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Classless Investing: Why Enforcing Class Action Waivers is Proper and Beneficial for Investors
Justin C. Ferrone*

I. Introduction

Mandatory pre-dispute arbitration provisions, and specifically those that include explicit class action waiver provisions, have recently become a hot topic for consumers and the Supreme Court.¹ Consumers time and again have challenged mandatory pre-dispute arbitration provisions that restrict their access to the courts—whether as individuals or as members of a class—on unconscionability grounds, only to be consistently rebuffed by the nation’s highest court.

In 2010, Charles Schwab Corp. (“Schwab”) settled a class action lawsuit with many of its securities investors resulting in a \$200 million payout.² The class of investors alleged false and misleading statements and omissions in documents issued by Schwab’s YieldPlus Fund regarding the investment profile and objectives of the YieldPlus Fund.³ Schwab subsequently attempted to insulate itself from a similarly harsh class action payout in the future.⁴

In 2011, Schwab became the first broker-dealer to amend the language in its pre-existing customer agreements, and in its new customer agreements, to require that: (1) all disputes between the parties be resolved through mandatory FINRA⁵ arbitration (on an individual, case-

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¹ See Dan Jamieson, *Supremes May Decide Finra-Schwab Scuffle*, INVESTMENTNEWS (Mar. 3, 2013, Updated 9:49 AM), <http://www.investmentnews.com/article/20130303/REG/303039977> (“‘To say that the court is interested in these issues right now is an understatement,’ David Garcia...wrote on the Supreme Court’s blog.”); Paul Karlsgodt, *More Perspectives on Trends in Class Arbitration Waivers a Year After Concepcion*, CLASSACTIONBLAWG.COM (May 25, 2012), <http://classactionblawg.com/2012/05/25/more-perspectives-on-trends-in-class-arbitration-waivers-a-year-after-concepcion/>.

² FAQs, SCHWAB YIELD PLUS SETTLEMENT, <http://www.schwabyieldplussettlement.com/schwab/faq.html> (last visited Sep. 10, 2013).

³ *Id.*

⁴ Mark Shoeff, Jr., *States Urge SEC to Chuck Finra’s Schwab Decision*, INVESTMENTNEWS (Mar. 4, 2013, Updated 7:23 AM), <http://www.investmentnews.com/article/20130504/FREE/130509954>.

⁵ “FINRA” is the Financial Industry Regulatory Authority, Inc. FINRA is not part of the government. They are “an independent, not-for-profit organization authorized by Congress to protect America’s investors by making sure the securities industry operates fairly and honestly.” *About the Financial Industry Regulatory Authority*, FINRA, <https://www.finra.org/AboutFINRA/> (last visited Feb. 9, 2014). Although FINRA is not part of the government,

by-case basis); and (2) that each party agrees to waive any right to bring, or participate in, a judicial class action.⁶ Because class action arbitration is prohibited under FINRA Rules,⁷ Schwab's customers are precluded from resolving disputes through the traditionally perceived lower-cost class action procedure, a move that critics fear will limit investors' access to justice.⁸

Schwab is a FINRA member firm, and as such is subject to FINRA Rules.⁹ But Schwab's class action waiver provision appears to expressly violate two FINRA Rules, one of which specifically deals with an investor's right to file a class action.¹⁰ FINRA's Enforcement Department ("FINRA Enforcement") investigated Schwab's new class action waiver provision, and a Hearing Panel concluded that although Schwab's class action waiver violates FINRA Rules, the Rules at issue are unenforceable because they are preempted by the Federal Arbitration Act ("FAA") "as construed by the Supreme Court in *Concepcion* and other decisions."¹¹

courts have considered it to be a quasi-governmental agency. *See Fiero v. Fin. Indus. Regulatory Auth., Inc.*, 606 F. Supp. 2d 500, 517 (S.D.N.Y. 2009) rev'd, 660 F.3d 569 (2d Cir. 2011).

⁶ In re Charles Schwab & Co., 2013 WL 1463100, at *2, *10 (N.A.S.D.R. Feb. 21, 2013). *But see* Dan Jamieson & Mark Schoeff Jr., *Schwab Drops Class Action Ban Temporarily*, InvestmentNews (May 19, 2013, Updated 12:01 AM), <http://www.investmentnews.com/article/20130303/REG/303039977> (discussing how Schwab stands by their class action waiver provision but has voluntarily removed it until the legal issue can be decided).

⁷ FINRA's Rules of Customer Arbitration provide that "Class action claims may not be arbitrated under the Code." FINRA Rule 12204(a).

⁸ *See e.g.*, CONSUMER FINANCIAL PROTECTION BUREAU, ARBITRATION STUDY PRELIMINARY RESULTS: SECTION 1028(A) STUDY RESULTS TO DATE, (Dec. 12, 2013), *available at* <http://www.consumerfinance.gov/reports/section-1028a-arbitration-study-results-to-date/>; Barbara Black & Jill Gross, *Investor Protection Meets the Federal Arbitration Act*, 1 STAN. J. COMPLEX LITIG. 1 (2012); Susan Antilla, *Schwab Case Casts Spotlight on Securities Arbitration and Its Flaws*, N.Y. TIMES (Sep. 4, 2013, 5:56 PM), <http://dealbook.nytimes.com/2013/09/04/schwab-case-casts-spotlight-on-securities-arbitration-and-its-flaws/>; Mark Schoeff Jr., *House Democrat introduces bill to end mandatory arbitration*, INVESTMENTNEWS (Aug. 5, 2013, Updated 2:59 PM), <http://www.investmentnews.com/article/20130805/FREE/130809965?template=printart>.

⁹ In re Charles Schwab & Co., 2013 WL 1463100, at *7 (N.A.S.D.R. Feb. 21, 2013).

¹⁰ FINRA Rule 2268(d)(3) ("No pre-dispute arbitration agreement shall include any condition that . . . limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement.").

¹¹ In re Charles Schwab & Co., 2013 WL 1463100, at *1 (N.A.S.D.R. Feb. 21, 2013). This decision is currently on appeal before FINRA's National Adjudicatory Council ("NAC"). The Securities and Exchange Commission ("SEC"), then a U.S. Circuit Court of Appeals and finally the Supreme Court of the United States would hear any appeals beyond the NAC. *See Jamieson, supra* note 1.

The purpose of this Comment is to discuss FINRA’s recent Enforcement Action against Schwab (hereinafter, the “Schwab Enforcement Decision”), why it was properly decided based on Supreme Court precedent, and why this decision will inure to the benefit of investors rather than detrimentally affecting their ability to seek justice. Part II of this Comment discusses the applicable federal laws, Congress’s delegation of power to regulate the securities industry to the SEC, and FINRA’s role in promulgating rules for securities claims. Part III of this Comment discusses the relevant case law, including the FAA and its role in recent Supreme Court decisions regarding mandatory arbitration clauses and class action waivers. Part IV of this Comment examines the Schwab Enforcement Decision and explains why it was properly decided and should be upheld. Part V of this Comment discusses why FINRA arbitrations provide the best forum for resolving disputes between investors and broker-dealers. Part VI concludes this Comment.

II. SEC Regulation and FINRA Rules for Arbitrations Prior to the Schwab Enforcement Decision

A. FINRA and its Role in Dispute Resolution

The Financial Industry Regulatory Authority, otherwise known as FINRA, is a self-regulatory organization (“SRO”)¹² tasked with immediate oversight of the securities industry.¹³ FINRA is subject to U.S. Securities and Exchange Commission (“SEC”) oversight, and was created in 2007 after the SEC “approved the merger of the enforcement arms of the New York Stock Exchange (“NYSE”) and the National Association of Securities Dealers (“NASD”).”¹⁴ In this role, FINRA creates rules that govern the securities industry, investigates firms to ensure

¹² “The term ‘self-regulatory organization’ means any national securities exchange, registered securities association, or registered clearing agency, or (solely for purposes of sections 78s(b), 78s(c), and 78w(b) of this title) the Municipal Securities Rulemaking Board established by section 78o-4 of this title.” 15 U.S.C.A. § 78c (2014) (West).

¹³ Rhonda Wasserman, *Legal Process in A Box, or What Class Action Waivers Teach Us About Law-Making*, 44 LOY. U. CHI. L.J. 391, 416 (2012).

¹⁴ *Id.* See also 15 U.S.C. § 78s (2012) (authorizing the SEC to grant the registration of self-regulatory organizations).

compliance therewith, provides tools to educate investors, and supervises the arbitration of disputes between broker-dealers and customers.¹⁵ These arbitrations have been the primary method of dispute resolution for the industry since 1987.¹⁶ Similar to filing a claim in court, a complaining investor (“claimant”) is required to file a submission agreement, filing fee,¹⁷ and a statement of claim.¹⁸ Decisions can be made solely on the papers, or through a formal hearing process.¹⁹

B. Securities Exchange Act and Delegation of Authority

Congress delegated authority to regulate the securities industry to the SEC in the 1934 Securities Exchange Act (the “Exchange Act”).²⁰ Three separate provisions of the Exchange Act grant the SEC authority to regulate pre-dispute arbitration agreements between customers and broker-dealers.²¹

Section 15A gives self-regulatory organizations (“SROs”),²² such as FINRA, the authority to regulate the broker-dealer industry, subject to SEC oversight.²³ Though it may seem odd, “[i]ndustry self-regulation is ‘an essential and officially sanctioned part of the regulatory pattern.’”²⁴ Through this delegation of power, Congress indirectly “vested the Financial Industry Regulatory Authority . . . with the power to promulgate rules that, once adopted by the SEC,

¹⁵ *About the Financial Industry Regulatory Authority*, *supra* note 5; Wasserman, *supra* note 13.

¹⁶ Roberta S. Karmel, *Should Securities Industry Self-Regulatory Organizations Be Considered Government Agencies?*, 14 STAN. J.L. BUS. & FIN. 151, 173 (2008).

¹⁷ These fees vary depending upon the amount of damages alleged. *See* FINRA Rule 12900.

¹⁸ *File a Claim*, FINRA, <http://www.finra.org/arbitrationandmediation/arbitration/process/fileclaim/> (last visited Feb. 12, 2014).

¹⁹ *See* FINRA Rule 12800.

²⁰ 15 U.S.C. § 78d (2013).

²¹ *See* Black & Gross, *supra* note 8, at 17.

²² Pursuant to the 1934 Exchange Act (and subsequent amendments), Congress decided to rely on national securities exchanges—private entities—to regulate day-to-day activity in the securities industry. *See* Rohit A. Nafday, *From Sense to Nonsense and Back Again: Sro Immunity, Doctrinal Bait-and-Switch, and A Call for Coherence*, 77 U. CHI. L. REV. 847, 849 (2010).

²³ Exchange Act 15A, 15 U.S.C. § 78o-3. *See* Black & Gross, *supra* note 8, at 17.

²⁴ Black & Gross, *supra* note 8, at 17 (quoting U.S. SEC. AND EXCH. COMM’N, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, H.R. DOC. NO. 88–95, pt. 4, at 501).

have the force of law.”²⁵ The Exchange Act provides that a SRO (like FINRA) must adopt rules designed to, *inter alia*, prevent fraud and promote equitable principles of trade.²⁶ But the SEC maintains rulemaking oversight: “FINRA must file proposed rule changes with the SEC, and the SEC must publish notice and provide interested persons an opportunity to comment on the proposal.”²⁷ Moreover, the SEC may unilaterally amend FINRA’s rules as it deems “necessary or appropriate.”²⁸ Further, in an exercise of its understood regulatory authority, “the SEC has specifically approved the arbitration procedures of the New York Stock Exchange . . . and the NASD.”²⁹

Beyond the SEC’s delegated authority pursuant to § 15A, two other provisions of the Exchange Act address pre-dispute arbitration agreements: § 29(a)³⁰ prohibiting forced waivers of statutory or regulatory compliance; and § 15(o),³¹ granting the SEC authority to ban pre-dispute arbitration agreements for federal securities and SRO matters.³² Through the Exchange Act, Congress properly delegated authority to regulate the securities industry to the SEC, and the SEC in turn uses FINRA to police against regulatory violations and resolve disputes.

