CASE NO. 11-20736

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

Morgan Keegan & Company, Inc.,

Plaintiff – Appellee,

v.

John J. Garrett; et al.

Defendants – Appellants,

Craig J. McCann,

Appellant.

John J. Garrett; et al.

Plaintiffs – Appellants,

v.

Morgan Keegan & Company, Inc.,

Defendant – Appellee.

On Appeal From the United States District Court for the Southern District of Texas, Houston Division, Honorable Lynn N. Hughes,
Civil Action No. 4:10-cv-04308

BRIEF OF AMICUS CURIAE THE PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION IN SUPPORT OF 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 Rule 29, the Public Investors Arbitration Bar Association ("PIABA") respectfully submits this amicus brief, in support of Defendants-Appellants' appeal seeking to reverse the decision of the United States District Court for the Southern District of Texas (Hughes, J.), entered on September 30, 2011, vacating the award issued by the arbitration panel in the underlying dispute before the Financial Industry Regulatory Authority ("FINRA").[1]

II. STATEMENT OF INTEREST

PIABA is a national bar association established in 1990 as an educational and networking organization for attorneys representing the public investor in securities disputes. PIABA's members are involved in promoting the interests of public investors in securities and commodities arbitration. The mission of PIABA is to promote the interests of public investors in securities and commodities arbitration by protecting them from abuses in the arbitration process. PIABA endeavors to make securities and commodities arbitration as just and fair as systematically possible by creating a level playing field for the public investor.

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[1] No party or party's counsel authored this brief in whole or in part, and no party or party's counsel 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.

PIABA has a specific interest in this appeal because the District Court's decision vacating the award in the underlying FINRA arbitration is inconsistent with judicial precedent and the plain language of the relevant FINRA rules. The District Court's exceedingly narrow interpretation of the term "customer," as applied under the FINRA Code of Arbitration Procedure ("FINRA Code"), would significantly harm the efficient, timely, and inexpensive resolution of disputes between FINRA members and their customers. Additionally, the District Court's improper expansion of the scope of review of an arbitration award would similarly weaken the role the FINRA dispute resolution forum.

If the District Court's decision is affirmed, it would prompt FINRA members that did not prevail in arbitration to burden the courts with a barrage of claims seeking to vacate FINRA awards over factual disputes beyond the scope of review, such as those involving the existence of a "customer" relationship between the parties. Like the instant case, many such actions would undoubtedly seek to improperly vacate arbitration awards where the facts conclusively established that, under the plain language of the applicable FINRA rules, the prevailing party was a "customer" of the non-prevailing party.

PIABA appears as amicus curiae because it is in its members' interest that their clients--aggrieved "customers" of brokerage and investment firms--have available a speedy, efficient, and relatively inexpensive arbitration forum to vindicate their rights

with finality. Moreover, a clear and unambiguous decision by this Court rejecting the District Court's unduly restrictive definition of the term "customer" would promote predictability in the FINRA arbitration process.

Additionally, while its amicus brief primarily addresses legal arguments not made or not thoroughly discussed in the principal brief, PIABA submits that it fully supports the arguments made by Defendants-Appellants in their brief.

III. SUMMARY OF ARGUMENT

The District Court made legal and factual errors in vacating the arbitration award at issue. Among other things, the District Court improperly construed the term "customer" under the FINRA Code and therefore erred in holding that two of the Appellants were not customers of Morgan Keegan. Additionally, the District Court exceeded the scope of review of the arbitration award by making impermissible and erroneous factual determinations, including its determination that two of the Appellants were "non-customers" and regarding the veracity of expert testimony. The issues raised below do not constitute an exhaustive list of the errors made by District Court, but they nevertheless provide a sufficient basis for reversal of the District Court's opinion.

