IN THE SUPREME COURT OF ALABAMA

APPELLATE No. 1190381

Kathryn L. Honea,

Plaintiff/Appellee,

v.

Raymond James Financial Services, Inc., et al.,

Defendants/Appellants.

Motion for Leave to File Brief Amicus Curiae

ON APPEAL FROM THE CURCUIT COURT OF JEFFERSON COUNTY, ALABAMA

Case No.: CV-2006-1896

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

Pursuant to Alabama Rule of Appellate Procedure 29, the Securities Industry and Financial Markets Association ("SIFMA") respectfully moves for leave to file a brief as *amicus curiae* in support of Defendants/Appellants Raymond James Financial Services, Inc.'s and Bernard Michaud's (collectively "RJFS") appeal of the Circuit Court's Final Judgment, granting Plaintiff/Appellee's ("Honea") motion to vacate the 2008 Arbitration Award that had been unanimous in RJFS's favor. SIFMA's proposed brief accompanies this motion.

SIFMA is a trade association representing the shared interests of hundreds of securities firms, banks, and asset managers. SIFMA's members operate and have offices in all fifty states. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation, and economic growth, while building trust and confidence in the financial markets. SIFMA has offices in New York and Washington, D.C., and is

the U.S. regional member of the Global Financial Markets Association.[1]

SIFMA has particular interest in this litigation and this brief is desirable because the outcome on appeal has potentially far-reaching implications. SIFMA's members are parties to thousands of disputes each year, including both judicial proceedings and arbitrations, in which claims similar to those brought by the Honea are made. The Circuit Court's decision, interpreting language commonly found in SIFMA's members' client agreements referring to the laws, rules, and regulations applicable to securities transactions as constituting an *express* contractual undertaking by RJFS and allowing Honea to assert a breach of contract claim based on alleged violations of the Financial Industry Regulatory Authority ("FINRA") Rules, is contrary to established national and Alabama law. An affirmance on appeal could, thus, have potentially far-reaching, national implications for the financial services industry, the investing public, and the timely, orderly, and consistent adjudication of securities-related disputes.

[1] For more information about SIFMA, *see* SIFMA's website, https://www.sifma.org/ (last visited August 4, 2020).

WHEREFORE, SIFMA respectfully requests the Court grant this motion and permit the filing of the accompanying brief amicus curiae in support of RJFS.

Dated: August 10, 2020

Respectfully submitted,

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Brief of Amicus Curiae
The Securities Industry And Financial Markets Association

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STATEMENT REGARDING ORAL ARGUMENT

The Securities Industry and Financial Markets Association ("SIFMA") does not believe oral argument is necessary on the limited issues addressed in this Amicus Curiae brief.

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SUMMARY OF THE ARGUMENT

While the parties have presented and briefed multiple issues on appeal, SIFMA wishes to address the following narrow questions about which it has vast experience and interest and which directly affect the financial services industry and the investing public:

1. Whether a private right of action exists for alleged violations of FINRA Rules.

2. Whether a breach of contract claim based on alleged violations of FINRA Rules exists in this case.

Established authority from across the country holds that no private right of action exists for alleged violations of FINRA Rules. Nationally, courts also reject efforts to recover for alleged FINRA Rule violations indirectly through a breach of contract action, even where such rules are mentioned in the contract.

Here, however, the Circuit Court allowed Plaintiff/Appellee ("Honea") to proceed (and ultimately prevail) on a breach of contract claim when the Circuit Court found "the standards established by FINRA's Rules of Conduct formed part of the contract" between Honea and Defendants/Appellants (collectively "RJFS"). C. 11658. The

RJFS Client Agreement (the "Agreement") included a standard notice provision where the client (referred to as "I" in the Agreement) acknowledged that her transactions would be subject to applicable laws, rules, regulations, and customs prevalent in the industry:

> Applicable Regulations: (a) I understand and agree that every transaction in my account is subject to the rules or customs in effect at the time of the transaction which, by the terms of the rule or custom, applies to the transaction. These rules or customs include state and federal laws, rules and regulations established by state or federal agencies, the Constitution, rules, customs and usages of the applicable exchange, association, market or clearinghouse or customs and usages of individuals transacting business on the applicable exchange, market or clearinghouse.
> (b) If this agreement is incompatible with any rule or custom, or if a rule or custom is changed, this agreement will automatically modify to conform to the rule or custom. The modification of this agreement shall not affect any of its other provision.

