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Arbitration Case Law Update 2013

By

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The U.S. Supreme Court and lower state and federal courts continue to decide cases under the Federal Arbitration Act (“FAA”)¹ at an astounding rate. This chapter summarizes Supreme Court opinions over the past year that interpret the FAA, as well as selected lower court decisions that apply the FAA and could have an impact on securities arbitration practice.²

I. U.S. Supreme Court

Since last summer when I authored the Arbitration Law Update 2012 for PLI, the United States Supreme Court decided one new arbitration case and heard oral argument on two other cases.³

A. Separability doctrine

In November 2012, the Supreme Court issued a *per curiam* opinion in *Nitro-Lift Technologies, L.L.C. v. Howard*,⁴ holding that the FAA preempted a decision by the Supreme Court of Oklahoma to rule, in the first instance, on the validity of a covenant not to compete despite the existence of an arbitration clause.

Nitro-Lift Technologies, a provider of services to operators of oil and gas wells, entered into confidentiality and noncompetition agreements with two of its employees, Respondents Howard and Schneider.⁵ Those agreements contained

¹ 9 U.S.C. §§ 1 *et seq.* (2013).

² Because securities arbitration necessarily “involves commerce” (FAA § 2), courts apply the FAA to issues arising out of securities arbitrations. *See* *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002).

³ I will provide updates on these two cases at the program, as they are likely to be decided after this chapter is submitted for publication but before the date of the program.

⁴ 133 S.Ct. 500 (2012).

⁵ *Id.* at 501-02.

a broad arbitration clause, delegating to an arbitrator “[a]ny dispute, difference or unresolved question between Nitro–Lift and the Employee[s].”⁶ When the employees quit Nitro-Lift and started working for competitors, Nitro-Lift demanded arbitration, alleging breach of the noncompetition agreements.⁷

Respondents filed suit in state court in Oklahoma, asking the court to declare the noncompetition agreements unenforceable under an Oklahoma statute that limits the enforceability of covenants not to compete.⁸ The trial court dismissed the complaint, concluding the dispute was arbitrable. On appeal, the Oklahoma Supreme Court ruled that, in Oklahoma, courts decide the enforceability of noncompetition agreements, thus ignoring the arbitration clause. The Oklahoma high court then declared the noncompetition agreements unenforceable as against public policy.⁹

Nitro-Lift appealed to the U.S Supreme Court. The Court ruled that the Oklahoma high court blatantly and improperly ignored the FAA separability doctrine, which declares that arbitrators decide in the first instance the enforceability of

⁶ *Id.* at 502.

⁷ *Id.*

⁸ *Id.* 15 Okl.St. Ann. § 219A (2012) provides:

A. A person who makes an agreement with an employer, whether in writing or verbally, not to compete with the employer after the employment relationship has been terminated, shall be permitted to engage in the same business as that conducted by the former employer or in a similar business as that conducted by the former employer as long as the former employee does not directly solicit the sale of goods, services or a combination of goods and services from the established customers of the former employer.

B. Any provision in a contract between an employer and an employee in conflict with the provisions of this section shall be void and unenforceable.

⁹ 133 S.Ct at 502.

contracts containing a pre-dispute arbitration clause, as long as the challenge is not to the arbitration clause itself.¹⁰ In vacating the decision, the Court harshly reprimanded the Oklahoma high court:

State courts rather than federal courts are most frequently called upon to apply the Federal Arbitration Act (FAA), 9 U.S.C. § 1 *et seq.*, including the Act's national policy favoring arbitration. It is a matter of great importance, therefore, that state supreme courts adhere to a correct interpretation of the legislation. Here, the Oklahoma Supreme Court failed to do so. By declaring the noncompetition agreements in two employment contracts null and void, rather than leaving that determination to the arbitrator in the first instance, the state court ignored a basic tenet of the Act's substantive arbitration law.¹¹

In the end, while the Supreme Court harshly rebuked the Oklahoma high court, *Nitro-Lift* offers no new law: it just reiterates and reaffirms fundamental principles of the Court's FAA jurisprudence, including doctrines of broad FAA preemption, separability, and the power of the arbitrators to decide the enforceability of contracts containing an arbitration clause.

B. Vindication of statutory rights

Also in November 2012, the Supreme Court granted the petition for a writ of certiorari in *American Express Co. v. Italian Colors Restaurant*,¹² to decide the following question presented: “Whether the Federal Arbitration Act permits courts, invoking the ‘federal substantive law of arbitrability,’ to invalidate arbitration

¹⁰ See *Buckeye Check Cashing Inc. v. Cardegna*, 546 U.S. 440, 446 (2006).

¹¹ *Nitro-Lift*, 133 S.Ct at 501.

¹² 667 F.3d 204 (2d Cir. 2012) (“Amex III”), *cert. granted*, 133 S.Ct. 594 (2012).

agreements on the ground that they do not permit class arbitration of a federal-law claim.”¹³

In *Amex III*, the Second Circuit ruled that a pre-dispute arbitration clause containing a class action waiver in merchants’ credit card processing agreements was unenforceable because it precluded plaintiff merchants from vindicating their statutory rights under the federal antitrust laws.¹⁴ *Amex III* was the third time the Second Circuit had found that arbitration clause unenforceable under the “vindicating rights” doctrine, this last time even after a review of the case in light of the Supreme Court’s April 2011 decision in *AT&T Mobility v. Concepcion*.¹⁵

The Court of Appeals reconsidered, in light of *AT&T Mobility*, its prior decisions¹⁶ that a class action waiver clause in a

¹³ American Exp. Co. v. Italian Colors Restaurant, Petition for a Writ of Certiorari, 2012 WL 3091064, *i (U.S. July 30, 2012).

¹⁴ 667 F.3d at 219. Under the “vindicating statutory rights” doctrine derived from the Supreme Court’s pronouncement that “so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, the [federal] statute [providing that cause of action] will continue to serve both its remedial and deterrent function” (*Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985)), a disputant can argue that an arbitration agreement is unenforceable because an unfair aspect of the arbitration process would preclude that party from vindicating its statutory rights. *Id.* at 637; *see also* *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 92 (2000) (recognizing in *dicta* that, if a party showed that pursuing its statutory claims through arbitration would be prohibitively expensive, and thus it could not vindicate its statutory rights, a court could validly refuse to enforce a pre-dispute arbitration agreement).

¹⁵ 131 S.Ct. 1740 (2011) (enforcing class action waiver in consumer services arbitration agreement and preempting state law of unconscionability).

