U.S. CHAMBER OF COMMERCE

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July 5, 2013

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: *"Duties of Brokers, Dealers, and Investment Advisers"*
Release No. 34-69013, IA-3558, File No. 4-606

Dear Ms. Murphy:

These comments are submitted on behalf of the U.S. Chamber of Commerce Center for Capital Markets Competitiveness ("CCMC") and the U.S. Chamber Institute for Legal Reform ("ILR"). The U.S. Chamber of Commerce (the "Chamber") is the world's largest business federation, representing the interests of more than three million companies of every size, sector, and region. The Chamber created CCMC to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. ILR is an affiliate of the Chamber dedicated to making our nation's overall civil legal system simpler, fairer and faster for all participants.

ILR and CCMC appreciate the opportunity to submit this letter addressing your request for data and other information "related to the ability of retail consumers to bring claims against their financial professionals," and their experiences in "mediation, arbitration, and litigation." 78 Fed. Reg. 14848, 14853 (Mar. 7, 2013).

The availability of arbitration as a system for resolving disputes—including disputes between retail customers and their broker-dealers and investment advisers—is extremely important to both businesses and investors. Arbitration of investor and consumer disputes has been common practice for over two decades; there are perhaps hundreds of millions of consumer contracts currently in force that include arbitration

agreements—many of them relating to consumer financial products or services. Indeed, arbitration of securities claims by individual investors has long been established under the rules of FINRA and its predecessor organizations. And the Supreme Court has time and again rejected the notion that the federal policy in favor of arbitration embodied in the Federal Arbitration Act (9 U.S.C. §§ 1-16) ("FAA") was not meant to apply to investors and consumers.[1]

Moreover, there is broad recognition of the benefits of arbitration to both businesses and investors. As Congress has explained, ""The advantages of arbitration are many: it is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is often more flexible in regard to scheduling of times and places of hearings and discovery devices.""[2] Indeed, for a large category of injuries suffered by investors and consumers, the choice is "arbitration—or nothing."[3]

For these reasons, it is imperative that in addressing standards of conduct for broker-dealers and investment advisers under Section 913 of the Dodd-Frank Act, the Commission gather all relevant information about the benefits that arbitration provides to retail customers who choose to pursue disputed claims and—in associated rulemaking process—ensure that arbitration is available to resolve disputes. Indeed, Congress itself recognized the need to avoid regulatory activity based on intuition, generalized impressions, or misconceptions (whether based upon an idealized view unrelated to the "facts on the ground" or based upon negative stereotypes not

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[1] The Court has clearly stated that "Congress, when enacting this law, had the needs of consumers, as well as others, in mind." *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 280 (1995). *See also*, *e.g.*, *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006); *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 122-23 (2001) (citing *Allied-Bruce*); *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79 (2000); *Rodriguez de Quijas v. Shearson/Am. Express*, *Inc*. 490 U.S. 477 (1989); *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

[2] *Allied-Bruce Terminix*, 513 U.S. at 280 (quoting H.R. Rep. No.97-542, at 13 (1982), *reprinted in* 1982 U.S.C.C.A.N. 765, 777); *see also*, *e.g.*, *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1749 (2011) ("[T]he informality of arbitral proceedings is itself desirable, reducing the cost and increasing the speed of dispute resolution.").

[3] Theodore J. St. Antoine, *Mandatory Arbitration: Why It's Better Than It Looks*, 41 U. Mich. J.L. Reform 783, 792 (2008) (discussing analogous situation of employees with low-dollar claims).

grounded in the real world), and specifically required the Commission to gather the relevant facts—and report to Congress—***before*** embarking on any rulemaking effort.[4]

We commend the Commission for requesting comments at this stage of rulemakingthe process, so that it may take into account the views of interested parties in determining the ability of retail investors to pursue effectively their claims against broker dealers and investor advisers in arbitration. We also appreciate that the Commission has employed the common-sense notion that arbitration cannot be analyzed in isolation, and that outcomes must be compared to dispute resolution in litigation.

Our comments focus on two fundamental points:

- Arbitration is an effective method of dispute resolution that benefits consumers—including retail investors—by reducing the transaction costs of pursuing claims against broker-dealers and investment advisers, all while providing them with outcomes superior to litigation.

- Because retail investors are not made worse off by entering into pre-dispute arbitration agreements—and virtually always are benefited by such agreements—an investment adviser or broker-dealer who requires clients to enter into such agreements acts consistently with the best interests of the client, and therefore does not violate any duties or standards of conduct owed to the client.

1. Arbitration Provides Significant Benefits To Retail Investors.

The questions posed in the Commission's Request for Information seek data about retail customers' relationships and experiences with their broker dealers and investment advisors. In the part that is relevant to our submission in this letter, the Commission's questions specifically seek data and information about retail customers' resolution of disputes with their broker dealers and investment advisers in mediation, arbitration, and litigation.

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[4] *See* Dodd-Frank Wall Street Reform and Consumer Financial Protection Act, Pub. L. No. 111-203, § 913(d)(1), (f), 124 Stat. 1376, 1827-28 (2010).

The Financial Industry Regulatory Authority ("FINRA"), an industry self-regulatory organization overseen by the Commission, has provided data about its arbitration program. Analysis of that data reveals that arbitration provides an extremely effective means for retail investors to pursue their disputes. And just as important, arbitration produces positive outcomes for retail investors more quickly and at lower costs than the alternatives, such as litigation. [5]

The Securities Industry and Financial Markets Association ("SIFMA") has estimated that FINRA arbitration can cost as little as a quarter of the expense of litigating the claim.[6] The filing fee for a customer with a claim for up to $1,000 is only $50. FINRA Rule 12900(a)(1). But payment of that fee may be deferred upon a showing of financial hardship. *Id.* If the case is not settled before the hearing—as many cases are—the hearing fee is only $50. *Id.* 12902(a)(1). And the arbitrator can allocate even that amount to the defendant, rather than requiring the customer to pay a share of the fee. *Id.* 12902(c).

As one court has observed, the low cost of arbitration of securities claims serves as a "relative economic benefit favoring arbitration for the customer."[7] Because FINRA arbitrations provide access to fair, efficient dispute resolution at a lower cost than litigation, one law professor who represents investors in FINRA arbitrations has explained that retail investors with meritorious claims have an easier time "find[ing] a contingent-fee attorney to handle it [a claim in arbitration], even if it is a small case."[8] Moreover, as Justice Stephen Breyer has reasoned, for "the typical consumer who has only a small damage claim (who seeks, say, the value of only a defective refrigerator or television set)," the costs and delays of proceeding in court "could eat up the value of

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[5] As the Supreme Court has reiterated, arbitration involves "'lower costs'" than litigation in court. *Concepcion*, 131 S. Ct. at 1751 (quoting *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1775 (2010)). And "[p]arties generally favor arbitration precisely because of the economics of dispute resolution." *14 Penn Plaza LLC v. Pyett*, 556 U.S. 247, 257 (2009).

