S121532

IN THE

SUPREME COURT

OF THE STATE OF CALIFORNIA

JACK JEVNE, et al.,
Petitioners,

v.

SUPERIOR COURT OF LOS ANGELES COUNTY,
Respondent;

JB OXFORD HOLDINGS, INC., et al.,
Real Parties in Interest

NASD DISPUTE RESOLUTION, INC.
and NEW YORK STOCK EXCHANGE, INC.,
Interveners.

Second Appellate District No. B167044
Los Angeles County Superior Court No. SC062784

APPLICATION TO FILE *AMICUS CURIAE* BRIEF, AND BRIEF OF *AMICUS CURIAE* SECURITIES INDUSTRY ASSOCIATION IN SUPPORT OF REAL PARTIES IN INTEREST AND INTERVENERS

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7.21.04

APPLICATION TO FILE *AMICUS CURIAE* BRIEF

TO THE ACTING CHIEF JUSTICE OF CALIFORNIA:

Pursuant to Rule 29.3(c) of the California Rules of Court, the Securities Industry Association ("the SIA") hereby requests leave to file an *amicus curiae* brief in support of Respondent JB Oxford Holdings, Inc. and Interveners, the National Association of Securities Dealers ("NASD") and the New York Stock Exchange, Inc. ("NYSE").

The SIA is the securities industry's principal trade association, representing the common interests of more than 600 securities firms. SIA member firms, which include investment banks, broker-dealers, and mutual fund companies, are active in all phases of corporate and public finance, throughout the United States and abroad. The SIA's goals include encouraging efficient regulation and strengthening public trust and confidence in the U.S. securities industry.

In contracting with their brokerage customers, the SIA's member firms almost invariably use standard customer agreements that provide for arbitration of disputes. Those provisions generally specify that arbitration will take place before federally-registered self-regulatory organizations ("SROs"), such as NASD and the NYSE. Member firms rely heavily on these arbitration provisions to provide an efficient, fair and economical means of resolving the thousands of customer disputes that arise each year. Indeed, SIA member firms are parties to numerous pending cases in California state and federal courts that raise the same issues presented by the instant case and will necessarily be affected by the decision in this case. Accordingly, the SIA has a substantial interest in the extent to which agreements to arbitrate claims between securities firms and their customers

may be enforced, and what rules should apply to such arbitrations.

The SIA believes that by addressing the potential impact on its members of imposing varying state standards upon already extensively federally-regulated securities arbitrations, it can contribute to the Court's resolution of the issues posed in this case in a manner not fully explicated in the briefs filed by the parties to the litigation.

DATED: July 21, 2004

Respectfully submitted,

MUNGER, TOLLES & OLSON LLP

By: 

Marc T.G. Dworsky

Attorneys for *Amicus Curiae*
Securities Industry Association

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I. Introduction

The National Association of Securities Dealers ("NASD") and the New York Stock Exchange ("NYSE"), both federally-registered self-regulatory organizations ("SROs") registered with the Securities and Exchange Commission ("SEC"), administer the vast majority of securities arbitration claims in the United States. In the past four years alone, they handled over 35,000 such claims. *See* www.nasdadr.com/statistics.asp; www.nyse.com/pdfs/arbstats042004.pdf. Those arbitrations are conducted pursuant to uniform, nationally-applicable procedural rules that have been approved by the SEC as protecting investors and the public interest, and as consistent with the requirements of the Securities and Exchange Act of 1934. 15 U.S.C. § 78s(b); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 233 (1987). However, the generic arbitrator disclosure and disqualification standards recently promulgated by the Judicial Council of California (the "California Standards") conflict with these federally-approved rules. *See* Cal. R. Ct. App. Div. VI.

Both the SEC and the SROs have concluded that the California Standards cannot and do not apply to arbitrations administered by the SROs. Since the California Standards took effect, however, there has been a spate of litigation over this precise question, and the instant case offers this Court the opportunity to resolve the issue. The SIA will not repeat the factual background set out in the Interveners' and Respondents' briefing, nor will it reiterate the legal arguments made ably by those parties. Rather, the SIA will address one narrow but important issue – the significance of this decision for the viability of arbitration as an effective, efficient and just method of resolving disputes between investors and securities firms.

As courts, commentators and claimants involved in securities arbitrations have recognized, arbitration offers a fair, fast and economical method of resolving disputes. But the position advocated by Petitioners, namely, that each state is free to impose additional conditions and regulations upon such arbitrations, would effectively strip arbitration of the very benefits it offers. Accordingly, this Court should find that the California Standards are preempted by the Securities and Exchange Act. A contrary result would deprive SIA members of the benefits of the federally-approved procedures for which they have contracted, and would subvert federal policy favoring arbitration by forcing parties and arbitrators to try to reconcile the fifty states' competing and sometimes explicitly conflicting general arbitration rules with the uniform, industry-specific rules promulgated by the SROs and approved by the SEC.

