16-4234

United States Court of Appeals
for the Third Circuit

READING HEALTH SYSTEM,

Plaintiff-Appellee,

v.

BEAR STEARNS & CO., n/k/a J.P. MORGAN SECURITIES LLC,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

AMICUS CURIAE BRIEF OF PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION IN SUPPORT OF PLAINTIFF-APPELLEE

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STATEMENT OF THE IDENTITY OF THE AMICUS CURIAE, ITS INTEREST IN THE CASE, AND THE SOURCE OF ITS AUTHORITY TO FILE AN AMICUS BRIEF

Proposed Amicus Public Investors Arbitration Bar Association ("PIABA") is an international bar association comprised of attorneys who represent investors in securities arbitrations, as well as state securities regulators and faculty at law schools who work on investor issues. Since its formation in 1990, PIABA has promoted the interests of public investors in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and securities industry misconduct.

PIABA members regularly represent public investors in securities arbitration disputes against financial advisors, registered representatives and broker-dealers registered by the Securities and Exchange Commission ("SEC") and the Financial Industry Regulatory Authority ("FINRA"). Our members and their clients have a strong interest in protecting public investors and customers of the securities industry from the misconduct of members of the securities industry, and in creating a level playing field for public investors and customers of the securities industry in securities disputes with industry members.

PIABA monitors litigation of concern to public investors and customers of broker-dealers, such as Appellant Bear Stearns & Co., n/k/a J.P. Morgan Securities

LLC ("Appellant" or "J.P. Morgan"), and identifies cases that have statewide or national significance. PIABA has identified this case as having such significance.

Pursuant to Fed. R. App. P. 29(a)(4)(E), PIABA states that (i) neither party's counsel authored this Brief in whole or in part; (ii) neither a party nor a party's counsel contributed money that was intended to fund preparing or submitting this Brief; and (iii) no person—other than the amicus curiae, its members, or its counsel—contributed money that was intended to fund preparing or submitting this Brief.

To fulfill its role as a voice for public investors and customers of broker-dealers, PIABA frequently files *amicus* briefs in cases likely to impact the rights and protections afforded to public investors and customers of broker-dealers. PIABA files here out of concern that J.P. Morgan's appeal, if successful, will permit broker-dealers to require **all** of their customers to sign one-sided agreements that greatly favor the broker-dealers, which will have the effect of eviscerating the legal protections afforded to all customers by SEC approved FINRA rules.

Specifically, FINRA is charged with regulating the brokerage firms and, in that capacity, has promulgated numerous rules that govern the securities industry. Those rules exist for customer and investor protection. Broker-dealers, such as Appellant, are required by the Exchange Act to be members of FINRA, which in

turn requires that such broker-dealers abide by FINRA rules. Since the SEC approves FINRA rules and makes those rules binding on broker-dealers, FINRA rules have the force of federal regulations. *See Charles Schwab & Co. Inc. v. Fin. Indus. Regulatory Auth. Inc.*, 861 F. Supp. 2d 1063, 1065 (N.D. Cal. 2012) ("Because of the SEC's oversight, FINRA rules approved by the SEC are expressions of federal legislative power and have the force and effect of a federal regulation."). One such rule is FINRA Rule 12200, allowing customers of a broker-dealer to invoke FINRA Arbitration and arbitrate any and all disputes that arise in connection with the business activities of the FINRA member.

Through its appeal, J.P. Morgan seeks to avoid complying with the FINRA rules it is mandated to follow. The result of this case, should Appellant prevail, is likely to have a dramatic and detrimental impact on public investors that are PIABA's mission to protect. Specifically, J.P. Morgan seeks to avoid its obligation to arbitrate disputes with its customers, and instead enforce a forum selection clause. As courts have concluded that the term "customer" in FINRA Rule 12200 applies equally to public customers and issuers of securities, the Court's holding in this case will have as great an impact, if not more, on public investors as it does on issuers like Reading Health. *See, e.g., Ross Sinclaire & Assoc. v. Premier Senior Living, LLC*, No. 11-CV-5104 YGR, 2012 U.S. Dist. LEXIS 89229 (N.D. Cal. June 27, 2012). FINRA has previously articulated that

this type of effort to undermine the FINRA rules requiring customer access to arbitration is violative and improper conduct, and inconsistent with the agreement and obligations of broker-dealers such as J.P. Morgan. Moreover, Section 29(a) of the Securities Exchange Act voids a contract that results in avoiding a self-regulatory rule, such as the one at issue in this case. *See* 15 U.S.C. § 78cc(a).[1]

PIABA maintains that if J.P. Morgan's appeal is successful, it will provide legal precedent and authority for broker-dealers around the country to ignore the rules governing the securities industry in order to gain an unfair advantage over their customers (issuers and public investors alike), or otherwise violate regulatory rules designed for the protection of public investors and customers of broker-dealers.

