Understanding Legal Terminology in NFA Arbitration Cases

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INTRODUCTION

In 1983, National Futures Association (NFA) developed an arbitration program to provide a convenient, fair and cost-effective method for investors to resolve futures-related disputes. Since that time, NFA arbitration has become the primary venue for dispute resolution in the futures industry.

Many people who file claims at NFA or have claims filed against them are not represented by lawyers. If you are a party to NFA arbitration and you are acting without legal representation ("*pro se*"), you should remember that NFA arbitrations are legal proceedings, just like court proceedings. This means there are a number of legal principles that affect what claims a person can file and what the person filing the claim can ask the arbitrators to do.

NFA has prepared this Guide to help *pro se* parties like you understand some of the more complicated legal issues that may affect your ability to file a claim at NFA or in any other forum.

This Guide is not designed to address NFA's procedural or jurisdictional rules. Those rules are described in two separate NFA brochures: *A Guide to Arbitration of Customer Disputes* and *A Guide to Arbitration of Member Disputes*. Rather, this Guide concentrates on answering general legal questions about whether a claim can be filed in the first place, who can file it, whom it can be filed against, and what type of relief the person filing the claim can ask for. Although this Guide may mention how NFA rules apply to a particular issue, the issues themselves are general legal principles that apply to most forums, including court proceedings.

This Guide is an overview and does not include every detail about the legal principles it discusses. It should not be used as a substitute for your own legal research and analysis.

Before going on, you should understand several of the terms that will be used throughout this Guide.

Claim For our purposes, a claim is a legal cause of action (the right to sue someone under a specific legal theory) that is based on a particular act or transaction or a related series of acts or transactions. For example, if a customer alleges that his account executive told him he could not lose money trading futures, he has raised only one claim even though there may have been several losing trades in his futures account. If he also alleges that the account executive churned his account, he has raised a separate claim, even if it involves the same trades. At times, the term "claim" may also be used more broadly to mean all of the claims brought by the same person in the case.

Forum The forum is the organization that administers or hears the case. NFA runs an arbitration forum. Other entities, like NASD, also run arbitration forums. The Commodity Futures Trading Commission runs a reparations forum. The courts are also forums that administer and hear cases. Each forum has its own rules on how it handles cases.

Claimant At NFA and most arbitration forums, the person who files the claim is called the “claimant.” In court, the person who files the claim is usually called the “plaintiff.” We will use the term “claimant” unless specifically referring to a court proceeding.

Respondent At NFA and most arbitration forums, the person the claim is filed against is called the “respondent.” In court, the person the claim is filed against is usually called the “defendant.” We will use the term “respondent” unless specifically referring to a court proceeding.

One of the first questions that must be answered in any legal dispute is "Who can sue?" A person bringing a claim must decide if he, she, or it has the right to sue on the claim. This section discusses general issues relating to who can sue. See page 6 for a discussion of who has the right to sue on behalf of certain types of legal entities.

As long as NFA has jurisdiction over the parties and the dispute, NFA staff will not reject a claim just because the wrong person filed the claim. However, the arbitrators will dismiss the claim if they find that the wrong person filed it.

Standing

In general, a person has standing to bring a claim if that person has suffered, or is threatened with, actual injury from the actions of the respondent. For example, assume a commodity trading advisor places an order for a managed account, a broker mishandles the order, and the managed account loses money as a result. Even though the owner of the managed account did not place the order, the owner has standing to sue because it is the owner who was harmed when the account lost money. On the other hand, the trading advisor who placed the order does not have standing to sue because it is not the trading advisor's loss.

Assignment

An assignment is a transfer of some right or interest from one person to another. The person making the assignment gives up all claims to the right or interest, which now belongs to the person receiving the assignment. A person can assign its right to sue to another person, either by assigning the right to sue after the claim arises or by assigning the rights that later result in the claim. The person who receives the assignment sues in its own name and must convince the judge or arbitrators that it has a valid assignment.

With a few exceptions, the person who receives the assignment and files the case has exactly the same rights as the person who originally had the right to sue. For example, assume a brokerage firm assigns its right to sue a customer for a debit balance. Even though the brokerage firm is not the person filing the claim, the customer can use the same defenses it would have had against the brokerage firm, including the defense that the brokerage firm itself caused the debit by churning the account. Similarly, if a former employee assigns its right to receive unpaid commissions, the employer can reduce the amount of commissions it pays by the amount the employee owes it for leaving before he earned his up-front signing bonus.

Most claims that are heard in NFA arbitration can be assigned. However, claims that are personal to the person injured, such as libel and slander, may not be assigned.

Power of Attorney

A power of attorney is a signed document giving another person the authority to act on behalf of the person signing the document. It differs from an assignment in that the person who receives the power of attorney acts as an agent of the person who gives the power of attorney. A power of attorney only gives as much authority as it says it is giving and is no longer any good after the person giving it revokes it or dies.

