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CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SEVEN

JACK JEVNE et al., Petitioners, v. THE SUPERIOR COURT OF LOS ANGELES COUNTY, Respondent; JB OXFORD HOLDINGS, INC., et al., Real Parties in Interest.	No. B167044 (Super. Ct. No. SC062784) (Jacqueline A. Connor, Judge)

ORIGINAL proceeding, application for writ of mandate. Writ denied.

Zilinskas & Woosley, Victor G. Zilinskas and Eric A. Woosley for Petitioner.

No appearance for Respondent.

Miller Milove & Kob, Jeffrey S. Kob and W. Richard Sintek for Real Parties in Interest.

Bill Lockyer, Attorney General, Andrea Lynn Hoch, Chief Assistant Attorney General, David S. Chaney, Senior Assistant Attorney General, and Amy J. Winn, Deputy Attorney General, for Amicus Curiae Attorney General Bill Lockyer.

Milbank, Tweed, Hadley & McCloy, Douglas W. Henkin and M. Benjamin Valerio for Amicus Curiae New York Stock Exchange, Inc.

Gibson, Dunn & Crutcher and Mark A. Perry for Amicus Curiae NASD Dispute Resolution, Inc.

Giovanni P. Prezioso, General Counsel, Jacob. H. Stillman, Solicitor, and Eric Summergrad, Deputy Solicitor; Of Counsel Meyer Eisenberg, Deputy General Counsel, for Amicus Curiae Securities and Exchange Commission.

Horovitz & Levy, David S. Ettinger and Mitchell C. Tilner for Amicus Curiae Judicial Council of California

Jack Jevne and Avalon Investments, S.A. (collectively "Jevne") filed a petition for writ of mandate directing respondent Superior Court to vacate its order denying Jevne's motion: (1) to set aside the court's prior order compelling binding arbitration of Jevne's claim against Real Parties, a brokerage and financial services firm; and (2) to restore the matter to the active civil trial calendar. Below Jevne argued the agreement to arbitrate was unenforceable because the designated dispute resolution provider, NASD Dispute Resolution, Inc. (hereinafter known as "NASD") had refused to appoint a replacement arbitrator during the arbitration unless Jevne agreed to waive application of the recently enacted California ethics standards for neutral arbitrators (the "California Standards"). Jevne claimed that notwithstanding his agreement to arbitrate in accord with the NASD rules and procedures, which include provisions for arbitrator appointments, disqualifications and disclosure of conflicts of interest, he was entitled to the benefit of the California Standards. The trial court disagreed concluding, in view of his agreement to arbitrate under the NASD rules, the California Standards did not apply and were, in essence, preempted by federal law.

This writ petition raises several issues of first impression for the California State Courts, including, whether the Judicial Council of California acted within its authority in drafting the California Standards and whether they are preempted by the Federal Arbitration Act (FAA) and/or the Securities Exchange Act of 1934. As we discuss more

fully below, the Judicial Council decision to make the California Standards applicable to arbitrators appointed by dispute resolution providers was not inconsistent with the intent of the Legislature. In addition, the California Standards are not hostile to arbitration and thus, in the abstract, the FAA does not preempt them. Notwithstanding these conclusions, we find under the circumstances presented here, the California Standards are preempted by the Securities Exchange Act of 1934, in that they conflict with NASD's arbitration procedures authorized by the Securities and Exchange Commission. Consequently, we conclude the trial court did not err in denying Jevne's motion and accordingly, we deny the writ of mandate.

FACTUAL AND PROCEDURAL HISTORY

In the summer of 2000, Jevne filed an action against Real Parties, a brokerage and financial services firm and a member of the NASD, asserting causes of action for negligence, breach of fiduciary duties and conversion in connection with funds which Jevne alleged had been improperly withdrawn from an account Real Parties maintained on his behalf.

Real Parties moved to compel arbitration of the matter based on an arbitration provision in an agreement relating to one of Jevne's accounts. The provision required all disputes arising out of the relationship between the parties to be settled through binding arbitration in accordance with the rules and procedures of the NASD, a self-regulatory organization (SRO), registered with the Securities and Exchange Commission (SEC) to, among other functions, administer securities arbitrations.[1] Jevne did not oppose the

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[1] The Securities Exchange Act of 1934 created the SEC. (15 U.S.C., §§ 78d.) The SEC is responsible for the administration and enforcement of the federal securities laws, regulations, and oversight of SROs like the NASD and the New York Stock Exchange (NYSE).

motion to compel, and in February 2001, the court granted it.

Thereafter in May 2001, the parties signed a Uniform Submission Agreement memorializing their agreement to have the arbitration conducted in accordance with NASD rules and overseen by NASD's Director of Arbitration. During the summer of 2001, the parties selected a three arbitrator panel pursuant to the NASD procedures for appointing arbitrators.

The arbitration commenced and Real Parties filed a demurrer to Jevne's claims. In July 2002, the arbitration panel sustained the demurrer with leave to amend. Jevne amended his claim. Real Parties filed a second demurrer and the matter was set for hearing in October 2002. Prior to the hearing, one of the arbitrators voluntarily recused himself.

In late September 2002, NASD stopped appointing arbitrators in NASD arbitrations in California in light of the California Standards which imposed new ethical obligations (including requirements for disclosure of potential conflicts of interests and procedures for disqualification of arbitrators) upon all persons appointed to serve as arbitrators in California after July 1, 2002. The NASD informed Jevne it would not appoint a replacement arbitrator and would not proceed with the arbitration unless he agreed to waive the California Standards or he agreed to have his arbitration conducted in another state.

Jevne would not agree to the waiver and instead filed a motion in the trial court for an order to set aside the court's prior order compelling binding arbitration and to restore the matter to the active civil trial calendar. Jevne argued the California Standards governed his arbitration and therefore the agreement to arbitrate was no longer enforceable because of NASD's refusal to proceed with the arbitration without a waiver of the California Standards.

The court denied the motion concluding, in essence, federal law preempted the California Standards. Specifically, the court found Jevne had agreed to arbitrate under the NASD rules, the arbitration was governed by the FAA and the California Standards

could not supplant the NASD rules.

