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Arbitration of a Securities Dispute—An Overview for the Practitioner

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ARTICLE

ARBITRATION OF A SECURITIES DISPUTE—AN OVERVIEW FOR THE PRACTITIONER

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I. INTRODUCTION

A. What is Arbitration?

Arbitration, in its simplest sense, is the resolution of a dispute before an independent person or persons by whose decision, after a hearing at which both parties have an opportunity to be heard, the parties to the dispute agree in advance to abide.¹ In 1947, Congress enacted the Federal Arbitration Act² setting forth certain rules and procedures applicable to arbitrations. Although much of the Federal Arbitration Act deals expressly with litigation in federal tribunals, the United States Supreme Court has held that the Act creates a body of substantive federal law which governs in state court as well.³ The state

1. BLACK'S LAW DICTIONARY 96 (5th ed. 1979). Arbitrations are typically viewed as an informal means of dispute resolution intended to avoid the formalities, delay, expense and cost of ordinary litigation. *E.g.*, *Wauregan Mills, Inc. v. Textile Workers Union of Am., AFL-CIO*, 21 Conn. Supp. 134, 146 A.2d 592 (1958).

Broadly and generally speaking an arbitration is a contractual proceeding by which the parties to a controversy or dispute, in order to obtain a speedy and inexpensive final disposition of matters involved, voluntarily select arbitrators or judges of their own choice, and by consent submit the controversy to such tribunal for determination in substitution for the tribunals provided by the ordinary processes of the law.

6 C.J.S. *Arbitration* § 2.

2. 9 U.S.C. §§ 1-14 (1982).

3. *Southland Corp. v. Keating*, 465 U.S. 1, 10-15 (1984).

common law of contracts confers the right of action and the Federal Arbitration Act simply prescribes a federal substantive rule requiring enforcement of the contract's arbitration clause by whichever court obtains jurisdiction of the case.⁴ The Federal Arbitration Act can be used to enforce arbitration provisions, regardless of whether the issue arises in federal court or state court.⁵

In *Moses H. Cohn Hospital v. Mercury Construction*,⁶ the Supreme Court affirmed a decision vacating a stay of arbitration by the trial court. In making its ruling, the Court explained:

The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.⁷

The Arkansas Supreme Court has likewise ruled that doubts and ambiguities concerning arbitration should be resolved in favor of arbitration.⁸ Arkansas has adopted the Uniform Arbitration Act.⁹ Section 1 of the Act provides for the enforcement of arbitration agreements provided that the section has "no application to personal injury or tort matters, employer-employee disputes, nor to any insured or beneficiary under any insurance policy or annuity contract."¹⁰ The full application of the Uniform Arbitration Act is beyond the scope of this article.

B. NASD Arbitrations

This article addresses the arbitration of a securities dispute before the National Association of Securities Dealers, Inc. ("NASD").¹¹ The

4. *Id.* at 15 n.9; *Moses H. Cohn Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 25 n.32 (1983). Substantive issues are determined by the Federal Arbitration Act and procedural issues are determined by state law. *England v. Dean Witter Reynolds, Inc.*, 306 Ark. 225, 227, ___ S.W.2d ___, ___ (1991).

5. *E.g.*, *Butcher & Singer, Inc. v. Frisch*, 433 So. 2d 1360, 1362 (Fla. Dist. Ct. App. 1983).

6. 460 U.S. 1 (1983).

7. *Id.* at 24-25.

8. *Wessell Bros. Found. Drilling Co. v. Crossett School Dist.* No. 52, 287 Ark. 415, 418, 701 S.W.2d 99, 101 (1985).

9. ARK. CODE ANN. § 16-108-201 to -224 (1987).

10. *Id.* at § 201.

11. Arbitrations may be conducted before numerous other self-regulatory organizations including, but not limited to, the Municipal Securities Rulemaking Board, the New York Stock Exchange, the American Stock Exchange, and the Chicago Board of Trade. Although the arbitration provisions of these self-regulatory organizations are not within the scope of this article, to a

NASD is a non-profit Delaware corporation registered with the Securities and Exchange Commission ("SEC") as a national securities association under authority of the Maloney Act.¹² Through the Maloney Act, Congress granted the NASD extensive self-regulatory authority over its own members in order to attain and preserve the highest standards of legal and ethical behavior in the nation's securities markets, subject to SEC oversight.¹³ Pursuant to this congressionally delegated self-regulatory authority, in 1968 the NASD adopted the Code of Arbitration Procedure ("Arbitration Code" or "Code") setting forth the rules and procedure for conducting arbitrations.¹⁴

II. ARBITRATION V. CIVIL LITIGATION

In evaluating an arbitrable¹⁵ dispute, the potential claimant may have the option of either instituting an arbitration proceeding or civil litigation.¹⁶ There are a myriad of factors which can affect this decision. One of the most important considerations is the loss of a trial by jury through the arbitration process. Depending on the facts of each particular case this factor alone could be decisive in determining whether arbitration of a dispute is beneficial.

The standard language used by courts and legislators in encouraging the arbitration of disputes is that it is a speedy economical alternative to litigation.¹⁷ Although this language is often repeated by the courts, there is seldom any statistical or factual evidence supporting

large extent their provisions are similar or identical to those of the NASD. The names and addresses of other securities industry organizations having arbitration facilities are: American Stock Exchange, Inc., 86 Trinity Place, New York, NY 10006; Boston Stock Exchange, Inc., 53 State Street, Boston, MA 02109; Chicago Board Options Exchange, Inc., La Salle at Jackson, Chicago, IL 60604; Cincinnati Stock Exchange, Inc., 205 Dixie Terminal Building, Cincinnati, OH 45202; Midwest Stock Exchange, Inc., 120 South La Salle Street, Chicago, IL 60603; Municipal Securities Rulemaking Board, 1150 Connecticut Avenue, N.W., Washington, D.C. 20036; New York Stock Exchange, Inc., 11 Wall Street, New York, NY 10005; Pacific Stock Exchange, Inc., 618 South Spring Street, Los Angeles, CA 90014; Philadelphia Stock Exchange, Inc., 17th and Stock Exchange Place, Philadelphia, PA 19103.

12. 15 U.S.C. §§ 78o-3, amending the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78(a).

13. 15 U.S.C. § 78o-3; S. REP. NO. 1455, 75th Congress, 3rd Sess. 4 (1938).

14. NASD Manual (CCH) ¶¶ 3701 through 3746 (1984) [hereinafter CODE OF ARBITRATION PROCEDURE].

15. See *infra* Section III.

16. As to the duty to arbitrate, see *infra* Section III.

17. *E.g.*, Speck v. Oppenheimer & Co., Inc., 583 F. Supp. 325, 329 (W.D. Mo. 1984) (citing *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983); *Wilko v. Swan*, 346 U.S. 427, 438 (1953)).

this conclusion.¹⁸ As a result of several factors including the stock market crash of 1987, increased market activity, recent Supreme Court decisions,¹⁹ growth in the securities industry, and increased familiarity with the arbitration process, the number of NASD arbitrations has substantially increased.²⁰ The NASD has retained additional staff to meet the demands of increasing claims for arbitration.²¹ An arbitration before the NASD takes an average of twelve months from filing to conclusion.²² Thus, depending upon the forum in which civil litigation would be filed, arbitration may or may not be a speedier method of dispute resolution.²³

The contention that arbitration is a less expensive means of resolving disputes appears to be true because of the informality surrounding the conduct of arbitration hearings.²⁴ While parties have the right to retain counsel for arbitration hearings,²⁵ they are not required to do so. A large percentage of arbitration hearings do not require multi-day hearings.²⁶

Further, discovery in arbitration proceedings is more limited than in civil litigation²⁷ and is usually resolved without numerous discovery hearings.²⁸ Despite these often repeated advantages of arbitration, there are also substantial disadvantages in submitting a case to arbitration. The limited discovery in arbitration can work to the disadvantage of a potential claimant.²⁹ Likewise, the limited availability of punitive

18. See Marcotte, *Avoiding Courts*, A.B.A. J., Dec. 1990, at 27. As the Supreme Court noted in *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" should inhibit enforcement of the Federal Arbitration Act.