C. FINRA Rules Governing Claims Filed by Investors against Broker-Dealers

Subject to the SEC’s strict oversight, FINRA has promulgated numerous rules that apply to customer arbitrations, only a few of which are particularly relevant when discussing class action waivers and mandatory pre-dispute arbitration agreements. For example, FINRA Rule 2268(d) was directly at issue in the Schwab Enforcement Decision, and reads:

²⁵ *McDaniel v. Wells Fargo Invs., LLC*, 717 F.3d 668, 673 (9th Cir. 2013)(footnote and citation omitted).

²⁶ *See* Black & Gross, *supra* note 8, at 18.

²⁷ *Id.* (citations omitted).

²⁸ *Id.* (citations omitted).

²⁹ *Shearson/Am. Exp., Inc. v. McMahon*, 482 U.S. 220, 234 (1987). *See also* Black & Gross, *supra* note 8, at 4 n.15 (explaining that the New York Stock Exchange (“NYSE”) and the NASD (National Association of Securities Dealers) were FINRA’s predecessors.).

³⁰ Exchange Act § 29(a), 15 U.S.C. § 78cc (2013).

³¹ Exchange Act 15(o), 15 U.S.C. § 78o(o).

³² Black & Gross, *supra* note 8, at 17.

No predispute [sic] arbitration agreement shall include any condition that: (1) limits or contradicts the rules of any self-regulatory organization; (2) limits the ability of a party to file any claim in arbitration; (3) limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement; (4) limits the ability of arbitrators to make any award.³³

Thus, FINRA Rule 2268(d)(3) appears to expressly prohibit a broker-dealer from instituting a mandatory arbitration provision in a customer agreement that would restrict an investor's (or, for that matter, a broker-dealer's) ability to file a claim in court, so long as FINRA's Rules permit a claim to be filed in court.

FINRA's Arbitration Rules expressly prohibit class action claims from being arbitrated under the FINRA Code of Arbitration, but the Rules appear to contemplate that class action claims could be properly brought in court.³⁴ FINRA Rules do, however, permit the joinder of arbitration claims in order to promote efficiency and cost-savings in dispute resolution.³⁵ This distinction would appear to show that FINRA believes there are times when the joinder of multiple claims benefits the dispute resolution process, but that class actions are better left to the judiciary.

But FINRA Rules do not exist in a vacuum. Despite the SEC's delegation of authority to FINRA to promulgate rules that operate with the force of law, it is necessary to examine the extrinsic forces that may affect the SEC's oversight of the securities industry and FINRA's Rules: namely the FAA and Supreme Court rulings in cases dealing with mandatory pre-dispute arbitration clauses and class action waivers.

³³ FINRA Rule 2268(d).

³⁴ See *In re Charles Schwab & Co.*, 2013 WL 1463100, at *1 (N.A.S.D.R. Feb. 21, 2013); FINRA Rule 12204(a) ("Class action claims may not be arbitrated under the Code."). *But see* FINRA Rules 12204(b) and (d) (stating that for any claim that is based upon the same facts and law, and involving the same defendants as a court certified or putative class action, arbitration must be stayed *until the results of the class action are finalized or unless the Plaintiff refuses to participate in the class action.*). Rule 12204's language appears to infer that FINRA believes individual investors are permitted to file and/or participate in class actions rather than being required to participate exclusively in mandatory arbitrations.

³⁵ Black & Gross, *supra* note 8, at 29.

III. The Federal Arbitration Act and its Role in Recent Supreme Court Decisions Regarding Mandatory Arbitration Clauses, Class Action Waivers and FINRA

A. The FAA and FINRA

Congress enacted the FAA in 1925 “to overrule the judiciary’s long-standing refusal to enforce agreements to arbitrate.”³⁶ Section 2 of the FAA, which is known as the “Savings Clause,” states that agreements to arbitrate are “valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”³⁷ Further, the FAA governs arbitration agreements “evidencing a transaction involving commerce.”³⁸ The Supreme Court has interpreted this language “to include any transaction that *in fact* involves interstate commerce, even if the parties did not anticipate an interstate impact.”³⁹ Moreover, the FAA is meant to, and does, apply in both federal and state courts.⁴⁰

Two other sections of the FAA play important roles in the enforcement of arbitration agreements. Section 3 of the FAA provides that if an arbitrable dispute is subject to a valid arbitration agreement, and is otherwise submitted to a federal court, the court filing will be stayed until the arbitration is completed pursuant to the terms of the arbitration agreement.⁴¹ Thus, if the FAA properly applies to customer agreements with broker-dealers, a pre-dispute arbitration agreement should be enforced as the plaintiff’s sole means to seek justice, even if a claim is filed in federal court. Further, § 4 of the FAA provides that if a party to an arbitration

³⁶ Black & Gross, *supra* note 8, at 11 (citing *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989)). *See also* *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006).

³⁷ *Id.* citing 9 U.S.C. § 2.

³⁸ 9 U.S.C. § 2 (2013).

³⁹ Black & Gross, *supra* note 8, at 12 n.67 (emphasis original). *See also* *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002) (applying the FAA to securities arbitrations).

⁴⁰ *See* *Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984) (“The statements of the Court in *Prima Paint* that the Arbitration Act was an exercise of the Commerce Clause power clearly implied that the substantive rules of the Act were to apply in state as well as federal courts.”).

⁴¹ *Id.* (citing 9 U.S.C. § 3).

agreement refuses to resolve a covered dispute through arbitration, the other bound party may petition a federal district court for an order compelling arbitration.⁴²

Thus, one important question remaining is whether the FAA applies to all customer disputes between FINRA member firms and their customers. In the Schwab Enforcement Decision, FINRA’s Hearing Panel acknowledged “courts have recognized that FINRA’s Arbitration Rules *themselves* constitute an agreement to arbitrate that is covered by the FAA, even separate from a customer-member agreement.”⁴³ Therefore, according to the FINRA Hearing Panel and a plain reading of the FAA, the FAA applies to all customer disputes between FINRA member firms, their broker-dealers, and their customers.

Commenters have noted, however, that even if the FAA applies, FINRA Rules should control because they are promulgated with the force of law subsequent to the FAA, are more specific than the general mandates promulgated by the FAA, and are the result of “active engagement by the SEC and FINRA” in regulating the securities arbitration process pursuant to congressional authority.⁴⁴ These positions, however, are at odds with Supreme Court jurisprudence, as discussed *infra*.

B. The Supreme Court’s Recent Decisions Regarding the FAA’s Role in Litigation

In the Schwab Enforcement Decision, FINRA’s enforcement panel concluded that “The Supreme Court has repeatedly held that the FAA requires a party to an arbitration agreement to go to arbitration to resolve any claim covered by the agreement, unless Congress—and Congress

⁴² *Id.* (citing 9 U.S.C. § 4).

⁴³ In re Charles Schwab & Co., 2013 WL 1463100, at *16 (emphasis added). *See also* Morgan Keegan & Co. v. Silverman, 2013 U.S. App. LEXIS 2412, *3–4 (4th Cir. Feb. 4, 2013) (“[I]n the absence of a separate arbitration agreement, a party can compel a FINRA member to participate in FINRA arbitration” so long as the party is a customer of the FINRA member and the dispute is between the customer and the member.); *Washington Square Sec., Inc. v. Aune*, 385 F.3d 432, 435 (4th Cir. 2004) (NASD Code constitutes a binding arbitration agreement under the Federal Arbitration Act).

⁴⁴ *Infra* Part IV.A.2; Black and Gross, *supra* note 8 at 18, 37–40.

alone—has created an exception to the FAA.”⁴⁵ It is important to note that Schwab’s insistence on resolving customer disputes through arbitration is not unique. Since 1987, when the Supreme Court decided *Shearson/American Express v. McMahon*⁴⁶ (holding that arbitration provisions in brokerage contracts are enforceable with respect to claims under the Exchange Act), investors are typically precluded from accessing the courts for disputes with their brokers.⁴⁷ After *Shearson*, “virtually every firm has added a so-called mandatory arbitration agreement to its new-account documents.”⁴⁸ The difference in the Schwab Enforcement Decision is that Schwab not only required mandatory arbitration, but expressly prohibited access to the courts through judicial class actions.

In *Shearson*, customer agreements signed by Eugene and Julia McMahon provided for the mandatory arbitration “of any controversy” relating to the McMahons’ accounts.⁴⁹ In analyzing the agreements, the Court focused on the FAA which “establishes a federal policy favoring arbitration . . . requiring that we rigorously enforce agreements to arbitrate.”⁵⁰ The Court showed further deference to the FAA, noting that the FAA’s mandate to enforce arbitration agreements may only be overridden by clear Congressional command, flowing from Congress itself.⁵¹ Thus, in order to prove their case, the McMahons needed to show that Congress intended to make an exception to the FAA for Exchange Act claims.⁵²

⁴⁵ In re Charles Schwab & Co., 2013 WL 1463100, at *17 (N.A.S.D.R. Feb. 21, 2013).

⁴⁶ 482 U.S. 220 (1987).

⁴⁷ See Antilla, *supra* note 8.

⁴⁸ *Id.* See also Rhonda Wasserman, *Legal Process in A Box, or What Class Action Waivers Teach Us About Law-Making*, 44 LOY. U. CHI. L.J. 391, 416 (2012) (“Since 1987, when the Supreme Court held that pre-dispute agreements to arbitrate claims arising under the Securities Exchange Act of 1934 were enforceable, virtually all disputes between broker-dealers and their customers have been arbitrated under FINRA supervision.”)(footnotes omitted).

⁴⁹ *Shearson*, 482 U.S. at 223.

⁵⁰ *Id.* at 226 (internal citations and quotation marks omitted).

⁵¹ *Id.*

⁵² *Id.* at 227.

The McMahons argued that an arbitration agreement forcing them to waive the statutorily mandated exclusive jurisdiction of the district courts of the United States, found in § 27 of the Exchange Act, should be unenforceable.⁵³ Specifically, § 29 of the Exchange Act “voids the waiver of ‘any provision’ of the Exchange Act,” which the McMahons argue indicated Congress’s intention to make an exception to the FAA.⁵⁴

In deciding to enforce the mandatory arbitration agreement, the Court wrote that Congressional intent must be discernible from the statute’s text, history, or purposes; a Congressional intent to require a judicial forum for the resolution of securities claims could not be deduced from the Exchange Act itself.⁵⁵ While the section at issue, § 29(a), declares agreements that “waive compliance with any provision of [the Act] void,” the Court decided that § 29(a) only prohibited waivers of the Act’s substantive obligations, and would not void a jurisdictional waiver.⁵⁶ Thus, the Court determined that the Exchange Act was concerned with the potential for liability to be determined, and a prohibition against waiving that right.

In fact, the Court’s decision in *Shearson*, and its focus on jurisdictional waivers is in direct contrast to an earlier holding in *Wilko v. Swan*,⁵⁷ which “stated that the Securities Act’s jurisdictional provision was ‘the kind of ‘provision’ that cannot be waived under . . . the Securities Act.’”⁵⁸ In *Shearson*, the Court distinguished *Wilko* without overturning it, stating that “*Wilko* must be understood, therefore, as holding that the plaintiff’s waiver of the ‘right to select the judicial forum,’ was unenforceable only because arbitration was [previously] judged

⁵³ *Id.*

⁵⁴ *Id.* The Court in *Shearson* noted that a Congressionally intended exception to the FAA “will be deducible from [the statute’s] text or legislative history, . . . or from an inherent conflict between arbitration and the statute’s underlying purposes.” *Shearson*, 482 U.S. at 227 (internal citations and quotations omitted). The Court ultimately held, however, that the statute’s underlying purpose was rooted in the availability of substantive relief and not in the availability of a certain forum or jurisdiction. *Id.* at 238.

