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Securities Law Update – November 2007

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USING EXPERT WITNESSES TO PROVE TRUST DEPARTMENT MISCONDUCT

In *Alco Industries, Inc. v. Wachovia Corporation*, 2007 U.S. Dist. LEXIS 82204 (E.D. Pa. November 5, 2007), a copy of which is provided below, the defendant's Motion in Limine was granted in part. The court precluded the plaintiff from presenting expert witness testimony that purported to show that Wachovia "violated its duty of prudent investment by failing to diversify" the plaintiff's investment portfolios. The court concluded that the expert's report represented no more than a series of legal conclusions, and was "essentially a brief on the ultimate legal issues *sans* case citations." The decision reached opposite conclusions regarding other expert witnesses, and is therefore helpful as to the limits and appropriateness of experts on various investment related issues.

HEDGE FUNDS – EVEN INVESTORS WHO GOT OUT EARLY END UP UNHAPPY

In *In re: BAYOU GROUP, LLC*, 372 B.R. 661; 2007 Bankr. LEXIS 2715 (S.D.N.Y. 2007), non-redeeming hedge fund investors are pitted against redeeming investors in the context of fraudulent conveyances. A copy is provided below. Although the redeeming investors may have been happy when they were initially able to redeem their hedge fund investments, that happiness was short lived. The redeeming investors were pursued in bankruptcy court by the non-redeeming investors, who wanted their share of the pie. Because the non-redeeming investors were considered creditors, the bankruptcy court permitted them to pursue claims of fraudulent conveyance against the redeeming investors.

ARBITRATION AGREEMENT NOT ENFORCEABLE AGAINST CO-EMPLOYEE

In *Finnie v. H & R Block Financial Advisors, Inc. and Patrick A. Looby*, 2007 U.S. Dist. LEXIS 74472 (W.D. Mo. 2007), a former employee alleged violations of the Missouri Human Rights Act and the Family Medical Leave Act by both her former employer and a co-employee. Although the court directed that Finnie's claims against her former employer must be arbitrated, the court held otherwise with regard to the claims against the co-employee. The court's ruling was based upon the absence of a specific agreement between the two individuals. Looby, the court held, could not enforce the arbitration agreement between Finnie and her employer. I believe that this decision is contrary to the law in many states.

CONTRACTUALLY SHORTENED STATUTE OF LIMITATION ENFORCEABLE

In *In re: Cotton Yarn Antitrust Litigation*, 2007 U.S. App. LEXIS 23979 (4th Cir. 2007), a copy of which is provided below, the 4th Circuit held that a contract shortening the Clayton Act's 4 year statute of limitations to 1 year may be enforceable, depending on various factors discussed in detail. On remand, the district court was directed that if it "concludes that the claims were not timely, the court must then determine ... whether that fact renders the contractual limitations period unenforceable. Finally, if the district court concludes that the one-year limitations period bars the plaintiffs' claims and is unenforceable, the district court must then consider whether severance of the limitations provisions, rather than invalidation of the arbitration agreements, would be the appropriate remedy." Interestingly, the contract itself provided that the court would rule on any limitations issue.

**ALCO INDUSTRIES, INC., Plaintiff, v. WACHOVIA
CORPORATION, et al., Defendants.**

Civ. No. 04-6090

**UNITED STATES DISTRICT COURT FOR THE EASTERN
DISTRICT OF PENNSYLVANIA**

2007 U.S. Dist. LEXIS 82204

**November 5, 2007, Decided
November 5, 2007, Filed**

COUNSEL: For ALCO INDUSTRIES, INC., Plaintiff: GEORGE W. CRONER, LEAD ATTORNEY, KOHN, SWIFT & GRAF, P.C., PHILADELPHIA, PA; CHRISTINA DONATO SALER, KOHN SWIFT & GRAF, PC, PHILADELPHIA, PA.

For EVERGREEN INVESTMENT MANAGEMENT COMPANY, LLP, Defendant: E. THOMAS HENEFER, STEVENS & LEE, READING, PA; KIRK L. WOLGEMUTH, READING, PA.

For FOREFRONT CAPITAL ADVISORS, LLC., Defendant: E. THOMAS HENEFER, STEVENS & LEE, READING, PA; KIRK L. WOLGEMUTH, READING, PA.

For WACHOVIA BANK, N.A., Defendant: KIRK L. WOLGEMUTH, LEAD ATTORNEY, READING, PA; E. THOMAS HENEFER, STEVENS & LEE, READING, PA.

JUDGES: Louis H. Pollak, J.

OPINION BY: Louis H. Pollak

OPINION

Pollak, J.

Presently before the court are the parties' cross-motions for summary judgment (Docket Nos. 43 and 45) and cross-motions *in limine* to exclude each other's expert witnesses (Docket Nos. 44 and 46). These motions are now ripe for disposition.

I. Background

Plaintiff Alco Industries provides retirement benefits to some of its employees through two defined benefit pension plans. ¹ The parties agree that the Alco plans are "employee benefit plans," and thus governed by the Employee Retirement Income Security Act of 1974 ("ERISA"), 20 U.S.C. §§ 1001 --1461. Rather than managing the plans' trust funds itself, Alco entrusted the funds' management to Wachovia ² between 1989 and 2002.

ERISA expressly authorizes delegating the management of an ERISA trust to a professional investment manager. 29 U.S.C. § 1102(c)(3).

1 There are two major categories of pension plans: (1) defined benefit plans, and (2) defined contribution plans. In a defined benefit plan, the participant's benefits are determined according to a formula that typically emphasizes salary and years of service. The benefits are paid out of a segregated trust fund that the employer funds and invests. See *Int'l Union of Elec., Salaried, Mach. & Furniture Workers v. Murata Erie N. Am., Inc.*, 980 F.2d 889, 894 (3d Cir. 1992). In a defined contribution plan, the participant and employer contribute money to a participant's individual account in a larger trust fund. The participant selects how to invest the money in the account from a closed set of options provided by the trust's manager. Rather than receiving a formula-determined benefit, the employee receives as benefits the contributions to her account plus any investment gains, minus any investment losses. See *Graden v. Conexant Sys., Inc.*, 296 F.3d 291, 294, 297 (3d Cir. 2007).

The economics of the two types of plans are quite different. In defined benefit plans, participants are entitled to their formula-determined benefits irrespective of the performance of the trust's investments. Thus, while participants have an interest in the trust being fully funded, they have little interest in any excess profits. Employers, on the other hand, have a great interest in the plan's profitability because excess profits reduce the amount they have to contribute to keep their plans fully funded. See *Malia v. Gen. Elec. Co.*, 23 F.3d 828, 831 n.2 (3d Cir. 1994). In defined contribution plans, on the other hand, all profits inure to the participants' (rather than employers') benefit, so it is they who have a significant interest in their accounts' profitability (and bear the risk of investment loss). See *Faircloth v. Lundy Packing Co.*, 91 F.3d 648, 661--62 (4th Cir. 1996).

2 I use "Wachovia" to refer collectively to the defendants, all of which are affiliates or predecessors-in-interest of defendant Wachovia Bank.

As investment manager, Wachovia owed the plans' participants and beneficiaries a series of fiduciary duties, one of which was the duty of prudent investment. ³ 29 U.S.C. § 1104(a)(1)(B)--(C). This duty is a familiar one, as it has long bound common-law trustees, and, as in trust law, there is a heavy presumption that fulfilling that duty requires diversifying investments to reduce the risk of a large loss. 29 U.S.C. § 1104(a)(1)(C); see also Restatement (Third) of Trusts § 90(b) (2007).

3 Though Alco is the plaintiff, Wachovia did not owe Alco any fiduciary duties. Rather, the provision under which Alco is suing, 29 U.S.C. § 1132(a)(2), allows one plan fiduciary (here, Alco) to bring an action against another plan fiduciary (here, Wachovia) to make good to the plan any losses caused by the defendant-fiduciary's breach of duty.

From at least 1998 until the end of 2002, Wachovia, through equity portfolio manager Steven Dalton, pursued an investment strategy that focused on "large-cap secular growth" stocks. ⁴ Alco alleges that, in pursuing this strategy, Wachovia breached its duty of prudent investment by failing to diversify the equities portion of the plans' portfolios. Alco claims

that investments were unduly concentrated in large-cap growth stocks and, more specifically, in the technology, media, and telecommunications industries, which resulted in significant and avoidable losses. Wachovia disputes this, arguing that its investments were consistent with Alco's guidance on the character and purpose of the plans, that Alco's proof that the portfolios were not diversified is flawed in a number of key respects, and that Alco's proof of damages is similarly flawed.

4 A company's market capitalization is measured by multiplying its stock price by the total number of shares it has issued. See Sec. & Exch. Comm'n, Market Capitalization, *available at* <http://www.sec.gov/answers/marketcapitalization.htm>. Though the precise contours of the "large-cap," "mid-cap," and "small-cap" categories are disputed, the basic idea is that they divide all public companies into three categories based on their amount of market capitalization. "Secular" refers to a relatively long time-frame. Oxford English Dictionary (2d ed. 1989). "Growth" stocks, as Steven Dalton explained in his deposition, are those for which analysts expect the underlying companies to turn in increasing, above-average earnings. Dalton Dep. at 66--67. "Secular growth" stocks, then, are those that analysts expect to turn in higher-than-average earnings over a relatively long period of time. *Id.* The typical contrast is "value" stocks, which are thought to be undervalued relative to the expected performance of the underlying company. *Id.* As both categories are defined by analysts' expectations, it is rarely clear whether a particular stock belongs in one category rather than the other. *Id.*

When this breach of duty--if it was a breach--began is also a subject of controversy. Alco claims that the breach began in July 1999 when it adopted a formal investment policy statement that called for the plans' assets to be "well-diversified" and spread among small-, mid-, and large-cap stocks. Investment strategy policies are typically considered "plan documents" that investment managers must follow in exercising their discretion. 29 U.S.C. § 1104(a)(1)(D). Wachovia, on the other hand, claims it employed the same investment strategy from at least 1996 and that Alco understood and approved of that strategy. According to Wachovia, then, the breach--if there was one, which it of course denies--began no later than 1996.

It may seem bizarre for Wachovia, while strenuously denying any breach, to argue in the alternative that the breach began earlier than plaintiff asserts. But the reason is simple: the disputed strategy was apparently quite profitable in the heady 1990s, and only became unprofitable during the so-called "dot com bust" and "telecom meltdown" of 2000--2001.⁵ Under well-settled principles of trust law, defendants are entitled to offset profits from a single, continuous breach of trust against losses flowing from that same breach, see Restatement (Third) of Trusts: Prudent Investor Rule § 213 (1992), so Wachovia has a significant interest in showing that any breach began well before the market turned sour in 2000.

5 These phenomena were well documented in the press. See, e.g., Peter Elstrom & Heather Timmons, *Telecom Meltdown*, BusinessWeek, Apr. 30, 2001, at 100; John Schwartz, *Business on internet time; the ups are fast. The downs could be faster.*, N.Y. Times, Mar. 30, 2001, at C1.

After voluminous discovery, the parties have filed related cross-motions *in limine* to exclude each others' expert witnesses and for summary judgment. Because the cross-motions for summary judgment rely heavily on the exclusion of expert testimony, I will begin with the question of whether the four experts (three for Alco, one for Wachovia) meet the threshold set by the rules of evidence for offering expert testimony. Then, bearing in mind which experts may offer testimony at trial, I will address the cross-motions for summary judgment.

II. Motions *in limine*

A. Legal standard

Under Federal Rule of Evidence 702, courts must allow expert testimony when "(1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case." These requirements are often referred to in shorthand as "qualification, reliability, and fit." See, e.g., *In re Unisys Sav. Plan Litig.*, 173 F.3d 145, 156 (3d Cir. 1999). Under the rule announced in *Daubert v. Merrill-Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993) and expanded in *Kumho Tire Co. v. Carmichael*, 526 U.S. 137 (1999), district courts must ensure that experts--scientific and otherwise--will offer testimony that is methodologically sound and relevant to the facts of the case before admitting their expert testimony. *Daubert*, 509 U.S. at 590--91; *Kumho*, 526 U.S. at 149.

In considering whether to admit expert testimony, it is important to remember that "Rule 702 mandates a policy of liberal admissibility." *In re Paoli R.R. Yard PCB Litig.*, 35 F.3d 717, 741 (3d Cir. 1994).

Daubert does not require that a party who proffers expert testimony carry the burden of proving to the judge that the expert's assessment of the situation is correct. As long as an expert's scientific testimony rests upon good grounds, based on what is known, it should be tested by the adversary process--competing expert testimony and active cross-examination--rather than excluded from jurors' scrutiny for fear that they will not grasp its complexities or satisfactorily weigh its inadequacies. In short, *Daubert* neither requires nor empowers trial courts to determine which of several competing scientific theories has the best provenance. It demands only that the proponent of the evidence show that the expert's conclusion has been arrived at in a scientifically sound and methodologically reliable fashion.

Ruiz-Troche v. Pepsi Cola Bottling Co., 161 F.3d 77, 85 (1st Cir. 1998) (internal quotation marks and citations omitted) (*quoted in United States v. Mitchell*, 365 F.3d 215, 244 (3d Cir. 2004)).

Because this case arises under ERISA, a statute grounded primarily in equity, it will not be tried before a jury. See *Motor Carriers Labor Advisory Council v. Trucking Mgmt., Inc.*, 731 F. Supp. 701, 703 (E.D. Pa. 1990). In the context of preparing for a bench trial, it is not necessary to apply the *Daubert* standard with full force in advance of trial. See *In re*

Salem, 465 F.3d 767, 777 (7th Cir. 2006) ("Where the gatekeeper and the factfinder are one and the same--that is, the judge--the need to make such decisions prior to hearing the testimony is lessened."). Rather, the court has the flexibility to allow testimony provisionally and revise its view once the testimony is taken. ⁶ *Id.* Thus, at this stage, I will incline toward hearing expert testimony unless it is clear from the reports and depositions that the testimony cannot prove helpful to resolving this case.

6 None of this is to say that the court may rule on the merits on the basis of fundamentally flawed testimony; it is only to say that the court may defer the final decision on whether testimony is admissible until after that testimony is taken at trial.

B. Dr. Cathy Niden

Dr. Cathy Niden, an economist whom Alco proposes as an expert witness, has prepared a report on whether the Alco plans' portfolios were diversified. ⁷ She concluded that they were not. According to her report and deposition testimony, perfect diversification occurs when a portfolio eliminates all risk except so-called "market" or "compensated" risk. Niden Report, at 6. This view of diversification is well-accepted. See, e.g., Restatement (Third) of Trusts: Prudent Investor Rule § 227 cmt. g ("The ultimate goal of diversification would be to achieve a portfolio with only the rewarded or 'market' element of risk."). Unfortunately, according to Niden, the perfectly diversified "market portfolio" exists only in the realm of theory. Niden Report, at 7. Therefore, to determine how diversified a given portfolio is, one can only compare it to a proxy for the market portfolio. *Id.* Here, Niden compared the Alco portfolios to the S&P 500, the S&P MidCap 400, and the Russell 2000, the benchmark indices specified in Alco's 1999 investment policy statement. Niden noted that the S&P 500 was a particularly good proxy. *Id.* at 7--8. Through these comparisons, Niden calculated that up to 38 percent of the risk in the Alco portfolios was uncompensated (non-market) risk. *Id.* at 13. She further reported that this amount of uncompensated risk was both foreseeable in light of the investments and unreasonable. *Id.* at 9--11. She concluded that Wachovia could have reduced the uncompensated risk and added to the expected return significantly through additional diversification. *Id.* at 14.

7 Niden holds a Ph.D. in business and an M.B.A., from the University of Chicago. She has taught financial economics, including the principles of diversification, at the University of Notre Dame and the University of Pittsburgh. She has also worked as an academic fellow and an associate chief economist at the Securities and Exchange Commission, and an economist at Lexecon. She presently works as an economist at LECG, a firm that provides litigation support services, including the provision of expert reports and testimony.

Wachovia raises five objections to Niden's testimony. First, it argues that Niden's analysis did not properly take account of the character and aims of the plans, and is thus unreliable. I disagree. While it is true that the factfinder should consider the purpose of the plan, see *In re Unisys Sav. Plan. Litig.*, 74 F.3d 420, 434 (3d Cir. 1996), here, Niden testified that her method did not--and did not need to--take into account the investor's goals because a high level of uncompensated risk is inconsistent with any reasonable investor's goals. Niden. Dep., at 35. Moreover, by measuring diversification against

benchmarks identified in Alco's policy statement (one of which was the S&P 500), Niden arguably did consider Alco's preferences. More to the point, Niden's methodology--measuring diversification by comparing a given portfolio to a benchmark portfolio--appears well-supported in the finance literature. See, e.g., Frank J. Fabozzi, *Investment Mgmt.* 90-91 (1995).

Second, Wachovia argues that Niden did not consider that Alco had a lengthy time horizon, which, according to some of the caselaw, is a relevant factor. See *Metzler v. Graham*, 112 F.3d 207, 210 (5th Cir. 1997). Niden, however, testified that her method did not need to take time into account because, again, a reasonable investor would not desire a high level of uncompensated risk over any time horizon. Niden Dep., at 50--51. Indeed, when courts hold that relatively more risk can be appropriate over a relatively longer time horizon, they appear to be (and, indeed, should be) referring to *compensated* risk. Uncompensated risk is by definition never attractive. Compensated risk, on the other hand, increases in attractiveness as the time horizon lengthens because, given enough time, returns should approach their (higher) expected value.⁸

8 It may be noted that in *Metzler*, a facially undiversified investment in commercial real estate was justified on the ground that it was a hedge against the threat of rising inflation. *Metzler*, 112 F.3d at 211.

Third, Wachovia argues that Niden should have considered the overall portfolios to determine diversification, not just the equities portions. But the duty of diversification extends into an ERISA plan's asset classes. Cf. Restatement (Third) of Trusts § 227 cmt. f(3) (1992) ("So far as practical, the duty to diversify ordinarily applies even within a portion of a trust portfolio that is limited to assets of a particular type or having special characteristics."). It is undisputed that a portion of the assets were to be invested in equities. What Niden analyzed was whether the equities portions of the portfolios were diversified. At this stage, I have no reason to think this was an inappropriate inquiry.

Fourth and fifth, Wachovia complains about Niden's analysis of damages. Alco notes, however, that Niden did not claim to analyze the damages in this case, leaving that to Alco's damages expert, Steven Wolf. Thus, Wachovia's objections are misplaced. Of course, should Niden attempt to offer testimony on Alco's damages at trial, I will reconsider Wachovia's objection at that time.

