Brooklyn Law Review

Volume 61
Issue 1
SYMPOSIUM:
The Sixth Abraham L. Pomerantz Lecture

Article 6

1-1-1995

Time Limits On Arbitrability of Securities Industry Disputes Under the Arbitration Rules of Self-Regulatory Organizations

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NOTES

TIME LIMITS ON ARBITRABILITY OF SECURITIES INDUSTRY DISPUTES UNDER THE ARBITRATION RULES OF SELF-REGULATORY ORGANIZATIONS

INTRODUCTION

The arbitration of security industry disputes has displaced litigation as the adjudication method of choice.[1] With a growing number of securities-related disputes submitted to arbitration, the number of legal problems created by arbitration has grown accordingly.[2] These arbitration problems range from the procedural aspects of the arbitration process to its compatibility with areas of substantive law.

One of the most contested issues in securities arbitration involves application of the six-year time-bar provisions of the Code of Arbitration Procedure. Each of the major self-regulatory organizations ("SRO")—the National Association of Securities Dealers ("NASD"), the New York Stock Exchange ("NYSE"), and the American Stock Exchange—have adopted

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[1] *See* Shearson/American Express Inc. v. McMahon, 482 U.S. 220, 232 (1987) ("The suitability of arbitration as a means of exploring Exchange Act rights is evident . . . ."). Securities industry arbitration has been endorsed by the Supreme Court and welcomed by Wall Street: "The industry figured that dealing with such spats out of court would be quicker and cheaper—and reduce the possibility of astronomical awards by jurors sympathetic to individual investors." Marilyn B. Cane & Howard S. Weinstein, *Securities Arbitration Update 1993-1994*, *in* 13TH ANNUAL SO. FED. SEC. INST. 387 at 391 (ALI-ABA Course of Study Feb. 24, 1994) [hereinafter "*Arbitration Update*"].

[2] Securities arbitration has caught the eye of the academic community. After the Supreme Court's decision in Shearson/American Express v. McMahon, 482 U.S. 220 (1987), the Index to Legal Periodicals, LRI compiled a new section under the heading *Securities Arbitration*. In 1990-91, when this section first appeared, it had 16 entries.

these provisions.[3] Modeled after the time-limit rule of the Uniform Arbitration Act proposed by the Securities Industry Conference on Arbitration, these provisions of each self-regulatory organization bar those claims arising from an event that occurred more than six years before the filing of the arbitration claims.[4] Short and simple at first glance, these provisions have created a great deal of controversy over their interpretation.[5]

The controversy flows from the unusual nature of these limitation periods. Unlike conventional statutes of limitations that attach to a claim by operation of law, arbitration time-bars apply to a claim as all other arbitration procedural rules do: by incorporation in the arbitration agreement between parties. The unconventional origin of such arrangements, in comparison with statutory time-limitations, has caused courts to disagree over how to define their character. Some courts consider the time-bars to be procedural defenses subject to an arbitral disposition.[6] Other Courts perceive these six-year periods as substantive eligibility requirements that preclude a claim from submission to an arbitration forum altogether and therefore require a judicial determination.[7]

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[3] The American Arbitration Association's independent arbitration forum, ("AAA"), does not have any specific time limitations on the submission of a claim to arbitration. *See* AMERICAN ARBITRATION ASSOCIATION, SECURITIES ARBITRATION RULES (1993).

[4] These rules all provide:

> No dispute, claim, or controversy shall be eligible for submission under this Code where six (6) years shall 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.

NASD C.A.P. R. 15 (present version), NASD MANUAL (CCH) ¶ 3715; NYSE Arbitration Rules, R. 606, NYSE GUIDE (CCH) ¶ 2606; AmEx Arbitration Rules R. 605, AmEx GUIDE (CCH) ¶ 9544; Municipal Securities Rulemaking Board ("MSRB") R. G-35, Section 6(a), MSRB MANUAL (CCH) ¶ 3671, at 5404 (1994).

[5] The federal circuit courts are split over whether time-bars are procedural or substantive in nature what entity decides the timeliness of claims. The Second, Fourth, Eighth, Ninth, Eleventh and District of Columbia Circuits have concluded that arbitrators rather than courts should decide the issue. The Third, Sixth and Seventh Circuits have come to the opposite conclusion. *See* Wylie v. Investment Mgmt. & Research, Inc., 629 So. 2d 898, 900 (Fla. Dist. Ct. App. 1993). The judicial treatment of the arbitration time-bars is discussed in considerable detail *infra* part II.

[6] *See infra* notes 115-53 and accompanying text.

[7] *See infra* notes 154-95 and accompanying text.

To secure some uniformity and reduce the number of disputes over the time-bars, the NASD first proposed to amend its time limitations provision in 1993.[8] The proposal delegates the final determination of eligibility to the NASD's Director of Arbitration.[9] To ensure the finality of the director's determination, NASD members who do not follow it run the risk of sanctions, but not investors.[10] Because the Code of Arbitration Procedure is incorporated in the arbitration clause of a contract, the NASD asserts that parties to a contract ultimately are bound by this provision, which prohibits resort to the courts or other forums in case of an unfavorable disposition.[11]

This Note examines the arbitration time-bars and their treatment by various courts and considers the effects of adopting the NASD proposal. Part I reviews the background of time-bars and provides a history of securities arbitration that explains how the industry has changed its attitude toward arbitration. Part I also discusses the important role the time-bar provisions play considering the almost mandatory nature of securities arbitration. This discussion demonstrates how the courts' deference to arbitrators' decisions allows the time-bars to defeat an otherwise valid claim. Further, this Part describes the types of limitations periods and how federal equitable doctrines affect the length of these periods, including how arbitration time-bars may conflict with other statutes of limitations.

Next, Part II discusses SROs' time-bar provisions and the judicial treatment of these provisions. The majority of courts perceive the time-bars as procedural limitations defenses to be decided by arbitrators rather than by courts. Part II argues, however, that the minority view, which considers time-bars to be eligibility or jurisdictional requirements subject to judicial determination, is more in accord with the Federal Arbitration Act and with Supreme Court precedent. It also proposes a more appropriate model for the determination of the timeliness of arbitration.

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[8] SEC Exchange Act Release No. 33108, 1993 WL 441275 (Oct. 26, 1993) [hereinafter "First Proposal"]; SEC Exchange Act Release No. 34,442, 59 Fed. Reg. 39,373 (Aug. 2, 1994) [hereinafter "Second Proposal"].

[9] Second Proposal, *supra* note 8, at 39,373.

[10] Second Proposal, *supra* note 8, at 39,373.

[11] Second Proposal, *supra* note 8, at 39,374.

Finally, Part III reviews the changes the NASD has proposed for its time-bar rule. It argues that the proposal suffers from two major drawbacks: first, the NASD's Director of Arbitration is not the best possible authority to determine this complex legal issue; and second, the amended rule does not close all the loopholes that enable parties to relitigate this issue. This Note concludes that the question of whether a claim is time-eligible for arbitration should be decided by courts through summary proceedings.

I. BACKGROUND: THE GENEALOGY OF TIME-BARS

The time-bar provisions in the SROs' Code of Arbitration Procedure are significant for two reasons. First, in most instances arbitration of securities claims is mandatory[12] by way of an enforceable agreement to arbitrate. As such, arbitration may be the only available procedure by which a claimant can recover for an alleged wrong. That is, if there is a valid arbitration agreement and the claim is ruled ineligible for arbitration, courts usually consider a claim barred from litigation. Second, in addition to federal and state statutes of limitations, the time-bar provisions further limit a cause of action. Securities arbitration encompasses a variety of causes of action governed by time limits of different length. The six-year period at times may shorten the statute of limitations that controls a claim presented to arbitration. As a result, the six-year time-bars may preclude a claim from arbitration and litigation that otherwise would be allowed by the statute of limitations governing the underlying legal claims.

A. *Arbitration in the Securities Industry*

Arbitration has had a long history in the securities industry. As early as 1872, the NYSE initiated a program to arbitrate disputes between members and non-members.[13] Never-

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[12] For example, Article VIII, section 1 of the Constitution of the American Stock Exchange provides: "Members . . . *shall* arbitrate all controversies . . . among themselves or between them and their customers . . . ." American Stock Exchange Guide (CCH) ¶ 9062 (emphasis added).

[13] David A. Lipton, *Broker-Dealer Regulation*, 15 SEC. L. SERIES 4-2, § 4.01[1] (1988).

theless, until well into the 1980s, the enforceability of agreements to arbitrate securities disputes was questionable, and thus undermined the legitimacy of securities arbitration.[14]

Judicial hostility to all kinds of arbitration initially came to the United States as part of English common law heritage. Although British courts before the Companies Act of 1900[15] honored stipulations that bound purchasers to waive the statutory liabilities—as long as the stipulations were not too "tricky"[16]—they "traditionally considered irrevocable arbitration agreements as 'ousting the court of jurisdiction,' and refused to enforce such agreements for this reason."[17] Yet this hostility did not fit the industrialization-driven and business-oriented societal model of twentieth-century America.[18] In 1925, Congress, "profit[ing] from English experience,"[19] enacted the Federal Arbitration Act.[20] The Arbitration Act was designed to reverse generations of judicial hostility toward arbitration clauses in contracts.[21] For example, section 2 of the Act provided that an agreement to arbitrate "shall be valid, irrevocable, and enforceable."[22] The Act reflected a liberal federal policy favoring arbitration agreements.[23]

Although the Federal Arbitration Act opened the doors for arbitration, its application to the securities industry was

[14] *See*, Wilko v. Swan, 346 U.S. 427 (1953) (refusing to enforce an agreement to arbitrate in connection with § 12(2) of the Securities Act), *overruled on different grounds by* Rodriguez DeQuijas v. Shearson/American Express, Inc., 490 U.S. 277 (1989).

[15] Companies Act of 1900, 63 & 64 Vict. ch. 48 (Eng.).

[16] LOUIS LOSS & JOEL SELIGMAN, X SECURITIES REGULATION 4552 (3d ed. 1993) (quoting Greenwood v. Leather Shod Wheel Co., 1900-01 ch. 421 (C.A.)).

[17] Scherk v. Alberto-Culver Co., 417 U.S. 506, 510 n.4 (1974) (enforcing an agreement to arbitrate a dispute arising out of the sale of business before the International Chambers of Commerce in Paris).

[18] As U.S. Senator Sterling had noted in the report accompanying S. 1005, which later became the Federal Arbitration Act, "[t]he settlement of disputes by arbitration appeals to big business and little business alike, to corporate interests as well as to individuals." S. REP. NO. 536, 68th Cong., 1st Sess. 3 (1924).

[19] LOSS & SELIGMAN, *supra* note 16, at 4554.

[20] 9 U.S.C. §§ 1-16 (1988 & II Supp. 1990).

[21] *See* Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 219-21 & 220 n.6 (1985) (enforcing an arbitration agreement in connection with the purchase of securities); *see also* S. REP. NO. 536, *supra* note 18, at 2.

[22] 9 U.S.C. § 2 (1988).

[23] Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983) (if it is necessary to enforce an arbitration agreement, the Arbitration Act allows a piecemeal resolution).

thought to be incongruous with federal securities laws. As Professor Loss has noted, all six securities statutes specified that "any condition, stipulation or provision binding any person to waive compliance" with any provision of the securities laws or any rule of the Securities and Exchange Commission was void.[24] In light of these non-waiver provisions, courts interpreted arbitrability of securities disputes as an impermissible waiver of the legal rights given to investors by the federal securities statutes.[25] Such an interpretation led to a "neat conflict between two socially desirable policies—arbitration with its advantages of speed and economy and protection of the rights of investors against persons with superior bargaining power."[26]

When the Supreme Court first discussed this conflict in 1953 in *Wilko v. Swan*, it tilted the balance in favor of judicial disposition of securities claims.[27] *Wilko* involved fraudulent misrepresentations a broker made to his customer in violation of the Securities Act of 1933. The Court considered the selection of a judicial forum to be crucial in the system of protection the Securities Act afforded to investors.[28] In the majority's view, "the arbitral system . . . would not afford the plaintiff the rights to which he is entitled [under the Securities Act]."[29]

In the course of time, however, the Supreme Court gradually became less suspicious of arbitration's ability to resolve securities laws claims adequately. Twenty-one years later, in *Scherk v. Alberto-Culver Co.*, the Supreme Court retreated from its *Wilko* position when it considered a Rule 10b-5 claim emanating out of a sale of a business in which the parties had agreed to arbitrate disputes under the rules of the International Chamber of Commerce in Paris.[30] In *Scherk*, the Court reasoned that, in the context of international contract, the advantages given to plaintiffs by securities laws, which, according to

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[24] LOSS & SELIGMAN, *supra* note 16, at 4555; *see e.g.*, Exchange Act § 29(a), 15 U.S.C. § 78cc(a) (1988).

[25] *See infra* notes 27-29 and accompanying text.

[26] LOSS & SELIGMAN, *supra* note 16, at 4560.

[27] Wilko v. Swan, 346 U.S. 427 (1953) (refusing to enforce an arbitration agreement in connection with the violation of § 12(2) of the Securities Act), *overruled by* Rodriguez DeQuijas v. Shearson/American Express, Inc., 490 U.S. 277 (1989).

[28] *Id.* at 435.

[29] *Id.* at 439 (Frankfurter, J., dissenting).

[30] 417 U.S. 506 (1974).

Wilko, may be lost in arbitration, "become chimerical" since the parties may resort to the foreign courts thus blocking access to the American courts.[31] Although the international aspect of the case certainly influenced the justices, the Court appeared to revise its distrust of securities arbitration. Finally, by the mid-1980s, in *Dean Witter Reynolds, Inc. v. Byrd*, where arbitrable state claims were joined with then non-arbitrable federal claims arising from the same transaction, the Supreme Court interpreted the Arbitration Act to require "district courts to compel arbitration of pendent arbitrable claims when one of the parties files a motion to compel, even where the result would be the possibly inefficient maintenance of separate proceedings in different forums."[32]

Next, in 1987, the Supreme Court in *Shearson/American Express, Inc. v. McMahon*[33] refused to apply *Wilko* to a 10b-5 claim involving fraudulent conduct by a broker. Although *Wilko* was distinguished rather than overruled,[34] in *McMahon* the Court reached a totally different conclusion: "The suitability of arbitration as a means of enforcing Exchange Act rights is evident . . . ."[35] The *McMahon* Court held that only contrary command by Congress could override the Arbitration Act's mandate to enforce agreements to arbitrate statutory claims.[36] A majority of the Court did not find that the Exchange Act had issued such a countervailing command;[37] nor did the court find that arbitration weakened the ability of investors to recover under section 10(b) of the Act.[38]

Ultimately, the Court explicitly overruled *Wilko* in *Rodri-*

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[31] *Id.* at 518.

[32] Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 217 (1985). Professor Bloomenthal considered such an attitude a "strong predilection toward enforcing predispute agreements to submit disputes to arbitration." Harold Bloomenthal, *Securities and Federal Corporate Law, in* 3A SEC. L. SERIES § 8.30[2][a], at 8-154.1 (1989).

[33] 482 U.S. 220 (1987).

[34] The Court had a perfect reason not to follow the precedent: *Wilko* was decided under the Securities Act of 1933, whereas *McMahon* involved the Securities Exchange Act of 1934. *Id.* at 234. Other than this formal difference, it is difficult to explain why arbitration affords investors equivalent protection under the Exchange Act and not under the Securities Act.

[35] *McMahon*, 482 U.S. at 232 (interpreting *Scherk*, 417 U.S. 213).

[36] *Id.* at 226.

[37] *Id.* at 227-30.