IV. ARGUMENT

A. THE DISTRICT COURT IMPROPERLY CONSTRUED THE TERM "CUSTOMER" UNDER THE FINRA CODE AND THEREFORE ERRED IN

HOLDING THAT TWO OF THE APPELLANTS WERE NOT CUSTOMERS OF MORGAN KEEGAN

The District Court erred in concluding that the claims of two of the Appellants, J. Stephen Harris ("Harris") and William C. Goodwin ("Goodwin"), should have been excluded from the arbitration. Harris and Goodwin were two out of a total of 18 investors that filed claims against Morgan Keegan in the underlying FINRA arbitration.[2] Under FINRA Rule 12200, absent a written arbitration agreement, for a claim against a FINRA member, such as Morgan Keegan, to be subject to mandatory arbitration, the dispute must: (1) be "between a *customer* and a member or associated person of a member"; and (2) arise "in connection with the business activities of the member or the associated person." FINRA R. 12200 (emphasis added). Federal courts have held that the interpretation of FINRA arbitration provisions is one of contract interpretation, so that they should be interpreted by their plain language. *See, e.g., UBS Sec. LLC v. Voegeli*, 684 F. Supp. 2d 351, 355 (S.D.N.Y. 2010) (citing *Bensadoun v. Jobe-Riat*, 316 F.3d 171, 176 (2d Cir. N.Y. 2003)).

Thus, under a "plain language" reading, most federal courts have held that the FINRA Code (or its predecessor, the NASD Code) defines the term "customer"

[2] This brief presumes familiarity with the facts of the dispute, as set out in Appellants' Brief. *See* Appellants' Br., Case No. 11-20736, at 2-13 (5th Cir. Jan. 9, 2012).

broadly, as it provides only that "[a] customer shall not include a broker or dealer." FINRA R. 12100(i); *see also UBS Fin. Servs. v. W. Va. Univ. Hosps., Inc.*, 660 F.3d 643, 650 (2d Cir. N.Y. 2011) (citing *John Hancock Life Ins. Co. v. Wilson*, 254 F.3d 48, 59 (2d Cir. N.Y. 2001) (noting that NASD Code "defines 'customer' broadly")); *Vestax Sec. Corp. v. McWood*, 116 F. Supp. 2d 865, 869 (E. D. Mich. 2000) (noting that "in the securities context" courts have taken a broad view of "customer"); *WMA Sec. v. Ruppert*, 80 F. Supp. 2d 786, 789 (S.D. Ohio 1999) (defendants who conducted business with plaintiff, an NASD member, were "customers," even though they never had an account with the plaintiff and the promissory notes in which both defendants invested were not approved products of plaintiff); *WMA Sec. v. Wynn*, 191 F.R.D. 128, 130 (S.D. Ohio 1999) (Under the NASD Code, a "customer" is defined as anyone who is not a broker or dealer, not as a person who opened an account with a brokerage firm); *First Montauk Secs. Corp. v. Four Mile Ranch Dev. Co.*, 65 F. Supp. 2d 1371, 1381 (S.D. Fla. 1999) ("[The NASD Code] contains no limitations other than exclusion of brokers and dealers from invoking rules relating to customers); *Oppenheimer & Co. v. Neidhardt*, 56 F.3d 352, 358 (2d Cir. 1995) (holding that investors who had been defrauded by a representative of an NASD firm were customers of that firm under the NASD Code, even though they never opened formal accounts with the firm).[3]

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[3] In fact, at least one of the decisions cited by the Appellee in support of its Motion

In finding that Harris and Goodwin were not customers of Morgan Keegan, the District Court in the present case used an exceedingly narrow interpretation of the term "customer" under the FINRA Code that is not supported by the case law. Specifically, the District Court stated, without citing any authority, that "[a] customer has a direct relationship with a firm." (Op. at 2.) Then, it summarily concluded that Harris and Goodwin had no direct relationship with Morgan Keegan because they "bought shares in the fund from third-party brokers on the secondary market," had "information from the street," "never gave money to Morgan Keegan," and "never contacted Morgan Keegan for advice." (Op. at 2.) These factual findings are inaccurate because both Harris and Goodwin were induced to invest by Morgan Keegan's financial advisor, Russell Stein, and relied on him to their detriment.