Jevne filed a petition for a writ of mandate and this court issued an Order to Show Cause.

DISCUSSION

The parties addressed the issue of whether the California Standards were preempted by the Securities and Exchange Act of 1934 and/or the FAA. Because no California State Court has directly addressed this issue[2] and because of its far reaching

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[2] Federal preemption of the California Standards was raised in *Alan v. Superior Court (UBS Painewebber, Inc.)* (2003) 111 Cal.App.4th 217, 231. The Court of Appeal, Division One of this District declined to resolve the issue, however. Noting the NASD was not a party in the case nor had filed an amicus curiae brief, the court deferred the matter to other civil actions in which the NASD was an active participant.

The issue of federal preemption of the California Standards has also arisen in the federal courts. NASD and the NYSE filed an action in federal court to have the California Standards declared inapplicable to SRO arbitrations. (See *NASD Dispute Resolution, Inc. & New York Stock Exchange, Inc. v. Judicial Council of California* (N.D. Cal. 2002) 232 F.Supp.2d 1055.) The district court dismissed the action without reaching the merits of the preemption issue based on the conclusion the Judicial Council and its members (sued in their official capacities) enjoyed Eleventh Amendment immunity from suit in federal court. (*Id.* at pp. 1063-1066.) An appeal of the decision is currently pending before the Ninth Circuit.

Other federal district courts that have considered the issue have found the California Standards inapplicable to SROs for various reasons. In *Mayo v. Dean Witter Reynolds, Inc.* (N.D. Cal. 2003) 258 F.Supp. 1097, the court found the California Standards conflicted with the NYSE's arbitration rules and procedures and thus were preempted by the Securities and Exchange Act of 1934 and the FAA. (In accord *Wilmot v. McNabb* (N.D. Cal. 2003) 269 F.Supp.2d 1203.) In contrast, in *Credit Suisse First Boston Corp. v. Grunwald* (N.D. Cal., Mar. 31, 2003) No. C 02-2051 SBA, the court noted in passing the California Standards were not preempted by the FAA. Nonetheless, the court found the California Standards could not apply to SRO-appointed arbitrators because such arbitrators did not fall within the definition of "neutral arbitrators" in the Code of Civil Procedure. Consequently, the court concluded the Judicial Council had exceeded its authority in drafting the California Standards and thus declared them void.

implications for the general public, various governmental entities and national institutions, this court invited amici curiae briefing from the NASD and the NYSE[3] (hereinafter NASD and NYSE are collectively referred to as the SROs) the SEC, the California Attorney General, and the Judicial Council of California on the issue of federal preemption.

We also requested the parties and the amici curiae to address another issue considered in the federal litigation and implicated here, specifically whether the California Standards may be applied to SROs as a matter of California law in light of the definition of "neutral arbitrator" contained in Code of Civil Procedure section 1280, subdivision (d) which does not expressly include arbitrators selected or appointed by a dispute resolution provider organization. It is to these matters which we now turn our attention.

I. Application of the California Standards to Dispute Resolution Provider Organizations.

The Real Parties and the SROs argue the Judicial Council exceeded its legislative mandate in drafting the California Standards to apply to arbitrators appointed by dispute resolution provider organizations (DRPOs).[4] The Real Parties and the SROs assert the Legislature directed the Judicial Council to promulgate ethical rules for "neutral arbitrators" and they point out the definition of "neutral arbitrator" in Code of Civil

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[3] The NYSE, like the NASD, is registered with the SEC to administer securities arbitrations. Though not at issue in this case, we note the NYSE's arbitration rules and procedures are substantially similar to those of NASD in all matters relevant here.

[4] Standard 2 defines the term "arbitrator" as used in the California Standards. Specifically it provides, in pertinent part, that an (a) "arbitrator and 'neutral arbitrator' mean any arbitrator . . . who is to serve impartially, whether selected or appointed by . . . (1)(c) By a dispute resolution provider organization, under an agreement of the parties." Standard 2, further defines "Dispute resolution provider organization" in subdivision (g) as any nongovernmental entity that, or individual who, coordinates, administers, or provides the services of two or more dispute resolution neutrals."

Procedure section 1280 does not include arbitrators appointed by DRPOs. Thus, they contend the California Standards cannot apply to arbitrators appointed by the SROs. As we shall explain, we disagree.

The Judicial Council is empowered to adopt rules for court administration, practice and procedure[5] "not inconsistent with statute." (Cal. Const., art. VI, § 6.) To comply with this requirement, a rule drafted by the Judicial Council must not conflict with statutory intent. (*People v. Hall* (1994) 8 Cal.4th 950, 960-963.) Nonetheless a rule promulgated by the Judicial Council may go beyond the specific provisions of a related statute so long as the rule reasonably furthers the statutory purpose. (*Trans-Action Commercial Investors, Ltd. v. Firmater, Inc.* (1997) 60 Cal.App.4th 352, 364.) Consequently whether the Judicial Council exceeded its authority here turns on whether including DRPOs within the California Standards furthers the statutory purpose, which is determined by examining the Legislative intent.

To ascertain the intent of the Legislature the court first looks to the language of the statute. (*Elden v. Superior Court* (1997) 53 Cal.App.4th 1497, 1504.) If the meaning is without ambiguity, doubt, uncertainty and would not otherwise result in absurd consequences which the Legislature could not have intended, then the language of the statute controls. (*Ibid.; Horwich v. Superior Court* (1999) 21 Cal.4th 272, 276.) If, however, the meaning is not clear, then the court looks to the legislative history to determine the intent. (*Elden v. Superior Court, supra,* 53 Cal.App.4th at p. 1504.)

Pursuant to Code of Civil Procedure[6] section 1281.85, subdivision (a), the Legislature directed the Judicial Council to establish ethical standards for "neutral

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[5] The power to adopt "rules" is not limited to "court administration, practice and procedure." The Legislature may also direct the Judicial Council to adopt rules and procedures governing substantive matters. (*People v. Wright* (1982) 30 Cal.3d 705, 711-712.)