SUMMARY OF ARGUMENT

An important goal for the regulation of the securities industry is – from the statutory framework Congress created, to the regulations the SEC has promulgated and the industry rules FINRA established – public investor protection. J.P. Morgan is attempting to eviscerate a fundamental protection provided to investors, *i.e.*, the superior right of a customer to rely on FINRA's rules, as approved by the

[1] For a more detailed discussion of Section 29(a) and the non-waivable nature of a customer's right to FINRA arbitration, *see* Jill I. Gross, *The Customer's Nonwaivable Right to Choose Arbitration in the Securities Industry*, 10 Brook. J. Corp. Fin. & Com. L. 383 (Spring 2016).

SEC, in deciding where to file a claim involving FINRA members or associated persons.

FINRA rules are not simple creatures of contract, but rather, they are regulatory obligations imposed upon brokerage firms and those firms, including J.P. Morgan, are required to adhere to those rules. Moreover, as a regulatory rule not only imposing a duty upon brokerage firms, but also effectively creating a substantive right for its customers, Rule 12200 cannot be waived via the one-sided contract J.P. Morgan is seeking to enforce. For the benefit of all customers of brokerage firms, including public investors, and on the clear precedent of both statutory authority and public policy, the opinion of the district court should be affirmed.

ARGUMENT

A. Purpose of Securities Laws and Regulations

Federal regulation of the securities markets was created to, among other things, "promote ethical standards of honesty and fair dealing." *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 195 (1976). In 1934, Congress enacted the Securities Exchange Act of 1934 (the "Exchange Act"), that created the Securities and Exchange Commission ("SEC"). *See* 15 U.S.C. § 78d.

The Exchange Act empowers the SEC with "broad authority over all aspects of the securities industry, including the power to register, regulate, and oversee brokerage firms, transfer agents, and clearing agencies, as well as the nation's securities self-regulatory organizations (SROs)." *United States v. Wittig*, 575 F.3d 1085, 1105 (10th Cir. 2009). In 1938, Congress imposed a regulatory framework for the off-exchange market through the *Maloney Act*, which added Section 15A to the Exchange Act. *See United States v. Nat'l Ass'n of Sec. Dealers, Inc.*, 422 U.S. 694, 700 n.6 (1975). It provided for creation of national securities associations of broker-dealers with powers to adopt and enforce rules to regulate the off-exchange market. *Id.* Only one such Association was ever created – the National Association of Securities Dealers (the "NASD"), which is now known as FINRA. *See Morgan Keegan & Co. v. McPoland*, 829 F. Supp. 2d 1031, 1033 n.1 (W.D. Wash. 2011). Under the Exchange Act, any broker-dealer, including Appellant J.P. Morgan, is now required to be a registered member of FINRA. *See* 15 U.S.C. § 78o(b)(8).[2]

[2] It shall be unlawful for any registered broker or dealer to effect any transaction in, or induce or attempt to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills), unless such broker or dealer is a member of a securities association registered pursuant to section 78o–3 of this title or effects transactions in securities solely on a national securities exchange of which it is a member.

B. FINRA's Role in Regulatory Framework

FINRA is a self-regulatory organization born out of a merger between the National Association of Securities Dealers ("NASD") and the regulatory arm of the New York Stock Exchange ("NYSE"). *See* Press Release, FINRA, NASD and NYSE Member Regulation Combine to Form the Financial Industry Regulatory Authority (July 30, 2007), *available at* http://www.finra.org/newsroom/2007/nasd-and-nyse-member-regulation-combine-form-financial-industry-regulatory-authority. FINRA is the largest independent regulator for all securities firms doing business in the United States, handling virtually every aspect of the securities business including registrations, rulemaking, enforcement, and dispute resolution. *See id.*

The NASD, FINRA's predecessor, became authorized as an "association" under the Exchange Act in 1938, which entitled NASD/FINRA to incorporate and register with the SEC.[3] *See* 15 U.S.C. § 78a *et seq*. While it began as a professional organization, NASD/FINRA was designed to function like a regulator and therefore has a quasi-governmental function. *See NASD v. SEC*, 431 F.3d 803, 804 (D.C. Cir. 2005). Indeed, the government delegated power to NASD/FINRA so that NASD/FINRA could function as a regulator. *Id.* (citing *Merrill Lynch v.*

[3] In 1938, as discussed above, the Maloney Act amended the Exchange Act to permit broker-dealers to create a self-regulatory organization to oversee the securities industry. *See* Maloney Act of 1938, Pub. L. No. 75-719, 52 Stat. 1070 (1938).