The case law contravenes the District Court's conclusion that *only* those who have a "direct relationship" with a FINRA member can be considered "customers" under the FINRA Code. For instance, in *Hancock*, the Second Circuit expressly rejected the notion that "indicia of a direct customer relationship between the [NASD] member and the customer" is inherent in the definition of "customer"

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to Vacate recognizes a broad definition of the term "customer" under the NASD (now FINRA) Rules. *See, e.g., Herbert J. Sims & Co. v. Roven*, 548 F. Supp. 2d 759, 763 (N.D. Cal. 2008) ("The NASD rules define the term 'customer' broadly, excluding only brokers and dealers").

under NASD Rule 10301, as that notion is "contrary to the plain language of Rule 10301."[4] *See Hancock*, 254 F.3d at 60. In *Hancock*, the plaintiffs, (collectively referred to as "John Hancock"), filed an appeal from an order and judgment of the United States District Court for the Northern District of New York that, *inter alia*, granted defendants' (the "investors") motion to compel arbitration. *Id.* at 50. The investors' underlying claims related to the purchase of fraudulent promissory notes from a broker and his associate. *Id.* Under NASD regulations, the broker was considered an "associated person" of John Hancock, which was an NASD member. *Id.* at 51-52. The appellate court stated that in determining whether John Hancock had to arbitrate the investors' claim, it needed to "look no further than the plain language of [NASD] Rule 10301, keeping in mind that any ambiguity in the language must be construed in favor of arbitration." *Id.* at 58. John Hancock argued that the investors "had to be customers of John Hancock and not merely of an associated person" of John Hancock to trigger the arbitration provision of the NASD Code. *See id.* at 59. The appellate court rejected this "narrow definition of the term customer," finding instead that the term "customer" plainly referred to either a member's or the associated person's customer. *Id.* Hence, the appellate

[4] FINRA Rule 12200 of the FINRA Code, which took effect on April 16, 2007, is an amended version of NASD Rule 10301. *See* FINRA R. 12200; NASD R. 10301; *see also Herbert*, 548 F. Supp. 2d at 763 n.2 ("The cases interpreting and applying [NASD] Rule 10301 apply with equal force to [FINRA] Rule 12200, as the amendment did not effect any substantive change to the rule").

court affirmed the district court's ruling compelling arbitration of the investors' claims.

Recent federal court decisions have attempted to circumscribe the FINRA definition of "customer" to instances where there is at least some kind of business relationship between the purported customer and the broker/dealer or its associated person. *See, e.g., Voegeli*, 684 F. Supp. 2d at 356 (investors are not "customers" of the broker/dealer under FINRA Rule 12200, where they were unable to show a relationship, direct or indirect, with the broker/dealer or one of its associated persons, other than as shareholders of a company the broker/dealer was advising in connection with an IPO); *J.P. Morgan Sec. v. La. Citizens Prop. Ins. Corp.*, 712 F. Supp. 2d 70, 78-79 (S.D.N.Y. 2010) (issuer is a customer of an underwriter for purpose of FINRA Rule 12200); *Bensadoun*, 316 F.3d at 177 (quoting *Fleet Boston Robertson Stephens, Inc. v. Innovex, Inc.*, 264 F.3d 770, 772 (8th Cir. 2001) (defining "customer" under FINRA Rule 12200 as "one involved in a business relationship with [a FINRA] member that is related directly to investment or brokerage services"); *Brookstreet Sec. Corp. v. Bristol Air, Inc.*, 2002 U.S. Dist. LEXIS 16784, at *23 (N.D. Cal. Aug. 5, 2002) (narrow definitions of the term "customer" have been rejected, but term must not be defined so broadly as to upset the reasonable expectations of FINRA members).

Nevertheless, not even the more restrictive interpretation of the term "customer" found in recent decisions provides support for the District Court's defining of "customer" as only those parties with a "direct relationship" to the FINRA member. For example, in *Bensadoun*, although it found that the investors were not "customers" of the broker, the Second Circuit readily stated that its finding did not mean that "a 'customer' relationship with a broker or dealer for the purposes of demanding arbitration could not be formed in cases where an investor acted through an intermediary or agent." *See Bensadoun*, 316 F.3d at 177-178.

