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ARBITRATION

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Collective Employment Actions in Securities Industry Arbitration

Arbitration of employment claims pursuant to predispute agreements has received initial judicial endorsement in the securities industry.

In its 1991 decision in *Gilmer v. Interstate/Johnson Lane Corp.*,[1] the Supreme Court held that given the pro-arbitration policy of the Federal Arbitration Act of 1925 (FAA),[2] the Form U-4 agreement that all registered representatives of a brokerage house must enter into with their employers, both as a condition of employment and a condition of registration with the major stock exchanges, could provide for binding arbitration of any and all disputes between the parties to the employment relationship, even if the dispute involved, as in that case, the interpretation and application of the Age Discrimination in Employment Act of 1967, and by extension other federal anti-discrimination statutes.

Despite this provenance, however, plaintiffs have a ready means of avoiding securities industry arbitration by alleging class-action claims because the rules of the major exchanges exclude such claims from their arbitration process.

'Coheleach v. Bear Stearns'

A recent decision of the U. S. District Court for the Southern District of New York, *Coheleach v. Bear Stearns & Co., Inc.*[3] leaves open whether "opt-in" collective action claims under the §16(b) of the Fair Labor Standards Act of 1938 (FLSA)[4] fall within the stock exchange exclusion and may be pursued in non-class arbitration, while holding that putative "opt-out" class action claims arising under state and local laws do not come within the exclusion and cannot be arbitrated.

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Mr. Coheleach was employed by Bear, Stearns as a stockbroker for approximately three years. Claiming he had been improperly classified as an FLSA-exempt employee and required to work more than 40 hours a week without receiving overtime pay, he brought an opt-in collective action suit in federal district court under the FLSA and raised pendent claims, styled as Rule 23, FRCivP class actions, under New York State and New York City laws. Defendant moved to compel arbitration, relying on two arbitration agreements plaintiff had signed. The first was included in a letter offering him employment (Employment Agreement):

> You and the firm both specifically and knowingly and voluntarily agree to a pre-dispute arbitration clause so that should any controversy or dispute arise in connection with your employment, the cessation of your employment or the interpretation of the offer letter, you and the Firm agree to arbitrate any and all such claims before a neutral panel of the National Association of Securities Dealers, Inc. [(NASD)] (pursuant to its rules, including those related to discovery) at an NASD situs closest to the last Firm office in which you were employed.

The other agreement was included in the Uniform Application for Securities Industry Registration or Transfer (the U-4) required of all brokers working with the major exchanges, and it provides:

> I agree to arbitrate any dispute, claim or controversy that may arise between me and my firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions, or by-laws of the [NASD] as may be amended from time to time and that any arbitration award rendered against me may be entered as a judgment in any court of competent jurisdiction.

Main Issue

Mr. Coheleach's principal argument responding to the motion to dismiss was that his opt-in collective action claim under §16(b) of the FLSA came within the exclusion from arbitration in NASD Rule 10301(d)(1) which provides that "a class action shall not be eligible for [NASD] arbitration"; moreover, the NASD would interpret its rule to cover purported collective actions as well as "opt-out" class action claims. Without squarely deciding that issue, District Judge Cedarbaum noted that during the eight months the suit was pending Mr. Coheleach had been free to invite other potential plaintiffs to join the FLSA action but no other individual had come forward, and that she had issued an order setting July 15, 2006 as the

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deadline for joining additional plaintiffs. That date was passed, and no additional individuals elected to join his suit.

Reasoning that district courts have broad discretion in the certification and management of collective actions, the district court ruled that, in view of the failure of other potential plaintiffs to join his action, "plaintiff's FLSA claims is an individual one, and subject to NASD arbitration under both the U-4 and the Employment Agreement." The court further stated: "Since plaintiff has been unable to attract other registered securities brokers and his individual claim is subject to arbitration, it is not necessary to decide whether Rule 10301 applies to collective actions."

As for Mr. Coheleach's pendent state and local law claims, the court held they came within the NASD exclusion and could not be arbitrated under NASD auspices. Distinguishing decisions holding that individuals cannot avoid arbitration of their employment claims by alleging class action claims,[5] the court explained: "Unlike the cases defendant relies on, in this case both parties have agreed to arbitrate pursuant to the rules of the NASD, which provides in Rule 101301 for exclusion of class actions. The Court also quoted from NASD Rule 10304(d)(3), which provides:

> No member or associated person shall seek to enforce any agreement to arbitrate against a customer, other member or person associated with a member who has initiated in court a putative class action…until (A) the class certification is denied; (B) the class is decertified; (C) the [plaintiff] is excluded from the class; or (D) the [plaintiff] elects not to participate in the putative or certified class action….

