FINANCIAL INDUSTRY REGULATORY AUTHORITY
NATIONAL ADJUDICATORY COUNCIL

In the Matter of Department of Enforcement, Complainant, vs. Charles Schwab & Company, Inc. (CRD No. 5393), Respondent.	**Disciplinary Proceeding** **No. 2011029760201**

AMICUS CURIAE BRIEF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

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NASAA is the non-profit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has 67 members, including the securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Formed in 1919, NASAA is the oldest international organization devoted to protecting investors from fraud and abuse in connection with the offer and sale of securities.

The members of NASAA include the state agencies that are responsible for regulating securities transactions under state securities statutes, commonly referred to as "Blue Sky" laws. Their fundamental mission is protecting investors, and their principal activities include registering certain securities; licensing the firms and individuals who offer and sell securities and offer investment advice; and, where appropriate, pursuing enforcement actions for violations of state law. NASAA presents the views of its members in testimony before Congress and advocates for the adoption of strong, fair, and uniform securities laws and regulations.

NASAA supports the work of its members by coordinating multi-state enforcement actions, conducting training programs, publishing investor education materials, and presenting the views of its members in testimony before Congress on matters of securities regulation. Another core function of the association is to represent the membership's position, as *amicus curiae*, in significant cases involving the interpretation of securities laws and the rights of investors.

NASAA's interest in this case stems from its strong belief that investors should be free to join with other investors through the representative class action process to resolve

claims that are too costly to bring independently. The Hearing Panel's Decision deprives investors of this choice through an erroneous application of the Federal Arbitration Act and should therefore be reversed.

STATEMENT OF FACTS

NASAA incorporates by reference the facts as presented by the FINRA Department of Enforcement in its Opening Brief.

ARGUMENT

The Hearing Panel erred by refusing to enforce FINRA Rules prohibiting the use of class action waivers in customer agreements because FINRA is statutorily required to enforce its rules and its membership agreement with Schwab. The only agreement at issue in this enforcement action is the agreement between FINRA and Schwab and that agreement is unquestionably valid and permissible under the Federal Arbitration Act ("FAA"), 9 U.S.C. § 1, *et seq*. Furthermore, as Section II explains, the Hearing Panel's Decision poses an imminent threat to investors' ability to seek redress for small dollar claims. Therefore, NASAA urges the National Adjudicatory Council ("NAC") to overturn the Hearing Panel's dismissal of the FINRA Department of Enforcement's ("DOE") first two causes of action.

I. The Hearing Panel Erred By Refusing To Enforce FINRA Rules Prohibiting The Use of Class Action Waivers.

The clause of the Schwab Customer Agreement at issue in the Complainant's first and second Causes of Action states that both parties "waive any right to bring a class action, or any type of representative action … in court."[1] The Hearing Panel concluded that this provision violates FINRA Rules 2268(d)(1) and (d)(3) prohibiting the use of class action

[1] R. 275-362 (Schwab Account Agreement Dated January 2011).

waivers in pre-dispute arbitration agreements ("PDAA"), which were "intended and designed to preserve judicial class actions as an option." R. 2461 (Hearing Panel Decision at 23-24). However, the Hearing Panel also noted that the U.S. Supreme Court in *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740, 1745 (U.S. 2011), expressly held that the FAA establishes a "federal policy in favor of arbitral dispute resolution" and that countervailing policy concerns cannot override that mandate without express instruction from Congress. R. 2461 (Hearing Panel Decision at 36-37). Therefore, the Hearing Panel held that Schwab was entitled to continue its practice of including class action waivers in its PDAAs, despite the clear prohibition in FINRA's rules.

This analysis is flawed in two principal ways. First, the Hearing Panel overstepped its authority by refusing to enforce FINRA Rules. Second, the Hearing Panel erred by failing to enforce Schwab's contractual obligation through its membership agreement with FINRA.

