

2013

## Class Warfare: Preventing Investor Casualties by Importing England's GLO into America's Class Action Arbitrations

Alissa Piccione

Follow this and additional works at: <https://scholarlycommons.law.hofstra.edu/jibl>



Part of the [Law Commons](#)

---

### Recommended Citation

Piccione, Alissa (2013) "Class Warfare: Preventing Investor Casualties by Importing England's GLO into America's Class Action Arbitrations," *Journal of International Business and Law*. Vol. 12: Iss. 2, Article 18. Available at: <https://scholarlycommons.law.hofstra.edu/jibl/vol12/iss2/18>

This Notes & Student Works is brought to you for free and open access by Scholarship @ Hofstra Law. It has been accepted for inclusion in Journal of International Business and Law by an authorized editor of Scholarship @ Hofstra Law. For more information, please contact [lawscholarlycommons@hofstra.edu](mailto:lawscholarlycommons@hofstra.edu).

## CLASS WARFARE: PREVENTING INVESTOR CASUALTIES BY IMPORTING ENGLAND'S GLO INTO AMERICA'S CLASS ACTION ARBITRATIONS

Alissa Piccione\*

### INTRODUCTION

The latest skirmish in securities law over mandatory arbitration clauses began when The Carlyle Group included a mandatory arbitration clause in its Initial Public Offering (IPO) prospectus.<sup>1</sup> The mandatory arbitration clause was designed to preclude courtroom class actions, which are investors' primary weapon against issuer fraud.<sup>2</sup> The Securities Exchange Commission (SEC) counter-attacked by threatening to thwart the Carlyle Group's offering if it refused to remove the clause from its prospectus.<sup>3</sup> Although the Carlyle Group waived its white flag and removed the offending clause, it is likely that other firms or companies that want to go public will challenge the SEC's position that mandatory arbitration clauses are void,<sup>4</sup> arming themselves with pro-business recommendations from former SEC Chairman Chris Cox<sup>5</sup> and the recent flurry of pro-arbitration Supreme Court decisions.<sup>6</sup>

The Carlyle Group kerfuffle—although a rogue attack, in that most IPO issuers have yet to dare include mandatory arbitration clauses in their prospectuses<sup>7</sup>—demonstrates a general preference for arbitration by defendants when in disputes with investors.<sup>8</sup> This preference is supported with ample approval from the courts, which have long recognized that arbitration is beneficial and that federal policy demands its use.<sup>9</sup>

---

\* J.D. Candidate, 2014, Hofstra University School of Law. I would like to thank Professor Colesanti and the *Hofstra Law Journal of International Business and Law* for their contributions to this Note.

<sup>1</sup> See Ralph C. Ferrara & Stacy A. Puente, *Holding IPOs Hostage to Class Actions: Mandatory Arbitration Clauses in IPOs*, SEC. LITIG. REP., April 2012, at 1, 1. The Carlyle Group is a private equity firm. *Id.*

<sup>2</sup> See *id.*

<sup>3</sup> See *id.*

<sup>4</sup> See *id.* at 7.

<sup>5</sup> See Edward Pekarek & Genevieve Shingle, Case Comment, *The Land of Litigation Make Believe: Janus Capital Group, Inc., et al. v. First Derivative Traders*, 19 PIABA B.J., no. 1, at 1, 7 (2012). President George W. Bush had appointed Christopher Cox Chairman of the SEC in 2005. *Id.* Cox, a well-known conservative, initiated a shift in the SEC's policies that was more favorable to business interests. *Id.*

<sup>6</sup> See Ferrara & Puente, *supra* note 1, at 6.

<sup>7</sup> See Karen Singh Tyagi & Gide Loyrette Nouel, *Carlyle Leaves Out Mandatory Arbitration Clause in IPO*, KLUWER ARB. BLOG (Feb. 7, 2012), <http://kluwarbitrationblog.com/blog/2012/02/07/carlyle-leaves-out-mandatory-arbitration-clause-in-ipo/>; Ferrara & Puente, *supra* note 1, at 4. Although the Carlyle Group was one of the first to include a mandatory arbitration clause in its IPO prospectus, the idea is not novel. Ferrara & Puente, *supra* note 1, at 4. For example, Royal Dutch Shell included a mandatory arbitration clause in its Articles of Association. *Id.* Likewise, Franklin First Financial Corp. sought to include an arbitration provision in its charter and bylaws in 1990, when it was planning its IPO. Tyagi & Nouel, *supra*. However, the SEC firmly objected to Franklin's attempt. *Id.*

<sup>8</sup> See Ferrara & Puente, *supra* note 1, at 6.

<sup>9</sup> See, e.g., *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740, 1749 (2011) (“[O]ur cases place it beyond dispute that the FAA was designed to promote arbitration.”).

The SEC has been reluctant to take direct action against mandatory arbitration clauses, despite its gambit to block them from IPO registration materials.<sup>10</sup> The Dodd-Frank Act expressly requires the SEC to study mandatory arbitration clauses and grants the SEC the authority to make a rule prohibiting such clauses.<sup>11</sup> However, after completing a study,<sup>12</sup> the SEC decided not to exercise its rule-making authority.<sup>13</sup>

The SEC's self-regulatory organization,<sup>14</sup> the Financial Industry Regulatory Authority (FINRA),<sup>15</sup> permits mandatory arbitration for disputes between broker/dealers and investors.<sup>16</sup> Ever since *Rodriguez de Quijas v. Shearson/American Express, Inc.*,<sup>17</sup> mandatory arbitration clauses have been boilerplate in broker/dealers' contracts with their customers and have been continually enforced.<sup>18</sup> Arbitrations between broker/dealers and customers are usually under FINRA's jurisdiction.<sup>19</sup>

FINRA places minimal restrictions on mandatory arbitration clauses between broker/dealers and their customers as well as the subsequent arbitrations resulting from them.<sup>20</sup> First, FINRA forbids broker/dealers from including waivers of access to courtroom class actions in customer agreements.<sup>21</sup> However, in a recent FINRA action against Charles Schwab, the arbitration panel held that FINRA Rule 12204, which prohibits courtroom class action waivers, was unenforceable because it conflicted with the Federal Arbitration Act

---

<sup>10</sup> See *Massachusetts Calls On SEC To Prohibit RIAs From Using Mandatory Arbitration Clauses, Saying It Is "Troubling," Widespread And Not Consistent With Fiduciary Practice*, ADVISORS4ADVISORS (February 13, 2013, 12:48 PM), <http://advisors4advisors.com/compliance/registered-investment-advisors/article/17202-massachusetts-calls-on-sec-to-prohibit-riAs-from-using-mandatory-arbitration-clauses-saying-it-is-qtroubling-q-widespread-and-not-consistent-with-fiduciary-practice> ("Dodd Frank legislation empowered the SEC in July 2010 to eliminate the practice of mandatory arbitration clauses in broker/dealer agreements, but the SEC has not acted on this.").

<sup>11</sup> See *id.*

<sup>12</sup> See SEC, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS 134 (2011), <http://www.sec.gov/news/studies/2011/913studyfinal.pdf> ("[d]uring the Dodd- Frank Act legislative process, concerns were raised regarding mandatory-pre-dispute arbitration, including costs and limited grounds for appeal, among others.").

<sup>13</sup> See Ferrara & Puente, *supra* note 1, at 4.

<sup>14</sup> Self-regulatory organizations (SROs) function as self-policing mechanisms for the securities industry. They create rules for themselves that must comply with § 6 of the Securities Exchange Act, and the SEC is authorized to take enforcement actions against SROs if they fail to perform their regulatory duties. Deepa Sarkar, *Self Regulatory Organization*, LEGAL INFO. INST., [http://www.law.cornell.edu/wex/self\\_regulatory\\_organization](http://www.law.cornell.edu/wex/self_regulatory_organization) (last visited Feb. 16, 2013).

<sup>15</sup> "FINRA is the largest independent regulator for all securities firms doing business in the United States. FINRA's mission is to protect America's investors by making sure the securities industry operates fairly and honestly....FINRA oversees about 4,275 brokerage firms, about 161,495 branch offices and approximately 630,010 registered securities representatives." *About the Financial Industry Regulatory Authority*, FINRA, <http://www.finra.org/AboutFINRA/> (2013).

<sup>16</sup> See FINRA Rule 12200 Arbitration Under an Arbitration Agreement or the Rules of FINRA, *available at* [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=4106](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4106) (2013).

<sup>17</sup> See *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477 (1989) (overruling *Wilko v. Swan* and holding that claims under the Securities Exchange Act were arbitrable).

<sup>18</sup> See Rhonda Wasserman, *Legal Process in A Box, or What Class Action Waivers Teach Us About Law-Making*, 44 LOY. U. CHI. L.J. 391, 416 (2012).

<sup>19</sup> See *id.*

<sup>20</sup> See FINRA Rule 12204 Class Action Claims, *available at* [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=4110](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4110) (2013).

<sup>21</sup> *Id.*

(FAA).<sup>22</sup> The effects of the panel's decision have yet to be seen. Second, FINRA prohibits class actions in arbitrations without defining what a class action is.<sup>23</sup> FINRA should reexamine its own Rules governing mandatory arbitrations, in light of Dodd-Frank and the fact that FINRA Rule 12204 was deemed unenforceable against a brokerage firm.

Like the Second Circuit in *In re American Exp. Merchant's Litigation* ("Amex III"),<sup>24</sup> FINRA recognizes the dangers of class action waivers. However, FINRA has never pushed the *Amex III* argument to its logical conclusion. In *Amex III*, the court explained that the high costs of separately arbitrating intricate claims can grossly outweigh the gains for each plaintiff.<sup>25</sup> The court tersely stated, "[O]nly a lunatic or a fanatic sues for \$30."<sup>26</sup> Therefore, the court held, plaintiffs are prevented from vindicating their federal rights.<sup>27</sup>

*Amex III* dealt with federal antitrust law,<sup>28</sup> but the court's reasoning is equally applicable to federal securities law.<sup>29</sup> Investor claims against broker/dealers under the Securities Exchange Act are factually complicated and yield high investigatory costs, which may be greater than the potential reward.<sup>30</sup> Therefore, forbidding collective action for investors under these circumstances precludes legitimate securities claims from receiving redress, and allows broker/dealer power to remain unchecked.<sup>31</sup>

Although touting itself as investors' white knight, the SEC stopped short of going as far as the court in *Amex III* went by maintaining its prohibition against class actions in the arbitral forum.<sup>32</sup> Collective arbitration of investors' federal securities claims against broker/dealers can be a desirable and even necessary alternative to bilateral arbitration or class litigation.<sup>33</sup> For example, an investor with a small claim is likely to have difficulties meeting the stringent requirements for class certification under Federal Rule of Civil Procedure (FRCP) 23.<sup>34</sup> Thus, the investor would be locked out of the courtroom and forced to arbitrate individually against the broker.

