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## The Great and Powerful FAA: Why Schwab's Class Action Waiver Should Have Been Enforced Over FINRA's Rules

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# The Great and Powerful FAA: Why Schwab’s Class Action Waiver Should Have Been Enforced Over FINRA’s Rules

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## I. INTRODUCTION

The Supreme Court's recent progressive pro-arbitration campaign has transformed the Federal Arbitration Act (FAA) into a powerful tool for big businesses to try and limit their prospective liability and reduce consumers' options in bringing claims against them.<sup>1</sup> At the same time, since the creation of the Financial Industry Regulatory Authority (FINRA) in 2007 and the increased power over the securities industry given to the Securities and Exchange Commission (SEC), broker-dealers in the securities industry have become more and more closely regulated.<sup>2</sup> Thus, it was only a matter of time before these competing policies collided.

The first domino fell with the Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*<sup>3</sup> to uphold a class action waiver in an arbitration agreement against state law that found the provision unconscionable.<sup>4</sup> In the aftermath of *Concepcion*, Charles Schwab & Co., a brokerage firm in the securities industry, made an attempt to shield itself from having to defend against an accumulation of small dollar claims by amending its agreement with customers to include a provision that prohibited class actions and the joinder of claims—requiring that all disputes be individually arbitrated.<sup>5</sup> However, FINRA, exercising its regulatory

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1. Barbara Black & Jill I. Gross, *Investor Protection Meets the Federal Arbitration Act*, 1 STAN. J. COMPLEX LITIG. 1, 2 (2012).

2. Thomas J. Greene, *Finding Fairness in Arbitration: A Discussion About Whether Securities Class Action Waivers Should Be Prohibited*, 20 No. 2 PIABA B.J. 207, 207 (2013); see also *infra* Part II.A.

3. 131 S. Ct. 1740 (2011).

4. See discussion *infra* Part II.B.2.

5. Greene, *supra* note 2, at 208; see *Charles Schwab & Co. v. Fin. Indus. Regulatory Auth. Inc.*, 861 F. Supp. 2d 1063, 1066 (N.D. Cal. 2012). The entire text of the provision included:

**Waiver of Class Action or Representative Action.** Neither you nor Schwab shall be entitled to arbitrate any claims as a class action or representative action, and the arbitrator(s) shall have no authority to consolidate more than one parties' claims or to proceed on a representative or class basis. You and Schwab agree that any actions between us and /or [sic] Related Third Parties shall be brought solely in our individual capacities. You and Schwab hereby waive any right to bring a class action, or any type of representative action against each other or any Related Third Parties in court. You and Schwab waive any right to participate as a class member, or in any other capacity, in any class action or representative action brought by any other person, entity or agency against Schwab or you.

*Id.* In explaining why it changed its customer agreement, Schwab stated that it "acted to protect its shareholders and customers from the high costs and inefficiencies associated with customer class

authority in pursuit of investor protection,<sup>6</sup> brought a disciplinary action against Schwab on February 1, 2012, seeking sanctions because it believed Schwab's arbitration agreement violated FINRA's rules applicable to all of its broker-dealer members.<sup>7</sup> Therefore, a concrete conflict, which the Supreme Court has yet to directly address, arose over whether the FAA's mandate to enforce arbitration agreements according to its terms<sup>8</sup> is powerful enough to defeat rules promulgated—in pursuit of providing increased investor protection—by FINRA, a self-regulatory organization overseen by the SEC pursuant to the Securities Exchange Act of 1934.<sup>9</sup>

This debate sparked substantial publicity.<sup>10</sup> Most obviously, if Schwab would have succeeded and was able to enforce its class action waiver, many other broker-dealers in the securities industry would likely have followed suit.<sup>11</sup> Moreover, the ultimate decision, especially if the case would have made it to a federal circuit court or the Supreme Court,<sup>12</sup> would have likely provided an answer to the broader question that all self-regulatory organizations and government agencies are asking: “Does the FAA limit the ability of federal regulators acting pursuant to congressional authority to impose conditions and limitations on the use of arbitration provisions in order to ensure fairness?”<sup>13</sup>

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actions.” Complaint for Declaratory and Preliminary and Permanent Injunctive Relief ¶ 25, *Charles Schwab & Co.*, 861 F. Supp. 2d 1063 (No. CV 12 0518).

6. *About FINRA*, FINRA, <http://www.finra.org/AboutFINRA/> (last visited Oct. 7, 2014).

7. *Charles Schwab & Co.*, 861 F. Supp. 2d at 1067.

8. *See infra* Part II.B.1.

9. *See infra* Part II.A.

10. *See infra* note 253 and accompanying text.

11. *See infra* note 222 and accompanying text.

12. *See infra* note 46 and accompanying text.

13. Black & Gross, *supra* note 1, at 10. However, instead of the case making its way to a federal circuit court where the decision would become guidance and precedent governing at least a portion of the country, on April 24, 2014, the parties settled. *Charles Schwab Fined \$500,000 by FINRA Over Class Action Waiver*, IMPACT LITIG. J. (May 12, 2014), <http://www.impactlitigation.com/2014/05/12/charles-schwab-fined-500000-by-finra-over-class-action-waiver/>. Schwab agreed to pay \$500,000 in fines and acknowledged that its inclusion of a class action waiver in its customer agreement was a violation of FINRA Rules, pursuant to a ruling by the FINRA Board of Governors. *Id.*; *see also* Decision, Dep't of Enforcement v. Charles Schwab & Co. (Complaint No. 2011029760201) (FINRA Board of Governors Apr. 24, 2014) [hereinafter FINRA Board of Governors Decision], available at <http://www.impactlitigation.com/wp-content/uploads/2014/05/Schwab-FINRA-Board-Decision.pdf>. Thus, although this specific dispute has been resolved anticlimactically, the broader question of how the FAA should be interpreted

This Comment answers that question in the affirmative and argues that recent Supreme Court precedent,<sup>14</sup> circuit court decisions in contexts similar to FINRA's oversight of the securities industry,<sup>15</sup> and investors' true interests<sup>16</sup> all instruct that Schwab's class action waiver should have been enforced over FINRA's contrary command.<sup>17</sup> Part II discusses FINRA's role in the securities industry, the FAA and recent Supreme Court precedent interpreting the FAA, and the FINRA Rules that Schwab's class action and joinder waiver violated.<sup>18</sup> Part III analyzes why the conflict between the FAA and FINRA's rules should have been resolved in favor of the FAA<sup>19</sup> and supports this argument with discussion of federal circuit court decisions in contexts analogous to the securities industry.<sup>20</sup> Part IV addresses the fears voiced by investor protection advocates and articulates the policy reasons in support of enforcing the class action waiver, arguing that its enforcement would have actually benefited investors.<sup>21</sup> Part V concludes.<sup>22</sup>

## II. BACKGROUND: THE ORIGIN OF FINRA AND THE SUPREME COURT'S INTERPRETATION OF THE FAA

### A. *FINRA's Role in the Securities Industry*

Congress has recognized, as part of the "national public interest," the need to "provide for regulation and control of [securities] transactions" and related matters by adopting the Securities Exchange Act of 1934 and its subsequent amendments.<sup>23</sup> Through this enactment, Congress asserted its

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when its rules contradict regulations promulgated by unelected federal regulators still remains.

14. *See infra* Part II.B.

15. *See infra* Part III.B–C.

16. *See infra* Part IV.

17. *See infra* Part III.A.

18. *See infra* Part II.

19. *See infra* Part III.A.

20. *See infra* Part III.B–C.

21. *See infra* Part IV.

22. *See infra* Part V.

23. 15 U.S.C. § 78b (2012). One of the main factors prompting "enactment of the Federal securities acts was recognition of the intricate nature and high liquidity of securities and of the corresponding duties necessarily assumed by those who deal in them." SEC, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS OF THE SEC, H.R. DOC. NO. 88-95, pt. 1, at VI (1963). The

reliance, to a large extent, “on industry self-regulation and designated national securities exchanges as [self-regulatory organizations (SROs),] because they were already in existence” and regulating their members.<sup>24</sup> Congress amended the Exchange Act in 1938, authorizing “the registration of national securities associations to regulate brokers in the over-the-counter market.”<sup>25</sup> The National Association of Securities Dealers<sup>26</sup> (NASD) was incorporated in 1936 and then, in 2007, “merged with the regulation and enforcement functions of the New York Stock Exchange [(NYSE)].”<sup>27</sup> The resulting entity was renamed the Financial Industry Regulatory Authority, or FINRA.<sup>28</sup>

FINRA functions “as a self-regulatory organization . . . registered with the Securities and Exchange Commission . . . as a national securities association.”<sup>29</sup> FINRA’s main duty “is to carry out the statutory purposes and to enforce compliance by its members and associated persons with the provisions of the Exchange Act and its regulations as well as FINRA’s own rules.”<sup>30</sup> FINRA is required by the Exchange Act to promulgate rules for a variety of purposes, but in general, it must work to protect both the public

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securities industry, specifically broker-dealers, “is highly regulated ‘because of its economic importance’ and ‘the possibility of investor abuse.’” Black & Gross, *supra* note 1, at 17 (quoting NORMAN S. POSER & JAMES A. FANTO, *BROKER-DEALER LAW AND REGULATION* § 1.01 (4th ed. 2007)).

24. Black & Gross, *supra* note 1, at 16 n.98.

25. *Id.*; *see, e.g.*, *Desiderio v. Nat’l Ass’n of Sec. Dealers, Inc.*, 191 F.3d 198, 201 (2d Cir. 1999) (“As an integral part of a comprehensive system of federal regulation of the securities industry, the NASD regulates the over-the-counter securities market, which includes securities firms and registered representatives who buy and sell over-the-counter-securities.”).

26. The NASD was a SRO of the securities industry in charge of the “operation and regulation of the Nasdaq stock market and over-the-counter markets.” *Nat’l Ass’n of Sec. Dealers—NASD*, INVESTOPEDIA, <http://www.investopedia.com/terms/n/nasd.asp> (last visited Oct. 7, 2014).

27. *Charles Schwab & Co. v. Fin. Indus. Regulatory Auth. Inc.*, 861 F. Supp. 2d 1063, 1065 (N.D. Cal. 2012).

28. *Id.* “FINRA, as NASD’s successor, is the only officially registered national securities association under [the Exchange Act].” *Karsner v. Lothian*, 532 F.3d 876, 880 (D.C. Cir. 2008) (alteration in original) (internal quotation marks omitted). In fact, FINRA “is the largest independent regulator for all securities firms doing business in the United States.” Black & Gross, *supra* note 1, at 17.

29. *Charles Schwab & Co.*, 861 F. Supp. 2d at 1065. FINRA is not a government agency; rather, it is “a private, not-for-profit Delaware corporation.” *Id.*

30. Black & Gross, *supra* note 1, at 17–18; *see* 15 U.S.C. § 78o-3 (2012).

interest and investors.<sup>31</sup>

Congress passed another amendment to the Exchange Act in 1975 that gave broad new powers over SROs in the securities industry to the SEC.<sup>32</sup> Among these powers was the ability to review all of the SROs' proposed rules after they have been published for public comment<sup>33</sup> "and to require [SROs] to adopt, change or repeal any rules."<sup>34</sup> Additionally, the SEC's oversight of FINRA includes FINRA's arbitration forum, which is the largest dispute resolution tribunal in the securities industry.<sup>35</sup> The SEC, since the 1970s, has found it essential to have a "nationwide investor dispute resolution system to handle small claims" and has worked alongside FINRA, industry members, and "investor groups to develop arbitration rules to achieve this result."<sup>36</sup> FINRA's rules now have substantial power because the Exchange Act voids any agreement or contract that forces a party to waive compliance with FINRA Rules.<sup>37</sup> Most important for this Comment, the SEC also has "explicit authority to prohibit, or to impose conditions or limitations on the use of"<sup>38</sup> agreements by broker-dealers that require investors to arbitrate future disputes, as long as the action is taken in pursuit of "the public interest and [is] for the protection of investors."<sup>39</sup> FINRA has

31. Black & Gross, *supra* note 1, at 18.

32. *Id.* at 16 n.98; see POSER & FANTO, *supra* note 23, at § 1.01.

33. 15 U.S.C. § 78s(b)(1) (2012); *Charles Schwab & Co.*, 861 F. Supp. 2d at 1065.

34. Black & Gross, *supra* note 1, at 16 n.98; see 15 U.S.C. § 78s(c) (2012). However, FINRA "members can petition the SEC for changes to FINRA's rules." *Charles Schwab & Co.*, 861 F. Supp. 2d at 1065.

35. Black & Gross, *supra* note 1, at 17; *Arbitration & Mediation*, FINRA, <http://www.finra.org/ArbitrationAndMediation/index.htm> (last visited Oct. 7, 2014).

36. Black & Gross, *supra* note 1, at 18 (citing Order Approving Proposed Rule Changes by NYSE, NASD, and ASE Relating to the Arbitration Process and the Use of Predispute Arbitration Clauses, 54 Fed. Reg. 21144-03 (May 16, 1989)). The SEC has consistently focused on fairness and has required not only that investors properly understand the FINRA arbitration process, but also that investors maintain similar rights and remedies they otherwise would have in court. *Id.* at 19.

37. 15 U.S.C. § 78cc(a) (2012) ("Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of a self-regulatory organization, shall be void." (emphasis added)).

38. Black & Gross, *supra* note 1, at 23.

39. 15 U.S.C. § 78o(o) (2012) ("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 between them arising under the Federal securities laws, the rules and regulations thereunder, or the rules of a self-regulatory organization if it finds that such prohibition, imposition of conditions, or limitations are in the public interest and for

enormous power over broker-dealer members because it is the only regulator in the securities industry, is backed by the SEC, and has the ability to independently “sanction members for noncompliance with securities laws and FINRA Rules”—it can even impose “fines, censure, and suspension or revocation of membership or registration.”<sup>40</sup>

In its regulation of broker-dealers, FINRA disciplines members in a five-stage process.<sup>41</sup> The first step is for a FINRA Hearing Panel to hear FINRA’s Department of Enforcement’s complaint.<sup>42</sup> Then, either party can appeal the Hearing Panel’s decision to the FINRA National Adjudicatory Council (NAC).<sup>43</sup> Next, the NAC’s decision can be reviewed by the FINRA Board of Governors *sua sponte*,<sup>44</sup> or an aggrieved broker-dealer can ask for

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the protection of investors.”). Thus, under § 78o(o), the SEC can ban broker-dealers from using pre-dispute arbitration agreements in the federal securities industry as long as it can show that it was done in order to protect investors and was in the public interest. Black & Gross, *supra* note 1, at 23. This authority obviously encompasses class action waivers, and some scholars argue that the SEC may do so even “if [it] conflicts with the policies and purposes of the FAA.” *Id.* at 24.

40. *Charles Schwab & Co. v. Fin. Indus. Regulatory Auth. Inc.*, 861 F. Supp. 2d 1063, 1065 (N.D. Cal. 2012); *see also* FINRA R. 8310. Due to the SEC’s oversight, FINRA’s SEC-approved rules “are expressions of federal legislative power and have the force and effect of a federal regulation.” *Charles Schwab & Co.*, 861 F. Supp. 2d at 1065; *see also* *Credit Suisse First Bos. Corp. v. Grunwald*, 400 F.3d 1119, 1132 (9th Cir. 2005) (“In sum, we conclude that SRO rules that have been approved by the Commission pursuant to 15 U.S.C. § 78s(b)(2) preempt state law when the two are in conflict, either directly or because the state law stands as an obstacle to the accomplishment of the objectives of Congress. Specifically, we hold that the NASD arbitration procedures in dispute here have preemptive force over conflicting *state* law.” (emphasis added) (footnote omitted)); *supra* notes 23–39 and accompanying text.