[6] SIFMA, *White Paper on Arbitration in the Securities Industry* 29 (Oct. 2007), available at http://www.sifma.org/uploadedfiles/societies/sifma_compliance_and_legal_society/whitepaperonarbitration-october2007.pdf.

[7] *Sec. Indus. Ass'n v. Connolly*, 703 F. Supp. 146, 159 (D. Mass. 1988), *aff'd*, 883 F.2d 1114 (1st Cir. 1989).

[8] Seth Lipner, "Is Arbitration Really Cheaper?" *Forbes.com* (July 14, 2009), at http://www.forbes.com/2009/07/14/lipner-arbitration-litigation-intelligent-investing-cost.html.

an eventual small recovery."[9] For such a consumer, arbitration may provide the only real-world opportunity to vindicate his or her rights.[10]

Moreover, arbitration in general—and FINRA arbitration in particular—is much faster than litigation in court. In fact, studies confirm that FINRA arbitrators typically resolve cases involving up to $50,000 (which qualify for FINRA's streamlined "simplified arbitration procedures" (FINRA Rule 12800)) in less than a third of the time it takes to litigate in the overburdened federal and state court systems. So far in 2013, FINRA arbitrators have resolved simplified arbitration cases in only 7.4 months (and larger cases in an average of only 14.4 months).[11]

By contrast, civil cases filed in federal district court face delays of almost two years (23.4 months) before reaching trial.[12] In state court, the picture is even grimmer.

In 2001, a contract suit tried before a jury took 25 months on average to reach judgment.[13] Although more recent comprehensive statistics are not available, the current crisis in the funding of state courts has resulted in ever-increasing delays for litigants. According to the American Bar Association's "Task Force on the Preservation of the Justice System," co-chaired by David Boies and Theodore B. Olson, budget shortfalls have led 40 states recently to cut funding to state courts.[14] At least nine states have furloughed judges and 16 have furloughed judicial staff, with

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[9] *Allied-Bruce*, 513 U.S. at 281.

[10] One study of litigation in the employment context concluded that "[e]mployers will wait out most smaller claims, assuming employees will not be able to pursue them in court." St. Antoine, 41 U. MICH. J.L. REFORM at 790 (2008).

[11] FINRA, *Dispute Resolution Statistics* (June 20, 2013), available at http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/Statistics/.

[12] *See* Admin. Office of the U.S. Courts, *Federal Judicial Caseload Statistics* tbl. C-5 (2012), at http://www.uscourts.gov/Viewer.aspx?doc=uscourts/Statistics/FederalJudicialCaseloadStatistics/2012/tables/C05Mar12.pdf (reporting data for the 12-month period ending in March 2012).

[13] *See* Bureau of Justice Statistics, *Contract Trials and Verdicts in Large Counties, 2001*, at 2 (Jan. 2005), at http://www.bjs.gov/content/pub/pdf/ctvlc01.pdf

[14] Am. Bar Ass'n, *The Growing Crisis of Underfunding State Courts* 1 (Mar. 16, 2011), at http://www.abanow.org/wordpress/wp-content/files_flutter/1300290469court_funding_crisis_background2.pdf.

California closing courtrooms and clerks' offices in 24 counties.[15] Courts in many states have delayed trials, with New Hampshire deferring all civil trials for one year.[16] Participants in FINRA arbitrations avoid all of these delays.

But individual FINRA arbitration is not merely efficient and quick. It also does a far better job than lawyer-driven class actions do of securing recoveries for investors with legitimate injuries. A study of FINRA's docket reveals that, in 2012, customers were able to obtain settlements in approximately 60 percent of cases, and prevailed in 45 percent of cases that reach a hearing.[17] In other words, approximately 78 percent of FINRA arbitrations filed by customers resulted, through settlements or awards, in a

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[15] William T. Robinson, *ABA President Robinson Explains Nationwide Crisis on Dwindling Court Budgets* (Aug. 4, 2011), at http://www.abanow.org/2011/08/bill-robinson-speaks-on-court-underfunding/ (video); Erin Coe, *California Justice Warns of Looming Case Delays*, LAW360, Mar. 19, 2012, at http://www.law360.com/legalindustry/articles/319086.

[16] Am. Bar Ass'n, *supra* note 14, at 1; *Courts to Be Closed Some Mornings*, Morning Sentinel, Aug. 30, 2010, at 2010 WLNR 17475261; Tim Carpenter, *Nuss Orders 5-day Furlough, Court Closure*, TOPEKA CAPITAL J., Apr. 4, 2012, at http://www.cjonline.com/news/2012-04-04/nuss-orders-5-day-furlough-court-closure; Rebecca Webster, *Local Courts Suffer from Budget Cuts*, Press-Republican (Plattsburgh, N.Y.), Mar. 7, 2012.

[17] *See* FINRA, *supra* note 11. Consumers in previous years obtained similar win rates. *See id.* (customers prevailed in 45 percent of arbitrated cases in 2009, 47 percent in 2010, and 44 percent in 2011). Moreover, a study of all arbitrations by self-regulatory organizations ("SROs"), such as FINRA and its predecessor NASD, found that consumers prevailed in 52.26 percent of arbitrations resolved between 1980 and 2001. *See* Michael A. Perino, *Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations* 42 (Nov. 4, 2002).

recovery for the investor.[18] In federal court, by contrast, only 1.1 percent of civil cases ever reach trial.[19]

In addition to all these advantages, arbitration administered by the SROs also resolves retail investors' disputes to their satisfaction. One study on behalf of NASD examined survey responses from 415 parties to NASD arbitrations, administered from 1997 to 1999, and found that an astounding 92% of participants believed that arbitrators displayed fairness in their cases and sensitivity to the parties, and used unbiased language. Claimants were more strongly in favor of the arbitration process than respondents.[20]

These favorable results for retail investors are consistent with the many studies outside the FINRA context that show that consumers and employees who arbitrate their claims against businesses are at least as likely—if not more likely—to prevail than consumers or employers who proceed in court. For example, one study of employment arbitration in the securities industry concluded that employees who arbitrate were 12 percent more likely to win their disputes than employees litigating in federal court.[21] Another study of the arbitration of employment-discrimination claims concluded that arbitration is "substantially fair to employees, including those

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[18] *See* FINRA, *supra* note 11. The General Accounting Office, in 2002, updated a 1992 study on arbitrations under the auspices of the National Association of Securities Dealers ("NASD"), the predecessor to FINRA, and the New York Stock Exchange ("NYSE"). The GAO's report found that while the overall win rate for investors had declined, the percentage of settlements had increased; attorneys fees were liberally awarded, and punitive damages were frequently awarded. Arbitrations were, on average, two times faster than the few securities claims to have reached final judgment in court. *See* GAO Report to Congressional Requesters, *Securities Arbitration: Actions Needed to Address Problem of Unpaid Awards* (June 2000), at http://www.gao.gov/archive/2000/gg00115.pdf.

[19] *See* Admin. Office of the U.S. Courts, *Federal Judicial Caseload Statistics* tbl. C-4 (2012), at http://www.uscourts.gov/Viewer.aspx?doc=uscourts/Statistics/FederalJudicialCaseloadStatistics/2012/tables/C04Mar12.pdf (reporting data for the 12-month period ending in March 2012).

