13-2172-cv

United States Court of Appeals
For the Second Circuit

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CITIGROUP GLOBAL MARKETS INC.,

Plaintiff-Counter-Defendant-Appellee,

against-

GHAZI ABDULLAH ABBAR, AJIAL LEVERAGED FEEDER HOLDINGS LIMITED, AMATRA LEVERAGED FEEDER HOLDINGS, LIMITED, AMAVEST HOLDINGS LIMITED, GAMA INVESTMENT HOLDINGS LIMITED,

Defendants-Counter-Claimants-Appellants,

ABDULLAH MAHMOUD ABBAR,

Defendant-Counter-Claimant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR AMICUS CURIAE THE PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION IN SUPPORT OF DEFENDANTS-APPELLANTS' REQUEST FOR REVERSAL

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CORPORATE DISCLOSURE STATEMENT

Amicus curiae Public Investors Arbitration Bar Association is a non-profit association. It has no parent corporation, and no publicly held corporation owns 10% or more of its stock.

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I.

INTRODUCTION AND INTEREST OF *AMICUS CURIAE*

Pursuant to Federal Rule of Appellate Procedure 29 and this Court's Local Rule 29.1, the Public Investors Arbitration Bar Association ("PIABA") respectfully submits this, its brief *amicus curiae*, in support of Defendants-Counter-Claimants-Appellants' appeal seeking the reversal of the decision of the United States District for the Southern District of New York (Stanton, J.), entered on May 22, 2013, enjoining the arbitration of the underlying dispute before the Financial Industry Regulatory Authority ("FINRA").[1]

All parties to this appeal have consented to the filing of this brief.

II.

STATEMENT OF INTEREST

PIABA is an international bar association established in 1990. PIABA's members are attorneys who represent public investors in securities arbitration proceedings. The mission of PIABA is to promote the interests of public investors in arbitration by protecting investor claimants from abuses in the arbitration process, such as those associated with avoidance of the arbitral forum. PIABA seeks to make securities and commodities arbitration as just and fair as

[1] No counsel for a party or party to this proceeding authored this brief in whole or in part, and no counsel for a party or party to this proceeding made a monetary contribution intended to fund either the preparation or the submission of this brief. No person other than PIABA, its members, or its counsel made a monetary contribution to the preparation or submission of this brief.

systematically possible and to create a level playing field for the public investor in securities and commodities arbitration.

PIABA has a particular interest in the present litigation because the district court's decision creates without legitimacy new requirements that investors must maintain an account at and make securities purchases through the brokerage firm as a prerequisite to being deemed a customer for purposes of determining arbitrability. These requirements are inconsistent with the law as it exists in the Second Circuit and is in contravention of the FINRA[2] rules that were properly promulgated in conjunction with the SEC, the federal securities laws and SEC rules and mandates.

This new requirement that an investor open an account at and make purchases through a FINRA member[3] to be deemed a "customer" for the purposes of arbitrability significantly harms the efficient, timely and inexpensive resolution of disputes between FINRA members and their customers. If the position advocated by the Appellee and ordered by the district court were to be broadly adopted, it would be an invitation for FINRA members to burden the courts with

[2] FINRA, formerly the National Association of Securities Dealers ("NASD"), is a self-regulatory organization that licenses and regulates securities broker-dealers in the national securities industry. Its Code of Arbitration Procedure governs, *inter alia*, arbitrations between its members and their customers and has been approved by the Securities and Exchange Commission pursuant to the Securities and Exchange Act of 1934. *See* 15 U.S.C. § 78a *et seq*.

[3] The Order is ambiguous, as it demands an account with and purchase from a registered person or firm, but does not mandate how those purchases must be made (i.e., for example, on an exchange or directly with an issuer, or by prospectus). According to the Order, the Appellants followed the advice of the registered firm, so they should be deemed customers.

endless arguments denying a "customer" relationship in a wide spectrum of settings, including the following: (1) selling away claims in which FINRA member registered persons subject to supervision by FINRA members sell unapproved products to public investors who are the intended beneficiaries of FINRA Rules; (2) failure to supervise claims; and (3) other claims where advice is clearly given to a public investor by a registered person being supervised for just such activity. It is important to note that in today's environment, alternative investments, which do not trade on public exchanges, are very popular and are sold by registered persons, although such products may not appear on monthly statements or may not require the opening of an account with the FINRA member.