[38] *Id.* at 231-34.

guez de Quijas v. Shearson/American Express.[39] On facts substantially similar to those of *Wilko*, the Court found that the right to select the adjudicatory forum is not such an essential feature of the securities laws, nor is it so critical that it cannot be waived due to the rationale that the securities laws were intended to place buyers of securities on equal footing with sellers.[40] The Court thus held that the agreements to arbitrate securities disputes will be enforced.[41]

McMahon and *Rodriguez de Quijas* gave the green light to arbitration. Not long before these Supreme Court decisions, the SEC similarly had shifted its policies regarding arbitration. SEC Rule 15c2-2, promulgated prior to *McMahon* in 1984,[42] prohibited brokers' agreements purporting to bind customers to arbitration and required brokers to disclose the unenforceability of such agreements. In 1987, the year *McMahon* was decided, the SEC found the rule inappropriate in light of the Supreme Court case law and repealed it.[43]

As a result of the Supreme Court decisions and the SEC's changed policies, arbitration today has become the dominant method of resolving securities disputes.[44] Judicial approval of securities arbitration has made the definition of arbitration—a method of alternative dispute resolution—a misnomer. Typical-

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[39] 490 U.S. 477 (1989).

[40] *Id.* at 481.

[41] *Id.* at 484.

[42] 17 C.F.R. § 240.15c2-2 (1984) (repealed by SEC Exchange Act Release No. 25,034, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,163 (Oct. 15, 1987)).

[43] Exchange Act Release No. 25,034, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,163 (Oct. 15, 1987). Not only did the SEC revise its anti-arbitration position, but in its amicus brief in *McMahon*, it supported Shearson's position and urged the court to enforce an arbitration agreement between the parties. *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 221 (1987).

[44] As one commentator noted, "[a]s a consequence of [the *Wilko* reversal], a relatively modest arbitration system that had initially been promoted by the Securities and Exchange Commission as a consumer protection device for small investors underwent extraordinary growth in staff, budget, and case load." David A. Lipton, *Generating Precedent in Securities Industry Arbitration*, 19 SEC. REG. L.J. 26, 27 (1991). Indeed, the structure of securities arbitration is fairly complex. The industry has a coordinating body, the Securities Industry Conference on Arbitration ("SICA"). The plaintiffs' bar also has its own organization, Public Investors Arbitration Bar Association ("PIABA") created in October 1990. A newsletter called the *Securities Arbitration Commentator* regularly reports on significant developments and cases. *See generally* Martin L. Budd, *Securities Industry Arbitration* 35, 37 (ALI-ABA Course of Study No. 882 1994).

ly, arbitration is the exclusive way of resolving a securities dispute. The exclusivity of arbitration is a byproduct of the very nature of arbitration—the principle of its finality, which is "a basic ingredient of the practical-idealistic mix that defines arbitration and sets it apart from Diogenesic search for truth to which litigation sometimes aspires."[45] Although due process guarantees and notions of fairness and impartiality require that at least some judicial review remain available, the principle of finality has limited such review substantially, making arbitration the sole available forum for most claims.

Indeed, unsuccessful arbitrants have very few judicial options available to change the disposition of their claims. Substantive law limits the grounds upon which an arbitration award can be challenged. Four of these grounds—fraud, impartiality, prejudice or overreaching—are enumerated in the section 10 of the Federal Arbitration Act.[46] The other ground for a vacatur, a "manifest disregard of the law" by arbitrators, is grounded in common law.[47] Finally, the award can be challenged collaterally, pursuant to the 1988 amendments to the Arbitration Act.[48]

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[45] Richard P. Ryder, *Arbitration Award Results & Post-Award Proceedings, in* 2 SECURITIES ARBITRATION 437, 460 (PLI Course Handbook Series No. 782 1992).

[46] 9 U.S.C. § 10(a)-(d) (1988). The award can be vacated: a) where it "was procured by corruption, fraud, or undue means"; or b) where there was "evident partiality" by arbitrators; or c) one of the parties was prejudiced by the arbitrators' misbehavior; or d) where "arbitrators exceeded their powers." *Id.*; *see also* Wall Street Assocs. v. Becker Paribas, Inc., 27 F.3d 845, 849 (2d Cir. 1994) (the grounds listed in the Federal Arbitration Act are the exclusive grounds to vacate an award, which otherwise should be enforced).

[47] This doctrine originated with Wilko v. Swan, 346 U.S. 427, 436-37 (1953), *overruled on different grounds by* Rodriguez DeQuijas v. Shearson/American Express, 490 U.S. 477 (1989), survived *Wilko*'s overruling, was subsequently elaborated on in Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker, 808 F.2d 930 (2d Cir. 1986), and has been adopted by the majority of the circuits. *See* Advest, Inc. v. McCarthy, 914 F.2d 6, 8 (1st Cir. 1990); Kanuth v. Prescott Ball & Turben, Inc. 949 F.2d 1175 (D.C. Cir. 1991).

[48] Congress enacted Section 16 of the Arbitration Act, 9 U.S.C. § 16, to limit interlocutory appeals and to provide for immediate appeals where arbitration is denied by a court. Unfortunately, this section backfired by offering a means to vacate an award even if the award is absolutely legitimate. Wiepking v. Prudential-Bache Securities, 940 F.2d 996 (6th Cir. 1991), is a good example of how this occurs. Initially, the arbitration in *Wiepking* was compelled by the court. *Id.* at 997. Some claims that were sent to arbitration were non-arbitrable under then-existing SEC Rule 15c2-2. *Id.* After the arbitration, the losing party did not challenge the award per se but rather attacked the initial ruling of the district court

In addition to the limits imposed on judicial review by substantive law, courts have been extremely deferential to decisions of arbitration panels. Courts that follow a "liberal federal policy favoring arbitration agreements"[49] are unlikely to vacate an award if there is at least some rational explanation of the award.[50]

This combination of substantive limits and courts' deference to the arbitration panels' decisions has created a situation that increases the importance of arbitration time-bars. Most courts have held that a claim is not eligible for judicial disposition if its arbitration is time-barred.[51] Courts have reasoned that arbitration is a matter of contract. If the parties have agreed to submit all claims to arbitration and their agreement has incorporated the SROs' provisions requiring an aggrieved party to submit the controversy within six years, the time-barred party cannot litigate the claim.[52] Although the validity of such an approach is debatable considering the mandatory,[53]

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that had compelled the arbitration. *Id.* at 999. As a result, the Sixth Circuit concluded that the district court had improperly compelled the arbitration, and the otherwise valid award was vacated, despite the fact that the SEC already had rescinded Rule 15c2-2. *Id.*

[49] Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).

[50] Very often, arbitrators do not write opinions and, where there are multiple causes of action, it is not clear which particular legal theory supports the award. In such situations, courts most likely would hold that, as long as a winning party could have reasonably prevailed on the basis of any theory, the award will stand. *See Wall Street Assocs.*, 27 F.3d at 849 (although the defendants showed that arbitrators accepted evidence that arguably related to impermissible theory, other proper theories submitted to arbitrators could have supported the award).

[51] *See* Calabria v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 855 F. Supp 172 (N.D. Tex. 1994) (customer who signed an agreement that contained a mandatory arbitration provision was precluded from litigating her claims once she became ineligible to arbitrate her claims by virtue of NASD Section 15); Dean Witter Reynolds, Inc. v. McCoy, 853 F. Supp. 1023 (E.D. Tenn. 1994) (investors waived their rights to pursue remedies in court when they signed arbitration agreements with a broker); Picollo v. Faragalli, Civ. A. No. 93-2958 1993 WL 331933 (E.D. Pa. Aug. 24, 1993) (ineligibility to arbitrate by operation of NASD Section 15 precluded customer from seeking relief in court); Castellano v. Prudential-Bache Sec., Inc., [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,321 (S.D.N.Y. 1990) (investor lost his right to seek alternative forum after the arbitration forum he had selected dismissed his breach of contract claim as time-barred).

[52] *Calabria*, 855 F. Supp. at 176.

[53] Even though arbitration is a matter of contract, the parties to an agreement have little or no choice but to accept arbitration. Broker-customer agreements contain a standard arbitration clause and investors sign on to these clauses when

rather than voluntarily contractual, nature of arbitration clauses, the vast majority of courts follow this rule.[54] The determination of a claim's arbitrability therefore is crucial for the parties.

B. *Statutes of Limitations in Securities Industry Disputes*

Six-year time-bars on whole operate like statutes of limitations. Unlike most statutes of limitations, however, which are predicated on a particular legal theory, the arbitration time-bars apply to all arbitration claims regardless of the substantive law involved.

In addition to this blanket coverage, the process of creating six-year time-bars also is distinct. As the Supreme Court stated, it is "axiom[atic] . . . that arbitrators derive their authority to resolve disputes only because the parties have agreed in advance to submit such grievances to arbitration."[55] Time-bars to arbitration claims are created by contract rather than through statute. A typical customer-broker agreement incorporates an arbitration clause that requires parties to submit all disputes to arbitration and identifies one or more arbitration forums where a dispute may be resolved.[56] Employment agreements between registered representatives and SROs' member firms also contain arbitration clauses.[57] The

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they sign the investment contract. As to the employer-employee agreements, all Self-regulatory organizations ("SRO") require registered representatives to sign a U-4 form, which contains an arbitration clause. Although the Federal Arbitration Act excludes employment contracts from its coverage, *see* 9 U.S.C. § 1, the arbitration clause in the U-4 form was upheld in Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 25 n.2 (1991), as a contract with the SRO rather than with an employer. Finally, even broker-dealers do not have freedom of choice; the SROs' rules require them to arbitrate all disputes.

[54] Only one court has suggested that claims that are ineligible for arbitration by virtue of six-year bar can be relitigated. Prudential Sec., Inc. v. LaPlant, 829 F. Supp. 1239, 1244 (D. Kan. 1993).

[55] AT&T Technologies, Inc. v. Communication Workers of Am., 475 U.S. 643, 648-49 (1986) (citing Gateway Coal Co. v. Mine Workers, 414 U.S. 368, 374 (1974)).

[56] Cane & Weinstein, *supra* note 1, at 405. For an example of a typical clause, see *infra* note 58.

[57] These clauses are part of a required U-4 form. *See supra* note 53. On the employer side, all SROs mandate the arbitration of disputes between its members. *See e.g.*, Art. VIII of AmEx Constitution, American Stock Exchange Guide (CCH) ¶ 9062; *see also* the Uniform Code of Arbitration developed by Securities Industry

time-bar provisions along with the other provisions of the SROs' Code of Arbitration, usually are incorporated into the agreement by reference.[58] As such, the parties are deemed to have agreed to exclude from arbitration those claims falling outside the limitations period.

The theoretical differences between "conventional" statutes of limitations and time-bar provisions in the SROs' Arbitration Code has led to differences in the way they are applied. Generally, courts place time limits on liability in order to make the law more predictable. As Justice Jackson noted fifty years ago, time limits "promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared."[59] Yet the effectiveness of statutes of limitations may be curtailed when the accrual point is not easily ascertainable. For example, if a plaintiff was defrauded by a so-called "Ponzi scheme"[60] or "pyramid," years may pass before the fraud is discovered. To avoid injustice, courts have developed equitable doctrines that toll the applicable limitations period. Equitable tolling postpones a statute of limita-

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Conference on Arbitration ("SICA") and adopted by SROs; NASD Code of Arbitration Procedure, Part III, § 12, NASD MANUAL (CCH) ¶ 3712. Moreover, failure of an NASD member to submit a dispute to arbitration is considered by the Board of Governors to be a violation of Article III, Sec. 1 of the Rules of Fair Practice and is deemed to be inconsistent with just and equitable principles of trade. *Failure to Act Under Provisions of Code of Arbitration Procedure: Resolution of the Board of Governors*, NASD MANUAL (CCH) ¶ 3748, at 3731.

[58] For example, a standard arbitration clause used in employment agreements in the industry today provides as follows:

> Any claim or controversy arising out of or relating to this Agreement, or the interpretation thereof, or your employment or termination of your employment shall be settled by arbitration under the then prevailing Constitution and Rules of the New York Stock Exchange, Inc. or the National Association of Securities Dealers, as the initial Complainant may elect.

Bill T. Singer & Scott I. Noath, *Situs Selection in Employment Agreement Arbitration Clauses*, *in* SECURITIES ARBITRATION 1992, at 603, 608 (Corporate Law & Practice Handbook Series No. 781 1992). Broker-customer agreements also incorporate the arbitration rules of several SROs.

[59] Order of R.R. Telegraphers v. Railway Express Agency, 321 U.S. 342, 348-49 (1944).

[60] In a classic Ponzi scheme, named after its inventor, new layers of victims enable the swindlers to partially repay previously defrauded customers and, thus, keep the system running for a considerable period of time. For a description of a Ponzi scheme, *see* Cunningham v. Brown, 205 U.S. 1, 7-9 (1924).

tions from running until the plaintiff becomes aware or should have become aware of the wrong.[61] The application of equitable tolling may be triggered by either fraudulent concealment or adverse domination.[62] The centerpiece of the equitable tolling doctrine is the discovery rule, which tolls the statute of limitations until the plaintiff discovers the fraud or should have discovered it had he exercised due diligence.[63] Alternatively, the tolling may end when the market itself puts the plaintiff on constructive or inquiry notice, so that a diligent person in the plaintiff's position would have discovered the fraud.[64]

The doctrine of equitable estoppel, the counterpart of the equitable tolling doctrine, "acknowledges that the statute [of limitations] has run, but is invoked to estop the defendant from asserting this as a defense."[65] Equitable estoppel has been applied when "one, by his conduct, lulls another into a false security, and into a position he would not take only because of such conduct."[66]

Both equitable tolling and equitable estoppel apply to statutes of limitations but not to statutes of repose. Unlike a statute of limitations, a "statute of repose is typically an absolute time limit beyond which liability no longer exists and is

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[61] Christopher R. Leslie, *Den of Inequity; The Case for Equitable Doctrines in Rule 10b-5 Cases*, 81 CAL. L. REV. 1587, 1592 (1993); *see also* Tregenza v. Great Am. Co., 12 F.3d 717, 721 (7th Cir. 1993) ("Equitable tolling just means that without fault by either party the plaintiff does not have enough information to sue within the period of limitations . . ."), *cert. denied*, 114 S. Ct. 1837 (1994).

[62] Leslie, *supra* note 61, at 1592. The doctrine of adverse domination holds that "where an action is brought on behalf of an entity which has been defrauded by persons who completely dominated and controlled it, the statute of limitations is tolled as to controlling wrongdoers during the period of their domination and control." Armstrong v. McAlpin, 699 F.2d 79, 87 (2d Cir. 1983).

[63] For example, section 13 of the Securities Exchange Act of 1934 bars suit unless "brought within one year after discovery of the untrue statement or omission or after such discovery *should have been made* by exercise of reasonable diligence." 15 U.S.C. § 77m (1988) (emphasis added).

[64] *See* Dodds v. Cigna Sec., Inc., 12 F.3d 346, 350-51 (2d Cir. 1993) (investor was put on notice that the investments may be unsuitable for him when he received prospectuses disclosing the riskiness and illiquidity of the investments); *Tregenza*, 12 F.3d at 721-22 (in 10b-5 actions, one-year statute of limitations begins to run when investor receives "inquiry notice," at which point the investor has learned facts that would lead a reasonable person to investigate).

[65] Harold S. Bloomenthal, *The Statute of Limitations and Rule 10b-5 Claims: A Study in Judicial Lassitude*, 60 U. COLO. L. REV. 235, 292 (1989).

[66] Bomba v. W.L. Belvidere, Inc., 579 F.2d 1067, 1071 (7th Cir. 1978).

not tolled for any reason because to do so would upset the economic balance struck by the legislative body."[67] Thus, in most cases, a statute of repose will take a claim out of courts' subject-matter jurisdiction making it impossible for courts to apply equitable doctrines.[68]

Statutes of repose, statutes of limitations and judge-made equitable rules create a complex structure that governs time limits imposed on securities claims. Most commonly, securities-related disputes encompass claims based on express or implied rights of action under federal securities laws, civil enforcement provisions of the Racketeering Influenced and Corrupt Organizations Act ("RICO"),[69] and common law causes of action for fraud, negligence, breach of fiduciary duty, or breach of contract.[70] In addition, securities arbitration is used in a variety of employment disputes between the SROs' member firms and their employees.[71] Even this incomplete list of claims[72] re-

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[67] First United Methodist Church v. United States Gypsum Co., 882 F.2d 862, 866 (4th Cir. 1989), *cert. denied*, 493 U.S. 1070 (1990).

