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NOT TO BE PUBLISHED IN OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FOUR

JOHN J. DAVIS, JR., Individually and as Trustee, etc. Plaintiffs and Respondents, v. OPPENHEIMER & CO. et al., Defendants and Appellants.	A102929 (San Francisco County Super. Ct. No. CGC-03-416751)

An investor sued his securities brokers for breach of fiduciary duty and other alleged wrongs arising out of the brokers' investment advice and management of a brokerage account. The brokers moved to compel arbitration of the dispute pursuant to the parties' brokerage agreement, which provides that all controversies shall be submitted to binding arbitration, and to stay proceedings until arbitration was complete. (Code of Civ. Proc., §§ 1281.2, 1281.4.) The trial court denied the brokers' motion.

The court found that the agreement's forum selection provision failed because the selected arbiters were the New York Stock Exchange (NYSE) or the National Association of Securities Dealers, Inc. (NASD), and neither organization will conduct arbitrations in California unless the parties waive application of California arbitrator disclosure and disqualification standards that are the subject of a pending judicial challenge. The brokers appeal, contending that the investor is not entitled to an arbitration compliant with state arbitration standards because those standards are preempted by federal law, or otherwise invalid. We conclude that the state arbitration

standards are preempted by federal law as applied to NYSE and NASD arbitrations, and accordingly reverse the trial court's order denying the brokers' motion to compel arbitration and to stay proceedings.

FACTS

Respondent John J. Davis, Jr., individually and as trustee for the John J. Davis, Jr. 1989 Living Trust, sued his securities brokers, appellants Oppenheimer & Co., Inc., CIBC World Markets Corp., and David S. Carey (collectively, CIBC).[1] The complaint, filed January 27, 2003, alleges breach of fiduciary duty and related wrongs arising out of CIBC's investment advice and management of a securities brokerage account opened in 1995 and actively managed through at least August 2002.

On April 10, 2003, CIBC moved to compel arbitration of the dispute pursuant to the client agreement (Agreement) executed upon opening the account, which provides that all controversies shall be submitted to binding arbitration. The trial court denied CIBC's motion to compel arbitration, by order filed May 23, 2003. The court found that the Agreement's forum selection provision failed because the selected arbiters, the NYSE or the NASD, will not conduct arbitrations in California unless the parties waive their rights under California arbitrator ethics standards adopted in July 2002. (Cal. Rules of Court, appen., div. VI, Ethics Standards for Neutral Arbitrators in Contractual Arbitration (California Standards).) The question on appeal is whether Davis is entitled to proceed before an arbitration panel that is compliant with the California Standards. CIBC argues that Davis is not so entitled because the California Standards are preempted by federal securities law providing different arbitration rules.

[1] Davis opened his brokerage account with Oppenheimer & Co., Inc. in 1995. In 1997, Oppenheimer & Co., Inc. merged with CIBC Wood Gundy Securities Corp. and Oppenheimer Holdings to form CIBC Oppenheimer Corp., which was later renamed CIBC World Markets Corp. David S. Carey is the investment advisor who handled Davis's account.

DISCUSSION

The question of whether the California Standards are preempted by the federal Securities Exchange Act of 1934 (15 U.S.C. § 78a, et seq. (the Exchange Act)), and rules promulgated under the Exchange Act, is a pending issue before our Supreme Court. (*Jevne v. Superior Court* (2003) 113 Cal.App.4th 486, review granted March 17, 2004, S121532 (*Jevne*).) We conclude, as did the Second District in *Jevne*, that the California Standards are preempted by the Exchange Act with respect to arbitrations before the NYSE and NASD. (*Jevne, supra,* 113 Cal.App.4th at pp. 506-508; accord *Mayo v. Dean Witter Reynolds, Inc.* (N.D. Cal. 2003) 258 F.Supp.2d 1097, 1108-1112 (*Mayo*).) We therefore reject Davis's contention that his performance under the arbitration clause has been rendered impossible, and is thus excused, because he cannot arbitrate his claims without "giving up rights and protections that he is entitled to under California law." The California Standards are preempted by federal law, and thus Davis is not entitled to proceed before an NYSE or NASD arbitration panel compliant with the California Standards.