PIABA appears as *amicus* because it is in its members' interest, and therefore the public interest, that their clients – aggrieved public investors and/or "customers" of brokerage and investment firms – have available a speedy, efficient, inexpensive and fair forum to vindicate their rights. More importantly, a clear and unambiguous decision by this Court upholding Second Circuit law and reversing the district court's attempt to read in additional requirements to the definition of "customer" will further FINRA's regulatory role as the administrator of the dispute resolution forum for disputes between public customers and broker-dealers, and would also promote predictability in the FINRA arbitration process.

III.

SUMMARY OF ARGUMENT

The district court improperly determined that FINRA Rule 12200 of the FINRA Code[4] requires a customer of a broker-dealer to maintain "an account"[5] with the firm and make a purchase of securities from the firm in order to arbitrate his or her disputes in a FINRA arbitration.[6] The district court noted that CGMI structured and negotiated the investments in which Appellants invested their money, monitored those investments and provided to Appellants monthly statements as to the status of those investments.[7] CGMI therefore created and managed Appellants' investments and provided regular updates regarding those investments.

Rule 12200 requires FINRA members to arbitrate disputes requested by the customer involving disputes between the customer and member and arising from disputes connected with the member's business activities, even absent a written

[4] The facts of the dispute are set forth in the Defendants'-Appellants' brief. This brief refers to Defendants-Counter-Claimants-Appellants collectively as "Appellants" and to Plaintiff-Counter-Defendant-Appellee as "CGMI" or "Appellee."

[5] The district court did not define what constituted maintaining an account with a broker-dealer, rendering it a vague and nonjusticiable requirement. The district court's Order did not discuss whether a file maintained by a broker or broker-dealer related to recommendations made to an investor containing notes, agreements to sell or other documents would constitute an account, or whether same was present in this case.

[6] Opinion of the District Court, No. 11 Civ. 6993 (LLS) (docket No. 47), p. 13 (herein "Order").

[7] *Id*. at p. 4.

agreement.[8] Rule 12200 makes no mention of a customer's obligation to have an account or to make a purchase of securities from the FINRA member, and no administrative material from FINRA or the SEC defines a "customer" for purposes of arbitrability as requiring same. Not only have courts (including very recently the Second Circuit) defined the term "customer" more broadly than the district court and have not required an account for such designation, but courts have found a customer relationship in factual scenarios where the broker-dealer provided more limited and less typical services than alleged in this action.

By reading in additional requirements to the designation by which investors are "customers" for arbitrability purposes, the district court misinterprets the plain language of Rule 12200, and emasculates FINRA's role as the administrator of the forum where securities disputes are resolved.

The district court's inappropriate application of FINRA Regulatory Notice[9] ("Reg. Not.") 12-55 sets a dangerous precedent. Not only does Reg. Not. 12-55 not apply for purposes of determining arbitrability of securities claims, but approving the district court's holding would, essentially, permit an unconventional and unpermitted change to the applicable FINRA Rules. All such rule changes

[8] *See* FINRA Rule 12200.

[9] FINRA publishes Regulatory Notices to provide "timely information" regarding "FINRA rules … and legal interpretations and guidance relating to existing rules." *See* FINRA, Types of FINRA Notices, http://www.finra.org/Industry/Regulation/Notices/p085286 (last visited Sept. 12, 2013).

must be approved by the SEC, generally after providing an opportunity for public comment, which did not happen before Reg. Not. 12-55 was circulated.[10]

Because the Appellants are clearly customers of CGMI and the FINRA Rules clearly apply to the dispute between the parties, this Court should reverse the district court's Order.

IV.

ARGUMENT

A.

THE DISTRICT COURT'S ORDER REQUIRING AN INVESTOR TO HAVE AN ACCOUNT WITH AND MAKE A PURCHASE FROM A BROKER-DEALER AS PREREQUISITES TO BRINGING A DISPUTE THROUGH FINRA ARBITRATION IS CONTRARY TO CONTROLLING SECOND CIRCUIT LAW

The district court failed to follow clear and controlling Second Circuit law by holding that an investor must have an account with and make a purchase from a FINRA member before the investor could bring a dispute through FINRA arbitration. To the contrary, the Second Circuit has uniformly applied a broader interpretation of the term "customer" for arbitrability purposes.[11]

When determining the arbitrability of claims, courts generally limit their inquiry to identifying an agreement between the parties delineating arbitration as the chosen forum. Rule 12200 provides that:

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[10] *See* Rule 19b-4, Securities Exchange Act of 1934.
[11] *See, e.g., John Hancock Life Ins. Co. v. Wilson*, 254 F.3d 48 (2d Cir. 2001).

