BEFORE THE BOARD OF GOVERNORS

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of Department of Enforcement, Complainant, vs. Charles Schwab & Company, Inc. San Francisco, CA, Respondent.	DECISION Complaint No. 2011029760201 Dated: April 24, 2014

Respondent inserted provisions in predispute arbitration agreements that prevented customers from bringing or participating in judicial class actions and FINRA arbitrators from consolidating more than one party's claims. Held, findings affirmed in part and reversed in part; remanded for consideration of sanctions.

Appearances

For the Complainant: Thomas B. Lawson, Esq., Christopher A. Perrin, Esq., Daniel L. Gardner, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Gilbert R. Serota, Esq., Julian Y. Waldo, Esq.

Decision

In this case, we consider whether Charles Schwab & Company, Inc. ("Schwab" or the "Firm"), violated NASD and FINRA rules when the Firm included new provisions in predispute arbitration agreements with customers that prevented customers from bringing or participating in judicial class actions and arbitrators from consolidating individual claims filed in FINRA's arbitration forum.[1] In October 2011, Schwab sent amendments to the Firm's customer account agreement to more than 6.8 million customers in their September 2011 month-end account

[1] The rules that apply in this case are those that existed at the time of the conduct at issue.

statement.[2] The amendments included a "Waiver of Class Action or Representative Action" ("Waiver") requiring customers both to waive their right to bring or participate in class actions against Schwab and the authority of arbitrators to consolidate more than one party's claims.[3] As a result of these provisions, all disputes between Schwab and its customers would be resolved through bilateral arbitration. The amendments were effective upon notification to customers.[4] Once FINRA became aware that Schwab was using these provisions, FINRA's Department of Enforcement ("Enforcement") commenced the investigation that culminated in the proceedings before us.

We are presented with two central questions regarding the enforceability of Schwab's predispute arbitration agreements with its customers. The first is whether NASD and FINRA rules preserve for customers the ability to bring or participate in judicial class actions and FINRA arbitrators the ability to consolidate more than one party's claims in arbitration. The second is whether the Federal Arbitration Act ("FAA"), which applies to arbitrations of commercial transactions, applies to NASD and FINRA arbitration rules and preempts enforcement of those rules.

The Hearing Panel found that Schwab violated NASD and FINRA rules by eliminating the ability of Schwab's customers to participate in judicial class actions, but determined that the FAA preempted these rules and made them unenforceable. The Hearing Panel found no clear expression of congressional intent to preserve judicial class actions as an option for customer claims when there is an agreement providing for arbitration of those claims.

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2 Schwab has been registered with FINRA or its predecessors since 1970. The Firm maintains approximately 340 offices nationwide and employs more than 7,000 registered individuals.

3 The Waiver in full states:

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

4 Schwab also placed the Waiver in account agreements for new customers.

The Hearing Panel also determined that Schwab violated NASD and FINRA rules by preventing arbitrators from consolidating claims in FINRA arbitration and that the FAA did not preclude enforcement of rules governing the powers of arbitrators and the procedures for FINRA arbitration. For this violation, the Hearing Panel fined Schwab $500,000 and ordered the Firm to remove the violative language and notify all customers whose agreements contained the language that the provision was void.

After our independent review, we affirm the Hearing Panel's findings that Schwab violated NASD and FINRA rules with respect to the Waiver in its entirety. For well over twenty years, FINRA has been in the forefront of establishing the rules under which securities industry arbitrations take place. During this time, FINRA and its premerger self-regulatory organizations ("SROs"), NASD and the New York Stock Exchange, revised their rules repeatedly and responsively for arbitrations between customers and firms or associated persons. FINRA's arbitration forum has been the subject of numerous high-profile legal challenges. There can be little doubt that Congress and the federal courts have repeatedly scrutinized the FINRA rules that govern securities arbitration. Nonetheless, Schwab's misconduct in this case demonstrates its attempted piecemeal erosion of FINRA's well-established arbitration rules.

One aspect of FINRA rules that was approved by the SEC is that customer class actions will be litigated in court, while FINRA arbitration will be available for customers to make individual claims against FINRA firms. FINRA has complementary rules to separate class actions from individual claims: one prohibits any class actions in FINRA arbitration, a second prevents FINRA firms from using an arbitration agreement to defeat a putative class action in court. Yet Schwab argues that these FINRA rules, which have been in force since 1992, are invalid. Although Schwab is noncommittal on this point, we understand the logical extent of its theory to be that the SEC's past approval of these rules was invalid at the time, because Congress had not authorized the SEC to approve these types of arbitration rules. We reject this theory as a misreading of the Exchange Act. We uphold these FINRA rules and find that Schwab's inclusion of a mandatory waiver of participation in judicial class actions, as well as its restriction of an arbitrator's power to join together individual claims violates NASD and FINRA rules. Because we determine that the FAA does not preclude FINRA's enforcement of its rules, we reverse the Hearing Panel's dismissal of the first two causes of action. We remand this matter to the Hearing Panel to determine appropriate sanctions.[5]

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[5] Schwab appealed the sanctions imposed for its violation under the third cause of action. We hold the issue of appropriate sanctions under cause three in abeyance pending the Hearing Panel's determination of sanctions under the first two causes of action.

I. Procedural Background

A. Enforcement's Allegations

On February 1, 2012, Enforcement filed a three-cause complaint against Schwab. The first cause of action alleged that Schwab, by placing the Waiver in its customer agreements and attempting to limit customers' ability to bring or participate in class actions when class actions are permitted under the FINRA Code of Arbitration Procedure for Customer Disputes ("Customer Code"), violated NASD Rule 3110(f)(4)(C), from October 2011 until December 4, 2011, and FINRA Rule 2268(d)(3), from December 5, 2011, to the present.[6] FINRA Rule 2268(d)(3) prohibits member firms from placing "any condition" in a predispute arbitration agreement that "limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement." As a result of these rule violations, Enforcement also alleged that Schwab violated FINRA Rule 2010.

The second cause of action, which directly relates to the first, alleged that including the Waiver in Schwab's customer agreements also violated NASD Rule 3110(f)(4)(A), and FINRA Rules 2268(d)(1) and 2010. FINRA Rule 2268(d)(1) states that "[n]o predispute arbitration agreement shall include any condition that . . . limits or contradicts the rules of any self-regulatory organization." Enforcement alleged that the Waiver limits or contradicts Rule 12204(d) of the Customer Code. Rule 12204(d) provides:

> A member or associated person may not enforce any arbitration agreement against a member of a certified or putative class action with respect to any claim that is the subject of the certified or putative class action until:
>
> - The class certification is denied;
> - The class is decertified;
> - The member of the certified or putative class is excluded from the class by the court; or
> - The member of the certified or putative class elects not to participate in the class or withdraws from the class according to conditions set by the court, if any.

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[6] NASD Rule 3110(f)(4) was effective until December 4, 2011, and was superseded without change to its text by FINRA Rule 2268(d) on December 5, 2011, as part of the FINRA consolidated rulebook process. For ease of reference, this decision discusses the rule using its current numbering.

The third cause of action alleged that Schwab violated NASD Rule 3110(f)(4)(A), and FINRA Rules 2268(d)(1) and 2010, because the Waiver contradicts Rule 12312(b)[7] of the Customer Code, which provides that arbitrators have the authority to consolidate claims.[8]

B. Proceedings Before the Hearing Panel and the Hearing Panel's Findings

The parties filed cross-motions for summary disposition, and the Hearing Panel heard oral argument on those motions. On August 28, 2012, the Hearing Officer issued an order informing the parties that the Hearing Panel had decided to dismiss causes one and two of Enforcement's complaint, but to find a violation under cause three. The parties subsequently submitted briefs on the issue of sanctions for the findings of violation under cause three. The Hearing Panel issued its decision on February 21, 2013.

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[7] Rule 12312(b) states:

> After all responsive pleadings have been served, claims joined together under paragraph (a) of this rule may be separated into two or more arbitrations by the Director before a panel is appointed, or by the panel after the panel is appointed. A party whose claims were separated by the Director may make a motion to the panel in the lowest numbered case to reconsider the Director's decision.

Schwab represented to FINRA that, beginning in January 2013, the Firm removed from customer account agreements the Waiver provision that relates to the consolidation of claims and notified its customers of the amendment. Schwab, in May 2013, removed the Waiver in its entirety from customer account agreements, for disputes related to events on or after May 15, 2013.

[8] On February 1, 2012, contemporaneous with FINRA's initiation of disciplinary proceedings against the Firm, Schwab filed a complaint for declaratory and preliminary and permanent injunctive relief against FINRA in the United States District Court for the Northern District of California. In seeking a declaratory judgment, Schwab argued that FINRA Rule 2268(d), properly interpreted, does not prohibit class action waivers and, in the alternative, even if intended to do so, the rule's enforcement would impermissibly violate the FAA, as interpreted by the Supreme Court in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011), and *CompuCredit Corp. v. Greenwood*, 132 S. Ct. 665 (2012).

FINRA filed a motion to dismiss the complaint, arguing that the federal court lacked jurisdiction. On May 11, 2012, the district court granted FINRA's motion and dismissed Schwab's complaint. The court determined that it lacked subject matter jurisdiction because Schwab failed to exhaust the administrative remedies established by the Securities Exchange Act of 1934 ("Exchange Act"). The court further found that, even if the exhaustion of administrative remedies in disciplinary cases was not jurisdictional, Schwab failed to show it was entitled to an exception from the general exhaustion requirement.

