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NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIFTH APPELLATE DISTRICT

JERI L. WINBERG, as Co-trustee, etc., et al.,

Plaintiffs and Respondents,

v.

SALOMON SMITH BARNEY et al.,

Defendants and Appellants.

F042866

(Super. Ct. No. 02 CE CG 04684)

OPINION

APPEAL from a judgment of the Superior Court of Fresno County. Mark W. Snauffer, Judge.

Keesal, Young & Logan, Paul J. Schumacher, Dawn Schock, Danielle J. Tarasen, and Matthew J. Esposito; Bingham, McCutchen, Paul J. Schumacher, Dawn Schock, and Danielle J. Tarasen for Defendants and Appellants.

Law Offices of Cornwell & Sample and Stephen R. Cornwell for Plaintiffs and Respondents.

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Plaintiffs and respondents Jeri L. Winberg and Judy Ann McCoy, co-trustees of the Allbritten Family Trust, the Dorothy P. Allbritten Decedent's Trust, and the Clyde R. Allbritten Survivors Trust, Jeri Winberg, individually, and Judy Ann McCoy,

individually (collectively, plaintiffs) filed suit against defendants and appellants Salomon Smith Barney Inc. (SSB) and Tracy Rae Turner (collectively, defendants), alleging breach of fiduciary duty, breach of contract, negligence and related claims. Defendants moved to compel arbitration pursuant to a written contract between the parties.

Plaintiffs opposed the motion on the ground that the National Association of Securities Dealers (NASD) and the New York Stock Exchange (NYSE), both self-regulatory organizations (SROs), refused to appoint arbitrators in California because of newly adopted disclosure requirements for all arbitrators. The trial court denied the motion. We reverse.

PROCEDURAL AND FACTUAL HISTORIES[1]

Plaintiffs, as trustees, maintained four accounts with SSB at its Fresno branch. In late 1999, in connection with each of these accounts, plaintiffs executed SSB's Account Application and Client Agreement, which provides above the signature line: "I acknowledge that I have received the Client Agreement which contains a pre-dispute arbitration clause in section 6."

Section 6 of the Client Agreement states:

> "I agree that all claims or controversies, whether such claims or controversies arose prior, on or subsequent to the date hereof, between me and SSB and/or any of its present or former officers, directors, or employees concerning or arising from (i) any account maintained by me with SSB individually or jointly with others in any capacity; (ii) any transaction involving SSB or any predecessor firms by merger, acquisition, or other business combination and me, whether or not such transaction occurred in such account or accounts; or (iii) the construction, performance or breach of this or any other agreement between us, any duty arising from the business of SSB or otherwise, shall be determined by arbitration before,

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[1]There being no opposition by plaintiffs, we grant defendants' July 8, 2003 and October 21, 2003, requests for judicial notice pursuant to Evidence Code sections 451, 452 and 459.

> and only before, any self-regulatory organization or exchange of which SSB is a member. I may elect which of these arbitration forums shall hear the matter …."[2]

The Client Agreement also contains a New York choice-of-law clause: "Except for statutes of limitation applicable to claims, this Agreement and all the terms herein shall be governed and construed in accordance with the laws of the State of New York without giving effect to principles of conflict of laws."

In September 2001, the California Legislature added Code of Civil Procedure section 1281.85, which states:

> "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. These standards shall be consistent with the standards established for arbitrators in the judicial arbitration program and may expand but may not limit the disclosure and disqualification requirements established by this chapter. The standards shall address the disclosure of interests, relationships, or affiliations that may constitute conflicts of interest, including prior service as an arbitrator or other dispute resolution neutral entity, disqualifications, acceptance of gifts, and establishment of future professional relationships." (See Sen. Bill No. 475 (2001-2002 Reg. Sess.).)

The Legislature also amended Code of Civil Procedure section 1286.2, subdivision (a)(6), to provide that the court must vacate an arbitration award if it determines that an arbitrator making the award failed to disclose within the time required for disclosure a ground for disqualification of which the arbitrator was then aware.

Effective July 1, 2002, the Judicial Council of the State of California adopted Division VI of the Appendix to the California Rules of Court, "Ethics Standards for

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[2]There is no dispute that SSB is a member of the NASD and the NYSE, both SROs.

Neutral Arbitrators in Contractual Arbitration" (California Standards). The California Standards contain extensive disclosure requirements for arbitrators of information relating to potential biases or conflicts of interest. The NASD and NYSE announced that, as of July 1, 2002, they were temporarily postponing the appointment of arbitrators for new arbitration cases in California until their concerns over the new rules governing the arbitration process in California were addressed.