41. *Charles Schwab & Co.*, 861 F. Supp. 2d at 1066. FINRA exerts substantial effort to “employ[] a fair system for disciplining firms and individuals who break the rules.” *Adjudication*, FINRA, <http://www.finra.org/Industry/Enforcement/Adjudication/> (last visited Oct. 7, 2014).

42. *Charles Schwab & Co.*, 861 F. Supp. 2d at 1066; *see also* 15 U.S.C. § 78o-3(h)(1) (2012); FINRA R. 9231(b). The Hearing Panel “is chaired by a professional hearing officer and includes two industry representatives.” *Adjudication*, *supra* note 41. In making its decision as to whether a violation has occurred, the Hearing Panel “considers previous court, SEC, and FINRA’s National Adjudicatory Council (NAC) decisions.” *Id.* To determine the appropriate sanctions, the Hearing Panel “uses the FINRA Sanction Guidelines.” *Id.* Finally, the Hearing Panel releases a written decision where it explains its reasoning. *Id.*

43. *Charles Schwab & Co.*, 861 F. Supp. 2d at 1066; *see also* FINRA R. 9311(a)–(b). The NAC is composed of an equal balance of “individuals who are in the securities business and nonindustry representatives.” *Adjudication*, *supra* note 41. FINRA cannot appeal the NAC’s decision unless “FINRA’s Board of Governors decides to review the . . . decision.” *Id.*

44. *Charles Schwab & Co.*, 861 F. Supp. 2d at 1066; *see also* FINRA R. 9351.

the decision to be reviewed by the SEC.<sup>45</sup> Finally, the process culminates by allowing a broker-dealer to “appeal an adverse determination by the SEC to a federal circuit court of appeals.”<sup>46</sup> Thus, although this process can take quite some time to complete,<sup>47</sup> it provides sufficient review to protect members from disciplinary decisions that are unfounded or result in excessive punishment.<sup>48</sup>

FINRA is aggressively vigilant in disciplining registered brokers and firms, levying fines, and referring fraud and insider trading cases to the SEC for prosecution.<sup>49</sup> Overall, FINRA enforces its rules against, and governs the activities of, over “4,135 securities firms with approximately 634,505 brokers.”<sup>50</sup> However, despite FINRA’s power as the lone self-regulatory organization of the securities industry, its rules and discipline must still abide by other congressional legislation like the FAA and Supreme Court precedent.<sup>51</sup>

## *B. The Federal Arbitration Act as Interpreted by the Supreme Court*

### 1. The Federal Arbitration Act

Congress enacted the FAA in 1925 as a “response to widespread judicial hostility to arbitration agreements.”<sup>52</sup> The FAA seeks to compensate for this hostility by “plac[ing] arbitration agreements upon the same footing as other

45. *Charles Schwab & Co.*, 861 F. Supp. 2d at 1066; *see also* 15 U.S.C. § 78s(d) (2012); FINRA R. 9370(a).

46. *Charles Schwab & Co.*, 861 F. Supp. 2d at 1066; *see also* 15 U.S.C. § 78y(a) (2012).

47. *See, e.g., PAZ Sec., Inc. v. SEC*, 494 F.3d 1059 (D.C. Cir. 2007) (exemplifying a disciplinary complaint that lasted from August 14, 2003, until the appellate court ruling on July 20, 2007).

48. *See supra* notes 42–47 and accompanying text.

49. *About FINRA*, *supra* note 6. In 2013 alone, FINRA instituted 1,535 disciplinary actions against broker-dealers, fined broker-dealers and their associated persons over \$65 million, “ordered more than \$9.5 million in restitution to harmed investors,” and “referred 660 fraud and insider trading cases” for prosecution or litigation to the SEC and other enforcement agencies. *Id.*

50. *Id.*

51. *See infra* Part III.A.

52. *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1745 (2011); *see also* *Hall St. Assocs., LLC v. Mattel, Inc.*, 552 U.S. 576, 581 (2008) (“Congress enacted the FAA to replace judicial indisposition to arbitration with a ‘national policy favoring [it] and plac[ing] arbitration agreements on equal footing with all other contracts.’” (alterations in original) (quoting *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006))).

contracts.”<sup>53</sup> “[T]he primary substantive provision of the Act,”<sup>54</sup> § 2, states:

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.<sup>55</sup>

Thus, the FAA, and specifically § 2, establishes “a liberal federal policy favoring arbitration agreements.”<sup>56</sup> The Supreme Court has continually stated that the FAA “create[s] a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act.”<sup>57</sup> However, the Supreme Court’s more recent jurisprudence has elevated the FAA’s status whereby it now “governs virtually every arbitration clause arising out of a commercial transaction.”<sup>58</sup> In addition, the

53. *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 225–26 (1987) (alteration in original) (quoting *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 (1974)) (internal quotation marks omitted).

54. *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).

55. 9 U.S.C. § 2 (2012). This provision reflects the “fundamental principle that arbitration is a matter of contract.” *Rent-A-Ctr., W., Inc. v. Jackson*, 561 U.S. 63, 67 (2010). The last phrase of § 2, “save upon such grounds as exist at law or in equity for the revocation of any contract,” has been deemed the “saving clause” and “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.” *Concepcion*, 131 S. Ct. at 1746 (quoting *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996)). In addition, the FAA “provides that a court must stay its proceedings if it is satisfied that an issue before it is arbitrable under the agreement.” *McMahon*, 482 U.S. at 226 (citing 9 U.S.C. § 3 (1982)). The Act also “authorizes a federal district court to issue an order compelling arbitration if there has been a ‘failure, neglect, or refusal’ to comply with the arbitration agreement.” *Id.* (quoting 9 U.S.C. § 4 (1982)).

56. *Mercury Constr. Corp.*, 460 U.S. at 24; *see also* *CompuCredit Corp. v. Greenwood*, 132 S. Ct. 665, 669 (2012); *Concepcion*, 131 S. Ct. at 1749; *McMahon*, 482 U.S. at 226.

57. *Mercury Constr. Corp.*, 460 U.S. at 24. The *Mercury Construction Corp.* Court stated that the FAA creates “the duty to honor an agreement to arbitrate.” *Id.* at 25 n.32.

58. *Black & Gross*, *supra* note 1, at 12. As seen above, § 2 of the FAA states that it governs arbitration agreements within “transaction[s] involving commerce” which the Court has broadly interpreted to mean any transaction that “affect[s]” commerce. *Allied-Bruce Terminix Cos. v.*

Court has found that the FAA applies in both state and federal court,<sup>59</sup> “compels the arbitrability of federal statutory claims,”<sup>60</sup> allows the arbitrator to decide if an arbitration clause is unconscionable,<sup>61</sup> and preempts any state law that “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”<sup>62</sup> Thus, the FAA is a powerful act with widespread effects.

## 2. *AT&T Mobility LLC v. Concepcion*

*Concepcion* is an extremely important case in this analysis because its holding prompted Schwab to change its contract with investors and is the first of many recent high-profile FAA-related Supreme Court decisions.<sup>63</sup> *Concepcion* involved a contract between AT&T Mobility LLC (AT&T) and Vincent and Liza Concepcion, which “provided for arbitration of all disputes between the parties, but required that claims be brought in the parties’ individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding.”<sup>64</sup> A dispute arose when the

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Dobson, 513 U.S. 265, 273–74 (1995) (emphasis omitted) (quoting 9 U.S.C. § 2 (1994)); see also *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002) (applying the FAA to securities transactions).

59. See *Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984) (finding that previous statements by the Court made the FAA “an exercise of the Commerce Clause power[, which] clearly implied that the substantive rules of the Act were to apply in state as well as federal courts”).

60. Black & Gross, *supra* note 1, at 12 (citing *CompuCredit Corp.*, 132 S. Ct. 665).

61. *Rent-A-Ctr., W., Inc. v. Jackson*, 561 U.S. 63, 75–76 (2010).

62. *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1753 (2011) (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)).

63. Complaint for Declaratory and Preliminary and Permanent Injunctive Relief, *supra* note 5, at ¶ 25; see also Bill Singer, *FINRA Decision on Charles Schwab Arbitration Agreement*, BROKEANDBROKER.COM (Feb. 21, 2013), <http://www.brokeandbroker.com/1886/decision-charles-schwab-arbitration-agreement/>; E. Sebastian Arduengo, *FINRA/Schwab Arbitration Decision: Taking the Cash in Hand and Waiving the Rest*, AM. CONST. SOC’Y (Mar. 11, 2013), <http://americanconstitutionsociety.org/acsblog/finraschwab-arbitration-decision-taking-the-cash-in-hand-and-waiving-the-rest>. *Concepcion* was decided April 27, 2011, *Concepcion*, 131 S. Ct. at 1740, and then Schwab amended its customer agreement just a few months later in October of 2011. *Charles Schwab & Co. v. Fin. Indus. Regulatory Auth. Inc.*, 861 F. Supp. 2d 1063, 1066 (N.D. Cal. 2012); see *infra* note 116 and accompanying text.

64. *Concepcion*, 131 S. Ct. at 1744 (internal quotation marks omitted). This contract provision stated “the arbitrator may not consolidate more than one person’s claims, and may not otherwise preside over any form of a representative or class proceeding.” *Id.* at 1744 n.2. The agreement also allowed AT&T to make unilateral amendments to the arbitration provision, which it did numerous

Concepcions purchased AT&T service in response to an advertisement where purchasing service came with free phones.<sup>65</sup> The Concepcions received their free phones, but “were charged \$30.22 in sales tax based on the phones’ retail value.”<sup>66</sup> So, the Concepcions filed suit in the United States District Court for the Southern District of California, and their complaint was consolidated with a putative class action against AT&T alleging “false advertising and fraud by charging sales tax on phones it advertised as free.”<sup>67</sup>

In March 2008, AT&T tried to compel arbitration pursuant to the terms of the contract.<sup>68</sup> The district court evaluated the clause in light of California law, specifically California Supreme Court precedent from the *Discover Bank* case.<sup>69</sup> The *Discover Bank* decision relied on California’s unconscionability law<sup>70</sup> to invalidate a class-action waiver in an arbitration agreement. The California Supreme Court held that:

[W]hen the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then . . . the waiver becomes in practice the exemption of the party ‘from responsibility for [its] own fraud, or

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times. *Id.* at 1744. One of the amendments made in December 2006, and that was controlling in the dispute, included several parts favorable to customers. *Id.* The amendment allowed AT&T to offer to settle the claim; required AT&T to pay all arbitration “costs for nonfrivolous claims;” required that the arbitration “take place in the county in which the customer is billed;” prevented AT&T from seeking reimbursement for its attorney fees; and, “in the event that a customer receives an arbitration award greater than [AT&T’s] last written settlement offer, require[d] [AT&T] to pay a \$7,500 minimum recovery and twice the amount of the claimant’s attorney’s fees.” *Id.* In 2009, AT&T increased this guaranteed minimum recovery to \$10,000. *Id.* at 1744 n.3.

65. *Id.* at 1744.

66. *Id.*

67. *Id.*

68. *Id.* at 1744–45.

69. *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005), *abrogated by Concepcion*, 131 S. Ct. 1740.

70. “[C]ourts may refuse to enforce any contract found ‘to have been unconscionable at the time it was made,’ or may ‘limit the application of any unconscionable clause.’” *Concepcion*, 131 S. Ct. at 1746 (quoting CAL. CIV. CODE § 1670.5(a) (West 1985)).

willful injury to the person or property of another.’ Under these circumstances, such waivers are unconscionable under California law and should not be enforced.<sup>71</sup>

Despite describing AT&T’s arbitration clause favorably,<sup>72</sup> the district court denied the motion based on *Discover Bank* and found AT&T’s arbitration provision unconscionable because AT&T could “not show[] that bilateral arbitration adequately substituted for the deterrent effects of class actions” and the efficient resolution of third-party claims.<sup>73</sup>

After the district court refused to compel arbitration, AT&T appealed.<sup>74</sup> The Ninth Circuit affirmed, holding “that the *Discover Bank* rule was not preempted by the FAA because that rule was simply ‘a refinement of the unconscionability analysis applicable to contracts generally in California.’”<sup>75</sup> AT&T sought review from the Supreme Court and certiorari was granted.<sup>76</sup>

The Supreme Court reversed the Ninth Circuit’s decision, holding that the FAA preempts California’s *Discover Bank* rule because it “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”<sup>77</sup> Despite the *Discover Bank* rule’s applicability to all class action waivers in dispute resolution contracts,<sup>78</sup> the Court found that

71. *Discover Bank*, 113 P.3d at 1110 (quoting CAL. CIV. CODE ANN. § 1668 (West 1985)).

72. The district court noted that the arbitration process “was ‘quick, easy to use’ and likely to ‘prompt[] full or . . . even excess payment to the customer *without* the need to arbitrate or litigate” and that “consumers who were members of a class would likely be worse off.” *Concepcion*, 131 S. Ct. at 1745 (alteration in original) (quoting *Laster v. T-Mobile USA, Inc.*, No. 05cv1167 DMS (AJB), 2008 WL 5216255, at \*11 (S.D. Cal. Aug. 11, 2008), *aff’d sub nom.*, *Laster v. AT & T Mobility LLC*, 584 F.3d 849 (9th Cir. 2009), *rev’d*, *Concepcion*, 131 S. Ct. 1740).

73. *Id.* (citing *Laster*, 2008 WL 5216255, at \*14).

74. *Laster*, 584 F.3d 849, 851.

75. *Concepcion*, 131 S. Ct. at 1745 (quoting *Laster*, 584 F.3d at 857).

76. *AT & T Mobility LLC v. Concepcion*, 560 U.S. 923 (2010).

77. *Concepcion*, 131 S. Ct. at 1753 (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)). The Court stated that, despite the dissent’s contrary argument, “[t]he overarching purpose of the FAA . . . is to ensure the enforcement of arbitration agreements according to their terms *so as to facilitate streamlined proceedings*. Requiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA.” *Id.* at 1748 (emphasis added). Contrary to the majority stating that a purpose of the FAA was procedural expediency, the dissent referenced the Court in *Dean Witter* that “reject[ed] the suggestion that the overriding goal of the [FAA] was to promote the expeditious resolution of claims.” *Id.* at 1758 (Breyer, J., dissenting) (citing *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219 (1985)).

78. Justice Breyer argued in dissent (joined by Justices Ginsburg, Sotomayor, and Kagan) that the generally applicable nature of the *Discover Bank* rule allowed class action waivers to fall within

the rule did not fall within the FAA's saving clause.<sup>79</sup> The majority reasoned that although the *Discover Bank* rule did not require classwide arbitration, consumers could demand it after the fact, which went against the FAA's purposes.<sup>80</sup> The majority further found that class arbitration, as compared to bilateral arbitration, was inconsistent with the FAA because it sacrificed arbitration's "principal advantage" of informality in three ways: (1) by making the process slower and more costly; (2) by increasing formality because absent class members would have to be dealt with properly to make the decision binding on them; and (3) by increasing risks to defendants because judicial review would be more difficult, causing "defendants [to] be pressured into settling questionable claims."<sup>81</sup> So, despite the dissent's argument that enforcing class arbitration waivers on consumers would deprive them of their claims,<sup>82</sup> the Court held that "States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons."<sup>83</sup>

Justice Breyer, in his dissent, maintained that the *Discover Bank* rule was consistent with the FAA and fell within the FAA's saving clause because it "applie[d] equally to class action litigation waivers in contracts without arbitration agreements" as to those with arbitration agreements.<sup>84</sup>

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the FAA's saving clause, thus making it consistent with the FAA. *Id.* at 1757.