19. *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985).

20. In 1985, the NASD had 1,400 arbitration filings; in 1986 - 1,587; in 1987 - 2,886; in 1988 - 3,990; in 1989 - 3,632 and for the first three quarters of 1990 - 2,636. Telephone interview with Enno Hobbing, Vice President, News Bureau, NASD (Nov. 19, 1990) [hereinafter "Hobbing conversation"].

21. *Id.*

22. *Id.*

23. This will be an individualized decision based upon the court docket in the various forums.

24. See *infra* § VII.

25. See *infra* § VII. CODE OF ARBITRATION PROCEDURE § 27.

26. Hobbing conversation, *supra* note 20.

27. See *infra* § VI.

28. See *infra* § VI.

29. See *infra* § VI. Documentation otherwise discoverable in civil litigation may be unobtainable or difficult to obtain in an arbitration proceeding. The claimant's individualized position with regard to the need for discovery should be a factor in making the ultimate decision whether

damages³⁰ and ability to recover attorney's fees³¹ may impact directly on this decision. Further, even if the claimant is successful in prosecuting its arbitration claim, an arbitration award is not the same as a court judgment. The claimant will be required to take additional steps to confirm the arbitration award and reduce it to judgment.³² Finally, in the event the claimant is unsuccessful in obtaining an arbitration award, grounds for appeal are severely limited.³³

There are often questions concerning the ability of securities customers to obtain a fair hearing before arbitration panels.³⁴ While these authors' personal experience³⁵ in arbitration hearings has been directly to the contrary, it has been the traditional notion of securities firms that arbitration hearings are more useful as a shield from liability than as a sword for recovery.³⁶ In any event, the decision to arbitrate or file civil litigation should be an individualized decision based upon the facts of each case.

III. ARBITRABILITY

Mandatory arbitration of securities disputes can be traced to one of two sources: (i) predispute agreement; or (ii) self-regulatory (industry) organization membership requirements which bind a member or its agents to arbitrate.

A. Predispute Arbitration Agreements

Arbitration of securities disputes pursuant to a predispute agreement is now the law of the land.³⁷ In twin cases the Supreme Court

to arbitrate.

30. *See infra* § VIII.

31. *See infra* § VIII.

32. *See infra* § X.

33. *See infra* § XI.

34. *See infra* § V, addressing composition of arbitration panels in public customer cases.

35. The authors of this article have participated in over fifty arbitrations representing both individuals and securities firms and also serving as arbitrators. It has been the authors' experience that arbitration panels go to great lengths to protect the interests of the individual investors and often resolve doubts in favor of the investors and against securities firms or registered representatives.

36. Arbitration hearings avoid the dangers and unpredictability of jury verdicts. Arbitrators are typically knowledgeable of the industry and actively participate in the hearing through questions and comments. As discussed in Section III, the limited availability of punitive damages and attorneys' fees is further incentive for a securities firm to prefer arbitration over civil litigation.

37. *E.g.*, *Rodriguez De Quijas v. Shearson/Am. Express*, 109 S. Ct. 1917 (1989); *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987); *Dean Witter Reynolds, Inc. v. Byrd*,

first refused to extend the *Wilko v. Swan*³⁸ case to Exchange Act cases and later overruled *Wilko*.³⁹ The change in rationale can be traced to the Supreme Court decision in *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth*.⁴⁰ In *Mitsubishi Motors* a party was making a similar argument to that in *Wilko*; i.e., the arbitration agreement acted as a waiver of statutory rights regarding antitrust claims.⁴¹ The Supreme Court compelled arbitration of the antitrust claims and held arbitration of federal statutory claims was permissible unless Congress had exempted them from arbitration.⁴²

In *Shearson/American Express, Inc. v. McMahon*⁴³ the Supreme Court established a duty to arbitrate⁴⁴ and imposed a burden upon the person opposing arbitration to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue.⁴⁵ In refusing to extend the *Wilko* decision to Exchange Act cases, the Court stated that section 29(a) of the Exchange Act⁴⁶ was not a bar to enforcement of predispute arbitration agreements.⁴⁷ Following *McMahon*, the Supreme Court in *Rodriquez De Quijas v. Shearson/American Express*⁴⁸ reversed the *Wilko* decision.⁴⁹ It held that *Wilko* was incorrectly decided and that section 14 of the Securities Act⁵⁰ and section

470 U.S. 213, 218 (1985) (“[t]he Arbitration Act requires the district court to compel arbitration of pendent arbitrable claims when one of the parties files a motion to compel . . .”).

38. 346 U.S. 427 (1953).

39. In *Wilko*, the Supreme Court held that a predispute agreement to arbitrate a purchaser's claim under section 12(2) of the Securities Act of 1933 acted as an impermissible waiver of those statutory rights and, therefore, was barred by section 14 of the Securities Act. *Id.* at 438. Section 14 states “[a]ny condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the commission shall be void. 15 U.S.C. § 77(N) (1982).

40. 473 U.S. 614 (1985).

41. *Id.* at 628.

42. *Id.* at 637.

43. *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

44. *Id.* at 226.

45. *Id.* at 227.

46. Section 27 of the Exchange Act states, in part, “The district courts of the United States . . . shall have exclusive jurisdiction of the violations of this title or the rules and regulations thereunder, and if regarding suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder.” 15 U.S.C. § 78aa (1988). Section 29(a), 15 U.S.C. § 73cc(a) (1988), states: “[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision” of the Exchange Act is void.

47. *McMahon*, 482 U.S. at 229.

48. 109 S. Ct. 1917 (1989).

49. *Id.* at 1922.

50. 15 U.S.C. § 77n (1988).

29(a)⁵¹ of the Exchange Act are to be similarly construed.⁵² The Court, in light of its previous rulings in *Mitsubishi Motors* and *McMahon*, stated that arbitration agreements are enforceable under the 1933 Act. As a result of these recent decisions, a party wishing not to arbitrate must find a reason other than the *Wilko* rationale.

B. Mandatory Arbitration Due to NASD Membership

Section 8 of the NASD Code of Arbitration Procedure requires arbitration of disputes between members or members against persons associated with a member.⁵³ In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Hovey*,⁵⁴ the Eighth Circuit held that a dispute arising out of a brokerage firm's employment of an account executive is a dispute, claim, or controversy arising from or in connection with the business of a member and therefore within the scope of disputes requiring compulsory arbitration. In an analogous situation of a New York Stock Exchange (NYSE) firm and an account executive who submitted a form U-4⁵⁵ to the NYSE, the court in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Thompson*⁵⁶ held the form U-4 submitted by the account executive and rules of the New York Stock Exchange constituted an enforceable contract to arbitrate between the account executive and the New York Stock Exchange member by stating:

The U-4 form is part of the application to become a registered representative of a member of the New York Stock Exchange (NYSE). The NYSE requires both the applicant, here each of the named defendants, and the sponsoring NYSE member, in this case, Merrill Lynch, sign the U-4 form. The U-4 form contains an arbitration clause that requires representatives and member firms to resort to arbitration as prescribed in the constitution rules of the exchange.⁵⁷

Other courts have recognized that members are contractually bound by the regulations of their organization, including any arbitration provisions. Thus, individuals and corporations registered with the NASD

51. See *supra* note 46.

52. *Rodriguez*, 109 S. Ct. at 1922.