¹⁶ *See In Re American Exp. Merch. Litig.*, 634 F.3d 187 (2d Cir. 2011) (“*Amex II*”); *In Re American Exp. Merch. Litig.*, 554 F.3d 300 (2d Cir. 2009) (“*Amex I*”). The Court of Appeals reconsidered *Amex I* in light of the Supreme Court’s subsequent ruling in *Stolt-Nielsen S.A. v. AnimalFeeds Intern. Corp.*, 559 U.S. 662, 130 S.Ct. 1758 (2010).

merchants' credit card agreement was unenforceable under the FAA because "enforcement of the clause would effectively preclude any action seeking to vindicate the [plaintiffs'] statutory rights."¹⁷ The Court of Appeals found that *AT&T Mobility* did not alter its prior analysis, which rested on a different ground than that of *AT&T Mobility*.¹⁸ Rather, the Court of Appeals recognized, "[h]ere...our holding rests squarely on a 'vindication of statutory rights analysis, which is part of the federal substantive law of arbitrability.'"¹⁹ Because plaintiffs in this case demonstrated through expert testimony that pursuing their statutory claims individually as opposed to through class arbitration would not be economically feasible, "effectively depriving plaintiffs of the statutory protections of the antitrust laws,"²⁰ the Court of Appeals directed the district court to deny defendant's motion to compel arbitration.²¹

The Court heard oral argument on February 27, 2013. Since the "vindicating rights" doctrine seemed one of the only valid exceptions to *AT&T Mobility*'s broad preemption of state unconscionability law as applied to class action waivers, the *AMEX III* decision will surely be the most important arbitration law case coming out of the Court this term. Most scholars who listened to the argument or read the transcript predict that the Court will rule in favor of American Express on the grounds that

¹⁷ *Amex I*, 554 F.3d at 304.

¹⁸ *Amex III*, 667 F.3d at 214 ("What *Stolt-Nielsen* and *Concepcion* do not do is require that all class-action waivers be deemed per se enforceable. That leaves open the question presented on this appeal: whether a mandatory class action waiver clause is enforceable even if the plaintiffs are able to demonstrate that the practical effect of enforcement would be to preclude their ability to bring federal antitrust claims.").

¹⁹ *Id.* at 213, citing *Amex I*, 554 F.3d at 320.

²⁰ *Id.* at 217.

²¹ *Id.* at 219. *But see* *Homa v. American Exp. Co.*, 494 Fed. Appx. 191, 196-98 (3d Cir. 2012) (enforcing class action waiver and rejecting "vindicating rights" challenge).

plaintiffs' claim that they will not be able to vindicate their statutory rights under the antitrust laws is too speculative.²²

C. Class arbitration

Only a few weeks after granting certiorari in *Amex III*, the Court agreed to hear another FAA-related case, *Oxford Health Plans LLC v. Sutter*.²³ *Sutter* follows on the heels of the Court's 2010 decision in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*,²⁴ which held that courts must construe an arbitration agreement that is truly "silent" as to class arbitration to mean that the parties did not authorize arbitrators to conduct class arbitration.

In *Stolt-Nielsen*, the Court found that the arbitration panel had "exceeded their powers" within the meaning of FAA §10(a)(4) by reading into a silent arbitration agreement the parties' intent to arbitrate aggregable claims. Notably, however, the parties in *Stolt-Nielsen* "stipulated that there was 'no agreement' on the issue of class-action arbitration."²⁵ As a result, the Court conceded that it had "no occasion to decide what contractual basis may support a finding that the parties agreed to authorize class-action arbitration."²⁶

The arbitrator in *Sutter* also interpreted a "silent" arbitration clause to allow class arbitration, but in this case the parties had not stipulated as to their intention with respect to class arbitration, so the arbitrator had to discern the parties' intentions.²⁷

²² See, e.g., Sarah Cole, *American Express v. Italian Colors Restaurant Oral Argument Report*, ADR Law Prof Blog (Feb. 27, 2013), <http://www.indisputably.org/?p=4382>.

²³ 675 F.3d 215 (3d Cir. 2012), cert. granted, 133 S.Ct. 786 (2012).

²⁴ 559 U.S. 662, 130 S. Ct. 1758 (2010).

²⁵ 130 S.Ct. at 1776 n.10.

²⁶ *Id.*

²⁷ The *Sutter* clause provided:

The arbitrator, in his written order, “[f]ram[ed] the question as one of contract construction,” and described the parties’ arbitration clause as “‘much broader even than the usual broad arbitration clause;’ it was ‘unique in [his] experience and seem[ed] to be drafted to be as broad as can be.’”²⁸ The arbitrator concluded that the broad language of “[n]o civil action” in the clause “embrace[d] all conceivable court actions, including class actions” and the clause’s second phrase sent “all such disputes” to arbitration.²⁹ Thus, he reasoned, “the clause expressed the parties’ intent to authorize class arbitration ‘on its face.’”³⁰

The district court and ultimately the Third Circuit confirmed the arbitrator’s ruling. The Third Circuit reasoned that *Stolt-Nielsen* “did not establish a bright line rule that class arbitration is allowed only under an arbitration agreement that incants ‘class arbitration’ or otherwise expressly provides for aggregable procedures.”³¹ Rather, the case established a “default rule” that, “[a]bsent a contractual basis for finding that the parties agreed to class arbitration, an arbitration award ordering that procedure exceeds the arbitrator’s powers and will be subject to vacatur under §10(a)(4).”³²

The Supreme Court heard oral argument on March 25, 2013. The Justices’ questions crystallized the tension between the two competing policies at stake in this case: should courts defer to

‘No civil action concerning any dispute arising under this Agreement shall be instituted before any court, and all such disputes shall be submitted to final and binding arbitration in New Jersey, pursuant to the Rules of the American Arbitration Association with one arbitrator.’

675 F.3d at 217 (citing App. 55).

²⁸ *Id.* at 217-18 (citing App. at 47).

²⁹ *Id.* at 218.

³⁰ *Id.* (citing App. at 48).

³¹ *Id.* at 222.

³² *Id.*

an arbitrator’s interpretation of parties’ arbitration agreements, even if that interpretation seems implausible, or should courts overturn such interpretations when the arbitrators interpreted the agreement in an implausible manner, and thus exceeded their powers?³³

A decision in this case likely will close the gap left by footnote 10 of *Stolt-Nielsen* and hopefully address once and for all whether an arbitrator can ever read a silent arbitration clause to authorize class arbitration.

