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Class Action Waivers in Arbitration Agreements:

What's a Financial-Services Employer to Do?

*By Robert S. Whitman**

Introduction

Most national financial-services companies have a substantial presence in New York. Despite the obvious charms of life in the Big Apple, it is fraught with uncertainty these days for employers who are looking to use pre-dispute arbitration agreements to avoid class actions with their employees.

Here's the dilemma: A single-claimant arbitration, while always potentially dangerous, is nonetheless a familiar and comfortable environment for financial-services employers. Given the industry's strong tradition of arbitration of employment and customer claims, defending employment claims by individuals in arbitration, even in high-value cases involving Managing Directors and other senior executives, presents known and usually quantifiable risks.

Arbitration on a class or collective basis, however, is the opposite – a potential nightmare scenario that, most management lawyers agree, is devoutly to be avoided.

Background

The solution, especially after the Supreme Court's one-two punch on class arbitration in 2010 and 2011, appeared to be readily at hand: arbitration agreements with class action waivers. First the Court held, in *Stolt-Nielsen S.A. v. Animalfeeds Int'l Corp* (SLA 2010-20), that an arbitration panel exceeded its authority under the Federal Arbitration Act ("FAA") by directing arbitration on a class basis where the parties had not agreed to such procedures.

Next came a decision that few observers expected, when the Court held in *AT&T Mobility v. Concepcion* (SLA 2011-18) that the FAA pre-empts a California rule that deemed class action waivers unconscionable, effectively declaring that waivers are permissible and cannot be undermined by state contract law doctrines.

But within the Second Circuit, the answer has not been so simple. A series of recent court decisions within the Circuit has left the law on class arbitration in flux and employers wondering whether waivers such as the one approved in *Concepcion* will survive here.

Recent Second Circuit Developments

Fortunately, recent developments on two successive days in March offered glimmers of hope.

Oral Argument: Raniere and Sutherland

The first development, on March 20, was the oral argument before a Second Circuit panel in two similar but unrelated appeals testing whether arbitral class action waivers can survive:

- In *Raniere v. Citigroup* (SAA 2012-07), District Judge Robert Sweet held, notwithstanding *Concepcion*, that the Fair Labor Standards Act ("FLSA") conveys a substantive right to proceed by a collective action, and that such right cannot be waived via an arbitration agreement's explicit preclusion of collective proceedings. At oral argument, Citi's contentions to the contrary appeared to find a receptive audience in the Circuit panel, offering reason to believe that the judges were signaling an inclination to reverse and hold that the right to pursue a collective action is procedural, not substantive, and therefore amenable to waiver in arbitration.

cont'd on page 2

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TABLE OF CONTENTS

Class Action *cont'd from page 1*

• In *Sutherland v. Ernst & Young* (SAA 2012-07), another wage-hour case, District Judge Kimba Wood held that a class waiver was unenforceable because, in light of the anticipated costs of an individual arbitration and the relatively low amount of damages at stake, the claimant could not effectively vindicate her rights without class or collective procedures – even though E&Y had agreed to pay all forum costs. The same panel heard argument in this appeal.

In *Sutherland,* Judge Wood's decision was based in large part on *American Express Co. v. Italian Colors Restaurant* (SAA 2012-05), an antitrust case in which the Second Circuit held that a class waiver was unenforceable where its effect was to render a claimant economically unable to pursue his claim individually. *AmEx III*, as that case is known, is now pending before the Supreme Court and, while both sides at the *Sutherland* argument took pains to explain why they win regardless of how the High Court decides that case, the judges seemed inclined to "wait and see" what the Court does before resolving *Sutherland*.

Parisi Decision

The second development, on March 21, was the appellate court's reversal in *Parisi v. Goldman Sachs* (SLA 2013-13), in which the Second Circuit appeared to have little difficulty rejecting a District Court ruling that Title VII plaintiffs have an unwaivable right to pursue their claims on a class-wide "pattern or practice" basis, notwithstanding an arbitration agreement that bars class proceedings. Referring to the lower court's conclusion that individual (i.e., non-class) arbitration "would preclude [Parisi] from vindicating her right to bring a substantive 'pattern-or-practice' claim under Title VII," the Second Circuit held: "[S]uch a right does not exist…. [I]n Title VII jurisprudence, 'pattern-or-practice' simply refers to a method of proof and does not constitute a freestanding cause of action."

