

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-66774; File No. SR-FINRA-2011-075)

April 9, 2012

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, Amending Rule 13024 of the Code of Arbitration Procedure for Industry Disputes to Preclude Collective Action Claims from Being Arbitrated

I. Introduction

On December 22, 2011, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposal to amend Rule 13204 of the Code of Arbitration Procedure for Industry Disputes (“Industry Code”) to preclude collective action claims by employees of FINRA members under the Fair Labor Standards Act (FLSA), the Age Discrimination in Employment Act (ADEA), or the Equal Pay Act of 1963 (EPA) from being arbitrated under the Industry Code. Specifically, the proposal would, among other things, (1) state that collective action claims under the FLSA, the ADEA, or the EPA may not be arbitrated under the Code; (2) provide that any claim involving similarly situated plaintiffs against the same defendants, such as a court-certified collective action or a putative collective action, would not be arbitrated in FINRA’s arbitration forum; (3) give arbitrators the authority to decide disputes about whether a claim is part of a collective action; and (4) prohibit a member firm or associated person from enforcing any arbitration agreement against a member of a certified or putative collective action with respect to any claim that is the subject of the certified or putative collective action until either the collective certification is denied or the group is decertified.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

The proposed rule change was published for comment in the Federal Register on January 11, 2012.<sup>3</sup> The Commission received two comments on the proposed rule change.<sup>4</sup> On March 29, 2012, FINRA filed a response to comments and a partial amendment to the proposed rule change (“Amendment No. 1”).<sup>5</sup> The Commission is publishing this notice and order to solicit comment on Amendment No. 1 and to approve the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

## II. Description of Proposed Rule Change

As stated in the Notice, Rule 13204 of the Industry Code generally provides that any claim that is based upon the same facts and law, and involves the same defendants as in a court-certified class action or a putative class action, shall not be arbitrated. The Notice also stated that in 1999 FINRA issued an Interpretive Letter stating that its class action rules should include collective action claims brought under the FLSA and, therefore, considered these claims ineligible for arbitration in its forum.<sup>6</sup> However, as described in the Notice, the United States District Court for the Southern District of New York found that an FLSA collective action is not

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<sup>3</sup> See Exchange Act Release No. 66109 (Jan. 5, 2012), 77 FR 1773 (Jan. 11, 2012) (Notice of Filing of Proposed Rule Change to Amend the Code of Arbitration Procedure for Industry Disputes to Preclude Collective Action Claims from Being Arbitrated) (“Notice”). The comment period closed on February 1, 2012.

<sup>4</sup> See Letter from Kevin M. Carroll, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated February 1, 2012 (“SIFMA Letter”); and letter from Jill I. Gross, Director, Edward Pekarek, Assistant Director, and Genavieve Shingle, Student Intern, Investor Rights Clinic at Pace Law School, dated February 1, 2012 (“PIRC Letter”). Comment letters are available at <http://www.sec.gov>.

<sup>5</sup> See Letter from Mignon McLemore, Assistant Chief Counsel, FINRA, FINRA Dispute Resolution, to Elizabeth M. Murphy, Secretary, SEC, dated March 28, 2012 (“Response to Comments No. 1 and Partial Amendment No. 1”). The text of Response to Comments No. 1 and Partial Amendment No. 1 is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA, and on the Commission’s website at <http://www.sec.gov>.

<sup>6</sup> See Notice (citing FINRA Interpretive Letter to Cliff Palefsky, Esq., dated September 21, 1999).

a class action for purposes of Rule 13204 of the Industry Code and compelled arbitration of such claims in FINRA's dispute resolution forum.<sup>7</sup>

In response to the court's finding, FINRA is proposing to amend Rule 13204 to preclude collective action claims from being arbitrated in FINRA's forum under the Industry Code. The proposed amendments to Rule 13204, would separate Rule 13204 into two sections: subparagraph (a) for class actions, and subparagraph (b) for collective actions. Subparagraph (a) would be titled, "Class Actions," and re-numbered. Subparagraph (b) would be titled, "Collective Actions," and would contain four subparagraphs.

Proposed subparagraph (b)(1) would state that collective action claims under the FLSA, the ADEA, or the EPA may not be arbitrated under the Industry Code.

Under proposed subparagraph (b)(2), any claim that involves plaintiffs who are similarly-situated against the same defendants as in a court-certified collective action or a putative collective action, or that is ordered by a court for collective action at a forum not sponsored by a self-regulatory organization, would not be arbitrated under the Industry Code, if the party bringing the claim has opted in to the collective action.

Under proposed subparagraph (b)(3), as originally proposed, the Director would have referred to a panel any dispute as to whether a claim is part of a collective action, unless a party asked the court hearing the collective action to resolve the dispute within 10 days of receiving notice that the Director has decided to refer the dispute to a panel. Amendment No. 1, however, would permit a party to ask any forum (not just a court) hearing the collective action to resolve the dispute within the specified time.

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<sup>7</sup> Id. (citing Hugo Gomez et al. v. Brill Securities, Inc. et al., No. 10 Civ. 3503, 2010 U.S. Dist. LEXIS 118162 (S.D.N.Y. Nov. 2, 2010)).

Subparagraph (b)(4), as originally proposed, would have provided that a member or associated person may not enforce any arbitration agreement against a member of a certified or putative collective action with respect to any claim that is the subject of the certified or putative collective action until the collective action certification is denied or the collective action is decertified. Amendment No. 1, however, would specify that subparagraph (b)(4) would apply only to agreements to arbitrate in the FINRA forum, thus not affecting agreements to arbitrate in fora other than FINRA's.