The Circuit Court's finding that this notice provision created an enforceable contractual obligation against RJFS is inconsistent with well-settled Alabama precedent requiring the existence and breach of an explicit contractual promise before a breach of contract action will lie. The notice provision in the RJFS Agreement contains no explicit promise requiring RJFS to abide by FINRA Rules, and, under Alabama law, does not form a basis for a viable

breach of contract claim. The Court's decision is also inconsistent with those of numerous other courts interpreting similar contractual language – **language that is almost universally found in broker-dealer client agreements** – all of which have held no breach of contract claim exists.

That no private right of action or contractual claims exist for a violation of the FINRA Rules does not leave aggrieved investors without remedies. Where factually warranted and timely filed, aggrieved investors may assert certain federal and state statutory claims and common law claims for relief against broker-dealers and their agents. Honea asserted one or more of such claims below, and they were deemed time-barred.

If this Court affirms the Circuit Court's re-writing of the parties' contract, which necessarily added language to create a cause of action where none existed, in place of the actual agreement of the parties, the Court will effectively upend thousands of customer agreements in Alabama and decades of established jurisprudence in this state and across numerous jurisdictions.

ARGUMENT

I. THE CIRCUIT COURT'S APPROACH IS INCONSISTENT WITH THE WEIGHT OF AUTHORITY CONCERNING ALLEGED VIOLATIONS OF FINRA RULES

A. No private right of action exists for alleged violations of FINRA Rules[1]

The weight of authority across the United States holds – and has long held – that no private right of action exists for alleged violations of FINRA Rules or other self-regulatory organization rules, including those of the NYSE and NASD. *See, e.g., Thompson v. Smith Barney, Harris Upham & Co., Inc.*, 709 F.2d 1413, 1419 (11th Cir. 1983) ("We have considered all of the appellant's contentions . . . that there is a private cause of action under the federal securities laws for violation of both the New York Stock Exchange 'know your customer rule' and the National

[1] The Financial Industry Regulatory Authority ('FINRA") is a self-regulatory organization approved by the Securities and Exchange Commission ("SEC"). FINRA was created in July 2007, through the consolidation of the National Association of Securities Dealers ("NASD") and the member regulation, enforcement and arbitration operations of the New York Stock Exchange ("NYSE"). Working under the supervision of the SEC, FINRA adopts and enforces Rules governing its member firms and their associated persons and operates the largest securities dispute resolution forum in the United States. For more information about FINRA, see FINRA's website, https://www.finra.org/#/ (last visited August 8, 2020).

Association of Securities Dealers' 'suitability' rule, and find them to be without merit."); *In re VeriFone Securities Litigation*, 11 F.3d 865, 870 (9th Cir. 1993) ("It is well established that violation of an exchange rule will not support a private claim"); *Carrott v. Shearson Hayden Stone, Inc.*, 724 F.2d 821, 823 (9th Cir. 1984) (granting summary judgment because there is no private right of action under NYSE rules); *Jablon v. Dean Witter & Co.*, 614 F.2d 677, 680-81 (the Securities Exchange Act does not provide a private right of action for alleged violations of NASD or stock exchange rules); *Hayden v. Walston & Co.*, 528 F.2d 901 (9th Cir. 1975) (same); *Craighead v. E.F. Hutton & Co.*, 899 F.2d 485, 493 (6th Cir. 1990) (no private right of action exists for violation of NASD or NYSE rules); *Hoxworth v. Blinder, Robinson & Co.*, 903 F. 2d 186, 200 (3d Cir. 1990) (no private right of action exists for violation of NASD rules); *Colonial Realty Corporation v. Bache & Co.*, 358 F.2d 178 (2d Cir.) (same), *cert. denied*, 385 U.S. 817 (1966); *Interactive Brokers LLC v. Saroop*, Civil Action No. 3:17-cv-127, 2018 WL 6683047 (E.D. Va. Dec. 19, 2018) ("The clear weight of authority holds that a violation of the rules of a financial self-regulatory entity like FINRA (or

