial reluctance is not clear; this is clearly one money damage claim for which judicial review—by whatever standard—is appropriate.

CONCLUSION

As arbitration has become more and more the mandated forum for the resolution of civil disputes, so too it has come to resemble the civil litigation system it was designed to replace. The only area that seems not to have kept pace is the right to seek review of

⁹⁵ N.Y. CIV. PRAC. L. & R. § 7513 (McKinney 1989).

⁹⁶ *E.g.*, Arthur Richards, Ltd. v. Brampton Textiles, Ltd., 399 N.Y.S.2d 111, 112 (N.Y. App. Div. 1977) ("Since it is not indicated on this record that the agreement contains such provision for attorneys' fees, that claim may not be submitted to arbitration."); Geneseo Police Benevolent Ass'n v. Village of Geneseo, 458 N.Y.S.2d 384, 385 (N.Y. App. Div. 1982), *aff'd*, 463 N.Y.S.2d 440 (1983) ("Inasmuch as the arbitration agreement made no provision for attorneys' fees, the arbitrator properly denied petitioner's application."); Grossman v. Laurence Handprints-N.J., Inc., 455 N.Y.S.2d 852 (N.Y. App. Div. 1982) ("attorneys' fees are specifically excluded, unless they are expressly provided for in the arbitration agreement") (citation omitted); *see also* 8 WEINSTEIN, KORN, MILLER, NEW YORK CIVIL PRACTICE § 7513.02, at 75-303 (1988) ("The parties may, if they wish, provide for the reasonable payment of attorney's fees by the losing party. In the absence of an agreement, CPLR 7513 provides that such fees would not be included as expenses." (citations omitted)).

⁹⁷ Brockport v. County of Monroe Pure Water Div., 429 N.Y.S.2d 931, 935 (N.Y. App. Div. 1980), *aff'd*, 442 N.Y.2d 510 (1981) ("Simply stated, arbitration as a contractually selected remedy cannot be ordered absent an express, direct and unequivocal agreement in writing between the parties.").

⁹⁸ *See, e.g.*, Transvenezuelan Shipping Co. v. Czarnikow-Rionda Co., No. 81-4987, slip op. (S.D.N.Y. Dec. 30, 1981) (holding that "the scope of [the arbitrators'] authority is an issue subject to judicial review" under the FAA, and that the arbitrators had exceeded their authority under 9 U.S.C. § 10 where there was no agreement to provide for attorneys' fees).

⁹⁹ Sammi Line Co. v. Altamar Navegacion S.A., 605 F Supp. 72 (S.D.N.Y. 1985) (arbitrators had no authority to award attorneys' fees where there was no showing that such an award was within the scope of arbitrable issues).

¹⁰⁰ *See, e.g.*, *supra* note 94 and accompanying text.

arbitration awards; there, it remains very difficult to overturn an award, even where it can be shown that the arbitrators have completely misinterpreted the applicable law. This state of affairs becomes exceedingly problematic when the resolution of complicated statutory rights and the power to award huge sums of money is placed in the hands of poorly trained arbitrators. Although the SEC has belatedly acknowledged that there is a need for further reform in arbitration procedure, what is needed is prompt recognition that, if arbitrators are expected to make decisions in which complicated legal matters are at issue, those decisions must be judicially reviewable.