### III. Summary of Comment Letters

As stated above, the proposed rule change was published for comment in the Federal Register on January 11, 2012, and the comment period closed on February 1, 2012. The Commission received two comment letters in response to the proposed rule change. On March 28, 2012, FINRA responded to the comments and filed Amendment No. 1 to the proposed rule change.

The PIRC Letter strongly supported the proposed rule change.

The SIFMA Letter did not object to the proposed rule change, but recommended revisions to certain language in proposed subparagraph (b). First, SIFMA recommended modifying proposed subparagraph (b)(2) to replace the phrase, "Any claim that involves plaintiffs who are similarly situated against the same defendants as in a court-certified collective action or a putative collection action," with, "Any claim that is the subject of a certified or putative collective action." SIFMA argued that FINRA's proposed language could be misconstrued to include multi-party litigation outside of the collective action context. SIFMA suggested that its proposed change would clarify FINRA's intent to limit the application of the proposed rule to collective actions.

In its Response to Comments No. 1, FINRA declined to amend its proposed subparagraph (b)(2) as SIFMA suggested. FINRA stated that the revision is unnecessary because as proposed the rule already clarifies its applicability to only those parties who opt in to a collective action; furthermore, as proposed the rule would preclude those claims from being arbitrated in FINRA’s forum only, and would not preclude their being arbitrated in other fora. FINRA also declined to remove the term “similarly situated” from proposed subparagraph (b)(2) as SIFMA suggested because the term is consistent with language used in the FLSA to describe party plaintiffs in collective actions under the statute,<sup>8</sup> and the term helps define the parties to whom the proposal would apply.

Second, SIFMA recommended modifying proposed subparagraphs (b)(3) and (b)(4) to limit their scope to FINRA arbitration. Specifically, SIFMA recommended modifying proposed subparagraph (b)(3) by replacing “the court hearing the collective action” with “the court or other forum hearing the collective action.” SIFMA stated that this change would clarify that arbitration fora, other than FINRA’s forum, accept collective action claims. Similarly, SIFMA recommended modifying proposed subparagraph (b)(4) by replacing “may not enforce any arbitration agreement” with “may not enforce an agreement to arbitrate in this forum.” SIFMA stated that this change would clarify that under the proposed rule agreements to arbitrate collective action claims in arbitration fora other than FINRA would remain valid and enforceable.

FINRA agreed to amend proposed subparagraphs (b)(3) and (b)(4) as SIFMA recommended. FINRA stated that it made these changes because the proposed rule is designed to prohibit collective action claims from being arbitrated in its forum only; FINRA members and

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<sup>8</sup> See 29 U.S.C. 216(b).

their employees may, however, agree to address collective action claims either by filing them in a court of competent jurisdiction or by arbitrating them in other arbitration fora.

#### IV. Commission's Findings

The Commission has carefully considered the proposed rule change, the comments received, FINRA's Response to Comments No. 1, and Amendment No. 1. The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Exchange Act, and the rules and regulations thereunder that are applicable to a national securities association.<sup>9</sup> In particular, the Commission finds that the proposal is consistent with Section 15A(b)(6) of the Act,<sup>10</sup> which requires, among other things, that the rules of a national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest.

The proposed rule change, as amended, would facilitate the efficient resolution of collective actions under the FLSA, ADEA, or the EPA, as courts have established procedures to manage these types of representative actions. It also would preserve access to courts for these types of claims for employees of FINRA members.

The Commission believes that FINRA has responded adequately to SIFMA's comments recommending revisions to certain language in proposed subparagraphs (b)(2), (b)(3) and (b)(4) to the proposed rule by explaining, among other things, why it is proposing to revise proposed subparagraphs (b)(3) and (b)(4), but is not proposing to revise subparagraph (b)(2). In response

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<sup>9</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>10</sup> 15 U.S.C. 78o-3(b)(6).

to SIFMA's comments, FINRA proposed to amend proposed subparagraphs (b)(3) and (b)(4) to acknowledge that arbitration fora other than FINRA's dispute resolution forum accept collective action claims. FINRA has suitably explained its reasons for declining to amend proposed subparagraph (b)(2) as SIFMA recommended.

#### V. Accelerated Approval

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act<sup>11</sup> for approving the proposed rule change, as modified by Amendment No. 1, prior to the 30th day after publication of Amendment No. 1 in the Federal Register. The changes proposed in Amendment No. 1 revised proposed subparagraphs (b)(3) and (b)(4) in response to specific concerns raised by SIFMA. The amendment addresses these concerns by clarifying that arbitration fora, other than FINRA's forum, accept collective action claims, and that under the proposed rule agreements to arbitrate collective action claims in arbitration fora other than FINRA would remain valid and enforceable.

Accordingly, the Commission finds that good cause exists to approve the proposal, as modified by Amendment No. 1, on an accelerated basis.

#### VI. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether Amendment No. 1 to the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form

(<http://www.sec.gov/rules/sro.shtml>); or

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<sup>11</sup> 15 U.S.C. 78s(b)(2).

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2011-075 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2011-075. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>).

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2011-075 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>12</sup> that the proposed rule change (SR-FINRA-2011-075), as modified by Amendment No. 1, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>12</sup> 15 U.S.C. 78s(b)(2).

<sup>13</sup> 17 CFR 200.30-3(a)(12).