Similarly, in *Brookstreet*, the district court stated that "[m]ost courts have rejected the requirement of indicia of a direct customer relationship between the member and the customer." *See Brookstreet*, 2002 U.S. Dist. LEXIS 16784, at *23. Furthermore, the court noted that a customer relationship was typically created between a member firm and a third party when "the individual who solicited the investments or provided investment advice to the purported 'customers' was a representative or employee of the broker." *See id.* at *24. Although the court ultimately found that a customer relationship was not established between the investors and the member firm in that case, it did so based on the fact that the investors interacted only with their investment advisor, who maintained an account with the member firm, but was not an employee, agent, or registered representative of the member firm. *See id.* at *25-26.

In the instant case, the record shows that Harris and Goodwin had a business relationship with Morgan Keegan relating to the investments funds at issue.[5] Both Harris and Goodwin were officers of corporate respondents or were otherwise affiliated with other claimants that had account advisory contracts with Morgan Keegan. (Opp'n Mot. Vacate, at 10.) Furthermore, there was undisputed testimony that both Harris and Goodwin received and relied solely on investment advice from Morgan Keegan's broker, Russell Stein, when they made the purchases of shares in the investment funds at issue. (Opp'n Mot. Vacate at 10-11.) In fact, Stein confirmed that it was his and Morgan Keegan's intent that Harris and Goodwin rely on the information he provided to them regarding the funds. (Opp'n Mot. Vacate at 11.) Thus, under the FINRA Code, Harris and Goodwin were "customers" of Morgan Keegan, so as to trigger the mandatory arbitration provision of FINRA Rule 12200.

Preserving a broad definition of the term "customer" under the FINRA Code, as most federal courts have done, is crucial to the ability of aggrieved investors to obtain a fair and practical resolution to their investment disputes with FINRA members. The District Court's narrow definition of "customer" only

[5] While Harris and Goodwin stipulated in the FINRA arbitration that each of them was not "an individual customer of Mr. Stein," it is clear from the context that such stipulation did not refer to the term "customer" as defined or employed within the FINRA Code, but was a reference to the term in its ordinary usage. (*See* Agreed Stipulation of Facts at 6, 8).

serves to impermissibly limit the scope of disputes that belong in FINRA arbitration, forcing investors to look to the courts for relief. Clearly, such a result is not in the best interest of either investors or the securities industry, both of whom benefit greatly from maintaining the FINRA dispute resolution forum as a viable alternative to the judicial process.

B. THE DISTRICT COURT EXCEEDED THE SCOPE OF REVIEW OF THE ARBITRATION AWARD BY MAKING IMPERMISSIBLE AND ERRONEOUS FACTUAL DETERMINATIONS

As noted in Appellants' brief, the court's scope of review of an arbitration award is very narrow and greatly deferential. (Appellants' Br. at 16.) In this case, the District Court did not observe this standard of review. For instance, after enunciating its overly narrow definition of "customer," the District Court engaged in a swift factual review, whereby it concluded that Harris and Goodwin were not "customers" of Morgan Keegan. This kind of conclusory analysis, essentially supplanting the resolution of an issue that had been presented and decided by the arbitrators in the underlying case, was clearly beyond the District Court's purview. Moreover, the result of such a practice is highly prejudicial to the interests of investors that select FINRA arbitration to resolve their disputes, as it greatly diminishes the finality and predictability associated with proceedings in that forum.

If allowed, this type of judicial overreaching would also undoubtedly strip the FINRA arbitration forum of two of its most valuable features: expediency and

cost-effectiveness. Having suffered economic losses, potential claimants are ill-equipped to endure more financial hardships en route to obtaining redress for their grievances against FINRA members. The scope of review of an arbitration award should remain highly deferential, as established by the overwhelming weight of the case law. It should not, as in this case, be effectively ignored—so as to remove the reasonable expectations of the parties to the arbitration.

