Filed 9/30/04 Marcus v. Trautman Wasserman CA1/1

NOT TO BE PUBLISHED IN OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION ONE

LAWRENCE MARCUS, Plaintiff and Respondent, v. TRAUTMAN WASSERMAN & COMPANY, INC., Defendant and Appellant.	A104817 (San Francisco County Super. Ct. No. CGC-03-421042)
RICHARD GOLDSTEIN, Plaintiff and Respondent, v. TRAUTMAN WASSERMAN & COMPANY, INC., Defendant and Appellant.	A106306 (San Francisco County Super. Ct. No. CGC-03-424541)

In these two consolidated appeals, Trautman Wasserman & Company, Inc. (hereafter TW), appeals from separate orders that denied arbitration of claims asserted by plaintiffs. We reverse both orders.

PROCEDURAL AND FACTUAL BACKGROUND

1. Marcus appeal

On June 3, 2003, Lawrence Marcus (hereafter Marcus) filed a complaint in the San Francisco Superior Court for breach of contract, Labor Code violations and declaratory relief against TW, his former employer. In response, TW filed a petition to

compel arbitration under the rules of the National Association of Securities Dealers (NASD) as required by a provision in Marcus's employment application, Form U-4 Uniform Application for Securities Industry Registration or Transfer. The trial court granted TW's petition but retained jurisdiction "to determine if the arbitration venue designated by the NASD is proper."

Subsequently, Marcus filed a "Motion to Determine Proper Venue," supported by a declaration stating that NASD would not proceed with the arbitration of the claim in California unless Marcus waived the Ethics Standards for Neutral Arbitrators in Contractual Arbitration promulgated by the California Judicial Council (California Ethics Standards). Ruling on the motion, the trial court found that Marcus was unwilling to waive the California Ethics Standards and would not ask NASD to assign him an out-of-state hearing location. NASD refused to proceed with arbitration in the absence of such a waiver or a request for an out-of-state hearing. Accordingly, the court ruled that Marcus was "relieved of his obligation to arbitrate his claims with the NASD" and could proceed with his state court lawsuit against TW. Properly regarding the ruling as the functional equivalent of an order denying a petition to compel arbitration, TW has filed a timely notice of appeal. (Code Civ. Proc., § 1294, subd. (a); *Henry v. Alcove Investment, Inc.* (1991) 233 Cal.App.3d 94, 99.)

2. Goldstein appeal

Richard Goldstein (hereafter Goldstein) also signed a securities industry Form U-4 providing for NASD-sponsored arbitration as a condition to securing employment with TW and later filed a complaint against TW in the San Francisco Superior Court alleging claims for breach of contract, Labor Code violations, fraud and conversion. TW filed a petition to compel arbitration under NASD rules. The trial court granted the petition and stayed the state court proceedings. Goldstein attempted to file a claim for arbitration pursuant to the arbitration clause but NASD would not process his claim unless he would sign a waiver of the California Ethics Standards, which he was unwilling to do. Goldstein then filed a motion for relief from stay in the San Francisco Superior Court.

On March 29, 2004, the trial court entered an order lifting its prior stay of proceedings and permitting Goldstein to proceed with his state court lawsuit against TW on the ground that NASD had failed to provide Goldstein with a forum for hearing his claim. TW filed a timely notice of appeal from the order.

DISCUSSION

In its first assignment of error, TW argues that the California Ethics Standards are preempted by the Securities Exchange Act of 1934 (15 U.S.C. § 78a et seq., hereafter Exchange Act) and therefore have no application to the arbitration at issue. We will examine, first, the issue of federal preemption under the Exchange Act and then turn to the respondents' failure-of-forum argument.