The Hearing Panel's decision concentrated primarily on two issues: (1) whether Schwab's Waiver conflicts with FINRA rules, and (2), if so, whether the FAA preempts FINRA rules. The Hearing Panel found that both FINRA Rules 2268(d)(3) and (d)(1), acting in conjunction with Rule 12204 of the Customer Code, banned the use of class action waivers by FINRA members. The Hearing Panel next turned to the issue of whether the FAA preempts FINRA Rule 2268(d)(3) and Rule 12204 of the Customer Code. The Hearing Panel noted that § 2 of the FAA, by its own terms, applies to any written agreement to arbitrate, observing also that Schwab, FINRA, and numerous courts have previously concurred that the FAA applies to FINRA arbitration rules and its members' arbitration agreements. This, according to the Hearing Panel, put the FAA in direct conflict with FINRA Rule 2268(d)(3) and Rule 12204 of the Customer Code because these rules place a substantial roadblock in the way of arbitration of claims.

The Hearing Panel determined that, under the holdings of the Supreme Court, the FAA's mandate that arbitration agreements be "valid, irrevocable, and enforceable" outweighs any countervailing rule or law (state, federal or regulatory) unless "overridden by a contrary congressional command," with the burden of proving such a command placed on the party opposing arbitration. The Hearing Panel determined that FINRA rules, promulgated pursuant to the SEC's delegation of authority, and approved by the SEC, are subject to the same limits. Finally, the Hearing Panel concluded that nothing in the securities laws exempted FINRA rules from the FAA's general applicability. The Hearing Panel noted that the Supreme Court repeatedly has relied on the FAA to enforce arbitration clauses in claims brought under federal securities statutes. Because the Hearing Panel found no clear expression of congressional intent to preserve judicial class actions as an option for customer claims where there is an agreement providing for arbitration of those claims, the Hearing Panel granted Schwab's motion for summary disposition on causes one and two concerning the Waiver's class-action provision.

With respect to the third cause of action, the Hearing Panel found that the FAA did not preclude enforcement of FINRA rules governing the powers of FINRA arbitrators and FINRA arbitration procedures. The Hearing Panel rejected Schwab's argument that those rules will enable arbitrators to create de facto class actions, as those rules only allow arbitrators to combine separately filed individual claims. The Hearing Panel explained that the "focus" of the FAA is "on requiring those who have agreed in advance to resolve their disputes by arbitration to go to arbitration after a dispute arises and enforcing any decision the arbitrators may reach, not on regulating the governance of arbitration forums or arbitration procedures." The Hearing Panel found that the language in Schwab's Waiver prohibiting the consolidation of claims related primarily to the "governance of arbitration forums or arbitration procedures" and therefore improperly attempted to circumscribe the power of FINRA arbitrators. For this violation, the Hearing Panel fined Schwab $500,000 and ordered Schwab to remove the violative language from customer agreements and notify all customers whose agreements contained the language that the provision was void.

Pursuant to FINRA Rule 9311, Enforcement appeals, and Schwab cross appeals, the Hearing Panel's decision. On appeal, Enforcement challenges the Hearing Panel's dismissal of

causes one and two. Schwab challenges the Hearing Panel's interpretation of FINRA rules in causes one and two and the sanctions imposed for cause three.[9]

II. Discussion

We affirm the Hearing Panel's findings that Schwab's Waiver violated NASD and FINRA rules, but reverse the finding that the FAA precludes FINRA from enforcing the rule violations in causes one and two. We affirm the findings in cause three in their entirety. We hold the issue of appropriate sanctions under cause three in abeyance pending the Hearing Panel's determination of sanctions under the first two causes of action. We discuss the findings in detail below.

A. Causes One and Two

1. The Rule Language

Because this case is one of rule interpretation, we begin our analysis with the plain language of the relevant rules. *See K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 291-92 (1988) (holding that a statutory analysis must begin with the plain language of the rule). "[W]hen the [rule's] language is plain, the . . . sole function . . . is to enforce it according to its terms." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000); *see also Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 254 (1992) ("When the words of a statute are unambiguous, then, this first canon is also the last: 'judicial inquiry is complete.'"). In determining whether rule language is plain and unambiguous, we must read all parts of the rule together and give full effect to each part. *See United States v. Morton*, 467 U.S. 822, 828 (1984). We therefore examine rule text as a whole by considering its context, object, and policy. *See Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997) ("The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole."). When rule language is not plain, but instead ambiguous, we also review the rulemaking history and any other authorities that might assist our efforts to discern the intent behind the particular rule in question. A particular rule is ambiguous when it is susceptible to more than one reasonable interpretation. *See Chickasaw Nation v. United States*, 534 U.S. 84, 90 (2001) (defining "ambiguity," in the statutory-construction context, as "'capable of being understood in two or more possible senses or ways'" (quoting *Webster's Ninth New Collegiate Dictionary* 77 (1985))).

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[9] We received amicus briefing in support of Enforcement's appeal from: Public Investors Arbitration Bar Association; Professors Barbara Black and Jill Gross; North American Securities Administrators Association, Inc.; and one brief filed collectively by AARP, National Consumer Law Center, and Public Justice, P.C. We received amicus briefing in support of Schwab's appeal from the Chamber of Commerce of the United States of America.

a. FINRA Rule 2268 and "Any Claim"

FINRA Rule 2268 sets forth the requirements for FINRA members when using predispute arbitration agreements for customer accounts. The rule governs both the allowable form and content of a predispute arbitration agreement with a customer. For example, Rule 2268(a) requires any predispute arbitration agreement clause to be highlighted and to include in outline form certain language related to the rights of the parties, composition of the arbitration panel, and the rules of the arbitration forum. Rule 2268(b) requires any agreement containing a predispute arbitration agreement to prominently disclose that fact and indicate the page and paragraph where the predispute arbitration agreement is located within the agreement. Rule 2268(c) requires members to provide customers with a copy of the predispute arbitration agreement and, if requested, with information on how to obtain the rules of the arbitration forums where a claim may be filed under the predispute arbitration agreement. Rule 2268(e) informs broker-dealers that if a customer files a complaint in court against the firm, and the complaint contains claims that are subject to arbitration pursuant to a predispute arbitration agreement, the firm may seek to compel arbitration of the arbitrable claims. If the member seeks to compel arbitration of such claims, the member must agree to arbitrate all of the claims contained in the complaint if the customer so requests. Rule 2268 also requires, in subsection (f), that all predispute arbitration agreements for customer accounts state that no person may bring a class action in arbitration, nor seek to enforce a predispute arbitration agreement against a person who has initiated a judicial class action or is a member of a putative class until class certification issues are decided.

Enforcement alleged that the class action prohibition contained within Schwab's Waiver violated FINRA Rules 2268(d)(1) and (d)(3). Subsection (d) prohibits members from incorporating four conditions in a predispute arbitration agreement, including a provision that limits or contradicts the rules of any self-regulatory organization and one that "limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement." FINRA Rules 2268(d)(1), (d)(3). Enforcement argues that FINRA Rule 2268(d)(3)'s phrase "any claim" includes class actions and therefore Schwab's Waiver contravenes this prohibition. In addition, Enforcement contends that because Rule 12204 of the Customer Code permits the filing of class actions in court, the Waiver contradicts this rule. In other words, because the rules of FINRA's arbitration forum, and specifically Rule 12204 of the Customer Code, reference class action claims in court, the waiver of any ability to file class action claims in court constitutes a prohibited limit on "any claim" within the meaning of FINRA Rule 2268 and contradicts Rule 12204 of the Customer Code.

Schwab argues that FINRA Rule 2268(d)(3) cannot be referring to class actions when the rule language uses the term "claim" because class actions are procedural mechanisms and not claims. While we assume "that the ordinary meaning of that language accurately expresses the [rule's] purpose," these arguments underscore the ambiguity in the phrase "any claim in court." *See Hardt v. Reliance Standard Life Ins. Co.*, 560 U.S. 242, 251 (2010) (internal quotation omitted). Thus, FINRA Rule 2268(d)(3)'s isolated use of the phrase "any claim," without explanation, provides little insight into the interpretive question before us. "We do not," however, "construe [rule text] in isolation." *See Morton*, 467 U.S. at 828.

We also look to the dictionary definition of these terms to determine their ordinary meanings. With respect to the word "any," the Supreme Court has acknowledged that "'any' can and does mean different things depending upon the setting." *Nixon v. Mo. Mun. League*, 541 U.S. 125, 132 (2004). For example, "any" may mean "[o]ne or some, regardless of sort, quantity, or number"; "[o]ne or another selected at random"; or "[t]he whole amount of: all." *Webster's II New College Dictionary* 51 (2001). Nevertheless, "[i]n a series of cases, the Supreme Court has drawn upon the word 'any' to give the word it modifies an 'expansive meaning' when there is 'no reason to contravene the clause's obvious meaning.'" *New York v. EPA*, 443 F.3d 880, 885 (D.C. Cir. 2006) (quoting *Norfolk S. Ry. Co. v. Kirby*, 543 U.S. 14, 31-32 (2004)); *see also SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1466 (2d Cir. 1996) (interpreting use of word "any" in Rule 10b-5 as broad and inclusive). An examination of the relevant rule language in this case reveals "no reason to contravene the clause's obvious meaning." *See Norfolk S. Ry. Co.*, 543 U.S. at 31-32. Through the use of the word "any," the claims referred to in FINRA Rule 2268(d)(3) are meant to be inclusive.