[68] The existence of equitable doctrines is equally important for arbitration time-bars. But for the presence of these equitable rules, the six-year limitation on the submission of a claim to arbitration would have been longer than almost all other statutes of limitations that control securities-related disputes. Without equitable extensions of time-limits, the joint application of the six-year time-bar and other statutes of limitations to a claim would have necessitated a purely mechanical task best handled by computers.

[69] 18 U.S.C. §§ 1961-1964 (1988).

[70] Professor Grant, who serves as an arbitrator on the NYSE, NASD and AAA arbitration panels, suggested that the following be a non-exclusive list of claims that can exist in the broker-customer relationship and may be subject to arbitration: 1) 10(b) and 10b-5 fraud; 2) RICO; 3) blue sky laws; 4) common law fraud for misrepresentation; 5) breach of contract; 6) unsuitability; 7) churning; 8) unauthorized trading; 9) omissions; 10) margin account liquidation and margin calls; 11) order failure or mistaken order; 12) forgery; 13) broker ignorance in areas too dangerous or too complicated; 14) breach of fiduciary duty; 15) failure to supervise; and 16) insider trading. J. Kirkland Grant, *Securities Arbitration: Is Required Arbitration Fair to Investors?*, 24 NEW ENG. L. REV. 389, 488 (1989).

[71] According to a 1991 survey conducted by the *Securities Arbitration Commentator*, the most frequently asserted claims are: breach of contract, compensation, defamation, discrimination, and wrongful termination. Ryder, *supra* note 45, at 457. Employment disputes are governed by different statutes and common law rules and have their own statutes of limitations. The discussion of time limitations for these types of claims is outside the scope of this Note. It is worth noting, however, that the limitations periods and policies underlying them do not necessarily coincide with the six-year time-bar provisions. Thus, it is possible that the six-year cutoff generally applicable to all arbitrable claims may well conflict with the policy against, for example, employment discrimination.

[72] *See e.g.*, McMahan Sec. Co., v. Forum Capital Markets, [1994-1995 Transfer

veals a conflict between six-year time-bars and statutes of limitations. Although existing statutes of limitations in securities-related disputes rarely exceed six years, judicially created equitable rules often extend the time limits within which to bring suit.

The vast majority of claims allege violations of various provisions of the securities statutes, in particular, their antifraud provisions. Before 1991, courts applied different statutes of limitations to securities laws. Express rights of action were limited by a one-year statute of limitations and a three-year statute of repose.[73] In contrast, the most important and frequently litigated implied 10(b) and Rule 10b-5 actions had no specific limitations periods. Instead, courts followed the usual rule that, absent an express congressional act, they would apply similar state fraud statutes of limitations to implied actions.[74] The lack of uniformity created a considerable disparity in the limitations periods for 10(b) and 10b-5 actions in the circuits courts.[75] Finally, the Supreme Court, in its decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*,[76] looked to the "statute of origin"[77] and adopted a uniform scheme from the express right of action provisions of securities laws that allowed a claim one year from the discovery of the cause of action but no longer than three years.[78] The equitable tolling doctrine had no place in the *Lampf* scheme: "[t]he 1-year period, by its terms, begins after discovery of the facts constituting violation, making tolling unneces-

Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,402 (2d Cir. Sept. 9, 1994) (copyright claims are suitable for arbitration in a conflict between two broker-dealers).

[73] *See* 15 U.S.C. §§ 78i(e), 78r(c), 78m (1988). The exceptions are 15 U.S.C. § 78p(b), which provides for a two-year statute of repose and the insider trading provision, 15 U.S.C. § 78t-1 (Supp. II, 1990) which contains a five-year time limit. Although the insider trading limitations period looks long enough to go beyond the six-year period if tolled, this is not the case because the five-year term starts from the date of the last transaction in dispute and operates as statute of repose.

[74] Lampf, Pleva, Lipkind, Prupis & Petigrov v. Gilbertson, 501 U.S. 350, 355 (1991) ("It is the usual rule that when Congress has failed to provide for a federal cause of action, a court 'borrows' or 'absorbs' the local time limitation most analogous to the case at hand.").

[75] Richard L. Jacobson, *Shining a* Lampf *on Section 10(b) Limitations Periods*, 6 INSIGHTS 12 (1992).

[76] 501 U.S. 350 (1991).

[77] *Id.* at 359

[78] *Id.* at 359-60.

sary. . . . Because "the purpose of the 3-year limitation is clearly to serve as a cutoff, . . . tolling principles do not apply to that period."[79]

In contrast to the equitable tolling doctrine, the Court has yet to resolve the application of equitable estoppel to these claims. In *Tregenza v. Great American Communications Co.*,[80] the Seventh Circuit suggested that equitable estoppel applies to at least the one-year limitations period.[81] As to the three-year period, Professor Bloomenthal has argued that, in the most egregious situations, equitable estoppel may apply to both parts of the time-limitation scheme.[82] He noted:

> Equitable estoppel, properly understood, is not inconsistent with the fact that Congress intended the periods of limitation to be absolute. The Congress was attempting to assure directors and others that, after a period of time, no action would be brought against them for allegedly false statements made in a registration statement or otherwise in connection with the sale or purchase of a security. Congress was not saying that by their own subsequent conduct they could not, in effect, extend the period of limitation.[83]

For equitable estoppel to apply, the conduct must go beyond the fraud itself and involve an affirmative action by the defendant that justifiably causes the plaintiff to forbear from bringing his claim.[84] At least one court[85] has applied equitable estoppel to the three-year period in an action brought under section 12(2) of the Securities Act of 1933.[86] The U.S. Dis-

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[79] *Id.* at 363.

[80] 12 F.3d 717 (7th Cir. 1993).

[81] *Id.* at 721 ("there may still be a room in such a case for equitable estoppel") (citing Katz v. Amos Treat & Co., 411 F.2d 1046, 1055 (2d Cir. 1969) (Friendly, J.), and Short v. Belleville Shoe Mfg., 908 F.2d 1385, 1392 (7th Cir. 1990)).

[82] Bloomenthal, *supra* note 65, at 293. Bloomenthal's view appears to be significant in light of the fact that in its *Lampf* decision, the Supreme Court bolstered its discussion of the applicability of equitable tolling to the new time frame for a 10b-5 action by quoting Bloomenthal. *See Lampf,* 501 U.S. at 363.

[83] Bloomenthal, *supra* note 65, at 292.

[84] Bloomenthal, *supra* note 65, at 297.

[85] *In re* Home-Stake Prod. Co. Secs. Litig., 76 F.R.D. 337 (N.D. Okla. 1975), *rev'd,* Anixter v. Home-Stake Prod. Co., 939 F.2d 1420 (10th Cir. 1991). The district court decision was finally reversed sixteen years later in Anixter v. Home-Stake Prod. Co., 939 F.2d 1420 (10 Cir. 1991), *cert. granted and judgment vacated on other grounds,* Dennler v. Trippet, 503 U.S. 978 (1992). Although *Anixter* refused to apply equitable estoppel to Section 13 statutes of repose, *id.* at 1436, it admitted that "there may be circumscribed settings in which the doctrine of equitable estoppel might apply to claims governed by Section 13 . . . . *Id.*

[86] Although *Home-Stake* talked about the application of equitable tolling to the

trict Court for the Northern District of Oklahoma applied the doctrine in *In re Home-Stake Production Co. Securities Litigation*, where the fraud was extensive, continued for a decade, and constituted a fraud on the SEC, courts and investors. Another case, *Zola v. Gordon*, also recognized the applicability of equitable estoppel under appropriate circumstances, to the three-year statute of repose of section 13 of the 1933 Act.[87] The *Zola* court, however, refused to apply the estoppel because it did not find affirmative acts by the defendant that would have forbade the plaintiff from bringing a suit.[88]

Thus, in the appropriate situation, courts may apply the doctrine of equitable estoppel to extend the three-year statute of repose.[89] Clearly, whether or not courts apply the doctrine, a claim under either express or implied provisions of securities laws has a different time frame than arbitration time-bars.

Civil RICO is another frequently asserted claim in securities disputes.[90] Since RICO does not provide an express stat-

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three-year period, the Southern District of New York explained that in reality the *Home-Stake* court "used equitable estoppel against the defendants." Zola v. Gordon, 685 F. Supp. 354, 361 n.7 (S.D.N.Y. 1988).

[87] *Id.* at 361-62.

[88] *Id.* at 362.

[89] Professor Bloomenthal suggested that the following facts may require an application of equitable estoppel: The proceeds of the sale of unregistered, fractional, undivided oil and gas interests are used to drill a dry hole. Investors threaten to sue under section 12(1) of the Securities Act of 1933, but the defendant-promoter assures the investors that the property is still a good prospect, and if they don't bring a suit, another hole will be drilled on the property at no extra cost. The statute of limitations then runs and the well has never been drilled. Bloomenthal, *supra* note 65, at 292. Although the example relates to the one-year period, it may well apply to the three-year repose.

[90] *See* 18 U.S.C. §§ 1961-1964 (1988). RICO's civil enforcement provision specifically provides: "Any person injured in his business or property by reason of a violation of Section 1962 of this chapter may sue therefor in any appropriate United States district court." *Id.* § 1964(c).

The RICO limitations period may be longer than the six-year arbitration limitation. *See infra* notes 94-96 and accompanying text. This inconsistency has allowed defendants to fight their opponents by invoking the arbitration time-bars rather than by attacking the merits of the claim. For an example of a dispute over the application of six-year time-bars in the context of RICO claims, see e.g., Roney & Co. v. Kassab, 981 F.2d 894 (6th Cir. 1992) (it is for the court, not arbitrators, to decide whether an investor's RICO claim was barred by the NASD six-year rule); Edward Jones & Co. v. Sorrels, 957 F.2d 509 (7th Cir. 1992) (six-year period of NASD section 15 cannot be tolled by allegations of fraudulent concealment which were part of investors' RICO claim because section 15 is an eligibility provision and not a statute of limitations); Smith Barney Shearson v. Boone, 838 ute of limitations for actions brought under its civil enforcement provision, the courts simply borrowed limitation periods from different state laws. In 1987, the Supreme Court ended this practice in *Agency Holding Corp. v. Malley-Duff & Associates, Inc.*[91] The Court applied the four-year statute of limitations from Clayton Act civil enforcement actions[92] to civil RICO actions.[93]

The *Agency Holding* Court did not address the application of equitable doctrines. Nevertheless, case law under the Clayton Act, which lent its statute of limitations to civil RICO, indicates that fraudulent concealment would toll the limitations period.[94] As to the discovery rule, cases subsequent to *Agency Holding* have held that the four-year statute of limitations in civil RICO claims brought by defrauded investors accrues when the plaintiff discovers or should have discovered an injury, even if he has not yet discovered the pattern of racketeering.[95] In addition, the majority of circuits apply a so-called

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F. Supp. 1156 (N.D. Tex. 1993) (the timeliness of arbitration under the AmEx time bar provision is decided by arbitrators, not courts); Piccolo v. Faragalli, 1993 WL 331933 (E.D. Pa. Aug. 24, 1993) (RICO claim was dismissed since the plaintiff failed to file for arbitration within six years from the time of events giving rise to his claims).

[91] 483 U.S. 143 (1987).

[92] 15 U.S.C. § 15b (1988 & Supp. V 1993).

[93] The Court reasoned that the close resemblance between RICO and Clayton Act civil enforcement provisions was not accidental. *Agency Holding*, 483 U.S. at 151. Examining the legislative history of both statutes, the Court concluded that "[t]he use of an antitrust model for the development of remedies against organized crime was unquestionably at work when Congress later considered the bill that eventually became RICO." *Id.* at 151-52.

[94] For cases involving the tolling of statutes of limitations in antitrust actions, see New York v. Hendrickson Bros., Inc., 840 F.2d 1065 (2d Cir.) (as part of their scheme, contractors fraudulently concealed their conspiracy to rig the bids on highway construction), *cert. denied*, 488 U.S. 848 (1988); King & King Enter. v. Champlin Petroleum Co., 657 F.2d 1147 (5th Cir. 1981) (plaintiffs' claims were not barred by statute of limitations, even though they occurred four years before lawsuit instituted, because the evidence showed that defendant fraudulently concealed its price-fixing activities), *cert. denied*, 454 U.S. 1164 (1982); *In re* Coordinated Pretrial Proceedings in Petroleum Prods. Antitrust Litig., 782 F. Supp. 487 (C.D. Cal. 1991) (in horizontal price-fixing schemes, the statute of limitations would be tolled if plaintiffs showed that defendants fraudulently concealed price-fixing conspiracy that could not have been discovered had the plaintiffs exercised due diligence).

[95] McCool v. Strata Oil Co., 972 F.2d 1452, 1464-65 (7th Cir. 1992); Granite Falls Bank v. Henrikson, 924 F.2d 150, 154 (8th Cir. 1991) (a civil RICO cause of action begins to accrue as soon as the plaintiff discovers, or reasonably should

"separate accrual" rule to civil RICO claims, where a new cause of action arises for each separate injury.[96]

If a civil RICO's limitations period is subject to the discovery rule and arguably to a fraudulent concealment claim, a RICO claim would not be time-barred beyond six years. For example, victims of a "Ponzi scheme" may not have discovered the fraud for years, even while exercising the utmost diligence. In such a case, the four-year RICO statute of limitations would not have accrued until actual or constructive discovery of the fraud, and the plaintiffs normally would be allowed to proceed with the claim in court. The situation may differ, however, if such a claim is asserted in an arbitration forum. The six-year arbitration time-bars may preclude a claimant from asserting an otherwise timely claim.

Another conflicting situation occurs when an arbitration claim is predicated either on state blue sky laws or on a common law cause of action.[97] These causes of action encompass hundreds of different claims limited by time periods ranging from one to six years, and in some cases the substantive law will allow claimants to bring their grievances in a time period greater than six years. For example, under the common law of New York, the statute of limitations for an action for actual fraud is six years from the commission of the wrong or two

have discovered, "both the existence and source of his injury and that the injury is part of a pattern").

[96] *McCool*, 972 F.2d at 1465; *see also* Bankers Trust v. Rhoades, 859 F.2d 1096, 1102 (2d Cir. 1988) (under the "separate accrual" rule, the new cause of action arises when plaintiff discovers or should have discovered injury caused by each RICO violation), *cert. denied*, 490 U.S. 1007 (1989); *cf.* Bath v. Bushkin, Gaims, Gaines & Jones, 913 F.2d 817, 820 (10th Cir. 1990) (accrual occurs when a plaintiff discovers or should have discovered the existence and source of an injury and that injury was part of a pattern); Keystone Ins. Co. v. Houghton, 863 F.2d 1125, 1130-31 (3d Cir. 1988) (accrual occurs when a plaintiff knew or reasonably should have known when the last predicate act occurred).

