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When Should a Court Rather Than an Arbitrator Decide Whether a Claim Is Arbitrable?

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Case at a Glance

This case presents the issue of whether a court or an arbitrator should determine whether a securities claim is arbitrable when the arbitration rules provide that no claim "shall be eligible for submission to arbitration ... where six ... years have elapsed from the occurrence or event giving rise to the act or dispute, claim or controversy."

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by Jay E. Grenig

PREVIEW of United States Supreme Court Cases, pages 4–7.

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ISSUE

When must a court rather than an arbitrator make threshold determinations of eligibility for arbitration?

FACTS

Karen Howsam was a customer of Dean Witter Reynolds, Inc. in March and April 1986, at which time she was advised by two Dean Witter brokers to invest in four limited partnerships. Howsam remained invested in those limited partnerships until late 1994, when she closed her Dean Witter accounts and moved her funds to another investment firm. While a customer of Dean Witter, Howsam signed a standard client services agreement providing that all controversies between her and Dean Witter must be determined by arbitration.

On March 7, 1997, Howsam commenced arbitration before the National Association of Securities Dealers (NASD) regarding Dean Witter's recommendation that she invest in the four limited partnerships. She later filed an amended claim alleging that Dean Witter, through its agents, made material misrepresentations about the investments prior to her decision to purchase them and that the investments were unsuitable for someone with her investment needs. Howsam further alleged that Dean Witter continued to inform her that the investments were sound, despite indications to the contrary, which impeded her understanding of the true nature of the investments until 1994.

In commencing the arbitration, Howsam executed a Uniform Submission Agreement as required by the NASD. The Submission Agreement provided that she agreed to be bound by the NASD Uniform Code of Arbitration. The NASD Code contains a provision that no claim is eligible for submission to arbitration after six years have elapsed from the occurrence or event giving rise to the claim.

HOWSAM V. DEAN WITTER REYNOLDS, INC.
DOCKET NO. 01-800

ARGUMENT DATE:
OCTOBER 9, 2002
FROM: THE TENTH CIRCUIT

Dean Witter brought suit for declaratory relief in federal court, seeking to enjoin Howsam from arbitrating her dispute with Dean Witter on the ground that the dispute was time-barred under the NASD rules. Dean Witter argued that the question of arbitrability of Howsam's claims was for the court, and not for NASD arbitrators, to decide. Howsam responded by filing a motion to dismiss, arguing that the district court lacked jurisdiction to decide the issue of arbitrability.

The district court concluded that the parties had "clearly and unmistakably" agreed that all disputes between the parties, including questions regarding the arbitrability of those disputes, would be determined by an arbitrator rather than by the courts. The district court dismissed Dean Witter's suit.

On appeal, the U.S. Court of Appeals for the Tenth Circuit held that the district court erred in finding that the parties had "clearly and unmistakably" agreed to allow an arbitrator, rather than the courts, to decide whether specific disputes are arbitrable. 261 F.3d 956 (10th Cir. 2001). The court held that the original arbitration agreement signed by Dean Witter and Howsam, as supplemented by the subsequent submission agreement required by NASD and signed only by the customer, was the controlling arbitration contract between the parties. The court found that Howsam had agreed in the original agreement to choose an arbitration forum from a list of approved organizations and, in filing the submission agreement, elected to have her claims resolved by NASD pursuant to NASD rules and regulations.

The Tenth Circuit reasoned that the NASD Code provision, § 10304, requiring claims to be brought within six years of the occurrence or event giving rise to the claim can be reasonably interpreted only one way—as a substantive limit on the claims that the parties have contracted to submit to arbitration. The Tenth Circuit found that § 10304 could not provide the type of "clear and convincing" evidence that is required to allow arbitrators to decide the arbitrability of the parties' dispute. The Tenth Circuit observed that it seems entirely possible that an express statement in the contract is not only preferable, but also necessary to a finding that the parties "clearly and unmistakably" agreed to submit arbitrability questions to an arbitrator rather than to the courts. The Tenth Circuit concluded that the courts, not the arbitrators themselves, must decide whether a claim is time-barred under that provision, because the agreements between Howsam and Dean Witter did not "clearly and unmistakably" provide that the question of arbitrability should be resolved by an arbitrator.