> Parties must arbitrate a dispute under the Code if:
>
> - Arbitration under the Code is either:
> (1) Required by a written agreement, or
> (2) Requested by the customer;
> - The dispute is between a customer and a member or associated person of a member; and
> - The dispute arises in connection with the business activities of the member or the associated person, except disputes involving the insurance business activities of a member that is also an insurance company.

Therefore, in the absence of a written agreement to arbitrate between the member and the customer, courts have determined that claims must be submitted to arbitration where: (1) the investor requests arbitration with a FINRA member; (2) the dispute arose in connection with the business activities of the FINRA member; and (3) the investor is a "customer" for purposes of arbitrability. The Order concedes the first two elements. As to whether Appellants were customers of the Appellee, FINRA Rule 0160 provides only that "[t]he term 'customer' shall not include a broker or dealer."[12]

The Second Circuit has held that investors are "customers" for arbitrability purposes in a wide range of instances, including where an investor-registered representative relationship exists, where the FINRA member acted as an issuer of securities that were purchased by the investor, and where the FINRA member

[12] FINRA Code of Arbitration Procedure Rule 12100(i) similarly provides that "[t]he term 'customer' shall not include a broker or dealer."

acted as a referring broker by recommending an investment to an investor through another FINRA member.[13]

The district court, apparently choosing not to follow controlling Second Circuit law, read in additional requirements to the definition of a customer: that the investor have an account with the FINRA member and that the investor make a purchase from the FINRA member, citing the presence of these as being the "touchstone of status as a customer."[14] However, in this Court's recent ruling in *UBS Financial Services, Inc.*, the investor did not have a brokerage account with UBS. Nevertheless, this Court held that a customer relationship existed based on

[13] *See John Hancock Life Ins. Co.*, 254 F.3d 48 (applying a broad definition of "customer" for arbitrability purposes, this Court noted "[t]o the extent any of these cases require indicia of a direct customer relationship between the member and the customer, we reject them as contrary to the plain language of Rule 10301"); *Twenty-First Securities Corp. v. Crawford*, No. 11 Civ. 6406(WHP), 2011 WL 6326128, at *2 (S.D.N.Y. Dec. 15, 2011), *aff'd* , 502 F. Appx. 64 (2d Cir. Nov. 9, 2012) (holding that a customer could proceed in an arbitration against a referring firm, even when the investment was held at an unregistered separate firm because the customer received "advice as opposed to investment or brokerage services"); *J.P. Morgan Securities Inc. v. Louisiana Citizens Property Ins. Corp.*, 712 F.Supp.2d 70, 80 (S.D.N.Y. 2010) (finding a customer/member relationship existed sufficient to compel arbitration as a result of the parties' issuer/underwriter relationship"); *Multi-Financial Securities Corp. v. King*, 386 F.3d 1364, 1367 (11th Cir. 2004) ("Although there is no direct agreement to arbitration between [the FINRA member] and [the investor], the code serves as a sufficient written agreement to arbitrate, binding its members to arbitrate a variety of claims with third party claimants"); *see also, McMahon Securities v. Aviator Master Fund*, 862 N.Y.S.2d 747, 753 (Sup. Ct. NY County 2008) ("Even when the parties have not entered into a direct agreement to arbitrate, NASD Rule 10101 and 10301(a) [now codified as Rule 12200] bind a NASD member to arbitrate certain third party claims"); *First Montauk Securities Corp. v. Four Mile Ranch Devel. Co., Inc.*, 65 F. Supp. 2d 1371, 1378 (S.D. Fla. 1999) ("It is now fairly established that a person or entity's contractual agreement with the New York Stock Exchange … or NASD which obligates the person/entity to arbitrate according to NYSE or NASD arbitration provision may be enforced by a non-party to the agreement-even though there is no direct agreement between the party seeking to invoke arbitration and the party seeking to avoid it").

[14] Order, pg. 10.

