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SCOTUS Rules in *Epic Systems:*

What it Means for Securities Employment Arbitration

By George H. Friedman*

In a 5-4 decision split along ideological lines, the Supreme Court on May 21 held in *Epic Systems Corp. v. Lewis*, No. 16-285, that the Federal Arbitration Act ("FAA") permits employers to use arbitration clauses containing class action waivers, notwithstanding the National Labor Relations Act's ("NLRA") protections of workers' rights to act collectively. Justice Neil Gorsuch authored the majority Opinion, joined by Justices Alito, Kennedy, and Thomas, and Chief Justice Roberts. The Court's liberal wing dissented in a blistering Opinion authored by Justice Ginsburg, joined by Justices Breyer, Kagan, and Sotomayor. This article covers what the decision may mean for the securities industry.

The Issues in *Epic Systems*

Securities Arbitration Alert issue SAA 2018-20 (May 23) and an accompanying SAC blog post cover the decision in detail. I present here the main takeaways, borrowing liberally therefrom and with the permission of SAC. The Supreme Court in January 2017 granted *Certiorari* in three cases involving whether the FAA prevails over the NLRA when it comes to enforcing class action waivers in employment arbitration agreements. The issue under review: The National Labor Relations Board ("NLRB") and some Circuits had held that class action waivers in employment PDAAs violate NLRA section 8(a)(1), because they interfere with the employees' statutory right to "concerted activities." Other Circuits had ruled to the contrary, resulting in a split.

The specific question before the Court as framed by the Petition for *Certiorari* was: "Whether an agreement that requires an employer and an employee to resolve employment-related disputes through individual arbitration, and waive class and collective proceedings, is enforceable under the Federal Arbitration Act, notwithstanding the provisions of the National Labor Relations Act." The Court granted Certiorari "to clear the confusion" over these issues and the conflicting holdings.

An *Epic* Decision

In the *Epic* decision, the Supreme Court holds: "As a matter of policy these questions are surely debatable. But as a matter of law the answer is clear. In the Federal Arbitration Act, Congress has instructed federal courts to enforce arbitration agreements according to their terms – including terms providing for individualized proceedings." What of the NLRA language protecting workers' rights to collective action and the tension with PDAAs containing class action waivers? Say the majority, if in

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***George H. Friedman,** Chairman of the Board of Directors of Arbitration Resolution Services, Inc. and an ADR consultant, retired in 2013 as FINRA's Executive Vice President and Director of Arbitration, a position he held from 1998. In his extensive career, he previously held a variety of positions of responsibility at the American Arbitration Association, most recently as Senior Vice President from 1994 to 1998. He is an Adjunct Professor of Law at Fordham Law School. Mr. Friedman serves on the Board of Editors and is a Contributing Legal Editor of the* Securities Arbitration Commentator. *He is also a member of the AAA's national roster of arbitrators. He holds a B.A. from Queens College, a J.D. from Rutgers Law School, and is a Certified Regulatory and Compliance Professional.*

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enacting the NLRA Congress intended to preclude these PDAAs it would have said so explicitly: "Congress has likewise shown that it knows how to override the Arbitration Act when it wishes…. What all these textual and contextual clues indicate, our precedents confirm…. Throughout, we have made clear that even a statute's express provision for collective legal actions does not necessarily mean that it precludes "'individual attempts at conciliation'" through arbitration…. And we've stressed that the absence of any specific statutory discussion of arbitration or class actions is an important and telling clue that Congress has not displaced the Arbitration Act" (citations omitted).

Easy to see this One Coming

This outcome was easy to see coming a mile away.