53. New York Stock Exchange Rule 600 has a similar provision.

54. 726 F.2d 1286, 1288-89 (8th Cir. 1984).

55. See *infra* note 676.

56. 575 F. Supp. 978, 979 (N.D. Fla. 1983).

57. *Id.* See also *England v. Dean Witter Reynolds, Inc.*, 306 Ark. 225, 227, ____ S.W.2d ____, ____ (1991); *Muh v. Newberg, Loeb & Co.*, 540 F.2d 970, 972-73 (9th Cir. 1976); *Coenen v. R.W. Pressprich & Co.*, 453 F.2d 1209, 1211 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972).

have a contractual obligation to arbitrate industry disputes.

C. Defenses to Enforceability of Arbitration Clauses

In opposing enforcement of an arbitration clause, an initial point of inquiry is whether the parties agreed to arbitrate. In that regard, the inquiry may relate to the adhesive nature of securities brokerage firm contracts.⁵⁸ Because securities brokerage firm contracts are standard printed form agreements, they have been attacked as being adhesive. However, the issue of an agreement of the parties does not end once it is shown the contracts are adhesive. Even if found to be adhesive, they may be held valid and enforceable because they are neither unconscionable nor violative of public policy.⁵⁹ Nevertheless, these contracts will be invalidated if arbitration is not within the reasonable expectations of the parties or is unconscionable.⁶⁰

The defense of fraud in the inducement is another defense which goes to whether the parties agreed to arbitrate. However, there is a jurisdictional issue which must be resolved first. Is a claim of fraud in the inducement of the entire contract one which is to be resolved by the federal court or a matter for arbitrators?⁶¹ The Supreme Court said the answer is found in section 4 of the Arbitration Act,⁶² stating:

[I]f the claim is fraud in the inducement of the arbitration clause itself - an issue which goes to the "making" of the agreement to arbitrate - the federal court may proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally.⁶³

Therefore, allegations of inability to read the English language⁶⁴ and signing an agreement under duress⁶⁵ were both determined to be defenses to the contract generally and left for the arbitrators.

A second point of inquiry is the scope of the arbitration agree-

58. *E.g.*, *Coleman v. Prudential Bache Sec., Inc.*, 802 F.2d 1350, 1352 (11th Cir. 1986).

59. *Id.*

60. *E.g.*, *Finkle & Ross v. A.G. Becker Paribas, Inc.*, 662 F. Supp. 1505, 1512 (S.D.N.Y. 1985).

61. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402 (1967).

62. 9 U.S.C. § 4 (1988).

63. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, at 403.

64. *Villa Garcia v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 833 F.2d 545, 548 (5th Cir. 1987).

65. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Haydu*, 637 F.2d 391, 398 (5th Cir. 1981).

ment. In particular, does the arbitration agreement cover the subject matter which created the controversy? The boundaries of an arbitration agreement are determined through interpretation of the contract and "parties to such an agreement cannot be required to submit to arbitration any matter that they did not agree would be subject to that manner of dispute resolution."⁶⁶ For example, when two separate arbitration agreements were involved, one involving disputes limited to the clearing (handling) of securities and the other involving matters related solely to the customer's account, the court found the scope of the customer agreement controlled customer claims and the clearing agreement controlled those matters covered by it.⁶⁷ Excluded matters, such as securities law claims, have been upheld where an express intent to exclude is shown.⁶⁸ A party cannot be required to submit to arbitration a matter which he did not agree would be subject to arbitration.⁶⁹ However, if some, but not all, matters are subject to arbitration a mixed result may occur. The issue then becomes whether the court should stay the remaining items pending arbitration.⁷⁰

D. Compelling Arbitration and Waiver of Remedy

Closely related to the duty to arbitrate is the remedy to enforce the arbitration agreement and whether the remedy has been waived. The remedy for enforcement of an arbitration agreement is a court order compelling arbitration.⁷¹ However, the contractual right and the remedy to enforce may be waived.⁷² The determination is largely factual as to whether the motion to compel has been filed timely.⁷³ Courts have noted the dominant federal policy favoring arbitration and ruled

66. *United Steelworkers of Am. v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960).

67. *Creative Sec. Corp. v. Bear Stearns & Co.*, 671 F. Supp. 961 (S.D.N.Y. 1987), 847 F.2d 834 (2d Cir. 1988).

68. *Brick v. J.C. Bradford & Co.*, 677 F. Supp. 1251 (D.D.C. 1987); *Pezely v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 683 F. Supp. 767 (D. Utah 1987).

69. *Azriliant v. Shearson Lehman/Am. Express*, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶93,393 (1987).

70. *See, e.g., Genesco, Inc. v. T. Kakiuchi & Co.*, 815 F.2d 840, 856 (2d Cir. 1987).

71. 9 U.S.C. § 4 (1988); *Shihadeh v. Dean Witter Reynolds, Inc.*, 766 F.2d 461 (11th Cir. 1985).

72. *E.g., Frye v. Paine, Webber, Jackson & Curtis, Inc.*, 877 F.2d 396 (5th Cir. 1989).

73. *Brown v. Dean Witter Reynolds, Inc.*, 882 F.2d 481 (11th Cir. 1989). *See also* Subcommittee on Annual Review, *Significant 1989 Court Decisions, Pre-dispute Arbitration Agreements: The Trend Toward Arbitration Continues*, 45 Bus. Law. 1281, 1286 (1990).

that waiver is not to be inferred.⁷⁴ A heavy burden of proof is imposed upon the party arguing waiver.⁷⁵ In fact, at least one court has found a presumption against waiver.⁷⁶

E. New NASD Rules Regarding Arbitration Clauses

In response to the Supreme Court's decisions in *McMahon* and *Rodriguez* and litigation regarding enforcement of predispute arbitration clauses, the NASD promulgated rules regarding the form of agreements. The gist of these rules⁷⁷ is that the arbitration agreement must:

- (1) Highlight the arbitration clause;
- (2) Contain disclosure language which states:
 - (a) The arbitration agreement is final and binding;
 - (b) The parties waive right to jury/judicial relief of remedies;
 - (c) Discovery is limited;
 - (d) The arbitration award is not required to contain factual findings and the party's right to appeal or seek modification is strictly limited;
 - (e) The arbitration panel will contain members from the industry;
- (3) The signature line must reference the arbitration clause;
- (4) The customer must acknowledge receipt of a copy of the agreement; and
- (5) The agreement cannot limit the SRO rules, the ability of the customer to file a claim, or the panel's ability to grant an award.

IV. INITIATION OF AN ARBITRATION CLAIM

The mechanics of filing a claim have also been defined by NASD procedures.⁷⁸ The content of a claim is left to the petitioner.⁷⁹ How-

74. *E.g.*, *Rush v. Oppenheimer & Co.*, 779 F.2d 885, 887 (2d Cir. 1985).

75. *Belke v. Merrill Lynch, Pierce, Fenner & Smith*, 693 F.2d 1023, 1025 (11th Cir. 1982).