A general power of attorney gives the agent the authority to do anything the person giving the power of attorney can do, including sue. However, the agent must file the suit in the name of the person giving the power of attorney. A limited power of attorney only gives the agent the authority to do what it says the agent can do. For example, trading authorizations are limited powers of attorney. A person who is authorized to place trades in an account under a limited power of attorney may not sue on behalf of the account owner unless the limited power of attorney specifically states that the agent can sue on the account owner's behalf.

In the simplest case, one claimant sues one respondent for one claim. However, many cases involve more than these two parties and/or more than one claim. There are a number of rules and legal principles that must be followed in deciding whether multiple parties or multiple claims can be decided as part of the same case.

Joinder

Joinder refers to filing one case against more than one party or for more than one claim. Different forums have different rules on what claims can be joined.

NFA arbitration rules allow the person filing the claim to join multiple respondents in the same case if they may all be liable for the same claim. (See page 16 for a discussion of liability.) NFA arbitration rules also allow a party to join multiple claims in some circumstances. For example, a claimant can join multiple claims if they involve common questions of fact, if they arise out of the same act or transaction, or if a single claimant files them against the same respondent.

Consolidation

Consolidation takes two or more cases that were filed separately and treats them as if they were one case. This is different from joinder, where the claims are filed together in the same case. Cases can be consolidated for a limited purpose (e.g., to decide a particular question of fact or law) or for the entire proceeding.

In some forums, cases that cannot be joined may, in the right circumstances, be consolidated. Assume that two separate, unrelated customers attended the exact same sales meeting and heard the same sales presentation. The forum may not allow different customers to file one case. It may, however, agree to consolidate the two separate cases if they involve common questions of fact – e.g., if what the broker said at the sales meeting is in dispute and is an important part of both cases.

NFA arbitration rules permit NFA to consolidate cases if the claims involve common questions of fact or if they arise from the same act or transaction. NFA consolidates cases only if doing so will make the proceedings fairer or more efficient.

Counterclaims

A counterclaim is a claim filed by one party against another party who has already filed a claim against it. In most circumstances, the original respondent files a counterclaim against the original claimant, although a third-party respondent can also file a counterclaim against a third-party claimant who has filed a claim against it. (See page 5 for a discussion of third-party claims.) For purposes of simplicity, references to a respondent or a claimant include a third-party respondent or claimant.

Compulsory counterclaims are counterclaims that, under the rules of the forum hearing the case, the respondent must file in that case. If the respondent does not file it in that case, the claim is waived (meaning that the respondent can not file it in any other case). In federal courts, counterclaims are compulsory if they arise out of the same transaction or occurrence as the plaintiff's claim.

Permissive counterclaims are counterclaims that, under the rules of the forum, the respondent can choose to file in the case. However, if the respondent chooses not to file it, she can still file it somewhere else (or in a different case in the same forum). In many state courts, counterclaims arising out of the same transaction or occurrence as the plaintiff's claim are permissive rather than compulsory. Counterclaims that do not arise out of the same transaction and occurrence are usually permissive, even in federal courts. However, some forums may not allow counterclaims that do not arise out of the same transaction or occurrence as the claimant's claim.

At NFA, counterclaims that arise out of the same act or transaction as the claimant's claim are permissive in cases filed under the Code of Arbitration. For cases filed under the Member Arbitration Rules, counterclaims arising out of the same act or transaction are permissive if one of the parties to the counterclaim is an Associate and compulsory if the parties to the counterclaim are all Members. Claims that do not arise out of the same act or transaction may not be filed as counterclaims unless both the claimant and NFA agree.

Cross-claims

A cross-claim is a claim filed by one party against another party on the same side of the case. Generally, cross-claims are filed by respondents against other respondents. NFA rules permit or require cross-claims under the same circumstances as counter-claims.

Third-party Claims

A third-party claim is a claim filed by a respondent against a person who is not already a party to the case. Most third-party claims allege that the third party is or may be liable for all or part of the damages that the claimant may win from the respondent. NFA rules permit or require third-party claims under the same circumstances as counterclaims, except that NFA has no jurisdiction over a person who is not an NFA Member or Associate unless that person consents.

Intervention

Intervention allows a person who is not originally a party to the case to become a party in order to protect its own interests. The person is not forced to join the case but does so at its own request.

NFA arbitration rules allow a futures commission merchant (FCM) to intervene in a case against an introducing broker it guaranteed at the time of the acts or transactions involved in the claim. The guarantor FCM could be liable for an award against the introducing broker and could be suspended from NFA membership if the introducing broker fails to pay the award. Since the guaranteed introducing broker does not always have the same incentive to defend the case that the guarantor FCM does – especially if the introducing broker has gone out of business – NFA rules give the guarantor FCM the right to defend the case itself if it chooses to do so.

