RECORD NO. 12-1208

In The

United States Court Of Appeals

For The Fourth Circuit

MORGAN KEEGAN & COMPANY, INC.,

Plaintiff - Appellee,

v.

LOUISE SILVERMAN; LOUISE SILVERMAN TRUST; MAX SILVERMAN,

Defendants - Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND AT GREENBELT

BRIEF OF APPELLANTS

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UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT
DISCLOSURE OF CORPORATE AFFILIATIONS AND OTHER INTERESTS

Only one form needs to be completed for a party even if the party is represented by more than one attorney. Disclosures must be filed on behalf of all parties to a civil, agency, bankruptcy or mandamus case. Corporate defendants in a criminal or post-conviction case and corporate amici curiae are required to file disclosure statements. Counsel has a continuing duty to update this information.

No. 12-1208 Caption: Morgan Keegan v. Silverman Trust, et al

Pursuant to FRAP 26.1 and Local Rule 26.1,

Louise Silverman
(name of party/amicus)

who is appellant, makes the following disclosure:
(appellant/appellee/amicus)

1. Is party/amicus a publicly held corporation or other publicly held entity? ☐ YES ☑ NO

2. Does party/amicus have any parent corporations? ☐ YES ☑ NO
If yes, identify all parent corporations, including grandparent and great-grandparent corporations:

3. Is 10% or more of the stock of a party/amicus owned by a publicly held corporation or other publicly held entity? ☐ YES ☑ NO
If yes, identify all such owners:

4. Is there any other publicly held corporation or other publicly held entity that has a direct financial interest in the outcome of the litigation (Local Rule 26.1(b))? ☐YES ☑NO
If yes, identify entity and nature of interest:

5. Is party a trade association? (amici curiae do not complete this question) ☐YES ☑NO
If yes, identify any publicly held member whose stock or equity value could be affected substantially by the outcome of the proceeding or whose claims the trade association is pursuing in a representative capacity, or state that there is no such member:

6. Does this case arise out of a bankruptcy proceeding? ☐YES ☑NO
If yes, identify any trustee and the members of any creditors' committee:

CERTIFICATE OF SERVICE

****

I certify that on March 9, 2012 the foregoing document was served on all parties or their counsel of record through the CM/ECF system if they are registered users or, if they are not, by serving a true and correct copy at the addresses listed below:

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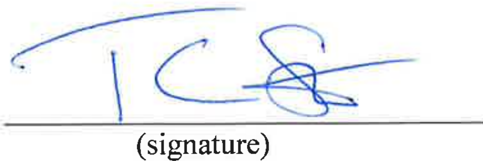

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No. 12-1208 Caption: Morgan Keegan v. Silverman Trust, et al

Pursuant to FRAP 26.1 and Local Rule 26.1,

Louise Silverman Trust
(name of party/amicus)

who is appellant, makes the following disclosure:
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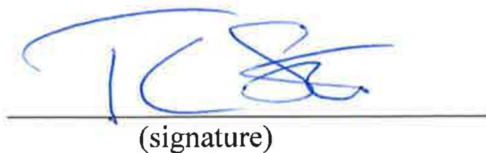

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No. 12-1208 Caption: Morgan Keegan v. Silverman Trust, et al

Pursuant to FRAP 26.1 and Local Rule 26.1,

Max Silverman
(name of party/amicus)

who is appellant, makes the following disclosure:
(appellant/appellee/amicus)

1. Is party/amicus a publicly held corporation or other publicly held entity? ☐ YES ☑ NO

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Defendants-Appellants Louise Silverman Trust, Max Silverman, and Louise Silverman (collectively "Defendants") respectfully submit their opening brief on appeal against Plaintiff-Appellee Morgan Keegan & Company, Inc. ("Plaintiff" or "Morgan Keegan"). This appeal is from the order of the U.S. District Court for the District of Maryland where the lower court issued a preliminary and permanent injunction prohibiting Defendants from pursuing their securities claims in arbitration (the "Order:") against Morgan Keegan before the Financial Industry Regulatory Authority ("FINRA").

JURISDICTIONAL STATEMENT

A. Basis for Subject Matter Jurisdiction in the District Court

Pursuant to the Federal Arbitration Act ("FAA"), 9 U.S.C. § 4 federal courts have subject matter jurisdiction to hear a petition to compel arbitration where the underlying dispute between the parties "arises under" federal law. *Vaden v. Discover Bank*, 129 S. Ct. 1263, 1271 (2009). While *Vaden* addressed a federal court's subject matter jurisdiction to compel arbitration, the doctrine applies with equal force to motions to enjoin arbitration proceedings. *See In re Sept. 11 Litig.*, 765 F. Supp. 2d 587, 591 (S.D.N.Y. 2011).

Here, Defendants incorporated questions of federal law under the Securities Acts of 1933 and 1934 in their underlying FINRA arbitration. [JA.30][1]. Therefore, jurisdiction is conferred to the federal courts under 28 U.S.C. § 1331.

B. Basis for Jurisdiction in the Court of Appeals

28 U.S.C. § 1292(a)(l) allows a party to appeal interlocutory orders "granting, continuing, modifying, refusing or dissolving injunctions, or refusing to dissolve or modify injunctions, except a direct review may be had in the Supreme Court." This appeal stems from the District Court for the District of Maryland's order issuing a preliminary injunction prohibiting Defendants from pursuing their FINRA arbitration claim against Morgan Keegan. [JA.335]. On January 26, 2012, the District Court of Maryland permanently enjoined Defendants from pursuing their arbitration claims. [JA.336]. Thus, jurisdiction in this Fourth Circuit Court of Appeals is proper.

C. Timeliness of Appeal

On January 26, 2012, the U.S. District Court for the District of Maryland filed an order granting Plaintiff's preliminary and permanent injunction. [JA.336]. The Notice of Appeal for this matter was filed with that Court on February 13, 2012. [JA.337]. Thus, this appeal was timely filed pursuant to Rule 4(a)(1) of the Federal Rules of Appellate Procedure ("FRAP").