[20] Gary Tidwell, et al., *Party Evaluation of Arbitrators: An Analysis of Data Collected from NASD Regulation Arbitrations*, presented to National Meeting, Academy of Legal Studies in Business (Aug. 5, 1999).

[21] *See* Michael Delikat & Morris M. Kleiner, *An Empirical Study of Dispute Resolution Mechanisms: Where Do Plaintiffs Better Vindicate Their Rights?*, 58 DISP. RESOL. J. 56, 58 (Nov. 2003-Jan. 2004).

employees at the lower end of the income scale," with employees enjoying a win rate comparable to the win rate of employees proceeding in federal court.[22]

Similarly, statistics regarding consumer claims resolved by the American Arbitration Association ("AAA") show that consumers obtain settlements in 60 percent of the cases they bring against businesses and, in the remaining 40 percent of cases, prevail roughly half (48 percent) of the time.[23] Other studies of consumer arbitration covering different time periods have found even higher win rates for consumers for arbitrations that are not settled.[24]

In short, FINRA arbitration—like arbitration in other contexts—allows retail investors to obtain redress faster, cheaper, and more effectively than they could in court.[25]

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[22] *See* Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at Low Cost*, 58 DISP. RESOL. J. 9, 13 (May 2003-July 2003) (reporting employee win rate in arbitration of 43 percent); *see also* Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 DISP. RESOL. J. 44, 48 tbl. 1 (Nov. 2003-Jan.2004) (reporting employee win rate in federal district court during the same time period was 36.4 percent); Lewis T. Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 46 (1998) (concluding that employees who arbitrate prevail more often than employees who litigate).

[23] *See* AAA, *Analysis of the American Arbitration Association's Consumer Arbitration Caseload* 1 (Nov. 2011), at http://www.adr.org/aaa/ShowPDF?doc=ADRSTG_004325 (studying consumer arbitration awards issued between January and August 2007).

[24] *See, e.g.*, Searle Civil Justice Inst., *Consumer Arbitration Before the American Arbitration Association Preliminary Report* 68 (2009), at http://www.adr.org/aaa/faces/aoe/gc/consumer (reporting consumer win rate of 53.3 percent in consumer-initiated arbitrations that reached a decision between April and December 2007); Cal. Disp. Resol. Inst., *Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure* 25 (Aug. 2004), at http://www.mediate.com/cdri/cdri_print_aug_6.pdf (finding 71 percent win rate for consumers in consumer-initiated arbitrations during 2003 in which the identity of the prevailing party was reported); Ernst & Young, *Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases* 2 (2004), at http://www.adrforum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005ErnstAndYoung.pdf (finding 55 percent consumer win rate in consumer-initiated arbitrations that reached a decision).

[25] Some opponents of arbitration point to the fact that class actions are available in court but arbitration generally proceeds on an individualized basis, asserting that class procedures are

2. Pre-Dispute Arbitration Agreements Are Fully Consistent With Any Duties The Commission Might Impose On Broker Dealers and Investment Advisers.

In the previous section, we explained why arbitration leads to superior outcomes for retail investors when compared to the alternatives, such as litigation. Here, we do not take a position on the substantive question presented by the Commission's Request for Information—the proposed uniform standard of conduct for broker-dealers and investment advisers. Rather, we explain why mandatory pre-dispute arbitration agreements are fully consistent with any duties and standards that the Commission ultimately decides to adopt (or not adopt).

Massachusetts Secretary of State William Galvin has written to the Commission urging it to exercise its authority under Section 921 of the Dodd-Frank Act to study pre-dispute arbitration agreements. In his February 12, 2013, letter, Secretary Galvin suggested that "a clause binding an investor to arbitration before the circumstances are known may not be in the client's best interest nor consistent with an investment adviser's fiduciary duty."[26] Secretary Galvin's office surveyed Massachusetts investment adviser firms and found that 40% (147) of the responding firms (370)

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essential to enable plaintiffs to vindicate their rights. As the Chamber explained in its amicus brief filed in *Department of Enforcement v. Charles Schwab & Co., Inc.*, Disciplinary Proceeding No. 2011029760201 (FINRA Nat'l Adjudicatory Council)—a copy of which is attached to these comments—most claims asserted by retail investors are not even susceptible to class treatment and, for those that are, individualized arbitration enables investors to vindicate legitimate claims. That conclusion is confirmed by the Supreme Court's recent decision in *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013). The dissenting opinion in that case would have held arbitration agreements unenforceable if they prevented the "effective vindication" of a federal right, but it made clear that class procedures ***are not essential*** to satisfying that standard: an arbitration agreement "could have prohibited class arbitration without offending the effective-vindication rule *if* it had provided an alternative mechanism to share, shift, or reduce the necessary costs." *Id*. at 2318 (Kagan, J., dissenting). The dissent specifically identified as sufficient mechanisms "joinder or consolidation of claims"; "informal coordination among individual claimants"—the sharing by individual claimants of the costs of litigating and proving their claims, such as "informally arranging with other merchants to produce a common expert report"; and "amelioration of arbitral expenses." *Id*. One or more of these mechanisms is permissible under virtually all arbitration agreements.

[26] *See* Letter from William F. Galvin to Chairman Elisse Walter, et al., *Re: Prohibiting the Use of Mandatory Pre-Dispute Arbitration Clauses by Investment Advisers* (Feb. 12, 2013), at http://www.sec.state.ma.us/sct/sctarbitration/arbitration-letter.pdf.

included mandatory pre-dispute arbitration clauses in their advisory contracts. Of those who did, 65% (95) designated a particular arbitrator. Of that subset 65% (60) designated the AAA, and 16% (15) designated FINRA.[27] From this data, Secretary Galvin concluded without further analysis that when investment advisers adopt such pre-dispute arbitration agreements, they risk violating duties owed to their retail investor clients.

That view is mistaken. It rests on the completely erroneous premise that arbitration provides retail investors with worse outcomes than proceeding in court. As we explained in the previous section of this letter, arbitration leaves investors at least as well off—and virtually always better off—than if they had pursued their claims in court. And that may be especially true for individualized claims typically asserted by retail investors for which lower-cost arbitration under FINRA or another provider may be many retail investors' ***only*** real chance to have their disputes resolved by an impartial decisionmaker.

There is no empirical basis for concluding that mandatory pre-dispute arbitration clauses are against the best interests of retail investors. Rather, as we have shown, the available evidence is entirely to the contrary: arbitration is an effective and low-cost method of resolving disputes arising out of a retail investor's relationship with an adviser or a broker-dealer. Accordingly, an investment adviser or broker-dealer who adopts such a clause would not thereby breach a fiduciary duty to the investor.