The evils of ignoring the proper scope of review of arbitration awards are perfectly illustrated in the District Court's treatment of issues relating to Dr. McCann's testimony. In reviewing this issue, the District Court essentially performed an independent credibility determination and concluded that "the panel based its damages calculation on knowingly false testimony." (Op. at 3.) This conclusion was plainly wrong, as it ignored critical facts on record that showed that Dr. McCann did not provide false testimony to the arbitration panel.

Dr. McCann testified in the *Garrett* arbitration on August 17, 2010. Under FINRA Rule 12609, Morgan Keegan had the right to introduce any new or supervening evidence to the *Garrett* panel at any point before the issuance of the *Garrett* award on October 8, 2010. (*See* Dkt. 57 at 2.) Morgan Keegan had that opportunity, however, because it received a set of slides with the same revised estimates at issue in the *Arispe* arbitration in an earlier set of slides on September 7, 2010, as part of the 20-day exchange of exhibits for the *Semmes* arbitration.

(*See* Dkt. 48-1 at 14, n.5; *see also* Dkt. 48-13 and Dkt. 48-14.) Moreover, Dr. McCann testified about existence of this change in the September 7, 2011 slides from his previous estimates when he testified at the *Cooper* arbitration proceeding on September 21, 2010. *See id.* Specifically, Dr. McCann explained to Morgan Keegan at the *Cooper* hearing that the basis for the change was an extra reference to internally-priced securities that one of Dr. McCann's staff members had discovered in Morgan Keegan's SEC disclosures at some point after the *Garrett* hearing closed on September 1, 2010. (*See* Dkt. 57 at 10-11).

Unlike the *Garrett* claimants and their counsel, Morgan Keegan participated in the *Cooper* hearing and heard Dr. McCann's explanation. (*See* Dkt. 57 at 3; *see also* Dkt. 48-13 and Dkt. 48-14.) In pursuing its motion to vacate, however, Morgan Keegan did not disclose the September 7, 2010 *Semmes* slides or the September 21, 2010 *Cooper* testimony. (*See* Dkt. 19 at 28-34; Dkt. 24 at 9-13; Dkt. 26-1 at 2.) The *Cooper* testimony on September 21, 2010, put Morgan Keegan directly on notice about the revision to some of Dr. McCann's calculations and the basis for the change, and Morgan Keegan could have offered such revised figures and testimony to the *Garrett* panel under FINRA Rule 12609. Morgan Keegan never exercised this right.

Instead, Morgan Keegan asserted in its amended motion to vacate that Dr. McCann had waited until October 13, 2010, to talk about his revised estimate:

> In his Arispe report, [McCann] changed the numbers from those he swore to in the Garrett Arbitration. . . . His report did not address his alteration of the Garrett numbers or why the changes were made; he simply changed the numbers and said nothing. . . . It was not until October 13, 2010, during the Arispe Arbitration, that McCann admitted, when pressed by counsel on re-cross regarding the undisputed change in his numbers, that during his testimony in the Garrett Arbitration, he realized his numbers may not be accurate but revealed nothing.

(Dkt. 19 at 13). Similarly, at the April 14, 2011 hearing on its motion to vacate, Morgan Keegan's counsel made the same argument:

> And [McCann] immediately went back, confirmed the mistake, didn't disclose it before [the Garrett] closing, didn't disclose it in the Arispe [sic], just put in new numbers without saying they're new and without saying why, and then the Garrett award was published on October 8th and then he testifies on October 13th. That's what's indicated by the time line.

(Tr. of April 14, 2011 Hearing, 58:22-59:3).

The timeline that Morgan Keegan's counsel presented to Judge Hughes is attached as part of the Court's docket entry for the April 14, 2011 hearing. (*See* Dkt. 26-1 at 2.) Morgan Keegan's demonstrative exhibit moved from the *Garrett* hearing to the September 22, 2010 *Arispe* slides and October 13, 2010 *Arispe* testimony, without referencing the September 7, 2010 *Semmes* slides and September 21, 2010 *Cooper* testimony that acknowledged and discussed the revision. *See id.*

Thus, the record reflects that Morgan Keegan was aware since September 21, 2010, of the existence of Dr. McCann's revised estimate and the basis for the revised estimate, before the *Garrett* award. Instead, Morgan Keegan represented to Judge Hughes that Dr. McCann's revised estimate was not identified or explained until October 13, 2010, five days after the *Garrett* award. Morgan Keegan's selective use of certain testimony outside the record of the *Garrett* arbitration (while withholding testimony from another arbitration proceeding) shows why a district court should not usurp an arbitration panel's proper role by making an independent credibility determination.