Black's Law Dictionary defines "claim" in relevant part as the "aggregate of operative facts giving rise to a right enforceable by a court." *Black's Law Dictionary* 240 (7th ed. 1999). The Federal Rules of Civil Procedure treat a class action as an aggregation of a particular type of claim. *See, e.g.*, Fed. R. Civ. Pro. 23 ("[T]he claims or defenses of the representative parties are typical of the claims or defenses of the class."). This does not, however, end our inquiry. Schwab's argument that class actions are merely procedural devices, and not a substantive form of claim, is not a frivolous one. *See, e.g.*, *Gen. Tel. Co. v. Falcon*, 457 U.S. 147, 159 (1982) (explaining that class action is a procedural mechanism to aggregate individual claims for purposes of judicial efficiency); *Ehrheart v. Verizon Wireless*, 609 F.3d 590, 606 (3d Cir. 2010) ("'[A] class action is a procedural device.'" (quoting *1 Newburg on Class Actions* § 1:2)); *Montgomery Ward & Co. v. Langer*, 168 F.2d 182, 187 (8th Cir. 1948) ("The class action was an invention of equity mothered by the practical necessity of providing a procedural device so that mere numbers would not disable large groups of individuals, united in interest, from enforcing their equitable rights nor grant them immunity from their equitable wrongs."). We therefore must determine how the rules of FINRA's arbitration forum treat class actions and whether class actions are included in "any claim" for purposes of FINRA Rule 2268.

b. <u>"Class Action Claims" under Rule 12204 of the Customer Code</u>

In determining the intent and meaning of a term used in FINRA rules, the words must be considered in their context and sections of the rule relating to the same subject are said to be *in pari materia*, as well as cognate rules, and must be considered in order to arrive at the true meaning and scope of the words.[10] We therefore look to FINRA's Customer Code to harmonize

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[10] Rules "*in pari materia*" (i.e., in relation to the same matter or subject) are those having a common purpose such that they should be "construed together" for the purpose of learning and giving effect to the legislative intention. *See Black's Law Dictionary* 794. A primary rule of statutory construction is that when interpreting multiple statutes dealing with a related subject or object, the statutes are *in pari materia* and must be considered together. *See United States v. Freeman*, 44 U.S. (3 How.) 556, 564-65 (1845). The proper comprehensive analysis thus reads

[Footnote continued on next page]

sections covering the same subject matter (arbitrations involving customer disputes), in order to determine if the phrase "any claim" in FINRA Rule 2268, when interpreted together with FINRA arbitration rules, includes judicial class actions for customer disputes involving member firms.

Rule 12100(d) of the Customer Code defines a "claim" as "an allegation or request for relief." Rule 12204 of the Customer Code is titled "Class Action Claims" and specifically addresses the status of class action claims in FINRA arbitration. Rule 12204(a) states that "[c]lass action claims may not be arbitrated under the [Customer] Code," while subsection (d) forbids members and associated persons from enforcing arbitration agreements against members of certified or putative class actions, until the class certification is denied or the class is decertified, or the member is excluded or withdraws from the class.[11] A careful reading of the rule text reveals that Rule 12204 uses the phrase "class action claims" interchangeably with "a claim [that] is part of a class action" and "any claim that is the subject of the certified or putative class action." Rules 12204(a), (c), (d) of the Customer Code.

We also consider the presumption against surplusage to be important here. It is "a cardinal principle of statutory construction that we must give effect, if possible, to every clause and word of a statute." *Williams v. Taylor*, 529 U.S. 362, 404 (2000) (internal quotation omitted). Enforcement and Schwab present us with two competing interpretations. Only Enforcement's interpretation of Rule 12204 "avoids surplusage." *See Freeman v. Quicken Loans, Inc.*, 132 S. Ct. 2034, 2043 (2012). Were we to adopt Schwab's construction of the rules, we would render the adjective "class action" preceding "claims" in Rule 12204 not only insignificant but wholly superfluous. Under Schwab's rendition, FINRA's inclusion of the phrase "class action," in both the rule's title and substantive provisions, has no operative effect on the scope of the provision because class actions are not claims. We are reluctant "to treat statutory terms as surplusage" where, as here, the term occupies a pivotal place in the regulatory scheme related to arbitration of customer disputes and the availability of bringing class action claims in court. *See Babbitt v. Sweet Home Chapter of Cmtys. for a Great Or.*, 515 U.S. 687, 698 (1995). We determine that a securities-law claim brought as a class action therefore is a category of claim that was intended to be filed in court under FINRA rules. Our determination is also supported by the rulemaking history discussed in detail below.

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the parts of a regulatory scheme together, bearing in mind the intent underlying the whole scheme. *See, e.g., Chapman v. Houston Welfare Rights Org.*, 441 U.S. 600, 607-12 (1979).

[11] Schwab contends that the statement at the end of Rule 12204(d) of the Customer Code stating that "[t]his paragraph does not otherwise affect the enforceability of any rights under this Code or any other agreement" means that its Waiver is permissible under FINRA rules because the Waiver is "any other agreement." We reject this argument based on a plain reading of the rule language. Rule 12204(d) of the Customer Code expressly applies to "any arbitration agreement" with a customer. Thus, "any other agreement" means an agreement other than the predispute arbitration agreement with a customer. Schwab's Waiver is part of a predispute arbitration agreement with customers.

While the inclusion of Rule 12204(a) in the Customer Code squarely addresses that class actions may not proceed in FINRA's arbitration forum, the Customer Code on its face does not state directly that it *preserves* the right for customers to bring claims via judicial class actions. Rather, Rule 12204(d) of the Customer Code presupposes that judicial class actions are possible and then sets forth restrictions on enforcement of existing arbitration agreements with respect to any claim that is part of a putative or certified class action. Schwab argues that a customer can agree, through Schwab's Waiver, to relinquish participation in a class action, without Schwab violating FINRA rules. The timing of Schwab's Waiver, requiring customers to agree when they open an account, conflicts with FINRA rules. Rule 12204(d) of the Customer Code by its terms prevents a firm from enforcing a predispute arbitration agreement *until* a court disposes of the class action allegations or the customer opts out of the putative or certified class. Thus, none of the exceptions listed in subsection (d) apply until a customer is given the opportunity to participate in a class action. It therefore stands to reason that Rule 12204 of the Customer Code does not contemplate a prospective waiver of a customer's right to participate in a class action.

Schwab argues that several cases involving class-action waivers inserted in employment agreements between firms and employees direct the outcome here.[12] *See Cohen v. UBS Fin. Servs., Inc.*, No. 12 Civ. 2147, 2012 U.S. Dist. LEXIS 174700 (S.D.N.Y Dec. 3, 2012) (finding that Rule 13204 of the Industry Code does not prohibit a waiver of judicial class action in employment agreements as employers and employees "may contract beyond the default arbitration rules of the securities industry"); *Lewis v. UBS Fin. Servs. Inc.*, 818 F. Supp. 2d 1161 (N.D. Cal. 2011) (finding class-action waiver entered into between employer and employee enforceable); *Suschil v. Ameriprise Fin. Servs., Inc.*, No. 1:07CV2655, 2008 U.S. Dist. LEXIS 27903 (N.D. Ohio Apr. 7, 2008) (finding FINRA Industry Code not applicable to collective action lawsuits brought pursuant to Fair Labor Standards Act and determining class-action waiver in employment agreement was enforceable). We disagree that these cases are controlling over disputes with customers. The cases upon which Schwab relies analyze Rule 13204 of the Industry Code. While Rule 13204(a)'s text is identical to Rule 12204 of the Customer Code, there are no restrictions upon firms regarding the content of predispute arbitration agreements with employees, unlike the strict parameters set forth by FINRA Rule 2268 for predispute arbitration agreements with customers. In comparison, FINRA Rule 2268 expressly prohibits provisions that contradict SRO rules or which limit the ability of customers to file the kind of

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[12] The SEC approved FINRA's amendments to now-current Rule 12204 of the Customer Code in 1994 to extend the prohibition on class action arbitration to include claims by associated persons such as employment-related claims and other industry class actions. *Order Approving Proposed Rule Change Relating to Exclusion of Class Action Claims from Arbitration*, Exchange Act Release No. 33939, 59 Fed. Reg. 22,032, 1994 SEC LEXIS 1156 (Apr. 20, 1994). This provision related to employee class actions is now contained in Rule 13204 of FINRA's Code of Arbitration for Industry Disputes ("Industry Code").

claims that FINRA arbitration rules determine can be brought in court.[13] This difference makes the employment agreement cases inapplicable to this dispute.

We also review the rulemaking history of FINRA Rule 2268 and Rule 12204 of the Customer Code to determine the intent of the drafters.