⁵⁵ *Shearson*, 482 U.S. at 227.

⁵⁶ *Id.* at 228.

⁵⁷ 346 U.S. 427 (1953).

⁵⁸ *Id.* at 435.

inadequate to enforce the statutory rights created by [the Exchange Act].”⁵⁹ Thus, it is inferred that because arbitration is now considered an appropriate forum for securities dispute resolution, and because Congress passed the FAA favoring arbitration, there was no reason to invalidate an arbitration agreement solely because of a jurisdictional waiver.⁶⁰

Separately, but of no less importance to the prevalence of pre-dispute arbitration agreements in the securities industry, the Court held that even if an arbitration agreement appears to be a contract of adhesion, it cannot be ignored unless there is a “well-founded claim that an arbitration agreement resulted from the sort of fraud or excessive economic power” that traditionally lead to contract revocation.⁶¹ Thus, going forward, securities investors could not skirt their responsibilities under a pre-dispute arbitration agreement simply by claiming it stemmed from a contract of adhesion.

But what makes the Schwab Enforcement Decision unique is not that Schwab attempted to enforce a mandatory pre-dispute arbitration provision against its investors; rather, Schwab was the first broker-dealer to expressly prohibit claims between it and its investors from being litigated through class actions.

The issue of consumers expressly waiving their right to file or participate in class actions was recently taken up by the Supreme Court in *AT&T Mobility LLC v. Concepcion*.⁶² In *Concepcion*, the Court decided “whether the FAA prohibits States from conditioning the enforceability of certain arbitration agreements on the availability of class-wide arbitration procedure.”⁶³ The Court, in an opinion written by Justice Scalia, “upheld a prohibition on class

⁵⁹ *Shearson*, 482 U.S. at 228–229.

⁶⁰ The Court’s holding in *Shearson* was reaffirmed, and *Wilko* was later reversed in *Rodriguez de Quijas v. Shearson/Am. Exp., Inc.*, 490 U.S. 477 (1989) (holding that a pre-dispute agreement to arbitrate claims under the Securities Act of 1933 is enforceable and judicial resolution is not required).

⁶¹ *Shearson*, 482 U.S. at 224.

⁶² 131 S. Ct. 1740 (2011).

⁶³ *Id.* at 1744.

actions in a consumer contract, despite state law that refused to enforce such provisions on unconscionability grounds.”⁶⁴

Vincent and Liza Concepcion entered into a contract of adhesion with AT&T for “the sale and servicing” of mobile phones.⁶⁵ The contract between the parties contained a mandatory arbitration clause that doubly acted as a class action waiver.⁶⁶ Despite the arbitration agreement being a contract of adhesion, AT&T implemented some safeguards for the benefit of their customers. AT&T endeavored to make arbitration an attractive option by, *inter alia*, offering to pay all costs of non-frivolous claims if conciliation attempts were unsuccessful after thirty days, and by allowing customers to decide whether the arbitration should proceed in person, by phone, or solely on the submissions for claims of less than \$10,000.⁶⁷

The Concepcions sought damages in the amount of \$30.22 stemming from sales tax they were charged when purchasing a free phone.⁶⁸ To that end, they filed a complaint in the U.S. District Court for the Southern District of California, which was later consolidated in a putative class action against AT&T.⁶⁹ AT&T moved to compel arbitration, pursuant to the FAA and the terms of its contract with the Concepcions. The Concepcions opposed, arguing that the arbitration agreement was “unconscionable and unlawfully exculpatory under California law because it disallowed classwide procedures.”⁷⁰

The district court noted that consumers who were members of the class at hand would likely be worse off than if they proceeded with their claims pursuant to their agreement with

⁶⁴ Black & Gross, *supra* note 8, at 1.

⁶⁵ *Concepcion*, 131 S. Ct. at 1744.

⁶⁶ *Id.* Note, this language is similar to the provision Schwab instituted in its customer agreements.

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.* at 1744–45.

AT&T.⁷¹ The court, however, denied AT&T's motion to compel arbitration on unconscionability grounds, pursuant to the California Supreme Court decision in *Discover Bank v. Superior Court*.⁷² On appeal, the Court of Appeals for the Ninth Circuit affirmed and further held that the FAA did not preempt the *Discover Bank* rule,⁷³ because *Discover Bank* simply reinforced the unconscionability analysis applicable to contracts in California.⁷⁴

Upon review, the Supreme Court's five-to-four majority opinion held that § 2 of the FAA—the savings clause—“permits agreements to arbitrate to be invalidated by ‘generally applicable contract defenses, such as fraud, duress, or unconscionability,’ but not by defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue.”⁷⁵ Therefore, a contract requiring pre-dispute arbitration is not *per se* unconscionable. Importantly, the decision holds that “nothing in [the Savings Clause] suggests [a Congressional] intent to preserve state-law rules that stand as an obstacle to the accomplishment of the FAA's objectives.”⁷⁶

Finally, Justice Scalia wrote that “the overarching purpose of the FAA . . . is to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings.”⁷⁷ Thus, the majority held that “[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA.”⁷⁸

⁷¹ *Concepcion*, 131 S. Ct. at 1745.

⁷² See *Discover Bank v. Superior Court*, 113 P.3d 1100, 1110 (Cal. 2005) (holding that class action waivers in consumer contracts of adhesion are unconscionable when the conflict involves “small amount of damages.”).

⁷³ The Court referred to the *Discover Bank* rule to mean “California’s rule classifying most collective-arbitration waivers in consumer contracts as unconscionable.” *Id.* at 1746.

⁷⁴ *Id.* at 1745.

⁷⁵ *Id.* at 1746 (quoting *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 684 (1996)).

⁷⁶ *Id.* at 1748. Recall that FINRA Rules are neither state laws nor federal laws, but are instead quasi-governmental rules acting with the force of law. So logic follows that they would not be able to contravene § 2 of the FAA as the Court describes it here.

⁷⁷ *Id.*

⁷⁸ *Concepcion*, 131 S. Ct. at 1748.

In 2012, the Supreme Court decided *CompuCredit Corp. v. Greenwood*,⁷⁹ and “reaffirmed the principle that parties may agree to arbitrate claims arising under a federal statute so long as the statute does not contain a ‘contrary congressional command.’”⁸⁰ CompuCredit, Inc. was a credit repair organization, and respondents were a group of individuals who received a Visa credit card through CompuCredit.⁸¹ The credit application that respondents submitted in order to obtain the card contained a mandatory pre-dispute arbitration clause covering “[a]ny claim, dispute or controversy . . . relating to your Account, any transferred balances or this Agreement.”⁸² Instead of filing for arbitration, respondents filed a class-action complaint in the U.S. District Court for the Northern District of California alleging violations of the Federal Credit Repair Organizations Act (“CROA”).⁸³ The claims involved alleged misleading representations that the defendant’s credit card would help an applicant to rebuild poor credit, and that the credit limit advertised was not accurate due to the immediate assessment of fees to the card.⁸⁴ The district court denied defendant’s motion to compel arbitration citing a congressional intent that claims under CROA be non-arbitrable.⁸⁵

Following the Ninth Circuit’s affirmance, the Supreme Court considered whether CROA contained a sufficient Congressional intent to override the FAA, thus rendering the arbitration agreement at issue subject to challenge.⁸⁶ Respondents argued that CROA did so by expressly stating, “[y]ou have a right to sue a credit repair organization that violates the Credit Repair Organization Act.”⁸⁷ Further, “[t]he Act’s nonwaiver provision states, ‘Any waiver by any

⁷⁹ 132 S. Ct. 665 (2012).

⁸⁰ See Black & Gross, *supra* note 8, at 3 (quoting *CompuCredit Corp.*, 132 S. Ct. at 669).

⁸¹ *CompuCredit Corp.*, 132 S. Ct. at 668.

⁸² *Id.*

⁸³ *Id.* See also the Credit Repair Organizations Act at 15 U.S.C. § 1679—1679j (2013).

⁸⁴ *CompuCredit Corp.*, 132 S. Ct. at 668.

⁸⁵ *Id.* (quoting *Greenwood v. CompuCredit Corporation*, 617 F.Supp.2d 980, 988 (2009)).

⁸⁶ *Id.* at 669.

⁸⁷ *Id.*

consumer of any protection provided by or any right of the consumer under this subchapter—(1) shall be treated as void; and (2) may not be enforced by any Federal or State court or any other person.”⁸⁸

The Ninth Circuit held that the “disclosure provision gives consumers the ‘right to sue,’ which ‘clearly involves the right to bring an action in a court of law.’”⁸⁹ Thus, as the argument goes, an arbitration agreement would constitute a waiver of the right to bring an action in court, and therefore could not be enforced pursuant to CROA’s non-waiver provision.⁹⁰ Further, respondents argued that CROA’s plain language (including the use of such terms as “action,” “class action,” and “court”) demonstrated a Congressional intent to preserve a consumer’s right to bring judicial actions.⁹¹

Once again, the Court placed arbitration on equal footing with judicial actions as a proper means for dispute resolution. Writing for the majority, Justice Scalia wrote that CROA’s “right to sue” provision merely guarantees a consumer’s right to hold a credit repair organization liable for violating law.⁹² As the six-to-three opinion noted, the Court has “repeatedly recognized that contractually required arbitration of claims satisfies the statutory prescription of civil liability in court.”⁹³ More explicitly stated, and in terms that surely inure to Schwab’s benefit when defending their class action waiver provision, Justice Scalia wrote:

We think it clear, however, that this mere “contemplation” of suit in any competent court does not guarantee suit in all competent courts, disabling the parties from adopting a reasonable forum-selection clause . . . so also can the contemplated availability of judicial action be limited to judicial action compelling or reviewing initial arbitral adjudication. The parties remain free to

⁸⁸ *Id.*

⁸⁹ *Id.* (quoting *Greenwood v. CompuCredit Corp.*, 615 F.3d 1204, 1208 (2010)).

⁹⁰ *CompuCredit Corp.*, 132 S. Ct. at 669.

⁹¹ *Id.*

⁹² *Id.* at 670 (footnote omitted).

⁹³ *Id.* at 671. *See also* *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985).

specify such matters, so long as the guarantee of [CROA]—*the guarantee of the legal power to impose liability*—is preserved.⁹⁴

In 2013, the Court decided *American Express Co. v. Italian Colors Restaurant*, holding that pursuant to the FAA, arbitration agreements with class action waivers cannot be invalidated solely because the plaintiff’s costs to arbitrate would exceed their potential recovery.⁹⁵ In this case, the contract was between American Express (and one of its subsidiaries) and merchants who accept American Express credit cards.⁹⁶ The contract clause at issue mandated that all disputes between the parties be resolved through arbitration, and further prohibited any claim “to be arbitrated on a class action basis.”⁹⁷

The merchants brought a class action against American Express for violating federal antitrust laws claiming American Express used its “monopoly power . . . to force merchants to accept credit cards at rates approximately 30% higher than the fees for competing credit cards.”⁹⁸ American Express moved to compel arbitration, and instead of opposing on the grounds that the arbitration clause/class action waiver were *per se* unconscionable, the merchants asserted “that the cost of an expert analysis necessary to prove the antitrust claims would be ‘at least several hundred thousand dollars, and might exceed \$1 million,’ while the maximum recovery for an individual plaintiff would be \$12,850, or \$38,549 when trebled.”⁹⁹ American Express won at the district court level, but the Court of Appeals reversed and remanded because the merchants proved prohibitive costs to arbitrate, thereby rendering the clause unenforceable.¹⁰⁰

⁹⁴ *CompuCredit Corp.*, 132 S. Ct. at 671 (emphasis in original).

