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The Customer's Nonwaivable Right to Choose Arbitration in the Securities Industry

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ABSTRACT

Arbitration has been the predominant form of dispute resolution in the securities industry since the 1980s. Virtually all brokerage firms include predispute arbitration agreements (PDAAs) in their retail customer contracts, and have successfully fought off challenges to their validity. Additionally, the industry has long mandated that firms submit to arbitration at the demand of a customer, even in the absence of a PDAA.

More recently, however, brokerage firms have been arguing that forum selection clauses in their agreements with sophisticated customers (such as institutional investors and issuers) supersede firms' duty to arbitrate under FINRA Rule 12200. Circuit courts currently are split over whether, under general principles of contract interpretation, FINRA member firms can circumvent their duty to arbitrate by inserting forum selection clauses in their customer agreements.

Most of these courts have not addressed the argument that the anti-waiver provision of the Securities Exchange Act of 1934 (section 29(a)) bars securities firms from forcing customers to waive their right to arbitrate disputes. The Supreme Court long ago interpreted section 29(a) to apply to waivers of substantive rights arising under the Exchange Act. Is the right to

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arbitrate in the FINRA forum, which is heavily regulated by the SEC to promote investor protection, a right that cannot be waived?

This Article will explore the interaction between the anti-waiver provision of the Exchange Act, and the right of a customer to demand a particular dispute resolution process. This Article argues that investors' long-standing right to choose arbitration in the securities industry is a right that brokerage firms cannot force their customers to waive.

INTRODUCTION

The Securities and Exchange Commission (SEC) has long supported a brokerage customer's right to choose arbitration as a means to resolve customer disputes fairly and efficiently, and as a critical component of investor protection.[1] Under an SEC-approved rule, broker-dealers, all of which must be members of the Financial Industry Regulatory Authority (FINRA),[2] a securities self-regulatory organization (SRO), have an obligation to submit to arbitration at the demand of a customer. FINRA Rule 12200 provides that member firms must arbitrate a claim if "requested by a customer," "[t]he dispute is between a customer and a member or associated person of a member; and . . . [t]he dispute arises in connection with the business activities of the member or the associated person."[3]

To prevent investors from having a unilateral right to demand arbitration, virtually all brokerage firms include provisions in their form contracts with retail customers requiring arbitration of customers' disputes in an SRO forum, primarily FINRA's Office of Dispute Resolution.[4] Because the Federal Arbitration Act (FAA)[5] declares the validity, irrevocability, and

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1. *See* Exchange Act Release No. 131, at 3, 1935 WL 29028 (Mar. 21, 1935) (immediately after its own formation, recommending to the New York Stock Exchange (NYSE) that it maintain the right of customers to arbitrate disputes with NYSE firms); *see also* Jill I. Gross, *The History of Securities Arbitration as Investor Protection*, 2016 J. DISP. RESOL. 171 (2016) [hereinafter Gross, *The History of Securities Arbitration*] (describing the history of the SEC's support of customer's choice of arbitration); Barbara Black & Jill I. Gross, *Investor Protection Meets the Federal Arbitration Act*, 1 STAN. J. COMPLEX LITIG. 1, 18 (2012) [hereinafter Black & Gross, *Investor Protection*] ("At least since the mid-1970s the SEC has asserted the need for a nationwide investor dispute resolution system to handle small claims and has worked with the SROs, industry representatives and investor groups to develop arbitration rules to achieve this result."); Sarah R. Cole, *Fairness in Securities Arbitration: A Constitutional Mandate?*, 26 PACE L. REV. 73, 79 (2005) ("[T]he SEC has been anything but a passive bystander regarding the implementation of SRO arbitration.").

2. Securities Exchange Act of 1934 (Exchange Act) § 15(b)(1), 15 U.S.C. § 78o(b)(1) (2012).

3. FINRA RULE 12200.

4. *See* Jill I. Gross, *The End of Mandatory Securities Arbitration?*, 30 PACE L. REV. 1174, 1179 (2010) [hereinafter Gross, *The End of Mandatory Securities Arbitration?*].

5. Federal Arbitration Act (FAA), Pub. L. No. 68-401, 43 Stat. 883 (1925) (codified as amended at 9 U.S.C. §§ 1–16 (2012)). FAA section 2 provides:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an

enforceability of arbitration agreements, which reflects "an emphatic federal policy in favor of arbitral dispute resolution,"[6] courts enforce these predispute arbitration agreements (PDAAs) strictly according to their terms.[7] In 2010, although Congress, as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank),[8] expressly authorized the SEC to prohibit PDAAs,[9] the provision designates no deadline for action, and, as of 2016, the SEC has taken no action pursuant to this express power.[10]

While some scholars criticize the fairness of mandatory or "forced"[11] arbitration, particularly in the consumer context,[12] I have argued that FINRA arbitration is a fair and efficient forum for the resolution of investor disputes.[13] In particular, arbitrators can decide investors' disputes on grounds

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> agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Id. § 2. The final phrase of the section constitutes the FAA's "savings clause," which preserves common law contract defenses to challenge arbitration agreements.

6. Marmet Health Care Ctr., Inc. v. Brown, 132 S. Ct. 1201, 1203 (2012) (per curiam) (quoting KPMG LLP v. Cocchi, 132 S. Ct. 23, 25 (2011)) (internal quotation marks omitted); *see also* Southland Corp. v. Keating, 465 U.S. 1, 10 (1984) (declaring the FAA reflects a "national policy favoring arbitration").

7. *See* Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477, 482–83 (1989) (enforcing PDAA in a broker-dealer's customer agreement with respect to claims arising under the Securities Act); Shearson/Am. Express, Inc. v. McMahon (*McMahon II*), 482 U.S. 220, 242 (1987) (enforcing PDAA in a broker-dealer's customer agreement with respect to claims arising under the Exchange Act).

8. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 7, 12, and 15 U.S.C.).

9. *Id.* § 921(a) (providing that "[t]he 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"). For the legislative history and development of this provision, see Gross, *The End of Mandatory Securities Arbitration?*, *supra* note 4, at 1180–83.

10. Though securities regulators currently do not ban PDAAs in customer agreements, they do require that, if a firm inserts a PDAA in a customer agreement, it must contain particular language. *See* FINRA RULE 2268.

11. Mandatory arbitration in this context means arbitration resulting from a PDAA in an adhesive contract between parties of unequal bargaining power.

12. *See, e.g.*, Jean R. Sternlight, *Disarming Employees: How American Employers are Using Mandatory Arbitration to Deprive Workers of Legal Protection*, 80 BROOK. L. REV. 1309, 1345 (2015) (critiquing employers' use of mandatory arbitration to decrease employees' access to justice); Thomas J. Stipanowich, *The Arbitration Fairness Index: Using a Public Rating System to Skirt the Legal Logjam and Promote Fairer and More Effective Arbitration of Employment and Consumer Disputes*, 60 U. KAN. L. REV. 985, 988–91 (2012) (identifying fairness concerns surrounding growth of mandatory arbitration clauses).

13. *See, e.g.*, Gross, *The End of Mandatory Securities Arbitration*?, *supra* note 4, at 1186; Jill I. Gross & Barbara Black, *When Perception Changes Reality: An Empirical Study of Investors' Views of the Fairness of Securities Arbitration*, 2008 J. DISP. RESOL. 349, 353 (2008); Jill I. Gross, McMahon *Turns Twenty: The Regulation of Fairness in Securities Arbitration*, 76 U. CIN. L. REV. 493, 499 (2008) [hereinafter Gross, McMahon *Turns Twenty*].

of law, equity, and industry custom.[14] Equitable bases of awards may often favor investors, as current securities laws in many jurisdictions disfavor investors.[15]

Broker-dealers, virtually all of whom are regulated by FINRA,[16] also argue that arbitration is fair to investors and have lobbied long and hard to prevent federal regulators from prohibiting mandatory arbitration clauses in customer agreements.[17] It is therefore surprising that, for large-dollar-value disputes primarily involving institutional (as opposed to individual) investors, broker-dealers frequently resist arbitration.[18] Respondent firms sometimes thwart arbitration by contending that the claimant is not a "customer" of the FINRA member firm within the meaning of FINRA Customer Code Rule 12200. This contention has fallen flat in many cases, as courts have expanded the definition of "customer" to include not only traditional brokerage customers, but also issuers that purchase other services offered by broker-dealers, such as investment banking and underwriting services.[19]

As a result, to avoid arbitration in multimillion-dollar disputes with entities that qualify as "customers" under Rule 12200, some firms have invoked forum selection clauses that had been inserted in the underlying transaction agreements with sophisticated customers.[20] Firms argue that the

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14. *See* Barbara Black & Jill I. Gross, *Making It Up as They Go Along: The Role of Law in Securities Arbitration*, 23 CARDOZO L. REV. 991, 1047 (2002) [hereinafter Black & Gross, *Making It Up as They Go Along*] (explaining multiple bases of arbitrators' decisions).