[6] All statutory references are to the Code of Civil Procedure unless indicated otherwise.

arbitrators." The Legislature did not define "neutral arbitrator" in connection with its directive to the Judicial Council to adopt the new ethical standards. The phrase, "neutral arbitrator" is defined, however, elsewhere in the Code of Civil Procedure at section 1280 which provides the general definitions for the Civil Procedure title governing arbitration. Section 1280, subdivision (d) defines a neutral arbitrator as "an arbitrator who is (1) selected jointly by the parties or by the arbitrators selected by the parties or (2) appointed by the court . . . ." (§ 1280, subd. (d).)

The Real Parties and the SROs assert the language of definition is clear and its exclusion of DRPOs is dispositive. They point out that Judicial Council staff has elsewhere conceded that DRPOs are not included within the definition of "neutral arbitrator."[7]

Before this court, Jevne and the Judicial Council, assert that the language "selected jointly by the parties or by the arbitrators selected by the parties" is unclear because it can encompass arbitrators both directly *and indirectly* selected by the parties. They further argue that because the parties using an SRO as a dispute resolution provider have input into the selection of the arbitrators, then the arbitrators appointed by the SROs are indirectly selected by the parties and therefore they fall within the definition of neutral arbitrator in section 1280.

In our view, the "selected by the parties" language is ambiguous. It could reasonably be said to include both a direct selection of the arbitrators and an indirect selection, where, for example, the parties review a list of potential arbitrators, rank them according to preference and the DRPO makes the final appointment from the preferred list of arbitrators. Because the term "selected" is susceptible to both meanings, we turn to

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[7] In April of 2002 the Judicial Council staff recognized it had expanded upon the definition of "neutral arbitrator" in section 1280, subdivision (d) by including DRPO in the definition of "neutral arbitrator" in the California Standards. This acknowledgement, however, does not undermine the Judicial Council's long held position that the California Standards are fully consistent with the intent of the Legislature in directing them to adopt the ethical rules.

the Legislative history of section 1280 for guidance.

Section 1280 was enacted in 1961 as part of a body of legislation governing arbitration proposed by the California Law Revision Commission (CLRC). In a report issued to the Legislature, the CLRC discussed the definition of "neutral arbitrator." The CLRC indicated arbitrators fell into two basic categories—"party" arbitrators and "neutral arbitrators." According to the report, arbitrators were distinguished based on whether the arbitrator was intended to serve in an impartial and unbiased manner (in which case the arbitrator should be classified as "neutral") or whether the arbitrator was intended to advocate on behalf of a party. The report further explained the meaning of the definition of "neutral" (as used in the proposed legislation): "the arbitrator appointed by both parties, or by the two arbitrators chosen by the parties, or appointed by the court, or *any other disinterested agency* should be designated the 'neutral arbitrator.'" (See Recommendation Relating to Arbitration (Dec. 1960) Cal. Law Revision Com. Rep. (1960), p. G-42.)

The Legislative history shows CLRC expected the arbitration provisions would apply to all arbitrators who held themselves out to be neutral, unbiased and impartial, irrespective of whether they were directly selected by the parties, the court or appointed by a DRPO chosen by the parties. Thus, CLRC's explanation supports the view the phrase "selected by the parties" in section 1280 should be broadly interpreted to include "neutral" arbitrators indirectly selected by the parties through a DRPO. Because the Legislature adopted the exact language of section 1280 as proposed by the CLRC the explanation provided by the CLRC is strong evidence of the Legislature's intent. (See *People v. Martinez* (2000) 22 Cal.4th 106, 129.)

Given our interpretation of section 1280, subdivision (d), SRO arbitrators fall within the definition of "neutral arbitrator" in the California Standards. The SROs characterize their arbitrators as impartial and unbiased. In addition, there is no question the parties play an important, albeit indirect, role in the selection process of the SRO arbitrators. The Director sends a list of potential arbitrators to the parties. The parties

may strike arbitrators from the list for any reason and thereafter the parties rank the remaining arbitrators numerically according to their individual choices. The Director of Arbitration then consolidates the parties' lists and appoints arbitrators to serve on the panel based on the rankings on the consolidated list, subject to availability and disqualification. Given the input the parties have in selecting the SRO arbitrators and the common sense interpretation of "selected by the parties" indicated by the Legislative history, we conclude SRO arbitrators fall within the definition of "selected by the parties" and thus constitute "neutral arbitrators" under section 1280, subdivision (d).

We observe this conclusion is also consistent with the legislation that empowered the Judicial Council to adopt the Standards. Nothing in the recent legislative history indicates the Legislature intended to exclude certain classes of "neutral arbitrators" or manifests an intent the California Standards should have a narrow or limited application. On the contrary, the California Standards were intended to have a broad application to *all* persons who serve as private judges:

> "The Legislature must take a serious look at the growing use of private judges and how that growing use raises questions of fairness and the creation of a dual system of justice that favors the wealthy litigant over the poor litigant. In theory, the publicly financed court system is supposed to provide all civil disputants, rich or poor, with an impartial forum within which to litigate and resolve their differences. In reality, however, a fair number of cases end up before a private judge or arbitrator pursuant to contractual agreements. . . . [¶¶] [This law] is intended to address some of the concerns raised that increased use of private dispute resolvers creates a dual system of justice. The bill seeks to address concerns of fairness by requiring private arbitrators to comply with ethical guidelines to be established by the judicial council." (Sen. Judiciary Com. Rep. on Sen. Bill No. 475 (2001-2002 Reg. Sess.) (Apr. 16, 2001) p. 4.)

In view of the foregoing, we conclude the Judicial Council's definition of "neutral arbitrator" in the California Standards furthers the statutory purpose of section 1281.85 and is fully consistent with the directives of the Legislature.

II. Federal Preemption

A. Federal Arbitration Act

Real Parties, the SEC and the SROs assert the FAA preempts the California Standards in general because the California Standards impose requirements applicable only to arbitration contracts, rather than all contracts, and specifically because the California Standards impose terms which differ from those in the parties' arbitration agreement.