UBS's recommendations and its actions of underwriting and auctioning the auction rate securities ("ARS") to the investors.[15] In *Oppenheimer & Co. v. Neidhardt*, a customer relationship was found where the broker solicited money from the investor, in the absence of either an account or an actual purchase, in part due to the extent of the relationship between the investor and the broker.[16] Following similar reasoning, the Second Circuit held that no customer relationship existed when parties engaged in a credit default swap transaction and there was no further relationship or conduct between the parties.[17]

This case is significantly different from *Suntrust Banks, Inc. v. Turnberry Capital Mgmt. LP*, 13-Civ-879 (NRB), 2013 U.S. Dist. LEXIS 71254, 2013 WL 2128340 (S.D.N.Y. May 17, 2013), *appeal docketed*, No. 13-2075 (2d Cir. May 24, 2013), another case from the Southern District of New York where the district court found that an investor was not a customer of SunTrust Bank, Inc. In *Suntrust Banks, Inc.*, the court noted that the investor actually purchased the investment from Raymond James & Assocs., Inc., another unrelated FINRA-registered broker-dealer, and that Raymond James "provided significant information and advice to

[15] *See UBS Financial Services, Inc. v. West Virginia University Hospitals, Inc.*, 660 F.3d 643, 650 and 652 (2d Cir. 2011).
[16] *See Oppenheimer & Co. v. Neidhardt*, 56 F.3d 352, 356-357 (2d Cir. 1995); *see also, John Hancock Life Ins.*, 254 F.3d 48.
[17] *See Wachovia Bank, N.A. v. VCG Special Opportunities Master Fund, Ltd.*, 661 F.3d 164, 173 (2d Cir. 2011).

[the investor]" and was compensated directly by the investor.[18] Additionally, the court noted that the investor commenced a separate FINRA arbitration proceeding against Raymond James as a result of the same transactions complained of therein.[19]

Unlike in *Suntrust Banks, Inc.*, there was no middle man between the Appellants and CGMI, as it was CGMI that structured, negotiated, provided support for and continued to monitor the transaction, providing Appellants monthly statements after the closing on the investment.[20] It was reversible error for the district court to find that where there was such a substantial relationship between the Appellants and Appellee, the claims were not subject to binding arbitration because a non-FINRA-member affiliate was assigned to act as the counterparty.

B.

PUBLIC POLICY DIRECTS THAT ANY AMBIGUITY IN THE TERM "CUSTOMER" SHOULD BE CONSTRUED IN FAVOR OF ARBITRATION

Not discussed by the district court is the federal policy arising from the Federal Arbitration Act in favor of arbitration, as noted by the U.S. Supreme Court in *Shearson/American Express, Inc. v. McMahon*.[21] The Second Circuit has several times noted that any ambiguity in the term "customer" should be construed

[18] *Suntrust Banks, Inc.*, 2013 U.S. Dist. LEXIS 71254, *3-5, 17.
[19] *Id*. at *3.
[20] Order, pg. 4.
[21] *See Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S. Ct. 2332 (1987).

in favor of arbitration.[22] The Appellee is required by the FINRA Rules to arbitrate, given its structuring, recommendation and servicing of the investment. The affirmance of the Order would infringe on the strong public policy in favor of arbitration. CGMI should not be permitted to avoid its obligations to arbitrate pursuant to its membership agreement with FINRA by virtue of the manner in which it structured the investments at issue. CGMI chose to provide substantial structuring and support services to the Appellants as part of its business activities as a FINRA member, but it had a non-FINRA-member affiliate act as counterparty as part of CGMI's structuring of the investment. Allowing firms to avoid arbitrating with investors under such circumstances would thwart the strong public policy in favor of arbitration.

C.

THE DISTRICT COURT'S RELIANCE ON FINRA REG. NOT. 12-55 IS MISPLACED

The district court erred by relying upon Reg. Not. 12-55 in support of the court's ruling that an account with and a purchase from a FINRA member are necessary for a customer relationship to exist between the member and the investor.

[22] *See John Hancock Life Ins. Co.*, 254 F.3d at 59; *Bensadoun v. Jobe-Riat*, 316 F.3d 171, 176 (2d Cir. 2003) (same).

