CLOSE THE COURTHOUSE DOORS, OPEN THE BALLOT BOX: HOW MANDATORY ARBITRATION AGREEMENTS AFFECT FINANCIAL ADVISING AGREEMENTS

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As Professor Edwards discussed in his article, the rise in arbitration agreements has essentially closed the door for courts to gradually find that financial advisors have fiduciary duties to their clients. As a result, consumers—and the attorneys advocating on their behalf—must rely on the legislature to establish these fiduciary duties. Accordingly, I will briefly discuss the rise in mandatory arbitration in advisor agreements; how Tennessee specifically has responded to arbitration in financial services agreements; why Tennessee and other state legislatures should act to protect consumer interests; and how Congress has responded to the rise in mandatory arbitration provisions.

Mandatory arbitration clauses permeate nearly every major financial service agreement.[1] Although arbitration can be incredibly helpful for sophisticated parties to resolve disputes more efficiently and economically, forced arbitration clauses usually are a detriment to the consumer.[2] Indeed, mandatory arbitration provisions eliminate a consumer's right to process.[3] Specifically, mandatory arbitration agreements from financial services firms are often presented "on a take-it-or-leave-it basis."[4] As a result,

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[1] Michael J. Searcy, *When Signing Up with Financial Advisor, Beware Mandatory Arbitration Clause*, THE KANSAS CITY STAR (May 16, 2019, 3:02 PM), https://www.kansascity.com/news/business/personal-finance/article230488094.html.

[2] Jeff Brown, *Why Your Financial Service Agreement Includes Arbitration*, U.S. NEWS: MONEY (Mar. 27, 2017, 10:13 AM), https://money.usnews.com/investing/articles/2017-03-27/why-your-financial-service-agreement-includes-arbitration.

[3] Meredith R. Miller, *Contracting Out of Process, Contracting Out of Corporate Accountability: An Argument Against Enforcement of Pre-Dispute Limits on Process*, 75 TENN. L. REV. 365, 367 (2008) ("[C]orporations us[e] the pre-dispute arbitration regime to contract around process in an attempt to insulate themselves from any potential responsibility they might otherwise take on by virtue of their contractual relationships with stakeholder constituencies.").

[4] *Id.* at 373; *see also* Brown, *supra* note 2.

consumers must decide whether to agree to mandatory arbitration or forgo financial services. Moreover, consumers are often ignorant to the implications of signing these documents because mandatory arbitration clauses may include waivers to punitive or consequential damages.[5] These agreements also increasingly waive the consumer's right to join a class-action lawsuit.[6] While theoretically consumers could find a financial services provider that does not require mandatory arbitration, these provisions have become so popular as to render that possibility extinct.[7] As a result, consumers are left with only suboptimal choices: either agree to mandatory arbitration or forgo financial advice all together.[8] Accordingly, whenever disputes arise with their financial advisors—such a breach of fiduciary duty—consumers find themselves with limited recourse due to arbitration and waiver issues.

Although mandatory arbitration agreements eliminate consumers' access to the courts, arbitration is an excellent alternative to judicial proceedings for financial advising firms. Indeed, "[f]inancial services firms prefer arbitration because it limits their costs and exposure and resolves the dispute quickly and confidentially through individuals with industry knowledge and expertise."[9] Indeed, arbitration allows companies to better control the costs of dispute resolution, and the process is less publicized than litigation. Furthermore, arbitration agreements are grounded in contract law;[10] as a result, arbitration agreements are given significant leeway under the freedom of contract principle. In fact, some believe that mandatory arbitration clauses "have been elevated to the status of 'super contract' because of their 'near-automatic enforcement by means of specific performance.'"[11] Consequently, the drafter of an arbitration agreement (typically, the financial services firm) may rely on contract law to enforce the provisions of the agreement. Accordingly, financial advising firms benefit significantly from mandatory arbitration and have a significant interest in maintaining their validity.

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[5] *See* Miller, *supra* note 3, at 373 ("[C]orporations have also attempted to use form arbitration clauses to exact limits on the other party's procedural rights.").

[6] *See id.*

[7] *Id.*

[8] *See id.*

[9] Brown, *supra* note 2.

[10] Miller, *supra* note 3, at 366.

[11] *Id.* at 367.