On July 22, 2002, the NASD and the NYSE filed a declaratory relief action in the United States District Court for the Northern District of California seeking a determination that SROs are not governed by the new California arbitrator disclosure rules. (See *NASD Dispute Resolution v. Judicial Council of CA* (N.D.Cal. 2002) 232 F.Supp.2d 1055.) The NASD also issued a news release advising:

> "The new California rules were designed to address conflicts of interest in private arbitration forums that are not part of a national regulatory system overseen on a uniform, national basis by the Securities and Exchange Commission (SEC), as are the forums administered by the NASD and the NYSE. The conflicts the new rules are designed to correct do not exist in the NASD and NYSE dispute resolution programs - which are not-for-profit and highly regulated.
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> "'As a result of the new rules, arbitrators are not being appointed to hear new investor disputes in California until this matter is resolved; however, arbitrations already underway will proceed to conclusion unless a replacement arbitrator is required ….' 'If … SROs were required to implement the California rules, investors and other parties would be saddled with higher costs, a less efficient and streamlined process, and a much smaller arbitrator roster from which to select the panelists who will decide their cases.' [¶] … [¶]
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> "NASD Dispute Resolution provides investors a fair, efficient, cost-effective forum to arbitrate disputes with their brokers or brokerage firms. The average resolution for disputes is 12 to 14 months from the filing of a claim."

On November 12, 2002, the district court dismissed the action, concluding that the Judicial Council and the individual members of the Judicial Council were immune from

suit under the Eleventh Amendment. (*NASD Dispute Resolution v. Judicial Council of CA*, *supra*, 232 F.Supp.2d at pp. 1057, 1063-1066.) The NASD and the NYSE appealed to the United States Court of Appeals for the Ninth Circuit.

By December 2002, the NASD posted on its website a notice to parties in California arbitration matters that they could have their cases heard in neighboring states (e.g., Oregon, Washington, Nevada and Arizona), mediate their cases, or waive all rights and remedies to which they would otherwise be entitled under the California Standards.

On December 30, 2002, plaintiffs filed suit against defendants, among others, alleging claims for breach of fiduciary duty, breach of contract, negligence, fraud, and intentional and negligent infliction of emotional distress. Defendants moved to compel arbitration before the NASD Dispute Resolution and stay the proceedings.

The trial court denied the motion, recognizing that the only alternatives to California claimants would be to agree to proceed with arbitrators in another states or agree to execute a waiver of their rights to object under California law to California arbitrators.

DISCUSSION

Defendants contend that the trial court erred in denying the petition to compel arbitration because 1) the California Standards are preempted by the Securities Exchange Act of 1934 (Exchange Act) and/or the Federal Arbitration Act (FAA),[3] and 2) the contracts to arbitrate are not unenforceable under state law. We first turn to the issue of preemption.

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[3]The Exchange Act is codified at 15 U.S.C. section 78a et seq., and the FAA is codified at 9 U.S.C. section 1 et seq.

I. Preemption by federal law

Preemption of the California Standards by the Exchange Act and/or the FAA is a legal issue subject to de novo review. (See *Mount Diablo Medical Center v. Health Net of California, Inc.* (2002) 101 Cal.App.4th 711, 716-717.) The Second District Court of Appeal exhaustively addressed the issue of whether the California Standards are preempted by federal law in *Jevne v. Superior Court* (2003) 113 Cal.App.4th 486. The court's analysis is directly pertinent here and we cite to it at length.

The *Jevne* court first addressed whether the California Standards are preempted by the FAA:

> "The FAA governs all agreements to arbitrate where the transactions at issue in the dispute involve interstate commerce.… 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.… State laws concerning arbitration are only preempted to the extent that they conflict with congressional intent to favor the enforcement of arbitration agreements. [Citation.] [¶] … [¶]
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> "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 [United States] 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.' [Citation.]
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> "In our view, the California Standards are consistent with the other California arbitration procedures the [Supreme] [C]ourt endorsed. On their face, the California Standards are not anti-arbitration.… [T]he 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.… Consequently, we conclude the California Standards are not preempted by the FAA as a matter of law." (*Jevne v. Superior Court*, *supra*, 113 Cal.App.4th at pp. 497-498, fn. omitted.)

The *Jevne* court went on to address whether the California Standards are nonetheless preempted by the Exchange Act:

"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.… [¶] … [¶] [S]tate law is preempted to the extent it conflicts with federal law. [Citations.] 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."' [Citations.] [¶] … [¶]

"[T]he 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 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.… [¶] … [¶]

" … 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.

" … 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.

"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.… Because Standard 10 effectively eliminates the role of the Director of Arbitration, we find that it conflicts with NASD rules 10309-10313, and 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. [¶] … [¶]

"In any event, the California Standards relating to disclosure of conflicts of interest also appear to stand as an obstacle to the NASD rules.… [¶] … [¶] The Exchange Act … requires the SEC to approve all NASD rules, upon finding the rule complies with the Exchange Act. [Citation.] 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. [Citation.] 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. [Citation.] SEC approval of a NASD regulation constitutes a determination by the SEC the rule comports with congressional directives and the Exchange Act.…

"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.… [W]here, as here, the SEC determines that a state law conflicts with a federal regulation, we feel compelled to defer to the agency's judgment. [Citations.]

"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." (*Jevne v. Superior Court*, *supra*, 113 Cal.App.4th at pp. 499-502, 506-508, fns. omitted; see also *Mayo v. Dean Witter Reynolds, Inc.* (N.D.Cal. 2003) 258 F.Supp.2d 1097, 1109-1116 [California Standards preempted by Exchange Act and FAA].)