Nat'l Ass'n of Sec. Dealers, Inc., 616 F.2d 1363, 1367 (5th Cir. 1980) ("As a registered securities association, [NASD] has been 'delegated governmental power . . . to enforce . . . the legal requirements laid down in the Exchange Act.'"). SROs such as FINRA exercise important public policy functions in the marketplace, including efforts meant to protect public investors and limit fraudulent and deceptive practices in the marketplace. *See Nat'l Ass'n of Sec. Dealers, Inc. v. SEC*, 431 F.3d 803 (D.C. Cir. 2005).

The Exchange Act was amended in 1975, giving the SEC greater authority to regulate and supervise the NASD and the exchanges. *See* Pub. L. No. 94-29, 89 Stat. 97 (1975). This amendment gave the SEC the power to initiate and approve SRO rule-making. *See* 15 U.S.C. §78k-1; 15 U.S.C. § 78s(c). The SROs' powers grew as well and, in 1983, all broker-dealers registered with SEC were required to become members of the NASD. *See* 15 U.S.C. § 78o(b)(8). While the exchanges primarily served marketplace functions, the NASD served a regulatory function, adopting and enforcing rules that have the force of federal law. *See Credit Suisse First Bos. Corp. v. Grunwald*, 400 F.3d 1119, 1128 (9th Cir. 2005) (finding that FINRA rules preempt conflicting state law, just as any other federal law would do – "Because the NASD arbitration rules at issue here were approved by the Commission and because the California Ethics Standards conflict with the NASD arbitration disclosure rules, the California Ethics Standards are preempted by the

NASD rules.") (relying on *City of New York v. FCC*, 486 U.S. 57, 63-64, 108 S. Ct. 1637 (1988) and *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 414 U.S. 117, 127, 94 S. Ct. 383, 390 (1973)).[4]

1. Process to Create FINRA Rules

One of the main functions of FINRA is to promulgate rules that govern the conduct of its members, and in turn govern the securities industry. For these rules to come into effect, they must go through a rigorous process and are subject to substantial federal oversight. First, FINRA itself determines a potential rule it wants to enact. In many cases, FINRA will solicit comments from its membership and make amendments to the proposed rules based upon concerns raised through that process. *See* FINRA, *FINRA Rulemaking Process*, *available at* http://www.finra.org/industry/finra-rulemaking-process.

Assuming the FINRA Board of Directors chooses to move forward with a proposed rule, FINRA then must comply with the requirements of the Exchange Act. *See* 15 U.S.C. § 78s(b)(1). This requires that the SEC be given notice of any

[4] *See also*, *Lee v. Hirschtritt*, No. 13 C 1061, 2013 U.S. Dist. LEXIS 110235, at *4 (N.D. Ill. Aug. 6, 2013) ("Congress has delegated authority to FINRA in that any FINRA regulation approved by the Securities and Exchange Commission, which oversees FINRA, has the force of a federal regulation."); *Standard Inv. Chartered, Inc. v. NASD*, 2007 U.S. Dist. LEXIS 32566, at *26 n.2 (S.D.N.Y. May 2, 2007) ("Courts have more recently concluded that SRO rules that have been approved by the Commission pursuant to 15 U.S.C. § 78s(b)(2) preempt state law when the two are in conflict." (internal quotations omitted)).

proposed rule. The SEC then publishes the proposed rule or rule change in the Federal Register for notice and public comment. The SEC commonly asks for comments from FINRA in response to public comments it receives.

As part of this process, amendments to the proposed rule are often made. If they are substantial, FINRA sends the proposed rule back to the FINRA Board to determine if it should move forward with the modifications. *See* FINRA, *FINRA Rulemaking Process*, *available at* http://www.finra.org/industry/finra-rulemaking-process. In some cases, the SEC publishes the proposed rule a second time, with the amendments, inviting even further public comment. *Id.*[5] If and when the SEC approves the final rule, notice of the adoption of the rule is published in the Federal Register. *Id.* The SEC's oversight also allows the SEC to "abrogate, add to, and delete from" the rules of an SRO. 15 U.S.C § 78s(c).

2. FINRA Arbitration Rules

Through this process, FINRA passed – and the SEC approved – FINRA Rule 12200, which states that FINRA member firms and associated persons are required to arbitrate disputes through FINRA arbitration if a customer requests it, so long as the dispute arises in connection with the business activities of the firm or associated person. *See* FINRA Rule 12200. To ensure that FINRA member firms

[5] *See also* Lanny Schwartz, *Suggestions for Procedural Reform in Securities Market Regulation*, 1 Brook. J. Corp. Fin. & Com. L. 409, 431-36 (2007).

did not restrict the customer's right to this forum, FINRA also passed Rule 2268(d)(2), which further prohibits FINRA member firms from using a pre-dispute arbitration agreement to limit the ability of "a party to file **any claim in arbitration**…."[6] FINRA Rule 2268(d)(2)(emphasis added).