[97] For cases predicated on a conflict between statutes of limitations for state statutory or common law claims and arbitration time-bars, see e.g., Dean Witter Reynolds v. McCoy, 995 F.2d 649 (6th Cir. 1993) (breach of fiduciary duty); Calabria v. Merrill Lynch Pierce Fenner & Smith, Inc., 855 F. Supp. 172 (N.D. Tex. 1994) (common law claims and Texas Deceptive Trade Practices Act); Dean Witter Reynolds, Inc. v. McCoy, 853 F. Supp. 1023 (E.D. Tenn. 1994) (breach of fiduciary duty); Soares Fin. Group, Inc. v. Hansten, [1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,316 (N.D. Cal. 1994) (breach of fiduciary duty); Prudential-Bache v. LaPlant, 829 F. Supp. 1239 (D. Kan. 1993) (fraud, misrepresentation, negligence and breach of contract); Merrill Lynch Pierce Fenner & Smith, Inc. v. Ohnuma, 161 Misc. 2d 923, 613 N.Y.S.2d 811 (Sup. Ct. N.Y. County 1994).

years from the discovery of the wrong, whichever is later.[98] In *IIT v. Cornfeld*, the Second Circuit, applying a New York statute of limitations, extended the time-limit up to seven years from the date of an occurrence.[99] In *IIT*, the alleged fraud on investors had been perpetrated well beyond six years but the court held that the plaintiffs could have discovered the fraud only after a considerable time, and thus "the action was brought within two years from the time in which they themselves discovered or should have discovered the fraud."[100] Thus, in New York, an action for actual fraud may be brought more than six years after the event.[101]

This brief overview of the limitations periods for different securities-related claims indicates that statutes of limitations applicable to substantive law underlying an arbitration dispute may conflict with the six-year time-bar. Further, regardless of the substantive law, a conflict may occur between six-year bars and statutes of limitations if they are extended by equitable doctrines. Shortening the time in which a claim may be brought by "contract" undermines both the legislative intent underlying the original time limitations and the judicial policy

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[98] N.Y. CIV. PRAC. L. & R. 213(8) commentary (McKinney 1990). This interpretation stems from a joint reading of §§ 203(f) and 213(8). Section 203(f) provides for a two year limitations period "where the time within which an action must be commenced is computed from the time when facts were discovered or from the time when the facts could with reasonable diligence have been discovered." Section 213(8) provides for a six-year limitations period for actions for fraud. *See also* IIT v. Cornfeld, 619 F.2d 909, 928-29 (2d Cir. 1980) ("The combined effect of CPLR 213(8) and 203(f) thus is 'two separately-timed and alternative limitations periods in the case of a delayed discovery: six years from accrual or two years from discovery whichever is longer.'").

[99] 619 F.2d at 929-30. Although *Cornfeld* was implicitly overruled by the Supreme Court's *Lampf* decision insofar as it applied the state statute to the 10b-5 action, its interpretation of CPLR sections 203 and 213 is in accord with the state courts' position.

[100] *Id.* at 929. Note, however, that this rule applies only to actual fraud, i.e., where a defendant knowingly and intentionally deceived a plaintiff. N.Y. CIV. PRAC. L. & R. 213(8) commentary. In a case of constructive fraud, the discovery rule does not apply and the limitations period would be six years from the date of the commission of the wrong. *See* McCabe v. Gelfand, 58 Misc. 2d 497, 295 N.Y.S.2d 583 (Sup. Ct. Kings County 1968). Yet, many securities claims alleging common law fraud would involve material misrepresentations made with the intent to deceive—a cause of action that constitutes actual rather than constructive fraud.

[101] In this particular instance, the likelihood of mistaken use of the statute of limitations and arbitration time-bars is very high as both provide for the same time period—six years—but operate in an entirely different manner.

of equitably extending those time limitations.

Even if the substantive statute of limitations is shorter than the six-year bar, the conflict may still exist. For example, imagine an investor who has lost all of his savings because of a broker's fraud but the *Lampf* time frame bars the claim.[102] A sympathetic arbitration panel may misinterpret the six-year time bar as a special "arbitration-related" extension of the applicable statute of limitations.[103] Furthermore, if a dispute brought before an arbitration panel contains only one cause of action—for example, a Rule 10b-5 claim with the three-year statute of repose—it is likely that such a misinterpretation would be detected and vacated by a court on the ground of manifest disregard of the law.[104] Unfortunately, most claims encompass more than one cause of action, and arbitrators often do not state the reasons for their awards.[105] In such a case, a reviewing court would not second-guess the arbitrators' findings and most likely would uphold the award on the ground that there might be a reasonable basis for an arbitration award.[106]

The Fourth Circuit faced this type of scenario in *Miller v. Prudential-Bache Securities*.[107] In *Miller*, after the NASD panel dismissed the plaintiff's securities claim as untimely, the plaintiff argued that the arbitrators had misapplied New York's borrowing statute of limitations.[108] Moreover, Miller

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[102] *See supra* notes 76-79 and accompanying text.

[103] Although the time-bar rules provide that they "shall not extend applicable statutes of limitations," *see, e.g.*, NASD C.A.P. § 15, N.A.S.D. MANUAL (CCH) ¶ 3715, it nonetheless is possible that arbitrators disregard this unequivocal message. *See infra* notes 107-10 and accompanying text.

[104] *See supra* note 47 and accompanying text.

[105] *See* Antwine v. Prudential Bache Sec., Inc., 899 F.2d 410 (5th Cir. 1990) (Securities Arbitration Rule 42, requiring an award to include a "statement" regarding disposition of statutory claims, does not require an arbitration panel to provide a statement of reasons underlying the award); *see also* David A. Lipton, *Generating Precedent in Securities Industry Arbitration*, 19 SEC. REG. L.J. 26, 28 n.7 (1991) ("Some of the concerns that exist relating to the nature of arbitration include . . . the absence of written reasoned arbitrator opinions and the impact of such limitation upon the ability of the parties to bring an appeal . . . .").

[106] Barbier v. Shearson Lehman Hutton, Inc., 948 F.2d 117, 121 (2d Cir. 1991) ("courts generally 'will not look beyond the lump sum award in an attempt to analyze the reasoning processes of arbitrators'"); *see also supra* note 50 and accompanying text.

[107] 884 F.2d 128 (4th Cir. 1989), *cert. denied*, 497 U.S. 1004 (1990).

[108] *Id.* at 129-30.

argued that the six-year time-bar from section 15 of the NASD Code of Arbitration Procedures should be the only limitations period governing arbitration procedures.[109] Instead of discussing the nature of statutes of limitations and arbitration time-bars, the court affirmed the award by simply stating:

> Even if Miller's argument is that the panel either misinterpreted or misapplied the applicable law—in this case either the borrowing statute or Rule 15—there still exists no basis for overturning the panel's decision. Once again, federal courts have consistently held that they will not "set aside an arbitrator's award for mere errors of law."[110]

In *Miller*, the arbitration panel did not accept the plaintiff's argument that the six-year time-bar is the only limitations period for the arbitration proceedings. There is no guarantee, however, that another arbitration panel would reject a similar argument made by another plaintiff under similar circumstances. And, if the subsequent panel were to accept such an argument, a court that follows *Miller*'s approach would uphold that panel's finding despite its reaching a diametric result.

Thus, the Code of Arbitration Procedures of various SROs have, in effect, created a separate limitation provision that merely by virtue of submission applies to all claims submitted to arbitration. By adopting these provisions, the SROs have attempted to limit access to their arbitration forums.[111] Although the arbitration forums are secure in their rights to create such limitations,[112] the conflict between statutes of limitations and arbitration's six-year time-bars poses a serious question that may be resolved only by compromise that maintains the conflicting policies behind both time limitations.

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[109] *Id.* at 130.

[110] *Id.*

[111] Second Proposal, *supra* note 8, at 39377.

[112] Even though the practice of limiting access to an arbitration forum may be reasonable, it is not vital for the forum. For example, the AAA, an alternative arena for securities-related battles does not have any time limits on the submission of a claim to arbitration. Cane & Weinstein, *supra* note 1, at 407 ("The 'Securities Arbitration Rules promulgated by the AAA do not set forth a time limitation which would bring into question the subject matter jurisdiction of an AAA arbitration panel to hear an arbitration case properly before it.").

II. INCONSISTENT TREATMENT OF THE TIME-BAR PROVISIONS

Courts interpreting time-bar provisions are split on two issues.[113] First, whether the timeliness of a claim should be determined by courts or by arbitrators. Second, courts disagree about whether the time-bars are statutes of limitations, subject to all equitable doctrines, or statutes of repose, intended to cut off liability regardless of equity.

A. *Quod Licet Ioui . . .*[114]

The majority of circuits—the Second, Fourth, Eighth, Ninth, Eleventh and District of Columbia Circuits—have concluded that under the Federal Arbitration Act arbitrators, rather than courts, should decide statute of limitations issues.[115] Most of these circuits simply base their reasoning on

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[113] The split among circuits has allowed litigants to shop for the most favorable forum. In Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Lauer, 49 F.3d 323 (7th Cir. 1995), Merrill Lynch attempted to compel arbitration in the U.S. District Court for the Northern District of Illinois, although the investors had requested, and the NASD had selected, a Florida arbitration site. *Id.* at 325. The court noted with respect to Merrill Lynch's "unreasonable" choice of district court: "The 'whys' of all this forum shopping are self-evident: If the Northern District of Illinois decides arbitrability, the [investors] lose a chunk of their claims; if the decision rests with the Northern District of Florida, . . . potentially stale claims may go to the arbitrator for resolution." *Id.* at 326. The *Lauer* court refused to compel arbitration in Illinois because Illinois lacked a "geographical link" with the site of the arbitration. *Id.* at 327. It seems that *Lauer* provided a good lesson for brokers who now will be more careful in selecting "appropriate" arbitration sites in their arbitration agreements with customers.

[114] *Quod licet Ioui non licet Bovi* ("What is permitted to Jupiter is not permitted to an ox."). This Latin proverb is commonly used to emphasize the limits of one's powers; in this case, the power of the arbitrators in comparison with the power of courts.

[115] Wylie v. Investment Research & Mgmt., Inc., 629 So. 2d 898, 900 (Fla. Dist. Ct. App. 1993). *See* Miller v. Prudential Bache Sec., Inc., 884 F.2d 128 (4th Cir. 1989) *cert. denied*, 497 U.S. 1004 (1990); Automotive, Petroleum & Allied Indus. Employees Union, Local No. 618 v. Town & Country Ford, Inc., 709 F.2d 509 (8th Cir. 1983) (arbitrator, not district court, had to decide whether union's alleged failure to submit complaint to employer within five working days from notice of discharge, as required by agreement, barred arbitration); Belke v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 693 F.2d 1023 (11th Cir. 1982) (defendant had not waived its right to compel arbitration where it brought the motion after the district court had determined that the federal securities claims were time barred), *partially abrogated on the other grounds, sub. nom.*, Dean Witter Reynolds, Inc. v.

a Second Circuit case, *Conticommodity Services, Inc. v. Philipp & Lion.*[116] In *Conticommodity*, a domestic commodities broker applied in state court for an order to stay arbitration of a dispute arising out of customer's account. The customer, Philipp & Lion, a British company, removed the action to federal court and cross-moved for an order compelling arbitration. At the center of the controversy was the arbitration clause contained in the customer agreement between the parties. The clause provided that any controversy between the parties should be settled by arbitration under the rules of the American Arbitration Association or one of the Exchanges where Conticommodity was a member.[117] Most importantly, the arbitration clause provided that "[a]rbitration must be commenced within one year after the cause of action has accrued . . . ."[118]

The transactions that gave rise to the dispute between Conticommodity and Philipp & Lion occurred in 1974, but the claim for arbitration was not filed until 1978.[119] The district court granted a motion to stay but the Second Circuit reversed.[120] The Circuit court admonished the trial court to not usurp "procedural" questions from arbitrators.[121] According to the Second Circuit, "judicial hostility," which conflicts with the "policy considerations embodied in the Federal Arbitration Act,"[122] often compels courts to overreach in deciding procedural issues. Although the court correctly described the federal policy favoring arbitration, the statement itself was predicated on the view that timeliness was a procedural question.[123]

Byrd, 470 U.S. 213; *see also* O'Neel v. NASD, 667 F.2d 804 (9th Cir. 1982); Conticommodity Servs. Inc. v. Philipp & Lion, 613 F.2d 1222 (2d Cir. 1980); Hanes Corp. v. Millard, 531 F.2d 585 (D.C. Cir. 1976) (where the parties agreed to resolve all contractual disputes by arbitration, trial judge did not have jurisdiction to render declaratory judgment that any claim arising from the assignment contract was barred by statute of limitations). It is significant that most of the precedents cited by the *Wylie* court had nothing to do with the issue of arbitration time-bars. *Wylie*, however, is not the only case decided by following inapplicable authorities. *See infra* notes 127 & 146-47 and accompanying text.

[116] 613 F.2d 1222 (2d Cir. 1980).

[117] *Id.* at 1223 n.1.

[118] *Id.*

[119] *Id.* at 1224.

[120] *Id.* at 1223.

[121] *Conticommodity*, 613 F.2d at 1224.

[122] *Id.*

[123] Unfortunately, *Conticommodity* blurred the distinction between the procedural

To support its finding that arbitration time-bars are procedural defenses, the *Conticommodity* court reviewed section 4 of the Arbitration Act. This section directs judges, "upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, . . . [to] make an order directing the parties to proceed to arbitration."[124] The *Conticommodity* court properly concluded that "unless the 'making' of the agreement to arbitrate . . . is in dispute, the court must compel arbitration."[125] The court's next statement, however, conflicts with the preceding conclusion. Strangely, the court found that "[i]n the present case, the existence of an arbitration agreement . . . [was] undisputed."[126] Contrary to the court's assertion that the agreement to arbitrate was undisputed, however, the parties had agreed to not arbitrate disputes older than one year. The *Conticommodity* court overlooked the fact that the one-year provision was a part of the arbitration agreement and thus was related to the "making of the agreement." Therefore, that issue should have been decided by the court according to section 4 of the Arbitration Act.[127]

The validity of *Conticommodity* appears doubtful in light of subsequent Supreme Court cases, and particularly, *AT&T Technologies, Inc. v. Communications Workers of America,*[128]

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and substantive aspects of time-bars. For a discussion of the distinction between procedural and substantive aspects of time-bars, see *infra* notes 166-86 and accompanying text.

[124] *Conticommodity*, 613 F.2d at 1225 (quoting 9 U.S.C. § 4).

[125] *Id.*

[126] *Id.*

[127] To draw additional support for its holding, the *Conticommodity* court mistakenly relied upon a district court case, *In re* Reconstruction Finance Application, 106 F. Supp. 358, 361-62 (S.D.N.Y. 1952), that had addressed the statute of limitations defense in arbitration proceedings. *Conticommodity*, 613 F.2d at 1225. *Reconstruction Finance* is distinguishable, however, because the regular statutes of limitations are, by definition, affirmative defenses, whereas the arbitration time-bar is more like a jurisdictional statement that goes to the heart of the question of whether or not parties have agreed to arbitrate stale claims. Indeed, the time-bar provisions of various SROs contain the word "eligibility" and are viewed by the SROs themselves as jurisdictional limitations. *See infra* note 254 and accompanying text. Although the one-year time limit at issue in *Conticommodity* did not contain the word "eligibility" or any other words of a like import, it was, nevertheless, part of an agreement to arbitrate. Since an arbitration agreement is the source of arbitrators' jurisdiction over a claim, every part of this agreement is part of a jurisdictional statement.

[128] 475 U.S. 643 (1986) (courts, not arbitrators, decide, as a preliminary matter, whether the parties to collective bargaining agreement intended to arbitrate claims

where AT&T and its worker's union entered into a collective-bargaining agreement covering telephone equipment installation workers.[129] Article 8 of the agreement provided for arbitration of differences arising over interpretation of the agreement, but Article 9 clarified that AT&T's decisions regarding the hiring, placement and termination of employees were not subject to the arbitration clause.[130] After AT&T laid off seventy-nine installers from its Chicago location, the union filed a grievance and sought to compel arbitration by filing suit in federal district court. The district court held that it was for the arbitrator, not the court, to decide whether the claim had merit, and ordered AT&T to arbitrate.[131] On appeal, the Seventh Circuit affirmed.[132]

The Supreme Court reversed the lower courts' decisions and stated that "the question of arbitrability . . . is undeniably an issue for judicial determination."[133] In light of the *AT&T* holding, a court that follows *Conticommodity* in finding arbitration time-bars to be procedural defenses must first decide whether the time-bars affect the arbitrability of a claim. In other words, the threshold question is whether the parties to the arbitration agreement intended for claims older than six years to be resolved by arbitration.