- Back in 2014 I wrote in a blog post, *NLRB is Cruisin' for a Bruisin' on its Anti-Arbitration Policy:* "Despite the fact that a federal circuit court, relying heavily on several Supreme Court holdings, had expressly overruled the NLRB's take on class action waivers, some of the Board's administrative law judges continued to issue rulings ignoring [the decision]…. There's not much I remember from civics class or law school, but I do remember this: Congress passes laws, the president signs laws, the courts interpret laws, and, federal administrative agencies carry out and apply federal laws. It is my view that the NLRB is having a bit of an identity crisis, and that sooner or later, the Supreme Court will – in 'read our lips' fashion – deliver the message that class action waivers in PDAAs are enforceable under the FAA … *and the NLRA*."[1]

- In *The Elections are over: What it means for Consumer Arbitration: Five things to look for in 2015*,[2] I wrote: "SCOTUS will rebuke the National Labor Relations Board on its anti-arbitration policy…. Sooner or later, the Supreme Court is going to hit the NLRB with a 2 x 4 over its rulings on class action waivers in arbitration clauses in employment agreements."

- In September 2016, I penned a guest SAC blog post, *Seems Like I May Be Right After All on One of My 2015 Predictions – Just a Little Late*,[3] where I noted that the *Certiorari* petition was pending, and wrote: "I predict SCOTUS will grant *Certiorari* in at least one of the three cases, most likely *Murphy Oil* because it involves NLRB as a party. This is an important issue and there is an evident, major split in the Circuits. My view is that these sections of the NLRA aim to protect concerted activities like organizing union representation, not participating in class actions, and that *Gilmer v. Interstate/Johnson Lane Corp.*,[4] would require the NLRA to expressly ban arbitration if that was the intent of Congress."

- When President Trump nominated Neil Gorsuch in early 2017, I analyzed in a blog post his opinions in the Tenth Circuit, *Supreme Court Nominee Gorsuch Seems to be Pro-*

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Mailing Address: SAC, P.O. Box 112, Maplewood, N.J. 07040. Business Office: 45 Essex Street, Ste. 203, Millburn, NJ 07041. Tel: (973) 761-5880; 973-232-5698; 973-232-5032.

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Arbitration!, and concluded he was pro-arbitration.[5]

- Last, with Justice Gorsuch on the bench and the *Epic* case having been argued, as 2018 dawned I wrote in *Consumer and Employment Arbitration – Six Things to Look for in 2018*: "I predict a close decision from SCOTUS in *Epic Systems* reaffirming the preemptive effect of the FAA over other federal laws that do not expressly preclude arbitration, with Justice Gorsuch voting with the pro-arbitration camp."[6]

As I said, this was easy to see coming a mile away.

What *Epic* Means for Securities Industry Arbitration: Don't Assume Anything

Where do we go from here? Now that SCOTUS has elevated the FAA over the NLRA and permits the rest of American employers to use class action waivers, many observers assume that FINRA will not block the brokerage industry from exercising the same right. I'm not so sure the analogy works…or maybe it does (see "confusion" below). One of my favorite sayings is, "I built a career on the words 'assume' and 'presume.'" By that I mean those words can lead to misunderstandings and conflict. In that spirit, I suggest folks not jump to conclusions based on presumptions or assumptions about *Epic Systems* and securities arbitration. Indeed, FINRA has in my view not closed the door on class action waivers in *the employment context*, as it has (i.e., the Charles Schwab disciplinary action), in the *customer arena***.**

The Schwab Ruling: Don't Assume FINRA's Policy on Customer Agreement Class Action Waivers Carries Over to Employment

Some time after the Supreme Court issued its ruling in *AT&T Mobility LLC v. Concepcion*,[7] upholding class action waivers in consumer contracts based on FAA preemption of State law, Charles Schwab Corp. started inserting class action waivers in its customer agreements. FINRA in early 2012 brought an enforcement action against Schwab, contending that brokerage firms cannot use class action waivers in customer contracts notwithstanding *Concepcion*. Schwab countered that FINRA's rules on class actions were preempted by the FAA in line with *Concepcion*. At the Hearing Panel level in February 2013, FINRA prevailed on its claim that Schwab had violated the Authority's rules, but lost on FAA preemption. The FINRA Board eventually "called" the case and in April 2014 ruled against Schwab on both issues.[8] In a nutshell, the Board agreed with the Hearing Panel that Schwab had violated several FINRA rules by including a class action waiver, but disagreed that the FAA preempted FINRA's rules on class actions.

