

Client Alert

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FINRA Board of Governors Invalidates Class Action Waivers in Customer Account Agreements

By Daniel A. Nathan and Jeremy B. Merkelson

In an April 24th ruling that will have widespread impact among financial institutions, the FINRA Board of Governors held that a broker-dealer violated FINRA rules by including a mandatory class action waiver in its customer account agreements.

According to FINRA's release, following the Board decision, Charles Schwab & Company entered into a settlement with FINRA, agreeing to pay a fine of \$500,000 and to notify all of its customers that the class action waiver requirement was withdrawn.

The Board decision reverses in part and affirms in part an earlier decision by a FINRA Hearing Panel which held that, while the firm's customer class action waiver violated FINRA rules, those rules were unenforceable because they were preempted by the Federal Arbitration Act (FAA). The Board found that the firm's class action waiver violated FINRA Rules 2268(d)(3) and (d)(1), which, in concert with Rule 12204 of FINRA's Code of Arbitration Procedure for Customer Disputes, effectively ban the use of customer class action waivers by FINRA members. The Board was not swayed by several cases in the employment context where courts have upheld class action waivers between FINRA member firms and their employees. In comparison, the Board said, FINRA Rule 2268 expressly prohibits provisions that limit the ability of customers to file the kind of claims that FINRA arbitration rules determine can be brought in court. Thus, based on this reasoning, the Board held that the employment agreement cases were inapplicable to the customer agreement at issue here.

The Board also reversed the Hearing Panel's finding that the FAA preempted FINRA's arbitration rules. The decision notes that the Exchange Act gives FINRA the ability to propose, and the SEC the authority to approve, rules that govern which claims will be submitted to arbitration and which will not. The Board found that the Exchange Act's broad authorization encompassing FINRA arbitration rules that are approved by the SEC constitutes the necessary "congressional command" to overcome the general mandate of the FAA to enforce arbitration agreements. Thus, even where there is an otherwise valid pre-dispute arbitration agreement between a firm and its customers, the Board ruled that FINRA still has the authority to preserve customers' rights to file or participate in class action lawsuits in court.

The Board decision also upheld the Hearing Panel's finding, which the firm did not contest, that the firm violated FINRA rules by including a provision limiting the arbitrator's authority to consolidate individual claims.

The Board was obviously well aware of the broader implications of its decision in this case. It noted, and on occasion cited to, various amicus briefs filed on behalf of financial institutions and consumer advocacy groups, including industry associations, law professors, consumer rights groups, and others.

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