Arbitration (Axelrod & Co. v. Kordich, Victor & Neufeld; Coenen v. Pressprich)

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upon oral statements made during the hearing. . . . Rather, the court relied upon all the evidence which had been accumulating from the time the . . . [action was] initially commenced."\textsuperscript{116} SIPC, in fact, had conceded at the district court proceeding that the court should make its own finding about the ability of Hughes, Inc. to meet its obligations to customers within the meaning of the 1970 Act.\textsuperscript{117} On the facts of the case, the Second Circuit found that the district court had recognized its responsibility under the 1970 Act, and that its responsibility had been fulfilled upon sufficient evidence.\textsuperscript{118}

The importance of the decision rendered by the Second Circuit in this case stems not from the complexity of the issues involved, but rather from the fact that it is a case of first impression.\textsuperscript{119} In \textit{SEC v. Alan F. Hughes, Inc.} the court made the initial adjudication of constitutional considerations under the 1970 Act.\textsuperscript{120}

\textbf{Arbitration}

\textit{Axelrod \& Co. v. Kordich, Victor \& Neufeld}

\textit{Coenen v. Pressprich}

An apparent conflict between stock exchange rules and provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 was resolved when the Second Circuit, in separate cases, held 1) that a non-member may use the rules of an exchange to compel a member firm to arbitrate a dispute and 2) that a member firm may likewise compel an allied member to arbitrate.

In the first case, \textit{Axelrod \& Co. v. Kordich, Victor \& Neufeld},\textsuperscript{121} the non-member defendant, alleging breach of a common stock purchase contract,\textsuperscript{122} had commenced arbitration proceedings before the question to be resolved. If a case places "adjudicative facts" in dispute, a trial seems best suited. I Davis, Administrative Law Treatise § 702, at 413 (1958).

The complex fact questions raised in a determination as to the financial stability of a SIPC member are of an adjudicative nature and, therefore, worthy of a due process hearing. No such hearing was guaranteed upon the initial determination and, as the Second Circuit concluded, a cursory review of the initial findings would not remedy the due process issue. \textit{See generally} 461 F.2d at 979 n.8.

\textsuperscript{116} 461 F.2d at 981.
\textsuperscript{117} Id.
\textsuperscript{118} Id. at 982.
\textsuperscript{119} Id. at 976.
\textsuperscript{120} Prior to the instant case the only other aspect of the 1970 Act which had been adjudicated was the question of retroactivity. It was held in Loff v. Casey, 330 F. Supp. 356 (D. Colo. 1971) (mem.), aff'd, CCH Fed. Sec. L. Rep. ¶ 99,589 (10th Cir.), that the 1970 Act affords protection only to the customers of those firms which were actually in business on or after the effective date of the legislation. In the \textit{Loff} case the firm seeking 1970 Act status had been adjudicated a bankrupt prior to December 30, 1970. \textit{Id.} at 357.
\textsuperscript{121} 451 F.2d 838 (2d Cir. 1971).
\textsuperscript{122} Axelrod had contracted to purchase five thousand shares of On Site Energy Sys-
New York Stock Exchange (NYSE) against Axelrod & Co., a member firm. Axelrod responded by suing for rescission of the contract in the United States District Court for the Southern District of New York. Axelrod claimed fraudulent misrepresentation in violation of both the Securities Act of 1933\(^{123}\) and the Securities Exchange Act of 1934.\(^{124}\) A temporary restraining order staying the arbitration proceedings was issued by the district court on the plaintiff's motion. Subsequently, defendant's cross motion, made pursuant to section 3 of the United States Arbitration Act\(^{125}\) for a stay of the action pending completion of arbitration was granted and the injunction dissolved. The court held that the non-member firm had standing to require arbitration of its dispute with the NYSE member firm under the Stock Exchange rules.\(^{126}\) The Second Circuit affirmed.\(^{127}\)

Consistent with the policy of self-regulation effected by the Securities Exchange Act of 1934,\(^{128}\) the NYSE requires arbitration of a dispute

\(^{125}\) 9 U.S.C. § 3 (1970) provides:
If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.
\(^{127}\) 451 F.2d at 843.

