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No. 82311-1

SUPREME COURT OF THE STATE OF WASHINGTON

[CT APP. DOCKET No. 60115-6-I]

MICHAEL BROOM, KEVIN BROOM and ANDREA BROOM,

Respondents,

v.

MORGAN STANLEY DW INC., and KIMBERLY ANNE
BLINDHEIM,

Petitioners.

**THE SECURITIES INDUSTRY AND FINANCIAL MARKETS
ASSOCIATION'S AMICUS CURIAE MEMORANDUM
IN SUPPORT OF REVIEW**

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I. INTEREST OF AMICUS CURIAE

The Securities Industry and Financial Markets Association (“SIFMA”) brings together the shared interests of more than 650 securities firms, banks, and asset managers. SIFMA’s mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public’s trust and confidence in the markets and the industry. SIFMA works to represent its members’ interests locally and globally. It has offices in New York, Washington D.C., and London, and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

Although the case before the Court involves only a single arbitration proceeding, the Court of Appeals’ decision raises issues of national importance to the securities industry and to all participants in the arbitration process (whether or not related to the securities industry).¹

¹ The highly regulated securities industry has established a national securities arbitration system which operates under the framework established by the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (the “Exchange Act”). The Exchange Act authorizes self-regulatory organizations (“SROs”) such as NASD Regulation, which administered the arbitration proceeding at issue in this dispute, to promulgate rules for arbitration subject to approval by the Securities Exchange Commission. The NASD (now known as the Financial Industry Regulatory Authority or “FINRA” after a 2007 merger) has enacted rules that require its member firms to arbitrate a dispute at the customer’s request. As a result, arbitration is the primary dispute resolution mechanism in the industry. Over 54,000 separate arbitrations were filed with FINRA and its predecessor NASD since 2000. *See FINRA Summary Arbitration Statistics September 2008*, available at <http://www.finra.org/ArbitrationMediation/AboutFINRADR/Statistics/index.htm> (statistics through September 2008).

The decision below would substantially effect the arbitration process by expanding the scope and nature of judicial review of arbitration awards. Additionally, the decision would deprive arbitration litigants of an important substantive defense to stale claims -- the statute of limitations -- which would impact arbitration both within Washington and beyond.

Accordingly, SIFMA has a significant interest in this action to ensure that the arbitration process is not burdened by excessive post-award litigation and arbitration participants are not unjustifiably deprived of important statutes of limitations-based defenses.

II. ISSUES PRESENTED FOR REVIEW

1. Whether “legal error on the face of the award” is a viable non-statutory ground for judicial vacatur of an award under Washington law?
2. Whether Washington law precludes all arbitrators from applying any statute of limitations in arbitration?

III. STATEMENT OF THE CASE

FINRA incorporates and accepts the factual summary provided by Morgan Stanley in its Petition for Review, which was accepted in relevant part by the Respondents (the “Brooms”). (Answer to Petition for Review at 3). The Petition seeks appellate review of an unpublished Washington Court of Appeals, Division One, decision affirming the vacatur of a

securities arbitration award because “the arbitrators committed an error of law when they dismissed the Brooms’ claims under Washington statutes of limitation.” (App-4).

By upholding the “legal error” standard and permitting parties to seek de novo judicial review of arbitrators’ legal determinations, the Court of Appeals’ ruling threatens to dramatically increase the prevalence of post-award litigation involving arbitration awards, thus compromising the important goals of expediency and finality in the arbitration process.

To justify its ruling, the Court of Appeals creatively interpreted and distinguished two Washington Supreme Court decisions. Specifically, the court applied the non-statutory legal error standard for vacatur despite the unanimous Supreme Court’s express guidance in *Malted Mousse, Inc. v. Steinmetz*, which provided that “[w]hen reviewing an arbitrator’s decision, the court’s review is limited to the grounds provided for in RCW 7.04.160-.170...” 150 Wn.2d 518, 526-27, 79 P.3d 1154 (1995) (“*Malted Mousse*”). Additionally, the Court of Appeals held that the arbitrators made a clear error of law by applying the statutes of limitations in arbitration because such a proceeding is not an “action” and therefore is not precluded by the statutes. This portion of the court’s holding conflicts with the Supreme Court’s decision in *Int’l Assoc. of Fire Fighters, Local 46 v. City of Everett*, which held that “whether an arbitration is deemed a

judicial ‘action’ depends on the legal context in which the question arises.” 146 Wn.2d 29, 42 P.3d 1265 (2002) (“*Fire Fighters*”).²