A. The Exchange Act and the NYSE and NASD Arbitration Rules

The NYSE, a national securities exchange, and the NASD, a national securities association, are "self-regulatory organizations" (SROs) registered with the United States Securities Exchange Commission (SEC) pursuant to the Exchange Act. (*Alan v. Superior Court* (2003) 111 Cal.App.4th 217, 222 (*Alan*); *Mayo, supra,* 258 F.Supp.2d at p. 1101.) The Exchange Act authorizes SROs to regulate their members but that self regulation is subject to extensive oversight, supervision, and control by the SEC. (*Alan, supra,* at p. 222.)

" 'The Exchange Act directs SROs to adopt rules and by-laws that conform with the Exchange Act . . . . With some exceptions . . . , the SEC must approve all SRO rules, policies, practices, and interpretations prior to their implementation . . . . Each SRO must comply with the provisions of the Exchange Act as well as its own rules . . . . [¶] One of the functions of the SROs is to provide arbitral fora for the resolution of securities

industry disputes . . . . Securities broker-dealers routinely include arbitration clauses in their customer agreements . . . . As a result, both the NYSE and the NASD . . . provide arbitration services to their members. The SEC has expansive power to regulate the SRO arbitration programs.' " (*Alan, supra,* 111 Cal.App.4th at pp. 222-223, quoting *Mayo, supra,* 258 F.Supp.2d at pp. 1101-1102.)

"Arbitration services provided by the NYSE are conducted in accordance with the NYSE Arbitration Rules; those provided by [NASD] are conducted in accordance with the NASD Code of Arbitration Procedure." (*Mayo, supra,* 258 F.Supp.2d at p. 1102.) The NYSE and the NASD arbitration rules and procedures are substantially similar to each other in all matters relevant here. Those rules provide a comprehensive system for arbitrations, and include rules governing disclosures of potential conflicts of interest and procedures for disqualification of arbitrators. (NASD rules 10312-10313; NYSE rules 608-611.)

B. The California Standards

In 2001, the Legislature enacted Code of Civil Procedure section 1281.85, which directed the Judicial Council to promulgate ethical standards for neutral arbitrators, and which imposed these standards on persons serving as neutral arbitrators. (See Sen. Bill No. 475 (2001-2002 Reg. Sess.).) In response to that directive, the Judicial Council issued the California Standards, effective July 1, 2002, which include extensive disclosure requirements and standards for disqualification. (California Standards, Standards 1, 3, 7-10.) If an arbitrator fails to make the disclosures required by the California Standards, a court must vacate the arbitration award. (Code Civ. Proc., §§ 1281.9, subd. (a)(2), 1281.91, 1286.2, subd. (a)(6).)

C. SEC Response to the California Standards

The NYSE and NASD have challenged the California Standards as preempted by federal law. (See *Jevne*, *supra*, 113 Cal.App.4th at pp. 492-493, fn. 2.) Pending a definitive resolution of that issue, the SEC approved an NYSE interim rule requiring investors to arbitrate their securities disputes outside California or waive the California

Standards. (NYSE rule 600(g); see 68 Fed. Reg. 57496-01 (Oct. 3, 2003).) NASD has a similar SEC-approved rule. (NASD rule IM-10100; see 68 Fed. Reg. 17713-01 (April 10, 2003).)

D. Preemption

The laws of the United States are "the supreme law of the land." (U.S. Const., art. VI, cl. 2.) "[S]tate law that conflicts with federal law is 'without effect.' " (*Cipollone v. Liggett Group, Inc.* (1992) 505 U.S. 504, 516.) Federal preemption may arise in three circumstances: express preemption by explicit statutory language; field preemption by pervasive federal regulation; or direct preemption by an actual conflict such that it is impossible to comply with both state and federal requirements, or state law obstructs accomplishment of the purposes and objectives of Congress. (*English v. General Electric Co.* (1990) 496 U.S. 72, 78-79.) Only conflict preemption is implicated in this case.