---

[1] References to the page number from the Joint Appendix are herein designated as [JA._].

D. Final Order

This Appeal stems from an order granting a permanent injunction prohibiting Defendants from pursuing claims in FINRA arbitration. [JA.336]. The Order precludes Defendants from pursuing their claims in FINRA and, denying Defendants of their legal right to arbitrate disputes as provided under the FINRA Rules.

STATEMENT OF THE ISSUES

Whether the lower court erred in enjoining Defendants from proceeding in FINRA arbitration where Defendants are entitled to a presumption of arbitrability under the FAA and where the Court could not conclude with positive assurances that the Defendants are not "customers" of Plaintiff under FINRA's customer code of arbitration procedures ("FINRA Code").

STATEMENT OF THE CASE

On or about August 2, 2011, Defendants commenced a FINRA arbitration proceeding against Morgan Keegan in connection with the firm's business activities in the sales, marketing, and valuation of the Regions Morgan Keegan Bond Funds (the "Morgan Keegan Funds" or the "Funds"). On or about September 8, 2011, Morgan Keegan filed a Motion for Preliminary Injunction in the United States District Court for the District of Maryland to prohibit Defendants from proceeding with the FINRA arbitration. [JA.35]. Judge Motz granted

Morgan Keegan's motion for preliminary injunction as detailed in the memorandum accompanying the order. [JA.322-34]. Subsequently, Judge Motz granted a permanent injunction barring Defendants' claims. [JA.336].

STATEMENT OF FACTS

Defendants' FINRA Statement of Claim alleges that Morgan Keegan's marketing materials and sales persons provided false and misleading information that Defendants and their advisors relied upon in making Morgan Keegan Fund recommendations and purchases. [JA.14-34]. As a FINRA member, Morgan Keegan is obligated to truthfully advertise and communicate with the investing public under federal, state, and FINRA Rules. *See e.g.*, FINRA Rule 2210 Communications with the Public. Morgan Keegan's failure to abide by FINRA Rules, federal, and state securities laws with respect to the firm's Morgan Keegan Funds' sales efforts led to coordinated disciplinary action by a multitude of regulatory agencies.

On June 22, 2011, FINRA's Department of Enforcement[2], the Securities and Exchange Commission[3] ("SEC"), and at least four state regulatory

[2] FINRA Press Release, Morgan Keegan Ordered to Pay $200 Million to Investors to Settle Allegations Regarding Sales of Bond Funds, available at http://www.finra.org/Newsroom/NewsReleases/2011/P123798 (last visited March 21, 2012).

[3] SEC Order Making Findings and Imposing Remedial Sanctions and A Cease-And-Desist Order (hereinafter "SEC Order") [JA.177-196].

agencies[4] ("State Regulators") (collectively the "Regulators"), concluded that Morgan Keegan committed fraud in connection with the sale and advertisement of the Morgan Keegan Funds.[5] The regulators found that Morgan Keegan schemed to induce investors to invest in hedge fund like concentrations of CDOs and other ill-liquid real estate related derivative products without disclosing the risks of the investment strategy. [JA.148-151]. Due to the illiquidity of these investments and Morgan Keegan's involvement in deceptively setting the net asset values ("NAVs") of the Morgan Keegan Funds' investments, the firm was able to manipulate investors, including Defendants to purchase the funds. [JA.16]. Plaintiff's deceptive practices induced investors to believe that the Morgan Keegan Funds were stable, income producing funds, when the firm knew that the value of the Funds had dropped precipitously and that the stability of the Funds was being artificially achieved. *Id.*

James Potter and Dennis Laughlin served as Defendants' financial advisor and recommended that the Defendants purchase the Morgan Keegan Funds. *Id.* Mr. Potter researched the Funds by downloading and reviewing materials provided on Morgan Keegan's website including the RMK Funds' prospectuses,

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[4] The five state agencies include the Alabama State Securities Commission, the Kentucky State Securities Commission, the Mississippi Secretary of State, the Attorney General of South Carolina and the Tennessee Department of Commerce and Insurance.

[5] Alabama Consent Order [JA.131-75].

SAI's, semi-annual reports, quarterly slicks, and fund manager commentaries. [JA.127-29]. In addition, Defendants' advisors called Morgan Keegan at the number provided by the firm on their website and spoke to several sales representatives about the Funds. *Id.* Defendants' and their advisors relied upon information provided by Morgan Keegan in advising Defendants to purchase the RMK Funds. As a result, Defendants suffered a loss of nearly their entire investment.

SUMMARY OF THE ARGUMENT

The issue is whether Defendants fall within the scope of FINRA's arbitration agreement between Morgan Keegan and FINRA allowing "customers" to compel member firms to arbitrate disputes in connection with the business activities of its members. In interpreting the scope of an arbitration contract this Court has held that if the contract language is ambiguous, subject to multiple interpretations, then there is a presumption that the dispute at issue is covered under the arbitration clause unless it could be said with positive assurance that parties did not intend to arbitrate the asserted dispute. The District Court did not apply this standard in its decision. Instead, the lower court required Defendants to prove that the scope of the arbitration agreement covered the instant dispute even after concluding that the arbitration provision was ambiguous. In so doing, not only did the District Court's holding directly

contradict the U.S. Supreme Court's instructions on interpreting arbitration clauses, but also this Court's holding with respect to interpreting the FINRA Code.

Even assuming that extrinsic evidence was required to show or defend the intent of the parties to submit this dispute to arbitration, which Defendants argue is not necessary, the District Court still erred in its analysis of FINRA's arbitration clause. The lower court failed to apply contract principals to the FINRA Code, failed to analyze the "customer" term in the context of FINRA's statutory scheme, failed to give any weight to SEC interpretation of the "customer" term, and failed to give any weight to FINRA's own interpretative guidance. Moreover, in rendering its decision, the lower court relied upon authorities in other circuits, without adhering to the authorities in this Circuit.