Class Actions

A class action involves very similar claims by a large number of persons against the same respondents. In a class action, one person whose claim is representative of those claims sues on behalf of everyone in the same situation. A judge must determine that the standards for filing a class action are met and that the claimant's claim is representative of other claims in the class before certifying a case as a class action.

The idea behind class actions is that the rights and liabilities of the claimants can be decided more efficiently as a group than as a series of individual cases. That is why the claims must be very similar and the claimant must have the same interest in the outcome of the case as the other members of the class. For example, a class action might be appropriate for persons who were victims of the same Ponzi scheme. However, a class action is not appropriate merely because the same general type of claim exists against the same respondent (e.g., a number of customers claim that a particular account executive made similar misrepresentations in individual telephone conversations).

NFA does not accept class actions because they are too unwieldy to administer. Class actions involving futures transactions are very rare in any forum because the claims are not usually similar enough to qualify as class actions.

Firms conduct business using different forms of legal entities. For owners, each type of legal entity has its own tax consequences, methods for sharing in profits and losses, ability to control the entity's activities, and liability for the firm's actions. The type of entity also determines who can file a claim on behalf of the firm. This section will discuss only those differences that parties must know when filing a claim for or against a firm.

Corporation

A corporation is a separate legal entity that is owned by its shareholders and run by its officers and directors. With rare exceptions, a corporation's shareholders cannot be held personally liable for the acts of the corporation. This is true even when it has only one owner. The corporation's officers, directors, and employees also cannot be held personally liable for the acts of the corporation, although they can be held liable for their own actions done on behalf of the corporation. On the other hand, the corporation is liable for the acts of its officers, directors, and employees when they are acting on behalf of the corporation or in the scope of their employment.

The corporation's shareholders can be held liable for the acts of the corporation if the claimant can prove that the judge or arbitrators should "pierce the corporate veil." The corporate veil can only be pierced where the corporation is a fiction to insulate the shareholders from liability for fraudulent activities. The mere fact that the corporation was established to insulate the shareholders from liability for the corporation's acts is not enough (in fact, that is the reason all corporations are created), nor is the fact that the corporation is engaging in fraudulent activity. In most instances, the corporation itself must have been established for fraudulent purposes.

A corporation can sue and be sued. The claim must be filed in the corporation's name by an officer with authority to file it. Shareholders can not file a claim on behalf of a corporation unless the case qualifies as a derivative action.

A derivative action is a case brought by a shareholder on behalf of a corporation to enforce a right or collect a liability that the corporation has wrongfully failed to enforce or collect. The most common derivative action is brought against an officer of the corporation for debts owed to the corporation or against a party that conspired with an officer of the corporation to defraud the corporation, where the officer had undue influence in the corporation's decision not to sue. A shareholder cannot bring a derivative action if the corporation, acting through its officers or directors, has made a reasonable business judgment that the claim is not worth pursuing (e.g., because it may be hard to prove or because it would be too expensive to litigate). A derivative action must be brought in the name of the corporation, and any relief goes to the corporation, not to the shareholders.

A corporation can be merged into or acquired by another corporation or can purchase the assets of another corporation. Merger, acquisition, and the purchase of assets are different types of transactions with different legal results. The type of transaction determines which entity can be sued for the acts and obligations of the original corporation.

When two corporations merge they become one new corporation, even if the new corporation keeps the name of one of the original corporations. The old corporations cease to exist, and the new corporation takes on all of their rights, obligations, and liabilities. In other words, if a person had a claim against one of the original corporations, it can file it against the new corporation. Similarly, the new corporation can file claims that belonged to either of the original corporations.

A corporation can also acquire ownership of another corporation by buying all or part of its stock. In this case, the two corporations continue as separate legal entities. The acquiring corporation is simply a shareholder of the acquired corporation. For example, assume XYZ Company purchases all the stock of ABC Company but does not merge with ABC Company. A customer who has a claim against ABC Company must file it against ABC Company, not against XYZ Company. Similarly, XYZ Company cannot sue on behalf of ABC Company (unless the case qualifies as a derivative action).

A corporation can also buy another corporation's assets. In this situation, one corporation buys the furniture and equipment, customer accounts, receivables, and/or other assets of the corporation but does not buy the corporation's stock. With some limited exceptions, the corporation that buys the assets is not responsible for the other corporation's liabilities unless the acquiring corporation has agreed to assume those liabilities. Where the acquiring corporation purchases receivables or other claims, it has an assignment to those claims. (See the discussion of assignment on page 3.)

