DISCIPLINARY PROCEEDING NO. 2011029760201

Financial Industry Regulatory Authority
National Adjudicatory Counsel

DEPARTMENT OF ENFORCEMENT,

Complainant,

-against-

CHARLES SCHWAB & COMPANY, INC.,

Respondent.

AMICUS CURIAE BRIEF OF PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION IN SUPPORT OF FINRA'S DEPARTMENT OF ENFORCEMENT

Lisa A. Catalano
CATALANO ARBITRATION AND MEDIATION SERVICES
61-20 Grand Central Parkway
C702
Forest Hills, NY 11375
(347) 639-0615
(917) 796-5760
lisa@lcmediator.com

Attorney for Amicus Curiae, Public Investors Arbitration Bar Association
2415 A Wilcox Drive, Norman, OK 73069

Date Completed: May 7, 2013

TABLE OF AUTHORITIES

CASES

STATUTES

RULES

OTHER AUTHORITIES

INTRODUCTION

The Public Investors Arbitration Bar Association ("PIABA") respectfully submits its brief, as *amicus curiae,* in support of FINRA's Department of Enforcement ("DOE") appeal of the Hearing Panel's decision of February 21, 2013. The DOE seeks to affirm the Panel's decision holding that Charles Schwab & Company, Inc. ("Schwab"), violated FINRA's rules by including class action waiver and non-consolidation language in its pre-dispute arbitration agreements ("PDAAs"), but requests that the National Adjudicatory Council ("NAC") *reverse* the Panel's conclusion that, notwithstanding Schwab's violations, enforcement of FINRA's rules is foreclosed by the Federal Arbitration Act ("FAA").[1]

[1] No counsel for a party or party to this proceeding authored this Brief, in whole or in part, and no counsel for a party or party to this proceeding made a monetary contribution intended to fund either the preparation or the submission of this brief. No person other than PIABA, its members, or its counsel made a monetary contribution to the preparation or submission of this Brief.

STATEMENT OF INTEREST

PIABA is a national, non-profit, voluntary bar association established in 1990, whose members are attorneys across the country that represent the public investor in securities disputes. The mission of PIABA is to promote the interests of the public investor in securities arbitration by protecting public investors from abuses in the arbitration process; working to make securities arbitration as just and fair as possible; and creating a level playing field for the public investor in securities arbitration.

PIABA has particular interest in this proceeding, given its goal of seeking to assure that victimized investors have a just and fair forum in which to pursue redress of their claims. Schwab's PDAAs forbidding class action participation and joinder of claims in FINRA arbitration plainly violate FINRA Rules 12204(d) and 2268(d). These rules recognize that some investor claims can only effectively be pursued as a class action in court, and serve to protect investors' rights to pursue these remedies. While the Panel agreed that the class action waiver provision in Schwab's PDAA violates these conduct rules, it held that the rules were unenforceable under the FAA. If allowed to stand, this decision will invite all FINRA members to insert similar class action waivers in their PDAAs, a result that is particularly egregious to investors with smaller claims. Such a ruling would cause victimized investors to either abandon their claims or proceed on a *pro se*

basis. FINRA Rules were specifically designed to avoid such a catastrophic scenario.

SUMMARY OF ARGUMENT

The Hearing Panel correctly decided that Schwab's PDAAs requiring its investors to waive participation in class actions and preventing them from seeking consolidation of claims in FINRA arbitration violated FINRA and NASD Rules. However, the Panel further held that FINRA's rules addressing investors' rights to participate in class actions were unenforceable under the FAA, as construed by the United States Supreme Court in *AT&T Mobility LLC v. Concepcion* ("*Concepcion*").[2] PIABA urges the NAC to affirm the Panel's finding that Schwab's provision violate FINRA's Rules, but reverse its finding that the rules are unenforceable.