We conclude, as did the *Jevne* and *Mayo* courts, that the disqualification rules of the California Standards present an actual conflict with the NYSE and NASD rules, resulting in direct preemption. (*Jevne, supra,* 113 Cal.App.4th at pp. 501-502; *Mayo, supra,* 258 F.Supp.2d at pp. 1107, 1110.) The California Standards provide that a superior court judge make the ultimate decision on the disqualification of an arbitrator. (California Standards, Standard 10; see Code Civ. Proc., § 1281.91.) In contrast, the director of arbitration makes the ultimate decision on disqualification under the NYSE and NASD rules. (NYSE rules 609-611; NASD rules 10308-10313.)

The California Standards "greatly reduce, if not eliminate in practice, the role of the Director of Arbitration in the disqualification process." (*Mayo, supra,* 258 F.Supp.2d at p. 1107.) This conflict between the California Standards and SRO arbitration rules is not without consequences. National uniformity maintained by submission of all disqualification requests to the director of arbitration would be lost were another decision maker substituted for the director of arbitration in California securities arbitrations. In addition to thus frustrating the objectives of the SEC-approved arbitration rules, the California Standards also directly conflict with those rules as it is impossible for a private

party seeking disqualification of an arbitrator to comply with both sets of procedures. An investor must either submit his or her disqualification request to a superior court judge (California Standards) or to the director of arbitration (NYSE and NASD rules). This direct conflict mandates a finding of preemption.

In light of our conclusion that the California Standards are preempted by the Exchange Act, it is unnecessary to address CIBC's argument that additional grounds for finding preemption exist, or that the Judicial Council exceeded its mandate in making the California Standards applicable to SROs.

Our finding of federal preemption of the California Standards also obviates Davis's claim that the SRO's interim rules requiring out-of-state arbitration or waiver of the California Standards excuses his performance under the arbitration clause. (See NYSE rule 600(g).) Davis argues that the object of the arbitration clause is now impossible because he cannot pursue arbitration before the NYSE or NASD, as specified in the arbitration clause, "without giving up rights and protections that he is entitled to under California law." The California Standards are preempted by federal law, and thus Davis is not entitled to proceed before an NYSE or NASD arbitration panel compliant with the California Standards.

Davis's arguments that the required waiver of the California Standards constitutes a modification of the Agreement, and makes the Agreement unconscionable, are similarly flawed. The California Standards conflict with federal law and are thus " 'without effect.' " (*Cipollone v. Liggett Group, Inc., supra,* 505 U.S. at p. 516.) It follows that the waiver of California Standards does not modify the parties' contract, which has always provided for application of NYSE or NASD arbitration rules. There is also nothing unconscionable about requiring affirmation of the governing arbitration rules and waiver of ineffective, conflictual rules that are preempted.

Alan v. Superior Court, supra, 111 Cal.App.4th 217 at p. 230, is not to the contrary. In that case, the trial court granted a securities broker's motion to compel arbitration and the appellate court reversed and remanded for a factual determination as to whether an out-of-state venue for arbitration was reasonable. The court did not

consider the waiver alternative to an out-of-state venue, and expressly declined to address whether the California Standards were preempted. (*Id.* at pp. 230-231.) Unlike *Alan*, the preemption issue has been fully litigated in this case and, having found that the California Standards are preempted by federal law, those standards can provide no basis for invalidating the parties' Agreement.

DISPOSITION

The order denying the motion to compel arbitration and to stay trial court proceedings is reversed. The case is remanded with directions to enter an order granting the motion. The parties shall bear their own costs incurred on appeal.

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Sepulveda, J.

We concur:

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Reardon, Acting P.J.

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Kline, J.