The FAA governs all agreements to arbitrate where the transactions at issue in the dispute involve interstate commerce. (See 9 U.S.C., §§ 1, 2.) Section 2 of the FAA provides agreements to arbitration are "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.) The FAA is a manifestation of congressional intent to favor arbitration agreements. It was enacted to overcome a perceived hostility in the common law courts towards arbitration. However, "there is no federal policy favoring arbitration under a certain set of procedural rules . . . nor does [the FAA] reflect congressional intent to occupy the entire field of arbitration." (*Volt Information Sciences, Inc. v. Board of Trustees* (1989) 489 U.S. 468, 476-477.) Thus, states are free to establish their own arbitration rules and procedures even where the controversy is governed by federal substantive law. (*Felder v. Casey* (1988) 487 U.S. 131, 138.) State laws concerning arbitration are only preempted to the extent that they conflict with congressional intent to favor the enforcement of arbitration agreements. (*Volt Information Sciences, Inc. v. Board of Trustees*, *supra*, 489 U.S. at p. 477.)

Consequently, state laws that single out arbitration agreements for special scrutiny

or suspect status are viewed as inhospitable to arbitration as well as those that seek to limit the use of the arbitral process, have been routinely found preempted by the FAA. (See e.g., *Doctor's Associates Inc. v. Casarotto* (1996) 517 U.S. 681, [preempting Montana law which invalidated arbitration agreements unless they contained special notice placed on first page of the agreement]; see also *Securities Industry Association v. Connolly* (1st Cir. 1989) 883 F.2d 1114, 1119-1121 [citing cases].) As the Supreme Court has explained, the FAA preempts state law where it is necessary to overcome the historic refusal of some state courts to enforce arbitration agreements; FAA preempts state law because Congress wanted to protect arbitration. (*Allied-Bruce Terminix Cas. v. Dobson* (1995) 513 U.S. 265, 270. [FAA preempted Alabama law which invalidated predispute arbitration agreements].)

Thus state laws that are not anti-arbitration or antagonistic to the process are not automatically preempted by the FAA even though the state law relates only to arbitration agreements. The Supreme Court has specifically recognized California's procedures and rules governing arbitration "are manifestly designed to encourage resort to the arbitral process," do not conflict with "any policy embodied in the FAA" and "generally foster the federal policy favoring arbitration." (*Volt Information Sciences, Inc. v. Board of Trustees, supra*, 489 U.S. at p. 476.)

In our view, the California Standards are consistent with the other California arbitration procedures the *Volt* court endorsed. On their face, the California Standards are not anti-arbitration. In fact, they comport with the spirit of section 10 of the FAA which has been interpreted to require arbitrators to disclose to the parties any dealings that might create the impression of possible bias. (See *Commonwealth Coatings Corp. v. Continental Casualty Co.* (1968) 393 U.S. 145, 149.) Unlike other preempted state laws which automatically invalidate arbitration agreements or which singled out such agreements and condition their validity upon special procedural or notice requirements, the California Standards do not invalidate arbitration agreements or impose special requirements on the agreements themselves. Arbitration agreements do not fail by

operation of law, nor are they automatically invalid if the parties fail to comply with the Standards. Failure to comply with the Standards presents, at most, only the potential the agreement may be invalidated or an award vacated. Consequently, we conclude the California Standards are not preempted by the FAA as a matter of law.[8]

B. Securities Exchange Act of 1934

Real Parties, the SEC and the SROs assert the Securities Exchange Act of 1934

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[8] Notwithstanding our conclusion, we recognize some question remains as to whether the California Standards are preempted as a *matter of fact*. As the Real Parties, SEC and SROs argue and as we explain elsewhere in this opinion, the California Standards differ from the NASD arbitration procedures agreed to by the parties in their arbitration agreement. Thus, Real Parties assert FAA preemption based on the contention that under the FAA, they are entitled to have the arbitration agreement enforced according to its terms. They maintain Jevne's effort to avoid arbitration altogether based on California Standards fails because an arbitration agreement subject to the FAA may be invalidated only on legal or equitable grounds for the revocation of any contract. (See 9 U.S.C. § 2; *Southland Corporation v. Keating* (1984) 465 U.S. 1, 10.) In other words, FAA's preference for arbitration is outweighed only where a party seeks to invalidate the arbitration provision pursuant to a contract law defense rather than a defense which would only arise in connection with an effort to avoid arbitration.

Jevne, however, raises several contract law defenses, including the contention the arbitration agreement is void as against public policy. Specifically, the NASD has conditioned the appointment of a replacement arbitrator on Jevne waiving application of the California Standards. In so doing, the NASD requests Jevne not only to forgo his rights and remedies under the California Standards but also the obligations of the arbitrators under them. In light of the strong public policy expressed in the California Standards, we wonder whether Jevne can waive *the arbitrators'* statutory duties, especially in view of the fact the ethical obligations were imposed for the parties' benefit *and* for the benefit of the general public: "[the standards] are intended to guide the conduct of arbitrators, to inform and protect the participants in arbitration, and *to promote public confidence in the arbitration process*." (Cal. Rules of Court, Ethics Std. 1(a); emphasis added.) In any event, we need not decide whether the California Standards are preempted by the FAA as applied in this case, in view of our conclusion elsewhere the California Standards are preempted by the Securities Exchange Act of 1934

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(the Exchange Act) preempts the California Standards because the standards conflict with the Exchange Act and/or stand as an obstacle to the accomplishment of the Exchange Act's purposes.

Preliminarily we observe certain general principles which inform these issues and place the concept of "conflict preemption" in the proper context.

1. Preemption Principles

In general the federal government and the states have the power to pass legislation regulating the same subjects. California and the federal government both regulate securities industry and arbitration agreements and proceedings. (*Matsuchita Elec. Industrial Co. v. Epstein* (1996) 516, U.S. 367, 383 ["Congress plainly contemplated the possibility of dual litigation in state and federal courts relating to securities transaction"]; *Moncharsh v. Heily & Blasé* (1992) 3 Cal.4th, 1, 9 [California has a strong public policy in favor of regulating private arbitration]; *Graham v. Scissor-tail, Inc*. (1981) 28 Cal.3d 807.)