A finding that the DOE cannot enforce FINRA Rules in light of the FAA essentially renders Schwab's PDAAs enforceable and would leave a large gap in investor protection. Investors with small claims would be left wholly without an adequate forum or remedy to seek redress of their claims. The viability of the class action waivers in Schwab's PDAA would also encourage brokerage firms to

---

[2] 563 U.S. ___, 131 S.Ct. 1740 (2011). In *Concepcion*, the United States Supreme Court held that the FAA preempted California's judicially created rule of not enforcing class action waiver provisions in PDAAs as unconscionable. 131 S.Ct. 1753. The Panel's conclusion that *Concepcion* precludes enforcement of FINRA's rules prohibiting class action waivers is misguided for several reasons, including the following. First, the Panel was not asked to rule upon the enforceability of the PDAA as between Schwab and any of its customers; rather, the dispute concerns whether FINRA can promulgate and enforce the conduct rules it places on its members. Second, the Panel's decision places a judicially created equitable rule on the same footing as conduct rules promulgated by FINRA and approved by the Securities and Exchange Commission.

arbitrarily include such waivers in their PDAAs with their customers to limit their liability and deter investors with small claims from pursuing them.

ARGUMENT

I. SCHWAB'S PDAAs WILL HAVE CATASTROPHIC EFFECTS ON INVESTORS WITH SMALL CLAIMS

A. Investors with Small Claims Will Be Left With the Choice of Either Abandoning Their Claims or Proceeding on a *Pro Se* Basis

The United States Supreme Court and many scholars have expressed the view that class action waiver and non-aggregation of claims clauses will cause investors with small claims to either abandon their claims because the costs of pursuing their claims may be more than their claims are actually worth, or they may be forced to proceed *pro se* in simplified arbitration. In a 5-4 decision, the dissent in *AT&T Mobility LLC v. Concepcion* criticized class action waivers, observing that

> class proceedings have . . . advantages. In general agreements that forbid the consolidation of claims can lead small-dollar claimants to abandon their claims rather than to litigate. . . . [A]s the Court of Appeals recognized, AT&T can avoid the $7,500 payment (the payment that supposedly makes the Concepcions' arbitration worthwhile) simply by paying the claim's face value, such that 'the maximum gain to the customer for the hassle of arbitrating a $30.22 dispute is still just $30.22.'[3]

---

[3] 131 S. Ct. 1740, 1760 (2011), (Breyer, J., dissenting) (citation omitted). *See also*, Jill I. Gross, *AT&T Mobility and the Future of Small Claims Arbitration*, 42 Sw. L. Rev. 47, 49 (2012) ("By inserting a class action waiver clause in their consumer contracts, companies can prevent consumers from aggregating small claims, forcing them to pursue small claims individually. . . . The funneling of low dollar value claims into simplified arbitration has serious implications for consumers and most investors of modest means seeking substantive and procedural justice in a forum in which their claim is heard solely on the papers. Substantively, *pro se* parties may not have the education, training, or ability to effectively communicate their complex arguments in writing. Moreover, 'where credibility and veracity are at issue, . . . written submissions are a wholly unsatisfactory basis for decision.'") (internal citations omitted); Sarah Rudolph Cole, *On Babies and Bathwater: The Arbitration Fairness Act and the Supreme Court's Recent Arbitration Jurisprudence*, 48 Hous. L. Rev. 457, 462-63 (2011) ("[T]he most pressing issue in consumer arbitration, in the wake of recent Supreme Court decisions, is the lack of a viable

Additionally, investors with small claims will be left without the benefit of legal representation. The *Concepcion* dissent explained,

> [w]hat rational lawyer would have signed on to represent the Concepcions in litigation for the possibility of fees stemming from a $30.22 claim? *See, e.g., Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (C.A. 7 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"). . . . [N]on-class arbitration over such sums will also sometimes have the effect of depriving claimants of their claims (say, for example, where claiming the $30.22 were to involve filling out many forms that require technical legal knowledge or waiting at great length while a call is placed on hold.) *Discover Bank* sets forth circumstances in which the California courts believe that the terms of consumer contracts can be manipulated to insulate an agreement's author from liability for its own frauds by 'deliberately cheat[ing] large numbers of consumers out of individually small sums of money.'[4]