76. *E.g.*, *Miller Brewing Co. v. Ft. Worth Distrib. Co.*, 781 F.2d 494, 496 (5th Cir. 1986).

77. NASD Manual (CCH) ¶ 2,171(f)(1) (1984); Article III, § 21(f)(1) of the NASD Rules of Fair Practice.

78. For purposes of the article, only NASD regulations are noted, but the New York Stock Exchange, the American Arbitration Association, and the American Stock Exchange have similar rules.

79. Because of the limited discovery in arbitration and the informality of the procedures, many practitioners use the claim to set forth their case in great factual detail. Attached to many such complaints are documents and other materials which may be objectionable in a court of law. In filing the complaint, the petitioner may attempt to pre-try the issues in this manner by having

ever, the regulations do give an outline of matters which should be presented.

Section 25(a) of the NASD Code of Arbitration Procedures sets forth very generally the contents of a statement of claim.⁸⁰ The claim should set out facts and remedies sought and contain documentary support. Other than this, the drafting is left to the author. The statement of claim should have a chronological presentation of the events leading up to the dispute. It should set forth all factual bases upon which the relevant claim is based, such as phone conversations and meetings. Documentary evidence of the events cited, such as confirmations, monthly statements or correspondence should be included. Each of these items should be attached to the claim and noted as an exhibit.⁸¹ Since arbitrators are required to read the pleadings,⁸² the statement of claim and answer are the parties' best opportunity to inform the arbitrators of their version of the facts prior to the hearing.

In addition to the statement of claim, NASD procedure requires a uniform submission agreement to be included and signed by the parties.⁸³ By signing this agreement, the parties agree to abide by the decision, the award of the arbitrators, and the decision-making process. If the brokerage firm or the broker refuse to sign it, they are subject to sanctions by the NASD,⁸⁴ or a motion to compel arbitration.⁸⁵ Also, if

the panelists review the underlying facts prior to the hearing.

The counterside is that arbitration panels include members of the industry and persons familiar with securities claims. Because of the panelists' expertise, many items which would be needed to educate a jury or judge are unnecessary in an arbitration proceeding. For this reason, a succinct statement of claim may also prove to be beneficial.

80. CODE OF ARBITRATION PROCEDURE § 25(a).

81. These are the authors' suggestions only and are based solely upon personal experience.

82. CODE OF ARBITRATION PROCEDURE § 31.

83. *Id.* § 25(a).

84. Resolution of the Board of Governors:

It may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Article III, Section I of the Rules of Fair Practice for a member or a person associated with a member to fail to submit a dispute for arbitration under the CODE OF ARBITRATION PROCEDURE as required by that Code, or to fail to appear or to produce any document in his possession or control as directed pursuant to provisions of the CODE OF ARBITRATION PROCEDURE, or to fail to honor an award of arbitrators properly rendered pursuant to the CODE OF ARBITRATION PROCEDURE where a timely motion has not been made to vacate or modify such award pursuant to applicable law. All awards shall be honored by a cash payment to the prevailing party of the exact dollar amount stated in the award. Awards may not be honored by crediting the prevailing party's account with the dollar amount of the award, unless authorized by the express terms of the award or consented to in writing by the parties. Awards shall be honored upon receipt thereof, or within such other time period as may be prescribed by

there is an arbitration agreement, it should be attached.

NYSE Rule 629 and section 43 of the NASD Code of Arbitration Procedure set forth the amount of the filing fee, usually predicated on the amount of the claim.⁸⁶

V. THE ARBITRATION PANEL

A. General

The individuals⁸⁷ who serve on an arbitration panel are chosen by the Director of Arbitration.⁸⁸ There are two types of arbitrators, public arbitrators and those from the securities industry.⁸⁹ An arbitrator is a public arbitrator if he is not from the securities industry.⁹⁰ An arbitrator from the securities industry is one with close ties to the industry as set forth in the Code of Arbitration Procedure.⁹¹ This distinction is im-

the award.

Action by members requiring associated persons to waive the arbitration of disputes contrary to the provisions of the CODE OF ARBITRATION PROCEDURE shall constitute conduct that is inconsistent with just and equitable principles of trade and a violation of Article III, Section 1 of the Rules of Fair Practice.

(Resolution adopted effective May 1, 1973, as amended July 1, 1987.) NASD Manual (CCH) ¶ 3744.

85. See *supra* § III(C).

86. Amount in Dispute	Deposit
(Exclusive of interest and expenses)	
\$1,000 or less	\$ 15
Above \$1,000 but not exceeding \$2,500	25
Above \$2,500 but not exceeding \$5,000	100
Above \$5,000 but not exceeding \$10,000	200
Above \$10,000 but not exceeding \$50,000	400
Above \$50,000 but not exceeding \$100,000	500
Above \$100,000 but not exceeding \$500,000	750
Above \$500,000	1,000

87. CODE OF ARBITRATION PROCEDURE § 20.

88. The Director of Arbitration is appointed by the NASD Board of Governors and is charged with the performance of all administrative duties and functions in connection with matters submitted for arbitration pursuant to the Code. *Id.* § 4.

89. *Id.* § 19(c) and (d).

90. *Id.* § 19(d). "A person will not be classified as public arbitrator if he or she has a spouse or other member of the household who is a person who is associate with a member or other broker/dealer, municipal securities dealer, government securities broker, or government securities dealer."

91. *Id.* § 19(c) and (d). Section 19(c) provides:

- (c) An arbitrator will be deemed as being from the securities industry if he or she:
 - (1) is a person associated with a member or other broker/dealer, municipal securities dealer, government securities broker or government securities dealer, or
 - (2) has been associated with any of the above within the past three years, or

portant because it determines the different composition of arbitration panels in industry versus public customer arbitrations.⁹²

Parties to an arbitration must be informed of the arbitrators' names, employment histories for the previous ten years, and certain other information,⁹³ at least eight business days prior to the arbitration hearing.⁹⁴ Upon the appointment of arbitrators, each party has one peremptory challenge.⁹⁵ This challenge must be exercised within five business days of notification of selection of the arbitrators.⁹⁶ Each party has an unlimited number of challenges for cause.⁹⁷

It is not uncommon for parties to an arbitration proceeding to be notified of the selection of arbitrators via telefacsimile on the eighth business day prior to the date of the hearing. This practice, coupled with the parties' absolute right to exercise one peremptory challenge, would appear to create the ability to obtain a continuance of the arbitration hearing upon the disqualification of one of the members of the arbitration panel. Thus, by the mere exercise of a peremptory challenge, a party appears to have the power to postpone an arbitration hearing as a matter of right. The NASD has removed this opportunity by administratively ruling that the eight-business-day notice as to arbitrators is not applicable once a party exercises its peremptory challenge.⁹⁸ Although these authors have been unable to find any cases on point, it appears that such an application is contrary to NASD rules and could later provide the basis for appeal of an arbitration award.⁹⁹

(3) is retired from any of the above, or

(4) is an attorney, accountant, or other professional who has devoted twenty (20%) percent or more of his or her professional work to securities industry clients within the last two years.

92. See *supra* notes 89-91.

93. Section 23 of the CODE OF ARBITRATION PROCEDURE requires that arbitrators disclose:

- (1) Any direct or indirect financial or personal interest in the outcome of the arbitration;
- (2) Any existing or past financial, business, professional, family, or social relationships that are likely to affect impartiality or might reasonably create an appearance of partiality or bias. Persons requested to serve as arbitrators should disclose any such relationships that they personally have with any party or its counsel, or with any individual whom they have been told would be a witness. They should also disclose any such relationship involving members of their families or their current employers, partners, or business associates.