A. The Hearing Panel Overstepped Its Authority By Refusing To Enforce FINRA Rules.

By refusing to enforce Rules 2268(d)(1) and (d)(3), FINRA, through the Decision by its Hearing Panel, failed to comply with the terms of Section 19(h) of the Securities Exchange Act of 1934, codified at 15 U.S.C. § 78a, *et seq.*("Exchange Act"), which requires self-regulatory organizations like FINRA to enforce their own rules. In addition, the Hearing Panel has circumvented Section 19(b) of the Exchange Act, 15 U.S.C. § 78s(b), requiring all rule changes, additions, and deletions to be filed with the Securities and Exchange Commission ("SEC" or "Commission"). Therefore, NASAA urges the NAC to overturn the Hearing Panel's Decision as to the first two causes of action.

1. Section 19(h) Of the Exchange Act of 1934 Requires FINRA To Enforce Its Own Rules

NASAA urges the NAC to reverse the Hearing Panel's dismissal of the first two causes of action because FINRA is required to enforce its own rules under Section 19(h) of the Exchange Act. Section 19(h) states in pertinent part:

> **Suspension or revocation of self-regulatory organization's registration; censure; other sanctions**
>
> The appropriate regulatory agency for a self-regulatory organization is authorized ... to suspend for a period not exceeding twelve months or revoke the registration of such self-regulatory organization, or to censure or impose limitations upon the activities, functions, and operations of such self-regulatory organization, if such appropriate regulatory agency finds ... that such self-regulatory organization has violated or is unable to comply with any provision of ... its own rules or without reasonable justification or excuse has failed to enforce compliance ... by a member.

15 U.S.C. § 78a. There is ample precedent of the SEC using this oversight mechanism against FINRA's predecessor, the NASD,[2] and numerous securities exchanges.[3] For instance, *In the Matter of National Association of Securities Dealers, Inc.*, the Commission issued an Order stating in part:

> The Exchange Act requires the NASD, as a self-regulatory organization, to comply with, and **vigorously enforce**, in an evenhanded and impartial manner, the provisions of the Exchange Act, the rules and regulations thereunder and **its own rules**, in carrying out its role as the entity responsible for the day-to-day oversight of its members and the Nasdaq market. The NASD has an affirmative obligation to be vigilant in

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[2] *See* Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and the NASDAQ Market, *available at* http://www.sec.gov/litigation/investreport/nd21a-report.txt (noting that the NASD "The Order Instituting Proceedings in that action alleges that the NASD failed to comply with certain NASD rules and, without reasonable justification or excuse, failed to enforce compliance with the Exchange Act, the rules and regulations promulgated thereunder, and its own rules, in violation of Section 19(g) of the Exchange Act. The Order finds, among other things, that the NASD failed to take appropriate action to investigate effectively and to address adequately violations and potential violations of the federal securities laws and the NASD's rules.").

[3] *See, e.g.*, *In the Matter of EDGX Exchange, Inc.*, Exchange Act Rel. No. 65556, 2011 WL 4860052 (Oct. 13, 2011) (Finding against the Direct Edge Exchanges for failing "to comply with its own Commission-approved rules.")

> surveilling for, evaluating, and effectively addressing issues that could involve violations of such provisions.

In the Matter of Nat'l Ass'n of Sec. Dealers, Inc., Exchange Act Rel. No. 37538, 62 SEC Docket 1346 (Aug. 8, 1996)(emphasis added). In that instance, the Commission found that the NASD failed to meet this standard by inadequately enforcing its own rules, "applying, in certain cases, ad hoc standards and criteria not embodied in NASD rules." *Id.*

In the instant case, the Hearing Panel's Decision constitutes a violation by FINRA of its duty to enforce the prohibition against class action waivers contained in Rules 2268(d)(1) and (d)(3). The FINRA Hearing Panel found a violation of these rules, but refused to enforce the rules due to a hypothetical conflict with the FAA. The Hearing Panel does not have discretion to determine which of FINRA's rules it will or will not enforce.

Whether or not the FAA applies to a particular agreement between Schwab and its customers is a fact-based inquiry for the courts to decide in a dispute between Schwab and a customer. However, as explained below, the FAA does not dictate the terms of FINRA's membership agreement with Schwab. Although Schwab may generally have the option to freely contract with its customers for arbitration and can enforce such an agreement under the FAA, Schwab is equally free to give up that option when it enters into a membership agreement with FINRA. Accordingly, FINRA has no "reasonable justification or excuse" not to enforce Schwab's compliance with FINRA rules as required under Section 19(h).