Moreover, class action waiver clauses may impede a party's ability to vindicate their statutory rights, a result prohibited by the Supreme Court. *See, e.g., Mitsubishi Motors Corp. v. Soler Chyrsler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985) ("so long as the prospective litigant may vindicate their statutory cause of action in the arbitral forum, the [federal] statute [providing the cause of action] will continue to serve both remedial and deterrent function."); *Green Tree Fin. Corp.-Ala. V. Randolph*, 531 U.S. 79, 90-91 (2000) (a court may bar enforcement of an

---

forum for consumers with low value claims."); Jean R. Sternlight, *Tsunami: AT&T LLC v. Concepcion Impedes Access to Justice*, 90 Or. L. Rev. 703, 704 (2012) ("It is highly ironic but no less distressing that a case with a name 'conception' should come to signify *death for the legal claims of many potential plaintiffs*.") (Emphasis added).

[4] *Concepcion*, 131 S. Ct. at 1761 (emphasis in original) (citation omitted).

arbitration agreement if a claimant can prove excessive fees which impede the claimant's ability to vindicate their statutory rights.)

Investors who decide to proceed with their claims on an individual basis will have to do so in simplified arbitration pursuant to FINRA Customer Code Rule 12800. They most likely will do so on a *pro se* basis because, as the *Concepcion* dissent has stated, "[w]hat rational lawyer would [sign on] to represent . . . [a party] in litigation for the possibility of fees stemming from a . . . [small-dollar] claim?"[5] They will also most likely request a paper case rather than a hearing because of the small dollars involved. While there are many advantages to paper cases (*i.e.,* faster turnaround time, lower processing costs, no evidentiary hearing fees, and less discovery and motions,) there are also many disadvantages.[6] For example, claimants may not have access to all of the documents necessary to effectively prove their cases; the credibility or veracity of the claimants cannot be assessed by the arbitrator; and the claimants will not have their "day in court."[7] "[A]cademic research shows that participants perceive a dispute resolution process as more fair if they believe they have been heard. . . . In the end, under the current system design, being heard in person may prove too costly for small dollar value disputants."[8]

---

[5] *Id.*
[6] Gross, *supra* note 3, at 65-66.
[7] *Id.* at 66.
[8] *Id.*

Moreover, as discussed in further detail below, *pro se* claimants fare far worse in FINRA arbitration than those represented by legal counsel.

B. The Odds are Stacked Against *Pro Se* Claimants

In 1992, the United States General Accounting Office ("GAO") conducted a two year study entitled "Securities Arbitration: How Arbitration Fares" ("GAO Study"). The GAO Study found that investors represented by counsel settled roughly 1.7 times more than *pro se* claimants and that represented investors' recovery rates were 1.6 times more likely to exceed the average recovery rate when they did prevail.[9]

About five years later, the Securities Arbitration Commentator conducted a survey comparing results of simplified arbitrations with those exceeding the $10,000 simplified arbitration threshold ("SAC Survey.) Claims by *pro se* investors represented more than 75% of the simplified arbitration awards[10], prevailing in 44.87% of those cases versus an overall win rate of 49% in simplified arbitrations.[11] *Pro se* investors who had their cases decided on the papers prevailed 45.9% of the time versus 51% for represented investors.[12] *Pro se* investors who requested a live hearing prevailed 41.7% of the time, while represented parties

---

[9] *See GAO Study: How Arbitration Fares*, 5 Sec. Arb. Commentator 1, 1 (1992).
[10] *See SAC Award Survey: How Fares the Pro Se Investor In Arbitration?* 8 Sec. Arb. Commentator, 1, 1 (1997).
[11] *Id.* at 1-2.
[12] *Id.* at 2.

prevailed 55.4% of the time.[13] Additionally, *pro se* investors recovered less of what they sought than represented parties when they did prevail. *Pro se* investors recovered 70.2%, while represented parties recovered 77%. Both the GAO Study and the SAC Survey revealed that the disparity in win rates between represented and *pro se* claimants increased as the size of compensatory damages grew.[14] According to the GAO Study and the SAC Survey, *pro se* investors clearly fare far worse in FINRA arbitration than those represented by legal counsel.