Finally, the lower court erred by making unsupported assumptions as to the meaning of the term "customer" and the intent of the parties by injecting impermissible public policy arguments against arbitration. The lower court's public policy arguments reflected the type of judicial hostility to arbitration agreements that the FAA was designed to prevent. For all the foregoing reasons, the lower court's Order must be reversed.

ARGUMENT

STANDARD OF REVIEW

The court reviews *de novo* a district court's determination that a dispute is arbitrable. *Washington Square Sec., Inc. v. Aune*, 385 F.3d 432, 435 (4th Cir. 2004) (*citing Cara's Notions v. Hallmark Cards*, 140 F.3d 566, 569 (4th Cir. 1998).

DISCUSSION OF THE ISSUES

By passing FAA, 9 U.S.C. § 4, Congress established a "federal policy favoring arbitration." *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987) (*quoting Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp*., 460 U.S. 1 (1983) (internal quotations omitted). Thus, "courts must place arbitration agreements on an equal footing with other contracts…and enforce them according to their terms." *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1745-46, 179 L. Ed. 2d 742 (2011) (internal citations omitted). The U.S. Supreme Court has explained that if:

> it has been established that…the contract contains an arbitration clause, there is a presumption of arbitrability in the sense that '[a]n order to arbitrate the particular grievance should not be denied unless it may be said with *positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute. Doubts should be resolved in favor of coverage. Such a presumption is particularly applicable where the clause is as broad* as the one employed in this case…

AT & T Techs., Inc. v. Commc'ns Workers of Am., 475 U.S. 643, 650, 106 S. Ct. 1415, 1419, 89 L. Ed. 2d 648 (1986) (internal citations and quotations omitted) (emphasis added); *see also Washington Square*, 385 F.3d at 436 ("In the absence of any express provision excluding a particular grievance from arbitration,...*only the most forceful evidence of a purpose to exclude the claim from arbitration can prevail*, particularly where, as here, … the [NASD][6] arbitration clause [is] quite broad.") (*quoting United Steelworkers of Am. v. Warrior & Gulf Nav. Co.*, 363 U.S. 574, 584-85, 80 S. Ct. 1347, 1352, 4 L. Ed. 2d 1409 (1960) (emphasis added); *cf Fisher v. Wheat First Sec., Inc.*, 62 F. App'x 472, 475 (4th Cir. 2003); *Zandford v. Prudential-Bache Sec., Inc.*, 112 F.3d 723, 726 (4th Cir. 1997) (analyzing the scope of NASD's arbitration clause and finding that any "doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.") (*quoting Moses H. Cone Mem'l Hosp.*, 460 U.S. at 24-25).

Perhaps no other issue has been as frequently litigated in the past four years before the U.S. Supreme Court as the issue of

[6] In 2007 the NASD and NYSE merged to form FINRA.

arbitrability.[7] The Supreme Court's direction however is clear; if the dispute involves the scope of an arbitration agreement, err on the side of arbitration.

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[7] *Marmet Health Care Ctr., Inc. v. Brown,* 132 S. Ct. 1201, 1202 (2012) (Vacating the West Virginia Supreme Court decision where "the state court found the FAA's coverage to be more limited than mandated by this Court's previous cases."); *CompuCredit Corp. v. Greenwood,* 132 S. Ct. 665, 669, 181 L. Ed. 2d o586 (2012) (Arbitration clause applies to federal laws providing for a private right of action 'unless the FAA's mandate has been overridden by a contrary congressional command.'") (internal quotations and citations omitted); *KPMG LLP v. Cocchi*, 132 S. Ct. 23, 25-26, 181 L. Ed. 2d 323 (2011) ("the [FAA] Act leaves no place for the exercise of discretion by a district court, but instead mandates that district courts shall direct the parties to proceed to arbitration on issues as to which an arbitration agreement has been signed.") (internal quotations omitted); *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 179 L. Ed. 2d 742 (2011) (holding that the FAA preempts California's judicial rule regarding the unconscionably of class action arbitration waivers in consumer contracts); *Granite Rock Co. v. Int'l Broth. of Teamsters,* 130 S. Ct. 2847, 2850, 177 L. Ed. 2d 567 (2010) ("the parties agreed to arbitrate a particular dispute by (1) applying the presumption of arbitrability only where a validly formed and enforceable arbitration agreement is ambiguous about whether it covers the dispute at hand and (2) ordering arbitration only where the presumption is not rebutted.") (citations omitted); *Rent-A-Ctr., W., Inc. v. Jackson*, 130 S. Ct. 2772, 177 L. Ed. 2d 403 (2010) (acknowledging that a written provision to settle by arbitration is enforceable without mention of the validity of the contract in which it is contained) (internal citations omitted); *Arthur Andersen LLP v. Carlisle*, 556 U.S. 624, 129 S. Ct. 1896, 1902, 173 L. Ed. 2d 832 (2009) ("Because 'traditional principles' of state law allow a contract to be enforced by or against nonparties to the contract through…the Sixth Circuit's holding that nonparties to a contract are categorically barred from § 3 relief was error."); *14 Penn Plaza LLC v. Pyett*, 556 U.S. 247, 129 S. Ct. 1456, 1463, 173 L. Ed. 2d 398 (2009) (holding that a union's collective bargaining agreement binding individual employees to arbitration even if the arbitration affects an employees individual, non-economic statutory rights); *Preston v. Ferrer*, 552 U.S. 346, 352, 128 S. Ct. 978, 983, 169 L. Ed. 2d 917 (2008) (holding that Federal Arbitration Act, and its associated national policy favoring arbitration, supercedes state law lodging primary jurisdiction in another forum); *Hall St. Associates, L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 585, 128 S. Ct. 1396, 1404, 170 L. Ed. 2d 254 (2008) (holding no other arbitration vacatur remedies exist outside those enumerated under the FAA).