Partnership

A partnership is owned by its partners and run by its general partners. Every partnership must have at least two partners, and at least one of them must be a general partner.

Partnerships can have two types of partners. General partners have the right to participate in the partnership's decisions regarding its day-to-day activities. In exchange for this right, they are fully liable for the acts and obligations of the partnership and of the other general partners. Limited partners are more like corporate shareholders. They do not run the partnership and are not liable for its acts or obligations.

Normally, any general partner can file a claim in the partnership's name. A claim against the partnership may be filed against the partnership, one or more general partners, or both.

Limited Liability Company (LLC)

For most purposes, a limited liability company is treated like a corporation. It is generally used to provide its owners with the same protection from liability that corporate shareholders receive while giving those owners the same tax benefits as a partnership.

Sole Proprietorship

A sole proprietorship is a business that is owned and controlled by a single individual and is not a corporation. Legally, the individual owner and the sole proprietorship are the same person. Since they are the same person, the individual owner is fully liable for the sole proprietorship's acts and obligations. The owner can file a claim in his own name or in the name of the sole proprietorship and can be sued in his own name or in the name of the sole proprietorship.

Trust

A trust is an entity that owns money or other property that is held and managed by a trustee for the benefit of one or more beneficiaries. As a general rule, the trustee must file or defend a claim on behalf of the trust. If a trust is named as a respondent, the claim must be served on the trustee.

Estate

When an individual dies, that person's assets and liabilities become the property of the person's estate until they are distributed. In most instances, an executor or administrator is named or appointed, and the executor or administrator must file or defend any claim on behalf of the estate. (An executor is named in a will. If there is no will, or if the executor cannot serve, a probate court will appoint an administrator.) Some states have statutes that allow a friend or relative to act on behalf of a very small estate without getting court authorization.

If a claim is filed against someone who has already died, the claim must be served on the executor or administrator. If a party dies after the case has been filed, the estate becomes the party, and only the executor or administrator can act on the estate's behalf.

When an individual or firm files for bankruptcy, all claims against that person are automatically stayed. This means that no one can file a claim against the bankrupt person, proceed with a claim that has already been filed, or collect on an award or judgment unless the claimant receives permission from the bankruptcy court. The claimant can, however, file its claim with the bankruptcy court. If it fails to do so, it will not be able to sue on or collect any part of its claim.

The stay remains in effect until the bankruptcy proceeding is dismissed or closed. If the claim was discharged in the bankruptcy proceeding, it cannot be filed anywhere else. If it was not discharged for some reason (e.g., the bankruptcy court found that the debtor did not qualify for bankruptcy or that the particular claim was a result of fraud by the debtor), the claimant will be able to file or re-file it in another forum.

A person who files for bankruptcy usually loses control of its assets to a bankruptcy trustee or a creditors' committee. This means that a bankrupt claimant cannot file or proceed with a claim against someone else without the consent of the bankruptcy court. The trustee can, however, file or proceed with the claim on behalf of the creditors of the bankrupt person.

Res judicata and collateral estoppel are legal doctrines designed to keep a party from filing a claim or arguing an issue that has already been decided against it.

Many people, including many lawyers, get *res judicata* and collateral estoppel mixed up or use the two terms as if they were the same, which they are not. As the U.S. Supreme Court said in Parklane Hosiery Co. v. Shore:

> Under the doctrine of *res judicata*, a judgment on the merits in a prior suit bars a second suit involving the same parties or their privies based on the same cause of action. Under the doctrine of collateral estoppel, on the other hand, the second action is upon a different cause of action and the judgment in the prior suit precludes re-litigation of issues actually litigated and necessary to the outcome of the first action.
>
> 439 U.S. 322, 327, fn. 5 (1979).

Res Judicata

Once a final judgment or award has been entered on a claim, the claimant may not sue again on that same claim. The doctrine of *res judicata* also prohibits a respondent from arguing that the decision was wrong or raising a new defense when a claimant tries to enforce the judgment or award.

According to the courts, several conditions must be met for a claim to be prohibited by *res judicata*. The judgment or award must be 1) final, 2) on the merits, 3) between the same parties, and 4) based on the same cause of action. The judgment or award must also be valid.

Final. A judgment or award is usually considered final when the judge or arbitrators issue a decision that resolves all the issues necessary to decide the claim, even if the judge or the arbitrators have the power to modify or reconsider the decision on limited grounds. In the federal courts, a judgment that has been appealed is final until it has been reversed or modified by the appellate court. In some state courts, however, a judgment is not final until all pending appeals are determined, so the doctrine of *res judicata* does not apply until then.