15. *Id.* at 1035–40.

16. Virtually all broker-dealers are required to register with FINRA. *See* Exchange Act § 15(b)(1), 15 U.S.C. § 78o(b)(1) (2012).

17. *See* SEC. INDUS. & FIN. MKTS. ASS'N, WHITE PAPER ON ARBITRATION IN THE SECURITIES INDUSTRY pts. VI, VII (2007). The industry, however, announced that it will seek the repeal of Rule 12200 if the SEC bans mandatory arbitration clauses to prevent investors from having a unilateral right to demand arbitration of customer disputes. In response, FINRA promised to fight to retain Rule 12200 for investor protection purposes. *See* INV'R ADVISORY COMM., *Open Meeting of the SEC Investor Advisory Committee*, U.S. SEC. & EXCH. COMM'N (May 17, 2010), http://www.sec.gov/news/otherwebcasts/2010/iacmeeting051710.shtml (see comments of Linda Fienberg, the now-retired President of FINRA Dispute Resolution); *see also Seminar Highlights: Revisiting Mandatory Arbitration*, SEC. ARB. COMMENTATOR, Apr. 2010, at 5, 5 (reporting that "FINRA head Rick Ketchum has made it clear that FINRA's rule mandating [broker-dealer] arbitration at the demand of customers will stay, regardless of the PDAA's fate").

18. *See* Barbara Black, *The Irony of Securities Arbitration Today: Why Do Brokerage Firms Need Judicial Protection?*, 72 U. CIN. L. REV. 415, 416 (2003) ("Brokerage firms no longer find arbitration entirely to their liking. Increasingly they turn to the courts to resist arbitration, to interfere with ongoing arbitration, or to undo the results of arbitration."); *Forum Selection Clauses & FINRA Rule 12200: Why Are Broker-Dealers Litigating Large-Dollar Disputes?*, SEC. ARB. COMMENTATOR, Oct. 2014, at 1, 5.

19. *See, e.g.*, Citigroup Glob. Mkts. Inc. v. Abbar, 761 F.3d 268, 275 (2d Cir. 2014).

20. Additionally, the industry has threatened to make more widespread use of these clauses by inserting them into retail customers' agreements if the SEC bans mandatory arbitration clauses to prevent the customers from having a unilateral right to arbitrate disputes. *See* Kevin Carroll, *Op-Ed: Why Banning Mandatory Securities Arbitration Would be a Mistake*, WEALTHMANAGEMENT (May 27, 2015, 1:11 PM), http://wealthmanagement.com/commentary/op-ed-why-banning-mandatory-securities-arbitration-would-be-mistake (predicting that, if the SEC banned mandatory

clauses operate as a "waiver" of the customer's right to demand arbitration under Rule 12200. Those clauses—which drafting parties likely included at a time when courts had not yet applied Rule 12200 to broker-dealers acting in an underwriting capacity—typically provide that "all actions and proceedings" related to disputes arising out of the agreements "shall be brought in [a designated court]."[21] The clauses examined by courts thus far contain no reference to arbitration, whether with language of waiver or otherwise. Rather, the agreements underlying those transactions more likely included these types of clauses because the drafting parties assumed disputes would be pursued in court and the clause functioned as a choice of venue provision.

The federal appellate courts, applying contract law, currently are split on the question of whether a forum selection clause supersedes the firms' obligation to arbitrate.[22] Some courts reason that parties can contract out of the firms' "default" obligation to arbitrate, and enforce the forum selection clause as a superseding agreement.[23] Other courts rule that the forum selection clause is not specific enough to supersede the obligation to arbitrate since the clause does not mention arbitration.[24] The different outcomes reflect the courts' application of similar principles of contract interpretation and arbitrability, which are difficult to reconcile.[25]

More fundamentally, however, I submit that recently amended section 29(a) of the Securities Exchange Act of 1934 (Exchange Act), largely ignored by the courts in this context,[26] voids the parties' forum selection clause. Section 29(a), also known as the Exchange Act's anti-waiver provision, voids "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of a self-regulatory organization."[27]

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arbitration clauses in customer agreements, "[s]ome [member firms] might elect to include forum selection clauses in their customer contracts in order to supersede the FINRA mandatory arbitration rule, and require that all disputes be resolved in court").

21. Goldman, Sachs & Co. v. City of Reno, 747 F.3d 733, 736 (9th Cir. 2014). For example, the forum selection clause in *City of Reno* designated the District of Nevada.

22. *See infra* Part I.

23. *See, e.g.*, *City of Reno*, 747 F.3d at 741.

24. UBS Fin. Servs., Inc. v. Carilion Clinic, 706 F.3d 319, 329 (4th Cir. 2013).

25. *Compare* Goldman, Sachs & Co. v. Golden Empire Sch. Fin. Auth., 764 F.3d 210, 214–17 (2d Cir. 2014), and *City of Reno*, 747 F.3d at 741–47, *with Carilion Clinic*, 706 F.3d at 329–30. *See also* Suleman Malik, Note, *Where Do We Fight?: A Way To Resolve the Conflict Between a Forum Selection Clause and FINRA Arbitration Rule 12200*, 17 CARDOZO J. CONFLICT RESOL. 215, 233–35 (2015) (arguing that FINRA Rule 12200 supersedes forum selection clauses on, inter alia, contract law grounds).

26. One exception is a recent district court decision concluding that section 29(a) does not void a forum selection clause because the customer did not waive a substantive right. *See* J.P. Morgan Sec. LLC v. Quinnipiac Univ., No. 14 Civ. 429 (PAE), 2015 WL 2452406, at *5 (S.D.N.Y. May 22, 2015). The district court also inferred, based on the parties' Federal Rule of Appellate Procedure 28(j) submissions, that the Second Circuit in *Golden Empire* had considered section 29(a) "but did not find it determinative." *Id.* (footnote omitted).

27. Exchange Act § 29(a), 15 U.S.C. § 78cc(a) (2012).

In 2010, as part of Dodd-Frank, Congress amended section 29(a) of the Exchange Act to include the phrase "or of any rule of a self-regulatory organization."[28] This amendment was part of Congress' effort to harmonize the securities laws so that investors were as equally protected from conduct prohibited by SROs as from conduct prohibited by securities exchanges.[29] Thus, since 2010, section 29(a) explicitly invalidates provisions in brokerage agreements that require customers to waive compliance with the FINRA rules.

If courts interpret a forum selection clause as superseding firms' duty to arbitrate, those courts are permitting firms to force customers to waive compliance with their right to demand arbitration under FINRA Rule 12200. This contradicts the SEC's long-held position that the option to arbitrate for retail investors is critical to maintain and protect those investors who lack bargaining power and resources relative to broker-dealers.[30] Although courts thus far have enforced forum selection clauses only in the context of institutional investors (rather than individuals) as customers, their rationale could easily be expanded to individual retail investors.

The Supreme Court has interpreted section 29(a) to apply to waivers of substantive rights arising under the Exchange Act,[31] and has held that a mandatory arbitration provision forcing customers to waive their right to proceed in court does not violate section 29(a).[32] However, broker-dealers have no obligation under the securities laws or regulations to submit customer disputes to court for resolution, and therefore customers are not waiving a substantive right actionable under section 29(a).[33] Is, then, the inverse true as well: if the predispute choice of court can be waived, can the post-dispute choice of arbitration be waived, too? In other words, is the right to demand arbitration of a customer dispute a nonwaivable right under section 29(a)?

This Article argues that the right to choose arbitration in the securities industry, as a device to further investor protection, is a right that firms cannot force investors to waive. Part I of this Article provides the statutory framework governing broker-dealers' agreements with their customers. Part II describes how courts have applied this framework to forum selection clauses in broker-dealers' agreements with customers in recent years. Part III argues that the anti-waiver provision of the Exchange Act bars courts from

28. *Id.*; *see* Dodd-Frank Act, Pub. L. No. 111-203, §§ 927, 929T, 124 Stat. 1376, 1852, 1867 (2010).