II. THE PDAAS CONTRADICT THE LETTER AND SPIRIT OF FINRA AND NASD RULES

A. The PDAA's Prohibition Against Class Actions

Schwab's PDAAs provide that:

> [n]either 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 one or more than one parties' [sic] claims or to proceed on a representative or class action basis.
>
> You and Schwab agree that any actions between us and/or 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.

---

[13] *Id.*
[14] *Id.*

By stark contrast, while FINRA Rules prohibit class actions in the FINRA arbitration forum,[15] they specifically permit investors to pursue class action claims in court pursuant to Rule 12204(d), prohibiting members and associated persons from enforcing arbitration agreements against an investor who is a member of a certified or putative class until certain conditions are met. FINRA Rules also proscribe language in PDAAs such as that contained in the Schwab agreements. FINRA Rule 2268(d)(3) prohibits PDAAs from including a provision that "limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement."[16] Thus, Schwab's PDAAs contradict and violate the clear mandates of FINRA Rule 12204 and prohibitions contained in FINRA Rule 2268.

Schwab's PDAAs also violate the spirit of those rules. Most investors are bound by PDAAs when they establish a relationship with a brokerage firm.[17] FINRA Rule 12204 was promulgated because FINRA and the SEC believe that class actions are better handled by the courts with established processes, rather than in the arbitration forum. Indeed, the SEC agreed with the NASD that investors

---

[15] *See* FINRA Rule 12204(a).

[16] FINRA Rule 2268(d) (2011) was originally NASD, Rules of Fair Practice Art. III, §21(f) (1989) which was renumbered NASD Rule 3110(f) (1996).

[17] *See* REPORT OF THE ARBITRATION POLICY TASK FORCE TO THE BOARD OF GOVERNORS NAT'L ASSOC. OF SECURITIES DEALERS, INC. 3 (1996), also known as the RUDER REPORT.

should have the ability to pursue class action claims in court. The SEC stated when approving Rule 12204:

> The Commission agrees with the NASD's position that, in all cases, class actions are better handled by the courts and that investors should have access to the courts to resolve class actions efficiently. In the past, individuals who attempted to certify class actions in litigation were subject to the enforcement of their separate arbitration contracts by their broker-dealers. Without access to class actions in appropriate cases, both investors and broker-dealers have been put to the expense of wasteful, duplicative litigation . . ..
> . . . *The Commission believes that investor access to the courts should be preserved for class actions* . . . .[18]

Additionally, FINRA Rule 2268 was designed in part to restrict firms from including overreaching provisions in their PDAAs inconsistent with SRO arbitration. "[T]he prohibition against inconsistent conditions was necessary because 'agreements cannot be used to curtail any rights that a party may otherwise have had in a judicial forum.' Accordingly , new [Rule 2268] . . . 'appropriately balance[s] the need to strengthen investor confidence in the arbitration systems at the SROs . . . with the need to maintain arbitration as a forum of dispute resolution that provides for equitable and efficient administration of justice.'"[19]

---

[18] Order Approving Proposed Rule Change Relating to the Exclusion of Class Actions from Arbitration Proceedings, 57 Fed.Reg. 52659, 52661 (Nov. 4, 1992) (emphasis in original).

[19] Barbara Black and Jill I. Gross, *Investor Protection Meets the Federal Arbitration Act*, 1 Stan. J. Complex Litig. 1, 25 (2012) (*quoting* the Order approving NYSE, NASD, and AMEX Proposed Changes relating to Arbitration Process and the Use of Predispute Arbitration Clauses, 54 Fed. Reg. 21,144 (May 16, 1989)).