2. The Rulemaking History

a. FINRA Rule 2268

FINRA adopted the provisions now contained in Rule 2268 to address SEC concerns about the "fairness and efficiency of the arbitration process administered by the SROs." *See Order Approving Proposed Rule Changes by the New York Stock Exchange, Inc., National Association of Securities Dealers, Inc., and the American Stock Exchange, Inc. Relating to the Arbitration Process and the Use of Predispute Arbitration Clauses*, Exchange Act Release No. 26805, 54 Fed. Reg. 21,144, 1989 SEC LEXIS 843, at *1 (May 16, 1989) ("*1989 Approval Order*").[14] In the wake of the Supreme Court's decision in *Shearson/Am. Express Inc. v. McMahon*, 482 U.S. 220 (1987), which held that customers who enter into predispute arbitration agreements with brokerage firms can be compelled to arbitrate claims under the Exchange Act, the SEC approved the SROs' arbitration rules. The SEC found the new rules were "designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, provide for an equitable allocation of fees, and, in general, protect investors and the public interest," and that they were consistent with Exchange Act §15A. *1989 Approval Order*, 1989 SEC LEXIS 843, at *66. The SEC noted that the arbitration rules:

> represent the promise of the SROs to maintain fair and efficient forums for the arbitration of disputes between members and investors . . . [and] appropriately balance the need to strengthen investor confidence in the arbitration systems at the SROs, both by

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[13] Schwab also relies on *French v. First Union Sec., Inc.*, 209 F. Supp. 2d 818 (M.D. Tenn. 2002). *French* involved customer, rather than employee, class-action claims in FINRA's forum. The court examined whether a customer having both class action and nonclass action claims may compel arbitration of nonclass claims. *Id.* at 833. The court determined that a customer's class-action claims may not be arbitrated in FINRA's forum but that "[o]nce a class-action claim is dismissed, it is no longer a roadblock to the arbitration of non-class claims." *Id.* Unlike the instant matter, the court's holding in *French* does not deal with a class-action waiver in a predispute arbitration agreement with a customer, and we do not find it helpful to Schwab's position.

[14] In 1977, the SEC invited a group of SROs, including FINRA, to develop uniform arbitration rules for the resolution of disputes between broker-dealers and their customers, as an alternative to the SEC's own proposals. *See id.* at *3. The rules approved in the 1989 Approval Order are the culmination of that 12-year process. *See id.*

> improving the procedures for administering the arbitrations and by creating clear obligations regarding the use by SRO members of predispute arbitration clauses, with the need to maintain arbitration as a form of dispute resolution that provides for equitable and efficient administration of justice.

Id. at *63-64. The FINRA rules therefore are intended to make investors aware of the existence, nature, and effect of predispute arbitration agreements and to improve the FINRA arbitration process so that it is a "fair, expeditious, and economical means for resolution of disputes," taking into account the interests of investors, broker-dealers, and the public. *See 1989 Approval Order*, 1989 SEC LEXIS 843; *NASD Notice to Members 89-21*, 1989 NASD LEXIS 25, at *2 (Mar. 1989).

In reference to the provision that is now FINRA Rule 2268(d)(1), prohibiting any condition in a predispute arbitration agreement that limits or contradicts the rules of an SRO, the SEC stated that it "believe[d] that the new provision in the rule . . . benefits investors." *1989 Approval Order*, 1989 SEC LEXIS 843, at *61. The SEC made clear that "[a]greements cannot be used to curtail any rights that a party may otherwise have had in a judicial forum." *Id.* Consistent with the SEC's approval order, FINRA announced in August 1989 that amendments to predispute arbitration agreements in customer agreements could not limit or contradict the rules of an SRO. *See NASD Notice to Members 89-58*, 1989 NASD LEXIS 107, at *2-4 (Aug. 1989).[15]

In the SEC releases announcing the rule proposal and approving adoption of what is now FINRA Rule 2268(d), the SEC stated that the "[r]ule would be amended to clarify the prohibition against provisions that limit rights or remedies," including the prohibitions now found in FINRA Rules 2268(d)(1) & (d)(3). *Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Amendments to NASD Rule 3110(f) Governing Use of Predispute Arbitration Agreements with Customers*, Exchange Act Release No. 42160, 64 Fed. Reg. 66,681, 1999 SEC LEXIS 2484, at *14-15 (Nov. 19, 1999); *Order Granting Approval to Proposed Rule Change as Amended Regarding NASD Rule 3110(f) Governing Predispute Arbitration Agreements with Customers*, Exchange Act Release No. 50713, 69 Fed. Reg. 70,293, 2004 SEC LEXIS 2832, at *11-12 (Nov. 22, 2004). In the Notice to Members announcing the rule change, FINRA stated that the amendments were done in part to include new disclosures that, "in some cases, claims that are ineligible for arbitration may be brought in court."[16] *NASD*

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[15] FINRA Rule 2268(d)(1) was originally adopted as § 21(f)(4) of Article III of NASD's Rules of Fair Practice. *See id.* at *4.

[16] Schwab argues that the phrase "any claim" used in FINRA Rule 2268(d)(3) singularly refers to the ability of a customer to bring in court claims that are time-barred in arbitration pursuant to Rule 12206 of the Customer Code, which is known as the eligibility rule. There is nothing, however, in FINRA Rule 2268(d)(3)'s language or the rulemaking history that limits "any claim" in the manner that Schwab suggests. Rather, the rulemaking history reflects that the purpose of now-current FINRA Rule 2268(d) was to adopt a general prohibition against

[Footnote continued on next page]

Notice to Members 05-09, 2005 NASD LEXIS 16, at *3. FINRA explained that the amendments were intended to "amplify" the restrictions on provisions in a predispute arbitration agreement that limit a customer's rights or remedies, and referred to Rule 2268(d)(3) as one of those restrictions. *Id.* at *3, 5.

b. Rule 12204 of the Customer Code

FINRA proposed what is now Rule 12204 of the Customer Code to exclude class action matters from arbitration proceedings conducted by FINRA and to require that predispute arbitration agreements contain a notice that class action matters may not be arbitrated. *Notice of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Improvements in the NASD Code of Arbitration Procedure*, Exchange Act Release No. 30882, 57 Fed. Reg. 30,519, 1992 SEC LEXIS 1566 (July 1, 1992) ("*July 1992 Proposal*"). FINRA stated in the July 1992 Proposal that the rule provisions were developed in response to former SEC Chairman David S. Ruder's suggestion that SROs "consider adopting procedures that would give investors access to the courts in appropriate cases, *including class actions*." *Id.* at *5-6 (emphasis added). In response to comments on the rule, FINRA stated "that it agrees that the bar on class actions in arbitration was designed to provide investors with access to the courts, which already have developed the procedures and the expertise for managing class actions." *October 1992 Approval Order*, 1992 SEC LEXIS 2767, at *5-6. Moreover, FINRA stated that "paragraph (d)(3) [now Rule 12204(d) of the Customer Code] clearly prohibits NASD members from enforcing existing arbitration contracts to defeat class certification or participation." *Id.* at *8, 9. The SEC in its approval order stated that "in all cases, class actions are better handled by the courts and that investors should have access to the courts to resolve class actions efficiently." *Id.* The SEC explained that "[w]ithout access to class actions in appropriate cases, both investors and broker-dealers have been put to the expense of wasteful, duplicative litigation. The new rule ends this practice." *Id.* The SEC concluded by stating that it "believes that investor access to the courts should be preserved for class actions and that the rule change approved herein [now-current Rule 12204 of the Customer Code] provides a sound procedure for the management of class actions arising out of securities industry disputes between NASD members and their customers." *Id.* at *9-10.

[Cont'd]

"provisions . . . that limit rights or remedies, *including* provisions that would circumvent [the] eligibility rule." *See id.* (emphasis added); *see also NASD Notice to Members 05-09*, 2005 NASD LEXIS 16, at *5-6 (Jan. 2005) (explaining that the amendments were intended "to, *among other things*, address provisions that attempt to circumvent" the eligibility rule) (emphasis added). Thus, the ability of customers to bring certain time-barred arbitration claims in court was merely one concern addressed by FINRA Rule 2268. Customers' ability to participate in class actions was another. *See Order Approving Proposed Rule Change Relating to the Exclusion of Class Actions from Arbitration Proceedings*, Exchange Act Release No. 31371, 57 Fed. Reg. 42,659, 1992 SEC LEXIS 2767, at *5-6, 8-9 (Oct. 28, 1992) ("*October 1992 Approval Order*").

3. Schwab's Waiver Violates FINRA Rules

After reviewing the rule language and rulemaking history, we determine that Rule 12204 of the Customer Code was intended to preserve investor access to the courts to bring or participate in judicial class actions, and that through its Waiver, Schwab violated FINRA Rules 2268(d)(1) and (d)(3), and Rule 12204 of the Customer Code. FINRA's explanation to the SEC regarding the impetus of the rule's development in the July 1992 Proposal and response to comments in the October 1992 Approval Order are clear statements that continued investor access to the courts for class action claims was of paramount concern and central to the rule's purpose. FINRA crafted Rule 12204 of the Customer Code to prevent member firms from using an existing arbitration agreement as a weapon against customers "to defeat class certification or participation." *See October 1992 Approval Order*, 1992 SEC LEXIS 2767, at *8-9. Consistent with this purpose and in harmony with the prohibitions of Rule 12204(d) of the Customer Code, FINRA Rule 2268(f) requires firms to include a statement in customer predispute arbitration agreements that such agreements are not enforceable against a person who has initiated a judicial class action or is a member of a putative class until class certification issues are decided. Moreover, the SEC's directive in approving the rule echoed this sentiment: "investor access to the courts should be preserved for class actions." *See October 1992 Approval Order*, 1992 SEC LEXIS 2767, at *9-10. Schwab's Waiver eliminates access to the courts in violation of FINRA rules.

Schwab argues that the purpose of Rule 12204 of the Customer Code was "to express and enforce the determination that class actions should not be arbitrated before FINRA Dispute Resolution." Schwab is correct with respect to portions of Rule 12204, but that singular purpose gives short shrift to subsection (d). The purpose of Rule 12204(d), as indicated through FINRA's response to comments about the rule, and included in the SEC's approval order, was to avoid the subversion of the judicial class action after FINRA eliminated the ability to file class action claims in its arbitration forum. *See October 1992 Approval Order*, 1992 SEC LEXIS 2767, at *8-9.