---

<sup>22</sup> Jed Horowitz, *Schwab gets OK to ban client class-action suits*, REUTERS (February 21, 2013), <http://www.reuters.com/article/2013/02/21/schwab-fine-arbitration-idUSL1N0BL96S20130221>. Charles Schwab's account agreements with its customers were modified to ban its customers from participating in courtroom class actions against Charles Schwab. *Id.* FINRA maintained that the ban violated Rule 12204. *Id.* However, the arbitration panel determined that Rule 12204 was unenforceable. *Id.* Therefore, Charles Schwab is legally permitted to ban customer class action lawsuits via its customer agreements. *Id.*

<sup>23</sup> FINRA Rule 12204, *supra* note 20.

<sup>24</sup> 667 F.3d 204 (2d Cir. 2012), *rev. 'd sub nom.*, *Am. Express v. Italian Colors Restaurant*, No. 12-133, slip op. (U.S. June 20, 2013).

<sup>25</sup> *Id.* at 217.

<sup>26</sup> *Id.* at 214 (quoting *Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (7<sup>th</sup> Cir. 2004)).

<sup>27</sup> *Id.* at 217.

<sup>28</sup> *See id.* at 208.

<sup>29</sup> *See* Sen. Al Franken, Sen. Robert Menendez & Sen. Richard Blumenthal, *Senators Urge SEC to Oppose Forced Arbitration for Shareholder Disputes*, 9 No. 3 SEC. LITIG. REP., March 2012, at 19,19 ("[i]ndividual, confidential arbitration of complex securities claims required by Carlyle Group LP's registration papers would effectively foreclose the vindication of its investors' statutory rights under the Exchange Act....").

<sup>30</sup> *See id.*

<sup>31</sup> *See id.*

<sup>32</sup> *See* FINRA Rule 12204, *supra* note 20. The court in *Amex III* approves of class arbitration when a federal right is at stake. *See Amex III*, 557 F.3d 204. FINRA does not. *See* FINRA Rule 12204, *supra* note 20.

<sup>33</sup> *See generally Amex III*, 557 F.3d 204.

<sup>34</sup> *See* Karen Sandrik, Notes and Comments, *Overlooked Tool: Promissory Fraud in the Class Action Context*, 35 FLA. ST. U. L. REV. 193, 202 (2007).

Individual arbitration is really not an option for small claims because the potential reward is likely to be too small to make individual arbitration feasible.<sup>35</sup> Most lawyers will not represent investors in arbitration when the claims are small.<sup>36</sup> Law schools created securities arbitration clinics to take small claims that lawyers reject.<sup>37</sup> However, only a handful of law schools operate securities arbitration clinics, primarily on the East and West Coasts.<sup>38</sup> Additionally, these security arbitration clinics place their own dollar maximums on the claims that they will take.<sup>39</sup> Therefore, some investor plaintiffs are still prevented from vindicating their federal securities rights.

Nonetheless, the SEC's apprehension toward class action arbitration is not baseless. Class actions are poorly defined.<sup>40</sup> The weaknesses of class actions are amplified when moved from the courtroom into arbitration.<sup>41</sup> In general, class action arbitration was recently condemned by the Supreme Court in *American Express v. Italian Colors Restaurant*<sup>42</sup> (the Supreme Court's reversal of *Amex III*) and *AT&T Mobility LLC v. Concepcion*,<sup>43</sup> as well as by the SEC.<sup>44</sup> But other legal scholars have criticized the Supreme Court's tongue-lashing in *Concepcion* and have exposed some of the faulty reasoning behind the arguments against class action arbitration.<sup>45</sup> Justice Kagan, in her passionate *Italian Colors* dissent, explained that the vindication of federal rights doctrine should have been applied to invalidate the mandatory, bilateral arbitration clause.<sup>46</sup>

The SEC's stance on class action arbitration is one that prohibits an arbitration procedure that conforms to FRCP 23. However, FINRA arbitrations are not bound by the Federal Rules of Civil Procedure. Therefore, a FINRA class action arbitration rule would not have to parrot FRCP 23. Other countries have learned from the United States' mistakes regarding class actions and have developed their own collective litigation procedures.<sup>47</sup> Specifically, England's group litigation order (GLO) is a strong alternative to American class actions in the arbitral forum.<sup>48</sup> A GLO is non-representative, opt-in<sup>49</sup> and has fewer

---

<sup>35</sup> See *Amex III*, 557 F.3d at 217.

<sup>36</sup> See *Arbitration/Mediation Clinics in California, District of Columbia, Florida, Illinois, Massachusetts, New Jersey, New York, and Pennsylvania*, SEC, <http://www.sec.gov/answers/arbclin.htm#> (last modified Mar. 8, 2013).

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> See Securities Litigation Uniform Standards Act of 1998, 15 U.S.C. § 77p (2011); Class Action Fairness Act of 2005, 28 U.S.C. § 1711 (2011).

<sup>41</sup> See generally Emanuel Josef Turnbull, *Opting Out of the Procedural Morass: A Solution to the Class Arbitration Problem*, WIDENER L. REV. (forthcoming spring 2013), available at <http://ssrn.com/abstract=2196921> (arguing that American class action procedures are unsuitable for arbitration).

<sup>42</sup> *Am. Express v. Italian Colors Restaurant*, No. 12-133, slip op. at 8-9 (U.S. June 20, 2013).

<sup>43</sup> See *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740, 1750-52 (2011).

<sup>44</sup> See Order Approving Proposed Rule Change Relating to the Exclusion of Class Actions From Arbitration Proceedings, Release No. 34-31371, 57 Fed. Reg. 52659 (Nov. 4, 1992).

<sup>45</sup> See Turnbull, *supra* note 41 (manuscript at 14-15).

<sup>46</sup> *Italian Colors Restaurant*, No. 12-133, slip op. at 3-13 (Kagan, J., dissenting).

<sup>47</sup> See Turnbull, *supra* note 41 (manuscript at 1).

<sup>48</sup> See *id.* But see Stephen C. Yeazell, *From Group Litigation to Class Action - Part I: The Industrialization of Group Litigation*, 27 UCLA L. REV. 514, 514-15 (1979).

<sup>49</sup> Turnbull, *supra* note 41 (manuscript at 27). To "opt-in" a plaintiff must request to be added to the GLO. *Id.*

CLASS WARFARE: PREVENTING INVESTOR CASUALTIES

requirements for class certification than FRCP 23.<sup>50</sup> These characteristics make the GLO more flexible than rigid American class actions, and, therefore, a better match for arbitration, a dispute resolution mechanism known for its fluidity.<sup>51</sup>

Accordingly, this Note advocates that FINRA lower its barricade and embrace class actions in arbitration by striking the prohibitive language in Rule 12204<sup>52</sup> and replacing it with an express grant of authority for investors to file a class action in FINRA arbitrations. FINRA should discard Rule 12312, which provides for joinder of claims,<sup>53</sup> and promulgate a new rule for class action arbitration, which defines a class as two or more plaintiffs and establishes class procedures based on England's GLO.

Part I of this Note will detail the history of the Supreme Court's acceptance of arbitration. It will show that, even despite *Italian Colors* and *Concepcion*, class actions could serve an important role in FINRA arbitrations. Part II will explain why FINRA's current Rule prohibiting class actions in arbitration should be changed. Part III will highlight the weaknesses of American class action litigation, and explain that, if FINRA were to draft a rule for class action arbitration, it should not copy FRCP 23. And Part IV will explain why GLOs are more advantageous for use in arbitration than American class action litigation. It will draw the contours of the GLO-based class action in arbitration rule that FINRA ought to consider.

## PART I: THE ARBITRATION WAR IN THE U.S. COURTS

Like class action arbitrations today, bilateral arbitrations were once met with hostility by U.S. courts.<sup>54</sup> However, arbitration underwent a metamorphosis, and the courts are now staunch supporters of arbitration.<sup>55</sup> Therefore, it is likely that class action arbitrations are destined for acceptance from the courts in the future.

### A) Declaring War

Congress enacted the FAA in 1925<sup>56</sup> to compel courts to honor and enforce valid arbitration agreements regularly.<sup>57</sup> Previously, the courts did not trust arbiters to handle claims brought under federal statutes, and viewed arbitration with contempt.<sup>58</sup> Even after the

---

<sup>50</sup> See *id.* (manuscript at 27-28).

<sup>51</sup> See *id.* (manuscript at 1).

<sup>52</sup> See FINRA Rule 12204, *supra* note 20.

<sup>53</sup> See FINRA Rule 12312 Multiple Claimants, *available at* [http://finra.complinet.com/en/display/display.html?rbid=2403&record\\_id=5213&element\\_id=4134&highlight=12312#r5213](http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=5213&element_id=4134&highlight=12312#r5213).

<sup>54</sup> See Carroll E. Neesemann et al., *The Law of Securities Arbitration*, in SECURITIES ARBITRATION 2001: HOW DO I DO IT? HOW DO I DO IT BETTER?, 165, 170 (PLI Corp. Law & Practice Course, Handbook Series, 2011).

<sup>55</sup> See generally Edward P. Boyle & David N. Cinotti, *Beyond Nondiscrimination: AT&T Mobility LLC v. Concepcion and the Further Federalization of U.S. Arbitration Law*, 12 PEPP. DISP. RESOL. L.J. 373 (2012) (noting that the Supreme Court has evolved in its interpretation of the FAA over the last 50 years).

<sup>56</sup> *Id.* at 375.

<sup>57</sup> See Neesemann, *supra* note 54, at 169 ("The legislative intent behind the FAA was to place an arbitration agreement 'upon the same footing as other contracts, where it belongs....'").

<sup>58</sup> See *id.* at 170.

passage of the FAA, courts were reluctant to enforce arbitration agreements, when the underlying claim involved a federal right.<sup>59</sup>

In *Wilko v. Swan*,<sup>60</sup> decided in 1953, the Court articulated its distrust of arbitration for a claim filed under the Securities Act of 1933 ('33 Act).<sup>61</sup> *Wilko* is factually similar to the types of cases to which this Note pertains: ones in which there is a bilateral arbitration agreement between the parties, an alleged violation of federal securities law, and an investor plaintiff battling a broker defendant.

Petitioner *Wilko*, a customer, claimed that his broker, the respondent, made misrepresentations and omissions, which induced him to buy 1,600 shares of Air Associates stock and then sell it at a loss.<sup>62</sup> The petitioner filed a complaint for damages, and the respondent moved to stay the action until the parties arbitrated, pursuant to their agreement.<sup>63</sup>

However, § 14 of the '33 Act, provides, "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void."<sup>64</sup> Therefore, the issue before the Court was whether an arbitration agreement covering all disputes—including those that had yet to arise—was a waiver under § 14.<sup>65</sup> The Court answered that question affirmatively and required a judicial forum to protect the substantive rights granted by the '33 Act.<sup>66</sup> The Court stated, "As the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness, it seems to us that Congress must have intended §14 to apply to waiver of judicial trial and review."<sup>67</sup>

After *Wilko*, the Court spent twenty years refusing to honor arbitration agreements when claims were filed for violations of the '33 Act, as well as the Securities Exchange Act of 1934 ('34 Act).<sup>68</sup> It was not until *Scherk v. Alberto Culver*, in 1974, that the Court's perspective began to shift.<sup>69</sup> In that case, an American manufacturer bought three German businesses, with their trademarks, from a German seller.<sup>70</sup> The seller made express warranties in the sales contract that the trademarks were free from encumbrances.<sup>71</sup> When the buyer discovered that the trademarks were subject to substantial encumbrances, he asked the seller to rescind the contract.<sup>72</sup> The seller refused, and the respondent sued, alleging that the seller violated § 10(b) of the '34 Act and Rule 10b-5 by making fraudulent representations about the trademarks.<sup>73</sup>

---

<sup>59</sup> *See id.*

<sup>60</sup> 346 U.S. 427 (1953).

