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Securities Law Update – May 2009

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Are Arbitration Clauses Within U-4 Agreements Unconscionable?

No, according to a federal judge in the Southern District of Illinois. A former Morgan Stanley branch office manager sought to attack the enforceability of an arbitration clause contained in a standard U-4 employment application. Although the court found that the agreement was neither procedurally nor substantively unconscionable, I disagree that this issue is conclusively resolved. Pursuant to FINRA rules, in industry disputes involving claims of less than $25,000.00, a respondent is not permitted to request an in-person hearing where the claimant has not requested a hearing. All such cases are resolved on the papers, without a respondent having the opportunity to call witnesses or cross-examine witnesses. A more unfair playing field is difficult to imagine.

Impact of Granting Motion to Compel Arbitration

In the Banco Santander case, reflected below, the defendant broker dealer was sued by a family, some of whom signed arbitration agreements and some of whom did not. Banco Santander moved to compel arbitration as to those plaintiffs who signed arbitration agreements, and moved for a stay of the non-arbitrable claims. The court granted both motions. Given that some of the plaintiffs did not sign arbitration agreements, it is difficult to understand why they should be prejudiced by a stay of their case. Judicial economy should be irrelevant. It is unclear how any economy is achieved by delaying the clearly non-arbitrable claims.

SEC Affirms FINRA Unsuitability Findings

This case involves a broker who failed to disclose the differences between mutual fund “A” shares and “B” shares, who exercised discretion without written authorization, and who

recommended the inappropriate use of margin. The broker's penalty for his bad behavior was a lifetime bar from the securities industry. The case involved two clients.

Registered Representatives are Associated Persons of One Firm Only

In this case from the Middle District of Alabama, the court was faced with the issue of whether individuals were entitled to maintain a FINRA arbitration proceeding against AXA Distributors. The individuals would only be entitled to arbitrate their claims if they were "customers" of AXA Distributors. They could only be "customers" if their financial advisors, who admittedly were "associated persons" of Raymond James, could also be considered "associated persons" of AXA. The court held that under the facts presented, AXA had neither direct nor indirect control over the Raymond James employees. Accordingly, the claimants within the arbitration had no right to arbitrate their claims against AXA.

ANDREW MILLAS, Plaintiff, vs. MORGAN STANLEY & CO., INC., Defendant.

Case No. 08-cv-0573-MJR

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ILLINOIS

2008 U.S. Dist. LEXIS 97154

December 1, 2008, Decided
December 1, 2008, Filed

CORE TERMS: arbitration, arbitration provision, arbitration clause, unconscionability, unconscionable, employment agreement, arbitrate, arbitration agreements, compel arbitration, tortious interference, agreement to arbitrate, enforceable, bargaining, salary, defamation, employment contract, claim arising, substantive unconscionability, adverse decision, excessive, generic, waive, business activities, false statements, termination, unilateral, filling, resign, arbitration process, dispute resolution

COUNSEL: For Andrew Millas, Plaintiff: Holly A. Reese, LEAD ATTORNEY, Goldenberg Heller et al., Generally Admitted, Edwardsville, IL.

For Morgan Stanley & Co., Inc., Defendant: Ericka D. McCaskill, John W. Shaw, LEAD ATTORNEYS, Berkowitz Oliver et al., Kansas City, MO.

JUDGES: MICHAEL J. REAGAN, United States District Judge.

OPINION BY: MICHAEL J. REAGAN

OPINION

MEMORANDUM and ORDER

REAGAN, District Judge:

A. Factual and Procedural History

On June 23, 2008, Millas filed this action in the Third Judicial Circuit, Madison County, Illinois (Doc. 2-2). Morgan Stanley is registered to sell securities as a member of the Financial Industry Regulatory Authority ("FINRA"). [1] Morgan Stanley hired Millas as a branch manager in August 1999. The employment agreement included the following arbitration clause:

> **ARBITRATION**
>
> Any controversy or claim arising out of or relating to this Agreement, or its breach, will be settled by arbitration before either the National Association of Securities Dealers, Inc. or the

> New York Stock Exchange, Inc., as Dean Witter may elect, in accordance with their respective rules, and judgment upon the award entered by the arbitrator(s) may be entered in any court having jurisdiction thereof. Employee agrees to stipulate, upon request by Dean Witter, to expedited hearing procedures for such arbitration. This paragraph will not be deemed a waiver of Dean Witter's right to injunctive relief as provided for in paragraph 3 of this Agreement.

Doc. 16, Exh. B, P 7. Additionally, as required by FINRA rules, Millas completed and filed a Uniform Application for Securities Industry Regulation ("Form U-4"), which also included an arbitration provision:

> I agree to arbitrate any dispute, claim or controversy that may arise between me and my firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions, or by-laws of the SROs indicated in Item 11 as may be amended from time to time and that any arbitration award rendered against me may be entered as a judgment in any court of competent jurisdiction.

Doc. 16, Exh. C, P 5. [2] NASD Code § 13200 requires that a dispute that "arises out of the business activities of a member or an associated person and is between . . . Members and Associated Persons" must be submitted to arbitration. Neither party disputes that Morgan Stanley is a "member" and Millas is an "associated person" under the Code.

> 1 FINRA was previously known as the National Association of Securities Dealers, Inc. ("NASD"). The NASD Code governs FINRA arbitrations.
>
> 2 The Form U-4 provided by Morgan Stanley is not signed by Millas, as that copy was kept and maintained in the World Trade Center and was destroyed on September 11, 2001. However, Morgan Stanley represents that the standard Form U-4 provided is a fair and accurate representation of the Form U-4 signed by Millas. Millas does not contest this representation.

In December 2006, Millas assumed the title of Vice President and Financial Advisor. In August 2007, Millas was informed that Morgan Stanley was placing him on "heightened security" due to allegations that he engaged in unauthorized trading through client accounts. Millas claims that he was never provided with any specific information regarding these allegations. Millas filed a letter of resignation on January 29, 2008, but Morgan Stanley terminated his employment on that date anyway.

Soon after he was terminated, Millas pursued an employment offer with Stifel Nicolaus. On February 11, 2008, Morgan Stanley filed a Uniform Termination Notice for Securities Industry Registration ("Form U-5") with the FINRA, wherein Morgan Stanley stated that Millas was discharged because he "exercised discretion in customer accounts without proper authorization." According to the complaint, Morgan Stanley replied affirmatively to a question on the Form U-5 that asked: "Did the individual voluntarily resign from your firm, or was the individual discharged or permitted to resign from your

firm, after allegations were made that accused the individual of: violating investment-related statutes, regulations, rules or industry standards and conduct?" Millas claims that these statements are false, and that Stifel Nicolaus rescinded its employment offer due to the false statements.

Millas's complaint alleges that Morgan Stanley breached contract by failing to properly compensate him according to the fee-sharing and commission provisions in his contract. He also raises a claim of defamation, alleging that Morgan Stanley's statements on his Form U-5 are false and were made with the intent to damage his reputation. Finally, Millas claims that Morgan Stanley's refusal to accept a written resignation and its false statements on the Form U-5 constitute a tortious interference with a business expectancy, as Stifel Nicolaus rescinded its employment offer due to Morgan Stanley's conduct.

On August 11, 2008, Morgan Stanley removed the case to this federal District Court alleging diversity jurisdiction under 28 U.S.C. § 1332 (Doc. 2). Claiming that Millas's employment contract, his Form U-4, and the FINRA rules require the parties to settle their dispute via arbitration, Morgan Stanley moved this Court to stay proceedings and compel arbitration on September 11, 2008 (Doc. 16). Millas filed a response on October 14, 2008 (Doc. 23). Morgan Stanley elected not to file a reply.

Having fully considered the parties' filings, the Court hereby **GRANTS** Morgan Stanley's motion to compel arbitration (Doc. 16) and **STAYS** this action pending the parties' resolution of this matter via arbitration.

B. Analysis

Federal law strongly favors the enforcement of private arbitration agreements. The Federal Arbitration Act ("FAA") provides that an arbitration provision in "a contract evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." **9 U.S.C. § 2.** Additionally, the caselaw is well-settled that the presence of an arbitration clause in a contract creates a presumption that the dispute should be arbitrated, "unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute." ***AT&T Techs., Inc. v. Commc'ns Workers of America,*** **475 U.S. 643, 650, 106 S. Ct. 1415, 89 L. Ed. 2d 648 (1986) (quoting *United Steelworkers v. Warrior & Gulf Navigation Co.,* 363 U.S. 574, 582-83, 80 S. Ct. 1347, 4 L. Ed. 2d 1409 (1960)).** Where a court compels arbitration pursuant to any such provision, the FAA provides that the case shall be stayed "until such arbitration has been had in accordance with the terms of the agreement." **9 U.S.C. § 3.**

In determining whether to grant a motion to compel arbitration, this Court looks for three elements: "a written agreement to arbitrate, a dispute within the scope of the arbitration agreement, and a refusal to arbitrate." ***Zurich American Ins. Co. v. Watts Indus., Inc.,*** **417 F.3d 682, 687 (7th Cir. 2005).** Millas argues that the arbitration clauses are unenforceable due to unconscionability. Additionally, Millas argues that even if the clauses are enforceable, the complaint alleges intentional conduct that is outside the scope of the arbitration provisions.

It is abundantly clear that Millas refuses to arbitrate his claims. Thus, the Court begins with the question of whether a valid

agreement to arbitrate exists. If so, the Court then considers whether the arbitration provision encompasses any of the claims involved in the instant action.

1. Whether a Valid Agreement to Arbitrate Exists

Millas first argues that the arbitration provisions are unenforceable due to unconscionability. It should be noted that Millas primarily attacks the employment agreement on these grounds, but the Court construes his response as addressing the Form U-4 as well. Under Illinois law, an unconscionable contract provision will not be enforced. In analyzing this issue, the Court looks for both procedural and substantive unconscionability.

Illinois law provides that:

> Unconscionability may be procedural or substantive, or a combination of both. *Kinkel v. Cingular Wireless, LLC*, . . . 223 Ill. 2d 1, 857 N.E.2d 250[, 263, 306 Ill. Dec. 157] (2006). "'Procedural unconscionability refers to a situation where a term is so difficult to find, read, or understand that the plaintiff cannot fairly be said to have been aware he was agreeing to it.'" *Kinkel*, . . . 223 Ill. 2d 1, 857 N.E.2d 250, 306 Ill. Dec. 157[, 264] (quoting *Razor v. Hyundai Motor America*, 222 Ill. 2d 75, 854 N.E.2d 607[, 622, 305 Ill. Dec. 15] (2006)). This analysis also takes into account the disparity of bargaining power between the drafter of the contract and the party claiming unconscionability. *Razor*, . . . 222 Ill. 2d 75, 854 N.E.2d 607, 305 Ill. Dec. 15[, 622]. On the other hand, substantive unconscionability "'concerns the actual terms of the contract and examines the relative fairness of the obligations assumed' and is indicated by 'contract terms so one-sided as to oppress or unfairly surprise an innocent party, an overall imbalance in the obligations and rights imposed by the bargain, and significant cost-price disparity.'" *Hutcherson v. Sears Roebuck & Co.*, . . . 342 Ill. App. 3d 109, 793 N.E.2d 886[, 895, 276 Ill. Dec. 127] (2003) (quoting *Maxwell v. Fidelity Financial Services, Inc.*, . . . 184 Ariz. 82, 907 P.2d 51, 58 (1995)).