What is more, Secretary Galvin provides no basis in law for his unreasoned premise that pre-dispute arbitration agreements violate duties to principals or clients. Secretary Galvin cites no authority from any jurisdiction—not even his home state—that would establish that a pre-dispute arbitration agreement would violate a fiduciary or analogous duty. (Nor could state law discriminate against arbitration in that way–

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[27] *See* Massachusetts Securities Division Staff, *Report on Massachusetts Investment Advisers' Use of Mandatory Pre-Dispute Arbitration Clauses in Investment Advisory Contracts* (Feb. 11, 2013), at http://www.sec.state.ma.us/sct/sctarbitration/Report%20on%20MA%20IAs'%20Use%20of%20MPDACs.pdf. To use FINRA's arbitration program, investment advisers (as compared to broker-dealers) must enter into a post-dispute agreement to arbitrate. *See* FINRA, *Guidance on Disputes between Investors and Investment Advisers who are not FINRA-regulated firms*, at http://www.finra.org/ArbitrationAndMediation/Arbitration/SpecialProcedures/P196162.

certainly not without running afoul of the Federal Arbitration Act.[28]) And to our knowledge, Massachusetts does not single out arbitration agreements in that manner.

Indeed, in another context Massachusetts law is clear that fiduciaries may require their clients to enter into pre-dispute arbitration agreements. Attorneys licensed in Massachusetts owe their clients fiduciary duties.[29] Yet the Massachusetts Supreme Judicial Court has recently rejected the argument that attorneys who insist on mandatory pre-dispute arbitration agreements concerning fee disputes thereby violate their professional duties to their clients under the Massachusetts Rules of Professional Conduct.[30]

Whether or not the Commission implements uniform standards of conduct on broker-dealers and investment advisors, there is no reason for the Commission to prohibit, limit, or impose conditions upon the use of pre-dispute arbitration agreements between such professionals and their retail-investor clients. The Commission should reaffirm its support for the FINRA arbitration regime, which has proven itself to be an effective system for resolving investors' disputes with broker-dealers.

And even if the Commission decides to impose analogous standards of conduct on investment advisers, it should consider ways in which FINRA and other arbitration providers offer the simplicity, efficiency, and procedural fairness that make arbitration a desirable forum for dispute resolution.

With respect to investment advisors—who are currently eligible to participate in FINRA arbitrations only if they enter into post-dispute arbitration agreements—the Commission should authorize the same pre-dispute arbitration agreements that are permissible in the broker-dealer context. The current prohibition on such agreements

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[28] *See* 9 U.S.C. §§ 1 *et seq*. As the Supreme Court recently explained, "[w]hen state law prohibits outright the arbitration of a particular type of claim"—such as a claim by a retail investor against a broker-dealer or an investment advisor—"the analysis is straightforward: The conflicting rule is displaced by the FAA." *Concepcion*, 131 S. Ct. at 1747. Moreover, a state-law rule discriminating against arbitration agreements between fiduciaries and their principals would be invalid because it violates the principle that "courts must place arbitration agreements on an equal footing with other contracts" and "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Id*. at 1745, 1753.

[29] *See, e.g., Hendrickson v. Sears*, 310 N.E.2d 131, 135 (Mass. 1974).

[30] *See In re Discipline of an Attorney*, 884 N.E.2d 450, 460 n.13 (Mass. 2008).

significantly reduces the ability of parties to utilize arbitration—for example, where an investor asserts a relatively small individualized claim that as a practical matter cannot be litigated in court, the investment advisor has little incentive to agree to arbitration. Indeed, all available information indicates that post-dispute arbitration is rarely utilized.[31]

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We thank you for your consideration of these comments and would be happy to discuss these issues further with the Commission's staff.

Sincerely,

David Hirschmann
President and Chief Executive Officer
Center for Capital Markets Competitiveness
U.S. Chamber of Commerce

Lisa A. Rickard
President
U.S. Chamber Institute for
Legal Reform

Attachment

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[31] For example, a study of employment arbitrations administered by the American Arbitration Association found that only 6% of arbitrations in 2001 and 2.6% of arbitrations in 2002 were the result of a post-dispute agreement to arbitrate. *See* Lewis L. Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313, 314 (2003). Another study found that, of several thousand employment cases initiated before the Illinois Human Rights Commission ("IHRC") over a five-year period, the parties agreed to arbitrate in few (far less than 1%), if any, cases. This was despite the fact that the IHRC organized the arbitration program and affirmatively offered the option to the parties. *See* David Sherwyn, *Because It Takes Two: Why Post-Dispute Voluntary Arbitration Programs Will Fail to Fix the Problems Associated with Employment Discrimination Law Adjudication,* 24 BERKELEY J. EMP. & LAB. L. 1, 61-62 (2003).

DISCIPLINARY Proceeding No. 2011029760201

Financial Industry Regulatory Authority
National Adjudicatory Counsel

Department of Enforcement,

Complainant,

vs.

Charles Schwab & Company, Inc. (CRD No. 5393),

Respondent.

BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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INTRODUCTION

The Disciplinary Panel in this matter recognized that the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16, requires that the arbitration agreements between respondent Charles Schwab & Co., Inc. ("Schwab") and its customers—under which parties must arbitrate their disputes on an individual basis—be enforced as written.[1]

In supporting the Department of Enforcement's attack on the Disciplinary Panel's reading of the FAA, the Department's *amici* assert that only class actions—and not individual FINRA arbitrations—can provide redress to Schwab's customers. As we explain, that contention is misguided. *Amicus curiae* The Chamber of Commerce of the United States of America represents 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every size, from every region of the country, and in every industry sector—including the financial services industry. Chamber members have entered into hundreds of millions of arbitration agreements with individuals in which both parties agreed to resolve their disputes

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[1] All parties to this proceeding have consented to the filing of this brief. No party to this proceeding or their counsel authored this brief, in whole or in part. Nor did any party or their counsel make a monetary contribution intended to fund either the preparation or the submission of this brief. No person other than the Chamber of Commerce of the United States of America, its members, or its counsel made a monetary contribution to the preparation or submission of this brief.

through individual arbitration, and have substantial experience before every major arbitration provider—including FINRA. Moreover, Chamber members have intimate familiarity with how class-action litigation functions (or more precisely, fails to function) in practice.

In the experience of the Chamber and its members, the *amici* supporting the Department of Enforcement have it exactly backwards—individual arbitration before FINRA is a proven mechanism for providing fair outcomes to customers of broker-dealers (such as Schwab). As this tribunal well knows, FINRA arbitration is a fast, inexpensive, and fair way for investors to obtain redress for any harms they may have suffered. The data bear this out: customers who arbitrate before FINRA pay less in costs and prevail more often than plaintiffs who litigate in court. And FINRA arbitration takes a fraction of the time that a lawsuit in federal or state court would take.