⁹⁵ 133 S. Ct. 2304, 2311 (2013).

⁹⁶ *Id.* at 2308.

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.*

The Supreme Court’s five-to-three¹⁰¹ majority explanation for upholding the arbitration provisions, including the class action waiver, sounded similar to the prior cases discussed above. The Court could not find a “contrary congressional command” requiring the abrogation of the class action waiver at issue, because the federal antitrust laws “do not guarantee an affordable procedural path to the vindication of every claim,” only that a right to seek vindication exist.¹⁰² Moreover, Justice Scalia noted that the federal statutes at issue (the Sherman¹⁰³ and Clayton¹⁰⁴ Acts) do not mention class actions at all, so it would be improper to assume the federal statutes guarantee the right to proceed via class action.¹⁰⁵

Separately, the Court noted that Rule 23 of the Federal Rules of Civil Procedure, a rule governing class actions, “was ‘designed to allow an exception to the usual rule that litigation is conducted by and on behalf of the individual named parties only.’”¹⁰⁶ But Justice Scalia wrote that the parties here “agreed to arbitrate pursuant to that ‘usual rule,’ and it would be remarkable for a court to erase that expectation.”¹⁰⁷ The same would presumably be argued, and hold true, about FINRA arbitrations between customers and broker-dealers. Further, the Court explained that Rule 23 of the Federal Rules of Civil Procedure does not establish a congressionally approved “entitlement to class action proceedings for the vindication of statutory rights,” to the

¹⁰¹ Justice Sotomayor was a judge on the panel that decided the case below, and as such, took no part in the Court’s decision. Mike Gottlieb, *Details: American Express v. Italian Colors Restaurant*, SCOTUSBLOG (June 20, 2013, 11:39 AM), <http://www.scotusblog.com/2013/06/details-american-express-v-italian-colors-restaurant/>.

¹⁰² *American Exp. Co.*, 133 S. Ct. at 2309. This language is important when discussing criticisms of Schwab’s class action waiver provision.

¹⁰³ See Sherman Anti-Trust Act (“Sherman Act”), as codified in 15 U.S.C. §§ 1–7 (2013).

¹⁰⁴ See Clayton Act, as codified in 15 U.S.C.A. §§ 12–27 (2014).

¹⁰⁵ *American Exp. Co.*, 133 S. Ct. at 2309.

¹⁰⁶ *Id.* (quoting *Califano v. Yamasaki*, 442 U.S. 682, 700–01 (1979)).

¹⁰⁷ *Id.*

detriment of private arbitration agreements.¹⁰⁸ Enforcing Rule 23 as such would be in violation of 28 U.S.C. § 2072(b).¹⁰⁹

But what about the fact that the prohibitive costs to pursuing required arbitration in this case means that the plaintiff may not deem it worth pressing forward? In this case, the merchants argued that the “effective vindication” exception should be applied. This exception stems from a 1985 Supreme Court case—*Mitsubishi Motors*—where, in *dicta*, the Court “expressed a willingness to invalidate, on ‘public policy’ grounds, arbitration agreements that ‘operat[e] . . . as a prospective waiver of a party’s *right to pursue* statutory remedies.’”¹¹⁰

In deciding *American Express*, the Court reaffirmed the pro-arbitration position they espoused in *Mitsubishi Motors* twenty-eight years earlier: if a plaintiff or potential plaintiff can effectively vindicate its statutory cause of action in arbitration (the “Effective Vindication Rule”), and there is a valid and binding arbitration agreement, a plaintiff must proceed in arbitration.¹¹¹ Moreover, and more relevant to many of the critics’ complaints of class action waivers in brokerage agreements, the Court stated “the fact that it is not worth the expense involved in proving a statutory remedy does not constitute the elimination of the right to pursue that remedy.”¹¹²

In her dissent, Justice Kagan advanced similar arguments to those proffered by critics of the Schwab Enforcement Decision. Justice Kagan wrote that the Effective Vindication Rule is “to prevent arbitration clauses from choking off a plaintiff’s ability to enforce congressionally created rights,” and that it should be applied “when (but only when) [a mandatory arbitration

¹⁰⁸ *Id.* at 2309–10.

¹⁰⁹ *Id.* (28 U.S.C. §2072(b) states that the Federal Rules of Civil Procedure “shall not abridge, enlarge or modify any substantive right. All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect.”).

¹¹⁰ *American Exp. Co.*, 133 S. Ct. at 2310 (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 n.19 (1985)) (modifications and emphasis original).

¹¹¹ *Id.*

¹¹² *Id.* at 2311.

clause] operates to confer immunity from potentially meritorious federal claims.”¹¹³ Put more simply, the dissent’s main focus was that enforcing a mandatory arbitration clause with a class action waiver allows the party with more bargaining power to insulate itself from liability, even if it has violated the law. In consequence, a wronged customer/investor who lacks financial means would not be able to afford the cost of proving their case in an individual arbitration.¹¹⁴

It was the dissent’s position that this timely application of the Effective Vindication Rule would not only reconcile the FAA with a federal law, but that it would go so far as to promote “the most fundamental purposes of the FAA itself”—namely, preferring arbitration over litigation, not a preference for “*de facto* immunity.”¹¹⁵ Moreover, without the Effective Vindication Rule, Justice Kagan argued that companies would be enticed to make arbitrations unavailable or pointless, rather than a forum to dispense justice in an efficient and streamlined manner.¹¹⁶

Recalling *Mitsubishi Motors*, Justice Kagan conceded that the Court held it would enforce arbitration agreements so long as a prospective litigant could effectively vindicate its rights through arbitration.¹¹⁷ She noted, however, that the Court went on to say that “[i]f an arbitration provision ‘operated . . . as a prospective waiver of a party’s right to pursue statutory remedies,’ we emphasized, we would ‘condemn[]’ it.”¹¹⁸ In such a case, the Court would ignore the mandatory arbitration clause if forcing litigation through arbitration would be “so gravely difficult” that the plaintiff is effectively “deprived of his day in court.”¹¹⁹ Thus, Justice Kagan argued that it is truly the Court’s practice and precedent to instruct lower courts “not to enforce

¹¹³ *Id.* (Kagan, J., dissenting).

¹¹⁴ *Id.* at 2313.

¹¹⁵ *Id.* at 2315.

¹¹⁶ *American Exp. Co.*, 133 S. Ct. at 2315.

¹¹⁷ *Id.* at 2314.

¹¹⁸ *Id.* (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 n.19 (1985)).

¹¹⁹ *Id.* (quoting *Mitsubishi Motors Corp.*, 473 U.S. at 632).

an arbitration agreement that effectively (even if not explicitly) forecloses a plaintiff from remedying the violation of a federal statutory right,” even if that is because the arbitration would be prohibitively expensive for the potential plaintiff.¹²⁰ This lends credence to critics of mandatory pre-dispute arbitration clauses who argue that investors’ access to justice will be limited if these agreements are fully enforced. As will be discussed below, however, these concerns are minimized in a FINRA arbitration context.

In 2013, FINRA Enforcement applied FINRA Rules, federal statutes, and Supreme Court jurisprudence to decide whether Schwab’s new customer agreements—which include both a mandatory arbitration provision and an explicit class action waiver clause—should be invalidated for violating FINRA Rules 2268(d)(1) and 2268(d)(3) which FINRA claims “operate to preserve judicial class actions as an alternative to arbitration, even when there is a pre-dispute arbitration agreement between a FINRA member firm and its customer.”¹²¹ The Hearing Panel concluded that although the new Schwab customer agreements violate FINRA Rules 2268(d)(1) and (3)—rules by which Schwab and all other FINRA member firms are bound—the FINRA Rules at issue are preempted by the FAA because “adjudicators must enforce agreements to go to arbitration to resolve disputes and must reject any public policy exception that disfavors arbitration, unless Congress itself has indicated an exception to the Act.”¹²²

In 2011, Schwab amended the language in its customer agreements, thereafter expressly requiring customers to waive any right to bring or participate in judicial class actions, and

¹²⁰ *Id.* See also 14 Penn Plaza LLC v. Pyett, 556 U.S. 247 (2009); Green Tree Fin. Corp.-Ala. v. Randolph, 531 U.S. 79 (2000) (holding that when “a party asserting a federal right seeks to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive, that party bears the burden of showing the likelihood of incurring such costs”); Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer, 515 U.S. 528 (1995); Gilmer v. Interstate/ Johnson Lane Corp., 500 U.S. 20 (1991).

¹²¹ In re Charles Schwab & Co., 2013 WL 1463100, at *1 (N.A.S.D.R. Feb. 21, 2013).

¹²² *Id.*

mandating that all disputes be resolved exclusively through arbitration on an individual basis.¹²³ The language was clearly marked under the heading of “Waiver of Class Action or Representative Action,” and was not hidden away from investors or potential investors.¹²⁴ Moreover, the customer agreements themselves included pre-dispute arbitration provisions, stating that FINRA’s Arbitration Rules would apply to any claim submitted to FINRA, and expressly stated that the FAA governed the agreements.¹²⁵

The complaint alleged that Schwab’s new language would “eliminate judicial class actions, and without exception all claims would go to arbitration.”¹²⁶ Further, since class action arbitration is expressly prohibited by FINRA Rules, the complaint alleged that the new language had the effect of banning any and all class action against Schwab.¹²⁷ Thus, the ultimate issue at hand was whether Schwab’s new language violated enforceable FINRA Rules.¹²⁸

In its defense, Schwab argued that the FAA should apply and should preempt FINRA Rules, such that an agreement to arbitrate and prohibit class actions should be fully enforced.¹²⁹ Further, Schwab argued that “class action” is a type of procedure rather than a claim and, thus, that restricting class actions did not conflict with FINRA Rule 2268(d)(3) because it did not limit the ability of a party to file a claim in court that FINRA Rules otherwise permitted to be filed in court.¹³⁰

FINRA contends that the FAA is irrelevant to the enforcement of its rules.¹³¹ Further, it argues that FINRA Rules permit the filing of a class action “claim” in court, thus arguing that

¹²³ *Id.* at *2.

¹²⁴ *Id.* at *1.

¹²⁵ *Id.* at *11.

¹²⁶ *Id.* at *2.

¹²⁷ *In re Charles Schwab & Co.*, 2013 WL 1463100, at *2 (N.A.S.D.R. Feb. 21, 2013).

¹²⁸ *Id.*

¹²⁹ *Id.* at *4–5.

¹³⁰ *Id.* at *4.

¹³¹ *Id.* at *5.

class actions are a type of claim and not merely a procedure.¹³² Separately, FINRA argues that Schwab’s language is a condition that limits or contradicts FINRA Rules and therefore violates rules that can, and should, be enforced.¹³³

More specifically, FINRA’s argument is that “FINRA Rule 12204 contemplates that a customer claim may be adjudicated in a judicial class action or in an arbitration proceeding. It is clearly premised on the availability of judicial class actions, and allows customer claims to be pursued in that manner in a judicial forum, rather than by arbitration.”¹³⁴ This conclusion stems from a plain reading of the rule (which is silent regarding an affirmative right to judicial class actions while explicitly prohibiting class action arbitrations at FINRA), and by the SEC’s explanation that it “believed that investors should have access to the courts for resolution of class actions” when it approved the rule in 1992.¹³⁵ Further, FINRA argued that if Rule 12204 were construed otherwise, it would render Rule 2268(d)(3) meaningless.¹³⁶ Thus, FINRA contends it was clear that Schwab’s new customer agreements violated both the letter and the spirit of its rules.