***Williams v. Jo-Carroll Energy, Inc.*, 382 Ill. App. 3d 781, 890 N.E.2d 566, 569, 321 Ill. Dec. 844 (Ill. App. Ct. 2008).**

With respect to procedural unconscionability, Millas does not forcefully argue that the arbitration agreements were difficult to find, read, or understand, though he does make a generic claim that he may not have signed the agreements knowingly and voluntarily. But this argument is to no avail. The provisions in the employment agreement and Form U-4 are quite straightforward. Additionally, the arbitration clauses therein are not buried within these agreements. In the employment contract, the provision appears on page 2 of 2 at paragraph 7 and is labeled "**ARBITRATION**" in bold, capital letters. Form U-4 is a one-page document, and the relevant provision appears at paragraph 5 of 10.

Millas instead focuses his procedural unconscionability argument on the bargaining power of the parties. Specifically, he claims that the agreements were contracts of adhesion and that he had no real expectation to modify the terms of the employment contract, except for possibly salary and vacation. In other words, Millas argues that he either had to accept the employer's terms, including the arbitration clauses, or else find other work.

In ***Oblix, Inc. v. Winiecki,*** the Seventh Circuit has indicated that such arguments, without more, are not sufficient to make a showing of unconscionability. Discussing an employee's argument that the arbitration clause in her contract was unconscionable because it was adhesive, the court noted:

> Winiecki does not deny that the arbitration clause is supported by consideration--her salary. Oblix paid her to do a number of things; one of the things it paid her to do was agree to non-judicial dispute resolution. It is hard to see how the arbitration clause is more suspect, or any less enforceable, than the others--or, for that matter, than her salary.
>
> . . . Businesses regularly agree to arbitrate their disputes with each other; giving employees the same terms and forum . . . that a firm deems satisfactory for commercial dispute resolution is not suspect. Employees fare well in arbitration with their employers--better by some standards than employees who litigate, as the lower total expenses of arbitration make it feasible to pursue smaller grievances and leave more available for compensatory awards.

374 F.3d 488, 491 (7th Cir. 2004).

The same reasoning applies to Millas's blanket assertions here. The fact that Millas had no power to negotiate each and every term of the employment agreement is not sufficient for this Court to find that the contract is unconscionable. And Millas does indicate in his response that he engaged in some negotiations with respect to salary and vacation. The level of procedural unconscionability, if any existed at all, with respect to the parties' bargaining position was quite small. ***See Williams,*** **890 N.E.2d at 571 ("However, just because a contract is prepared by a party in a superior bargaining position, without allowing the other party to negotiate any terms, does not mean that an included arbitration clause is unconscionable. Rather, some fraud or similar wrongdoing must be shown to invalidate such a provision as unconscionable.") (citing *Zobrist v. Verizon Wireless*, 354 Ill. App. 3d 1139, 822 N.E. 2d 531, 541, 290 Ill. Dec. 946 (2004)).**

With respect to the question of substantive unconscionability, Millas argues that the arbitration clauses do not require Morgan Stanley to arbitrate its claims, waive his right to further review of an adverse decision, and require Millas to pay excessive costs. Millas also argues that the prescribed arbitration system is inherently biased in favor of the industry and against claimants.

The Court cannot find that the terms of the agreements are substantively unconscionable. First, Millas's argument that the arbitration agreements are unilateral, because they require Millas to arbitrate

disputes but do not require the same of Morgan Stanley, is simply unfounded. The employment agreement states that both the employer and employee agree to all terms therein, providing in relevant part:

> In consideration of Dean Witter's employment and compensation of the Employee as an Account Executive and other good and valuable consideration, **the parties hereby agree as follows:**
>
> . . . . Any controversy or claim arising out of or relating to this Agreement, or its breach, will be settled by arbitration before either the National Association of Securities Dealers, Inc. or the New York Stock Exchange, Inc., as Dean Witter may elect . . . .

Doc. 16, Exh. B, P 7. The agreement is signed by both Millas and a branch manager for his employer. The fact that the agreement provides that the employer may choose between two specifically identified arbitrators does not make the provision unilateral.

Moreover, as far as the Court can tell, while Form U-4 is not an agreement between the parties, the arbitration provision at paragraph 5 recognizes an applicant's agreement to arbitrate disputes in accordance with FINRA/NASD regulations. **Doc. 16, Exh. C.** As noted above, those very regulations require arbitration of any dispute that "arises out of the business activities of a member or an associated person and is between . . . Members and Associated Persons." **NASD Code § 13200.** In other words, Morgan Stanley is held to the same arbitration requirements as Millas under the FINRA regulations. Thus, there is no merit to Millas's argument that the arbitration provision in Form U-4 is unilateral.

Additionally, the Court is unmoved by Millas's argument that the arbitration process imposes excessive costs and unfairly requires Millas to waive his right to the review of an adverse decision. These arguments cover ground on which the law is well-settled. The Appellate Court of Illinois recently noted that the burden of showing excessive costs in the arbitration process lies on the party seeking to invalidate the provision. ***Bess v. DirectTV, Inc.*, 381 Ill. App. 3d 229, 885 N.E.2d 488, 498, 319 Ill. Dec. 217 (Ill. App. Ct. 2008).** "In order to meet her burden, the party must provide some individualized evidence to show that she is likely to face prohibitive costs in the arbitration and that she is financially incapable of meeting those costs." ***Id.*** Millas does not attempt to show either, preferring a generic allegation of unfairness in the costs involved in arbitration. This approach is insufficient to satisfy Millas's burden.

Likewise, Millas's generic claims of bias do not persuade this Court that the arbitration provision is unconscionable. There is no support in the record for these bare bones assertions, and the Court need not give credence to them. It is sufficient to note that Millas has utterly failed to present anything from which the Court could conclude that the FINRA's arbitration procedures are biased against the claimant to the extent that each and every provision requiring arbitration under the FINRA's rules is substantively unconscionable.

Finally, Millas's argument that the arbitration provisions waive his right to review of an adverse decision is without merit. The nature of an agreement to submit disputes to binding arbitration rather than the

courts obviously includes an understanding that appellate review is extremely limited. Millas's agreements to arbitrate necessarily included this concession. The mere suggestion that this component makes the provisions unfair does not overcome the force of the FAA's requirements.

Accordingly, the Court is unable to find that the arbitration provisions in the employment agreement and Form U-4 are unconscionable.

2. The Scope of the Arbitration Agreement

Having found that the arbitration provisions in question are enforceable, the Court must now determine whether they apply to the particular claims at issue in this case. The controlling language in the employment agreement requires arbitration of "Any controversy or claim arising out of or relating to this Agreement, or its breach . . ." **Doc. 16, Exh. B, P 7.** The Form U-4 requires arbitration of "any dispute, claim or controversy that may arise between [Millas and Morgan Stanley]" insofar as arbitration is required by FINRA rules. **Doc. 16, Exh. C, P 5.** Broad arbitration clauses such as these have expansive reach and create a presumption of arbitrability. ***Kiefer Specialty Flooring, Inc. v. Tarkett, Inc.*, 174 F.3d 907, 909-10 (7th Cir. 1999) (citing *Elzinga & Volkers, Inc. v. LSSC Corp.*, 47 F.3d 879, 881 (7th Cir. 1995); *Tracer Research Corp. v. Nat'l Envtl. Servs. Co.*, 42 F.3d 1292, 1295 (9th Cir. 1994)).**

Millas raises three causes of action: breach of contract, defamation, and tortious interference with a business expectancy. It should be self-explanatory why Millas's breach of contract claim "arises out of or relates to" the employment agreement or its breach. Indeed, Millas essentially concedes this point by focusing his arguments only on the defamation and tortious interference claims. So the Court now turns to the question of whether the broad arbitration provisions here encompass these two claims.

The defamation claim and the tortious interference claim pertain to the statements Morgan Stanley made after Millas's termination when filling out his Form U-5. The tortious interference claim also involves Millas's allegation that Morgan Stanley wrongly refused his request to resign voluntarily. These claims certainly "arise out of or relate to" Millas's employment at Morgan Stanley. Morgan Stanley explains, and Millas does not dispute, that it was required by FINRA regulations to file the Form U-5 upon Millas's termination. As a result, any statements or conduct in conjunction with filling out the Form U-5 are certainly related to Millas's employment, and therefore fall under the broad language of the arbitration provisions at issue here.

Millas's sole argument on this point is that intentionally making false statements on the Form U-5 cannot possibly "relate to" Morgan Stanley's business activities. But it most certainly does, when filling out the Form U-5 is a direct and necessary consequence of terminating Millas's employment with the firm. Moreover, Millas does not cite a single case, and the Court can locate none, to support the proposition that the mere allegation of willful conduct removes a dispute from the scope of a broad arbitration clause.

As a result, the Court finds that Millas's three causes of action fall within the scope of the arbitration provisions and must be submitted to arbitration.

C. Conclusion

Accordingly, the Court hereby **GRANTS** Morgan Stanley's motion to compel

arbitration (Doc. 16) and **STAYS** this action pending the parties' resolution of this action via arbitration.

Additionally, the Court **DIRECTS** Morgan Stanley to file regular status reports apprising the Court as to the parties' progress in resolving this dispute via arbitration. Such reports **shall be filed** on the following dates: March 2, 2009, May 4, 2009, August 3, 2009, and every two months thereafter.

IT IS SO ORDERED.

DATED this 1st day of December 2008.

/s/ Michael J. Reagan

MICHAEL J. REAGAN

United States District Judge

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VENANCIO MARTI SANTA CRUZ, et al., Plaintiffs, v. BANCO SANTANDER PUERTO RICO, et al., Defendants.

Civil No. 08-1225 (JAF)

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF PUERTO RICO

2008 U.S. Dist. LEXIS 99574

December 10, 2008, Decided
December 10, 2008, Filed

CORE TERMS: arbitration, arbitration agreement, non-arbitrable, compel arbitration, unknown, embezzled

COUNSEL: For Venancio Marti Santa-Cruz, Julita Soler-Vila, Conjugal Partnership Santa-Soler, Maria Rosa Marti-Soler, Sofia Marti-Soler, Plaintiffs: Emilio F. Soler-Ramirez, LEAD ATTORNEY, Santurce, PR.

For Banco Santander Puerto Rico, Defendant: Leslie Yvette Flores-Rodriguez, LEAD ATTORNEY, McConnell Valdes, San Juan, PR; Jose G. Barea-Fernandez, Gonzalez-Nieto, Garcia & Balzac Law Office, San Juan, PR.

For Santander Securities Inc., Defendant: Roberto C. Quinones-Rivera, LEAD ATTORNEY, Leslie Yvette Flores-Rodriguez, McConnell Valdes, San Juan, PR.

For Fernando Gallardo-Alvarez, Defendant: Ludwig Ortiz-Belaval, Ortiz & Rodriguez Law Office, San Juan, PR.

