Journal of Dispute Resolution

Volume 1996 | Issue 2 Article 4

1996

# Determining the Timeliness of a Securities Claim Filed for Arbitration: Substantive Eligibility Requirement or Procedural Statute of Limitations

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COMMENT

# Determining the Timeliness of a Securities Claim Filed for Arbitration: Substantive Eligibility Requirement or Procedural Statute of Limitations?

## I. INTRODUCTION

The ever-growing popularity of alternative dispute resolution has changed the face of securities arbitration.[1] The era when securities arbitration was characterized as a "one-day proposition which even inexperienced litigators waited until the last minute to prepare for," no longer exists.[2] Each day, cases heard in the securities arbitration fora are increasing in complexity, length, and size of monetary awards.[3] Today, securities arbitration is considered to be nearly as complex as traditional litigation.[4]

A growing debate is adding fuel to the already-complex securities arbitration arena. In a nutshell, the issue is whether a claim for arbitration is filed within the time limit contained in the rules governing arbitration.[5] In general, under the

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1. *See* J. Stratton Shartel, *Securities Arbitration Attorneys Describe Diverse Strategies*, 8 INSIGHTS 14, 14 (1994). Mr. Shartel believes "the factor most responsible for changing the face of securities arbitration" may be the U.S. Supreme Court's 1987 decision in Shearson/Am. Express v. McMahon, 482 U.S. 220 (1987). *Id.* at 15. In *McMahon*, the Court held arbitration was the preferred method for resolving federal securities claims under the Securities Exchange Act of 1934 and the Racketeer Influenced Corrupt Organizations Act. *See Id. See also* Carroll E. Neesemann, *The State of the Law, in* SECURITIES ARBITRATION 1992, at 403 (PLI Corp. Law & Practice Course Handbook Series No. 781, 1992). The decision had the effect of substantially increasing the number of securities arbitration cases. Shartel, *supra*, at 15. In fact, "since 1989, the Supreme Court has moved forward to eliminate barriers to arbitration of virtually any dispute related to the securities industry." Neesemann, *supra*, at 407.

2. Shartel, *supra* note 1, at 14. Mr. Shartel noted that as arbitration has become more popular, the cases have grown more complex. *See Id.*

3. *Id.*

> The National Association of Securities Dealers (NASD), one of several self-regulating organizations (SROs) which handle the vast majority of securities arbitrations, reports that in 1980, 318 securities arbitration cases were filed. By 1993, that number had risen to 5,419. Damages requested in NASD arbitration cases rose from $56.9 million in 1983 to $499.9 million in 1993.

*Id.*

4. *Id.*

5. *Id.* at 19.

rules of self-regulating organizations (SROs), a controversy is not "eligible" for submission to arbitration if six or more years have elapsed from the date of the event giving rise to the dispute.[6] Though a seemingly simple rule, the circuits are split with regard to its interpretation.[7]

Specifically, the debate centers around this question: Is the arbitration rule a substantive eligibility rule granting jurisdiction to the arbitrator, or is it merely a procedural limitation on the already-obtained jurisdiction of the arbitrator? The distinction between these two interpretations is whether a court or an arbitrator determines if the claim was timely filed.

Not surprisingly, this issue has borne several sub-issues including: (1) what is the "occurrence or event" triggering the start of the time limitation for arbitrability; (2) if the legal statute of limitations on the claim has not run, may the claim be brought in court even after the time limit for arbitration has run; (3) may the time period be tolled by equitable considerations; (4) may arbitration be stayed if the legal statute of limitations on the claim has run; and (5) can a claimant effect an end-run around the time limitation by taking the claim to court and asking the court to send the case to arbitration.[8]

This Comment will focus on the development of this debate, the positions taken by the courts, and a possible resolution of these issues by the SROs themselves.[9] Specifically, Part II briefly discusses the development of arbitration in the United States; Part III discusses the issues surrounding the debate, including what positions the courts have taken; and Part IV discusses the possible resolution of this debate by amendment to the SRO codes.

## II. THE DEVELOPMENT OF SECURITIES ARBITRATION IN THE UNITED STATES

Generally speaking, arbitration as a form of dispute resolution derives its jurisdiction from the agreement between the parties to submit their grievances to an arbitrator.[10] In 1925, Congress intended to place arbitration agreements "upon

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6. *Id.*

7. For example, the Second, Fifth, Eighth, and Ninth Circuits view the time limitation as a procedural limitation, but the Third, Sixth, Seventh, and Eleventh Circuits view it as a substantive eligibility requirement. *See* discussion *infra* Part III.

8. Martin L. Budd, *Securities Industry Arbitration -- Recent Issues* 205, 208 (ALI-ABA Course of Study No. 977, 1995).

9. Generally, customer agreements identify one (or more) of four arbitration fora to hear their disputes. Marilyn B. Cane & Howard S. Weinstein, *Securities Arbitration Update 1993-1994* 387, 407 (ALI-ABA Course of Study No. 903, 1994). Three of the four are SROs -- the National Association of Securities Dealers (NASD), the New York Stock Exchange (NYSE), and the American Stock Exchange (AMEX) -- which are overseen and regulated by the Securities and Exchange Commission. *Id.* The fourth is the American Arbitration Association (AAA) which is an independent arbitral forum. *Id.* The AAA handles 8 to 10% of the arbitration filings while the SROs handle the remaining filings. Budd, *supra* note 8, at 207. Furthermore, NASD handles about 80% of the SROs' total caseload. *Id.*

10. Cane & Weinstein, *supra* note 9, at 404.

the same footing as other contracts"[11] when it enacted the Federal Arbitration Act (FAA), 9 U.S.C. § 1-14 (1925).[12] The Supreme Court recognized Congress' intent in *AT&T Technologies, Inc. v. Communications Workers of America*[13] when the Court held that "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit."[14]

Arbitration in the securities industry appears to have its beginnings in the New York Stock Exchange (NYSE) Constitution of 1817. This constitution provided that: "All questions of dispute in the purchase of stocks shall be decided by a majority of the Board."[15] In 1935, the Securities & Exchange Commission stated in a release that "the Exchange should encourage its members to offer customers a standard arbitration agreement . . ."[16] Arbitration in the securities industry continued to grow as other SROs provided arbitration services. For example, NASD adopted its Code of Arbitration Procedure in 1968.[17]

## III. THE ELIGIBILITY REQUIREMENT

SRO rules impose a time limit upon the arbitrability of securities disputes.[18] The NYSE, NASD, and American Stock Exchange (AMEX) rules all have a six-

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11. H.R. REP. NO. 96, 68th Cong., 1st Sess. 1 (1924).

12. Carroll E. Neesemann & Maren E. Nelson, *The Law of Securities Arbitration, in* SECURITIES ARBITRATION 1995, at 135 (PLI Corp. Law & Practice Course Handbook Series No. 899, 1995). The FAA embodies the federal government's policy of favoring arbitration where the parties have agreed in writing to arbitrate disputes. Cane & Weinstein, *supra* note 9, at 405. In Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468 (1986), the Supreme Court explained that the "Act was designed to overrule the judiciary's long standing refusal to enforce agreements to arbitrate . . . and place such agreements upon the same footing as other contracts." *Id.* at 474 (citing Scherk v. Alberto-Culver Co, 417 U.S. 506, 511 (1974)). *See* Cane & Weinstein, *supra* note 9, at 404.

13. 475 U.S. 643 (1986).

14. *Id.*

15. Deborah Masucci & Robert S. Clemente, *Securities Arbitration at the New York Stock Exchange, Inc. and National Association of Securities Dealers, Inc. - Administration and Procedures, in* SECURITIES ARBITRATION 1995, at 291, 295 (PLI Corp. Law & Practice Course Handbook Series No. 899, 1995).