II. Notable Administrative Law Decision: FINRA v. Schwab

The Supreme Court’s seminal April 2011 decision in *AT&T Mobility, LLC v. Concepcion*,³⁴ in which it held that the FAA preempts California’s *Discover Bank* rule, which “classif[ie]d most collective-arbitration waivers in consumer contracts as unconscionable,”³⁵ confirmed the strong preemptive force of the FAA, and reduced consumers’ ability to challenge class action waivers as unconscionable under state law. As a result, since *AT&T Mobility*, companies have been inserting class action waivers in their consumer agreements, and courts largely have been enforcing them.³⁶

³³ See Steve Vladeck, *Argument recap: How much deference do arbitrators deserve under Stolt-Nielsen?*, SCOTUSblog (Mar. 27, 2013), <http://www.scotusblog.com/2013/03/argument-recap-how-much-deference-do-arbitrators-deserve-under-stolt-nielsen/>.

³⁴ 131 S. Ct. 1740 (2011). For a detailed discussion of the case, see Jill I. Gross, *Arbitration Case Law Update 2011*, in SECURITIES ARBITRATION 2011, at 205 (Practising Law Institute 2011).

³⁵ *AT&T Mobility*, 131 S.Ct. at 1746.

³⁶ See, e.g., *Muriithi v. Shuttle Express, Inc.*, 712 F.3d 173 (4th Cir. 2013); *Kilgore v. Keybank, N.A.*, __ F.3d __, 2013 WL 1458876 (9th Cir. Apr. 11, 2013); *Pendergast v. Sprint Nextel Corp.*, 691 F.3d 1224, 1226 (11th Cir. 2012).

However, one question not addressed by *AT&T Mobility* is how courts should resolve challenges to class action waivers on the grounds that they violate a competing *federal* law. Indeed, it is well-established that the mandate of the FAA is not absolute: it may be “overridden by a ‘contrary congressional command.’”³⁷ While the FAA preemption doctrine requires the broad displacement of *state* laws that conflict with the policies underlying the FAA, courts must turn to other doctrines when resolving conflicts between the FAA and other federal laws.³⁸

Last year’s chapter detailed the contention of one broker-dealer, FINRA member Charles Schwab & Co., Inc. (“Schwab”), that the holding of *AT&T Mobility* applies in the securities context, and displaces conflicting FINRA rules, which are approved by the Securities and Exchange Commission.³⁹ In October 2011, Schwab

³⁷ *CompuCredit Corp. v. Greenwood*, 132 S. Ct. 665, 669 (2012) (quoting *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987)). Courts have been very reluctant this past year to find such a “contrary congressional command” sufficient to overcome a class action waiver. *See, e.g., Owen v. Bristol Care, Inc.*, 702 F.3d 1050, 1054 (8th Cir. 2013) (enforcing a class action waiver in the Fair Labor Standards Act context and stating “our conclusion is consistent with all of the other courts of appeals that have considered this issue and concluded that arbitration agreements containing class waivers are enforceable in FLSA cases”).

³⁸ *See, e.g., In the Matter of Eber*, 687 F.3d 1123 (9th Cir. 2012) (affirming bankruptcy court’s denial of motion to compel arbitration on the grounds that the federal bankruptcy laws displaced the FAA); *State of Wash. v. James River Ins. Co.*, 292 P.3d 118 (WA Sup. Ct. 2013) (declaring a mandatory arbitration clause in an insurance contract unenforceable under a state law that was shielded from FAA preemption under the McCarran-Ferguson Act, 5 U.S.C. § 1012(b)).

³⁹ Jill I. Gross, *Arbitration Case Law Update 2012*, in *SECURITIES ARBITRATION 2012*, at 233-34 (Practising Law Institute 2012)

amended its customer agreement to add a class action waiver to the arbitration clause.⁴⁰

In response, in early 2012, FINRA Enforcement brought a disciplinary action against Schwab for including the class action waiver.⁴¹ FINRA charged that requiring customers to waive their right to bring or participate in a class action violates NASD Rule 3110(f)(4)(A) and (C), and its successor rules FINRA Rule 2268(d)(1) and (3) (effective Dec. 5, 2011). Those rules prohibit member firms from placing “any condition” in a pre-dispute arbitration agreement that “limits or contradicts the rules of any self-regulatory organization,” and “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,” respectively. FINRA argued that, because Rule 12204(d) of the FINRA Code of Arbitration Procedure for Customer Disputes addresses the manner in which customers can bring and participate in class actions against member firms, the forum rules clearly permit class actions, and Schwab’s class action waiver contradicts Rule 12204.⁴²

On February 21, 2013, a FINRA hearing panel issued its decision, finding that Schwab’s actions in inserting the class action waiver did indeed violate FINRA rules, but that the FAA precluded FINRA from enforcing its rules against Schwab.⁴³ That

⁴⁰ SECURITIES ARBITRATION ALERT 2011-38 (Oct. 12, 2011) (reporting that Schwab inserted a new clause entitled “Waiver of Class Action or Representative Action” in its Customer Account Agreements).

⁴¹ Complaint and Request for Expedited Hearing, Department of Enforcement v. Charles Schwab & Co., Inc., Disc. Proc. No. 2011029760201, *available at* <http://www.finra.org/web/groups/industry/@ip/@enf/@ad/documents/industry/p125516.pdf> (FINRA Office of Hearing Officers Feb. 1, 2012).

⁴² *Id.*

⁴³ Hearing Panel Decision, Department of Enforcement v. Charles Schwab & Co., Inc., Disc. Proc. No. 2011029760201, *available at*

decision is currently on appeal to the National Adjudicatory Council and briefing will continue throughout the summer of 2013.

I have argued that the hearing panel's decision is wrong, and that the Securities Exchange Act of 1934, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank),⁴⁴ provides the "contrary congressional command" required by *AT&T Mobility* and *CompuCredit* to displace the FAA.⁴⁵ In my view, unless reversed on appeal, the Hearing Panel's decision deals a crippling blow to the authority of FINRA and the SEC to adopt arbitration rules that balance the benefits of arbitration with the need to protect investors.

III. Notable federal court decisions

A. Defenses to Arbitrability

Litigation about arbitration often results when one party to a purported arbitration agreement seeks to compel a reluctant party to arbitrate a dispute. In response to the motion to compel, the reluctant party can raise several defenses to the arbitrability of the dispute, including a statutory prohibition, the absence of an enforceable arbitration agreement (due to contract law doctrines or, in FINRA arbitration, the claimant is not a "customer" of respondent), and waiver. Discussed below are some recent federal court of appeals decisions interpreting these defenses.