On violation of investor-protection Rules,[9] the Board found:

- FINRA Rule 2268(d)(3) prohibits member firms from placing "any condition" in a customer predispute arbitration agreement that "limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement."

- FINRA Rule 2268(d)(1) states that "[n]o predispute arbitration agreement shall include any condition that . . . limits or contradicts the rules of any self-regulatory organization."

- Rule 12204(d) provides: "A member or associated person may not enforce any arbitration agreement against a member of a certified or putative class action with respect to any claim that is the subject of the certified or putative class action until: • The class certification is denied; • The class is decertified; • The member of the certified or putative class is excluded from the class by the court; or • The member of the certified or putative class elects not to participate in the class or withdraws from the class according to conditions set by the court, if any."

- Therefore, Schwab's class action waiver "limits or contradicts" Rule 12204 of the Customer Code.

On FAA preemption, the Board's rationale was:

- "FINRA rules have the force and effect of a federal regulation for the purposes of resolving federal conflicts of law. See *Credit Suisse First Boston Corp. v. Grunwald,* 400 F.3d 1119, 1132 (9th Cir. 2005) (explaining that FINRA rules have the force and effect of federal law because they are derived from the Exchange Act)."

- "In reconciling the conflict between FINRA arbitration rules that prohibit use of a predispute arbitration agreement to eliminate judicial class actions and the FAA's enforcement of class action waivers, we find -- based on the SEC's approval orders -- that FINRA's rules are in furtherance of the Exchange Act's protection of investors. This core aspect of the Exchange Act prevails over the FAA."

- "FINRA rules that restrict Schwab's ability to use a class action waiver to defeat customers from bringing or participating in judicial class actions are valid and enforceable. Just as the Supreme Court has held that the Exchange Act, the Investment Company Act, and SEC and FINRA rules regarding securities activities take priority over federal antitrust law, the Exchange Act and FINRA's specific rules prohibiting class action waivers likewise take priority over the FAA....The SEC's approval conferred on FINRA rules the equivalent status of a federal regulation. FINRA rules and their rulemaking history confirm that FINRA members may not include class action waivers in predispute arbitration agreements with customers."

But as discussed below, FINRA's rules protecting customers are not identical to those applicable to employees.

Don't Assume FINRA's Rules Must Treat Employment Arbitration the Same as Customer Arbitration

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Concepcion allowed companies to use class action waivers in *consumer* PDAAs. Thereafter, many businesses like Schwab did just that. FINRA, exercising its authority to protect investors, banned the practice for the entities it regulates. In other words, to protect investors FINRA rightly asserted that it could promulgate reasonable policies and regulations governing the securities industry, even ones that might impinge on a statutory right enjoyed by the securities industry. Need examples?

- Shortened Timeframe to Challenge Awards: A major tool used to encourage arbitration award payment is FINRA Rule 9554, which allows the Authority to suspend industry parties for not paying arbitration awards, unless they raise a valid defense to non-payment, such as filing a motion to vacate. Rule 12904 requires that the broker file the motion to vacate within 30 days or face suspension or termination. FAA section 12 allows a party opposing the award three months to file a motion to vacate. So, FINRA's Rules say essentially to the industry party: "We know you have three months under the Federal Arbitration Act to move to vacate, but we insist you exercise that right in 30 days." By what authority can FINRA limit a broker's rights under the FAA? Because it is acting reasonably to carry out its investor-protection mission.

- Limitations on Customer PDAA Content: The FAA does not prohibit damage limitations clauses in customer arbitration agreements. Yet FINRA Rule 2268 bans them in customer agreements, along with several other prohibitions. The Rule also requires that PDAAs give certain warnings that the FAA does not require. For example, a PDAA in a customer agreement must contain "a highlighted statement immediately preceding any signature line or other place for indicating agreement that states that the agreement contains a predispute arbitration clause. The statement shall also indicate at what page and paragraph the arbitration clause is located."

But these are basically *customer-protection* rules.