Unfortunately, many courts neglect this part of analysis, and simply follow the *Conticommodity* reasoning. For example, in *Shearson Lehman Hutton, Inc. v. Wagoner*,[134] the Second Circuit held that "any limitations defense—whether stemming from the arbitration agreement, arbitration association rule, or state statute—is an issue to be addressed by the arbitrators."[135] A district court in New York followed this approach in *Merrill Lynch Pierce Fenner & Smith, Inc. v. Noonan*,[136]

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arising out of layoffs by the employer).

[129] *Id.* at 644.

[130] *Id.* at 645.

[131] *Id.* at 645-47.

[132] *Id.* at 647; *see* Communications Workers of Am. v. Western Elec. Co., 751 F.2d 203 (7th Cir. 1984), *judgment vacated by* AT&T Technologies, Inc. v. Communications Worders of Am., 475 U.S. 643 (1986).

[133] *AT&T*, 475 U.S. at 649.

[134] 944 F.2d 114 (2d Cir. 1991).

[135] *Id.* at 121 (citing Conticommodity Servs., Inc. v. Philipp & Lion, 613 F.2d 1222, 1224-25 (2d Cir. 1980)).

[136] [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,973, at 94,174

reasoning that:

> Since the NASD Code reserves the right to interpret all provisions under its Code [referring to section 35], including Section 15, and since the *Second Circuit has mandated that any limitations defense is in the province of the arbitrators*, this Court compels arbitration before the NASD in New York City and defers to the arbitrator's judgment on the issue of timeliness of respondents' claims.[137]

The *Noonan* court did not attempt to explore the peculiar nature of the arbitration time-bars, instead preferring to rely on the Second Circuit's "mandate."

The Ninth Circuit in *O'Neel v. NASD*,[138] analyzed the timeliness of an arbitration claim under the NASD CAP section 15 in a similar fashion. Relying on *Conticommodity*, the court wrote:

> We adopt the rule enunciated in [*Conticommodity*], which holds, in effect, that the validity of time-barred defenses to enforcement of arbitration agreements should generally be determined by the arbitrator rather than by the court. *We specifically renounce the contention that the defense of the statute of limitations goes to jurisdiction of the tribunal, whether it be judicial or arbitration.*[139]

O'Neel failed to recognize the difference between a statute of limitations defense and the time-bar of an arbitration agreement, which provides the sole source of subject matter jurisdiction for arbitration panels. Although *O'Neel*, like *Conticommodity*, had been decided before *AT&T*, lower courts in the Ninth Circuit nevertheless adopted *O'Neel's* reasoning without questioning it in light of the *AT&T* decision.

In contrast, the Northern District of California in *Soares Financial Group, Inc. v. Hansten*,[140] at least recognized the relevance of *AT&T*, although it too failed to analyze the time-bar as an eligibility requirement. *Soares* held that "[b]ecause the interpretation of § 15 lies within the exclusive jurisdiction of the arbitration panel, this court must defer to the NASD

(S.D.N.Y. July 31, 1992).

[137] *Id.* at 94,180 (emphasis added). The validity of the argument that section 35 of the NASD Code mandates referral of the issues of timeliness under the time-bar rules is discussed, *infra* notes 149-53 and accompanying text.

[138] 667 F.2d 804 (9th Cir. 1982).

[139] *Id.* at 807 (emphasis supplied) (citations omitted).

[140] [1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,316, at 90,208 (N.D. Cal. June 16, 1994) (citing O'Neel v. NASD, 667 F.2d 804, 807 (9th Cir. 1982)).

arbitration panel's interpretation." To support its deference to the NASD arbitration panel's determination of the time-bars, the court reasoned that under *AT&T*, a court was not to rule on the potential merits of an underlying claim.[141] The *Soares* court, however, failed to recognize that the arbitration time-bars related more to the arbitrability of a claim rather than to its merits.[142]

Conticommodity had far-reaching effects. Even though some courts did not follow *Conticommodity* directly, they reasoned in a similar fashion and relied on other precedents that had considered statute of limitations defenses in the context of arbitration. The federal district court in Minnesota used such reasoning in *FSC Securities Corp. v. Freel*,[143] where a broker asserted that section 15 of the NASD Code of Arbitration Procedures time-barred its clients' claims concerning certain investments in a limited partnership. The court acknowledged that a Seventh Circuit case, *Edward D. Jones & Co. v. Sorrells*,[144] which held the arbitration time-bars to be a question for courts rather than arbitrators, was "directly on point and, if followed, would require vacation of the arbitration

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[141] *Soares*, [1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,316, at 90,207 (citing AT&T Technologies, Inc. v. Communications Workers of Am., 475 U.S. 643, 650 (1986)).

[142] Similarly, in Wylie v. Investment Management & Research, Inc., 629 So. 2d 898, 900 (Fla. Dist. Ct. App. 1993), a Florida state court thoroughly analyzed federal law to decide whether a court, under the Federal Arbitration Act, can stay arbitration of a claim that became stale under the NASD C.A.P. Section 15. *Id.* The *Wylie* court too failed to distinguish arbitration time-bars from the rest of statute of limitation defenses applicable to a particular cause of action and concluded that the NASD six-year time-bar was a procedural defense that had to be heard by an arbitration panel. *Id.* at 901. To support this conclusion, the court extensively quoted the language from *ContiCommodity*, reasoning that a court may decide only two issues: first, whether there is an agreement to arbitrate, and second, whether the party to such an agreement has refused to arbitrate. *Id.* at 900. All remaining issues, including limitations, are for arbitrators to decide. *Id.* *Wylie* also relied on Miller v. Prudential-Bache Sec., 884 F.2d 128 (4th Cir. 1989), which dealt with the state statute of limitations defense and not with the arbitration time-bars. Some of the federal courts considering the issue of arbitration time-bars have also relied on this distinguishable authority. *See infra* notes 146-147 and accompanying text.

[143] 811 F. Supp. 439 (D. Minn. 1993).

[144] 957 F.2d 509 (7th Cir. 1992). This case posits that time-bars are substantive limitations subject to judicial disposition. For a discussion of *Sorrels*, see *infra* notes 158-65 and the accompanying text.

award."[145] The court instead chose to follow the Fourth Circuit's decision in *Miller v. Prudential-Bache Securities*,[146] where the claim had been timely filed for arbitration but was dismissed by arbitrators as untimely under the state statute of limitations applicable to the claim. The *Freel* court missed this distinction and stated that it agreed with the *Miller* court that "section 15 is a procedural provision to be interpreted by the arbitrators rather than a substantive limitation on arbitrability to be interpreted by the court."[147]

Subsequently, the holding of the district court in *Freel* was affirmed by the Eighth Circuit, although without reference to *Miller*.[148] The Eighth Circuit instead relied on section 35 of the NASD Code, which empowers arbitrators to interpret all provisions of the Code.[149] According to the Eighth Circuit, the parties expressly had agreed to have their dispute governed by the entire NASD Code of Arbitration Procedure, including section 35.[150] The court inferred from this section that "the parties' adoption of this provision is a 'clear and unmistakable' expression of their intent to leave the question of arbitrability to the arbitrators."[151] The court, however, failed to recognize that section 15 precedes section 35, and as such its position in the Code indicates that a claim initially must be arbitrable. Arbitrators thus may determine the applicability of the provisions of the Code only for arbitrable claims.[152] If a claim is ineligible for submission—i.e., the parties to an arbitration agreement have not agreed to arbitrate this kind of

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[145] *Freel*, 811 F. Supp. at 442.

[146] 884 F.2d 128 (4th Cir. 1989), *cert. denied*, 497 U.S. 1004 (1990).

[147] *Freel*, 811 F. Supp. at 443. The *Miller* court never said that section 15 is a procedural defense. Moreover, the *Miller* court never analyzed section 15, and indeed mentioned it in a totally different context. *See supra* notes 107-09 and the accompanying text.

[148] FSC Sec. Corp. v. Freel, 14 F.3d 1310 (8th Cir. 1994).

[149] *Id.* at 1312. Section 35 provides in pertinent part: "The arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code . . . ." NASD MANUAL (CCH) ¶ 3735.

[150] *FSC*, 14 F.3d at 1312-13.

[151] *Id.*

[152] Even the NASD itself, in proposing amendments to section 15, did not advance a section 35 argument to support its contention that timeliness under section 15 should be decided within the forum. *See generally* SEC Exchange Act Release No. 33,108, 1993 WL 441275 (Oct. 26, 1993); SEC Exchange Act Release No. 34,442, 59 Fed. Reg. 39,373 (Aug. 2, 1994).

claim—then there is nothing for arbitrators to interpret.[153]

Although the majority of the circuits consider time-bars to be procedural defenses, the Third, Sixth and Seventh Circuits have presented decisions that are more persuasive and accord better with Supreme Court precedent. For example, in *PaineWebber Inc. v. Farnam*,[154] the Seventh Circuit did not require the brokerage firm to enter arbitration with customers whose claims were more than six years old.[155] *Farnam* involved unsuitable investments and material misrepresentations allegedly made by a PaineWebber employee who had left its employ more than six years before the claim was filed with an NASD arbitration panel.[156] To support its conclusion that arbitration was not required, the court cited a NASD letter indicating that section 15 was an eligibility requirement rather than a statute of limitations.[157] Although the NASD position cannot be regarded as an ultimate authority on the issue, it helped the *Farnam* court to distinguish the time-bars from statutes of limitations.

Another significant Seventh Circuit case, *Edward D. Jones & Co. v. Sorrells*,[158] followed the reasoning of *Farnam*. In *Sorrells*, investors claimed that their stockbroker had made material misrepresentations, failed to supervise its employees, and violated federal securities laws.[159] A "Statement of Claim" was filed with an NASD arbitration panel in 1988, seven years after the transactions in question had occurred.[160] The *Sorrells* court stated: "We decline to reconsider our explicit holding in *PaineWebber* [*v. Farnam*] that NASD Section 15 operates as an eligibility requirement which bars from arbitration claims submitted more than six years after the event which gave rise to them."[161] The investors attempt-

[153] *See infra* notes 209-11 and accompanying text.

[154] 870 F.2d 1286 (7th Cir. 1989).

[155] *Id.* at 1292.

[156] *Id.* at 1288.

[157] *Id.* (the letter cited was from John R. Wylie, an NASD Staff Attorney, to Walter C. Greenough dated Aug. 5, 1988).

[158] 957 F.2d 509 (7th Cir. 1992).

[159] *Id.* at 510.

[160] *Id.* Since the case had been filed before *Lampf* was decided, the securities claim was governed by the state statute of limitations and subject to equitable tolling.

[161] *Id.* at 512.

ed to distinguish *Farnam*, pointing out that in 1984 section 15 had been amended to delete the words "[shall not be eligible] in any instance."[162] They argued the deletion demonstrated that the 1984 amendments' purpose was to remove the absolute time-bar from the NASD Code.[163] The court disagreed, noting that the 1984 Amendments also had added the words "nor shall [this section] apply to any case which is directed to arbitration by a court of competent jurisdiction."[164] Examining the amendments as a whole, the court concluded 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."[165] Thus, *Sorrells* stands for two very important propositions: first, the arbitration time-bars are substantive and not procedural limits on a claim; and second, the court is the only proper forum for the determination of a claim's timeliness under the time-bar provisions.

Unfortunately, the *Farnam* and *Sorrells* courts did not extend their inquiries beyond the NASD interpretation of the time-bars. In contrast, the Third Circuit in *PaineWebber Inc. v. Hartmann*[166] and *PaineWebber Inc. v. Hofmann*[167] presented a far broader analysis. In *Hartmann*, the Third Circuit reviewed a district court's interpretation of the NYSE Department of Arbitration's, Rule 603, which the parties had incorporated by reference into their arbitration agreement.[168] The case involved PaineWebber's allegedly fraudulent mishandling of the Hartmanns' account.[169] Although the opinion did not

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[162] *Id.* at 513.

[163] *Id.* at 513.

[164] *Sorrells*, 957 F.2d at 513.

[165] *Id.*

[166] 921 F.2d 507 (3d Cir. 1990) (six-year eligibility requirement under NYSE C.A.P. § 603).

[167] 984 F.2d 1372 (3d Cir. 1993) (NASD C.A.P. § 15).

[168] *Hartmann*, 921 F.2d at 509. The language of Rule 603 is identical to that of the NASD C.A.P. section 15. Both provide:

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

NYSE GUIDE (CCH) ¶ 2603 (1992).

[169] *Hartmann*, 921 F.2d at 509.

state legal theories advanced by the plaintiffs, it would be safe to assume that the Hartmanns alleged a Rule 10b-5 violation. At the time of this claim, in 1990 (before the *Lampf* decision), Rule 10b-5 claims were governed by borrowed statutes of limitations, so the application of a six-year arbitration time-bar was crucial for the case.[170] The district court interpreted Rule 603 to be a substantive bar on the arbitrability of claims.[171] In upholding the district court's interpretation, the Third Circuit specifically distinguished the substantive language of Rule 603 from that of rules considered procedural in nature.[172] According to the court,

> the plain language of Rule 603 states that after six years from the events giving rise to a dispute have elapsed, the dispute "shall [not] be *eligible* for *submission* to arbitration." . . . "Eligible" is defined as "fitted or qualified to be chosen or used" or "worthy to be chosen or selected." . . . "Submission" is defined as the act of "commit[ing something] for consideration, study, or decision."[173]

The court then conducted an interesting verbal experiment. It incorporated the dictionary definitions into the text of the rule and concluded that "a dispute 'shall [not] be worthy to be chosen or selected for [the] consideration, study, or decision [of] arbitration.'"[174] This perfect demonstration of the jurisdictional nature of the time-bars was the best argument the *Hartmann* court could advance.

Having formulated Rule 603 as a substantive rather than a procedural provision, the *Hartmann* court emphasized that arbitration should be compelled unless it can be said with "positive assurance" that the agreement to arbitrate does not cover the dispute.[175] To this end, "a compelling case for nonarbitrability should not be trumped by a flicker of interpretive doubt."[176] If the court determines that the matter at is-

[170] Apparently, PaineWebber was afraid that the applicable statute of limitations could have been tolled and, as it might have been interpreted by arbitrators, would not bar the Hartmanns' claims. Therefore, it invoked NYSE Rule 603 in a more predictable judicial forum. *Id.*

[171] *Id.* at 509-10.

[172] *Id.* at 513-14.

[173] *Id.* at 513 (quoting WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 736 & 2277 (1966)).

[174] *Hartmann*, 921 F.2d at 513.

[175] *Id.* at 512.

[176] *Id.* at 513.

sue clearly falls outside of the substantive scope of the agreement, it must enjoin arbitration.[177]

PaineWebber Inc. v. Hofmann[178] further developed the *Hartmann* court's argument. In 1977, Mr. Hofmann opened an investment account with PaineWebber's Philadelphia brokers, and invested in municipal bonds and conservative-to-moderate-risk stocks.[179] In 1980, Hofmann's account was assigned a PaineWebber broker who invested most of Hofmann's assets in stocks, which subsequently lost almost all of their value in the October, 1987 stock market crash.[180] Hofmann filed a claim with the NASD in October 1991, which alleged that PaineWebber and its broker had engaged in a fraudulent scheme to support the price of the stock they sold to Hofmann for their own benefit, and in furtherance of this scheme, the broker executed unauthorized trades and made unsuitable recommendations.[181] Because the majority of purchases had occurred before October 1985, PaineWebber asserted that section 15 of the NASD Code barred Hofmann's claims.[182] Thus, the *Hofmann* court was asked to decide whether the court or arbitrators should determine the timeliness of the submission of Hofmann's claims to arbitration.