94. CODE OF ARBITRATION PROCEDURE § 21.

95. *Id.* § 22.

96. *Id.*

97. *Id.*

98. Hobbing conversation, *supra* note 20.

99. See *infra* § XI(B).

B. Industry Arbitration

The composition and size of the arbitration panel depends to a large degree upon the amount in controversy and the nature of the dispute. Simplified industry arbitrations,¹⁰⁰ when the amount in controversy is less than \$10,000, are resolved solely upon the pleadings and documentary evidence filed by the parties unless one of the parties requests a hearing within ten days following the filing of the last pleading.¹⁰¹ When a hearing is requested the dispute is determined by an arbitration panel of one to three arbitrators, all of whom are in securities industry.¹⁰² All awards rendered under the simplified industry arbitration are to be rendered within thirty days from the date the arbitrators review all the written statements, documents, and other evidence.¹⁰³

All other industry arbitration disputes¹⁰⁴ not exceeding \$30,000 are decided by a single arbitrator chosen from the securities industry.¹⁰⁵ At the request of either of the parties, a panel of three arbitrators, all from the securities industry, will be appointed.¹⁰⁶ If an industry arbitration matter exceeds \$30,000 in controversy, the arbitration panel consists of three arbitrators from the securities industry.¹⁰⁷

C. Public Customer Arbitration

Not surprisingly, different rules apply to arbitrations between customers and members of the securities industry.¹⁰⁸ However, the simplified arbitration procedure for public customers is very similar to the simplified industry arbitration procedure. Public customer disputes not exceeding \$10,000 are submitted to a single arbitrator knowledgeable in the securities industry.¹⁰⁹ The arbitrator resolves the dispute solely

100. "Any dispute, claim or controversy arising between or among members or associated persons . . . shall be resolved by an arbitration panel . . ." CODE OF ARBITRATION PROCEDURE § 10(a).

101. *Id.*

102. *Id.* § 10(a)(1).

103. *Id.* § 10(b).

104. *See supra* note 91.

105. CODE OF ARBITRATION PROCEDURE § 9(a).

106. *Id.*

107. *Id.* § 9(b).

108. Compare with *supra* notes 104-07 and accompanying text; *infra* notes 113-15 and accompanying text.

109. CODE OF ARBITRATION PROCEDURE § 13(a) and (f). The phrase "knowledgeable in the securities industry" is unclear. It is difficult to determine whether the CODE OF ARBITRATION

based upon the pleadings and evidence unless the customer demands or consents to a hearing or the arbitrator calls a hearing.¹¹⁰ Upon request of the arbitrator, two additional arbitrators may be appointed to the panel,¹¹¹ but when there are more than two arbitrators, the majority must be public arbitrators.¹¹²

In public customer arbitrations other than simplified arbitrations, with an amount in controversy not exceeding \$30,000, a single public arbitrator will decide the controversy.¹¹³ Upon the request of either party in their initial filings, or the arbitrator, a panel of three arbitrators will be appointed to decide the controversy.¹¹⁴ In such a situation, the majority of the arbitrators will not be from the securities industry unless the public customer so requests.¹¹⁵

In public customer arbitrations in excess of \$30,000, or when the controversy does not disclose a monetary claim, an arbitration panel of three to five members will be appointed.¹¹⁶ At least a majority of these arbitrators must be public arbitrators unless the customer requests otherwise.¹¹⁷

VI. DISCOVERY

Usually, when one thinks of arbitration, prospects of limited discovery immediately come to mind. Indeed, the opportunity to avoid extended discovery and accompanying discovery disputes may be viewed as an advantage of arbitration. Corporate defendants who face the prospect of voluminous document production may favor the limited discovery in arbitration. Similarly, individual claimants may prefer arbitration over the oppressive discovery which often accompanies civil litigation.

For better or worse, the rules concerning discovery in arbitration are changing. Effective May 10, 1989, section 32 of the Code of Arbi-

PROCEDURE is referring to a "public Arbitrator knowledgeable in but who is not from the securities industry," or an arbitrator from the securities industry. *Id.* §§ 19(a) and 19(c). *See also supra* notes 89-91. It appears that in simplified public customer arbitrations with a single arbitrator, the arbitrator must be a public customer arbitrator.

110. CODE OF ARBITRATION PROCEDURE § 13(f).

111. *Id.* § 13(i).

112. *Id.* § 13(j). *See supra* note 90 for the definition of "public arbitrators."

113. CODE OF ARBITRATION PROCEDURE § 19(a).

114. *Id.*

115. *Id.*

116. *Id.* § 19(b).

117. *Id.*

tration was amended to increase the scope of discovery in arbitration.¹¹⁸ It had long been the rule that “[t]he parties shall cooperate to the fullest extent practicable in the voluntary exchange of documents and information to expedite the arbitration.”¹¹⁹

The recent amendments to section 32 of the Code of Arbitration Procedure made three important changes. First, the new rules provide deadlines for the production of documents and information pursuant to discovery requests.¹²⁰ Prior to the rule changes, there was no specific deadline for the production of documents and information responsive to discovery requests and parties were left on their own to determine a timetable.¹²¹ Information requests now must be satisfied or objected to within thirty days from the date of service.¹²² Likewise, responses to objections must be filed within ten days of receipt of the objection.¹²³

Closely related is the second change which provides a method of resolving discovery disputes. Prior to the recent rule changes, parties were forced to await the appointment of an arbitration panel to resolve discovery disputes.¹²⁴ Since panels are often appointed only weeks before the hearing,¹²⁵ a recalcitrant party could effectively avoid discovery until the eve of the arbitration hearing. Discovery disputes may now be resolved by one of two methods. Upon written request of the moving party, discovery disputes may be referred to the Director of Arbitration for either a pre-hearing conference or the appointment of a single arbitrator to resolve the dispute.¹²⁶ Issues, including discovery disputes, can be resolved at a pre-hearing conference for the purpose of expediting the arbitration proceedings.¹²⁷ In the alternative, the Director of Arbitration may appoint a single member of the arbitration panel to decide unresolved issues under section 32 of the Code of Arbi-

118. *Id.* § 32.

119. NASD Manual (CCH), ¶ 3732 (1984) (amended effective May 10, 1989). Unfortunately for parties seeking discovery, this general provision was a far cry from the rules of civil procedure outlining discovery procedure. As a result, when discovery disputes were brought to the attention of an arbitration panel consisting primarily of laymen, they had little guidance or experience in these areas.

120. CODE OF ARBITRATION PROCEDURE § 32(b)(1)-(3).

121. *See supra* note 119 and accompanying text.

122. CODE OF ARBITRATION PROCEDURE § 32(b)(3).

123. *Id.*

124. NASD Manual (CCH) ¶ 3733(b) (1984).

125. *See supra* notes 98-99 and accompanying text.