<http://disciplinaryactions.finra.org/viewdocument.aspx?DocNB=33101>

(FINRA Office of Hearing Officers Feb. 21, 2103).

⁴⁴ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁴⁵ See Barbara Black & Jill Gross, *Investor Protection Meets the Federal Arbitration Act*, 1 STAN. J. COMPLEX LITIG. 1 (2012).

1. A “contrary congressional command”

If a federal statute has explicitly declared that claims arising under it are non-arbitrable, then a court must deny a motion to compel arbitration of those claims. Several federal statutory schemes establishing rights of action arising under them include nonarbitrability provisions, including the whistleblower provisions of the Sarbanes-Oxley Act of 2002 (SOX).⁴⁶

§806 of SOX adds protection for and gives a right of action to “whistleblowers” who report fraud at publicly-traded companies.⁴⁷ In §922 of Dodd-Frank, Congress declared that pre-dispute arbitration agreements purporting to require arbitration of SOX whistleblower claims are not enforceable.⁴⁸ This past year, a federal district court applied this ban on arbitrating SOX whistleblower claims retroactively, thus precluding arbitration of whistleblower claims that arose even before Dodd-Frank’s enactment.⁴⁹ This decision could be helpful to pre-2010 whistleblowers from securities industry firms forced into arbitration.

2. Was there an enforceable arbitration agreement?

Before a court will grant a motion to compel arbitration under the FAA, it must be satisfied that the disputing parties entered into a valid and enforceable arbitration agreement. Thus, defenses to contracts generally can be raised in response to a motion to compel arbitration. For example, this past year, the Fourth Circuit refused to enforce an arbitration agreement between home purchasers and a real estate development company due to

⁴⁶ Pub. L. No. 107-204, 116 Stat. 745 (2002).

⁴⁷ 18 U.S.C. §1514A (2012).

⁴⁸ 18 U.S.C. § 1514A(e)(2) (2012).

⁴⁹ *See Wong v. CKX, Inc.*, 890 F. Supp.2d 411 (S.D.N.Y. 2012).

lack of mutual consideration.⁵⁰ Applying Maryland law, the Court of Appeals concluded that consideration for the underlying contract is not sufficient to constitute consideration for a stand-alone contract, including an arbitration clause within that contract.⁵¹

However, even if parties did not directly enter into an arbitration agreement, they still may be able to compel arbitration of claims arising out of an arbitration agreement between signatories under the doctrine of equitable estoppel. A nonsignatory can enforce an arbitration clause with a signatory:

- (1) when a signatory must rely on the terms of the written agreement in asserting its claims against the nonsignatory or the claims are ‘intimately founded in and intertwined with’ the underlying contract, and (2) when the signatory alleges substantially interdependent and concerted misconduct by the nonsignatory and another signatory and ‘the allegations of interdependent misconduct [are] founded in or intimately connected with the obligations of the underlying agreement.’⁵²

In *Kramer*, a putative class action brought by purchasers and lessees of allegedly defective hybrid cars against Toyota, the manufacturer, Toyota attempted to compel arbitration of plaintiffs’ claims based on an arbitration agreement in the purchase

⁵⁰ See *Noohi v. Toll Bros., Inc.*, 708 F.3d 599 (4th Cir. 2013).

⁵¹ *Id.* at 609.

⁵² See *Kramer v. Toyota Motor Corp.*, 705 F.3d 1122, 1128-29 (9th Cir. 2013) (internal citations omitted); see also *Escobal v. Celebration Cruise Operator, Inc.*, 482 Fed. Appx. 475, 476 (11th Cir. 2012) (“Escobal’s claim against Cruise Line is inextricably intertwined with his claims against the contract signatory Celebration Cruise Operator. Thus, the district court properly applied equitable estoppel in requiring Escobal to arbitrate his claim against Cruise Line.”).

agreements between the plaintiffs and car dealerships. The Ninth Circuit refused to compel arbitration under the doctrine of equitable estoppel, finding that plaintiffs' claims were not "intimately founded in and intertwined with" the plaintiffs' purchase agreements, nor were their allegations that Toyota and the dealerships engaged in a pattern of denial or concealment of the alleged defects "inextricably bound up with the obligations" in the purchase agreements.⁵³

Courts of Appeal have likewise rejected several other attempts by nonsignatories to enforce arbitration agreements against signatories this past year, on both equitable estoppel⁵⁴ and third-party beneficiary⁵⁵ theories. These cases signal a trend in courts to reject arbitration of claims other than between or among signatories to a written arbitration agreement. This trend may have implications for investors who, for example, have arbitration agreements with a custodial broker-dealer who is a FINRA member with few duties to customers but not necessarily with the investment adviser who controls the account. The investment adviser is a third-party beneficiary of the arbitration agreement between the broker-dealer and the investor, but courts may not permit the investor to compel arbitration with the adviser if it applies the third-party beneficiary doctrine narrowly or not at all.

⁵³ *Kramer*, 705 F.3d at 1129-33.

⁵⁴ *See, e.g.*, *Baldwin v. Cavett*, 502 Fed. Appx 350, 356 (5th Cir. 2012); *In re Wholesale Grocery Prod. Antitrust Litig.*, 707 F.3d 917, 922-23 (8th Cir. 2013); *Branch v. Ottinger*, 477 Fed. Appx. 718, 720 (11th Cir. 2012).

⁵⁵ If a nonsignatory can demonstrate it is a third-party beneficiary of an arbitration agreement, it can enforce that agreement against signatories. *See Fundamental Admin. Servs., LLC v. Patton*, Civ. No. 12-2014, 2012 WL 5992259, *3 (10th Cir. Dec. 3, 2012).

3. Who is a “customer” under FINRA Rule 12200?

In a FINRA customer-initiated arbitration, in the absence of a pre-dispute arbitration clause, respondents may resist arbitration on the ground that the claimant is not a “customer” of the FINRA member firm within the meaning of FINRA Code of Arbitration Procedure for Customer Disputes Rule 12200. That rule provides that a FINRA member firm 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”⁵⁶

Courts continue to interpret Rule 12200 in the context of respondents’ motions for declaratory and/or injunctive relief on the grounds that the claimant is not a “customer” within the meaning of the rule. The Fourth Circuit Court of Appeals alone has issued at least four decisions on this issue in the past year.