The Customer and Industry Rules are Similar on Class Actions but Not on PDAA Use: Rule 2268 vs. Rule 2263

While the Customer and Industry Rules both allow the investor/employee to opt out of arbitration to participate in a class action,[10] they differ as to PDAA use. Rule 2268 governs the use of PDAAs in customer agreements, setting up stringent requirements for what can and cannot be included, and even regulating placement of the PDAA. And indeed, Schwab was found to have violated this Rule, which among other things says a PDAA cannot include any condition that "limits or contradicts the rules of any self-regulatory organization." In other words, Schwab's class action waiver use contradicted and limited Rule 12204, and thus violated Rule 2268.

However, there's no Rule 2268 analog in the Industry Rules governing PDAA use in the employment context. The closest we get is Rule 2263 which establishes certain required disclosures to Associated Persons signing or acknowledging a Form U4 (which requires APs to arbitrate with their employers). Nothing in the Rule resembles Rule 2268, although one part of the Rule requires firms to advise APs that sexual harassment claims are arbitrable only via a pre- or post-dispute PDAA and not via the U4.[11]

This is not just my observation. The FINRA Board said the same thing in its *Schwab* decision:

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

The bottom line? The absence of a Rule 2268 analog for employee PDAA use, coupled with the Board's own language, pretty much destroys any analogy suggesting that the *Schwab* holding carries over to the employment side.

FINRA's Investor-Protection Mission is Clear; Not so its Employee-Protection Role

But, whereas FINRA has clear, statutorily-defined authority to promulgate rules and establish policies to protect investors, its employee-protection mission is not as clear. The Maloney Act of 1938 amended the Securities Exchange Act of 1934 to provide for the creation

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of what was to become NASD and later FINRA. The Authority describes its original statutory mandate this way: "to protect investors and the public interest, and to remove the impediments to and perfect the mechanism of a free and open market."[12] Nothing about employee protection there. It's current mission statement[13] also is devoid of references to employee protection and stresses investor protection: "FINRA is dedicated to investor protection and market integrity through effective and efficient regulation of broker-dealers. " And: "FINRA is not part of the government. We're a not-for-profit organization authorized by Congress to protect America's investors by making sure the broker-dealer industry operates fairly and honestly." Also, the boilerplate at the end of every SEC Approval Order[14] makes no mention of a FINRA employee-protection mission:

> After careful review of the proposed rule change … the Commission finds that the rule change is consistent with Section 15A(b)(6) of the Exchange Act, which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

But, as discussed below, this has not stopped FINRA from asserting an employee-protection mandate.

So, What Should FINRA Do?

It's clear from the foregoing discussion that, if FINRA sits tight and does nothing, broker-dealers will take (and some already have taken) advantage of the *Concepcion* ruling (now fortified by *Epic)* and insert class action waivers in their employment agreements, just as other business sectors throughout the country have been doing. In the wake of *Epic Systems*, and in view of the current state of FINRA's Rules and policies in this area, what should FINRA do at this juncture? I offer three long, intermediate, and short-term steps FINRA should take: 1) give employees a choice; 2) regulate PDAA use in the employment context; and 3) articulate the Authority's views.

Long Run: Give Employees a Choice

I'm certain that pressure to permit employment PDAAs with class action waivers will be brought to bear on FINRA by the securities industry in the wake of *Epic Systems*, similar to what happened after *Concepcion*. And as it did in that circumstance, I think FINRA should stick to its guns by just making a few rule changes. Then the analogy to *Schwab* will be complete. Securities industry employees in my view should have the same class action waiver protections as customers.

I'm aware that, whereas FINRA has a clear statutorily-defined authority to protect investors, a mandate to protect employees is not self-evident, but it would seem that FINRA has a fair amount of leeway in regulating the industry, even as to employees. It's certainly worth a try, given that the Commission has approved other rule proposals clearly aimed at protecting employees. For example, FINRA Rule 2263(2) requires firms to advise APs that sexual harassment claims are arbitrable only via a pre- or post-dispute PDAA and not via the U4. Rule 2263(3) states that a dispute "arising under a whistleblower statute that prohibits the use of predispute arbitration agreements is not required to be arbitrated under FINRA rules. Such a dispute may be arbitrated only if the parties have agreed to arbitrate it after the dispute arose." And, Rule 13802(d)(1)(A) provides that in cases arising out of a PDAA, "a party who is a current or former associated person shall pay a non-refundable filing fee according to the schedule of fees set forth in Rule 13900(a), provided that… in no event shall such a person pay more than $200 for a filing fee."

