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IS ARBITRATION WORTH FIGHTING FOR—PART TWO: DO STATUTES OF LIMITATIONS APPLY?

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INTRODUCTION

In October of last year we wrote about the Arbitration Fairness Act of 2013 and asked the question: is arbitration really worth fighting for? In doing so, we discussed how FINRA arbitration proceedings have limited discovery, prohibitions on taking depositions, strict limitations on filing dispositive motions, limited procedural safeguards at hearings (i.e., no rules of evidence or right of appeal), and incredible uncertainty. In this article, we will explore how FINRA arbitration proceedings handle statutes of limitations and how that impacts the fight for, or against, arbitration.

DO STATUTES OF LIMITATIONS APPLY IN FINRA ARBITRATION?

This question becomes incredibly important in cases where the investor asserts a claim that is technically "eligible" for arbitration—the claim is asserted within FINRA's six-year eligibility rule—but filed outside the statute of limitations. The following is a brief example: Mr. Investor lives in Ohio. He invested in a variable annuity on January 1, 2008 based on the recommendation of Mr. Adviser. Mr. Investor files a FINRA Statement of Claim against Mr. Adviser five years after he purchased his variable annuity and alleges that Mr. Adviser was negligent in recommending the variable annuity. Under Ohio law, the statute of limitations (time limitation) to bring a negligence claim is generally four years. FINRA, however, says that a claim is "eligible" for arbitration if it is brought within six years from when the investment at issue was made. In this scenario, Mr. Investor's negligence claim was filed outside the statute of limitations—because it was filed more than four years after the allegedly negligent advice. But it would be technically "eligible" for arbitration because it was filed within FINRA's six-year eligibility rule.

In these types of cases, Claimants' attorneys and Respondents' attorneys will undoubtedly disagree about whether state law statutes of limitations apply. Claimants' attorneys often argue that FINRA is an "equitable" forum in which statutes of limitations do not apply. Indeed, FINRA's Dispute Resolution Arbitrator's Guide opens by quoting Aristotle: "Equity is justice in that it goes beyond the written law. And it is equitable to prefer arbitration to the law court, for the arbitrator keeps equity in view, whereas the judge looks only to the law, and the reason why arbitrators were appointed was that equity might prevail." Claimants' attorneys have latched onto the theme that arbitration is an "equitable proceeding" to argue against a strict application of statutes of limitations. In support of their position, Claimants' attorneys cite everything from Congressional testimony to case opinions, including statements like the following from Linda Feinberg, the former Director of Arbitration for FINRA:

"[T]he strict rules of evidence do not apply….In arbitration, an SRO, an NASD arbitration, unlike courts, you get an equitable result. You do not have to have a claim that is cognizable under state or federal law. It can be cognizable under NASD rules. So, for example, there is only one cause of action under the federal securities laws, that's 10b, its limited, it has a very short statute of limitations. The rules that are applied by arbitrators looking for equitable relief are much broader than if they had to strictly follow the law."

Courts across the country have also issued opinions favoring a more lenient application of statutes of limitations in arbitration proceedings. See e.g., NCR Corp. v. CBS Liquor Control, 874 F.Supp. 168 (S.D. Ohio 1993) ("…the effect of a statute of limitations is to bar an action at law, not arbitration."); *Metro. Waste Control Comm'n v. City of Minnetonka*, 308 Minn. 385, 242 N.E.2d 830, 832 (1976) (arbitrators "may make an award according to their own notion of justice without regard to the law"). Other courts have held that state statutes of limitations do not apply unless the arbitration agreement between the parties expressly states that statutes of limitations will apply in the arbitration

proceeding. *See e.g. Lewiston Firefighters Assoc. v. City of Lewiston*, 354 A.2d 154 (Me. 1976); *SCM Corp. v. Fisher Park Lane*, 358 N.E. 2d 1024, 390 N.Y.S. 2d 670 (1973).

Attorneys for broker-dealers and other respondents have just as much (or more) authority to argue the contrary position. In fact, the argument in favor of the strict application of statutes of limitations is grounded in the FINRA Rules. FINRA Rule 12206(c) provides that FINRA's eligibility "rule does not extend applicable statutes of limitations…." (Emphasis added.) If statutes of limitations did not apply in FINRA proceedings, there would be no need to reference them in this rule or clarify that FINRA's eligibility rule does not extend any such limitations. Court opinions have also supported this contention. A recent case out of a Pennsylvania federal court recently stated that "*The Arbitrator's Manual*-compiled by members of the Securities Industry Conference on Arbitration as a guide for arbitrators and designed to supplement the Uniform Code of Arbitration—expressly approves the application of statutes of limitations in NASD/FINRA arbitrations." *See Dailey v. Legg Mason Wood Walker, Inc.*, 2009 WL 4782151 (W.D. Pa. 2009).

With both positions supported by credible authority, whether to apply state law statutes of limitations is left to the discretion of the FINRA arbitration panel. One panel of arbitrators may agree with Claimants' position, while another may agree with Respondents' position. This uncertainty adds another layer of risk to FINRA arbitration, and another potential argument in favor of keeping cases in state or federal court.

DOES IT EVEN MATTER IF STATUTES OF LIMITATIONS APPLY?

As we highlighted in Part One of this series, FINRA rules only permit dispositive motions—motions that dispose of a case prior to hearing—in three limited circumstances: 1) when a respondent was previously released from the claims through a signed settlement agreement or release, 2) when a respondent was not associated with the conduct at issue, or 3) when the claims are not eligible for arbitration. Bringing a claim outside the statute of limitations is not one of the circumstances. Practically speaking, this means a respondent must defend a claim that would otherwise be barred by the statute of limitation up to the hearing, expend the resources to defend the case, and then move for dismissal at the hearing. And for the reasons discussed above, there is no guarantee that a panel will follow state law and dismiss claims that are barred by the applicable statutes of limitations.

CONCLUSION

There are three important take-aways from this discussion. First, if a case is filed in state or federal court, a broker-dealer would be wise to diligently assess the state law statutes of limitations before filing a motion to compel arbitration. All too often, broker-dealers have a knee-jerk reaction to a case being filed in court and immediately file a motion compel arbitration. They then find themselves making strong statute of limitations arguments in a FINRA arbitration proceeding—a forum that provides no procedural mechanism to dismiss a case on statute of limitations grounds. If there are strong statute of limitations defenses, a broker-dealer should seriously consider keeping the case in state or federal court.

Second, review your arbitration agreements. Make sure they contain a provision that expressly states that state law statutes of limitations will apply in any FINRA arbitration proceeding. Having this provision will eliminate one potential argument—that state statutes of limitations do not apply unless the arbitration agreement between the parties expressly states that state law statutes of limitations apply.

Lastly, a broker-dealer should fully appreciate the uncertainty surrounding statute of limitations arguments. When evaluating the exposure and settlement value of a FINRA arbitration case, a broker-dealer would be wise to focus primarily on the merits of the case and less on statute of limitations arguments, which may or may not be recognized by the FINRA arbitration panel.

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