I. The FINRA Code is a Contract Requiring the Application of the "Presumption of Arbitrability" of Ambiguous Clauses

In *Washington Square Securities, Inc. v. Aune*, the District Court for the Western District of North Carolina held that "[c]ontrary to Defendants' contention that the presumption in favor of arbitrability is relevant to the Court's present inquiry, the presumption that a dispute is subject to arbitration cannot apply if there is no agreement to arbitrate." 253 F. Supp. 2d 839, 842 (W.D.N.C. 2003) *aff'd*, 385 F.3d 432 (4th Cir. 2004). While the District Court ultimately held in favor of arbitration, on appeal this Court disagreed with the reasoning of the lower court.

> We address first the district court's finding that no presumption in favor of arbitration applied in this case because the Investors and Washington Square never entered into an agreement to arbitrate. Washington Square urges the court to follow the reasoning of the district court on this point. We find Washington Square's argument and the reasoning of the district court unpersuasive.

Washington Square, 385 F.3d at 435.

This Court further explained that, in fact, "[t]he NASD Code constitutes an 'agreement in writing' under the Federal Arbitration Act, 9 U.S.C. § 2, which binds Washington Square, as an NASD member, to submit an eligible dispute to

arbitration upon a customer's demand."[8] *Id.* (*citing Kidder, Peabody & Co., Inc. v. Zinsmeyer Trusts P'ship*, 41 F.3d 861, 863-64 (2d Cir.1994)); *see also Bank of the Commonwealth v. Hudspeth*, 714 S.E.2d 566, 572 (Va. 2011); (applying the arbitration presumption where the term "customer" is susceptible to multiple interpretations); *Spear, Leeds & Kellogg v. Cent. Life Assur. Co.*, 85 F.3d 21, 26 (2d Cir. 1996) ("the arbitration rules of a securities exchange are themselves 'contractual in nature.'") (*quoting Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Georgiadis*, 903 F.2d 109, 113 (2d Cir.1990)); *Bensadoun v. Jobe-Riat*, 316 F.3d 171, 176 (2d Cir. 2003) ("interpretation of the NASD arbitration provision is a matter of contract interpretation…[t]he analysis differs from ordinary contract interpretation in that any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.") (internal citations and quotations omitted); *Patten Sec. Corp., Inc. v. Diamond Greyhound & Genetics, Inc.*, 819 F.2d 400, 407 (3d Cir. 1987) (holding same).

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[8] *Waterford Inv. Serv., Inc. v. Bosco*, 3:10CV548-REP, 2011 WL 3820723 at *9 (E.D. Va. July 29, 2011) *report and recommendation adopted sub nom. Waterford Investor Serv., Inc. v. Bosco*, 3:10CV548, 2011 WL 3820496 (E.D. Va. Aug. 26, 2011) ("In *Aune*, the lower court had found that there was no presumption in favor of arbitration, because the investors and the NASD member had never directly entered into an agreement with one another to arbitrate…However, the Fourth Circuit reversed the lower court, ruling that the presumption in favor of arbitration did apply to the interpretation of the terms 'customer' and 'associated member' in the NASD Code.") (citations omitted); *see also Newman v. First Montauk Fin. Corp.*, 7:08-CV-116-D, 2010 WL 2933281 at *4 (E.D.N.C. July 23, 2010). ("The FINRA Manual constitutes an "agreement in writing" under the Federal Arbitration Act, 9 U.S.C. § 2") (citations omitted).

The lower court erred because it did not find that a contract existed between FINRA and Morgan Keegan and consequently failed to apply the presumption of arbitrability, which contradicted this Court's mandate. [JA.325] ("There is no arbitration agreement between Morgan Keegan and the defendants."). *Contra O.N. Equity Sales Co. v. Gibson*, 514 F. Supp. 2d 857, 862 (S.D.W.Va. 2007) ("This presumption in favor of arbitrability while interpreting the provisions of the NASD Code is in fact mandated by the Fourth Circuit's holding in *Washington Square*."). The lower court, like the Western District of North Carolina court in *Washington Square,* failed to apply the correct legal standard in interpreting the scope of FINRA's arbitration clause. Because Morgan Keegan is a FINRA member its arbitration agreement binds the firm to arbitrate disputes under FINRA Rule 12200 unless Morgan Keegan can present "forceful evidence" that the instant dispute is not covered by the arbitration clause. *Washington Square,* 385 F.3d at 436.

II. The Lower Court Failed to Apply a "Presumption of Arbitrability" and No Evidence Was Submitted Showing that FINRA Intended to Exclude Defendants' Dispute

FINRA Rule 12200 requires a member to arbitrate a dispute if: the arbitration is requested by 1) a customer; 2) the dispute is between a customer and a member or associated person in connection with; 3) the business activities of the member or associated person; and 4) the dispute does not involve insurance

business activities. *See* FINRA Code Rule 12200. [JA.82]. A "customer" is defined under the FINRA Code as not a broker or a dealer. *See* FINRA Rule 12100(i) [JA.84].