A. Regulatory Background

The Exchange Act creates a comprehensive system of federal regulation of the securities industry. The foundation of the system consists of government oversight of self-regulating organizations (SRO's), such as the stock exchanges and the NASD, which regulate the over-the-counter securities market. (*Swirsky v. National Ass'n of Securities Dealers* (1st Cir. 1997) 124 F.3d 59, 61; *Alan v. Superior Court* (2003) 111 Cal.App.4th 217, 222.) In 1975 Congress amended the Exchange Act to vest more control in the SEC and to subject SRO's to "extensive oversight, supervision, and control by the SEC on an ongoing basis." (*Austin Mun. Securities v. National Ass'n of Securities Dealers* (5th Cir. 1985) 757 F.2d 676, 680; 15 U.S.C. § 78s.) As amended, the Exchange Act gives the SEC "expansive power to ensure the adequacy of the arbitration procedures employed by SROs . . . including the power to mandate the adoption of any rules it deems necessary to ensure that arbitration procedures adequately protect statutory rights." (*Shearson/ American Express Inc. v. McMahon* (1987) 482 U.S. 220, 233-234.)

"The Exchange Act directs SROs to adopt rules and by-laws that conform with the Exchange Act. *See* 15 U.S.C. §§ 78f(b), 78o-3(b). With some exceptions not relevant here, the SEC must approve all SRO rules, policies, practices, and interpretations prior to their implementation. *See* 15 U.S.C. §78s(b). Each SRO must comply with the provisions of the Exchange Act as well as its own rules. *See* 15 U.S.C. § 78s(g)." (*Mayo*

v. Dean Witter Reynolds, Inc. (N.D.Cal. 2003) 258 F.Supp.2d 1097, 1101-1102.) Under this regulatory scheme, the NASD has adopted, with SEC approval, a Code of Arbitration Procedure similar to that of the New York Stock Exchange. (*Roney & Co. v. Goren* (6th Cir. 1989) 875 F.2d 1218, 1222.) The SEC approval of the NASD Code of Arbitration Procedure entailed a determination that the rule is consistent with the directives of the Exchange Act. (*Shearson/American Express Inc. v. McMahon, supra,* 482 U.S. 220, 233.)

The present disputes were precipitated when the California Legislature enacted legislation in 2001 governing dispute resolution. (Stats. 2001, ch. 362.) The legislation included a provision in Code of Civil Procedure section 1281.85, subdivision (a), requiring the California Judicial Council to adopt ethics standards for arbitrators: "Beginning July 1, 2002, a person serving as a neutral arbitrator pursuant to an arbitration agreement shall comply with the ethics standards for arbitrators adopted by the Judicial Council pursuant to this section. The Judicial Council shall adopt ethical standards for all neutral arbitrators effective July 1, 2002."

In fulfillment of this mandate, the Judicial Council promulgated the California Ethics Standards at issue in this appeal. (See Cal. Rules of Court, appen., div. VI, Ethics Standards for Neutral Arbitrators in Contractual Arbitration, 23 pt. 2 West's Ann. Codes, Rules (2004 supp.) pp. 604-620.) Though the California Ethics Standards address many matters, we are concerned here with two standards that present issues of conflict with the NASD Code of Arbitration Procedure: Standard 7 dealing with disclosure by arbitrators of matters that may affect their impartiality and Standard 10 concerning the disqualification of arbitrators pursuant to Code of Civil Procedure section 1281.91.

The NASD immediately took the position that the California Ethics Standards were preempted by federal law, including the Exchange Act, and filed suit for a declaration to this effect. The lawsuit was dismissed on Eleventh Amendment grounds (*NASD Dispute Resolution v. Judicial Council of CA* (N.D.Cal. 2002) 232 F.Supp.2d 1055), but a separate suit resulted in a decision that the California Ethics Standards were preempted by the closely parallel rules of the New York Stock Exchange. (*Mayo v. Dean*