16. *Id.* SEC Release No. 34-131 (1935).

17. Masucci & Clemente, *supra* note 15, at 295.

18. Cane & Weinstein, *supra* note 9, at 407. The "Securities Arbitration Rules" promulgated by the AAA do not contain a time limitation for filing a claim for arbitration. *Id.* Instead, the AAA relies on statutes of limitation. David E. Robbins, *Securities Arbitration Procedure and Case Evaluation*, 401, 426 (ALI-ABA Course of Study No. 879, 1993). Therefore, because there is no possible dispute over an eligibility requirement, it is not contested that the AAA arbitration panel may hear the claim irrespective of when the events giving rise to the dispute occurred. Cane & Weinstein, *supra* note 9, at 407.

year limitation.[19] Because most securities arbitration agreements incorporate the rules of the NYSE and/or the NASD,[20] this Comment will refer to those rules. Rule 603 of the NYSE and Section 15 of the NASD Code provide that:

> No dispute, claim, or controversy shall be eligible for submission to arbitration under this Code where six (6) years have elapsed from the occurrence or event giving rise to the act or dispute, claim or controversy. This section shall not extend applicable statutes of limitations, nor shall it apply to any case which is directed to arbitration by a court of competent jurisdiction.[21]

This limitation has borne what appears to be the hottest topic of debate in securities arbitration: Who decides the timeliness of a securities arbitration claim, the court or the arbitrator? The Third, Sixth, Seventh, and Eleventh Circuits for the Court of Appeals say the court decides the issue.[22] The Second, Fifth, Eighth and Ninth Circuits, on the other hand, say the arbitrator decides.[23]

Specifically, the issue is whether the time limitation acts as a substantive eligibility requirement or a procedural limitation on arbitration.[24] If it acts as a substantive eligibility requirement, the determination that a claim is untimely would mean that the arbitrator does not have jurisdiction over the matter. This lack of jurisdiction is based on the argument that the parties did not agree to arbitrate disputes which arose over six years ago.[25] Therefore, if the claim does not fall within this substantive limitation of the agreement, the arbitrator does not have jurisdiction.[26]

If it is a procedural limitation, however, the arbitrator already has jurisdiction over the matter. The limitation then acts as a statute of limitations of sorts with the arbitrator deciding its applicability.[27] The argument follows that because the parties agreed to arbitrate these types of disputes, the time limitation is merely a procedural limitation on the right of the cause of action, not on the arbitrator's

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19. Cane & Weinstein, *supra* note 9, at 407.

> The historical rationale of the six-year rule is that most of the records of a customer's account maintained by the brokerage firm must be preserved for that period of time. Requiring a firm to defend a claim which arose beyond that six-year period, it is argued, could prejudice a firm because key records (e.g., monthly account statements, confirmations, opening account forms) may no longer be available.

Robbins, *supra* note 18, at 426.

20. Cane & Weinstein, *supra* note 9, at 407.

21. *Id.*

22. *See* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cohen, 62 F.3d 381 (11th Cir. 1995); Roney & Co. v. Kassab, 981 F.2d 894 (6th Cir. 1992); PaineWebber Inc. v. Hartmann, 921 F.2d 507 (3rd Cir. 1990); PaineWebber Inc. v. Farnam, 870 F.2d 1286 (7th Cir. 1989).

23. *See* Smith Barney Shearson, Inc. v. Boone, 47 F.3d 750 (5th Cir. 1995); FSC Sec. Corp. v. Freel, 14 F.3d 1310 (8th Cir. 1994); O'Neel v. Nat'l Ass'n of Sec. Dealers, Inc., 667 F.2d 804 (9th Cir. 1982); Conticommodity Serv., Inc. v. Philipp, 613 F.2d 1222 (2nd Cir. 1980).

24. *Hartmann*, 921 F.2d at 510-12.

25. *Id.*

26. *Id.*

27. *Id.*

jurisdiction.[28] Metaphorically speaking, it is as if "the parties were already through the gate and within the jurisdiction of the arbitrator."[29]

This dispute is not so much legal as it is linguistic and interpretive in nature.[30] While both interpretations of the time limitation are plausible, this author believes the better-reasoned interpretation is that the limitation is a substantive eligibility requirement and timeliness is a matter for the court to decide.

### *A. What the Courts Say*

The roots of this debate within the federal courts of appeals can be traced back to the early 1980s. In *Conticommodity Services, Inc. v. Philipp*,[31] the Second Circuit held that the arbitrator, not the court, is to determine the validity of any time-barred defenses to enforcement of arbitration agreements.[32] Two aspects of the court's decision are weak. First, the court relied solely on the language and policy considerations of the FAA without citing any Supreme Court precedent.[33] Second, the court, without any legal analysis, merely asserted that the time limitation was a procedural defense rather than a substantive eligibility requirement.[34]

The basis for the court's decision was the language of Section 4 of the FAA.[35] Section 4 provides that when a party petitions a district court for an order directing arbitration, "[t]he court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement."[36]

The court felt that the language of Section 4 was "straightforward", stating that "unless the 'making' of the agreement to arbitrate or 'the failure, neglect, or refusal' of one party to arbitrate is in dispute, the court must compel

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28. *Id.*

29. *Id.* at 512.

30. *Id.*

31. 613 F.2d 1222 (2nd Cir. 1980).

32. *Id.* at 1225.

33. *Id.* at 1224-26. *See* Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960).

34. *Conticommodity Services*, 613 F.2d at 1225. The Customer Agreement provided that the arbitration of "(a)ny controversy . . . arising out of or relating to" the trading contract between the parties was to commence within one year of the accrual of any such cause of action. *Id.* at 1223. The parties were also members of the Commodities Exchange Inc. (COMEX) and thus were subject to its rules. *Id.* COMEX Rule 702 imposed a time limitation on arbitration which provided that "[a] party desiring to initiate an arbitration proceeding, within one year of the date of the transaction or event which gave rise to the claim or grievance, shall file . . . ." *Id.* COMEX was chosen as the arbitration forum. *Id.* at 1224.

35. *Id.* at 1224-25.

36. *Id.* at 1225.

arbitration."[37] Therefore, the court reasoned, because the existence of an arbitration agreement and the broker's refusal to arbitrate were both undisputed,[38] Section 4 required the district court "to send the dispute to arbitration, regardless of the validity of any procedural defenses" such as timeliness.[39]

The court also relied upon policy considerations embodied in the FAA which favor the enforcement of arbitration agreements.[40] One such policy is that "[a]rbitration is intended to provide the parties to a dispute with a speedy and relatively inexpensive trial before specialists."[41] Another policy is that arbitration "eases the workload of the courts."[42] To avoid frustrating the policies embodied in the Act, the court reasoned that the FAA "carefully limits the role of courts in considering motions to compel arbitration."[43]

Although the general language of Section 4 offers a very plausible approach, the Second Circuit failed to recognize Supreme Court precedent which has clarified Section 4 of the FAA. In the Steelworkers Trilogy cases, the Supreme Court held that (1) "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit"; (2) "arbitrators derive their authority to resolve disputes 'solely from the parties' agreement to submit their grievances to arbitration"; and (3) "unless the parties clearly and unmistakably provide otherwise, the question of whether the parties agreed to arbitrate [a particular grievance] is to be decided by the court, not the arbitrator."[44] Commentators agree that the Court's holdings in these cases are in accord with the FAA.[45]

Based on the above cases, the author believes that the proper reasoning is as follows: By incorporating the SRO rules into their arbitration agreement, the parties agreed to arbitrate only those disputes that are brought to arbitration within six years of the date of the occurrence or event giving rise to the dispute. Because the determination of whether this six-year period has elapsed affects whether the parties have a duty to arbitrate, the court must make that determination.