Member firms, including J.P. Morgan, were provided the opportunity to vote on the passage of both these rules. *See* NASD, Regulatory Notice 89-21 (1989) ("Members are invited to vote on a proposed amendment… [which] would prohibit the use in any agreement of any language that limits or contradicts the rules of any self-regulatory organization, limits the ability of a party to file a claim in arbitration, or limits the ability of the arbitrators to make any award."). Once the FINRA membership voted to approve these rules, they were submitted to the SEC for review and for further public comment. *See* NASD, Regulatory Notice 89-58 (1989) ("In keeping with its support for the continued improvement of securities industry arbitration as a fair, expeditious, and economical means for the resolution of disputes, the NASD, responding to suggestions of the Securities and Exchange Commission and others seeking more explicit disclosure of the existence and meaning of pre-dispute arbitration clauses in customer agreements, filed with the SEC following approval by membership vote an amendment to Article III, Section

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[6] While Rule 2268(d)(2) speaks specifically to using a "predispute arbitration agreement" to limit a claim that can be brought to arbitration, FINRA makes it clear it interprets that to mean that members cannot use any type of agreement to limit a right to arbitration under FINRA rules.

21, of the NASD Rules of Fair Practice.”). Following a public comment period, the SEC approved the rules. *Id.*

As a result of the passage of these rules, FINRA’s arbitration system has developed into the largest securities dispute resolution forum in the United States. *See* FINRA, Regulatory Notice 16-25, 1 (2016). FINRA’s arbitration system is intended to be “a fair, efficient and economical alternative to litigation, ***particularly*** for customers with small claims.” *Id.* (emphasis added). According to FINRA, claims are generally resolved more quickly and with less expense involved than many court cases. *Id.*

C. Waivers of FINRA Arbitration Rules Are Unenforceable

Despite the fact that J.P. Morgan had multiple opportunities to comment, and even vote, on the creation of these arbitration rules, J.P. Morgan now claims, essentially, that it can avoid complying with them simply by adding a forum selection clause in its agreement with certain customers. As discussed above, however, a FINRA rule is not a mere contract between parties, whose rights can be waived more easily than they were created. Rather, FINRA rules have the force and effect of law under the Exchange Act and cannot be waived through a contract. *See Credit Suisse First Bos. Corp. v. Grunwald*, 400 F.3d 1119, 1128 (9th Cir. 2005).

Specifically, the Securities Exchange Act of 1934 has an anti-waiver provision that explicitly prohibits parties from waiving compliance with the rules of self-regulatory organizations, like FINRA. Section 29(a) of the Exchange Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, supports that positon and states that "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, **or of any rule of a self-regulatory organization,** shall be void." 15 U.S.C. § 78cc(a)(emphasis added). As such, J.P. Morgan's venue selection clause in contradiction to FINRA rules is void as a matter of law and, as discussed below, violates a strong public policy in that it results in J.P. Morgan attempting to waive "compliance with .. [a] rule of a self-regulatory organization …."

The Second Circuit confronted this issue in *Thomas James Assocs. v. Jameson*, 102 F.3d 60 (2d Cir. 1996).[7] In the *Jameson* case, a brokerage member firm[8] included a contractual provision in the employment agreement with its employees that expressly stated that the employees waived "all rights to arbitration which may be provided by any federal, state or self-regulatory organization rule or

[7] The Third Circuit adopted the Second Circuit's interpretation of NASD Arbitration Rules in *Seus v. John Nuveen & Co*., 146 F.3d 175, 185 (3d Cir. 1998).
[8] The case was heard when the NASD was still in existence. As described above, FINRA is the successor in interest to the NASD, and the arbitration rules at issue are effectively identical.

regulation for the resolution of any dispute arising out of this agreement or the termination thereof, including but not limited to NASD Manual - Code of Arbitration Procedure." *Id.* at 63. Thomas James's waiver provision, unlike the one J.P. Morgan relies upon in this case, expressly and unequivocally waived arbitration rights.[9] *See id.* The Court was then required to evaluate whether this waiver was legally effective, and concluded that it was not as the rule requiring arbitration of industry disputes was more than just a contractual agreement between parties that could be rewritten without violating public policy. *See id.* at 66-67.