2. SRO Rules May Be Modified Or Deleted Only Pursuant To Section 19(b) Of The Exchange Act of 1934.

The SRO rulemaking process is the primary means for the SEC to oversee the National Securities Exchanges and Registered Securities Associations it regulates.[4] Accordingly, Section 19(b) requires all rule changes, additions, or deletions to SRO rules to be filed with the SEC for approval or denial, stating further that "no proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection." 15 U.S.C. § 78s(b). This process also includes a robust public comment period in which the Commission is statutorily required to "give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change."[5] It is important to recognize that the FINRA rules at issue became effective only after meeting the public comment and SEC-approval requirements of the SRO rulemaking process.[6] By declaring FINRA Rules 2268(d)(1) and (d)(3) "non-enforceable," the Hearing Panel has *de facto* deleted the rules or, at the very least, modified them so that they carry no penalty. In either case, the Hearing Panel has attempted to do what FINRA statutorily cannot do on its own – change FINRA rules without complying with the notice and comment process. If FINRA wanted to remove Rules 2268(d)(1) and (d)(3) from its rulebook or to make them simply suggestions for its

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[4] *See generally* Commission Guidance and Amendment to the Rules Relating to Organization and Program Management Concerning Proposed Rule Changes Filed By Self-Regulatory Organizations, Exchange Act Rel. No. 58092, 93 SEC Docket 1838 (July 3, 2008).

[5] *See* Section 19(b)(1) of the Exchange Act, codified at 15 U.S.C. § 78s(b)(1). NASAA notes that Section 19(b)(3) allows for certain fillings to take effect upon filing, however those filings are limited to proposal to copy existing rules of an SRO; establishing, changing, and removing fees; other non-controversial changes; and emergency situations. Changes to the substantive provisions of Rule 2268 would clearly require proper notice under 19(b)(2). 15 U.S.C. §§ 78s(b)(2) & 78s(b)(3).

[6] *See* FINRA Regulatory Notice 92-65 (Oct. 28, 1992), noting that "the SEC approved amendments to Section 12 of the NASD Code of Arbitration Procedure (Code) and Article III, Section 21 of the NASD Rules of Fair Practice to exclude class-action matters from arbitration proceedings conducted by the NASD and to require that predispute arbitration agreements contain a notice that class-action matters may not be arbitrated."

members rather than requirements, it could do so only through the 19(b)(4) rulemaking process. 15 U.S.C. § 78s(b)(4).

B. The Hearing Panel Erred By Failing To Enforce Schwab's Contractual Obligation With FINRA To Not Include A Class Action Waiver In Its Customer Agreements.

Schwab violated the clause of its Membership Agreement requiring it to follow FINRA rules simply by including a class action waiver in its PDAA. The Hearing Panel's conclusion that the FAA precluded enforcement of the applicable FINRA rules was misplaced because nothing in the FAA prevents parties from agreeing not to arbitrate class action claims with third parties. Unlike the instant case, the cases cited by the Hearing Panel involve customer contracts (as opposed to an SRO membership agreement) and thus do not control this case. Therefore, the Hearing Panel erred by failing to enforce Schwab's contractual obligation to not include a class action waiver in its customer agreements.

1. The Violation Occurred When Schwab Included A Class Action Waiver In Its PDAA

In its membership agreement and subsequent renewals, Schwab agreed "[t]o accept, abide by, comply with, and adhere to all the provisions [of all] … NASD rules." (FINRA DOE Opening Brief at 3). FINRA Rules 2268(d)(1)[7], 2268(d)(3)[8], and 12204[9] all prohibit class action waivers in a member's pre-dispute arbitration agreements.[10] As

[7] FINRA Rule 2268 (d)(1) states in pertinent part that "[n]o predispute arbitration agreement shall include any condition that … limits or contradicts the rules of any self-regulatory organization."
[8] FINRA Rule 2268 (d)(3) states in pertinent part that "[n]o predispute arbitration agreement shall include any condition that … limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement."
[9] The provisions of FINRA Rule 12204 *inter alia* prohibit class action claims from being heard in FINRA arbitration and specifically contemplate class action claims being brought in court. As the Hearing Panel explained, a common sense reading of Rule 12204 and its history clearly indicates that it was broadly "intended and designed to preserve judicial class actions as an option." R. 2461 (Hearing Panel Decision at 24).
[10] Also constitutes a violation of FINRA Rule 2010.