In sum, without determining the ultimate credibility of any testimony that Niden may offer, defendants have raised no objections to her testimony serious enough to exclude it from trial. Therefore, as to Niden, Wachovia's motion *in limine* will be denied.

C. Steven Wolf

Steven Wolf, a forensic accountant proposed as an expert by Alco, has offered a report on Alco's damages stemming from Wachovia's alleged imprudent investments.⁹ Specifically, he compared the performance of the Alco portfolios against four portfolios Alco believes would have been more in line with its policy statement and the duty of prudent investment: (1) a portfolio equally spread among small-, mid-, and large-cap index funds, (2) a portfolio comprised of 60% small-cap index funds, and 20% each of mid- and large-cap index funds, (3) a portfolio comprised of 60% mid-cap index funds, and 20%

each of small-and large-cap index funds, and (4) a portfolio comprised of 60% large-cap index funds, and 20% each of small-and mid-cap index funds. Wolf Report, at 8--9. All four performed better than the Alco portfolios between July 1, 1999 (Alco's alleged start date) and December 31, 2001 (the undisputed end date). *Id.* at 18.

9 Wolf holds an M.B.A. from Temple University, and a Bachelor's degree in accounting from Binghamton University. He is a certified fraud examiner and a certified public accountant. He has spent much of his career working as a public accountant at a "Big Four" accounting firm. He presently works as a principal at LECG, where he provides expert reports and testimony on a variety of forensic accounting subjects.

Wachovia objects to Wolf's testimony on the grounds that (1) he is not adequately qualified, (2) his methodology is flawed, (3) the portfolios to which he compared the Alco portfolios would not have been prudent investments, and (4) he used an improper time-frame. As to the first objection, Wachovia argues that Wolf's background as a forensic accountant does not qualify him to analyze Alco's damages. Specifically, Wachovia notes that Wolf had no previous experience with ERISA plans or with analyzing the damages flowing from imprudent investments. But Wolf appears qualified to carry out the "lost profits" methodology that both he and Wachovia's proffered expert used. See Wolf Dep., at 32 (testifying that he has carried out lost profits analyses many times). This method compares the performance of the actual portfolio against that of a benchmark portfolio to determine the difference. Making this calculation appears within the professional expertise of accountants.¹⁰

10 Evidence of this is that Wachovia's expert, Stewart Frank, who employed the same basic methodology, is also an accountant.

Wachovia's second objection--that Wolf's methodology is not appropriate for measuring damages in this case--is similarly unavailing. Wachovia argues that Wolf should have considered only the portion of each investment that was imprudent. In other words, if a manager invested 90% of a plan's assets in a stock that no prudent investor would place more than 10% in, the damages would be loss attributable to the imprudent 80% only, not the entire 90%. This may be sound logic, but as a criticism of Wolf's methodology it is misdirected. Rather than evaluating individual investments, Wolf compared the portfolios' performance against that of four allegedly more prudent ones to determine the difference. Other courts have approved this method as an acceptable means of calculating damages flowing from a breach of the duty of prudent investment. See, e.g., *GIW Indus., Inc. v. Trevor, Stewart, Burton & Jacobson, Inc.*, 895 F.2d 729, 733--34 (11th Cir. 1990). This is not to say that it is necessarily the best method, but it easily satisfies the threshold requirement of reliability for Rule 702 purposes.

Wachovia's third objection--that Wolf's benchmark portfolios are unreliable--is weightier. When advancing a lost profits analysis, the plaintiff has a basic obligation to put forward "plausible" alternatives to the offending portfolio. See *Donovan v. Bierwith*, 754 F.2d 1049, 1056 (2d Cir. 1985). Here, Alco seems to argue that Wolf's comparator portfolios are plausible because they all reflect a diversified mix of small-, mid-, and large-cap stocks, as Alco's investment policy statement suggests. Wolf Dep., at 38. Alco does

not argue that Wolf is qualified to select a prudent portfolio; rather, it argues that his comparator portfolios are clearly "plausible" from the face of the 1999 investment policy statement and the general observation that index funds are assumed to be diversified within the market segments they cover.¹¹ Thus, Wachovia's argument that Wolf is not qualified to select diversified portfolios misunderstands the nature of his proposed testimony. On the one hand, it may seem odd that Alco did not choose an expert qualified to select a diversified portfolio to serve as the benchmark; on the other hand, I agree with Alco that a factfinder could conclude that one or more of Wolf's portfolios is plausible simply by reading the policy statement, since the policy statement does, in fact, appear to call for some mix of small-, mid-, and large-cap stocks. This is not to say that Wolf's portfolios are not open to attack through cross-examination or rebuttal evidence, but they find enough support in the record to allow Wolf's testimony to proceed.

11 For example, it is generally assumed that the S&P MidCap 400 is diversified within the universe of mid-cap stocks.

As to Wachovia's fourth objection--that Wolf used the wrong time-frame--the underlying question is when the alleged breach began. This issue is disputed: Alco has presented evidence that, at least as of the adoption of the 1999 investment policy statement, Wachovia employed an imprudent strategy. See *generally* Niden Report. Wachovia, in turn, has presented evidence that it pursued the same (potentially breaching) investment strategy from at least 1996 on. See 1998 Investment Review; 1996 Investment Review. It is not clear from the record which of these views is correct. Niden formally analyzed the portfolios' level of diversification from July 1999 to the end of 2002, and her analysis appears to find fault not only with Wachovia's overall large-cap secular growth strategy, but also with its concentration of stocks in three particular industries. Though it appears that Wachovia began employing the allegedly offending investment strategy before July 1999, it is unclear when it began doing so and whether the portfolios suffered from any excess concentration in any particular industry before July 1999.

Moreover, Wolf's report is relevant to an issue on which Alco bears the burden of proof: damages that accrued between 1999 and 2001. Wachovia's contentions that (1) the alleged breach began before 1999, and (2) the profits from that initial period completely offset any 1999--2001 damages, are in the nature of an affirmative defense.¹² Wachovia bears the burden of proof on those contentions, *cf. Cook v. Wikler*, 320 F.3d 431, 438 (3d Cir. 2003) (noting that defendant bears burden of proof on affirmative defenses), and Alco has no obligation--in its expert report or otherwise--to come forward with evidence on those subjects. It would be inappropriate to exclude Wolf's report solely because it does speak in terms to issues on which Alco need not come forward with evidence, particularly when it is relevant to an issue on which Alco does bear the burden of proof. Therefore, as to Wolf, I will deny Wachovia's motion *in limine*.

12 An affirmative defense is one that bars recovery even if the facts alleged in the complaint are true. Here, Wachovia's contentions form an affirmative defense because its basic point is that even if it breached its duty (as alleged in the complaint), and even if that breach caused damage between July 1999 and December 2002 (as alleged in the complaint), it is nonetheless not liable because the

breach began, and resulted in off-setting profits, well before the period alleged in the complaint.

D. Paul Gewirtz

Paul Gewirtz, an actuary offered as an expert by Alco, has prepared a report opining that Wachovia violated its duty of prudent investment by failing to diversify the Alco plans' portfolios.¹³ Wachovia objects to his report on the ground that it is merely a series of legal conclusions. See *Carswell v. Borough of Homestead*, 381 F.3d 235, 243--44 (3d Cir. 2004) (noting that expert testimony should not be allowed on questions of law). I agree. A glance at Gewirtz's "questions presented" reveals that his report addresses legal, not factual, questions. See, e.g., Gewirtz Report § B(3) ("Did the Defendants violate their ERISA fiduciary duty . . . ?"). Indeed, the report contains no substantive analysis of the risks inherent in the Alco plans' portfolios;¹⁴ rather, it is essentially a brief on the ultimate legal issues *sans* case citations. Therefore, I will grant Wachovia's motion *in limine* as to Paul Gewirtz: he will not be allowed to testify at trial, and his expert report will not be admitted into evidence.

13 Gewirtz holds a Bachelor's degree from Brooklyn College, and is a fellow of the Society of Actuaries and the Conference of Consulting Actuaries. Over the course of a more-than-forty-year career, Gewirtz has worked as an actuary for Hartford Life Insurance Company, Towers Perrin, and Ernst & Young. In 2004, having reached the mandatory retirement age of 60 for Ernst & Young partners, he formed his own actuarial consulting company, and he has worked there ever since.

14 A lack that is somewhat surprising, because that would seem to be the sort of analysis one would expect from an actuary, as that profession specializes in the evaluation of risk.

E. Stewart Frank

Stewart Frank, an accountant presented as an expert by Wachovia, has prepared a report concluding that (1) the expert reports of Niden and Wolf are methodologically flawed, and (2) Wachovia's investment strategy, when measured over a five-year period, produced better returns than a benchmark diversified portfolio would have produced.¹⁵ Alco moves to exclude his testimony.

15 Frank holds a Bachelor's degree from the University of Michigan, and is a certified public accountant and an accredited investment fiduciary analyst. Since 1965 he has practiced accounting at his own firm. He is also a principal of the Tillit Group, a firm that provides litigation services, including expert reports and testimony.

On the issue of diversification, Frank takes issue with Niden's use of the portfolios' actual performance--rather than sticking to information available in 1999--to determine whether the portfolios were diversified. Frank Report, at 4--5. Frank further reports that were one considering only the information available in 1999, a portfolio emphasizing large-cap secular growth stocks would appear to offer a better risk/reward balance than the S&P 500 would. *Id.* This is an arguably legitimate criticism of Niden's methods and conclusions,

and I see no reason to exclude it from trial. It may be noted that Frank has disclaimed any intention of offering his own opinion on whether the portfolios were diversified at any given time.¹⁶ Frank Dep., at 149--51. But because diversification is an issue on which Alco bears the burden of proof, it is acceptable for Wachovia's expert to poke holes in Alco's proof without offering its own.

16 Given Frank's deposition testimony, I assume that he will not offer an opinion on whether the Alco portfolios were diversified during the relevant time period. Under this assumption, I have not analyzed whether such testimony would be admissible. Should Frank attempt to offer such an opinion at trial, I will allow Alco to renew its motion *in limine* at that time, insofar as the motion addresses that aspect of Frank's proposed testimony.

On the issue of damages, Frank reports that Wolf's method was flawed since it analyzed the wrong time period and selected the wrong benchmark. Frank Report, at 7, 11. In his deposition, Frank testified that he and Wolf followed the same basic lost profits methodology. Frank Dep., at 146. On the time-period issue, Frank argues that one must analyze an investment strategy over at least a five-year time horizon to measure its performance accurately. Frank Report, at 10--11. I will, somewhat *dubitante*, allow him to present this argument at trial. I say "*dubitante*," because there would appear to be ground for concluding that the proper time-frame would be the length of the breach, and I am not clear why Frank would have it otherwise. In any event, Frank's analysis will be of clear relevance should Wachovia succeed in proving that the alleged breach began before 1999, as he is the only expert to have considered the portfolios' pre-1999 performance. On the benchmark issue, Frank offers arguably legitimate reasons for preferring the S&P 1500 to any of Wolf's benchmarks--namely that the S&P 1500 is a broader, more representative, index, and thus a more plausible and appropriate proxy for the market portfolio. *Id.* at 9.

The upshot is that both Frank and Wolf have presented approaches to calculating damages that are arguably aggressive, and are certainly highly favorable to their respective clients. Both approaches are arguably open to attack on cross-examination, but neither appears so off the mark as to exclude its presentation. Moreover, it is at least possible, if the court should find a breach and should also determine that damages are to be assessed, that the court would conclude that the best measure of damages would be some blend of the two approaches, in which case it would be necessary to use both reports to construct the damages award. Accordingly, I will deny Alco's motion *in limine*.

III. Motions for summary judgment

A. Wachovia's motion

Wachovia moves for summary judgment on the ground that Alco has failed to meet its burden of coming forward with evidence that (1) Wachovia failed to diversity the Alco plans' equities portfolios, and (2) Alco suffered damage. Wachovia's predicate is that Alco's experts's testimony on both of those points was fatally flawed and would not be allowed at trial. Because I will allow Niden and Wolf to testify, Alco has met its burden of production.

Wachovia also moves for summary judgment on statute-of-limitations grounds. The parties agree that the applicable limitations period is set forth in 29 U.S.C. § 1113, which requires that actions be filed before the earlier of (1) six years after the date of the last action constituting the breach of duty, and (2) three years after the plaintiff had actual knowledge of the breach. The parties agree that the suit was filed within six years of the last allegedly breaching act; they disagree as to whether it was filed within three years of Alco having actual knowledge of the alleged breach.

The Third Circuit has set the bar high for proving actual knowledge:

[U]nder 29 U.S.C. § 1113 (2), "actual knowledge of a breach or violation" requires that a plaintiff have actual knowledge of all material facts necessary to understand that some claim exists, which facts could include necessary opinions of experts, knowledge of a transaction's harmful consequences, or even actual harm. . . .

In so holding, we differ somewhat from the rigid formulation that "[t]he statute of limitations is triggered by . . . knowledge of the transaction that constituted the alleged violation, not by their knowledge of the law," We disagree that mere knowledge of a transaction is always enough. "Actual knowledge of a breach or violation" requires knowledge of all relevant facts at least sufficient to give the plaintiff knowledge that a fiduciary duty has been breached or ERISA provision violated.

Gluck v. Unisys Corp., 960 F.2d 1168, 1177--78 (3d Cir. 1992). Subsequent cases confirm that *Gluck* sets forth a two-pronged test requiring knowledge both of the facts underlying the breach and that those facts constituted a breach. See, e.g., *Richard B. Roush, Inc. Profit Sharing Plan v. New Eng. Mut. Life Ins. Co.*, 311 F.3d 581, 587 (3d Cir. 2002).

Wachovia claims that Alco had actual knowledge of the alleged breach no later than March 2001 when Wachovia client manager Anthony Waskiewicz sent Alco a letter recommending changes to Steven Dalton's investment approach. However, the thrust of the letter was not that Dalton's approach was unsound, but rather that minor alterations could improve the portfolios' performance. See Waskiewicz Letter of March 6, 2001. Indeed, the letter expressed confidence in Dalton's large-cap secular growth strategy. *Id.* ("We are confident that Steve Dalton and his large-cap growth strategy will produce exceptional relative performance going forward, and we believe that introducing a complimentary style will help the ALCO Industries Group Trust achieve better risk-adjusted returns over the long term."). Waskiewicz himself testified that he did not intend to imply that the portfolios were imprudently invested; he only intended to recommend changes that would place them on even better footing. Waskiewicz Dep., at 267, 288. Moreover, Alco executives testified that they did not read the letter as informing them of a problem with the way their portfolios were invested. See Devine Dep., at 71, 74--75; Evanick Dep., at 105. On the contrary, they testified that they were encouraged by Waskiewicz's confidence in Dalton's general approach and merely understood the letter as recommending minor improvements. Devine Dep., at 71, 74--75; Evanick Dep., at 105. Given this record, the contention that Waskiewicz's letter gave Alco actual knowledge, in the *Gluck* sense, of a

breach of duty is, at best, disputed. Therefore, Wachovia's statute-of-limitations defense is unavailing.

Accordingly, Wachovia's motion for summary judgment will be denied.

B. Alco's motion

Alco moves for summary judgment, claiming that the undisputed facts establish that Wachovia breached its duty of prudent investment and thereby damaged Alco as specified in Wolf's report.

Determining whether an ERISA fiduciary breached the duty of prudent investment is a two-step process. The first step concerns whether the investment portfolio was, on its face, sufficiently diversified. *In re Unisys Sav. Plan Litig.*, 74 F.3d at 438; *see also Metzler*, 112 F.3d at 209. If it was, the inquiry is at an end, and there was no breach. If it was not, the next question is whether the fiduciary can prove that its investment strategy was nonetheless prudent. *In re Unisys Sav. Plan Litig.*, 74 F.3d at 438. On the first issue, the plaintiff has the burden of proof; on the second, the burden shifts to the fiduciary. *Metzler*, 112 F.3d at 209.

Niden testified that, in retrospect, the performance of the plans showed more volatility than a diversified portfolio's performance would have. Niden Report, at 13. She further testified that, given the portfolios' sector and asset-class concentrations, unnecessary volatility should have been expected. *Id.* at 10--12. From this, a rational factfinder could conclude that Wachovia did not adequately diversify investments. Wachovia challenges her conclusion that the portfolios were facially not diversified through Frank's criticism that her methodology is largely *post-hoc* and ignores how well Wachovia's investment strategy had performed in the past. Frank Report, at 4--5. This is a legitimate point, so neither party is entitled to judgment as a matter of law on whether the portfolios were facially diversified.

Wachovia further argues that any lack of diversification was prudent. On this point, Steven Dalton testified that his strategy was appropriate given Alco's relatively high risk tolerance and its demand for high returns. Dalton Dep., at 149. Wachovia also harps on Alco's alleged consent to its investment strategy. I understand this argument to be somewhat nuanced: Alco's knowledge of and consent to the investment strategy, Wachovia argues, should inform the factfinder's understanding of (1) the somewhat amorphous investment policy statement, and (2) the character and purpose of the plans themselves. At the summary judgment stage, this point is well-taken. At trial, I will undertake to determine how intimate Alco's knowledge of the strategy was, and what that says (if anything) about the proper interpretation of the policy statement and the purpose and character of Alco's plans.

Because there is legitimate evidence on both sides of the question of whether Wachovia violated its duty of prudent investment, I will deny Alco's motion for summary judgment on the issue of liability. Given that Alco is not entitled to judgment on the issue of liability, addressing the question of damages at this stage would be premature.

* * * * *

An appropriate order accompanies this opinion.

ORDER

For the reasons set forth in the accompanying opinion, it is ORDERED that:

(1) Alco's motion *in limine* (Docket No. 44) to exclude the testimony of Wachovia's proposed expert Stewart Frank is DENIED;

(2) Wachovia's motion *in limine* (Docket No. 46) to exclude the testimony of

Alco's proposed experts is DENIED as to Cathy Niden and Steven Wolf and GRANTED as to Paul Gewirtz;

(3) Alco's motion for summary judgment (Docket No. 43) is DENIED;

(4) Wachovia's motion for summary judgment (Docket No. 45) is DENIED;

(5) the parties will submit a joint pre-trial memorandum in accordance with Local Rule 16.1(d)(2) by December 10, 2007. That memorandum will, in part (1), state what matters the parties agree on, and, in parts (2) and (3), state, in separate recitals, the respective contentions of the parties as to matters the parties disagree on. Within a week after filing the joint memorandum, each party may, if it wishes, file a memorandum responding to the contentions of the adversary party contained in part (2) or part (3) of the joint memorandum. Thereafter, Deputy Clerk Donna Bozzelli will, after consultation with counsel, schedule a pretrial conference.

BY THE COURT:

/s/ Louis H. Pollak

Pollak, J.