In Reg. Not. 12-55, FINRA discussed who is a "customer" for purposes of the suitability rule."[23] The suitability rule, FINRA Rule 2111, which has no application to arbitrability issues, was approved by the SEC on July 9, 2012.[24] [25] Reg. Not. 12-55, entitled "Guidance on FINRA's Suitability Rule," states:

> The suitability rule applies to a broker-dealer's or registered representative's recommendation of a security or investment strategy involving a security to a "customer." FINRA's definition of a customer in FINRA Rule 0160 excludes a "broker or dealer." In general, for purposes of the suitability rule, the term customer includes a person who is not a broker or dealer who opens a brokerage account at a broker-dealer or purchases a security for which the broker-dealer receives or will receive, directly or indirectly, compensation even though the security is held at an issuer, the issuer's affiliate or a custodial agent (e.g., "direct application" business, "investment program" securities, or private placements), or using another similar arrangement.[26]

By its own terms, Reg. Not. 12-55 (which is not a promulgated rule), states that for an investor to be a customer of a FINRA member, solely for the purposes of the suitability rule, the investor needs to have a brokerage account with the member or purchase a security from the member (an ambiguous statement), not both. FINRA clearly sought to limit the application of Reg. Not. 12-55 to issues of suitability

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[23] FINRA Reg. Not. 12-55 (Dec. 2012), p. 2.

[24] FINRA Rule 2111(a) directs, in pertinent part, that a "member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy … is suitable for the customer, based upon the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile." Rule 2111 further sets forth certain information that must be collected by the member or associated person, and defines when the suitability obligation may be fulfilled.

[25] *See* 75 Fed. Reg. 71479 (Nov. 23, 2010) (Order Approving Proposed Rule Change, File No. SR-FINRA-2010-039).

[26] Reg. Not. 12-55, p. 2.

only. FINRA specifically referred to the definition of a customer by using the language from Rule 0160 (Definitions) as "exclud[ing] a broker or dealer."[27] Further evidencing its position to limit applicability of Reg. Not. 12-55, FINRA noted that even when the suitability rule may not be applicable, other FINRA Rules could still apply, depending on the "facts and circumstances," a factually intensive inquiry intended for arbitration panels. FINRA made clear in Reg. Not. 12-55 at footnotes 11 and 18 that:

> Depending on the facts and circumstances, a registered representative's recommendation to a potential investor also could raise concerns under, among other rules, FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade); FINRA Rule 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices); Rule 2210 (Communications with the Public); and NASD Rule 3040 (Private Securities Transactions of an Associated Person); see also Dep't of Enforcement v. Salazar, No. 20100224056, 2012 FINRA Discip. LEXIS 22 (Mar. 12, 2012) (finding that registered representative violated NASD Rules 2310 and 3040 when he recommended unsuitable private securities transactions to investors who were not his firm's customers, received compensation in relation to the transactions and failed to notify his firm of such activity); Maximo J. Guevara, 54 S.E.C. 655, 2000 SEC LEXIS 986 (2000) (holding that registered representative violated NASD Rules 2310 and 3040 where he recommended unsuitable securities that were sold away from the firm with which he was associated without providing his firm prior notice of such activities).
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> * * *
>
> While the suitability rule applies only to recommendations involving a security or securities, other FINRA rules potentially apply, depending on the facts of the particular case, to broker-dealers' or registered

[27] *Id.*

> representatives' conduct that does not involve securities. See, e.g., FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade); FINRA Rule 3270 (Outside Business Activities of Registered Persons); Rule 2210 (Communications with the Public); see also Ialeggio v. SEC, No. 98-70854, 1999 U.S. App. LEXIS 10362, *4-5 (9th Cir. May 20, 1999) (holding that FINRA's requirement that registered representatives act in a manner consistent with just and equitable principles of trade applies to all unethical business conduct, regardless of whether the conduct involves securities); Vail v. SEC, 101 F.3d 37, 39 (5th Cir. 1996) (same); Robert L. Wallace, 53 S.E.C. 989, 995, 1998 SEC LEXIS 2437, at *13 (1998) (emphasizing, in an action involving viatical settlements, that Rule 2210 is "not limited to advertisements for securities, but provide[s] standards applicable to all [broker-dealer] communications with the public").

