Client Alert

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Citing *Concepcion*, FINRA Panel OKs Class Action Waivers in Broker-Dealer Customer Arbitration Agreements

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A Financial Industry Regulatory Authority ("FINRA") hearing panel held that FINRA's own rules prohibiting judicial class action waivers in broker-dealer customer arbitration agreements are preempted by the Federal Arbitration Act and unenforceable. Once this decision becomes final, it will likely change the landscape of broker-dealer arbitrations. Many other broker-dealers will adopt a judicial class action waiver in their customer arbitration agreements and end decades of securities class action lawsuits, which generally provide little benefit to class members.

In a thoughtful 48-page decision, a FINRA hearing panel on Thursday, February 21, 2013 followed the U.S. Supreme Court's holding in *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740 (2011) ("*Concepcion*") and held that FINRA Rules prohibiting broker-dealers from adopting judicial class-action waivers in customer arbitration agreements are unenforceable and preempted by the Federal Arbitration Act ("FAA"). For more background on *Concepcion* and recent California litigation post-*Concepcion*, please see our prior client alerts including, "Recent Maverick Ruling in CA Appellate Court Finds *Concepcion* Does Not Overrule *Gentry*."

The decision arises from a Complaint filed on February 1, 2012 by FINRA's Department of Enforcement against Charles Schwab & Co., Inc. ("Schwab"). In September 2011, Schwab added a provision to its pre-dispute arbitration agreements requiring customers to "waive any right to bring a class action, or any type of representative action" against Schwab or any related third party "in court." The Complaint alleged that the waiver violated FINRA's Rules prohibiting self-regulatory organizations ("SROs") from adopting pre-dispute arbitration agreements that prohibited customers from filing judicial class actions.

On motions for summary judgment, the panel found that Schwab's provision violated FINRA Rules that require providing customers with the option to bring class actions in court. However, the panel held that

such violation was of no consequence as the FINRA Rules were unenforceable and preempted by the FAA under *Concepcion*. The panel noted that securities law claims are not exempt from the FAA's "mandate that a party to an arbitration agreement must go to arbitration to resolve any claim subject to the agreement" unless Congress has otherwise expressed clear intent to carve out an exception to the FAA. The panel found no such expression of congressional intent for an exception and deemed the FINRA Rules preempted by the FAA.

Once final, the panel's decision will likely result in sweeping changes to broker-dealer customer arbitration agreements. Many other broker-dealers will include judicial class action waivers in their customer arbitration agreements. As the panel itself noted, that will end "decades of class action securities litigation in the courts."

In a footnote, the hearing panel noted that it "recognizes that, despite the Supreme Court decisions discussed above, the interplay of arbitration and class actions remains controversial" and refers to a fully briefed U.S. Supreme Court case, *In re American Express Merchants' Litig.*, 667 F.3d 204, 219 (2d Cir. 2012) ("*Amex III*"). In *Amex III*, the Second Circuit Court of Appeals held that a class action waver in an arbitration agreement is unenforceable if it would preclude a plaintiff's ability to vindicate federal statutory rights. The panel predicted that the U.S. Supreme Court will strike down the Second Circuit's decision in the face of *Concepion*. Even if that decision was upheld by the U.S. Supreme Court, the Hearing Panel found that it would only be applicable if there "was a finding that SRO arbitration is insufficient to protect investors' substantive rights, a finding that would fly in the face of decades of judicial, legislative, and regulatory history endorsing the securities industry arbitration system."

FINRA's Department of Enforcement recently announced that it will appeal the decision. It bears noting that the hearing panel left intact FINRA's Rules permitting arbitrators to have the discretion to consolidate arbitrations filed by separate individual investors.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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