In addition, the courts employ a presumption against finding federal preemption. (*Ting v. AT&T* (9th Cir. 2003) 319 F.3d 1126, 1136.) Where, as here, however, a state regulates in an area, such as securities arbitration, with a history of significant federal presence, the presumption against preemption does not apply. (*Mayo v. Dean Witter Reynolds, Inc*., *supra*, 258 F.Supp. at p. 1108.)

The supremacy clause of the United States Constitution, nonetheless, requires courts to find federal preemption of state law as long as it is clear that Congress intended to eclipse the historic police powers of the state. (U.S. Const., art. VI, cl. 2; *Gibbons v. Ogden* (1824) 22 U.S. 1, 9; *California v. ARC America Corp*. (1989) 490 U.S. 93, 101; *Crosby v. National Foreign Trade Council* (2000) 530 U.S. 363, 372 ["A fundamental principle of the Constitution is that Congress has the power to preempt state law."]; *McKey v. Charles Schwab* (1998) 67 Cal.App.4th 731, 736.)

There are three generally recognized types of preemption. First, where Congress

expressly defines the extent to which a federal provision preempts state law; this has been characterized as "express" preemption. (See *Crosby v. National Foreign Trade Council, supra,* 530 U.S. at p. 372.) Second, courts find preemption when federal regulation of an area is so broad and pervasive that it appears Congress intended federal law to "occupy the field." (*United States v. Locke* (2000) 529 U.S. 89, 108.)

Finally, state law is preempted to the extent it conflicts with federal law. (*Hines v. Davidowitz* (1941) 312 U.S. 52, 66-67; *Crosby v. National Foreign Trade Council, supra,* 530 U.S. at p. 372.) Courts have found "conflict" preemption in two types of circumstances: (1) "where it is impossible for a private party to comply with both state and federal law and [(2)] where 'under the circumstance of [a] particular case, [the challenged state law] stands as an obstacle to the accomplishments and execution of the full purposes and objectives of Congress.'" (*Crosby v. National Foreign Trade Council, supra,* 530 U.S. at p. 372, quoting *Hines v. Davidowitz, supra,* 312 U.S. 52 at p. 67; internal citations omitted and emphasis added.)

Determining a sufficient "obstacle" requires an examination of "the federal statute as a whole and identifying its purposes and intended effects." (*Crosby v. National Foreign Trade Council, supra,* 530 U.S. at p. 373.) "If the purpose of the act cannot otherwise be accomplished—if its operation within its chosen field else must be frustrated and its provisions be refused their natural effect—the state law must yield to the regulation of Congress." (*Ibid.* quoting *Savage v. Jones* (1912) 225 U.S. 501, 533; cf *Hines v. Davidowitz, supra,* 312 U.S. at p. 67, fn. 20.)

2. Conflict Preemption

The Exchange Act contains a state saving clause (15 U.S.C. § 77p and 15 U.S.C. § 78bb) and because Congress has provided for concurrent state regulation of securities (15 U.S.C. §77r), there is no express or field preemption under the federal securities laws of the California Standards. (*Roskind v. Morgan Stanley Dean Witter & Co*. (2000) 80 Cal.App.4th 345, 352 [State law remedies and regulations available under Cal. Bus. and

Prof. Code § 17200 supplement federal securities law]; cf. *Diamond Multimedia Systems, Inc. v. Superior Court* (1999) 19 Cal.4th 1036, 1056-1057; see also *Green v. Fund Asset Management, L.P*. (3d Cir. 2001) 245 F.3d 214, 223, fn 7.) Accordingly, only conflict preemption is implicated in this case.

More specifically, the questions here are whether California Standards on disqualification of arbitrators (Standard 10) and on arbitrator disclosure of potential conflicts of interest (Standard 7) create a physical impossibility such that private parties cannot comply with both the California Standards and the NASD regulations[9] on disqualification (NASD Rules 10308-10313) and disclosure (NASD Rule 10312(a)), and/or whether Standard 10 and Standard 7 stand as obstacles to the Exchange Act. (*Hines v. Davidowitz, supra*, 312 U.S. 52 at p. 67.) For the reasons discussed below, we concluded NASD rules preempt the California Standards based on the direct conflict between arbitrator disqualification provisions in the NASD rules and the disqualification provisions in the California Standards.

a. The Disqualification Rules of Standard 10 And NASD Rules 10308-10313.

Real parties, the SEC and the SROs argue Standard 10 conflicts with NASD Rules for arbitrator disqualification. We agree. Despite the laudable goals of the Legislature in promulgating the California Standards to protect consumers and maintain judicial scrutiny of securities arbitrations, the disqualification rules of Standard 10 present a clear physical conflict with the NASD rules. Specifically, the issue of who, the Director of Arbitration (under the NASD Rules) or the parties (under the California Standards), makes the ultimate decision to disqualify an arbitrator presents a conflict.

Preliminarily, however, we note some similarities exist between the state and NASD arbitrator disqualification rules. As the Attorney General points out: (1) the

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[9] For the purposes of federal preemption doctrine, federal law includes statutorily authorized federal regulations. (*City of New York v. F.C.C* (1988) 486 U.S. 57, 64; see also, *Sparta Surgical Corp. v. NASD, Inc*. (9th Cir. 1998) 159 F.3d 1209, 1210-1214.)

parties play some role in the disqualification of arbitrators under NASD rules 10308-10313[10] and may also initiate the disqualification process under Standard 10; and (2) disqualification is not automatic under either set of rules. Nonetheless, the fact remains each set of rules has a different decision maker determining when an arbitrator should be disqualified. Under Standard 10, an arbitrator is disqualified when a party files notice with the court, and assuming the arbitrator fails to disqualify him or herself upon learning of the challenge, the superior court judge will make the ultimate decision on disqualification under the California Rules.[11]

In contrast, under the NASD rules, the Director of Arbitration has the final say on any challenge for cause or any determination that a conflict of interest warranting disqualification exists. There is no reconciling the conflict between the California Standards and the NASD Rules; it is simply impossible to comply with both of them. Moreover, there is no support for the assumption implicit in the Attorney General's argument that these two vastly different decision makers would reach the same conclusion regarding whether disqualification is warranted in any given case. Reasonable people differ. Because Standard 10 effectively eliminates the role of the Director of Arbitration, we find that it conflicts with NASD rules 10309-10313, and

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[10] Each party to a NASD arbitration receives one peremptory challenge. (NASD Rule 10311.) The Director may in the interest of justice award additional peremptory challenges. (*Ibid*.) The parties then rank the arbitrators in order of preference. (NASD Rule 10308(c)(4).) If the number of arbitrators on the list is insufficient to form a panel, the Director shall appoint one or more arbitrators. (*Ibid*.) Parties may only challenge arbitrators for cause who were subsequently appointed by the Director. (NASD Rule 10308(d)(1).) The Director has the ultimate discretion in granting or denying the challenge. (*Ibid*.).