Schwab's PDAAs are designed to do precisely what FINRA Rule 2268 prohibits. They "curtail any rights that a party may otherwise have had in a judicial forum", and they undermine investor confidence in the SRO arbitration systems by foreclosing dispute resolution alternatives that provide "for equitable and efficient administration of justice."

The Hearing Panel stated that "the Supreme Court has expressed the view that class actions are inconsistent with the underlying purpose of the FAA to streamline the resolution of disputes." However, eliminating the ability of investors with small claims to consolidate their claims in a class action actually creates far greater litigation or, as previously explained, leaves small claim investors with no remedy whatsoever.

B. <u>The PDAA's Prohibition Against Consolidation of Claims</u>

The clause forbidding arbitrators from consolidating claims clearly violates FINRA Rules 12312, 12313 and 12314. Joinder of multiple claims is permitted where:

> the claims contain common questions of law or fact and:
> • The claims assert any right to relief jointly and severally; or
> • The claims arise out of the same transaction or occurrence, or series of transactions or occurrences. [20]

The Director of Arbitration is to decide whether consolidation is appropriate in the first instance and may be reconsidered once a panel is appointed.[21] Thus,

[20] FINRA CUSTOMER CODE R. 12312 (a) and 12313 (a).

Schwab cannot thwart the ability of parties to seek consolidation and certainly cannot tie the hands of the arbitrators in exercising the discretion to determine whether consolidation is appropriate. Indeed, Rule 12409 grants broad discretion to the arbitrators, providing that "[t]he panel has the authority to interpret and determine the applicability of all provisions under the Code. Such interpretations are final and binding upon the parties."

Schwab's non-consolidation language thwarts the purpose of FINRA's consolidation rules, which is to aggregate similar claims promoting a more efficient and economical process. The SEC and FINRA's

> rulemaking has been guided by two realities: (1) virtually all customers' disputes with their brokers are resolved in the SRO forum, and (2) investors' trust and confidence in their brokers is paramount to maintaining strong capital markets. Accordingly, the federal regulators, based on their understanding of the industry, have determined that some investors' claims can be better handled if aggregated. If there are a discrete number of similar claims, FINRA permits joinder in the arbitration forum . . . .[22]

The only option that Schwab's agreements leave investors with is the pursuit of individual claims, which in many instances is not feasible because of the small amount of dollars involved. This result is unjust and inequitable.

---

[21] FINRA CUSTOMER CODE R. 12312.
[22] Black and Gross, *supra* note 19, at 42-43.

III. THE "VIABILITY" OF PDAAs SUCH AS THE ONE AT ISSUE IN THIS CASE WILL ENCOURAGE FIRMS TO INCLUDE SUCH CLAUSES IN THEIR CONTRACTS WITH THEIR CUSTOMERS

If Schwab's PDAAs are permitted to stand, other firms will include such clauses in their arbitration agreements with their customers to limit, and possibly avoid, liability altogether. Indeed, this has already begun to transpire. A firm by the name of Carlyle Group LP amended a registration statement in 2012 filed with the SEC for an IPO, disclosing that investors could only bring individual claims; consolidation of claims was prohibited; and the proceedings and awards were to be confidential.[23] The firm subsequently dropped the provision when the SEC and certain members of Congress expressed displeasure.

Additionally, in 2012, four publicly traded companies sought to include in their proxy statements proposals to amend their bylaws to provide that all shareholders' claims were subject to arbitration and to prohibit class actions.[24] Two of the corporations, Pfizer Inc. and Gannett Co. received no-action letters from the SEC to keep the proposals off their statements.[25] The other two companies, Google and Frontier Communications, did not gain management endorsement or shareholder support for the proposal. "[I]t is likely that other issuers will brave public criticism and challenge the SEC's opposition to class

---

[23] *Id.* at 7.
[24] Id. at 8.
[25] Id.

action waivers some time in the future."[26] FINRA should not countenance this result.