126. CODE OF ARBITRATION PROCEDURE § 32(b)(4).

127. *Id.* § 32(d)(1).

tration Procedure.¹²⁸

Section 32 of the Code of Arbitration Procedure addresses the voluntary production of documents and exchange of information between the parties. Section 33 grants the authority to issue subpoenas and the power to direct appearances. Interestingly, both the arbitrators and counsel of record have the power of subpoena process as provided by state law.¹²⁹ The arbitrators also have the power to direct the appearance at the arbitration hearing of any person employed or associated with any member of the NASD or the production of any records in the person's control or both.¹³⁰

VII. THE HEARING

Typically, the location for the arbitration hearing and the date of the initial hearing is determined by the Director of Arbitration.¹³¹ However, it is the practice of the NASD to solicit the position of the parties prior to selection of the arbitration site.¹³² If a party objects to the site selection, the arbitrators may change the forum from that selected by the Director of Arbitration.¹³³ Once the hearing date is set and the arbitrators have been appointed, parties requesting an adjournment or continuance of the arbitration hearing are required to pay a fee of \$100 or a fee equal to the deposit of costs, whichever is less.¹³⁴

With few exceptions,¹³⁵ all arbitrations require a hearing unless

128. *Id.* § 32(e).

129. *Id.* § 33(a). The scope of the subpoena power is a matter of state law and parties should resort to the applicable state arbitration act to determine the extent of any subpoena power.

130. *Id.* § 33(b).

131. *Id.* § 26.

132. With few exceptions, it has been the authors' experience that the forum for an NASD arbitration involving a customer dispute is the residence of the customer. Similarly, the forum for dispute between a registered representative and a broker/dealer is the residence of the registered representative. Factors involved in the forum selection include, but are not limited to, the locality where the dispute arose, the convenience of travel to the site, the number of witnesses being called by each party, location of documents and witnesses, and other such factors. Although never specifically enunciated, many of the arguments applicable to a change of venue under the Federal Rules of Civil Procedure are also applicable to NASD forum selection decisions. The stated NASD goal is that forum should be decided on the basis of maximum convenience of both parties. Hobbing conversation, *supra* note 20.

133. CODE OF ARBITRATION PROCEDURE § 26.

134. *Id.* § 30(b). The arbitrators may waive this fee or in their award may direct the return of the adjournment fee.

135. Except as provided in section 10 (Simplified Industry Arbitration) or section 13 (Simplified Arbitration) of the CODE OF ARBITRATION PROCEDURE.

waived in writing by all parties.¹³⁶ It is at these hearings that much of the informality associated with arbitrations takes place. If the arbitration is conducted in a city without an NASD office, the hearing is typically conducted at a hotel conference room, a law office conference room, or similar site. Many of the formalities of courtroom practice do not apply and the parties are usually seated around a conference table. Arbitrators are not bound by the rules of evidence¹³⁷ and they determine the materiality and relevance of any evidence offered.¹³⁸ The arbitrators are empowered to interpret and determine the applicability of the provisions of the Code of Arbitration Procedure and this interpretation is final and binding.¹³⁹ Each party is entitled to be represented by counsel.¹⁴⁰ The parties and their counsel are entitled to attend all hearings.¹⁴¹

A record of the hearings is normally kept by means of a tape recording maintained by the NASD representative.¹⁴² The record is not transcribed unless requested by the parties (in which case the parties must bear the cost of transcription) or the arbitrators.¹⁴³

VIII. SPECIAL ITEMS OF DAMAGE

A. Attorney Fees

As in most civil litigation, prevailing parties in arbitration hearings often seek to recover their attorney fees. Generally attorney fees are not available under the 1933 Act or the Exchange Act.¹⁴⁴ Because of

136. CODE OF ARBITRATION PROCEDURE § 14(a). Even if the parties agree to waive a hearing, a majority of the arbitrators may call for and conduct a hearing. *Id.* § 14(b).

137. *See, e.g.,* Shearson Hayden Stone, Inc. v. Liang, 653 F.2d 310 (7th Cir. 1981).

138. CODE OF ARBITRATION PROCEDURE § 34. THE CODE OF ARBITRATION PROCEDURE does not specify that the parties are entitled to cross examine. Although the right to cross examine is uniformly provided when parties are present, this omission allows for the introduction of testimony by affidavit and other means. Similarly, given the informality of the arbitration proceedings, arbitration panels commonly consent to witnesses appearing via speakerphones as opposed to in person testimony.

139. *Id.* § 35.

140. *Id.* § 27.

141. *Id.* § 28. Default judgments in arbitration procedure are very rare in these authors' experience. Section 29 of the CODE OF ARBITRATION PROCEDURE provides that if a party fails to appear at a hearing or any adjourned hearing, the panel may proceed with the arbitration and controversy. In all such cases, awards shall be rendered as if each party had entered an appearance and the matter submitted. The end result is that the claimant must make a prima facie case and establish that he is at least entitled to the relief requested.

142. *Id.* § 37.

143. *Id.*

144. *In re National Student Mktg. Litigation*, 78 F.R.D. 726, (D.D.C. 1978), *aff'd sub*

this, an award of attorney fees may be grounds for vacating the arbitration award, at least in part.¹⁴⁵

The NASD policy is that parties asserting claims for attorney fees should provide state statutory or case law authority for such a claim. The final decision to award or deny attorney fees rests with the arbitrators.¹⁴⁶

B. Punitive Damages

There is a split of authority as to whether punitive damages may be awarded in an arbitration proceeding.¹⁴⁷ The chief case opposing punitive damages is *Garity v. Lile Stuart, Inc.*,¹⁴⁸ which states that enforcement of an award of punitive damages violates public policy.¹⁴⁹ However, in *Willis v. Shearson/American Express, Inc.*,¹⁵⁰ the court rejected *Garity* and held that the arbitration award covered any controversy arising out of or relating to the account, and there was no public policy prohibiting arbitrators from resolving punitive damages issues.¹⁵¹

The NASD policy with respect to awarding punitive damages is the same as that concerning attorney fees, *i.e.*, the parties must provide state statutory or case law authority for awarding punitive damages.¹⁵² As with attorney fees, the final determination to award or deny punitive damages is within the discretion of the arbitrators.¹⁵³

nom. Lipsig v. National Student Mktg., 663 F.2d 178 (D.C. Cir. 1980).

145. 9 U.S.C. § 10 (1988).

146. Hobbing conversation, *supra* note 20.

147. *Cf.* Garrity v. Lyle Stuart, Inc., 40 N.Y.2d 354, 353 N.E. 2d 793, 386 N.Y.S.2d 831 (1976) (arbitrators have no power to award punitive damages, as a matter of public policy, even if agreed upon by the parties) and Duggal Int'l, Inc. v. Sallmetall, Civil Action No. 84 Civ. 717 (JMC)(S.D.N.Y. 1986)(the question of punitive damage is to be determined by the federal rule rather than state law). *See also* Willoughby Roofing and Supply Co. v. Kajima Int'l, Inc., 598 F. Supp. 353, 358 (N.D. Ala. 1984), *aff'd*, 776 F.2d 269 (11th Cir. 1985); Willis v. Shearson/Am. Express, Inc., 569 F. Supp. 821, 824 (M.D.N.C. 1983) (The court perceived no public policy reason persuasive enough to justify prohibiting arbitrators from resolving issues of punitive damages submitted by the parties.).

148. 40 N.Y.2d 354, 353 N.E. 2d 793, 386 N.Y.S.2d 831 (1976).

149. *Id.* at 356, 353 N.E.2d at 795, 386 N.Y.S.2d at 833; *see also* Pierson v. Dean Witter Reynolds, Inc., 742 F.2d 334 (7th Cir. 1984).

150. 569 F. Supp. 821 (M.D.N.C. 1983).

151. *Id.* at 824; *see also* Willoughby Roofing & Supply Co. v. Kajima Int'l, 598 F. Supp. 353, 358 (N.D. Ala. 1984), *aff'd*, 776 F.2d 269 (11th Cir. 1985); Baker v. Sadick, 162 Cal. App. 3d 618, 208 Cal. Rptr. 676 (1984).