The Hearing Panel agreed, and decided that “the Waiver does deprive the customer of the ability to bring or participate in a judicial class action, as permitted by FINRA Rule 12204, in a violation of both subsection (d)(1) and subsection (d)(3) of FINRA Rule 2268.”¹³⁷ Separately, however, the Hearing Panel held that the FAA applied to the agreements at issue, because: (1) § 2 of the FAA expressly applies to every written agreement to arbitrate evidencing a transaction

¹³² *Id.* at *3.

¹³³ *In re Charles Schwab & Co.*, 2013 WL 1463100, at *3–4 (N.A.S.D.R. Feb. 21, 2013).

¹³⁴ *Id.* at *11 (N.A.S.D.R. Feb. 21, 2013).

¹³⁵ *Id.* at *12 (The Hearing Panel further noted that the absence of a class action waiver in pre-dispute arbitration agreements until now, “despite decades of class-action securities litigation in the courts” was indicative as to an industry understanding of FINRA’s Rules).

¹³⁶ *Id.* at *12. As discussed above, FINRA Rule 2268(d)(3) says that “no predispute arbitration agreement shall include any condition that: . . . limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement”

¹³⁷ *Id.* at *11.

involving commerce—which the arbitration agreements at issue are; (2) the agreements expressly state that the FAA governs; (3) this language has long been in Schwab’s customer agreements without objection from FINRA; and (4) FINRA’s rules themselves constitute an agreement to arbitrate that is covered by the FAA.¹³⁸

Once the Hearing Panel decided that the FAA applied, they were bound by Supreme Court precedent to hold that the FAA preempted FINRA Rules because no clear congressional exception to the FAA existed.¹³⁹ Moreover, it was irrelevant that the FINRA Rules were being preempted rather than state or federal statutes, because FINRA “promulgates its Rules pursuant to delegated authority from the SEC and subject to the SEC’s oversight and approval, as part of its mission to protect investors and promote market integrity.”¹⁴⁰

Finally, the Hearing Panel stated that FINRA Rules cannot contravene federal law, including the FAA, and “unless *Congress* has created a relevant exception,” FINRA Rules must be preempted.¹⁴¹ Echoing Justice Scalia, the Hearing Panel stated that “FINRA’s promulgation of a rule pursuant to SEC approval and oversight that preserves judicial class actions as an option is not the same as a Congressional command creating an exception to the FAA.”¹⁴²

Therefore, together and in their entirety, these cases all stand for the proposition that arbitration agreements—even those with class action waivers—are required to be upheld and enforced with full effect unless and until Congress specifically statutorily contravenes the FAA.

¹³⁸ *Id.* at *16.

¹³⁹ *In re Charles Schwab & Co.*, 2013 WL 1463100, at *17 (N.A.S.D.R. Feb. 21, 2013).

¹⁴⁰ *Id.* at *18.

¹⁴¹ *Id.* (emphasis in original).

¹⁴² *Id.* at *19.

IV. The Schwab Enforcement Decision Was Properly Decided and Should be Upheld on Future Appeals

A. Applying Supreme Court Jurisprudence to the Schwab Enforcement Decision

It is standard practice for FINRA member firms to include mandatory pre-dispute arbitration clauses in their customer agreements, and at least since *Shearson*, the Supreme Court has upheld these mandatory pre-dispute arbitration agreements as constitutional.¹⁴³ *Shearson* stands for the principle that mandatory pre-dispute arbitration agreements are valid and enforceable in a securities context, even when they amount to a jurisdictional waiver, unless Congress carves out an exception.¹⁴⁴ Thus, because no express contrary congressional exception to the FAA exists requiring the availability of judicial class actions, so long as an investor has the ability to seek justice through arbitration—a forum the Court deems on par with the judicial system—agreements between Schwab and its customers must stand.

But the inclusion of an express class action waiver is what made Schwab's mandatory pre-dispute arbitration agreement distinguishable from its peers' agreements, and was not discussed in *Shearson*. *Concepcion* addressed the constitutionality of class action waivers, although in a different context (consumer cell phone contracts) than the Schwab Enforcement Decision. Despite the difference in industries, factual similarities between the administration of the arbitration agreement and class action waivers make a strong case that the Schwab Enforcement Decision should be upheld pursuant to *Concepcion*.

For example, whereas AT&T offered to pay all arbitration costs for non-frivolous claims,¹⁴⁵ Schwab offers to pay arbitration expenses for claims under \$25,000.¹⁴⁶ Further, both

¹⁴³ See Antilla, *supra* note 8.

¹⁴⁴ *Shearson/Am. Exp., Inc. v. McMahon*, 482 U.S. 220, 228 (1987).

¹⁴⁵ *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1744 (2011).

¹⁴⁶ See Antilla, *supra* note 8.

AT&T and FINRA offer the claimant low-cost options for dispute resolution, such as having the matter decided based on the submissions without the extra expense of paying for a hearing.¹⁴⁷

Moreover, in deciding *Concepcion*, Justice Scalia wrote for the majority that § 2 of the FAA applied to the AT&T mandatory pre-dispute arbitration clause and class action waiver, and held that nothing in the FAA suggested an intention to preserve state-law rules standing in opposition to the accomplishment of the FAA's objectives.¹⁴⁸ As this case pertains to the Schwab Enforcement Decision, it can be said that nothing in the FAA suggests congressional intent to preserve FINRA rules that stand as an obstacle to accomplishing the FAA, and there are no contract defenses applicable (nor were any asserted) to invalidate the Schwab class action waiver.

Following *Concepcion*, if rigid enforcement of mandatory pre-dispute arbitration agreements means that “corporations cannot only require consumers of their products and services to arbitrate their disputes in a forum of the corporation's choice, they can also block consumers from aggregating their claims in court or in arbitration,”¹⁴⁹ then broker-dealers (who provide access to the investment products just as corporations provide products to their consumers) should be permitted to block investors from aggregating *their* claims in court or in arbitration.

The *Concepcion* decision demonstrates the Court's willingness to allow class action waivers in arbitration agreements, writing “[t]he point of affording parties discretion in designing arbitration processes is to allow for efficient, streamlined procedures tailored to the type of

¹⁴⁷ *Concepcion*, 131 S. Ct. at 1744; FINRA Rule 12800.

¹⁴⁸ *Concepcion*, 131 S. Ct. at 1748. Recall that FINRA Rules are neither state laws nor federal laws, but are instead quasi-governmental rules acting with the force of law. So logic dictates that they would not be able to contravene § 2 of the FAA as the Court describes here.

¹⁴⁹ See Black & Gross, *supra* note 8, at 3.

dispute.”¹⁵⁰ Thus, while consumer cell phone contracts are distinguishable from investor agreements with broker-dealers, the parties should be free to choose FINRA arbitration as the sole manner for dispute resolution in efforts to achieve “efficient, streamlined procedures tailored to the type of dispute.”¹⁵¹

CompuCredit further solidified just how explicit a congressional command to supersede the FAA must be, holding that even definite language such as the “right to sue” in a federal statute merely guarantees consumers the right to hold wrongdoers liable for violating the law, rather than a right to bring a claim in court.¹⁵² So long as the consumers are able to have liability imposed in a fair forum—of which arbitration has been deemed to be—their right to sue is undiminished.¹⁵³ Applying *CompuCredit* to the FINRA context, even if the SEC intended to preserve investors’ rights to file judicial class actions when approving FINRA Rule 12204, a valid arbitration agreement controls, and access to the courts should be denied. The SEC is not Congress, and despite Congress’s proper delegation of power, no congressional carve-out from the FAA can be inferred. Thus, mandatory pre-dispute arbitration agreements with class action waivers in a FINRA context must be enforced, so long as FINRA provides a fair and accessible forum for dispute resolution—which it does.

American Express Co. v. Italian Colors Restaurant stands for the proposition that even if FINRA arbitrations were so expensive (in comparison to judicial class actions) that filing an arbitration claim would be fruitless, a mandatory pre-dispute arbitration agreement would not be *per se* unconscionable and unenforceable.¹⁵⁴ Moreover, the majority held that F.R.C.P. Rule 23

¹⁵⁰ *Concepcion*, 131 S. Ct. at 1749.

¹⁵¹ *Id.*

¹⁵² *CompuCredit Corp. v. Greenwood*, 132 S. Ct. 665, 670 (2012).

¹⁵³ *Id.* at 671.

¹⁵⁴ *Am. Exp. Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304, 2309 (2013).

is a procedural rule governing class actions, not a guarantee to citizens that they may always have access to a class action.¹⁵⁵

Justice Kagan’s dissent argued that the Effective Vindication Doctrine previously espoused by the Court would invalidate arbitration agreements that insulate parties of superior bargaining power from liability by limiting suits to arbitration, where arbitrations are prohibitively expensive.¹⁵⁶ Regardless, this would not be the case in FINRA arbitrations because FINRA arbitrations implement safeguards to ensure all claimants can seek justice.¹⁵⁷ In the instant matter, Schwab also institutes safeguards to keep costs down for investors filing suit.¹⁵⁸ Moreover, even if the availability of class actions would allow some investors to seek recovery who otherwise might not have, class actions would more often than not leave investors in a worse position than FINRA arbitration would.¹⁵⁹

Thus, the binding case law is on Schwab’s side. The Supreme Court agrees that mandatory pre-dispute arbitration agreements with class action waivers are enforceable short of a valid contract defense or a clearly expressed congressional command to provide an exception to the FAA’s applicability. But some critics argue that Supreme Court precedent is wrong, or should not apply.

B. The Schwab Enforcement Decision Should be Upheld on Appeal

1. FINRA Rules Do Not Illustrate a Congressional Intent to Supersede the FAA

One argument against the Schwab Enforcement Decision is that the FINRA Rules, which are approved by the SEC through proper congressional delegation, should be considered a clear

¹⁵⁵ *Id.* at 2309–10.

¹⁵⁶ *Id.* at 2313 (Kagan, J. dissenting).

¹⁵⁷ *See infra*, Part V.

¹⁵⁸ *See Antilla, supra* note 8.

¹⁵⁹ *See infra*, Part V.

congressional carve-out from the FAA. This argument fails for two reasons. First, FINRA’s rules do not explicitly grant a right to file judicial class actions, and should not be read to implicitly do so. Congress delegated its power to regulate the securities industry to the SEC (who, in turn, delegated the power to promulgate and enforce rules to FINRA—a SRO).¹⁶⁰ With that authority, the NASD (FINRA’s predecessor) promulgated a Rule (that the SEC approved), which it explained would prohibit “the use in any agreement of any language that limits or contradicts the arbitration rules of any self-regulatory organization, [or] limits the ability of a party to file a claim in arbitration.”¹⁶¹ No FINRA Rule expressly granting the availability of judicial class actions exists. While allowing investors to file judicial class actions may have been accepted as common industry practice for many years, there is no discernable congressional intent to affirmatively give investors that right. As such, requiring the availability of class actions to the detriment of enforcing arbitration agreements is impermissible because FINRA Rules themselves are an agreement to arbitrate subject to the FAA, and allowing otherwise would frustrate the FAA’s objectives.¹⁶²

Second, had Congress wanted to guarantee such a right, it fully had (and has) the power to do so, but it has chosen not to do so. Because the customer agreements at issue (and most likely the vast majority of customer agreements used industry wide) expressly stated that the FAA applied, and because Supreme Court jurisprudence indicates that no congressional intent can be found to override the FAA in this context, FINRA and the SEC had ample time to modify a rule, or seek to have Congress enact an exemption from the FAA permitting judicial class

¹⁶⁰ *See supra*, Part II.

¹⁶¹ *In re Charles Schwab & Co.*, 2013 WL 1463100, at *7, n.20 (N.A.S.D.R. Feb. 21, 2013)(citing NASD NTM 89-58).