Analyzing the issue, the court noted that fundamentally, "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."[183] The *Hofmann* court acknowledged the Federal Arbitration Act's strong presumption in favor of coverage by an arbitration agreement.[184] The court also agreed that "[l]anguage less distinct than 'eligible for submission to arbitration' might well be insufficient to overcome the strong jurisprudential pull towards the arbitration."[185] This

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177 *Id.* at 511.

178 984 F.2d 1372 (3d Cir. 1993).

179 *Id.* at 1374.

180 *Id.*

181 *Id.* at 1375. Although the court did not say which legal theory Hofmann asserted, it appears from the description of the facts that he brought claims for violation of securities laws, civil RICO and for common law fraud.

182 *Id.*

183 *Id.* at 1376 (quoting AT&T Technologies, Inc. v. Communications Workers of Am., 475 U.S. 643, 648 (1986)).

184 *Hofmann*, 984 F.2d at 1377 (quoting *AT&T*, 475 U.S. at 650).

185 *Id.* at 1379 (quoting *Hartmann*, 921 F.2d at 514).

"pull" notwithstanding, *Hofmann* held that this presumption toward arbitration had been overcome since "§ 15 can reasonably be read in only one way—as a substantive limit on the claims that the parties have contracted to submit to arbitration."[186]

The *Hartmann-Hofmann* logic was followed by the Sixth Circuit in *Roney & Co. v. Kassab*[187] and *Dean Witter Reynolds v. McCoy*.[188] Heavily relying on *Hartmann*, *Roney* held that according to NYSE Rule 603, the court first must examine the contract provisions concerning arbitration to determine the particular grievances that the parties intended to subject to arbitration.[189] The following year in *McCoy*, the court reached the same conclusion with respect to NASD section 15.[190]

In addition to federal courts, the "substantive" position has been adopted by New York state courts. Though opponents of this position have asserted the Second Circuit's *Conticommodity* ruling, New York courts have rejected this argument. Instead, New York courts cite to *Volt Information Sciences, Inc. v. Board of Trustees of the Leland Stanford Junior University*,[191] a Supreme Court case that held that the Federal Arbitration Act did not preempt a choice of state law to govern the arbitration.[192] Thus, the New York courts pre-

[186] *Id.*

[187] 981 F.2d 894 (6th Cir. 1992).

[188] 995 F.2d 649 (6th Cir. 1993).

[189] *Roney*, 981 F.2d at 899.

[190] *McCoy*, 995 F.2d at 651. Although "substantive" courts posit that the court is the appropriate forum for determining the timeliness of a submission of claims to arbitration, their reasoning is not uniform. For instance, the district court in Prudential Securities, Inc. v. LaPlant, 829 F. Supp. 1239 (D. Kan. 1993) following *Hofmann* and *Roney*, took the approach that section 15 of the NASD Code acts as a substantive bar akin to a statute of repose. *Id.* at 1243. Yet the court diverged from other "substantive" circuits and stated that section 15 does not give a court the right to determine that an issue should go to arbitration when it is more than six years old. *Id.* at 1244. Then the court turned back once again and, having found the eligibility requirement to be a substantive bar to arbitration that thus cannot be tolled, did not send to arbitration claims that were clearly outside six-year time limits. *Id.* This decision supports the inference that the District of Kansas would not compel the arbitration of claims found to be older than six years. Nevertheless, despite an apparent difference between the *LaPlant* analysis and the *Hofmann* approach, the *LaPlant* court can be regarded as one that follows other "substantive" courts because *LaPlant*, like the other "substantive" courts deems the issue of the arbitration time-bars to be in the province of the judiciary, not arbitrators.

[191] 489 U.S. 468 (1989).

[192] *See In re* Smith Barney, Harris, Upham & Co. v. Luckie, 85 N.Y.2d 193,

ferred the "substantive" interpretation of the time-bars and felt that the timeliness of a claimant's demand for arbitration should be left to the courts' discretion.[193] In fact, New York courts went even further, considering all statute of limitations issues to be subject to a preliminary judicial determination.[194]

These decisions, although not made under the Federal Arbitration Act, are important for three reasons. First, the Federal Arbitration Act was modeled after the New York Arbitration Act.[195] Second, New York always has held a significant place in the securities industry. Finally, New York courts in these cases interpret the time-bar provisions of the SROs' arbitration rules, just as their federal colleagues do.

B. *To Toll or Not to Toll?*

Although the "substantive" circuits may offer a more convincing analysis of the issue than the "procedural" majority,[196] their view falters in the application of equitable rules.[197] Because "procedural" circuits do not distinguish between time-bars and statutes of limitations, equitable doctrines are considered equally applicable to each. The treatment of equitable doctrines, however, is not so easy for courts that consider time-bars to be a species of statutes of repose. A statute of repose acts as a cutoff to assure a definite end to liability.[198] It therefore is difficult to reconcile the flexibility of eq-

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623 N.Y.S.2d 800, 647 N.E.2d 1308 (N.Y. 1995); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. DeChaine, 194 A.D.2d 472, 600 N.Y.S.2d 459 (1st Dep't 1993).

[193] *DeChaine*, 194 A.D.2d at 473, 600 N.Y.S.2d at 460; *see also In re* Prudential Bache Sec. v. Archard, 179 A.D.2d 652, 579 N.Y.S.2d 890 (1st Dep't 1992); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ohnuma, 161 Misc. 2d 423, 613 N.Y.S.2d 811 (Sup. Ct. N.Y. County 1994).

[194] *Luckie*, 85 N.Y.2d at 195, 623 N.Y.S.2d at 802, 647 N.E.2d at 1310 (under New York statutory and case law a court may address, on a motion to compel or stay arbitration, the threshold question of whether the claim sought to be arbitrated would be time-barred if it were asserted in state court); *see also* N.Y. CIV. PRAC. L. & R. 7502(b) & 7503 (McKinney 1990).

[195] *See* S. REP. NO. 536, *supra* note 18, at 3 ("The [Federal Arbitration Act] follows the lines of the New York arbitration law enacted in 1920, amended in 1921, and sustained by the decision of the Supreme Court of the United States in the matter of *Red Cross Line v. Atlantic Fruit Co.*").

[196] *See supra* notes 154-94 and accompanying text.

[197] Since the "procedural" courts deem time-bars to be a province of arbitrators, they do not have to reach the question of equitable tolling.

[198] *See supra* note 67 and accompanying text.

uity with the rigidity of statutes of repose. Once the time prescribed by the statute of repose has expired, equity doctrines cannot let a claim pass this boundary.

This consequence is the likely explanation for the Seventh Circuit's view that section 15 of the NASD Code of Arbitration Procedure is not a statute of limitations and may not be tolled by allegations of fraudulent concealment.[199] Similarly, the Third Circuit found the tolling doctrine inapplicable in *PaineWebber v. Hofmann*, so that the district court would have to enjoin arbitration if "the claim is clearly no more than a tolling or discovery argument."[200] Alternatively, the court found, arbitrators should decide what constitutes an "occurrence or event."[201]

The district courts in the Sixth Circuit are in disagreement over the issue of interaction of equitable doctrines and six-year eligibility rules. According to the district court in *Dean Witter Reynolds v. McCoy*, the date of an "occurrence or event" is the date of investment and does not depend on the date when the aggrieved investor first discovered the loss.[202] *McCoy*, however, did not settle the issue. Two years before the district court on remand decided *McCoy*, the Sixth Circuit in *Roney & Co. v. Kassab*[203] held that plaintiffs challenging the untimeliness of their claim under the NYSE eligibility rule had failed to state a fraudulent concealment claim sufficiently because they had not shown the required affirmative act.[204] Based on this holding, the Sixth Circuit, in remanding *McCoy*, suggested that an exception to the six-year eligibility requirement may exist where the wrongful conduct has been fraudulently concealed.[205] The district court, on remand, found fraudulent

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[199] Edward D. Jones & Co. v. Sorrells, 957 F.2d 509, 512-13 (7th Cir. 1992); *accord* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Jana, 835 F. Supp. 406, 411 (N.D. Ill. 1993) (under Section 15 of the NASD Code, the arbitration panel has no jurisdiction over any claim not submitted to arbitration within six years of the "event or occurrence" leading to the dispute; an "event or occurrence" is the date of investment).

[200] 984 F.2d 1372, at 1382 (3d Cir. 1993).

[201] *Id.* at 1382-83. The position stated in *Hofmann* is discussed *infra* notes 225-29 and accompanying text.

[202] Dean Witter Reynolds v. McCoy, 853 F. Supp. 1023, 1030-31 (E.D. Tenn. 1994).

[203] 981 F.2d 894 (6th Cir. 1992).

[204] *Id.* at 900.

[205] Dean Witter Reynolds, Inc. v. McCoy, 995 F.2d 649, 651 (6th Cir. 1993).

concealment inapplicable to the six-year rule, because it considered this rule a statute of repose rather than a statute of limitations.[206] Yet, another district court in the Sixth Circuit subsequently held, in *Davis v. Keyes*, that section 15 of the NASD Code of Arbitration Procedures operates as a statute of repose "except in the cases where the claim involves fraudulent concealment."[207] In the case of fraud, the "'occurrence or event,' which starts the running of the six-year eligibility period, is the date of discovery of the fraud."[208]

In sum, courts appear to apply traditional reasoning to compare six-year time-bars either to statutes of repose or to statutes of limitations when ruling on arbitration time-bars. First, they decide whether the time-bar rule is a procedural (like a statute of limitations) or substantive (like a statute of repose) limitation on the arbitrability of a claim. Next, they decide which forum—arbitration or courts—should resolve the issue. This sequence in courts' reasoning may be reversed. Nonetheless, all courts associate the finding that time-bars are procedural limits with the finding that the timeliness issue should be determined by arbitrators. By the same token, if courts find that time-bars operate as statutes of repose, they find that judges, not arbitrators, determine the arbitrability of a claim.

Because the time-bar provisions are unique in that they are created in part by contract and in part by statute, a conventional analysis does not seem to be practical. Following this approach, if an arbitration time-bar is considered a statute of limitations subject to all equitable rules, this necessarily leaves the determination of timeliness of a claim to arbitrators. Conversely, if the issue of timeliness is appropriately disposed of by courts, this implies that the time-bar operates as a statute of repose inconsistent with equitable tolling. This reasoning fails to consider the possible conflict with the limitations periods for the substantive predicate of a claim. To avoid this con-

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206 *Id.*

207 Davis v. Keyes, [1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,387 at 90,637 (E.D. Mich. Aug. 1 1994). Interestingly, Judge Feikins in Michigan based his decision on *Roney* and the *McCoy* circuit case, the same cases that led Judge Edgar in Tennessee to hold otherwise in *McCoy* on remand.

208 *Id.* at 90,636.

flict, a court should analyze arbitration time-bars from a different perspective.

C. *Breaking the Circle*

As a threshold matter, the arbitrability of claims under the time-bar rules should be the courts' prerogative. In *AT&T Technologies, Inc. v. Communications Workers of America,*[209] the Supreme Court explained that "the question of arbitrability . . . is undeniably an issue for judicial determination. Unless the parties clearly and unmistakably provided otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court not the arbitrator."[210] In addition, the time-bar provisions' plain language that "[n]o dispute, claim, or controversy shall be *eligible* for submission to arbitration"[211] indicates that the six-year limitation is an eligibility requirement that strips arbitrators of subject-matter jurisdiction over the stale claim. Furthermore, the application of the arbitration time-bars is a complex matter and courts are undoubtedly better able to handle this question than arbitrators.

The next issue is the applicability of equitable rules to the time-bar provisions. Central to this issue is that arbitration is a matter of contract and no party should be forced to arbitrate a claim that it did not agree to submit to arbitration.[212] Courts, however, are "not to rule on [the] potential merits of the underlying claims."[213] From the first premise it follows that allowing tolling permits a party to circumvent the contractual limitation of the six-year time-bar, thereby forcing the party to arbitrate a claim it never agreed to arbitrate.[214] Also, if courts cannot rule on the merits of the claim, they cannot apply equitable tolling or the discovery rule because this would prevent arbitrators from determining the merits of the claim.[215]

This reasoning leads to the conclusion that tolling doc-

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[209] 475 U.S. 643 (1986).
[210] *Id.* at 649.
[211] NASD C.A.P. § 15, NASD MANUAL (CCH) ¶ 3715 (1994).
[212] *See AT&T*, 475 U.S. at 648.
[213] *Id.* at 649-50.
[214] PaineWebber v. Hofmann, 984 F.2d 1372 (3d Cir. 1993).
[215] *See AT&T*, 475 U.S. at 650.

trines are inapplicable to six-year time-bars. But such a conclusion inevitably conflicts with the statutes of limitations governing the underlying claims, which may be extended by equitable rules and thus can allow for a longer period to bring a claim. As the district court in *Prudential Securities, Inc. v. LaPlant* suggested, the conflict may be resolved by allowing a party precluded by the six-year time bar to relitigate the claim later in court.[216]

A few objections exist to this approach, however. For instance, relitigation of claims ineligible for arbitration may violate the federal policy favoring arbitration. As the Supreme Court stated in *Southland Corp. v. Keating*, "[c]ontracts to arbitrate are not to be avoided by allowing one party to ignore the contract and resort to the courts. Such a course could lead to prolonged litigation, one of the very risks the parties, by contracting for arbitration, sought to eliminate."[217] Underlying a federal right to enforcement of arbitration agreement terms is a party's contractual right to a particular forum and procedures that are more efficient, expeditious and simple than litigation.[218] Hence, the majority of courts are reluctant to allow the relitigation of claims precluded from arbitration by a six-year time-limit.[219] Those courts hold that by entering into an arbitration agreement a party to the agreement waives her rights to resort to a judicial forum.[220]

Although the practice of prohibiting relitigation of nonarbitrable claims seems accepted universally, it nonetheless creates an inconsistency in the treatment of time-bars. If, by implication, the parties to an arbitration agreement have agreed to not arbitrate claims beyond the six-year time limit, it

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[216] 829 F. Supp. 1239, 1244 (D. Kan. 1993).

[217] 465 U.S. 1, 7 (1984).

[218] Olde Discount Corp. v. Tupman, 1 F.3d 202, 213 (3d Cir. 1993) (where Federal Arbitration Act provided basis for federal preemption claim, district court could not abstain and had to address merits of claim), *cert. denied*, 114 S. Ct. 741 (1994).

[219] *See* Calabria v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 855 F. Supp. 172 (N.D. Tex 1994); Picollo v. Faragalli, Civ.A.No. 93-2758 1993 WL 331933 (E.D. Pa. Aug. 24, 1993); Castellano v. Prudential-Bache Sec., Inc., [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,321, at 95,536 (investor was not entitled to seek an alternative forum for his untimely claims).

[220] *See, e.g.*, Dean Witter Reynolds, Inc. v. McCoy, 853 F. Supp. 1023, 1033-34 (E.D. Tenn. 1994); *Calabria*, 855 F. Supp. at 176-77; *Piccolo*, Civ. A. No. 93-2758, 1993 WL 331933, at *2.

follows that claims older than six years are not covered by the agreement; therefore, there is nothing for the parties to waive. Although this reasoning appears to be very logical, it may lead to disastrous consequences. As the court in *Piccollo v. Faragalli* warned, "for us to find that plaintiff could assert his claims in [judicial] 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."[221]

Given that investors do not trust SROs' arbitration forums because they are created by the securities industry itself, and would rather bring their claims before a potentially more sympathetic jury, the outcome described in *Piccollo* is very plausible. As a result, courts would be clogged with stale claims "that have been allowed to slumber until evidence has been lost, memories have faded and witnesses have disappeared."[222]

As the conflict between time-bars and statutes of limitations cannot be resolved by allowing plaintiffs to relitigate stale, non-arbitrable claims, another solution is needed. An interesting compromise was offered by *PaineWebber Inc. v. Hofmann*.[223] This solution allows a determination of eligibility to remain with the courts as the Federal Arbitration Act and Supreme Court cases require, while enabling courts to minimize consideration of the merits of an underlying claim. Furthermore, it helps avoid a direct conflict with the statute of limitations that controls an underlying claim.