the Second Circuit Court of Appeals held, "FINRA membership constitutes an agreement to 'adhere to FINRA's rules and regulations, including its Code and relevant arbitration provisions contained therein.'" *In re Am. Exp. Fin. Advisors Sec. Litig.*, 672 F.3d 113, 128 (2d Cir. 2011) (quoting *UBS Fin. Servs. v. W. Va. Univ. Hosps., Inc.*, 660 F.3d 643, 649 (2d Cir. 2011)). Therefore, Schwab contracted with FINRA to, *inter alia*, not include a class action waiver in its pre-dispute arbitration agreements in exchange for the benefits of FINRA Membership.

The clause of the Schwab Customer Agreement at issue in the Complainant's first and second Causes of Action states that both parties "waive any right to bring a class action, or any type of representative action … in court."[11] This language is in direct violation of Rule 2268(d). Therefore, the Hearing Panel correctly concluded that the waiver violates FINRA Rules 2268(d)(1) and (3). R. 2461 (Hearing Panel Decision at 24).

As this is a FINRA enforcement case, brought by DOE to be adjudicated by a FINRA Hearing Panel, the violation of FINRA rules is the only applicable question at issue. Whether the arbitration agreement is enforceable against a customer because of the FAA is inconsequential.[12] Therefore, the Hearing Panel committed error by relying on

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[11] The mandatory pre-dispute arbitration agreement states in its entirety: "Section 16: Waiver of Class Action or Representative Action. Neither you nor Schwab shall be entitled to arbitrate any claims as a class action or representative action, and the arbitrator(s) shall have no authority to consolidate more than one parties' claims or to proceed on a representative or class action basis. You and Schwab agree that any actions between us and/or Related Third Parties shall be brought solely in our individual capacities. You and Schwab hereby waive any right to bring a class action, or any type of representative action against each other or any Related Third Parties in court. You and Schwab waive any right to participate as a class member, or in any other capacity, in any class action or representative action brought by any other person, entity or agency against Schwab or you."

[12] It is important to note that, at this point in time, Schwab has yet to enforce its new Waiver. No investors have been denied the opportunity to bring a claim as a class action and, thus, no investors have had the opportunity to challenge the Waiver in district court.

FAA jurisprudence and the applicability of that case law to the customer contracts in not enforcing its SEC-approved rules.

2. Nothing In The FAA Prevents Parties From Agreeing Not To Arbitrate.

NASAA maintains that the FAA is not at issue in this matter because this case simply involves an "agreement to adhere to rules that modify what may be placed in the arbitration agreement." (FINRA DOE Opening Brief at 18). However, it is worth noting that even if the FAA was at issue, nothing in the FAA prevents Schwab from entering into such an agreement with FINRA.

The U.S. Supreme Court has stated that the purpose of the FAA is simply to put arbitration agreements "'upon the same footing as other contracts.'"[13] Although the FAA ensures the enforceability of arbitration agreements between contracting parties, nothing prevents a party from declining to include an arbitration provision in a contract. As the Seventh Circuit Court of appeals explained, this would be an absurd policy to maintain because:

> [i]f the federal policy embodied in the Arbitration Act is based on the enforcement of private agreements, we see no reason why [an] agreement not to arbitrate is any less enforceable than [an] ... agreement to arbitrate ...

St. Mary's Med. Ctr. of Evansville, Inc. v. Disco Aluminum, 969 F.2d 585, 591 (7th Cir. 1992). The Seventh Circuit has also noted that parties are free to waive a contractual right to arbitrate, and can do so in an express or implied manner. *Cabinetree of Wisconsin, Inc. v. Kraftmaid Cabinetry, Inc.* 50 F.3d 388, 391 (7th Cir. 1995). Schwab waived its right to seek and subsequently enforce a class action waiver in its customer agreements because,

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[13] *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219 (1985) (citing H.R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924)).

as a FINRA member, it agreed to be prohibited from using such waivers. Therefore, the Hearing Panel improperly dismissed the first two causes of action.