Specifically, the Second Circuit noted that "while violations of public policy must be determined through definite indications in the law of the sovereignty, courts ***must not be timid*** in voiding agreements which tend to injure the public good or contravene some established interest of society." *Id.* at 66 (citing *Stamford Bd. of Educ. v. Stamford Educ. Ass'n,* 697 F.2d 70, 73 (2d Cir. 1982)). The Court

[9] While not addressed in this case given the lower court's ruling, there is considerable question as to whether J.P. Morgan's waiver argument would be valid, even if it were allowed under federal law, given that the waiver does not disclose anywhere in the forum selection clause that it is a waiver of a right under FINRA rules. Other courts have found that such a waiver is ineffective because it does not give the party waiving the right sufficient notice of the waiver. *See, e.g., UBS Fin. Servs. v. Carilion Clinic*, 706 F.3d 319, 328-29 (4th Cir. 2013) ("any [agreement to waive arbitration] must be sufficiently specific to impute to the contracting parties the reasonable expectation that they are superseding, displacing, or waiving the arbitration obligation created by FINRA Rule 12200… one would reasonably expect that a clause designed to supersede, displace, or waive arbitration would mention arbitration.").

further noted that the FAA represents "a strong federal policy favoring arbitration." *Id.* The Court additionally found that this policy established by the FAA is strengthened by an NASD resolution, which the SEC had approved. *Id.*

Significantly, in response to member firms trying to avoid arbitration through a venue selection clause like that in *Jameson*, the NASD issued a resolution admonishing member firms who were attempting this waiver, which stated that:

> It has come to the NASD's attention that certain broker/dealers have been including in their agreements with registered representatives language **that purports to waive the representative's right to obtain arbitration of any disputes arising out of the agreement**. . . . **This . . . conflicts with the NASD's Code of Arbitration Procedure**, which requires industry disputes to be arbitrated at the instance of either party… it shall be considered conduct inconsistent with just and equitable principles of trade and a violation of Article III, section 1 of the NASD's Rules of Fair Practice for a member to require its associated persons to waive the arbitration of disputes arising out of their association with the member.

Id. (citing 52 Fed. Reg. 9232 (1987)) (emphasis added).

Based on the NASD's pronouncement, the Court concluded that "[w]hen a self-regulatory association of securities firms, under direct federal supervision, ordains that its members may not require their employees to waive arbitration rights, it would be inappropriate for us to enforce such a waiver." *Id.* The Second

Circuit, like others before it and since, was noting that NASD/FINRA rules are more than just contractual agreements. It therefore would not allow member firms to rewrite or ignore the rules, especially when the self-regulatory firm specifically expressed its findings that the waiver was a rule violation.

J.P. Morgan now attempts to bind its customers to precisely what was forbidden in *Jameson*. Moreover, just as in *Jameson*, FINRA has made its position known in a Regulatory Notice, admonishing members such as J.P. Morgan for using agreements to avoid arbitration. *See generally*, FINRA Regulatory Notice 16-25 (2016) (the "Notice"). FINRA's issuance of the Notice was a direct result of the holdings in a handful of jurisdictions addressing arguments similar to the ones J.P. Morgan makes in this case. Incredibly, J.P. Morgan still relies heavily upon the very cases that prompted the Notice from FINRA rejecting such decisions - *Goldman, Sachs & Co. v. Golden Empire Schs. Fin. Auth.,* 764 F.3d 210 (2d Cr. 2014), and *Goldman, Sachs & Co. v. City of Reno*, 747 F.3d 733 (9th Cir. 2014).

J.P. Morgan ignores the language in the Notice expressly stating that "FINRA is aware of federal appellate court decisions that have held that forum selection clauses in agreements between member firms and customers supersede the requirements of FINRA Rule 12200, permitting member firms to require customers to arbitrate in a private arbitration forum or to litigate in state or federal

court." *Id.* at 3. (Citing *Golden Empire* and *City of Reno*). In reference to the cases relied up on by J.P. Morgan in this case, the Notice stated that FINRA

> is concerned regarding the potential impact of this line of judicial decisions and that member firms are requiring customers to sign predispute arbitration agreements or otherwise enter into agreements that include exclusive forum selection provisions, with the potential effect of limiting the customer's ability to exercise his or her **arbitration rights under FINRA Rule 12200** and **in contravention of the requirements of FINRA Rule 2268**. Thus, FINRA is issuing this Notice to remind member firms of the requirements of FINRA's arbitration rules and their obligations under these rules.

Id. at 4 (emphasis added).