JUDGES: JOSE ANTONIO FUSTE, U.S. District Judge.

OPINION BY: JOSE ANTONIO FUSTE

OPINION

ORDER

Plaintiffs, Venancio Marti Santa Cruz ("Marti"), his wife Julita Soler Vila, their conjugal partnership, and their daughters Maria Rosa Marti Soler ("Maria Rosa") and Sofia Marti Soler ("Sofia"), brought this action on February 21, 2008, against Defendants, Banco Santander Puerto Rico ("BSPR"), Santander Securities, Inc., Fernando Gallardo Alvarez ("Gallardo"), his unknown supervisors, and unknown insurance companies, for violations of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. 240.10b-5, the Racketeer Influenced and Corrupt Organization Act, 18 U.S.C. § 1964, and Puerto Rico law. *Docket No. 1.* On July 2, 2008, Defendants moved to compel arbitration of certain of Plaintiffs' claims and stay the remaining claims pending the arbitration. *Docket No. 10.* Plaintiffs opposed on October 30, 2008, *Docket No. 22*, and Defendants replied on November 19, 2008, *Docket No. 27.*

Plaintiffs allege that Gallardo, a financial advisor at Santander Securities and BSPR and Sofia's ex-husband, embezzled money from Marti and Maria Rosa that he fraudulently induced them to invest with him. *Docket No. 1.* Plaintiffs also allege that Gallardo embezzled money from Sofia by inducing her to refinance the mortgage of their apartment with BSPR while they were married. *Id.*

Defendants assert that Marti's and Maria Rosa's claims must be arbitrated pursuant to the arbitration clauses in the contracts they signed creating the accounts with Santander Securities. *Docket No. 10.* The contracts state that "the parties are waiving their right to seek remedies in court, including a jury trial," and that "any controversy between [the parties] arising out of [their] business or this agreement shall be submitted to arbitration." *Docket Nos. 10-2, 10-3.*

Plaintiffs concede that Maria Rosa's claims are subject to arbitration pursuant to the contract she signed. *Docket No. 22.* Plaintiffs allege, however, that Gallardo forged Marti's signature on the contract; therefore, Marti never agreed to submit his claims to arbitration. *Docket Nos. 1, 22.* Plaintiffs do not oppose a stay of the non-arbitrable claims. *Docket No. 22.*

"Any analysis of a party's challenge to the enforcement of an arbitration agreement must begin by recognizing the [Federal Arbitration Act's ("FAA")] strong policy in favor of rigorously enforcing arbitration agreements." *KKW Enters. V. Gloria Jean's Gourmet Coffees Franchising Corp.,* 184 F.3d 42, 49 (1st Cir. 1999). Through the FAA, congress has declared "a liberal federal policy favoring arbitration agreements." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.,* 460 U.S. 1, 24 (1983). Nevertheless, "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." *Large v. Conseco Fin. Servicing Corp.,* 292 F.3d 49, 52 (1st Cir. 2002) (quoting *McCarthy v. Azure,* 22 F.3d 351, 354 (1st Cir. 1994)) (internal quotation marks omitted).

Marti's contention that he never signed the contract, if true, would preclude compelled arbitration of his claims and entitle him to a trial. *See id.* Plaintiffs, however, fail to submit any evidence to support their allegation. In the absence of any such evidence, for example a sworn affidavit from Marti attesting to the forgery, we cannot find that a genuine issue exists as to the existence of the arbitration agreement. *See, e.g., Doctor's Assocs. v. Jabush,* 89 F.3d 109, 114 (2d Cir. 1996) (requiring an "unequivocal denial" that there was an agreement to arbitrate and "some evidence . . . to substantiate the denial"); *Chastain v. Robinson-Humphrey Co.,* 957 F.2d 851, 854-55 (11th Cir. 1992) (same). We find, therefore, that arbitration of Marti's claims is required by the contract and the FAA. *See* 9 U.S.C. § 4.

Where some claims are referred for arbitration, we have discretion to stay litigation of the remaining non-arbitrable claims pending the outcome of the arbitration proceeding. *McCarthy,* 22 F.3d at 361 n.15. In the interest of maximizing judicial economy and avoiding piecemeal litigation, and in the absence of any opposition from Plaintiffs, we find that a stay of Plaintiffs' non-arbitrable claims is appropriate.

Accordingly, we **GRANT** Defendants' motion to compel arbitration, *Docket No. 10.* We hereby **ORDER** arbitration as to the claims of Plaintiffs Marti and Maria Rosa Marti Soler, and **STAY** the claims of Sofia Marti Soler pending the arbitration.

IT IS SO ORDERED.

San Juan, Puerto Rico, this 10th day of December, 2008.

/s/ Jose Antonio Fuste

JOSE ANTONIO FUSTE

U.S. District Judge

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RAGHAVAN SATHIANATHAN, PETITIONER v. SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

No. 07-1002

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

2008 U.S. App. LEXIS 24452

December 2, 2008, Filed

NOTICE: PLEASE REFER TO FEDERAL RULES OF APPELLATE PROCEDURE RULE 32.1 GOVERNING THE CITATION TO UNPUBLISHED OPINIONS.

PRIOR HISTORY:

On Petition for Review of an Order of the Securities and Exchange Commission.

CORE TERMS: recommendations, reconsider, mutual fund, unsuitable, stock, volatile, margin, buy

COUNSEL: Raghavan Sathianathan, Petitioner, Pro se, Montclair, NJ.

For Securities and Exchange Commission, Respondent: Hope Hall Augustini, Brian Grant Cartwright, Leslie E. Smith, Senior Litigation Counsel, Jacob H. Stillman, Solicitor, Andrew N. Vollmer, Securities & Exchange Commission (SEC), Washington, DC.

For David William DeBruin, Appointed Amicus Curiae for Petitioner: David William DeBruin, Larry Paul Ellsworth, Michelle April Groman, Thomas C. Newkirk, Jenner & Block LLP, Washington, DC.

JUDGES: Before: ROGERS, TATEL and KAVANAUGH, Circuit Judges.

OPINION

JUDGMENT

This case was considered on the record from the Securities and Exchange Commission and on the briefs and arguments of the parties. It is

ORDERED and **ADJUDGED** that the petition for review is denied.

On November 8, 2006, the SEC affirmed findings of the National Association of Securities Dealers (NASD) that Raghavan Sathianathan made unsuitable recommendations to two clients, Anjan Venkatramani and Srikar Srinath, to buy: (i) Class B mutual fund shares in multiple fund

families, rather than Class A shares in fewer fund families; and (ii) mutual funds and warrants on margin, secured by the shares of a volatile stock. The SEC also affirmed NASD findings that Sathianathan undertook discretionary trades in Venkatramani's account without written authorization. Finally, the SEC sustained a bar on Sathianathan from associating with any NASD member in any capacity.

Sathianathan petitioned for review on January 3, 2007. The SEC contends that we have no jurisdiction over Sathianathan's petition because it was "filed before the challenged action [wa]s final and thus ripe for review." *TeleSTAR, Inc. v. FCC,* 281 U.S. App. D.C. 119, 888 F.2d 132, 134 (D.C. Cir. 1989). The SEC argues that Sathianathan had tried to file a motion to reconsider, which would mean his petition was filed too early and that he was required to file a new petition after his motion to reconsider was denied. However, the SEC itself stated, in an order issued on February 2, 2007, that Sathianathan "never made a filing in compliance with the Rules of Practice and, therefore, no motion to reconsider [the November 8, 2006 Opinion] is pending before the Commission." *In re Raghavan Sathianathan,* Securities Exchange Act Rel. No. 55227 (Feb. 2, 2007), Supplemental Appendix 191. Based on the SEC's own characterization of the record and its statement that Sathianathan did not file a motion for reconsideration, the challenged SEC action *was* final when the petition was filed. Accordingly, under the unusual facts of this case, we have jurisdiction.

Turning to the merits of the petition, substantial evidence supports the SEC's findings that Sathianathan made unsuitable recommendations and unauthorized trades. Sathianathan admitted that he urged Venkatramani and Srinath to purchase Class B shares in different mutual fund families, on margin and collateralized by volatile stock, and that he discussed the relative risks of Class A and B shares only cursorily. Sathianathan also admitted that he could not get in touch with Venkatramani while he was in India in May 2001, but nonetheless proceeded to buy 13,000 shares of stock on his behalf. The SEC's conclusions that Sathianathan's recommendations were unsuitable and that he lacked price and time discretion to make the trades in Venktramani's account are supported by the record.

The SEC's sanctions for the violations were not an "abuse of discretion." *Stoiber v. SEC,* 333 U.S. App. D.C. 195, 161 F.3d 745, 753 (D.C. Cir. 1998). Sathianathan had previously been on probation, and his risky recommendations flouted both his employer's express guidelines and NASD policy while causing substantial financial injuries. The associational bar is thus appropriate.

Finally, Sathianathan's remaining claims that he was targeted because he was a whistleblower, selectively prosecuted because of his race, and subjected to unfair or biased NASD proceedings lack merit. The SEC's rejection of each of these arguments was reasonably explained and supported by the record.

Pursuant to D.C. Circuit Rule 36, this disposition will not be published. The Clerk is directed to withhold issuance of the mandate herein until seven days after resolution of any timely petition for rehearing or rehearing en banc. *See* FED. R. APP. P. 41(b); D.C. CIR. R. 41.

Per Curiam

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AXA DISTRIBUTORS, LLC, et al., Plaintiffs, v. GAYLE S. BULLARD, et al., Defendants.

CASE NO. 1:08-CV-188-WKW [WO]

UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF ALABAMA, SOUTHERN DIVISION

2008 U.S. Dist. LEXIS 103837

December 24, 2008, Decided
December 24, 2008, Filed

CORE TERMS: distributor, broker-dealer, customer's, arbitration, finra, registered representatives, arbitrate, Exchange Act, FINRA Rules, indirect control, marketing, indirectly, broker, injunction, training, entity, indirect, by-laws, independent contractors, investor, undisputed, marketed, injunctive relief, registered, annuity, dealer, business activities, solicitation, supervise, variable

COUNSEL: For AXA Distributors, LLC, AXA Advisors, LLC, Plaintiffs: Andrea Morgan Greene, Armistead Inge Selden, III, John Norman Bolus, LEAD ATTORNEYS, Maynard, Cooper & Gale, P.C., Birmingham, AL.

For Gayle S. Bullard, Peggy J. Cole, Beverly L. Davis, Jesse D. Dean, Hans D. Erbskorn, Charlene B. Erbskorn, Rabon W. Harrison, Ruth K. Harrison, Kenneth W. Joyner, Sarah A. Martin, Sarah McCord, Nina Sue New, Mary Harriett Patton, Freddy Quattlebaum, Anita Carol Shirah, Willa C. Storey, Jeanette S. Sutherland, Mary E. Todd, Betty M. Vann, Helen S. Hall Walworth, Debra Rebecca White, Pheobie D. Wilson, Charles H. Woodham, Jerry Mims, Floyd Starling, Virginia Starling, F. Terry Walden, Reuben S. Shelley, June K. Shelley, Shirley J. Walker, Donald W. Hendley, Edward L. Hinson, Jeanette C. Hinson, Jack R. Perry, Hazel J. Odom, Carolyn H. Saunders, Roy W. Saunders, James H. Hausman, James R. Little, Linda D. Little, Earl T. Senn, Edna Senn, Danny L. Snell, Jacqueline P. Draughon, Gayle O. Hudson, Defendants: Andrew P. Campbell, LEAD ATTORNEY, Campbell Gidiere Lee Sinclair & Willaims, Birmingham, AL; Caroline Smith Gidiere, LEAD ATTORNEY, Campbell Waller & Poer LLC, Birmingham, AL; Marion Dale Marsh, LEAD ATTORNEY, Marsh Cotter & Stewart LLP, Enterprise, AL.