¹⁶² *Id.* at *16.

actions. Moreover, even if the agreements did not specify that the FAA applied, the FAA would still govern.¹⁶³

2. FINRA Rules Should Not Impliedly Repeal the FAA

Another argument that Schwab’s use of class action waivers is improper centers around the Doctrine of Implied Repeal.¹⁶⁴ In its most basic terms, the Doctrine of Implied Repeal stands for the proposition that a new law in contravention of an old law supersedes it “when necessary to make a later enactment work, and even then only applies to the extent necessary to reconcile the conflicting laws.”¹⁶⁵ Here, the argument would be that the FAA is impliedly repealed in order to make later enactments—namely the Exchange Act, FINRA Rules, and Dodd-Frank¹⁶⁶—work. Traditionally, if the more recent law is “plainly repugnant” to the earlier, or completely at odds with it, such that the two cannot be enforced simultaneously, then the earlier law is impliedly repealed.¹⁶⁷ But for the sake of legislative efficiency, implied repeal is a narrowly used doctrine that “allows for only the most modest displacement of the earlier law.”¹⁶⁸

An argument for implied repeal follows Supreme Court decisions holding that federal antitrust laws were impliedly repealed by securities regulations,¹⁶⁹ and reasons that because Congress recently gave the SEC explicit authority to ban pre-dispute arbitration agreements “if it

¹⁶³ *Id.* at *16, n.74

¹⁶⁴ See Black & Gross, *supra* note 8, at 32.

¹⁶⁵ *Id.*

¹⁶⁶ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010) (codified in scattered sections of U.S.C.).

¹⁶⁷ *Id.*

¹⁶⁸ *Id.* at 33 (citing Jesse W. Markham, Jr., *The Supreme Court’s New Implied Repeal Doctrine: Expanding Judicial Power To Rewrite Legislation Under the Ballooning Conception of “Plain Repugnancy,”* 45 GONZ. L. REV. 437, 439 (2009)).

¹⁶⁹ See *Credit Suisse Sec. (USA) LLC v. Billing*, 551 U.S. 264, 285 (2007) (holding that the antitrust law at issue was impliedly repealed because it created “a substantial risk of injury to the securities markets,” met the four-part test in *Gordon*, and was “clearly incompatible” with the securities laws at issue); *Gordon v. N.Y. Stock Exch., Inc.*, 422 U.S. 659, 691 (1975) (holding that “The Securities Exchange Act was intended by the Congress to leave the supervision of the fixing of reasonable rates of commission to the SEC.”).

finds that such prohibition, imposition of conditions, or limitations are in the public interest and for the protection of investors,”¹⁷⁰ that the FAA should be impliedly repealed.¹⁷¹

In *Credit Suisse Sec. (USA) LLC*, the Court used a four-part test to determine that securities laws impliedly repealed antitrust laws:

(1) the existence of regulatory authority under the securities law to supervise the activities in question; (2) evidence that the responsible regulatory entities exercise that authority; (3) a resulting risk that the securities and antitrust laws, if both applicable, would produce conflicting guidance, requirements, duties, privileges, or standards of conduct; [and] (4) the possible conflict affect[s] practices that lie squarely within an area of financial market activity that the securities law seeks to regulate.¹⁷²

Applying these factors to the instant matter, it is possible that a court could find FINRA Rules impliedly repeal the FAA.¹⁷³ But even though it is possible, courts should not hold as such. Section 15(o) of the Exchange Act, recently enacted through Dodd-Frank, is titled “Authority to restrict mandatory pre-dispute arbitration,”¹⁷⁴ meaning that Congress grants the SEC the authority—at some time in the future, if they so choose—to restrict mandatory pre-dispute arbitration. To be clear, the law granting the SEC authority to abolish pre-dispute arbitration agreements is a may, not a must. The text of the statute states:

The Commission, by rule, *may* prohibit, or impose conditions or limitations on the use of, agreements that require customers or clients of any broker, dealer, or municipal securities dealer to arbitrate any future dispute . . . if it finds that such prohibition, imposition of conditions, or limitations are in the public interest and for the protection of investors.¹⁷⁵

This text alone cannot be said to evidence a congressional intent to create an exception to the FAA. Instead, it relies on the SEC to limit or prohibit the use of mandatory pre-dispute arbitration clauses, if it eventually deems such an action necessary. Section 15(o) is not plainly

¹⁷⁰ Exchange Act, § 15(o), 15 U.S.C. § 78o(o).

¹⁷¹ See Black & Gross, *supra* note 8, at 37.

¹⁷² *Credit Suisse Sec. (USA) LLC*, 551 U.S. at 275–76 (2007).

¹⁷³ See Black and Gross, *supra* note 8, at 40.

¹⁷⁴ Exchange Act, § 15(o), 15 U.S.C. § 78o(o).

¹⁷⁵ *Id.* (emphasis added).

repugnant to the FAA because it does not render arbitration agreements void or unenforceable. In fact, it does not even suggest that Congress believes such agreements should be unenforceable. It merely grants the SEC power to limit such agreements in the future if they so choose. Moreover, the SEC endorsed the securities arbitration process,¹⁷⁶ and stated that they preferred class actions be kept out of the process.¹⁷⁷ Further, nothing in the Exchange Act, Dodd-Frank, or FINRA's Rules explicitly guarantees the availability of class actions for dispute resolution.

Separately, it is unclear at best what ability, if any, FINRA Rules have to preempt other federal laws.¹⁷⁸ In *Gordon and Credit Suisse Sec. (USA) LLC*, the two precedential cases for implied repeal, the Court's focus was only on "the SEC's authority and the SEC's oversight of the conduct in question," instead of the fact that it was a SRO rule displacing the antitrust laws.¹⁷⁹ FINRA is not a government agency;¹⁸⁰ rather, it has been called a quasi-governmental agency.¹⁸¹ Lower courts have held that FINRA Rules operate with the force of law such that they can preempt state laws.¹⁸² Even so, the Hearing Panel in the Schwab Enforcement Decision decided "FINRA's general authority to promulgate Rules is not a congressional command to

¹⁷⁶ *Shearson/Am. Exp., Inc. v. McMahon*, 482 U.S. 220, 234 (1987).

¹⁷⁷ Order Approving Proposed Rule Change Relating to the Exclusion of Class Actions From Arbitration Proceedings, 57 FR 52659-02, 52661 (Nov. 4, 1992).

¹⁷⁸ See *Fiero v. Fin. Indus. Regulatory Auth., Inc.*, 660 F.3d 569 (2d Cir. 2011) (holding that Congress did not intend to empower FINRA to bring judicial actions to enforce its disciplinary fines); *U.S. v. Solomon*, 509 F.2d 863 (2d Cir. 1975) (discussing how often "government relies on self-policing by private organizations to effectuate the purposes underlying federal regulating statutes," but without explaining if FINRA has the authority to preempt federal regulating statutes.). See also Steven Irwin et al., *Self-Regulation of the American Retail Securities Markets—An Oxymoron for What Is Best for Investors?*, 14 U. PA. J. BUS. L. 1055, 1071–72 (2012) (discussing differences between FINRA and governmental agencies); Joseph McLaughlin, *Is FINRA Constitutional?*, 12 Engage: J. Federalist Soc'y Prac. Groups 111 (2011), available at http://www.fed-soc.org/doclib/20110912_McLaughlinEngage12.2.pdf; Karmel, *supra* note 16, at 152 ("In some areas, the courts have just stated that an SRO is exercising delegated governmental power. In other areas, the courts have stated that an SRO is a private membership organization.").

¹⁷⁹ Karmel, *supra* note 16, at 196.

¹⁸⁰ See ABOUT FINRA, *supra* note 5.

¹⁸¹ See *Fiero v. Fin. Indus. Regulatory Auth., Inc.*, 606 F. Supp. 2d 500, 517 (S.D.N.Y. 2009) rev'd, 660 F.3d 569 (2d Cir. 2011).

¹⁸² See e.g. *McDaniel v. Wells Fargo Invs., LLC*, 717 F.3d 668, 673 (9th Cir. 2013); *Whistler Invs., Inc. v. Depository Trust & Clearing Corp.*, 539 F.3d 1159, 1166 (9th Cir. 2008).

promulgate the particular Rule carving out an exception to the FAA.”¹⁸³ No definitive authority to the contrary exists.

FINRA is different from administrative agencies because it is a private company whose actions and rules (or laws) are not accountable to Congress or the President.¹⁸⁴ Courts have found that pursuant to Article I of the U.S. Constitution, administrative law promulgated by congressionally created agencies is enforceable.¹⁸⁵ But SROs like FINRA are not congressionally created, and thus are further removed from that implied lawmaking power.¹⁸⁶ Instead, FINRA is accountable only to the SEC, which has oversight authority over it, and to its own members.”¹⁸⁷ FINRA’s decisions and awards are final, and are rarely subject to SEC or judicial review or appeal.¹⁸⁸ Moreover, often a SRO such as FINRA cannot even be deemed a state or governmental actor.¹⁸⁹

In fact, in the Schwab Enforcement Decision, the Hearing Panel relied upon Supreme Court precedent in deciding that the FAA could preempt FINRA Rules as well as state and federal laws.¹⁹⁰ The Hearing Panel wrote: “[w]hile the Rules have the force and effect of federal regulation and may preempt state law, FINRA’s Rules can only be enforced to the extent that they are not inconsistent with federal law.”¹⁹¹ Since the FAA is a federal law, “FINRA’s Rules may not be enforced to the extent they are inconsistent with the FAA, unless Congress has

¹⁸³ In re Charles Schwab & Co., 2013 WL 1463100, at *19 (N.A.S.D.R. Feb. 21, 2013).

¹⁸⁴ See Irwin et al., *supra* note 178, at 1071.

¹⁸⁵ *Id.*

¹⁸⁶ *Id.*

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ *Id.* at 1069–70. See also Karmel, *supra* note 16 at 152.

¹⁹⁰ See Jamieson, *supra* note 1 (“The hearing panel decision turns on its application of Supreme Court precedent,’ specifically AT&T Mobility LLC v. Concepcion, Mr. Carroll [associate general counsel at the Securities Industry and Financial Markets Association] said. Finra must ‘overcome the underpinnings of the hearing panel decision, which was thoroughly reasoned.’”).

¹⁹¹ In re Charles Schwab & Co., 2013 WL 1463100, at *18 (N.A.S.D.R. Feb. 21, 2013) (footnote omitted).

created a relevant exception.”¹⁹² Therefore, it is a stretch at best to equate FINRA Rules with direct congressional intent, or even with the powers of governmental agency regulations that operate with the force of law. As such, the FAA—a federally enacted statute—should control.

C. Congress Has Not Created an Exception to the FAA That Would Overcome a Valid Class Action Waiver Agreement

Supreme Court jurisprudence has yet to find a clear congressional carve-out of the FAA that would preserve judicial class actions in the face of otherwise valid pre-dispute arbitration agreements. In fact, members of Congress have repeatedly proposed passing an Arbitration Fairness Act to provide that missing carve-out, but have thus far been unsuccessful.¹⁹³ As recently as May of 2013 (only a few months after the Schwab Enforcement Decision) bills were introduced in the House and Senate that would amend the FAA “by adding a new chapter invalidating pre-dispute arbitration agreements (“PDAAs”) for consumer, investor, employment, or civil rights claims.”¹⁹⁴ These bills were notably similar to prior failed efforts to amend the FAA since 2005.¹⁹⁵ The proposed legislations were an attempt to create the missing congressional intent to override the FAA that the Supreme Court deemed necessary.¹⁹⁶ Further, they indicate that Congress and the SEC seem to be largely satisfied with the Supreme Court jurisprudence regarding class action waivers because they have yet to pass any legislation “scaling back the reach of the FAA.”¹⁹⁷

¹⁹² *Id.*

¹⁹³ George Friedman, *The Arbitration Fairness Act of 2013: A Well-intended but Potentially Dangerous Overreaction to a Legitimate Concern*, ARBITRATION RESOLUTION SERVS. BLOG (Jul. 9, 2013), <http://blog.arbresolutions.com/2013/07/09/afa201/#.UjStDRbXTCE>.