79. *Id.* at 1748 (majority opinion); *see also* 9 U.S.C. § 2 (2012) (stating that the saving clause refers to the language from § 2 of the FAA, "save upon such grounds as exist at law or in equity for the revocation of any contract"); *supra* note 55 and accompanying text. Justice Scalia noted that although the "saving clause preserves generally applicable contract defenses, nothing in it suggests an intent to preserve state-law rules that stand" in the way of achieving the FAA's objectives. *Concepcion*, 131 S. Ct. at 1748. As additional support, the Court found it "worth noting that California's courts have been more likely to hold contracts to arbitrate unconscionable than other contracts." *Id.* at 1747.

80. *Concepcion*, 131 S. Ct. at 1750–51.

81. *Id.* at 1750–52. Justice Scalia also highlighted that class procedures make confidentiality more difficult and that finding an arbitrator familiar with class-certification procedures is similarly onerous. *Id.* at 1750.

82. *Id.* at 1761 (Breyer, J., dissenting).

83. *Id.* at 1753 (majority opinion). Justice Thomas concurred, but wrote separately because he found a limit in the FAA's saving clause on permissible contract defenses. *Id.* (Thomas, J., concurring). Under his reading, "the FAA requires that an agreement to arbitrate be enforced unless a party successfully challenges the formation of the arbitration agreement, such as by proving fraud or duress." *Id.* Therefore, he argued that the *Discover Bank* rule was inconsistent with the FAA because it "d[id] not relate to defects in the *making* of an agreement." *Id.* (emphasis added).

84. *Id.* at 1757 (Breyer, J., dissenting) (quoting *Discover Bank v. Super. Ct.*, 113 P.3d 1100,

Justice Breyer further supported his argument by highlighting how “class proceedings [were] necessary to prosecute small-dollar claims that might otherwise slip through the legal system.”<sup>85</sup> He contended that enforcing class arbitration waivers would “have the effect of depriving claimants of their claims,” so state courts should have the ability to protect investors and prevent an agreement’s author from “insulat[ing itself] from liability for its own frauds by ‘deliberately cheat[ing] large numbers of consumers out of individually small sums of money.’”<sup>86</sup> Conveniently, the Court did not wait long before providing further clarification of how conflicts between arbitration agreements and class action plaintiffs are to be resolved.

### 3. *American Express Co. v. Italian Colors Restaurant*

Despite many cries of support for Justice Breyer’s dissent in *Concepcion*, two years later in *American Express Co. v. Italian Colors Restaurant*, the Court strongly stated that enforcement of the FAA and arbitration agreements according to their terms would endure even in the face of claims that will go unrecompensed without a class action alternative.<sup>87</sup> In *Italian Colors Restaurant*, the restaurant alleged that “American Express used its monopoly power in the market for charge cards to force merchants to accept credit cards at rates approximately 30% higher than the fees for competing credit cards,” thus violating § 1 of the Sherman Act.<sup>88</sup> The parties’ contract “require[d] all disputes between [them] to be resolved by arbitration” and also included a class action waiver, so American Express moved to compel arbitration under the FAA.<sup>89</sup> Italian

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1112 (Cal. 2005), *abrogated by Concepcion*, 131 S. Ct. 1740).

85. *Id.* at 1753 (majority opinion). Justice Breyer questioned the majority, “What rational lawyer would have signed on to represent the Concepcions in litigation for the possibility of fees stemming from a \$30.22 claim?” *Id.* at 1761 (Breyer, J., dissenting) (citing *Carnegie v. Household Int’l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004) (“The *realistic* alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for \$30.”)).

86. *Id.* at 1761 (Breyer, J., dissenting) (second alteration in original) (quoting *Discover Bank*, 113 P.3d at 1110). However, this second argument about making sure that consumers are able to recover on small-value claims was foreclosed by the Court’s subsequent ruling in *American Express Co. v. Italian Colors Restaurant*. See 133 S. Ct. 2304 (2013); see also *infra* Part II.B.3.

87. *Italian Colors Rest.*, 133 S. Ct. at 2312.

88. *Id.* at 2308.

89. *Id.*

Colors Restaurant resisted this compulsion, arguing that “the cost of an expert analysis necessary to prove the antitrust claims . . . might exceed \$1 million, while the maximum recovery for an individual plaintiff would be \$12,850 [to] \$38,549.”<sup>90</sup> After a busy lower court history,<sup>91</sup> the Supreme Court granted certiorari to determine “[w]hether the [FAA] permits courts . . . to invalidate arbitration agreements on the ground that they do not permit class arbitration of a federal-law claim.”<sup>92</sup>

In a majority opinion, the Court found that the class action waiver was enforceable because “[n]o contrary congressional command require[d]” the Court to reject it.<sup>93</sup> Regarding Italian Colors Restaurant’s “effective vindication” argument,<sup>94</sup> the Court found that “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.”<sup>95</sup> In fact, Justice Scalia felt that the Court’s “decision in [*Concepcion*] all but resolve[d] this case” because that decision “rejected the argument that class arbitration was necessary to prosecute claims ‘that might otherwise slip through the legal system.’”<sup>96</sup> Thus, it is well settled that the Supreme Court has no sympathy

90. *Id.* (internal quotation marks omitted).

91. *Id.* The district court granted the motion to compel, but the court of appeals reversed, after which the Supreme Court “granted certiorari, vacated the judgment, and remanded for further consideration in light of *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*, 559 U.S. 662 [2010].” *Id.* The Second Circuit “stood by its reversal,” but “then *sua sponte* reconsidered its ruling in light of” *Concepcion*, but again maintained its decision, and even “denied rehearing en banc.” *Id.*

92. *Id.* (first and third alterations in original).

93. *Id.* at 2309. The Court found that “the antitrust laws do not guarantee an affordable procedural path to the vindication of every claim” nor do they “‘evinc[e] an intention to preclude a waiver’ of class-action procedure.” *Id.* (alteration in original) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985)).

94. The effective vindication exception is a “judge-made exception to the FAA” where the Court in *Mitsubishi Motors*, in dictum, “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.’” *Id.* at 2310 (alterations in original) (quoting *Mitsubishi Motors*, 473 U.S. at 637 n.19). Thus, Italian Colors Restaurant’s argument was that enforcing the class action waiver against them prevented them from effectively vindicating their rights because the high costs of experts would leave them with “no economic incentive to pursue their antitrust claims individually in arbitration.” *Id.*

95. *Id.* at 2310–11 (arguing that “so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function” (quoting *Mitsubishi Motors*, 473 U.S. at 637)).

96. *Id.* at 2312 (quoting *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1753 (2011)). Justice Thomas concurred in the opinion because the result was “required by the plain meaning of

for, and gives no weight to, the argument that class action waivers should not be enforceable when they prevent a party from seeking redress because it is economically unwise.<sup>97</sup>

#### 4. *CompuCredit Corp. v. Greenwood*

*Concepcion* made it clear that the FAA overrides conflicting state law,<sup>98</sup> and *Italian Colors Restaurant* demonstrated that the lack of an economic incentive to pursue a claim when no class action alternative exists does not prevent the application of the FAA either.<sup>99</sup> But, is the FAA so powerful that it trumps contrary federal agency-approved rules? The Court provided additional clues in *CompuCredit Corp. v. Greenwood*.<sup>100</sup>

In *CompuCredit Corp.*, the Court held that even with regard to *federal* statutory claims, unless the statute explicitly requires resolution in court by class action, the parties' arbitration agreement is still enforceable pursuant to the FAA.<sup>101</sup> Plaintiffs were consumers who received a credit card marketed by CompuCredit and issued by Columbus Bank and Trust that had been advertised to consumers with poor credit as a way to rebuild their bad credit and boost their credit ratings.<sup>102</sup> These customers were told they would receive a \$300 credit limit, but the limit was greatly reduced when they were immediately assessed multiple fees, making it very difficult for them to

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the [FAA]" because Italian Colors Restaurant did not challenge the formation of the contract. *Id.* (Thomas, J., concurring). Justice Kagan dissented because she found that the "effective vindication" exception applied, because applying the rule in this context "would ensure that Amex's arbitration clause does not foreclose Italian Colors from vindicating its right to redress antitrust harm." *Id.* at 2313 (Kagan, J., dissenting). Justice Kagan found that it was not just the class action waiver that prevented Italian Colors Restaurant from gaining redress, but it was the class action waiver in addition to the disallowance of "joinder or consolidation of claims or parties," the prevention of Italian Colors Restaurant from working "with other merchants to produce a common expert report," the preclusion of "any shifting of costs to Amex," and Amex's refusal "to enter into any stipulations that would obviate or mitigate the need for the economic analysis." *Id.* at 2316. She found that the agreement "cut[] off not just class arbitration, but any avenue for sharing, shifting, or shrinking necessary costs," thus preventing vindication of Italian Colors Restaurant's rights. *Id.*

97. See *supra* notes 86–96 and accompanying text.

98. See *Concepcion*, 131 S. Ct. 1740; see also *supra* Part II.B.2.

99. See *Italian Colors Rest.*, 133 S. Ct. 2304; see also *supra* Part II.B.3.

100. 132 S. Ct. 665 (2012).

101. *Id.* at 673.

102. *Id.* at 668 (majority opinion), 676 (Ginsburg, J., dissenting).

improve their credit ratings.<sup>103</sup> The consumers alleged violations of the Credit Repair Organizations Act (CROA),<sup>104</sup> which provides that consumers have the “right to sue [the] credit repair organization,”<sup>105</sup> but the parties’ contract contained a provision requiring all disputes to be resolved by binding arbitration.<sup>106</sup> The consumers filed a class action in federal court, and the district court refused to compel arbitration.<sup>107</sup> The Ninth Circuit affirmed, finding that the CROA’s “right to sue” language required the right to sue in a court of law.<sup>108</sup> The Supreme Court granted certiorari to decide whether the CROA precluded enforcing an “arbitration agreement in a lawsuit alleging violations of that Act.”<sup>109</sup>

The Court stated that the FAA requires enforcement of arbitration agreements *unless* its mandate “has been ‘overridden by a contrary congressional command.’”<sup>110</sup> Because the Court did not find a contrary congressional command, and because arbitration satisfied the “statutory prescription of civil liability in court,” the Court deemed the arbitration agreement enforceable.<sup>111</sup> As additional support, the Court noted that if Congress truly wanted to preserve consumers’ right to sue in judicial court, it would have said so more explicitly.<sup>112</sup> Thus, *CompuCredit Corp.* clearly stands for the proposition that the FAA mandates the arbitration of federal statutory claims that lack express language disfavoring arbitration.<sup>113</sup>

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103. *Id.* at 676–77 (Ginsburg, J., dissenting).

104. The CROA was enacted in order to ensure that consumers of credit repair organization services have “the information necessary to make an informed decision” and to protect them from “unfair or deceptive advertising and business practices.” 15 U.S.C. § 1679(b)(1)–(2) (2012).

105. § 1679c(a).

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

107. *Id.*

108. *Id.* at 669.

109. *Id.* at 668.

110. *Id.* at 669 (quoting *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987)). The lone dissenter, Justice Ginsburg, thought the “right to sue” language in the CROA meant “the right to litigate in court.” *Id.* at 676 (Ginsburg, J., dissenting). She argued that Congress drafted the CROA for laypeople to understand and that most lay individuals would interpret “right to sue” as the right to sue in court, not a right to go to arbitration. *Id.* at 678.

111. *Id.* at 671, 673 (majority opinion).

112. *Id.* at 672. The Court noted that in 1996, the year the CROA was enacted, arbitration clauses were not rare, so Congress would have been clearer if it really wanted to preserve the right of consumers to sue in court. *Id.* at 672–73.

113. *See id.* at 673. In other words, absent more precise language prohibiting arbitration or

However, neither *CompuCredit Corp.*, nor *Concepcion*, nor *Italian Colors Restaurant* governs whether the FAA prevents the SEC—a federal regulator granted authority by the Exchange Act—and FINRA from conditioning and limiting arbitration agreements between brokerage firms and investors in the securities industry, because, as discussed below, FINRA and its rules have certainly not been silent on the issue of allowing investors to resolve their claims by class actions in judicial courts.<sup>114</sup>

### C. *Schwab's Arbitration Agreement and FINRA's Rules Collide*

As the Supreme Court repeatedly expressed its clear intent to enforce arbitration agreements pursuant to the FAA unless the source of the contrary mandate was Congress itself,<sup>115</sup> broker-dealers in the securities industry were paying attention and taking notes.<sup>116</sup> But, contemporaneous with the Supreme Court's evolving precedent regarding the FAA, FINRA was created in 2007, and the SEC received increased authority over the securities industry, causing broker-dealers to be regulated more and more.<sup>117</sup> Hence, a showdown between these competing policies was inevitable.

It all started with the Court's holding in *Concepcion* that California state law, which made an arbitration agreement's class action waiver unconscionable, had to cede to the FAA's mandate of enforcing arbitration agreements according to their terms.<sup>118</sup> In *Concepcion's* wake, and in an effort "to protect its shareholders and customers from the high costs and inefficiencies associated with customer class actions,"<sup>119</sup> Schwab amended

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requiring litigation in court than "right to sue," the FAA will cause the arbitration agreement to be enforceable. *Id.* The Court's reference to CROA's silence regarding arbitration and its citation of numerous other statutes in which Congress had explicitly precluded the enforcement of arbitration agreements in suits under the statutes, hints at the strong possibility that when the preclusive language is included in the statute, the FAA would concede to the other statute and the arbitration agreement would be unenforceable. *See id.* at 672–73.

114. *See* Black & Gross, *supra* note 1, at 48.

115. *See* discussion *supra* Part II.B.

116. *See, e.g.*, Complaint for Declaratory and Preliminary and Permanent Injunctive Relief, *supra* note 5, at ¶ 25 (stating that Schwab amended its customer agreement after the Supreme Court's decision in *Concepcion*).

117. Greene, *supra* note 2, at 207; *see also supra* Part II.A.

118. *See* discussion *supra* Part II.B.2.