Witter Reynolds, Inc., supra, 258 F.Supp.2d 1097, 1108-1112.) To regulate arbitrations in California while this litigation was pending, NASD implemented a pilot rule, IM-10100(f), through appropriate filing with the Securities and Exchange Commission, that required parties seeking arbitration to waive application of the California Ethics Standards and agree to arbitration under the NASD Code of Arbitration Procedure. (68 Fed.Reg. 57494 (Oct. 3, 2003).) In California courts, *Alan v. Superior Court, supra,* 111 Cal.App.4th 217, 231, deferred a decision of the preemption issue to "the other civil actions in which the NASD is actively involved," but the precise issue of federal preemption involved in this appeal was later raised in *Jevne v. Superior Court* (2003) 113 Cal.App.4th 486, which is now before the Supreme Court on a petition for review. (Review granted March 17, 2004, S121532.) We are obliged here to consider the issue of federal preemption in advance of an authoritative ruling by the high court in the *Jevne* case.[1]

In the Marcus case, counsel sought a clarification of the NASD position and received a letter from Linda Fienberg, president of the NASD dispute resolution division, stating that the organization would proceed with arbitration in California only if the claimant waived "all rights and remedies they might otherwise be entitled to under the California Standards." In the event a claimant refused to sign a waiver, the NASD would not assign the arbitration to an out-of-state hearing location unless the claimant requested that their case be heard in a neighboring state. In the Goldstein case, the parties stipulated that because Goldstein would not sign a "Waiver Agreement" concerning the California Ethics Standards for Neutral Arbitrators, NASD Dispute Resolution would not process Goldstein's claim.

[1] Marcus and Goldstein argue that *Jevne* addresses only two ethics rules, Standards 7 and 10, pertaining to disclosure and disqualification of arbitrators, respectively. The waiver agreement at issue here, they argue, broadly applies to all of the ethics standards and thus presents issues that will not be resolved in *Jevne*. We consider, however, that the present case presents the same general issue as *Jevne* -- the validity of the condition to NASD arbitration that the parties agree to arbitration governed by the NASD Code of Arbitration procedure and waive the California Ethics Standards.

B. Federal Preemption

"A fundamental principle of the Constitution is that Congress has the power to preempt state law. [Citations.] Even without an express provision for preemption, we have found that state law must yield to a congressional Act in at least two circumstances. When Congress intends federal law to 'occupy the field,' state law in that area is preempted. [Citations.] And even if Congress has not occupied the field, state law is naturally preempted to the extent of any conflict with a federal statute. [Citations.] We will find preemption where it is impossible for a private party to comply with both state and federal law, [citation], and where 'under the circumstances of [a] particular case, [the challenged state law] stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' [Citation.]" (*Crosby v. National Foreign Trade Council* (2000) 530 U.S. 363, 372-373, fn. omitted; see also *Hines v. Davidowitz* (1941) 312 U.S. 52, 67-68; *Ting v. AT&T* (9th Cir. 2003) 319 F.3d 1126, 1135-1136.)

Only the issue of conflict preemption is raised in the present case. The Exchange Act "makes it clear that, except to the extent it has been subsequently modified by the Securities Litigation Uniform Standards Act of 1998, federal law in this area supplements, but does not displace state regulation and remedies." (*Diamond Multimedia Systems, Inc. v. Superior Court* (1999) 19 Cal.4th 1036, 1057; *Roskind v. Morgan Stanley Dean Witter & Co.* (2000) 80 Cal.App.4th 345, 352.) "Congress plainly contemplated the possibility of dual litigation in state and federal courts relating to securities transactions." (*Matsushita Elec. Industrial Co. v. Epstein* (1996) 516 U.S. 367, 383.)

We consider that rules for disqualification of an arbitrator in Standard 10 and Code of Civil Procedure section 1281.91 directly conflict with NASD rule 10308(d) and rule 10311. Standard 10 gives the parties the power to serve a notice of disqualification on an arbitrator who fails to make the required disclosures or makes an omission or misrepresentation in the disclosure or, alternatively, to issue a notice of disqualification based on the disclosure itself. In addition, Code of Civil Procedure section 1281.91, subdivision (b)(2), provides that "[a] party shall have the right to disqualify one court-appointed arbitrator without cause in any single arbitration, and may petition the court to

disqualify a subsequent appointee only upon a showing of cause." The NASD rules, in contrast, set up a distinct procedural system for the selection of arbitrators, which assigns a deciding role to the Director of Arbitration in many situations. (See NASD rules 10308(c) & (d) and 10311.)