29. *See* S. REP. NO. 111-176, at 114 (2010).

30. *See infra* notes 70-77 and accompanying text.

31. Shearson/Am. Express, Inc. v. McMahon (*McMahon II*), 482 U.S. 220, 228 (1987).

32. *Id.* at 234.

33. *Id.* at 228 (stating that the Exchange Act's section 27, which provides federal district courts with original jurisdiction for suits arising under the Act, "itself does not impose any duty with which persons trading in securities must 'comply'").

enforcing these forum selection clauses in the face of a customer's choice of arbitration.

I. THE STATUTORY FRAMEWORK

In the wake of the stock market crash of 1929, Congress passed the Exchange Act[34] to protect investors from abuses in the capital markets.[35] In addition to creating the SEC as the primary federal securities regulator, the Exchange Act also set up a system of industry self-regulation to further protect investors and serve the public interest.[36] Congress designated national securities exchanges (e.g., the New York Stock Exchange) as SROs because they already existed as organizations that proscribed rules to govern their members.[37]

A. EXCHANGE ACT SECTION 29(A)

Since its enactment, the Exchange Act has included an anti-waiver provision. Section 29(a) originally stated that "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of this or of any rule or regulation thereunder, or of any rule of an exchange required, shall be void."[38]

Legislative history of the original provision is scant,[39] but it seems apparent that, in 1934, Congress sought to preclude any entity or individual from circumventing the full force of the new federal securities laws by requiring a weaker party to waive the protections that the Act was designed to provide for investors.[40] Congress wanted to ensure that securities firms did not exert their market power on investors by contracting around their new

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34. Exchange Act, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78pp (2012)).

35. *See* NORMAN S. POSER & JAMES A. FANTO, BROKER-DEALER LAW AND REGULATION § 1.01 (4th ed. 2007 & Supp. 2015) (explaining that the broker-dealer "industry is highly regulated because of its economic importance" and the "possibility of investor abuse").

36. *See id.* § 4.01, at 4-3.

37. *See id.* § 4.01[C], at 4-9.

38. Exchange Act § 29(a) (codified as amended at 15 U.S.C. § 78cc(a)).

39. Section 29(a) "was taken verbatim out of the [S]ecurities [A]ct." *Stock Exchange Practices: Hearings on S. Res. 84, S. Res. 56 and S. Res. 97 Before the S. Comm. on Banking & Currency*, 73d Cong. (1934), *reprinted in* 6 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934, at 7421, 6568 (J. S. Ellenberger & Ellen P. Mahar eds., 2001). The legislative history of the parallel provision, section 14 of the Securities Act, 15 U.S.C. § 77n, is silent as to the statute's scope. *See* Margaret V. Sachs, *The Relevance of Tort Law Doctrines to Rule 10b-5: Should Careless Plaintiffs Be Denied Recovery?*, 71 CORNELL L. REV. 96, 127 n.237 (1985).

40. *See* C. Edward Fletcher, III, *Privatizing Securities Disputes Through The Enforcement of Arbitration Agreements*, 71 MINN. L. REV. 393, 402–03 (1987) (arguing that Congress included antiwaiver clauses such as section 29(a) in federal securities laws to reverse the common law's enforcement of brokers' predispute waivers of statutory liability).

statutory duties and obligations. Firms could not accomplish via contract what the regulations prohibited them from doing.[41]

In 2010, the Dodd-Frank Act amended the anti-waiver provision by striking "an exchange required thereby" and inserting "a self-regulatory organization."[42] Thus, section 29(a) now explicitly invalidates provisions in brokerage agreements that require customers to waive compliance with FINRA rules, whereas before Dodd-Frank, the express language of the statute appeared to apply to waivers of rules of only securities exchanges.

The animating purpose of the 2010 amendment to section 29(a) is as mysterious as the origin of the section itself. The section in Dodd-Frank containing the amendment bore the heading "Equal Treatment of Self-Regulatory Organization Rules."[43] The Senate Report for the amendment states its purpose was to "provide[] equal treatment for the rules of all SROs under Section 29(a)."[44] Congress wanted to harmonize the securities laws so that rules of all SROs have equal force to those of exchanges (which are also SROs), so as to maximize investor protection. This made sense in an era in which FINRA had gained power and prestige as a securities regulator, and reached all broker-dealers, unlike the exchanges, which could regulate only its members, a far smaller subset of broker-dealers.

The Supreme Court has interpreted the anti-waiver provision in the context of a mandatory arbitration clause in a broker-dealer's customer's account agreement. In 1987, in *Shearson/American Express, Inc. v. McMahon*,[45] the Supreme Court held that, contrary to the thirty-year-old precedent from *Wilko v. Swan*,[46] the anti-waiver provision did not render a PDAA unenforceable with respect to federal securities claims.

Eugene and Julia McMahon were investors who alleged that their broker engaged in fraud and excessive trading in their brokerage account. The McMahons' opening account agreement contained an arbitration provision covering "any controversy arising out of or relating to [their] accounts,"[47] but

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41. *See* AES Corp. v. Dow Chem. Co., 325 F.3d 174, 183 (3d Cir. 2003) ("Section 29(a) is not intended to protect substantive rights created by contract. It is designed to protect rights created by the Exchange Act, and it expressly forecloses contracting parties from 'defin[ing] the boundaries of the[ir] transaction' in a way that relieves a party of the duties imposed by that Act . . . .").

42. Dodd-Frank Act §§ 927, 929T, 15 U.S.C. § 78cc(a) (2012).

43. *See id.* § 927 ("Equal Treatment of Self-Regulatory Organization Rules. Section 29(a) of the Securities Exchange Act of 1934 (15 U.S.C. § 78cc(a)) is amended by striking 'an exchange required thereby' and inserting 'a self-regulatory organization.'").

44. S. REP. NO. 111-176, at 114 (2010).

45. Shearson/Am. Express, Inc. v. McMahon (*McMahon II*), 482 U.S. 220, 227 (1987) (holding that section 29(a) did not void a PDAA in a customer agreement with respect to claims under the Exchange Act); *see also* Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477, 482–83 (1989) (holding that anti-waiver clause of the Securities Act of 1933 did not void a PDAA in a customer agreement with respect to claims arising under that Act).

46. Wilko v. Swan, 346 U.S. 427 (1953). The Court did not technically overrule *Wilko* until *Rodriguez de Quijas*, 490 U.S. at 485.

47. *McMahon II*, 482 U.S. at 223 (internal quotation marks omitted) (quoting McMahon v. Shearson/Am. Express, Inc., 618 F. Supp. 384, 385 (S.D.N.Y. 1985)).

they resisted arbitration on the grounds that the clause was inapplicable to claims arising under section 10(b) of the Exchange Act and the Racketeer Influenced and Corrupt Organizations Act (RICO). After the U.S. Court of Appeals for the Second Circuit ruled that the Exchange Act claims were not arbitrable under *Wilko* and section 29(a),[48] the brokerage firm appealed to the Supreme Court.

The Supreme Court disagreed with the Second Circuit, divining the anti-waiver provision's central purpose: "Section 29(a) is concerned, not with whether brokers 'manuever[ed customers] into' an agreement, but with whether the agreement 'weaken[s] [customers'] ability to recover under the [Exchange] Act.'"[49] It then rejected the McMahons' first argument that section 29(a) voided the McMahons' PDAA because it was an agreement that waived compliance with Exchange Act section 27. That section provides: "[t]he district courts of the United States . . . shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder."[50] The Court reasoned:

> What the antiwaiver provision of § 29(a) forbids is enforcement of agreements to waive "compliance" with the provisions of the statute. But § 27 itself does not impose any duty with which persons trading in securities must "comply." By its terms, § 29(a) only prohibits waiver of the substantive obligations imposed by the Exchange Act. Because § 27 does not impose any statutory duties, its waiver does not constitute a waiver of "compliance with any provision" of the Exchange Act under § 29(a).[51]

Thus, the Court suggests that "substantive obligations" under the Exchange Act that cannot be waived are provisions that impose a duty on a regulated entity.[52]

In rejecting the McMahons' second argument that their "arbitration agreement effects an impermissible waiver of the substantive protections of the Exchange Act" because it resulted from broker overreaching,[53] the Court repeated a phrase it first penned two years earlier when deciding the

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48. McMahon v. Shearson/Am. Express, Inc. (*McMahon I*), 788 F.2d 94, 96–98 (2d Cir. 1986), *rev'd*, 482 U.S. 220 (1987).