By contrast, the notion that class actions provide meaningful relief to injured investors is a mirage: Class actions principally benefit the lawyers—those who bring the cases and those who defend them. Certainly there is no evidence that class actions effectively target compensation to plaintiffs who are actually injured. To the contrary, because virtually every class action that is certified results in a settlement, and the settlements fall within a narrow range tied principally to size of the potential claim, all of the evidence indicates that class action settlements

overcompensate plaintiffs with meritless claims by providing relief to those who deserve none, and undercompensate those who may actually be injured. According to a study of all securities class actions filed and resolved between January 2000 and December 2012:

- Courts grant motions to dismiss the complaint in a significant number of securities class actions—after inflicting significant defense costs on the parties sued.
- The very few class actions that are certified settle for large payments to the class counsel and relatively little for class members. In 2012, class members in the median securities class action settlement recovered only 1.8 percent of their alleged losses.
- In other words, the median recovery from the typical securities class action currently is a paltry 0.18 percent of alleged investor losses.[2]

Despite this powerful evidence that securities class actions are wasteful and ineffective, the Department's *amici* suggest that class procedures are essential to enable investors to remedy wrongdoing. But the reality is otherwise: Even assuming that it were not possible for an investor to "go it alone," investors and their counsel can readily pool resources and share costs in pursuing their claims

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[2] *See* NERA Economic Consulting, *Recent Trends in Securities Class Action Litigation: 2012 Full-Year Review* (Jan. 29, 2013), *at* http://www.nera.com/67_7992.htm.

against broker-dealers. They are, for example, free to cooperate in developing shared evidence and theories of liability and to split the cost of attorney time and expert witness fees among numerous cases. Indeed, in the experience of Chamber members, members of the plaintiffs' bar are doing precisely that. And in Schwab's case, customers are free to use joinder or other consolidation devices (apart from class actions) to aggregate individual claims in arbitration. All that is prohibited are the class actions that impose huge costs and provide little benefit to actually injured customers in the judicial litigation context.

Finally, the Department's *amici* fail to recognize that arbitration serves individual investors well, and that requiring broker-dealers and their customers to exempt class actions from their arbitration agreements would affirmatively harm investors. Because defending class actions is enormously expensive, the higher cost of dispute resolution for broker-dealers is passed along to investors in the form of higher fees and commissions.

In sum, the Disciplinary Panel's ruling that Schwab's arbitration agreements are enforceable should be affirmed.

ARGUMENT

I. INDIVIDUAL ARBITRATION IS AN EFFECTIVE MEANS OF PROVIDING REDRESS TO CLAIMANTS.

Arbitration of disputes between broker-dealers and their customers on an individual basis before FINRA is inexpensive, fast, and fair. All parties involved

benefit from this manner of resolving disputes.

To begin with, as the Supreme Court has reiterated, arbitration involves "'lower costs'" than litigation in court. *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1751 (2011) (quoting *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1775 (2010)). And "[p]arties generally favor arbitration precisely because of the economics of dispute resolution." *14 Penn Plaza LLC v. Pyett*, 556 U.S. 247, 257 (2009).

Those who stand to benefit the most from the cost savings of arbitration are individuals with modest claims that otherwise would be priced out of court. As Justice Breyer has put it, "arbitration's advantages often would seem helpful to individuals . . . who need a less expensive alternative to litigation." *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 280 (1995). Without arbitration, "the typical consumer who has only a small damage claim" would be left "without any remedy but a court remedy, the costs and delays of which could eat up the value of an eventual small recovery." *Id.* at 281.

FINRA arbitration is no exception. The Securities Industry and Financial Markets Association ("SIFMA") has estimated that FINRA arbitration may cost as little as a quarter of the expense of litigating the claim. SIFMA, *White Paper on Arbitration in the Securities Industry* 29 (Oct. 2007). And FINRA's fee schedule is tailored to the needs of customers with even small claims. For example, the

filing fee for a customer with a claim for up to $1,000 is only $50. FINRA Rule 12900(a)(1). But payment of that fee may be deferred upon a showing of financial hardship. *Id.* If the case is not settled before the hearing—as many cases are—the hearing fee is only $50. *Id.* 12902(a)(1). And the arbitrator can allocate even that amount to the defendant, rather than requiring the customer to pay a share of the fee. *Id.* 12902(c). As one court has observed, the low cost of arbitration of securities claims serves as a "relative economic benefit favoring arbitration for the customer." *Sec. Indus. Ass'n v. Connolly*, 703 F. Supp. 146, 159 (D. Mass. 1988), *aff'd*, 883 F.2d 1114 (1st Cir. 1989).

Moreover, arbitration in general—and FINRA arbitration in particular—is much faster than litigation in court. In fact, studies confirm that FINRA arbitrators typically resolve cases for up to $50,000 (which qualify for FINRA's streamlined "simplified arbitration procedures" (FINRA Rule 12800)) in less than a third of the time it takes to litigate in the overburdened federal and state court systems. So far in 2013, FINRA arbitrators have resolved simplified arbitration cases in only 7.4 months (and larger cases in an average of only 14.4 months). FINRA, Dispute Resolution Statistics, *at* http://www.finra.org/ArbitrationAndMediation/FINRA DisputeResolution/AdditionalResources/Statistics/. By contrast, civil cases filed in federal district court face delays of almost two years (23.4 months) before reaching

trial.[3]

In state court, the picture is even more grim. In 2001, a contract suit tried before a jury took 25 months on average to reach judgment.[4] Although more recent comprehensive statistics are not available, the current crisis in the funding of state courts has resulted in ever-increasing delays for litigants. According to the American Bar Association's "Task Force on the Preservation of the Justice System," co-chaired by David Boies and Theodore B. Olson, budget shortfalls have led 40 states recently to cut funding to state courts.[5] At least nine states have furloughed judges and 16 have furloughed judicial staff, with California closing courtrooms and clerks' offices in 24 counties.[6] Courts in many states have delayed

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[3] *See* Admin. Office of the U.S. Courts, Federal Judicial Caseload Statistics tbl. C-5 (2012), *at* http://www.uscourts.gov/Viewer.aspx?doc=/uscourts/Statistics/FederalJudicialCaseloadStatistics/2012/tables/C05Mar12.pdf (reporting data for the 12-month period ending in March 2012).

[4] *See* Bureau of Justice Statistics, *Contract Trials and Verdicts in Large Counties, 2001*, at 2 (Jan. 2005), *at* http://www.bjs.gov/content/pub/pdf/ctvlc01.pdf.

[5] Am. Bar Ass'n, *The Growing Crisis of Underfunding State Courts* 1 (Mar. 16, 2011), *at* http://www.abanow.org/wordpress/wpcontent/files_flutter/1300287161court_funding_crisis_background.pdf (citing Nat'l Ctr. for State Courts, *State Activities Map, Budget Shortfalls by State*, *at* http://www.ncsc.org/Information-and-Resources/Budget-Resource-Center/States-activities-map.aspx).

[6] William T. Robinson, ABA President Robinson Explains Nationwide Crisis in Dwindling Court Budgets (Aug. 4, 2011) *at* http://www.abanow.org/2011/08/bill-robinson-speaks-on-court-underfunding/ (video); Am. Bar Ass'n, *supra* note 5, at 1; Erin Coe, *California Justice Warns of Looming Case Delays*, LAW360, Mar. 19, 2012, *at* http://www.law360.com/legalindustry/articles/319086.

trials, with New Hampshire deferring all civil trials for one year.[7] Participants in FINRA arbitrations avoid all of these delays.