its predecessor, NASD) does not give rise to a private right of action."); *see also Brady v. Calyon Sec. (USA) Inc.*, 406 F.Supp. 2d 307, 312 (S.D.N.Y. 2005); *SSH Co. v. Shearson Lehman Bros.*, 678 F. Supp. 105, 1058 (S.D.N.Y. 1987); *Lantz v. Private Satellite Television, Inc.*, 813 F. Supp. 554 (E.D. Mich. 1993); *Charter House, Inc. v. First Tenn. Bank*, 693 F. Supp. 593, 597 (M.D. Tenn. 1988); *Carroll v. Bear, Stearns & Co.*, 416 F. Supp. 998 (S.D.N.Y. 1976); *Architectural League v. Bartos*, 404 F. Supp. 304 (S.D.N.Y. 1975); C*oronado Credit Union, Inc. v. Bevill, Bresler & Schulman, Inc.*, No. CIV-80-216 C, 1983 WL 1420 (D.N.M. Dec. 23, 1983); *Thompson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 401 F. Supp. 111 (W.D. Okla. 1975); *Piper, Jaffray & Hopwood, Inc. v. Ladin*, 399 F. Supp. 292 (S.D. Iowa 1975); *Jenny v. Shearson, Hammill & Co., Inc.*, CCH FED. SEC. L. REP. P 95,021 (S.D.N.Y. 1975); *Utah v. Dupont Walston, Inc.*, CCH FED. SEC. L. REP. P 94,812 (D. Utah 1974); *Wells v. Blythe & Co., Inc.*, 351 F. Supp. 999 (N.D. Cal. 1972); *Mercury Investment Co. v. A. G. Edwards & Sons*, 295 F. Supp. 1160 (S.D. Texas 1969); *Wheeler v. Boettcher & Co.*, 539 P. 2d 1322 (Colo. Ct. App. 1975); *Stevenson v. Rochdale Inv. Mgmt., Inc.*, No. CIV. A. 3:97CV1544L, 2000 WL

1278479, at *9 (N.D. Tex. Sept. 7, 2000); *Owens v. Stifel, Nicolaus & Co.*, No. 7:12-CV-144 (HL), 2014 WL 2769044, at *6 (M.D. Ga. Jun. 18, 2014), *rev'd in part on other grounds*, 650 F. App'x 764 (11th Cir.2016); *Knight v. E.F. Hutton & Co.*, 750 F. Supp. 1109, 1113-14 (M.D. Fla. 1990); *Greene v. Loeb Partners*, 532 F. Supp. 747, 748 (S.D. Fla. 1982); *Gallier v. Woodbury Fin. Servs., Inc.*, No. H-14-888, 2015 WL 1296351, at *6 (S.D. Tex. Mar. 23, 2015); *Appert v. Morgan Stanley Dean Witter, Inc.*, No. 08-CV-7130, 2009 WL 3764120, at *4 (N.D. Ill. Nov. 6, 2009).

B. Courts reject efforts to seek recovery for alleged violations of FINRA Rules under the guise of a breach of contract claim

Similarly, courts in other jurisdictions have consistently rejected aggrieved investors' efforts to recast alleged violations of FINRA Rules as breach of contract claims. *See, e.g., Davantzis v. PaineWebber Inc.*, No. 20032/2000, 2001 WL 1423519, at *3 (N.Y. Sup. Ct. Jul. 23, 2001) (rejecting breach of contract claim based on alleged violation of NASD rule as a "mere attempt[] to circumvent the decisions that hold that plaintiffs do not have a private right of action under [self-regulatory organization] rules" (brackets in original)(citation and

internal quotation marks omitted); *Columbus Council v. KFS BD, Inc.*, 791 N.W.2d 317, 324-26 (Neb. 2010) (affirming dismissal of breach of contract claim that had been based on NASD rules violations and a similar contractual notice provision); *Mercury Inv. Co.*, 295 F. Supp. at 1163 (rejecting plaintiff's argument that the court should incorporate the NASD rules into the contract between the broker-dealer and customer and stating "[o]nly the most convincing policy arguments should persuade a court to indulge in the legal fiction of implying such contractual terms"); *Gallier*, 2015 WL 1296351, at *7 ("Courts have rejected attempts to recharacterize FINRA claims as breach-of-contract claims to circumvent the absence of a private right of action for violations of FINRA rules.").[2]

This well-established body of case law, rejecting efforts to hold brokerage firms liable in tort or contract for alleged violations of FINRA Rules, recognizes that enforcing compliance with FINRA's Rules is vested in the SEC and FINRA, both of which vigorously enforce the Rules.