In re: BAYOU GROUP, LLC, et al, Debtors. Bayou Accredited Fund, LLC v. Redwood Growth Partners, L.P.; Bayou No Leverage Fund, LLC v. Christian Brothers H.S. Endowment; Bayou Superfund, LLC v. D. Canale Beverages, Inc.; Bayou No Leverage Fund, LLC v. Fred Montesi IRA and Fred Montesi; Bayou Superfund, LLC v. Helen Yulman Revocable Trust; Bayou Superfund, LLC v. Heritage Hedged Equity Fund LP; Bayou Superfund, LLC v. John D. Canale III; Bayou Superfund, LLC v. KFI Capital Partners LLC; Bayou Superfund, LLC v. Mary P. Smythe Residuary Trust; Bayou No Leverage Fund, LLC v. Mayer and Morris Kaplan Foundation; Bayou Superfund, LLC v. YK Investment Partnership II; Bayou Superfund, LLC v. Marvin E. Bruce Living Trust; Bayou Superfund, LLC v. Singer 1995 Family Trust; Bayou Accredited Fund, LLC v. Freestone Low Volatility Partners LP; Bayou Superfund, LLC v. Randall M. Rothstein and Sheryl B. Rothstein; Bayou Accredited Fund, LLC v. Steven R. Selcer; Bayou Accredited Fund, LLC v.

Madison Capital Advisors Ltd.; Bayou Accredited Fund, LLC v. Ciconia & Co., LLC; Bayou Superfund, LLC v. Myrna Bennett; Bayou Superfund, LLC v. H & B Hedge Fund II LLC; Bayou No Leverage Fund, LLC v. Marc Fleisher IRA and Marc Fleisher; Bayou Superfund, LLC v. Kevin Bass; Bayou Superfund, LLC v. Michael Davidson; Bayou No Leverage Fund, LLC v. John Barr III IRA and John Barr III

Chapter 11, Case No. 06 B 22306 (ASH), Jointly Administered Adv. Proc. No. 06-08318A, Adv. Proc. No. 06-08320A, Adv. Proc. No. 06-08321A, Adv. Proc. No. 06-08329A, Adv. Proc. No. 06-08332A, Adv. Proc. No. 06-08333A, Adv. Proc. No. 06-08336A, Adv. Proc. No. 06-08337A, Adv. Proc. No. 06-08338A, Adv. Proc. No. 06-08340A, Adv. Proc. No. 06-08341A, Adv. Proc. No. 06-08368A, Adv. Proc. No. 06-08371A, Adv. Proc. No. 06-08373A, Adv. Proc. No. 06-08389A, Adv. Proc. No. 06-08401A, Adv. Proc. No. 06-08403A, Adv. Proc. No. 06-08411A, Adv. Proc. No. 06-08420A, Adv. Proc. No. 06-08422A, Adv. Proc. No. 06-08423A, Adv. Proc. No. 06-08431A, Adv. Proc. No. 06-08435A, Adv. Proc. No. 07-08244A

UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

372 B.R. 661; 2007 Bankr. LEXIS 2715; 48 Bankr. Ct. Dec. 170

August 9, 2007, Decided

CASE SUMMARY:

PROCEDURAL POSTURE: Plaintiff bankruptcy debtors, which were hedge funds, brought adversary proceedings against defendant investors in the funds who redeemed their investments prior to the debtors' bankruptcies, alleging that the investors' redemptions were fraudulent transfers under 11 U.S.C.S. §§ 544, 548 and N.Y. Debt. & Cred. Law § 273 et seq. The redeeming investors moved for summary judgment.

OVERVIEW: The debtors allegedly engaged in a fraudulent investment

scheme which nonetheless honored investors' contractual rights to redeem their investments in order to lend credibility to the scheme. The redeeming investors contended that the debtors' fraudulent transfer claims could only be brought for the benefit of creditors, which did not include the intended beneficiaries of avoidance of the transfers who were non-redeeming investors, and thus merely equity holders. The bankruptcy court held, however, that the non-redeeming investors were in fact creditors of the debtors, since the non-redeeming investors not only had contractual redemption claims against the debtors but also asserted tort claims based on fraudulent inducement to purchase their

investments. Further, the fact that, for purposes of distribution, the non-redeeming investors' tort claims were subject to subordination did not result in the disallowance of the claims, and thus did not preclude the debtors' fraudulent transfer claims for the benefit of the non-redeeming investors.

OUTCOME: The debtors' motions for summary judgment were denied.

CORE TERMS: investor, hedge, non-redeeming, adversary proceedings, fraudulent conveyances, fraudulent, tort claims, subordinated, entity, redemption, disallowance, rescission, allowance, subordination, non-existent, claimant, holder, stock, summary judgment, contractual, case law, fraudulently induced, equity security, equity interests, common stock, disallowance of claims, subordinate, pre-petition, fictitious, matter of law

LexisNexis(R) Headnotes

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Fraudulent Transfers > General Overview

Civil Procedure > Judgments > Entry of Judgments > Enforcement & Execution > Fraudulent Transfers

[HN1]The statutory language, both federal and state, and case law make clear that fraudulent conveyance claims under 11 U.S.C.S. §§ 544, 548 and N.Y. Debt. & Cred. Law § 273 et seq. may be brought by or on behalf of a debtor for the benefit of creditors.

Business & Corporate Law > Corporations > Shareholders > General Overview

[HN2]Shareholders in an ordinary stock corporation generally do not have a contractual right to redeem their investments in the corporate entity.

Bankruptcy Law > Claims > Types > Unsecured Priority Claims > Subordination

[HN3]See 11 U.S.C.S. § 510(b).

Bankruptcy Law > Claims > Types > Unsecured Priority Claims > Subordination

[HN4]11 U.S.C.S. § 510(b) provides that a tort claim for rescission or damages arising from purchase, retention, or (broadly stated under the case law) ownership of common stock or other equity security has no greater priority for distribution purposes than that of the underlying stock or equity interest in question and, therefore, will be subordinated to any creditor interest which has a higher priority under the Bankruptcy Code than that of the underlying stock or equity interest.

Bankruptcy Law > Claims > Allowance Bankruptcy Law > Claims > Types > Unsecured Priority Claims > Subordination

[HN5]11 U.S.C.S. § 510(b) does not deal with the question of allowance or disallowance of claims in a bankruptcy case. The statute is concerned solely with priority of claims and does no more nor less than subordinate the tort claim of an owner of securities of a bankruptcy debtor below the priority of other creditor/claimants. It does not result in the disallowance of the subordinated claim.

COUNSEL: [omitted]

JUDGES: Adlai S. Hardin, Jr., U.S.B.J.

OPINION BY: Adlai S. Hardin, Jr.

OPINION

DECISION DENYING MOTIONS FOR SUMMARY JUDGMENT

Before the Court for this decision are self-styled motions for summary judgment filed by defendants in twenty-four out of some 110 adversary proceedings. The adversary proceedings were commenced by debtors-plaintiffs to recover alleged fraudulent conveyances under Sections 544 and 548 of the Bankruptcy Code and Sections 273 through 276 of the New York Debtor & Creditor Law ("DCL").

The plaintiffs in these twenty-four adversary proceedings (Bayou Superfund, LLC, Bayou No Leverage Fund, LLC and Bayou Accredited Fund, LLC) are three hedge funds organized in 2003 (collectively, the "Bayou Hedge Funds" or, together with other Bayou-related entities, the "Bayou Entities"). The defendants are persons and entities who invested in the Bayou Hedge Funds. The gravamen of the amended complaints is that the Bayou Entities including the Bayou Hedge Funds were operated by their pre-petition principals as a "massive Ponzi scheme." It is alleged that the Bayou Hedge Funds sustained consistent losses from their inception and that the pre-petition principals of the Funds misappropriated substantial sums from the Funds. To deceive existing and future investors and the regulators, the pre-petition principals of the Bayou Hedge Funds caused the Funds to publish fraudulent financial statements reporting substantial but entirely fictitious

profits, certified by a purportedly independent but non-existent accounting firm.

To avoid detection of the fraud, to retain existing investors and to lure new investors, the Bayou Hedge Funds invariably honored requests by investors who sought to exercise their contractual right to redeem their investments as falsely reported in the fraudulent financials, both as to impaired or non-existent principal and fictitious profits. These redemption payments thus constituted an integral and essential element of the alleged fraud, necessary to validate the false financials and to avoid disclosure.

As alleged in the complaints in all 110 adversary proceedings, all investors in the Bayou Hedge Funds were fraudulently induced to invest in the Funds and were, therefore, victims of the fraud. The contest in these adversary proceedings pits the interests of the investors who did not receive payments in redemption of their Bayou investments ("non-redeeming investors") against the conflicting interests of the investors who received payments in redemption of their investments ("redeeming investors") who are the defendants in the adversary proceedings. The alleged fraudulent conveyances sought to be recovered are payments to the defendant-redeeming investors of "non-existent principal and fictitious profits" in redemption of defendants' purported but non-existent interests in the Bayou Hedge Funds as reflected in the Funds' false financial reports.

The Prior Motions to Dismiss

The movants in the instant motions for summary judgment (hereinafter the "defendants") were among the defendants in ninety-five of the adversary proceedings which previously filed motions to dismiss.

Those motions to dismiss were denied in a decision dated February 23, 2007 reported as *In re Bayou Group, LLC, et al*, 362 B.R. 624 (Bankr. S.D.N.Y. 2007) (the "February 23 Decision").

Although denominated motions for summary judgment, these contested matters are in substance and effect also motions to dismiss based upon the asserted legal insufficiency of the complaints, rather than upon uncontested facts outside of the complaints. The defendants' arguments here could and should have been asserted in the prior motions to dismiss.

To avoid unnecessary repetition, the February 23 Decision is incorporated by reference as if set forth herein in its entirety. This decision presumes familiarity with the February 23 Decision.

Jurisdiction

This Court has jurisdiction over these core proceedings under 28 U.S.C. §§ 1334(b) and 157(a) and (b)(2) and the standing order of reference to bankruptcy judges dated July 10, 1984 signed by Acting Chief Judge Robert J. Ward.

Defendants' Arguments for Dismissal

The defendants rely upon a simple syllogism in support of their demand for dismissal. The argument is as follows. ¹

Point I.

Fraudulent transfer claims can only be brought for the benefit of creditors -- not equity holders -- and only to the extent necessary to satisfy such creditors.

Point II.

The non-redeeming investors in the Bayou Funds do not qualify as creditors eligible to support the debtors' fraudulent transfer claims.

Since the claims of non-investor creditors are *de minimis* or nil, defendants argue that all of the adversary proceedings must be dismissed because there is no creditor constituency for whose benefit the fraudulent conveyance claims can be asserted as a matter of law.

1 Quotations are from the point headings in defendants' brief.

In addition, defendants argue that these adversary proceedings must be dismissed as a matter of law under Section 510(b) of the Bankruptcy Code. They argue:

Point III.

All claims by Bayou investors to recover for losses in their investments must be treated as equal or subordinate to equity interests pursuant to 11 U.S.C. § 510(b), and cannot support fraudulent transfer claims.

Discussion

A. The argument that the non-redeeming investors are not creditors

Section 548(a)(1)(A) refers to the debtors' intent to hinder, delay or defraud "any entity to which the debtor was or became . . . indebted," *i.e.*, any present or future creditor. The DCL refers in its several provisions relating to fraudulent

conveyance to conveyances "fraudulent as to creditors" or "fraudulent as to both present and future creditors." [HN1]The statutory language, both federal and state, and the case law make clear that fraudulent conveyance claims under Sections 544 and 548 of the Bankruptcy Code and Sections 273 *et seq.* of the DCL may be brought by or on behalf of the debtor for the benefit of creditors. It is *not* clear that fraudulent conveyance claims can *never* be brought in whole or in part to benefit equity, as argued in point I of defendants' syllogism.² But this controversial issue need not be addressed in this decision. The patent and uncontroversial defect in defendants' argument is the premise of point II that non-redeeming investors in the debtors are not creditors of the debtors.

2 In most cases, from the perspective of Bankruptcy Code objectives, it makes sense to say that fraudulent conveyance claims may be asserted only to the extent necessary to benefit creditors, as opposed to the debtor and the debtor's equity. But I decline to embrace an all-encompassing bright line rule holding that a fraudulent conveyance claim can never be brought to benefit equity. It is not difficult to imagine circumstances where stockholders or "equity" (such as the non-redeeming investors here) have no knowledge of, responsibility for or timely capacity to deter a fraudulent scheme by rogue management and suffer precisely the same harm as creditors of a corporate entity which has been victimized by the scheme. In such a case, permitting a debtor-in-possession or Chapter 11 or Chapter 7 trustee to assert fraudulent

conveyance claims for the benefit of innocent equity investors, as well as creditors, would not offend any statutory language and would serve Bankruptcy Code objectives.

It may well be that under Delaware law and the controlling agreements governing their investments in the Bayou Hedge Funds, the non-redeeming investors were and are deemed to be equity holders in the Bayou Hedge Funds. Of course, defendants overlook one respect in which Bayou Hedge Fund investors were different from shareholders in an ordinary stock corporation. [HN2]Shareholders in an ordinary stock corporation generally do not have a contractual right to redeem their investments in the corporate entity, whereas investors in the Bayou Hedge Funds had a contractual right of redemption of their investments and any accumulated profits. The difference is significant because the Bayou Hedge Fund investor had a contractual right of redemption, and a party with a contract claim against a debtor is a creditor of the debtor. Of course, the non-redeeming investors' claims against the Bayou Hedge Funds as creditors in respect of their contract claims for redemption of their investments may be worth little or nothing to the extent that, as alleged, the principal investments of all investors had been reduced by trading losses and the deprivations of the prior principals of the debtors.

But the premise of the amended complaints in these adversary proceedings is that the investors in the Bayou Hedge Funds were not merely contract claimants, but tort claimants as well. It is alleged that all of the Bayou Hedge Fund investors were fraudulently induced to purchase their investments in the Funds by the fraudulent financial statements certified by the non-

existent accounting firm. To quote defendants (Brief at 5), "as everyone concedes, [the non-redeeming investors] had the right prior to the filing of the petition to pursue claims for damages or rescission against the Bayou Hedge Funds." On this premise, all of the non-redeeming investors have tort claims against the debtors for rescission or damages for the entire amount of their principal investments in the Funds. As tort claimants, there can be no doubt that the non-redeeming investors are creditors of the debtors. See *Dillon v. Axxsys Int'l, Inc.*, 185 Fed. Appx. 823, 830 (11th Cir. 2006) (finding plaintiffs who were fraudulently induced into investing to be "creditors" of a corporation by virtue of having "claims" against it); *Scholes v. Lehmann*, 56 F.3d 750, 755 (7th Cir. 1995) ("[D]efrauded investors . . . are tort creditors."); *Drenis v. Haligiannis*, 452 F. Supp. 2d 418, 428 (S.D.N.Y. 2006) ("[Limited partner-investors] here are tort creditors of the Partnership by virtue of their claims against the defrauding defendants."); *In re Independent Clearing House Co.*, 11 B.R. 843, 847 (D. Utah 1987) (Ponzi scheme investors "had a claim against the debtors for the return of [their] money."); see also *IDS Holding Co. v. Madsen (In re IDS Holding Co.)*, 292 B.R. 233, 238 (Bankr. D. Conn. 2003) ("[I]n addition to being an equity security holder . . . '[t]here is no provision in the Bankruptcy Code that a limited partner . . . cannot also have an independent claim within the definition of 101(4) arising out of the same instrument.'" (quoting *In re St. Charles Pres. Investors, Ltd.*, 112 B.R. 469, 474 (D.D.C. 1990) (It cannot be shown that "the definitions of 'creditor' and 'equity security holder' are mutually exclusive."))).

Accordingly, even assuming (without deciding) that as a general proposition fraudulent conveyance claims may not be

asserted by or on behalf of a debtor for the sole or partial benefit of equity investors in the debtor, these adversary proceedings may be prosecuted for the benefit of the non-redeeming investors because such investors are indubitably creditors of the plaintiff Bayou Hedge Funds to the extent of the entirety of their unredeemed investments in the Funds by reason of their tort claims for rescission or damages for fraudulent inducement.

B. Defendants' argument under 11 U.S.C. § 510(b)

Section 510(b) of the Bankruptcy Code provides as follows:

[HN3](b) For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

In the context of this contested matter, the key words in Section 510(b) are the first clause "For the purpose of distribution under this title." The provision governs only the question of priority among claims "[f]or the purpose of distribution" -- Section 510(b) does *not* deal with allowance or disallowance of claims. Indeed, the statute

expressly deals with claims which are "allowed under section 502," and the last clause expressly states that "such [subordinated] claim" remains a "claim" (*i.e.*, is *not* disallowed) with "the same priority as common stock." [HN4]The statute simply provides that a tort claim for rescission or damages arising from purchase, retention or (broadly stated under the case law) ownership of common stock or other equity security shall have no greater priority for distribution purposes than that of the underlying stock or equity interest in question and, therefore, will be subordinated to any creditor interest which has a higher priority under the Bankruptcy Code than that of the underlying stock or equity interest.

Section 510(b) is applicable in this case to the extent that any creditor claims not arising from an investment interest in the Bayou Hedge Funds must be paid in full before any distribution can be made in these Chapter 11 proceedings to any non-redeeming investor/creditor based on the investor/creditor's tort claim for rescission or damages.

The defendants' argument based on Section 510(b) is precisely encapsulated in the following quotation (Brief at 28):

The first clear, direct effect of subordination to the level of equity holder in an insolvent estate is disallowance of the claim -- no distribution or recovery.

This statement of law is utterly without foundation. Nothing in Section 510(b) or any other provision of the Bankruptcy Code supports the conclusion that the effect of subordination under Section 510(b) is disallowance of a claim. It bears repeating

that [HN5]Section 510(b) does not deal with the question of allowance or disallowance of claims. The statute is concerned solely with priority of claims and does no more nor less than subordinate the tort claim of an owner of securities of the debtor below the priority of other creditor/claimants. But it does *not* result in the disallowance of the subordinated claim.

Nor does defendants' sweeping statement of law that subordination under Section 510(b) "is disallowance of the claim -- no distribution or recovery" find any support in the case law. The decisions cited by defendants, *Carrieri v. Jobs.Com Inc.*, 393 F.3d 508, 528 (5th Cir. 2004), *In re Geneva Steel Company*, 281 F.3d 1173 (10th Cir. 2002), *In re WorldCom, Inc.*, 329 B.R. 10, 11-12 (Bankr. S.D.N.Y. 2005), and *In re Walnut Equipment Leasing Co., Inc.*, 1999 Bankr. LEXIS 1626, 1999 WL 1271762 (Bankr. E.D.Pa. 1999), all involved situations in which tort claims subordinated under Section 510(b) to the level of equity received no distribution under the particular debtor's plan because equity received no distribution under the debtor's plan. Of course, it is self-evident that subordination of a tort claim under Section 510(b) to the level of equity may be said to have the same practical effect as disallowance in such a case because the tort claimant gets nothing under the debtor's reorganization or liquidation plan where there is no value left over for equity after the creditors have been paid their *pro rata* entitlements. Such was the case in all of the decisions relied upon by defendants for their erroneous statement of the law quoted above from page 28 of their brief.