In 1982, the Ninth Circuit in *O'Neel v. National Association of Securities Dealers, Inc.*[46] adopted the rule set forth by the Second Circuit in *Conticommodity Services.*[47] The rule in *Conticommodity Services* provided that

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37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.* at 1224.

41. *Id.*

42. *Id.*

43. *Id.*

44. Steelworkers v. American Mfg. Co., 363 U.S. 564 (1960); *Warrior & Gulf Navigation,* 363 U.S. 574, 582 (1960); Steelworkers v. Enterprise Wheel & Car Corp., 363 U.S. 593 (1960). *See* AT&T Technologies, Inc. v. Communications Workers of Am., 475 U.S. 643, 648 (1986) (citing Gateway Coal Co. v. Mine Workers, 414 U.S. 368, 374 (1974)).

45. Cane & Weinstein, *supra* note 9, at 405.

46. 667 F.2d 804 (9th Cir. 1982).

47. *Id.* at 807.

the arbitrator, not the court, should determine "the validity of time-barred defenses."[48]

In 1989, the Seventh Circuit in *PaineWebber Inc. v. Farnam*[49] declared that the court, not the arbitrator, decides the timeliness of the claim.[50] Looking at the language of Section 15 of the NASD Code, the Seventh Circuit found that on Section 15's face it stated that it was an eligibility requirement, not a statute of limitations.[51] The court then pointed to a letter written by a NASD Staff Attorney which stated that "the NASD will not process a claim that falls wholly outside the six year period."[52] Based on these findings, the court held that Section 15 served "as an absolute bar to claims submitted for arbitration more than six years after the event which gave rise to the dispute."[53]

Subsequently, the Seventh Circuit offered a more in-depth analysis of this issue in its 1992 decision in *Edward D. Jones & Co. v. Sorrells*.[54] The court began by restating its previous holding that Section 15 is an eligibility requirement that bars certain claims from arbitration.[55] The court reasoned that because Section 15 limits the range of disputes the parties contractually agreed to arbitrate, Section 15 also limits the jurisdiction of NASD arbitrators.[56]

The Seventh Circuit then cited the Supreme Court's holding in *AT&T Technologies* which states that defining the limits of arbitral jurisdiction is generally the function of courts, not arbitrators "unless the parties clearly and unmistakably provide otherwise."[57] Finding that the claimants had not pointed to any evidence in the record demonstrating that the parties intended the arbitrators to define their own jurisdiction, the court held that the court must decide the arbitral jurisdiction in that case.[58]

Finally, in a footnote, the court addressed Section 35 of the NASD Code.[59] Section 35 provides that the "arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code which interpretation shall be final and binding upon the parties."[60] Although the opinion offers no argument relating to the application of Section 35, the court did state that the language of Section 35 was not "a clear and unmistakable expression of the

48. *Id.*
49. 870 F.2d 1286 (7th Cir. 1989).
50. *Id.* at 1292.
51. *Id.*
52. *Id.*
53. *Id.*
54. 957 F.2d 509 (7th Cir. 1992).
55. *Id.* at 512.
56. *Id.* at 514.
57. *Id.*
58. *Id.*
59. *Id.* n.6.
60. *Id.*

parties' intent" to have the arbitrator determine which disputes the parties agreed to submit to arbitration.[61]

The Third Circuit provided the most impressive analysis of this issue in *PaineWebber Inc. v. Hartmann*.[62] The court began by noting that the general language of Section 4 of the FAA "fails to delineate with precision the scope of the district court's jurisdiction in an action to compel arbitration."[63] The court did recognize, however, that the limits of the court's jurisdiction had been addressed and clarified by case law.[64]

Focusing on the language of Section 4, the court found that "[a]n 'issue' requiring resolution by the district court arises under Section 4 only when the party refusing to arbitrate contends that the dispute is not one that the parties agreed to arbitrate."[65] The court then pointed to the Supreme Court's holding in *AT&T Technologies* in which the Court stated that "as a matter of contract, no party can be forced to arbitrate unless that party has [agreed to do so]."[66]

Based on the language of Section 4 and the Supreme Court's holding in *AT&T Technologies*, the court reasoned that Section 4 requires the court to engage in a limited review of the arbitration agreement to ensure (1) that a valid agreement to arbitrate exists, and (2) that the dispute falls within the substantive scope of that agreement.[67] Because the parties did not dispute the existence of a valid agreement to arbitrate, the court found that the sole issue was whether the matter in dispute fell outside the substantive scope of the agreement.[68]

Next, the court addressed the question of whether the time limitation was a substantive eligibility requirement or a procedural requirement.[69] The court recognized that the latter interpretation was plausible and that precedent existed which supported that view.[70] The court stated, however, that it must recognize the underlying concern that the Supreme Court articulated in *AT&T Technologies*: "The willingness of parties to enter into agreements that provide for arbitration of

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61. *Id.* (citing AT&T Technologies Inc. v. Communications Workers of Am., 475 U.S. 643, 649 (1996)).

62. 921 F.2d 507 (3rd Cir. 1990).

63. *Id.* at 510.

64. *Id.* at 510-11.

65. *Id.* at 511.

66. *Id.*

67. *Id.* The court noted that:

> [l]ike any contract, an agreement to arbitrate may be limited in its substantive scope in an almost infinite variety of ways. Obvious examples include limitations as to the parties and the types of disputes covered by the agreement. . . . Similarly, as numerous courts have recognized, parties to an arbitration agreement might substantively limit their obligation to arbitrate in a temporal sense.

*Id.*

68. *Id.*

69. *Id.* at 512.

70. *Id.*

specified disputes would be 'drastically reduced' [if the arbitrator] had the 'power to determine his own jurisdiction . . . .'" [71]

Recognizing that resolution of the issue was based solely on linguistics and interpretation, the court turned to the language of Rule 603.[72] The court looked to Webster's Third New International Dictionary for the definitions of "eligible" and "submission."[73] Inserting these definitions into the text of Rule 603, the court came up with the following: "[A]fter six years, a dispute 'shall [not] be worthy to be chosen or selected for [the] consideration, study, or decision [of] arbitration.'"[74] The court concluded that this expanded reading of Rule 603 unambiguously supported the interpretation that it is a substantive eligibility requirement.[75]

In 1992, the Sixth Circuit in *Roney & Co. v. Kassab*[76] adopted the Third Circuit's position in *Hartmann* that the district court should decide timeliness.[77]

In 1994, however, the Eighth Circuit in *FSC Securities Corp. v. Freel*[78] decided to break from the growing consensus. The court found that the arbitrator, not the court, is to determine timeliness.[79] In its ruling, however, the court did not even address Section 15 of the NASD Code.[80] Instead, the court focused solely on the language of Section 35 of the NASD Code.[81] The court found that the language of Section 35, which committed the interpretation of all provisions of the NASD Code to the arbitrator, represented the "clear and unmistakable"

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71. *Id.* at 511-12. The court cited the Court of Appeals for the District of Columbia's reasoning that:

> if we allow the federal policy favoring arbitration, with its accompanying presumption of arbitrability, to override the will of the parties by giving the arbitration clause greater coverage than the parties intended, then in the longer run we risk undermining rather than serving that policy. . . . [P]rivate parties may be reluctant to agree to arbitration if they believe that, despite their best efforts to express their wishes to the contrary, any slight ambiguity in their words or deeds can be seized upon to extend their obligation to arbitrate beyond the term of their contract. Therefore, mindful as we are of the federal policy in favor of arbitration, it is our task nonetheless to determine what appears to be most consistent with the intent of the parties.

*Id.* (citing National R.R. Passenger Corp. v. Boston & Maine Corp., 850 F.2d 756, 760-61 (D.C. Cir. 1988)).

72. *Id.* at 511, 513.

