

Client Alert

Leveling the Playing Field for FINRA Rule 12206 Eligibility Motions

7/06/2017

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The U.S. Supreme Court's decision in *CalPers v. ANZ Securities, Inc.* provides compelling new support for a respondent arguing an eligibility motion before a FINRA arbitration panel. With the weight of the Court on their side, broker-dealers may have their own opportunity to level the playing field.

Background

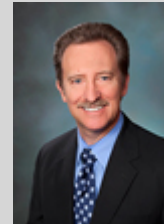
In 2009, the Financial Industry Regulatory Authority (FINRA) implemented Rule 12504, severely restricting the types of dispositive motions FINRA arbitration panels can act upon before the close of a claimant's case-in-chief. FINRA Dispute Resolution staff explained that the rule change ensures claimants have their "day in court"^[1] and "levels the playing field" between claimants and broker-dealers.

However, many defense practitioners believe that FINRA put its thumb on the scales of justice. Indeed, in its Arbitrator's Guide, FINRA instructs arbitrators that "motions to dismiss filed prior to the conclusion of a party's case-in-chief are discouraged and granted only under limited circumstances."^[2]

One exception to the broad prohibition on summary disposition is the rule of repose in FINRA Rule 12206, barring claims that arose more than six years prior to filing in the FINRA Dispute Resolution Forum. Unfortunately, all too often, arbitrators take FINRA's admonition to heart and, in an effort to give claimants their day in court, they apply equitable tolling to the time bar in Rule 12206. In *CalPers v. ANZ Securities, Inc.*, however, the U.S. Supreme Court may have provided future respondents with the arguments they need to level the playing field.^[3]

FINRA Rule 12206

Rule 12206 establishes a two-tiered scheme governing the eligibility and limitation of claims in the FINRA arbitration forum. First, Rule 12206(a) states that "[n]o claim shall be eligible for submission to arbitration under the Code where six years have elapsed from the occurrence of the event giving rise to the claim." Second, Rule 12206(c) states that "this rule does not extend applicable statutes of limitations."



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The first provision, establishing a six-year time limit, dovetails with the SEC's requirement that broker-dealers maintain records of all purchases and sales of securities for six years,^[4] thus protecting broker-dealers from claims concerning matters so old that the relevant documentation may no longer exist. The second provision, preserving all applicable statutes of limitation, contemplates state-law time bars, subject to equitable tolling, that work in conjunction with FINRA's six-year rule of repose.

Courts currently disagree on whether arbitration panels may apply equitable tolling to circumvent the six-year rule of repose. Some have interpreted the rule as a bright-line test categorically barring claims more than six years old.^[5] Others have treated it like a statute of limitations, subject to equitable tolling at the arbitrators' discretion in cases where the claimants did not discover the alleged injuries until months or years after the fact.^[6] Given this split, broker-dealers currently face the specter of arbitration over claims arising out of events that occurred many years in the past.

CalPers v. ANZ Securities

In *CalPers v. ANZ Securities*, several years after an alleged securities violation, the California Public Employees Retirement System opted to abandon a class-action suit and instead bring its own separate action against the broker-dealer.^[7] However, because CalPers brought the subsequent action more than three years after the broker-dealer's alleged misconduct had occurred, the U.S. District Court dismissed CalPers' claims as time-barred by Section 13 of the Securities Act of 1933.^[8]

Section 13 not only requires that a plaintiff bring suit within one year of discovering an alleged securities violation; it also provides that "[i]n no event shall any [action under Section 11 of the Securities Act] be brought more than three years after the security was bona fide offered to the public."^[9]

After the Second Circuit affirmed the dismissal, the Supreme Court granted certiorari.^[10] Writing for the majority, Justice Kennedy rejected CalPers' argument that the doctrine of equitable tolling could extend Section 13's three-year time limit.^[11] He emphasized Section 13's binary structure, observing that the statute sets forth two time bars: one running from the time a plaintiff discovers the securities-law violation, and another, the above-mentioned three-year limitation.^[12]

Holding that the latter rule was a statute of repose and therefore not subject to equitable tolling, Justice Kennedy explained: "[t]he pairing of a shorter statute of limitations and a longer statute of repose is a common feature of statutory time limits. The two periods work together: the discovery rule gives leeway to a plaintiff who has not yet learned of a violation, while the rule of repose protects the defendant from an interminable threat of liability."^[13] Therefore, the three-year rule of repose was an absolute bar to CalPers' claim.^[14]

Relevance of *CalPers* to Rule 12206

The structure of Section 13 of the Securities Act of 1933 corresponds closely to that of FINRA's Rule 12206. Like Section 13, Rule 12206 expressly contemplates two distinct limitations on the time to bring a claim: a six-year rule of repose in Section (a) and a reference to state-law statutes of limitations in Section (c).

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Accordingly, the Supreme Court's recent decision offers powerful ammunition for respondents seeking dismissal under Rule 12206. Given the Rule's structural similarity to Section 13, which contains both a statute of limitations and a rule of repose, the six-year rule of repose should be read as an absolute bar—a rule designed to “protect[] the defendant from an interminable threat of liability”^[15] and therefore not subject to equitable tolling.

Conclusion

The Supreme Court's decision in *CalPers v. ANZ Securities, Inc.* provides compelling new support for a respondent arguing an eligibility motion before a FINRA arbitration panel.

The Court's holding that the statute of repose in Section 11 of the Securities Act is not subject to equitable tolling analogizes closely to the argument that Rule 12206 is not simply a statute of limitations subject to equitable tolling, but rather a statute of repose, strictly barring any claims from being brought after a six-year period.

With the weight of the U.S. Supreme Court on their side, broker-dealers may have their own opportunity to level the playing field.

Significant research and drafting support for this article was provided by John Thorpe, Summer Associate at Lewis Roca Rothgerber Christie, LLP.

^[1] Financial Industry Regulatory Authority, FINRA Office of Dispute Resolution Arbitrator's Guide 49 (Feb. 2017), <http://www.finra.org/sites/default/files/arbitrators-ref-guide.pdf>.

^[2] Id.

^[3] *Cal. Pub. Employees' Retirement Sys. v. ANZ Securities, Inc.*, No. 16-373, 2017 WL 2722415 (June 26, 2017).

^[4] 17 C.F.R. § 240.17a-3. Moreover, six years is the default time period for books and records not subject to any specific rule. See FINRA, *Books & Records*, <http://www.finra.org/industry/books-records> (last visited June 30, 2017).

^[5] See, e.g., *Edward D. Jones & Co. v. Sorrells*, 957 F.2d 509, 512 (7th Cir. 1992); *Chubb Sec. Corp. v. Manning*, 569 N.W.2d 886, 887 (Mich. Ct. App. 1997); *Ohio Co. v. Nemecek*, 98 F.3d 234, 237 (6th Cir. 1996).

^[6] See, e.g., *Oshidary v. Purpura-Andriola*, 2012 WL 2135375, at *5 (N.D. Cal. 2012); *Mid-Ohio Sec. Corp. v. Estate of Burns*, 790 F.Supp.2d 1263, 1271–72 (D. Nev. 2011).

^[7] *Cal. Pub. Employee's Retirement System*, 2017 WL 2722415, at *5.

^[8] *Id.* at *6.

^[9] *Id.* at *5; 15 U.S.C. § 77m.

^[10] *Cal. Pub. Employee's Retirement System*, 2017 WL 2722415, at *6.

^[11] *Id.* at 14.

^[12] *Id.* at 7.

^[13] *Id.* (citations omitted).

^[14] *Id.*

^[15] *Id.*

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