The district court's improper application of Reg. Not. 12-55, if allowed to stand, would adversely affect public investors. The district court's requirements of the maintenance of an account with and the purchase of a security from a FINRA member for an investor's claim to be arbitrable would prevent investors from arbitrating many cases involving the sale of unapproved products by registered representatives. Investors are and have repeatedly been victims of registered representatives who sell unapproved promissory notes or investments in a side business or entity of the registered representative in circumstances where investors do not have an account with the registered representative's firm, and the firm does not receive any compensation. Such "investments" include purchases of interests in fictitious businesses and Ponzi schemes.[28] The district court's ruling would

[28] There are countless examples in the FINRA Arbitration Awards Database of cases involving such schemes. *See, e.g., Fazio v. Lehman Brothers*, NYSE Case No. 03-014766 (Respondents

preclude such victimized investors from arbitrating their claims, despite the applicability of numerous FINRA Conduct Rules imposing liability on FINRA members in such circumstances. In fact, the SEC has directed that it is the obligation of broker-dealers, as gate-keepers of the securities industry, to protect investors from such schemes.[29]

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found liable to Claimants for claims related to a fraudulent Ponzi scheme in amount of $2,377,000.00 in compensatory damages, attorneys' fees and expert fees); *Moore v. Prudential Equity Group*, NASD Case No. 05-03586 (Respondents found liable to Claimants for claims related to a Ponzi scheme in amount of more than $1.6 million in compensatory damages and $392,000.00 in punitive damages); *Rau v. Stipek Securities, LLC*, NASD Case No. 05-02261 (Respondents found liable to Claimants for claims including failure to supervise and fraud related to the sale of unqualified, non-exempt real estate interest securities promising 9-11% returns on investment that were found to be a Ponzi scheme and ordered to pay Claimants $1 million in compensatory damages, as well as more than $500,000.00 in punitive damages and attorneys' fees); *Lieberman v. Morgan Keegan & Company, Inc*., FINRA Case No. 10-00009 (Respondents found liable for claims related to a Ponzi scheme and ordered to pay Claimants $264,000.00 for full compensatory damages, expert expenses, and punitive damages); *Armstrong v. Madison Avenue Securities, Inc.*, FINRA Case No. 10-00477 (Respondent was found liable to Claimant for claims related to a Ponzi scheme and ordered to pay Claimant's full requested compensatory damages and attorneys' fees totaling $208,163.00); *Zyber v. East-West Capital Corporation*, NASD Case No. 97-00128 (Respondent found liable to Claimants for failing to disclose an investment that was in fact a Ponzi scheme and ordered to pay Claimant $100,000.00 compensatory damages, costs and attorneys' fees).

[29] The SEC has instructed that it is "the responsibility of broker-dealers to supervise their employees by means of effective, established procedures is a critical component in the federal investor protection scheme regulating the securities markets." *SG Cowen Securities, Corp.*, Release No. 34-48335 (Aug. 14, 2003) (citing *Smith Barney, Harris Upham & Co., Inc*., Release No. 34-21813 (March 5, 1985)); SEC Staff Legal Bulletin No. 17: Remote Office Supervision (March 19, 2004). Because a firm can act only through individuals, it is the obligation of those persons with supervisory responsibilities to ensure that supervision is adequate. *See In re Stuart K. Patrick*, 51 SEC 419 (1993), *aff'd*, 19 F.3d 66 (2d Cir. 1993), *cert. denied*, 513 U.S. 807 (1994).

Indeed, FINRA has issued directives to its members reminding them of the substantial risks to public investors over such matters as private securities transactions, and that the member firms can be held liable.[30]

Relying on Reg. Not. 12-55 is particularly inappropriate, given the many court decisions finding a customer relationship exists even in the absence of account agreements and securities purchased from the FINRA member. Courts have held that investors who are customers of an associated person are customers of the broker-dealer that employs the associated person and that such investors may pursue their claims in FINRA arbitration.[31]

[30] *See, e.g.*, NASD Notice to Members ("NTM") 85-84 (New Rule of Fair Practice Relating to Private Securities Transactions) ("The firm, in fact, may be unaware of the associated person's participation in [private securities transactions]. Under some circumstances, the firm may be liable for the actions of the associated person, even though the firm was not aware of his or her participation in the transaction"); NASD Rule 3010(a) (Supervision) ("Each member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules. Final responsibility for proper supervision shall rest with the member").

[31] *See Oppenheimer & Co., Inc.*, 56 F.3d at 357 ("when [c]laimants dealt with [the broker], they were dealing with [the firm]"); *see also, Vestax Sec. Corp. v. McWood*, 280 F.3d 1078 (6th Cir. 2002) (following the Second Circuit holding in *Oppenheimer & Co., Inc. v. Neidhardt* to hold that claimants who never held accounts with the firm still were customers of the firm and entitled to pursue their arbitration claims against the firm); *John Hancock Life Ins. Co.*, 254 F.3d at 60 (citing *WMA Sec. v. Ruppert*, 80 F. Supp. 2d 786, 789 (S.D. Ohio 1999) for the proposition that the presence of a customer account or purchases made from a FINRA member are "irrelevant" to finding a customer relationship); *Multi-Fin. Secs. Corp.*, 386 F.3d at 1367 ("when an investor deals with a member's agent or representative, the investor deals with the member).