73. *See Id.* "Eligible" is defined as "fitted or qualified to be chosen or used" or "worthy to be chosen or selected." *Id.* at 513 (citing WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 736 (1966)). "Submission" is defined as the act of "commit[ting something] for consideration, study, or decision." *Id.* (citing WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 2277 (1966)).

74. *Id.*

75. *Id.*

76. 981 F.2d 894 (6th Cir. 1992).

77. *Id.* at 897.

78. 14 F.3d 1310 (8th Cir. 1994).

79. *Id.* at 1311-13.

80. *Id.*

81. *Id.*

intent by the parties adopting the Code to have the arbitrator determine arbitrability under Section 15.[82]

The Eight Circuit's interpretation cannot stand as it is arguable whether the language of Section 35 represents the "clear and unmistakable" intent of the parties that the arbitrator determine eligibility under Section 15. The Seventh Circuit in *Sorrells* and the Third Circuit in *Paine Webber Inc. v. Hofmann*[83] held that Section 35 was not a clear and unmistakable expression of the parties' intent to have the arbitrators, not the court, determine which disputes the parties agreed to submit to arbitration.[84]

Looking at the language of Section 35, the arbitrator is empowered to *interpret*[85] and determine the *applicability*[86] of all provisions under the Code. A reasonable interpretation of this language seems to be that Section 35 merely gives the arbitrator final say with regard to the meaning of provisions and whether they apply to the situation at hand.

Furthermore, the Eighth Circuit's interpretation of Section 35 goes against the policy consideration espoused by the Supreme Court to ensure that the parties' intent is not undermined. In *AT&T Technologies*, the Supreme Court was concerned that "[t]he willingness of parties to enter into agreements that provide for arbitration of specified disputes would be 'drastically reduced' [if the arbitrator] had the 'power to determine his own jurisdiction . . . .'"[87]

In 1995, the Fifth Circuit, without addressing the provisions of the SRO Codes, relied on its holdings in prior non-securities cases that "a question of timeliness is generally to be considered one of procedural arbitrability."[88]

In that same year, the Eleventh Circuit joined the Third, Sixth and Seventh Circuits in finding that Section 15 of the NASD Code is a substantive eligibility requirement.[89] The Eleventh Circuit noted that the plain language of Section 15 supported the conclusion that it is a jurisdictional prerequisite to arbitration.[90]

With regard to Section 35, the Eleventh Circuit pointed to the recent Supreme Court case, *First Options of Chicago, Inc. v. Kaplan*.[91] In *Kaplan*, the Court reiterated that the presumption in favor of arbitration is not applicable to the issue of who decides arbitrability: "Courts should not assume that the parties agreed to arbitrate arbitrability unless there is 'clea[r] and unmistakabl[e] evidence that they

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82. *Id.* at 1312-13. Section 35 provides that, "[t]he arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code which interpretation shall be final and binding upon the parties." *Id.* at 1312.

83. 984 F.2d 1372 (3rd Cir. 1993).

84. *See Sorrells*, 957 F.2d at 514 n.6; *Hofmann*, 984 F.2d at 1379 n.4.

85. "Interpret" is defined as to "explain or tell the meaning of." WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 632-33 (1988).

86. "Applicability" is defined as "capable of or suitable for being applied; appropriate." *Id.* at 97.

87. *Hartmann*, 921 F.2d at 511-12.

88. *Boone*, 47 F.3d at 754.

89. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cohen, 62 F.3d at 383.

90. *Id.* at 384.

91. 115 S. Ct. 1920 (1995).

did so.'"[92] The Eleventh Circuit found that Section 35 was not "clear and unmistakable evidence of the parties' intent to allow the arbitrator to determine the timeliness of the claim."[93] The Eleventh Circuit noted that "Section 35 is a general contract term which gives the arbitrator the power to interpret the NASD Code," and, by contrast, section 15 "is a specific provision, which delineates the claims that are untimely, and not eligible for arbitration."[94] The Eleventh Circuit also noted that "when general positions in a contract are qualified by specific provisions, the rule of construction is that the specific provisions in the agreement control."[95] Therefore, the court concluded that "at most Section 35 creat[ed] an ambiguity as to who determines arbitrability" and that "[a]n ambiguity is insufficient to override the presumption that courts determine arbitrability."[96]

### *B. Sub-Issues*

#### 1. What is the "occurrence or event" triggering the start of the time limitation for arbitrability?

At least one court of appeals clearly holds that the "occurrence or event" triggering the running of the time limitation for arbitrability is always the purchase date of the investment.[97] Two courts of appeals, however, have held that the "occurrence or event" does not have to be the purchase date of the investment,[98] rather, it can be the wrongdoing giving rise to a cause of action.[99]

The Seventh Circuit clearly holds that the purchase date of the investment starts the running of the time limitation for eligibility.[100] In *Sorrells*, the Sorrells alleged that their former broker and brokerage firm (1) fraudulently misrepresented material information as to the nature of their investment; (2) violated federal securities laws, federal Racketeer Influenced and Corrupt Organizations statutes, and the Rules of NASD and NYSE, (3) fraudulently concealed wrongdoing; and (4) the firm improperly supervised its broker.[101] Despite these allegations, the Seventh Circuit held that the Sorrells' claims were ineligible for arbitration under

92. *Id.* at 1921 (citing *AT&T Technologies*, 475 U.S. at 649).

93. *Cohen*, 62 F.3d at 384.

94. *Id.*

95. *Id.*

96. *Id.*

97. *Edward D. Jones & Co.*, 957 F.2d at 512-13. Although less clear, the Sixth Circuit also may view the purchase date as the beginning of the time limitation. Dean Witter Reynolds, Inc. v. McCoy, 70 F.3d 1271, 1272 (6th Cir. 1995).

98. *See Hofmann*, 984 F.2d at 1379-80; *Cohen*, 62 F.3d at 385.

99. *Id.*

100. *Sorrells*, 957 F.2d at 512-13.

101. *Id.* at 510, 512.

Section 15 of the NASD Code because more than six years had elapsed from the date they purchased their last investment.[102]

The Sixth Circuit may also view the purchase date as the start of the time limitation; however, it is not certain. In *Dean Witter Reynolds, Inc. v. McCoy* (hereinafter *McCoy II*),[103] on remand, a district court in the Sixth Circuit, quoting *Sorrells*, held that the "date of the 'occurrence or event' giving rise to the act or dispute, claim or controversy," for purposes of Section 15, is the date of the investment.[104]

In *McCoy I*,[105] the claimants alleged that their broker made risky investments in order to reap excessive fees and commissions.[106] The claimants argued that the "occurence or event" giving rise to their claim was when their investments turned sour, not when they made their investments.[107]

On appeal from *McCoy II*, the Sixth Circuit for the Court of Appeals in *McCoy III*[108] reasoned that "the injury [the claimants] complain of occurred when the investments were first made. Consequently, the Investors' claim arose and the six-year time limit began to run at the time the investments were made."[109]

The Sixth Circuit reasoned that adopting the claimants' allegation that the "occurrence or event" arose when their investments turned sour, rather than when they were made, "would clearly undermine the intention of Section 15 calling for a six-year time limit on the arbitrability of claims, and "would enable the Investors to control the running of the time limit while they reaped the benefits of the investments about which they would later complain."[110]

Throughout its opinion, however, the Sixth Circuit never stated that it was affirming the district court's finding that, for purposes of Section 15 of the NASD Code, the purchase date is the relevant "occurrence or event" that triggers the

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102. *Id.* at 512-13. The true issue in this case was whether Section 15 of the NASD Code could be tolled for equitable considerations. *Id.* The Sorrells alleged that the broker and brokerage firm fraudulently concealed the wrongdoing thus making it impossible for them to discover their injury until six years from the purchase date of the investment had run. *Id.* Therefore, the Sorrells contended, the doctrine of equitable tolling suspended the running of the limitations period until they discovered the wrongdoing. *Id.* The Seventh Circuit, therefore, analyzed the issue from the standpoint of the doctrine of equitable tolling. *Id.* Nevertheless, the court held that, because "[m]ore than six years elapsed from the date the Sorrells made the last of the ten investments which gave rise to their claims . . . the Sorrells' arbitration claims were not timely filed under Section 15." *Id.*

103. 853 F.Supp. 1023 (E.D. Tenn. 1994).