But individual FINRA arbitration is not merely efficient and quick. It also does a far better job than lawyer-driven class actions do of securing recoveries for investors with legitimate injuries. In federal court, only 1.1 percent of civil cases ever reach trial.[8] Fewer than 10 percent of securities class actions are ever certified, with being dismissed under the heightened pleading standards of the Private Securities Litigation Reform Act of 1995, Pub. L. 104-67, 109 Stat. 737, or are rejected at summary judgment.[9] By contrast, a study of FINRA's docket has confirmed that, in 2012, customers were able to obtain settlements in approximately 60 percent of cases, and prevailed in 45 percent of cases that reach a

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[7] Am. Bar Ass'n, *supra* note 5, at 1; *Courts to Be Closed Some Mornings*, MORNING SENTINEL, Aug. 30, 2010, *at* 2010 WLNR 17475261; Tim Carpenter, *Nuss Orders 5-day Furlough, Court Closure*, TOPEKA CAPITAL J., Apr. 4, 2012, *at* http://www.cjonline.com/news/2012-04-04/nuss-orders-5-day-furlough-court-closure; Rebecca Webster, *Local Courts Suffer from Budget Cuts*, PRESS-REPUBLICAN (Plattsburgh, N.Y.), Mar. 7, 2012.

[8] *See* Admin. Office of the U.S. Courts, Federal Judicial Caseload Statistics tbl. C-4 (2012), *at* http://www.uscourts.gov/Viewer.aspx?doc=/uscourts/Statistics/FederalJudicialCaseloadStatistics/2012/tables/C04Mar12.pdf (reporting data for the 12-month period ending in March 2012).

[9] *See* NERA Economic Consulting, *Recent Trends in Securities Class Action Litigation: 2012 Full-Year Review* 20 (Jan. 29, 2013), *at* http://www.nera.com/67_7992.htm.

hearing.[10] In other words, approximately 78 percent of FINRA arbitrations filed by customers resulted, through settlements or awards, in a recovery for the investor.[11]

These favorable results for customers are consistent with the many studies outside the FINRA context that show that consumers and employees who choose to arbitrate their claims against businesses on an individual basis are at least as likely—if not more likely—to prevail than consumers or employees who proceed in court, particularly those who are unwittingly swept up in a massive class action. For example, one study of employment arbitration in the securities industry concluded that employees who arbitrate were 12 percent more likely to win their disputes than employees litigating in federal court.[12] Another study of the arbitration of employment-discrimination claims concluded that arbitration is "substantially fair to employees, including those employees at the lower end of the income scale," with employees enjoying a win rate comparable to the win rate of

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[10] *See* FINRA, Dispute Resolution Statistics, *supra*. Customers in previous years obtained similar win rates. *See id.* (customers prevailed in 45 percent of cases in 2009, 47 percent in 2010, and 44 percent in 2011). Moreover, a study of all arbitrations by self-regulatory organizations ("SROs"), such as FINRA and its predecessor NASD, found that customers prevailed in 52.26 percent of arbitrations resolved between 1980 and 2001. *See* Michael A. Perino, *Report to the Securities Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations* 42 (Nov. 4, 2002)

[11] *See* FINRA, Dispute Resolution Statistics, *supra*.

[12] *See* Michael Delikat & Morris M. Kleiner, *An Empirical Study of Dispute Resolution Mechanisms: Where Do Plaintiffs Better Vindicate Their Rights?*, 58 DISP. RESOL. J. 56, 58 (Nov. 2003-Jan. 2004).

employees proceeding in federal court.[13]

Similarly, statistics regarding consumer claims resolved by the American Arbitration Association show that consumers obtain settlements in 60 percent of the cases they bring against businesses and, in the remaining 40 percent of cases, prevail roughly half (48 percent) of the time.[14] Other studies of consumer arbitration covering different time periods have found even higher win rates for consumers for arbitrations that are not settled.[15]

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[13] *See* Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at Low Cost*, 58 DISP. RESOL. J. 9, 13 (May/July 2003) (reporting employee win rate in arbitration of 43 percent); *see also* Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 DISP. RESOL. J. 44, 48 tbl. 1 (Nov. 2003/Jan. 2004) (reporting employee win rate in federal district court during the same time period was 36.4 percent); Lewis L. Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 46 (1998) (concluding that employees who arbitrate prevail more often than employees who litigate).

[14] See Am. Arbitration Ass'n, Analysis of the American Arbitration Association's Consumer Arbitration Caseload 1, *at* http://www.adr.org/aaa/ShowPDF?doc=ADRSTG_004325 (studying consumer arbitration awards issued between January and August 2007).

[15] *See, e.g.*, Searle Civil Justice Inst., *Consumer Arbitration Before the American Arbitration Association Preliminary Report* 68 (2009), *at* http://www.adr.org/aaa/faces/aoe/gc/consumer (reporting consumer win rate of 53.3 percent in consumer-initiated arbitrations that reached a decision between April and December 2007); Cal. Disp. Resol. Inst., *Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure* 25 (Aug. 2004), *at* http://www.mediate.com/cdri/cdri_print_aug_6.pdf (finding 71 percent win rate for consumers in consumer-initiated arbitrations during 2003 in which the identity of the prevailing party was reported); Ernst & Young, *Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases* 2 (2004), *at* http://www.adrforum.

In short, FINRA arbitration allows customers to obtain redress faster and cheaper and more likely than they could in court.

II. CLASS-ACTION PROCEDURES ARE NOT NECESSARY TO PROVIDE RELIEF TO CLAIMANTS.

The *amici* supporting the Department of Enforcement contend that class actions are indispensible for customers. But that argument rests upon profoundly mistaken assumptions about how securities class actions and individual arbitrations function in practice.

A. Securities Class Actions Are Enormously Costly For Businesses And Rarely Benefit Investors.

The reality is that class actions are no panacea. Quite the opposite: They impose massive costs on businesses yet rarely, if ever, provide any meaningful relief to claimants with legitimate claims. In the aggregate, businesses spend billions in legal fees and costs in defending class actions, not to mention the business disruptions caused by compliance with unnecessarily burdensome discovery requests—the favorite weapon of a lawyer seeking to leverage a class action into a blackmail settlement.[16]

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com/rcontrol/documents/ResearchStudiesAndStatistics/2005ErnstAndYoung.pdf (finding 55 percent consumer win rate in consumer-initiated arbitrations that reached a decision).

[16] *See, e.g.*, The 2013 Carlton Fields Class Action Survey 6, *available at* http://www.classactionsurvey.com/ (reporting that in a survey of 368 in-house counsel, their companies spent $2.1 billion in legal costs in defending class actions in 2012).

For all of these enormous costs, class actions provide very little to injured investors. To begin with, most securities class actions are not aimed at broker-dealers. Of the 207 securities class actions filed last year, just 13 percent targeted entities in the financial industry, such as broker-dealers. NERA Economic Consulting, *Recent Trends in Securities Class Action Litigation: 2012 Full-Year Review* 4, 10 (Jan. 29, 2013) ("NERA Study"), *at* http://www.nera.com/67_7992.htm.

