

February 2004

## Court Holds Predispute Arbitration Agreement Between Broker and Client Precludes State Securities Regulator From Pursuing Victim-Specific Relief in a Subsequent Enforcement Action

By J. Richard Tucker and Dennis A. Meloro

***“The Court’s decision invalidates the Securities Commission’s practice of acting as an advocate by seeking victim-specific relief in the Securities Commission’s Administrative Forum where the client had entered a predispute arbitration agreement.”***

The United States District Court for the District of Delaware has held that where a broker and a client enter into a predispute arbitration agreement, a state securities regulator may not, in a subsequent enforcement action, pursue victim-specific relief against the broker on behalf of the client. *Ropp v. 1717 Capital Management Co.*, Civ. A. No. 02-1701-KAJ, 2004 WL 93945 (D.Del. Jan. 14, 2004). The Court based its decision on *Olde Discount Corp. v. Tupman*, 1 F.3d 202 (3d Cir. 1993), cert. denied, *Hubbard v. Olde Discount Corp.*, 510 U.S. 1065 (1994).

The 1991 amendments to § 7325 of the Delaware Securities Act, 6 Del. C. §§ 7301-7330, added restitution to investors to the list of remedies the Securities Commissioner is empowered to seek on behalf of Delaware citizens. Notwithstanding this state legislation, both *Olde* and *Ropp* stand for the proposition that the Commissioner should not be seeking victim specific relief on behalf of Delaware citizens where the parties have entered into a predispute arbitration agreement.

The Court’s decision invalidates the Securities Commission’s practice of acting as an advocate, on behalf of Delaware citizens, by seeking victim-specific relief in the Securities Commission’s Administrative Forum, (for clients of financial institutions who are involved in disputes with those financial institutions) when the parties have a contractual predispute agreement specifying Arbitration as the exclusive forum for remediation of any disputes arising between the financial institution and its clients.

### Summary of the Case

In April 1997, Lisle and Patricia Shaffer (the “Shaffers”) opened a brokerage account with 1717 Capital Management Company (“1717”). The Shaffers completed an application form and account agreement,

Albany  
Amsterdam  
Atlanta  
Boca Raton  
Boston  
Chicago  
Dallas  
Delaware  
Denver  
Fort Lauderdale  
Los Angeles  
Miami  
New Jersey  
New York  
Orange County  
Orlando  
Philadelphia  
Phoenix  
Tallahassee  
Tysons Corner  
Washington, D.C.  
West Palm Beach  
Zürich



each of which contained a predispute arbitration agreement. In August 2001, Lisle Shaffer filed a complaint with the Division of Securities of the State of Delaware (the "Securities Division") regarding the manner in which 1717 and one of its representatives, Raymond N. Ianni ("Ianni") were handling the brokerage account. After an investigation, the Securities Division filed an administrative complaint with the Securities Commissioner for the Division of Securities of the State of Delaware Department of Justice, James B. Ropp (the "Commissioner"). The Securities Division's complaint alleged that 1717 and Ianni had engaged in "dishonest and unethical conduct" and that 1717 had "failed to reasonably supervise Mr. Ianni," in violation of 6 Del. C. §§ 7316 and 7325. After a pre-hearing conference, 1717 filed a Motion to Preclude Restitution and Other Relief Available Through Arbitration. The Commissioner then filed the instant complaint seeking a declaratory judgment that he may pursue restitution and other victim-specific relief in a state administrative proceeding against 1717.

### ***Both parties filed motions for summary judgment.***

#### **The Commissioner's Argument**

The Commissioner advanced three primary arguments in support of his motion: (1) *Olde* had been effectively overruled by the United States Supreme Court in *Equal Employment Opportunity Commission v. Waffle House*, 534 U.S. 279 (2002); (2) the predispute arbitration agreement was limited in scope to disputes between the Shaffers and 1717; and (3) the Federal Arbitration Act ("FAA") did not preempt the Commissioner's statutory authority to pursue or order victim-specific relief for violations of the Delaware Securities Act.

