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Can Consent Waive Absolute Rights To An Article III Court?

by Ronald H. Filler

Commodity Futures Trading Commission

v.

William T. Schor
(Docket No. 85-621)

ContiCommodity Services, Inc.

v.

William T. Schor
(Docket No. 85-642)

Argued April 29, 1986

Article III of the United States Constitution provides that the "judicial power of the United States shall be vested in one Supreme Court, and in such inferior courts as the Congress may from time to time ordain and establish" and that the judges of these courts shall serve "during good behavior," with compensation that "shall not be diminished" during their tenure. These provisions protect the role of the independent judiciary and assure impartial adjudication in federal courts. However, for over 150 years, the Supreme Court has granted Congress substantial flexibility to assign adjudicative tasks to legislative courts and other administrative tribunals, created pursuant to its powers under Article I.

The Court must decide in this consolidated case whether to apply an absolutist interpretation of Article III or to extend this congressional flexibility to an administrative remedy which provides for substantive expertise and which was voluntarily elected by the party not seeking the common law claim.

ISSUES

1. Whether the Commodity Futures Trading Commission which adjudicates, subject to judicial review, claims for money damages brought against commodity brokers by customers alleging a violation of the Commodity Exchange Act, is precluded by Article III of the Constitution from entertaining the broker's state law counterclaim arising out of the same transac-

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tion or occurrence, when the customer could have brought the claim in an Article III court in the first instance, but chose to proceed before the commission instead.

2. Whether this case is distinguishable from *Northern Pipeline Co. v. Marathon Pipe Line Co.* (458 U.S. 50 (1982)), in which both the initial proceeding and the related state law claim were brought by the same party, whereas in *Schor* the common law counterclaim was brought by a party, which by statute and regulation, could not have initiated the CFTC administrative proceeding.

FACTS

The Commodity Futures Trading Commission Act of 1974, which significantly amended the Commodity Exchange Act, established a new federal administrative agency, the Commodity Futures Trading Commission (CFTC) to monitor and regulate futures transactions and activities and to protect users of the futures markets. These same amendments established an administrative proceeding, known as reparations, which permits commodity customers to seek damages and other relief against their commodity brokerage firms, known as futures commission merchants. The CFTC has promulgated extensive regulations involving reparations which provide, in part, several of the same procedural rights conferred on parties in federal courts.

Pursuant to the Commodity Exchange Act and CFTC regulations, a reparation proceeding may only be initiated by a customer against a futures commission merchant, broker or other commodity professional which is registered in some capacity with the CFTC. These proceedings are commenced when the aggrieved customer files a complaint. The brokerage firm then files an answer. Upon receiving the complaint and answer, a division of the CFTC determines whether to forward the matter to the hearing stage. Depending on the size of the requested damages claim, an actual hearing before an administrative law judge (ALJ) occurs or a summary proceeding based on the written record will be decided by the ALJ. Most reparation actions, however, result in a hearing.

The ALJ's decision is subject to review by the CFTC, whose decision is reviewable by the appropriate United States court of appeals.

The reparation proceeding, as noted above, may only be initiated by the commodity customer against a

brokerage firm or broker. In the alternative, the customer may choose to bring such an action, based on a violation of the Commodity Exchange Act, in federal court. In either forum, the brokerage firm may bring a counterclaim against the customer for a debit balance which may exist in the customer's account. This debit balance occurs if trading losses in the customer's account exceed the equity or amount invested by the customer. Unlike other forms of investment, futures transactions, due to their leverage feature, provide for greater risk and reward to the customer.

Quite often, the brokerage firm initiates a collection action in either state or federal court to recover this debit balance award. In such actions, the customer may file a counter claim against the brokerage firm, alleging violations of the Commodity Exchange Act or CFTC regulations. Typically, the alleged violations of the Commodity Exchange Act and the debit balance claim arise out of the same transactions.

In this case, William Schor had filed a reparation complaint with the CFTC. Before ContiCommodity Services, Inc. (Conti), Schor's brokerage firm, had received notice the reparation action was filed, Conti filed a diversity action in federal court to recover the debit balance in Schor's account. Schor filed a counterclaim in that federal action, alleging, among other things, that Conti had violated the Commodity Exchange Act. Schor also moved to dismiss or stay the federal action on the grounds that the reparation proceeding would fully and completely resolve and adjudicate all of the rights of the parties. In support of this motion, Schor argued that the continuation of both proceedings would require him, at great expense, to litigate the same issues in two forums. Although the federal district court declined to stay or dismiss the federal action, Conti voluntarily dismissed the federal court action and filed a debit balance counterclaim in the CFTC reparation proceeding.

The ALJ found for Conti on both the claim and counterclaim. The CFTC denied Schor's application for review of the ALJ's decision. Schor then filed a petition for review of the CFTC's order in the United States Court of Appeals for the District of Columbia Circuit. After briefing and argument, the court of appeals, relying on the *Northern Pipeline Co.* case, dismissed Conti's counterclaim on the ground that the CFTC lacks subject matter jurisdiction to adjudicate common law counterclaims.

The Solicitor General, on behalf of the CFTC, filed a petition for a writ of certiorari. The Supreme Court granted the petition and remanded the case for further consideration in light of *Thomas v. Union Carbide Agricultural Products Co.* (87 L.Ed.2d 409) (1985); *Preview* 1984-85 term, pp. 437-39, which held that an administrative arbitration scheme did not contravene Article III. On remand, the court of appeals reinstated its prior judgment (770 F.2d 211 (1985)).