JUDGES: W. Keith Watkins, UNITED STATES DISTRICT JUDGE.

OPINION BY: W. Keith Watkins

OPINION

MEMORANDUM OPINION AND ORDER

Plaintiff AXA Distributors, LLC ("AXA Distributors") brings this action to enjoin the arbitration of disputes over the purchase of variable annuities distributed by AXA Distributors and purchased by Defendants. [1] Defendants initiated arbitration proceedings against AXA Distributors under the rules of the Financial Industry Regulatory Authority ("FINRA"), formerly the National Association of Securities Dealers ("NASD"). [2] AXA Distributors asks the court to enjoin the arbitration in this action. Three motions are pending and will be addressed in this opinion: Defendants' Motion to Dismiss or in the Alternative, Motion to Compel Arbitration (Doc. # 9); AXA Distributors' motion for preliminary injunction (Doc. # 12); and Defendants' motion to strike affidavit of John E. Pinto (Doc. # 29). For the reasons that follow, all three motions are due to be denied.

1 AXA Advisors, LLC ("AXA Advisors") is also a plaintiff, but, on the representation of the Defendants that AXA Advisors is not implicated in the business activities made the basis of this action, AXA Advisors is not a proper subject of the motion to dismiss or compel.

2 *See, e.g.*, About Finra, http://www.finra.org/AboutFINRA/index.htm (last visited Dec. 23, 2008).

I. JURISDICTION

The court exercises subject matter jurisdiction pursuant to 28 U.S.C. § 1332(a), and venue is appropriate under 28 U.S.C. § 1391(a). The parties contest neither. [3]

3 Defendants initially challenged jurisdiction to consider the arbitrability question (*see* Mot. to Dismiss or Compel 6) but have since abandoned that argument (Mots. Hr'g Tr. 22, Aug. 1, 2008 (Doc. # 35)). Even if not abandoned, the argument was due to be decided against Defendants; arbitrability "is undeniably an issue for judicial determination," *AT&T Techs., Inc. v. Commc'ns Workers of Am.*, 475 U.S. 643, 649 (1986). The only remaining argument with respect to dismissal is for a failure to state a claim. (Mot. to Dismiss or Compel 1.)

II. BACKGROUND

A. Facts

In the mid-1990s, The Equitable Life Assurance Society of the United States, now AXA Equitable Life Insurance Company ("AXA Equitable"), developed and issued the Equitable Accumulator (the "Accumulator") variable annuity investment product. [4] AXA Equitable did not market the Accumulator directly because it is not a broker-dealer, but instead entered into distribution arrangements with registered broker-dealers AXA Distributors for wholesale distribution, and AXA Advisors for retail distribution of the security. AXA Distributors is described by AXA Equitable as an "indirect, wholly owned subsidiar[y]" of AXA Equitable, and "the distributor[] of the contract[] [with] responsibility for sales and marketing functions." (Mot. to Dismiss or Compel Ex. F at 38.) AXA Distributors in turn entered into a Broker-Dealer and

General Agent Sales Agreement ("Distribution Agreement") with the business predecessors of Raymond James Financial Services, Inc. ("Raymond James"), [5] an agreement which identified Raymond James as a broker-dealer for the retail distribution of the Accumulator. Raymond James uses registered representatives who are independent contractors (Hr'g Tr. 28) to sell a variety of financial products, including in this case, the Accumulator. Defendants purchased Accumulator contracts from two Raymond James representatives, Ann Holman ("Ms. Holman"), and Maxine Chappell ("Ms. Chappell"). In order to sell the Accumulator, it is undisputed that Ms. Holman and Ms. Chappell were appointed non-exclusive insurance agents for AXA Equitable. (Verified Compl. P 16 (Doc. # 1).)

4 The Accumulator was described in company documents as "a combination fixed and variable deferred annuity designed to provide for the accumulation of retirement savings and for income at a future date." (Mot. to Dismiss or Compel Ex. C.)

5 In the interest of convenience and simplicity, this entity will be referred to as Raymond James. For the record, Investment Management & Research, Inc. was identified in the agreement as the "Broker-Dealer," and Planning Corporation of America was identified as the "General Agent." (*See* Distribution Agreement (Pls.' Reply Mem. Ex. B (Doc. # 28)).) Apparently, there was a merger of one or both of these companies into the Raymond James group of entities in 1998.

In its agreement with the NASD, as amended March 21, 1996, Equitable Distributors (now AXA Distributors) agreed to limit its business activities as a broker-dealer to "a) wholesaling variable and fixed contracts . . . through other broker/dealers and banks, and b) distributing investment company securities on a wholesale basis only." (NASD Agreement (Pls.' Reply Mem. Ex. A).) AXA Equitable described AXA Distributors as having "responsibility for sales and marketing functions." In furtherance of the sales and marketing functions, AXA Distributors undertook several business functions to assist in the marketing of the Accumulator. It directly provided training to Ms. Holman and Ms. Chappell with respect to the Accumulator's features and materials (Holman Aff. & Chappell Aff. (Defs.' Supplemental Br. Exs. 1 & 2 (Doc. # 34))), directly provided follow-up services to the customers of Ms. Holman and Ms. Chappell (Mot. to Dismiss or Compel Ex. C), and offered "effective sales ideas, and a commitment to excellent service to help [them] and [their] clients achieve their goals" (Mot. to Dismiss or Compel Ex. E). According to correspondence from AXA Distributors to the Raymond James office from which Ms. Holman and Ms. Chappell worked, AXA Distributors offered "immediate marketing support and illustrations" and told the Raymond James representatives to "not hesitate to contact AXA Distributors for anything that [they] need[ed] to help grow [their] business." (Mot. to Dismiss or Compel Ex. E.)

Though they were non-exclusive agents of AXA Equitable when they marketed the Accumulator, Ms. Holman and Ms. Chappell were independent contractors, and therefore "associated persons" of Raymond James, which also served, by the then-NASD rules and the express terms of the Distribution Agreement, as their supervising broker-dealer (Distribution Agreement Articles III & IV). Specifically, Raymond James agreed that it would "train, supervise and be solely responsible for the conduct of the Agents in their solicitation activities in connection with the Contracts" and cause its agent-representatives to comply strictly with the

rules and procedures of AXA Equitable and all "federal and state securities laws and NASD requirements" in connection with solicitation activities. (Distribution Agreement §§ 4.1, 4.2.) Thus, while they were agents of AXA Equitable, the issuer of the security, the agents were registered representatives of, and supervised by, a third-party broker-dealer. [6]

6 Ms. Holman and Ms. Chappell are no longer associated with Raymond James.

Sales procedures for marketing the Accumulator were straightforward. Ms. Holman, for instance, took orders and payment from her customers. (Holman Aff.) Raymond James forwarded the funds collected by Ms. Holman (or, in some cases, which were already on deposit with Raymond James) to AXA Equitable, which retained the right under the Distribution Agreement to reject applications. [7] (Distribution Agreement § 2.5; Holman Aff. P 16.) If the application was accepted, AXA Equitable issued the contract directly to the customer. (*See* Distribution Agreement § 4.7.) AXA Distributors sent follow-up correspondence directly to the customer, identifying at least in some cases Ms. Holman as as "your financial professional." (Mot. to Dismiss or Compel Ex. C.) AXA Distributors received remuneration for marketing from AXA Equitable, and forwarded commissions downstream to Raymond James, which then paid the selling agents, in this case, Ms. Holman and Ms. Chappell. (William C. Miller Supplemental Aff. P 10 (Pls.' Reply Mem. Affs.); Distribution Agreement §§ 7.1, 7.5.) It is undisputed that, in addition to the Accumulator, Ms. Holman and Ms. Chappell had several other financial products in their inventory.

7 While AXA Distributors is a wholly owned subsidiary of AXA Equitable, this retained power is nevertheless deemed control retained by the issuer, not the distributor, and is not attributed to the distributor.

In their arbitration Statement of Claim, Defendants seek damages from AXA Distributors in excess of one million dollars arising out of their purchases of the Accumulator. [8] (Statement of Claim 12 (Verified Compl. Ex.).) Their claims include fraud, suppression, negligent training and supervision, breach of contract, conversion, Alabama securities fraud, and unsuitable investment/suitability review. (Statement of Claim 7-12.) Raymond James, Ms. Holman and Ms. Chappell are not named as respondents in the arbitration proceeding. Interestingly, Ms. Holman is a claimant in the arbitration proceeding but is not named as a defendant in this action. [9] The essence of the claims in arbitration is that Defendants were fraudulently induced to purchase the Accumulator "based upon representation that the annuity provided a guaranteed rate of return, guarantee of principal, and liquidity at the end of term." (Mot. to Dismiss or Compel 2.) Defendants also claim that AXA Distributors failed to disclose that these representations were false. (Mot. to Dismiss or Compel 2.) Arbitration of this dispute is premised solely on the characterization by Defendants of Ms. Holman and Ms. Chappell as "associated persons" of AXA Distributors when they marketed the Accumulator. "Associated persons" is a term of art and law in the securities world.

8 AXA Equitable is also named as a respondent in the arbitration, but AXA Equitable is not a member of FINRA and is not required to submit to arbitration. (*See* Verified Compl. 4 n.1.)

9 Because "she was an associated person of Raymond James . . . during the relevant time period, . . . [Ms.] Holman may be entitled to rely upon different FINRA rules . . . to determine at least the eligibility of her claims for arbitration against the Plaintiffs." (Verified Compl. 4 n. 1.)

B. FINRA Rules

FINRA is an industry association. In connection with its FINRA membership, AXA Distributors bound itself, by subscribing to the FINRA Rules as a condition of membership, to arbitrate certain disputes between its customers and itself, or between its customers and its associated persons, when such customer disputes arise in connection with its (or the associated persons') business activities. Because there is no written arbitration agreement between the parties, determining arbitration begins with Rule 12200 of the FINRA Rules relating generally to matters eligible for submission to arbitration. [10] It requires arbitration if arbitration is 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 of the associated person." Rule 12200.

10 The Securities and Exchange Commission ("SEC") approved new FINRA Rules, which became effective December 15, 2008, and apply to all claims filed on or after April 16, 2007. Order Approving FINRA Proposed Rule Changes, Exchange Act Release No. 34-58643, 73 Fed. Reg. 57,174 (Oct. 1, 2008); FINRA, Regulatory Notice 08-57, SEC Approves New Consolidated FINRA Rules, 2008 WL 4685588 (Oct. 16, 2008). Authority arising under the NASD Code governs and guides interpretations of the FINRA Rules to the extent that there is no meaningful change from the NASD Code.