One case construed the term “associated person” for purposes of Rule 12200.⁵⁷ Specifically, it addressed the “novel question” of “[w]hether a person who is not in a contractual relationship with a member firm nevertheless can be an ‘associated person’ of that firm for purposes of FINRA arbitration.”⁵⁸ In that case, investors brought arbitration claims against their financial advisor George Gilbert, Gilbert’s current investment firm, Waterford Investment Services, Inc. (Waterford), and his prior firm, Community Bankers Securities, LLC (CBS).⁵⁹ During the

⁵⁶ FINRA R. 12200.

⁵⁷ *See* *Waterford Inv. Serv., Inc. v. Bosco*, 682 F.3d 348 (4th Cir. 2012).

⁵⁸ *Id.* at 354.

⁵⁹ Notably, the district court found that Waterford was a “‘mere continuation’ of CBS.” *Waterford Inv. Servs., Inc. v. Bosco*, 2011 WL

time period of the relevant transactions (which turned out to be a Ponzi scheme), Gilbert sold securities through CBS, but not Waterford, under an “Independent Associate Agreement.”

To avoid arbitration with the investors, Waterford sought a declaratory judgment in federal district court that the investors were not its customers under Rule 12200. The parties did not dispute that the investor claimants were customers of Gilbert and that their claims arose out of Gilbert’s business activities. Because a member firm must arbitrate the claims of its associated person’s customers, the only issue was whether Gilbert was an associated person of *Waterford* during the relevant time period. The court looked to FINRA Rule 12100(r), which defined a “person associated with a member” as “a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member.” Ultimately, by examining the close relationship between CBS and Waterford at the relevant time, including the facts that they shared many officers, directors and employees, and shared office space and trading resources, the Court of Appeals agreed with the district court’s finding that Waterford had “the power and ability to exercise power” over Gilbert.⁶⁰ Thus, Gilbert was an associated person of Waterford at the time of the relevant transactions and Waterford was required to arbitrate the investors’ claims.

Another case interpreted the definition of “customer” in the context of an issuer of auction rate securities suing the financial institutions that advised the issuer and underwrote those issuances. In January 2013, the Fourth Circuit affirmed a district court’s refusal to enjoin the arbitration claims of a not-for-profit healthcare organization that had issued auction rate securities against UBS

3820723 (E.D. Va. July 29, 2011), aff’d, 682 F.3d 348 (4th Cir. 2012) (quotation omitted).

⁶⁰ *Waterford*, 682 F.3d at 354 (internal citations omitted).

Financial Services, Inc. and Citigroup Global Markets, Inc., both of which had advised it in connection with the issuance.⁶¹ UBS and Citi argued that the claimant was not its “customer” under Rule 12200 because its claims “did not relate to a brokerage account or investment relationship with UBS or Citi.”⁶²

The Court of Appeals rejected that narrow definition, instead defining the term “customer” as “one, not a broker or dealer, who purchases commodities or services from a FINRA member in the course of the member's business activities insofar as those activities are regulated by FINRA—namely investment banking and securities business activities.”⁶³ Because UBS and Citi had provided multiple services to Carilion in connection with the securities offering and received payment from Carilion for those services, the court had “little difficulty concluding that Carilion is such a ‘customer.’”⁶⁴

In contrast, two subsequent Fourth Circuit cases applied the *Carilion* definition of “customer” and ruled that the claimants were *not* customers of FINRA members.⁶⁵ In *Silverman*, the circuit court concluded that investors were not “customers” of the principal distributor and underwriter of bond funds that they purchased through another broker-dealer.⁶⁶ In *Cary*, the circuit

⁶¹ See *UBS Financial Services, Inc. v. Carilion Clinic*, 706 F.3d 319 (4th Cir. 2013)

⁶² *Id.* at 324 (citing *Fleet Boston Robertson Stephens, Inc. v. Innovex, Inc.*, 264 F.3d 770 (8th Cir. 2001)).

⁶³ *Id.* at 327.

⁶⁴ *Id.*; see also *UBS Financial Services Inc. v. West Virginia University Hospitals Inc.*, 660 F.3d 643 (2d Cir. 2011) (holding that an issuer who purchases auction-facilitating services for its auction rate securities from a broker-dealer is a “customer” of that broker-dealer within the meaning of FINRA Rule 12200).

⁶⁵ *Morgan Keegan & Co. Inc. v. Silverman*, 706 F.3d 562 (4th Cir. 2013); *Raymond James Fin'l Serv., Inc. v. Cary*, 709 F.3d 382 (4th Cir. 2013).

⁶⁶ *Silverman*, 706 F.3d at 567-68.

court concluded that investors were not “customers” of Raymond James Financial Services when they purchased securities on the recommendation of an attorney who was not affiliated with Raymond James but merely was a “personal friend and business acquaintance” of a Raymond James broker.⁶⁷

Similarly, an Eighth Circuit court rejected investors’ claims that they were “customers” of a broker-dealer, Berthel Fisher & Co., which had managed an offering of securities that were sold directly to the investors by other “selling” broker-dealers. The Court of Appeals concluded that, because Berthel Fisher or its associated persons had not provided investment or brokerage services directly to the investors, and the investors had no relationship with Berthel Fisher, the investors could not compel arbitration of their claims against that broker-dealer.⁶⁸

These conflicting decisions demonstrate that courts struggle to come up with a coherent definition of “customer” under Rule 12200, leaving industry firms with a lack of clarity and predictability as to who might be able to compel arbitration of their disputes.

4. Waiver

Litigants seeking to avoid arbitration have sometimes been successful asserting the defense of waiver to a motion to compel arbitration. This is a claim that one party to an arbitration clause has waived its right to arbitrate based on conduct in parallel litigation. While the waiver test varies slightly among the federal circuits, courts typically consider factors such as: (1) the time elapsed from commencement of litigation to the request for arbitration; (2) the amount and nature of litigation, including

⁶⁷ *Cary*, 709 F.3d at 386.