Tennessee traditionally supports arbitration judicially and legislatively.[12] Consequently, it is unsurprising that there is little caselaw on the validity of mandatory arbitration clauses. In fact, the Tennessee Uniform Arbitration Act (the "TUAA"), enacted in 1983, greatly resembles the Uniform Arbitration Act.[13] Under the TUAA, the legislature provides arbitration substantial leeway to adjudicate disputes outside the court system.[14] Neither Tennessee case law nor legislation indicates that the state is worried about the effects of mandatory arbitration agreements on consumers in financial services agreements.

As a general rule, Tennessee courts give arbitration agreements as "broad a construction as the words . . . will allow."[15] Indeed, in the leading case *Arnold v. Morgan Keegan & Co.,* where a consumer entered into a financial services agreement that included forced arbitration, the Tennessee Supreme Court noted that "[i]t is well established that courts should play only a limited role in reviewing the decisions of arbitrators."[16] Specifically, a court should confirm an arbitrator's decision "[a]s long as the arbitrator is, arguably, construing or applying the contract and acting within the scope of his authority[.]"[17] Even if the court believes the arbitrator has made a "serious error," the court should nevertheless confirm the arbitrator's decision.[18] Accordingly, not only are Tennessee courts largely unconcerned about the validity of mandatory arbitration agreements, but the courts are highly deferential to the arbitrator's decision. Thus, consumers in Tennessee should expect to perform mandatory arbitration provisions in financial services agreements; they should also expect for the arbitrator's decision to be final, regardless of the court's opinion on the circumstances.

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12 *See* Buraczynski v. Eyring, 919 S.W.2d 314, 317 (Tenn. 1996); *see also* TENN. CODE ANN. § 29-5-303 (2018). *But see generally* Wofford v. M.J. Edwards & Sons Funeral Home, Inc., 490 S.W.3d 800 (Tenn. Ct. App. 2015) (holding that where a company forced arbitration by reference to a document that was not provided to the customer, the mandatory arbitration provision was unconscionable and unenforceable).

13 Steven W. Feldman, *Vacatur of Awards Under the Tennessee Uniform Arbitration Act: Substance, Procedure, and Strategies for Practitioners*, 26 U. MEM. L. REV. 271, 273 (2016).

14 *See* Uniform Arbitration Act, TENN. CODE ANN. §§ 29-5-301–20 (2018).

15 Feldman*, supra* note 13 (quoting Urology Assocs. v. CIGNA Healthcare of Tenn., No. M2001-02252-COA-R3-CV, 2002 WL 31302922, at *5 (Tenn. Ct. App. Feb. 18, 2003).

16 914 S.W.2d 445, 448 (Tenn. 1996) (citing United Paperworkers Int'l Union, AFL-CIO v. Misco, Inc., 484 U.S. 29, 36 (1987)).

17 *Id.* at 449.

18 *Id.*

Tennessee courts have found that no arbitration agreement exists, however, whenever a consumer receives no notice of a mandatory arbitration provision until after the purchase is complete.[19] Nevertheless, the courts and legislature have been relatively quiet on financial advising agreements specifically. In *Morgan Keegan & Co. v. Smythe,* the Tennessee Supreme Court again did not question the validity of an advising agreement's mandatory arbitration clause; however, the court addressed the reviewability of a trial court's order to either vacate or confirm an arbitration award.[20] Specifically, the court held that appellate courts have subject matter jurisdiction over a trial court order "that vacates an arbitration award and orders a second arbitration."[21] Although this decision says nothing about the enforceability of mandatory arbitration clauses, the court's decision in *Smythe* illustrates that the Tennessee Supreme Court is shying away from the extensive deference provided to arbitrators in *Arnold.*

Indeed, Tennessee, along with many other states across the country, has done little to protect consumer interests against mandatory arbitration provisions. While we wait and see if the courts will step back into the arena for resolving advisor contract disputes, the state and federal legislatures must step up to protect consumer interests. As Professor Edwards suggests in his article, one avenue to protect consumer interests is to formally place fiduciary duties on financial advisors. Another choice, however, would be to eliminate mandatory arbitration provisions in financial advising agreements. For example, Virginia banned mandatory arbitration clauses in investment client contracts through a new state rule. Specifically, the state reasoned that mandatory arbitration clauses are "totally contrary to the fiduciary duty of an investment advisor to take away a right someone has to pursue the forum of their choice if they have a disagreement with an investment adviser."[22] While investment brokers are typically the focus for mandatory arbitration clauses, banning these

[19] Capps v. Adams Wholesale Co., No. E2014-01882-COA-R3-CV, 2015 WL 2445970, at *3 (Tenn. Ct. App. May 21, 2015) (holding that "there was never an objective mutual assent to the terms of the agreement when Plaintiffs were not notified that such an agreement existed.").