Schwab contends that because FINRA Rule 2268(d)(3) does not expressly refer to class-action claims, the Firm had insufficient notice that its Waiver violated the rule. As we discussed above, FINRA Rule 2268(d)(3) uses the broad adjective "any" to modify "claim." This is not a case where a new interpretation of a rule has been adopted, but rather a case where a firm has ignored rule text as a whole by failing to consider its context, object, and policy. The Customer Code, which actually defines "claim" in the context of customer disputes and uses the phrase "class action claims," is *in pari materia* with FINRA Rule 2268 and should be considered together to discern meaning. *See Freeman*, 44 U.S. at 564-65. The plain language of Rule 12204 of the Customer Code illustrates that the rule includes class actions as a form of claim. Moreover, the rulemaking history of Rule 12204 reveals that customer access to the courts for class actions was central to the rule's purpose. Finally, it is not necessary for a rule to specify each possible type of conduct that might violate the rule. *See, e.g.*, *Vill. of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 498 (1982) (stating that "economic regulation is subject to a less strict vagueness test . . . because," among other reasons, "businesses, which face economic demands to plan behavior carefully, can be expected to consult relevant legislation in

advance of action. Indeed, the regulated enterprise may have the ability to clarify the meaning of the regulation by its own inquiry, or by resort to an administrative process"); *see also Am. Fund Distribs., Inc.*, Exchange Act Release No. 64747, 2011 SEC LEXIS 2191, at *19 n.23 (June 24, 2011) (noting that regulatory requirements can be enforceable beyond the language used to precisely delineate each course of conduct).

We affirm the Hearing Panel's finding that Schwab, through its Waiver, violated NASD Rule 3110(f)(4)(C), and FINRA Rules 2268(d)(3) and 2010, as alleged in cause one, and NASD Rule 3110(f)(4)(A), and FINRA Rules 2268(d)(1) and 2010, as alleged in cause two. Our finding that Schwab violated NASD and FINRA rules related to class-action claims does not end the case with respect to causes one and two. We now consider whether the FAA prevents FINRA from enforcing these rules against Schwab.

4. The Federal Arbitration Act

a. Applicability to FINRA Rules

As a threshold matter, Enforcement and several of its amici argue that the FAA does not apply to this case. They argue that the FAA has no effect on the application of FINRA rules governing predispute arbitration agreements because the rules are enforceable as a result of a private contract, Schwab's membership agreement with FINRA. We agree, but only to a point. Through Schwab's membership agreement, FINRA's arbitration rules apply to Schwab. *See, e.g.*, *Anderson v. Beland*, 672 F.3d 113, 128 (2d Cir. 2011) ("FINRA membership constitutes an agreement to adhere to FINRA's rules and regulations, including its Code and relevant arbitration provisions contained therein." (Internal quotation omitted)). The FAA, however, does apply to this case because it governs virtually every arbitration agreement arising out of a commercial transaction, and Schwab's customer transactions are no exception.[17] *See* 9 U.S.C. § 2 (the FAA governs agreements to arbitrate "transactions involving commerce"). Federal circuit courts also have recognized that FINRA arbitration rules themselves constitute an "agreement in writing" under the FAA. *See Wash. Square Sec., Inc. v. Aune*, 385 F.3d 432, 435 (4th Cir. 2004); *Kidder, Peabody & Co. v. Zinsmeyer Trusts P'ship*, 41 F.3d 861, 863-64 (2d Cir. 1994).

Section 2, the FAA's primary substantive provision, provides that "[a] written provision in any . . . contract . . . to settle by arbitration a controversy thereafter arising out of such contract . . . 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. The Supreme Court has interpreted § 2 of the FAA broadly. *See Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 273-74, 281 (1995) (interpreting the reach of the FAA broadly to all transactions "involving commerce" and stating that "'involving' is broad and is indeed the functional equivalent of 'affecting'"). The Court has emphasized that § 2 establishes a "liberal federal policy favoring arbitration agreements," *CompuCredit*, 132 S. Ct. at 669, and most notably, has applied the FAA to

[17] Schwab's customer agreements included an express provision that stated that the FAA governs Schwab's arbitration agreements.

securities arbitrations under the Exchange Act. *See McMahon*, 482 U.S. at 226-27, 238. We accordingly determine that a necessary component of a comprehensive legal analysis in this case requires us to review how FINRA arbitration rules (promulgated pursuant to and acting in concert with the Exchange Act) interact with the requirements of the FAA and the FAA's presumption of arbitrability of Exchange Act claims.[18]

b. The Federal Arbitration Act's Statutory Purpose

The Supreme Court has consistently recognized two key aspects of the FAA. The Court has explained that the "FAA's primary purpose [is to] ensur[e] that private agreements to arbitrate are enforced according to their terms."[19] *Volt Info. Scis. Inc. v. Bd. of Trs. of Leland Stanford Jr. Univ.*, 489 U.S. 468, 479 (1989); *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 221 (1985) (holding that § 2 of FAA requires that arbitration agreements be enforced according to their terms). Second, the FAA establishes a federal policy favoring arbitration. "The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the

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[18] Enforcement suggests the FAA's application to FINRA arbitration rules implicates the issue of whether FINRA is a state actor. As we discussed, the FAA applies to virtually all agreements to arbitrate disputes involving commercial transactions irrespective of the parties involved. *See* 9 U.S.C. § 2. We disagree that the application of a federal statute to FINRA rules somehow turns FINRA into a state actor. *See, e.g.*, Exchange Act § 15A(b)(6); 15 U.S.C. § 78o-3(b)(6) (requiring that FINRA adopt rules that are consistent with the Exchange Act). FINRA is a private entity. It may engage in quasi-judicial functions, but that does not mean it is a state actor. *See Desiderio v. NASD*, 191 F.3d 198, 206-07 (2d Cir. 1999) (affirming trial court's dismissal of plaintiff's constitutional claims challenging the arbitration clause in the Form U4 because NASD is not a state actor nor can its actions be fairly attributable to the state). Moreover, there are countless arbitration cases concerning disputes among private parties where courts have found state action absent. *See, e.g.*, *FDIC v. Air Fla. Sys., Inc.*, 822 F.2d 833, 842 n.9 (9th Cir. 1987) ("[T]he arbitration involved here was private, not state, action; it was conducted pursuant to contract by a private arbitrator. Although Congress, in the exercise of its commerce power, has provided for some governmental regulation of private arbitration agreements, we do not find in private arbitration proceedings the state action requisite for a constitutional due process claim."); *Elmore v. Chicago & Ill. Midland Ry. Co.*, 782 F.2d 94, 96 (7th Cir.1986) ("[T]he fact that a private arbitrator denies the procedural safeguards that are encompassed by the term 'due process of law' cannot give rise to a constitutional complaint."); *Int'l Ass'n of Heat and Frost Insulators and Asbestos Workers Local Union 42 v. Absolute Envtl. Serv., Inc.*, 814 F. Supp. 392, 402-03 (D. Del. 1993) (finding no state action in arbitration proceedings pursuant to a collective bargaining agreement between private parties); *Austern v. Chicago Bd. Options Exch., Inc.*, 716 F. Supp. 121, 125 (S.D.N.Y. 1989) (holding that the conduct of an arbitration panel "did not in any way constitute state action"), *aff'd*, 898 F.2d 882 (2d Cir. 1990).

[19] The FAA was enacted in 1925 and re-enacted in 1947. *See Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991).

construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983).

c. The Federal Arbitration Act's Presumption in Favor of Arbitrability Yields to Federal Law that Limits Arbitration of Claims

Despite the "liberal federal policy favoring arbitration agreements," the FAA has limits. *See Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83 (2002). "The FAA directs courts to place arbitration agreements on equal footing with other contracts." *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 294 (2002). The savings language in § 2 of the FAA explicitly directs adjudicators to do what other laws require. 9 U.S.C. § 2 (providing that arbitration agreements can be revoked upon "grounds as exist at law or in equity for the revocation of any contract"). If a valid arbitration agreement exists, then an adjudicator must determine whether any external legal constraints preclude arbitration of the claims in question. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985).

In *CompuCredit Corp. v. Greenwood*, the Supreme Court reaffirmed the principle that the mandate of the FAA is not absolute, explaining that it may be "overridden by a 'contrary congressional command.'" 132 S. Ct. 665, 669 (2012) (quoting *McMahon*, 482 U.S. at 226). In *McMahon*, the Court specified that congressional intent to overcome the FAA would be "deducible from [the statute's] text or legislative history, or from an inherent conflict between arbitration and the statute's underlying purpose." *McMahon*, 482 U.S. at 226-27; *see also Gilmer*, 500 U.S. at 26 ("If such an intention exists, it will be discoverable in the text of the [statute], its legislative history, or an 'inherent conflict' between arbitration and the [statute's] underlying purposes.").

d. The Exchange Act Contains Congress's Command that the SEC Can Approve FINRA's Rules that Govern Arbitration

Here, both the text of the Exchange Act and the rulemaking history of NASD's proposal to adopt what are currently FINRA Rule 2268 and Rule 12204 of the Customer Code demonstrate a statutorily authorized intent to overcome the FAA. Congress, through the Maloney Act amendments to the Exchange Act, gave registered securities associations, such as FINRA, front-line responsibility for regulating the brokerage industry. Specifically, Exchange Act § 15A empowers FINRA to regulate broker-dealers including how they resolve disputes with their customers, subject to SEC oversight. Exchange Act § 15A; 15 U.S.C. § 78o-3. FINRA must file with the SEC a proposal to change one of its rules and the SEC must approve the rule for the proposal to become effective.[20] In the past twenty years, the SEC approved dozens of FINRA's arbitration rules, including FINRA Rule 2268 and Rule 12204 of the Customer Code and their predecessor rules, after public notice and comment. *See, e.g.*, Jill I. Gross, *McMahon*

[20] *See* Exchange Act § 19(b)(2). Under exceptions that do not apply here, some SRO rule filings do not need SEC approval to become effective. *See* Exchange Act § 19(b)(3)(A).