The NASD Code does not define the word "cause" or provide a standard for granting challenges for the arbitrators appointed by the Director. (*Ibid*.; cf. Perino Report at p. 22.)

[11] It is unclear whether the court has discretion in this matter or if disqualification is mandatory when a party files notice. (Std 10.)

accordingly is preempted. This conflict is direct and insurmountable, and is sufficient, standing alone, to support a finding the California Standards are preempted by the NASD rules.

b. Disclosure Rules of Standard 7 And NASD Rule 10312(a).

In any event, the California Standards relating to disclosure of conflicts of interest also appear to stand as an obstacle to the NASD rules. In addition to their preemption arguments concerning California Standard 10, Real Parties, the SEC and the SROs argue Standard 7 physically conflicts and stands as an obstacle to NASD Rule 10312(a). They are correct, in part.

In his amicus brief, the Attorney General argues that there is no material difference between the disclosure requirements of the Standard 7 and NASD rule 10312(a). We agree.

Standard 7(d) requires disclosure of "[A]ll matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed arbitrator would be able to be impartial." Sub-Sections (1)-(14) of Standard 7(d) contain a non-exclusive enumeration of "matters" which an arbitrator is required to disclose.[12] For its part,

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[12] Standard 7(d) (1)-(14) states in full:

"(1) (*Family relationships with party*) The arbitrator or a member of the arbitrator's immediate or extended family is a party, a party's spouse or domestic partner, or an officer, director, or trustee of a party.

"(2) (*Family relationships with lawyer in the arbitration*) The arbitrator or the spouse, former spouse, domestic partner, child, sibling, or parent of the arbitrator or the arbitrator's spouse or domestic partner is:

"(A) A lawyer in the arbitration.

"(B) The spouse or domestic partner of a lawyer in the arbitration; or

"(C) Currently associated in the private practice of law with a lawyer in the

arbitration.

"(3) (*Significant personal relationship with party or lawyer for a party*) The arbitrator or a member of the arbitrator's immediate family has or has had a significant personal relationship with any party or lawyer for a party.

"(4) (*Service as arbitrator for a party or lawyer for party*)

"(A) The arbitrator is serving or, within the preceding five years, has served:

"(i) As a neutral arbitrator in another prior or pending noncollective bargaining case involving a party to the current arbitration or a lawyer for a party;

"(ii) As a party-appointed arbitrator in another prior or pending noncollective bargaining case for either a party to the current arbitration or a lawyer for a party; or

"(iii) As a neutral arbitrator in another prior or pending noncollective bargaining case in which he or she was selected by a person serving as a party-appointed arbitrator in the current arbitration.

"(B) [Case information] If the arbitrator is serving or has served in any of the capacities listed under (A), he or she must disclose:

"(i) The names of the parties in each prior or pending case and, where applicable, the name of the attorney representing the party in the current arbitration who is involved in the pending case, who was involved in the prior case, or whose current associate is involved in the pending case or was involved in the prior case.

"(ii) The results of each prior case arbitrated to conclusion, including the date of the arbitration award, identification of the prevailing party, the amount of monetary damages awarded, if any, and the names of the parties' attorneys.

"(C) [Summary of case information] If the total number of the cases disclosed under (A) is greater than five, the arbitrator must also provide a summary of these cases that states:

"(i) The number of pending cases in which the arbitrator is currently serving in each capacity;

"(ii) The number of prior cases in which the arbitrator previously served in each capacity;

"(iii) The number of prior cases arbitrated to conclusion; and

"(iv) The number of such prior cases in which the party to the current arbitration, the party represented by the lawyer for a party in the current arbitration, or the party represented by the party-arbitrator in the current arbitration was the prevailing party.

"(5) (*Compensated service as other dispute resolution neutral*) The arbitrator is serving or has served as a dispute resolution neutral other than an arbitrator in another pending or prior noncollective bargaining case involving a party or lawyer for a party and the arbitrator received or expects to receive any form of compensation for serving in this capacity.

"(A) [Time frame] For purposes of this paragraph (5), 'prior case' means any case in which the arbitrator concluded his or her service as a dispute resolution neutral within two years before the date of the arbitrator's proposed nomination or appointment, but does not include any case in which the arbitrator concluded his or her service before January 1, 2002.

"(B) [Case information] If the arbitrator is serving or has served in any of the capacities listed under this paragraph (5), he or she must disclose:

"(i) The names of the parties in each prior or pending case and, where applicable, the name of the attorney in the current arbitration who is involved in the pending case, who was involved in the prior case, or whose current associate is involved in the pending case or was involved in the prior case;

"(ii) The dispute resolution neutral capacity (mediator, referee, etc.) in which the arbitrator is serving or served in the case; and

"(iii) In each such case in which the arbitrator rendered a decision as a temporary judge or referee, the date of the decision, the prevailing party, the amount of monetary damages awarded, if any, and the names of the parties' attorneys.

"(C) [Summary of case information] If the total number of cases disclosed under this paragraph (5) is greater than five, the arbitrator must also provide a summary of these cases that states:

"(i) The number of pending cases in which the arbitrator is currently serving in each capacity;

"(ii) The number of prior cases in which the arbitrator previously served in each

capacity;

"(iii) The number of cases in which the arbitrator rendered a decision as a temporary judge or referee; and

"(iv)The number of such prior cases in which the party to the current arbitration or the party represented by the lawyer for a party in the current arbitration was the prevailing party.