The Notice further reviewed the development and reasoning behind *Golden Empire* and *City of Reno*, and ultimately concluded the reasoning was flawed and directly contradicted FINRA's interpretation of its own rules. First, FINRA reviewed the analysis of those and other courts, concluding that every court that had upheld a forum selection provision similar to the one J.P. Morgan is seeking to enforce improperly relied upon *Kidder, Peabody & Co. v. Zinsmeyer Trusts Partnership*, 41 F.3d 861 (2d Cir. 1994), and *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Georgiadis*, 903 F.2d 109 (2d Cir. 1990). *See* FINRA, Regulatory Notice 16-25, fn. 10 (2016). Such reliance is misplaced, and has resulted in a handful of subsequent cases that improperly reduced FINRA rules to the level of mere waivable contract terms.

Specifically, in *Kidder,* the Second Circuit expressly stated that its rulings were without considering whether a customer was even able to waive his option to arbitrate based upon NASD rules. *See Kidder*, 41 F.3d at 864. *Georgiadis* addressed whether a customer could change from one arbitration forum to another without running afoul of NASD rules. *See Georgiadis*, 903 F.2d at 112. The Second Circuit expressly stated that, in both cases, it did "not consider the broader issue of whether a customer can waive entirely the option to arbitrate conferred by the broker's exchange membership obligations." *Kidder*, 41 F.3d at 864. As such, neither case supports a claim that FINRA arbitration rules are mere contract terms that can be waived with a simple forum selection clause, as neither case "actually decided whether a member firm may obtain and enforce a waiver of its obligation to arbitrate as set forth in FINRA Rules 12200 and 13200." *See* FINRA, Regulatory Notice 16-25, 4 (2016).

Instead, FINRA concluded that "Rule 2268(d)—which provides that member firms may not include terms in predispute arbitration agreements with customers that 'limit[] or contradict[] the rules of' FINRA—is a clear statement that member firms cannot require customers to waive Rule 12200 in those agreements." *Id.* Contrary to J.P. Morgan's argument, FINRA has expressly stated that member firms are required to use customer agreements which "preserve the rights of the contracting parties under SRO rules and that arbitration must be a

choice for the parties as a means of dispute resolution." *Id.* at 3 (2016). FINRA concluded in the Notice that "[a] customer's right to request FINRA arbitration at any time under FINRA rules, however, ***cannot be superseded or disclaimed*** by any separate agreement between the customer and member firm." *Id.* at 5 (emphasis added).

FINRA's position on the issue is not stated for the first time in Notice 16-25. In 2007, FINRA adopted IM-12200, which states that "fail[ure] to submit a dispute for arbitration under the Code as required by the Code" constitutes "conduct inconsistent with just and equitable principles of trade and a violation of Rule 2010 for a member or a person associated with a member."[10] Similarly, FINRA has repeatedly disciplined member firms for refusing to abide by arbitration rules. *See, e.g., AXA Advisors, LLC,* FINRA AWC No. 2012034518801 (February 26, 2015); *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* FINRA AWC No. 2009020188101 (January 25, 2012). As such, it should be no surprise to J.P. Morgan and other FINRA members that these types of contractual provisions are a violation of FINRA rules.

FINRA's interpretation of its own rules is afforded considerable discretion by the courts in determining their proper meaning and application. *See*

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[10] FINRA IM-12200, *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4098.

Intercontinental Indus., Inc. v. Am. Stock Exch., 452 F.2d 935, 940 (5th Cir. 1971) (recognizing that allowing AMEX deference in determining the meaning of its own rules was "keeping with the congressional intent to make the exchange a self-regulatory body"); *see also FDA v. Brown & Williamson Tobacco Corp.,* 529 U.S. 120, 132 (2000); *SEC v. Citigroup Global Mkts., Inc.*, 752 F.3d 285, 296 (2d Cir. 2014). Accordingly, relying on the ruling in *Jameson* and on FINRA's own statements in Notice 16-25 (and other rules), this Court should hold that as a FINRA member, J.P. Morgan cannot enforce a contractual provision that attempts to waive its compliance with the FINRA arbitration rules.

Notwithstanding that Notice 16-25 clearly supports a ruling in favor of the customer in this case, it is also worth noting that FINRA's Notice did not address all of the deficiencies with the holdings that permitted waiver of Rule 12200, i.e., their reliance on *Kidder* and *Georgiadis*. *See id.* Thus, it is appropriate that PIABA address below some of the more glaring problems with the cases J.P. Morgan relies upon even beyond FINRA's noted errors in their reasoning and findings.

First, those cases presume, without authority or discussion, that FINRA Rule 12200 is a mere contract right and no more. *See generally Goldman, Sachs & Co. v. Golden Empire Schs. Fin. Auth.*, 764 F.3d at 214-15; *Goldman, Sachs & Co. v. City of Reno*, 747 F.3d at 739 n.1. As discussed above, FINRA rules are enacted

under federal authority pursuant to the Securities Exchange Act, and therefore must be afforded the weight of federal regulation. As with any federal regulation, the directives of Rule 12200 cannot be simply cast aside by agreement.