104. *Id.* at 1030.

105. Dean Witter Reynolds, Inc. v. McCoy, 995 F.2d 649 (6th Cir. 1993) (hereinafter *McCoy I*).

106. *Id.* at 650.

107. Dean Witter Reynolds, Inc. v. McCoy, No. 94-5779, 1995 WL 699619, at *2 (6th Cir. Nov. 27, 1995).

108. Dean Witter Reynolds, Inc. v. McCoy, No. 94-5779, 1995 WL 699619 (6th Cir. Nov. 27, 1995) (hereinafter *McCoy III*).

109. *Id.* at *2.

110. *Id.*

running of the time limitation.[111] Also, from the language used by the Sixth Circuit, it could be argued that the court merely held that a claim of unsuitable securities investment necessarily arose at the time the investment was purchased.

The Third Circuit, however, holds that the "occurrence or event" from which the claim arises and which triggers the running of the time limitation is not necessarily the purchase date of the investment.[112] In *Hofmann*, Hofmann alleged the "occurrences or events" giving rise to his claims were (1) the giving of wrongful advice, (2) the active concealment of wrongdoing, (3) the discovery of wrongdoing, and (4) the continuation of wrongdoing.[113] The Third Circuit remanded the case back to the district court to determine whether the claims arose from "occurrences or events" within the six-year period provided by Section 15 of the NASD Code.[114]

In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cohen*,[115] the Eleventh Circuit appeared to adopt the approach advocated by the Third Circuit in *Hofmann*.[116] Quoting the Third Circuit, the Eleventh Circuit held that it was not a "foregone conclusion" that the time period for arbitrability runs from the date the investment is purchased.[117] The court noted that Section 15 of the NASD

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111. *Id.*

112. *Hofmann*, 984 F.2d at 1379-80.

113. *Id.* at 1380. Specifically, the customer claimed that the following events or occurrences occurred within the six-year period provided for in Section 15 of the NASD Code: (1) the stockbroker's advice to "hold" all stock -- each time this advice was given being an actionable occurrence; (2) the brokerage firm's active concealment of the stockbroker's wrongdoing and of the undue speculative nature of the customer's portfolio -- the concealment being an independent, actionable wrong; (3) the customer's discovery of the brokerage firm's and the stockbroker's wrongdoing -- the date of discovery being the first date on which the customer could prevent further injury; (4) the continuation of an integrated pattern of wrongdoing -- the fraudulent inducement to buy and hold the stock over the period from 1982 through 1991 constituting a single, ongoing wrong; and (5) the continuation of a wrongful brokerage relationship -- the entire brokerage relationship being so tainted with fraud and mismanagement that the relationship itself constitutes a single, actionable wrong. *Id.*

Also, the Third Circuit noted that if it is unclear on the record how the parties intended to resolve disputes over the meaning of "occurrence or event," then the first step is to determine whether the parties intended to submit disputes over the operative occurrence or event to arbitration. *Id.* at 1382. If the court finds that the parties intended to submit such disputes to arbitration, the question of what constitutes the relevant occurrence or event (and/or when such occurrence or event took place) should be sent to an arbitrator for initial determination. *Id.* at 1382-83. If the arbitrator finds that the occurrence or event which gave rise to the particular claim occurred more than six years before the filing of arbitration, the arbitrator no longer has jurisdiction and his or her inquiry as to that claim is at an end. *Id.* at 1383. If the arbitrator, however, finds that the occurrence or event transpired within the six-year period before the filing of an arbitration demand, the arbitrator is to rule on the merits of the claim. *Id.* On the other hand, if the district court found that the parties did not intend to submit disputes over the relevant occurrence or event to arbitration, the court is to determine what the relevant occurrence or event is (and/or when it took place). *Id.*

114. *Id.* at 1380.

115. 62 F.3d 381 (11th Cir. 1995).

116. *Id.* at 385.

117. *Id.*

Code did not define relative "occurrence or event" as the purchase of the investment.[118] Based on these findings, the court remanded the case back to the district court with instructions to determine what the relevant "occurrences or events" were.[119] In a footnote, the court used the Cohens' claim for breach of fiduciary duty to illustrate that if such a duty existed, each misrepresentation might be an "occurrence or event."[120] If, however, the Cohens' claim was predicated solely on the unsuitability of their purchase, the relevant "occurrence or event" might be the underlying investment.[121]

Supporting the view of the Third and Eleventh Circuits, the NASD Director of Arbitration in a 1991 letter expressed that the time period for arbitrability may begin to run upon the discovery of losses.[122] Specifically, the letter stated:

> It has been determined that the purchase date is not the event or occurrence that gave rise to this dispute. Also, Section 15 does not refer specifically to the purchase date as the time the six-year limitation begins to run. Therefore, it is equally appropriate that the discovery by the claimant be treated as the occurrence or event giving rise to the dispute."[123]

The better-reasoned approach appears to be the one adopted by the Third and Eleventh Circuits. Their approach is supported by the following facts: (1) no provision in the NASD Code defines "occurrence or event," (2) the Director of Arbitration of the NASD has stated that the time limitation does not have to run from the purchase date, and (3) the wrongdoing may not occur within six years of the purchase date of the investment.

Despite these facts, the Seventh Circuit's approach appears to be equally well-reasoned in light of the historical rationale behind the choice of a six-year limitation. The historical rationale bases the six-year time limit on the requirement that most records of a customer's account must be preserved by the brokerage firm for six years.[124]

### 2. May the claim be brought in court, after the time limit for arbitration has run, if the legal statute of limitations on the claim has not run?

When addressing this issue, one court of appeals and several district courts have found that the answer lies in the language of the individual customer agreement.

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118. *Id.*

119. *Id.*

120. *Id.* n.7.

121. *Id.*

122. Quinton F. Seamons, *Does Securities Arbitration Go on Forever? Eligibility and Statutes of Limitation*, INSIGHTS, May 1994, at 17, 19.

123. *Id.*

124. *See* Robbins, *supra* note 18, at 426.

In *Piccolo v. Faragalli & PaineWebber, Inc.*,[125] the court focused on the language in the customer agreement which stated that all controversies between the parties must be determined by arbitration.[126] The court's focus on this language is especially significant in light of the fact that the customer agreement incorporated by reference Section 15 of the NASD Code and Rule 603 of the NYSE Rules.[127]

With this focus, the court found that there was "simply no language anywhere in the Client's Agreement which stat[ed] that plaintiff may seek relief in federal district court once it has been determined that his claims are not eligible for arbitration."[128] The court reasoned that "for us to find that plaintiff could assert his claims in this forum after having been time-barred from asserting them in arbitration, would only encourage a plaintiff seeking to avoid arbitration to wait six years and then assert his claims in federal district court."[129]

Citing *Piccolo*, the district court in *McCoy II* looked to the terms of the customer agreement. From that angle, the court found that the plain language used by the parties clearly stated that it was the intent of the parties that all disputes would be resolved through arbitration rather than litigation in the courts.[130] Based on this plain language, the court concluded that the parties, by contract, waived their right to litigate their claims in court.[131] On appeal, the Sixth Circuit affirmed the district court's ruling.[132]

Two district courts have implied that claims ineligible for arbitration may be pursued in court.[133] The holdings in these cases, however, have been distinguished.