The Supreme Court thereafter granted Howsam's petition requesting review of the Tenth Circuit's decision. 122 S.Ct. 1171 (2002).

Case Analysis

Arbitration is a matter of contract, and parties should not be forced to arbitrate issues that have not been agreed upon. *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 648 (1986). In *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995), the Supreme Court declared that, just as the arbitrability of the merits of a dispute depends upon whether the parties agreed to arbitrate that dispute, the question of who has the primary power to decide arbitrability turns upon what the parties agreed on that matter. 514 U.S. at 943.

In *First Options*, the Supreme Court described the analysis courts must apply in determining whether arbitrators or courts are to decide whether a matter is subject to arbitration. The Court stated:

> Courts should not assume that the parties agreed to arbitrate arbitrability unless there is "clea[r] and unmistakabl[e] evidence that they did so. ... In this manner the law treats silence or ambiguity about the question "who (primarily) should decide arbitrability" differently from the way it treats silence or ambiguity about the question "whether a particular merits-related dispute is arbitrable because it is within the scope of a valid arbitration agreement"—for in respect to this latter question the law reverses the presumption.

514 U.S. at 1924 (citations omitted).

The Court explained that the arbitrability inquiry is more stringent given the principle that a party can be forced to arbitrate only those issues it specifically has agreed to submit to arbitration.

Section 10304 (formerly § 15) of the NASD Code states that "[n]o dispute, claim or controversy shall be eligible for submission to arbitration under this Code where (6) years have elapsed from the occurrence or event giving rise to the act or dispute, claim or controversy." Section 10324 (formerly § 35) of the NASD Code states that "arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code."

According to Howsam, the time limitation in Section 10304 is a procedural rather than substantive rule. She argues that the limitation does not present an issue of arbitrability and thus must be decided by the

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arbitrator. She argues that the plain language of the agreement provides "clear and unmistakable" evidence of an intent to arbitrate timeliness.

Dean Witter contends that the concept of "arbitrability" encompasses all restrictions on the scope of arbitration. It asserts that the arbitration agreement does not "clearly and unmistakably" evidence an intent to arbitrate arbitrability. Accordingly, Dean Witter says that a court must decide whether Howsam's claim is eligible for submission to arbitration.

Although it was the securities industry that sought the inclusion of arbitration provisions in its agreements with its customers, the Securities Industry Association argues in support of Dean Witter that determinations regarding eligibility should not be made by arbitrators—who may apply varying standards and whose rulings on eligibility are insulated from effective challenge—unless the parties clearly and unmistakably indicate their desire to arbitrate that critical initial issue.

SIGNIFICANCE

Using conflicting lines of reasoning, the U.S. courts of appeals are sharply divided on the issue of who determines whether an action is time-barred by the NASD Code. This case presents the Supreme Court with an opportunity to resolve the split among the circuits.

In addition to the Tenth Circuit, the Third, Sixth, Seventh, and Eleventh Circuits have held that courts, and not arbitrators, should determine whether an action is time-barred by the NASD Code because that determination involves the scope of the arbitrator's subject matter jurisdiction. *PaineWebber, Inc. v. Hoffman*, 984 F.2d 1372 (3d Cir. 1993); *Dean Witter Reynolds, Inc. v. McCoy*, 995 F.2d 649 (6th Cir. 1997); *Smith Barney, Inc. v. Schell*, 53 F.3d 807 (7th Cir. 1995); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cohen*, 62 F.3d 831 (11th Cir. 1995).