119. Complaint for Declaratory and Preliminary and Permanent Injunctive Relief, *supra* note 5, at ¶ 25.

its customer agreement to include a class action and claims joinder waiver, effectively requiring all claims to be arbitrated on an individual basis.<sup>120</sup> But, pursuant to its congressionally granted regulatory authority, FINRA instituted a disciplinary action against Schwab on February 1, 2012, for violating its rules, which Schwab had agreed to abide by when it became a member of NASD in the 1970s.<sup>121</sup>

In an attempt to moot the disciplinary proceedings, Schwab filed suit in the U.S. District Court for the Northern District of California seeking a declaratory judgment that FINRA could not enforce its rules against Schwab regarding its class action waiver because doing so would violate the FAA.<sup>122</sup> The district court dismissed the complaint because Schwab failed to exhaust FINRA's administrative remedies, which begins with the parties appearing in front of FINRA's Hearing Panel.<sup>123</sup> On May 30, 2012, the Hearing Panel heard the parties' oral arguments and held a non-evidentiary hearing before it issued its decision on February 21, 2013.<sup>124</sup> Despite finding that Schwab's class action and joinder waivers violated FINRA Rules, the Panel found for Schwab regarding the class action waiver, concluding that the FAA and Supreme Court precedent interpreting the FAA trumped FINRA Rules.<sup>125</sup> However, the Hearing Panel also held that "nothing in the FAA prohibits FINRA from authorizing arbitrators to consolidate [or join] multiple claims."<sup>126</sup> Dissatisfied, FINRA subsequently appealed the case to its NAC,

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120. *Charles Schwab & Co. v. Fin. Indus. Regulatory Auth., Inc.*, 861 F. Supp. 2d 1063, 1066 (N.D. Cal. 2012). For the entire text of the waiver, see *supra* note 5. This new agreement was distributed to nearly seven million customers. *Id.* Note, however, that Schwab removed the clause while the dispute was still pending. Susan Antilla, *Schwab Case Casts Spotlight on Securities Arbitration and Its Flaws*, N.Y. TIMES, Sept. 4, 2013, available at <http://dealbook.nytimes.com/2013/09/04/schwab-case-casts-spotlight-on-securities-arbitration-and-its-flaws/>.

121. *Charles Schwab & Co.*, 861 F. Supp. 2d at 1065–67.

122. *Id.* at 1064. Again, the FAA requires agreements to arbitrate to be enforced according to their terms. See discussion *supra* Part II.B.1.

123. *Charles Schwab & Co.*, 861 F. Supp. 2d at 1079; see *supra* notes 41–48 and accompanying text.

124. Hearing Panel Decision Granting in Part and Denying in Part the Parties' Cross-Motions for Summary Disposition at 1, 4, Dep't of Enforcement v. Charles Schwab & Co. (No. 2011029760201) (FINRA Office of Hearing Officers Feb. 21, 2013) [hereinafter Hearing Panel Decision], available at <http://www.finra.org/web/groups/industry/documents/ohodecisions/p258285.pdf>.

125. *Id.* at 1.

126. *Id.* at 43.

but before the NAC could issue a decision, FINRA's Board of Governors stepped in and reversed the Hearing Panel's decision and held for enforcement of FINRA's rules.<sup>127</sup> In response, Schwab agreed to not appeal its case, pay a \$500,000 fine, and no longer include the waiver in its customer agreements.<sup>128</sup> A decision by a self-interested board of governors—and an agreement to settle by a company seeking to maintain its “reputation and [the] public[s] trust”<sup>129</sup>—is hardly a reliable source to defer to regarding the question of whether the FAA trumps contrary rules created by a self-regulatory organization and approved by a federal agency. Therefore, to fully understand the dispute, an examination of FINRA's rules and Schwab's class action waiver's violation of these rules is required.

Schwab's class action and claims joinder waivers expressly violated FINRA Rules 12204, 12312, and 2268.<sup>130</sup> FINRA Rules 12204 and 12312 are substantive rules governing what kind of disputes can be arbitrated in the arbitration forum, as well as the arbitration process itself.<sup>131</sup> Rule 2268 prevents broker-dealers from violating FINRA's rules as it provides that predispute agreements to arbitrate cannot “limit[] or contradict[] the rules of any” SRO,<sup>132</sup> including FINRA, and also prevents the limiting of a party's ability to file a claim in court that FINRA's rules permit to be brought in court.<sup>133</sup> The FINRA Hearing Panel found that Schwab's arbitration provision violated all three rules.<sup>134</sup>

FINRA Rule 12204 permits a customer claim to be adjudicated in a class action proceeding “in a judicial forum, rather than by arbitration,” and states that a customer cannot be forced to arbitrate any claim that is still part of a judicial class action.<sup>135</sup> Rule 12204's history also supports this finding

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127. Matthias Rieker, *FINRA Wins Appeal in Schwab Class-Action Dispute*, WALL ST. J. (Apr. 24, 2014, 7:17 PM), <http://online.wsj.com/news/articles/SB10001424052702303380004579522093469025968>.

128. *Id.*

129. *Id.*

130. *See* Charles Schwab & Co. v. Fin. Indus. Regulatory Auth. Inc., 861 F. Supp. 2d 1063, 1068–69 (N.D. Cal. 2012); Hearing Panel Decision, *supra* note 124, at 1–2.

131. FINRA R. 12204(a), 12204(d), 12312.

132. FINRA R. 2268(d)(1).

133. FINRA R. 2268(d)(3).

134. Hearing Panel Decision, *supra* note 124, at 1.

135. *Id.* at 24; *see also* FINRA R. 12204(a), (d). In effect, this rule attempts to preserve investors' option of resolving their disputes through class action litigation in court. *See* FINRA R. 12204.

because in 1992, when the SEC approved the rule, it stated its belief that investors should be able to resolve their claims through class actions in court.<sup>136</sup> FINRA Rules 2268(d)(1) and (d)(3) preserve 12204's force because they are designed to prevent FINRA members from abrogating any of FINRA's rules.<sup>137</sup> These provisions work in conjunction to preserve investors' option to bring a class action in court.<sup>138</sup> Schwab's waiver provided that neither party may "bring . . . [or] participate . . . in any class action."<sup>139</sup> Thus, because Schwab's waiver prevented customers from bringing or participating in class actions in court, the waiver directly violated FINRA Rules 2268(d)(1) and (d)(3).<sup>140</sup>

FINRA Rule 12312 allows "[o]ne or more parties [to] join multiple claims together in the same arbitration."<sup>141</sup> For decades it has been understood that FINRA arbitrators have the authority to determine whether multiple parties can join and consolidate their claims.<sup>142</sup> Again, the conjunction of Rules 12312 and 2268(d)(1) prevents any FINRA member broker-dealer from using a predispute agreement to interfere with an

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136. Hearing Panel Decision, *supra* note 124, at 24. In fact, in 1992, when the NASD proposed these new provisions, NASD stated that one of the reasons for the new provisions was as a "response to suggestions by former SEC Chairman David S. Ruder that NASD 'consider adopting procedures that would give investors access to the courts in appropriate cases, including class actions.'" *Id.*

137. *Id.* at 25. Subsection (d)(1) prevents members from limiting or contradicting any FINRA Rules, while (d)(3) prohibits members from limiting customers' ability to file a claim in court that FINRA permits to be filed in court. *Id.*; see FINRA R. 2268(d)(1), (3).

138. See *supra* notes 135–37 and accompanying text. In fact, the entire securities industry has understood the rules to operate this way for nearly two decades. Hearing Panel Decision, *supra* note 124, at 25.

139. Charles Schwab & Co. v. Fin. Indus. Regulatory Auth. Inc., 861 F. Supp. 2d 1063, 1066 (N.D. Cal. 2012). See *supra* note 5 for the entire text of the waiver.

140. Hearing Panel Decision, *supra* note 124, at 26; see also *supra* notes 135–39 and accompanying text. To be clear, Schwab's contract language prohibiting any form of class actions violates FINRA Rule 12204's reservation of investors' option of participating in judicial class actions and FINRA Rule 2268's mandate that FINRA members—like Schwab—not violate any FINRA Rules in their predispute arbitration agreements. See FINRA R. 2268(d)(1), 2268(d)(3), 12204; *supra* note 5 and accompanying text.

141. FINRA R. 12312. This rule also serves the interests of the forum and parties by permitting the forum to efficiently and consistently resolve similar claims in a single proceeding. Hearing Panel Decision, *supra* note 124, at 30.

142. Hearing Panel Decision, *supra* note 124, at 27. Arbitrators for the NASD were given authority to join or consolidate claims in 1984, and arbitrators for the NYSE were given this same authority in 1990. *Id.* Hence, securities broker-dealers have been aware that arbitrators of securities disputes have had this power for at least twenty-four years. *Id.*

arbitrator's authority to determine the joinder or consolidation of multiple parties' claims in arbitration.<sup>143</sup> In violation of FINRA Rule 2268, Schwab's waiver stated "the arbitrator(s) shall have no authority to consolidate more than one parties' claims" and that "any actions . . . shall be brought solely in [each parties'] individual capacities."<sup>144</sup> This language limited and contradicted FINRA Rule 12312's reservation of authority to arbitrators to determine joinder of claims and hence resulted in a violation of FINRA Rule 2268(d)(1).<sup>145</sup> This violation, and subsequent invalidation of this part of Schwab's customer agreement, is important, not regarding the FAA because the Hearing Panel correctly held that the FAA does not prevent FINRA from compelling compliance with its arbitration joinder and consolidation rules.<sup>146</sup> Rather, it is important for policy reasons, because it causes a class action waiver to have a less severe impact on investors' opportunities to vindicate their rights.<sup>147</sup>

Therefore, it is undisputed that Schwab violated FINRA's rules.<sup>148</sup>

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143. See *supra* notes 141–42 and accompanying text.

144. *Charles Schwab & Co.*, 861 F. Supp. 2d at 1065–66. See *supra* note 5 for the entire text of the waiver.

145. Hearing Panel Decision, *supra* note 124, at 28; see also *supra* notes 141–44 and accompanying text. In other words, by trying to rob FINRA arbitrators of their claims consolidation authority, Schwab's customer agreement violates FINRA's express rules reserving this power for arbitrators and prohibiting FINRA members from contradicting FINRA Rules in arbitration agreements. See FINRA R. 12312, 2268(d)(1); *supra* note 5 and accompanying text.

146. Hearing Panel Decision, *supra* note 124, at 42–45. Nothing in the FAA mandates that "arbitrators should have specified powers or that arbitration must follow a particular procedure," nor does it obligate "arbitration agreements [to] follow any particular rules or procedures." *Id.* at 42 (citing *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 476, 479 (1989), and *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995)). Rather, all the FAA requires is that parties follow through and "arbitrate if they agreed in writing to arbitrate" and that federal courts compel disputes to arbitration if the dispute is subject to an agreement to arbitrate. *Id.* In fact, consolidation furthers the FAA's goals of "efficiency and streamlined resolution of similar issues" without the characteristics of class actions disfavored by the FAA, such as having to notify absent parties. *Id.* at 43–44.

147. See *infra* notes 248–49 and accompanying text.

148. See *supra* notes 132–45 and accompanying text. It seems quite obvious that FINRA's rules prohibit class action waivers in brokers' agreements with customers, just as the Hearing Panel found. Hearing Panel Decision, *supra* 124, at 1. But, even if it was alleged that FINRA's rules were ambiguous regarding class action waivers, FINRA and the SEC should still receive substantial deference to their interpretations of their rules and rule-making authority. See *United States v. Nat'l Ass'n of Sec. Dealers, Inc.*, 422 U.S. 694, 719 (1975) ("Th[e] consistent and longstanding interpretation by the agency charged with administration of the Act [the SEC], while not controlling, is entitled to considerable weight."); *Charles Schwab & Co.*, 861 F. Supp. 2d at 1065

Additionally, Schwab itself accepted that the FAA permits the enforcement of FINRA's arbitration consolidation and joinder rules.<sup>149</sup> However, due to Schwab's settlement after the FINRA Board of Governors reversed<sup>150</sup> the Hearing Panel's decision,<sup>151</sup> it is still unclear which way the higher appellate bodies in FINRA's disciplinary process<sup>152</sup> would have decided the issue of whether the FAA forecloses FINRA from enforcing its SEC-approved rules that permit investors to bypass arbitration and participate in judicial class actions.

### III. THE GOVERNORS GOT IT WRONG: AS THE LOWER COURTS HAVE SHOWN, THE FAA SHOULD HAVE PREVAILED

#### A. *The FAA Trumps FINRA Rules*

The FAA undoubtedly applies to the customer agreement between Schwab and its investors.<sup>153</sup> The most relevant portion of the FAA, § 2, states in express terms that it applies to any "contract evidencing a transaction involving commerce to settle by arbitration a controversy

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("Because of the SEC's oversight, FINRA Rules approved by the SEC are expressions of federal legislative power and have the force and effect of a federal regulation."); *see also* Black & Gross, *supra* note 1, at 40–42; Roberta S. Karmel, *Should Securities Industry Self-Regulatory Organizations Be Considered Government Agencies?*, 14 STAN. J.L. BUS. & FIN. 151, 152 (2008) (opining that FINRA should be treated as a government agency when it is exercising its investigative and disciplinary functions); Rhonda Wasserman, *Legal Process in a Box, or What Class Action Waivers Teach Us About Law-Making*, 44 LOY. U. CHI. L.J. 391, 424 (2012) (finding it likely that FINRA's rules should receive *Chevron* deference). Therefore, regardless of whether the rules at issue are ambiguous or not, Schwab's customer agreement violated them.

149. *See* Hearing Panel Decision, *supra* note 124, at 42–45; *see also supra* notes 128, 146. Schwab agreed "to sever the prohibition on joinder and consolidation of claims" from its customer agreement. Brief of the Chamber of Commerce of the United States of America as *Amicus Curiae* in Support of Respondent at 16, *Dep't of Enforcement v. Charles Schwab & Co.*, (No. 2011029760201) (FINRA NAC June 5, 2013) [hereinafter Brief of the Chamber of Commerce], available at <http://www.chamberlitigation.com/sites/default/files/cases/files/2013/NCLC%20Amicus%20Brief%20--%20Department%20of%20Enforcement%20v.%20Charles%20Schwab%20%28FINRA%29.pdf>.

150. FINRA Board of Governors Decision, *supra* note 13.

151. Hearing Panel Decision, *supra* note 124.

152. *See supra* notes 41–46 and accompanying text.

153. Hearing Panel Decision, *supra* note 124, at 33–34.

thereafter arising out of such contract or transaction.”<sup>154</sup> Schwab’s contract with its customers regarding how the customers’ money will be invested is a contract that involves a transaction in commerce,<sup>155</sup> and the parties’ contract included an agreement to arbitrate disputes that arise concerning the transaction.<sup>156</sup> Thus, when applied, the FAA requires that the agreement to arbitrate be enforced according to its terms<sup>157</sup> unless *Congress itself* has issued a contrary congressional command to override the FAA in the given context.<sup>158</sup>

Just as with any other statutory directive, Congress—and Congress alone—may create an exception to the FAA.<sup>159</sup> In addition, the party opposing arbitration, in this instance FINRA and its disciplinary team, bears the burden of showing that Congress intentionally precluded the waiver of

154. 9 U.S.C. § 2 (2012); *see also* AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1745 (2011); *supra* Part II.B.1.

155. Hearing Panel Decision, *supra* note 124, at 33. Separate from the FAA’s command over all transactions involving commerce, Schwab’s customer agreements themselves expressly refer to the FAA as the governing law of the agreement. *Id.* at 34. Further cementing that the FAA applies is the fact that this language has been included in Schwab’s customer agreements for a long time and FINRA has never objected, despite its close regulation of its members’ customer agreements. *Id.* Additionally, federal courts have found that FINRA’s arbitration rules themselves embody an agreement between the FINRA member and its customers to arbitrate disputes under the FAA, completely separate from the customer-member agreement. *Id.*; *see e.g.*, Morgan Keegan & Co. v. Silverman, 706 F.3d 562, 564 (4th Cir. 2013) (stating that even “in the absence of a separate arbitration agreement, a party can compel a FINRA member to participate in FINRA arbitration” as long as the other party is a “customer” of the member, the dispute is between the FINRA member and its “customer,” and the dispute is related to the FINRA member’s business activities); Wash. Square Sec., Inc. v. Aune, 385 F.3d 432, 435 (4th Cir. 2004) (finding that NASD Code creates an agreement under the FAA that binds the member to take eligible disputes to arbitration, regardless of the customer agreement to arbitrate). So, Schwab’s inclusion of FINRA’s arbitration rules in its customer agreement further confirms the FAA’s applicability to Schwab’s customer-member agreement. Hearing Panel Decision, *supra* note 124, at 34.

