Anachronism Revealed: FINRA Rules Trump *Italian Colors* to Give Registered Members Their Day in Court

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It is rare these days for a court to deny a motion to compel arbitration. It is especially surprising to find such a decision where the parties are subject to an arbitration agreement. Using the fundamental principle underlying arbitration – "arbitration is a matter of contract" – the Court in *Zeltser v. Merrill Lynch & Co.*[1] did just that.

In *Zeltser*, employees brought a putative collective action alleging that their employers had violated the Fair Labor Standards Act ("FLSA") and the New York Labor Law by refusing to pay for overtime.[2] There is no question that the employees were registered with FINRA and had signed a uniform application, commonly known as a Form U-4, to be employed by the securities firm defendants, and there is no question that the FINRA rules, which govern the Form U-4, provide for arbitration of disputes between employees and securities industry employers.[3] There is also no question, however, that the FLSA permits "collective" actions, treated as class actions, and this is where the anachronism comes into play.

Years before the Supreme Court held in *American Express Co. v. Italian Colors Restaurant*[4] that a plaintiff is not entitled to effectively vindicate an injury by means of a class action, it was commonly considered that certain types of claims, particularly those in which an individual action would be so prohibitively expensive that the wrong might never be vindicated, would be subject to the Rule 23 provisions providing for class treatment. While class claims may theoretically be tried in arbitration, typically it is believed that courts are better suited to manage such claims. Indeed, the view was that such effective vindication barred companies from drafting arbitration provisions that deprived a plaintiff of the right to pursue class claims.

It was in this atmosphere that FINRA adopted a rule that explicitly prohibited arbitration for those members who were part of a putative class or collective action, barring:

> the enforcement of arbitration agreements against a member of a putative class or collective action until class or collective certification has been denied or decertified, and for class actions only, until a member has been excluded from the class by the Court or opted to of the class.[5]

It was this Rule the Court cited in denying defendants' motion to compel arbitration in *Zeltser*.[6]

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[1] No. 13CV1531, 2013 WL 4857687, *2 (S.D.N.Y. Sep. 11, 2013) (citation omitted).
[2] 2013 WL 4857687 at *1.
[3] *Id.*
[4] __ U.S. __, 133 S.Ct. 2304 (June 20, 2013).
[5] *Zeltser*, 2013 WL 4857687 at *2 (citing FINRA Rule 13204).
[6] *Id.*

Much as the majority is loath to admit it, *Italian Colors* has changed the prevailing view and, thus, the landscape. While it still may be – and probably is – true that courts are still best situated to "resolve class actions efficiently,"[7] since the decision in *Italian Colors*, it is no longer the prevailing view that plaintiffs must be given the opportunity to effectively vindicate their rights.[8] Commentators expect a rash of arbitration agreements in areas in which such agreements have traditionally been barred such as, for example, in consumer agreements. The *Zeltser* court is absolutely correct that, according to the FINRA rules themselves, arbitration could not be ordered in that case. It remains to be seen how long this anachronism survives.

About the Author

Ms. McCallion is partner in the firm's Litigation and Arbitration practice group. She has substantial trial and arbitration experience and has litigated a broad array of complex commercial disputes, with an emphasis on products liability, patent and trademark litigation, and international arbitration. Ms. McCallion is a member of the firm's Diversity Committee. She formerly practiced with Debevoise & Plimpton LLP. She is a graduate of Yale Law School, where she served as a Lead Editor of the Yale Journal on Regulation.

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[7] *Zeltser* at *2 (quoting FINRA Interpretive Letter to Cliff Palefsky, Esq., Sept. 21, 2009).
[8] *See, e.g., Sutherland v. Ernst & Young LLP*, 12-3-4-cv, 2013 WL 4033844 (2d Cir. Aug. 9, 2013) (holding that, in light of *Italian Colors*, employee cannot invalidate a class-action waiver provision in an arbitration agreement when waiver removes financial incentive to pursue claim under FLSA).