We find a narrow common ground in the right of a party to issue a single preemptory challenge under Code of Civil Procedure section 1281.91 and NASD rule 10311, but, in other respects, it is impossible to reconcile the state and federal rules. The state rules give the parties a right to disqualify an arbitrator on matters pertaining to the duty of disclosure and gives the court a general power to disqualify for cause. The NASD rule gives the Director of Arbitration -- an office that does not exist in state rules -- the final authority to rule on a challenge to an arbitrator.

The compatibility of Standard 7 dealing with required disclosures by an arbitrator and NASD rule 10312(a) presents a closer question. Standard 7 generally requires disclosures of 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" and sets forth a series of precise rules describing particular kinds of disclosures, i.e., family relationships with a party or lawyer in the arbitration, other significant personal relationships, service as arbitrator for a party or lawyer for a party, other compensated service as dispute resolution neutral, current arrangements for prospective service in such capacities, financial interests in a party or in the subject of arbitration, other interests affected by the arbitration, personal knowledge of disputed facts, membership in organizations practicing discrimination, attorney-client relationships broadly described as embracing an officer, director, or a trustee of a party within the preceding two years and lawyers with whom the arbitrator is or was associated in private practice, other professional relationships, and a catchall provision referring to other matters. As an example, the rule pertaining to prior service as an arbitrator requires detailed disclosure of services for a party or lawyer for a party within precise time periods and requires names, results, and number of prior or pending cases.

In contrast, NASD rule 10312(a) provides in general terms that an arbitrator shall disclose: "(1) Any direct or indirect financial or personal interest in the outcome of the arbitration; [¶] (2) Any 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 partiality or bias. Persons requested to serve as arbitrators should disclose any such relationships or circumstances that they have with any party or its counsel, or with any individual whom they have been told will be a witness. They should also disclose any such relationship or circumstances involving members of their families or their current employers, partners, or business associates." The rule proceeds to state that arbitrators should "make a reasonable effort to inform themselves" of matters requiring disclosure and that their obligation to disclose relevant interests, relationships, or circumstances is a continuing duty.

In our view, it is possible to comply with both Standard 7 and NASD rule 10312. The rigorous requirements of Standard 7 clearly satisfy the general guidelines of rule 10312, and a punctilious observance of rule 10312 would often lead to the sort of disclosures that are articulated in Standard 7. The issue of conflict preemption turns on whether the complex and precisely articulated rules in Standard 7 nevertheless "stand[] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." (*Hines v. Davidowitz, supra,* 312 U.S. 52, 67.) We conclude that the state standards are indeed preempted under this strand of conflict preemption doctrine.

The NASD arbitration rules represent a balance between considerations of fairness and efficiency in adjudication of disputes. More demanding or complex rules can diminish the availability of arbitrators and impose costs, delays and uncertainty in the arbitration process. The SEC approval of the NASD rules constitutes a determination that the rules combine adequate personal protections for claimants with a flexibility conducive to efficient resolution of disputes. Standard 7 represents a distinctly different assessment of the appropriate balance between these considerations. In light of the SEC's legislative mandate to ensure the adequacy of arbitration procedures employed by SRO's, we are obliged to defer to its determination that the NASD rule at issue here is

appropriate for the securities industry. (*Shearson/American Express Inc. v. McMahon, supra,* 482 U.S. 220, 233; *Cohen v. Wedbush, Noble, Cooke, Inc.* (9th Cir. 1988) 841 F.2d 282, 287.)