The courts have been inclined to rule in favor of arbitration in matters involving securities dealers when such holdings would not compromise the protection afforded customers by the anti-waiver provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. See generally In re Revenue Properties Litigation Cases, 451 F.2d 510 (1st Cir. 1971) (defendant broker was required to arbitrate at instance of third party defendant); Daniel v. Board of Trade of City of Chicago, 164 F.2d 815 (7th Cir. 1947) (commodities board chosen to represent buyer and seller was arbitrator, not mere stakeholder and its actions precluded suit absent a showing of bad faith); Isaacson v. Hayden, Stone Inc., 319 F. Supp. 929 (S.D.N.Y. 1970) (plaintiff, a former allied member, was required to arbitrate his dispute with member firm notwithstanding that plaintiff had relinquished his allied member status after the dispute arose and prior to commencement of his action); Brown v. Gilligan, Will & Co., 287 F. Supp. 766 (S.D.N.Y. 1968) (buyer of unregistered stock, uninformed that it was sold by controlling stockholder, was required to arbitrate dispute with defendant broker); Robinson v. Bache & Co., 227 F. Supp. 456 (S.D.N.Y. 1964) (plaintiff securities buyer who brought diversity action against defendant broker without alleging violations of the Securities Act of 1933 or Securities Exchange Act of 1934 was nevertheless required to arbitrate); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Griesenbeck, 28 App. Div. 2d 99, 281 N.Y.S.2d 580 (1st Dep't 1967) (action
between a member firm and a non-member at the instance of the non-member. Therefore, Axelrod was clearly bound by article VIII, section 1 of the New York Stock Exchange Constitution to arbitrate its dispute.

Axelrod insisted, however, that compulsory arbitration of the complaint alleging violation of the Securities Act of 1933 and the Securities Exchange Act of 1934 was barred by sections 14 and 29(a) of the respective Acts which nullify any waiver of legal rights granted by the Acts. The language of section 29(a) of the 1934 Act is almost identical to that of section 14 of the 1933 Act. The latter provision was interpreted by the United States Supreme Court in Wilko v. Swan which held an agreement to arbitrate any future controversy between a plaintiff customer and a defendant brokerage house void notwithstanding section 3 of the Arbitration Act.

The Second Circuit distinguished Axelrod from Wilko on two separate grounds, i.e., differences both in the status of the respective parties and in the policy considerations applicable to the two cases.

Section 28(b) of the 1934 Act removes from the scope of stipula-

129 Article VIII, section 1 of the New York Stock Exchange Constitution states that:

Any controversy between parties who are members, allied members, member firms or member corporations shall, at the instance of any such party, and any controversy between a non-member and a member or allied member or member firm or member corporation arising out of the business of such member, allied member, member firm or member corporation, . . . shall, at the instance of such non-member, be submitted for arbitration, in accordance with the provisions of the Constitution and the rules of the Board of Directors.


Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

132 15 U.S.C. § 78cc(a) (1970) provides:

Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

133 346 U.S. 427 (1953).

134 Id. at 438.

135 15 U.S.C. § 78bb(b) (1970) provides:
tions made void by section 29(a) agreements by exchange members to arbitrate disputes in accordance with exchange rules. This exception to the non-waiver provision of the Act applies only to exchange members and could not be invoked by the plaintiff customer in Wilko to require arbitration. However, since Axelrod is a member firm, it falls within the purview of the section and may therefore be compelled to arbitrate. The Second Circuit also held that notwithstanding the absence of similar language in the Securities Act of 1933, section 28(b)'s exception to the anti-waiver provisions of the 1934 Act is also applicable to the anti-waiver provisions of the 1933 Act, the two acts being "in pari materia and ... [construable] as one body of law."\(^{136}\)

The Second Circuit noted that the benefits of permitting litigation in Wilko would not result from a similar decision in Axelrod. In Wilko, the Supreme Court looked behind the anti-waiver provision of the statute and found a legislative intent to protect the small investor from the superior bargaining advantage held by the brokerage firms with whom he dealt.\(^{137}\) This purpose, while served by nullification of the plaintiff's agreement to arbitrate in Wilko, would not be promoted by relieving Axelrod, a member brokerage firm, of its obligation to arbitrate.