On the merits. In order for a judgment or award to be on the merits, the court must issue a decision on the validity of the claim. The most obvious example is a decision issued after a full trial where the judge, a jury, or an arbitrator actually decides who is right and who is wrong. However, summary judgments, judgments based on the pleadings (e.g., a dismissal because the claim is barred by the statute of limitations), and directed verdicts are also decisions on the merits. Dismissals for failure to amend a claim to state a cause of action or for failure to diligently prosecute the action and judgments based on failure to defend an action are on the merits because the claimant had a fair opportunity to get to the merits. Any judgment that states it is “with prejudice” is on the merits, and any judgment that states it is “without prejudice” is not on the merits.

Between the same parties. The party filing the “new” claim and the party arguing that the claim is barred by *res judicata* must both have been parties to the earlier judgment, although the other parties do not have to be identical. For example, if a customer filed a case against a brokerage firm and lost and is now filing an identical claim against the brokerage firm and a commodity trading advisor, the case between the customer and the brokerage firm is barred by *res judicata* (if the other conditions are met) but the case between the customer and the commodity trading advisor is not.

Some courts also apply the doctrine of *res judicata* if one of the parties to the second action was not a party to the first action but was "in privity" with a party. In this context, two persons are in privity when their interests are so similar that the party is really acting for the other person as well. For example, two parties are in privity when one person has assigned its interest in the claim to the other or when one party controls (or has the right to control) the other.

Based on the same cause of action. A claim is clearly based on the same cause of action as another claim when they both involve the same transaction and the same legal theories. For example, two claims alleging that a broker churned an account for the three months it was open are based on the same cause of action. Although the courts agree that the claims have to involve the same transaction or series of transactions, however, not all courts require that they be based on the same legal theories.

Valid. A judgment or award is considered valid unless the forum lacked jurisdiction over the claim or the respondent was not given adequate notice of the case. It must also be issued in a "judicial-like" forum, meaning a forum that allows the parties to present evidence and argue the case and that issues a binding decision. Arbitration qualifies as a "judicial-like" forum.

Collateral Estoppel

Collateral estoppel prohibits a party from re-litigating an <u>issue</u> (not a claim) that was decided in an earlier case. As with *res judicata*, the prior case must have been decided on the merits and the judgment or award must be valid. In addition, 1) the issue must be identical to the one decided in the prior case, 2) the issue must have been actually resolved in the prior case, 3) the party to be collaterally estopped must have been a party to or in privity with a party to the prior case, and 4) that party must have had a full and fair opportunity to litigate the issue in the prior case.

Identical Issue. In order for collateral estoppel to apply to a particular issue, it must be identical to the one decided in the prior case. For example, if the first case found that a particular piece of promotional material was not misleading, a different respondent in the second case might use collateral estoppel as a defense to keep the same customer from claiming its is misleading. Using another example, if the first case found that a guarantee agreement was in effect during a specified period of time, a customer could use collateral estoppel to prohibit the FCM from arguing that it was not in effect during that same period of time. The customer could not, however, use collateral estoppel to prove that the agreement was in effect during a different period of time, since that is not an identical issue.

Actually resolved. The issue must also have been actually resolved. Obviously, this is easy to determine if the decision makes a specific finding on the issue. If the decision does not come out and say how the decision-maker (e.g., judge, jury, arbitrator) found on that issue in the first case, the decision-maker in the second case must be able to infer it from the result. For example, assume that the issue is whether individual A is an employee of firm B. If the only cause of action against firm B in the first case was based on *respondeat superior* (i.e., that a firm is liable for the acts of its employees) and firm B was found liable, then the trier of fact must have found that A was an employee of B. On the other hand, if there were two causes of action against firm B – only one of which required an employment relationship – and the decision did not say which cause of action created liability, then the decision-maker in the second case cannot infer that the first case actually decided that A was an employee of B, so collateral estoppel does not apply.

Party to or in privity with a party. The party the estoppel is being used *against* – and only that party – must have been a party to or in privity with a party to the first case. For example, if the previous case found that a piece of promotional material used by a firm who was a party to the first case was misleading and a customer is trying to use that finding against the firm in another case, collateral estoppel would apply because the firm – who the finding is being used against – was a party to both cases, even though the customer was not. On the other hand, if the prior case had found that the promotional material was *not* misleading, the firm would not be able to use that finding against a customer who was not a party to the first case, even though the firm was.

Full and fair opportunity to litigate. The party the estoppel is being used against must have had a full and fair opportunity to litigate the issue. This is why, in the previous example, the customer can use a finding against the firm but the firm cannot use a finding against the customer – the firm had the opportunity to litigate the issue but the customer did not.

The courts differ on whether a default judgment gives a party a full and fair opportunity to litigate. Some courts hold that it does because the party had the opportunity to litigate the issue even though it chose not to do so. Other courts require that the first decision-maker actually heard evidence and decided the case based on the evidence, whether or not the party that collateral estoppel is used against defended the case. On the other hand, if the court did not have jurisdiction over the case or the party, the party did not have a full and fair opportunity to litigate – and collateral estoppel cannot be used – even if the issue was decided based on evidence presented by the claimant in that case.