And many of those are meritless. Most fail at the motion-to-dismiss or class-certification stages. *Id.* at 16, 20.

The claim that class actions are essential because they frequently provide injured investors with relief is thus plainly wrong. The vast majority of these cases provide no benefits at all to the claimants. What class actions do is to impose huge costs on businesses that are passed through to customers in the form of higher prices and to investors in the form of lower returns.

Even those class actions that are eventually certified do not target relief on injured parties. That is because virtually every securities class action that is certified results in a class settlement. Since the enactment of the PSLRA in 1995, only 14 securities class actions have ever been tried to a verdict. *See id.* at 38-39 & tbl. 2 (listing cases). And the certified class actions that are not tried invariably settle for a tiny fraction of the amount in dispute: Although class counsel typically

is rewarded handsomely, the median settlement recovery in securities fraud class actions in 2012 was only 1.8 percent of total alleged investor losses. *Id.* at 33.

This arithmetic reveals the unpleasant truth about securities class actions: Despite the payments to the class counsel and the tremendous costs associated with litigating a securities class action, the typical securities class action gives class members less than a 10 percent chance to recover about 1.8 percent of their alleged losses. In other words, for every class action filed, the defendants can expect to waste enormous sums in defense costs, but absent class members can expect a median recovery of only about 0.18 percent of their alleged losses.[17]

To be sure, these statistics are derived from the entire gamut of securities class actions, including many types of cases that would not be filed against broker-dealers. But class certification—and hence recovery—is often even *more* difficult in broker-dealer cases than in the typical securities fraud action against an issuer of securities, because the plaintiff in a class action against a broker-dealer frequently cannot rely on the fraud-on-the-market presumption of reliance. *See, e.g.*, *Levitt v. J.P. Morgan Sec., Inc.*, 710 F.3d 454 (2d Cir. 2013). And in cases alleging that

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[17] Specifically, if motions for class certification are filed in only 23 percent of securities class actions, only 43.2 percent of those motions are granted, and the certified class actions result in settlements providing class members with 1.8 percent of their alleged losses, the typical class action yields an expected recovery of 0.18 percent (*i.e.*, 1.8 percent of 43.2 percent of 23 percent). *See* NERA Study, *supra*, at 16-33.

broker-dealers have violated the duty of best execution, plaintiffs often cannot establish economic loss on a class-wide basis. *See, e.g.*, *Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 178-81 (3d Cir. 2001). In other cases, putative class actions against broker-dealers founder well before the class-certification stage. *See, e.g.*, *Wilson v. Merrill Lynch & Co.*, 671 F.3d 120 (2d Cir. 2011); *In re JP Morgan Auction Rate Sec. (ARS) Mktg. Litig.*, 867 F. Supp. 2d 407 (S.D.N.Y. 2012); *In re Citigroup, Inc.*, 2011 WL 744745 (S.D.N.Y. Mar. 1, 2011), *aff'd sub nom. Finn v. Smith Barney*, 471 F. App'x 30 (2d Cir. 2012); *In re Bank of Am. Corp.*, 2011 WL 740902 (N.D. Cal. Feb. 24, 2011).

Unsurprisingly, class members have been expressing their dissatisfaction with securities class actions by opting out of certified classes in droves. For example, in 2007, a federal judge in New Jersey postponed a $195 million settlement between KPMG and tax shelter investors because more than 60 of the 284 investors had chosen to pursue individual arbitrations. Aff. of Steven Cirami ¶¶ 9-10 *Simon v. KPMG*, No. 2:05-cv-03189-DMC-MF (D.N.J. Jan. 10, 2006) (Dkt. No. 121); *see also, e.g.*, *In re Prudential Sec. Inc. Ltd. Partnership Litig.*, 107 F.3d 3 (table), 1996 WL 739258, at *1-2 (2d Cir. 1996) (noting that so many class members opted out of proposed settlement as to trigger "blow up provision" in settlement agreement).

Even a number of recent mega-class settlements—which proponents of

securities class actions trumpet as success stories—have seen increasing numbers of class members opt out in order to pursue individual claims. For example, in the AOL-Time Warner securities-fraud class settlement, class members with over $795 million in claims opted out; many of those opt-out class members reported individual recoveries of between 6.5 and 50 times the amount they would have recovered under the class settlement.[18] Similarly, in the Tyco securities-fraud class action, some investors who opted out of the class settlement, which would have paid them approximately 3 percent of their losses, instead recovered 80 percent of their losses in individual actions.[19] In the experience of Chamber members, this phenomenon also is occurring in class actions involving broker-dealers.

B. Class Actions Are Not Needed For Claimants To Vindicate Their Claims.

The *amici* supporting the Department of Enforcement compound their error in painting an all-too-rosy picture of class actions by taking an unduly pessimistic

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[18] *See* Neal R. Troum, *The Securities Class Action Opt-Out Plaintiff: By the Numbers*, METROPOLITAN CORPORATE COUNSEL (Oct. 18, 2012), at http://www.metrocorpcounsel.com/articles/21035/securities-class-action-opt-out-plaintiff-numbers#_ftnref11; Oakbridge Ins. Servs., *Opt-Outs: A Worrisome Trend in Securities Class Action Litigation* (Apr. 2007), *at* http://www.rtspecialty.com/rtproexec/insights/Insights_VolumeIIIssue3.pdf; Josh Gerstein, *Time Warner Case Finds a Surprise*, N.Y. SUN, Dec. 7, 2006, at 1; Gilbert Chan, *CalPERS' Time Strategy Pays Off: The State Pension Fund Gets $117.7 Million after Opting Out of Class Action against Media Giant*, SACRAMENTO BEE, Mar. 15, 2007; *Time Warner Settles Lawsuit for $144 Million*, L.A. TIMES, Mar. 8, 2007, at C6.

[19] *See* Matthew P. Siben & David A. Thorpe, *Recovering Investment Losses* 6, *at* http://www.dstlegal.com/downloads/Recovering-Investment-Losses.pdf.

view of individual arbitration. To begin with, as noted above, individual FINRA arbitration is quick and efficient way of providing redress to investors with legitimate claims.

Moreover—and contrary to what the Department's *amici* say—Schwab customers do not need class-action procedures in order to pursue their claims. To begin with, Schwab has accepted the Disciplinary Panel's ruling to sever the prohibition on joinder and consolidation of claims from the arbitration agreement. Accordingly, Schwab customers are free to bring their claims together in arbitration, greatly reducing the already-low per-claimant cost of pursuing claims.[20]

Second, even if each claimant were required to bring a separate arbitration proceeding, claimants who have overlapping or identical claims based on common facts or legal principles are not required to reinvent the wheel. Nothing about individual arbitration prevents claimants (or their attorneys) from sharing the expenses of expert witnesses, fact investigation, and attorney preparation. Claimants' attorneys also can share successful strategies and pool information or evidence gleaned from non-confidential sources.