We decline to further adjudicate the preemption issue and apply the court's analysis in *Jevne*. Thus, we conclude the California Standards are preempted by the Exchange Act. In fact, plaintiffs apparently concede this point, as they fail to provide any response to the argument. The California Standards, therefore, do not provide a basis for rescinding the contracts to arbitrate. In light of our conclusion, it is unnecessary to address defendants' argument that the Judicial Council of the State of California exceeded its mandate in making the California standards applicable to SROs.

II. Unenforceability under state law

Plaintiffs contend that the contracts to arbitrate are unenforceable under state law theories of impossibility and/or unconscionability or under general equities of the case. Plaintiffs' argument is fatally flawed. As recognized by defendants, because we find the California Standards are preempted, they cannot independently provide a basis under state law for the rescission of the contracts to arbitrate.

In *Perry v. Thomas* (1987) 482 U.S. 483, 492-493, footnote 9, the United States Supreme Court explained the role of state law under the FAA in determining whether an arbitration contract is enforceable:

> "An agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law*, [citation], 'save upon such grounds as exist at law or in equity for the revocation of *any* contract.' 9 U. S. C. § 2 (emphasis added). Thus state law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally. A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of § 2. [Citation.] A court may not, then, in assessing the rights of litigants to enforce an arbitration agreement, construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law. Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what we hold today the state legislature cannot." (See also *Thomas v. Perry* (1988) 200 Cal.App.3d 510, 514-515 [argument NYSE rules for selection of arbitrator are unfair is clearly the type addressed to the uniqueness of agreement to arbitrate].)

Plaintiffs first argue that the unavailability of the contract forum—arbitration before an SRO—makes the contract impossible to perform. However, the contract forum is, and has been, available to plaintiffs. Plaintiffs had two options: 1) arbitrate their dispute in another state, or 2) arbitrate their dispute in California with a waiver of their rights and remedies under the California Standards. Plaintiffs contracted to arbitrate before an SRO. They did not contract to arbitrate in any particular venue. Although

arbitration hearings generally take place in a major urban area where the customer resided when the dispute arose, the NASD rules provide that the venue of any arbitration is at the discretion of the Director of Arbitration. (See NASD rule 10315.) Further, plaintiffs made no factual showing that an out-of-state venue would be so inconvenient or burdensome as to render performance impossible. (See 1 Witkin, Summary of Cal. Law (9th ed. 1987) Contracts, § 774, pp. 699-701 ["[M]ere unforeseen difficulty or expense does not constitute impossibility and ordinarily will not excuse performance."].)

Plaintiffs next argue that the contracts to arbitrate are unconscionable. "If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract …." (Civ. Code, § 1670.5; see also *Flores v. Transamerica HomeFirst, Inc.* (2001) 93 Cal.App.4th 846, 851 [arbitration provision may be held unenforceable if it is unconscionable].) The alleged unconscionability here did not exist at the time of the contracts' making, since the conflicting California Standards were not in existence at the time the Client Agreements were signed.

Citing to the Second District Court of Appeal case of *Alan v. Superior Court* (2003) 111 Cal.App.4th 217, plaintiffs next contend that the equities favor proceeding to trial. We disagree. *Alan* was decided prior to *Jevne v. Superior Court*, *supra*, 113 Cal.App.4th 486. In *Alan*, the heir of a deceased investor filed suit against the investor's broker for claims relating to the alleged mismanagement of the investor's accounts. The investment agreements signed by the investor required all controversies to be decided by arbitration before one of the securities industry SROs. However, the SROs refused to conduct arbitrations in California as a result of the California Standards. On motion of the brokers, the trial court ordered the case to arbitration. (*Alan, supra,* at p. 219.)

The appellate court issued a peremptory writ of mandate directing the trial court to vacate its order granting the broker's motion to compel arbitration. The court never

reached the issue of whether the California Standards are preempted by federal law. Instead, the court concluded that the trial court should first decide whether the out-of-state location selected by the NASD was proper. The court held that if California was found to be the proper location, the dispute should be tried in a California court since the SRO refused to arbitrate the matter. However, if an out-of-state location was found to be proper, the dispute should be resolved through arbitration there. (*Alan v. Superior Court*, *supra*, 111 Cal.App.4th at pp. 219-220, 230-231.) The case is inapposite here, as we apply the holding in *Jevne v. Superior Court*, *supra.*

Finally, plaintiffs argue that the SROs' refusal to appoint arbitrators in California results in a denial of their constitutional right to a trial by jury. It is beyond dispute that a right to jury trial may be waived by entering into an arbitration contract. (See *Shearson/American Express Inc. v. McMahon* (1987) 482 U.S. 220, 226-227.) The delay in this case does not amount to a constitutional deprivation of a trial by jury, which has already been waived.

In sum, the trial court erred in denying the petition to compel arbitration, since the California Standards are preempted by the Exchange Act and the contracts to arbitrate are not unenforceable under state law.

DISPOSITION

The order denying the motion to compel arbitration and stay the proceedings is reversed. The case is remanded with directions to enter an order granting the motion. Costs are awarded to defendants.

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Wiseman, J.

WE CONCUR:

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Buckley, Acting P.J.

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Cornell, J.