The Seventh Circuit explained that the time period in § 15 of the NASD Code is not a statute of limitations in the ordinary sense, but that it defines the arbitrator's subject matter jurisdiction. Because § 15 defines which claims are cognizable in an arbitration proceeding, the Seventh Circuit held that a district court faced with an application for an order compelling arbitration before the NASD must determine whether the Code bars the arbitrators from exercising jurisdiction.

On the other hand, the First, Second, Fifth, Eighth, and Ninth Circuits have held that arbitrators, and not courts, can decide the issue of timely submission to arbitration of a securities dispute. *PaineWebber, Inc. v. Elahi*, 87 F.3d 589 (1st Cir. 1996); *PaineWebber, Inc. v. Bybyk*, 81 F.3d 1193, 1196 (2d Cir. 1996); *Smith Barney Shearson, Inc. v. Boone*, 47 F.3d 750 (5th Cir. 1995); *FSC Securities Corp. v. Freel*, 14 F.3d 1310, 1312-13 (8th Cir. 1994); *O'Neel v. National Ass'n of Securities Dealers, Inc.*, 667 F.2d 804 (9th Cir. 1982). The First Circuit reasoned that many a mandatory procedural rule could be called an "arbitrability" rule if the failure to comply prevented arbitration of the merits. According to the First Circuit, § 15 is analogous to a statute of limitations rather than a "substantive eligibility requirement." The First Circuit stated that in such cases, the issue of timeliness is for the arbitrator to decide.

The U.S. Court of Appeals for the District of Columbia has applied the presumption in favor of arbitration to the question of whether the court or the arbitrator should decide if a claim was barred by the statute of limitations. *Hanes Corp. v. Millard*, 531 F.2d 585 (D.C. Cir. 1976).

The Supreme Court has the opportunity to determine whether the issue of "arbitrability" includes only the questions of whether the parties are bound by a valid agreement to arbitrate and whether the underlying dispute is within that agreement.

The First Circuit's opinion recognizes that there are two types of arbitrability. Substantive arbitrability is concerned with the question of whether the parties have contractually agreed to submit a particular dispute to arbitration. Procedural arbitrability, on the other hand, is concerned with whether there has been compliance with the procedures for submitting a dispute to arbitration. The Revised Uniform Arbitration provides that when the parties have not agreed otherwise, questions of procedural arbitrability are for the arbitrator to decide. *Cf. John Wiley & Sons v. Livingston*, 376 U.S. 543 (1964) (in a case involving a collective bargaining agreement, the Supreme Court held that once it is determined that the parties are obligated to submit the subject matter of a dispute to arbitration, "procedural" questions that grow out of the dispute and bear on its final disposition should be left to the arbitrator).

The Court in *John Wiley* explained that whether procedural prerequisites apply, whether they have been followed or excused, and whether the unexcused failure to follow them bars arbitration cannot ordinarily be answered without consideration of the merits of the dispute presented for arbitration. See also

International Union of Operating Engineers v. Flair Builders, Inc., 406 U.S. 487 (1972) (once it is determined that parties had signed an agreement to arbitrate "any difference," then a claim that particular grievances are barred by the doctrine of laches is an arbitrable question under the agreement).

Unlike most of the arbitration cases submitted to the Supreme Court in recent years, this case presents a situation in which the consumer is demanding arbitration and the party that included an arbitration clause in the contract presented to the consumer is arguing against arbitration. Nonetheless, some believe that requiring courts to make the determination as to whether a claim is timely may provide a base level of fairness for parties with limited choice regarding arbitration. The Securities Industry Association suggests that allowing courts to determine eligibility reduces the risk of either intentional or *de facto* nonenforcement of the timeliness requirement by arbitrators.

On the other hand, however, requiring issues of timeliness to be submitted to a court rather than an arbitrator may increase the costs of arbitration and delay resolution of the merits of the claims submitted to arbitration. Requiring a "mini-trial" to resolve timeliness disputes before proceeding to arbitration could result in needless delay and obstruction in the courts, discouraging consumers from seeking recovery for their claims.

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Amicus Briefs

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