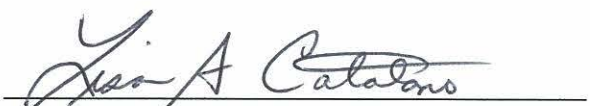
CONCLUSION

As a FINRA member, Schwab has agreed to abide by FINRA's Rules. Those rules include Rules 2268, 12204, and 12312-12314. The NAC should require Schwab to live up to its agreement. Such a ruling would vindicate FINRA's sound policy reasons for permitting class actions to proceed in court and for allowing the consolidation of claims in arbitration.

Affirmance of the Disciplinary Panel's FAA preemptive ruling would lead to disastrous results. Thousands of investors with small claims would be detrimentally affected, left only with the choice of abandoning their claims or proceeding in simplified arbitration on a *pro se* basis, where the prospect of success is very bleak.

For all of the reasons stated, The Disciplinary Panel's FAA preemptive ruling should be reversed, and the remainder of the decision should be affirmed.

Respectfully Submitted,

By: 

LISA A. CATALANO
Attorney for *Amicus Curiae*

[26] *Id.* at 9.

Public Investors Arbitration Bar Association
CATALANO ARBITRATION AND
MEDIATION SERVICES
61-20 Grand Central Parkway
C702
Forest Hills, NY 11375
(347) 639-0615
(917) 796-5760
lisa@lcmediator.com

FINRA NATIONAL ADJUDICATORY COMMITTEE

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	
	:	Disciplinary Proceeding No.
v.	:	2011029760201
	:	
	:	
CHARLES SCHWAB & COMPANY, INC.,	:	
	:	
Respondent.	:	

MOTION FOR LEAVE TO FILE *AMICUS CURIAE* BRIEF

The Public Investors Arbitration Bar Association ("PIABA") hereby files its motion for leave to file an *amicus curiae* brief and accompanying brief in support of the FINRA Department of Enforcement's ("DOE") position in the above captioned matter.

PIABA is a national, non-profit, voluntary bar association established in 1990, whose members are attorneys across the country that represent the public investor in securities disputes. The mission of PIABA is to promote the interests of the public investor in securities arbitration by protecting public investors from abuses in the arbitration process; working to make securities arbitration as just and fair as possible; and creating a level playing field for the public investor in securities arbitration.

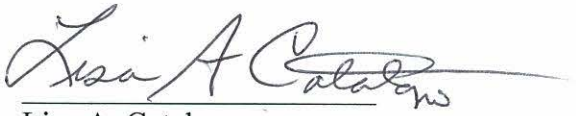
PIABA has particular interest in this case because the Hearing Panel's February 21, 2013 decision will have catastrophic effects on investors with small claims. Pursuant to the decision, FINRA is unable to enforce its own rules against member firms. Hence, the effect is that pre-dispute arbitration agreements ("PDAAs") such as the one at issue in this proceeding, are rendered enforceable. The consequence is that investors with small claims will either abandon their claims

or will proceed *pro se* in simplified arbitration where the results are very bleak. Additionally, the decision will encourage member firms to include such PDAAs in their contracts with their customers. Investors with small dollar claims will be left virtually remediless – an inequitable and disastrous result.

PIABA supports the DOE's position that the Hearing Panel's decision holding that Schwab's PDAAs violate FINRA rules should be affirmed, but that the conclusion that the enforcement of FINRA rules is foreclosed by the Federal Arbitration Act be reversed.

PIABA requests that the NAC consider its brief in this matter.

Respectfully submitted,



Lisa A. Catalano
Attorney for *Amicus Curiae*
Public Investors Arbitration Bar Association
Catalano Arbitration and
Mediation Services
61-20 Grand Central Parkway
#C 702
Forest Hills, NY 11375