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[2] Additional cases rejecting breach of contract claims premised on language in client agreements similar to the notice provision in the RJFS Agreement are discussed below, *infra* pp. 14-17.

This is entirely consistent with the concept across numerous other industries that regulators (not private litigants) enforce many laws.

II. THE CIRCUIT COURT'S FINDING THAT HONEA COULD PROCEED ON HER BREACH OF CONTRACT CLAIM IS INCONSISTENT WITH ESTABLISHED AUTHORITY AND ALABAMA LAW

Against this foundational backdrop, the Circuit Court erroneously created a cause of action for alleged violations of FINRA Rules when it allowed Honea to proceed on a breach of contract action premised on the fact that unspecified "rules" were referenced in the Agreement. The RJFS Agreement included a standard notice provision where the client (referred to as "I" in the Agreement) acknowledged that her transactions would be subject to applicable laws, rules, regulations, and customs prevalent in the industry:

> Applicable Regulations: (a) I understand and agree that every transaction in my account is subject to the rules or customs in effect at the time of the transaction which, by the terms of the rule or custom, applies to the transaction. These rules or customs include state and federal laws, rules and regulations established by state or federal agencies, the Constitution, rules, customs and usages of the applicable exchange, association, market or clearinghouse or customs and usages of individuals transacting business on the applicable exchange, market or clearinghouse.
> (b) If this agreement is incompatible with any rule or custom, or if a rule or custom is changed, this

> agreement will automatically modify to conform to the rule or custom. The modification of this agreement shall not affect any of its other provision.

(C. 42).

The Circuit Court's ruling is inconsistent with Alabama law which requires an *explicit* promise in a contract be broken before a breach of contract action will lie. The ruling is also inconsistent with numerous decisions from other jurisdictions examining essentially the same notice provision as that found in the RJFS Agreement and finding no breach of contract claim existed.

A. The Circuit Court misapplied Alabama law, which requires the breach of an explicit promise before a breach of contract action will lie

The purpose of contract interpretation is to enforce the plain agreement of the parties, giving certainty to commercial interactions. *See Ex parte Dan Tucker Auto Sales, Inc.*, 718 So.2d 33, 36 (Ala. 1998) ("When interpreting a contract, a court should give the terms of the agreement their clear and plain meaning and should presume that the parties intended what the terms of the agreement clearly state."). The Circuit Court deviated from this concept, however, essentially re-writing the Agreement to create a duty that was not contemplated by the

parties, an action which, if affirmed, impacts thousands of Alabamians and the securities firms with which they do business. In doing so, the Circuit Court misapplied *Blumberg v. Touche Ross & Co.*, 514 So. 2d. 922 (Ala. 1987) in rendering its decision.

Touche stands for the proposition that "when one contracts with another and **expressly promises** to use due care or to do an act, he is liable in both tort and contract when his negligence injures the other party." *First Ala. Bank of Montgomery, N.A. v. First State Ins. Co.*, 899 F.2d 1045, 1068 (11th Cir. 1990) (emphasis added). As explained by *Touche's* author (Houston, J.) in a separate case: "In *Blumberg*, this Court held that an accountant is liable in contract for breaching an express (*but probably not an implied*) promise to use due care." *Jamison, Money, Famer & Co., P.C. v. Standeffer*, 678 So.2d 1061, 1068 (Ala. 1996) (Houston, J., concurring in the result) (emphasis added).

Since *Touche* and *Standeffer*, other courts applying Alabama law have held that a breach of contract action may not arise out of professional negligence absent an express provision in the contract. For example, in *Goostree v.*

Liberty Nat'l Life Ins. Co., 421 F. Supp. 3d 1268, 1275-76 (N.D. Ala. 2019), the Northern District of Alabama held that a group of 15 individual life insurance contracts and a lengthy business relationship did not create an implied "'agreement to utilize knowledge, skill and expertise to properly assess and recommend insurance products.'" The court noted that, in cases where a contractual duty of care was found to create a cause of action in contract, the subject contracts contained an "actual contractual agreement" rather than an implied duty. *Id.* at 1276.