V. CONCLUSION

This Court should reverse the ruling of the District Court.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT
New Orleans, LA

Case No. 11-20736, Morgan Keegan & Co., Inc. v. John J. Garrett, et al.

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

Certificate of Compliance with Type-Volume Limitation,
Typeface Requirements, and Type Style Requirements

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because:

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Signed: ***/s/ Andrew V. Tramont***
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Dated: January 17, 2012

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On Appeal From the United States District Court for the Southern District of Texas, Houston Division, Honorable Lynn N. Hughes,
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MOTION BY THE PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION FOR LEAVE TO FILE AMICUS CURIAE BRIEF IN SUPPORT OF 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.

MOTION BY PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION, INC. FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE IN SUPPORT OF REVERSAL

The Public Investors Arbitration Bar Association ("PIABA") respectfully moves for leave to file the attached brief as Amicus Curiae. Appellants have consented to the filing of this brief, but Appellee has not yet given its consent. Thus, in an abundance of caution, PIABA is seeking leave of court to file the attached brief.

PIABA is a national non-profit, voluntary public bar association with a membership of more than 700 attorneys. To be a member, attorneys must devote a significant portion of their practice to representing public investors in securities arbitrations. Collectively, PIABA members have represented tens of thousands of investors in securities arbitrations around the country.

PIABA's official mission is to promote the interests of public investors in securities arbitration by protecting public investors from abuses prevalent in the arbitration process; making securities arbitration just and fair; and creating a level playing field for public investors in securities arbitration. PIABA seeks to advance the rights of public investors through a variety of activities, including the submission of briefs as amicus curiae.

The United States Supreme Court, federal Circuit Courts of Appeal, and state supreme courts have permitted PIABA to appear as amicus curiae

in cases involving issues of importance to public investors' claims against their stockbrokers and financial advisors. PIABA also publishes books and reports on securities arbitrations, conducts regular CLE programs for its members, and communicates with governmental and quasi-governmental agencies, such as the Securities and Exchange Commission, the North American Securities Administrators Association, and the Financial Industry Regulatory Authority ("FINRA"), on issues of interest to PIABA members and public investors.

PIABA has a specific interest in this appeal because the District Court's decision vacating the award in the underlying FINRA arbitration is inconsistent with judicial precedent and the plain language of the relevant FINRA rules. Counsel for the Appellants has ably presented the case for review of the District Court's Order. PIABA asks for leave to provide an additional perspective from the viewpoint of public investors, who are potential parties in future securities arbitrations with FINRA members.

In particular, PIABA's submission addresses the errors of the District Court in construing the term "customer," as applied under the FINRA Code of Arbitration Procedure, as well as the improper expansion of the scope of review of an arbitration award. PIABA also submits its brief to show how the legal and factual mistakes of the District Court, if allowed to stand, would

significantly harm the efficient, timely, and inexpensive resolution of disputes between FINRA members and their customers.

The Amicus Curiae brief will provide a broader perspective, addressing the impact of this Court's decision on public investors, including those seeking to enforce their rights in securities arbitration. The amicus brief will provide the Court with an understanding of the potential impact that the Court's decision will have in those areas.

PIABA has reviewed the Appellants' brief and believes that its authorities and arguments support Appellants' position. Therefore, PIABA asks for leave to file an amicus brief pursuant to Federal Rule of Appellate Procedure 29 in support of Appellants and on behalf of public investors.

WHEREFORE, PIABA respectfully requests this Court grant this motion.

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CERTIFICATE OF SERVICE

I hereby certify that all parties have been served with the foregoing via ECF and U.S. mail on January 17, 2012:

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