⁶⁸ *Berthel Fisher & Co. Fin’l Serv., Inc.*, 695 F.3d 749 (8th Cir. 2012).

substantive motions and discovery; and (3) prejudice to the party opposing arbitration.⁶⁹

This past year, the Eleventh Circuit held that Wells Fargo Bank, N.A. (for itself and its predecessor Wachovia Bank, N.A.) waived its right to compel arbitration of class action claims alleging that it charged its checking account customers unlawful overdraft fees.⁷⁰ In the proceedings below, Wells Fargo had declined two invitations by the district court to move to compel arbitration. Soon after the Supreme Court's decision in *AT&T Mobility*, however, Wells Fargo "reversed course" and moved to compel arbitration of plaintiffs' claims on an individual basis, but the district court denied the motion on the grounds of waiver.⁷¹

The Eleventh Circuit affirmed, concluding that Wells Fargo's conduct met its two-part waiver test: it had acted inconsistently with its arbitration right by "substantially invoc[ing] the litigation machinery prior to demanding arbitration," and its actions "in some way prejudiced the other party."⁷² In assessing prejudice, the circuit court considered the substantial discovery that the parties already had conducted in the litigation, and at substantial cost.⁷³

The Court of Appeals also rejected Wells Fargo's argument that it would have been futile to move to compel arbitration initially on the grounds that the relevant arbitration

⁶⁹ See, e.g., *Nat'l Union Fire Ins. Co. of Pittsburgh, P.A. v. NCR Corp.*, 376 Fed. Appx. 70, 71 (2d Cir. 2010); see also *Zuckerman Spaeder, LLP v. Aufferberg*, 646 F.3d 919, 924 (D.C. Cir. 2011) ("By this opinion we alert the bar in this Circuit that failure to invoke arbitration at the first available opportunity will presumptively extinguish a client's ability later to opt for arbitration.").

⁷⁰ *Garcia v. Wachovia Corp.*, 699 F.3d 1273, 1278 (11th Cir. 2012).

⁷¹ *Id.* at 1275.

⁷² *Id.* at 1277 (internal quotations and citations omitted).

⁷³ *Id.* at 1279.

clause had a class action waiver that arguably was unenforceable pre-*AT&T Mobility*. Instead, the Court of Appeals found that *AT&T Mobility* “established no new law” and Wells Fargo could have made the same arguments that AT&T successfully made in its case.⁷⁴

This decision signals that financial services institutions that have allowed class actions to go forward in the past on the assumption that class action waivers rendered their arbitration clauses unenforceable likely will be found to have waived their right to compel arbitration of those class claims on an individual basis.

B. Vacatur of Awards

Since the Court’s 2008 decision in *Hall Street Assoc., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008), it is well-established that FAA §10(a) provides the sole grounds for vacating an arbitration award under federal law. Appellate courts have continued to interpret the scope of those grounds over the past year.

1. Procured by fraud

In a decision important to the career of a well-known securities arbitration expert, Dr. Craig McCann, the Fifth Circuit reversed a district court’s decision to vacate a FINRA arbitration award on the ground that, *inter alia*, it was procured by fraud within the meaning of FAA §10(a)(1).⁷⁵ The district court had concluded that Dr. McCann, who had testified as an expert at the arbitration hearing, “knowingly testified to incorrect numbers, and

⁷⁴ *Id.* at 1275, 1279-80.

⁷⁵ *Morgan Keegan & Co., Inc. v. Garrett*, 495 Fed. Appx. 443 (5th Cir. 2012).

‘the [arbitration] panel based its damages calculations on [Dr. McCann’s knowingly false testimony.’”⁷⁶

The Court of Appeals concluded that the district court erred in vacating the award under §10(a)(1). The Court noted that Dr. McCann had provided revised calculations to Morgan Keegan’s lawyers in the context of another arbitration before the issuance of the award in *Garrett*. In addition, Dr. McCann’s calculations relied on Morgan Keegan’s own internal pricing numbers. Had Morgan Keegan performed any due diligence, the appellate court concluded, it could have discovered any alleged fraud on its own, and thus could not meet its burden of proof on the three-prong test for vacatur on this ground.⁷⁷ Thus, the Court of Appeals “expressly vacate[d] the finding that Dr. McCann committed fraud” and reinstated the arbitration award.⁷⁸

2. Evident Partiality

Losing parties to arbitration awards can also seek vacatur pursuant to FAA § 10(a)(2) if they show “evident partiality” in the arbitrators. Courts have had difficulty developing a test for “evident partiality,” since the Supreme Court’s only decision under that subsection is the 45-year old decision in *Commonwealth Coatings v. Continental Casualty Co.*,⁷⁹ and that case yielded plurality and concurring opinions that are difficult to synthesize. Most circuits follow the test set forth by the Second Circuit in *Morelite Constr. v. New York City Dist. Council Carpenters Ben. Funds*,⁸⁰ where the court held that “evident partiality” is “where a

⁷⁶ *Id.* at 445 (citing district court opinion).

⁷⁷ *Id.* at 447.

⁷⁸ *Id.* at 447-48.

⁷⁹ 393 U.S. 145 (1968).

⁸⁰ 748 F.2d 79 (2d Cir. 1984).

reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration.”⁸¹

This past year, the Third Circuit adopted the Second Circuit’s test.⁸² Under that test, the circuit court in *Freeman* concluded that an arbitrator who was formerly a judge did not demonstrate “evident partiality” by failing to disclose she: (1) received small donations to her former judicial campaign from the minority owner of the prevailing party in the arbitration and some of its top-level employees; and (2) taught a seminar on labor law with the prevailing party’s senior employment attorney.⁸³

In contrast, the Sixth Circuit vacated an award on the ground of evident partiality under the same test in an arbitration arising out a contract between an artist and an art dealer.⁸⁴ There, the parties agreed to a tri-partite panel, and the neutral arbitrator selected by the party-appointed arbitrator was Mark Kowalsky. After almost five years and 50 hearing days of the arbitration, Kowalsky disclosed to the artist-claimant that the dealer-respondent as well as its party-appointed arbitrator had both retained Kowalsky’s law firm for other lucrative litigation matters. Subsequent procedural and substantive rulings by Kowalsky in the arbitration all favored the respondent, including the final award.⁸⁵ The circuit court concluded that “[claimant] established a

⁸¹ *Id.* at 83; *see also* *NGC Network Asia, LLC v. PAC Pacific Group Intern., Inc.*, No. 12-00967, 2013 WL 490935 (2d Cir. Feb. 11, 2013) (affirming denial of motion to vacate on grounds of, *inter alia*, evident partiality, where arbitrator had disclosed at time of his selection that his law firm had a business relationship with a company that had an indirect, non-controlling interest in the losing party to the arbitration).

⁸² *See Freeman v. Pittsburgh Glass Works, LLC*, 709 F.3d 240, 252-53 (3d Cir. 2013).

⁸³ *Id.* at 254-56; *see also Morgan Keegan & Co., Inc. v. Grant*, 497 Fed. Appx. 715 (9th Cir. 2012) (no evident partiality from fact that arbitrator sometimes represented investors against brokers in private practice).

⁸⁴ *Thomas Kinkade Co. v. White*, 711 F.3d 719 (6th Cir. 2013).