Here, the Agreement is not aligned with *Touche* as it contains no "actual contractual agreement." Although securities laws, rules, regulations, and customs are mentioned, nowhere in the provision (or elsewhere in the Agreement) does RJFS *expressly promise* that it would follow them. Rather, it is Honea who "understand[s] and agree[s]" that RJFS would do so. The Circuit Court's reasoning in allowing the breach of contract claim to stand in the absence of an express promise thus deviates from established Alabama law interpreting *Touche* and contracts generally.

B. The Circuit Court interpreted the Agreement's notice provision in a manner rejected by other jurisdictions considering the same or similar language

The notice provision in the Agreement, and provisions very similar to it, are prevalent in broker-dealer customer agreements throughout the industry. In contrast to the Circuit Court's decision to allow Honea to proceed with a breach of contract claim premised on alleged FINRA Rule violations, other courts considering such notice provisions have consistently held that no breach of contract action exists when a referenced law, rule, or regulation is violated. *See Gurfein v. Ameritrade, Inc.*, 312 F. App'x 410, 413-14 (2d Cir. 2009) (holding that provision in contract stating "I am aware of and agree . . . [a]ll my option transactions are subject to applicable rules and regulations, and thus did not provide a breach of contract claim for NASD violations based on a similar provision in her brokerage contract); Interactive Brokers, 2018 WL 6683047, at *12 ("[Like *Gurfein*, this provision puts the customer on notice about how her trades will be governed. But, as the Second Circuit has made clear, it does not create a private cause of action for violation of financial regulatory rules and regulations under a breach of contract

theory."); *Luis v. RBC Capital Markets, LLC*, 401 F. Supp.3d 817, 830 (D. Minn. 2019) (holding that plaintiff had no breach of contract claim based on defendant's alleged breach of a similar brokerage contract provision, as it was simply an "'acknowledgement' by the client" that transactions would be subject to such rules, and was not a contractual promise by the broker to abide by such rules); *Hauptman v. Interactive Brokers, LLC*, No. 17 Civ. 9382, 2018 WL 4278345, at *7 (S.D.N.Y. June 12, 2018) (granting motion to dismiss breach of contract claim for same reasons, and adding that no private cause of action exists for FINRA Rule violations).

Similarly, the New York Appellate Division — the state upon whose law *Touche* relied heavily in its holding, *see Touche*, 514 So.2d at 925-26 (applying the reasoning of New York cases and stating that "[w]e find precedent from New York persuasive in a case of this nature") — has held that "underlying account agreements between [the parties, which] incorporate[d] FINRA rules by reference" did not "form a basis for a viable breach of contract claim." *Grace Fin. Grp., LLC v. Dino*, 31 N.Y.S.3d 472, 473 (N.Y. App. Div. 2016); *see also DeBlasio v. Merrill Lynch & Co., Inc.*, No.

07 Civ 318(RJS), 2009 WL 2242605, at *38 n.17 (S.D.N.Y. July 27, 2009) ("Contrary to Plaintiffs' assertion, the Rules and Regulations promulgated by the NYSE and the NASD do not broaden the scope of the Brokerage Defendants' contractual duties, implied or otherwise. First, as Plaintiffs acknowledge, SROs' rules cannot serve as the basis for a private cause of action. Second, even 'when those regulatory rules are incorporated into a customer agreement, they do not bring with them a right to sue for an infraction.' Therefore the SRO pronouncements cited by Plaintiffs do not bolster their breach of contract claim."). In *Lanier v. BATS Exchange, Inc.*, 105 F. Supp. 3d 353, (S.D.N.Y. 2015), the plaintiffs asserted that an agreement that stated it was "subject to the Securities and Exchange Act of 1934, the rules under that act" and certain agreements with other third parties allowed the plaintiff to sue the defendant for breach of contract when defendant failed to follow the procedures set forth in those rules and agreements. 105 F. Supp. 3d at 360, 367. The court rejected this argument: "The fact that an agreement states that it is 'subject to' particular rules and regulations does not necessarily incorporate all of those rules and

regulations into the contract, such that it would 'contractually obligate [the defendant] to its customers to follow these rules and regulations so as to create a separate cause of action for any alleged violation of them.'" *Id.* at 367 n.6 (quoting *Gurfein*, 312 Fed.Appx. at 413).