Nine months after Axelrod, the Second Circuit, in a similar decision, held that a dispute between an allied member\(^ {138} \) of the NYSE and

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See also In re Revenue Properties Litigation Cases, 451 F.2d 310 (1st Cir. 1971) (Although the court agreed with the interpretation that section 28(b) of the 1934 Act also applied to the 1933 Act, it was able to require arbitration of a customer-broker dispute by finding that the anti-waiver provisions of the 1933 Act did not apply to a sales transaction which contained no agreement requiring arbitration, the only requirement of arbitration being in the Stock Exchange Constitution.)

\(^{137}\) 451 F.2d at 842-43.

\(^{138}\) The New York Stock Exchange Constitution provides the following definition:

**Article I**

(d) Allied Member. The term 'allied member' means:

(i) a general partner in a member firm who is not a member of the Exchange and who has become an allied member as provided in Article IX, or

(ii) an employee of a member corporation who is actively engaged in its business and devotes the major portion of his time thereto, who is not a member of the Exchange, who has become an allied member as provided in Article IX, and who is either:

(a) a director and a holder of record and beneficial owner of voting stock of such corporation, or

(b) a principal executive officer and a holder of record and beneficial owner of voting stock of such corporation, or

(c) a holder of record and beneficial owner of 5% or more of the outstanding voting stock of such corporation.

2 CCH NEW YORK STOCK EXCHANGE GUIDE, CONSTITUTION, ¶ 1003 (1972).
a member brokerage firm must be arbitrated. In Coenen v. Pressprich,\textsuperscript{139} the plaintiff contended that a dispute\textsuperscript{140} between himself and the defendant NYSE member firm which arose prior to the plaintiff’s attainment of allied member status\textsuperscript{141} was not within the scope of the arbitration clause of the New York Stock Exchange Constitution. The Second Circuit rejected this argument and affirmed the district court’s decision granting the defendant’s motion to stay the action pending arbitration.\textsuperscript{142}

In addition to the policy considerations of protecting the small

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**Article IX**

Sec. 9 Any person, not a member of the Exchange, shall become an allied member of the Exchange by pledging himself to abide by the Constitution as the same has been or shall be from time to time amended, and by all rules adopted pursuant to the Constitution and by either

(a) becoming a general partner in a member firm, or
(b) becoming a holder of record and beneficial owner of 5% or more of the outstanding voting stock of a member corporation, or
(c) becoming a director and a holder of record and beneficial owner of voting stock of a member corporation, or
(d) becoming a principal executive officer and a holder of record and beneficial owner of voting stock of a member corporation.

Such pledge to abide by the Constitution and Rules shall be made by written instrument filed with the Exchange in which the signer pledges himself as aforesaid.

*Id.* at ¶ 1409.

\textsuperscript{139} 453 F.2d 1209 (2d Cir. 1972).


Plaintiff, while a director of Stirling Homex Corporation, is alleged to have purchased 90,000 shares of unregistered Stirling stock for “investment purposes.” The shares were imprinted with a restrictive legend prohibiting transfer unless registered in accordance with the Securities Act of 1933 or Stirling received satisfactory opinion of counsel that registration wasn’t required. (For the type of restrictive legend used see 1 P-H \textit{Securities Regulation, How to Comply with SEC Rules} ¶ 115.4 (1972)). Following this transaction, Pressprich sold 1,175,000 shares of Stirling stock to the public pursuant to a registration statement. Plaintiff alleged that his subsequent attempt to sell his 90,000 shares to raise needed cash was thwarted by Pressprich and Stirling ostensibly for lack of registration or satisfactory opinion of counsel that registration was not required, but actually to limit the number of shares available to the market and thus artificially support the price of Stirling stock. It was further alleged that as a result of misrepresentations and coercion by Pressprich, plaintiff was eventually forced to sell his stock through Pressprich to an institutional buyer at the inequitable price of ten dollars per share.

\textsuperscript{141} When Coenen & Co. became a member of the NYSE, the plaintiff, an officer of that brokerage firm, became an allied member of the Exchange and a party to a contract with both the Exchange and its members of which the constitution and stock exchange rules were a part.