[20] Morgan Keegan & Co. v. Smythe, 401 S.W. 595, 603 (Tenn. 2013).

[21] *Id.* at 612.

[22] Mark Schoeff Jr., *Virginia Poised to Ban Mandatory Arbitration Clauses for State-Registered Advisers*, INV. NEWS (Sept. 9, 2019, 2:30 PM), https://www.investmentnews.com/article/20190909/FREE/190909948/virginia-poised-to-ban-mandatory-arbitration-clauses-for-state.

provisions against advisors certainly takes a step in the right direction. Indeed, Virginia is the first state to ban mandatory arbitration for financial advisors.[23] The new rule, which went into effect on September 16, illustrates the emerging awareness for protecting consumer interests. If more states followed in Virginia's footsteps to limit forced arbitration clauses in financial service agreements, then consumers could finally have their days in court to adjudicate their disputes. This would also allow judges to establish precedent that favored consumers' interest.

The federal government has also begun to take notice of the detrimental effects of mandatory arbitration clauses. Specifically, the U.S. House of Representatives recently passed a bill that, if passed, would have banned mandatory arbitration clauses in advisor contracts.[24] The Forced Arbitration Injustice Repeal Act[25]—the FAIR Act, for short—was passed by the House on Friday, September 20, 2019 and was sent to the Senate the following Tuesday.[26] Coined a "sweeping" bill of legislation, the FAIR Act would have banned any future mandatory arbitration clauses and retroactively nullified all existing clauses in advisor contracts.[27] Under this bill, firms could still offer arbitration to its investors whenever disputes arise, but financial advisors could no longer force consumers to agree to mandatory arbitration at the outset of their relationship.[28] Representative Jim Jordan proposed an amendment to the bill to eliminate the safe-harbor provision, and the bill ultimately died in Senate committee.[29] Nevertheless, the FAIR Act serves as a glimmering hope for consumer advocates.[30] Specifically, the bill itself illustrates that Congress is beginning to take a critical look at mandatory arbitration clauses on both sides of the aisle.[31] Thus, it is hopeful that in the future we will see bipartisan legislation aimed at protecting consumers from mandatory arbitration clauses.

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[23] *Id.*

[24] Tracey Longo, *Bill Ending Mandatory Arbitration In Advisor, Broker Contracts Clears House*, FIN. ADVISOR (Sept. 23, 2019), https://www.fa-mag.com/news/bill-ending-mandatory-arbitration-in-advisor--broker-contracts-clears-house-51805.html

[25] Forced Arbitration Injustice Repeal Act, H.R. 1423, 116th Cong. (2019).

[26] 165 CONG. REC. H7, 848–49 (daily ed. Sept. 20, 2019) (voting record of House of Representatives).

[27] Longo, *supra* note 24.

[28] *Id.*

[29] *Id.*

[30] *Id.*

[31] *See id.*

[32] Longo, *supra* note 24.

Financial advising firms have a serious interest in protecting mandatory arbitration agreements. Thus, it is no surprise that the financial industry lobbies heavily to protect mandatory arbitration clauses.[32] Nevertheless, consumer protection is more important now than ever as retirees rely more and more on investments and personal savings.[33] Thus, protecting investors' interests from the consistently disappointing results of mandatory arbitration, and holding advising firms accountable, is a pressing legal issue that needs a resolution. Nevertheless, the prominence of mandatory arbitration has taken the issue outside of the courthouse doors. Accordingly, it is time that the issue be addressed through the ballot box—our elected officials, the state, and federal legislatures. While the FAIR Act indicates that protecting consumer interests is on Congress's radar, state legislatures are already empowered to protect consumer interests—and should take action—by limiting the validity of mandatory arbitration provisions in financial services agreements.