Here, the Agreement does not go so far as to "incorporate" the rules (like the contract being considered in *Grace Financial*; which found no breach of contract action). Rather, the "subject to" language in the Agreement is similar to that interpreted in *Lanier* where the court also concluded no breach of contract action existed. This Court should reach the same result; a result that would be consistent with the weight of authority and *Touche.*[3]

[3] Honea cites to one case in support of her argument that a breach of contract action can be supported by the breach of FINRA rules, citing *Fernandez v. UBS AG*, 222 F. Supp. 3d 358, 359-60 (S.D.N.Y. 2016). *See* Honea's Brief at 58. As reflected in a later decision in that case, the UBS contract stated "We [UBS] must have a reasonable basis for believing that any securities recommendations . . . are suitable . . .." *Fernandez v. UBS AG*, Case No. 15-Cv-2859 (SHS), 2018 WL 4440498, at *3 (S.D.N.Y. Sept. 17, 2018). The *Fernandez* decision may be consistent with Alabama law in that UBS made an express promise to make suitable

III. AGGRIEVED INVESTORS HAVE REMEDIES OUTSIDE THE FINRA RULES AND THE ERRONEOUS BREACH OF CONTRACT CLAIM CREATED BY THE DISTRICT COURT

Neither the absence of a private right of action for an alleged FINRA Rule violation nor the inability to bring a breach of contract action premised on the same alleged violation leaves aggrieved investors without remedies against offending broker-dealers or their agents. The same conduct that results in a FINRA Rule violation (for which the SEC and/or FINRA may sanction the violator(s)) may give rise to well-recognized common law causes of action like fraud, negligence, and breach of fiduciary duty, and to statutory claims under federal and state securities statutes. For example, the anti-fraud provisions of the Securities Exchange Act of 1934 (the "Exchange Act") have been interpreted as allowing for private rights of action against those who defraud investors. *See, e.g.,* Section 10(b) of the Exchange Act (codified at 15 U.S.C. § 78j) which prohibits the use of any "device, scheme or artifice to defraud", and Rule 10b-5 promulgated thereunder which imposes liability for any misstatement or omission of

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investment recommendations, but it is not instructive here where no such express promise was made by RJFS.

material fact in connection with the purchase or sale of securities. *See also* Section 20 of the Exchange Act (codified at 15 U.S.C. § 78t) which imposes joint and several liability on persons and entities who control those who violate the Exchange Act.

Courts have found claims of alleged unsuitable investment recommendations and failure to supervise by a broker-dealer (like those asserted by Honea) actionable as a misrepresentation or omission of a material fact under the anti-fraud provisions of the Exchange Act. *See, e.g., Robert N. Clemons Tr. v. Morgan Stanley DW, Inc.*, 485 F.3d 840, 848 (6th Cir. 2007) ("A suitability claim is a type of section 10(b) fraud claim.") (citing *Banca Cremi, S.A. v. Alex Brown & Sons, Inc.*, 132 F.3d 1017, 1032 (4th Cir. 1997)); *see also Craighead v. E.F. Hutton & Co.*, 899 F.2d 485, 493 (6th Cir. 1990) (noting that claim for unsuitability sounds in fraud).

Such claims are, of course, subject to applicable statutes of limitations and/or repose. *See* 28 U.S.C. §1658(b) (a private right of action under the Exchange Act's anti-fraud provision is barred is not brought within the earlier of 2 years after the discovery of the facts

constituting the violation or 5 years after such violation).

That Honea may have waited too long to file suit does not justify creating a breach of contract claim based on FINRA and other rule violations that is not supported by the contract language or Alabama law, and that has been routinely rejected on the merits by other courts throughout the country considering the issue.

This Court should reverse the Circuit Court's creation of a breach of contract action where none exists.

CONCLUSION

For the foregoing reasons, SIFMA respectfully submits that the Circuit Court's judgment allowing Honea to proceed on her breach of contract claim should be reserved.

Respectfully submitted,

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