⁸⁵ *Id.* at 720-23.

convergence of undisputed facts that, considered together, show a motive for Kowalsky to favor the Whites and multiple, concrete actions in which he appeared actually to favor them.”⁸⁶ The appellate court’s opinion harshly criticized Kowalsky for his actions, declaring that “[a] party who pays a neutral arbitrator to prepare for, and then sit through, nearly 50 days of hearing over a five-year period, deserves better treatment than this.”⁸⁷

3. Exceeding powers

Another ground of vacatur under the FAA is that the arbitrators exceeded their powers within the meaning of §10(a)(4). Late last year, a Third Circuit court reversed a district court’s vacatur of a FINRA award on this ground.⁸⁸ There, a financial advisor sought to overturn an award to pay back her former employer, Merrill Lynch, amounts based on a promissory note she signed when she started employment. The district court vacated the award on the ground that the arbitrators “irrationally constru[ed] the parties’ arrangements” and the impact on those arrangements of a settlement of an ERISA action that the broker had brought against Merrill Lynch.⁸⁹

The Court of Appeals held that, to prove arbitrators exceeded their powers under §10(a)(4), a losing party must show that the arbitrators “fashion[ed] an award that cannot ‘be rationally derived from the agreement between the parties or from the parties’ submissions to the arbitrators’ or when the terms of the arbitration award itself ‘are completely irrational.’”⁹⁰ The court found that there was some support in the record for the arbitrators’

⁸⁶ *Id.* at 724.

⁸⁷ *Id.* at 725.

⁸⁸ *See* *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Schwarzfelder*, 496 Fed. Appx. 227 (3d Cir. 2012).

⁸⁹ *Id.* at 230-31.

⁹⁰ *Id.* at 231-32.

interpretation of the financial arrangements. Moreover, even if that interpretation is “open to criticism, ‘[a court] may not overrule an arbitrator simply because [the court] disagree[s].’”⁹¹ Because the Third Circuit concluded that the panel’s decision “can be rationally derived from the parties’ agreements and submissions to the panel,” it did not exceed its powers.⁹²

In the *Garrett* case discussed above in section III.B.1., the Fifth Circuit also reversed the district court’s vacatur of the award on the ground that the panel had exceeded its powers under FAA §10(a)(4) by arbitrating derivative claims and claims brought by claimants who were not “customers” of Morgan Keegan. The Fifth Circuit ruled that, because a FINRA panel has the power under FINRA Rule 12409 to “interpret and determine the applicability of all provisions under the [FINRA Customer] Code,” the arbitrators’ decision to arbitrate those claims could not have exceeded its powers.⁹³

Finally, two state courts in the past year reminded FINRA parties that arbitrators do not exceed their powers by awarding attorney’s fees because FINRA rules provide FINRA arbitrators with the authority to award attorney’s fees under applicable law.⁹⁴

⁹¹ *Id.* at 233 (citations omitted).

⁹² *Id.*

⁹³ *Garrett*, 495 Fed. Appx. at 448-49.

⁹⁴ See *Kaplan v. Shanahan*, 985 N.E.2d 413 (Mass. App. Ct. 2013) (unpub.) (holding that FINRA arbitrators did not exceed their authority by awarding attorney’s fees because FINRA Dispute Resolution Arbitrators’ Guide provides that “attorney’s fees are allowed when the contract includes a clause that provides for the fees and the [sic] all of the parties request or agree to such fees, as was the case in this matter”); *Bear Stearns & Co., Inc. v. Intern. Capital & Management Co. LLC*, 952 N.Y.S.2d 106, 107-08 (N.Y. App. Div. 2012) (holding that FINRA panel did not exceed its powers by awarding attorney’s fees to respondent brokerage firm and its affiliates when claimant sought attorney’s fees in its pleadings, agreed to arbitration pursuant to FINRA rules, which

These decisions collectively reflect that long-standing law that arbitrators have broad powers to award legal and equitable relief, as long as the parties' arbitration agreement vests such power in the arbitrators.

4. Manifest Disregard of the Law

Since the Supreme Court's holding in *Hall St. Assoc., L.L.C. v. Mattel, Inc.*⁹⁵ that parties to an arbitration agreement cannot contractually expand the judicial grounds of review of an award under the FAA, the circuit courts have split on whether an arbitration panel's "manifest disregard of the law" is a valid ground to vacate an arbitration award. The Supreme Court expressly declined to resolve this split in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*⁹⁶ The circuit split continues, as follows:

- The Second, Fourth, Sixth, Seventh and Ninth Circuits acknowledge the continued vitality of the "manifest disregard" ground of vacatur.⁹⁷

specifically authorize an award of attorney's fees, and failed to object to respondents' request for fees).

⁹⁵ 552 U.S. 576 (2008).

⁹⁶ 559 U.S. 662, 130 S. Ct. 1758, 1768 n.3 (2010).

⁹⁷ See *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 548 F.3d 85, 94 (2d Cir. 2008), *vacated on other grounds*, 559 U.S. 662 (2010); *Wachovia Securities, LLC v. Brand*, 671 F.3d 472, 482 (4th Cir. 2012) ("Although we find that manifest disregard continues to exist as either an independent ground for review or as a judicial gloss, we need not decide which of the two it is because Wachovia's claim fails under both"); *Coffee Beanery, Ltd. v. WW, L.L.C.*, 300 Fed. Appx. 415, 419 (6th Cir. 2008); *Affymax, Inc. v. Ortho-McNeil-Janssen Pharmaceuticals, Inc.*, 660 F.3d 281, 285 (7th Cir. 2011) (recognizing "manifest disregard" as a ground to vacate but only for an "award that directs the parties to violate the legal rights of third persons who did not consent to the arbitration"); *Comedy Club, Inc. v. Improv West Assocs.*, 553 F.3d 1277, 1290 (9th Cir. 2009).

- The Fifth, Eighth and Eleventh Circuits have expressly ruled that manifest disregard is no longer a valid vacatur ground.⁹⁸
- The First and D.C. Circuits have addressed “manifest disregard” subsequent to *Hall Street*, but only in *dicta*.⁹⁹
- The Third and Tenth Circuits have expressly declined to address the issue.¹⁰⁰

For those courts that still recognize this ground of vacatur, they often note that it is virtually impossible to determine whether the panel manifestly disregarded the law in the absence of a reasoned or explained award.¹⁰¹ This fact is particularly relevant to FINRA arbitration, because parties have the right to jointly request an explained award under FINRA Rule 12904(g) and 13904(g). In *Murray*, the Sixth Circuit noted that, because claimant never sought an explained award, “[h]e therefore has no

⁹⁸ See *Citigroup Global Markets, Inc. v. Bacon*, 562 F.3d 349, 352 (5th Cir. 2009); *Medicine Shoppe Intern., Inc. v. Turner Investments, Inc.*, 614 F.3d 485 (8th Cir. 2010); *Frazier v. CitiFinancial Corp.*, 604 F.3d 1313, 1324 (11th Cir. 2010).