156. *See supra* note 5 and accompanying text. Although it is a class action waiver, it also acts as an agreement to arbitrate. *See* Charles Schwab & Co. v. Fin. Indus. Regulatory Auth. Inc., 861 F. Supp. 2d 1063, 1066 (N.D. Cal. 2012).

157. CompuCredit Corp. v. Greenwood, 132 S. Ct. 665, 669 (2012); *see also* *Concepcion*, 131 S. Ct. at 1745; Volt Info. Scis. v. Bd. of Trs. of Leland Stanford Junior Univ., 489 U.S. 468, 478 (1989); Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 226 (1987).

158. Am. Express Co. v. Italian Colors Rest., 133 S. Ct. 2304, 2309 (2013); *CompuCredit Corp.*, 132 S. Ct. at 669; *McMahon*, 482 U.S. at 226; *see also* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985).

159. *McMahon*, 482 U.S. at 226–27; Hearing Panel Decision, *supra* note 124, at 34; *see also* *Italian Colors Rest.*, 133 S. Ct. at 2309; *CompuCredit Corp.*, 132 S. Ct. at 669.

judicial remedies with regard to the statutory rights at issue.<sup>160</sup> Further, in order to prove Congress's intent to prohibit the waiver of a right to a judicial forum for a specific claim, Congress's intent must be discernible and deducible either from the statute's text itself or legislative history, or "from an inherent conflict between arbitration and the statute's underlying purposes."<sup>161</sup> The Court's decision in *Concepcion* firmly established that "no state policy against arbitration can supersede Congress's statute [(the FAA)] favoring arbitration."<sup>162</sup> Later cases such as *KPMG LLP v. Cocchi*, *Marmet Health Care Center v. Brown*, and *Nitro-Lift Technologies LLC v. Howard* were all similar to *Concepcion* in that they involved applying the FAA to override state laws based on state policy concerns.<sup>163</sup> However,

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160. *McMahon*, 482 U.S. at 227; see also Hearing Panel Decision, *supra* note 124, at 34–35.

161. *McMahon*, 482 U.S. at 227; see also Hearing Panel Decision, *supra* note 124, at 34–35. There is also the further presumption, established by the FAA, that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Mitsubishi Motors*, 473 U.S. at 626 (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24–25 (1983)). So, as with all contracts, the parties' intentions still control, but the intentions are construed in a way that is generous toward arbitration regarding arbitration issues. *Id.*

162. Hearing Panel Decision, *supra* note 124, at 35; see also *supra* Part II.B.2. When in conflict, the FAA displaces the conflicting state law/rule. *Concepcion*, 131 S. Ct. at 1747 (citing *Preston v. Ferrer*, 552 U.S. 346, 353 (2008)). The Ninth Circuit Court of Appeals has been more express in its opinions, reading *Concepcion* to mean, "unrelated policy concerns, however worthwhile, cannot undermine the FAA." *Coneff v. AT & T Corp.*, 673 F.3d 1155, 1159 (9th Cir. 2012); see also *Kilgore v. KeyBank, Nat'l Ass'n*, 673 F.3d 947, 963 (9th Cir. 2012) ("Although [a rule that requires a claim to be resolved judicially rather than through arbitration] may be based upon the sound public policy judgment of the California legislature, we are not free to ignore *Concepcion*'s holding that state public policy cannot trump the FAA when that policy prohibits the arbitration of a 'particular type of claim.'"), *aff'd on other grounds en banc*, 718 F.3d 1052 (9th Cir. 2013). In the few years since *Concepcion* was decided in 2011, the Court reiterated on numerous occasions that the FAA mandates a "federal policy in favor of arbitral dispute resolution." Hearing Panel Decision, *supra* note 124, at 36; see, e.g., *Nitro-Lift Techs., LLC v. Howard*, 133 S. Ct. 500, 503 (2012) (per curiam) (The FAA "declare[s] a national policy favoring arbitration." (alteration in original)); *Marmet Health Care Ctr., Inc. v. Brown*, 132 S. Ct. 1201, 1203 (2012) (per curiam) (The FAA "reflects an emphatic federal policy in favor of arbitral dispute resolution."); *CompuCredit Corp.*, 132 S. Ct. at 669 (The FAA establishes "a liberal federal policy favoring arbitration agreements."); *KPMG LLP v. Cocchi*, 132 S. Ct. 23, 25 (2011) (per curiam) ("The Federal Arbitration Act reflects an 'emphatic federal policy in favor of arbitral dispute resolution.'"). In sum, these decisions further "instruct that claims subject to an arbitration agreement covered by the FAA must be sent to arbitration for resolution, and that countervailing policy concerns cannot override that mandate." Hearing Panel Decision, *supra* note 124, at 36–37.

163. *Nitro-Lift Techs., LLC*, 133 S. Ct. 500 (vacating an Oklahoma state court decision that held

*CompuCredit Corp.* was somewhat different because it did not deal with state law or state policy concerns.<sup>164</sup>

Instead, *CompuCredit Corp.*, as discussed previously, dealt with the CROA—a federal law—showing that the same analysis applies in the context of federal statutory claims as well.<sup>165</sup> In the Schwab and FINRA dispute, however, it is FINRA Rules that are at issue, rather than a state or federal statute.<sup>166</sup> Again, FINRA promulgates its rules pursuant to its authority delegated from the SEC, and the SEC still oversees and must approve FINRA’s rules.<sup>167</sup> But, although FINRA Rules have the effect and force of federal regulations and can preempt state law,<sup>168</sup> the rules can only be enforced insofar as they are not inconsistent with federal law, which includes the FAA.<sup>169</sup> Therefore, without a relevant exception created by Congress itself that protects FINRA’s rules from being overruled by the FAA’s mandate, FINRA’s rules are unenforceable “to the extent they are inconsistent with the FAA.”<sup>170</sup>

non-compete agreements to be unenforceable despite the employee contract containing a valid arbitration agreement); *Marmet Health Care Ctr., Inc.*, 132 S. Ct. 1201 (invalidating a West Virginia state court decision that permitted personal injury and wrongful death claims against nursing homes to be brought in court despite a predispute agreement to arbitrate); *KPMG LLP*, 132 S. Ct. 23 (vacating a Florida state court decision that refused to compel the arbitration of two claims because two other related claims were not subject to arbitration).

164. See *CompuCredit Corp.*, 132 S. Ct. 665; see also *supra* Part II.B.4.

165. See *CompuCredit Corp.*, 132 S. Ct. 665; see also *supra* Part II.B.4. In the analysis, there is a requirement of an express congressional intent to prohibit the waiver of a right to resolve a claim in a judicial forum or “an inherent conflict between arbitration and the statute’s underlying purposes” in order for the FAA to not apply. *McMahon*, 482 U.S. at 227; see also Hearing Panel Decision, *supra* note 124, at 38.

166. See Hearing Panel Decision, *supra* note 124, at 39; see also *supra* Part II.C.

167. See Hearing Panel Decision, *supra* note 124, at 39; see also *supra* Part II.C.

168. See *Credit Suisse First Bos. Corp. v. Grunwald*, 400 F.3d 1119, 1128–32 (9th Cir. 2005) (holding that SRO Rules approved by the SEC preempt state laws when in conflict with each other); see also *Heilemann v. Bank of Am. Corp.*, No. CV 10–8623–GW(JCx), 2011 WL 2444812, at \*1 (C.D. Cal. 2011) (finding that NYSE Rules may have preemptive effect as a federal statute or regulation); Hearing Panel Decision, *supra* note 124, at 39–40.

169. Hearing Panel Decision, *supra* note 124, at 40; see also *Tuan Thai v. Ashcroft*, 366 F.3d 790, 798 (9th Cir. 2004) (stating that a federal regulation cannot do what a federal statute forbids); *Pub. Citizen v. Dep’t of Transp.*, 316 F.3d 1002, 1031 (9th Cir. 2003) (noting that EPA regulations do not permit the agency to act contrary to a federal statute), *rev’d on other grounds*, 541 U.S. 752 (2004); *Watson v. Proctor*, 161 F.3d 593, 598 (9th Cir. 1998) (“A federal regulation in conflict with a federal statute is *invalid* as a matter of law.”).

170. Hearing Panel Decision, *supra* note 124, at 40. Recent cases analyzing the conflicts between

There simply is, as FINRA's Hearing Panel concluded, no congressionally-created exception to the FAA in the securities context that would cause the FAA, and its mandate to enforce arbitration agreements according to their terms, to not apply to Schwab's class action waiver.<sup>171</sup> FINRA's Enforcement Team, and all other parties who submitted amicus briefs in support of FINRA's Department of Enforcement, were unable to identify any congressional intent to maintain the option of judicial class actions for consumers in the securities context, or anything that would cause FINRA's rules to rise to a higher priority than the FAA.<sup>172</sup> In actuality,

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the FAA and rules promulgated by other federal agencies overseeing the labor relations field, the National Labor Relations Board (NLRB), and organizations protecting consumers with regard to written warranty laws, the Federal Trade Commission (FTC), have displayed the necessity of finding a contrary congressional command to abrogate an arbitration agreement that eradicates class, collective, or representative actions. *See infra* Part III.B–C. Again, these cases concern conflicts between federal laws enacted by Congress and rules promulgated by independent un-elected agencies, so it is obvious that deference should be given to the body that created the agencies—Congress—rather than to these independent agencies. *See infra* Part III.B–C.

171. Hearing Panel Decision, *supra* note 124, at 40. However, some scholars believe that FINRA's rules and regulations, because they were promulgated pursuant to the Exchange Act and have the force and effect of federal law, prevail over the FAA via the statutory construction doctrine of implied repeal. *See* Black & Gross, *supra* note 1. In short, the doctrine of implied repeal holds that if a later promulgated law is "plainly repugnant" to an earlier made law, then the newest enactment impliedly repeals the former law to the extent the two are in conflict. *Id.* at 33–34. The Court has refined the test involved in the implied repeal doctrine, adding four factors to evaluate in choosing between conflicting federal laws; Professors Black and Gross believe that by applying the factors, FINRA Rules promulgated pursuant to the Exchange Act impliedly repeal the FAA. *See* Credit Suisse Sec. (USA) LLC v. Billing, 551 U.S. 264 (2007); Black & Gross, *supra* note 1, at 37–40. However, this argument requires the assumption that Congress, by granting authority to FINRA to make rules with SEC oversight and approval, expressly permitted FINRA to make rules that conflict with the FAA. But, this assumption goes too far because FINRA's rules are not the same as a congressional command creating an exception to the FAA. Rather, [FINRA's rules] represent[] only a determination by FINRA, pursuant to its general authority to promulgate Rules, to make an exception to the FAA. FINRA's general authority to promulgate rules is not a congressional command to promulgate the particular [r]ule carving out an exception to the FAA.

Hearing Panel Decision, *supra* note 124, at 41. Thus, it seems much more likely that the doctrine of implied repeal does not apply and actual congressional promulgation evidencing an exception to the FAA must be found in order to not enforce the FAA. *Id.*

172. *See* Hearing Panel Decision, *supra* note 124, at 40. The Board of Governors held that Congress's delegation of authority to the SEC to approve FINRA's rules causes FINRA Rules to become some form of a "congressional command," and thus deserving of deference. FINRA Board of Governor's Decision, *supra* note 13, at 18–21. The Board then analyzed cases involving conflicts between antitrust laws and securities laws as an analogy to support its view that FINRA's rules override the FAA. *Id.* at 21–31. However, this analysis concentrating on FINRA and the SEC's

judicial precedent hints at the conclusion that the FAA should have applied and governed Schwab's arbitration agreement.<sup>173</sup> The Court has previously held that the FAA requires the arbitration of claims covered by predispute arbitration agreements, even with regard to securities claims under the Exchange Act or the Securities Act.<sup>174</sup> Therefore, regarding Schwab's customer agreement that foreclosed investors' opportunity to participate in judicial class actions, the FAA should have applied and prevented the enforcement of FINRA's rules that would preserve that option for investors.<sup>175</sup>

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authority to make and approve rules focuses on the wrong issue. Just because an agency or organization has authority to promulgate rules does not mean it has the power to make rules in conflict with other congressional objectives. *See infra* note 183 and accompanying text. Instead, the focus should be on the FAA and its effect on contrary regulations promulgated by federal agencies. *See infra* Part III.B–C. The Board also curtly dismissed the idea that *Italian Colors* or *Concepcion* had anything to provide to its analysis. FINRA Board of Governors Decision, *supra* note 13, at 23–24. But this short shrift fails to adequately acknowledge the substantial power the FAA maintains in the eyes of the Supreme Court. *See supra* Part II.B.

173. Hearing Panel Decision, *supra* note 124, at 41; *see AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1751–53 (2011) (discussing the benefits of bilateral arbitration as opposed to classwide arbitration); *see also supra* note 163 and accompanying text. The Court said expressly in *Concepcion* that “[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA.” *Concepcion*, 131 S. Ct. at 1748.

174. Hearing Panel Decision, *supra* note 124, at 41. In *McMahon*, the Court held that the FAA applies to claims under the Exchange Act because no congressional intent to require a judicial forum to resolve Exchange Act claims could be found or discerned from the Exchange Act's text. *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987). Two years later the Court held similarly regarding the Securities Act of 1933 that claims under the Act governed by a predispute arbitration agreement were enforceable under the FAA and that resolution of claims only in a judicial forum is not required. *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477 (1989).

175. Hearing Panel Decision, *supra* note 124, at 33–41. Note that FINRA would have only been precluded from enforcing its rules that preserve investors' right to participate in judicial class actions, and that FINRA would have still been able to enforce its rules regarding FINRA's arbitrators' power of joinder and consolidation of claims and parties. *Id.* at 42–45. This is true because the Court has found that the FAA does not require arbitration agreements to follow specific rules or procedures, instead allowing arbitrators substantial freedom in deciding how the arbitration should proceed. *Id.* at 42; *see, e.g., Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 81 (2002) (finding that the interpretation of a NASD Arbitration Rule about a six-year eligibility limit was to be determined by the arbitrators rather than a court); *see also Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995); *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 476, 479 (1989).

*B. The FAA Supersedes the NLRB's Interpretations of the NLRA*

The labor relations field provides further support for the proposition that an agency or regulatory organization's own policy-based rules and interpretation of a federal statute granting it authority is not enough to rise to the level of a congressional command capable of overriding a contrary federal statute.<sup>176</sup> In recent cases within the labor relations law field, district and circuit courts have repeatedly held that an agency or organization's own view that its power-granting statute overrides the FAA is unpersuasive and unavailing.<sup>177</sup>

A recent Fifth Circuit case exemplifying this is *D.R. Horton, Inc. v. NLRB*.<sup>178</sup> Horton is a company that builds homes in over twenty states, and in 2006, Horton began requiring all of its employees to sign a Mutual Arbitration Agreement as a condition of employment.<sup>179</sup> The agreement provided that both Horton and the employee waived all rights to "trial[s] in court," that all disputes between the parties would be "determined exclusively" by arbitration, and that the arbitrator would not be able to "consolidate the claims of other employees" or "fashion a proceeding as a class or collective action."<sup>180</sup> Michael Cuda, one of Horton's employees, "filed an unfair labor practice charge, alleging that the class-action waiver violated the National Labor Relations Act (NLRA)."<sup>181</sup> The National Labor Relations Board (NLRB) found that the class action waiver violated the NLRA, but the Board's decision was appealed to the Fifth Circuit.<sup>182</sup>

176. Hearing Panel Decision, *supra* note 124, at 40 n.92.

177. *Id.*; *see also infra* note 187.