In *Prudential Securities, Inc. v. LaPlant*,[134] the court flatly held that claims which were ineligible for arbitration because more than six years had passed could still be litigated in federal district court.[135] The court in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Shelapinsky*,[136] however, declined to follow the decision

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125. No. CIV.A.93-2758, 1993 WL 331933 (E.D. Pa. Aug. 24, 1993).

126. *Id.* at *1.

127. *Id.*

128. *Id.*

129. *See Id. See also* Calabria v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 855 F.Supp. 172 (N.D. Tex. 1994); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Shelapinsky, No. CIV.A.93-1553, 1994 WL 397123 (W.D. Pa. Mar. 10, 1994); Castellano v. Prudential-Bache Sec., Inc., No. CIV.A.90-1287, 1990 WL 87575 (S.D.N.Y. June 19, 1990).

130. *McCoy II*, 853 F. Supp. at 1033. Specifically, the parties "agreed that any controversy arising out of or relating to the contract or the breach thereof 'shall be settled by arbitration' and the arbitrators' decision shall be final." *Id.*

131. *Id.*

132. *McCoy III*, 1995 WL 699619, at *2.

133. *See* Smith Barney, Harris Upham & Co., Inc. v. St. Pierre, No. 92-C5735, 1994 WL 11600 (N.D. Ill. Jan. 4, 1994); Prudential Sec., Inc. v. LaPlant, 829 F.Supp. 1239 (D. Kan. 1993).

134. 829 F.Supp. 1239 (D. Kan. 1993).

135. *Id.* at 1244.

136. No. CIV.A.93-1553, 1994 WL 397123 (W.D. Pa. Mar. 10, 1994).

in *LaPlant*.[137] Because the court in *LaPlant* did not discuss the provisions contained in the customer agreement, the *Shelapinsky* court found that "the issue of whether claims that were ineligible for arbitration could be brought in federal district court was never decided [in *LaPlant*]. Rather, it was assumed that the claims could proceed."[138] The *Shelapinsky* court found that the claimant in *LaPlant* was requesting that stale claims be arbitrated along with the eligible claims to avoid claim splitting.[139] Whether the stale claims could be litigated in federal court was not even an issue in *LaPlant*.[140]

The district court in *Smith Barney, Harris Upham & Co. v. St. Pierre*,[141] in determining whether the brokerage firm met the requisite proof for an injunction, noted that "[b]arring [the claimants] from arbitrating their claims does not bar [them] from proceeding through a proper court."[142] This decision, however, has also been distinguished. In *Calabria v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[143] the court observed that the district court in *St. Pierre* was interpreting and applying NYSE Rules 600(a) and 603, rather than the provisions in the customer agreement.[144] Also, the court noted that the *St. Pierre* court, like the court in *LaPlant*, did not decide the precise issue of whether claims made ineligible for arbitration could be brought in court.[145] Rather, the *St. Pierre* court, like *LaPlant*, merely presumed they could proceed.[146]

3. May the time limitation be tolled by equitable considerations?

When interpreted as a substantive eligibility requirement, the SROs' time limitation is often analogized to a statute of repose.[147] A statute of repose "limits potential liability by limiting [the] time during which [a] cause of action can arise."[148] Therefore, when the claimant discovers the wrong plays no role in a statute of repose.

When interpreted as a procedural limitation, however, the limitation is often analogized to a statute of limitations.[149] A statute of limitations "bars [the] right

137. *See Id.* at *4.
138. *Id.*
139. *Id.*
140. *Id.*
141. No. 92-C5735, 1994 WL 11600 (N.D. Ill. Jan. 4, 1994).
142. *Id.* at *4.
143. 855 F. Supp. 172 (N.D. Tex. June 17, 1994).
144. *Id.* at 176.
145. *Id.*
146. *Id.*
147. Cane and Weinstein, *supra* note 9, at 408.
148. *Id.* (citing BLACK'S LAW DICTIONARY 1141 (6th ed. 1990); Kline v. J.I. Case Co., 520 F. Supp. 564, 567 (N.D. Ill. 1981)).
149. *Id.*

of action unless it is filed within a specified period of time after injury occurs."[150] Therefore, a statute of limitations allows the time limit for the bringing of the action to toll until the wrong is discovered.[151]

Not surprisingly, the Third, Seventh and Eleventh Circuits, which hold that the time limitation for arbitration is a substantive eligibility requirement, also hold that the time limitation is not subject to tolling. For example, in *Hofmann*, the Third Circuit reasoned that:

> [a]llowing 'claims' that are tolling or discovery arguments would permit a party to circumvent the contractual limitation of Section 15 (of the NASD Code) and thereby force a party to arbitrate a claim it never agreed to submit to arbitration. The court therefore must enjoin the arbitration of such claims in order to give full effect to the contract.[152]

Similarly, the Seventh Circuit in *Farnam* and the Eleventh Circuit in *Cohen* agreed that since the time limitation is a substantive eligibility requirement rather than a procedural statute of limitations, equitable tolling is not available.[153]

An interesting question, however, exists with regard to the Sixth Circuit's position on equitable tolling. Even though the Sixth Circuit holds that the time limitation for arbitrability is a substantive eligibility requirement,[154] it has held that it is not a statute of repose.[155]

The Sixth Circuit has managed to avoid ruling on the issue of tolling the time limitation for arbitrability. For example, in *McCoy III*, claimants alleged that the running of the time limitation for arbitrability did not begin until their discovery of the brokerage firm's wrongdoing.[156] The alleged wrongdoing was the investment by the brokerage firm in risky investments to reap excessive fees and commissions.[157] Claimants contended that the brokerage firm inhibited the claimants' discovery of the injury by fraudulently concealing its wrongdoing.[158] The court held that the issue of equitable tolling did not have to be reached

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150. *Id.* (citing BLACK'S LAW DICTIONARY 927 (6th ed. 1990); Hanson v. Williams County, 389 N.W.2d 319, 321 (N.D. 1986)).

151. *Id.*

152. *Hofmann*, 984 F.2d at 1381. The Third Circuit also cleared up any confusion regarding whether the customer's claims amount to a single, aggregated, indivisible claim. The district court in *Hofmann* held that, because one of the customer's claims fell outside the six-year period, all of his claims fell outside the period. *Id.* at 1377. The court of appeals, however, held that that analysis was flawed. *Id.* Actually, the dispute was comprised of a number of distinct claims any one of which could fall inside the six-year period and, therefore, be subject to arbitration, even if all of the other claims fell outside of the period. *Id.* at 1377, 1380. The Third Circuit also pointed to the fact that the Seventh Circuit treated such claims in the same manner. *Id.* at 1377.

153. Paine Webber Inc. v. Farnam, 870 F.2d 1286, 1292 (7th Cir. 1989); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cohen*, 62 F.3d 281, 385 n.4.

154. *Roney*, 981 F.2d at 897.

155. *McCoy I*, 995 F.2d at 651.

156. *McCoy III*, 1995 WL 699619, at *2.

157. *McCoy I*, 995 F.2d at 650.