49. *McMahon II*, 482 U.S. at 230 (alterations in original) (quoting Wilko v. Swan, 346 U.S. 427, 432 (1953)).

50. Exchange Act § 27, 15 U.S.C. § 78aa (2012).

51. *McMahon II*, 482 U.S. at 228.

52. *Id.*; *see also* Black & Gross, *Investor Protection*, *supra* note 1, at 20 ("The investor protections afforded by the statute and its rules are so important that Congress would not permit parties to negotiate deals that weakened the statutory framework. While the congressional purpose may have been at least partly protective, reflecting a concern that the more sophisticated party might persuade the less sophisticated party to give up his rights, Congress also must have been concerned about the national interest and the importance of federal regulation for the overall fairness and effectiveness of the securities markets.").

53. *McMahon II*, 482 U.S. at 229.

arbitrability of an antitrust claim arising under the Sherman Act: "[b]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum."[54] This phrase seems to suggest that the selection of a forum is merely a procedural choice, not a substantive one. However, the Court continued: "[t]he voluntariness of the agreement is irrelevant to this inquiry: if a stipulation waives compliance with a statutory duty, it is void under § 29(a), whether voluntary or not."[55] Again, the Court focused on finding a nonwaivable protection in a statutory duty.

Subsequent to *McMahon*, lower courts have interpreted section 29(a) to bar provisions that weaken investors' ability to recover under the federal securities laws, no matter what form they take: "non-reliance" clauses in stock purchase or other acquisition agreements,[56] "no-action" clauses in indentures,[57] prospective liability waivers,[58] or clauses that specify indemnification as the sole remedy.[59] Conversely, courts have found that provisions that do not weaken an investor's ability to recover under federal securities (or equivalent) laws are not voided by section 29(a).[60] Only one

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54. *Id.* at 229–30 (alteration in original) (internal quotation marks omitted) (quoting Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985)).

55. *Id.* at 230.

56. *See, e.g.*, Caiola v. Citibank, N.A., 295 F.3d 312 (2d Cir. 2002) (synthetic trading relationship); AES Corp. v. Dow Chem. Co., 325 F.3d 174 (3d Cir. 2003); Universal Am. Corp. v. Partners Healthcare Sols. Holdings, L.P., 61 F. Supp. 3d 391 (D. Del. 2014) (merger agreement); MBI Acquisition Partners, L.P. v. Chronicle Publ'g. Co., No. 01-C-177-C, 2001 WL 1478812 (W.D. Wis. Sept. 6, 2001); Roll v. Singh, No. 07-CV-04136(FLW), 2008 U.S. Dist. LEXIS 50125 (D.N.J. June 26, 2008). Some courts have enforced nonreliance clauses in negotiated contracts among sophisticated investors or corporate insiders where the written agreement contains specific representations and the nonreliance clause serves the purpose of barring representations not contained in the agreement. *See, e.g.*, Harsco Corp. v. Segui, 91 F.3d 337, 343 (2d Cir. 1996) (recognizing that plaintiff's remedies were weakened, but emphasizing that this was a detailed written agreement negotiated among sophisticated parties); Rissman v. Rissman, 213 F.3d 381 (7th Cir. 2000) (no discussion of section 29(a)); *see also* Harborview Master Fund, LP v. Lightpath Techs., Inc., 601 F. Supp. 2d 537, 547 n.8, 548 (S.D.N.Y. 2009) (ruling that "big boy" clause in contract between sophisticated parties did not violate section 29(a)).

57. *See, e.g.*, McMahan & Co. v. Wherehouse Entm't, Inc., 65 F.3d 1044, 1051 (2d Cir. 1995).

58. *See, e.g.*, Vacold LLC v. Cerami, 545 F.3d 114, 122 (2d Cir. 2008) ("[W]e do not give effect to contractual language, such as the language here, purporting to be a general waiver or release of Rule 10b-5 liability altogether."); Valentini v. Citigroup, Inc., 837 F. Supp. 2d 304, 317–18 (S.D.N.Y. 2011) ("We cannot give effect to contractual provisions that amount to a general waiver of liability under § 10(b).") (citing *Vacold*, 545 F.3d at 122); Dresner v. Utility.com, Inc., 371 F. Supp. 2d 476, 490 (S.D.N.Y. 2005) (voiding releases that "purported prospectively to waive plaintiffs' rights to pursue causes of action of which they were not yet aware").

59. Citibank, N.A. v. Itochu Int'l Inc., No. 01 Civ. 6007(GBD), 2003 WL 1797847, at *3 (S.D.N.Y. Apr. 4, 2003).

60. *See, e.g.*, Bonny v. Soc'y of Lloyd's, 3 F.3d 156, 162 (7th Cir. 1993); Roby v. Corp. of Lloyd's, 996 F.2d 1353, 1360–63 (2d Cir. 1993) (holding that section 29(a) does not void a choice-of-law clause designating English law and an English forum for investors' claims arising out of contracts for underwriting capital between Lloyd's of London and U.S. residents because these were international transactions among sophisticated investors and available English remedies provided investors with adequate alternatives); Richards v. Lloyd's of London, 135 F.3d 1289, 1296 (9th Cir. 1998) (en banc) (holding that section 29(a) does not void choice of forum and choice of law

lower court has directly addressed whether section 29(a) bars a forum selection clause from superseding a broker-dealer's duty to arbitrate.[61]

The following section describes the provision of the Exchange Act that authorizes the SEC to monitor SROs and their dispute resolution programs to ensure protection of investors.

B. EXCHANGE ACT SECTION 15A

In 1938, Congress amended the Exchange Act to authorize the registration of nonexchange, national securities associations as SROs to regulate brokers in the over-the-counter market.[62] FINRA—now the largest independent regulator for all securities firms doing business in the United States—is the only registered national securities association under section 15A of the Exchange Act.[63]

In 1975, Congress again amended the Exchange Act, this time to give the SEC broad new powers over all SROs, including the power to review all of their proposed rules and to require them to adopt, change, or repeal any rules.[64] Through this power, the SEC exercises oversight of FINRA's activities, including operation of its arbitration forum, the largest dispute resolution forum in the securities industry.[65] The Exchange Act requires FINRA to adopt rules that may be designed for a variety of purposes, ranging from preventing "fraudulent and manipulative acts and practices" to promoting "just and equitable principles of trade," and "in general, [protecting] investors and the public interest."[66]

FINRA must file proposed rule changes with the SEC, and, before approving them, the SEC must publish notice and provide interested persons an opportunity to comment on the proposals.[67] The SEC can approve FINRA's rules, after a public comment period, if it finds they are consistent with the requirements of the Exchange Act and are designed to protect investors and the public interest.[68] In addition, the SEC may, on its own

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provisions because English law provided "adequate substitutes" for federal securities laws); Lipcon v. Underwriters at Lloyd's, London, 148 F.3d 1285, 1287–88 (11th Cir. 1998) (recognizing it is a "close question," but following the "weight of circuit authority").

61. *See* J.P. Morgan Sec. LLC v. Quinnipiac Univ., No. 14 Civ. 429 (PAE), 2015 WL 2452406, at *5 (S.D.N.Y. May 22, 2015).

62. *See* POSER & FANTO, *supra* note 35, § 4.01[C], at 4-9.

63. *About FINRA*, FIN. INDUS. REGULATORY AUTH., http://www.finra.org/AboutFINRA/ (last visited Mar. 21, 2016).

64. Exchange Act § 19, 15 U.S.C. § 78s (2012). *See generally* POSER & FANTO, *supra* note 35, § 4.04[A], at 4-33.

65. *Arbitration and Mediation*, FIN. INDUS. REGULATORY AUTH., http://www.finra.org/ArbitrationAndMediation/index.htm (last visited Mar. 13, 2016).

66. Securities Exchange Act § 15A(b)(6), 15 U.S.C. § 78o-3(b)(6). The statute also lists certain improper purposes, including regulating "matters not related to the purposes of [the Act]." *Id.*

67. *Id.* § 19(b)(1), 15 U.S.C. § 78s(b)(1). Conversely, the SEC must disapprove a proposed rule change if it does not make the requisite finding. *Id.* § 19(b)(2)(C)(ii), 15 U.S.C. § 78s(b)(2)(C)(ii).