Commentary & Analysis

All of this is good news for employers looking to enforce explicit class action waivers in their arbitration agreements. What about those whose agreements are silent on class actions? While *Stolt-Nielsen* would appear to mean that such agreements cannot be construed to permit class arbitration, the Second Circuit in *Jock v. Sterling Jewelers* held, in a 2-1 decision issued in 2011, that a clause that said nothing about class procedures, but called for arbitration of "any dispute, claim, or controversy," implicitly did authorize class arbitration proceedings, despite *Stolt-Nielsen*.

Jock's days may be numbered. On March 25, the Supreme Court heard argument in *Oxford Health Plans LLC v. Sutter* (SAA 2012-46), addressing whether an arbitrator may determine that parties agreed to authorize class arbitration within the meaning of *Stolt-Nielsen* based solely on broad language

cont'd on page 3

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Class Action *cont'd from page 2*

requiring arbitration of any dispute under their agreement. The Third Circuit in *Sutter*, relying in part on *Jock*, answered this question in the affirmative, whereas the Fifth Circuit, in *Reed v. Florida Metropolitan University*, expressly disagreed with *Jock*. The Court granted *certiorari* in *Sutter* to resolve the Circuit-split, and many observers believe the Fifth Circuit's view will hold sway with the Justices.

Waiver Developments Elsewhere

To complicate matters further, the NLRB's decision in *D.R. Horton* (SAA 2012-07) remains on the books – for now – even as numerous courts around the country have disagreed with or refused to follow it. *D.R. Horton* held that class action waivers in arbitration agreements contravene the National Labor Relations Act. The case is pending on appeal in the Fifth Circuit, and aside from the merits (or lack thereof) of the Board's holding, the decision is additionally called into question by doubts about the constitutionality of certain recess appointments to the Board.

Amidst all this uncertainty, the financial-services industry received a bit of welcome news in February when a FINRA Disciplinary Panel held, in an enforcement action against Charles Schwab, that the class action waiver in the company's customer arbitration agreements was enforceable under *Concepcion* (SAA 2013-07). The Panel did not opine on whether waivers in employment arbitration agreements would be permissible, but there is nothing in the decision to suggest that it would not take a similar view in that context.

Conclusion

So what is a financial-services employer in the Second Circuit to do while we wait and see how these issues will be resolved? There appear to be four options:

1. Get out of Gotham – If you have the option to venue a case outside the Second Circuit where the law is more favorable (as suggested above, the Fifth Circuit seems especially welcoming these days), take it.

2. Stay in court – If you don't have an explicit class action waiver, or you are concerned that your waiver might not be upheld, then you may want to forego arbitration altogether and defend the case in court (assuming it is brought there initially). You will lose the benefit of your bargain to arbitrate, but at least you will have the procedural protections and appeal rights that you would lose in a class arbitration.

3. Enforce the waiver and take your chances – Some courts within the Second Circuit have approved waivers and rejected *Raniere* and its ilk. For example, Judge Barbara Jones in *LaVoice v. UBS Financial Services* (SLA 2012-46) upheld a class action waiver, refusing to follow both *Raniere* and *D.R. Horton*.

4. Continue to watch and wait – As suggested above, greater clarity may be in sight. With *Parisi*, the upcoming Second Circuit rulings in *Raniere* and *Sutherland*, and the Supreme Court's decisions in *AmEx III* and *Sutter*, we may have a lot more clarity by the summer or fall of 2013 than seemed possible a few months ago. If employers can hold out a little longer, they may be pleased by where the law ends up.

FINRA DISCIPLINE STUDY

Sutherland, Asbill & Brennan LLP has issued the latest of its annual studies of FINRA enforcement actions and fines, this one covering 2012. The study found that FINRA filed 1,541 cases, the fourth consecutive year that the number has increased and a growth of 44% since 2008, and issued fines of $78.2 million, an increase of 15% since the previous year alone. The results also reveal a 43% annual increase in the number of firms expelled (30 in 2012), 16 "supersized" fines of $1 million or more, totaling $43 million, and $34 million in restitution to investors in a single year (a whopping 80% surge in a single year). The leading enforcement issue was suitability, followed by due diligence, research reports and analysts, advertising and exchange-traded funds (ETFs), in that order. Suitability cases yielded $19.4 million in fines, a 152% increase since 2011, and due diligence cases $12.8 million (a 41% increase), largely due to problems with ETFs and "supersized" fines in cases involving complex products.

(Source: "Annual Sutherland Analysis of FINRA Sanctions Shows Number of Enforcement Actions Rises Slightly in 2012, Fines Jump by 15%," by Barry L. Rubin and Deborah G. Heilizer, Sutherland Asbill & Brennan, www.sutherland.com/NewsEvents (3/13/13))