152. Hobbing conversation, *supra* note 20.

153. *Id.*

IX. ARBITRATION AWARDS

At the close of the hearing, the arbitrators must render an award, preferably within thirty days from the date the record is closed.¹⁵⁴ The arbitration award must contain the following information: (a) names of the parties; (b) a summary of the issues in controversy; (c) the damages and other relief requested; (d) damages and other relief awarded; (e) statement of any other issues resolved; (f) names of the arbitrators; (g) the date the claim was filed and the award rendered; (h) the number and dates of hearing sessions; (i) the location of the hearings; and (j) the signatures of the arbitrators upon any award.¹⁵⁵ All awards involving public customers, excluding the names of arbitrators, are made available to the public.¹⁵⁶ Once an award is rendered, it is served upon the parties by the Director of Arbitration by certified mail, personal service, or any other manner authorized by law.¹⁵⁷

X. ENFORCEMENT OF AN AWARD

A. Procedure

According to the Federal Arbitration Act, within one year of an award and upon application of a party, the court shall enter an order confirming the award.¹⁵⁸ The court order has the same effect as a judgment. Unless otherwise agreed to in the arbitration agreement, the order will be granted by the district court located where the arbitration award was entered. Section 9 of the Act specifies that the application is filed and shall be served upon the opposing party either (i) if a resident of the district, in the same manner as service of a motion; or (ii) if a nonresident, by the marshal of the district where the adverse party is located, and in a manner as other court processes.

B. Collateral Estoppel

Generally speaking, a court may give collateral estoppel effect to all factual determinations which are necessary and critical to the arbitration panel's award.¹⁵⁹ The intent is for the court to honor the award

154. CODE OF ARBITRATION PROCEDURE § 41(d).

155. *Id.* § 41(e).

156. *Id.* § 41(b).

157. *Id.* § 41(c).

158. U.S.C. § 9 (1988).

159. *Greenblatt v. Drexel Burnham Lambert, Inc.*, 763 F.2d 1352 (11th Cir. 1985).

and to provide conclusiveness to the panel's decision.¹⁶⁰ But, because the panel is not required to give factual findings in its award, it may become troublesome to determine whether the panel made a factual decision with respect to a particular issue. NASD section 37 of the Code of Arbitration Procedure requires a verbatim transcript of all hearings which would, at a minimum, set out the record and show whether the issue was factually, fully, and fairly litigated.¹⁶¹

XI. APPEAL, VACATION, OR MODIFICATION OF ARBITRATION AWARDS

A. General

There is a common misconception that arbitration awards are not appealable. They are. However, the grounds for the appeal of such awards are narrow and are strictly construed. Arbitration awards are presumptively valid,¹⁶² and all doubts are to be resolved in favor of upholding the award.¹⁶³ Procedures also exist for modifying or correcting arbitration awards, similar to rules allowing modification or correction of erroneous court orders.

The appeal of arbitration awards is governed by the Federal Arbitration Act. The following rules regarding appeals apply to arbitrations under the Federal Arbitration Act:¹⁶⁴ (1) An appeal may be taken from an order refusing a stay of arbitration proceedings,¹⁶⁵ but an appeal may not be taken from an interlocutory order granting a stay of any action;¹⁶⁶ (2) an appeal may be taken from an order denying a petition to compel arbitration,¹⁶⁷ but an appeal may not be taken from an interlocutory order directing an arbitration to proceed;¹⁶⁸ (3) an ap-

160. *Taylor v. Ashby*, 134 A.2d 245, 520 N.Y.S.2d 587, 588 (1987).

161. *See Shell, Res Judicata and Collateral Estoppel Effects of Commercial Litigation*, 35 U.C.L.A. L. REV. 623 (1988).

162. *E.g.*, *Local 1466 Int'l Bd. of Elec. Workers v. Columbus and S. Ohio Elec. Co.*, 455 F. Supp. 471, 473 (S.D. Ohio 1978), *aff'd*, 627 F.2d 1091 (6th Cir. 1980).

163. *E.g.*, *Kansas City Royals Baseball Corp. v. Major League Baseball Players Ass'n*, 409 F. Supp. 233, 257 (W.D. Mo.), *aff'd*, 532 F.2d 615 (8th Cir. 1976).

164. 9 U.S.C. section 15 was enacted through the Judicial Improvements and Access to Justice Act and applies retroactively to interlocutory arbitration orders. *Gooding v. Shearson Lehman Bros., Inc.*, 878 F.2d 281 (9th Cir. 1989); *Hays and Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149 (3d Cir. 1989); *Campbell v. Dominic & Dominic, Inc.*, 872 F.2d 358 (11th Cir. 1989).

165. 9 U.S.C. § 15(a)(1)(A) (1988).

166. *Id.* § 15(b)(1) (1988).

167. *Id.* § 15(a)(1)(B) (1988).

168. *Id.* § 15(b)(2) (1988). *England v. Dean Witter Reynolds, Inc.*, 306 Ark. 225, 227,

peal may be taken from an order denying an application to compel arbitration,¹⁶⁹ but an appeal may not be taken from an interlocutory order compelling arbitration;¹⁷⁰ (4) an appeal may be taken from an interlocutory order granting, continuing, or modifying an injunction against an arbitration,¹⁷¹ but an appeal may not be taken from an interlocutory order refusing to enjoin an arbitration;¹⁷² (5) an appeal may be taken from an order "confirming or denying confirmation of an award or partial award;¹⁷³ modifying, correcting, or vacating an award;¹⁷⁴ or from a final decision with respect to an arbitration."¹⁷⁵

B. Time Limits

A party desiring to appeal an arbitration award must be cognizant of the time limits within which to file the appeal. The appeal of an arbitration award "must be *served* upon the adverse party or his attorney within three months after the award is filed or delivered."¹⁷⁶ Upon the expiration of this three-month period, a party cannot move to vacate an award, even in opposition to a motion to confirm.¹⁷⁷

The three-month time period within which to file an appeal contrasts sharply with the one-year time period within which a party may move to confirm an award. Section 9 of the Arbitration Code provides that a party may move to confirm an arbitration award and reduce it to judgment "any time within one year after the award is made. . . ."¹⁷⁸

— S.W.2d —, — (1991).

169. *Id.* § 15(a)(1)(C) (1988).

170. *Id.* § 15(b)(3) (1988).

171. *Id.* § 15(a)(2) (1988).

172. *Id.* § 15(b)(4) (1988).

173. *Id.* § 15(a)(1)(D) (1988).

174. *Id.* § 15(a)(1)(E) (1988).

175. *Id.* § 15(a)(3) (1988).

176. *Id.* § 12 (1988) (emphasis added). As to residents of the district in which the action is filed the section allows service by any means "as prescribed by law for service of notice of motion in an action in the same court." However, section 12 also provides that if the adverse party is a nonresident, then the appeal "shall be served by marshall of any district within which the adverse party may be found in like manner as other process of the court." While there are no cases addressing it, a strict reading of the statute might require actual service by a marshall as opposed to other means of service prescribed by law.

177. *Florasynth, Inc. v. Pickholz*, 750 F.2d 171 (2d Cir. 1984); *Getty Oil Co. v. Norse Management Co., Ltd.*, 711 F. Supp. 175 (S.D.N.Y. 1989).