But if the effect of subordination versus disallowance makes no difference in a case where nothing is left for equity (including tort creditors subordinated to the level of equity under Section 510(b) after

payment to other creditors), it makes a great deal of difference in a case such as this where the claims of creditors (other than tort claims creditors subordinated under Section 510(b)) do not exhaust the assets in the debtors' estate which are available for distribution.

Defendants' assertion (Brief 29) that "Section 510(b) is not strictly limited to claims allowance for plan distribution purposes" is wrong for two reasons. The word "allowance" is wrong because the statute has nothing to do with claims allowance -- it is concerned solely with claims *priority*. If the word "priority" be substituted for "allowance," the statement is still wrong because Section 510(b) is indeed "strictly limited" to priority for "plan distribution purposes." Nothing in Section 510(b) articulates any purpose other than claims priority, and it is not for the courts to read into the statute any purpose or effect other than the precise claims priority which is prescribed in the statute. It may be that the claims priority prescribed in Section 510(b) will have other practical consequences in the context of any particular bankruptcy case, such as those reflected in the decisions cited by defendants in support of their erroneous assertion at page 29 of their brief. But *disallowance* of claims in a case such as this, where there may be assets available for distribution to claims subordinated

under Section 510(b), was not provided by Congress in Section 510(b) and may not be decreed by courts in contravention of the statute.

Conclusion

As stated in the Conclusion of the February 23 Decision, nothing in this Decision is intended to prejudge the facts as they may appear at a trial. I conclude here only that defendants' legal arguments in support of this misnamed motion for summary judgment must be denied because (A) the non-redeeming investors are, in fact and law, creditors of the Bayou Hedge Funds (in addition to being equity investors), and it is appropriate and lawful to assert fraudulent conveyance claims for their benefit, and (B) Section 510(b) of the Bankruptcy Code subordinates the non-redeeming investors' claims as tort creditors but does not disallow those claims.

Plaintiffs' counsel are directed to prepare an appropriate order and circulate it to defense counsel for approval as to form before submission to this Court.

Dated: White Plains, NY

August 9, 2007

/s/ Adlai S. Hardin, Jr.

U.S.B.J.

**JODI FINNIE, Plaintiff, v. H&R BLOCK FINANCIAL ADVISORS
INC., et. al. and PATRICK A. LOOBY, Defendants.**

Case No. 07-429-CV-W-NKL

**UNITED STATES DISTRICT COURT FOR THE WESTERN
DISTRICT OF MISSOURI, WESTERN DIVISION**

2007 U.S. Dist. LEXIS 74472

October 4, 2007, Decided

October 4, 2007, Filed

CORE TERMS: arbitration, arbitration agreements, employment application, arbitration clause, agreement to arbitrate, compel arbitration, contract of adhesion, unconscionability, arbitration provision, enforceable, weaker, application process, bargaining power, unconscionable, unconscionably, enforceable contract, agreed to arbitrate, acknowledgment, non-signatory, unilateral, oppressive, arbitrators', arbitrate, initialed, interviews, unfairly, stronger, specify, unfair, hired

COUNSEL: For Jodi Finnie, Plaintiff: Sarah Alderks Brown, LEAD ATTORNEY, Randles, Mata & Brown, LLC, Kansas City, MO.

For H&R Block Financial Advisors, Inc., Patrick A. Looby, Defendants: Denise K. Drake, Sarah Jane Bruer, LEAD ATTORNEYS, Spencer Fane Britt & Browne LLP-KCMO, Kansas City, MO.

JUDGES: Nanette K. Laughrey, United States District Judge.

OPINION BY: Nanette K. Laughrey

OPINION

ORDER

Pending before the Court is H&R Block Financial Advisors, Inc. ("H&R Block"), and Patrick A. Looby's ("Looby") Motion to Dismiss and Compel Arbitration on Plaintiff Jodi Finnie's ("Finnie") claims for failure to promote, racial harassment and retaliation with an additional claim for retaliation under the Family and Medical Leave Act. Because Finnie and H&R Block entered a valid agreement to arbitrate contained in her employment application, H&R Block's Motion will be granted. Patrick A. Looby's Motion to Dismiss and Compel Arbitration will be denied.

I. FACTS AS ALLEGED BY PLAINTIFF

On September 26, 2002, Finnie completed and signed a two-page Employment Application and Statutory Disqualification Disclosure & Certification Form ("Employment Application"). The Employment Application requested personal information about Finnie as well as educational and employment history. The second page of the Employment Application contained a paragraph providing that:

I agree to arbitrate any dispute claim or controversy that may arise between the company and me, including any controversy arising out of my employment or termination of employment with the company, any claim of discrimination arising under Title VII, the Americans with Disabilities Act, the Age Discrimination in Employment Act or any other applicable federal or state law, or any other dispute that is required to be arbitrated under the rules, constitution, or bylaws of the NYSE and/or the NASD as may be amended from time to time. This arbitration shall be conducted pursuant to the respective rules

and regulations of the NYSE and/or the NASD then in effect. Any award resulting therefrom may be entered as a judgment by any court of competent jurisdiction. (Def. Mot. Exhibit A.)

Finnie initialed a box located next to the paragraph. After six interviews occurring over six months, H&R Block extended Finnie a written and oral offer of employment which she accepted. Finnie claims that arbitration of disputes was not mentioned in either of these offers. (Affidavit of Jodie Finnie, 2.)

II. DISCUSSION

A. H&R Block

"The Federal Arbitration Act (FAA), 9 U.S.C. § 1 *et seq.*, declares a 'liberal federal policy favoring arbitration agreements.'" *Lyster v. Ryan's Family Steak Houses, Inc.*, 239 F.3d 943, 945 (8th Cir. 2001). The FAA applies to arbitration agreements in employment contracts. See *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001). Accordingly, a "dispute must be submitted to arbitration if there is a valid agreement to arbitrate and the dispute falls within the scope of that agreement." *Lyster v. Ryan's Family Steak Houses, Inc.*, 239 F.3d at 945. To determine if the agreement is valid, the Court looks at the contract law of the relevant state. See *Gannon v. Circuit City Stores, Inc.*, 262 F.3d 677, 680 (8th Cir. 2001). A contract is enforceable under Missouri law if there is an offer, an acceptance and bargained for consideration. *Thacker v. Massman Construction Co.*, 247 S.W.2d 623, 629 (Mo. 1952).

The arbitration provision in the Employment Application is a valid and enforceable provision of the employment agreement. Finnie argues that the Employment Application does not constitute an offer and fails for lack of consideration because the arbitration clause does not specify the consideration exchanged. (Pl. Mot. at 2.) Finnie reads the terms of the contract too narrowly. During the application process, H&R Block agreed to consider Finnie for employment in exchange for her agreement to arbitrate disputes if she were hired. H&R Block then hired Finnie. Finnie has presented no evidence that the arbitration agreement reached during the application process was altered by the terms of her subsequent hiring contract with H&R Block. Therefore, her agreement to arbitrate in her application for employment is enforceable. There was an offer, acceptance and consideration. See *EEOC v. Waffle House, Inc.*, 193 F.3d 805 (4th Cir. 1999); *Valdes v. Swift Transp. Co., Inc.*, 292 F. Supp.2d 524, 530-32 (S.D.N.Y. 2003); *Adkins v. Labor Ready, Inc.*, 185 F. Supp.2d 628, 638-39 (S.D. W. Va. 2001); *Schoenfeld v. U.S. Resort Management, Inc.*, 2006 WL 2707345 (W.D. Mo. Sept. 19, 2006); also see *Dunn Industrial Group, Inc. v. City of Sugar Creek*, 112 S.W.3d 421, 428 (Mo. banc. 2003) (ruling that a change order subsequent to an original contract with an arbitration clause did not rescind the original agreement to arbitrate).

Finnie argues that the Eighth Circuit's decision in *Patterson v. Tenet Healthcare, Inc.*, stands for the proposition that a unilateral distribution of an arbitration agreement to employees lacks acceptance and consideration necessary for a valid contract to form. 113 F.3d 832, 835 (8th Cir. 1997). In *Patterson*, the Eighth Circuit acknowledged that a

unilateral distribution of an employee handbook *after* employment normally could not, without more than mere receipt, constitute an enforceable contract. *Id.* Here, Finnie accepted H&R Block's offer knowing that she had already agreed to arbitrate. *Patterson* is, therefore, distinguished.

Finnie next argues that acknowledgment is not consent and that the written employment offer does not include any arbitration provision. (Pl. Mot., 6.) This argument fails because the Employment Application requires Finnie to agree to resolve employment disputes by arbitration; it does not merely require her acknowledgment. *Valdes*, 292 F. Supp. 2d at 530 (holding that anticipatory arbitration agreements are routinely enforced to compel arbitration of employment discrimination claims).

Finnie also raises several defenses to enforceable contracts under Missouri law. First, Finnie argues that the arbitration clause is procedurally unconscionable. (Pl. Mot., 7.) (citing *State ex rel. Vincent v. Schneider*, 194 S.W.3d 853 (Mo. banc. 2006)). The doctrine of unconscionability gives courts the power to invalidate contracts where one party faces an absence of meaningful choice and unfairly oppressive terms as a result of high pressure sales tactics, unreadable fine print, or misrepresentation among other unfair issues in the contract formation process. *Whitney v. Alltel Communs., Inc.*, 173 S.W.3d 300, 308 (Mo. Ct. App. 2005). Finnie claims that the arbitration clause was "buried" in the Employment Application which was followed by six months of interviews, effectively concealing the agreement to arbitrate from the terms of H&R Block's offer. (Pl. Mot., 8.)

Finnie's allegations do not support a defense of unconscionability. First, on September 26, 2002, Finnie initialed the separate and distinct paragraph on the Employment Application stating that she agreed to arbitrate any disputes with H&R Block. Second, a valid defense of unconscionability requires both procedural and substantive unconscionability. *Whitney v. Alltel Communs., Inc.*, 173 S.W.3d 300, 308 (Mo. Ct. App. 2005). Even if Finnie shows that H&R Block's "concealment" of the arbitration clause constitutes procedural unconscionability, she has not shown how it burdens her with unfairly oppressive terms; it merely provides an alternative forum in which her claims must be resolved. *Swain v. Auto Servs.*, 128 S.W.3d 103, 108 (Mo. Ct. App. 2003) ("An agreement choosing arbitration over litigation, even between parties of unequal bargaining power, is not unconscionably unfair.") (citation omitted). There may be circumstances when a specific arbitration agreement is unconscionable, but Finnie has not shown that this agreement is substantively unconscionable.

Next, Finnie claims that the arbitration clause is a contract of adhesion. A contract of adhesion, as opposed to a negotiated contract, is a form contract that is created and imposed by the party with greater bargaining power. *Robin v. Blue Cross Hospital Service, Inc.*, 637 S.W.2d 695, 697 (Mo. banc. 1982). The "stronger party" has more bargaining power than the "weaker party," often because the weaker party is unable to look elsewhere for more attractive contracts. *Id.* The contract is offered on a "take this or nothing" basis. *State ex rel. Vincent v. Schneider*, 194 S.W.3d 853, 857 (Mo. banc. 2006). The terms in the contract are imposed on the weaker party and "unexpectedly or unconscionably limit the obligations and liability of the [stronger party]." *Robin v. Blue Cross Hospital Service, Inc.*, 637 S.W.2d 695, 697 (Mo. banc. 1982).

Finnie has offered no set of facts from which the Court can infer that this was a contract of adhesion. Finnie alleges that H&R Block designed their application process to "spring" upon weaker parties a limitation of H&R Block's liability; the terms of the arbitration clause "unconscionably limit the obligations" of H&R Block; and the arbitration must be conducted according to the rules of the NYSE and/or the NASD which presumptively limit H&R Block's liability. This minimal evidence was the extent of Finnie's proof that the contracts were contracts of adhesion and it is insufficient. Finnie was put on notice of the arbitration provision before she accepted employment, so the obligation was not unexpected. Finnie has presented no evidence that this was the only employment available to her and there is not even evidence that she tried to eliminate the arbitration provision before signing the application for employment. In addition, her conclusory statements that the NYSE and NASD arbitration rules presumptively limit H&R Block's liability are insufficient to support a finding that this was a contract of adhesion.

Finally, Finnie claims that the arbitration clause fails to set forth the necessary matters regarding arbitration. *Id.* As noted above, the arbitration must be conducted according to the rules of the NYSE and/or the NASD which specify "how arbitrators will be appointed, arbitrators' right to exercise authority, notification of their award, and payment of fees and expenses." (Pl. Mot., 8.) See NASD Code § 10000 et seq.

B. Patrick A. Looby

The arbitration agreement is not enforceable as to Finnie's claims against Patrick A. Looby. To determine if an agreement to arbitrate is valid, the court looks at the contract law of the relevant state. See *Gannon v. Circuit City Stores, Inc.*, 262 F.3d 677, 680 (8th Cir. 2001). Under Missouri law, an arbitration agreement cannot be enforced against a person who is not a party to the contract. *Finney v. Nat'l Healthcare Corp.*, 193 S.W.3d 393, 394 (Mo. Ct. App. 2006). Finnie and Looby are not parties to an arbitration agreement. The arbitration agreement between Finnie and H&R Block confines arbitration of disputes to those that arise "between the company and [Finnie]." (Def. Mot. Exhibit A). Moreover, Finnie has brought claims against Looby in his individual capacity, as authorized under the Missouri Human Rights Act and the Family Medical Leave Act. *Cooper v. Albacore Holdings, Inc.*, 204 S.W.3d 238 (Mo. Ct. App. 2006); *Darby v. Bratch*, 287 F.3d 673 (8th Cir. 2002).

Looby argues that arbitration can be compelled where the relationship between the signatory and non-signatory is sufficiently close. *CD Partners, LLC v. Grizzle*, 424 F.3d 795, 798 (8th Cir. 2005). Looby further argues that a non-signatory agent is entitled to arbitration when the principal was party to an arbitration agreement. *Sprague v. Household Int'l*, 473 F. Supp. 2d 966, 977 (W.D. Mo. 2005) (citing *Madden v. Ellspermann*, 813 S.W.2d 51, 53 (Mo. Ct. App. 1991)). However, under Missouri law, it is the principal that can be bound by the agent, not the other way around. *Netco Inc. v. Dunn*, 2006 Mo. LEXIS 72 (Mo. 2006) (overruling the rule announced in *Madden* that non-signatory agents are entitled to enforce arbitration agreements of their principals). Thus, without an agreement between Finnie and Looby to arbitrate their claims, Looby's Motion to Dismiss and Compel Arbitration fails.

Accordingly, it is hereby

ORDERED that H&R Block's Motion to Dismiss and Compel Arbitration [Doc. # 6] is GRANTED;

ORDERED that Patrick A. Looby's Motion to Dismiss and Compel Arbitration [Doc. # 6] is DENIED.

s/ Nanette K. Laughrey

United States District Judge

Dated: October 4, 2007

Jefferson City, Missouri

In Re: COTTON YARN ANTITRUST LITIGATION; ATLANTIC TEXTILES, on behalf of itself and all others similarly situated; SOUTH CAROLINA TEES, INCORPORATED, on behalf of itself and all others similarly situated; LISA LESAVOY, Successor in Interest to Apparel Sales & Printing, Incorporated, on behalf of herself and all others similarly situated; ARMEN COMPANY, INCORPORATED, on behalf of itself and all others similarly situated; MEKFIR INTERNATIONAL CORPORATION, on behalf of itself and all others similarly situated; DELL CARTIER ASSOCIATES, INCORPORATED, on behalf of itself and all others similarly situated; PERFECT FIT GLOVE COMPANY, LLC, individually and on behalf of all others similarly situated; RONALD LITTLE, formerly doing business as Star Flight Hosiery, Incorporated, on behalf of himself and all others similarly situated; THOMASTON MILLS, INCORPORATED, by and through Charles Crumley, Trustee in Bankruptcy, on behalf of itself and all others similarly situated, Plaintiffs-Appellees, v. AVONDALE INCORPORATED; AVONDALE MILLS, INCORPORATED, Defendants-Appellants, and FRONTIER SPINNING MILLS, INCORPORATED; PARKDALE AMERICA, LLC; PARKDALE MILLS, INCORPORATED; UNIFI, INCORPORATED, Defendants. In Re: COTTON YARN ANTITRUST LITIGATION; ATLANTIC TEXTILES, on behalf of itself and all others similarly situated; SOUTH CAROLINA TEES, INCORPORATED, on behalf of itself and all others similarly situated; LISA LESAVOY, Successor in Interest to Apparel Sales & Printing, Incorporated, on behalf of herself and all others similarly situated; ARMEN COMPANY, INCORPORATED, on behalf of itself and all others similarly situated; MEKFIR INTERNATIONAL CORPORATION, on behalf of itself and all others similarly situated; DELL CARTIER ASSOCIATES, INCORPORATED, on behalf of itself and all others similarly situated; PERFECT FIT GLOVE COMPANY, LLC, individually and on behalf of all others similarly situated; RONALD LITTLE, formerly doing business as Star Flight Hosiery, Incorporated, on behalf of himself and all others similarly situated; THOMASTON MILLS, INCORPORATED, by and through Charles Crumley, Trustee in Bankruptcy, on behalf of itself and all others similarly situated, Plaintiffs-Appellees, v. FRONTIER SPINNING MILLS, INCORPORATED, Defendant-Appellant, and AVONDALE INCORPORATED; AVONDALE MILLS, INCORPORATED; PARKDALE AMERICA, LLC; PARKDALE MILLS, INCORPORATED; UNIFI, INCORPORATED, Defendants.

No. 05-2392, No. 05-2393

UNITED STATES COURT OF APPEALS FOR THE FOURTH
CIRCUIT

2007 U.S. App. LEXIS 23979

September 18, 2006, Argued
October 12, 2007, Decided

PRIOR HISTORY:

Appeals from the United States District Court for the Middle District of North Carolina, at Durham. James A. Beaty, Jr., District Judge. (MDL-04-1622-1-JAB).

DISPOSITION: VACATED AND REMANDED.