\textsuperscript{142} 453 F.2d at 1212.
investor promulgated in *Axelrod*, the court distinguished *Coenen* from *Wilko* on the basis of differences in the statutes under which each action was brought.\(^{143}\) It also noted that the sequence of the arbitration agreement and the occurrence of the dispute differed in the two cases.\(^{144}\)

*Coenen*’s contention that the exchange constitution’s arbitration clause is restricted to future disputes, *i.e.*, those arising subsequent to attainment of member status by both parties, was rejected upon examination of the constitution’s text which refers to “any controversy” and not merely to future controversies.\(^{146}\)

The third count in plaintiff’s complaint alleged anti-trust law infractions, *viz.*, conspiracy to restrain trade in and monopolize the market for the subject common stock in violation of sections 1 and 2 of the Sherman Act\(^ {146}\) respectively.\(^{147}\) Violations of sections 4 and 12 of the Clayton Act\(^ {148}\) were also alleged without supporting argument.\(^ {149}\) Although the Second Circuit conceded that antitrust claims are not normally arbitrable,\(^ {150}\) it noted that a claimant’s recourse in such a dispute

\(^{143}\) *Coenen* dealt with an alleged violation of section 10(b) of the Securities Exchange Act of 1934. *Wilko* involved only the Securities Act of 1933. Despite the Second Circuit’s earlier holding in *Axelrod*, that the exception (section 28(b)) to the non-waiver provision (section 29(a)) of the 1934 Act was equally applicable to that of the 1933 Act, the court relied on the absence of a similar exception from the 1933 Act to distinguish *Coenen* from *Wilko*.

In *Axelrod*, the finding that section 28(b) of the Securities Exchange Act of 1934 applied to section 14 of the Securities Act of 1933 was expressly limited to the facts of the case. 451 F.2d at 843. In *Coenen*, the court made no reference to the broadened interpretation given section 28(b) in *Axelrod*. Judge Mulligan sat in both cases. An explanation of the factual distinctions which warranted different applications of section 28(b) in the two instances is desirable. *Axelrod* relied on the fact that the plaintiff in *Wilko* was a small investor and not affected by section 28(b). *Coenen* depended on the absence of language similar to that of section 28(b) from the 1933 Act to reach the same result.

\(^{144}\) In *Wilko*, the plaintiff had executed an agreement to arbitrate differences between himself and the defendant brokerage firm prior to occurrence of the subject discord and therefore without knowledge of it. *Coenen*, on the other hand, was fully aware of the existence of his claim against Pressprich at the time he contracted to arbitrate “any” discrepancies between himself and all NYSE member firms. 453 F.2d at 1213. The non-waiver provisions of the Securities Exchange Act of 1934 do not bar arbitration of a controversy already in existence at the time of the agreement to arbitrate. See Garden v. Shearson, Hammill & Co., 433 F.2d 367 (5th Cir. 1970), *cert. denied*, 401 U.S. 978 (1971); Pearlstein v. Scudder & German, 429 F.2d 1136, 1143 (2d Cir. 1970), *cert. denied*, 401 U.S. 1013 (1971); Moran v. Paine, Webber, Jackson & Curtis, 389 F.2d 242 (9d Cir. 1968).

\(^{145}\) 458 F.2d at 1212.


\(^{147}\) 453 F.2d at 1214.


\(^{149}\) 453 F.2d at 1215.

\(^{150}\) There has been general agreement among the courts that antitrust claims are not arbitrable. Among the reasons courts have given are: rights adjudicated in an antitrust dispute affect not only the parties involved but also the public at large. A. & E. Plastik Pak Co. v. Monsanto Co., 396 F.2d 710, 715-16 (9th Cir. 1968); American Safety Equip. Corp. v J.P. Maguire & Co., 391 F.2d 821, 826-28 (2d Cir. 1968). Arbitrators are not qualified to properly apply the antitrust laws. Associated Milk Dealers, Inc. v. Local 753, Milk Drivers
is not limited to litigation and out-of-court settlement is a permissible alternative. Since the plaintiff had executed the arbitration agreement with full knowledge of his claim, he was deemed to have consented to settle his triple damage claim without the aid of the courts.\textsuperscript{151}