68. *Id.* §§ 15A(b)(6), 19(b)(2), 15 U.S.C. §§ 78o-3(b)(6), 78s(b)(2).

initiative, amend FINRA's rules as it deems "necessary or appropriate . . . in furtherance of the purposes of [the Exchange Act]."[69]

The SEC has long viewed the option of securities arbitration for investors as an important component of its investor protection mandate. Indeed, since its creation, the SEC has urged the SROs it regulates to provide an alternative dispute resolution forum for customers.[70] In the mid-1970s, the SEC proclaimed the need for a nationwide investor dispute resolution system to handle small claims and worked with the SROs, industry representatives, and investor groups to develop arbitration rules to achieve that result.[71] In the 1980s, the SEC filed several amicus briefs with courts expressing its strong support for SRO arbitration, as long as the forums followed SEC-approved arbitration procedures and enforced all SRO rules designed to protect investors.[72]

The SEC intensified its oversight of securities arbitration after *McMahon*, when SRO arbitration became the principal forum for resolving customers' disputes with their brokers.[73] Likewise, since *McMahon*, FINRA has engaged in ongoing review and reform of its arbitration rules[74] "for the continued improvement of securities industry arbitration as a fair, expeditious, and economical means for the resolution of disputes."[75] Among other things, the SEC now prohibits FINRA member firms from "having agreements with customers that limit or contradict the rules of any SRO or

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69. *Id.* § 19(c), 15 U.S.C. § 78s(c).

70. *See* Exchange Act Release No. 131, at 3–4, 1935 WL 29028 (Mar. 21, 1935).

71. Order Approving NYSE, NASD, and ASE Proposed Rule Changes Relating to the Arbitration Process and the Use of Predispute Arbitration Clauses, 54 Fed. Reg. 21,144, 21,145 (May 16, 1989) [hereinafter 1989 Approval Order] (describing how the SROs have worked for the past twelve years to develop uniform arbitration rules through the Securities Industry Conference on Arbitration (SICA), which was formed at the SEC's invitation to review arbitration procedures as alternatives to the SEC's own proposals).

72. *See, e.g.*, Brief for the Securities and Exchange Commission as Amicus Curiae Supporting Petitioners, Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220 (1987) (No. 86-44), 1986 WL 727882, at *17 ("The Commission has exercised this new authority [over SRO rules] since 1975 in several ways specifically designed to promote fair and effective arbitral forums for the resolution of disputes between customers and SRO-member brokerage firms."); Brief of the Securities and Exchange Commission, Amicus Curiae, Roney & Co. v. Goren, No. 88-1874, at 21 (2d Cir. 1988) [hereinafter Brief of the SEC in *Roney*] (on file with author) (emphasizing that "*McMahon* demonstrates the importance of enforcing compliance with SRO rules governing arbitration between SRO members and their customers").

73. Gross, McMahon *Turns Twenty, supra* note 13, at 514 (describing how the SEC staff, after *McMahon*, recommended numerous rule changes to make arbitration fairer and more neutral).

74. *See* Black & Gross, *Making It Up as They Go Along, supra* note 14, at 999–1005 (describing post-*McMahon* reforms); Gross, McMahon *Turns Twenty, supra* note 13, at 514–17 (describing SEC's robust oversight of FINRA's arbitration process and FINRA's frequent reforms of its codes of arbitration procedure).

75. *NASD Notice to Members, 89-21 Proposed Amendment Re: Predispute Arbitration Clauses in Customer Agreements*, FIN. INDUS. REGULATORY AUTH., http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=1404 (last visited Mar. 22, 2016).

limit the ability of a party to file any claim in arbitration. . . ."[76] The approval order for this provision explained that one of its purposes was to prevent member firms from "limit[ing] SRO forums otherwise available to parties."[77]

The next section discusses the FINRA rule that imposes a duty on broker-dealers to offer investors an arbitration forum.

C. FINRA RULE 12200: CUSTOMERS' RIGHT TO DEMAND ARBITRATION

FINRA's rules impose a duty on its member firms and their associated persons to arbitrate a dispute at the demand of a customer, even in the absence of an arbitration agreement. Under current FINRA Rule 12200, a FINRA member firm must arbitrate a claim if "requested by a customer,"[78] "[t]he dispute is between a customer and a member or associated person of a member; and . . . [t]he dispute arises in connection with the business activities of the member or the associated person."[79] Moreover, FINRA declares that it

> may be deemed conduct inconsistent with just and equitable principles of trade and a violation of [FINRA Conduct] Rule 2010 for a member or a person associated with a member to: . . . fail to submit a dispute to arbitration under the [FINRA Arbitration] Code as required by the Code.[80]

Thus, FINRA deems this right worthy of enforcing through disciplinary action.

As a threshold issue, because FINRA does not define "customer," courts have struggled to come up with a precise definition. While FINRA member firms historically have acknowledged that investors with brokerage accounts were "customers" within the meaning of Rule 12200, those firms challenged arbitration proceedings brought by others who did not have accounts, but had purchased other types of financial services from broker-dealers. Some circuit courts have concluded that a customer is "a non-broker and non-dealer who purchases commodities or services from a FINRA member in the course of the member's FINRA-regulated business activities."[81] More recently, after

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76. FINRA RULE 2268(d)(1)–(2); *see also* 1989 Approval Order, *supra* note 71, at 21,154.

77. 1989 Approval Order, *supra* note 71, at 21,154.

78. FINRA does not define "customer," except for its mention in Rule 12100(i) (a "customer shall not include a broker or dealer"). Courts continue to refine the definition of the term "customer" under FINRA Rule 12200. *See infra* notes 81–83 and accompanying text.

79. FINRA RULE 12200.

80. FINRA RULE IM-12000.

81. Goldman, Sachs & Co. v. City of Reno*,* 747 F.3d 733, 741 (9th Cir. 2014) (concluding that the municipality that issued auction-rate securities (ARS) qualified as the firm's "customer" because the firm "served as the underwriter for the 2005 and 2006 Bonds and as the broker-dealer for . . . ARS auctions," "sold Reno interest rate swaps to protect the financing structure," "acted as Reno's agent in dealing with the rating agencies," and "conducted discussions with bond insurers on Reno's behalf").

reviewing a long line of prior Second Circuit decisions on the subject,[82] the Second Circuit refined "the precise boundaries of the FINRA meaning of 'customer,'" and ruled that "a 'customer' under FINRA Rule 12200 is one who, while not a broker or dealer, either (1) purchases a good or service from a FINRA member, or (2) has an account with a FINRA member."[83]

Significantly, this duty to arbitrate upon the demand of a customer has been imposed on brokerage firms since the 1800s.[84] In the mid-1800s, the Arbitration Committee of the New York Stock and Exchange Board (the Board), the predecessor to the New York Stock Exchange, accepted jurisdiction over nonmember customer disputes with member firms.[85] The Board did this to ensure that nonmembers—that is, investors—trusted the Board and had confidence in its member brokers to conduct themselves honestly. As one scholar studying this history observed: "The Board cited this nonmember edge with some pride in its dealings with the outside world. Investors had more assurance of the honesty of members than other brokers, it argued, because members were aware of how much easier it would be to force them to comply with their contracts."[86]

In 1869, the New York Stock Exchange (NYSE) amended its constitution to expressly provide to investors the right to demand arbitration of disputes with its member firms, even in the absence of a PDAA.[87] Archival records indicate that investor protection goals animated the NYSE's grant of this right.[88]

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82. *See, e.g.*, Wachovia Bank, N.A. v. VCG Special Opportunities Master Fund, Ltd., 661 F.3d 164 (2d Cir. 2011); UBS Fin. Servs. Inc. v. W. Va. Univ. Hosps., Inc., 660 F.3d 643 (2d Cir. 2011).

83. Citigroup Glob. Mkts. Inc. v. Abbar, 761 F.3d 268, 275 (2d Cir. 2014) (concluding that a Saudi businessman who managed family trusts that lost $383 million invested with a UK affiliate of Citigroup, Inc. was not a "customer" of Citigroup Global Markets, Inc. (Citi NY) under Rule 12200 because he purchased no goods or services from Citi NY and had no account with it, and thus could not compel Citi NY to arbitrate the dispute).

84. For a more complete history of the customer's right to demand arbitration of a securities firm, see Gross, *The History of Securities Arbitration*, *supra* note 1.

85. STUART BANNER, ANGLO-AMERICAN SECURITIES REGULATION: CULTURAL AND POLITICAL ROOTS, 1690–1860, at 272–73 (Cambridge Univ. Press 1998).