We conclude that the California Ethics Standards are preempted by the NASD Code of Arbitration, as approved by the SEC. (U.S. Const., art. VI, cl. 2; *Crosby v. National Foreign Trade Council, supra,* 530 U.S. 363, 372.) Our conclusion makes it unnecessary to consider TW's related claim that the California Ethics Standards are preempted by the Federal Arbitration Act. (9 U.S.C., § 1 et seq.)

C. Unconscionability

Marcus and Goldstein argue that TW's arbitration agreement is unconscionable under California law and therefore unenforceable in a state court. Under section 1 of the FAA, the determination of whether an arbitration agreement is enforceable is to be made under state law. (9 U.S.C. section 1.)

We consider that this issue was exhaustively and correctly analyzed in *McManus v. CIBC World Markets Corp.* (2003) 109 Cal.App.4th 76. We see no reason to depart from the *McManus* holding that, with the exception of the cost provision, the agreements to arbitration before NASD were enforceable. With respect to the issue of costs of arbitration, the order to compel arbitration provided "that the requirement that Plaintiff pay forum fees to the NASD to have his claim heard are severed from the agreement. Defendant Trautman Wasserman & Company, Inc. shall be wholly responsible for paying forum fees associated with Plaintiff's NASD arbitration." The severance of this provision in the agreement avoids the defense of unconscionability. (*Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83, 121-127.)

D. Order to Compel Arbitration

The peculiar difficulty of the present cases arises from the NASD's requirement that Marcus and Goldstein waive the California Ethics Standards as a condition to arbitration in the forum provided by NASD. The objective of the waiver clearly was to prevent a later motion to vacate an award under Code of Civil Procedure section 1286.2, which would lead to further litigation and uncertainty. But by requiring a waiver, the

NASD gives some credence to their claims that they were denied a forum and deprived of the right of a prompt hearing on their wage claims. TW responds that the waiver is no more than a formality since the California Ethics Standards are inapplicable to the arbitration under the Preemption Clause of the United States Constitution.

As respondents point out, when the parties agree to arbitration in a particular forum, the refusal of that forum to conduct the arbitration renders the agreement to arbitrate unenforceable. The courts will not imply a promise to arbitrate in another forum but rather will deny the petition for arbitration on the ground of failure of forum and accept jurisdiction for adjudication of the dispute. (*Alan v. Superior Court, supra,* 111 Cal.App.4th 217, 224-227; *Smith Barney v. Critical Health Systems of N.C.* (4th Cir. 2000) 212 F.3d 858, 861-862; *In re Salomon Inc. Shareholders' Derivative Lit.* (2d Cir. 1995) 68 F.3d 554, 557-561.)

We recognize that the reasons for this procedural dilemma may disappear when the California Supreme Court decides the preemption issue in the *Jevne* case. A decision rejecting preemption will require the NASD to withdraw the waiver requirement while a decision affirming preemption will make the waiver requirement unnecessary. We must decide the present case, however, on the basis of our conclusion that the California Ethics Standards are preempted by the Exchange Act. Based on this conclusion we consider that the waiver of an inapplicable body of law is a reasonable condition to impose on a claimant seeking arbitration. Enforcement of the waiver requirement does not constitute a refusal to arbitrate that would result in a failure of the forum to conduct arbitration. Accordingly, we hold that in the Marcus case the trial court erred in setting aside the order to compel arbitration in its order entered November 4, 2003, on plaintiff's motion to determine venue, and in the Goldstein case the trial court erred in entering the order granting relief from stay filed March 29, 2004.

The order entered on November 4, 2003 in Lawrence Marcus v. Trautman Wasserman & Company, Inc. (A104817)[2] and the order entered on March 29, 2004, in

[2] The requests of TW for judicial notice filed March 11, 2004, and May 6, 2004, are granted.

Richard Goldstein v. Trautman Wasserman & Company, Inc. (A106306) are reversed. The respondents and appellants in each case are to bear their own costs on appeal.

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Swager, J.

We concur:

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Marchiano, P. J.

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Stein, J.