178. *D.R. Horton, Inc. v. NLRB*, 737 F.3d 344 (5th Cir. 2013).

179. *Id.* at 348.

180. *Id.* This agreement is strikingly similar to Schwab's class action waiver. *See supra* note 5 and accompanying text.

181. *D.R. Horton, Inc.*, 737 F.3d at 349.

182. *Id.* The relevant provision of the NLRA is § 7, which provides that:  
Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 158(a)(3) of this title.

29 U.S.C. § 157 (2012) (emphasis added); *D.R. Horton, Inc.*, 737 F.3d at 355. Thus, the Board

The Fifth Circuit noted that it would grant the NLRB's interpretations some deference, but noted, "the Board has not been commissioned to effectuate the policies of the Labor Relations Act so single-mindedly that it may wholly ignore other and equally important Congressional objectives," such as the FAA.<sup>183</sup> The Fifth Circuit first found that *Concepcion* prevented the NLRA from falling within the FAA's saving clause<sup>184</sup> because "[r]equiring a class mechanism is an actual impediment to arbitration and violates the FAA."<sup>185</sup> Next, the court found that there was no express congressional intent in the NLRA's text or its legislative history, nor was there an inherent conflict between the two Acts' purposes to override the FAA.<sup>186</sup> Additionally, the court was "loath to create a circuit split" because each of the other "circuits to consider the issue ha[d] either suggested or expressly stated that they would not defer to the NLRB's rationale, and held arbitration agreements containing class waivers enforceable."<sup>187</sup> Hence, in

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found that this "concerted activities" language created a substantive right and that Horton's Mutual Arbitration Agreement, with its class action waiver, infringed on this right. *D.R. Horton, Inc.*, 737 F.3d at 355–56.

183. *D.R. Horton, Inc.*, 737 F.3d at 356 (quoting *S. S. Co. v. NLRB*, 316 U.S. 31, 47 (1942)). The court further stated that it had "never deferred to the Board's remedial preferences where such preferences potentially trench upon federal statutes and policies unrelated to the NLRA." *Id.* (quoting *Hoffman Plastic Compounds, Inc. v. NLRB*, 535 U.S. 137, 144 (2002)). This is the same deference, but with limits based on other congressional statutes, which FINRA should be granted with its interpretations of the Exchange and Securities Acts. *See supra* note 171 and accompanying text.

184. *See supra* note 55 and accompanying text.

185. *D.R. Horton, Inc.*, 737 F.3d at 360. The Fifth Circuit listed all of the factors, described in *Concepcion*, inherent in class proceedings that take away from the biggest benefits of arbitration, like informality, efficiency, and low costs. *Id.* at 359. Additionally, the court noted that if companies are faced with "inevitable class arbitration, companies would have less incentive to continue resolving potentially duplicative claims on an individual basis." *Id.* Therefore, these impediments to arbitration from class proceedings and the discouragement of employers to use individual arbitration caused the "equity" portion of the saving clause not to be "a basis for invalidating the waiver of class procedures in the arbitration agreement." *Id.* at 359–60.

186. *Id.* at 360–61. Regarding the inherent conflict issue, the Fifth Circuit was persuaded that a conflict did not exist because the Supreme Court's and circuit courts' previous decisions foreclosed the idea that the Age Discrimination in Employment Act of 1967 (ADEA) or Federal Labor Standards Act (FLSA) provided a substantive right to proceed collectively. *Id.* at 357–58 (citing *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 32 (1991) (ADEA); *Carter v. Countrywide Credit Indus., Inc.*, 362 F.3d 294, 298 (5th Cir. 2004) (FLSA); *Adkins v. Labor Ready, Inc.*, 303 F.3d 496, 506 (4th Cir. 2002); *Kuehner v. Dickinson & Co.*, 84 F.3d 316, 319–20 (9th Cir. 1996)).

187. *Id.* at 362 (citing *Richards v. Ernst & Young, LLP*, 734 F.3d 871, 873–74 (9th Cir. 2013), *amended and superseded by* 744 F.3d 1072, 1075 n.3 (9th Cir. 2013) (per curiam); *Sutherland v.*

the field of labor relations law, it is well-settled that a contrary congressional command must be found in order to invalidate a class action waiver and that the NLRB's interpretation of the FLSA, the NLRA, or the ADEA, as overriding the FAA, is incorrect.<sup>188</sup> The securities industry, FINRA Rules, and FINRA's interpretation of the Securities and Exchange Acts are analogous to the NLRB and the labor relations field, and thus, should have been treated the same way: by allowing the FAA to apply and override FINRA Rules.<sup>189</sup> But the NLRB is not the only government entity whose rule interpretations have fallen when in conflict with the FAA, as the Federal Trade Commission (FTC) has experienced the same defeat.<sup>190</sup>

### C. The FAA Abrogates the FTC's Rules Regarding the MMWA

Courts have enforced the FAA's mandate in the face of conflicting agency rules in contexts other than the labor relations field, further supporting the proposition that FINRA Rules should not have received deference with regard to the Schwab dispute.<sup>191</sup> One such context is with warranties of consumer goods and the FTC's interpretation of the Magnuson-Moss Warranty Act (MMWA), as well as the Commission's rules promulgated pursuant to the Act.<sup>192</sup> The MMWA was passed in 1975 "to improve the adequacy of information available to consumers, prevent deception, and improve competition in the marketing of consumer products."<sup>193</sup> The MMWA also provided that if a warrantor includes a dispute settlement procedure in the warranty, it must comply with the rules

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Ernst & Young LLP, 726 F.3d 290, 297–98 n.8 (2d Cir. 2013); *Owen v. Bristol Care, Inc.*, 702 F.3d 1050, 1055 (8th Cir. 2013)). Therefore, the Fifth Circuit's decision was not an anomaly, but rather is the prevailing viewpoint among the Second, Eighth, and Ninth Circuits, which gives the decision greater weight.

188. Hearing Panel Decision, *supra* note 124, at 40 n.92; *see supra* notes 176–87 and accompanying text.

189. *See supra* notes 176–87 and accompanying text.

190. *See infra* Part III.C.

191. *See supra* Part III.A.

192. *See Davis v. S. Energy Homes, Inc.*, 305 F.3d 1268 (11th Cir. 2002); *Walton v. Rose Mobile Homes LLC*, 298 F.3d 470 (5th Cir. 2002); *see also* Hearing Panel Decision, *supra* note 124, at 40 n.92.

193. *Davis*, 305 F.3d at 1272 (quoting 15 U.S.C. § 2302(a) (1994)). The MMWA was passed in response to the growing number of customer complaints over the inadequacy of consumer good warranties. *Id.*

prescribed by the FTC.<sup>194</sup> The FTC had explicitly expressed that predispute alternative dispute resolution procedures can only be a “precursor to litigation and never binding,”<sup>195</sup> which has contradicted multiple warranty-granting companies’ *binding* arbitration agreements.<sup>196</sup> Both circuits to consider the issue, the Fifth and the Eleventh, found that the FAA and Supreme Court precedent favoring arbitration override the MMWA and the FTC’s Rules.<sup>197</sup>

The Eleventh Circuit most recently tackled the issue in 2002 in *Davis v. Southern Energy Homes, Inc.*, in which the Davises purchased a home from Southern Energy and signed a “binding arbitration agreement contained within the manufactured home’s written warranty.”<sup>198</sup> The Davises found multiple defects in the home and sued for multiple common law claims as well as for violations of the MMWA.<sup>199</sup> The case was appealed to the Eleventh Circuit,<sup>200</sup> with Southern Energy motioning to compel arbitration of the dispute, and the Davises arguing that the MMWA and the FTC’s rules preclude enforcement of binding arbitration agreements with respect to written warranty claims.<sup>201</sup>

The Eleventh Circuit found no congressional intent in the MMWA to preclude arbitration of a claim under it,<sup>202</sup> so the court applied a *Chevron*

194. 15 U.S.C. § 2310(a)(2) (2012).

195. *Davis*, 305 F.3d at 1277 (citing 16 C.F.R. § 700.8 (2002)).

196. *See, e.g., id.* at 1270. Therefore, the situation is strikingly similar, though with a different congressional act at issue, to Schwab’s dispute with FINRA because FINRA is charged, just like the FTC and the MMWA, with promulgating rules pursuant to the Securities and Exchange Acts; and, again, FINRA’s rules disfavor arbitration in the face of the FAA just like the FTC’s rules on dispute resolution procedures over MMWA violations disfavor arbitration by precluding binding arbitration. *See supra* Part II.C.

197. *See Davis*, 305 F.3d 1268; *Walton*, 298 F.3d 470. The Ninth Circuit considered this issue, contrarily finding that the buyer’s MMWA warranty claims were not arbitrable, but this decision was later withdrawn. *Kolev v. Euromotors W/The Auto Gallery*, 658 F.3d 1024 (9th Cir. 2011), *withdrawn*, 676 F.3d 867 (9th Cir. 2012).

198. *Davis*, 305 F.3d at 1270.

199. *Id.*

200. *Id.* The Davises filed suit in the circuit court of Lowndes County, Alabama, but Southern Energy removed the case to federal court. *Id.* The district court denied Southern Energy’s motion to compel arbitration pursuant to the parties’ arbitration agreement, so Southern Energy appealed to the Eleventh Circuit. *Id.*

201. *Id.* at 1271.

202. *Id.* at 1274–77. In coming to this determination, the Eleventh Circuit examined the MMWA’s text, legislative history, and whether there was an inherent conflict between the statute’s

analysis<sup>203</sup> to determine whether it should grant deference to the FTC's interpretation of the MMWA.<sup>204</sup> For the second part of the *Chevron* analysis, the court examined the reasonableness of the FTC's regulations and in doing so, looked at the FTC's underlying rationale.<sup>205</sup>

In its legislative regulations, the FTC explained its decision that warranty disputes may not be binding under the MMWA based on Congress's grant of concurrent jurisdiction for resolution of breach of warranty disputes to "state and federal courts;"<sup>206</sup> however, the Eleventh Circuit held, pursuant to Supreme Court precedent, that a statute merely providing for a judicial forum does not make a binding arbitration agreement unenforceable under the FAA.<sup>207</sup> Thus, the FTC's motive for its rule was contradictory to the Supreme Court's rationale in many other cases where it had required an explicit preclusion of arbitration,<sup>208</sup> and thus was an unreasonable interpretation of the MMWA.<sup>209</sup> This unreasonable

underlying purpose and arbitration, but found no intent by Congress, nor an inherent conflict in the statute's purposes, which would require precluding arbitration. *Id.* This was an application of the test, articulated in *McMahon*, just as the Hearing Panel applied the test in its decision in the Schwab and FINRA dispute. *See Shearson/Am. Express v. McMahon*, 482 U.S. 220, 226–27 (1987); Hearing Panel Decision, *supra* note 124, at 40–41.

203. *Chevron, U.S.A., Inc. v. Natural Res. Def. Counsel, Inc.*, 467 U.S. 837 (1984). *Chevron* prescribes a two-part test, first asking "whether Congress has directly spoken to the precise question at issue," and if not, then evaluating "whether the agency's answer is based on a permissible construction of the statute." *Id.* at 842–43.

204. *Davis*, 305 F.3d at 1277–80. The court found that the first prong of the *Chevron* analysis favored not granting deference to the FTC because, based on its analysis of the MMWA under the *Shearson* test, Congress failed to directly address binding arbitration in the MMWA. *Id.* at 1278. So, the court moved to an analysis of the second prong. *Id.* at 1278–80.

205. *Id.*

206. The FTC believed that the language of "[§] 110(d) of the Act gives state and federal courts jurisdiction over suits for breach of warranty," also known as concurrent jurisdiction, and that this grant of jurisdiction made it improper for resolution of warranty disputes in arbitration to be binding. *Id.* at 1278 (quoting 16 C.F.R. § 700.8).

207. *Id.* at 1279.

208. *See infra* notes 214–20.

209. *Davis*, 305 F.3d at 1279–80. The FTC also acknowledged its additional motive that it is "not now convinced that any guidelines which it set out could ensure sufficient protection for consumers," and the Eleventh Circuit found this rationale unreasonable as well, in light of Supreme Court precedent. *Id.* at 1279. The court expressly acknowledged that contrary to the FTC's views that arbitration negatively affects consumers, "the Supreme Court holds that arbitration is favorable to the individual." *Id.*; *see also Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 280 (1995) (stating that "arbitration's advantages often would seem helpful to individuals, say, complaining about a product, who need a less expensive alternative to litigation"). This is essentially FINRA's

interpretation caused the court to refuse to defer to the FTC's regulations and interpretation of the MMWA regarding binding arbitration agreements in written warranty agreements, making the arbitration agreement enforceable pursuant to the FAA.<sup>210</sup>

The Eleventh and Fifth Circuits' upholding of binding agreements to arbitrate<sup>211</sup> was not atypical or groundbreaking, but perfectly in line with Supreme Court precedent.<sup>212</sup> In their decisions, both circuits recognized the consistency and strength of Supreme Court precedent enforcing arbitration agreements, noting that "[i]n every case the Supreme Court has considered involving a statutory right that does not *explicitly* preclude arbitration, it has upheld the application of the FAA."<sup>213</sup> The list of statutes under which the Court has enforced arbitration agreements, due to the absence of explicit preclusion of arbitration, include: the Truth in Lending Act,<sup>214</sup> the Age Discrimination in Employment Act,<sup>215</sup> the Racketeer Influenced and Corrupt Organization Act,<sup>216</sup> the Credit Repair Organizations Act,<sup>217</sup> the Sherman Act,<sup>218</sup> the Securities Act of 1933,<sup>219</sup> and the Securities Exchange Act of 1934.<sup>220</sup> Therefore, even with regard to acts or statutes that the Supreme Court has not itself expressly dealt with, its overwhelming precedent of enforcing arbitration agreements requires lower courts, government agencies, and SROs to follow suit. These entities must follow this lead,

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rationale for its rules prohibiting class action waivers, that the option of participating in judicial class actions is required to sufficiently protect investors, which also contradicts Supreme Court precedent that has held arbitration as favorable for the individual. *See supra* Part II.A, C. So, just as the Eleventh Circuit determined that this rationale of protecting consumers was unreasonable, *Davis*, 305 F.3d at 1280, so too is the rationale of protecting investors by preserving a judicial class action alternative for dissatisfied investors.

210. *Davis*, 305 F.3d at 1280.

211. *See Davis*, 305 F.3d 1268; *Walton v. Rose Mobile Homes LLC*, 298 F.3d 470 (5th Cir. 2002).

212. *See infra* notes 213–20 and accompanying text.

213. *Walton*, 298 F.3d at 474 (emphasis added); *see also Davis*, 305 F.3d at 1273.

214. *Green Tree Fin. Corp.—Ala. v. Randolph*, 531 U.S. 79, 88–92 (2000).

215. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 35 (1991).

216. *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 242 (1987).

217. *CompuCredit Corp. v. Greenwood*, 132 S. Ct. 665, 671–73 (2012).