86. *Id.* at 273.

87. *See* CONSTITUTION AND BY-LAWS OF THE NEW YORK STOCK EXCHANGE, CONST. ART. III (1869) (establishing an "Arbitration Committee, to consist of nine members, whose duty it shall be to investigate and decide all claims and matters of difference arising between members of the Exchange; they shall also adjudicate such claims as may be preferred against members by non-members, when such non-members shall agree to abide by the rules of the New York Stock Exchange, in such cases provided"); *Id.* BY-LAWS ART. LII ("Any person not a member of the Exchange shall have the right to bring a claim arising from any transaction against a member of said Exchange, before the Arbitration Committee . . . ."); Norman S. Poser, *Making Securities Arbitration Work*, 50 S.M.U. L. REV. 277, 281 (1996) ("The NYSE Constitution of 1869 not only provided for arbitration of 'all claims and matters of difference' between members but also gave non-members the right to arbitrate disputes with members if they agreed to abide by the rules of the Exchange.").

88. *See* Gross, *The History of Securities Arbitration*, *supra* note 1, at 179.

In 1935, the SEC recognized this right just after its own formation, when it gained regulatory authority over the exchanges.[89] In a memorandum to the NYSE, the Chairman of the SEC stated: "[t]he right to arbitration before the arbitration committee of the exchange is at present granted to any customer regardless of the contract between the member and the customer."[90] To address its concerns regarding the composition and neutrality of arbitration panels for those customer arbitrations, the SEC recommended to the NYSE that it maintain this right for customers, but also provide an option for arbitration before independent arbitral tribunals rather than just before the NYSE.[91] Though renumbered as various provisions over the years, the right ultimately found its home in NYSE Constitution Art. XI and NYSE Arbitration Rule 600(a).[92]

In 1972, FINRA's predecessor, the National Association of Securities Dealers (NASD), which had started an arbitration program in 1969, adopted an identical rule—which ultimately became (now-retired) NASD Rule 10301 and (then) FINRA Rule 12200—providing the same right to customers who have disputes with NASD member firms and their associated persons.[93] When it first proposed the rule to its members, NASD explained that it had gained the necessary experience of running an arbitration program, and sought to establish a uniform dispute resolution system for industry-related disputes by adopting a rule identical to NYSE Rule 600.[94] In its notice to members, the NASD offered four reasons for seeking this rule change:

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89. *See* Exchange Act Release No. 131, at 3, 1935 WL 29028 (Mar. 21, 1935). In the memorandum, the SEC set forth its views on a variety of arbitration and nonarbitration issues as part of a review of the NYSE's rules and procedures.

90. *Id.* at 4.

91. *Id.* ("Since the customer can at any time prior to arbitration choose to seek his remedy in the courts, continued maintenance of this policy possesses no disadvantage, provided that the Exchange also encourages arbitration before independent arbitral tribunals as an additional remedy available to customers."). The NYSE did not follow this recommendation.

92. NYSE Rule 600(a) provided:

> Any dispute, claim or controversy between a customer or non-member and a member, allied member, member organization and/or associated person, arising in connection with the business of such member, allied member, member organization and/or associated person, in connection with his activities as an associated person shall be arbitrated under the Constitution and Rules of the New York Stock Exchange, Inc. as provided by any duly executed and enforceable written agreement or upon the demand of the customer or non-member.

NYSE RULE 600(a). This clause of the NYSE Constitution has been described as "the most significant of the measures taken to implement the self-regulation contemplated by the 1934 Act." Coenen v. R. W. Pressprich & Co., 453 F.2d 1209, 1215 (2d Cir. 1972).

93. Nat'l Ass'n of Sec. Dealers, NASD Notice to Members, Proposed Amendments to By-Laws, Rules of Fair Practice and the Code of Arbitration Procedure, at 1 (July 23, 1971).

94. Nat'l Ass'n of Sec. Dealers, Special Report to NASD Members (Dec. 1970) (seeking "advice and suggestions of members" on proposal to adopt a type of mandatory arbitration at NASD "similar to that in use by the exchanges" requiring member firms to arbitrate at the request of a "professional or member of the public").

> 1. Arbitration provides a more expedient means of settling disputes than litigation. If a mandatory arbitration program exists, a firm can enter into a contract with more confidence, realizing that most disputes can be settled without tying up capital for long periods of time.
>
> 2. Mandatory arbitration costs a fraction of the expense needed to settle disputes in the courts.
>
> 3. Arbitrators are chosen because of their immediate familiarity with the securities business.
>
> 4. Mandatory arbitration under NASD rules would make procedures within the industry more uniform to provide an equal opportunity to settle disputes.[95]

When the NYSE merged its enforcement and arbitration functions with the NASD in 2007,[96] NYSE Rule 600 was consolidated with NASD 10301 into today's FINRA Rule 12200. Thus, for almost 200 years, customers have had the right to demand arbitration of a dispute with a NYSE member firm, and since 1972 with every broker-dealer in the country.

Despite this time-honored right, brokerage firms now contend that they can force customers to waive that right via forum selection clauses. The next Part discusses whether courts have endorsed that argument.

II. THE CIRCUIT COURT SPLIT ON WHETHER RULE 12200 IS WAIVABLE

The circuit courts are currently split on whether the duty to arbitrate under FINRA Rule 12200 is waivable. Both the Second and Ninth Circuit have refused to compel a broker-dealer to arbitrate under Rule 12200 on the grounds that a forum selection clause in the disputants' agreements superseded the firm's duty to arbitrate.[97] These courts rejected an opposite

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95. *Id.*

96. Until mid-2007, the NASD and the NYSE ran separate arbitration forums that handled a combined ninety-nine percent of all securities arbitrations in the country. On July 30, 2007, NASD and NYSE Regulation, including their respective arbitration forums, consolidated and formed FINRA. *See* Press Release, Fin. Indus. Regulatory Auth., NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority – FINRA (July 30, 2007). FINRA now operates the largest dispute resolution forum in the securities industry. *See Arbitration and Mediation*, *supra* note 65.

97. *See* Goldman, Sachs & Co. v. Golden Empire Sch. Fin. Auth., 764 F.3d 210 (2d Cir. 2014) (reasoning that Rule 12200 was a "default" agreement to arbitrate that was trumped by the later-executed agreement—the forum selection clause); Goldman, Sachs & Co. v. City of Reno, 747 F.3d 733 (9th Cir. 2014) (concluding that the City of Reno, which had retained Goldman, Sachs for advisory and underwriting services in connection with its issuance of auction-rate securities to finance a series of city projects, was a "customer" under FINRA Rule 12200); Credit Suisse Sec. (USA) LLC v. Tracy, 812 F.3d 249 (2d Cir. 2016) (holding that "more specific" forum selection clause trumped the duty to arbitrate a member's dispute with its employee under FINRA Rule 13200). *Cf.* Presbyterian Health Care Servs. v. Goldman, Sachs & Co., No. CIV 14-0181 JB/SCY, 2015 WL 4993571 (D.N.M. Aug. 14, 2015) (enforcing a forum selection clause against customer of FINRA member that sought arbitration of claims and granting motion to transfer venue of claims

holding by the Fourth Circuit.[98] To the extent these courts considered section 29(a) at all, they rejected the argument that the anti-waiver provision applies to the duty to arbitrate.

