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JP Morgan Can't Duck FINRA Arbitration, 3rd Circ. Says

By **Jon Hill**

Law360 (August 7, 2018, 11:04 PM EDT) -- A Third Circuit panel ruled Tuesday that J.P. Morgan Securities must arbitrate a Pennsylvania health system's claims over several pre-2008 auction rate securities offerings, finding the system hadn't waived its right to arbitration before the Financial Industry Regulatory Authority by signing on to agreements with clauses pegging New York's Southern District as the forum for any disputes.

In a 36-page published opinion written by U.S. Circuit Judge Jane R. Roth, the three-judge panel affirmed a Pennsylvania federal court's 2016 decision to grant a bid by Reading Health System — now known as Tower Health — to compel arbitration of its claims against Bear Stearns & Co., the predecessor firm to J.P. Morgan Securities LLC that served as underwriter and broker-dealer on Reading's ARS issuances.

J.P. Morgan had appealed that court decision, citing forum selection clauses in two broker-dealer agreements executed by Reading to argue that the health system had contractually agreed to bring its claims in New York federal court and supersede its right to arbitration under FINRA Rule 12200, which mandates that member firms must arbitrate customer disputes.

But the panel concluded that those clauses didn't amount to an implicit waiver of this right, given that they didn't actually mention arbitration at all.

"Without a specific reference to arbitration, the forum-selection clause requiring parties to litigate actions 'arising out of' the contract and related transactions lacks the specificity required to advise Reading that it was waiving its affirmative right to arbitrate under FINRA 12200," the panel said.

According to the panel, the right to FINRA arbitration doesn't come from a contractual agreement but rather from a "binding, regulatory rule" put in place by FINRA and approved by the U.S. Securities and Exchange Commission, which has promoted giving investors the option of resolving securities-related disputes through arbitration.

"By condoning an implicit waiver of Reading's regulatory right to arbitrate, we would erode investors' ability to use an efficient and cost-effective means of resolving allegations of misconduct in the brokerage industry and thus undermine FINRA's ability to regulate, oversee and remedy any such misconduct," the panel said.

The panel's decision widens a circuit split on the question of whether forum selection clauses like these can effectively waive customers' right to arbitration under FINRA Rule 12200. While the Fourth Circuit has also said they can't — a position it staked out in a 2013 ruling in UBS Financial Services Inc. et al. v. Carilion Clinic — the Second and Ninth Circuits have found otherwise.

In a **2014 decision** in Goldman Sachs & Co. v. Golden Empire Sch. Fin. Auth., for example, the Second Circuit said such a clause "supersedes an earlier agreement to arbitrate," viewing FINRA's rule as tantamount to an agreement to arbitrate with customers.

For its part, FINRA has frowned on attempts by broker-dealers to use forum-selection clauses in this manner. In guidance issued in 2016, the organization stressed to member firms that "customers have a right to request arbitration at FINRA's arbitration forum" and said they don't give up that right "by signing any agreement with a forum selection provision specifying another dispute resolution process or an arbitration venue other than the FINRA arbitration forum."

Mark Strauss, counsel for Reading, echoed that point in a statement to Law360.

"Usually it's the brokerage industry that's the party seeking to compel arbitration of disputes with customers," Strauss said. "But it has to be remembered that, under FINRA rules, customers have the right to compel arbitration, too. This decision acknowledges the importance of that right. It establishes — at least in the Third Circuit — that the industry can't compel customers to litigate in court by putting cryptic supposed waiver clauses in their contracts which they can then decide to invoke whenever it suits them."

A representative for J.P. Morgan did not immediately return a request for comment late Tuesday.

The dispute that Reading sought to arbitrate was originally filed as a claim with FINRA in 2014. Reading has alleged that Bear Stearns grossly misrepresented the nature of the auction rate securities market when advising the health care system to issue nearly $519 million of ARS debt and enter interest rate swaps covering almost $319 million of that debt.

Reading was injured when Bear Stearns and other banks suddenly yanked undisclosed support for the ARS market, causing the market to collapse in February 2008, according to Reading's court filings.

U.S. Circuit Judges Roth and Patty Shwartz, along with U.S. District Judge Gerald J. Pappert, sat for the Third Circuit panel.

J.P. Morgan is represented by Jonathan K. Youngwood of Simpson Thacher &

Bartlett LLP.

Reading is represented by Mark A. Strauss, Thomas W. Elrod and Peter S. Linden of Kirby McInerney LLP.

The case is Reading Health System v. Bear Stearns & Co. n/k/a J.P. Morgan Securities LLC, case number 16-4234, in the U.S. Court of Appeals for the Third Circuit.

--Editing by Alanna Weissman.

Correction: A previous version of this story misidentified the date of the Carilion Clinic ruling. The error has been corrected.