158. *McCoy III*, 1995 WL 699619, at *2.

because the claimants provided no evidence sufficient to raise a genuine issue of fact material as to their claim of fraudulent concealment.[159]

*McCoy II* was the Sixth Circuit's most recent decision on the issue of equitable tolling and was before the Sixth Circuit twice. The first time the court remanded the case back to the district court and instructed the district court that if it finds that the brokerage firm or its agents fraudulently concealed the alleged wrongs, the claims could potentially be pursued in arbitration.[160] The Sixth Circuit also noted that *Kassab* should be looked to for guidance.[161]

On remand, the district court looked at *Kassab* and found that it did not address the question of whether the time limitation for arbitrability may be tolled on the ground of fraudulent concealment.[162] In *Kassab*, the claimants did not argue that the time limitation should be tolled on the ground of fraudulent concealment.[163] Rather, they contended that the brokerage firm had engaged in separate acts of wrongful conduct by fraudulently concealing the injuries to the claimants and that such wrongful conduct, in and of itself, was eligible for arbitration because it occurred within the six-year time limit.[164] The Sixth Circuit in *Kassab*, however, ruled that the claimants failed to state a sufficient claim for fraudulent concealment.[165]

The district court interpreted *Kassab* to mean that the issue of equitable tolling was still an open question and it considered the Sixth Circuit's statement in *McCoy I* to be dicta.[166] Therefore, the district court approached the issue of equitable tolling as one of first impression in the Sixth Circuit.[167]

Citing the Third and Seventh Circuits, the district court held that "since Section 15 is an eligibility or jurisdictional requirement rather than a statute of limitations, it is not subject to equitable tolling on the ground of fraudulent concealment."[168] The district court stated that it was convinced, in light of the Sixth Circuit's analysis in *Kassab*, that if the Sixth Circuit was confronted with the issue of equitable tolling, it would choose to follow the decisions of the Third and Seventh Circuits.[169] In its decision, the district court reasoned that

> [i]f the Court were to hold that the defendants' claims are eligible for arbitration beyond the six-year time limit provided in Section 15 based on theories of equitable tolling and discovery, it would permit defendants to breach and circumvent the contractual time limit they agreed to in Section 15 of the NASD Code thereby forcing [the other

159. *Id.*
160. *McCoy I*, 995 F.2d at 651.
161. *Id.*
162. *McCoy II*, 853 F. Supp. at 1029.
163. *Id.*
164. *Id.*
165. *Id.*
166. *Id.*
167. *Id.*
168. *Id.* at 1031.
169. *Id.*

party] to arbitrate stale claims it never agreed to submit to arbitration.[170]

However, as noted above, when *McCoy I* reached the Court of Appeals, the Sixth Circuit held that it need not reach the issue of equitable tolling at that time.[171]

With regard to the issue of SROs' time limitation versus a longer state statute of limitations and equitable tolling, unjust results appear inevitable from the courts viewing the time limitation as a substantive eligibility requirement. These courts take a strong contractual stance with regard to arbitration clauses. This contractual stance dictates that parties who incorporate arbitration clauses in their agreements opt out of the rules prescribed by the legislature and the courts.

Courts that view the time limitation as a statute of limitations of sorts believe equitable considerations are alive and well in the arbitral fora.

Both sides of the debate are, once again, very plausible. The strong contractual stance is supported by Supreme Court precedent, the FAA's underlying goal to place arbitration agreements "upon the same footing as other contracts,"[172] and by the historical rationale of the general six-year time limitation.[173]

Allowing one to fraudulently conceal wrongdoing long enough to avoid arbitration, however, is not a just result. It also seems unjust to completely preclude parties who "chose" to arbitrate because an arbitration provision was contained in their standardized customer agreement from the court system and equitable considerations.

### 4. May arbitration be stayed if the legal statute of limitations on the claim has run?

This issue has been addressed by the Ninth Circuit for the Court of Appeals, two district courts of the Sixth Circuit, and by the state of New York.

In the Ninth Circuit case, *O'Neel,* a dissatisfied customer filed a notice of claim in arbitration against her brokerage firm.[174] The firm then filed a third-party claim against O'Neel, an account executive at the firm, for any damages that might be awarded.[175] O'Neel claimed the arbitration panel had no jurisdiction over the claim since the legal statute of limitations on the claim had run.[176] The Ninth Circuit, however, held that the statute of limitations defense did not go to the jurisdiction of the arbitration panel.[177]

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170. *Id.*

171. *McCoy III,* 1995 WL 699619, at *2.

172. Volt Info. Sciences, Inc. v. Bd. of Trustees of Leland Standford Junior Univ., 489 U.S. 468, 474 (1986) (citing Scherk v. Alberto-Culver Co., 417 U.S. 506, 511 (1974)).

173. *See* Robbins, *supra* note 18, at 426. *See also supra* text accompanying note 19.

174. *O'Neel,* 667 F.2d at 806.

175. *Id.*

176. *Id.*

177. *Id.* at 807.

The Ninth Circuit's approach appears to be consistent with the view of the "substantive eligibility" courts that the parties to an arbitration agreement contracted out of the rules prescribed by the legislature and the courts.

In *Davis v. Skarnulis*,[178] a district court in the Sixth Circuit had to decide whether the parties agreed to arbitrate the issue of statutes of limitation when they agreed to arbitrate under the NASD rules.[179] The district court interpreted the second sentence of Section 15 of the NASD Code as "intend[ing] to set forth the agreement of the parties that the arbitrators shall be bound to abide by the state and federal statutes of limitation in adjudicating the disputes."[180] Therefore, the court compelled the parties to arbitrate the applicability of the state and federal statutes of limitation to the claims.[181]

In *McCoy II*, another Sixth Circuit district court held that:

> [a]lthough a claim may be eligible for arbitration under the first sentence of Section 15 where it has been brought within the six-year eligibility time limit, the claim may ultimately be dismissed by the arbitrators as being time-barred by the applicable state or federal statute of limitations.[182]

Although *McCoy II* was appealled to the court of appeals, that court did not rule on this specific issue.[183]

Finally, New York statutory law provides that the court may stay arbitration proceedings if the claim to be arbitrated would be barred by the state law statute

178. 827 F. Supp. 1305 (E.D. Mich. 1993).
179. *Id.* at 1307.
180. *Id.* at 1308.
181. *Id.* at 1309.
182. *McCoy II*, 853 F. Supp. at 1031 (citing *Davis*, 827 F. Supp. at 1308).
183. *McCoy III*, 1995 WL 699619, at *4.

of limitations.[184] It should be noted that most customer agreements containing arbitration clauses provide that New York law applies.[185]

In *Smith Barney, Harris Upham & Co., Inc. v. Luckie*,[186] the parties' arbitration agreement provided that any controversy arising from the contract shall be (1) settled by arbitration and (2) governed by the New York choice of law clause.[187] The petitioners commenced proceedings in the New York courts to permanently stay arbitration pursuant to the New York statute of limitations.[188]

The New York Court of Appeals held that:

> the parties' choice that New York law would govern 'the agreement and its enforcement' indicates their 'intention to arbitrate to the extent allowed by [this State's] law,' even if application of the State law -- and an adverse ruling on a Statute of Limitations claim -- would relieve the parties of their responsibility under the contract to arbitrate.[189]

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184. Two sparate sections of New York statutory law are relevant to the issue of arbitration and statute of limitations. *See* Smith Barney, Harris Upham & Co., Inc. v. Luckie, 85 N.Y.S.2d 193, 204 (N.Y. 1995).

First, N.Y. CIV. PRAC. L. & R. 7502(b) (McKinney Supp. 1997), entitled "Limitation of time," provides:

> If, at the time that a demand for arbitration was made or a notice of intention to arbitrate was served, the claim sought to be arbitrated would have been barred by limitation of time had it been asserted in a court of the state, a party may assert the limitation as a bar to the arbitration on an application to the court . . . . The failure to assert such bar by such application shall not preclude its assertion before the arbitrators, who may, in their sole discretion, apply or not apply the bar.