This Court recognizes that FINRA's "customer" term is both broad and ambiguous stating that the FINRA: 1) "rule[s] do[] not specify with whom the customer must conduct business"; and 2) "it is not clear from the language of the rule what is required before an investor is deemed a customer of a member." *Washington Square*, 385 F.3d at 436. Due to the breadth of FINRA's "customer" term, Defendants' interpretation that an investor who can trace their injury to a member's business activity in violation of the exchange's rules can compel the member to arbitrate their claim is not specifically or implicitly excluded.[9] Further it is undisputed that, "the goal of the NASD is to 'promote and enforce just and

[9] *Coenen v. R. W. Pressprich & Co*., 453 F.2d 1209, 1212 (2d Cir. 1972) ("One desiring the benefits of membership in the New York Stock Exchange must be willing to live up to the responsibilities of such membership.") (*quoted by Geldermann, Inc. v. Commodity Futures Trading Comm'n*, 836 F.2d 310, 319 (7th Cir. 1987)); *Pearce v. E.F. Hutton Group, Inc.*, 828 F.2d 826, 830-31 (D.C. Cir. 1987) ("The Exchange's interest in its member firms' business practices surely extends beyond their handling of customer accounts."); *Spear, Leads*, 85 F.3d at 28 ("Neither a transactional nexus between plaintiff and defendants, nor identification of these specific defendants as third party beneficiaries, is required to compel Spear, Leeds to arbitrate a dispute in accordance with NYSE procedures."); *Nomura Sec. Int'l, Inc. v. Citibank, N.A.*, 81 N.Y.2d 614, 620, 619 N.E.2d 385, 388 (N.Y. 1993) ("extend[ing] without justification the congressional mandate of self-regulation" is not present when a claim asserted by an outsider to the exchange raises questions about a member's business practices.") (q*uoting Paine, Webber, Jackson & Curtis, Inc. v. Chase Manhattan Bank, N.A.*, 728 F.2d 577, 581 (2d Cir. 1984).

equitable principles of trade and business, to maintain high standards of commercial honor and integrity among members of the NASD, to prevent fraudulent and manipulative acts and practices, [and]...*to protect investors and the public interest.*" *Washington Square Sec., Inc. v. Aune*, 253 F. Supp. 2d 839, 843 (W.D.N.C. 2003) *aff'd*, 385 F.3d 432 (4th Cir. 2004) (citations omitted) (emphasis in original). Accordingly, there is no reason or code provision requiring FINRA's arbitration clause to be interpreted less broadly then the extent of the organization's mandate to regulate the business activities of its members.

Here, Defendants have alleged that Morgan Keegan was obligated to truthfully advertise and communicate with the investing public under federal, state, and FINRA Rules. FINRA also requires the advertising materials posted on member's website not be misleading to investors. FINRA Rule 2210. In addition, Defendants' allegations against Morgan Keegan stem from the same violations that FINRA itself, in coordination with other regulatory agencies, brought against the firm for Morgan Keegan's sales and valuation practices of the Morgan Keegan Funds. Therefore, Defendants have pled sufficient facts to show that their injuries are in connection with Plaintiff's business activities.

However, the lower court improperly required Defendants to *affirmatively prove* that they were Morgan Keegan's "customers" instead of resolving ambiguities in favor of arbitration. The lower court admitted that the FINRA

Rules were ambiguous stating "[t]he Code, however, fails to throughout articulate what amounts to a 'customer' relationship." [JA.326]. The lower court, having determined that the FINRA Code was susceptible to Defendants' interpretation was bound to apply the presumption in favor of enforcing the arbitration agreement. *Washington Square*, 385 F.3d at 436 ("[B]ecause this ["customer"] clause is ambiguous in two separate respects which cover the instant dispute we must construe this clause in favor of arbitration."). Despite the lower court's admittance of the ambiguity of the FINRA rules, the court required Defendants to prove they were customers and applied no presumption of arbitability. [JA.330] ("The support for defendants' [customer] proposition, however, is weak.").

The lower court concluded that FINRA's "customer" requirement could only be satisfied by Defendants if they had a brokerage account or an unspecified relationship with Morgan Keegan but cited no FINRA Code provision in support of this proposition. [JA.328] ("The defendants never invested in the RMK Funds through Morgan Keegan, nor did they have a brokerage account or any other relationship with Morgan Keegan."). The lower court's holding on what is required to be a member's "customer" directly contradicted this Court's precedent holding. *Washington Square* at 440 ("While Washington Square wishes to limit 'customers' of members to those who opened accounts with the broker, or to those who had an informal business relationship with the broker, neither the plain

language of the rule nor the extrinsic evidence of intent requires such an interpretation.").

Finally, the lower court "declin[ed] to adopt defendants' interpretation" stating that reading an arbitration clause broadly would be "inappropriate" in this case. [JA.327 and 331]. The lower court supported its position that this case was inappropriate for arbitration by relying upon public policy arguments. *Compare Id.* ("Interpreting 'customer' so broadly as to include everyone who is not a broker or a dealer disregards the actual relationship between the claimant and a FINRA member and thereby frustrates FINRA members' reasonable expectations.") *with Concepcion,* 131 S. Ct. at 1746 ("This saving clause permits agreements to arbitrate to be invalidated by generally applicable contract defenses, such as fraud, duress, or unconscionability, but not by defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue.") (citations and quotations omitted); *see also Marmet Health Care*, 132 S. Ct. at 1203 (Vacating the West Virginia Supreme Court decision where "the state court considered whether…public policy was pre-empted by the FAA").

Here, the lower court considered the parties "reasonable expectations" in declining to enforce the arbitration agreement. The "reasonable expectations" of the parties clearly derives its meaning from the fact that an agreement to arbitrate is at issue and is not a generally applicable contract defense. *Concepcion*, 131 S.

Ct. at 1746. In fact, to Defendants' knowledge, the "reasonable expectations" test has never been applied to any other arbitration provision other than FINRA's arbitration clause. Thus, the "reasonable expectations" test derives its meaning solely from the fact that an agreement to arbitrate is at issue. The Supreme Court's position against FAA pre-emption on public policy grounds is inconsistent with the lower court's conclusion that sophisticated brokerage firms who join FINRA, understand and consent to FINRA's broad arbitration requirements, would have their "reasonable expectations" upset by having to arbitrate disputes in connection with their business activity.