<sup>61</sup> 15 U.S.C. § 77a-77mm (2011).

<sup>62</sup> *Wilko*, 346 U.S. at 429.

<sup>63</sup> *Id.*

<sup>64</sup> 15 U.S.C. § 77n (2011).

<sup>65</sup> *Wilko*, 346 U.S. at 430.

<sup>66</sup> *See id.*

<sup>67</sup> *Id.* at 437.

<sup>68</sup> 15 U.S.C. § 78a-78kk (2011).

<sup>69</sup> *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

<sup>70</sup> *Id.* at 508.

<sup>71</sup> *Id.*

<sup>72</sup> *Id.* at 509.

<sup>73</sup> *Id.*

CLASS WARFARE: PREVENTING INVESTOR CASUALTIES

The sales contract contained an arbitration clause stating that any claim arising from the contract or its breach would be referred to arbitration before the International Chamber of Commerce in Paris, France, and that Illinois law would govern the agreement.<sup>74</sup> The seller moved to dismiss or, alternatively, stay the proceedings.<sup>75</sup>

The case made it to the Supreme Court,<sup>76</sup> and the Court enforced the arbitration agreement.<sup>77</sup> The Court distinguished *Scherk* from *Wilko* on international policy grounds,<sup>78</sup> stating that the contract in *Sherk* was a “truly international agreement.”<sup>79</sup> The businesses sold under the contract were “organized under the laws of, and primarily situated in, European countries, whose activities were largely, if not entirely, directed to European markets.”<sup>80</sup> Therefore, it was necessary for the parties to specify which country’s laws should govern potential disputes and the appropriate forum, which they did. Had the Court failed to honor the choice of law agreement and arbitration agreement it would, “invite the unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages.”<sup>81</sup> For example, if the seller had known that the United States could enjoin the arbitration and permit the buyer to litigate the claim, the seller might have sought an order from France to enjoin the buyer from litigating in the United States.<sup>82</sup> The Court explained that failure to honor arbitration agreements would inhibit international business.<sup>83</sup>

## B) The Tide Turns

Even after *Sherk*, the Court clung to *Wilko*, so long as the contract at issue did not involve foreign entities.<sup>84</sup> However, the Court turned its back on *Wilko* in 1987, and *Shearson/American Express, Inc. v. McMahon* and *Rodriguez de Quijas v. Shearson/American Express, Inc.* ushered in an era of pro-arbitration,<sup>85</sup> which has endured for over twenty years.<sup>86</sup>

In *McMahon*, the Court held that a § 10(b) claim and a RICO claim were both arbitrable.<sup>87</sup> The McMahons lost because they failed to meet their burden; they were unable to show that Congress intended to prohibit waivers of judicial remedies for their claims.<sup>88</sup>

---

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> *Id.* at 510.

<sup>77</sup> *Id.* at 519.

<sup>78</sup> *Id.* at 517.

<sup>79</sup> *Id.* at 515.

<sup>80</sup> *Id.*

<sup>81</sup> *Id.* at 516-17.

<sup>82</sup> *Id.* at 517.

<sup>83</sup> *Id.*

<sup>84</sup> See Neesemann, *supra* note 54, at 170-71.

<sup>85</sup> See *id.* at 172.

<sup>86</sup> See generally *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740 (2011) (a pro-arbitration decision rendered twenty-four years after *Shearson/Am. Express, Inc. v. McMahon* was decided).

<sup>87</sup> *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

<sup>88</sup> *Id.* at 226-27 (“The Arbitration Act, standing alone, therefore mandates enforcement of agreements to arbitrate statutory claims. Like any statutory directive, the Arbitration Act’s mandate may be overridden by a contrary congressional command. The burden is on the party opposing arbitration, however, to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue.”).



First, the Court addressed the § 10(b) claim, and rejected the McMahons' argument that § 29(a) of the '34 Act forbids waiver of § 27 of the statute, which states that:

The district courts of the United States ... shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder.<sup>89</sup>

The Court explained that § 29(a) only states that compliance with a '34 Act provision cannot be waived, and § 27 is a jurisdictional provision that does not embody any duty with which one must comply.<sup>90</sup> Therefore, waiving § 27 is not waiving compliance with any duty created by the '34 Act, and an arbitration agreement does not violate § 29(a).<sup>91</sup>

Second, the Court distinguished § 29(a) of the '34 Act from § 14 of the '33 Act, the provision at issue in *Wilko*.<sup>92</sup> Although the two provisions have similar wording, § 14 of the '33 Act, the Court explained, was viewed by the *Wilko* Court as precluding waiver of a jurisdictional provision.<sup>93</sup> However, the Court continued, the *Wilko* Court's interpretation resulted from its belief that arbitration was an inadequate forum for enforcing the provisions of the '33 Act, and "a judicial forum was needed to protect the substantive rights created by the...['33] Act."<sup>94</sup> The Court explained, that, since *Wilko* was decided, arbitration had significantly improved.<sup>95</sup> Therefore, arbitration was an adequate forum within which to enforce the '34 Act.<sup>96</sup>

Next, the Court tackled the McMahons' second argument: that § 29(a) should be interpreted as a protection against a broker's superior bargaining power.<sup>97</sup> The McMahons relied, again, on *Wilko*, reasoning that brokerage agreements were not freely negotiated, and that Congress intended for § 29(a) to protect customers from the pressure to relinquish their rights.<sup>98</sup> However, the Court rejected this argument because "the voluntariness of the agreement is irrelevant" to compliance with the '34 Act.<sup>99</sup>

The McMahons further argued that arbitration would weaken their right to recover under the Act and would therefore be a waiver of their § 10(b) rights.<sup>100</sup> The Court

---

<sup>89</sup> *Id.* at 227. ("The McMahons contend, however, that congressional intent to require a judicial forum for the resolution of § 10(b) claims can be deduced from § 29(a) of the Exchange Act, 15 U.S.C. § 78cc(a), which declares void "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of [the Act].").

<sup>90</sup> *Id.* at 228.

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

<sup>94</sup> *Id.*

<sup>95</sup> *Id.* at 233 ("Even if *Wilko*'s assumptions regarding arbitration were valid at the time *Wilko* was decided, most certainly they do not hold true today for arbitration procedures subject to the SEC's oversight authority.").

<sup>96</sup> *Id.*

<sup>97</sup> *Id.* at 229.

<sup>98</sup> *Id.* at 230.

<sup>99</sup> *Id.*

<sup>100</sup> *Id.* at 231.

acknowledged that this argument was “the heart of the Court’s decision in *Wilko*,” but held that it was invalid, given the significant advancements made in arbitration since *Wilko*.<sup>101</sup>

Finally, the Court rejected the last argument pertaining to the *McMahons*’ § 10(b) claim, which was that Congress’ intent for *Wilko* to apply when parties with pre-arbitration agreements are disputing § 10(b) claims can be inferred from its failure to address arbitration when amending 28(b),<sup>102</sup> as well as from its reference to *Wilko* in its Conference Report.<sup>103</sup> However, the Court disagreed with the interpretation, and specifically stated that, from the Conference Report, it was clear that Congress intended for the courts to handle the “*Wilko* issue.”<sup>104</sup> Once the Court completed its analysis of the § 10(b) claim, it moved to the RICO claim, and decided that that claim must be arbitrated as well.<sup>105</sup>

Although the *McMahon* Court chipped away at *Wilko*, it refused to overrule it.<sup>106</sup> However, two years later, in *Rodriguez de Quijas v. Shearson/American Express, Inc.*, the Court overruled *Wilko*, and held that pre-dispute agreements to arbitrate claims under the ‘34 Act were valid and enforceable.<sup>107</sup>

The Court felt that the inconsistency between *Wilko* and *McMahon* needed to be resolved in order for the ‘34 Act and the ‘33 Act to have a “harmonious construction” to “discourage litigants from manipulating their allegations merely to cast their claims under one of the securities laws rather than another.”<sup>108</sup> Therefore, the Court overruled *Wilko*, and reiterated the *McMahon* holding that the arbitration process does not “inherently” prevent the exercise of substantive rights granted by the ‘33 Act.<sup>109</sup>

As a result of the Court’s willingness to enforce pre-dispute arbitration agreements, arbitration agreements became a staple in business contracts.<sup>110</sup> However, an issue that emerged was whether mandatory arbitration clauses precluded class action arbitration.<sup>111</sup> In *Green Tree Financial Corp. v. Bazzle*, the Supreme Court addressed the issue, but left the ultimate answer to arbitrators.<sup>112</sup>

The arbitration agreements at the heart of *Green Tree* read as follows:

---

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* at 234-35.

<sup>103</sup> *Id.* at 236-37 (“The Conference Report states: ‘The Senate bill amended section 28 of the Securities Exchange Act of 1934 with respect to arbitration proceedings between self-regulatory organizations and their participants, members, or persons dealing with members or participants. The House amendment contained no comparable provision. The House receded to the Senate. It was the clear understanding of the conferees that this amendment did not change existing law, as articulated in *Wilko v. Swan*, 346 U.S. 427 [74 S.Ct. 182, 98 L.Ed. 168] (1953), concerning the effect of arbitration proceedings provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations.’”) (quoting H.R.Conf.Rep. No. 94-229, p. 111 (1975)).

<sup>104</sup> *Id.* at 238.

<sup>105</sup> *Id.* at 238-42. The Court rejected that the RICO claim should be litigated in court, even though RICO claims can result in criminal liability and even though the public has an interest in RICO claims. *Id.*

<sup>106</sup> See Neeseemann, *supra* note 54, at 170-71.

<sup>107</sup> *Id.* at 172.

<sup>108</sup> *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 485 (1989).

<sup>109</sup> *Id.* at 486.

<sup>110</sup> See G. Richard Shell, *Arbitration and Corporate Governance*, 67 N.C. L. REV. 517, 517 (1989).

<sup>111</sup> See, e.g., *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444 (2003).

<sup>112</sup> See *id.* at 453.