CORE TERMS: arbitration, arbitration agreements, arbitration clauses, limitations period, confirmation, antitrust, antitrust claims, usage of trade, statutory rights, textile industry, usage, vindicating, conspiracy, discovery, arbitrate, arbitral, contractual, yarn, unenforceable, materially, arbitration proceeding, limitations provision, manufacturer, statutory claim, enforceable, per se rule, material alteration, substantive rights, majority opinion, Sherman Act

COUNSEL: ARGUED: Shari Ross Lahlou, CROWELL & MORING, L.L.P., Washington, D.C.; Jeffrey S. Cashdan, KING & SPALDING, L.L.P., Atlanta, Georgia, for Appellants.

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ON BRIEF: Jonathan A. Berkelhammer, Jonathan P. Heyl, SMITH MOORE, L.L.P., Greensboro, North Carolina; John S. Darden, KING & SPALDING, L.L.P., Atlanta, Georgia, for Appellants Avondale Incorporated and Avondale Mills, Incorporated; James T. Williams, Jr., Jennifer K. Van Zant, BROOKS, PIERCE, MCLENDON, HUMPHREY & LEONARD, L.L.P., Greensboro, North Carolina; Kent A. Gardiner, CROWELL & MORING, L.L.P., Washington, D.C., for Appellant Frontier Spinning Mills, Incorporated.

Anthony J. Bolognese, Michael E. Gehring, BOLOGNESE & ASSOCIATES, L.L.C., Philadelphia, Pennsylvania; Joseph C. Kohn, Steven M. Steingard, KOHN, SWIFT & GRAF, P.C., Philadelphia, Pennsylvania; Mindee J. Reuben, WEINSTEIN, KITCHENOFF & ASHER, L.L.C., Philadelphia, Pennsylvania; Steven A. Kanner, William H. London, Melinda J. Morales, MUCH, SHELIST, FREED, DENENBERG, AMENT & RUBENSTEIN, P.C., Chicago, Illinois; Robert C. Cone, TUGGLE, DUGGINS & MESCHAN, P.A., Greensboro, North Carolina, for Appellees.

JUDGES: Before WILLIAMS, Chief Judge, TRAXLER, Circuit Judge, and Thomas E. JOHNSTON, United States District Judge for the Southern District of West Virginia, sitting

by designation. Judge Traxler wrote the opinion for the court, in which Chief Judge Williams concurred as to Part II and in which Judge Johnston concurred as to Parts I, II(A), and II(B)(1). Chief Judge Williams wrote an opinion dissenting from Part I of the opinion of the court. Judge Johnston wrote an opinion dissenting from Parts II(B)(2) and II(B)(3) of the opinion of the court.

OPINION BY: TRAXLER

OPINION

TRAXLER, Circuit Judge:

Purchasers of cotton and polycotton yarn commenced a class action against various North Carolina manufacturers of the yarns, alleging that the manufacturers had engaged in a pricefixing conspiracy in violation of the Sherman Act. The manufacturers moved to dismiss the suit as to certain plaintiffs, arguing that those plaintiffs were bound by arbitration clauses that were broad enough to encompass the antitrust claims. The district court denied the motion. The court concluded that some of the contracts at issue did not include arbitration clauses. As to those contracts that did include binding arbitration clauses, the district court concluded that those clauses could not be enforced because they prevented the plaintiffs from effectively vindicating their statutory antitrust claims. Thus, the end result of the district court's ruling was that no plaintiff was required to submit its antitrust claims to arbitration.

The manufacturers appeal. We conclude that all contracts at issue in this appeal include a binding arbitration provision. We also conclude that the plaintiffs have failed to establish that the terms of the arbitration provisions prevent them from effectively vindicating their statutory rights. We therefore vacate the decision of the district court and remand for further proceedings.

I.

We turn first to the question of whether the contracts at issue include binding arbitration clauses. This case involves antitrust claims asserted against Avondale Inc., and Avondale Mills, Inc. (together, "Avondale") and Frontier Spinning Mills, Inc.,¹ by a putative class of those who purchased yarn from these manufacturers between January 1, 1999, and February 11, 2004. The district court concluded that all of the Avondale contracts at issue included binding arbitration provisions, and that some of the Frontier contracts also included binding arbitration agreements. However, the district court concluded that the Frontier contracts with plaintiffs Atlantic Textiles, South Carolina Tees, and Armen Company did not include binding arbitration clauses.

¹ Parkdale Mills, Inc., and Parkdale America, LLC were also named as defendants. The Parkdale defendants settled with the plaintiffs before the court ruled on the arbitration issue and are no longer a part of the case.

Starting in 2000 and 2001, the purchasers involved in the Frontier transactions arranged purchases over the phone, discussing quantity and price. Frontier then sent written contracts (which refer to themselves as "sales contracts" and "confirmations") that

confirmed the terms discussed and included additional terms, including an arbitration clause. The contracts provided that they were subject to "The Yarn Rules of 1989," J.A. 79, and stated that "[e]xcept to the extent a future transaction is governed by a signed contract between the parties, the terms and conditions hereof, including, without limitation, the arbitration provision, shall govern all further transactions." J.A. 80. The contracts were signed by Frontier, but the record contains no copy of the contracts signed by the purchasers. The contracts at issue, however, state that acceptance of the product constitutes acceptance of the contract terms.

New contracts were not sent with each shipment of yarn, because orders often contemplated multiple separate shipments, but Frontier did send invoices to the purchasers with each shipment. The invoices are not signed by either party. They do not include an arbitration provision, nor do they explicitly incorporate the terms of the sales contracts. According to an affidavit submitted by Frontier, however, the order number referenced on the face of each invoice "is the last four or five digits of the contract number." J.A. 746.

State contract law governs the question of whether the parties have agreed to arbitrate, see *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995); *Hightower v. GMRI, Inc.*, 272 F.3d 239, 242 (4th Cir. 2001), and the parties agree that North Carolina law governs the Frontier transactions. Because the transactions involve the sale of goods, they are governed by North Carolina's version of the Uniform Commercial Code.

The district court concluded that the contracts for sale in the Frontier transactions were oral, formed over the phone when the parties talked about price, quantity, and delivery. Because arbitration was not mentioned in those conversations, the district court concluded that arbitration was not a term of the oral agreements. Applying N.C. Gen. Stat. Ann. § 25-2-207 (the UCC's "battle of the forms" provision), the district court concluded that the arbitration clauses included in the contracts and confirmations sent by Frontier did not become part of the contract because, under North Carolina law, a proposed arbitration clause is a material alteration of a contract. See N.C. Gen. Stat. Ann. § 25-2-207(2)(b) (2006) (stating that additional terms contained in a confirmation of a contract between merchants become part of the contract unless the terms materially alter the contract); ² *Frances Hosiery Mills, Inc. v. Burlington Indus., Inc.*, 204 S.E.2d 834, 842-43 (N.C. 1974) (concluding that an arbitration provision included in a contract confirmation did not become part of the contract because the arbitration requirement materially altered the contract).

2 The parties agree that they are "merchants" within the meaning of the UCC.

On appeal, Frontier contends that arbitration of disputes is a well-established custom in the textile industry, and that, as a "usage of trade," arbitration was automatically part of the agreement reached by the parties. Frontier thus argues that because arbitration was already part of the agreement, it was not an "additional term" that could be knocked out as a material alteration under § 25-2-207(2)(b). We agree.

N.C. Gen. Stat. Ann. § 25-1-201, which sets out the UCC's general definitions, defines an agreement as "the bargain of the parties in fact, as found in their language or inferred from other circumstances, *including course of performance, course of dealing, or usage of trade* as provided in G.S. 25-1-303." N.C. Gen. Stat. Ann. § 25-1-201(b)(3) (2006)

(emphasis added).³ The authors of the definitive treatise on the Uniform Commercial Code have explained that by virtue of § 2-201,

[t]he express agreement may be silent on a matter, yet usage of trade . . . may fill the gap. . . .

* * *

The agreement of the parties includes that part of their bargain that may be found in course of dealing, usage of trade, or course of performance. These sources are relevant not only to the interpretation of express contract terms but may themselves constitute contract terms.

J. White & R. Summers, *Uniform Commercial Code* §§ 3-2, 3-3 (4th ed. 1995) (footnote omitted). Accordingly, if arbitration is a usage of trade in the textile industry, then it was included in the parties' agreement notwithstanding the fact that there was no mention of arbitration in the oral agreements. And if arbitration was already part of the agreement, the contracts and confirmations (which included an explicit arbitration clause) did not add additional terms, and § 25-2-207(2)(b) is irrelevant, at least as to the general requirement to submit any claim to arbitration. The question, then, is whether arbitration of disputes is a usage of trade in the textile industry.

³ North Carolina amended portions of its UCC effective October 1, 2006, well after the proceedings below concluded. See 2006 N.C. Sess. Laws S.L. 2006-112 (S.B. 1555). Although the amendments changed the language of some UCC sections relevant to this case, the changes are not material to our analysis of the issues. We therefore refer to the current version of the statutes at issue.

"Usage of trade" is defined as "any practice or method of dealing having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question." N.C. Gen. Stat. Ann. § 25-1-303(c) (2006). "The existence and scope of such a usage must be proved as facts. If it is established that such a usage is embodied in a trade code or similar record, the interpretation of the record is a question of law." *Id.*

In our view, Frontier has met its burden of proving that arbitration is a usage of trade in the textile industry. The "Yarn Rules" incorporated in the Frontier sales contracts and confirmations are a collection of "industry rules regarding contract terms and conditions and industry norms" that have been gathered and reported by the American Yarn Spinners Association for more than 50 years. J.A. 541. As to arbitration, the Yarn Rules state that "[p]arties to the sale and purchase of yarns are members of the textile industry, which has, for over fifty years, settled disputes by arbitration in accordance with the terms and conditions of contracts which have tended to become standard and in accordance with equity and good conscience and the customs and practices of the trade." J.A. 542-43. Thus, the Yarn Rules themselves are strong evidence that arbitration is a usage of trade in the textile industry.

Moreover, numerous cases have noted that arbitration of disputes is standard in the textile industry. See *Chelsea Square Textiles, Inc. v. Bombay Dyeing & Mfg. Co.*, 189 F.3d 289, 296 (2d Cir. 1999) ("We believe that a textile buyer is generally on notice that an agreement to purchase textiles is not only likely, but almost certain, to contain a provision mandating arbitration in the event of disputes, and must object to such a provision if it seeks to avoid arbitration."); *Stedor Enters., Ltd. v. Armtex, Inc.*, 947 F.2d 727, 733 (4th Cir. 1991) ("[I]n industries such as fabrics and textiles . . . the specialized nature of the product has led to the widespread use of arbitration clauses and knowledgeable arbitrators." (quoting *Pervel Indus., Inc. v. T M Wallcovering, Inc.*, 871 F.2d 7, 8 (2d Cir. 1989))); *Genesco, Inc. v. T. Kakiuchi & Co.*, 815 F.2d 840, 846 (2d Cir. 1987) ("[T]he widespread use of arbitration clauses in the textile industry puts a contracting party . . . on notice that its agreement probably contains such a clause."); *Helen Whiting, Inc. v. Trojan Textile Corp.*, 121 N.E.2d 367, 370 (N.Y. 1954) ("[W]e can almost take judicial notice that arbitration clauses are commonly used in the textile industry . . ."). We conclude that this evidence is sufficient to establish that arbitration is a usage of trade in the textile industry.

The purchasers submitted affidavits establishing that their corporate officers had never heard arbitration mentioned in their dealings with Frontier and that disputes were generally resolved informally. One executive stated that, to his knowledge, arbitration is not customarily used in the industry. The UCC, however, does not require that a party to a contract have actual knowledge of a usage of trade before that usage of trade is incorporated into the contract. See N.C. Gen. Stat. Ann. § 25-1-303(c) (defining usage of trade as "any practice or method of dealing having such regularity of observance in a place, vocation or trade *as to justify an expectation* that it will be observed with respect to the transaction in question." (emphasis added)); White & Summers, § 3-3 ("[I]t is not necessary for both parties to be consciously aware of the trade usage. It is enough if the trade usage is such as to justify an expectation of its observance."); *id.* ("[A] party can be chargeable with a usage of trade of which it is ignorant . . ."). Accordingly, the plaintiffs' affidavits are insufficient to overcome Frontier's showing.

Because Frontier sufficiently established that arbitration is a usage of trade, the oral contracts included an agreement to arbitrate notwithstanding the fact that arbitration was not mentioned in the telephone conversations. As to the general obligation to arbitrate, there is no reason to consider whether the arbitration clauses contained in the sales contracts and confirmations would become part of the contract under N.C. Gen. Stat. Ann. § 25-2-207(2)(b).⁴

4 Our resolution of this issue is not inconsistent with *Supak & Sons Manufacturing Co. v. Pervel Indus.*, 593 F.2d 135 (4th Cir. 1979), and *Frances Hosiery Mills, Inc. v. Burlington Industries, Inc.*, 204 S.E.2d 834 (N.C. 1974). In *Supak* and *Frances Hosiery*, the courts refused to compel arbitration after applying § 25-2-207 and concluding that the arbitration clauses materially altered the contracts. See *Supak*, 593 F.2d at 136-37; *Frances Hosiery*, 204 S.E.2d at 842-43. Our colleague suggests that *Supak* and *Frances Hosiery* established a *per se* rule that arbitration is a material alteration of a contract and that this *per se* rule prevents us from considering the facts of an individual case when determining whether an arbitration clause materially alters a contract. *Supak* and *Frances Hosiery* may well establish a *per se*

rule. In our judgment, that rule governs *only* the inquiry under § 25-2-207(2)(b): whether *additional* terms contained in a confirmation will become part of a contract. Because we have concluded that the oral agreement between the parties included an obligation to submit disputes to arbitration, the arbitration clause in the confirmation is *not* an additional term and § 25-2-207(2)(b) simply does not factor into our analysis on that point. The *Supak* rule that arbitration clauses materially alter the terms of a contract that does not otherwise include an arbitration requirement cannot somehow preclude inquiry into the threshold question of whether the contract already includes an arbitration requirement.

We also note that while *Supak* and *Frances Hosiery* both involved contracts for the sale of textiles, neither court considered whether arbitration was a usage of trade in the textile industry, and there is no indication that the issue was raised in either case. Given that usage of trade is a question of fact that must be proved by the party asserting it, the courts' silence on the usage of trade question in *Supak* and *Frances Hosiery* cannot be viewed as rejection of the contention that arbitration is a usage of trade in the textile industry.

The usage of trade established by Frontier is simply that arbitration is the manner in which disputes are resolved in the textile industry, and only that general obligation became part of the contract without regard to § 25-2-207(2). The terms and conditions under which any arbitration would proceed were set forth in the sales contracts and confirmations, and those terms and conditions proceeding must be viewed as additional terms subject to analysis under § 25-2-207(2). Because the oral agreement included the obligation to submit any disputes to arbitration, we do not believe that the details of the arbitration proceeding materially altered the contract. Those additional terms therefore became part of the contract under § 25-2-207. See N.C. Gen. Stat. Ann. § 25-2-207(2)(b) (explaining that additional terms contained in a confirmation of a contract between merchants become part of the contract unless the terms materially alter the contract).⁵

5 Although the initial agreement to arbitrate disputes was (as a usage of trade) part of the oral agreement, we believe that the subsequent written confirmations setting out the terms governing such arbitration are sufficient to satisfy the Federal Arbitration Act's requirement of a written agreement to arbitrate. See 9 U.S.C.A. § 2.

Accordingly, we reverse the district court's conclusion that there was no binding agreement to arbitrate between the parties to the Frontier transactions.

II.

We turn now to the broader question of whether the arbitration agreements are enforceable.

It is by now well established that the Federal Arbitration Act reflects "a liberal federal policy favoring arbitration agreements." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). Claims asserted under federal statutes generally are arbitrable, so long as the wording of the arbitration agreement is sufficiently broad to encompass the statutory claim and Congress has not indicated its intent to prohibit

arbitration of a given statutory claim. See *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991). As the Supreme Court has explained,

By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum. It trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration. We must assume that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that intention will be deducible from text or legislative history. Having made the bargain to arbitrate, the party should be held to it unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue.

Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985) (citation omitted).

In *Mitsubishi*, the Supreme Court concluded that antitrust claims arising from international transactions are suitable for arbitration. See *id.* at 636-37. Although the Supreme Court has yet to directly consider the arbitrability of domestic antitrust claims, the Court's analysis of the question in *Mitsubishi* is equally applicable to domestic antitrust claims, as confirmed by language in subsequent cases. See *Gilmer*, 500 U.S. at 28 ("The Sherman Act, the Securities Exchange Act of 1934, RICO, and the Securities Act of 1933 all are designed to advance important public policies, but . . . claims under those statutes are appropriate for arbitration."); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 232 (1987) ("In *Mitsubishi*, . . . we recognized that arbitral tribunals are readily capable of handling the factual and legal complexities of antitrust claims, notwithstanding the absence of judicial instruction and supervision."); *id.* at 239 (explaining that "[a]lthough the holding in *Mitsubishi* was limited to the international context, much of its reasoning is equally applicable" to the question of whether domestic RICO claims may be subject to arbitration (citation omitted)); see also *Kotam Elec., Inc. v. JBL Consumer Prods.*, 93 F.3d 724, (11th Cir. 1996) (en banc) ("In light of *Mitsubishi* and its progeny . . . , we hold that . . . arbitration agreements concerning domestic antitrust claims are enforceable."). We therefore have no difficulty concluding that domestic antitrust claims, as a class, are suitable for arbitration. And as the district court concluded, the arbitration clauses at issue in this case are broad enough to encompass the plaintiffs' antitrust claims. Thus, as an initial matter, it would appear that the claims asserted by the plaintiffs should be subject to arbitration.

However, even if an arbitration clause is broad enough to encompass a statutory claim for which Congress has not precluded arbitration, arbitration of the claim will not be compelled if the prospective litigant cannot effectively vindicate his statutory rights in the arbitral forum. See *Green Tree Fin. Corp.-Alabama v. Randolph*, 531 U.S. 79, 90 (2000) ("[E]ven claims arising under a statute designed to further important social policies may be arbitrated because so long as the prospective litigant effectively may vindicate his or her statutory cause of action in the arbitral forum, the statute serves its functions." (internal

quotation marks and alterations omitted)). The party seeking to avoid arbitration bears the burden of establishing that he cannot effectively vindicate his statutory rights under the terms of an arbitration agreement. See *Green Tree*, 531 U.S. at 92; *Booker v. Robert Half Int'l, Inc.*, 413 F.3d 77, 81 (D.C. Cir. 2005). Mere speculation about how the terms of the arbitration agreement might be construed by the arbitrator or how the agreement might affect the prospective litigant is insufficient to carry that burden. See *Green Tree*, 531 U.S. at 90-91 (explaining that while "the existence of large arbitration costs could preclude a litigant . . . from effectively vindicating her federal statutory rights in the arbitral forum . . . [,] the record does not show that Randolph will bear such costs if she goes to arbitration. . . . The 'risk' that Randolph will be saddled with prohibitive costs is too speculative to justify the invalidation of an arbitration agreement.").