"(6) (*Current arrangements for prospective neutral service*) Whether the arbitrator has any current arrangement with a party concerning prospective employment or other compensated service as a dispute resolution neutral or is participating in or, within the last two years, has participated in discussions regarding such prospective employment or service with a party.

"(7) (*Attorney-client relationships*) Any attorney-client relationship the arbitrator has or has had with a party or lawyer for a party. Attorney-client relationships include the following:

"(A) An officer, a director, or a trustee of a party is or, within the preceding two years, was a client of the arbitrator in the arbitrator's private practice of law or a client of a lawyer with whom the arbitrator is or was associated in the private practice of law;

"(B) In any other proceeding involving the same issues, the arbitrator gave advice to a party or a lawyer in the arbitration concerning any matter involved in the arbitration; and

"(C) The arbitrator served as a lawyer for or as an officer of a public agency which is a party and personally advised or in any way represented the public agency concerning the factual or legal issues in the arbitration.

"(8) (*Other professional relationships*) Any other professional relationship not already disclosed under paragraphs (2)-(7) that the arbitrator or a member of the arbitrator's immediate family has or has had with a party or lawyer for a party. Professional relationships include the following:

"(A) The arbitrator was associated in the private practice of law with a lawyer in the arbitration within the last two years.

"(B) The arbitrator or a member of the arbitrator's immediate family is or, within the preceding two years, was an employee of or an expert witness or a consultant for a party; and

"(C) The arbitrator or a member of the arbitrator's immediate family is or, within the preceding two years, was an employee of or an expert witness or a consultant for a lawyer in the arbitration.

"(9) (*Financial interests in party*) The arbitrator or a member of the arbitrator's immediate family has a financial interest in a party.

"(10) (*Financial interests in subject of arbitration*) The arbitrator or a member of the arbitrator's immediate family has a financial interest in the subject matter of the arbitration.

"(11) (*Affected interest*) The arbitrator or a member of the arbitrator's immediate family has an interest that could be substantially affected by the outcome of the arbitration.

"(12) (*Knowledge of disputed facts*) The arbitrator or a member of the arbitrator's immediate or extended family has personal knowledge of disputed evidentiary facts relevant to the arbitration. A person who is likely to be a material witness in the proceeding is deemed to have personal knowledge of disputed evidentiary facts concerning the proceeding.

"(13) (*Membership in organizations practicing discrimination*) The arbitrator's membership in any organization that practices invidious discrimination on the basis of race, sex, religion, national origin, or sexual orientation. Membership in a religious organization, an official military organization of the United States, or a nonprofit youth organization need not be disclosed unless it would interfere with the arbitrator's proper conduct of the proceeding or would cause a person aware of the fact to reasonably entertain a doubt concerning the arbitrator's ability to act impartially.

"(14) Any other matter that:

"(A) Might cause a person aware of the facts to reasonably entertain a doubt that the arbitrator would be able to be impartial;

"(B) Leads the proposed arbitrator to believe there is a substantial doubt as to his or her capacity to be impartial, including, but not limited to, bias or prejudice toward a party, lawyer, or law firm in the arbitration; or

"(C) Otherwise leads the arbitrator to believe that his or her disqualification will further the interests of justice." (Cal. Rules of Court, appen., Div. VI.)

NASD Rule 10312(a)(2) requires disclosure of "[a]ny existing or past financial, business, professional, family, social, or other relationships or circumstances that are likely to affect impartiality or might reasonably create an appearance of . . . bias."

Arguably parties in NASD arbitrations have the ability to request the same information as enumerated by Standard 7(d) pursuant to NASD Rule 10308(b)(6).[13] Thus, if a party is dissatisfied with the initial disclosure by a NASD arbitrator, the party may seek supplemental information. This is a regular practice among some lawyers. (Perino, Report To The Securities And Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements In NASD And NYSE Securities Arbitrations [hereinafter "Perino Report"] (2002) at p. 40.) At bottom, both sets of rules are consistent iterations of the principle that arbitrators must disclose "any dealings that might create an impression of bias." (*Commonwealth Coatings Corp. v. Continental Casualty Co., supra,* 393 U.S. at p.149.)

In our view, the California Standards are simply more detailed than the NASD disclosure rules, which in itself does not make it impossible for parties, and in particular arbitrators, to comply with both sets of rules. Even the independent reviewer the SEC commissioned to examine this issue, Professor Perino, indicated the "conflict" between the disclosure rules lacked real substance, observing "[t]he key difference between these two disclosure obligations is one of drafting philosophy - the SROs have adopted a broad disclosure standard while California has chosen to articulate numerous precise rules that describe the required disclosures." (Perino Report at p. 39.) A difference in drafting philosophy does not present a physical conflict requiring preemption.[14]

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[13] NASD Rule 10308(b)(6) provides in pertinent part: "If a party requests additional information about an arbitrator, the Director shall send such request to the arbitrator, and shall send the arbitrator's response to all parties at the same time."

[14] We acknowledge this conclusion differs from that of the *Mayo* court. (*Mayo*, *supra*, 258 F.Supp.2d at p. 1106.) Of course, the *Mayo* decision may have persuasive value but is not binding on this court. (*Bill Graham v. Scissor-Tail, Inc*. (1981) 28 Cal.3d 807, 830.)

Notwithstanding our view Standard 7 and NASD Rule 10312(a) do not actually conflict, we nevertheless must find Standard 7 stands as an obstacle to the Exchange Act.[15]

The Exchange Act, amended in 1975, requires the SEC to approve all NASD rules, upon finding the rule complies with the Exchange Act. (15 U.S.C. §78s(b).). The SEC also has the power, on its own initiative, to "[a]brogate, add to, and delete from" any SRO rule if it finds changes necessary or appropriate to further the objectives of the Exchange Act. (15 U.S.C. §78s(c).) Moreover, prior to approving rules, the SEC must find the rule at issue is designed to prevent fraudulent and manipulative practices; to promote equitable principles of trade; to safeguard against unreasonable profits and charges and to protect investors and be in the public's interest. (15 U.S.C. §78s.) SEC approval of a NASD regulation constitutes a determination by the SEC the rule comports with congressional directives and the Exchange Act. (*Shearson/American Express, Inc, v. McMahon* (1987) 482 U.S. 220, 233 ["No proposed rule change may take effect unless the SEC finds that the proposed rule is consistent with the requirements of the Exchange Act . . . ."].) Thus, because the SEC approved NASD Rule 10312(a) and the other NASD rules governing arbitration, the NASD arbitration rules must be deemed consistent with the Exchange Act. (*Id*. at p. 234.) The issue then becomes whether Standard 7 undermines or frustrates the purpose of NASD Rule 10312(a). The SEC has answered this question in the affirmative.