D.

PERMITTING REG. NOT. 12-55 TO CONTROL FOR PURPOSES OF ARBITRABILITY WOULD CONTRAVENE THE SEC'S CLEAR DIRECTIVE TO OVERSEE FINRA RULE MAKING

Permitting the district court's ruling to stand, premised on an assumption that Reg. Not. 12-55 suggests that for purposes of arbitrability an investor must have an account and must make purchases from a FINRA member,[32] would amount to an unregulated FINRA Rule change that would contravene the SEC's directive to solicit public comment as it oversees rule making for self-regulatory organizations.[33] The district court's ruling is akin to judicial legislation, and the opinion even reads as such.

FINRA defines a customer only as being neither "a broker or a dealer" and makes no mention of requiring an account.[34] Second Circuit decisions have broadly construed this rule by finding customer relationships in a variety of scenarios.[35] Reading in the requirement of maintaining an account and/or making a purchase, would amount to an amendment of Rule 0160 without due notice to the

[32] By its own terms, Reg. Not. 12-55 states that suitability rules apply when an investor maintains an account with the FINRA member or make purchases from the FINRA member, but both are not required.
[33] *See* 15 U.S.C. § 78s(b)(1).
[34] *See* Rule 0160(b)(4).
[35] *See* footnote 13, *supra*.

SEC and without permitting the SEC to approve or deny such amendment after a public comment period.[36]

FINRA clearly did not intend to change any rules other than those listed in proposed rule change of 2090 (Know Your Customer) and 2111 (Suitability) filed with the SEC on July 30, 2010 and amended on September 21, 2010.[37] Reg. Not. 12-55 was never submitted as a rule change itself or exposed to public comment, as required by SEC rules and mandates, if it had been intended to change the definition of a "customer" for the purposes of arbitrability. Nowhere in the actual proposed rule amendments filed with the SEC nor the SEC's Notice of Filing and Immediate Effectiveness of the Rules Changes to Rule 2090 and 2011 is there a discussion regarding amendment of the definition of customer for purposes of arbitrability, nor of FINRA Rule 0160, the general definition of a customer, particularly not in the manner described in the Order.[38]

V.

CONCLUSION

The district court's imposition of the requirements that an investor have an "account" and purchase securities "through" a brokerage firm for the investor to be considered a "customer" of the firm for the purposes of arbitrability is contrary to

[36] *See* 15 U.S.C. § 78s(b)(1); 17 C.F.R. § 240.19b-4.
[37] *See* Exchange Act Release No. 34-63325 (Nov. 17, 2010), 75 FR 71479 (Nov. 23, 2010).
[38] *Id.*; Exchange Act Release No. 62718A (Aug. 20, 2010), 75 FR 52562 (August 26, 2010); Exchange Act Release No. 34-64260 (April 8, 2011).

decisions by this Court and by courts in other circuits. The district court's decision ignores the necessary fact-intensive analysis typically utilized by courts in determining whether an investor is a customer of a firm. It also ignores the increasing complexity of the financial markets and securities products, and undercuts the investor protection mission of FINRA.

The district court's ruling is contrary to FINRA's broad definition of the term "customer." Reliance by the district court on Reg. Not. 12-55 to support its decision is clearly erroneous. It is evident from the plain language of Reg. Not. 12-55 that it only pertains to FINRA's suitability rule and that it has nothing to do with the definition of the term "customer" for the purposes of arbitrability.

For all of these reasons, the Court should reverse the district court's decision.

Respectfully Submitted,

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CERTIFICATION PURSUANT TO
Fed. R. App. P. 32(a)(7)(B) and (C)

The undersigned hereby certifies that the foregoing brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) and (C) because the brief contains 5,055 words of text.

The brief complies with the typeface requirements of Fed. R. App. P.32(a)(5) and the type style requirements of Fed.R.App.P.32(a)(6) because this brief was prepared in a proportionally spaced typeface using Microsoft Word 2003, Times New Roman, Size 14.

Dated: September 16, 2013

/s/ Jenice L. Malecki
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