Supreme Court review is appropriate in this case because the appellate decision below (i) conflicts with numerous recent decisions of the Supreme Court, and (ii) involves questions of substantive public interest that warrant review. *See* RAP 13.4(b).³

IV. ARGUMENT IN FAVOR OF REVIEW

A. THE COURT SHOULD GRANT REVIEW TO CLARIFY THAT “ERROR OF LAW” IS NO LONGER A BASIS TO VACATE AN ARBITRATION AWARD

The Washington Supreme Court has followed a national trend that has limited the grounds to attack arbitration awards. Specifically, in *Malted Mousse* the Court limited the bases for vacatur to those contained within the statutes governing arbitration proceedings:

When reviewing an arbitrator’s decision, the court’s review is limited to the grounds provided for in RCW 7.04.160-170. *See Barnett*, 119 Wn.2d at 156. In *Boyd v. Davis*, 127 Wn.2d 256, 897 P.2d 1239 (1995), we recognized that every case addressing a court’s ability to reverse an arbitrator’s error in law was based on a statute repealed by the current arbitration act, and that a reviewing court is limited to the statutory grounds. *Boyd*, 127 Wn.2d at 267.

² In reaching its conclusion, the Court of Appeals relied on two pre-*Fire Fighters* decisions, *Thorgaard Plumbing & Heating Co. v. King County*, 71 Wn.2d 126, 426 P.2d 828 (1967) (“*Thorgaard*”) and *City of Auburn v. King County*, 114 Wn.2d 447, 788 P.2d 534 (1990) (“*Auburn*”), for the proposition that statutes applying to “actions” cannot apply to arbitration proceedings even though *Fire Fighters* limited cases like *Thorgaard* and *Auburn* to their facts.

³ Although SIFMA believes that the decision below conflicts with prior Supreme Court authority, in the interest of space SIFMA has focused its analysis below on the policy considerations supporting Supreme Court review.

150 Wn.2d at 526-27 (emphasis added).

The *Malted Mousse* decision is entirely consistent with the United States Supreme Court's most recent decision limiting the review of arbitration awards to those grounds provided by the controlling statutes. See *Hall Street Associates, L.L.C. v. Mattel, Inc.*, ___ U.S. ___, 128 S. Ct. 1396 (2008) ("*Hall Street*") (rejecting vacatur based on "just any legal error" and limiting review to those grounds provided for under the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* (the "FAA") where applicable).

The public policy of Washington strongly favors arbitration as a comparatively quick, efficient and final means of dispute resolution. See *Godfrey v. Hartford Cas. Ins. Co.*, 142 Wn.2d 885, 892, 16 P.3d 617 (2001). This policy is consistent with the rulings of courts across the nation, including the Supreme Court of the United States. See, e.g., *Hall Street*, 128 S.Ct. at 1405 (recognizing "a national policy favoring arbitration with just the limited review needed to maintain arbitration's essential virtue of resolving disputes straightaway"). Washington courts have sought to avoid rulings that would compromise the finality of arbitration awards and render arbitration "a mere prelude" to post-arbitration judicial litigation. *Godfrey*, 142 Wn.2d at 892, 895-6; see also *Hall Street*, 128 S.Ct. at 1405. The judicial reluctance to interfere with

final arbitration awards gives the parties what they contracted for -- a determination by the arbitrators, not the courts.

The Court of Appeals' decision threatens these policy goals by opening the door to de novo review of any arguable legal rulings on the face of an arbitration award, likely resulting in extensive additional costs and delays in the resolution of matters subject to arbitration. The "legal error" basis for vacatur undermines the authority of arbitrators to finally resolve all factual and legal issues submitted to them. Additionally, it discourages arbitrators from offering written explanations of their decisions (which could open the door for a challenge). Such a result conflicts with and frustrates the Washington Supreme Court's sound decision in *Malted Mousse* (and other courts throughout the nation) to limit the bases for post-award challenges to those expressly provided by statute. In light of the substantial policy considerations relating to the Court of Appeals' decision, review is justified.