Rule 12100 defines "associated person," "customer," "member," and "person associated with a member." "For purposes of the Code, the term 'member' means any broker or dealer admitted to membership in [FINRA] . . . ." Rule 12100(o). The terms "associated person" or "associated person of a member" means "a person associated with a member, as that term is defined in paragraph (r)." Rule 12100(a). Paragraph (r) contains a more extensive definition of "person associated with a member":

> (1) A natural person registered under the Rules of FINRA; or
>
> (2) . . . a natural person engaged in the . . . securities business who is directly or indirectly . . . controlled by a member, whether or not any such person is registered or exempt from registration . . . .

Rule 12100(r). "Customer" is defined simply, but not particularly helpfully, by what it "shall not include" -- a broker or dealer. Rule 12100(i). The imprecise language of the Rules complicates the analysis of the legal characterization of Ms. Holman and Ms. Chappell, and consequentially, the status of Defendants as customers of AXA Distributors.

C. Issue for Resolution

The only issue for resolution is whether this dispute will be arbitrated. Because there is no independent written arbitration agreement between Plaintiff and Defendants, the dispute will be arbitrated only if Defendants were "customers" of AXA Distributors, thereby invoking the FINRA Rules. Defendants were not customers of AXA Distributors unless Ms. Holman and Ms. Chappell were "associated persons" of AXA Distributors when they marketed the Accumulator to Defendants. [11] Ms. Holman and Ms. Chappell were not associated persons of AXA Distributors unless they were directly or indirectly controlled by AXA Distributors when they were marketing the Accumulator.

11 "When an investor deals with a member's agent or representative, the investor deals with the member." *Multi-Fin. Sec. Corp. v. King*, 386 F.3d 1364, 1370 (11th Cir. 2004).

III. STANDARDS OF REVIEW

A party may move to dismiss actions raised against that party for "failure to state a claim upon which relief can be granted." Fed. R. Civ. P. 12(b)(6). A motion pursuant to Rule 12(b)(6) tests the sufficiency of the complaint against the pleading standards set forth in Rule 8 of the Federal Rules of Civil Procedure. "When considering a motion to dismiss, all facts set forth in the plaintiff's complaint 'are to be accepted as true and the court limits its consideration to the pleadings and exhibits attached thereto.'" *Grossman v. Nationsbank, N.A.*, 225 F.3d 1228, 1231 (11th Cir. 2000) (per curiam).

If a party is "aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement," it may petition a federal district court "for an order directing that such arbitration proceed in the manner provided for in [the] agreement." 9 U.S.C. § 4. When addressing a Section 4 motion, the district court must determine whether there is a binding agreement to arbitrate and if so, whether the nonmovant has breached its obligation to arbitrate under that agreement. *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 22 n.27 (1983) (citing 9 U.S.C. §§ 4, 6). If the existence of a binding agreement to arbitrate and the failure of the nonmovant to comply with that term are not at issue, the court must order arbitration. 9 U.S.C. § 4. If either of these determinations is at issue, however, the court must "proceed summarily to the trial" to determine the issues. *Id.* The court can consider evidence outside of the pleadings for purposes of a motion to compel arbitration. *See, e.g., Chastain v. Robinson-Humphrey Co., Inc.*, 957 F.2d 851, 854 (11th Cir. 1992); *Magnolia Capital Advisors, Inc. v. Bear Stearns & Co.*, 272 F. App'x 782, 785 (11th Cir. 2008) (per curiam) ("More specifically, we require a party resisting arbitration to 'substantiate[] the denial of the contract with enough evidence to make the denial colorable.'" (quoting *Wheat, First Sec. Inc. v. Green*, 993 F.2d 814 (11th Cir. 1993))).

IV. DISCUSSION

AXA Distributors contends that it has no legal obligation to arbitrate the FINRA dispute with Defendants "because (1) there is no agreement to arbitrate between Defendants and [] Plaintiffs, and (2) [] Defendants were not customers of [] Plaintiffs or their associated persons, nor does Defendants' arbitration proceeding arise in connection with Plaintiffs' business activities." (Verified Compl. 2.) Thus, say Plaintiffs, Defendants must litigate. (Pls.' Reply Mem. 3.) On the

other hand, Defendants claim to have been "customers" of AXA Distributors, as that term applies under the FINRA Rules and applicable case law, when they purchased the Accumulator from persons associated with AXA Distributors, and thus are entitled to arbitrate their dispute with AXA Distributors.

The FINRA Rules constitute the arbitration agreement for disputes between customers and FINRA members or persons associated with FINRA members. "[T]he [NASD] Code serves as a sufficient written agreement to arbitrate, binding its members to arbitrate a variety of claims with third-party claimants." *King*, 386 F.3d at 1367. As to governing contract law, the courts "must interpret the [NASD] Code as it would a contract under the applicable state law." *Id.* Thus, Alabama contract law applies, and it favors arbitration when there is doubt. *Carroll v.W. L. Petrey Wholesale Co.*, 941 So. 2d 234, 235-37 (Ala. 2006). Likewise, the Federal Arbitration Act, 9 U.S.C. §§ 1-16, creates a presumption in favor of arbitrability, but the Eleventh Circuit recently has been ambivalent as to whether that presumption applies when a court is determining whether an agreement to arbitrate exists. *Compare King*, 386 F.3d at 1367 ("[A]ny doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration."), *with MONY Sec. Corp. v. Bornstein*, 390 F.3d 1340, 1342 n.1 (11th Cir. 2004) ("However, the presumption is not necessary in this case because we can decide the issue as a matter of law without resorting to a presumption. Accordingly, we recognize that *King* addresses the applicable presumption, but we need not dwell on it in this case."). Determining whether the presumption applies, however, is not necessary for the resolution of this case, as will become apparent.

The question for resolution is whether Ms. Holman and Ms. Chappell were associated persons of AXA Distributors when they marketed the Accumulator to Defendants. Defendants urge the court to examine the question whether Defendants were customers of AXA Equitable as well, but this second question is subsumed in the first. Clearly, Defendants were customers of the Raymond James registered representatives. AXA Distributors is the broker-dealer and member of FINRA and thus, the AXA-related party subject to FINRA's arbitration rules; marketing the Accumulator is the business of AXA Distributors, and the parties have a dispute arising out of the marketing of the Accumulator to Defendants. Therefore, if the Raymond James representatives were "associated persons" of AXA Distributors, Defendants were customers of AXA Distributors. So, the salient issue can be reduced to whether the Raymond James registered representatives were associated persons of AXA Distributors.

Under Rule 12100(r), an "associated person" includes (1) a natural person (2) engaged in the securities business (3) who is directly or indirectly controlled (4) by a member (5) whether such person is registered or exempt from registration. It is undisputed that Ms. Holman and Ms. Chappell were natural persons engaged in the securities business who were directly controlled by Raymond James (a member), and that they were registered representatives. The ultimate question then becomes: Were they controlled directly or indirectly *by AXA Distributors* (also a member) at the relevant times? The facts impacting the question are largely undisputed.

A. AXA's Arguments

AXA Distributors asserts that Ms. Holman and Ms. Chappell were not associated persons. First, they insist that the agents were associated persons of Raymond James only. In the Distribution Agreement, Raymond James agreed to "train, supervise and be solely responsible

for the conduct of the Agents in their solicitation activities in connection with the Contracts." (Distribution Agreement § 4.1.) The agents were registered representatives of Raymond James who operated out of a Raymond James office and called on customers of Raymond James. Moreover, the agents had numerous products, not issued by or associated with any AXA entity, at their disposal to offer for sale to their customers, including Defendants. Ms. Holman and Ms. Chappell offered independent investment advice without interference, influence or control of AXA Equitable.

For AXA Distributors, "associated persons" is a term of art that specifies those persons subject to regulatory control. (Pls.' Opp'n (Doc. # 19).) In other words, a person who is supervised by a broker-dealer is an associated person of that broker-dealer, and any person not supervised by that broker-dealer cannot be an associated person of the broker-dealer. At oral argument, when confronted with the question of the distinction between direct and indirect control, AXA Distributors' counsel distinguished "indirect" control as relating to persons who are not "direct" employees of a broker-dealer, but are perhaps employees of their independent contractor registered representative. (Hr'g Tr. 43-44.) [12]

12 The second argument posited by AXA Distributors is that "there must be some connection between the investors and the member firm or their associated person in order to support a finding that a customer relationship exists." (Pls.' Mem. Supp. Mot. for Prelim. Inj.13 (Doc. # 13).) AXA Distributors finds comfort in the language of *Wheat, First Securities Inc.*, 993 F.2d 814. At issue was whether parties who purchased tainted securities from Marshall & Company ("Marshall"), a predecessor firm which ultimately sold its assets to Wheat First, could compel Wheat First to arbitrate claims arising out of the Marshall transaction that occurred *before* the asset purchase. In the asset purchase agreement, Wheat First "expressly did not assume any liability, known or unknown, fixed or contingent, of [Marshall]," and the court found that the investors were not customers because "[w]e cannot imagine that any NASD member would have contemplated that its NASD membership alone would require it to arbitrate claims which arose while a claimant was a customer of another member merely because the claimant subsequently became its customer. . . . We therefore hold that customer status . . . must be determined as of the time of the events providing the basis for the allegations of fraud." *Id.* at 816 (internal quotation marks omitted), 820. The language giving aid and comfort to AXA Distributors is the observation that "Wheat First and Appellants had absolutely no relationship at the time of the alleged events that Appellants seek to arbitrate." *Id.* at 818. The rationale for this "nexus" argument is that courts should factor in the reasonable expectations of the FINRA member when considering compulsion to arbitrate.

To bolster its narrower view of the definition of "customer," AXA Distributors cites *Fleet Boston Robertson Stephens, Inc. v. Innovex, Inc.*, 264 F.3d 770 (8th Cir. 2001), a case which turned on whether business activities outside of investing or brokerage activities fall within the NASD arbitration net. Rejecting a broad definition of "customer" in a "close call," the court declined to extend the definition "where the business relationship did not include [investing or brokerage activities]." *Id.* at 773.

> AXA Distributors additionally rejects the notion that the Rule 12100(i) defines "customer." The Rule, which is entitled "Definitions," says *in toto:* "A customer shall not include a broker or dealer." *Id.* According to AXA Distributors, "that definition is not intended to imply that every person or entity in the universe that is not a broker or dealer is a customer of every FINRA member firm." (Pls.' Reply Mem. 7.)
>
> All these arguments, consuming dozens of pages, miss the mark. It is undisputed that Defendants were customers of the Raymond James representatives. If it is found that Defendants were dealing with associated persons of AXA Distributors when they purchased the Accumulator, they were dealing with AXA Distributors, and thus, were customers of AXA Distributors.