Although the precise language varies from contract to contract, all of the arbitration clauses at issue in this case prevent joinder -- multiple plaintiffs may not join their claims against a single defendant, nor may a single plaintiff bring claims against multiple defendants in a single proceeding. The district court concluded that these provisions prevented the plaintiffs from effectively vindicating their antitrust claims, and the court therefore declined to enforce the arbitration clauses.

A.

We first consider whether the nojoinder terms of the arbitration agreements prevent the plaintiffs from effectively vindicating their statutory rights.

The plaintiffs contend that because they allege the existence of a pricefixing conspiracy, the inability to join all defendants in a single proceeding prevents them from vindicating their statutory rights. They claim that "[s]evering the conspiracy into separate parts would deprive Plaintiffs of the full benefit of their proof, and make the proving of the conspiracy, if not impossible, extremely difficult." Brief of Appellees at 31. Because the plaintiffs seek damages caused by the "conspiratorial actions of *all* the Defendants," the plaintiffs contend that individual arbitration proceedings would "[s]hift[] the focus . . . from the 'combined acts' of the Defendants to the 'individual acts' of the single Defendant before the arbitral forum" and would thereby "eviscerate" their antitrust conspiracy claims. Brief of Appellees at 32. We find this argument unpersuasive.

Contrary to the argument of the plaintiffs, we do not believe that the plaintiffs' inability under the terms of the arbitration clauses to sue both remaining defendants in a single proceeding affects their ability to prove a pricefixing conspiracy. Preliminarily, we note that the antitrust statutes themselves do not grant private plaintiffs a right to proceed against all coconspirators in a single action; the vagaries of the relevant venue and serviceofprocess requirements will sometimes require the dismissal of claims against an alleged coconspirator. See, e.g., *Piedmont Label Co. v. Sun Garden Packing Co.*, 598 F.2d 491, 495 (9th Cir. 1979) (concluding that claim against one alleged coconspirator must be dismissed because venue was improper); cf. *Bankers Life & Cas. Co. v. Holland*, 346 U.S. 379, 384 (1953) ("Congress . . . placed definite limits on venue in treble damage actions. Certainly Congress realized in so doing that many such cases would not lie in one district as to all defendants, unless venue was waived. It must, therefore, have contemplated that such proceedings might be severed and transferred or filed in separate districts

originally."). Accordingly, the nojoinder terms of the arbitration agreements do not deprive the plaintiffs of any statutorily conferred right.

Moreover, while many antitrust plaintiffs are able to proceed against all coconspirators in a single action, the fact remains that coconspirators are not necessary parties; a plaintiff can prove the existence of a conspiracy in an action against just one of the members of the conspiracy. See Fed. R. Civ. P. 20; Fed. R. Civ. P. 23; see also *Georgia v. Pennsylvania R.R. Co.*, 324 U.S. 439, 463 (1945) ("In a suit to enjoin a[n antitrust] conspiracy not all the conspirators are necessary parties defendant."); *Wilson P. Abraham Constr. Corp. v. Tex. Indus., Inc.*, 604 F.2d 897, 904 n.15 (5th Cir. 1979) ("Antitrust coconspirators are jointly and severally liable for all damages caused by the conspiracy to which they were a party. A private plaintiff need not sue all coconspirators but may choose to proceed against any one or more of them." (citations omitted)). The presence of only one defendant in a given arbitration proceeding thus in no sense would *prevent* the plaintiffs from proving the existence of a conspiracy.

Moreover, it is important to note that because the Parkdale defendants have settled, only two defendants remain. Consequently, each plaintiff would be required to pursue at most two arbitration proceedings in the place of one lawsuit. And because the defendants would be jointly and severally liable, a plaintiff who finds pursuing two actions unduly burdensome could simply seek to hold one defendant liable for all damages caused by the conspiracy.⁶

6 Although the plaintiffs do not specifically address it, we find nothing in the record that would permit us to conclude that the prohibition against joinder of *plaintiffs* provision would prevent the plaintiffs from vindicating their statutory rights. The plaintiffs did not initially seek to pursue a class action or even to file jointly their initial complaints. Instead, they filed seven separate actions, six in the Middle District of North Carolina and one in the Eastern District of North Carolina. Thus, the plaintiffs' own conduct suggests that they believed joinder of plaintiffs was unnecessary to pursue their actions successfully.

The district court relied on *Continental Ore Co. v. Union Carbide and Carbon Corp.*, 370 U.S. 690 (1962), and *Jung v. Association of American Medical Colleges*, 300 F. Supp. 2d 119 (D.D.C. 2004), in support of its conclusion that the antijoinder provisions prevented the plaintiffs from effectively vindicating their rights under the Sherman Act. We agree with the manufacturers that these cases are inapposite. *Continental Ore* and *Jung* both involved attempts to dissect a single conspiracy claim into pieces, effectively treating the subparts of the claim as separate suits.

In *Jung*, the court rejected the defendant's attempt to compel arbitration of only one part of a larger conspiracy claim, but the court did not address the propriety of requiring a plaintiff to proceed against coconspirators individually. See *Jung*, 300 F. Supp. 2d at 155. In this case, the defendants seek arbitration of *all* issues relating to the existence of a pricefixing conspiracy; that there must be separate arbitration proceedings for each defendant simply does not amount to an improper splitting of a single conspiracy claim. In *Continental Ore*, the court made it clear that when considering the conduct of any one defendant, the factfinder must be able to consider not only the actions of that one

defendant, but those of the entire conspiracy, looking at "the whole picture and not merely at the individual figures in it." 370 U.S. at 699 (internal quotation marks omitted). Nothing in *Continental Ore*, however, suggests that a comprehensive view of the entire conspiracy can be made only if all of the co-conspirators are parties to the action.

As noted above, coconspirators are not necessary parties in an action against a single conspirator. There is nothing in the arbitration agreements that would prevent the plaintiffs from presenting evidence about the actions of nonparty defendants in order to establish the existence of the pricefixing conspiracy alleged by the plaintiffs. Accordingly, the mere fact that the plaintiffs may not join the defendants in a single arbitration proceeding does not prevent the plaintiffs from effectively vindicating their statutory rights. While individual proceedings may be less efficient than a single proceeding, that inefficiency is a function of Congress's preference for resolution of disputes by arbitration and cannot be a basis for defeating the arbitration that Congress was seeking to encourage. See *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 20 ("It is true, therefore, that if Mercury obtains an arbitration order for its dispute, the Hospital will be forced to resolve these related disputes in different forums. That misfortune, however, is not the result of any choice between the federal and state courts; it occurs because the relevant federal law *requires* piecemeal resolution when necessary to give effect to an arbitration agreement.").

We recognize, of course, that requiring each plaintiff to proceed separately against each defendant will entail additional expense. The possibility that a party to an arbitration clause will be inconvenienced and will incur some extra expense, however, does not necessarily mean that the party cannot effectively vindicate its statutory rights through arbitration. For example, we have held that the inability to bring a class action does not in and of itself render an arbitration agreement unenforceable, see, e.g., *Adkins v. Labor Ready, Inc.*, 303 F.3d 496, 503 (4th Cir. 2002); *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631, 638-39 (4th Cir. 2002), but we have acknowledged that if a party could demonstrate that the prohibition on class actions likely would make arbitration prohibitively expensive, such a showing could invalidate an agreement, see *Adkins*, 303 F.3d at 502-03.

The plaintiffs in this case developed no evidentiary record below establishing how much it would cost to proceed individually against each defendant or how those increased costs would affect their ability to proceed in arbitration. The absence of an evidentiary record on this issue leaves us with mere speculation about the actual cost of individual proceedings and something little better than a wild guess about the ability of the corporate plaintiffs to bear those speculative costs. This kind of uninformed speculation about cost falls far short of satisfying the plaintiffs' burden of proving that the costs of proceeding individually against the defendants would be prohibitive and thus would prevent them from effectively vindicating their statutory rights. See *Green Tree*, 531 U.S. at 90-91; *Bradford v. Rockwell Semiconductor Sys., Inc.*, 238 F.3d 549, 558 (4th Cir. 2001) (affirming district court's decision to compel arbitration because plaintiff "has offered *no evidence* that he was unable to pay the \$4,470.88 that he was billed by the AAA, or that the fee-splitting provision deterred him from pursuing his statutory claim or would have deterred others similarly situated" (emphasis added)).

The plaintiffs also suggest that when the no-joinder provisions are considered in light of the restricted discovery available in arbitration, it becomes apparent that the prohibition against joinder prevents them from effectively vindicating their statutory rights. The plaintiffs argue that no third-party discovery would be available in arbitration. Given the importance of discovery to establishing an antitrust claim, *see, e.g., In re Uranium Antitrust Litig.*, 480 F. Supp. 1138, 1155 (N.D. Ill. 1979) ("[T]he heart of any American antitrust case is the discovery of business documents. Without them, there is virtually no case." (internal quotation marks omitted)), the plaintiffs contend that the limited discovery available in arbitration would prevent them from proving their antitrust claims. We disagree.

While discovery generally is more limited in arbitration than in litigation, that fact is simply one aspect of the trade-off between the "procedures and opportunity for review of the courtroom [and] the simplicity, informality, and expedition of arbitration" that is inherent in every agreement to arbitrate. *Mitsubishi*, 473 U.S. at 628. Because limited discovery is a consequence of perhaps every agreement to arbitrate, it cannot, standing alone, be a reason to invalidate an arbitration agreement. And while the plaintiffs contend that antitrust claims are uniquely dependent on the ability to engage in wideranging discovery, the Supreme Court has at least implicitly rejected the argument that discovery limitations render antitrust claims unsuitable for arbitration. *See Gilmer*, 500 U.S. at 31 ("Gilmer also complains that the discovery allowed in arbitration is more limited than in the federal courts, which he contends will make it difficult to prove discrimination. It is unlikely, however, that age discrimination claims require more extensive discovery than other claims that we have found to be arbitrable, such as RICO and antitrust claims.").

Even if there could be a particular case where the restricted discovery available in arbitration would effectively prevent a plaintiff from proving his antitrust claim, the plaintiffs have fallen far short of establishing that this is such a case. The plaintiffs do not contend that they would be unable to obtain adequate discovery from the defendant manufacturer in each of the separate arbitration proceedings, and they do not identify any other entity that might have discoverable information.⁷ Thus, even in separate arbitration proceedings, the plaintiffs will be able to obtain discovery from each of the defendants. Because the plaintiffs have identified no arbitration rule that would prevent them from introducing in a proceeding against one manufacturer information obtained from another manufacturer, the plaintiffs simply have not established that they will be handicapped by the level of discovery available in arbitration to such an extent that they would be unable to prove their claims.

⁷ We also note the possibility that discovery could be compelled by the district court. *See COMSAT Corp. v. Nat'l Sci. Found.*, 190 F.3d 269, 276 (4th Cir. 1999) (noting that while arbitrators generally lack the ability to compel third parties to provide pretrial discovery materials, we have nonetheless "contemplated that a party might, under unusual circumstances, petition the district court to compel pre-arbitration discovery upon a showing of special need or hardship").

As noted above, the plaintiffs bear the burden of showing that the terms of the arbitration agreement would preclude them from effectively vindicating their statutory rights. *See Green Tree*, 531 U.S. at 92. This burden is a substantial one and cannot be satisfied by a mere listing of ways that the arbitration proceeding will differ from a court

proceeding, or by speculation about difficulties that *might* arise in arbitration. See *id.*; cf. *Microstrategy, Inc. v. Lauricia*, 268 F.3d 244, 251-52 (4th Cir. 2001) ("[T]he party opposing arbitration bears a heavy burden of proving waiver. . . . [T]hat proof must be concrete, not merely speculative." (internal quotation marks omitted)). The plaintiffs' arguments about the discovery limitations attendant to arbitration proceedings fall well short of satisfying their burden. Accordingly, we conclude that the plaintiffs have failed to establish that the no-joinder provision of the arbitration agreements prevents them from effectively vindicating their statutory rights. The district court therefore erred when concluding that the restriction against joinder of parties rendered the arbitration agreements unenforceable.

B.

We now consider the issue of the contractually-established limitations period. The Clayton Act, 15 U.S.C.A. § 15b (West 1997), establishes a four-year limitations period in which to bring a claim for a violation of the Sherman Act, 15 U.S.C.A. § 1 (West 1997). The arbitration agreements, however, establish a one-year period in which claims must be brought. The plaintiffs contend that the shortened limitations period renders the arbitration agreements unenforceable.⁸

⁸ We note that South Carolina law prohibits contractual shortening of statutes of limitation. See S.C. Code Ann. § 15-3-140 (West 2005). If the South Carolina statute applies to the contracts that are subject to South Carolina law, a question that we need not and do not decide here, then the shortened limitation period could not be applied to the South Carolina plaintiffs and thus would not impair their ability to vindicate their statutory rights. But because North Carolina has no similar prohibition against contractual shortening of statutory limitation periods, we must still consider the enforceability of the one-year limitation period contained in the arbitration agreements.

1.

As a general rule, statutory limitations periods may be shortened by agreement, so long as the limitations period is not unreasonably short. See *Missouri, Kan., & Tex. Ry. Co. v. Harriman Bros.*, 227 U.S. 657, 672 (1913); *Atlantic Coast Line R. Co. v. Pope*, 119 F.2d 39, 44 (4th Cir. 1941). There is no language in the Clayton Act that would prevent parties from agreeing contractually to a shortened limitations provision. See 15 U.S.C.A. § 15b; cf. *Stephan v. Goldinger*, 325 F.3d 874, 876-77 (7th Cir. 2003) (concluding that statutory limitations period established by the Commodity Exchange Act could be contractually shortened, noting that language of statute did not preclude shortening). The question, then, is whether the oneyear period is reasonable.

Courts have frequently found contractual limitations periods of one year (or less) to be reasonable. See, e.g., *Thurman v. DaimlerChrysler, Inc.*, 397 F.3d 352, 357-59 (6th Cir. 2004) (finding a 6-month limitation period to be reasonable in a case raising claims under 42 U.S.C.A. § 1981); *Northlake Reg'l Med. Ctr. v. Waffle House Sys. Employee Benefit Plan*, 160 F.3d 1301, 1303-04 (11th Cir. 1998) (finding reasonable a 90-day limitations term contained in an ERISA-governed employee benefits plan); see also *Morrison v. Circuit City Stores, Inc.*, 317 F.3d 646, 673 n.16 (6th Cir. 2003) (en banc) (enforcing one-year limitations provision contained in arbitration agreement). Moreover, North Carolina

has by statute deemed one-year limitations periods reasonable in contracts, like the ones at issue here, that are subject to the Uniform Commercial Code. See N.C. Gen. Stat. Ann. § 25-2-725(1) (2006) (permitting parties to contracts subject to the UCC to shorten a statute of limitations to not less than one year). Because we are considering the shortening of a federal statute of limitations, the North Carolina statute is not determinative of the issue. Nonetheless, that the contractual limitations period is *per se* reasonable under the state law that governs the contract formation provides strong support for the reasonableness of the contractual limitations period.

The plaintiffs contend that the one-year period is "patently unreasonable," Brief of Appellees at 45, because it is a drastic reduction from the otherwise applicable four-year statutory limitations period. According to the plaintiffs, there is an "increased chance" that their complaint might be found to have been filed outside the limitations period and that the shortened limitations period "*could have* the effect of greatly reducing the amount of recoverable damages." Brief of Appellees at 44 (emphasis added).

The plaintiffs' arguments amount to little more than an observation that the limitations period under the arbitration agreements is shorter than that provided by federal law and the unremarkable recognition that limitations provisions affect the amount of damages that may be recovered. These same arguments, of course, could be made every time a contract establishes a shorter limitations period than that of an otherwise applicable statute. Given the established rule that statutory limitations periods can be contractually shortened, so long as the contractual period is not unreasonably short, the plaintiffs' remarking on the obvious cannot suffice to carry their burden of establishing that the contractual limitations period is unreasonable.

Antitrust is a complex area of the law, and antitrust trials (or arbitration proceedings) can be long and involved. There is no basis in the record, however, for us to conclude that the same difficulty and complexity also attends to the plaintiff's initial determination to pursue an antitrust claim, so as to make a one-year limitations period unreasonably short. Accordingly, we conclude that one-year limitations period established in the arbitration agreements is reasonable.

2.

Our conclusion that the contractual limitations period is reasonable, however, does not fully resolve the plaintiffs' challenges to the arbitration agreements. "By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum." *Mitsubishi*, 473 U.S. at 628. Thus, we must consider whether the contractual limitations period is inconsistent with any substantive rights conferred under the antitrust laws. If it is, then the contractual limitations period would not be enforceable. See, e.g., *Kristian v. Comcast Corp.*, 446 F.3d 25, 48 (1st Cir. 2006) (in case involving arbitration of antitrust claims, concluding that arbitration agreement's ban on treble damages was unenforceable, because right to recover treble damages is a substantive right); *Robert Half Int'l*, 413 F.3d at 83 (concluding that arbitration agreement's ban on punitive damages was not enforceable because civil rights statute under which the plaintiff was proceeding provided for punitive damages); *Hadnot v. Bay, Ltd.*, 344 F.3d 474, 478 & n.14 (5th Cir. 2003) (concluding that arbitration agreement's ban on punitive damages was not enforceable as

to the plaintiff's Title VII claim); *Morrison*, 317 F.3d at 673 (concluding that arbitration agreement's restriction on the damages recoverable was not enforceable because it was inconsistent with the damages authorized by Title VII).

Section 15b was added to the antitrust statutes in 1955, more than forty years after "the original substantive liabilities were established." *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538, 558 n.29 (1974), and we have found only two cases where courts have considered whether § 15b is substantive or procedural. In *Kristian v. Comcast Corp.*, the First Circuit concluded that an antitrust plaintiff's challenge to the oneyear limitations period included in the arbitration agreement must be submitted to the arbitrator and did not prevent the court from compelling arbitration. In the course of its discussion, however, the court described the limitations issue as a procedural one. See *Kristian*, 446 F.3d at 43. And the Eighth Circuit, in a case decided not long after § 15b was enacted (but which did not involve questions of arbitration), likewise viewed the limitations period as procedural rather than substantive. See *Kansas City, Mo. v. Federal Pac. Elec. Co.*, 310 F.2d 271, 282-83 (8th Cir. 1962).