In the experience of Chamber members—who are parties to millions of

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[20] Moreover, Schwab customers remain free to bring class actions in court against issuers of securities, even if the investment is held in a Schwab portfolio.

consumer and employee arbitration agreements—this sort of coordination and cost-sharing by individual arbitration claimants has become increasingly common. Indeed, given the strong financial incentives, some plaintiffs' lawyers have begun to recognize that pursuing serial individual arbitrations (or small-claims actions) can be an economically viable business model—especially in view of the ability to reach multiple similarly situated individuals by means of websites and social media. For a discussion of this phenomenon, see Carolyn Whetzel & Jessie Kokrda Kamens, *Opt Out's Use of Social Media Against Honda In Small Claim Win Possible "Game Changer,"* BLOOMBERG BNA CLASS ACTION LITIG. REP. (Feb. 10, 2012).

For example, before the Supreme Court upheld AT&T's consumer arbitration agreement in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011), a plaintiff had filed a putative class action alleging that AT&T improperly measures the amount of data used by iPhones and iPads, thereby supposedly causing customers to pay more for data usage than they otherwise would. Following *Concepcion*, the district court compelled the plaintiff to arbitrate on an individual basis in accordance with his arbitration agreement. *See Hendricks v. AT&T Mobility LLC*, 823 F. Supp. 2d 1015 (N.D. Cal. 2011).

Subsequently, counsel for Hendricks filed separate demands for arbitration on behalf of over 1,000 claimants—each making virtually identical allegations and

relying on the same expert witness whom Hendricks had proffered in support of his class action lawsuit. The parties arbitrated numerous claims on an individual basis. After the first dozen arbitrators rejected the claims on the merits (which a court would have taken years to reach, if ever), the remaining customers withdrew their arbitrations.

That lawyer's strategy is no aberration. Other lawyers have used Facebook posts, Youtube videos, and custom websites to recruit plaintiffs to bring waves of individual actions in small claims court.[21] These examples demonstrate that, especially in an era in which the Internet and social media can be used effectively to reach out to potential claimants, individual plaintiffs (and their counsel) can readily identify other individuals with similar claims who can share in the costs of pursuing claims.

Moreover, customers do not need class actions to deter wrongdoing by broker-dealers. For starters, few fraudulent or misleading practices could survive a wave of individual arbitrations (and attendant negative publicity).

More importantly, FINRA itself—and other regulators—have ample power

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[21] *See, e.g.*, Linda Deutsch, *Honda Loses Small-Claims Suit Over Hybrid MPG*, ASSOCIATED PRESS, Feb. 1, 2012, *at* http://www.msnbc.msn.com/id/46228337/ns/business-autos/t/honda-loses-smallclaims-suit-over-hybrid-mpg/; Sara Foley & Jessica Savage, *Court Filings Boost Revenue*, CORPUS CHRISTI CALLER TIMES, Nov. 27, 2010, *at* http://www.caller.com/news/2010/nov/27/courtfilings-boost-revenue/.

to police misconduct. FINRA's Department of Enforcement can seek to impose hefty sanctions against broker-dealers who violate their duties to their customers, including censure, fines, suspension or bar from the industry, and an order to pay restitution to the affected customers. *See* FINRA Rules 8313, 8320. In 2012 alone, FINRA barred 294 individuals and suspended 549 brokers from association with FINRA-regulated firms, and directed broker-dealers to pay over $100 million in fines and restitution to injured investors.[22]

FINRA is not alone. The Securities Exchange Commission ("SEC") also claims broad powers to remedy wrongdoing. In fiscal year 2012, the SEC brought 734 enforcement actions and obtained orders requiring the payment of more than $3 billion in penalties and disgorgement for the benefit of injured investors.[23] The 134 enforcement actions against broker-dealers was a 19 percent increase over the number of such cases filed in 2011.[24] Moreover, prosecutors can pursue criminal actions in cases involving fraud.

C. Exempting Class Actions From Arbitration Disserves Investors.

Rather than helping investors, the Department of Enforcement's effort to

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[22] *See* FINRA, Press Release, 2012: FINRA Year in Review (Jan. 8, 2013), *at* http://www.finra.org/Newsroom/NewsReleases/2013/P197624.

[23] SEC, Press Release, *SEC's Enforcement Program Continues to Show Strong Results in Safeguarding Investors and Markets* (Nov. 14, 2012), *at* http://www.sec.gov/news/press/2012/2012-227.htm.

[24] *Id.*

invalidate arbitration agreements with class waivers would—if successful—ultimately harm investors.

Because class actions are far more expensive than arbitration on an individual basis—indeed, a recent survey of general counsel and in-house attorneys reported that securities class actions are more expensive than any other type of class action[25]—they raise the cost of doing business for broker-dealers. As a matter of basic economics, broker-dealers predictably will pass that cost along to their customers in the form of higher fees and commissions.[26] Conversely, if broker-dealers have enforceable agreements to arbitrate disputes on an individual basis, market competition would lead to the cost savings being passed along to their customers as well in the form of higher fees and commissions.

In addition, by perpetuating the use of class actions—or more accurately, class settlements—to resolve vast swaths of claims, the Department's rule results in the systematic undercompensation of investors with legitimate claims. As noted

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[25] *See* The 2013 Carlton Fields Class Action Survey, *supra* note 16, at 12.

[26] *See* Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements—With Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251, 254-57 (2006) (explaining that arbitration agreements "lower dispute-resolution costs" and that market competition causes these cost savings to manifest in a "wage increase" for employees and "lower prices" for "consumers"); *cf. Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 594 (1991) (customers who accept contracts with forum-selection clauses "benefit in the form of reduced fares reflecting the savings that the [company] enjoys by limiting the fora in which it may be sued").

above, class settlements pay millions to class counsel yet garner any investors with potentially meritorious claims as little as a fraction of a penny on the dollar if they fail to opt out. *See* pages 12-13, *supra*. The fact that these investors might occasionally receive windfalls from class settlements in cases in which they (or even the entire class) do not have meritorious claims comes nowhere close to compensating for the shortfall when their claims are warranted.

Finally, a ban on agreements to arbitrate disputes on an individual basis distorts the market for legal services in FINRA arbitrations. There already are many lawyers willing to represent individuals in FINRA arbitrations; indeed, there is an organized bar association of such lawyers, the Public Investors Arbitration Bar Association, with members across the country.[27] But a sizeable segment of the securities plaintiffs' bar devotes its time exclusively to class actions, which offer the prospect of lucrative awards of attorneys' fees—often measured as a percentage of the class recovery rather than an hourly rate for work performed (and thus substantially overcompensating the plaintiffs' lawyers for the work they actually did). Indeed, 10 class settlements alone resulted in plaintiffs' counsel receiving in excess of $2.7 billion in fees and expenses. NERA Study, *supra*, at 30. The chance to obtain such windfall recoveries attracts lawyers who otherwise

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[27] *See* Pub. Investors Arbitration Bar Ass'n, *About PIABA*, http://piaba.org/about-piaba (claiming members in 44 states, Puerto Rico, and Japan).

could be representing individuals in FINRA arbitrations like moths to a flame.

CONCLUSION

For the foregoing reasons, the Disciplinary Panel's decision in favor of Schwab on the first and second causes of action should be affirmed.

Dated: June 5, 2013

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