"The Supreme Court directive to resolve doubts and ambiguities in favor of arbitration appears to foreclose recourse to extrinsic evidence of intent." *Washington Square*, 385 F.3d at 438 (*citing Volt Info. Sciences, Inc. v. Bd. of Trs. of Leland Stanford Jr. Univ.*, 489 U.S. 468, 475-76, 109 S. Ct. 1248, 103 L. Ed. 2d 488 (1989); *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25, 103 S. Ct. 927, 74 L. Ed. 2d 765 (1983)). "Nevertheless, the Supreme Court has also indicated that 'forceful evidence of a purpose to exclude the claim from arbitration' may help to resolve ambiguity in an arbitration provision." *Id.* (*quoting Warrior & Gulf*, 363 U.S. at 585). Thus, the lower court should have placed the burden on Morgan Keegan to show with "positive assurances" that it is not bound to arbitrate against Defendants' dispute.

Applying this standard, the lower court had no evidence, let alone "forceful evidence" to exclude Defendants claim from arbitration because: 1) FINRA's Code specifically limit the "customer" definition where necessary; 2) the development of the FINRA Code and the SEC's interpretive guidance is consistent with Defendants' position; 3) FINRA's statutory scheme supports Defendants' position; and 4) the Director of FINRA has ruled in several decisions that similarly situated defendants' claims are arbitrable. Each of the foregoing points supports that Defendants' interpretation of FINRA's "customer" provision was not excluded from the contract and is discussed below.

A. Defendants are "Customers" Because the FINRA Code Purposefully Redefines the "Customer" Term For Specific Provisions of the Code

FINRA Rule 2261 redefines the meaning of the term "customer" for this specific provision to mean "any person who, in the regular course of such member's business, has cash or securities in the possession of such member." Additionally FINRA Rule 4210(A)(3) redefines customer as "any person for whom securities are purchased or sold or to whom securities are purchased or sold…" These redefinitions of the term "customer" are "expressly limited in application to these particular FINRA rules" and indicate that FINRA intended to utilize the broad customer definition generally and under FINRA Rule 12200, the provision in dispute. *Hudspeth*, 714 S.E.2d at 570.

The lower court erred because it applied the Eighth Circuit's narrow definition of "customer" rather than FINRA's broad "customer" definition under FINRA Rule 12200. [JA.331] ("I find it more appropriate to follow the interpretation articulated by the Eigh[th][sic] Circuit in *Fleet Boston*"). The definition adopted by the lower court was incorrect because, first, it did not adopt FINRA's definition, and second because it conflated FINRA's purposeful distinctions in other sections of the Code with the language in the disputed provision. Since FINRA specified which provisions of the Code would use the term "customer" narrowly, the "customer" definition under FINRA Rule 12200 must have been intended to encompass a broader set of parties than as defined under FINRA Rule 2261 or 4210(A)(3).

In so holding, the lower court blurred any distinction between the different sections of the FINRA Code and redrafted the Code for the purposes of avoiding enforcement of an arbitration agreement.

B. SEC Interpretative Guidance is Consistent with a Broad Reading of the Term "Customer"

The Supreme Court has recognized that "the [SEC] has had expansive power to ensure the adequacy of the arbitration procedures employed by the SROs…" including "broad authority to oversee and to regulate the rules adopted by the SROs relating to customer disputes, including the power to mandate the adoption of any rules it deems necessary to ensure that arbitration procedures adequately

protect statutory rights." *Shearson/Am. Exp., Inc.*, 482 U.S. at 233-34. Accordingly, "the SEC has specifically approved the arbitration procedures of the New York Stock Exchange [NYSE], the American Stock Exchange [AMEX], and the NASD…" *Id.* Thus, the SEC's interpretative guidance as to the scope of the term "customer" should be controlling. *Udall v. Tallman*, 380 U.S. 1, 17, 85 S. Ct. 792, 801, 13 L. Ed. 2d 616 (1965) (the interpretation put forth by the agency is controlling unless it is plainly erroneous or inconsistent with the regulation) (citations and quotations omitted).

Both of FINRA's predecessor SROs, the NASD and the NYSE, required all disputes arising out of the business activities of a member to be arbitrated. For example, NYSE Rule 600(a) required that "any dispute, claim or controversy between a customer or non-member...arising in connection with the business of such member…shall be arbitrated under the Constitution and Rules of the New York Stock Exchange, Inc." Courts have held that "[t]he purpose…is to keep 'any controversy' between members and any controversy between members and non-members…arising out of the business of such member out of the courts." *Coenen*, 453 F.2d at 1212 (internal quotations omitted). The NASD Code has been interpreted to have the same breadth in scope as the NYSE Code. *John Hancock Life Ins. v. Wilson,* 254 F.3d 48, 56 (2d Cir. 2001). ("[T]he NYSE's arbitration

provisions, [] are substantially similar to the NASD Code provisions" even though the NYSE rules use the term "non-member" with "customer.")

The SEC intended to keep the term "customer" synonymous with NYSE's usage of term "non-member" when FINRA was created in 2007. *See* [JA.275] Securities Exchange Act Release No. 34-56208 (Aug. 6, 2007), 72 FR 45077, n. 7 (SR-NYSE-2007-48). When the NYSE and NASD combined, the NYSE consolidated its dispute resolution functions into the NASD while the NASD was in the process of becoming FINRA. *Id.* During the FINRA Rule comment period, members requested that the NASD consider narrowing the definition of the term "customer." *See* Securities Exchange Act Release No. 34-55158 (Jan. 31, 2007), 72 FR 4574, 4577 (SR-NASD-2003-158; SRNASD-2004-011). However, the NASD "specifically noted that the FINRA Code 'would define a 'customer' as not including a broker or a dealer....the same [definition] as that [previously] found in the general definitions for NASD rules.'" *See Hudspeth*, 714 S.E.2d at 570 (*quoting* Securities Exchange Act Release No. 34-55158, 72 FR at 4577).