ARBITRATION-All disputes, claims, or controversies arising from or relating to this contract or the relationships which result from this contract ... shall be resolved by binding arbitration by one arbitrator selected by us with consent of you. This arbitration contract is made pursuant to a transaction in interstate commerce, and shall be governed by the Federal Arbitration Act at 9 U.S.C. section 1.... THE PARTIES VOLUNTARILY AND KNOWINGLY WAIVE ANY RIGHT THEY HAVE TO A JURY TRIAL, EITHER PURSUANT TO ARBITRATION UNDER THIS CLAUSE OR PURSUANT TO A COURT ACTION BY U.S. (AS PROVIDED HEREIN)....The parties agree and understand that the arbitrator shall have all powers provided by the law and the contract. These powers shall include all legal and equitable remedies, including, but not limited to, money damages, declaratory relief, and injunctive relief.<sup>113</sup>

The North Carolina Supreme Court had held that the agreement was silent on the issue of whether the parties could arbitrate as a class, while Green Tree argued that the agreement prohibited class arbitration.<sup>114</sup> The Supreme Court found that it was not impossible for the arbitration agreement to be read as not prohibiting class arbitration<sup>115</sup> and, thus, “silent” on the matter.<sup>116</sup> However, the Court refused to “automatically accept” the North Carolina Supreme Court’s interpretation of the arbitration clause.<sup>117</sup> Instead, the Court reasoned that, because the parties had agreed to submit all contractual disputes to arbitration, and divergent opinions as to the meaning of the contract were such a dispute, the interpretation question should have been submitted to an arbitrator to resolve, not a court.<sup>118</sup> Therefore, the Court remanded the case to arbitration for the interpretation issue.<sup>119</sup>

The Court again confronted the issue of whether class arbitration is permissible in *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*<sup>120</sup> Pursuant to *Green Tree*, the parties in *Stolt-Nielsen* submitted the issue of whether their arbitration agreement permitted class arbitration of antitrust claims to an arbitration panel to decide.<sup>121</sup> However, before handing the matter over to the arbitrator, the parties stipulated that the arbitration agreement itself was “silent” on the issue.<sup>122</sup>

The arbitration panel decided that the arbitration clause permitted class arbitration, based upon evidence that, according to the panel, tended to show that the parties did not intend to preclude arbitration.<sup>123</sup> Furthermore, the panel was persuaded by the fact that other

---

<sup>113</sup> *Id.* at 448.

<sup>114</sup> *Id.* at 450.

<sup>115</sup> *Id.* at 451.

<sup>116</sup> *Id.* at 450.

<sup>117</sup> *Id.* at 451.

<sup>118</sup> *Id.* at 451-52.

<sup>119</sup> *Id.* at 454.

<sup>120</sup> *See Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*, 130 S.Ct. 1758 (2010).

<sup>121</sup> *Id.* at 1765.

<sup>122</sup> *Id.* at 1766 (“Counsel for AnimalFeeds explained to the arbitration panel that the term ‘silent’ did not simply mean that the clause made no express reference to class arbitration. Rather, he said, ‘[a]ll the parties agree that when a contract is silent on an issue there’s been no agreement that has been reached on that issue.’”).

<sup>123</sup> *Id.*

arbitrators, resolving other interpretation disputes, often found that the clauses in controversy permitted class arbitration.<sup>124</sup>

However, the Court held that the panel's decision was unenforceable<sup>125</sup> because the panel, according to the Court, "dispens[ed] [its] own brand of industrial justice."<sup>126</sup> The Court explained that the arbitrators failed to complete their task, which was to "identify the rule of law that govern[ed]" the dispute; the panel should have looked to the FAA or maritime law or New York law to find a default provision to fill the "silent" part of the arbitration agreement.<sup>127</sup> But because the panel failed to engage in such an inquiry, and, instead, based its decision on past arbitrations, the panel "simply imposed its own conception of sound policy."<sup>128</sup> Furthermore, the Court chastised the panel for alleging that the ruling was based on the perceived intent of the parties because the intent of the parties was unambiguous: the parties had stipulated that the agreement was silent because no understanding had been reached on this issue.<sup>129</sup> Therefore, it was beyond the scope of the panel's job to ask what the parties' intent was.<sup>130</sup>

After explaining the panel's error, the Court clarified that *Green Tree* "did not establish the rule to be applied in deciding whether class arbitration is permitted."<sup>131</sup> Furthermore, the Court then held that "a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so."<sup>132</sup> Therefore, the arbitration agreement in *Stolt-Nielsen* did not permit class arbitration because there was no evidence in the clause that the parties agreed to permit class arbitration.<sup>133</sup> The parties expressly stipulated that the agreement was silent, and, thus, there was no agreement to arbitrate as a class.<sup>134</sup>

### C) A Victory for Arbitration: *Concepcion*

Following the Court's decision in *Green Tree*, potential defendants included class waivers in their arbitration agreements,<sup>135</sup> insulating themselves from unwittingly arbitrating or litigating against a class. However, some jurisdictions, like California, found that class waivers were unconscionable, while other jurisdictions did not.<sup>136</sup> Therefore, the Supreme Court felt it was necessary to resolve the split, and agreed to hear *AT&T Mobility LLC v. Concepcion*.<sup>137</sup>

---

<sup>124</sup> *Id.*

<sup>125</sup> *Id.* at 1770.

<sup>126</sup> *Id.* at 1767 (quoting *Steelworkers v. Enter. Wheel & Car Corp.*, 363 U.S. 593, 597 (1960)).

<sup>127</sup> *Id.* at 1768-69.

<sup>128</sup> *Id.* at 1769.

<sup>129</sup> *Id.* at 1770.

<sup>130</sup> *Id.*

<sup>131</sup> *Id.* at 1772.

<sup>132</sup> *Id.* at 1775.

<sup>133</sup> *Id.* at 1776.

<sup>134</sup> *Id.* at 1775.

<sup>135</sup> Jan-Krzysztof Dunin-Wasowicz, Note and Comment, *Collective Redress in International Arbitration: An American Idea, a European Concept?*, 22 AM. REV. INT'L ARB. 285, 298 (2011).

<sup>136</sup> *Id.*

<sup>137</sup> *See id.*

In that case, the arbitration agreement required that all claims be brought individually.<sup>138</sup> In addition, the agreement included the following terms, as described by the Court:

AT&T must pay all costs for nonfrivolous claims; that arbitration must take place in the county in which the customer is billed; that, for claims of \$10,000 or less, the customer may choose whether the arbitration proceeds in person, by telephone, or based only on submissions; that either party may bring a claim in small claims court in lieu of arbitration; and that the arbitrator may award any form of individual relief, including injunctions and presumably punitive damages. The agreement, moreover, denies AT&T any ability to seek reimbursement of its attorney's fees, and, in the event that a customer receives an arbitration award greater than AT&T's last written settlement offer, requires AT&T to pay a \$7,500 minimum recovery and twice the amount of the claimant's attorney's fees.<sup>139</sup>

The Concepcions filed their claim in United States District Court for the Southern District of California, and the claim was consolidated into a class action.<sup>140</sup> AT&T moved to compel arbitration, but the Concepcions opposed the motion.<sup>141</sup> Citing the *Discovery Bank* rule,<sup>142</sup> the Concepcions alleged that the class waiver was unconscionable under California contract law and that the clause triggered the savings clause of the FAA.<sup>143</sup> After unfavorable rulings for AT&T in the lower courts, the Supreme Court granted certiorari.<sup>144</sup>

The Supreme Court explained that the savings clause of the FAA excluded contract defenses that are based on the contract's nature as an arbitration agreement or are only applicable to arbitration.<sup>145</sup> The Court held that the *Discover Bank* rule qualifies as such an

---

<sup>138</sup> AT&T Mobility LLC v. Concepcion, 131 S.Ct. 1740, 1744 (2011).

<sup>139</sup> *Id.*

<sup>140</sup> *Id.*

<sup>141</sup> *Id.* at 1744-45.

<sup>142</sup> The *Discovery Bank* rule is:

[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 willful injury to the person or property of another.' Under these circumstances, such waivers are unconscionable under California law and should not be enforced."

*Id.* at 1746 (quoting *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 162 (2005)).

<sup>143</sup> *Id.* "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 ... shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (2012).

<sup>144</sup> *Concepcion*, 131 S.Ct. at 1745.

<sup>145</sup> *Id.* at 1746.

CLASS WARFARE: PREVENTING INVESTOR CASUALTIES

excluded defense,<sup>146</sup> and, therefore, does not trigger the savings clause.<sup>147</sup> Furthermore, the Court states that § 2 of the FAA, a federal law requiring the enforcement of arbitration agreements, preempts California's *Discover Bank* rule, which obstructs the federal policy of enforcing arbitration.<sup>148</sup>

On the path toward its holding, the Court made several puzzling points. The Court emphasized that arbitration clauses, like contracts, rest on mutual agreement.<sup>149</sup> Therefore, requiring class arbitration—when the agreement expressly rejects it—is at odds with the spirit of contract law.<sup>150</sup> Nonetheless, the court recognized that most consumer contracts today are contracts of adhesion.<sup>151</sup> Adhesion contracts defy mutuality,<sup>152</sup> the cornerstone of contract law, yet the Court finds them permissible. In the Court's view, it seems, the undue surprise that results from a defendant being forced to arbitrate against a class is more distressing than the injustice that results from a plaintiff being forced to arbitrate according to unconscionable terms.<sup>153</sup>

Furthermore, the Court mounted an unwarranted attack on class arbitration, even those to which consent is given.<sup>154</sup> Relying on *Stolt-Nielsen*, the Court explained that class arbitration is completely different than bilateral arbitration.<sup>155</sup> The Court said that the benefits of arbitration—informality and speed—are lost when the arbitration is class wide.<sup>156</sup> Next, the Court explained that, when the FAA was drafted, Congress did not intend for an arbitrator to be responsible for protecting the parties' due process rights,<sup>157</sup> a task that the judge performs in class actions. Finally, the Court said that class arbitration poses too many risks for defendants.<sup>158</sup> These arguments, while not entirely lacking merit, have valid counterarguments, which will be explored in Part II of this Note.

The Court also used a slippery slope argument to rebut the *Concepcions*' argument that class waivers are unconscionable.<sup>159</sup> Like arbitration agreements with class waivers, arbitration agreements that fail to abide by the Federal Rules of Evidence, the Court reasoned, could be held to be unconscionable as well.<sup>160</sup> But, the Court continued, if a court was to hold that arbitration agreements that fail to abide by the Federal Rules of Evidence are unconscionable and, therefore, covered by the savings clause of the FAA, that holding would

---

<sup>146</sup> See *id.* at 1748. Not only did the Court state that the *Discover Bank* rule is not the kind of valid contract defense to which the savings clause applies, but it further stated that the *Discover Bank* rule is merely a state law standing "as an obstacle to the accomplishment of the FAA's objectives." *Id.*

<sup>147</sup> See *id.*

<sup>148</sup> See *id.* at 1750.

<sup>149</sup> See *id.* at 1745.

<sup>150</sup> *Id.* at 1750-51.

<sup>151</sup> *Id.* at 1750.

<sup>152</sup> See 22 N.Y. JUR. 2D CONTRACTS § 2 (2013).

<sup>153</sup> See *Concepcion*, 131 S.Ct. at 1750-51.

<sup>154</sup> See *id.* at 1751-53.

<sup>155</sup> *Id.* at 1750.

<sup>156</sup> *Id.* at 1751.

<sup>157</sup> *Id.* at 1751-52.

<sup>158</sup> *Id.* at 1752.

<sup>159</sup> See *id.* at 1747.