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[15] Our conclusion that Standard 7 does not physically conflict with NASD rule 10312(a) does not end the preemption inquiry. Though, at first blush, it might appear that where the state and federal laws do not directly conflict with each other, the state law could not possibly stand as an "obstacle" to the federal scheme, Supreme Court case law suggests otherwise. Preemption may be found *either* where a state law conflicts with a federal law or where the state law stands as an obstacle to the federal law. (See *Crosby v. National Foreign Trade Council*, *supra*, 530 U.S. at p. 372.)

When California adopted Standard 7, the SEC requested an exemption for NASD and NYSE from Standard 7 based on the SEC's belief Standard 7 would have an adverse effect on both investors and the SROs, by *inter alia*, increasing administrative costs and reducing the number of available arbitrators. (NASD amicus brief at p. 8.) In addition, the SEC commissioned Professor Perino to assess whether NASD should modify its rules to incorporate Standard 7. Professor Perino concluded NASD should not amend its rules to correspond to the California Standards.[16] Thus, the SEC contends Standard 7 is an obstacle to NASD Rule 10312(a) because it would increase costs, complexity and uncertainty of the arbitration process which in turn frustrates the Exchange Act's purpose of protecting investors and the public. In its view, current NASD disclosure rules represent the appropriate balance between efficiency and fairness while disclosure requirements under Standard 7 would interfere with the purpose of the Exchange Act. (See Perino Report at pp. 41-47.) Moreover, the SEC has concluded that allowing California arbitrations to be administered under a different set of rules will introduce

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[16] Professor Perino found: (1) there is "little if any indication that undisclosed conflicts represent a significant problem in SRO-sponsored arbitrations"; (2) perceived bias is caused by panel composition, not by current disclosure rules; (3) the California Standards may impose significant costs; and (4) the Standards may reduce investor's perception of fairness of SRO arbitrations due to inconsistency. (Perino Report at pp. 3-4.) He thus concluded that there is likely very little benefit from adopting the California Standards. (Perino Report at p. 48.)

Professor Perino made, however, four recommendations based on his investigation and research. He advised the SEC to: (1) amend the arbitration rules to emphasize that all conflict disclosures are mandatory; (2) re-examine the definition of public and non-public arbitrators; (3) provide greater transparency with respect to challenges for cause by including the cause standards in the rules; and (4) sponsor independent research to evaluate fairness of SRO arbitrations. (Perino Report at pp. 4-5.) Subsequently, the NASD proposed Professor Perino's recommendations be followed. (*Id*. at p. 5.) While the SEC has not yet officially endorsed the conclusions and recommendations, on January 13, 2003, the Director of the SEC's Division of Market Regulation agreed with Perino's conclusions and asked the SROs to inform the Division of the steps they were taking to meet Professor Perino's recommendations. (SEC brief at pp. 17-18.)

inconsistency into the process and thus undermine the national system of SRO arbitrations. (See Perino Report at pp. 3-4, 44, fn. 147.) In light of the SEC's intense oversight in the area of SRO arbitrations, we are reluctant to second guess the SEC's determination on these matters. (See *Shearson/American Express, Inc, v. McMahon, supra,* 482 U.S. at pp. 233-234.) When Congress delegates an agency, such as the SEC, authority to implement a statute (here the Exchange Act) the agency is in the better position to decide if a rule, such as Standard 7, would provide an "obstacle to the accomplishment and execution" of its objectives. (*Grier v. American Honda Motor Co. Inc.* (2000) 529 U.S. 861, 883; see *Cohen v. Wedbush, Noble, Cooke, Inc.* (9th Cir. 1988) 841 F.2d 282, 286 (overruled on other grounds) ["Because Congress has committed to the SEC the task of ensuring that the federal rights established by the Securities Acts are not compromised by inadequate arbitration procedures, we are bound by the Commission's determination[s concerning the adequacy of the arbitration procedures]."]) Thus, where, as here, the SEC determines that a state law conflicts with a federal regulation, we feel compelled to defer to the agency's judgment. (*Grier v. American Honda Motor Co. Inc., supra,* 529 U.S. at p. 883; see *Cohen v. Wedbush, Noble, Cooke, Inc., supra,* 841 F.2d at p. 286.)

In sum, in view of the SEC's involvement in the approval of the SRO arbitration rules, and in particular, given the direct conflict between the California Standards for arbitrator disqualification and NASD's disqualification provisions, we conclude the SRO arbitration rules and procedures (to the extent they have been approved by SEC) preempt the California Standards.[17]

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[17] There is some question whether the California Standards would apply to this case, even in the absence of federal preemption. The parties here have not addressed the retroactive application of the California Standards and, given our conclusion the Standards are preempted in any event, we do not have to decide the issue. Nonetheless, we note the argument exists the California Standards should not apply in this case because this arbitration was ongoing prior to the implementation of the standards. Indeed, three arbitrators were chosen and the case was proceeding in arbitration before the effective date of the standards, July 1, 2002. Here, the California Standards only

DISPOSITION

The writ is denied. Real Parties are entitled to recover costs on this proceeding.

CERTIFIED FOR PUBLICATION

WOODS, J.

We concur:

PERLUSS, P.J. ZELON, J.

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come into play because one of the original arbitrators voluntarily recused himself after July 1, 2002. Notwithstanding that, the California Standards purport to apply to all arbitrators appointed after July 1, 2002, the question remains whether they should apply to situations like this where the arbitration was already underway prior to July 2002.