Merger and Counterclaims

All claims that should have been raised in the prior case are "merged" into the judgment or award in that case. For example, if the prior case alleged that the respondent churned an account and the new case alleges that those same trades were unauthorized, the customer would be prohibited from litigating the new case because that legal theory should have been raised in the prior action. Claims are also "merged" into the judgment in the prior case if the new case asserts a violation of the same basic right or duty or turns on essentially the same evidence. For example, if the second case alleges that the respondent churned a different account that acted in tandem with the first account, the doctrine of merger could prohibit the customer from filing the second claim. On the other hand, the doctrine of merger would probably not apply if the two accounts were traded by different individuals using different patterns of trading even though the customer and the brokerage firm are the same. Many courts consider merger to be just another use of *res judicata*.

How merger and *res judicata* apply to counterclaims that were not filed in the prior case depends on whether they were mandatory or permissive. (See the discussion of counterclaims on page 4.) Mandatory counterclaims are merged into the judgment or award for purposes of *res judicata* even if they were not filed in that case. If the counterclaim was permissive, however, it is not merged into the judgment or award – and *res judicata* does not apply – unless the counterclaim was actually filed and decided.

Every case that is filed asks for some kind of relief from the respondents. In other words, every case asks the judge or arbitrators to decide that the respondents must do something (e.g., pay a particular amount of money to the claimant) or refrain from doing something (e.g., not contact former clients). This section discusses the different kinds of relief that may be available.

Monetary Damages

Monetary damages are money awarded to pay the claimant for the damage the respondent did to the claimant. Damages are not the same as costs or attorneys fees, which are expenses incurred during the case as a result of filing it. There are five basic types of monetary damages: compensatory, liquidated, nominal, punitive, and treble.

Compensatory damages are designed to put the claimant in the same position he or she would have been in if the wrongful conduct had not occurred. There are two general types of compensatory damages: actual damages and consequential damages. The claimant can recover both types of damages.

Actual damages pay the claimant for those losses directly resulting from the respondent's wrongful conduct. For example, if a floor broker misplaces an order to liquidate an open position and gets a poorer price when the order is eventually executed, the customer's actual damages are the difference between the price the customer would have gotten if the order had been executed properly and the price the customer actually received.

Consequential damages pay the claimant for indirect losses that are a natural and predictable result of the respondent's wrongful conduct. For example, assume that a margin clerk mistakenly believed a customer's futures account was in debit and sold securities from the customer's securities account to cover the perceived debit. If the customer has to pay additional taxes because the securities were sold before they qualified for long-term capital gains, the additional taxes are a consequence of the respondent's wrongful conduct and can be recovered as consequential damages. The claimant can get both actual and consequential damages.

A claimant cannot recover for losses that are speculative or avoidable. For example, assume that an account executive accidentally entered an order to liquidate a customer's open position. When the customer found out about it, the customer did not initiate a new position. The customer can recover the difference between the price the position was liquidated at and the price it was trading at when the customer found out it had been liquidated. However, the customer cannot recover lost profits it claims it would have made by leaving the position on for another two weeks. First, the lost profits are speculative. There is no way of knowing that the customer would actually have held the position for those two weeks and liquidated it then. Second, the lost profits were avoidable. The customer could have entered another order to re-establish the position as soon as it found out about the error, in which case it would have received those profits.

Liquidated damages are damages agreed on in a contract. The parties agree in advance that a particular amount will adequately pay them for their losses if the other party breaches the contract. Liquidated damage clauses only apply to breaches of the contract and cannot be used in cases of negligence or fraud.

Nominal damages are given to a claimant who has been wronged but has not suffered a loss. For example, assume that a customer enters a market order that, due to an error by the firm's order desk, is not immediately sent to the exchange for execution. It is eventually executed at a better price than the market was trading at when the order should have been executed. The firm's conduct was wrong, but the customer was not damaged by that conduct. An arbitrator could award the customer nominal damages of one dollar as a way of telling the parties that the arbitrator found liability but no damages.

Punitive damages (also called exemplary damages) are just what the name says – damages awarded to punish a wrongdoer and to deter the respondent and others from engaging in similar conduct. Since they are a punishment, punitive damages are only awarded where the respondent acted with malice, ill will, or conscious disregard of the consequences to others. Although punitive damages go to the claimant in order to give the claimant an incentive to sue the respondent, they are not intended to compensate or reward the claimant. Therefore, they are based on the respondent's conduct and circumstances, not the claimant's. Punitive damages are given in addition to compensatory damages.