<sup>160</sup> *Id.*

be “absolutely inconsistent with the provisions of the act.”<sup>161</sup> “The act cannot be held to destroy itself,” the Court said.<sup>162</sup>

However, there is a crucial difference between waiving class procedures and waiving the use of the Federal Rules of Evidence, and that difference is relevant to the vindication of a federal right analysis. Waiving use of the Federal Rules of Evidence will never make asserting a claim impossible. In contrast, as was held by the Court in *Amex III*, waiving the opportunity to utilize class procedures can make asserting a claim practically impossible.<sup>163</sup>

#### **D) The Aftermath of *Concepcion***

The Second Circuit interpreted *Concepcion* as resolving the conflict between a state law and the FAA, but felt that the Court left unanswered how the FAA would fare when in conflict with a federal law, under a vindication of federal rights analysis.<sup>164</sup>

The Amex case bounced between the courts due to contemporaneous changes in Supreme Court precedent.<sup>165</sup> But the underlining facts of the case remained as follows: Plaintiffs, a group of merchants, contracted with Amex to accept American Express charge cards.<sup>166</sup> These cards, as opposed to credit or debit cards, were attractive to merchants because affluent customers carry them.<sup>167</sup> Amex, realizing this, charged high “merchant discount fees,” and required that the merchants accept credit and debit cards as well.<sup>168</sup> Furthermore, the contract that the merchants had with Amex required that the merchants waive their right to pursue class claims in arbitration.<sup>169</sup>

Substantively, the plaintiffs argued that, by requiring them to “honor all cards” and pay the high merchant discount fees, Amex violated § 1 of the Sherman Act.<sup>170</sup> Procedurally, the plaintiffs argued that the class action waiver was unenforceable.<sup>171</sup> The defendant argued that class action arbitration waivers were per se enforceable, in light of the Supreme Court’s ruling in *Stolt-Nielsen* and *Concepcion*.<sup>172</sup> However, the Court of Appeals stated that *Stolt-Nielsen* and *Concepcion* did not demand that all class waivers be deemed per se enforceable.<sup>173</sup> In addition, the court explained that those two cases did not address the issue

---

<sup>161</sup> *Id.* at 1748.

<sup>162</sup> *Id.* (quoting *Texas & Pac. Ry. Co. v. Abilene Cotton Oil Co.*, 204 U.S. 426, 446 (1907)).

<sup>163</sup> *See Amex III*, 667 F.3d at 215-16.

<sup>164</sup> *See id.* at 213.

<sup>165</sup> *See id.* at 206. The Supreme Court granted defendant-appellant Amex certiorari, but remanded the case to the United States Court of Appeals, Second Circuit, to reconsider the enforceability of the class action waiver in light of the Supreme Court’s ruling in *Stolt-Nielsen*. *Id.* The Second Circuit stood by its original decision, and defendant-appellant filed another writ of certiorari. *Id.* Meanwhile, the Supreme Court issued the *Concepcion* decision, and, therefore, the Second Circuit agreed to hear arguments in the Amex case—again—and determine whether *Concepcion* would alter its ruling. *Id.*

<sup>166</sup> *Id.* at 207.

<sup>167</sup> *Id.*

<sup>168</sup> *Id.* at 208.

<sup>169</sup> *Id.* at 209.

<sup>170</sup> *Id.* at 208.

<sup>171</sup> *Id.* at 210.

<sup>172</sup> *Id.* at 212.

<sup>173</sup> *Id.* at 214.

CLASS WARFARE: PREVENTING INVESTOR CASUALTIES

at the heart of *Amex III*: whether a class waiver can be enforced when such enforcement would preclude the plaintiffs from vindicating their federal statutory rights.<sup>174</sup> Therefore, *Stolt-Nielsen* and *Concepcion* did not alter the Court of Appeals' prior rulings that such a waiver could not be enforced.<sup>175</sup>

When answering the question whether a class waiver can be enforced when such enforcement would preclude the plaintiffs from vindicating their federal statutory rights, the court cited *Gilmer v. Interstate/Johnson Lane Corp.*<sup>176</sup> The court explained that, although *Gilmer* emphasized that arbitration of statutory claims is permissible, the decision rested on the premise that arbitration was an adequate forum to vindicate the statutory right at issue, and that arbitrating the claim did not impede the statute's social aims.<sup>177</sup> However, the court said the premise is destroyed in cases like *Amex III*, where the arbitration agreement itself prevents the vindication of a statutory right.<sup>178</sup> The mandatory arbitration clause in the *Amex III* agreement precluded class procedures, making it impossible for plaintiffs to maintain their claim, and, thus, depriving them of the protections of the law.<sup>179</sup> The social aims of the legislation would not be achieved if the *Amex III* plaintiffs were forced to arbitrate individually.<sup>180</sup> Therefore, the court concluded, *Gilmer* was not an obstacle for plaintiffs like those in *Amex III*.<sup>181</sup> The court cited *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*<sup>182</sup> to explain types of arbitration clauses that undermine the *Gilmer* premise,<sup>183</sup> such as an arbitration agreement that includes a waiver of a party's right to seek a statutory remedy for antitrust violations.<sup>184</sup>

Next, the Court of Appeals reiterated the Supreme Court's decision in *Green Tree Financial Corp.-Alabama v. Randolph* to support the holding that arbitration of the merchants' claims was unenforceable.<sup>185</sup> In *Green Tree*, the Supreme Court held that the cost of bilateral arbitration is a valid ground for finding it to be an ineffective forum for the vindication of a federal right, but the plaintiff has the burden of showing that arbitration

---

<sup>174</sup> *Id.* at 212.

<sup>175</sup> *Id.* at 218.

<sup>176</sup> 500 U.S. 20 (1991). In *Gilmer*, the plaintiff filed a claim under the Age Discrimination in Employment Act (ADEA). *Id.* at 23. The plaintiff alleged that he was fired from his position as manager of a brokerage firm in violation of the ADEA. *Id.* The defendant moved to compel arbitration of the claim, arguing that the plaintiff had signed an agreement to be bound by NYSE Rules when he became a securities representative, and the NYSE Rules required mandatory arbitration of disputes. *Id.* at 24. The Court held that the plaintiff was obligated to arbitrate because precedent demonstrated that statutory claims were arbitrable, and that the plaintiffs did not show that the ADEA was intended to preclude a waiver of judicial remedies. *Id.* at 35.

<sup>177</sup> *Amex III*, 667 F.3d at 216.

<sup>178</sup> *Id.*

<sup>179</sup> *See id.* at 217.

<sup>180</sup> *See id.* at 218.

<sup>181</sup> *Id.*

<sup>182</sup> 473 U.S. 614 (1985). In *Mitsubishi*, a Puerto Rican car dealer alleged that a Japanese manufacturer violated the Sherman Act. *Id.* at 619. The parties had an arbitration clause in their sales contract, and the manufacturer moved to compel arbitration. *Id.* at 620-21. The dealer argued that the foreign commerce antitrust claims were not arbitrable; however, the Supreme Court rejected this argument. *Id.*

<sup>183</sup> *See Amex III*, 667 F.3d at 214.

<sup>184</sup> *Id.* at 214-15.

<sup>185</sup> *See id.* at 216.



would be prohibitively expensive.<sup>186</sup> The court explained that *Green Tree* has never been overruled,<sup>187</sup> and that the plaintiffs in *Amex III* met the *Green Tree* burden.<sup>188</sup>

During November 2012, the Supreme Court granted *Amex* certiorari in order to answer the certified question, “Whether the Federal Arbitration Act permits courts, invoking the ‘federal substantive law of arbitrability,’ to invalidate arbitration agreements on the ground that they do not permit class arbitration of a federal-law claim.”<sup>189</sup> Although legal scholars predicted that the Supreme Court would answer this question affirmatively, because such an analysis conforms to Supreme Court precedent and ensures that the federal antitrust statute operates as intended,<sup>190</sup> the Supreme Court reversed the Second Circuit’s ruling.<sup>191</sup>

Nonetheless, the time is ripe for FINRA to create a rule for class actions in arbitration. Although broker/dealers may legally include mandatory, bilateral arbitration clauses in their contracts, they may not want to because of the public’s swift criticism of *Italian Colors*.<sup>192</sup> If FINRA develops class procedures, broker/dealers may voluntarily arbitrate with plaintiffs on a class-wide basis, thereby saving broker/dealers reputational costs and boosting bottom lines. Moreover, commentators suggest that the Supreme Court’s distaste for class actions and class arbitration modeled after FRCP 23 colored its decision.<sup>193</sup> Accordingly, *Italian Colors* should not deter FINRA’s from developing class procedures different than those under FRCP 23.

## PART II: RALLYING THE TROOPS TO CHANGE FINRA’S RULES

FINRA should change its rule prohibiting class actions in arbitration because: (1) the rule is an obstacle to plaintiffs vindicating their federal securities rights;<sup>194</sup> (2) the rule

---

<sup>186</sup> *Id.* The plaintiff in *Green Tree* was unable to meet the burden of showing that arbitration would be prohibitively expensive. *Green Tree Fin. Corp.-Alabama v. Randolph*, 531 U.S. 79, 92 (2000)).

<sup>187</sup> *See Amex III*, *supra* note 25, at 216.

<sup>188</sup> *See id.* at 217-19. Plaintiffs hired an expert economist, who explained, “The median volume merchant, with half of the named plaintiffs having more and half having less American Express charge volume, and having reported \$230,343 American Express Card volume in 2003, might expect four-year damages of \$1,751, or \$5,252 when trebled.... The largest volume named plaintiff merchant, with reported American Express Card volume of \$1,690,749 in 2003, might expect four-year damages of \$12,850, or \$38,549 when trebled.” *Id.* at 218. Therefore, the economist concluded, “it would not be worthwhile for an individual plaintiff ... to pursue individual arbitration or litigation where the out-of-pocket costs, just for the expert economic study and services, would be at least several hundred thousand dollars, and might exceed \$1 million.” *Id.*

<sup>189</sup> *See Am. Express Co. v. Italian Colors Restaurant*, SCOTUSBLOG, <http://www.scotusblog.com/case-files/cases/american-express-co-v-italian-colors-restaurant/> (last visited Apr. 15, 2013).

<sup>190</sup> *See, e.g.,* Ellen Meriwether, *Class Action Waiver and the Effective Vindication Doctrine at the Antitrust/Arbitration Crossroads*, 26 ANTITRUST, Summer 2012, at 67, 70.

<sup>191</sup> *Italian Colors Restaurant*, No. 12-133, slip op. at 9.

<sup>192</sup> *See, e.g.,* Katherine V.W. Stone, *Supreme Court Approves Use of Faux Arbitration to Eliminate Consumer Rights*, HUFFINGTON POST (June 21, 2013, 2:04 AM), [http://huffingtonpost.com/katherine-vw-stone/supreme-court-approves-us\\_b\\_3476378.html](http://huffingtonpost.com/katherine-vw-stone/supreme-court-approves-us_b_3476378.html).

<sup>193</sup> *See* Philip Bump, *The Problem with the Supreme Court’s Amex Decision, Class Action and You*, THE ATLANTIC WIRE (June 20, 2013), <http://www.theatlanticwire.com/national/2013/06/supreme-court-american-express-italian-colors/66443/>.