Second, N.Y. CIV. PRAC. L. & R. 7503(a) (McKinney 1980), entitled "Application to compel arbitration; stay of action," provides:

> A party aggrieved by the failure of another to arbitrate may apply for an order compelling arbitration. Where there is no substantial question whether a valid agreement was made or complied with, and the claim sought to be arbitrated is not barred by limitation under subdivision (b) of section 7502, the court shall direct the parties to arbitrate. Where any such question is raised, it shall be tried forthwith in said court. If an issue claimed to be arbitrable is involved in an action pending in a court having jurisdiction to hear a motion to compel arbitration, the application shall be made by motion in that action. If the application is granted, the order shall operate to stay a pending or subsequent action, or so much of it as is referable to arbitration.

185. Budd, *supra* note 8, at 209 and accompanying text.

186. 647 N.E.2d 1308 (N.Y. 1995).

187. *Id.* at 1311.

188. *Id.*

189. *Id.* at 202. The real issue before the court was:

> whether, under standard Federal preemption analysis, the FAA's compulsory arbitration provisions and its underlying policies require that even those questions normally reserved to the courts pursuant to New York law must be resolved by the arbitrators, notwithstanding the presence of a New York choice of law provision in the agreement to arbitrate.

*Id.* at 203. The court held that it did not. *Id.* at 204.

### 5. Can a claimant effect an end-run around Section 15 by taking the claim to court and asking the court to send the case to arbitration?

In *Sorrells*, the Seventh Circuit noted that "Section 15's bar on all claims older than six years is removed only if a court with jurisdiction over the claim orders the matter be submitted to arbitration."[190] This exception to Section 15's time limitation for arbitrability was inapplicable to the Sorrells' claims because the Sorrells submitted their "ineligible" claims to NASD arbitration instead of a court.[191]

This "exception" to the time limitation has some claimants attempting an end-run around the time limitation by filing their claims in court, thus expecting their claims to be compelled to arbitration.[192] As one commentator noted, this end-run exception should be seriously considered by claimants' counsel because "[i]f the court is faced with simultaneously denying a motion to compel arbitration and tossing the plaintiff out of court, it seems less likely to do both."[193]

## IV. PROPOSED AMENDMENT TO SECTION 15 OF THE NASD CODE

In July 1994, hope for a resolution of the debate among the circuits emerged when NASD announced its proposal to amend Section 15 of the Code.[194] In October 1994, however, NASD withdrew its proposal to amend the Code in order to consider the issue further.[195]

The proposed amendments affected the following issues:

Substantive Eligibility Requirement or Procedural Limitation?

The proposed amendment changed the title of Section 15 from "Time Limitation on Submission" to "Eligibility." This change would have dispelled any doubt that the rule is anything other than a substantive eligibility requirement for arbitration.[196]

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190. 957 F.2d at 513.

191. *Id.* at 513-14.

192. Neesemann & Nelson, *supra* note 12, at 135.

193. Robbins, *supra* note 18, at 428.

194. Neesemann & Nelson, *supra* note 12, at 135. *See* Masucci & Clemente, *supra* note 15, at 295.

195. The proposed amendment to Section 15 was published to the Board twice. Neesemann & Nelson, *supra* note 12, at 135. Controversy surrounding the philosophy of the rule itself resulted in the withdrawal of the filing. *Id.* NASD is currently working with the Securities Industry Conference on Arbitration on a revised proposal. *Id.*

196. Cane & Weinstein, *supra* note 9, at 401.

Who Determines Arbitrability?

The proposed amendment provided that the Director of Arbitration would determine whether the claim took place within six years from the "occurrence or event" giving rise to the dispute.[197] Also, the amendment provided that the eligibility determination of the Director would not be subject to review by the arbitrators under Section 35 of the Code.[198] With this amendment, the main issue of the debate would have been resolved.

What is the "Occurrence or Event"?

The proposed amendment provided that the Director consider the following factors when making an eligibility determination:

> (1) the date(s) of the transaction(s) in question; (2) the date(s) of the act(s) or occurrence(s), if not concurrent with the transaction(s), which gave rise to the claim or which constituted the conduct complained of; and (3) the existence of fraudulent concealment or misrepresentations which cause the claimant to delay submission of a claim.[199]

Thus, the "occurrence or event" giving rise to the dispute would not be limited to the purchase of the investment.

Is the Time Limitation Subject to Equitable Tolling?

As noted above, the existence of fraudulent concealment or misrepresentations causing the claimant to delay submission of a claim would have been a factor in determining eligibility for arbitration.[200] The proposed amendment, however, also provided that the discovery of the existence of a claim within the six-year period alone would not suffice to make the claim eligible for submission if the transaction, act, or occurrence forming the basis for the claim occurred outside the six-year period.[201] Therefore, if the claim was discovered more than six years after the "occurrence or event" giving rise to the claim, the time limitation would not be tolled.

According to Section 15, May Claims be Litigated in Court Even Though They are Ineligible for Arbitration?

Under the new subsection 15(c), an ineligibility determination by the Director would not bar a claimant from pursuing a claim in a judicial forum.[202] This new subsection would also have allowed the parties to retain all rights and remedies available under applicable law.[203]

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197. *Id.*
198. *Id.*
199. *Id.* at 401-02.
200. *Id.* at 402.
201. *Id.*
202. *Id.*
203. *Id.*

May the Claimant Effect an End-Run Around Section 15?

Section 15(a) would have been amended to eliminate the provision which states "that the six-year eligibility limitation does not apply to cases directed to arbitration by a court. Therefore, a court order directing the parties to arbitration [would not have been] a determination that the matter [was] eligible for arbitration under" the NASD Code.[204]

Judicial Determination of Eligibility

Although the proposed amendment clarified the issues noted above, the amendment would have likely created a different mess.[205] The rule itself is clear, but the commentary to the rule would have caused the problem.[206]

Proposed subsection 15(b) provided that occurrences or events deemed ineligible for arbitration by the Director could be introduced in the arbitration as evidence relating to any substantive claim or defense.[207] The commentary to the rule, however, stated: "Notwithstanding the foregoing, the proposed rule change does not preclude a party from raising the issue of eligibility in any court proceeding."[208]

According to the commentary, the claimant whose issues were determined by the Director to be ineligible for arbitration could litigate his eligibility in front of a court.[209] Even if the court found that the issues were eligible for arbitration and ordered the matter to arbitration, the new subsection 15(c), however, would have prohibited the parties from seeking enforcement of any arbitration agreement where the claim had been declared ineligible under Section 15.[210] What then?

## V. CONCLUSION

The amendment to the NASD Code discussed in Part IV would have ended much of the eligibility debate. Unfortunately, because NASD withdrew this proposed amendment, the courts will continue the battle of substantive eligibility requirement versus procedural limitation.

Rationales for each view aside, a by-product of this debate that has not been touched upon is the increased burden on the federal court system. Piled onto the overburdened dockets of the federal court system are cases dealing with eligibility for arbitration. As discussed in Part III, this author believes the approach taken by the "substantive-eligibility" courts is the better-reasoned approach. This approach, however, burdens the federal court system. The Eleventh Circuit has

204. *Id.* at 401.
205. *See Id.* at 403.
206. *See Id.*
207. *Id.* at 401.
208. *Id.* at 403.
209. *Id.*
210. *Id.* at 402.

addressed this concern stating that "[c]oncerns for judicial economy alone are not sufficient to justify interference with the binding agreement of the parties."[211]

Perhaps the concern for judicial economy was the driving force behind the amendment to the NASD Code, providing that the Director of Arbitration was to decide the question of eligibility for arbitration. Nevertheless, it is likely that these issues will reach the Supreme Court if not resolved by amendment.[212] As one commentator most aptly noted, however, "[i]n the meantime, arbitration is becoming the litigation battlefield that it was intended to avoid."[213]

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211. *Cohen*, 62 F.3d at 385 (quoting Goldberg v. Bear, Stearns & Co., Inc., 912 F.2d 1418, 1422 (11th Cir. 1990)).

212. Seamons, *supra* note 122, at 21.

213. *Id.*