Second, these cases completely ignore the statutory amendment made to Section 29(a) in 2010. Specifically, in 2010, Congress amended Section 29(a) to include "any rule of a self-regulatory organization" to the list of statutory protections that are non-waivable. *See* S. REP. NO. 111-176, at 114 (2010). The courts in both *Goldman, Sachs & Co. v. Golden Empire Schs. Fin. Auth.* and *Goldman, Sachs & Co. v. City of Reno* ignored in their entirety this legislative change, which makes clear Congress's intent that the protections afforded public customers under FINRA rules are to be given the same level of deference as those included in the Exchange Act itself. As such, the rulings by these courts that Rule 12200 was a mere contract that could be waived are fundamentally flawed and cannot be relied upon by this court to uphold J.P. Morgan's position.

D. <u>Broader Implications of Appellant's Argument</u>

Beyond addressing some of the issues with the cases J.P. Morgan relied upon, FINRA also expressed grave concerns in Notice 16-25 about the impact these rulings could have on the public customers:

> In addition, these court decisions potentially remove an important investor protection provided by FINRA Rule 12200 by allowing member firms to deny investors the benefits of FINRA's arbitration program, **which may, as**

> **a practical matter, foreclose customers from asserting their claims, particularly small claims.** Litigation in a judicial forum can be complicated, protracted and costly, which may deter customers from bringing their claims before a court. By contrast, FINRA's arbitral forum provides customers with a simple, relatively fast and inexpensive way for their claims to be heard.
>
> ***
>
> In approving these rules, the SEC found that they were "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, . . . and, in general, to protect investors and the public interest," in compliance with the requirements of Section 15A(b)(6) of the Exchange Act.

FINRA, Regulatory Notice 16-25, 4 (2016)[11] (emphasis added).

PIABA has the same concerns with the potential impact of the arguments J.P. Morgan has made in this case if they are accepted by this Court. As written and approved by FINRA, its members and the SEC, the FINRA rules purposefully provide customers and FINRA members/associated persons with certainty and uniformity when it comes to the forum in which disputes between them will be decided. There are no exceptions to the applicable FINRA rules, no matter how much J.P. Morgan would like there to be.

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[11] Citing Securities Exchange Act Release No. 16860 (May 30, 1980), 45 FR 39608 (June 11, 1980) (Order Approving File No. SR-NASD-79-11) (approving NASD's revised arbitration rules and noting that "[a] primary purpose of this proposal is to provide investors and members of the NASD with a simple and inexpensive procedure for the resolution of their controversies").

If J.P. Morgan's arguments are successful here, that very same venue provision could later be interpreted and applied in a manner that extends beyond customers that are issuers, as is the case here, to any customer – including public investors. If brokerage firms are allowed to selectively and unilaterally force certain customers into court, the increased time and cost of going to court will most certainly result in brokerage firms avoiding otherwise meritorious claims. Moreover, it takes the choice of forum away from customers, as was FINRA's clear intention and the SEC's clear support of that intention, and gives it exclusively to brokerage firms, who may use that to take advantage of unsuspecting customers. Thus, any attempt to waive the protections afforded by FINRA Rule 12200 (and Rule 2268(d)) should properly be denied by this Court.

Allowing brokerage firms to avoid FINRA arbitration will only lead to those who can least afford it, small investors, being hurt. This result is directly contrary both to the mission statement of FINRA, and to the congressionally expressed goal of the entire securities industry regulatory system, including the Securities Exchange Act of 1934 and the Dodd-Frank Act. *See, e.g.,* DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT, 111 P.L. 203, 124 Stat. 1376 ("An Act… to protect consumers from abusive financial services practices…").

Should courts hold that FINRA rules – the rules governing the brokerage industry – can be so easily eviscerated by contract (essentially endorsing FINRA members being able to disobey FINRA rules through one-sided contracts with customers), then FINRA rules will be rendered virtually meaningless in their ability to regulate the industry and carry out the public mission of both FINRA and the SEC. Rather than operating under a regulatory regime made up of rules that have been formed and scrutinized through the federal rulemaking process and the SEC, FINRA firms would be able to use one-sided contracts with customers to pick and choose which rules they wish to follow.