3. The Cases Cited By The Hearing Panel Do Not Control This Case.

NASAA agrees with the FINRA DOE that the cases relied upon by the Hearing Panel do not control the outcome in this case. (FINRA DOE Opening Brief at 18). As the DOE stated, "in this proceeding, the controlling agreement is the membership agreement between the two parties to this proceeding, FINRA and Schwab, not an arbitration agreement between other parties." *Id.* The cases cited by the Hearing Panel involve the enforceability of an arbitration agreement between two parties to that agreement. Therefore, it was inappropriate for the Hearing Panel to rely on these cases.

4. Concepcion Does Not Render The Schwab Class-Action Waivers Per Se Enforceable

As Section (I)(A), *supra*, describes, FINRA is under an obligation to enforce its rules unless it has a "reasonable justification." Presumably, if class action waivers were per se enforceable in a post-*Concepcion* world, it would be reasonable for the Hearing Panel to decline to enforce a rule prohibiting class action waivers. However, "*Concepcion* [did] **not** ... require that all class-action waivers be deemed per se enforceable." *In re Am. Exp. Merchants' Litig.*, 667 F.3d 204, 214 (2d Cir. 2012), *cert. granted*, 133 S.Ct. 594 (Nov. 19, 2012 (No. 12-133) ("*Amex III*"). Conversely, subsequent case law that considered *Concepcion* has held that "each [class action] waiver must be considered on its own merits." *Id.* at 219. Accordingly, the Hearing Panel had no reasonable justification to decline to enforce its rule based on its prediction that Schwab's Class Action waiver would be uniformly upheld under the FAA.

In *Amex III*, the U.S. Court of Appeals for the Second Circuit found on remand from the U.S. Supreme Court that, despite the *Concepcion* ruling, a class action waiver was unenforceable because the Plaintiffs produced expert testimony demonstrating that it was economically impossible for them to vindicate their federal statutory rights outside of a class action proceeding. This case was scarcely mentioned by the Hearing Panel in footnote 89 of its Decision, even though it is the most on-point case cited in the Hearing Panel's Decision. Unlike *Concepcion*, upon which the Panel relied most heavily, *Amex III* involved the vindication of a federal statutory right, not a judicially-created state policy. Similarly, as Section II, *infra*, describes, if the Hearing Panel's Decision is upheld, many investors will be precluded from bringing certain federal securities claims.

The U.S. Supreme Court recently held oral arguments on the *Amex III* case.[14] This case will undoubtedly have a great impact on the enforceability of class action waivers like the one that Schwab included in its Customer Agreement. However, until the Supreme Court decides on this issue, it remains a legal uncertainty. As previously stated, the Hearing Panel never should have reached the question of FAA enforceability of the Schwab Customer Agreement; however, insofar as it did consider that question, it erred by declaring a one-size-fits-all approach to the enforceability of class action waivers in PDAAs.

5. Congress Has Repeatedly Expressed Its Intent to Preserve Judicial Class Actions And Promote Fairness In Customer Contracts

The Supreme Court noted in *McMahon* that the FAA's mandate that courts rigorously enforce arbitration agreements "may be overridden by a contrary

[14] Transcript of Oral Argument, *Amer. Exp. Co. v. Italian Colors Rest.*, No. 12-133 (U.S. argued Feb. 27, 2013).

congressional command." *Shearson/Am. Exp., Inc. v. McMahon*, 482 U.S. 220, 226 (1987). The Hearing Panel incorrectly concluded that no such Congressional command existed and heavily relied upon this conclusion to declare FINRA's rules non-enforceable. However, as explained below, Congress has expressed on numerous occasions its clear intent that a customer's right to bring a judicial class action claim be preserved and that, when it comes to agreements between customers and broker-dealers, regulation may be necessary in order to promote the fairness of these agreements.

a. Section 29(a) Of The Exchange Act

Section 29(a) of the Exchange Act provides:

> Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of a self-regulatory organization, shall be void.