B. THE COURT SHOULD GRANT REVIEW BECAUSE THERE IS NO AUTHORITY OR POLICY BASIS FOR A BLANKET RULE PROHIBITING THE APPLICATION OF STATUTES OF LIMITATION IN ARBITRATION

The Washington Supreme Court has established a flexible rule for whether a statute relating to an "action" shall apply to an arbitration proceeding. *See Fire Fighters*, 146 Wn.2d 29 ("whether an arbitration is

deemed a judicial ‘action’ depends on the legal context in which the question arises.”). As *Fire Fighters* noted, “nothing in the ‘plain language’ of ‘action’ prevents us from interpreting it to include arbitration proceedings.” *Id.* at 41. Neither of the cases relied on by the court below, *Thorgaard* or *Auburn*, addressed the specific issues before the Court or provide a blanket rule as to the general applicability of statutes of limitation in arbitration proceedings.⁴

A cornerstone of the arbitration process is that participants are provided an equal opportunity to pursue the substantive claims and defenses that are available in court. While procedural differences may exist between court and arbitration -- such as pleading standards or the requirement to submit a claim to a county commission that was addressed in *Thorgaard* -- substantive rights should be preserved.

⁴ The Brooms’ Answer to the Petition inaccurately suggests that both *Thorgaard* and *Auburn* related to the applicability of statutes of limitation in arbitration. [Answer to Petition at 17. To the contrary, the *Thorgaard* case did not involve a statute of limitations at all. Rather, it involved a nonclaim statute that created a procedural hurdle before a lawsuit could be filed. The Court held that the hurdle (submitting a pre-suit claim) was not required before a party brought claims in arbitration. Those facts are substantially different than the present case, which involves a statute of limitations that provides a substantive, permanent bar on claims that are not timely asserted. The *Auburn* case also did not establish a blanket rule on the applicability of statutes of limitation in arbitration. Rather, it simply held that one specific type of claim -- a claim under RCW 70.05.145 relating to health care payments by a city -- was not subject to the two-year catch-all limitations period set forth in RCW 4.16.130. 114 Wn.2d at 451. Moreover, *Fire Fighters* opened the door for the treatment of an arbitration proceeding as an “action” for purposes of applying a statute of limitations. Indeed, as discussed in greater depth below, the application in the underlying dispute would appear particularly appropriate because the Brooms have asserted certain claims under statutes that authorize a party to bring an “action” but they nevertheless seek to avoid the statutes of limitation that expressly relate to those very same statutory claims.

Under Washington law, “statutes of limitations are both substantive and procedural” in nature. *See Stikes Woods Neighborhood Assoc. v. City of Lacey*, 124 Wn.2d 459, 466, 880 P.2d 25 (1994) (holding that the calculation of time under a statute of limitation was procedural).⁵

Statutes of limitations ensure fairness to parties that are confronted with stale claims. As the Supreme Court of the United States has held:

Statutes of limitations, which “are found and approved in all systems of enlightened jurisprudence,” represent a pervasive legislative judgment that it is unjust to fail to put the adversary on notice to defend within a specified period of time and that “the right to be free of stale claims in time comes to prevail over the right to prosecute them.”

These enactments are statutes of repose, and although affording plaintiffs what the legislature deems a reasonable time to present their claims, they protect defendants and the courts from having to deal with cases in which the search for truth may be seriously impaired by the loss of evidence, whether by death or disappearance of witnesses, fading memories, disappearance of documents, or otherwise.

United States v. Kubrick, 444 U.S. 111, 117 (1979) (emphasis added)

(citations omitted); *see also Douchette v. Bethell Sch. Dist. No. 403*, 117

Wn.2d 805, 813, 818 P.2d 1362 (1991) (“The policy behind statutes of

limitation is “protection of the defendant, and the courts, from litigation of

⁵ Many courts throughout the country have held that a statute of limitations provides a substantive right to a defendant. *See, e.g., Springman v. AIG Marketing, Inc.*, 523 F.3d 685, 688 (7th Cir. 2008) (“The statute of limitations, however, is a substantive defense”); *In re: Enterprise Mortg. Acceptance Co. LLC Sec. Litig.*, 391 F.3d 401, 409-10 (2d Cir. 2004); *Kopalchick v. Catholic Diocese of Richmond*, 645 S.E.2d 439, 441 (Va. 2007); *Batista v. Publix Supermarkets, Inc.*, __ So. 2d __, 2008 WL 4643791, *2 (Fla. 1st DCA Oct. 22, 2008).

stale claims where plaintiffs have slept on their rights and evidence may have been lost or witnesses' memories faded.”) (citation omitted).