#### **1717's Argument**

1717 advanced three primary arguments in support of its motion: (1) the Supreme Court did not overrule *Olde* in *Waffle House*; (2) the statutory framework and

public policy concerns in employer-employee disputes involving the EEOC under federal law and state law securities disputes between brokers and investors are fundamentally different; and (3) the Securities Division was preempted from pursuing restitution on behalf of the Shaffers by the FAA.

#### **The District Court's Decision**

Both parties and the Court agreed that the Third Circuit's decision in *Olde* was controlling. *Olde* involved a nearly identical set of facts. In *Olde*, a couple had opened a brokerage account and signed an account agreement containing a predispute arbitration clause. The Third Circuit held that by seeking rescission on behalf of investors who had entered into a predispute arbitration agreement, the Delaware Division of Securities interfered with *Olde* Discount's right under the FAA to resolution of the issues through arbitration. *Olde*, 1 F.3d at 204, 209.

Delaware's pursuit of rescission was preempted by the FAA for two reasons. First, the rescission remedy presented an obstacle to the accomplishment of the congressional purpose of enforcing arbitration agreements. Second, it was impossible to give effect to both the administrative rescission remedy and the federal right to arbitration. *Id.* at 210. The Court reasoned that the potential for actual conflict between simultaneous proceedings, one before an arbitration panel, and another before the Delaware securities commissioner necessitated the conclusion that the two proceedings would be irreconcilable. *Id.* at 209-10.

While the Court in *Olde* recognized that its analysis might have been different if a finding of preemption were to work a "substantial interference" with traditional state objectives of securities law enforcement, it found that other remedies remain available to the state concerning a company's registration as a broker-dealer, including pursuing individualized remedies, such as rescission, as to



# Alert

securities transactions not subject to arbitration agreements. *Id.* at 210-11.

The District Court rejected the Commissioner's argument that *Waffle House* had effectively overruled *Olde*. Nothing in the language of *Waffle House* indicated that its holding applied beyond the employment dispute arena or implicitly overruled *Olde*. The Court held that the law of the Third Circuit set forth in *Olde* was clear. Because the Shaffers and 1717 had entered into predispute arbitration agreements, the Commissioner could not pursue such victim-specific relief, and therefore granted 1717's motion for summary judgment.

## Contact Information

Please contact one of the following for more information:

- Paul D. Brown ..... (302) 661-7000  
brownp@gtlaw.com
- William E. Chipman ..... (302) 661-7000  
chipmanw@gtlaw.com
- Victoria W. Counihan ..... (302) 661-7000  
counihanv@gtlaw.com
- Scott D. Cousins ..... (302) 661-7000  
cousinss@gtlaw.com
- Kelly Herring ..... (302) 661-7393  
herringk@gtlaw.com
- Monica L. Loftin ..... (302) 661-7000  
loftinm@gtlaw.com
- Dennis A. Meloro ..... (302) 661-7395  
melorod@gtlaw.com
- Cathy L. Reese ..... (302) 661-7000  
resec@gtlaw.com
- C. Michael Terribile ..... (302) 661-7381  
terribilem@gtlaw.com
- J. Richard Tucker ..... (302) 661-7000  
tuckerjr@gtlaw.com

### Practice Areas:

- Alternative Dispute Resolution
- ADA, Accessibility, Building and Life Safety Codes
- Antitrust
- Appellate
- Aviation and Aircraft Finance
- Biotechnology
- Construction
- Corporate and Securities
- Executive Compensation and Employee Benefits
- Employment Law
- Energy and Natural Resources
- Entertainment
- Environmental
- Financial Institutions
- Global Trade
- Golf and Resort
- Governmental Affairs
- Government Contracts
- Health Business
- Immigration
- Intellectual Property
- International
- Land Use
- Litigation
- Public Finance
- Public Infrastructure
- Public Utility
- Real Estate
- Real Estate Operations
- Reorganization, Bankruptcy and Restructuring
- Structured Finance
- Tax
- Technology, Media and Telecommunications
- Trusts and Estates

*This GT ALERT is issued for informational purposes only and is not intended to be construed or used as general legal advice. Greenberg Traurig attorneys provide practical, result-oriented strategies and solutions tailored to meet our clients' individual legal needs.*