<sup>194</sup> *See generally Amex III*, 667 F.3d 204.

chafes against the United States' pro-arbitration policy;<sup>195</sup> and (3) the rule finds its support in weak arguments.<sup>196</sup>

Agreements between broker/dealers and investors to arbitrate under FINRA rules undermine the *Gilmer* premise<sup>197</sup> because the arbitration forum under such agreements does not permit the vindication of investors' federal securities rights. Like the antitrust claims in *Amex III*, small investor claims against broker/dealers under the '34 Act can be fact intensive, and, thus, costly to pursue in arbitration.<sup>198</sup> If these costs outweigh the potential arbitration award, investors abandon their claims and broker/dealers continue to perpetuate fraud.<sup>199</sup>

Furthermore, it is difficult for investors with small claims to retain legal counsel.<sup>200</sup> The SEC's website encourages investors with small claims to contact securities arbitration clinics run by law schools.<sup>201</sup> However, these clinics only exist in California, District of Columbia, Florida, Illinois, Massachusetts, New Jersey, New York, and Pennsylvania.<sup>202</sup> Additionally, many securities arbitration clinics place a \$100,000 dollar maximum on the claims that they will take.<sup>203</sup> Although FINRA allows investors to arbitrate pro se, studies show that investors with legal representation fare much better than pro se investors in arbitrations.<sup>204</sup>

If investors could arbitrate their securities claims as a class, they could pool their resources to cover costs such as attorney's fees. In addition, arbitrating as a class would attract an attorney because the small claims would become one large claim. Therefore, FINRA is preventing some investor plaintiffs from vindicating their rights under the '34 Act by not allowing class procedures in arbitration.<sup>205</sup> FINRA is permitting broker/dealer power to expand to a degree that frustrates the '34 Act's purpose of rectifying the imbalance in power between broker/dealers and investors.<sup>206</sup>

FINRA could argue that investors may file a courtroom class action to vindicate their federal securities rights. However, this contradicts the federal policy of enforcing

<sup>195</sup> See generally *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740 (2011).

<sup>196</sup> See Turnbull, *supra* note 41 (manuscript at 14-15).

<sup>197</sup> The *Gilmer* premise is that statutory claims are arbitrable. See *Amex III*, 667 F.3d at 216.

<sup>198</sup> Sen. Al Franken, Sen. Robert Menendez & Sen. Richard Blumenthal, *Senators Urge SEC to Oppose Forced Arbitration for Shareholder Disputes*, 9 No. 3 SEC. LITIG. REP., March 2012, at 19,19.

<sup>199</sup> "Investors with smaller losses tend to join class action lawsuits because the attorney's fees and costs associated with joining a class action are typically less than those associated with bringing an individual FINRA arbitration action." *Class Action vs. Securities Arbitration*, MITCHELL & ASSOCIATES, <http://www.mitchell-attorneys.com/legal-articles/class-action-vs-securities-arbitration/> (last visited Feb. 16, 2013).

<sup>200</sup> See *Arbitration/Mediation Clinics in California, District of Columbia, Florida, Illinois, Massachusetts, New Jersey, New York, and Pennsylvania*, SEC, <http://www.sec.gov/answers/arbclin.htm#> (last modified Mar. 8, 2013).

<sup>201</sup> *Id.*

<sup>202</sup> *Id.*

<sup>203</sup> See *id.*

<sup>204</sup> See Jane Bryant Quinn, 'Small' Claimants Against Brokers Face Tough Odds, BALT. SUN, May 26, 1997, [http://articles.baltimoresun.com/1997-05-26/business/1997146091\\_1\\_arbitration-lawyers-investors](http://articles.baltimoresun.com/1997-05-26/business/1997146091_1_arbitration-lawyers-investors) ("Claims of \$10,000 to \$25,000 are generally heard before a single arbitrator. When these investors went lawyerless, they were 12 percent less likely to win." ).

<sup>205</sup> See *Amex III*, 667 F.3d 204.

<sup>206</sup> See Lee Applebaum, Comment, *Predispute Arbitration Agreements Between Brokers and Investors: The Extension of Wilko to Section 10(b) Claims*, 46 MD. L. REV. 339, 341 (1987).

arbitration agreements.<sup>207</sup> The Supreme Court has stated that § 2 of the FAA embodies a “liberal federal policy favoring arbitration,”<sup>208</sup> and the “fundamental principle that arbitration is a matter of contract.”<sup>209</sup> Accordingly, when broker/dealers make agreements to arbitrate with investors, they should be enforced, unless there is a valid contract defense against enforcement. Arbitration has many well documented benefits, such as efficiency and economy,<sup>210</sup> which are desirable to broker/dealers in disputes with investors.<sup>211</sup> Therefore, class actions in arbitrations would balance the competing interests of broker/dealers and investors and harmonize the FAA with the ‘34 Act.

Moreover, FINRA should ignore the anti-class action in arbitration propaganda because the criticisms of class action arbitration unravel when poked and prodded. Critics of class action arbitration believe that it changes the nature of bilateral arbitration to such a degree that introducing a class into the forum extinguishes arbitration’s benefits.<sup>212</sup> For example, some critics argue that class action arbitration is too slow, requires formality and does not offer defendants protection against risk of *in terrorem* settlements.<sup>213</sup> However, these criticisms are misleading and have been rejected by academic commentators.<sup>214</sup>

First, the criticisms are erroneously based on a comparison between bilateral arbitration and class action arbitration, “apples and oranges.”<sup>215</sup> The correct comparison should be one between class action arbitration and class action litigation.<sup>216</sup> Second, although statistics suggest that the average class action arbitration consumes more time than the average bilateral arbitration, statistics also show that class action arbitrations take less time than class action litigation, on average.<sup>217</sup> Third, there is no empirical evidence that would suggest that class action arbitration is ill fitting for the high stakes parties face when defending against class claims.<sup>218</sup>

### PART III: WEAPONS OF MASS DESTRUCTION—AMERICAN CLASS ACTIONS

Although class action arbitration is more advantageous than its critics suggest, class action, as it stands under FRCP 23, should not be transplanted into FINRA arbitrations. In U.S. Federal Courts, FRCP 23 governs class actions.<sup>219</sup> FRCP 23 is important to consider

---

<sup>207</sup> See *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740, 1745 (2011).

<sup>208</sup> *Id.* at 1745 (quoting *Moses H. Cone Mem’l Hosp. v. Mercury Const. Corp.*, 460 U.S. 1, 23 (1983)).

<sup>209</sup> *Id.* (quoting *Rent-A-Ctr., W., Inc. v. Jackson*, 130 S.Ct. 2772, 2776 (2010)).

<sup>210</sup> See Thomas Campbell, Roxane Busey & Peter Koch, *Arbitrating Antitrust Claims—the Road Less Traveled*, 19 ANTITRUST, Fall 2004, at 8, 8.

<sup>211</sup> See Tamara Hoffbuhr-Seelman, *The Future of Mandatory Securities Arbitration Under the Dodd-Frank Act*, 13 THE BUSINESS SUIT (DRI), No. 9, 2013, available at <http://clients.criticalimpact.com/newsletter/newslettercontentshow1.cfm?contentid=2584&id=417>.

<sup>212</sup> See Turnbull, *supra* note 41 (manuscript at 14-15).

<sup>213</sup> *Id.*

<sup>214</sup> See *id.* (manuscript at 15).

<sup>215</sup> *Id.*

<sup>216</sup> *Id.*

<sup>217</sup> See *id.*

<sup>218</sup> *Id.*

<sup>219</sup> S.I. Strong, *Resolving Mass Legal Disputes Through Class Arbitration: The United States and Canada Compared*, 37 N.C.J. INT’L L. & COM. REG. 921, 928 (2011-2012).

when assessing the viability of class arbitration because the Rule has served as a template for non-FINRA class action arbitration,<sup>220</sup> and contrasts with English group litigation rules.<sup>221</sup>

FRCP 23 sets stringent requirements for class certification.<sup>222</sup> Under the Rule, a member (or members) of a class must meet four prerequisites to sue on behalf of the class: numerosity, commonality, representativeness, and fairness.<sup>223</sup> If these prerequisites are not met, then the litigants may not sue as a class. However, even if these prerequisites are met, the class action may be maintained only if: (1) the litigation of the claims individually would create the risk of inconsistent judgments or would be dispositive of the rights of non-parties;<sup>224</sup> and (2) the necessary relief would be appropriate for the class as a whole,<sup>225</sup> or a class action is the best mode of dispute resolution, under the circumstances.<sup>226</sup>

Since 1966, a defining and controversial characteristic of the American class action has been its opt-out system, meaning that those who are similarly situated to the class are automatically added to the class, and must affirmatively request exclusion to remove themselves.<sup>227</sup> The opt-out system presents two issues: (1) classes are too large because, once litigants are automatically added to the class, there is little incentive to leave; and (2) the due process rights of absent claimants are vulnerable to attack.<sup>228</sup> Nonetheless, in regard to the latter issue, the Supreme Court has held that binding an out-of-state party to class litigation, even one who has no contacts within that state, is constitutional, provided that the party is afforded notice and opportunity to be heard, opportunity to participate in the litigation, and opportunity to request exclusion from the litigation.<sup>229</sup> The judge is responsible for protecting the litigants' due process rights, making him an important player in class actions.<sup>230</sup>

Although FRCP 23 lists many requirements for maintaining a class action, it does not clearly define what a class or class action is.<sup>231</sup> For example, the numerosity requirement is vague and does not say how many plaintiffs are needed to create a class.<sup>232</sup> Congress has enacted statutes with definitions for class actions; however, these definitions are inconsistent.<sup>233</sup>

---

<sup>220</sup> See S.I. Strong, *Enforcing Class Arbitration In the International Sphere: Due Process and Public Policy Concerns*, 30 U. PA. J. INT'L L. 14 (2008).

<sup>221</sup> See, e.g., Turnbull, *supra* note 41 (manuscript at 27).

<sup>222</sup> See FED. R. CIV. P. 23.

<sup>223</sup> See Strong, *supra* note 219, at 930.

<sup>224</sup> FED. R. CIV. P. 23(b)(1).

<sup>225</sup> *Id.* (b)(2).

<sup>226</sup> *Id.* (b)(3) ("The matters pertinent to these findings include: (A) the class members' interests in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already begun by or against class members; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and (D) the likely difficulties in managing a class action.").

<sup>227</sup> Dunin-Waswicz, *supra* note 135, at 293.

<sup>228</sup> *Id.*

<sup>229</sup> *Id.* (citing *Philips Petroleum Co v. Shutts*, 427 U.S. 797, 811-12 (1985)).

<sup>230</sup> See *id.*; Strong, *supra* note 220, at 18.

<sup>231</sup> See FED. R. CIV. P. 23(a).

<sup>232</sup> See *id.*

<sup>233</sup> Compare Class Action Fairness Act of 2005, 28 U.S.C. § 1711 (2011), with Securities Litigation Uniform Standards Act of 1998, 15 U.S.C. § 77p (2011).