The Washington Supreme Court has acknowledged that statutes of limitation are often applied in arbitrations. See *McKee v. AT&T Corp.*, 191 P.3d 845, 2008 LEXIS 816, *23-24 (2008) (“[A]rbitrations can (and often should)... apply appropriate statutes of limitation...”)⁶ The Court of Appeals’ decision would summarily eliminate this fundamental defense from all arbitrations.⁷

There simply is no policy basis to allow parties to bring claims in arbitration based on statutes that authorize the filing of an “action” (like the claims asserted by the Brooms), but remove a party’s right to assert the statutes of limitation applicable to those very same claims. In contrast to the facts in *Thorgaard*, where there was in fact a sound reason to eliminate

⁶ Numerous federal courts have held that arbitrators must apply statutes of limitation. See, e.g., *Hasbro v. Amron*, 419 F. Supp. 2d 678, 689 (E.D. Pa. 2006) (vacating an award based on arbitrators failure to apply statute of limitations); *Pellegrino v. Auerbach*, 2006 WL 565643 (S.D.N.Y. 2006) (holding that “the issue of the statute of limitations is for the arbitrators to decide”).

⁷ The Brooms’ Answer to the Petition suggests that the unavailability of statutes of limitation defenses in arbitration could be cured by parties expressly contracting for such limitations. (Answer to Pet. at 18). Moreover, the Brooms incorrectly suggest that the NASD eligibility rule (Rule 10304(a)) is precisely such a limitation. To the contrary, Rule 10304(a) does not provide a dispositive time bar to stale claims; rather, it simply limits those claims that are subject to arbitration. If a firm seeks to dismiss an arbitration pursuant to Rule 10304(a) (or its successor, FINRA Rule 12206), it must agree to litigate any ineligible claims in court. Accordingly, there is no dispositive time bar provided in the securities industry rules for mandatory arbitration. Additionally, because the securities industry rules are heavily regulated and must be approved by the SEC after an extensive comment process, the suggestion that parties subject to mandatory arbitration can privately contract for a substantive time limitation is misleading and unrealistic. Finally, even if additional time limitations were incorporated into arbitration agreements, parties might attempt to challenge them on the basis of alleged unconscionability.

an unnecessary procedural hurdle as a condition precedent to arbitration, the elimination of time defenses in arbitration will impose a further burden on the arbitration system and its participants.

Although the Court of Appeal's decision is unpublished, it has already been cited in arbitration proceedings outside the state of Washington in opposition to motions based on statutes of limitations. Because arbitration generally employs more lax procedural rules, parties frequently cite unpublished or non-controlling authority. Parties seeking to avoid time defenses will continue to use this decision in an attempt to prosecute stale claims if it is left to stand.

Because the Court of Appeals' decision would have far reaching implications and deprive parties of an important substantive defense without any sound legal or policy justification, review is appropriate.⁸

V. CONCLUSION

For the reasons set forth above, the Court of Appeals' decision should be reviewed because it presents compelling policy issues.

⁸ The Brooms' argument based on the fact that the decision below arose under the now repealed Washington Arbitration Act ("WAA") (Answer to Pet. at 10), is of no consequence. The WAA was replaced by the Revised Uniform Arbitration Act, which is materially identical to the relevant portion of the WAA. *Compare* RCW 7.04.160 with RCW 7.04A.230 (both providing a list a grounds for vacatur that does not include "legal error" but does include a basis for where arbitrators "exceeded their powers," upon which the legal error standard had been loosely based). As a result, if legal error was a viable ground under the WAA, parties and courts may look to the Court of Appeals' decision for guidance on the viability of the standard under the RUAA.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 28th day of November, 2008, I caused to be served by federal express overnight mail the foregoing **SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION'S AMICUS CURIAE MEMORANDUM IN SUPPORT OF REVIEW** on the following at the offices listed below:

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