For instance, one of the fundamental tenets of the brokerage industry is that member firms shall treat their customers in such a way that observes high standards of commercial honor and just and equitable principles of trade. This principal is embodied in FINRA Rule 2010 which requires that "A member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade." Beyond FINRA's own rules, the Exchange Act supports that FINRA rules should be promulgated with the purpose of promoting "just and equitable principles of trade." *See* 15 U.S.C. § 78o–3(b)(6) ("The rules of the association are designed to prevent fraudulent and manipulative acts and practices, ***to promote just and equitable principles of trade***…")(emphasis added). Such a fundamental right of customers and fundamental obligation of broker-

dealers cannot be waived. *See Shearson/American Express v. McMahon*, 482 U.S. 220, 228, 107 S. Ct. 2332, 2338, (U.S. 1987) ("What the antiwaiver provision of § 29(a) forbids is enforcement of agreements to waive 'compliance' with the provisions of the statute.")

FINRA has stated that, with respect to Rule 12200, "the failure to submit a dispute to arbitration under the Customer Code as required by the Code would violate FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade)." *See* FINRA, Regulatory Notice 16-25, 5 (citing FINRA IM-12000). Thus, allowing a brokerage firm to contract around the mutual obligation to arbitrate claims between the firm and customers would be akin to allowing a broker-dealer to contract around its obligation to observe just and equitable principles of trade.

PIABA is concerned, as this Court should be, that permitting brokerage firms to alter by contract FINRA rules under the circumstances in which J.P. Morgan requests here will inevitably result in continued erosion of the rules governing the securities industry. If courts do not enforce the application of these rules as they were intended and approved by FINRA and the SEC, the rules will be rendered ineffective in achieving their regulatory purpose. Simply put, if J.P. Morgan's logic and argument are accepted by the Court, both the efficacy of, and the public confidence in, the regulatory framework governing the securities

industry will be called into question, undermining the congressional intent behind the Exchange Act. *See Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 31 (D.C. Cir. 1987) ("it is quite clear that the Securities Exchange Act of 1934 had as its purpose the protection of American investors and markets.")

CONCLUSION

The entire securities industry legislative and regulatory structure is intended to protect customers from the misconduct of brokerage firms and to establish a uniform set of rules all broker-dealers must follow. FINRA Rules require that FINRA members submit claims to arbitration when customers so demand. Both legal precedent and FINRA itself have stated that FINRA arbitration is an important customer right and, as such, may not be contracted away. J.P. Morgan is attempting to eviscerate this fundamental right. In doing so, J.P. Morgan asks this Court to ignore FINRA rules (and FINRA's interpretation of those rules) and hold that brokerage firms can use one-sided contracts they draft to unilaterally force their customers to go to court notwithstanding the regulatory requirement that customers always have the choice to have their claims against brokerage firms arbitrated through FINRA. Because the rules are passed under the authority created by the Securities and Exchange Act of 1934, and approved by the SEC, to hold that investor protections can so easily be waived would run contrary to decades of law and regulation, and would greatly weaken investor rights across the

United States. For these reasons, PIABA respectfully requests that the Court affirm the district court's ruling.

Dated: Atlanta Georgia
May 18, 2017

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CERTIFICATE OF BAR MEMBERSHIP

The undersigned hereby certifies pursuant to LAR 46.1 that the attorney whose name appears on the Amicus Curiae Brief, Robert C. Port, was duly admitted to the Bar of the United States Court of Appeals for the Third Circuit, and is presently a member in good standing at the Bar of said Court.

Dated: Atlanta Georgia
May 18, 2017

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CERTIFICATE OF WORD COUNT

Pursuant to Fed. R. App. P. 32(a)(7)(C), I hereby certify that the foregoing Amicus Curiae Brief contains 6,237 words, excluding the parts of the brief exempted by Fed. R. App. R. 32(a)(7)(B)(iii)

Dated: Atlanta Georgia
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CERTIFICATE OF SERVICE

The undersigned hereby certify that, on May 18, 2017, I electronically filed the foregoing using the Court's CM/ECF system and, as such, the brief was served electronically upon all counsel of record.

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CERTIFICATE OF IDENTICAL COMPLIANCE OF BRIEF

The undersigned hereby certifies as follows:

1. The text of the electronic and hard copy forms of briefs are identical.

2. Pursuant to 28 U.S.C. § 1746, I certify under penalty of perjury that the foregoing is true and correct.

Dated: Atlanta Georgia
May 18, 2017

Respectfully Submitted,

s/ Robert C. Port
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VIRUS CERTIFICATION

The undersigned hereby certifies as follows:

1. I caused the electronic version of this brief to be checked for computer viruses using ESET Endpoint Antivirus, Version 6.4.2014.0. No computer virus was found.

2. Pursuant to 28 U.S.C. § 1746, I certify under penalty of perjury that the foregoing is true and correct.

Dated: Atlanta Georgia
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