15 U.S.C. § 78cc(a). The Supreme Court interpreted this provision to be "concerned with whether [an] agreement 'weakens [customers'] ability to recover under the exchange act." *Shearson/Am. Exp., Inc. v. McMahon*, 482 U.S. 220, 230 (1987) (quoting *Wilko v. Swan*, 346 U.S. 427 (1953)); Black, Barbara and Gross, Jill, Investor Protection Meets the Federal Arbitration Act (Sept. 5, 2012) 1 Stanford Journal of Complex Litigation (2012 Forthcoming); U of Cincinnati Public Law Research Paper No. 12-11, at 44, *available at*. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2141978.

In *McMahon*, the Supreme Court noted the limitations of Section 29(a) by upholding a waiver of Section 27 of the Exchange Act, which grants U.S. district courts exclusive jurisdiction over Exchange Act claims, in favor of arbitration. 482 U.S. 220 at 227. *McMahon* held that where arbitration was adequate to vindicate Exchange Act rights to bring a fraud claim under Section 10(b), the waiver did not implicate Section 29(a). *Id.* at 238.

In contrast to the facts in *McMahon*, this case involves a situation where Schwab customers will not have an adequate ability to vindicate their Exchange Act rights to bring small dollar amount claims. As Professors Barbara Black and Jill Gross have noted,

> Schwab's combination of a PDAA, a class action waiver and a prohibition on combining claimants with similar claims means that the only remedy available to every customer is an individual claim.

Black at 44. As Professors Black and Gross go on to note and Section II of this brief illustrates, the SEC, FINRA, courts, and academic commentators agree that bringing an individual small value claim in arbitration will often be economically impossible. Therefore, the Hearing Panel incorrectly applied the FAA because the Schwab Waiver violates Section 29(a) of the Exchange Act, which is a contrary congressional command as described by McMahon.

b. PSLRA And SLUSA Confirmed Congress's Intent To Preserve Judicial Class Action Claims

Congress has also expressed its intent to maintain securities class actions through the Private Securities Litigation Reform Act of 1995, Pub. L. 104-67, 109 Stat. 737 (1995) ("PSLRA"). Despite calls from certain business interests to eliminate judicial class action claims, Congress simply reformed the system, noting that "private securities litigation … is too important to the integrity of American capital markets to allow this system to be undermined..." *See* Black at 45 (citing H.R. Rep. No. 104-369, at 31 (1995). Similarly, in 1998 Congress again reaffirmed its intent to leave securities judicial class action claims in place when it enacted the Securities Litigation Uniform Standards Act of 1998, Pub. L. 105-353, 112 Stat. 3227 (1998) ("SLUSA").

c. Section 15(o)

As a part of the Dodd-Frank Act[15] in 2010, Congress provided the SEC with express power to modify or ban the use of PDAAs in customer agreements. Section 15(o) of the Exchange Act, codified at 15 U.S.C. § 78o(o), goes well beyond the current FINRA rules prohibiting only the use of a class action waiver in conjunction with a PDAA. Accordingly, Congress, recognizing the dangers of PDAAs, again ratified the current regulatory regime governing PDAAs, therefore encouraging the SEC to lean towards more, not less regulation in this area.

Taken together, Section 29(a), the preservation of class actions through the reform measures contained in the PSLRA and SLUSA, and most recently the enactment of Section 15(o) demonstrate the clear and unambiguous intent of Congress to preserve judicial class actions for investors and to empower regulators to ensure fairness in the contractual relationships between broker-dealers and their customers. Further, these provisions recognize that the relationship between broker-dealers and their customers is a highly regulated transaction unlike many other commercial transactions. The Hearing Panel disregarded these Congressional pronouncements and in doing so further erred in holding that the FINRA rules were unenforceable under the FAA.

II. The Hearing Panels Decision Poses An Imminent Threat To Investors' Ability To Seek Redress In Small Dollar Amount Claims.

The practical effect of the Hearing Panel's Decision is that it will eliminate the ability of investors to bring representative class action claims. As Massachusetts Secretary of State William F. Galvin, NASAA Member, noted:

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[15] Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010).