218. *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2309 (2013); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628–40 (1985).

219. *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 484–86 (1989).

220. *McMahon*, 482 U.S. at 238.

despite each entity's own contrary policy observations, because the Supreme Court's policy analysis, which trumps all other analyses, is that arbitration adequately protects individuals.<sup>221</sup>

#### IV. POLICY ARGUMENTS: ENFORCEMENT OF SCHWAB'S CLASS ACTION WAIVER, CONTRARY TO POPULAR OPINION, WOULD HAVE ACTUALLY BENEFITED INVESTORS

Many scholars and amici curiae have expressed a grave fear that permitting Schwab to include a class action waiver in its customer agreements would have caused numerous other broker-dealers to follow suit and effectively leave investors with small-value claims without protection or remedies.<sup>222</sup> However, although other broker-dealers may have followed Schwab's lead (if it had won) by putting class action waivers in their

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221. See *supra* Part III.A–C.

222. See Brief of Amici Professors Barbara Black & Jill Gross in Support of FINRA's Opening Brief at 15–17, *Dep't of Enforcement v. Charles Schwab & Co.* (No. 2011029760201) (FINRA NAC May 6, 2013), available at <http://lawprofessors.typepad.com/files/amicus-brief-final.pdf> (“The ability of brokerage customers to bring class actions in appropriate cases provides important investor protection, particularly for customers with small-value claims, who may have no effective remedy apart from a class action because of the costs of pursuing individual claims.”); Amicus Curiae Brief of Public Investors Arbitration Bar Ass'n in Support of FINRA's Department of Enforcement at 4, *Dep't of Enforcement v. Charles Schwab & Co.* (No. 2011029760201) (FINRA NAC May 7, 2013), available at <http://piaba.org/system/files/pdfs/Department%20of%20Enforcement%20vs%20Charles%20Schwab%20and%20Company%2C%20Inc.%2C%20PIABA%20Amicus%20%28May%207%2C%202013%29.pdf> (“Investors with small claims would be left wholly without an adequate forum or remedy to seek redress of their claims.”); Letter from William F. Gavin, Sec'y of the Commonwealth of Mass., to Charles R. Schwab, Chairman of the Bd. (Feb. 26, 2013) [hereinafter Letter from William F. Gavin], available at <http://www.sec.state.ma.us/sct/sctschwabarb/Schwab-letter.pdf> (“This ruling [permitting Schwab's class action waiver] is akin to giving every rogue broker-dealer the green light to steal from their customers in small dollar amounts.”); Amicus Curiae Brief of the North American Securities Administrators Ass'n, Inc. at 16–17, *Dep't of Enforcement v. Charles Schwab & Co.* (No. 2011029760201) (FINRA NAC May 8, 2013), available at [http://www.nasaa.org/wp-content/uploads/2013/05/Amicus-Curiae\\_Schwab.pdf](http://www.nasaa.org/wp-content/uploads/2013/05/Amicus-Curiae_Schwab.pdf) (“[The Hearing Panel's decision permitting Schwab's class action waiver has] placed investors in imminent harm by precluding their ability to seek redress for small dollar claims.”); Amended Brief of Amici Curiae AARP, National Consumer Law Center, & Public Justice, P.C. in Support of Complainant at 2, *Dep't of Enforcement v. Charles Schwab & Co.* (No. 2011029760201) (FINRA NAC May 8, 2013), available at <http://publicjustice.net/sites/default/files/downloads/Department-of-Enforcement-v-Schwab-Amici-Brief-of-AARP-NCLC-Public-Justice-8May2013.pdf> (“Unless FINRA enforces its own Rules to preserve class actions, there will be no effective protection for investors.”).

customer agreements,<sup>223</sup> class actions are not that beneficial to investors or necessary for deterrence of wrongdoing by broker-dealers, and arbitration is more economical, faster, and more efficient for everyone involved in the securities industry—even when brought individually.<sup>224</sup>

#### A. *Investors Experience Lower Costs and Faster Recoveries in FINRA Arbitrations*

Amongst all the assertions that investors' inability to bring class actions in court will rob them of any means of redress,<sup>225</sup> it has been forgotten that FINRA arbitrations are "a proven mechanism for providing fair outcomes to customers of broker-dealers."<sup>226</sup> Individual arbitration before FINRA is a "fast, inexpensive, and fair way for investors to obtain redress for any harms they may have suffered."<sup>227</sup> In fact, investors who participate in FINRA arbitrations experience fewer costs and more wins than their counterparts who litigate in court.<sup>228</sup> One scholar, and former president of the American

223. Dan Jamieson, *Schwab's Class Action Win a Blueprint for Other Firms*, INVESTMENTNEWS (Feb. 24, 2013, 12:01 AM), <http://www.investmentnews.com/article/20130224/REG/302249989> ("More brokerage firms are expected to follow the lead of The Charles Schwab Corp. and demand that customers give up their right to file class actions against them.").

224. See *infra* Part IV.A–C; see also Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements—With Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251, 259 (2006) ("[A]rbitration arising out of adhesive agreements is an entrepreneurial, private-sector innovation producing what disputing parties want: quick, inexpensive, common-sense adjudication of disputes. By contrast, civil litigation in the public-sector court system is slow and archaic, full of legalistic jargon, technicalities and formalities that produce a lot more work for lawyers without producing a corresponding increase in justice for the disputing parties who have to pay the lawyers.").

225. See *supra* note 222 and accompanying text.

226. Brief of the Chamber of Commerce, *supra* note 149, at 2. The Chamber of Commerce of the United States "represents 300,000 direct members and . . . more than three million companies and professional organizations of every size," and its members have substantial experience before FINRA and have "intimate familiarity with how class-action litigation functions (or more precisely, fails to function) in practice." *Id.* at 1–2.

227. *Id.* at 2; see also *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1751 (2011) ("In bilateral arbitration, parties forgo the procedural rigor and appellate review of the courts in order to realize the benefits of private dispute resolution: *lower costs, greater efficiency and speed*, and the ability to choose expert adjudicators to resolve specialized disputes." (emphasis added) (quoting *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 685 (2010))).

228. Brief of the Chamber of Commerce, *supra* note 149, at 2; see also *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 280 (1995) ("[A]rbitration's advantages often would seem helpful to

Bar Association, has estimated that investors can arbitrate their claims with FINRA for at least half, and maybe even a quarter, of the cost of litigating in court.<sup>229</sup> Investors accrue an additional cost savings due to more narrowly tailored discovery in FINRA arbitration than in federal litigation.<sup>230</sup> So, substantial evidence supports the argument that the lower discovery costs and cheaper filing fees in securities' arbitration result in a "relative economic benefit favoring arbitration for the customer."<sup>231</sup>

Also, investors save more money due to FINRA's quick arbitrations, as they are resolved in a "fraction of the time that a lawsuit in federal or state court would take."<sup>232</sup> Through August of 2014, FINRA's arbitration program has resolved regular cases in an average of 18.3 months and simplified arbitrations in just 8.1 months.<sup>233</sup> By comparison, civil cases in

individuals . . . who need a less expensive alternative to litigation."). Individuals with small value claims are better off going to arbitration because "the costs and delays of [court litigation] could eat up the value of an eventual small recovery." *Allied-Bruce Terminix Cos.*, 513 U.S. at 281.

229. WILLIAM G. PAUL, *ARBITRATION V. LITIGATION IN ENERGY CASES 3* (2002). Another study of the period between October 1, 1987, and June 30, 1988 (nearly twenty-five years ago), run by Deloitte Haskins found that "the average legal costs are \$12,000 less in arbitration than for litigation." J. KIRKLAND GRANT, *SECURITIES ARBITRATION FOR BROKERS, ATTORNEYS, AND INVESTORS 96* (1994). Additionally, FINRA has specifically tailored its fee schedule for customers with small claims, as the filing fee is only \$50 for claims up to \$1,000, and only \$75 for claims up to \$2,500. FINRA R. 12900(a)(1). This fee may be deferred in part, or whole, based upon a showing of financial hardship, or the arbitrator could allocate payment of the fee to the defendant, rather than the customer/investor. FINRA R. 12900(a)(1), (d).

230. Under the Federal Rules of Civil Procedure, discovery is guided by the parties, which often results in very broad and costly requests for disclosure, and parties are also allowed to depose up to ten witnesses before trial without leave of the court. SEC. INDUST. & FIN. MKTS ASS'N, *WHITE PAPER ON ARBITRATION IN THE SECURITIES INDUSTRY 28* (2007), available at [http://www.sifma.org/uploadedfiles/societies/sifma\\_compliance\\_and\\_legal\\_society/whitepaperonarbitration-october2007.pdf](http://www.sifma.org/uploadedfiles/societies/sifma_compliance_and_legal_society/whitepaperonarbitration-october2007.pdf) (citing FED. R. CIV. P. 26, 30). In contrast, FINRA arbitrations limit discovery to "presumptively discoverable material enumerated on specific discovery lists," interrogatories are for the most part impermissible, and "depositions are strongly discouraged," which results in a more streamlined (and less costly) discovery process than with typical court proceedings. *Id.* at 28–29 (citing CODE OF ARB. P. § 12506, 12507(a)(1), 12510).

231. *Sec. Indus. Ass'n v. Connolly*, 703 F. Supp. 146, 159 (D. Mass. 1988), *aff'd*, 883 F.2d 1114 (1st Cir. 1989).

232. Brief of the Chamber of Commerce, *supra* note 149, at 2. FINRA arbitrations under \$50,000—which are permitted to go through FINRA's "simplified arbitration procedures" under FINRA Rule 12800—are resolved in "less than a third of the time it takes to litigate in the overburdened federal and state court systems." *Id.* at 6.

233. *Dispute Resolution Statistics*, FINRA, <http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/Statistics/index.htm> (last visited Oct. 10, 2014).

federal court are currently facing median delays of 23.4 months.<sup>234</sup> State courts are faring even worse due to funding crises causing courtrooms to close,<sup>235</sup> but, even in 2001, studies showed that a contract suit tried “before a jury took slightly over 2 years (25 months) on average to proceed from filing to disposition.”<sup>236</sup> Thus, wronged investors, especially those with small value claims eligible for simplified arbitration status, can avoid the delays that exist in the overburdened federal and state courts and get their grievances resolved more quickly and more easily through FINRA’s bilateral arbitrations.<sup>237</sup>

*B. Investors Experience Higher Recovery Rates and Recover Greater Portions of Their Losses in Arbitration*

Contrary to popular belief,<sup>238</sup> securities class actions do not usually end with better results for investors than individual FINRA arbitrations.<sup>239</sup> First, less than 10% of intended class action suits ever get certified due to heightened pleading standards.<sup>240</sup> Second, of the portion of cases that are lucky enough to gain certification, many are rejected at summary

234. See Admin. Office of the U.S. Courts, *Federal Judicial Caseload Statistics Table. C-5*, (2012), <http://www.uscourts.gov/Viewer.aspx?doc=/uscourts/Statistics/FederalJudicialCaseloadStatistics/2012/tables/C05Mar12.pdf> (reporting data for the period of April 1, 2011, through March 31, 2012).

235. California, for example, due to \$653 million in budget cuts, has closed “courtrooms and clerk’s offices in 24 counties across the state,” resulting in significant litigation delays. Erin Coe, *Calif. Chief Justice Warns of Looming Case Delays*, LAW360 (Mar. 19, 2012), <http://www.law360.com/legalindustry/articles/319086>. Some states, like New Hampshire, for instance, have even gone so far as to defer all civil trials for one year. Brief of the Chamber of Commerce, *supra* note 149, at 7–8.

236. See THOMAS H. COHEN, CONTRACT TRIALS AND VERDICTS IN LARGE COUNTIES, 2001, at 2 (2005), <http://www.bjs.gov/content/pub/pdf/ctvlc01.pdf> (selected finding by the U.S. Department of Justice’s Bureau of Justice Statistics).

237. See *supra* notes 232–36 and accompanying text.

238. See *supra* note 222 and accompanying text.

239. See *infra* notes 240–49 and accompanying text.

240. Brief of the Chamber of Commerce, *supra* note 149, at 8. These heightened pleading standards are a result of the Private Securities Litigation Reform Act of 1995 (PSLRA). See 15 U.S.C. § 78u-4 (2012); see also Brief of the Chamber of Commerce, *supra* note 149, at 8. Of the cases that are not resolved before filing for certification, 18% have their motions for certification denied. RENZO COMOLLI ET AL., RECENT TRENDS IN SECURITIES CLASS ACTION LITIGATION: 2012 FULL-YEAR REVIEW 20 (2013).

judgment.<sup>241</sup> Third, class actions are now almost as likely to be dismissed as they are to result in settlement, further reducing the amount of class actions that result in restitution for investors.<sup>242</sup> Fourth, of the cases that actually result in settlement, investors usually only recoup a tiny fraction of their experienced losses.<sup>243</sup> Finally, substantial attorneys' fees and costs further contribute to the reduction of compensation for investors.<sup>244</sup> Thus, the chances of an investor recovering any substantial amount of his loss is very

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241. Brief of the Chamber of Commerce, *supra* note 149, at 8. For cases in which defendants filed summary judgment motions, 37.2% of the motions are granted. COMOLLI ET AL., *supra* note 240, at 22.

242. COMOLLI ET AL., *supra* note 240, at 24. Of all the cases filed between 2007 and 2009, including cases that have not yet reached resolution, 44%–49% have already been dismissed, and, according to the data, these rates of dismissal appear to be rising. *Id.* It is also important to note that significant defense costs are inflicted on the parties sued, even if the defendants are lucky enough to prevent class certification, win on summary judgment, or obtain a case dismissal. Brief of the Chamber of Commerce, *supra* note 149, at 11. Not to mention the costs of “business disruptions caused by compliance with unnecessarily burdensome discovery requests,” which are an important weapon for plaintiffs seeking to force a defendant into a blackmail-like settlement. *Id.*

243. Brief of the Chamber of Commerce, *supra* note 149, at 13. To be precise, in 2012, the median ratio of settlement recovery to investor losses was just 1.8%, and this rate has been decreasing since the passage of the PSLRA. COMOLLI ET AL., *supra* note 240, at 32–33 (calculating investors' losses based on “the aggregate amount that investors lost from buying the defendant's stock rather than investing in the broader market during the alleged class period”). This low loss recovery rate and the continued perpetuation of class actions results in “the systematic undercompensation of investors with legitimate claims,” with the occasional windfall to investors with meritless claims. Brief of the Chamber of Commerce, *supra* note 149, at 20–21.