Turns Twenty: The Regulation of Fairness in Securities Arbitration, 76 U. Cin. L. Rev. 493, 514 n.135 (2008) (noting that from 1997 to 2007, NASD filed with the SEC more than 65 proposed rule changes relating to arbitration).

Congress explicitly authorized the SEC to approve SRO proposed rule changes, including rule changes regarding arbitration, when the SEC finds that the rule change is consistent with the requirements of the Exchange Act. *McMahon*, 482 U.S. at 233; Exchange Act § 19(b)(2). In its opinion regarding arbitration of Exchange Act claims, the Supreme Court explained "the Commission has broad authority to oversee and to regulate the rules adopted by the SROs relating to customer disputes, including the power to mandate the adoption of any rules it deems necessary to ensure that arbitration procedures adequately protect statutory rights." *McMahon*, 482 U.S. at 233-34. Indeed, the SEC's exercise of its oversight powers regarding SRO arbitration rules was pivotal to the Supreme Court's holding in *McMahon* that arbitration agreements covering Exchange Act violations were valid and enforceable. *Id.* at 234. "We conclude that where, as in this case, the [arbitration procedures of the New York Stock Exchange, the American Stock Exchange, and the NASD] are subject to the Commission's § 19 authority, an arbitration agreement does not effect a waiver of the protections of the Act." *Id.* Therefore, the Exchange Act gives the SEC the authority to approve FINRA rules that govern arbitration in FINRA's forum and that regulate the content of predispute arbitration agreements.

Turning to another indication of congressional intent, the FINRA rulemaking history here highlights that the rules would restrict a broker-dealers' ability to use an arbitration agreement to defeat judicial class actions.[21] As noted previously, the rulemaking history for Rule 12204 of the Customer Code is explicit that FINRA would prevent its members from eliminating judicial class actions through provisions in predispute arbitration agreements. FINRA stated that "paragraph (d)(3) [now Rule 12204(d) of the Customer Code] clearly prohibits NASD members from enforcing existing arbitration contracts to defeat class certification or participation." *October 1992 Approval Order*, 1992 SEC LEXIS 2767, at *8, 9. The SEC's approval order concluded by stating that it "believes that investor access to the courts should be preserved for class actions and that the rule change approved herein [now-current Rule 12204 of the Customer Code] provides a sound procedure for the management of class actions arising out of securities industry disputes between NASD members and their customers." *Id.* at *9-10.

In discussing what is now Rule 12204(d) of the Customer Code, the SEC verified that its approval was consistent with the Exchange Act. The SEC found "that the proposed rule change is consistent with the requirements of Section 15A(b)(6)" of the Exchange Act, which requires—in part—"that the rules of NASD be designed 'to protect investors and the public interest.'" *Id.* at *9. Similarly, the SEC confirmed that its approval of what is now FINRA Rule 2268 was consistent with the Exchange Act:

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[21] Within the context of an SRO rule proposal, we rely on the SRO rulemaking history, including SEC approval, as the appropriate analog to legislative history under *McMahon* and *CompuCredit.*

> [T]he Commission finds that the proposals submitted by the NYSE, NASD and AMEX are consistent with the requirements of the [Exchange] Act, . . . which require that [SROs] have rules designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, provide for an equitable allocation of fees, and, in general, protect investors and the public interest.

1989 Approval Order, 1989 SEC LEXIS 843, at *65-66. The rulemaking history vividly shows that FINRA was imposing restrictions on predispute arbitration agreements.

The Hearing Panel found no congressional intent to preserve judicial class actions as an option for customer claims under FINRA rules because, it reasoned, FINRA's authority to promulgate rules is not a congressional command. The Hearing Panel mistakenly required that Congress restrict arbitration agreements directly in a statute.[22] A "congressional command," however, is not strictly confined to an arbitration restriction that is written into a statute. Congress can also pass a statute that grants authority to an agency to restrict predispute arbitration agreements. In *CompuCredit*, the Supreme Court cited as an example of a contrary congressional command the Consumer Financial Protection Bureau's ("CFPB") authority to regulate predispute arbitration agreements. 132 S. Ct. at 672. Indeed, in this instance Congress both delegated to an agency and allowed the agency to exercise judgment.[23] Consequently, we conclude that Congress's granting of authority to the SEC to approve of SRO limitations on arbitration agreements is equally as valid as its granting of authority to the CFPB.

Moreover, the emphasis of the congressional command requirement is that the legislative branch, as opposed to the judicial branch, determines when the FAA is overridden. The Supreme Court has often noted that the purpose of the FAA "was to reverse the longstanding *judicial* hostility to arbitration agreements." *Waffle House*, 534 U.S. at 289 (emphasis added); *Gilmer*, 500 U.S. at 24 (emphasis added). Our finding that the Exchange Act authorizes the SEC to approve SRO rules that limit arbitration agreements correctly focuses on the actions of Congress and the SEC. This is not a case of a court reading into a statutory scheme a restriction on arbitration that has no basis. *See CompuCredit*, 132 S. Ct. at 669 (rejecting a provision that prevented "[a]ny waiver by any consumer of any protection provided by or any right of the consumer under this subchapter" as having a contrary congressional command when no other statutory provision established a right to bring an action in court). The SEC is implementing Congress's plan by evaluating and approving SRO rule proposals that govern the conduct of the

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[22] The Hearing Panel also incorrectly failed in its analysis to determine whether the legislative history or an inherent conflict supplied an indication of a congressional command.

[23] "The [CFPB], by regulation, may prohibit or impose conditions or limitations on the use of an agreement . . . for arbitration . . . , if the [CFPB] finds that such prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers." 12 U.S.C. § 5518(b).

securities industry, including the rules that govern what FINRA firms can include in their predispute arbitration agreements with their customers.

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The Exchange Act manifestly 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 rulemaking history of FINRA's rules evidences that the SEC was approving FINRA's restrictions on predispute arbitration agreements pursuant to the Exchange Act. The SEC followed Congress's designated process for a FINRA rule to be approved. The Exchange Act's broad authorization encompassing FINRA arbitration rules that are approved by the SEC constitutes the Supreme Court's required congressional command to overcome the general mandate of the FAA to enforce arbitration agreements.

e. FINRA's SEC-Approved Rules Have the Force of Federal Law When Evaluating Federal Law Conflicts

FINRA rules have the force and effect of a federal regulation for the purposes of resolving federal conflicts of law. *See Credit Suisse First Boston Corp. v. Grunwald*, 400 F.3d 1119, 1132 (9th Cir. 2005) (explaining that FINRA rules have the force and effect of federal law because they are derived from the Exchange Act). We find this highly significant to the issue of whether FINRA's SEC-approved rules can override the FAA.

The Supreme Court has repeatedly found conflicts between the antitrust laws and the securities laws, including SEC and FINRA rules. The securities laws have prevailed when the Court has found—using either a test of plain repugnancy or clear incompatibility—that the antitrust laws would produce conflicting guidance in an area that is addressed by the securities laws. *See Gordon v. New York Stock Exchange, Inc.*, 422 U.S. 659 (1975); *United States v. NASD, Inc.*, 422 U.S. 694 (1975). In *Gordon*, the Supreme Court held that the New York Stock Exchange ("NYSE") possessed implied antitrust immunity from a federal antitrust suit challenging its fixed-rate commission structure. 422 U.S. at 691. Implied antitrust immunity was necessary, the Court explained, because allowing the antitrust suit to proceed would have subjected the NYSE to conflicting standards of conduct and "unduly interfere[d] . . . with the operation of the Securities Exchange Act." *Id.* at 686. In *NASD*, the Supreme Court held that an antitrust suit could not be brought challenging agreements fixing the price of mutual funds. 422 U.S. at 694. The suit alleged that mutual fund underwriters and broker-dealers had entered into agreements requiring the broker-dealers to maintain the pre-determined public offering price when selling mutual fund shares. *Id.* at 702 n.11. The Court held that the SEC had the power to authorize stock price restrictions under the Investment Company Act of 1940, even though the SEC had not exercised that authority. *Id.* at 729. The Court reasoned that the antitrust laws had to "give way" to ensure the viability of the mutual fund regulatory scheme and that there was "no way to reconcile the Commission's power to authorize these restrictions with the competing mandate of the antitrust laws." *Id.* at 722.

More recently, the Supreme Court found that the federal antitrust laws were impliedly repealed by the Exchange Act, as expressed through SEC and FINRA rules, regarding IPO

marketing practices. *See Credit Suisse Sec. (USA) LLC v. Billing*, 551 U.S. 264, 267-70 (2007). In *Billing*, investors filed a class action against investment banks and alleged antitrust violations that resulted from underwriters' IPO marketing practices. *Id.* at 267-70. In examining whether application of both the securities and antitrust laws would create a risk of conflicting guidance, requirements, or privileges, the Court analyzed NASD rules as part of the contours of the securities laws. *Id.* at 280 (citing NASD proposed rule 2712(a), which prohibited an underwriter from receiving excessive compensation as consideration for its IPO allocation decisions). The Court found persuasive that the conduct was within the parameters of securities regulation, and the Exchange Act granted the SEC considerable power over underwriters, including the authority to supervise all of the activities in question and regulate virtually every aspect of an underwriter's activity. *Id.* at 276-77. In addition, the SEC had exercised that authority. *Id.* at 277-78.