AXA Equitable is somewhat handicapped because it has to prove the negative. It claims that the Raymond James representatives were not AXA Equitable associated persons because they were never appointed such; it had no supervisory control or responsibility for the Raymond James agents - by agreement and FINRA rules, Raymond James supervised them; it was prohibited from retail activities by the terms of its FINRA membership; and it marketed wholesale to Raymond James, which marketed retail through its registered representatives. AXA Distributors therefore had no direct or indirect control over the Raymond James representatives.[13]

> 13 Though Plaintiffs make the more specific following points to argue that Defendants were not customers, the arguments bear on whether Ms. Holman and Ms. Chappell were "associated persons." Defendants were not customers of AXA Distributors, AXA Distributors argues, because it never conducted any business with any of them; never took an application or cash from them; never opened an account for them and never sent them an account statement; and never executed a retail order or confirmation of order for them. In short, there was "absolutely no relationship whatsoever" between them. (Pls.' Mem. Supp. Mot. for Prelim. Inj. 10-11.)

Thus, AXA Distributors concludes that, because the Raymond James representatives were not controlled directly or indirectly by AXA Distributors, they could not be "associated persons" of AXA Distributors under the Rules. *Ergo,* if the representatives were not associated persons of AXA Distributors, then Defendants cannot be customers of AXA Distributors. If Defendants are not customers, they are not entitled to arbitration of this dispute.

B. Defendants' Arguments

Defendants advance a broader definition of "associated person." Their contentions can be summed up in one statement: "Plaintiff's sole business was to sell and market the products at issue in this case and to train and supervise others who sell and market the products, and Plaintiff was involved in and received compensation for each sale." (Defs.' Reply 4 (Doc. # 21).) Leaning on the "indirect control" component of the definition of "associated person," Defendants point out that AXA Distributors conducted all the training on the Accumulator; directed the Raymond James representatives in sales techniques; advised the Raymond James representatives on how to sell the Accumulator and retained discretion over how it was marketed; provided direct customer and sales support, including prospectuses and marketing materials; and made post-sale contact

with the investors. It is undisputed by AXA Distributors that Raymond James provided no direct training on the Accumulator. The training consisted of AXA Distributors training events (*see* Holman Aff. P 4; Chappell Aff. P 3) and Raymond James training events conducted by AXA Distributors' representatives (*see* Holman Aff. P 13; Chappell Aff. P 4). Ms. Holman and Ms. Chappell deny any knowledge of the Accumulator except that which they received from the AXA entities. AXA Distributors explained the complicated product to them, taught them how to sell it, answered their questions almost daily, gave them quotes and illustrations, and directed and instructed them on interpreting the quarterly statements. (*See* Holman Aff.; Chappell Aff.) Indeed, AXA Distributors wrote Ms. Holman in March of 2000 that it was "always ready to answer [her] questions . . . give [her] a quote or a hypothetical illustration . . . provide [her] with marketing materials . . . help [her] in any way we can." (Mot. to Dismiss or Compel Ex. H. (ellipses in original).) [14] Defendants conclude that these activities amount to indirect control as contemplated by the definition of associated person in Rule 12100(r). [15] Defendants also argue generally that the fact that AXA Distributors benefitted financially from the sales of the Raymond James representatives is relevant.

14 To be fair, the same letter to Ms. Holman refers to "your client" or "your clients" three times - never to "our" clients. (Mot. to Dismiss or Compel Ex. H.)

15 A subset of the indirect control argument is that, having undertaken to train, direct and support the representatives of Raymond James, AXA Distributors had a duty to do so with due care. This argument can be taken as support for the state-law claims, not for arbitration. Of note, this is as close as Defendants come to suggesting that AXA Distributors had a duty to supervise the Raymond James representatives.

C. Analysis

1. Preliminary Discussion of Controlling Sources

Because the parties point to no case directly on point factually, and the court has found none, the cases upon which the parties rely are not particularly helpful in determining whether AXA Distributors controlled the Raymond James representatives. AXA Distributors relies upon *Wheat First* for the proposition that one cannot be a customer of a broker-dealer if one has absolutely no relationship with the broker-dealer at the time of the event causing the dispute. This is not an instructive conclusion when it is undisputed that Defendants are customers of the persons who sold them the Accumulator, and the issue is whether the persons selling it were associated with AXA Distributors. To that scenario, *Wheat First* does not speak. Likewise, Defendants rely upon the somewhat related but factually distinguishable cases, *King*, 386 F.3d 1364 and *Bornstein*, 390 F.3d 1340. (*See* Defs.' Reply 5.) *King* and *Bornstein* are not apropos because in both cases it was undisputed that the registered representative was an associated person of the broker-dealer and the investor was a customer of the associated person. [16]

16 In *King* and *Bornstein*, the issue was whether the broker-dealer would be compelled to arbitrate when its admitted agent or representative (associated person) sold securities not issued, marketed or approved by the broker-dealer to customers of the associated person. The issue in both turned on whether the customer of an associated person is also the

customer of the broker-dealer who supervised the associated person, even if the broker-dealer had no knowledge of the transaction. In both cases, the broker-dealer was compelled to arbitrate because the court ultimately found that the investor was a customer of both the associated person and the broker-dealer.

The essence of the dispute is whether the registered representative is an associated person of, in effect, two broker-dealers, Raymond James and AXA Distributors. The matter can be resolved only by interpretation and application of the FINRA Rules under state-law contract principles. In this exercise, the plain and unambiguous meaning of the Rules applies, unless ambiguities in the Rules are evident, in which case, parole evidence can be considered. [17] Of the Rules, only Rule 12100(r) defines "person associated with a member." [18] The Rule references "a member," which the court takes to mean, without any ambiguity, any member of FINRA, therefore inclusive of AXA Distributors. Direct or indirect control is not defined in the Rules.

17 AXA has submitted the affidavits of John Pinto (Pls.' Reply Mem. Affs.) and William C. Miller (Pls.' Mem. Supp. Mot. for Prelim. Inj. Ex. C) as parole evidence on the *legal* issues.

18 "Person associated with a member" is also defined in the FINRA By-Laws, and it includes a person "directly or indirectly . . . controlled by a member." FINRA, FINRA By-Laws Art. I(gg). Rule 0160 states that "[t]he terms in the Rules, if defined in the FINRA By-Laws, shall have the meaning as defined in the FINRA By-Laws unless the term is defined differently in a Rule, or unless the context of the term is defined differently in a Rule, or unless the context of the term within a Rule requires a different meaning." Thus, cases and FINRA (or formerly NASD) guidance elucidating definitions in the By-Laws that, by this standard, carry the same definition as in the Rules, are applicable and referred to in this analysis. Subsequent discussion of the FINRA Rules incorporates applicable interpretations of the By-Laws.

The definition of an "associated person" is also found in the Securities Exchange Act of 1934 ("Exchange Act") but its definition differs slightly from that in the FINRA Rules. Indeed, at least four circuits have held that the definition of "associated person" in 15 U.S.C. § 78(c)(21) of the Exchange Act does not trump the FINRA's definition of "associated person." "[N]othing in the [Exchange Act] prohibits a self-regulatory organization (such as the NASD) from using a term for its own purposes (in applying its *own* rules and regulations) in a way that is narrower than the way that term is defined in the [Exchange Act]." *Burns v. N.Y. Life Ins. Co.*, 202 F.3d 616, 621 (2d Cir. 2000) (joining the D.C. and 5th Circuits) (pointing out that the SEC must approve of the NASD's rules and that the NASD's definition did not result "in any rule or practice that is inconsistent with the statute or any regulatory command of the SEC" (citing *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 233-34 (1987) [19])); *see also Paul Revere Variable Annuity Ins. Co. v. Kirschhofer*, 226 F.3d 15, 21 (1st Cir. 2000) ("[I]n the absence of any specific reference to touchstones outside the NASD Code, there is not the slightest reason to believe that the drafters of the NASD Manual considered . . . the Exchange Act to be part of the 'context' relevant in deciding whether to adhere to the definition stated in the by-laws."). The First Circuit more explicitly has counseled against relying on the Exchange Act at all to interpret the FINRA Rules: "[I]t is much more plausible that the drafters [of the NASD Manual] intended to direct

interpreters to the text, structure, and purpose of the NASD's various regulations and practices rather than to an endless (and ever-changing) array of outside factors . . . ." *Paul Revere Variable Annuity Ins. Co.,* 226 F.3d at 21. Because the Exchange Act and the then-NASD Rules "serve very different purposes," the First Circuit reasoned, "it is hardly surprising that they employ dissimilar definitions." *Id.* at 22.

> 19 "Since the 1975 amendments [of the Exchange Act] . . . the [SEC] has had expansive power to ensure the adequacy of the arbitration procedures employed by the [self-regulatory organizations ("SRO")]. No proposed rule change may take effect unless the SEC finds that the proposed rule is consistent with the requirements of the Exchange Act; and the [SEC] has the power, on its own initiative to 'abrogate, add to, and delete from' any SRO it if finds such changes necessary or appropriate to further the objectives of the Act. In short, the [SEC] has 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. Express, Inc.,* 482 U.S. at 233-34 (citations omitted).

The way in which the Exchange Act's and FINRA's definitions of "associated person" conflict, however, is not implicated in this case. *Cf. Burns,* 202 F.3d at 620 (highlighting the difference between the provisions with respect to the inclusion or exclusion of "company"). Additionally, the cases interpreting the "directly or indirectly" controlled language in the Exchange Act are not motivated by policy implications that appear to deviate from FINRA's purposes. Furthermore, the Eleventh Circuit has not ruled on the interplay between these provisions in this context. For these reasons, the following "associated person" analysis will draw not only from case law on the FINRA and formerly-NASD language, and from FINRA and NASD decisions, [20] but also on case law interpreting the same language in the Exchange Act. [21]

> 20 AXA Distributors urges the court to afford deference to FINRA's interpretation of its own regulations. (Pls.' Supplemental Reply Mem. 4 (Doc. # 33).) It is not clear, however, that a "controlling weight" deference applies to the review of NASD decisions. Nevertheless, in light of *Paul Revere Variable Annuity Insurance Co.,* the prudence in considering an association's interpretation of its own rules, and the fact that the SEC delegated authority to NASD, the NASD interpretations factor into the analysis. *See, e.g., Nat'l Planning v. Achatz,* No. 02-cv-0196E (SR), 2002 WL 31906336, at *2 (W.D.N.Y. Dec. 17, 2002) (noting in the slightly different context of considering an arbitration rule on composing an NASD panel, that "courts should be wary about disregarding NASD Rules and should accord deference to the NASD's interpretation of its Rules"); *Kashner Davidson Sec. Corp. v. Mscisz,* 531 F.3d 68, 71 n.1 (1st Cir. 2008) (describing the relationship between the SEC and NASD).
>
> 21 It is appropriate to consider terminology as it is used throughout a statutory scheme. *See, e.g., United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.,* 484 U.S. 365, 371 (1988). Though the NASD is not a part of the Exchange Act, the interrelatedness between the SEC and the NASD justifies comparing the language. *See Credit Suisse Sec. (USA) LLC v. Billing,* 127 S. Ct. 2383, 2395 (2007) (describing the interrelatedness).