Bear, Stearns argued that because plaintiff's Employment Agreement was broader than the U-4 agreement, Mr. Coheleach's arbitration promise contained in that agreement was not subject to the NASD exclusion for class actions. The court, however, rejected the argument: "Even if the Employment Agreement were broader than the U-4, it still requires defendant to arbitrate pursuant to the NASD Rules." Moreover, if the employer sought to enforce a broader promise, it would run up against the prohibition in Rule 10304(d)(3) (quoted above), and possibly trigger a violation of NASD rule IM-10100, which provides:

> Action by members requiring associated persons to waive the arbitration of disputes contrary to the provision of the Code of Arbitration Procedure shall constitute conduct that is inconsistent with just and equitable principles of trade and a violation of [the NASD Rules].

Open Questions

1. Scope of Stock Exchange Exclusion of "Class Actions." There are several open questions to consider. The first is the issue expressly open by the court in *Coheleach*: whether a purported opt-in collective action under the FLSA comes within the exclusion from arbitration maintained by the NASD and some other major exchanges for "class actions." In *Chapman v. Lehman Brothers*,[6] a federal district court in Florida interpreted a similar NYSE Rule 600(d) to not include such collective actions. The *Chapman* court reasoned that (1) "[t[he applicable rules do not mention any of the identifying properties of a §16(b) collective action, which, unlike a class action, does not require all similarly situated persons to be bound by a judgment"; (2) "the rules detail the requirements for a class action plaintiff's claim to be eligible for arbitration," such as class certification, decertification, exclusion and opting out, which "are not functions of a §16(b) collective action, but rather speak directly to a FedRCivP 23 class action"; (3) no case was cited where relevant exchange rules have prohibited arbitration of an FLSA collective action; and (4) in view of "the federal policy strongly favoring enforcement arbitration agreements, the court refuses to indulge plaintiffs in an expansive reading of the governing rules' limitations on the arbitrability of the present claims."[7]

Bear, Stearns argued that because plaintiff's Employment Agreement was broader than the U-4 agreement, Mr. Coheleach's arbitration promise within that agreement was not subject to the NASD exclusion for class actions. The court, however, rejected the argument.

Ultimately, this issue is one of proper interpretation of the stock exchange rules, which would be governed by the language of the rules, an analysis of the differing characteristics of opt-in collective actions and opt-out class actions, and any contemporaneous evidence of the intention of the exchanges or the SEC in promulgating the rule.

2. Treatment of Pendent State and Local Law Claims. As a practical matter, even if a court construes the stock exchange exclusion of "class actions" not to encompass FLSA collective actions, the part of the *Coheleach* holding reading the exclusion to include opt-out class action claims under pendent state and local laws renders the arbitrability of the FLSA claim moot. From a defense standpoint, such an outcome invites the worst of both worlds: virtually unreviewable arbitration of the FLSA claim coupled with full-blown discovery of the class action claims in court. Defendants would be advised to consider whether they have a basis for seeking dismissal of the pendent claims before moving for arbitration of the FLSA claims.

3. Opting Out of the Self-Regulatory Organization Arbitration Process Entirely for Employment Claims. A third option employers should consider is whether to provide in bilateral agreements with their registered representatives, and perhaps other employees, for a binding arbitration process of employment disputes outside of the arbitration processes of the self-regulatory organizations altogether. Although beyond the scope of this article, such a course could be structured consistent with existing law.

1. 500 US 20 (1991).
2. 9 USC §§1 et seq.
3. 05 Civ. 8851(SDNY, July 26, 2006), reprinted in NYLJ, Aug. 1, 2006, p. 25, col. 1.
4. 29 USC §216(b).
5. Citing *Howard v. Klynveld Peat Marwick Goerdeler*, 977 FSupp 654, 665 n.7 (SDNY 1997); *Champ v. Siegel Trading Co.*, 55 F3d 269, 276-77 (7th Cir. 1995).
6. 279 FSupp2d 1286 (S.D.Fla. 2003).
7. Id. at 1289-90.