We also believe that § 15b should not be viewed as establishing substantive rights.⁹ As noted above, there was no federal limitations period during the early life of the Sherman Act. Until § 15b was enacted in 1955, private antitrust actions were governed by the most analogous *state* statute of limitations. See, e.g., *id.* at 282; *Movielcolor Ltd. v. Eastman Kodak Co.*, 288 F.2d 80, 82 (2d Cir. 1961). If Congress was content for so long to permit antitrust plaintiffs to be subject to different limitations periods (which of course affected the amount of damages that could be recovered), it seems difficult to conclude that Congress, by merely establishing a uniform limitations period, intended to vest plaintiffs in all antitrust cases with a substantive and non-waivable right to wait four years before bringing suit and to recover a full four years' worth of damages.

9 While the legislative history is not determinative of the question, we note that when § 15b was enacted, at least some members of Congress viewed it as purely procedural in nature, not substantive. See *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538, 558 n.29 (1974) ("During debate a member of the House Judiciary Committee reporting the bill was asked, '[A]m I correct in assuming that this limitation provided by this amendment is strictly a procedural limitation and has nothing to do with substance?' to which he replied: 'It was the specific purpose of the committee in reporting this bill to in no way affect the substantive rights of individual litigants. It is simply a procedural change and suggested with the thought of setting up a uniform statute of limitations. That is the sole purpose.'" (quoting 101 Cong. Rec. 5131 (1955) (remarks of Reps. Murray and Quigley))).

Accordingly, we conclude that § 15b does not establish substantive rights. A contractual modification of the otherwise applicable limitations therefore is not foreclosed by the Supreme Court's admonition that arbitration agreements may not dispossess plaintiffs of the substantive rights established by the statute under which their claims arose.

3.

While statutory claims are arbitrable unless Congress has specifically provided otherwise, agreements to arbitrate statutory claims may nonetheless be unenforceable if

the terms of the agreement prevent the plaintiff from effectively vindicating his statutory rights. See *Green Tree*, 531 U.S. at 90; *Mitsubishi*, 473 U.S. at 636-37. Accordingly, we must now determine whether the one-year limitations period, though generally reasonable, could somehow prevent the plaintiffs from effectively vindicating their statutory rights. The plaintiffs' arguments on this point are the same as those urged in support of their view that the limitations period is unreasonable. They contend that their antitrust claims might be found to be untimely filed under a one-year limitations period and that the one-year period could substantially reduce the amount of damages recoverable.

Implicit in the plaintiffs' argument about the amount of damages recoverable is the view that a plaintiff's rights under the antitrust laws are vindicated *only* if the plaintiff can recover damages for the full four-year period permitted under the Clayton Act. We disagree. We have explained that the "crucial inquiry" when considering a claim that an arbitration agreement prevents a plaintiff from vindicating his statutory rights "is whether the particular claimant has an adequate and accessible substitute forum in which to resolve his statutory rights." *Bradford*, 238 F.3d at 556. Given our conclusion that the Clayton Act's four-year limitation period does not create substantive, non-waivable rights for antitrust plaintiffs, we cannot conclude that the arbitral forum is inadequate or inaccessible merely because the plaintiff may recover a lesser quantum of damages than he might have in a judicial forum.

Also implicit in the plaintiffs' arguments and the decision of the district court is the assumption that if the plaintiffs' claims are untimely under the terms of the arbitration agreements, then the plaintiffs necessarily cannot effectively vindicate their statutory rights in the arbitral forum. As noted above, the relevant question is whether the arbitration agreement provides the plaintiff with an "adequate and accessible substitute forum." *Id.* We have recognized the possibility that very high arbitration costs could render the arbitral forum inaccessible to a given plaintiff, see, e.g., *Adkins*, 303 F.3d at 502-03; *Bradford*, 238 F.3d at 556, but it seems quite a different matter to allow a plaintiff's failure to commence an action within the reasonable contractually established limitations period to render an otherwise adequate and appropriate arbitral forum suddenly inadequate or inaccessible. Cf. *In re Vial*, 115 F.3d 1192, 1194 n.5 (4th Cir. 1997) (en banc) (explaining that while a federal prisoner may file a petition seeking relief under 28 U.S.C.A. § 2241 if § 2255 is inadequate or ineffective, § 2255 is not inadequate simply because the prisoner is procedurally barred from obtaining relief under § 2255). To do so would be to give plaintiffs a backdoor escape from the effects of their agreement to arbitrate and would be inconsistent with the strong federal policy favoring arbitration. See *Moses H. Cone*, 460 U.S. at 24 (explaining that the Federal Arbitration Act reflects "a liberal federal policy favoring arbitration agreements"). We need not, however, resolve this question at this point in the proceedings, because, as we will explain below, the plaintiffs have failed to establish that their claims are untimely under the one-year limitations provisions set forth in the arbitration agreements.

Generally speaking, an antitrust claim arises and the statute of limitations "begins to run when a defendant commits an act that injures a plaintiff's business." *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 401 U.S. 321, 338 (1971). "In the context of a continuing conspiracy to violate the antitrust laws, . . . this has usually been understood to mean that each time a plaintiff is injured by an act of the defendants a cause of action accrues to him to recover the damages caused by that act and that, as to those damages, the statute of

limitations runs from the commission of the act." *Id.* Thus, in cases like this one involving allegations of "a price-fixing conspiracy that brings about a series of unlawfully high priced sales over a period of years, each overt act that is part of the violation and that injures the plaintiff, e.g., each sale to the plaintiff, starts the statutory period running again." *Klehr v. A.O. Smith Corp.*, 521 U.S. 179, 189 (1997) (internal quotation marks omitted).

The complaint that consolidated the various individual actions brought by the plaintiffs was filed in January 2005, but the district court's docket reveals that the individual complaints were filed in March, April, May, and August of 2004. Under *Klehr*, then, the plaintiffs' claims would be timely even under a one-year limitations period so long as the plaintiffs made a purchase from the Defendants within a year before the complaints were filed. For the plaintiffs to carry their burden of showing that the terms of the arbitration agreement would prevent them from effectively vindicating their statutory rights, they should at least demonstrate that they made no purchases in the year before the complaints were filed. The plaintiffs, however, have made no effort to make such a showing. There is no factual record to support their assertion that their claims might be timebarred, or even an explanation of why they believe their claims might be barred. Moreover, the record contains evidence of sales taking place as late as November 2003 and January 2004, well within a year before the complaints were filed. Thus, at least as to some of the plaintiffs, there is evidence affirmatively demonstrating that a one-year statute of limitations would not prevent them from proceeding on their antitrust claims.

The plaintiffs' contention that a one-year limitations period would prevent them from proceeding on their antitrust claims also fails to account for the doctrine of fraudulent concealment, which is read into *all* federal statutes of limitations, including § 15b, see *Holmberg v. Armbrecht*, 327 U.S. 392, 397 (1946); *Supermarket of Marlinton, Inc. v. Meadow Gold Dairies, Inc.*, 71 F.3d 119, 122 (4th Cir. 1995).

The purpose of the fraudulent concealment tolling doctrine is to prevent a defendant from concealing a fraud, or committing a fraud in a manner that it concealed itself until the defendant could plead the statute of limitations to protect it. Thus, pursuant to this doctrine, when the fraud has been concealed or is of such a character as to conceal itself, and the plaintiff is not negligent or guilty of laches, the limitations period does not begin to run until the plaintiff discovers the fraud.

Meadow Gold Dairies, 71 F.3d at 122 (citation, internal quotation marks and alteration omitted).

The plaintiffs' complaint alleges that the Defendants fraudulently concealed their anti-competitive activities until February 11, 2004, when a shareholder in Parkdale (the manufacturer that settled before this appeal was filed) announced that Parkdale had participated in activities with competitors that may have violated antitrust laws. As noted above, the class action complaint was filed in January 2005 and the individual complaints were filed in 2004. If the fraudulent concealment doctrine applies to the contractually established limitations period,¹⁰ the plaintiffs' claim would appear to be timely filed.

10 See *Stephan v. Goldinger*, 325 F.3d 874, 877 (7th Cir. 2003) (concluding that "[o]ne year . . . is not an unreasonably short time for bringing a suit, at least given tolling doctrines that we assume . . . would be read into a contractual limitations period just as they are into a statutory one, unless negated by clear language" (citations omitted)).

We need not and do not decide whether the doctrine of fraudulent concealment applies in this case. The arbitration agreements provide that "[a]ll issues relating to Statute of Limitations barring or preventing the commencement of proceedings are not arbitrable and shall be determined by the Court and not the arbitrators." J.A. 202. ¹¹ Questions about the timeliness of the action and the applicability of the doctrine of fraudulent concealment will thus be determined by the district court on remand. For purposes of our decision now, it suffices to say that because it is far from certain that the one-year limitations period will have any effect on the plaintiffs' ability to prosecute their antitrust claims, the plaintiffs have not carried their burden of demonstrating that the terms of the arbitration agreement will prevent them from effectively vindicating their statutory rights. See *PacifiCare Health Sys., Inc. v. Book*, 538 U.S. 401, 406-07 (2003) (refusing to invalidate arbitration agreement that precluded award of punitive damages, which plaintiff contended was inconsistent with the treble damages authorized by the RICO statute, because it was unclear whether the arbitrator would interpret the arbitration to preclude an award of treble damages); *Morrison*, 317 F.3d at 673 n.16 (enforcing one-year limitations provision of arbitration agreement because the plaintiff "failed to show that the one-year limitations period in the agreement unduly burdened her or would unduly burden any other claimant wishing to assert claims arising from their employment").

11 The quoted language comes from a Frontier arbitration agreement. The relevant language in the Avondale contracts is largely identical. See J.A. 268.

On remand, the district court, after consideration of the principles discussed above, must determine whether the plaintiffs' claims were timely filed. If the district court concludes that the claims were timely, the court should stay the actions and order the plaintiffs to proceed in arbitration. If the district court concludes that the claims were not timely, the court must then determine, in light of the concerns that we have identified above, see *supra* at page 25, whether that fact renders the contractual limitations period unenforceable. Finally, if the district court concludes that the one-year limitations period bars the plaintiffs' claims and is unenforceable, the district court must then consider whether severance of the limitations provisions, rather than invalidation of the arbitration agreements, would be the appropriate remedy. See, e.g., *Terminix Int'l Co. v. Palmer Ranch Ltd. P'ship*, 432 F.3d 1327, 1331 (11th Cir. 2005) ("If all the provisions of the arbitration clause are enforceable, then the court must compel arbitration according to the terms of the agreement. If, however, some or all of its provisions are not enforceable, then the court must determine whether the unenforceable provisions are severable."); see also *Kristian*, 446 F.3d at 64 (concluding that various provisions in an arbitration agreement would prevent antitrust claimants from effectively vindicating their statutory rights, but severing the offending provisions and compelling arbitration); *Hadnot*, 344 F.3d at 478 (severing unenforceable restriction on punitive damages and ordering parties to proceed to arbitration); *Spinetti v. Service Corp. Int'l*, 324 F.3d 212, 219-23 (3d Cir. 2003) (concluding

that arbitration agreement provisions regarding attorney's fees and the payment of the costs of arbitration were unenforceable, but severing those terms and requiring the parties to proceed to arbitration); *Gannon v. Circuit City Stores, Inc.*, 262 F.3d 677, 683 (8th Cir. 2001) (severing unenforceable ban on the recovery of punitive damages from the arbitration agreement and compelling arbitration).

III.

To summarize, we conclude that arbitration is a usage of the trade in the textile industry and that an agreement to arbitrate therefore became a term of the Frontier contracts without the need for analysis of the battle of the forms under N.C. Gen. Stat. Ann. § 25-2-207. We conclude that the terms of the arbitration agreements prohibiting joinder of plaintiffs or defendants do not prevent the plaintiffs from effectively vindicating their statutory rights. And while the requirement of proceeding separately perhaps in some case could be prohibitively expensive, the plaintiffs in this case have failed to carry their burden of demonstrating that the costs of separate arbitration proceedings would be so high that they could not proceed with their claims. We also conclude that the Clayton Act's four-year limitations period is not a substantive portion of the federal antitrust laws and that the federal limitations period may be shortened by contract. The one-year limitation period established in the arbitration agreements is not unreasonably short, and the plaintiffs have failed to demonstrate that the one-year limitation period will prevent them from pursuing their antitrust claims. Accordingly, we hereby vacate the district court's judgment and we remand to the district court for further proceedings consistent with this opinion.¹²

12 In addition to seeking to compel arbitration, the manufacturers also requested a stay pending arbitration of the claims of two plaintiffs with whom the manufacturers had no dealings during the period alleged in the class action. Given its conclusion that arbitration was not required, the district court did not consider the motion to stay. On appeal, the manufacturers contend that the district court erred by denying the motion. We decline to consider the argument at this juncture. A decision to stay related claims pending arbitration is a matter entrusted to the discretion of the district court. *See Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 20 n.23 (1983) ("In some cases . . . it may be advisable to stay litigation among the non-arbitrating parties pending the outcome of the arbitration. That decision is one left to the district court . . . as a matter of its discretion to control its docket."). The district court on remand should reconsider whether a stay is warranted.

VACATED AND REMANDED

CONCUR BY: JOHNSTON (In Part); WILLIAMS (In Part)

DISSENT BY: WILLIAMS (In Part); JOHNSTON (In Part)

DISSENT

WILLIAMS, Chief Judge, concurring in part and dissenting in part: I fully concur in Part II of the majority opinion (the section addressing the enforceability of the arbitration clauses). I respectfully disagree, however, with the analysis and conclusion in Part I (the

section addressing whether all of the parties to the Frontier transactions have contracts containing binding arbitration agreements). I have two primary points of contention in this regard. First, I believe that this case is indistinguishable from *Supak & Sons Mfg. Co. v. Povel Indus.*, 593 F.2d 135 (4th Cir. 1979). Second, I do not believe that it is possible to distinguish *Supak* by applying N.C. Gen. Stat. Ann. § 25-2-207 (2005) (North Carolina's version of U.C.C. § 2-207) to each individual term of the arbitration clauses at issue, rather than addressing the arbitration clause as a whole.

I.

The district court, applying § 25-2-207, found that the arbitration clauses contained in the written confirmations sent by Frontier did not become part of the contracts between Frontier and those plaintiffs that did not sign and return the confirmation forms. This finding reflected the district court's belief that the North Carolina Supreme Court's decision in *Frances Hosiery Mills, Inc. v. Burlington Indust., Inc.*, 204 S.E.2d 834, 842 (N.C. 1974), and our decision in *Supak* were controlling. Because the case before us is indistinguishable from *Frances Hosiery* and *Supak*, I believe the district court did not err in following our precedent.

Frances Hosiery and *Supak* established binding precedent governing the construction of § 25-2-207 in the context of contractual arrangements virtually identical to those at issue in this case. In *Frances Hosiery*, the parties formed an oral contract for the sale of yarn, and when the seller shipped yarn to the buyer, it included invoices purporting to be "contracts" and containing arbitration clauses. 204 S.E.2d at 836-37, 841. The North Carolina Supreme Court determined that the invoices were confirmations within the meaning of § 25-2-207 and ultimately held that the arbitration clause constituted a proposed additional term that materially altered the contract. *Id.* at 842-43. In *Supak*, we applied the holding of *Frances Hosiery* to an oral contract for the sale of fabric followed by a written confirmation containing an arbitration clause. 593 F.2d at 136. In so doing, we explained that *Frances Hosiery* established a rule that "the addition of an arbitration clause constitutes a *per se* material alteration of the contract," and as a result, the arbitration clause in the confirmation form did not become part of the parties' contract. *Id.* at 136.1

* In *Supak & Sons Mfg. Co. v. Povel Indus.*, 593 F.2d 135 (4th Cir. 1979), we also rejected the argument that *Frances Hosiery's per se* rule was preempted by the Federal Arbitration Act (FAA) because it served to restrict the validity and enforceability of arbitration agreements. See *id.* at 137 (stating that "U.C.C. § 2-207, as judicially construed in . . . North Carolina" does not "restrict the validity or enforceability of arbitration agreements,[] but is rather a general rule of contract formation") (footnote omitted). Frontier argues that *Supak* was wrongly decided in this regard and was impliedly overruled by *Saturn Distrib. Corp. v. Williams*, 905 F.2d 719 (4th Cir. 1990). *Saturn Distrib. Corp.*'s recognition that the Federal Arbitration Act (FAA) "preempt[s] state rules of contract formation which single out arbitration clauses and unreasonably burden the ability to form arbitration agreements," *id.* at 723, does not call the into question *Supak's* validity, as *Supak* also acknowledged that the FAA "is preemptive of conflicting state laws which restrict the validity or enforceability of arbitration agreements," *Supak*, 593 F.2d at 137. In *Saturn Distrib.*

Corp., we distinguished the Virginia statute held to be preempted by the FAA from "the general rule of contract formation" at issue in *Supak*, and did not question *Supak's* validity. 905 F.2d at 723. Moreover, even if there were tension between the two decisions, one panel of this court cannot overrule another panel. See *McMellon v. United States*, 387 F.3d 329, 334 (4th Cir. 2004) (en banc) ("[W]e conclude that when there is an irreconcilable conflict between opinions issued by three-judge panels of this court, the first case to decide the issue is the one that must be followed, unless and until it is overruled by this court sitting *en banc* or by the Supreme Court.").

Supak addressed the application of the same statute at issue here -- § 25-2-207 -- to a factual scenario indistinguishable from that presented by this case -- an oral contract formed by merchants in the textile industry that was followed by a written confirmation containing an arbitration clause. In *Supak*, we did not deem it necessary to inquire into the particular facts of the case at hand in considering whether the arbitration clause at issue represented a material alteration. Because we interpreted *Frances Hosiery* as establishing a *per se* rule, we simply applied that rule to the arbitration clause at issue.

I am unpersuaded that we can distinguish *Supak* by virtue of its silence concerning whether arbitration is a usage of trade in the textile industry. The majority opinion asserts that we need not follow *Supak* because "usage of trade is a question of fact that must be proved by the party asserting it," and *Supak's* silence on the usage of trade issue therefore "cannot be viewed as rejection of the contention that arbitration is a usage of trade in the textile industry." *Ante* at 11 n.4. The issue, however, is not whether *Supak* rejected the idea that arbitration could be a trade usage in the textile industry. The question is whether *Supak* precludes us from conducting an inquiry into the facts of each case to determine whether the arbitration clause at issue is a material alteration, rather than simply applying *Frances Hosiery's per se* rule. Compare *N&D Fashions, Inc. v. DHJ Indust., Inc.*, 548 F.2d 722, 726 & n.7 (8th Cir. 1976) (stating that although cases such as *Frances Hosiery* have held that an arbitration clause materially alters a contract under UCC § 2-207, "the better reasoned position is that the question whether an additional term in a written confirmation constitutes a 'material alteration' is a question of fact to be resolved by the circumstances of each particular case"). *Supak* did not attempt to limit *Frances Hosiery* to its particular facts, but rather treated the decision as establishing a *per se* rule. A *per se* rule applies "without reference to additional facts." See *Black's Law Dictionary* (8th ed. 2004) (defining "per se" as "[o]f, in, or by itself; standing alone, without reference to additional facts"). Accordingly, I read *Supak* differently than the majority. I therefore believe that the district court did not err in applying *Frances Hosiery's per se* rule rather than resolving the factual question of whether Frontier had established a usage of trade.