In both \textit{Axelrod} and \textit{Coenen}, the Second Circuit supported the policy of self government of stock exchanges and compelled arbitration of disputes originally submitted to litigation by a member firm and an allied member respectively. At the same time, the court expressed its willingness to exclude the small investor from the scope of parties subject to the jurisdiction of the stock exchange and achieved that objective by affording him a less biased forum.\textsuperscript{152} In applying them to

\textsuperscript{151} Id., Judge Medina, writing for a unanimous panel, intimated that the antitrust count was not supported by the facts alleged in the complaint and was included merely to provide the plaintiff with an additional avenue by which to pursue redress of his grievance and collect treble damages. This practice was criticized as an unfortunate attempt to circumvent the arbitration provisions of the New York Stock Exchange Constitution. The court, therefore, denied the plaintiff's right of action and ordered arbitration to proceed. \textit{Id.} at 1215-16.

\textsuperscript{152} Although the neutrality of an arbitrator is theoretically equal to that of a judge, the former's repeated contact with a narrow class of parties necessitated by his specialized role sometimes raises the issue of the arbitrator's objectivity. See Garfield & Co. v. Wiest, 432 F.2d 849 (2d Cir. 1970), \textit{cert. denied}, 401 U.S. 940 (1971) wherein plaintiff sought to vacate an adverse arbitration award on the basis of the arbitrators' failure to fully disclose their former dealings with the defendant brokerage firm. The Second Circuit upheld the award on the basis of the plaintiff's constructive knowledge, as a member of the NYSE, that "any arbitrators, by their very connection with the Exchange, would, in the ordinary course of business, have dealings with specialists ... ." \textit{Id.} at 853. However, the court went on to note that "[w]e find rather unrealistic the Exchange's contention in its \textit{amicus} brief that there is no possibility of favoritism ... ." \textit{Id.} at 853-54.


The view that antitrust claims are not arbitrable has also developed on the state level. See Aimcee Wholesale Corp. v. Tomar Prods., Inc. 21 N.Y.2d 621, 628-30, 237 N.E.2d 223, 226-27, 289 N.Y.S.2d 968, 973-74 (1968). In addition to the reasons given above, the New York Court of Appeals in \textit{Aimcee} noted that the equitable doctrines of waiver, estoppel, and \textit{in pari delicto} would be more readily applied by an arbitrator than by a court of law thereby weakening the deterrent effect of the antitrust laws. \textit{Id.} at 629, 237 N.E.2d at 277, 289 N.Y.S.2d at 975.

Perhaps the most often quoted statement on the subject and the one which most concisely makes the case for barring arbitration of antitrust disputes is found in Circuit Judge Clark's dissent in Wilko v. Swan, 201 F.2d 439, 445 (2d Cir.) \textit{rev'd}, 346 U.S. 427 (1953).

Commercial arbitration has been highly successful in bringing a businessman's adjudication to business questions. But it would be vastly unfortunate if it became usable as a device to blunt or break social legislation.

\textit{Id.}

The Second Circuit in \textit{Coenen}, however, noted a recognized exception to the general rule barring arbitration of antitrust claims, \textit{viz.}, where the agreement to arbitrate takes place after the dispute arises. 453 F.2d at 1215 and cases cited therein. \textit{Coenen} was found to fall within this exception. \textit{Id.}
implement these policies, the Second Circuit also demonstrated the extreme flexibility of the non-waiver sections of the Securities Act of 1933 and the Securities Exchange Act of 1934 as well as the statutory exception to the non-waiver provision included in the 1934 Act.

577 (2d Cir. 1967); San Martine Compañía De Navegacion, S. A. v. Saguenay Terminals Ltd., 293 F.2d 796 (9th Cir. 1961); Kentucky River Mills v. Jackson, 206 F.2d 111 (6th Cir. 1953), cert. denied, 346 U.S. 887 (1953); Hyman v. Pottberg’s Ex’rs, 101 F.2d 262 (2d Cir. 1939); American Guar. Co. v. Caldwell, 72 F.2d 209 (9th Cir. 1934).