Treble damages, or three times the amount of the loss, can only be awarded when permitted by a statute that the respondent is found to have violated. Treble damages are different from punitive damages in two ways: 1) they include the compensatory damages rather than being in addition to those damages, and 2) the amount of the damages is directly related to the amount of the claimant's loss. The Racketeering Influenced and Corrupt Organizations Act (RICO) is one example of a statute that authorizes treble damages.

Declaratory Relief

Declaratory relief is a decision by the judge or arbitrators that tells the parties what their rights are without ordering them to do anything. Declaratory relief can be used to prevent the other party from suing the party asking for the declaratory relief. For example, a customer could ask for a decision against a firm saying that it is not liable for a debit balance in its account, in which case the firm would not be able to sue the customer for the debit balance. (See the discussion of *res judicata* on page 10.) Declaratory relief can also be used to prevent the other party from misinterpreting a contract and breaching the contract as a result. For example, if one partner is concerned that another partner will break up the partnership and take the partnership's most valuable asset (e.g., a computerized trading program) with him, the first partner could ask the arbitrators to declare that the partnership agreement gives the first party sole or joint ownership of the asset, thereby preventing the second partner from taking the asset with him if he breaks up the partnership.

A party cannot get declaratory relief in any NFA arbitration unless the respondent agrees to have the arbitrators hear and decide that part of the case. For example, assume a customer asks for $45,000 in damages from its brokerage firm for unauthorized trading. If the customer had only $40,000 in the account and the other $5,000 is a debit balance, the arbitrators can award $40,000 in actual damages but cannot wipe out the debit balance unless the brokerage firm agrees that the arbitrators can decide this issue.

Since NFA arbitrators can give only monetary relief in customer cases, the arbitrators must be able to calculate the amount at issue (e.g., a $5,000 debit balance). This restriction does not apply to cases between and among Members and Associates.

Equitable Relief

In general, equitable relief is an order granted when money alone cannot make the claimant whole. The most common type of equitable relief is an injunction.

An injunction orders the respondent to either do something (other than paying money) or refrain from doing something. For example, an injunction might order a partner who has already taken the trading program to return it or might order a former employee to stop soliciting the firm's customers. In order to grant an injunction, the judge or the arbitrators must find that the respondent is continuing to engage in wrongful conduct and that money damages will not adequately compensate the claimant for the harm that is being done to it.

At NFA, equitable relief can not be given in customer cases. It can only be given in cases between and among Members and Associates.

Liability is the legal responsibility to pay. Understanding the different types of liability may help a claimant decide if it should name a person as a respondent.

There are several types of liability. This section describes the most common ones involved in lawsuits and arbitration cases.

Joint and Several Liability

Respondents are jointly and severally liable when they are both legally responsible to the claimant for the conduct that caused the claimant's loss. This principle is designed to make the innocent party (the claimant) whole even if one respondent is unable or unwilling to pay.

Joint and several liability means that the claimant can collect the full judgment or award from any of the respondents held jointly and severally liable or can split it up in any way the claimant chooses. For example, the claimant can collect the entire amount from the respondent with the deepest pocket, can collect the entire amount from the respondent who is most at fault, or can collect part from each respondent found jointly and severally liable. The claimant cannot collect more than the amount awarded to it, but no respondent is off the hook until the entire amount has been paid.

Sole Liability

A respondent has sole liability (also called several liability) when the respondent is the only one liable for all or a portion of the judgment or award. A respondent can be solely liable for part of the award and jointly and severally liable for another part. For example, assume an introducing broker is found liable to a customer for churning the customer's account from May through November of a particular year. If the only other respondent is an FCM who guaranteed the introducing broker from May through September, the introducing broker would be jointly and severally liable with the guarantor FCM for the activity in the account from May through September but would be solely liable for the activity during October and November.

Contingent Liability

A person has a contingent liability if it is responsible for paying money if, but only if, some event occurs in the future. For example, some contracts say that a third party (e.g., a cosigner on a loan) will be liable for any amounts the primary party fails to pay after the other party to the contract has made reasonable attempts to collect from the primary party. The third party is not liable until those collection efforts fail.

Secondary Liability

Secondary liability is liability that is imposed on a respondent because of something someone else did. The person who actually committed the act has primary liability. Secondary liability is not the same as contingent liability. Instead, secondary liability makes the parties jointly and severally liable for compensatory damages. The two main types of secondary liability are vicarious liability and guarantor liability.

Vicarious liability is liability imposed by law based on the relationship between the respondent and the person who engaged in the conduct. The doctrine of *respondeat superior* says that an employer is liable for the acts of its employees acting in the scope of their employment. A principal is also vicariously liable for the acts of its agents acting in the scope of their agency. The person who has primary liability does not have to a party to the case.