And, given a choice, most employees I believe will likely gravitate toward arbitration as they already do today. Why? Several years ago I authored a blog post, *Ten Things About Litigation That Arbitration Critics Won't Tell You.*[15] One of my ten points was: "Class Actions Benefit the Lawyers, Not Individual Consumers." The arguments I made about consumer arbitration ring true for employment arbitration, perhaps more so. Legal Scholar Professor Samuel Estreicher echoed this view in a May 24th *Bloomberg* blog post,[16] *The Supreme Court Did Workers a Favor:* "For all the alarm expressed by Ginsburg and other critics of the decision, some perspective is in order. Most employment claims are unlikely to be brought as class-action suits. In contrast to many consumer class-action claims, which deal with things like credit-card disclosures, people who get fired or denied agreed-upon wages will almost always show up in court or arbitration. Moreover, federal and state administrative agencies are not bound by private arbitration agreements; they are able to sue to vindicate 'small claim' statutory rights where private claimants are not likely to come forward."

Intermediate Run: Regulate PDAA Use in the Employment Context

Let's remember that *Schwab* held that the class action waiver use by firms violated FINRA's Rules on PDAAs and class actions was based in large part on FINRA's Rule 2268 governing arbitration agreements in *customer* contracts. There is, however, no analogous rule governing *employment* PDAAs. Let's also remember, the FINRA Board in its *Schwab* decision noted this difference in the Customer and Industry Rules, thus inviting a challenge to any FINRA attempt to regulate employee PDAA use without such a rule change.

In my opinion, FINRA needs to promulgate a rule governing PDAA use in the employment context similar to Rule 2268. Such a rule would allow for a complete analogy to *Schwab:* 1) a SCOTUS decision saying class action waivers are permissible, but: 2) FINRA rules allowing the weaker party to opt out of arbitration and into a class action; 3) a rule governing the content and placement of PDAAs; and 4) a FINRA policy stating that, despite the Supreme Court's holding allowing industry in general to use class action waivers, the Authority's rules and policies prohibit class action waiver use by an industry party it regulates.

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I think in this day of the #MeToo movement, the Commission would be reluctant to disapprove a FINRA rule proposal aimed at protecting employees.

Short Run: FINRA Should Articulate its Views

FINRA's position on class action waivers in the consumer context is unlikely to alter, but, given the discussion above, it would not be inconsistent for FINRA to maintain a *laissez-faire* position in the employment context. Whatever FINRA does do, *Epic* demands, in my view, that FINRA clarify what its position will be going forward.

We must remember that when *Schwab* was decided back in 2011, SCOTUS had not yet weighed in on class action waivers in employment PDAAs. And, indeed that was an open question resolved by the Court by its decision in *Epic Systems*. Schwab did not challenge at the SEC or in court FINRA's ruling against it. Some firms already use class action waivers in employment agreements. The court decisions cited in the *Schwab* ruling (*Cohen*, *Lewis* and *Suschil*) indicate that UBS and Ameriprise already have enforced existing class action waivers. Morgan Stanley has as well, as indicated in *Frazier v. Morgan Stanley,* 16 Civ. 804 (S.D. N.Y. 2016). Now that SCOTUS has ruled in the employment context, what's to say more brokerage firms, emboldened by *Epic Systems* and silence on FINRA's part, won't force the issue and start using class action waivers in employment PDAAs?