178. 9 U.S.C. § 9 (1988). The section further provides that "the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this Title." 9 U.S.C. § 9. The award can be enforced even after the running of the one-year period, by an action for damages for refusal to honor the award. *See, Swink & Co., Inc. v. Harris, Orr &*

This difference in time between the limitation for filing a motion to confirm an arbitration award (one year) and filing an appeal from an arbitration decision (three months) gives the prevailing party a substantial advantage. A party appealing an arbitration award must serve a notice of appeal within three months of the arbitration award. Should he fail to do so, the prevailing party is entitled, as a matter of right, to an order confirming the arbitration award, provided the prevailing party moves to confirm within one year of the arbitration award. Thus, a prevailing party who anticipates a vigorous defense to the confirmation of an arbitration award should consider refraining from filing a motion to confirm until after the expiration of the three-month period for appeal of an award.¹⁷⁹

C. Grounds for Vacating Arbitration Awards

A court may vacate an arbitration award only upon very limited grounds.¹⁸⁰ A court's function in confirming or vacating an award is limited to avoid frustration of the purpose of arbitration—the avoidance of litigation.¹⁸¹ The court is not necessarily concerned with the correctness of the arbitrator's ruling and is not authorized to set aside an award on the basis of erroneous findings of fact or misinterpretation of law.¹⁸² The grounds for vacation as set forth in section 10 of the Federal Arbitrations Act¹⁸³ are as follows:

- (a) Where the award was procured by corruption, fraud, or undue means.
- (b) Where there was evident partiality or corruption in the arbitra-

Jones, Inc., Civil Action No. C86-1594A (N.D. Ga. Dec. 19, 1986).

179. It should be noted that section 9 provides for the confirmation of an arbitration award, "[i]f the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration . . ." It does not address the situation where the parties have agreed to arbitrate a dispute, but have not agreed that a judgment may be entered pursuant to the award. Parties drafting an arbitration agreement should be aware of this provision and specifically provide that a judgment may be entered in accordance with any arbitration award. The necessity of such a provision is beyond the scope of this article.

180. To determine whether an award should be vacated, the court may remand the matter to the arbitration panel for an explanation of the basis for the award. *Sargent v. Paine Webber, Jackson & Curtis, Inc.*, 674 F. Supp. 920 (D.D.C. 1987).

181. *Sixis Steamship Co. v. Multifacs Int'l Traders, Inc.*, 375 F.2d 577, 582 (2d Cir. 1967); *Amiciza Societa Navigazione v. Chilean Nitrate and Iodine Sales Corp.*, 274 F.2d 805, 808 (2d Cir.), *cert. denied*, 363 U.S. 843 (1960).

182. *Aerojet-General Court v. American Arbitration Ass'n*, 478 F.2d 248, 252 (9th Cir. 1973); *Shahmoon Indus., Inc. v. Steelworkers*, 263 F. Supp. 10, 14 (D.N.J. 1966).

183. 9 U.S.C. § 10 (1988).

tors, or either of them.¹⁸⁴

- (c) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or any other misbehavior by which the rights of any party have been prejudiced.¹⁸⁵
- (d) Where the arbitrators exceed their powers or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.¹⁸⁶

Thus, while arbitration awards are presumptively valid and are strictly construed by the courts, the grounds for vacation of an arbitration award are limited only by the imagination of attorneys.¹⁸⁷ The courts may also set aside an award for "manifest disregard of the law," a judicially created ground not found in the Federal Arbitration Act.¹⁸⁸

184. "Evident partiality" means more than a mere appearance of bias. *Florasynth, Inc. v. Pickholz*, 750 F.2d 171 (2d Cir. 1984). The standard for establishing bias is whether a reasonable person would have to conclude the arbitrator was partial to one of the parties to the arbitration. *Apperson v. Fleet Carrier Corp.*, 879 F.2d 1344 (6th Cir. 1989).

185. Although the arbitrators are not bound to hear all evidence tendered by the parties, they must give each of the parties to the dispute an adequate opportunity to present evidence. *Grahams Service, Inc. v. Teamsters Local No. 975*, 700 F.2d 420, 422 (8th Cir. 1982); *Hoteles Condado Beach v. Union De Tronquistas Local*, 763 F.2d 34, 39 (1st Cir. 1985); *Totem Marine Tug and Barge, Inc. v. North Am. Towing, Inc.*, 607 F.2d 649, 651 (5th Cir. 1979). Further, "misbehavior" under section 10(c) does not require any element of bad faith. Rather, "misbehavior, though without taint of corruption or fraud, [if] . . . born of indiscretion," is sufficient. *Newark Stereotypers' Union No. 18 v. Newark Morning Ledger Co.*, 397 F.2d 594, 599 (3d Cir.), *cert. denied*, 393 U.S. 954 (1968) (quoting Judge Cardozo's opinion in *Stefano Berizzi Co. v. Krausz*, 239 N.Y. 315, 317, 146 N.E. 436, 437 (1925)).

186. If an arbitration panel rules on issues not presented to it by the parties, it has exceeded its authority and the award must be vacated. *Dighello v. Busconi*, 673 F. Supp. 85 (D. Conn. 1987), *aff'd*, 849 F.2d 1467 (2d Cir. 1988).

187. See Annotation, *Construction and Application of § 10(a-d) of United States Arbitration Act of 1947 (9 U.S.C.S. § 10 (a-d)). Providing Grounds for Vacating Arbitration Awards*, 20 A.L.R. Fed. 295 (1974); Annotation, *What Constitutes Corruption, Fraud, or Undue Means in Obtaining Arbitration Award Justifying Avoidance of Award Under State Law*, 22 A.L.R.4th 366 (1983); Annotation, *Refusal of Arbitrators to Receive Evidence, or to Permit Briefs or Arguments, on Particular Issues as Grounds for Relief from Arbitration Award*, 75 A.L.R.3d 132 (1977); Annotation, *Setting Aside Arbitration Award on Ground of Interest or Bias of Arbitrators*, 56 A.L.R.3d 697 (1974); Annotation, *Appealability of Judgment Confirming or Setting Aside Arbitration Award*, 7 A.L.R.3d 608 (1966); 5 AM. JUR. 2d *Arbitration and Award* §§ 167-89 (1962).

188. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930 (2d Cir. 1986) (in which the Second Circuit vacated an award under Rule 10b-4).

D. Modification of Arbitration Awards

Section 11 of the Federal Arbitration Act¹⁸⁹ provides that a party may apply for an order modifying or correcting an arbitration award:

- (a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.
- (b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.
- (c) Where the award is imperfect in matter of form not affecting the merits of the controversy.

Despite these facially broad provisions, mere ambiguity in arbitration awards¹⁹⁰ or mistakes of fact¹⁹¹ do not provide a basis for modification of arbitration awards.

XII. CONCLUSION

Like it or not, a practitioner handling a customer's grievance with a securities firm will be faced with arbitration. This article provides the practitioner with a map of the terrain he or she is about to encounter. As with most forums, there are good and bad points. Arbitration is preferable for small dollar disputes and is less appealing for major disputes which take days to present. However, in an era when business people continuously express horror at the high cost of litigation, the securities industry has made a serious effort to address these concerns. We hope this article will aid the skilled litigator in making the most out of his or her case.

189. 9 U.S.C. § 11 (1988).

190. *United Steelworkers of Am. v. Enterprise Wheel & Car Corp.*, 363 U.S. 593 (1960).

191. *National Post Office Union of N. Am. v. United States Postal Service*, 751 F.2d 834 (3d Cir. 1984).