Although most of the transactions in dispute in *Hofmann* had occurred outside the six-year period, the plaintiff alleged that some events fell within the six-year period: (1) repeated, insistent and wrongful advice by PaineWebber's employee; (2) the active concealment of and affirmative misstatements about the risk to his account; (3) his discovery that his losses may have been caused by the wrongdoing of others; (4) the continuing pattern of wrongdoing with respect to investments from 1982 to 1987; and (5) the continuation of a wrongful brokerage relation from 1982 to 1987.[224]

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221 1993 WL 331933, at *2.

222 Order of R.R. Telegraphers v. Railway Express Agency, 321 U.S. 342, 348 (1944).

223 984 F.2d 1372, 1381 (3d Cir. 1993); *see also supra* notes 178-86 and accompanying text.

224 *Hofmann*, 984 F.2d at 1375. For a description of the underlying facts of the

Responding to Hofmann's argument, the court stated that

> the court should, as a benchmark, generally accept a party's statement as to what constitutes a cause of action and permit the arbitration of that claim *as long as* the asserted cause of action is not *clearly* a mere tolling or discovery argument. However, when the stated cause of action is patently nothing more than an attempt to toll the six year period, the court must enjoin the arbitration of that claim.[225]

As an example of this analysis, the court explained how it would apply to the facts of the case:

> [C]onsider Hofmann's claim that PaineWebber actively concealed [its employee's] wrongdoing. This claim easily could be viewed as an attempt to toll the time period on claims arising out of [its employee's] underlying wrongdoing. At the same time, however, this can also be viewed as an independent cause of action based on a duty owed by PaineWebber to its customers to inform them of a broker's wrongdoing or of the unsuitably speculative nature of their investments. Whether PaineWebber in fact owes such a duty to its customers is a merits question that must be left to the arbitrators. In this type of situation, the court must assume for the purposes of determining arbitrability that such a duty is owed.[226]

Hofmann, however, admonished judges to not give carte blanche to a potential claimant to submit any claim it asserts as a separate cause of action.[227] To avoid this problem, courts must analyze each claim individually to determine whether it can be said to constitute a separate cause of action.[228] For instance, the *Hofmann* court found that the plaintiff's claim of a separate cause of action was nothing more than a pure discovery argument.[229]

The *Hofmann* test not only avoids the disposition of a claim on its merits, it also leaves the issue of arbitrability to the judiciary. In addition, this position does not contradict the time-bar rules in their present version: these rules provide that they "shall not apply to any case which is directed to arbitration by a court of competent jurisdiction."[230] Addition-

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Hofmann case, see *supra* notes 179-82 and accompanying text.

[225] *Hofmann*, 984 F.2d at 1381.

[226] *Id.*

[227] *Id.* at 1381-82.

[228] *Id.* at 1382.

[229] *Id.*

[230] *See, e.g.*, NASD MANUAL (CCH) ¶ 3715 (1994); NYSE GUIDE (CCH) ¶ 2603

ally, the *Hofmann* test allows courts to weigh the federal policy favoring arbitration and its finality against the policy behind a particular statute of limitations. For example, some causes of action have longer limitations periods because of a strong policy to deter wrongdoers. The *Hofmann* court's "separate cause of action" theory balances these policies without considering the merits of the claim. Therefore, courts do not need to view the facts of the case to decide whether a particular claim calls for an extension of a pertinent limitations period. Generally speaking, the *Hofmann* approach seems the most reasonable resolution of the conflicts caused by the time-bar rules.[231]

III. THE NASD PROPOSED AMENDMENTS TO SECTION 15: AN ULTIMATE SOLUTION OR FURTHER AGGRAVATION?

Courts' conflicting interpretations of the time-bar provisions have resulted in a great deal of confusion. Although *Hofmann* provides a workable solution, unfortunately the position of the *Hofmann* court represents the minority view. In an attempt to resolve the controversy and avoid excessive litigation, the NASD has proposed a series of amendments to Rule 15 of the Code of Arbitration Procedure.

The first such proposal, which was submitted on October 26, 1993, would add two provisions to section 15.[232] Its provisions would empower the Director of Arbitration to make a final, non-appealable determination of arbitrability of a claim under the six-year time-bar.[233] The proposed section would be entitled "Eligibility," instead of "Time Limitation on Submission," to make its jurisdictional nature clear.[234]

Soon after the first proposal's introduction, SEC staff questioned the procedure for the eligibility determination.[235]

(1992); AMEX GUIDE (CCH) ¶ 9544(a).

[231] Another solution would require scrapping these provisions altogether. For example, the American Bar Association does not impose any time-limitations on the submission of claims. *See supra* note 3. This solution is not very likely, however, because the SROs apparently want to keep these provisions to regulate the caseload pressure on their arbitration forums. As to the compulsory elimination of these provisions, there are no grounds on which courts might strike them down, nor are courts willing to do so.

[232] *See* First Proposal, *supra* note 8.

[233] First Proposal *supra* note 8, 1993 WL 441275 at *3.

[234] First Proposal *supra* note 8, 1993 WL 441275 at *3.

[235] Letters from Ethan Corey, Staff Attorney, Over-the-Counter Regulation, SEC

Therefore, in July 1994, the NASD modified its proposal and offered the second version of the amendments to section 15.[236]

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to Suzanne Rothwell, Associate General Counsel, NASD (Jan. 31, 1994) and to Elliott Curzon, Senior Attorney, NASD (Feb. 4, 1994), *cited in* Exchange Act Release No. 34,442, 59 Fed. Reg. 39,373, at 39,377 (Aug. 2, 1994).

[236] *See* Second Proposal, *supra* note 8. Under the Second Proposal, the new section 15 will provide:

> (a) 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 or limit applicable statutes of limitations.
>
> (b) After the filing of a statement of claim, counterclaim, cross-claim or third-party claim (hereinafter "claim") pursuant to Section 13 or 25 of the Code, the Director of Arbitration shall determine if the claim is eligible for submission to arbitration by determining if the claim alleges that less than six (6) years have elapsed between the occurrence or event giving rise to the dispute, claim or controversy and filing of the claim. If the claim does not state clearly that less than six (6) years have elapsed between the occurrence or event giving rise to the dispute, claim or controversy and filing, the Director may ask the claimant to modify the claim, within a time period set by the Director, to so state. The Director will determine the eligibility of the claim for submission to arbitration either on the basis of the claim as stated in the original claim or, if modified, on the basis of the modified claim.
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> (c) Following service of a claim, but prior to the earlier of (1) the date the parties are notified of the appointment of the arbitrators pursuant to Sections 13 or 19 of the Code, or (2) the date the Director appoints an arbitrator to consider prehearing issues pursuant to Section 32(e) of the Code, a responding party disputing the eligibility of a claim shall, along with, or after, submitting an executed Uniform Submission Agreement and any fees or deposits required under the Code, submit a notice of objection to the Director of Arbitration supported by statements of fact and documentary evidence asserting that more than six (6) years have elapsed between the occurrence or event giving rise to the dispute, claim or controversy and filing. The claimant and any other party may respond to the notice of objection within the time period set by the Director. The Director shall promptly determine on the basis of the written record only, after considering any responses timely submitted, if the claim is eligible for submission to arbitration by determining if the disputing party's objections and assertions regarding eligibility: (i) contradict the allegations in the claim relating to eligibility; (ii) are supported by documentary evidence; and, (iii) are not contradicted by other allegations which, if true, would prevail.
>
> (d) Any determination by the Director pursuant to subparagraph (b) or (c) is final.
>
> (e) Any determination by the Director pursuant to subparagraph (b) or (c) that a claim is ineligible: (i) shall not limit the right of any party to offer evidence concerning the event or occurrence which was the basis of the eligibility determination at any other stage of the proceeding on the claim for any purpose other than contesting the eligibility of the

The new proposal added six new subsections and gave the Director of Arbitration the authority to determine whether less than six years had elapsed between the occurrence or event giving rise to a dispute.[237] As in the first proposal, the Director's decision would be final.[238] The proposal also described the procedure used by the Director to determine the claim's eligibility for arbitration. Pursuant to this procedure, the Director determines the timeliness of a claim on the basis of a statement of claim.[239] A respondent who disputes eligibility must submit to the Director a notice of objection supported by statements of fact and documentary evidence asserting that more than six years have elapsed between the occurrence or event giving rise to the controversy and filing.[240] Based only on the written record, the Director will then determine the eligibility of the claim to arbitration.[241]

Citing *AT&T Technologies, Inc. v. Communications Workers of America,*[242] the NASD stated in its proposal that its purpose was to make plain the intention of the parties to an arbitration agreement (which incorporates by reference all the provisions of the Code) to have the Director decide the issue of eligibility.[243] To strengthen the finality and absolute power of the Director's eligibility decision, the second version of section 15 deletes the statement of inapplicability of the rule to claims referred to arbitration by a court.[244] Generally, the second

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claim determined to be ineligible; (ii) shall not bar a claimant from bringing the claim before a judicial forum, notwithstanding any existing predispute arbitration agreement; (iii) shall not affect the rights and remedies of the claimant with respect to such claim, notwithstanding any existing predispute arbitration agreement; and, (iv) shall mean that the limitation period on eligibility set forth in Subsection (a) shall continue to run as though the claim had never been filed.

(f) Any determination by the Director relating to eligibility shall set forth in writing the occurrence or event that was the basis for the determination.

(g) No party shall seek to enforce any agreement to arbitrate if the claim has been determined to be ineligible under this Section.

Id. at 39,373-74.

[237] Second Proposal, *supra* note 8, at 39,374.

[238] Second Proposal, *supra* note 8, at 39,376.

[239] Second Proposal, *supra* note 8, § 15(b), at 39,373.

[240] Second Proposal, *supra* note 8, § 15(c), at 39,373.

[241] Second Proposal, *supra* note 8, at 39,375 n.6 (NASD commentaries).

[242] 475 U.S. 643 (1986).

[243] Second Proposal, *supra* note 8, at 39,374.

[244] The present version of section 15 provides that "[t]his section shall not . . .

proposal differs from the first only with respect to the procedural details of eligibility determination.

Some commentators have expressed concern that the new rule contradicts various court holdings.[245] In response, the NASD, relying on *AT&T Technologies*, claimed that "[a]rbitration is a creature of contract, . . . and it is for the parties to determine the terms of the contract."[246] The NASD also stated that the tolling doctrine "historically" is inapplicable to the eligibility rule.[247] At the same time, in the examples set forth in the Comments to the Rule, the Association tacitly admitted that fraudulent concealment would affect the timeliness of a claim.[248] The NASD also claimed that the new rule would not create a burden on competition.[249] As to the rights of the parties, the NASD argued that the arbitration forum has an inherent right to limit access to itself,[250] but this in no way affects a party's right to seek any remedy in the courts.[251] Interestingly, the rule also provides innovative police measures for use against members who try to compel arbitration after the claim has been determined ineligible.[252] Under the proposal a member would be prohibited from seeking an alternative forum and would be subjected to a disciplinary action in a case of non-compliance.[253]

The apparent goal of the new rule is to reduce the amount of litigation and to create uniformity in the enforcement of the

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apply to any case which is directed to arbitration by a court of competent jurisdiction." NASD MANUAL (CCH) ¶ 3715.

245 Second Proposal, *supra* note 8, at 39,378 & n.17 (referring to commentaries by Gregory L. Wilmes and Michael E. Friedman).

246 Second Proposal, *supra* note 8, at 39,378.

247 Second Proposal, *supra* note 8, at 39,378.

248 Second Proposal, *supra* note 8, at 39,375-76. ("An allegation that the account statement is fraudulent would be sufficient to overcome the disputing party's allegation [of ineligibility] . . . Therefore the proposed rule establishes a presumption in favor of the eligibility . . . .")

249 Second Proposal, *supra* note 8, at 39,376. Although this statement is a required formality, it received a special meaning in the context of this Proposal, which, in fact, does create a burden on competition. *See supra* note 261 and accompanying text.

250 Second Proposal, *supra* note 8, at 39,377.

251 Second Proposal, *supra* note 8, at 39,376 ("a determination that a claim is ineligible will not . . . bar a claimant from bringing the substantive claim before a judicial forum").

252 *See* Second Proposal, *supra* note 8, at 39,376.

253 Second Proposal, *supra* note 8, at 39,376.

six-year eligibility requirement. The proposal suffers from a number of flaws, however. First, it specifically indicates that the six-year period is a substantive, not procedural, bar to arbitration.[254] If so, the rule does, in fact, contradict the holdings of most courts.[255] All of the "substantive" circuits have held that the eligibility issue is for a court to decide.[256] In this respect, the NASD's reading of the Supreme Court's holding in *AT&T Technologies* is not entirely correct: *AT&T Technologies* held that "the question of arbitrability . . . is undeniably an issue for judicial determination."[257] The *AT&T* Court emphasized that "clear and unmistakable" agreement of the parties should be determined by the judiciary, not by arbitration forums,[258] and the courts that regard section 15 to be a substantive bar to the submission to arbitration have interpreted it as such. Furthermore, establishing that an investor clearly and unmistakably has intended to delegate eligibility determinations to the Director of Arbitration is difficult, since such eligibility determination is incorporated in the agreement by general reference to the Code, and presumably, most investors are unaware of the intricacies of the Code.[259]

Second, application of the Rule to a claim controlled by different statutes of limitations poses a very difficult question that is unlikely to be resolved by the Director. Equitable doctrines supposedly are inapplicable to the six-year limitation period of section 15. The *Hofmann* approach is the only way to avoid potential conflict with the limitations periods governing

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[254] Second Proposal, *supra* note 8, at 39,375 ("These changes are intended to further clarify the distinction between issues related to eligibility . . . and statutes of limitations. . . . ")

[255] Second Proposal, *supra* note 8, at 39,378.

[256] *See supra* notes 154-95 and accompanying text.

[257] AT&T Tech., Inc. v. Communications Workers, 475 U.S. 643, 649 (1986)

[258] *Id.*

[259] The court in Edward D. Jones & Co. v. Sorrels, 957 F.2d 509 (7th Cir. 1992) stated:

> NASD Code Section 35 does provide that the "arbitrators shall be empowered to interpret and determine the applicability of all provisions under the Code which interpretation shall be final and binding upon the parties." However, we do not believe that this provision is a clear and unmistakable expression of the parties' intent to have the arbitrators, and not the court, determine which disputes the parties have agreed to submit to arbitration.

Id. at 514, n.6.

an underlying claim.[260] Yet this approach envisions joint participation by courts and arbitrators: the courts make a preliminary determination whether a separate cause of action doctrine might apply, and then the arbitrators decide whether the facts of this particular case require them to use an accrual point other than the date of an original transaction. Under the proposed section 15, this analysis would be done by neither courts nor arbitrators.

Third, the claim that the rule does not impose an unfair burden on competition is not very persuasive.[261] Usually, the "Burden on Competition" statement is a mere formality required for any rule change proposed by the SROs. In the context of this Proposal, however, the statement sounds like a distortion of reality. The codes of other SROs still contain the older version of the rule, subject to existing precedent, and there is no indication that they are going to amend it in the immediate future. Therefore, the parties to arbitration in forums other than the NASD will enjoy judicial determination of the arbitrability of their claim (at least in "substantive" jurisdictions), whereas the disputants in the NASD forum will have to be satisfied by the pronouncements of the Director of Arbitration. Thus, the new Proposal does in fact create a burden on competition by encouraging arbitration forum shopping.[262]

Fourth, the Director's determination of ineligibility will totally bar a party from seeking a remedy in the courts in almost all jurisdictions. While an arbitration forum has a right to limit access to itself,[263] application of these provisions neglects what makes securities arbitration forums different from other ADR institutions. Given the mandatory nature of arbitration for most securities claims and the unavailability of a recourse in the courts for ineligible claims, the SROs' arbitration forums have become quasi-judicial bodies rather than voluntary alternatives to litigation. Under such circumstances, limitation of access to the forum would be more like a deprivation of parties' rights to adjudicate their disputes.