2. Defining Direct and Indirect Control

The pivotal definition of the FINRA Rules at issue is of "control," and the key distinction is between direct and indirect control. Black's Law Dictionary defines the noun "control" as "[t]he direct or indirect power to direct the management and policies of a person or entity, whether through ownership of voting securities, by contract, or otherwise; the power or authority to manage, direct, or oversee." *Black's Law Dictionary* 253 (8th ed. 1999); *see also id.* (defining the verb "control" as "to exercise power or influence over" or "[t]o regulate or govern"). Webster's defines "direct" as "characterized by . . . a close [especially] logical, causal, or consequential relationship" and "marked by absence of intervening agency, instrumentality, or influence." *Webster's Third International Dictionary (Unabridged)* 640 (1961). Indirect means "not straightforward and open" or "not directly aimed at or achieved." *Webster's, supra.* These definitions alone, however, are too general to resolve the meaning of control, or the distinction between direct and indirect control.

Courts tend to define direct and indirect control, both as used in the FINRA Rules and former NASD Code, and the Exchange Act, not expressly but through the description of factors. In *John Hancock Life Ins. Co. v. Wilson,* 254 F.3d 48 (2d Cir. 2001), the court found an independent insurance agent and investment broker an "associated person" under the NASD Code despite his working from home; the agent was authorized, through a sales representative agreement, to sell life insurance and annuities on behalf of John Hancock, a broker-dealer member. *Id.* at 51. In *First Liberty Inv. Group v. Nicholsberg,* 145 F.3d 647 (3d Cir. 1998), the court reviewed the factual realities of a business relationship and found an "associated person," eschewing labels that the parties chose for that relationship. *Id.* at 652. Even though an agreement between First Liberty and Nicholsberg specifically named him as an "independent contractor," that denomination was "not controlling in the face of the conflicting reality." *Id.* It was the "parties' *total* relationship," including limitations on Nicholsberg and First Liberty in conducting their business, that dictated the result. *Id.*

The total relationship amounted to at least "indirect control." [22] *First Liberty Inv. Group,* 145 F.3d at 642. The court highlighted the following underlying facts and provisions of the agreement: (1) First Liberty's provision of facilities to Nicholsberg for executing transactions; (2) First Liberty's appointing Nicholsberg's office to offer and solicit sales of securities; (3) First Liberty's giving Nicholsberg geographic exclusivity; (4) Nicholsberg's agreeing to comply with First Liberty's manual; (5) Nicholsberg's agreeing to First Liberty's prior approval before he sent correspondence or caused advertising pertaining to securities solicitation; and (6) Nicholsberg's promising not to engage in a security transaction with any other individual or broker-dealer. *Id.* Underlying those factors was also a policy concern. If First Liberty could "escape the NASD arbitration requirements simply by calling someone acting in Nicholsberg's capacity an independent contractor, [it] could easily frustrate NASD's firm policy of submitting industry disputes to binding arbitration." [23] *Id.* [24]

22 The court also found that the relationship "plac[ed] Nicholsberg in much the same practical position that would be occupied by a branch manager." *First Liberty Inv. Group,* 145 F.3d at 652.

23 The NASD acknowledged, albeit by implication, that it construes the definition of "associated person" broadly "as it must in order to take regulatory action in circumstances where a person's connection with a member firm implicates the public interest." *Dist. Bus. Conduct Comm. v. Paramount Invs. Int'l, Inc.*, No. C3A940048, 1995 WL 1093392 (NASDR Oct. 20, 1995) (affirming the District Business Conduct Committee's decision, which the NASD noted, included the observation that it "had always construed [the 'associated person'] definition broadly").

24 The Eleventh Circuit has addressed NASD language only briefly. It found an individual, Riccard, "was a natural person engaged in the securities business who was controlled by member Prudential at the time of the 1995 events giving rise to the dispute," and thus, was an associated person under the NASD By-Laws. *Riccard v. Prudential Ins. Co.*, 307 F.3d 1277, 1287 n.6, 1288 n.7 (11th Cir. 2002). The parties had considered Riccard an employee of Prudential at all relevant times. *Id.* at 1286 n.3.

Though FINRA has not provided clear guidance on what control means, it has provided some signals as to its meaning. FINRA's Uniform Application for Broker-Dealer Registration (Form BD) defines control as "power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise." [25] But that definition begs the question of what directing management or policies entails. Furthermore, the question of whether an individual is controlled *by* a broker-dealer is not presumptively synonymous with the definition of control for purposes of registration.

25 FINRA, Current Uniform Registration Forms for Electronic Filing in Web CRD, Form BD, http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p005260.pdf (last visited Dec. 23, 2008).

An NASD interpretive letter's discussion of "associated persons" under the NASD By-laws, although not binding, targets some relevant indicia of control. In a letter to Pamela M. Krill, the NASD commented on a proposed arrangement not entirely dissimilar to the arrangement here. [26] CAI was an insurance agency that intended to register as a broker-dealer and become a member of the NASD. CAI asked the NASD whether in that event, CAI could pay commissions from sales of variable annuity products and mutual funds shares to its insurance agent employees, who, by agreement, would become registered representatives at the same time of another broker-dealer and NASD member. [27] In determining whether the registered representatives were under the control of CAI and thus, deemed associated persons of CAI as well, the court looked to several indicia of control, some of which pertain specifically to the registered representatives' status as CAI's employees, but others that did not. The NASD noted how CAI would maintain control over the employee-registered representatives' commission payments, would issue paychecks to them, determine their benefits levels, help determine which securities products they would offer, and provide office space for securities-related activities. These factors for the most part relate to control CAI would have as an employer over the agent-representatives. The interpretive guidance continued, however, by noting other factors of control: (1) that CAI would retain a portion of the securities commission revenues; (2) that the other broker-dealer would receive only a flat fee for supervising, training, and providing administrative services to the

agents-representatives; (3) that CAI "potentially could have a greater financial interest in the securities-related activities of the registered representatives" than the other broker-dealer; and (4) that the registered representatives appeared to be selling the products on behalf of CAI.

26 NASD, Interpretive Ltr. (Feb. 3, 2003), http://www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/P002661 (last visited Dec. 23, 2008).

27 In our case, certain facts are distinguishable -- AXA Distributors had already registered as an NASD Member prior to the agreement with the broker-dealer of the registered representatives and the registered representatives were not *employees* of AXA Distributors but insurance agents of AXA Equitable. The discussion of control, however, is still applicable.

In a separate interpretive letter, in a factual situation less on point but still relevant, the NASD declined to find that one member broker-dealer (Firm A) controlled the representatives of another (Firm B) based on these factors: (1) Firm B's representatives "perform[ed] their functions solely as salaried employees" of Firm B; (2) Firm B's representatives did not "solicit securities transactions or make other recommendations"; and (3) Firm B's representatives did not "retain ownership or control of accounts opened and forwarded" to Firm A. [28] Importantly, the NASD also stated: "Since the activities of [Firm B's] registered representatives on behalf of [Firm A] occur pursuant to a contract between the two members, [Firm B's] registered representatives are not employed, directly or indirectly, outside the scope of their relationship with their employing member [Firm B]" and do not receive compensation outside that scope. *Id.* The contract between the outside firm and employing firm helped to buffer the employing firm's employees from being deemed "controlled" by the outside firm. [29]

28 NASD, Interpretive Ltr., Apr. 22, 1998, http://www.finra.org/Industry/RegulationGuidance/InterpretiveLetters/P005274 (last visited Dec. 23, 2008).

29 The National Adjudicatory Council's decision in *Department of Enforcement v. Respondent 1*, No. CAF000029, 2002 WL 970381 (NASDR Mar. 21, 2002) also addressed the meaning of "associated person." The facts in that case, however, are so distinguishable that extrapolating from its findings does not aid the analysis.

The word "control" comes up in analogous contexts under the Exchange Act. The Exchange Act defines "associated persons," in relevant part as "any person directly or indirectly controlling, controlled by . . . such broker or dealer." 15 U.S.C. § 78c(a)(18) (omitting distinguishable language). In a case applying this definition to the relationship between a securities broker barred from the U.S. market and a U.S. securities broker, *Sec. Exch. Comm'n v. Zahareas*, 272 F.3d 1102, 1004 (8th Cir. 2002), the Eighth Circuit chided the district court for "judicially grafting onto the statute . . . an expansive clause." *Id.* at 1106. Specifically, the circuit court declined to include in the definition of "associated person," "registered representative." *Id.* at 1107. The court also noted there was no precedent that "providing and verifying paperwork" amounted to control. *Id.* at 1106. Instead, the court focused on the lack of evidence that the broker-dealer controlled Zahareas's means and manner of performance. *Id.* The broker-dealer

"knew little about how [he] conducted his business . . . [,] provided none of the workplace instruments such as telephones or computers" and did not hire or monitor his employees. *Id.* Judge Bright, in dissent, listed other factual circumstances that persuaded him of the opposite conclusion -- that under Black's Law Dictionary's definition of control, the broker-dealer exercised control. *Id.* at 1108 (Bright, J., dissenting). Zahareas steered Greek investors to the broker-dealer, those customers received account numbers and materials from the broker-dealer, it provided Zahareas with its account opening materials, applications, tax forms, and margin agreements, and it reviewed and approved new account information from him on the new customers. *Id.* All of those factors, however, were not enough to convince the majority that the broker-dealer controlled an individual. [30] *Id.* at 1106.

30 Admittedly, the opinion was tied to the statute's express purpose, as well as the statute's plain language. *Zahareas,* 272 F.3d at 1106.

In a federal district court case from the Southern District of New York, the court listed various facts in support of its finding that the defendant violated an SEC order by willfully associating with various broker-dealer firms. *Sec. Exch. Comm'n v. Telsey,* Fed. Sec. L. Rep. (CCH) P 95,871 (Mar. 13, 1991). With one broker-dealer, Tesley had his own telephone and desk, solicited accounts for the broker-dealer, prepared order tickets, filled out account forms, used the broker-dealer's NASDAQ machine to trade on behalf of the broker-dealer's proprietary account, quoted bids and offers when asked, traded in stocks for the broker-dealer, went into its offices almost daily during business hours, had a registered representative number for identifying his customer's order tickets so that he could receive commissions, and was compensated for his association with the broker-dealer. *Id.* He was also associated with other broker-dealers based on those and additional facts including describing himself as a "principal" of the broker-dealer and bringing in new customers. *Id.*

The Exchange Act also uses "control" in defining control liability. The Exchange Act imposes liability on "[e]very person who, directly or indirectly controls any person liable under any provision" of the pertinent chapter, rule, or regulation unless the controlling person acted in good faith. 15 U.S.C. § 78t(a). The Eleventh Circuit recently has expounded on this language. *See Laperriere v. Vesta Ins. Group Inc.,* 526 F.3d 715 (11th Cir. 2008) (per curiam). In discussing the definition of controlling person, the court explained that "Congress recognized that it would be difficult, if not impossible, to enumerate or anticipate the many ways in which actual control may be exercised and expressly declined to define the term 'control,' leaving courts free to decide issues of control on a case by case basis." [31] *Id.* at 722-23. As the Ninth Circuit announced, control for purposes of control liability, like control under the Rules and the then-NASD By-Laws, is not limited to the relationship of employees or agents, and employers, but includes independent contractors. *Hollinger v. Titan Capital Corp.,* 914 F.2d 1564, 1574 (9th Cir. 1990) (en banc). To limit control by excluding independent contractors would "frustrate Congress's goal of protecting investors." *Id.* The court made a point of tying control to supervision. [32] *Id.* (In describing the outcome had it not found that independent contractors could be associated persons, the court noted the broker-dealer could have thereby "avoid[ed] *a duty to supervise* simply by entering into a contract that purports to make the representative . . . an 'independent contractor.'" (emphasis added)).