¹⁹⁴ *Id.*

¹⁹⁵ *Id.* (emphasis added).

¹⁹⁶ *Id.* Professor Friedman further noted that Rep. Hank Johnson (D. GA.) issued a press release accompanying the May 7, 2013 AFA proposal stating that the one of the purposes for the proposed amendments to the FAA was “restor[ing] the rights of workers and consumers to seek justice in our courts.” *Id.* Thus, if Congress had previously intended to override the FAA, this amendment would not serve its stated purpose.

¹⁹⁷ *Id.*

Congress's enactment of Dodd-Frank¹⁹⁸ is the closest it has come to limiting the FAA as it pertains to securities claims. Through Dodd-Frank, Congress created the Bureau of Consumer Financial Protection ("CFPB"), vesting it "with broad authority to administer, enforce and implement the provisions of federal consumer financial law."¹⁹⁹ The CFPB is currently conducting a study on the use and effect of pre-dispute arbitration agreements, and may adopt rules to "prohibit or impose conditions or limitations" on the use of PDAAs if it finds that such a rule is "in the public interest and for the protection of consumers."²⁰⁰ Congress also amended the Exchange Act to give the SEC explicit authority to prohibit or to impose conditions or limitations on the use of pre-dispute arbitration agreements for public interest reasons and for the protection of investors.²⁰¹ While these theoretical powers exist, no action has been taken by the CFPB or the SEC to restrict the use of pre-dispute arbitration agreements.

V. FINRA Arbitrations Should Be the Sole Forum for Resolving Disputes Between Investors and Broker-Dealers

FINRA arbitration is uniquely situated to best resolve disputes between investors and broker-dealers because its claims process is streamlined, affordable, and on average provides more favorable results to claimants than judicial class actions otherwise would.²⁰²

A. The Basics of Filing a FINRA Customer Claim

¹⁹⁸ See *supra* note 166.

¹⁹⁹ See Black & Gross, *supra* note 8, at 10 (footnote omitted). The CFPB is an actual government agency, as opposed to FINRA which is a quasi-government agency. As such, the CFPB has authority to promulgate rules that infer congressional intent.

²⁰⁰ *Id.* (citing 12 U.S.C. §5518). Preliminary results of the study were released on December 12, 2013, however the portions released do not directly address the effect of mandatory pre-dispute arbitration agreements with class action waivers on investors.

²⁰¹ Exchange Act 15(o), 15 U.S.C. § 78o(o) (2013).

²⁰² See *infra* Part V.B. See also Mark Schoeff Jr., *State Regulators, Independent Brokers Tussle Over Mandatory Arb: Abrogation of Rights or a Fair System? Opinions Fly at IN Roundtable*, INVESTMENTNEWS (Jun. 11, 2013 at 4:04 PM), <http://www.investmentnews.com/article/20130611/FREE/130619973?template=printart> ("Ira Hammerman, senior managing director and general counsel at the Securities Industry and Financial Markets Association, countered that the arbitration process, which is administered by the Financial Industry Regulatory Authority Inc., is the fairest and most efficient way to help small investors.").

Much like filing an action in court, FINRA claimants must pay an initial fee when filing a claim.²⁰³ Depending upon the amount of damages alleged in the claim, the initial fee ranges from fifty dollars (for claims up to \$1,000) to \$1,800 (for claims over \$1 million), with multiple price points along the continuum.²⁰⁴ Thus, the initial outlay of money for those claiming small amounts of damages is minor.²⁰⁵ Further, should the matter reach an arbitration hearing, fees will be charged to both parties, based on the amount in dispute.²⁰⁶ FINRA claimants have an opportunity to forgo a hearing and have the matter decided by an arbitrator solely on the papers, should they need to keep costs especially low.²⁰⁷ FINRA offers a fee calculator on their website so that a potential claimant can estimate what the process might cost, exclusive of any outside legal fees they choose to incur.²⁰⁸

B. FINRA Arbitrations Provide Appropriate Access to Justice for Claimants, and a More Favorable Timeline for Dispute Resolution, Than Judicial Actions

Critics of mandatory pre-dispute arbitration clauses (especially those with class action waivers) argue that foreclosing a potential litigant's ability to participate in or to file a judicial class action will restrict—if not entirely abolish—many investors' access to justice.²⁰⁹ But these agreements often inure to an investor's benefit, and requiring the availability of judicial class actions may end up hurting potential claimants by effectively abolishing arbitration as a tool for

²⁰³ See FINRA Rule 12900.

²⁰⁴ *Id.*

²⁰⁵ See Friedman, *supra* note 193 (“[FINRA] regulates fees to ensure that the securities industry bears the majority of administrative fees and waives hearing fees for investors.”)

²⁰⁶ See FINRA Rule 12902.

²⁰⁷ See FINRA Rule 12800.

²⁰⁸ See ARBITRATION FEE CALCULATOR, <http://apps.finra.org/ArbitrationMediation/ArbFeeCalc/1/Default.aspx> (last visited February 8, 2014).

²⁰⁹ See *e.g.*, Consumer Fin. Prot. Bureau, *Arbitration Study Preliminary Results: Section 1028(a) Study Results to Date*, (Dec. 12, 2013) available at <http://www.consumerfinance.gov/reports/section-1028a-arbitration-study-results-to-date/>; Black & Gross, *supra* note 8; Mark Schoeff Jr., *House Democrat Introduces Bill to End Mandatory Arbitration*, INVESTMENTNEWS (Aug. 5, 2013, Updated 2:59 PM), <http://www.investmentnews.com/article/20130805/FREE/130809965?template=printart>.

dispute resolution, thereby limiting their access to justice.²¹⁰ For example, allowing litigants to obfuscate their arbitration agreements through judicial class actions may lead broker-dealers to choose the procedural protections of the courts,²¹¹ over the often more pro-claimant FINRA setting.²¹² It would follow, then, that arbitrations would likely be few and far between, and so FINRA would likely scale back its own resources or raise fees on potential claimants.²¹³ If these disputes were bound to be tied-up in prolonged litigation, broker-dealers might be less interested in defraying a potential litigant's costs (as Schwab currently does in arbitration).²¹⁴

Separately, fears that FINRA arbitration would be so costly as to effectively deny access to justice are unfounded.²¹⁵ The costs to file a FINRA arbitration claim, and to have a claimant's case decided, are low for claims under \$100,000. If an investor deems it necessary to incur the additional expense of hiring an attorney to prove their individual case, they would be availing themselves of an option not otherwise afforded to most class action participants. Moreover, Schwab—the first company to institute class action waivers in its customer agreements—fosters access to justice by “offer[ing] to pay the arbitration fees for claims under \$25,000.”²¹⁶

If an investor were still unable to go forward and prove their claim without representation, law school clinics (such as those created by the FINRA Investor Education

²¹⁰ See Letter from the U.S. Chamber of Commerce for Capital Mkts. Competitiveness and the U.S. Chamber Inst. for Legal Reform to the Consumer Fin. Prot. Bureau (Dec. 11, 2013), *available at* http://www.instituteforlegalreform.com/uploads/sites/1/2013_12.11_CFPB_-_arbitration_cover_letter.pdf) at 4, 43.

²¹¹ *Id.* at 42.

²¹² See discussion of FINRA as a forum of equity, *infra* note 235.

²¹³ See Letter from the U.S. Chamber of Commerce for Capital Mkts. Competitiveness and the U.S. Chamber Inst. for Legal Reform to the Consumer Fin. Prot. Bureau, *supra* note 210 at 41.

²¹⁴ See Antilla, *supra* note 8.

²¹⁵ See Jamieson, *supra* note 1 (“Schwab can make a strong case on the key issue of giving small claims access to justice in an arbitration setting,” Mr. Carroll said. Finra’s ‘procedural rules are unique and more robust than many forums’, including lower costs and streamlined rules for filing small claims.”).

²¹⁶ See Antilla, *supra* note 8.

Foundation)²¹⁷ provide an option for counsel that is endorsed by the SEC and FINRA.²¹⁸ There are currently twenty ABA-accredited law schools with securities arbitration clinics, eight of which received a \$250,000 grant from the FINRA Investor Education Foundation.²¹⁹ Those clinics provide *pro bono* counsel to investors of various backgrounds who have a dispute with an investment professional, but are unable to otherwise retain counsel (due to an inability to pay or otherwise), or who would otherwise lose any recovery to attorneys' fees.²²⁰

Student advocates are supervised by licensed attorneys and receive school credit for their work, which includes overseeing claimants' cases from the initial complaint stage through the discovery process, motion practice, mediations and hearings.²²¹ FINRA's website directs potential claimants to those clinics in order to aid otherwise *pro se* litigants in their quest for justice.²²² Therefore, mandatory pre-dispute arbitrations clauses with class actions waivers do not limit an investor's access to justice because the perceived undue costs associated with FINRA arbitrations are not insurmountable hurdles to justice.

But more than that, arbitration has an advantage over judicial actions because FINRA claims are more timely heard. On average, FINRA claims take about fourteen months to

²¹⁷ Bob Braun, *Braun: Veterans hurt by investment advisers helped by Seton Hall law students*, NEWARK STAR-LEDGER (Oct. 15, 2012 at 9:25 AM), http://blog.nj.com/njv_bob_braun/2012/10/veterans_hurt_by_investment_ad.html.

²¹⁸ See *Arbitration/Mediation Clinics in California, District of Columbia, Florida, Georgia, Illinois, Michigan, New Jersey, New York, and Pennsylvania*, <http://www.sec.gov/answers/arbclin.htm#>.

²¹⁹ Interview with David M. White, Professor of Legal Practice, Seton Hall University School of Law, in Newark, N.J. (Feb. 6, 2014). The eight law school securities arbitration clinics that received a grant from the FINRA Investor Education Foundation are: Pepperdine, Suffolk, Howard, Seton Hall, Florida International, Miami, Michigan State, and Georgia State. The remaining twelve law schools with securities arbitration clinics are: Fordham, Pace, St. Johns, Benjamin N. Cardozo, Brooklyn, Hofstra, Syracuse, Cornell, Duquesne, Northwestern, Pittsburgh and San Francisco.

²²⁰ *Id.* See also *Finding An Attorney or Other Legal Representation*, <http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/OptionsforInvestors/FindanAttorney/index.htm>; Braun, *supra* note 217.

²²¹ Interview with David M. White, *supra* note 219.

²²² *Finding An Attorney or Other Legal Representation*, *supra* note 220.

complete from the time of filing.²²³ Claims that lead to hearings tend to take about a year and a half, while those filed without a request for hearing are typically completed in less than one year.²²⁴ Contrast that with conventional litigation, which typically “take[s] a long time, cost lots of money, and [is] subject to a long appeals process.”²²⁵ For example, a typical federal civil case has a median time of 26.1 months from filing to the beginning of trial.²²⁶ Class actions, in particular, “take a lot of time and cost a lot of money.”²²⁷ Saying nothing of how long it may take to complete a trial or how many more cases would jam up the court system if arbitration did not exist, the average securities class action takes more than four years to settle.²²⁸

Also, investors can benefit from the composition of the FINRA arbitration panel. For claims under \$50,000, FINRA appoints one arbitrator.²²⁹ For claims of more than \$50,000, both parties get input on who will arbitrate their case, by choosing from a list of potential arbitrators after having the opportunity to review each person’s Curriculum Vitae.²³⁰ This can be a decided advantage over litigation for both parties because the disputants acquire an educated understanding of who will decide the case. Each party has the ability to strike a certain number of neutrals with clear biases, or whose decision history appears to favor one side over the other.