The Supreme Court's holdings that federal antitrust laws are impliedly repealed when they conflict with securities laws support the conclusion that the Exchange Act, effectuated through FINRA rules, overrides the FAA here. First, the SEC, through its oversight of the FINRA arbitration forum and its review of FINRA rules, has consistently exercised its authority to oversee the arbitration process. Second, the Schwab dispute represents a direct conflict between the FAA, which mandates enforcement of arbitration agreements according to their terms, and FINRA rules, which require broker dealers to preserve judicial class actions for investors. Third, FINRA's arbitration rules for customer disputes with FINRA firms and associated persons address a critical aspect of investor protection under the Exchange Act, namely in what forum a customer class action will be litigated. In reconciling the conflict between FINRA arbitration rules that prohibit use of a predispute arbitration agreement to eliminate judicial class actions and the FAA's enforcement of class action waivers, we find—based on the SEC's approval orders—that FINRA's rules are in furtherance of the Exchange Act's protection of investors. This core aspect of the Exchange Act prevails over the FAA.

In addition to implied repeal of federal antitrust law, courts have upheld FINRA rules that were approved by the SEC as having the force of a federal regulation when they conflict with incompatible state laws. *See Grunwald*, 400 F.3d at 1132. In *Grunwald*, the Ninth Circuit held that NASD's arbitration rules regarding disclosure and disqualification of arbitrators, which had been approved by the SEC, preempted conflicting state-law requirements regarding arbitrators. *Id.* at 1132.[24] The Ninth Circuit underscored that the SEC "has extensive experience with regulating the SROs' arbitration procedures" and agreed with the SEC's "determination that the state law conflicts with SRO rules." *Grunwald*, 400 F.3d at 1136.

In summary, we find FINRA rules that restrict Schwab's ability to use a class action waiver to defeat customers from bringing or participating in judicial class actions are valid and enforceable. Just as the Supreme Court has held that the Exchange Act, the Investment

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[24] SRO rules have preempted conflicting state law in areas other than arbitration as well. *See McDaniel v. Wells Fargo Invs., LLC*, 717 F.3d 668, 674 (9th Cir. 2013) (finding SEC and SRO rules regarding supervision of associated person's securities trading preempted a state law prohibition on force patronage by employees).

Company Act, and SEC and FINRA rules regarding securities activities take priority over federal antitrust law, the Exchange Act and FINRA's specific rules prohibiting class action waivers likewise take priority over the FAA. Over twenty years ago, FINRA and other SROs proposed arbitration rules that were published for public comment in the wake of a major court battle over the ability of Exchange Act claims to be arbitrated. In this very context, the SEC approved these rules pursuant to the well-established process set forth in the Exchange Act. The SEC's approval conferred on FINRA rules the equivalent status of a federal regulation. FINRA rules and their rulemaking history confirm that FINRA members may not include class action waivers in predispute arbitration agreements with customers. Schwab included such waivers in millions of predispute arbitration agreements in violation of NASD Rule 3110(f)(4) and FINRA Rules 2268 and 2010, and the FAA does not impose an impediment to holding Schwab responsible for these violations.

f. Schwab's Arguments that FINRA's Prohibition on Class Action Waivers Is Invalid Are Misplaced

Schwab seeks to capitalize on a series of recent Supreme Court opinions involving predispute arbitration agreements between customers and corporations to invalidate two of FINRA's longstanding arbitration rules. After careful consideration, we find that FINRA rules have not been invalidated by recent Supreme Court holdings related to predispute arbitration agreements.

AT&T Mobility LLC v. Concepcion involved a state law rule that invalidated class action waivers when one party had superior bargaining power and was alleged to have caused small damages to many customers. 131 S. Ct. 1740 (2011). The Court approached the case as a potential conflict between California and federal law. "When state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA." *Id.* at 1747. The Court held that the state law rule interfered with arbitration and was preempted by the FAA. *Id.* at 1750, 1753. *AT&T Mobility* and the line of cases in which courts have invalidated state laws based on federal preemption, however, do not apply to this case. FINRA arbitration rules are not creatures of state law nor should they be treated as equivalent to state law.

Schwab argues that the Supreme Court opinion in *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013), reaffirms that the FAA "requires the enforcement of arbitration agreements containing class action waivers" unless a law contains a contrary congressional command. While we acknowledge that the Supreme Court reiterated this aspect of FAA law, *Italian Colors* decided a specific issue. In *Italian Colors*, the Supreme Court held that the FAA required enforcement of a class action waiver even where the cost of proving antitrust violations on an individual basis would exceed the potential recovery. *Id.* at 2311. The Court interpreted the "effective vindication" exception to enforcing the FAA by holding that only predispute waivers of a party's right to pursue a statutory remedy are invalid. *Id.* at 2310. Predispute arbitration waivers that have the effect of making an individual party bear the expense of proving a violation, however, are valid and enforceable. *Id.* at 2311. *Italian Colors* has no

application to this appeal, because Enforcement does not contend that customers must be allowed to pursue judicial class actions as a matter of efficiency.[25]

Schwab also contends that *McMahon* supports the proposition that the FAA requires us to enforce Schwab's predispute arbitration agreement as written. *McMahon*, 482 U.S. 220. Schwab argues that *McMahon*'s holding that arbitration agreements were not invalid waivers of Exchange Act claims (those claims could be pursued in arbitration) also mandates that class action waivers are valid waivers today. *McMahon*, however, hinged on the argument that a general waiver provision in the Exchange Act required that *all* legal claims based on the Exchange Act could not be arbitrated. The Court rejected this argument, noting that for the claims at issue, the Exchange Act did not "address the question of the arbitrability of § 10(b) claims." *Id.* at 227. The Court further explained that the anti-waiver provision, Exchange Act § 29(a), "only prohibits waiver of the substantive obligations imposed by the Exchange Act." *Id.* at 228. Rule 12204 of the Customer Code, in contrast, preserves investor access to the courts to bring or participate in judicial class actions. Schwab's class action waiver directly violates FINRA rules. It is not invalid because it requires a customer to waive a substantive obligation imposed by the Exchange Act. *McMahon* did not address the issues in this appeal.

Moreover, *McMahon* concluded that the arbitration agreement in the case was valid because arbitrators were capable of handling alleged violations of Exchange Act § 10(b). *Id.* at 232. But FINRA's arbitration forum prohibits class claims in arbitration. *See* Rule 12204(a) of the Customer Code. Schwab's class action waiver eliminates the ability of an investor to pursue a dispute as a judicial class action. There is no court or arbitration forum where a class action could be initiated. *McMahon*'s reasoning does not support invalidating FINRA's arbitration rules either.

McMahon's holding that securities claims can be arbitrated does not control the outcome of this appeal. FINRA's arbitration rules speak directly to Schwab's class action waiver and prohibit it. This prohibition does not disfavor arbitration; it recognizes that courts are better equipped to handle class action litigation.

Schwab argues that Enforcement's amici are incorrect in claiming that the Dodd-Frank amendments to the Exchange Act confirm that the SEC has the authority to restrict predispute arbitration agreements. Schwab asserts that, instead, the Exchange Act did not contain this power previously. We disagree. We do not draw any negative inference from the Dodd-Frank amendment's highlighting of the SEC's ability to undertake rulemaking regarding arbitration agreements that cover customer disputes with broker-dealers. The key aspects of this provision are that it is permissive, meaning the SEC may adopt a rule, and that the SEC must find that any restrictions on predispute arbitration agreements are "in the public interest and for the protection

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[25] All of Enforcement's amici argue that class actions are necessary for small claim plaintiffs to vindicate their statutory rights under the Exchange Act. We determine that the Court's statements in *Italian Colors* regarding effective vindication foreclose this argument.

of investors." *See* Exchange Act § 15(o), 15 U.S. C. § 78o(o).[26] Considering what the provision says and the context in which it says it, we do not see any implication that the provision should limit the authority of an SRO.

When examined thoroughly, Congress's grant of authority to the SEC in Exchange Act § 15(o) does not carry a negative implication of lack of authority for FINRA. First, the provision does not say or imply that the SEC is given the exclusive authority to prohibit or limit predispute arbitration agreements. Section 15(o) merely says that the SEC may do so. As the courts have observed, the negative implication maxim, *expressio unius*, merely embodies a presumption and "should be invoked only when other aids to interpretation suggest that the language at issue was meant to be exclusive." *Bailey v. Fed. Intermediate Credit Bank of St. Louis*, 788 F.2d 498, 500 (8th Cir. 1986) (declining to apply the *expressio unius* maxim); *see Martini v. Fed. Nat'l Mort. Assoc.*, 178 F.3d 1336, 1342 (D.C. Cir. 1999) (explaining that the negative implication maxim is a "non-binding rule of statutory interpretation" this is often misused) (citation omitted)). The language of Exchange Act § 15(o) simply does not support a negative inference.