244. For the time period of January 2010 to December 2012, plaintiffs' attorneys' fees and expenses were 34.2% of the settlement value of cases settled for less than \$5 million, and were 12.6% of the settlement value of cases settled for greater than or equal to \$1 billion. COMOLLI ET AL., *supra* note 240, at 34. In fact, just ten class action settlements alone resulted in plaintiffs' attorneys receiving over \$2.7 billion in fees and expenses. *Id.* at 30–31. Thus, lawyers in pursuit of the big payday that a class action settlement can provide is one of the main reasons for this continued push toward class actions instead of arbitrations. Brief of the Chamber of Commerce, *supra* note 149 at 21–22. So, FINRA's prevention of the enforcement of arbitration agreements like Schwab's “distorts the market for legal services in FINRA arbitrations.” *Id.* at 21. There are lawyers willing to represent investors in FINRA arbitrations evidenced by associations like the Public Investors Arbitration Bar Association (PIABA) who have members across the country. *See About PIABA*, PIABA, <http://piaba.org/about-piaba> (last visited Oct. 10, 2014) (claiming lawyers in forty-four states, Puerto Rico, and Japan). However, a large segment of the bar only work on class actions due to the high potential award from a contingency fee after a class action victory that just is not as substantial in individual arbitrations. Brief of the Chamber of Commerce, *supra* note 149, at 21. Hence, these lawyers that would otherwise be representing investors in FINRA arbitrations based on reasonable hourly rates instead chase the chance of “windfall recoveries” in class actions “like moths to a flame” to the detriment of investors. *Id.* at 21–22.

slim due to the difficulty in gaining class certification and surviving dismissal combined with the low amount of recovery as a percent of total losses after substantial attorneys' fees have been incurred.<sup>245</sup>

In contrast, FINRA arbitrations continually provide efficient compensation to claimants, with approximately 77% of FINRA arbitrations filed by customers in 2013 resulting in recovery for investors.<sup>246</sup> The premise that FINRA arbitration is a preferable route to recovery of investors' claims is further supported by the trend of class members of securities class actions opting out in favor of arbitrating their claims individually.<sup>247</sup> Additionally, due to the FAA allowing FINRA to enforce its rules, thereby permitting joinder and consolidation of claims in arbitration,<sup>248</sup> FINRA arbitration is favorable because investors with similar claims can still "pool resources and share costs" in pursuit of their claims.<sup>249</sup> Therefore, it is evident that FINRA arbitrations better compensate investors after losses than

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245. See *supra* notes 240–44 and accompanying text.

246. *Dispute Resolution Statistics*, *supra* note 233 (listing results of customer claimant arbitration award cases). Additionally, resolving claims through individual arbitration ensures that each individual investor is appropriately compensated for his individual loss and eliminates the windfall to investors with meritless claims.

247. Brief of the Chamber of Commerce, *supra* note 149, at 14–15; see also, e.g., *Prudential Sec. Inc. Ltd. P'ship Litig. v. Prudential Sec. Inc.*, 107 F.3d 3, 1996 WL 739258, at \*1–2 (2d Cir. 1996) (unpublished decision) (noting that so many class members opted out of proposed settlement as to trigger "blow provision" in settlement agreement). Examples include the AOL-Time Warner securities-fraud settlement in which many of the class members who opted out "reported individual recoveries of between 6.5 and 50 times the amount they would have recovered under the class settlement" and the Tyco securities-fraud class action in which some investors who opted out and arbitrated individually recovered 80% of their losses when they would have only received about 3% of their losses by participating in the class action settlement. Brief of the Chamber of Commerce, *supra* note 149, at 15.

248. See *supra* note 146 and accompanying text.

249. Brief of the Chamber of Commerce, *supra* note 149, at 3–4. Nothing prevents investors from cooperating with one another to develop and share evidence, theories of liability, attorney preparation, and expert witness fees, among multiple cases. *Id.* at 3, 16. In fact, due to the significant financial incentives, plaintiffs' attorneys have started to pursue serial individual arbitrations. *Id.* at 17. For example, the attorney for a class action that was dismissed against AT&T subsequently filed "separate demands for arbitration on behalf of over 1,000 claimants—each making virtually identical allegations and relying on the same expert witness." *Id.* at 17–18. This strategy is not unique, as other lawyers have taken similar actions, and thanks to today's social media and the Internet, reaching potential claimants with similar claims who can share costs has become quite easy. *Id.*; see also Carolyn Whetzel & Jessie Kokrda Kamens, *Opt Out's Use of Social Media Against Honda in Small Claim Win Possible "Game Changer"*, in BLOOMBERG BNA CLASS ACTION LITIGATION REPORT (2012).

class actions, making Schwab's proposed class action waiver much less problematic than it would initially seem.<sup>250</sup>

C. *Class Actions Are Not Necessary to Protect, and May Actually Harm, Investors*

FINRA and many other organizations and individuals argued, "Unless FINRA enforces its own Rules to preserve class actions [for investors as an alternative to arbitration], there will be no effective protection for investors."<sup>251</sup> However, this is just not true.<sup>252</sup> First, it would seem to be a rare situation in which a broker-dealer's "fraudulent or misleading practices could survive a wave of individual arbitrations" and the mass of negative publicity that would surely accompany them.<sup>253</sup> Second, FINRA itself, via its Department of Enforcement, "ha[s] ample power to police misconduct"<sup>254</sup>

250. See *supra* notes 240–49 and accompanying text.

251. Amended Brief of Amici Curiae AARP, *supra* note 222, at 2; see also *supra* note 222 and accompanying text.

252. Brief of the Chamber of Commerce, *supra* note 149, at 18.

253. *Id.* To prove this point, one need look no further than the vast amount of publicity Schwab's proposed class action waiver created, including law review articles, Internet articles and blogs, and a number of letters and amicus curiae briefs submitted to the NAC after the Hearing Panel's decision. See, e.g., Black & Gross, *supra* note 1 (law review article); Jamieson, *supra* note 223 (internet article); Singer, *supra* note 63 (internet blog); Arduengo, *supra* note 63 (internet blog); Letter from William F. Gavin, *supra* note 222 (letter); *supra* note 222 and accompanying text (listing amicus curiae briefs). If this much publicity is generated by a broker-dealer simply amending its customer agreement, it would seem that a broker-dealer would receive much more negative attention and notoriety after *actually* illegally wronging its investors.

254. Brief of the Chamber of Commerce, *supra* note 149, at 18–19; see also *supra* note 40 and accompanying text. FINRA's police power over its broker-dealer members and associated persons is evidenced by the vast number of ways FINRA can punish broker-dealers for violating any of numerous different rules, regulations, and laws as described in FINRA Rule 8310(a):

After compliance with the Rule 9000 Series, FINRA may impose one or more of the following sanctions on a member or person associated with a member for each violation of the federal securities laws, rules or regulations thereunder, the rules of the Municipal Securities Rulemaking Board, or FINRA rules, or may impose one or more of the following sanctions on a member or person associated with a member for any neglect or refusal to comply with an order, direction, or decision issued under the FINRA rules: (1) censure a member or person associated with a member; (2) impose a fine upon a member or person associated with a member; (3) suspend the membership of a member or suspend the registration of a person associated with a member for a definite period or a period contingent on the performance of a particular act; (4) expel a member, cancel the membership of a member, or revoke or cancel the registration of a person associated with a member; (5) suspend or bar a member or person associated with a member from

and has diligently exercised this power to patrol its members and safeguard investors.<sup>255</sup> Third, “FINRA is not alone” in its policing duties, as the SEC has “broad powers to remedy wrongdoing” as well,<sup>256</sup> and has similarly been willing to flex its enforcement authority.<sup>257</sup> Fourth and finally, in instances of fraud, prosecutors can pursue criminal actions against the fraudulent companies and individuals.<sup>258</sup> Hence, with multiple layers of oversight and regulation in the securities industry, class actions are not essential for investor protection and end up hurting investors more than helping them.<sup>259</sup>

In addition to class actions not being necessary to help police broker-

association with all members; (6) *impose a temporary or permanent cease and desist order* against a member or a person associated with a member; or (7) *impose any other fitting sanction.*

FINRA R. 8310(a) (emphases added). This substantial authority, along with FINRA’s sweeping oversight, provides substantial protection for investors, making class actions in court as further protection unnecessary. *See infra* note 255 and accompanying text.

255. *See* News Release, FINRA, 2012: FINRA Year in Review (Jan. 8, 2013), *available at* <http://www.finra.org/Newsroom/NewsReleases/2013/P197624>; *see also supra* note 49 and accompanying text. In 2012 alone, FINRA did “1,846 routine examinations, more than 800 branch office examinations, and 5,100 cause examinations” after receiving customer complaints, terminations for cause, and regulatory tips about misbehaving broker-dealers. News Release, FINRA, *supra*. These investigations led FINRA to expel “30 firms from the securities industry,” as well as “bar[] 294 individuals and suspend[] 549 brokers from association with FINRA-regulated firms.” *Id.* In addition, FINRA ordered broker-dealers to pay over \$100 million in fines and restitution to harmed investors. *Id.*

256. Brief of the Chamber of Commerce, *supra* note 149, at 19. The SEC has authority to “bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, upon a proper showing, a civil penalty to be paid by the person who committed [a] violation” of any provisions of the Securities and Exchange Act of 1934, any of the Act’s rules and regulations, or any cease-and-desist orders entered by the Commission. 15 U.S.C. § 78u(d)(3)(A) (2012). The SEC is also authorized to specifically protect and remedy wrongs against investors, by granting “any equitable relief that may be appropriate or necessary for the benefit of investors.” § 78u(d)(5).

257. In addition to all the efforts taken by FINRA in 2012, the SEC independently brought “734 enforcement actions,” one shy of the SEC’s record set the previous year, and obtained orders “requiring the payment of more than \$3 billion in penalties and disgorgement for the benefit of harmed investors.” Press Release, U.S. SEC, SEC’s Enforcement Program Continues to Show Strong Results in Safeguarding Investors and Markets (Nov. 14, 2012), *available at* <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171485830#.UuQ8hWTTky4>. Specifically, the SEC brought 134 enforcement actions against broker-dealers, which was a 19% increase from the prior year. *Id.* The SEC itself is quite satisfied with its recent work, evidenced by the SEC’s Division of Enforcement Director, Robert Khumazi, stating that “[i]t’s not simply numbers, but the increasing complexity and diversity of the cases we file that shows how successful we’ve been.” *Id.*

258. Brief of the Chamber of Commerce, *supra* note 149, at 19.

259. *See supra* notes 253–58 and accompanying text.

dealers, class actions only end up taking more money from investors in the long run than arbitrating individually in FINRA arbitrations.<sup>260</sup> Because class actions require broker-dealers to pay far more legal expenses and attorney's fees to defend than individual FINRA arbitrations,<sup>261</sup> broker-dealers' overall costs rise.<sup>262</sup> Basic economics correctly predict that these increased costs will be passed along to investors in the form of higher fees and larger commissions.<sup>263</sup> Conversely, if agreements to arbitrate disputes on an individual basis, like Schwab's, are properly enforced, "market competition w[ill] lead to the cost savings [experienced by broker-dealers] being passed along to their customers."<sup>264</sup> Thus, the enforcement of class action waivers results in joint savings for each side, benefitting both broker-dealers and investors.<sup>265</sup>

Therefore, taking a broader view of the effects of class actions on investors in the securities industry reveals that the fears expressed by so many critics of Schwab's proposed class action waiver are shortsighted.<sup>266</sup>

260. Brief of the Chamber of Commerce, *supra* note 149, at 19–20.

261. In fact, one recent study of in-house attorneys and general counsel found that securities class actions, due to their complexity, are the most expensive, based on money spent on legal fees, type of class action. CARLTON FIELDS, THE 2013 CARLTON FIELDS CLASS ACTION SURVEY 12 (2013), available at <http://www.cfjblaw.com/files/uploads/Carlton-Fields-Class-Action-Report-2013-electronic.pdf>. The source of these process costs are from "the time and legal fees[,] spent on pleadings, discovery, motions, trial or hearing, and appeal," associated with class actions that are greatly reduced in arbitration forums like FINRA's. Ware, *supra* note 224, at 258.

262. Ware, *supra* note 224, at 254; see Brief of the Chamber of Commerce, *supra* note 149, at 20. It is hard to dispute the argument that enforcing arbitration agreements saves broker-dealers money via lower dispute resolution costs, because, if it did not, "why would they continue to use them?" Ware, *supra* note 224, at 254.

263. Brief of the Chamber of Commerce, *supra* note 149, at 20; see Ware, *supra* note 224, at 254–57.

264. Brief of the Chamber of Commerce, *supra* note 149, at 20; see Ware, *supra* note 224, at 255 ("[W]hatever lowers costs to businesses tends over time to lower prices to consumers."). Although critics may debate the actual size of the price reduction for broker-dealer customers as a result of enforcing class action waivers, "it is inconsistent with basic economics to question the existence of the price reduction." Ware, *supra* note 224, at 256. Additionally, the argument that investors fare better at gaining recompense in arbitration than class actions, see *supra* Part IV.B, is not foreclosed by the fact that class action waivers save broker-dealers money because "the business defendant's process costs in arbitration are so much lower in arbitration [than class actions] that, for the business, the process-cost savings outweighs the increase in payments for awards and settlements" with investors. Ware, *supra* note 224, at 259.

265. See *supra* notes 260–64 and accompanying text.

266. See *supra* Part IV.A–C.

Thorough analysis shows that, when compared with securities class actions, FINRA arbitrations provide investors with quicker and cheaper resolutions of disputes with broker-dealers,<sup>267</sup> higher rates of recovery as well as larger recoveries,<sup>268</sup> and overall greater savings through broker-dealers not having to pass the increased costs of defending class actions on to investors.<sup>269</sup> Additionally, class actions are not truly necessary to protect investors from broker-dealer misconduct because there are multiple sources helping police the securities industry.<sup>270</sup> In sum, all of these findings lead to one conclusion: enforcing arbitration agreements and class action waivers would benefit investors rather than hurt them.<sup>271</sup>

## V. CONCLUSION

Because Schwab declined to appeal FINRA's Board of Governors' decision, which prevented a federal circuit court or the Supreme Court from hearing the issue, the question of whether SEC-approved FINRA Rules override the FAA's mandate will have to wait to be conclusively answered. However, the Supreme Court's most recent precedent interpreting the FAA is strikingly clear: arbitration agreements must be enforced according to their terms.<sup>272</sup> This policy of enforcing the FAA has persisted despite arguments that enforcing agreements to arbitrate robs individuals of the opportunity to vindicate their rights.<sup>273</sup> Enforcement of the FAA absent finding a contrary congressional command has been applied in numerous contexts similar to the securities industry and has permitted the FAA to override federal agencies' self-interested interpretations of federal statutes.<sup>274</sup> Hence, FINRA's Hearing Panel was actually correct in holding that Schwab could enforce its class action waiver despite FINRA Rules prohibiting it.<sup>275</sup>

Not only is this the conclusion that the law mandates, but it would have

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267. *See supra* Part IV.A.

268. *See supra* Part IV.B.

269. *See supra* Part IV.C.

270. *See supra* Part IV.C.

271. *See supra* Part IV.

272. *See supra* Part II.B.2–4.

273. *See supra* Part II.B.3.

274. *See supra* Part III.B–C.

275. *See supra* Part III.A.

also been the best result for investors because investors fare better in faster and cheaper FINRA arbitrations than in judicial class actions.<sup>276</sup> Additionally, preventing class actions benefits both broker-dealers and investors.<sup>277</sup> This is because broker-dealers' cost savings from arbitration are passed along to investors thanks to vigorous competition in the broker-dealer industry.<sup>278</sup> Moreover, the arguments made by opponents of Schwab's proposed class action waiver (i.e., that investors must be able to participate in class actions in order to help police broker-dealers and keep investors safe), are refuted by a deeper investigation into the facts.<sup>279</sup> Thus, instead of being fearful of the potential future adoption of class action waivers in customer agreements by other broker-dealers following Schwab's attempt,<sup>280</sup> these supposed protectors of investors should begin encouraging class action waivers, if they truly do have investors' best interests at heart.

Clint Hale\*

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276. *See supra* Part IV.A–B.

277. *See supra* Part IV.

278. *See supra* Part IV.C.

279. *See supra* Part IV.

280. *See supra* note 222 and accompanying text.

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