The Second Circuit's decision is instructive; in a single opinion, it resolved two cases: *Goldman, Sachs & Company v. Golden Empire School Financing Authority*, and *Citigroup Global Markets. Inc. v. North Carolina Eastern Municipal Power Agency.*[99] In the first case, Golden Empire Schools Financing Authority and Kern High School District issued approximately $125 million of auction-rate securities (ARS) in 2004, 2006, and 2007, for which Goldman Sachs was an underwriter and broker-dealer.[100] In the second case, the North Carolina Eastern Municipal Power Agency (NCEMPA) retained Citigroup Global Markets Inc. as its underwriter and broker-dealer for the issuance of $223 million of ARS.[101] In both cases, the issuers claimed that the member firms fraudulently induced them to issue their respective ARS.[102]

For each issuance, the parties executed an underwriter agreement and a broker-dealer agreement. While the underwriting agreements were silent as to dispute resolution, the broker-dealer agreements contained forum selection clauses that required "all actions and proceedings" related to the transactions between the parties be "brought in the United States District Court in the County of New York."[103]

In 2012, Golden Empire commenced a FINRA arbitration, alleging that Goldman Sachs fraudulently induced it to issue the ARS. In the same year, NCEMPA brought a similar FINRA arbitration against Citigroup. In both cases, the member firm sought to enjoin the FINRA arbitration on the grounds that the forum selection clause superseded its duty to arbitrate under Rule 12200.[104] The issuers responded that, because they were "customers" of a FINRA member firm, the firm had a duty to arbitrate the dispute under FINRA Rule 12200.[105]

The Second Circuit held that the forum selection clause superseded FINRA's mandatory arbitration rule.[106] The court reasoned that Rule 12200

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for transferee court to determine whether Rule 12200 supersedes forum selection clause). For a more detailed discussion of *City of Reno*, see Jill I. Gross & Olivia Darius, *Arbitration Case Law Update 2014*, *in* PRACTISING LAW INST., SECURITIES ARBITRATION 2014 COURSEBOOK 277, 296–97 (2014). For a more detailed discussion of *Golden Empire*, see Jill I. Gross, *Arbitration Case Law Update 2015*, *in* PRACTISING LAW INST., SECURITIES ARBITRATION 2015 COURSEBOOK 45, 60–61 (2015).

98. UBS Fin. Servs., Inc. v. Carilion Clinic, 706 F.3d 319, 330 (4th Cir. 2013).

99. *Golden Empire*, 764 F.3d 210.

100. *Id.* at 212.

101. *Id.* at 212–13.

102. *Id.*

103. *Id.*

104. *Id.* at 214.

105. *Id.*

106. *Id.* at 217.

was a "default" agreement to arbitrate that was trumped by the later-executed agreement—the forum selection clause.[107] Additionally, the court explained that the underwriting agreement contained a merger clause and thus the earlier agreement under Rule 12200 merged into the forum selection clause.[108]

Similarly, in the Ninth Circuit case, *Goldman, Sachs & Company v. City of Reno*, the court concluded that the City of Reno, which had retained Goldman Sachs for advisory and underwriting services in connection with its issuance of ARS to finance a series of city projects, was a "customer" under FINRA Rule 12200.[109] However, as in *Golden Empire*, the court also concluded that the city had waived its right to arbitrate under FINRA Rule 12200 because it had agreed to a forum selection clause in its 2005 and 2006 agreements with Goldman Sachs.[110]

In contrast, the Fourth Circuit in *UBS Financial Services, Inc. v. Carilion Clinic* held that the forum selection clause at issue was not specific enough to supersede Rule 12200 because it did not specifically mention "arbitration."[111] Rather, the court interpreted "all actions and proceedings" to apply only to litigations, not arbitrations.[112] The court noted that interpreting "all actions and proceedings" to include arbitrations would necessarily lead to the conclusion that the parties intended an "arbitration" to be brought in the district court, a nonsensical result.[113]

I believe the Second and Ninth Circuits—in *Golden Empire* and *City of Reno,* respectively—incorrectly interpreted Rule 12200. A fundamental premise to their rulings—that I believe is flawed—is that Rule 12200 is a written agreement to arbitrate required by the FAA that somehow is executed before the parties entered into the underwriting agreements. However, the duty to arbitrate arose at the exact same time as the execution of the agreements establishing the broker-customer relationship. And, as I see it, the duty to arbitrate is ongoing—at any time a customer can invoke Rule

107. *Id.* at 215. *See* Credit Suisse Sec. (USA) LLC v. Tracy, 812 F.3d 249, 256 (2d Cir. 2016) (holding that a "more specific" forum selection clause trumped the duty to arbitrate a member's dispute with its employee under FINRA Rule 13200).

108. *Golden Empire*, 764 F.3d at 216.

109. Goldman, Sachs & Co. v. City of Reno, 747 F.3d 733, 741 (9th Cir. 2014).

110. *Id.* at 743–47. The clause at issue designated the U.S. District Court for the District of Nevada. *Id.* at 736–37.

111. The clause at issue provided:

> The parties agree that *all actions and proceedings* arising out of this Agreement or any of the transactions contemplated hereby *shall be brought in the United States District Court* in the County of New York. To the extent permitted by law, *each of the parties hereto also irrevocably waives all right to trial by jury in any action, proceeding* or counterclaim arising out of this Agreement or the transactions contemplated hereby.

UBS Fin. Servs., Inc. v. Carilion Clinic, 706 F.3d 319, 329 (4th Cir. 2013) (emphasis added).

112. *Id.* at 330.

113. *Id.*

12200 and request a FINRA member firm to arbitrate a dispute. At the time the customer invokes the right by filing a Statement of Claim with FINRA initiating the arbitration, the customer is required to execute and file a submission agreement with the forum. When the member firm files an answer to the customer's claim, the firm must also execute and file a submission agreement. Those agreements signify the written agreements to arbitrate between the customer and member firm; not Rule 12200 itself.[114]

But, even if the forum selection clause can be seen as a later-executed agreement superseding a prior agreement to arbitrate, I believe section 29(a) of the Exchange Act voids that clause. The next Part explains why.

III. SECTION 29(A) APPLIES TO FINRA RULE 12200

Customers' right to compel a FINRA member to arbitrate disputes arising out of the business of their accounts is a nonwaivable right for investors and an obligation with which broker-dealers must comply. Under section 29(a)'s plain meaning, as recently amended by Dodd-Frank, any clause in a brokerage agreement that purports to waive the firm's compliance with any FINRA conduct or arbitration rule is void. The section does not distinguish between conduct or arbitration rules; all SRO rules are included.[115] The section also does not distinguish among the types of "persons" it covers: it protects retail customers as well as institutional investors; the relative sophistication of the "person" is not relevant.

In addition, *McMahon* dictates that agreements that purport to waive regulated entities' duties to comply with Exchange Act regulations are void. The SEC acknowledges that Rule 12200 creates a duty—an obligation of regulated firms under the Exchange Act.[116] Furthermore, lower courts interpreting Rule 12200 and its predecessors describe the rule as providing a *right* to the customer and imposing an *obligation* on the broker-dealer.[117]

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114. In any event, I also agree that a forum selection clause must mention arbitration for it to be specific enough to trump a statutory duty to arbitrate.

115. Since 1975, the SEC has had to approve all SRO rules, including arbitration rules, to ensure they fulfill the purposes of the statute and SEC's implementing regulations. *See* Gross, McMahon *Turns Twenty*, *supra* note 13, at 512 ("The 1975 amendments added an indispensable layer of statutory regulation over SRO arbitration with the express statutory purpose of enhancing investor protection.").

116. *See* Exchange Act Release No. 131, at 4, 1935 WL 29028 (Mar. 21, 1935) ("The *right* to arbitration before the arbitration committee of the exchange is at present granted to any customer regardless of the contract between the member and the customer.") (emphasis added); *see also* 1989 Approval Order, *supra* note 71, at 21,154 (reiterating the SEC's position that SRO rules barring firms from including in their agreements any condition that "limit[s] or contradict[s] the rule of any SRO" applies to clauses in agreements used to "limit SRO forums otherwise available to parties").

117. *Carilion Clinic*, 706 F.3d at 321 ("[W]e conclude that . . . the forum selection clause relied on by UBS and Citi did not have the effect of superseding or waiving Carilion's right to arbitrate."); Pershing, L.L.C. v. Bevis, 606 F. App'x 754, 755 (5th Cir. 2015) ("Because of Pershing's FINRA membership, its customers have the right to compel Pershing to arbitrate their disputes under FINRA Rule 12200."); Goldman, Sachs & Co. v. City of Reno, 747 F.3d 741, 746 (9th Cir. 2014) (holding that "forum selection clauses superseded Goldman's default obligation to arbitrate under

Applying section 29(a) to purported waivers of Rule 12200 is consistent with Congress' purpose of including anti-waiver provisions in its laws: to preclude private parties from leveraging their bargaining power to contract for something that the law otherwise prohibits.[118] Congress created obligations under the Exchange Act—or delegated to the SEC the authority to create such obligations—and blocked persons from contracting around them. In other words, agreements cannot thwart the intention of Congress.[119] As the SEC put it: "[i]f broker-dealers are allowed to avoid the application of SRO arbitration rules by enforcing conflicting provisions written into customer contracts, the customer protections afforded by those rules and the SRO arbitration system will be undermined and investor confidence in the system will be eroded."[120]

The SEC insists on the maintenance of the securities arbitration system precisely because it is fair to investors and provides a more hospitable forum than the court for the resolution of their disputes.[121] The SEC also recognizes that if investors cannot pursue their small-dollar-value claims in arbitration, they likely will have no forum in which to pursue them, as a court is not hospitable to such small claims.[122] Enforcing "[t]he principle of customer choice upon which the SRO arbitration system is grounded serves the Commission's goal of assuring that the most efficient and economical arbitration forum for a particular case will be available to the customer."[123] Likewise, FINRA insists on providing investors with the right to demand

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the FINRA Rules" and "that . . . Reno disclaimed any right it might otherwise have had to the FINRA arbitration forum").