For example, the Class Action Fairness Act of 2005 provides: (1) a class is “all of the class members in a class action;” (2) class members are “the persons (named or unnamed) who fall within the definition of the proposed or certified class in a class action;” and (3) a class action is “any civil action filed in a district court of the United States under rule 23 of the Federal Rules of Civil Procedure or any civil action that is removed to a district court of the United States that was originally filed under a State statute or rule of judicial procedure authorizing an action to be brought by 1 or more representatives as a class action.”<sup>234</sup> Furthermore, the Act exempts classes of less than 100 members from some of its provisions.<sup>235</sup>

In contrast, the Securities Litigation Uniform Standards Act of 1998 defines a “covered class action” as “any single lawsuit in which (1) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons or members; or (2) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members.”<sup>236</sup>

The courts, which have great discretion when determining whether a claim is appropriate for class treatment, have not offered clear guidance regarding what a class action is either.<sup>237</sup> For some courts, 13 members were sufficient, yet for other courts, 300 members were not sufficient to meet the numerosity requirement.<sup>238</sup> Additionally, courts differ in the amount of scrutiny applied when determining whether certain factual differences between the plaintiffs’ claims destroy commonality.<sup>239</sup> Therefore, it is possible that claims deserving of class treatment fail to make it to court.

Furthermore, FINRA perpetuates the legislature’s vagueness with regard to class actions by not defining class actions in the rule prohibiting them. FINRA Rule 12204 Class Action Claims states, “(a) Class action claims may not be arbitrated under the Code. (b) Any claim that is based upon the same facts and law, and involves the same defendants as in a court-certified class action or a putative class action, or that is ordered by a court for class-wide arbitration at a forum not sponsored by a self-regulatory organization, shall not be arbitrated under the Code...”<sup>240</sup> By failing to explain what a class action is, FINRA has given itself broad discretion and has created the risk of arbitrary and inconsistent rejections of claims.

Another concern American class actions raise is that they are “entrepreneurial,”<sup>241</sup> class counsel has a great deal of control over the case, selects the class representatives, and

---

<sup>234</sup> Class Action Fairness Act of 2005, 28 U.S.C. § 1711 (2011).

<sup>235</sup> *Id.* §1332.

<sup>236</sup> Securities Litigation Uniform Standards Act of 1998, 15 U.S.C. § 77p (2011).

<sup>237</sup> See Sandrik, *supra* note 35, at 199-200.

<sup>238</sup> *Id.* at 200. However, many cases have held that forty is an appropriate number of plaintiffs to fulfill the numerosity requirement. *Id.* Therefore, defendants usually do not contest numerosity. *Id.*

<sup>239</sup> *Id.* at 202-03.

<sup>240</sup> FINRA Rule 12204, *supra* note 20.

<sup>241</sup> Debra Lyn Bassett, *The Future of International Class Actions*, 18 SW. J. INT’L L. 21, 23-24 (2011).

CLASS WARFARE: PREVENTING INVESTOR CASUALTIES

employs contingent fee agreements, whereby the firm will be paid in an amount disproportionately greater than the actual benefit the class receives.<sup>242</sup> Furthermore, banks, brokerages and corporations, the likely defendants in class actions prior to the rise in popularity of class waivers,<sup>243</sup> criticize class actions because they feel that the consolidation of cases increases their risk of having to pay a huge award.<sup>244</sup> Rather than take that risk, they usually settle, even if the merits of the claim are questionable.<sup>245</sup> Noting these criticisms, Congress enacted the Private Securities Litigation Reform Act of 1995.<sup>246</sup> Foreign parties are also critical of class actions.<sup>247</sup> Foreigners denounce class actions because private individuals, instead of public officials, pursue the claims for the class, and the class can receive monetary damages, instead of merely injunctive relief.<sup>248</sup>

But despite these pitfalls, class actions serve an important function—they allow private individuals to litigate claims.<sup>249</sup> As a result, public agencies, which are otherwise responsible for prosecuting claims of fraud and public wrongs, have a more manageable caseload and preserve their resources.<sup>250</sup> Additional benefits of class actions include: (1) the reduction of duplicative discovery, motion practice, and pretrial procedures; (2) consistent results; (3) no overlapping or repetitive punishment; and (4) potential recoveries for small claims by those who may not even know they were injured and “almost certainly would not bother to sue even if they had known.”<sup>251</sup>

Although foreigners are especially vocal about the problems associated with class actions, increasing numbers of foreign investors are members of securities class actions in the United States.<sup>252</sup> This increase suggests that class action arbitration would not stifle international investing in U.S. markets, even if subject to a rule like FRCP 23,, and that foreign investors are not strictly opposed to group procedures. Many countries are even developing their own group procedures.<sup>253</sup> Therefore, securities law is ripe for the further development of class procedures in arbitration.

#### PART IV: WEAPON OF CHOICE, ENGLAND’S GLO

English civil procedure was codified in 2000 as Civil Procedure Rules (“CPR”). This legislation was enacted as a response to a report addressing procedure issued by the

<sup>242</sup> *Id.* at 24.

<sup>243</sup> Strong, *supra* note 220, at 15.

<sup>244</sup> Elliott J. Weiss, *Pleading Securities Fraud*, 64 LAW & CONTEMP. PROBS. 5, 6 (Spring/Summer 2001).

<sup>245</sup> Dunin-Waswicz, *supra* note 135, at 293.

<sup>246</sup> The Private Securities Litigation Reform Act of 1995 was enacted to curb the alleged abuses of in securities class actions by requiring heightened pleading standards and additional class qualifications. See Weiss, *supra* note 244 for an in depth discussion of the Act.

<sup>247</sup> See Strong, *supra* note 220, at 25-26.

<sup>248</sup> *Id.* The European Directive requires that all Member States of the European Union allow consumer associations or independent public bodies to file group litigation on behalf of plaintiffs. *Id.*

<sup>249</sup> *E.g.*, Turnbull, *supra* note 41 (manuscript at 10).

<sup>250</sup> *Id.*

<sup>251</sup> Strong, *supra* note 220, at 15-16.

<sup>252</sup> See Dunin-Waswicz, *supra* note 135, at 294.

<sup>253</sup> See, e.g., L. REFORM COMM’N, CONSULTATION PAPER ON MULTI-PARTY LITIGATION (July 2003), available at [http://www.lawreform.ie/\\_fileupload/CPS%202004%20and%20older/CPMulti%20Party%20Litigation.pdf](http://www.lawreform.ie/_fileupload/CPS%202004%20and%20older/CPMulti%20Party%20Litigation.pdf)

England and Wales High Court.<sup>254</sup> The report recognized the need for aggregate litigation, due to the high costs associated with individual litigation,<sup>255</sup> as well as a faster and simpler alternative to bilateral litigation.<sup>256</sup>

CPR 19 covers multi-party litigation.<sup>257</sup> Under the rule, collective redress may be maintained by: “(1) adding parties to an existing action or consolidating claims; (2) representative claims; and (3) the Group Litigation Order (“GLO”),”<sup>258</sup> the procedure best suited for implantation into FINRA arbitrations.

A GLO is “an order...to provide for the case management of claims which give rise to common or related issues of fact or law.”<sup>259</sup> GLOs are the primary multi-party procedure used in England.<sup>260</sup> When introduced, GLOs were considered a radical departure from existing litigation procedures.<sup>261</sup> Unlike litigation previously, GLOs entail pre-action disclosures by the parties, provide institutionalized opportunities for mediation to encourage early settlement, and give the courts the power to restrict evidence or issues to maintain cost efficiency and fairness.<sup>262</sup>

Plaintiffs, defendants or the judge, *sue sponte*, may apply for a GLO.<sup>263</sup> The application for a GLO should include: “a summary of the nature of the litigation; the number and nature of the claims already issued;<sup>264</sup> the number of parties likely to be involved; the common issues of fact or law that are likely to arise; and any matters distinguishing small groups of claims within the wider group.”<sup>265</sup>

Prior to applying for a GLO, an applicant hires a solicitor<sup>266</sup> to act on his behalf.<sup>267</sup> The solicitor will contact the Law Society,<sup>268</sup> which operates a Multi-Party Action Information Service.<sup>269</sup> The Multi-Party Action Information Service acts as a matchmaker for perspective applicants and their solicitors, allowing solicitors handling similar claims to join

<sup>254</sup> See Turnbull, *supra* note 41 (manuscript at 20).

<sup>255</sup> See *id.* It is worth noting that this argument resembles the plaintiffs’ argument in *Amex III*. See *Amex III*, 667 F.3d at 210-11.

<sup>256</sup> See David Collins, *Public Funding of Class Actions and the Experience with English Group Proceedings*, 31 MAN. L.J. 211, 213 (2005).

<sup>257</sup> Turnbull, *supra* note 41 (manuscript at 21).

<sup>258</sup> *Id.*

<sup>259</sup> *Id.* (quoting CPR 19.10).

<sup>260</sup> *Id.* (manuscript at 23). However, only seventy-nine GLOs are recorded on the Queens’ Bench Division of the High Court’s register. *Id.* (manuscript at 24). This is most likely because insurance, which is important in England’s “loser pays” system, is difficult to obtain in light of the heightened stakes of GLOs. *Id.*

<sup>261</sup> Christopher Hodges, *Multi-Party Actions: A European Approach*, 11 DUKE J. COMP. & INT’L L. 321, 345 (2001).

<sup>262</sup> *Id.*

<sup>263</sup> L. REFORM COMM’N, *supra* note 253, at 47.

<sup>264</sup> Under English law, the phrase “issue a claim” is similar to the phrase “file a claim” under U.S. law, except the English court issues the claim at the request of the claimant, while the claimant files the claim in U.S. court.

<sup>265</sup> L. REFORM COMM’N, *supra* note 253, at 47.

<sup>266</sup> Someone who provides legal guidance in England, usually in a particular field of law. See *Solicitor in England and Wales*, LAW REFORM SOCIETY (May 2005), <http://www.ukba.homeoffice.gov.uk/sitecontent/documents/policyandlaw/businessandcommercialocsheet/solicitorenglandwales.pdf?view=Binary>.

<sup>267</sup> L. REFORM COMM’N, *supra* note 253, at 47.

<sup>268</sup> *Id.* The Law Society is an organization providing resources and training for solicitors. THE LAW SOCIETY OF ENGLAND AND WALES, <http://www.lawsociety.org.uk/> (last visited Feb. 15 2013).

<sup>269</sup> L. REFORM COMM’N, *supra* note 253, at 47.