Arguably, courts also limit access to judicial forums by

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260 *See supra* notes 225-29 and accompanying text.
261 *See supra* note 249.
262 *See supra* note 113.
263 Second Proposal, *supra* note 8, at 39,377.

barring stale claims from adjudication. There is, however, a difference. Judicial determination of eligibility is made in a forum which is constitutionally empowered with adjudicatory functions. Moreover, judicial orders are subject to appellate review, which substantially lessens the possibility of mistake. In contrast, under the proposed rule the Director of Arbitration alone would make a crucial determination without the safeguard of appellate review. The lack of appellate review is especially dangerous because the Director is not an impartial adjudicator. Such circumstances, considering the fact that an ineligibility verdict would be the end of a claim, provide ample opportunity for abuse. The likelihood of abuse also is increased by the fact that an aggrieved party who is a NASD member would risk loss of membership and consequently employment by deciding to fight a potentially unfair or biased determination. Although due process challenge to securities arbitration thus far have been unsuccessful,[264] the new rule could change this situation.

Undoubtedly, courts could disregard the Director's powers to determine eligibility and make their own determination. For example, because the NASD does not require the Director to be an attorney,[265] the Director possibly could disregard existing law and determine the eligibility of a claim based on her own understanding of the subject. If the Director merely misapplied the law, such a determination will not be subject to judicial reversal.[266] If, however, a court finds that the Director manifestly disregarded the law, it must vacate the determination.[267] Under such circumstances, the NASD's claim that the

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[264] *See, e.g.*, Bernstein v. Lind-Waldock & Co., 738 F.2d 179, 186 (7th Cir. 1984) (while recognizing that the Chicago Mercantile Exchange was heavily regulated by the federal government, such regulation was insufficient to make the Exchange a de facto agent of the government for purposes of the Due Process Clause of the Fifth Amendment); R.J. O'Brien Assoc., Inc. v. Pipkin, No. 93C-3154, 1994 WL 96649, at *4 (N.D. Ill. Mar. 23, 1994) (except for ensuring that the protections of the FAA are satisfied, the government itself is indifferent to the resolution of this particular dispute between the parties); Rubin v. NYSE, Civ. A. No. 91-6604, 1992 WL 131154 (E.D. Pa. June 10, 1992).

[265] Although the present NASD Director of Arbitration, Deborah Masucci, is an attorney, the NASD Rules, just like the rules of other SROs, do not require that the Director hold a legal degree.

[266] *See* Miller v. Prudential-Bache Sec., Inc., 884 F.2d 128, 130 (4th Cir. 1989) ("federal courts have consistently held that they will not set aside an arbitrator's award for mere errors in law") (citation omitted).

[267] *See* Merrill Lynch Pierce Fenner & Smith, Inc. v. Bobker, 808 F.2d 930 (2d

Director's decision is final will conflict directly with a court's holding, and the NASD would have to disobey a judicial order and deny a claim referred to it by the court. This scenario is not unthinkable under the new rule considering the controversy among the courts as to the eligibility determination.

Finally, the withdrawal of eligibility determination from the courts will eradicate the precedent-generating system. Currently, the rules governing limitations periods in securities laws are not well-settled. Therefore, any new pronouncement on the subject has great precedential value. The detriment to common law will far outweigh any benefits to efficiency and expediency of the process.[268]

So far, only one court, the Southern District of New York in *Castellano v. Prudential-Bache Securities*,[269] has considered whether it is appropriate for the Director of Arbitration of the New York Stock Exchange to determine the issue of the eligibility under the NYSE six-year rule. The plaintiff in *Castellano* argued that limitations questions should have been determined by a panel of three arbitrators and not by the Director, whose responsibilities are limited by Rule 635[270] to ministerial duties.[271] The court rejected this argument, stating as its sole reason the court's deference to the New York Stock Exchange.[272]

Nevertheless, this case does not indicate a general judicial approval of the proposed amendments to the NASD CAP Section 15. The district court that decided *Castellano* followed the *Conticommodity* rule and generally considered timeliness issues to be the province of an arbitration forum. As noted above, the *Conticommodity* analysis contradicts the Supreme

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Cir. 1986) (manifest disregard of the law is a ground for vacating an arbitration award).

[268] For a discussion of the problem of generating a precedent in the securities industry, which is subjected to virtually mandatory arbitration, see generally Lipton, *supra* note 105 (arguing that arbitration leads to a malnourishment of common law and calling for modification of the arbitration system).

[269] [1990 Transfer Binder] Fed. Sec. L. Rep. ¶ 95,321 (S.D.N.Y. June 19, 1990).

[270] NYSE Code of Arbitration Rule 635 provides, in pertinent part: "The Director of Arbitration shall be charged with the duty to perform all ministerial duties in connection with the matters submitted for arbitration pursuant to these Rules." NYSE GUIDE (CCH) ¶ 2635 (1992).

[271] *Castellano*, at 96,536.

[272] *Id.*

Court holding in *AT&T Technologies*, as well as the NASD's own statement that Section 15 is a substantive rather than a procedural provision. Moreover, the *Castellano* court implied that it did not approve of the NYSE approach but would uphold the delegation to the Director of the issues of eligibility under Rule 603 because of the court's general deference to the arbitration forums.[273] It is unlikely that a "substantive" court would be as deferential to the arbitration forum when faced with the same case.

This analysis equally applies to the NASD Code of Arbitration. Section 3, entitled "Director of Arbitration," has a slightly different wording from NYSE Rule 635. It provides in pertinent part that the Director of Arbitration shall perform all "administrative duties and functions" in connection with NASD arbitration matters.[274] Although the NASD Director of Arbitration, unlike her NYSE counterpart, is empowered to carry out "all administrative" duties rather than simply those "ministerial" ones, the determination of limitations questions clearly is no more administrative than ministerial.

Furthermore, the new rule does not effectively deter excessive litigation. Consider two scenarios that exemplify situations where the determination could be challenged in courts. First, in the case of a dissatisfied broker, NASD members are at risk of facing disciplinary sanctions if they challenge the Director's determination. When an allegedly defrauded investor brings a claim against the broker, however, the matter may

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[273] "Whenever [*sic*] may be the Court's view as to whether the determination of limitations questions is merely ministerial, Rule 603 allows for the NYSE's interpretation." *Castellano*, [1990 Transfer Branch] Fed. Sec. L. Rep. ¶ 95,321, at 96,536.

[274] NASD MANUAL (CCH) ¶ 3703 (1994).

> The Board of Governors of the Association shall appoint a Director of Arbitration who shall be charged with the performance of all *administrative* duties and functions in connection with matters submitted for arbitration pursuant to this Code. He shall be directly responsible to the National Arbitration Committee and shall report to it at periodic intervals established by the Committee and at such other times as called upon by the Committee to do so.

Id. (emphasis added). The Proposal also contains an amended version of this section. However, these amendments relate to the delegation of the Director's duties to her appointee and to the matters related to the appointment of the Director. The part that presents a special interest for this Note—the section that describes the Director's duties as "administrative"—was left unchanged.

first go to a court on a motion to either compel or enjoin the arbitration. The parties then may litigate the issue of eligibility as a threshold question without running a risk of being penalized by the NASD.[275] Even if this strategy fails,[276] the award still is subject to collateral challenge under section 16 of the Arbitration Act.[277] Therefore, after the arbitration proceedings, a broker can return to court and challenge the award on the ground that the arbitrators lacked subject-matter jurisdiction and the court should not have compelled arbitration.[278] The *Sorrells* case, in which the court vacated an otherwise valid arbitration award after finding the claim was outside the six-year time limit, perfectly illustrates this situation.[279]

Second, consider the case of the Dissatisfied Investor. The threat of disciplinary sanctions for disobedience to the Director's determination does not apply to the investor. Therefore, the investor can always challenge the timeliness determination in court on the ground of unconscionability of the arbitration agreement. An investor could succeed in this challenge if a court finds unequal bargaining power, lack of knowledge of all the pertinent provisions of the Code incorporated into the agreement by reference, or that the arbitration agreement is pre-printed and therefore constitutes an inseparable part of a standard Customer Agreement.[280] Indeed, the Supreme Court

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[275] Indeed, the member who challenges the eligibility of a claim does not violate the proposed section 15. Since the matter first goes before a court, the Director does not have a chance to make any determination.

[276] According to the new rule, even if the matter is referred to arbitration by the court, the eligibility determination still is to be made by the Director. Second Proposal, *supra* note 8, at 39,375 ("a court order directing the parties to arbitration is not a determination that the matter is eligible for arbitration under the rules of the NASD").

[277] For the effects of collateral challenges on awards, see the discussion *supra* note 48.

[278] Once again, the NASD member does not violate the finality provisions of section 15. In this latter scenario, a broker challenges not the Director's determination but the award as a whole under the authority of section 16 of the Arbitration Act.

[279] Edward D. Jones v. Sorrels & Co., 957 F.2d 509 (7th Cir. 1992).

[280] *The Restatement (Second) of Contracts* explains that "gross inequality of bargaining power" may trigger the presumption of unconscionability. RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. d (1981). One of the factors that contributes to such a conclusion is "knowledge of the stronger party [in our case the broker-dealer] that the weaker party [investor] is unable reasonably to protect his inter-

in *Shearson/American Express v. McMahon* acknowledged that, notwithstanding the federal policy favoring arbitration, courts would entertain a "well-grounded claim that an arbitration agreement resulted from . . . excessive economic power" and consider it a basis for invalidating such agreement.[281] Most of the lower courts that have dealt with unconscionability challenges to arbitration agreements have not allowed claimants to overcome the clear federal policy favoring arbitration.[282] The proposed new NASD Rule presents a different case, however. Under the proposed rule, a potential claimant would not be trying to invalidate an arbitration agreement per se but rather would ask the court to sever the unconscionable portion[283]—the mandatory eligibility determination by the Director.[284]

In sum, the proposed rule, if adopted, will create more problems than solutions and may result in a proliferation of

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ests by reason of . . . ignorance, . . . or inability to understand the language of the agreement . . . " *Id.* The *Restatement* also provides that not necessarily the whole contract but only some of its terms may be unconscionable, and such an unconscionable clause may be stricken or limited, without destroying the whole contract. *Id.* § 208 cmt. e.

[281] 482 U.S. 220, 226 (1987) (quoting Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 627 (1985)). The *Rodriguez* opinion reiterates much of the same language, which derives from *Mitsubishi*, but does not further develop the law on the issue. *See* Rodriguez de Qujas v. Shearson/American Express, 490 U.S. 477 (1989). It merely concludes that "[a]lthough petitioners suggest that the agreement to arbitrate here was adhesive in nature, the record contains no factual showing sufficient to support that suggestion." *Id.* at 484.

[282] *See, e.g.*, Adams v. Merrill Lynch Pierce Fenner & Smith, Inc., 888 F.2d 696, 700 (10th Cir. 1989) (rejecting investors' argument that the arbitration agreement should not be enforced because it was a "form, boilerplated contract, drafted by Merrill Lynch, whose agents made no attempt to highlight the arbitration provision"); Dale v. Prudential Bache Sec., 719 F. Supp. 1164, 1169 (E.D.N.Y. 1989) (lack of ability to understand the arbitration agreement is not sufficient to find such agreement unconscionable).

[283] As discussed *supra* note 280, it is not necessary that the whole contract be stricken down. An unconscionable clause may be stricken or limited, without destroying the whole contract. RESTATEMENT (SECOND) OF CONTRACTS § 208 & cmt e.

[284] "The courts have consistently held that arbitration agreements are not unconscionable as a matter of law." Theodore A. Krebsbach & George H. Friedman, *Arbitral Forum*, *in* SECURITIES ARBITRATION UPDATE 3, 19 (M. Fitterman & T. Krebsbach eds., 1989) Courts, however, "are reluctant to find adhesion clauses enforceable, particularly if it is also 'unduly oppressive, unconscionable or otherwise against public policy.'" Consequently, the courts are an important ally of investor-customers in brokerage cases and may find the clause enforceable. Grant, *supra* note 70, at 453-54.

litigation. The better response to the increasing litigation of the six-year time-bars is to withdraw the proposal. The NASD instead may issue an official interpretation explaining that it intends the six-year time bar to be a substantive, eligibility provision.[285] Section 15 should be left unchanged in all other respects, including the clause allowing courts to refer a case to arbitration, notwithstanding the six-year bar. The application of the rule would then be a task for the courts, which ideally would apply the *Hofmann* test.[286]

CONCLUSION

Despite the antagonism between arbitration time-bars and statutes of limitations, these mechanisms will continue to serve as safety valves regulating the caseload pressure on arbitration forums by creating additional limitations on arbitration claims. The potential conflict can be avoided only by giving courts, not arbitration forums, the power to determine the timeliness of the claim under the time-bar rules. In this respect, the new time-bar rule proposed by the NASD is troublesome from a theoretical perspective and impractical for preventing excessive litigation. As this Note demonstrates, a party who is dissatisfied with the Director's determination easily can find a way to challenge the Director's "final" determination in court. It would be better therefore to leave the determination of eligibility to the courts, which may intervene regardless of the NASD rules. These proceedings would not be too burdensome and may be conducted summarily to use judicial resources efficiently.[287]

Allowing courts to resolve timeliness issues is just the first part of the problem. The second and perhaps even more important issue concerns how courts will approach the timeliness for

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[285] The NASD often issues similar interpretations of its various rules by the Board of Governors. *See, e.g.*, the interpretations of the Board of Governors to the Rules of Fair Practice. These interpretations are binding on NASD members and are usually taken into account by courts and the SEC.

[286] *See supra* notes 225-29 and accompanying text.

[287] Under the *Hofmann* approach, courts do not need and may not examine the factual records. They will only have to deal with a statement of claim to decide whether it alleges a "separate cause of action" theory as opposed to a mere tolling argument. The factual issues will be left for the arbitration panel to decide.

submission of a claim to arbitration. The best approach is offered by *PaineWebber Inc. v. Hofmann.*[288] The *Hoffman* approach allows a court to decide whether a claim alleges a separate cause of action, such as a breach of a duty to not conceal the wrong, or merely offers an equitable tolling argument. In the latter case, the claim will be dismissed as untimely, while in the former, the claim will be compelled to arbitration. Under this approach, courts disregard the merits of the case, leaving the disposition of factual disputes to arbitrators who may well dismiss any claim as untimely if its facts do not give rise to a separate cause of action.

In such settings, arbitrators will decide a procedural part of the issue—the limitations defense—whereas the courts will address the jurisdictional questions. This symbiosis provides for the best possible allocation of adjudicatory functions between the courts and arbitrators, and complies with the requirements of the Federal Arbitration Act.

Another advantage of the *Hofmann* analysis is that it allows courts to balance the policies behind the time-bar provisions (designed to limit stale arbitration claims) against the deterrence policies that may be a predicate of an underlying claim. Thus, an application of the arbitration time-bars will not be a mechanical computation and will best serve public policy.

Despite all the advantages of the *Hofmann* analysis, such an approach is impossible under the NASD proposal. If the rule is adopted, the timeliness question will be removed completely from the courts. Moreover, even an arbitration panel will be excluded. Thus, the determination of the timeliness of a claim will depend solely on the Director's discretion, and will not be subject to any appellate review. It is unlikely that any Director, no matter how qualified and diligent, can successfully cope with this enormous task.

Although the NASD, in proposing the new rule, was driven by the desirable goal of advancing the basic ingredient and major virtue of arbitration—the principle of finality and efficiency—the threshold question of eligibility should be decided by courts. In the long run, such a determination will make the

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[288] 984 F.2d 1372 (3d Cir. 1993).

arbitration process more efficient and will give additional weight to the arbitration award.

Emil Bukhman[239]

[239] The author wishes to thank Professor Norman S. Poser for his invaluable assistance in the preparation of this Note.