BACKGROUND AND SIGNIFICANCE

Since the 1974 amendments to the Commodity Exchange Act, several thousand reparation cases have been filed with the CFTC by commodity customers against their commodity brokerage firms and brokers. In its 1985 Annual Report, the CFTC reported the following statistics with respect to its reparations caseload for its 1985 fiscal year:

Cases Pending—Beginning of 1985 Fiscal Year	601
Cases Received	414
Cases Remanded	42
Cases Reconsidered	43
Cases Stayed	<u>2</u>
TOTAL	1,102
<i>Disposition of Cases:</i>	
Initial Decisions	210
Second Initial Decisions	25
Summary Dispositions	6
Settlements	181
Default Decisions	63
Dismissals for Cause	<u>63</u>
TOTAL DISPOSITIONS	548

TOTAL PENDING—End of 1985 Fiscal Year 554

While there are no statistics as to how many reparation cases involve a counterclaim for a debit balance, several clearly do. Therefore, one major significance of the *Schor* case will be the economic impact on the parties to a commodities case which involves both a claim and counterclaim. If the Supreme Court affirms the court of appeals' decision, thus eviscerating the statutory scheme designed by Congress, then both parties could be required to adjudicate their respective claims in separate forums, once the commodity customer elects the reparation proceeding over federal district courts.

Each commodity customer clearly has several alternatives for relief in a claim against alleged fraudulent practices committed by a brokerage firm or broker. One is reparation, which has been a very popular approach over the past ten years. A second alternative is arbitration, before a commodity exchange, the National Futures Association or an independent organization, such as the American Arbitration Association. This approach has increased in popularity in recent years. The third is federal action. The 1983 amendments to the Commodity Exchange Act adopted section 22 which provides for a private right of action for certain fraudulent activities, including those alleged in the *Schor* case. Prior to these amendments, there was uncertainty whether the reparation procedures, established in the 1974 amendments to the Commodity Exchange Act, preempted the right to seek relief in federal courts. The Supreme Court in *Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (456 U.S. 353 (1982)), held that a private right of action did

exist under the Commodity Exchange Act, even prior to the 1983 amendments which adopted section 22.

Clearly, then, Schor could have elected to pursue his claim in an Article III court. In fact, Conti had filed a diversity action in federal court to collect the outstanding debit balance in Schor's account. Schor filed a counterclaim in that federal action, alleging the same violations of the Commodity Exchange Act as set forth in his reparation complaint. For whatever reason, Conti volunteered to dismiss the federal action and file a counterclaim for the debit balance in the reparation proceeding. The issue, therefore, is whether a person who could have proceeded in an Article III court, but voluntarily elects an administrative remedy, has waived rights to adjudicate the common law counterclaim, by implied consent, in an Article III court.

Notwithstanding this election, Schor, in the reparation proceeding, received many of the procedural benefits of a federal action; in particular, discovery, albeit more limited in nature, and a hearing. Obviously, the ALJ does not have the tenure and salary protectives accorded federal district judges under Article III. On the other hand, the ALJ possesses intricate knowledge and expertise on very complex financial transactions, known as financial futures, which were traded in Schor's account at Conti. Many of the inherent limitations in federal actions involving commodity cases involve this lack of expertise and understanding of the underlying investment by the trier of fact.

A fundamental purpose of the provisions of Article III is to ensure impartial adjudication by independent judiciary. The question is whether Article III should be interpreted without exception on common law claims or whether a party can waive this Article III protection by voluntarily electing to seek relief in a non-Article III court, especially when such party can seek judicial review of the non-Article III court decision.

Unlike the *Northern Pipeline* case, in which the same party sought both the statutory and common law claims, different parties in *Schor* sought the statutory and common law claims. Therefore, another significant issue is whether the party which brought the non-Article III proceeding can deny the other party from seeking relief on common law grounds which arose out of the same transaction, especially when such other party was prevented by law from initially using this non-Article III forum.

These counterclaims, subject to CFTC adjudication, would be compulsory counterclaims in federal court. Thus, the Court must also weigh the protections of

Article III versus piecemeal litigation which could become quite expensive for the parties to litigate in different forums. In fact, the Court must consider whether the procedural protections of CFTC reparations outweigh the protections of a state court action, which is an alternative forum that the brokerage firm may use to recover the debit balance rather than in the federal courts. State court judges, like ALJs, do not possess the tenure and salary protections that exist under Article III.

ARGUMENTS

For William T. Schor (Counsel, Leslie J. Carson, Jr., 1004 Robinson Bldg., 42 S. 15th Street, Philadelphia, PA 19102; telephone (215) 568-1587

1. The court of appeals below correctly held that the Commodity Exchange Act does not authorize reparations awards on state law counterclaims.
2. Article III bars a grant of jurisdiction to the CFTC to adjudicate state law claims.
 - A. Congress may not depart from the understanding inherent in Article III that federal judicial power over state law claims would be exercised by independent judges.
 - B. The CFTC has not advanced a legitimate basis for giving jurisdiction over state law claims to judges unprotected by the provisions of Article III.

For Commodity Futures Trading Commission (Counsel, Kenneth M. Raisler, 2033 K Street, NW, Washington, DC 20581; telephone (202) 254-9880)

1. When a customer chooses to bring a reparations complaint against a broker before the Commodity Futures Trading Commission, the CFTC's adjudication, subject to judicial review, of the broker's counterclaim arising out of the same transaction giving rise to the complaint, is consistent with Article III.
 - A. The Commodity Exchange Act authorizes the CFTC to entertain a counterclaim that arises out of the same transaction that forms the basis for the underlying reparations complaint.
 - B. The CFTC's adjudication of counterclaims in these circumstances is necessary to achieve the purposes of the reparations program.
 - C. The CFTC's adjudication of Conti's counterclaim is consistent with Article III because Schor consented to that adjudication.
 - D. Article III does not preclude the CFTC from exercising ancillary jurisdiction over counterclaims that arise out of the same transaction as a reparations complaint.