Moreover, I suggest that FINRA act now, even before it changes the Rules. There's precedent. In July 2016, the Authority issued Regulatory Notice 16-25, *Forum Selection Provisions Involving Customers, Associated Persons and Member Firms*.[17] As the title indicates, a good part of the Notice focused on employment PDAA use:

> FINRA is also concerned that member firms are including in predispute agreements with associated persons provisions that have the effect of waiving the associated person's right to obtain FINRA arbitration of any disputes arising out of the agreement. For example, these provisions might require associated persons to resolve employment, business, commercial, or competition disputes at a private arbitration forum or in civil litigation. In FINRA's view, FINRA rules do not allow for the waiver of the Industry Code requirement to arbitrate disputes at FINRA in advance of a dispute (footnote omitted).

How did FINRA address the lack of a Rule 2268-type Rule in the employment context? It asserted authority derived from other parts of the FINRA Rules: "Moreover, the absence of a provision similar to FINRA Rule 2268(d)(1) in connection with predispute agreements under the Industry Code does not lead to the result that a member firm can require an associated person to waive the requirements of FINRA Rule13200. Under the Industry Code, FINRA IM-13000 states that '[i]t may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2010 for a member to require an associated person to waive the arbitration of disputes contrary to the provisions of the Code of Arbitration Procedure'…"

Nature abhors a vacuum, and silence will lead to confusion. Whether it ultimately permits or bans class action waivers in employment arbitration clauses, it behooves FINRA to make public its policy via a Regulatory Notice. A two-step approach might make sense, given the issues involved. An immediate Regulatory Notice might say, in effect, "We are aware of *Epic* and are evaluating the use by member firms of arbitration clauses with class action waivers for employees. Members should bear in mind that, as set forth in Regulatory Notice 16-25, FINRA believes it has the authority to regulate arbitration agreement use in Associated Person employment contracts. Until we decide our final policy, firms are to maintain the *status quo*." A later Notice would articulate any final policies. This will avoid confusion caused by assumptions and presumptions.

Conclusion

To put it mildly, things are a bit muddled right now. Silence from FINRA on this issue will only lead to confusion for both employees and the industry. And assumptions and presumptions… And disputes. Leadership calls for action now.

ENDNOTES

1. See https://www.arbresolutions.com/nlrb-is-cruisin-for-a-bruisin-on-its-arbitration-policy-2/ <Feb. 16, 2014>.
2. See https://www.arbresolutions.com/post-midterm-elections-effect-consumer-arbitration/#.VGtAz_ldX85 < Nov. 18, 2014>
3. See http://www.sacarbitration.com/blog/seems-like-may-right-one-2015-predictions-just-little-late/ <Sep. 14, 2016>.
4. 500 U.S. 20 (1991).
5. See https://www.arbresolutions.com/supreme-court-nominee-gorsuch-seems-pro-arbitration/ <Feb. 1, 2017>.
6. See https://www.arbresolutions.com/consumer-employment-arbitration-six-things-look-2018/ <Dec. 27, 2017>.
7. 517 U.S. 333 (2011).
8. See https://www.finra.org/sites/default/files/NACDecision/p496824.pdf <Apr. 24, 2014>.
9. Also at issue was Schwab's attempt to limit the Arbitrators' authority to consolidate related claims. It lost on that count, too.
10. See FINRA Rules 12204 (customer) and 13204 (industry).
11. On the other hand, there's IM-13000 in the Industry Rules which says: "It may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2010 for a member to require associated persons to waive the arbitration of disputes contrary to the provisions of the Code of Arbitration Procedure."
12. See https://www.finra.org/newsroom/2014/finra-marks-75th-anniversary-protecting-investors <Sep. 18, 2014>
13. See https://www.finra.org/about.
14. See, e.g. the Approval Order for SR-FINRA-2018-003 http://www.finra.org/sites/default/files/SR-FINRA-2018-003-approval-order.pdf <May 17, 2018>.
15. See https://www.arbresolutions.com/ten-things-litigation-arbitration-critics-wont-tell/ <Nov. 5, 2014>.
16. See https://www.bloomberg.com/view/articles/2018-05-24/how-neil-gorsuch-s-ruling-on-class-actions-does-workers-a-favor <May 24, 2018>.
17. See http://www.finra.org/industry/notices/16-25.