II.

I do not believe that we can distinguish *Supak* by asserting that because arbitration is a trade usage in the textile industry, the portion of the arbitration clause requiring the parties to submit their disputes to arbitration was not an "additional term" within the meaning of § 25-2-207(2) for two reasons. First, terms consistent with a trade usage may nevertheless constitute "additional terms" for purposes of § 25-2-207(2). Second, the existence of a trade usage is a question of fact that the district court has not resolved.

A.

Under § 25-2-207(2), "additional terms [in a written confirmation] are to be construed as proposals for addition to the contract." N.C. Gen. Stat. § 25-2-207(2). Between merchants, the additional terms become part of the contract unless "(a) the offer expressly limits acceptance to the terms of the offer; (b) they materially alter [the contract]; or (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received." § 25-2-207(2)(a)-(c).

The official comments to § 25-2-207 suggest that terms consistent with a trade usage may nevertheless be "additional" for purposes of § 25-2-207(2). Comment 5 lists examples of clauses that "involve no element of unreasonable surprise" and therefore should not be considered material alterations. Among these examples are "a clause providing for interest on overdue invoices or fixing the seller's standard credit terms *where they are within the range of trade practice* and do not limit any credit bargained for" and "a clause limiting the right of rejection for defects *which fall within the customary trade tolerances* for acceptance 'with adjustment' or otherwise limiting remedy in a reasonable manner." § 25-2-207 cmt. 5 (emphasis added). Thus, comment 5 suggests that the drafters of § 25-2-207(2) contemplated that terms consistent with trade usage might represent additional terms that would be screened for materiality. Moreover, comment 1 indicates that § 25-2-207 "is intended to deal with two typical situations," one of which "is where an agreement has been reached either orally or by informal correspondence between the parties and is followed by one or both of the parties sending formal memoranda embodying the terms so far as agreed upon and *adding terms not discussed*." § 25-2-207 cmt. 1 (emphasis added). Thus, comment 1 suggests that the terms that should be considered "additional" are those that the parties have not discussed.

At least two of our sister circuits, in interpreting other states' versions of U.C.C. § 2-207, have held that terms consistent with a trade usage or course of dealing may represent "additional terms" but do not materially alter a contract. In *Aceros Prefabricados, S.A. v. Trade-Arbed, Inc.*, 282 F.3d 92 (2d Cir. 2002), the Second Circuit noted that the official comments to New York's version of UCC § 2-207 "recognize the importance of trade practices to the material alteration analysis," because the examples of proposed terms that do not constitute material alterations contained in the comments include terms that are "within customary limits," or "within the range of trade practices," while "the common thread among the examples [of material alterations] provided is that they all constitute provisions that significantly deviate from industry norms." *Id.* at 101-02 (internal quotation marks and alteration omitted). There, the Second Circuit relied in part on "evidence that arbitration is standard practice in the steel industry" to conclude that an arbitration clause in a confirmation form was not a material alteration and therefore became part of the parties' contract. *Id.* at 102. Similarly, in *Schulze & Burch Biscuit Co. v. Tree Top, Inc.*, 831 F.2d 709 (7th Cir. 1987), the Seventh Circuit noted that Illinois's version of U.C.C. § 2-207 is followed by official comments suggesting that proposed terms consistent with trade practice or custom do not materially alter a contract. *Id.* at 714. In that case, Tree Top was seeking to enforce an arbitration clause contained in a written confirmation. The Seventh Circuit held that the arbitration clause did not constitute a material alteration of the parties' contract, because although Tree Top did not offer proof of

a trade usage, it did prove a course of dealing between the parties that should have put Schulze on notice that the confirmation was likely to contain such a clause. *Id.* at 714-15.

In contrast, there is a dearth of precedent supporting the view adopted in the majority opinion. I am aware of no other case in which the reviewing court has fragmented an arbitration clause in order to treat the portion governing the obligation to arbitrate differently than the portion setting forth the terms and conditions under which arbitration would proceed. Notably, none of the cases cited by the majority in support of the proposition that arbitration is a trade usage have concluded that a trade usage cannot represent an additional term for purposes of U.C.C. § 2-207. To the contrary, those cases conform to the view that arbitration clauses contained in written confirmations of oral agreements between merchants in the textile industry may represent additional terms, but do not materially alter a contract. See, e.g., *Chelsea Square Textiles, Inc. v. Bombay Dyeing & Mfg. Co.*, 189 F.3d 289, 296-97 (2d Cir. 1999) (textile buyer was bound by an arbitration clause in a written confirmation because he failed to object to its addition to the contract).

To be sure, some commenters have described the official comments to U.C.C. § 2-207 as "poor from [an] analytical view," because

"[i]f a term stated on a responsive document merely iterates what the law would otherwise impose, it is arguably not an 'additional' term." Duesenberg & King, *Sales and Bulk Transfers* § 3.03 (Bender's U.C.C. Service 2006) (stating that "[t]his would be true whether the term were implied by operation of a Code section, through custom and usage, prior course of dealing, or any other means by which a matter on which the parties are silent nonetheless becomes a part of their agreement"). Nevertheless, the official commentary to § 25-2-207 indicates that the statute's drafters meant the phrase "additional terms" to include all "terms not discussed" during the formation of an oral agreement, regardless of whether those terms in fact alter the agreement. Accordingly, I would follow the reasoning of our sister circuits to conclude that terms consistent with a trade usage may constitute "additional terms" within the meaning of § 25-2-207(2), but generally do not materially alter a contract.

B.

Even assuming that we could conclude that terms in keeping with a trade usage are not "additional terms" for purposes of § 25-2-207(2), I believe that it would be inappropriate for us to hold that arbitration is a trade usage in the textile industry when the district court has not ruled on this factual issue. See N.C. Gen. Stat. Ann. § 25-1-205(2) (2006) (stating that the existence and scope of a trade usage "are to be proved as facts" and if it "is established that such a usage is embodied in a written trade code or similar writing, the interpretation of the writing is a question for the court"). To be sure, the "Yarn Rules" and a number of cases indicate that, in general, arbitration is commonly used in the textile industry. In North Carolina, however, *Frances Hosiery* has been the law for over thirty years. Thus, it seems that the relevant trade usage in North Carolina could well be that parties enter into arbitration agreements by signing and returning written confirmations. Many of the plaintiffs in this case assented to Frontier's arbitration agreements in precisely that manner. Also, the "Yarn Rules" suggest that merchants in the textile industry should expect to be bound by arbitration clauses contained in confirmation forms, but might not

necessarily expect to be bound to arbitrate in the absence of such a writing. (See J.A. at 542-53 (excerpt from the "Yarn Rules" stating that "[p]arties to the sale and purchase of yarns are members of the textile industry, which has, for over, fifty years, settled disputes by arbitration *in accordance with the terms and conditions of contracts which have tended to become standard. . .*" (emphasis added)).) Because the district court has not addressed this issue, we should not take it upon ourselves to find that "Frontier has met its burden of proving that arbitration is a usage of trade" *Ante* at 9. Rather, we should allow the district court to make findings of fact on remand.

C.

Finally, another issue prevents us from resolving this case by relying on the UCC's "gapfiller" provision, codified in North Carolina as N.C. Gen. Stat. Ann. § 25-1-201 (2006). One might argue that after concluding that, under *Supak*, the arbitration clauses contained in the written confirmations constituted material alterations that did not become part of the parties' agreement, the district court should have turned to § 25-1-201 to fill the gap left by the oral contract's silence on the question of arbitration. See N.C. Gen. Stat. Ann. § 25-1-201(b)(3) (2006) (defining an "agreement" as "the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade").

Resolving this question after determining that the arbitration clauses in the written confirmations did not become part of the contracts, however, would be purely an academic exercise. The issue before this court is whether the district court erred in denying Frontier's motion to compel arbitration. To compel arbitration under the Federal Arbitration Act (FAA), a litigant must demonstrate, *inter alia*, "a *written* agreement that includes an arbitration provision which purports to cover the dispute." *Adkins v. Labor Ready, Inc.*, 303 F.3d 496, 500-01 (4th Cir. 2002) (emphasis added) (internal quotation marks omitted). Thus, Frontier cannot compel arbitration based on an implied term in an oral contract. It must proffer a *written* agreement containing an arbitration clause that purports to cover its dispute with the plaintiffs. The writings that Frontier provided to satisfy this requirement were the confirmations that it sent to the plaintiffs. Accordingly, Frontier's ability to compel arbitration depends on whether or not the arbitration clauses in the written confirmations became part of its contracts with the plaintiffs.

III.

In sum, I fully concur in Part II of the majority opinion. I therefore concur in the judgment only with regard to those plaintiffs that either signed and returned Frontier's confirmation forms or had contracts governed by South Carolina law. I respectfully dissent from Part I, however, because I believe that this case is controlled by our decision in *Supak*. Accordingly, I would hold that because the North Carolina arbitration agreements in Frontier's confirmation forms did not become part of the contracts with those plaintiffs that did not sign and return the forms, the district court did not err in denying Frontier's motion to compel arbitration as to those plaintiffs.

JOHNSTON, District Judge, concurring in part and dissenting in part:

I concur in Part I, Part II(A), and Part II(B)(1) of the majority opinion. I respectfully dissent, however, from Part II(B)(2), Part II(B)(3), and the result that this case should be remanded for further proceedings in the district court, as described in the majority opinion.

I.

The majority opinion acknowledges that federal statutory claims are subject to arbitration if the litigants can effectively vindicate their substantive statutory claims in the arbitral forum. The majority concludes that the Antitrust Act's four-year limitations period, 15 U.S.C. § 15b, is not a "substantive right" and that the arbitration clause's limitation of this period to one year does not, *per se*, prevent the plaintiffs from "effectively vindicating their statutory rights."¹ The majority then directs the district court, on remand, to examine whether the plaintiff's claims are *entirely* barred by operation of the one year limitations provision, taking into account the doctrine of fraudulent concealment. If the plaintiffs' claims are entirely barred, then the district must consider severance of the limitations provision, in addition to invalidation of the arbitration agreement.

1 Parts II(B)(2) & (3) of the majority opinion. In Part II(B)(1) of the opinion, the majority concludes that the one year limitation period is not unreasonably short.

I respectfully disagree with Part II(B)(2) and Part II(B)(3) of the opinion and the majority's directions to the district court upon remand. I would hold that the four-year limitations period contained in 15 U.S.C. § 15b is a non-waivable substantive right, and that the purported waiver of this right would, in this case, prevent the plaintiffs from effectively vindicating their statutory rights. I would further conclude that severance of this provision is the appropriate remedy, and remand the case to the district court to order that the case proceed to arbitration.

II.

The plaintiffs allege that the defendants engaged in a price fixing conspiracy from the beginning of 1999 through February of 2004, when the plaintiffs first became aware of the alleged anti-competitive activity. Based on these allegations, the plaintiffs brought Sherman Act claims against the defendants in 2004.²

2 As noted in the majority opinion, various plaintiffs filed actions in March, April, May, and August of 2004.

The Sherman Act, 15 U.S.C. § 1, *et seq.*, embodies an important, and now time-tested, public policy to prohibit market conduct which unfairly or unduly restrains competition. As Justice Black wrote more than half a century after its passage:

The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time

providing an environment conducive to the preservation of our democratic political and social institutions.

N. Pac. Ry. Co. v. United States, 356 U.S. 1, 4 (1958). More recently, Justice Stevens has stated:

The Sherman Act reflects a legislative judgment that ultimately competition will produce not only lower prices, but also better goods and services. . . . The assumption that competition is the best method of allocating resources in a free market recognizes that all elements of a bargain--quality, service, safety, and durability--and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers.

Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 695 (1978).

"Ordinarily, a cause of action accrues under the antitrust laws when the plaintiff suffers an injury to his business." *Sanderson v. Spectrum Labs, Inc.*, 227 F. Supp. 2d 1001, 1011 (N.D. Ind. 2000) (citing *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 401 U.S. 321, 338 (1971)). Generally, there is a four-year limitations period for Sherman Act claims. 15 U.S.C. § 15b. The arbitration agreements in this case provide that any claim must be brought within one year "after the claimed breach occurs" and "[t]he failure to institute arbitration proceedings within this one year period shall constitute an absolute bar to [those claims.]"

Application of the one year claims limitation period has two related effects: (1) limiting the defendants' exposure for any antitrust claim to one year from the date of the alleged anti-competitive behavior, and (2) limiting the plaintiffs' possible recovery to a one year period. Thus, while the Antitrust Act effectively requires a four year look-back period, the contract at issue would only allow the arbitrator to consider one year of anti-competitive behavior. The plaintiffs assert that they would be deprived of a substantive right under the statute -- the right to recover damages for three out of the four years of alleged anti-competitive activity.

III.

Generally, arbitration agreements are enforceable "so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, [and] the statute will continue to serve both its remedial and deterrent function." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637. In other words, an arbitration agreement cannot operate to waive substantive rights provided by statute. *Id.* at 628 ("By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum."). In this respect, "the arbitrability of [federal statutory claims] rests on the assumption that the arbitration clause permits relief equivalent to court remedies." *Paladino v. Avnet Computer Techs., Inc.*, 134 F.3d 1054, 1062 (11th Cir. 1998). Although the Supreme Court has never ruled directly on whether an arbitration clause that does not permit relief equivalent to court remedies might nevertheless be enforceable, it has indicated a willingness to strike down

arbitration agreements that have the effect of depriving litigants of remedies prescribed by the antitrust statutes. In *Mitsubishi*, the Court noted that in the event that an arbitration agreement's choice of forum and choice of law provisions operated, in effect, as "a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, [the Court] would have little hesitation in condemning the agreement as against public policy." *Id.* at 637 n.19.

Applying these principles, our sister circuits have consistently invalidated arbitration agreements that proscribe the arbitral award of damages guaranteed by statute. See, e.g., *Hadnot v. Bay, Ltd.*, 344 F.3d 474, 478 & n.14 (5th Cir. 2003) (noting that an arbitration clause that bans punitive damages is unenforceable in the context of a Title VII claim because Title VII provides for statutory punitive damages); *Paladino*, 134 F.3d at 1062 (11th Cir. 1998) (holding an arbitration agreement unenforceable because it proscribed an arbitral award of Title VII damages). The First Circuit recently relied on *Mitsubishi's* condemnation of arbitration agreements that effect a prospective waiver of plaintiff's right to pursue statutory remedies, as well as the mandatory language in the Clayton Act provision providing for treble damages, 15 U.S.C. § 15(a), to conclude that "the award of treble damages under the federal antitrust statutes cannot be waived." *Kristian v. Comcast Corp.*, 446 F.3d 25, 48 (1st Cir. 2006) (holding invalid an arbitration clause that purported to waive the availability of treble damages under the federal antitrust statutes).³ The issue in this case differs somewhat from that confronted by the *Kristian* court in that enforcement of the arbitration agreement's limitations provision would not proscribe the award of a particular *type* of damages, but it would instead affect the *amount* of the award. The practical effect of the provision, however, is the same. If the contractual limitations provision is enforced, the plaintiffs will not be permitted to recover treble damages for the injury sustained over the course of the statutory four-year period. See 15 U.S.C. § 15(a) (providing that a party "shall recover threefold the damages by him sustained").

³ In *Kristian v. Comcast Corp.*, 446 F.3d 25 (1st Cir. 2006), the plaintiffs argued that a one-year limitations provision in an arbitration clause was invalid as applied to their antitrust claims "on the basis of [the] direct conflict" between the contractual provision and the four year limitations period provided by the Clayton Act. *Id.* at 43. The First Circuit concluded that, under its precedent, a dispute over a statute of limitations was "the sort of procedural prerequisite that is presumed to be for the arbitrator," not the court. *Id.* (internal quotation marks omitted). In the case before us, the specific language of the arbitration agreements provides that a court, not an arbitrator, must decide statute of limitations issues. The agreements provide that "[a]ll issues relating to Statute of Limitations barring or preventing the commencement of proceedings are not arbitrable and shall be determined by the Court and not the arbitrators who shall have no power or jurisdiction to determine such issues." *In re Cotton Yarn Antitrust Litig.*, 406 F. Supp. 2d 585, 603 (M.D.N.C. 2005).

I would hold that the enforcement of the arbitration clause, which facially operates to strip the plaintiffs of seventy-five percent of the damages to which they would otherwise be entitled under the antitrust statutes, would defeat the statute's remedial and deterrent purposes. *Paladino*, 134 F.3d at 1062 ("When an arbitration clause has provisions that defeat the remedial purpose of the statute, . . . the arbitration clause is not enforceable.")

The dramatic reduction in damages would likely fall short of fully compensating the plaintiffs and allow the defendants the benefit of at least a portion of their alleged illegal activity.⁴

4 I decline to address whether the doctrine of fraudulent concealment would have any effect on my analysis of this issue because the parties arguably did not raise this issue, it has certainly not been developed by the parties in this appeal, and it was not considered at the district court level.

IV.

As noted in the majority opinion, the court must consider two remedies after finding an unenforceable term in an arbitration agreement: severance of the offending term and invalidation of the entire arbitration agreement. The limitations period, while of great importance to the defendants, is but one part of the arbitration agreement; it cannot be viewed as integral to or the primary object of the arbitration agreement. In my view then, the court should sever the offending limitations provisions from the otherwise enforceable arbitration agreements. See *Hadnot*, 344 F.3d at 478 ("The purpose of the arbitration provision is to settle any and all disputes arising out of the employment relationship in an arbitral forum rather than a court of law. Even with its unlawful limitation on the types or permissible damage awards lifted, so that the decision maker is free to address punitive damages, the arbitration clause remains capable of achieving this goal. In fact, the lifting of that illegal restriction enhances the ability of the arbitration provision to function fully and adequately under the law."). I believe that the limitations provisions can and should be severed from the arbitration agreements, and the case should be remanded to the district court with directions to send it to arbitration. Immediate severance of this single provision of the overall arbitration agreement is a purely legal matter which will allow the parties to avoid further time and resource intensive litigation of these threshold matters, and allow them to move toward a resolution of the substantive issues of these cases.

I therefore respectfully dissent from Parts II(B)(2) and II(B)(3) of the majority opinion.