Second, the multi-layered structure of the federal securities laws often means that the SEC and FINRA each have a rule that addresses the same topic. Experience teaches that granting the SEC permissive authority on a topic does not mean that SROs lack authority on that topic. For example, § 15(n) of the Exchange Act grants the SEC the power to issue rules that would require pre-sale disclosures about investment objectives, strategies, costs, and risks to retail investors who are purchasing investment products. Yet SROs, including FINRA, have existing rules that require pre-sale disclosure documents for several types of securities, including options and security futures.[27] The multi-layered structure of SEC and SRO regulation shows that Congress's grant of authority to the SEC under Exchange Act § 15(o) does not imply that FINRA lacks the power to enforce its existing arbitration rules.

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[26] Section 15(o) provides:

> The Commission, by rule, may prohibit, or impose conditions or limitations on the use of, agreements that require customers or clients of any broker, dealer, or municipal securities dealer to arbitrate any future dispute between them arising under the Federal securities laws, the rules and regulations thereunder, or the rules of a self-regulatory organization if it finds that such prohibition, imposition of conditions, or limitations are in the public interest and for the protection of investors.

[27] FINRA's options rule requires delivery of what is known as the options disclosure document. *See* FINRA Rule 2360(b)(11) (requiring the delivery of the Characteristics and Risks of Standard Options to a customer at or before an options account is opened). FINRA has a similar disclosure document requirement for security futures. *See* FINRA Rule 2370(b)(11) (requiring the delivery of Security Futures Risk and Disclosure Statement to a customer at or before a security futures account is opened).

B. Cause Three

Enforcement alleged in cause three of its complaint, and the Hearing Panel found, that Schwab's Waiver violated NASD Rule 3110(f)(4)(A), and FINRA Rules 2268(d)(1) and 2010, because the Waiver's statement that "the arbitrator(s) shall have no authority to consolidate more than one parties' [sic] claims" contradicts Rule 12312 of the Customer Code.[28] Schwab does not contest this finding of violation, and after our independent review, we affirm it.

1. The Rule Language

Rule 12312 of the Customer Code permits one or more parties to join multiple claims together in the same arbitration under certain circumstances.[29] The rule further provides that if the Director of Arbitration separates the claims prior to the appointment of an arbitration panel, the panel may subsequently reconsider the Director's decision. *Id.* Rule 12312 by its terms provides arbitrators with the authority to consolidate the claims of multiple parties. Schwab is bound by Rule 12200 of the Customer Code to arbitrate according to the procedures set forth "under the Code." We concur with the Hearing Panel's finding that Schwab is prohibited from modifying the SEC-approved arbitration procedures provided in the FINRA Customer Code.[30]

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[28] As discussed above in connection with cause two, a violation of Rule 2268(d)(1) occurs when a predispute arbitration agreement includes "any condition" that "limits or contradicts the rules of any self-regulatory organization."

[29] Those circumstances include claims containing common questions of law or fact; claims asserting rights to relief jointly and severally; or claims arising out of the same transactions or occurrences. Rule 12312 of the Customer Code.

[30] While we determine that the language of Rule 12312 of the Customer Code is sufficiently clear to find that Schwab's Waiver was directly in conflict, the relevant rulemaking history bolsters that finding. In 2007, FINRA amended Rule 10314 of the NASD Code of Arbitration Procedure, which contained the provisions regarding consolidation of claims, and those provisions were placed in Rule 12312 of the Customer Code. *See Order Approving Proposed Rule Change and Amendments 1, 2, 3, and 4 To Amend NASD Arbitration Rules for Customer Disputes and Notice of Filing and Order Granting Accelerated Approval of Amendments 5, 6, and 7 Thereto; Order Approving Proposed Rule Change and Amendments 1, 2, 3, and 4 To Amend NASD Arbitration Rules for Industry Disputes and Notice of Filing and Order Granting Accelerated Approval of Amendments 5, 6, and 7 Thereto*, Exchange Act Release No. 55158, 72 Fed. Reg. 4574, 4584 (Jan. 31, 2007). Rule 10314(d) provided that the Director of Arbitration was authorized to preliminarily determine whether multiple claimants should proceed in the same or separate arbitrations, and any further determinations with respect to joinder, consolidation, and multiple parties were to be made by the arbitration panel. In response to comments submitted during the rulemaking process related to Rule 12312, FINRA explained that it "did not intend to change the current policy that the Director's decision to consolidate claims is preliminary and may be reconsidered by the panel." *Id.* at 4585.

Accordingly, this provision in the Waiver is a condition in a predispute arbitration agreement that contradicts a FINRA rule, in violation of FINRA Rules 2268(d)(1) and 2010.

2. The Federal Arbitration Act

The Supreme Court explained that the FAA does not favor arbitration "under a certain set of procedural rules." *Volt*, 489 U.S. at 476. Indeed, the FAA does not prevent "the enforcement of agreements to arbitrate under different rules than those set forth in the Act itself." *Id.* at 479; *see also Italian Colors*, 133 S. Ct. at 2309 (stating that courts must enforce the terms of an arbitration agreement including "'the rules under which . . . arbitration will be conducted'" (quoting *Volt*, 489 U.S. at 479)). The Court held in *Howsam v. Dean Witter Reynolds, Inc.*, that the application of an arbitration procedural rule was "a matter presumptively for the arbitrator." 537 U.S. at 85. In *Howsam*, a brokerage firm sought to enjoin a customer from arbitrating a dispute before NASD. *Id.* at 81-82. The firm argued that the customer failed to comply with the NASD Code of Arbitration Procedure that expressly imposed a six-year time limit to file for arbitration. *Id.* at 82. The Court concluded that the question of whether a dispute was time-barred under the NASD arbitration rules was a gateway procedural issue that did not present a question of arbitrability for the courts. *Id.* at 85. Rather, the Court observed that "NASD arbitrators, comparatively more expert about the meaning of their own rule, are comparatively better able to interpret and to apply it." *Id.*

In this case, the arbitration provision in Schwab's customer account agreements contemplated that the rules of the FINRA arbitration forum would apply. The customer agreements stated in relevant part that:

> arbitration will be conducted by, and according to the securities arbitration rules and regulations then in effect of, the Financial Industry Regulatory Authority (FINRA) or any national securities exchange that provides a forum for the arbitration of disputes, provided that Schwab is a member of such national securities exchange at the time the arbitration is initiated.

Schwab's anti-consolidation provision included in the Waiver squarely contradicts FINRA's well-established arbitration procedure for consolidation of arbitration claims. Consolidation is a procedural issue for FINRA arbitrators to decide as claims proceed in arbitration and does not interfere with "the accomplishment of the FAA's objectives." *See AT&T Mobility*, 131 S. Ct. at 1748; *Volt*, 489 U.S. at 479; *Emp'rs Ins. Co. of Wausau v. Century Indem. Co.*, 443 F.3d 573, 581 (7th Cir. 2006).

Accordingly, we affirm the finding that Schwab violated NASD Rule 3110(f)(4)(A), and FINRA Rules 2268(d)(1) and 2010, by including a condition that contradicted Rule 12312 of the Customer Code and that Rule 12312 of the Customer Code is not pre-empted by the FAA.

C. Sanctions

Because the Hearing Panel dismissed causes one and two at the summary disposition stage, the parties did not have a full opportunity to present their case on the issue of sanctions related to these causes of action. In light of our findings of liability against Schwab for these two causes, we determine that it is appropriate under the circumstances to remand the case to the Hearing Panel for a hearing on the appropriate sanctions for this misconduct.

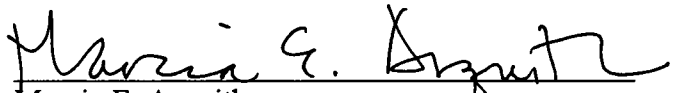
For its findings of violations in cause three, the Hearing Panel fined Schwab $500,000 and ordered Schwab to cease using the anti-consolidation language in its customer agreements and to notify in writing all customers who received the Waiver that the anti-consolidation language was not effective. We hold the issue of appropriate sanctions under cause three in abeyance pending the Hearing Panel's determination of sanctions for the violations under causes one and two. As a matter of judicial efficiency, we will review all the sanctions at one time, after this remand.

III. Conclusion

We affirm the Hearing Panel's findings that Schwab violated NASD Rule 3110(f)(4)(C), and FINRA Rules 2268(d)(3) and 2010, as alleged in cause one of the complaint, and NASD Rule 3110(f)(4)(A) and FINRA Rules 2268(d)(1) and 2010, as alleged in cause two. We further determine that there is the required congressional command in the Exchange Act that empowers FINRA to enforce its existing rules that preserve judicial class actions even when there is a valid predispute arbitration agreement between a firm and its customers. We therefore reverse the Hearing Panel's dismissal of the first two causes of action and remand the case to the Hearing Panel for a determination of sanctions.

We affirm the Hearing Panel's findings of liability under cause three. Schwab's Waiver contradicted Rule 12312 of the Customer Code and thereby impermissibly interfered with a FINRA arbitrator's ability to consolidate claims, in violation of NASD Rule 3110(f)(4)(A), and FINRA Rules 2268(d)(1) and 2010. Because the FAA does not dictate specific arbitration procedures and FINRA's procedures do not act as an obstacle to the FAA's goals, FINRA may enforce these rule violations against Schwab. We also affirm the Hearing Panel's order that Schwab pay $1,318.25 in hearing costs.[31]

On Behalf of the Board of Governors,



Marcia E. Asquith
Senior Vice President and Corporate Secretary

[31] We reserve for later consideration the award of any appeal costs. We also have considered and reject without discussion all other arguments of the parties.