> by placing this arbitration clause in every brokerage account agreement as a matter of course, [the investor is denied]the basic opportunity to decide for him or herself what forum is in his or her best interest. Further it ignores ... that often the cost of litigation leaves the class action lawsuit as the only viable method for small investors to seek redress for the wrongful actions of their brokers – something that is not necessarily apparent to an investor at the point the account is established. *This ruling is akin to giving every rogue broker-dealer the green light to steal from their customers in small dollar amounts.*[16]

FINRA requires all customer claims to be submitted to FINRA for arbitration. FINRA rules do not have a procedure for class actions claims, instead encouraging them to be filed in court. Because Schwab's PDAA prohibits class action claims from being brought in court, the result is that all investor claims must be brought on a case-by-case basis in FINRA Dispute Resolution Arbitration.

Congress, state and federal securities regulators, courts, academics, financial industry participants, and even FINRA all have routinely recognized that the judicial system, not the FINRA arbitration process, is the appropriate forum for claims involving a large number of claimants, especially those where the claimants are seeking a small recovery. As the Seventh Circuit Court of Appeals correctly observed, "[t]he realistic alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30." *Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004). Similarly, in its order approving the adoption of what is now FINRA Rule 12204, the SEC stated, "[t]he Commission agrees with the NASD's [now FINRA] position that, **in all cases, class actions are better handled by the courts** and that investors should have access to the courts to resolve class actions efficiently. Order Approving Proposed Rule Change Relating to the Exclusion of Class Actions from

[16] Letter from William F. Gavin, Secretary of the Commonwealth of Massachusetts, to Charles R. Schwab, Chairman of the Board, Charles Schwab & Co., Inc. (Feb. 26, 2013), *available at* http://www.sec.state.ma.us/sct/sctschwabarb/Schwab-letter.pdf.

Arbitration Proceedings, SEC Rel. No. 34-31371,1992 WL 324491 (Oct. 28,1992) (emphasis added).

Beyond being the most efficient means of handling multiple claims for small dollar amounts, class actions also serve as the best vehicle for providing notice to investors that they have been harmed. Securities claims are notoriously complex and even highly-educated investors may not understand what happens in their portfolios. When an investment loses value, most investors won't be able to discern whether it was due to market conditions or misconduct. Accordingly, investors often rely on the notification by the class that misconduct has occurred. Without this mechanism, many claims will go undiscovered, resulting in unjust losses to investors and windfalls to violators.

A recent case involving Schwab illustrates the impact of the Hearing Panel's Decision. The Schwab YieldPlus Fund was the subject of a class action against various Schwab entities including the broker-dealer registrant within Schwab.

> If the class action waivers Schwab inserted into its customer contracts had been in place and enforced, investors would have been required to arbitrate individual claims. [This] would not be an optimal outcome [because] [t]he average estimated settlement payment in the federal action was $881.36 an amount that would not have made individual arbitration feasible."

Black at 7.

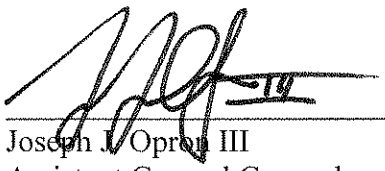
CONCLUSION

The Hearing Panel erred by refusing to enforce FINRA Rules prohibiting the use of class action waivers in customer agreements. In doing so, the Hearing Panel ignored FINRA's statutorily duty to enforce the organization's rules, relied on an erroneous application of the FAA, and placed investors in imminent harm by precluding their ability

to seek redress for small dollar claims. Therefore, NASAA urges the NAC to overturn the Hearing Panel's dismissal of the FINRA DOE's first two causes of action.

Dated: May 8, 2013

Respectfully submitted,



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I hereby certify that on May 8, 2013, I caused a copy of the foregoing *Amicus Curiae* Brief Of The North American Securities Administrators Association, Inc. to be sent by email and First Class U.S. mail to the following:

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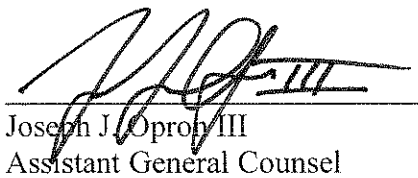

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