118. *See* Barbara Black, *Eliminating Securities Fraud Class Actions Under the Radar*, 2009 COLUM. BUS. L. REV. 802, 824 (2009) ("Congress [through section 29(a)] would not permit parties to negotiate deals that weakened the statutory framework. While the congressional purpose may have been at least partly protective, reflecting a concern that the more sophisticated party might persuade the less sophisticated party to give up his rights, Congress also must have been concerned about the national interest and the importance of federal regulation for the overall fairness and effectiveness of the securities market—the fundamental purpose of the Exchange Act.").

119. "When a self-regulatory association of securities firms, under direct federal supervision, ordains that its members may not require their employees to waive arbitration rights, it would be inappropriate for us to enforce such a waiver." Thomas James Assocs., Inc. v. Jameson, 102 F.3d 60, 66 (2d Cir. 1996) (voiding employee's waiver of right to arbitrate disputes with employer FINRA-member as against public policy). *But see* Credit Suisse Sec. (USA) LLC v. Tracy, No. 14 Civ. 8568(NRB), 2015 WL 170241, at *6 (S.D.N.Y. Jan. 8, 2015) (declining to void provision in employment agreement calling for arbitration at JAMS rather than FINRA and stating that "[r]espondents are in a different position from the employee in *Jameson* because the Credit Suisse EDRP does not waive the right to arbitration; it merely waives the right to FINRA's arbitral forum. In contrast to the clear federal policy favoring arbitration, there is no basis to conclude that federal policy favors FINRA's forum over JAMS (or the American Arbitration Association)"), *aff'd*, 812 F.3d 249, 2016 WL 336190 (2d Cir. 2016).

120. Brief of the SEC in *Roney*, *supra* note 72, at 4.

121. *See* Gross, *The End of Mandatory Securities Arbitration?*, *supra* note 4, at 1186–89 (listing the ways in which SRO arbitration rules ensure the protection of investors).

122. Brief of the SEC in *Roney*, *supra* note 72, at 10–11 (describing history of and reasons for SEC's development of an affordable forum for investors to pursue small claims).

123. *Id.* at 16.

arbitration because it believes that arbitration is a "faster, cheaper and less complex" method of resolving customer disputes than court.[124] And, the industry itself touts securities arbitration as offering "significant benefits to parties that are not available in court."[125]

McMahon's ruling that firms can force customers to waive the right to litigate and not run afoul of section 29(a) should not be extended to the right to arbitrate. Nowhere do the federal securities laws require member firms to *litigate* customer disputes; FINRA regulations only require particular language in a PDAA if firms do force customers to waive the right to proceed in court. *McMahon* was concerned with the different question of whether forcing customers to waive their right to go to court weakens their ability to recover under the Exchange Act. Since the Court concluded the heavily regulated system of securities arbitration provided an adequate forum to resolve disputes, investors were protected. Moreover, the Court in *McMahon* had no occasion to consider whether depriving investors of the arbitration forum weakened their ability to recover under the Exchange Act.

Lower courts' focus post-*McMahon* on whether a waiver addresses substantive or procedural rights misreads the scope of section 29(a), which does not use the word "substantive." Congress made the section applicable to "any condition, stipulation, or provision" that forces a person to "waive compliance with any provision" of the Exchange Act, or "any rule of a self-regulatory organization."[126] Moreover, "[t]he words 'substantive' and 'procedural' or 'remedial' are not talismanic. Merely calling a legal question by one or the other does not resolve it otherwise than as a purely authoritarian performance."[127] Rather, courts should examine whether the challenged agreement permits a regulated entity from *avoiding compliance* with its regulatory obligations.[128]

Finally, not permitting broker-dealers to force customers to waive their right to arbitration is consistent with the "emphatic federal policy favoring arbitral dispute resolution."[129] While scholars continue to challenge PDAAs in consumer and employment agreements as forcing an unfair arbitration process on weaker disputants,[130] securities arbitration is different because it

124. *See Arbitration and Mediation: Overview*, FIN. INDUS. REGULATORY AUTH., http://www.finra.org/arbitration-and-mediation/overview (last visited Apr. 6, 2016).

125. *Securities Arbitration System, Hearings Before the Subcomm. on Capital Markets, Insurance & Government Sponsored Enterprises of the H. Comm. on Financial Services*, 109th Cong. 67 (2005) (statement of Marc E. Lackritz, President, Sec. Indus. Ass'n).

126. Exchange Act § 29(a), 15 U.S.C. § 78cc(a) (2012).

127. Guaranty Trust Co. of N.Y. v. York, 326 U.S. 99, 115 (1945) (Rutledge, J., dissenting).

128. *See* Shearson/Am. Express, Inc. v. McMahon (*McMahon II*), 482 U.S. 220, 228 (1987).

129. Marmet Health Care Ctr., Inc. v. Brown, 132 S. Ct. 1201, 1203 (2012) (per curiam) (internal quotation marks omitted) (quoting KPMG LLP v. Cocchi, 132 S.Ct. 23, 25 (2011).

130. *See, e.g.*, Christopher R. Leslie, *The Arbitration Bootstrap*, 94 TEX. L. REV. 265, 316–20 (2015) (critiquing mandatory arbitration clauses); Mark E. Budnitz, *The High Cost of Mandatory Consumer Arbitration*, 67 L. & CONTEMP. PROBS. 133, 133 (2004) (arguing that arbitration is "unavailable to many consumers because its cost is too great"); Alexander J.S. Colvin, *Mandatory*

is regulated. Congress has delegated the regulation of the securities industry to the SEC, and the SEC has a strong policy favoring arbitration of investor disputes. Thus, the right of the investor to choose arbitration should not be waivable.

CONCLUSION

This Article has argued that the anti-waiver provision of the Exchange Act prohibits broker-dealers from invoking forum selection clauses in agreements to supersede their duty to arbitrate customer disputes if the customer wants arbitration. Courts and litigants have largely ignored this argument in cases involving the collision between FINRA Rule 12200 and a forum selection clause. Ignoring this argument, however, deprives investors of the dispute processing choice granted to them by securities regulators. As discussed above, offering the dispute resolution process choice of arbitration to retail investors has been a long-standing policy of the SROs and the SEC.

Advocating for arbitration in the securities industry might appear to some as contradictory to the current narrative of consumer arbitration as undesirable.[131] In my view, much of the criticism of consumer arbitration does not apply equally to securities arbitration, as the system is regulated and has many investor-protective features.[132] In any event, this Article does not address whether mandatory arbitration is desirable or undesirable. Rather, it aims to preserve arbitration as a process choice for investors. The equitable features of arbitration provide investors with a compelling alternative to courts today, particularly in light of the anti-investor bent of court holdings in recent decades. Congress has made it clear that investors must be protected; one way to protect investors is to prohibit waivers of obligations established by the Exchange Act; and submission to the investor's choice of arbitration is an obligation of an SRO regulation promulgated pursuant to the Exchange Act. Broker-dealers cannot supplant that choice with forum selection clauses.

Arbitration and Inequality of Justice in Employment, 35 BERKELEY J. EMP. & LAB. L. 71, 90 (2014) ("[R]ather than enhancing equality, mandatory arbitration exacerbates inequality in access to justice in the workplace."); Sternlight, *supra* note 12, at 1312 (critiquing employers' use of mandatory arbitration to decrease employees' access to justice); Stipanowich, *supra* note 12, at 988–91 (identifying fairness concerns surrounding the growth of mandatory arbitration clauses).

131. *See, e.g.*, Jessica Silver-Greenberg & Robert Gebeloff, *Arbitration Everywhere, Stacking the Deck of Justice*, N.Y. TIMES, Nov. 1, 2015, at A1.

132. *See* Gross, *The End of Mandatory Securities Arbitration?*, *supra* note 4, at 1185–93 (urging the SEC not to ban PDAAs in customer agreements).