When the comment period ended the SEC provided interpretive guidance on the final rule. The SEC noted the NYSE's usage of the term "non-member" in addition to term "customer" and understood that the elimination of "non-member" could cause interpretative confusion. The SEC clarified that:

> In almost all cases the change from NYSE to NASD DR [subsequently FINRA] arbitration rules *should not result in material substantive differences to persons participating in the arbitration process.*

[JA.275] (emphasis added). Thus, the SEC has stated that the term "customer" remains synonymous with the term "non-member." Accordingly, Morgan Keegan cannot present forceful evidence that FINRA intended to exclude Defendants' claims from being arbitrated.

C. Defendants are "Customers" of Morgan Keegan Under the FINRA Code's Statutory Scheme

FINRA Rule 12100 states a "member" is a broker or dealer. The same rule also states that a "customer" "shall not include a broker or dealer." [JA.84-5]. The two terms, member and customer, are defined with obvious reference to each other. "Member" is affirmatively defined to encompass all entities that engage in broker or dealer business activities that require FINRA membership, while "customer" is defined to include all non-broker or dealers that are not FINRA members.

In addition, the current FINRA Code, like its predecessors, adopted two separate code provisions to handle disputes between members as well as disputes between members and non-member "customers."[10] FINRA Rules 13000 *et seq.*

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[10] *See* FINRA Code Table of Contents available at: http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=607 (last visited March 29, 2012).

governs disputes between members. FINRA Rules 12000 *et seq* governs claims by non-members, "customers," and members. Reading the two clauses together, the term "customer" under FINRA Rule 12200 only indicates who is eligible to bring a claim under the "customer" dispute provisions of FINRA Rules 12000 *et seq*. *Coenen*, 453 F.2d at 1212 ("[T]he two clauses referring to disputes between members and disputes between members and non-members must be read together.").

FINRA's statutory scheme lends no weight to an argument that the drafters intended to exclude Defendants' claims from FINRA arbitration.

D. The Director of FINRA Has Declined to Rule That Similarly Situated Defendants' Claims Are Not Arbitable

The Supreme Court has stated that "NASD arbitrators, comparatively more expert about the meaning of their own rule, are comparatively better able to interpret and to apply it." *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 85, 123 S. Ct. 588, 593, 154 L. Ed. 2d 491 (2002); *see also Nat'l Planning Corp. v. Achatz*, 02-cv-0196E-SR, 2002 WL 31906336, at *2 (W.D.N.Y. Dec. 17, 2002) ("courts should be wary about disregarding NASD Rules and should accord deference to the NASD's interpretation of its Rules.").

The FINRA Rules grant the Director power to decide whether or not a dispute is appropriate for the FINRA forum. *See* FINRA Rule 12203.[11] In nearly identical circumstances, the Director has held that these 'customer' claims are arbitrable under the FINRA Rule 12200 in approximately 12 cases and has never denied a claimant from arbitrating their claims.

For example, in *Robert Barret v. Morgan Keegan & Co., Inc., and James C. Kelsoe, Jr.,* FINRA No. 08-03869, Morgan Keegan requested that the Director find that the case was not arbitrable because:

> - Barrett had no contract, account, or dealings with [Morgan Keegan] and was not their customer;
> - Barrett purchased the [RMK] Funds on the secondary market through an undisclosed account with another broker/dealer…
> - Barrett was not (and is not) a "customer" of Morgan Keegan since he…received no advice or other services directly from the firm.

[JA.201-04]. The arguments made by Morgan Keegan in *Barrett* are identical to the arguments made in the present motion. In *Barrett*, the Director ruled that the case would proceed in the FINRA forum and denied Morgan Keegan's motion. [JA.199]. Upon information and belief, the Director has never granted any

[11] "The Director may decline to permit the use of the FINRA arbitration forum if the Director determines that, given the purposes of FINRA and the intent of the Code, the subject matter of the dispute is inappropriate…" FINRA Rule 12203.

motion filed by Morgan Keegan to declare these types of claims non-arbitrable, despite the fact that Morgan Keegan filed similar motions on at least ten prior occasions.

Thus, if the Director of FINRA has decided on numerous occasions to refrain from exercising his authority to declare similarly situated defendants' claims non-arbitable under the FINRA Rules no weight could be added to the argument that Defendants' claims are excluded with positive assurance.

III. FINRA Rule 12200 Defendants' Dispute Involves Morgan Keegan's "Business Activities"

The Fourth Circuit has not expressly interpreted the "arises in connection with the business activities of the member or the associated person" provision as used in FINRA Code. [JA.82]. However, the Fourth Circuit has consistently interpreted similar language as very broad and as favoring including the dispute within the arbitration clause. *See, e.g., Raymond James Fin. Servs., Inc. v. Bishop*, 596 F.3d 183, 192–93 (4th Cir. 2010); *Washington Square*, 385 F.3d at 437; *Long v. Silver*, 248 F.3d 309, 316–17 (4th Cir. 2001); *Zandford* at 728–29; *Am. Recovery Corp. v. Computerized Thermal Imaging, Inc.*, 96 F.3d 88, 92–93 (4th Cir. 1996).

In the Second Circuit it is "settled law" that "[i]f the claim involved the member's exchange-related business, we would compel arbitration." *Spear, Leads,* 85 F.3d at 28-29 (*citing Paine, Webber,* 28 F.2d at 577). Likewise, the

court in *Lehman Bros. Inc. v. Certified Reporting Co.*, a case involving defendants similarly situated to the Defendants' in the present case, held that,

> Defining customers to include not only those who executed purchases with member firms, *but also those who maintained a less formal business relationship at the time of the alleged misconduct, furthers NYSE policy and recognizes market reality*. The Seventh Circuit noted in *Carlson v. Bear, Stearns, & Co.,* 906 F.2d 315, 318 (7th Cir. 1990) that the sale of securities "is usually a rather complex and convoluted transaction which requires the expertise and involvement of several parties to succeed." To allow Lehman to solicit Investors using allegedly bad market information without repercussion defeats the NYSE's goals of 'maintain[ing] high standards of commercial honor and integrity among its members.' NYSE Const. art. I, § 2. The Court has considered these goals, along with the federal mandate to resolve all doubts in favor of arbitration. In doing so, the Court finds that permitting Investors to compel arbitration as "customers" upholds the parties' reasonable expectations.