CLASS WARFARE: PREVENTING INVESTOR CASUALTIES

together and form a Solicitors' Group.<sup>270</sup> The Solicitors' Group will choose a lead solicitor to act as its representative.<sup>271</sup> The lead solicitor will apply for the GLO on behalf of the group and litigate the GLO issues.<sup>272</sup>

Once the application is made, the GLO will be granted upon approval of the Lord Chief Justice, when the proceeding is in the Chancery Division, or the Vice Chancellor, when the proceeding is in a county court.<sup>273</sup> A Group Register is generated, which contains information regarding the cases under the GLO.<sup>274</sup> Other claimants wishing to have their claims included in the GLO may apply to be added to the Register and "opt-in."<sup>275</sup>

One judge takes responsibility for managing the cases comprising the GLO,<sup>276</sup> and has broad discretion when managing GLO litigation.<sup>277</sup> For example, the judge defines the GLO issue and may designate one of the claims in the GLO as a test case.<sup>278</sup> A test case is the litigation of a single claim in the GLO that will serve as precedent for the other cases in the GLO.<sup>279</sup> Additionally, the judge managing a GLO may set a deadline for adding claims to the Register and may remove a case from the Register.<sup>280</sup>

GLO judgments are binding on all cases on the Register, but only with regard to the specific GLO issue or issues common to all the cases.<sup>281</sup> The GLO claimants are responsible for sharing the costs of litigation, with each claimant liable for an equal proportion of the common costs.<sup>282</sup> However, the costs unique to an individual claim are not dispersed among the group.<sup>283</sup>

GLOs are not class actions.<sup>284</sup> The rules covering GLOs (CPR 19.10-.15) are intentionally simple and brief in order to provide maximum flexibility.<sup>285</sup> The only requirements for those claimants seeking a GLO are commonality and numerosity.<sup>286</sup> Additionally, the aforementioned requirements are not as restrictive as commonality and numerosity under FRCP 23.<sup>287</sup> For example, FRCP 23(a)(2) requires that the claims have "common issues of fact or law," however "related" issues can satisfy CPR 19.10.<sup>288</sup> Likewise, FRCP 23(a)(1) requires that "the class is so numerous that joinder of all members is impracticable," while CPR 19.11 merely requires that "there are likely to be a number of

---

<sup>270</sup> *Id.*

<sup>271</sup> *Id.*

<sup>272</sup> *Id.*

<sup>273</sup> *Id.*

<sup>274</sup> *Id.* at 48.

<sup>275</sup> *Id.*

<sup>276</sup> *Id.* at 46.

<sup>277</sup> *Id.* at 48.

<sup>278</sup> *Id.*

<sup>279</sup> Hodges, *supra* note 261, at 345.

<sup>280</sup> L. REFORM COMM'N, *supra* note 253, at 48.

<sup>281</sup> Turnbull, *supra* note 41 (manuscript at 22).

<sup>282</sup> L. REFORM COMM'N, *supra* note 250, at 48-49.

<sup>283</sup> *Id.* at 49.

<sup>284</sup> See Turnbull, *supra* note 41 (manuscript at 27).

<sup>285</sup> Hodges, *supra* note 261, at 345.

<sup>286</sup> Turnbull, *supra* note 41 (manuscript at 27).

<sup>287</sup> *Id.* (manuscript at 28).

<sup>288</sup> *Id.*



claims giving rise to the GLO issues.”<sup>289</sup> Therefore, it is easier for plaintiffs to qualify for a GLO than a class action.<sup>290</sup>

Furthermore, GLOs are less complex than class actions.<sup>291</sup> While FRCP 23 provides for three distinct types of classes, each with its own requirements, there are no additional formal subdivisions or requirements for a GLO.<sup>292</sup> Another notable difference between GLOs and class actions is that GLOs are non-representative, meaning that they are networks of separate actions, rather than a single action like their American counterpart.<sup>293</sup> Therefore, the claims each maintain their individual character to some extent,<sup>294</sup> and individual claimants possess more control than in representative procedures like class actions. Moreover, GLOs are opt-in only,<sup>295</sup> providing for smaller class sizes than in opt-out actions.

Therefore, FINRA should delete Rules 12204 and 12312, and adopt the following new Class Action in Arbitration Rule, based on England’s CPR 19.10, 19.12 and 19.14:

A FINRA arbitrator may award a Class Action Designation in Arbitration for a claim where there are more than two claims<sup>296</sup> relating to the Class Issues. A Class Action in Arbitration serves as a network of related, individual claims. An arbitrator may make an award of a Class Action Designation at the request of any party or on his own initiative.<sup>297</sup> The right to request a Class Action Designation in Arbitration cannot be waived via contract.<sup>298</sup> When an arbitrator awards a Class Action designation in Arbitration he must: (a) notify FINRA within seven days in writing and (b) give a reasoned award identifying the Class Issues.<sup>299</sup> FINRA will establish and maintain a public online Register at the FINRA website of all cases that are part of the Class Action in Arbitration. Any similarly situated claimants may opt-in to the Class Action in Arbitration. The Class arbitrator may remove a claim from the Class Register at the request of the claimant in that claim.<sup>300</sup> When an award determining a claim included in the Class Register of a Class Action in Arbitration and the award relates to one or more of the Class Issues, the award (the “Class Award”) applies to all cases contained in the Class

---

<sup>289</sup> *Id.*

<sup>290</sup> *Id.*

<sup>291</sup> *See id.*

<sup>292</sup> *Id.* (manuscript at 27).

<sup>293</sup> *Id.*

<sup>294</sup> *Id.*

<sup>295</sup> *Id.*

<sup>296</sup> GLOs do not have a two plaintiff minimum. However, the Class Action in Arbitration Rule FINRA should adopt does in order to give the Rule clarity regarding class size.

<sup>297</sup> *Id.* (manuscript at 37).

<sup>298</sup> The ban on waiving the right to request a Class Action in Arbitration is unique to the new Rule and is not required by a GLO.

<sup>299</sup> *Id.* (manuscript at 37-8).

<sup>300</sup> *Id.* (manuscript at 39).

CLASS WARFARE: PREVENTING INVESTOR CASUALTIES

Register.<sup>301</sup> A Class Award must: be a reasoned award, list all the Class Issues that it determines, and list all the claims which involve those Class Issues.<sup>302</sup>

Like GLOs, the aforementioned Rule is opt-in, and it permits removal of a claim when requested by the claimant in that claim. Likewise, the Rule is non-representative, and the Class Award is only binding on the group issues it addresses. Furthermore, the Rule allows for the publication of information about the Class Action in Arbitration on the Internet, and it allows FINRA to conserve its resources by allowing multiple claims to be handled at once.

FINRA should adopt the new Rule because it preserves the benefits of courtroom class actions. Plaintiffs can afford to vindicate their federal securities rights because the rule provides a cost sharing mechanism. Furthermore, like courtroom class actions, individuals may join together to uncover broker/dealer abuses, thus aiding the SEC in its investigatory role and providing a public benefit. However, unlike class actions, Class Action in Arbitration is clearly defined by the new Rule. Furthermore, Class Action in Arbitration protects broker/dealers from the risks normally associated with class actions because: (1) the Class Action in Arbitration is only binding on the entire class with regard to the Class Action in Arbitration Issue, and (2) the Class Action in Arbitration is opt-in, preventing class sizes from growing impermissibly large.

FINRA should also adopt the new Rule because it preserves arbitration's benefits. The new rule maintains the informality and flexibility normally attributed to arbitration. The efficiency of arbitration is not lost under the new Rule because the Class Action in Arbitration is opt-in. Therefore, a cumbersome class that would slow the arbitration is unlikely. In addition, lay jurors, who may have difficulties understanding complex securities disputes, would not determine the awards resulting from the Class Action in Arbitration.<sup>303</sup> Instead, an arbitrator or arbitration panel with more experience handling securities claims than courtroom juries would determine the award, thus making Class Action in Arbitration superior to class action litigation of a securities claim.<sup>304</sup>

## CONCLUSION

The war on mandatory arbitration clauses is at fever pitch. Although the SEC has not drawn its sword by promulgating a rule voiding such clauses, Congress and investor advocates are urging the SEC to take arms and join the fight. The opposition, including firms like the Carlyle Group, is pushing the war into a new frontier, from broker/dealer customer agreements to IPO prospectuses. Meanwhile, the Supreme Court—in furtherance of its crusade against class arbitration—upheld the class waiver at issue in *Italian Colors*.

It is behind this backdrop that FINRA should look inward and change its own rules regarding mandatory arbitrations between broker/dealers and customer investors. Currently,

---

<sup>301</sup> *Id.*

<sup>302</sup> *Id.*

<sup>303</sup> See Bradley J. Bondi, *Facilitating Economic Recovery and Sustainable Growth Through Reform of the Securities Class-Action System: Exploring Arbitration As an Alternative to Litigation*, 33 HARV. J.L. & PUB. POL'Y 607, 613-14 (2010).

<sup>304</sup> See *id.*

FINRA allows mandatory arbitrations to take place in its jurisdiction, with the caveat that the arbitrations must be bilateral. Additionally, an investor is free to join a courtroom class action, and broker/dealers cannot use mandatory arbitration agreements to deny investors access to courtroom class actions.

FINRA's Rule prohibiting class actions in arbitration is problematic because it prevents plaintiffs from vindicating their rights under the '34 Act. While courtroom class actions are a valid forum for the vindication of a federal right, some investors are unlikely to get there due to the numerous yet vague requirements for class certification and the court's broad discretion in determining whether a group of plaintiffs has met the criteria to litigate as a class.

Therefore, investors must arbitrate individually or not at all. But individual arbitration can be prohibitively expensive. Given the economic consequences of forced individual arbitration, an investor will drop his claim, and, thus, broker/dealers are insulated from liability. Not only does this injure the individual investor, but also it hurts the investing public at large. Broker/dealer violations of the Securities Exchange Act can be difficult to detect, and, therefore, individuals pursuing their claims perform a public service.

FINRA's Rule prohibiting class action in arbitrations is also problematic because it is an obstacle to the FAA, which places agreements to arbitrate on equal footing as other contracts. If FINRA's members make an agreement with their customers to arbitrate, FINRA should not allow plaintiffs to escape their obligation by joining a courtroom class action. Furthermore, FINRA's Rule denies its members the benefits of arbitration, such as efficiency, informality and speed.

Accordingly, FINRA should change its Rule and take both investors' and broker/dealers' interests into account, while harmonizing the Securities Exchange Act with the FAA. To perform this balancing of interests, FINRA should abolish its Rule prohibiting class actions in arbitration as well as its Rule for joinder (as it muddies the waters) and create a Rule for Class Actions in Arbitrations. The new Rule should define a class as two or more plaintiffs. By doing so, the Rule will have concreteness, unlike FRCP 23 and the current FINRA Rule prohibiting class actions in arbitration.

Moreover, when FINRA drafts the new Rule, it should look across the pond to England and adopt some aspects of England's GLOs. GLOs preserve the benefits of class actions in litigation because they enable a group of plaintiffs to share the costs of arbitration instead of bearing them individually. However, GLOs avoid some of the pitfalls of class action litigation. GLOs are opt-in instead of opt-out and, therefore, minimize defendants' risk and only bind plaintiffs who have an invested interest in pursuing the claim. GLOs also have minimal requirements for class certification, which will allow valid claims to be arbitrated. In addition, GLOs preserve the benefits of arbitration because, like arbitration, GLOs are procedurally flexible. The opt-in requirement of GLOs maintains arbitration's efficiency by preventing classes from becoming unwieldy. Therefore, GLOs fit comfortably into FINRA arbitrations.

If approved by the SEC, FINRA's Class Action in Arbitration Rule would be the first step toward resolving the war on mandatory arbitration. The FAA and the '34 Act would both achieve their aims without destroying one another. Therefore, now is the time for FINRA to promulgate the Class Action in Arbitration Rule and bring both sides of the war together and down a path toward peace.