²²³ See *Dispute Resolution Statistics*, FINRA, <https://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/Statistics/> (last visited Feb. 10, 2014.).

²²⁴ *Id.*

²²⁵ See Friedman, *supra* note 193. See also Letter from the U.S. Chamber of Commerce for Capital Mkts. Competitiveness and the U.S. Chamber Inst. for Legal Reform to the Consumer Fin. Prot. Bureau, *supra* note 210.

²²⁶ Admin. Office of the U.S. Courts, *Federal Court Management Statistics September 2013: United States District Courts – National Judicial Caseload Profile*, available at <http://www.uscourts.gov/viewer.aspx?doc=/uscourts/Statistics/FederalCourtManagementStatistics/2013/district-fcms-profiles-september-2013.pdf&page=1>.

²²⁷ Kassem M. Dakhllallah, *Class Action Lawyers May Not Deserve Their Money – But They Sure Do Earn It*, ATTORNEY AT LAW MAGAZINE, <http://attorneyatlawmagazine.com/detroit/2013/07/29/class-action-lawyers-may-not-deserve-their-money-but-they-sure-do-earn-it/>.

²²⁸ Paul Weitzel, *The End of Shareholder Litigation? Allowing Shareholders to Customize Enforcement Through Arbitration Provisions in Charters and Bylaws*, 2013 B.Y.U. L. REV. 65, 87 (2013).

²²⁹ See *Arbitrator Selection*, FINRA, <http://www.finra.org/ArbitrationAndMediation/Arbitration/Process/ArbitratorSelection/index.htm> (last visited Oct. 19, 2013).

²³⁰ *Id.*

Separately, FINRA arbitrators awarded some damages to customers in approximately 40% of arbitration cases decided between 2008 and September 2013.²³¹ In 2012 alone, 78% of all FINRA customer claimants recovered some form of relief through arbitral award or settlement.²³² In 2012, the median securities class action settlement amount as a percentage of estimated damages was approximately 1.8 percent.²³³ In contrast, securities arbitration claimants fare better. In 2000, the median securities arbitration claimant could expect a recovery of approximately forty-seven percent of damages, although that number declined to thirty-four percent in 2005.²³⁴ Even if those numbers have declined over the past eight years, chances are they will exceed the expected returns of class actions by a wide margin. Some have observed that this varied, but greater, recovery rate might be because FINRA arbitrations are not bound by the law, and are more concerned with equity than the U.S. state and federal courts.²³⁵

As for those litigants whom critics of arbitration fear would be denied access to justice without class action availability, it should be noted that “[class actions] are not the weaker

²³¹ See *Dispute Resolution Statistics*, FINRA, <https://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/Statistics/> (last visited October 19, 2013).

²³² *Id.*

²³³ Ellen M. Ryan & Laura E. Simmons, *Securities Class Action Settlements: 2012 Review and Analysis*, CORNERSTONE RESEARCH, available at http://www.cornerstone.com/files/upload/Cornerstone_Research_2012_Settlements.pdf

²³⁴ Letter from Jill Gross, Dir., Pace Univ. School of Law Inv. Rights Counsel, and Stephanie Myers, Student Intern, Pace Univ. School of Law Inv. Rights Counsel, to Sec’y., Sec. and Exch. Comm’n. (Oct. 23, 2008) at 4 n.5, available at <http://www.sec.gov/comments/sr-finra-2008-047/finra2008047-4.pdf> (citing 2006 SEC. ARB. COMMENTATOR 1, No. 7 & 8 (Feb. 2007), 2006 SEC. ARB. COMMENTATOR 1, No. 2 (Apr. 2006)).

²³⁵ Alicia J. Surdyk, *On the Continued Vitality of Securities Arbitration: Why Reform Efforts Must Not Preclude Pre-dispute Arbitration Clauses*, 54 N.Y.L. SCH. L. REV. 1131, 1140 (2010). See also Barbara Black & Jill Gross, *The Explained Award of Damocles: Protection or Peril in Securities Arbitration*, 34 SEC. REG. L.J. 2 (2006) (“Arbitration is considered a forum of equity, as arbitrators may consider ‘common sense notions of fairness’ and other equitable factors when resolving disputes before them. This focus on equity has been a benefit of securities arbitration for investors, because the law is not investor-friendly in many jurisdictions.”); Sec. and Exch. Comm’n. Inv. Advocacy Comm., Minutes of May 17, 2010 Meeting, pg. 3, available at <https://www.sec.gov/news/otherwebcasts/2010/iac051710-minutes.pdf> (“[F]rom the investor’s perspective, the advantage of securities arbitration is that it provides an equitable forum where arbitrators may be able to find a remedy for investors that is not fully supported by law.”).

party's best friend, with the typical payout being cents on the dollar or a discount coupon."²³⁶ In fact, FINRA arbitration uniquely provides a forum where investors claiming "small" damage amounts (under \$50,000) can go to get their case resolved. According to Ira Hammerstein, Senior Managing Director and General Counsel at the Securities Industry and Financial Markets association, "[a] [FINRA] customer can literally fill out in handwriting a piece of paper . . . and even [a customer with a small account] can have their so-called day in court, where if it were a real court, there's no way that anyone could pursue that case."²³⁷

Moreover, FINRA severely limits pre-hearing motions to dismiss,²³⁸ whereas "most civil litigants never even get to trial."²³⁹ According to 2002 data, "98.2% of federal civil actions are resolved without recourse to jury trial."²⁴⁰ The blunt truth is that most traditional litigants have no meaningful alternative other than to settle their claims.²⁴¹ "Assuming a litigant has a good set of facts, competent counsel and adequate financial resources, then she can work the process to secure an objectively superior outcome and avoid the downside exposure of protracted litigation. This is what 'win/win' means today" in litigation.²⁴² Thus, even if filing a claim with FINRA merely leads to settlement discussions or mediation, the claimant stands to gain more than they would by participating in a judicial class action.

²³⁶ See Friedman, *supra* note 193. See also Adam Liptak, *When Lawyers Cut Their Clients Out of the Deal*, N.Y. TIMES (Aug. 12, 2013), http://www.nytimes.com/2013/08/13/us/supreme-court-may-hear-novel-class-action-case.html?_r=0; Lawrence W. Schonbrun, *The Class Action Racket*, AMERICAN THINKER (Apr. 1, 2013), http://www.americanthinker.com/2013/04/the_class_action_racket.html.

²³⁷ Mark Schoeff, Jr., *supra* note 202. See also Letter from the U.S. Chamber of Commerce for Capital Mkts. Competitiveness and the U.S. Chamber Inst. for Legal Reform to the Consumer Fin. Prot. Bureau *supra* note 210 (discussing impediments in bringing judicial actions for small claims investors).

²³⁸ Sec. and Exch. Comm'n. Inv. Advisory Comm. Panel on Securities Arbitration – May 17, 2010 Fin. Indus. Regulatory Auth. Statement on Key Issues, *available at* <http://www.sec.gov/spotlight/invadvcomm/iacmeeting051710-finra.pdf>

²³⁹ Patricia Lee Refo, *The Vanishing Trial*, 30 THE JOURNAL OF THE SECTION OF LITIGATION, at 2 (Winter 2004) ("Our federal courts actually tried fewer cases in 2002 than they did in 1962, despite a fivefold increase in the number of civil filings.").

²⁴⁰ Interview with David M. White, *supra* note 219.

²⁴¹ See David M. White, *The Cold Comfort of Settlement: Why Owen Fiss Was Wrong for the Right Reasons* (2012) (unpublished manuscript) (on file with Seton Hall L. Rev.).

²⁴² *Id.*

Moreover, FINRA arbitration is fair.²⁴³ “FINRA’s arbitration program got high marks when measured against the ‘arbitration fairness index’ created by Professor Tom Stipanowich, a leading authority in the arbitration field,”²⁴⁴ and remains subject to SEC oversight.²⁴⁵ All FINRA awards are available online for the public to see, and FINRA has responded to fairness concerns by creating a new option for cases that proceed to arbitration: a panel consisting exclusively of industry outsiders.²⁴⁶

One of the greatest criticisms of FINRA arbitrations—and arbitrations in general—is that the arbitrators are not required to provide explained decisions, thus frustrating any meaningful judicial review of an arbitrator’s decision.²⁴⁷ Indeed, FINRA arbitrators only provide an explained decision at the joint request of both parties.²⁴⁸ But when FINRA previously considered requiring every decision to be explained, “it received negative comments from both the industry, which was concerned about unfair explanations, and from investor lawyers, who worried that arbitrators would regard such explanations as precedential,” potentially limiting their clients’ ability to recover damages.²⁴⁹ Thus, it appears that withholding an explained decision except in cases when both parties jointly request it may actually inure to the benefit of both parties.

²⁴³ See Friedman, *supra* note 193.

²⁴⁴ *Id.*

²⁴⁵ See *infra* Part II.A.

²⁴⁶ See *Optional All Public Panel Rules*, FINRA,

<http://www.finra.org/ArbitrationAndMediation/Arbitration/Rules/NoticestoArbitratorsParties/NoticestoParties/p123997> (last visited Feb. 5, 2014). Industry outsiders, otherwise known as public arbitrators, are otherwise qualified as arbitrators but were not otherwise associated with the securities industry pursuant to criteria set forth in the FINRA Rules. See FINRA Rule 12100(p).

²⁴⁷ See, e.g., *Goldman Sachs Execution & Clearing, L.P. v. Official Unsecured Creditors' Comm. of Bayou Grp., LLC*, 758 F. Supp. 2d 222, 224 (S.D.N.Y. 2010). In this decision, Judge Rakoff wrote, “arbitrators do not have to give reasons for their decisions, and their decisions are essentially unappealable. Here, petitioner . . . having voluntarily chosen to avail itself of this wondrous alternative to the rule of reason, must suffer the consequences.”

²⁴⁸ FINRA Rule 12904(g). See also Sec. and Exch. Comm’n. Inv. Advocacy Comm., Minutes of May 17, 2010 Meeting, *supra* note 235, at 3.

²⁴⁹ See Sec. and Exch. Comm’n. Inv. Advocacy Comm., Minutes of May 17, 2010 Meeting, *supra* note 235, at 3.

Therefore, although on the surface it appears that mandatory arbitration clauses with class action waivers are detrimental to investors, the truth of the matter is that FINRA arbitration is the most efficient and best-equipped forum to effectuate equitable and meaningful relief to aggrieved investors.

VI. Conclusion

In summation, Supreme Court precedent has consistently held that the FAA requires arbitrations agreements, including those with class action waivers, are to be fully enforced. These holdings should logically extend to securities causes of action. The Court requires a clear congressional command to supersede the FAA in order to render unenforceable an otherwise valid mandatory pre-dispute arbitration agreement with a class action waiver. Because Congress has continued to remain silent on the matter, the Schwab Enforcement Decision correctly held that an arbitration agreement containing a class action waiver remains fully enforceable, even though it contravenes FINRA's prohibition against such language in arbitration agreements, because the FAA preempts FINRA Rules.

In fact, Congress's decision to remain silent is further indication of what the facts bear out: pre-dispute arbitration agreements with class action waivers—particularly in the securities context—are not the problem that outcry from some quarters and political protestations would indicate. Specifically, FINRA customer arbitrations are strictly regulated, sufficiently transparent, equitable in awarding damages, and they operate in a manner that both limits costs and fosters prompt resolution of investor claims.

Therefore, the Schwab Enforcement Decision was not only properly decided pursuant to Supreme Court jurisprudence, it was beneficial for investors. Should other broker-dealers decide to institute similar class action waivers to their pre-dispute arbitration agreements, Supreme

Court jurisprudence would mandate that the FAA uphold those as enforceable as well. Going forward, FINRA arbitrations should remain the predominant—if not only—manner of dispute resolution for investors.