939 F. Supp. 1333, 1340-41 (N.D. Ill. 1996) (emphasis added), *cited with approval in Bensadoun v. Jobe-Riat*, 316 F.3d 171, 177 (2d Cir. 2003).

Here, like the investors in *Lehman Bros.*, Morgan Keegan business activities included the solicitation of investments in their funds through their website and call centers using misleading information. Further, Morgan Keegan manipulated the valuation of the Morgan Keegan Funds in order to deceive investors by masking the true volatility of the Funds as well as the underlining assets' true market value. Morgan Keegan was also punished by FINRA and other regulatory agencies for its sales practices.

When regulators investigate and punish a member for their business practices no argument can be asserted that a related FINRA action does not arise in connection with the member's business activities. *Spear, Leeds,* 85 F.3d at 29. (An internal violation of the exchange rules, "receive the watchful attention of the exchange that would likely be deemed exchange-related.") (citations omitted). In *Spear, Leeds,* the court stated:

> Our decision today also strengthens the presumptive partnership between courts and the national exchanges by allowing and facilitating vigorous self-regulation. *See Silver*, 373 U.S. at 352, 83 S. Ct. at 1254; *Paine Webber*, 728 F.2d at 581. For all of these reasons, the instant controversy is exchange-related. As members should reasonably expect to be haled before an Exchange arbitration when their conduct violates Exchange rules and leads to Exchange investigations and penalties, we are implementing the reasonable expectations of the parties. Even if the narrower scope of the NYSE Rules governing arbitration between members and non-members warrants an "exchange-related business" requirement, the strong policy favoring self-regulation by exchange members suggests that a broad set of disputes are exchange-related when the NYSE member is the actor against whom arbitration is sought.

Id. (emphasis added).

Morgan Keegan's incredible proposition that Defendants cannot demand arbitration merely because they did not maintain an account with Morgan Keegan runs contrary to the entire rational for mandatory arbitration in cases where a party is injured due to a member's business activity in violation of the exchange's rules regulating such conduct.

IV. Recent District Court Decisions Erred Similarly to the Lower Court in this Matter

The recent district court decisions preventing arbitration in cases where the defendant was similarly situated to the present Defendants are inapplicable to this Court's determination. In all of those decisions, the district courts failed to find that the FINRA Code constitutes an arbitration agreement, expressed that the "customer" term was ambiguous, and failed to apply the presumption favoring arbitration. *See e.g., Morgan Keegan & Co. v. McPoland*, --- F. Supp. 2d ---, No. C11-1471RSM, 2011 WL 6326956 (W.D. Wash. Dec. 6, 2011) *appeal docketed*; *Morgan Keegan & Co. v. Jindra*, No. C11-570BHS, 2011 WL 5869586 (W.D. Wash. Nov. 22, 2011) *appeal docketed*; *Morgan Keegan & Co. v. Drzayick*, No. 1:11-CV-126-EJL, 2011 WL 5403031 (D. Idaho Nov. 8, 2011); *Morgan Keegan & Co. v. Shadburn*, --- F. Supp. 2d ---, No. 2:11-CV-624-WKW, 2011 WL 5244696 (M.D. Ala. Nov. 3, 2011); *Morgan Keegan & Co. v. Garrett*, --- F. Supp. 2d ---, No. 4:10-cv-04308, 2011 WL 4716060 (S.D. Tex. Sept. 30, 2011) *appeal docketed*; *Zarecor v. Morgan Keegan & Co.*, No. 4:10-cv-1643-SWW, 2011 WL 5592861 (E.D. Ark. July 29, 2011). Consequently, because these authorities did not apply the correct standard when interpreting the scope of an arbitration clause their reasoning is unpersuasive.

In these cases no presumption of arbitrability was applied even though, in some, it was admitted that the "customer" term was susceptible to Defendants' interpretation. For example, in *McPoland*, the district court stated that "[defendants] find some support for this argument in older cases (from the 1980's and 1990's) interpreting a similar provision under NASD rules." 2011 WL 6326956 at *4. The Court also noted that these earlier decisions were valid because "FINRA has stated that it intended no substantive change when it replaced NASD Rule 10301 with FINRA Rule 12200." *Id.* at *2. Despite the fact that the District Court admitted that there was "some support" for Defendants' interpretation and no support for Plaintiff's interpretation has been cited, other than case law, the Court nonetheless granted the injunction. *Id.* at *5. Notably absent from the District Court's holding in *McPoland* was the application of presumption of arbitrability absent positive assurance that the arbitration agreement intended to exclude the dispute. In so holding, the District Court in *McPoland* and the other authorities cited above failed to interpret the FINRA Code's arbitration provisions in accordance with the standard as set forth in this circuit.

Consequently, since these authorities did not follow the Supreme Court's or this Court's guidance in interpreting arbitration clauses and these decisions are irrelevant to this Court's determination.

CONCLUSION

For all the foregoing reasons, the District Court erred in granting Plaintiff's motion for preliminary injunction. Defendants respectfully request that this Court grant Defendants request to reverse the lower court's ruling and order Morgan Keegan to submit to arbitration.

REQUEST FOR ORAL ARGUMENT

Defendant-Appellants respectfully request oral arguments be heard on this matter. The scope of FINRA's arbitration agreement is a matter of public concern for all investors. In addition, the decision in this case is likely to affect the decision of other courts that address issues interpreting FINRA's arbitration provision.

New York, New York
Dated: April 10, 2012

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UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

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Dated: April 10, 2012

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I hereby certify that on April 10, 2012, I electronically filed the foregoing with the Clerk of Court using the CM/ECF System, which will send notice of such filing to the following registered CM/ECF users:

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The necessary filing and service were performed in accordance with the instructions given to me by counsel in this case.

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