31 The court also noted that the SEC's more specific definition of control, promulgated as a regulation, "like the statute, does not attempt to formulate a precise definition of 'control' applicable to all cases, but is intended only to provide some guidance, leaving a determination of whether control exists dependent on the particular factual circumstances of each case." *Laperriere*, 526 F.3d at 723. The regulation defines control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through ownership of voting securities, by contract, or otherwise." 17 C.F.R. § 230.405 (West 2008).

32 The company tried to contract away supervision by stating it had "no right to control or direct" the sales contractor, "'not only as to the result to be accomplished by the work but also as to the details and means by which the result is accomplished,'" except for oversight and instructions required for legal compliance, and left the contractor "'completely free'" to control the results and means. *Hollinger*, 914 F.2d at 1574 n.7 (quoting the contract).

Control that triggers liability can be indirect as well, though the difference between direct and indirect control remains largely unexplained. [33] The Eighth Circuit approached a definition of "indirect control" in *Martin v. Shearson Lehman Hutton, Inc.*, 986 F.2d 242 (8th Cir. 1993). There, it held that control liability "reaches persons who have only 'some indirect means of discipline or influence' less than actual direction." *Id.* at 244 (quoting *Myzel v. Fields*, 386 F.2d 718, 738 (8th Cir. 1967)); *accord Harrison v. Dean Witter Reynolds, Inc.*, 974 F.2d 873, 880-81 (7th Cir. 1992) (quoting the Eighth Circuit). The Seventh Circuit describes control that is indirect as the *potential* to control. The culpable party must have "possessed the power or ability to control the specific transaction or activity upon which the primary violation was predicated, whether or not that power was exercised." *Id.* at 882; *see also Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, 890-91 (3d Cir. 1975). The distinction between direct and indirect control otherwise must be gleaned by deciphering a distinction between the two from the facts of cases that interpret control.

33 For instances in which control is defined, in the SEC regulation for example, the definition of control includes a reference to both "direct" and "indirect" *embedded* in the definition of control. It is unclear, in those instances, whether "direct" or "indirect" within the definition of "control" sufficiently address what direct and indirect control mean.

3. Application: AXA Distributors Did Not Directly or Indirectly Control the Raymond James Representatives

AXA Distributors did not control the Raymond James representatives by any of the foregoing definitions of control. [34] Two features of this relationship account predominantly for why AXA Distributors did not control the Raymond James representatives: (1) the contractual relationship, which was between AXA Distributors and *Raymond James*, not its registered representatives; and (2) the separation of AXA Equitable from AXA Distributors. It is significant that it was Raymond James, and not its registered representatives, that entered into a contract with AXA Distributors, and that Raymond James retained control over its registered

representatives. It is also significant that any control the AXA entities retained over the Raymond James representatives was lodged in AXA Equitable.

> 34 The contract between AXA Distributors and Raymond James states that "[n]othing [therein] shall constitute [Raymond James] or any agents or representatives of [Raymond James] as employees of [AXA Equitable] or [AXA Distributors]" (Distribution Agreement § 2.7), and Raymond James is an independent contractor and not employee under the contract (Distribution Agreement § 2.7). Contractual language, however, is not dispositive of whether AXA Distributors controlled the Raymond James representatives. Determining control depends the factual details of the relationship, as well as the agreement.

AXA Distributors' sales agreement was with Raymond James, not its registered representatives. (Distribution Agreement 1.) Raymond James sold products of other companies. (Distribution Agreement § 2.7.) The registered representatives did not use AXA Distributors' facilities for their sales. [35] (*See* Holman Aff. P 4; Chappell Aff. P 3.) Raymond James retained the duties to train and supervise the registered employees more generally, and to be fully responsible for their solicitation activities. (Distribution Agreement § 4.1.) Raymond James provided the seminar where Ms. Holman and Ms. Chappell were trained by AXA Distributors on the Accumulator (Chappell Aff. P 4); they otherwise were not trained at AXA Distributor's facilities. *Raymond James* agreed that its representatives who were appointed AXA Equitable's agents would not solicit applications for contracts without certain materials and would only make statements with that information, and that AXA Distributors would be responsible for supplying the relevant materials. (Distribution Agreement, §§ 5.1(b), 6.1, 6.2.) Even if AXA Distributors conducted the actual training for Ms. Holman and Ms. Chappell, that factor alone is not enough to determine that AXA Distributors controlled them, especially in light the intermediary contractual party Raymond James.

> 35 Although Ms. Holman and Ms. Chappell stated that AXA Distributors provided the training for the Accumulator, that training was not at AXA Distributors' facilities, nor was any of the business solicitation. (*See* Holman Aff. & Chappell Aff.)

Additionally, though both AXA entities stood to gain by the arrangement, Raymond James directly received payment to distribute to its brokers and retained a portion for itself. To the extent that the agreement between AXA Distributors and Raymond James dictated the representatives' actions, that was an agreement that the supervising broker-dealer entered into and the supervisory broker-dealer retained responsibility over the representatives' actions, not to mention, the power and responsibility to discipline the representatives. (Distribution Agreement §§ 4.1, 4.9.) The factual circumstances of the arrangement do not undermine these roles. Ms. Holman and Ms. Chappell have attested only to constant communication with and assistance from AXA Distributors. (*See* Holman Aff. & Chappell Aff.) But AXA Distributors' control of the *information* for selling the products is not the same as control of Ms. Holman and Ms. Chappell in the brokering activities.

Also important to finding that AXA Distributors did not control the Raymond James registered representatives is the fact that AXA Equitable, and not AXA Distributors, retained control over the sales arrangement. AXA Equitable had discretion to refuse to appoint a

proposed agent or to terminate her with or without cause, and to reject applications or premiums. (Distribution Agreement §§ 2.3, 2.5.) AXA Distributors did not retain any commissions on the sales. (Miller Supplemental Aff. P 10.) Instead, it received an annual allowance from AXA Equitable "for its distribution activity," based in part on volume, and that allowance was a "pass-through for compensation" to brokers like Raymond James. (Miller Supplemental Aff. P 10.) *Raymond James* paid out the commissions due to *its* brokers, retaining the portion to which it was entitled. (Miller Supplemental Aff. P 10; *see also* Distribution Agreement, §§ 7.1, 7.5; Defs.' Reply Ex. A at 15 of original.) Registered representatives forwarded premiums and loan repayments to AXA Equitable, not to AXA Distributors. (Distribution Agreement § 4.5.)

AXA Distributors' business was to distribute securities on a wholesale basis to other broker-dealers, not to enter into relationships directly with registered representatives of other broker-dealers. (NASD Agreement.) The circumstances of the relationship bear this out, and the relationship does not amount to control. To the extent that the Raymond James representatives steered customers to AXA Equitable, to the extent that AXA Distributors provided the materials and applications for that business, and to the extent that those entities were involved in reviewing and approving that business, at least one circuit has found that those factors alone do not amount to "control," at least with respect to control liability. Furthermore, AXA Distributors only provided the materials and applications. It was, in effect, a marketing entity segmented off from AXA Equitable.

This arrangement may permit an entity like AXA Distributors, or AXA Equitable for that matter, to avoid responsibilities under the FINRA Rules, but that is a policy matter for other institutions to address. Based on the facts submitted by the parties, along with their briefs, and on an institutional reticence to transform a complicated business arrangement into a nefarious web of evasion, this court finds AXA Distributors did not control the registered representatives of Raymond James. Because Ms. Holman and Ms. Chappell were not "associated persons" of AXA Distributors, Defendants were not customers of AXA Distributors, and therefore, the FINRA Rules do not govern. Defendants have no agreement with Plaintiffs to arbitrate. Thus, the Motion to Dismiss or in the Alternative, Motion to Compel Arbitration (Doc. # 9) is due to be denied.

4. Preliminary Injunctive Relief

AXA Distributors also requests preliminary and permanent injunctive relief to restrain Defendants from proceeding with their claims against AXA Distributors, which are currently in FINRA arbitration. [36] (Verified Compl. PP 27-30.) A federal court may issue three types of injunctions: (1) "a 'traditional' injunction, which may be issued as either an interim or permanent remedy for certain breaches of common law, statutory, or constitutional rights"; (2) a statutory injunction; or (3) an injunction under the All Writs Act. *Klay v. United Healthgroup, Inc.,* 376 F.3d 1092, 1097, 1098 & 1099 (11th Cir. 2004) (footnote omitted). AXA Distributors requests a "traditional" injunction. (*See* Pls.' Mot. for Prelim. Inj. P 1.)

> 36 AXA Advisors is not entitled to preliminary injunctive relief for the reasons discussed in this analysis.

The type of injunction at issue in this case, however, is *not* a traditional injunction. *Klay,* 376 F.3d at 1098. A party requesting injunctive relief against defendants who have initiated (or

presumably continued in) arbitration even though a federal court denied their motion to compel arbitration on those claims, "[has] no cause of action against the defendants upon which the injunction [would be] based." *Id.* "'Wrongful arbitration' . . . is not a cause of action for which a party may sue." *Id.* Thus, a plaintiff seeking this relief must proceed under a different type of injunction. *Id.*

The parties in this case have not argued that relief is appropriate as a matter of statutory law, and as the Eleventh Circuit has not resolved the availability of statutory injunctive relief for enjoining arbitration, *Klay,* 376 F.3d at 1099, injunctive relief on this basis will not be awarded. Injunctive relief is also unavailable under the All Writs Act, 28 U.S.C. § 1651(a). *Klay,* 376 F.3d at 1099, 1113. The All Writs Act codifies the "traditional, inherent power" of courts to protect their jurisdiction derived from another source, and allows courts to "safeguard not only ongoing proceedings, but potential future proceedings, as well as already-issued orders and judgments." *Id.* at 1099 (footnotes omitted). Arbitrating nonarbitrable claims, however, is "a pointless endeavor" and for that reason, "does not threaten or undermine" a district court's order that denies a motion to compel or that court's jurisdiction over pending cases. *Id.* at 1113. The arbitrators lack jurisdiction over nonarbitrable issues, so a ruling would have no impact on a federal action, and parties would be unable to enforce any ruling in their favor. *Id.* Thus, preliminary injunctive relief is not appropriate. *Id.* "The defendants remain free to arbitrate the nonarbitrable claims in what will be nothing more than a moot court session." *Id.*

V. CONCLUSION

For the foregoing reasons, it is ORDERED that:

(1) Defendants' Motion to Dismiss or in the Alternative, Motion to Compel Arbitration (Doc. # 9) is DENIED;

(2) Plaintiffs' Motion for Preliminary Injunction (Doc. # 12) is DENIED; and

(3) Defendants' Motion to Strike Affidavit of John E. Pinto (Doc. # 29) is DENIED as moot.

Done this 24th day of December, 2008.

/s/ W. Keith Watkins

UNITED STATES DISTRICT JUDGE

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