Guarantor liability is liability imposed on the guarantor by contract. A guarantor FCM has guarantor liability for the acts of a guaranteed introducing broker if those acts are covered by the guarantee agreement.

When filing a claim, a claimant needs to know how much information it must include in the claim or complaint. Some forums require a fairly lengthy statement of the facts involved and will reject or dismiss a claim if this standard is not met (although most forums give the claimant one or more opportunities to amend the claim first). Other forums, including NFA, require what is called “notice pleading.”

A notice pleading is a short and plain statement of the claim showing that the claimant is entitled to relief. The purpose is simply to identify the transaction and the general conduct out of which the claimant’s claim arises. However, notice pleading forums do not reject or dismiss a claim because too much information has been provided, so it is always better to provide too much than too little.

For example, a customer could file a claim that simply states “My broker lied to me about how my account was doing. If I had known the truth, I would not have invested more money and lost it. I want that money back.” If the forum accepts notice pleadings, the claim does not have to list the misleading statements or provide specific details. Those facts can be developed during discovery or, in some cases, at the hearing.

On the other hand, even notice pleading requires enough facts so that the respondent knows what charges to defend against. It is not enough for a claim to say “I lost money trading with respondent and want my money back.” The claim must say what the claimant thinks the respondent did wrong (e.g., “my broker lied to me” or “the firm did not pay me the commissions it owed me when I quit”) and must at least imply how that conduct hurt the claimant. It must also say what relief the claimant wants (e.g., a specified sum of money).

If a respondent believes the claim should not have been filed or was filed against the wrong respondent, the respondent may be able to file a dispositive motion. A dispositive motion is a motion that, if granted, ends all or part of the case. Dispositive motions may end the entire case, may get rid of some but not all of the claims raised, or may end the case against some but not all of the respondents. The most common types of dispositive motions are discussed below.

Motion to Dismiss for Failing to State a Claim

Motions to dismiss are filed at the beginning of a case. Sometimes a respondent files a motion to dismiss a case on the grounds that the facts alleged in the claim do not show that the respondent has done anything wrong. This is called a motion to dismiss for failing to state a claim.

Since arbitration is intended to be an informal process that does not require an attorney, NFA does not allow motions to dismiss for failing to state a claim. Just because the claimant does not include all the important facts when a claim is filed does not mean that those facts don't exist. Even courts generally give plaintiffs several opportunities to amend their complaints before dismissing them for failure to state a claim.

If the parties agree on the important facts, the respondent may be able to file a motion for summary judgment, which is described below. However, NFA staff – not the respondent – decides whether a motion is a motion for summary judgment or is really just a motion to dismiss for failure to state a claim.

Other Motions to Dismiss

Respondents may also file motions to dismiss for other reasons. For example, a respondent may ask the arbitrators to dismiss the case because it was filed after the 2-year time-limit for filing the case or because the same claim was already heard and decided in another case.

A claim can be dismissed with or without prejudice, depending on the reason for dismissing the claim. A claim that is dismissed with prejudice cannot be re-filed or raised in another case. An order granting a motion to dismiss is normally with prejudice unless it is dismissed for lack of jurisdiction or unless a rule of the forum or the language in the order says it is without prejudice.

NFA allows motions to dismiss for reasons other than failing to state a claim. However, the motion must be included in a timely filed Answer or Reply.

Motion for Summary Judgment

Any party can file a motion for summary judgment if the parties agree on the material facts in the case but do not agree how the law applies to those facts. A motion for summary judgment is different than a motion to dismiss for failing to state a claim because all of the material facts should be known before a motion for summary judgment is filed. Arbitrators cannot grant a motion for summary judgment if the parties do not agree on the material facts.

For example, in a claim for misrepresentation where the conversation was tape-recorded, the parties may agree on what was said, the context in which it was said, that the customer relied on that statement when he opened his account, and that he lost money as a result. What the parties don't agree on is whether the statement was misleading. Since the facts are not in issue, the arbitrators can look at those facts and decide that the statement was or was not misleading. On the other hand, if the parties agree on what was said and the context in which it was said but the respondent does not agree that the customer relied on the statement or lost money as a result, summary judgment cannot be granted.

Since the parties may not know the material facts until they have conducted discovery (or, in some cases, until the hearing has begun), motions for summary judgment do not have to be filed at the beginning of the case. At NFA, motions for summary judgment can be filed at any time, including during the hearing.

Motion for Directed Verdict

A motion for directed verdict is made during the hearing, after the claimant has finished presenting its case. The motion asks the panel to dismiss the claim ("direct a verdict for the respondent") on the grounds that the claimant has not proved its case. Motions for directed verdict are designed to make the hearing more efficient by eliminating the need for a respondent to put on its defense.

NFA allows motions for directed verdict.

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