⁹⁹ See *Kashner Davidson Secs. Corp. v. Mscisz*, 601 F.3d 19, 21 (1st Cir. 2010) (acknowledging that the circuit has “not squarely determined whether our manifest disregard case law can be reconciled with *Hall Street*”); *Affinity Fin. Corp. v. AARP Fin., Inc.*, 468 Fed. Appx. 4, 5 (D.C. Cir. 2012) (“assuming without deciding” that manifest disregard standard still exists after *Hall St.*).

¹⁰⁰ See *Rite Aid New Jersey, Inc. v. United Food Commercial Workers Union, Local 1360*, 449 Fed. Appx. 126, 129 (3d Cir. 2011) (assuming without deciding that the manifest disregard standard survived *Hall Street*); *Abbott v. Law Office of Patrick J. Mulligan*, 440 Fed. Appx. 612, 620 (10th Cir. 2011) (“in the absence of firm guidance from the Supreme Court, we decline to decide whether the manifest disregard standard should be entirely jettisoned”).

¹⁰¹ See *Murray v. Citigroup Global Markets, Inc.*, No. 11-4355, 2013 WL 106826, *2 (6th Cir. Jan. 10, 2013).

one but himself to blame for our inability to assess his manifest-disregard argument.”¹⁰²

IV. Notable State Court Decisions

Because the state courts, like the federal courts, also continue to publish decisions under the FAA at a rapid rate, I could not even begin to cover important state court decisions in the arbitration law area. However, one recent decision caught my eye, as it could mean trouble for FINRA arbitration if other jurisdictions adopt its reasoning.

In April 2013, a Tennessee appellate court refused to enforce a pre-dispute arbitration clause in a brokerage firm’s account agreement with a customer on the grounds that the customer did not sign the arbitration agreement, and, in any event, it was unconscionable under Tennessee law.¹⁰³ The court also affirmed the trial court’s finding that the customer was fraudulently induced to enter into the customer agreement which contained the arbitration clause.¹⁰⁴

In *Webb*, plaintiff Franda Webb sued the broker-dealer affiliate of her bank in circuit court in Knox County, Tennessee, alleging it unsuitably recommended she use funds set aside for the special educational needs of her severely disabled son to purchase

¹⁰² *Id.* at *3. Of course, the court glosses over the fact that it is virtually impossible to get both parties to agree to jointly request an explained award.

¹⁰³ *See Webb v. First Tenn. Brokerage, Inc.*, No. E2012-00934-COA-R3-CV, 2013 Tenn. App. LEXIS 276, *47-52 (Apr. 23, 2013). Because the arbitration clause on its face did not require arbitration of disputes between the customer and an individual account representative, only with the firm itself, the firm’s associated person could not compel arbitration of the dispute with Ms. Webb. *Id.* at *12-18 (quoting lower court’s order).

¹⁰⁴ *Id.* at *53-54.

Lehman Brothers bonds. She alleged she was pressured to purchase \$300,000 of the bonds (which were rendered largely worthless when Lehman filed for bankruptcy later that year) the same day as the recommendation, as she was told they were a “one-day opportunity.”¹⁰⁵ She had little time to review the account application to open the new brokerage account (the funds were in her bank account). She testified that she was not asked to sign an account agreement (which contained an arbitration clause designating FINRA as the forum) and had never seen or discussed an arbitration agreement with the broker.¹⁰⁶ Other facts that emerged in the hearing on the broker’s motion to compel arbitration suggest that no arbitration agreement was found in her customer file at the brokerage firm.¹⁰⁷

The appellate court agreed with the district court’s conclusions that the firm did not prove that Ms. Webb signed the arbitration agreement,¹⁰⁸ and, even if she had, it was unenforceable as an unconscionable contract of adhesion.¹⁰⁹ The appellate court agreed with the trial court that the following factors are relevant to a determination of unconscionability of this agreement under Tennessee law:

- The arbitration clause was part of a contract of adhesion;
- The arbitration clause was on page 11 of a 14-page account agreement;
- The arbitration procedures were not set forth in a separate stand-alone document;
- The arbitration clause did not tell the customer how to initiate arbitration and was misleading;
- Plaintiff was pressured to sign the paperwork quickly;

¹⁰⁵ *Id.* at *4.

¹⁰⁶ *Id.* at *5-7.

¹⁰⁷ *Id.* at *9-11.

¹⁰⁸ *Id.* at *50-52.

¹⁰⁹ *Id.* at *47-50.

- The jury trial waiver language was printed in the same font size, type and color as the rest of the agreement;
- The likely arbitration fees would be “oppressive.”¹¹⁰

The appellate court also noted that Ms. Webb claimed she was fraudulently induced into signing the account agreement, and, under Tennessee law, fraudulent inducement claims are not arbitrable.¹¹¹

Most courts that have previously considered similar challenges to arbitration agreements in broker-dealers’ customer agreements have rejected claims of unconscionability in part because the language and formatting of pre-dispute arbitration clauses in FINRA member firms’ customer agreements is prescribed by FINRA Rule 2268, and FINRA’s arbitration rules are subject to regulatory approval. However, it appears that the arbitration clause that the brokerage firm used in this case did not meet the requirements of FINRA Rule 2268. Thus, it is unlikely that this decision will lead to wide-scale invalidation of arbitration clauses in customer agreements.

Finally, the Florida Supreme Court answered a question “of great public importance” certified to it from a lower court regarding the applicability of statutes of limitation in securities arbitration.¹¹² The Supreme Court of Florida quashed that holding, and concluded that statutes of limitation do apply in arbitration,

¹¹⁰ *Id.* at *20-27.

¹¹¹ *Id.* at *47.

¹¹² *Raymond James Financial Services, Inc. v. Phillips*, __ So.3d __, 2011 WL 5555691 (Fla. Dist. Ct. App. Nov. 16, 2011) (holding Florida statutes of limitation did not apply to FINRA arbitration, but certifying question to Florida high court).

reasoning that an arbitration is a “civil action or proceeding” within the meaning of the statute.¹¹³

¹¹³ Raymond James Financial Services, Inc. v. Phillips, 2013 WL 2096252 (Sup. Ct. Fla. May 16, 2013).