II. Petitioners' Attack On The Quality And Fairness Of Securities Arbitration Is Groundless.

Petitioners' Opening Brief seeks to frame the instant debate by challenging, without evidence or citation, the quality and fairness of the arbitrations held by the SROs. Petitioners' Opening Brief ("Op. Br.") at 1. Petitioners assert at length that California citizens are forced to submit to an arbitration system that is both slower and costlier than litigation in California, and that is skewed against the individual claimant. Op. Br. at 1-2. These assertions are simply not true.

A. Overview Of The Securities Industry And The Role Of Arbitration.

The securities industry employs more than 800,000 individuals, and serves approximately 50 million investors directly, as well as tens of millions indirectly through corporate, thrift, and pension plans. In 2002,

the industry generated $222 billion in U.S. revenue and $356 billion in global revenues.

The vast majority of disputes between investors and industry members are resolved by arbitration, pursuant to rules promulgated by self-regulatory organizations like NASD and the NYSE.[1] *See, e.g.*, Steven A. Ramirez, *Arbitration and Reform in Private Securities Litigation: Dealing With The Meritorious As Well As the Frivolous*, 40 Wm. & Mary L. Rev. 1055, 1060, 1099-1100 (1999) ("insofar as broker-customer disputes are concerned, arbitration is the pervasive means of dispute resolution"). As a result, from 1980 through 2002, the SROs have received over 113,904 cases for arbitration, and closed over 100,000.[2] *See* Securities Industry Conference on Arbitration 12th Annual Report, 33 (2003) ("SICA Report") (*available at* www.nasdadr.com/pdf-text/sica report.pdf).

In 2002 and 2003 alone, SIA member firms were involved in over 2500 arbitrations, *see* www.sia.com, and the SROs closed over 13,000 cases. *See* www.nasdadr.com/statistics.asp; www.nyse.com/pdfs/ arbstats042004.pdf. Indeed, in the first four months of 2004 alone, over 3,900 new arbitration cases

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[1] Although securities arbitration did not become common until the United States Supreme Court's 1987 decision in *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987), the practice dates from at least 1872, when the NYSE developed an arbitration program to resolve disputes between members and its customers. *See* Report of the Arbitration Policy Task Force to the Board of Governors of the National Association of Securities Dealers, Inc., (Jan. 1996) *reprinted in* Fed. Sec. L. Rep. (CCH) ¶ 85,735 at 87,433 ("Ruder Report"); Michael A. Perino, Report to the SEC Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations (2002) ("Perino Report") at 6.

[2] This number is relatively small, given the number of retail brokerage accounts in the United states (in the tens of millions), not to mention the number of daily transactions (the three largest stock markets trade 3.2 billion shares daily). *See* www.sia.com.

have been filed with the SROs. *See* www.nasdadr.com/statistics.asp; www.nyse.com/pdfs/arbstats042004.pdf. The claims raised in such arbitrations typically fall into certain basic categories, such as allegations of unsuitable recommendations, excessively large or frequent transactions (also known as "churning"), or market manipulation. David S. Ruder, *Elements of A Fair and Efficient Securities Arbitration System*, 40 Ariz. L. Rev. 1101, 1102-03 (1998); *see also* www.nasdadr.com/statistics.asp (categorizing the types of controversies involved in arbitration cases).

All arbitration rules promulgated by SROs must be approved by the SEC before taking effect, and such approval can be given *only* if the SEC expressly finds that the SRO rules are designed to protect investors and the public interest, *and* are consistent with the requirements of the Securities and Exchange Act of 1934. 15 U.S.C. § 78s(b); *see Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 233 (1987). Accordingly, through its federally-mandated regulation of SRO rulemaking, the SEC oversees a nationally uniform set of arbitration standards, enforceable under the Federal Arbitration Act ("FAA"). *See J. Alexander Securities, Inc. v. Mendez*, 17 Cal. App. 4th 1083, 1090 (1993).

B. Securities Arbitration Offers Significant Advantages Over Litigation As A Means Of Resolving Disputes.

The widespread use of arbitration agreements in the securities industry makes good sense in light of the acknowledged advantages of arbitration over litigation. Compared to litigation, arbitration is regarded by practitioners, academics, and the judicial system itself, as a relatively efficient, cost-effective means of resolving disputes fairly. *See, e.g., Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 280 (1995) ("'[t]he advantages of arbitration are many: it is usually cheaper and faster than litigation'") (quoting H.R. Rep.

No. 97-542).

The data support these conclusions. *See, e.g.*, Paul Lansing & John D. Bailey, *The Future of Punitive Damage Awards in Securities Arbitration Cases After Mastrobuono*, 8 DePaul Bus. L.J. 201, 205-06 (1996) (discussing study finding that, on average, disputes resolved in arbitration required 434 days and $8,000 in legal fees to achieve a final resolution, while disputes resolved in the courts required 599 days and $20,000 in fees); Steven A. Ramirez, *Arbitration and Reform in Private Securities Litigation: Dealing With The Meritorious As Well As The Frivolous*, 40 Wm. & Mary L. Rev. 1055, 1060-61, n.17 (1999) (arbitration more efficient than litigation and relatively inexpensive); Deborah Masucci, *Securities Arbitration – A Success Story: What Does the Future Hold?* 31 Wake Forest L. Rev. 183, 188-89 (1996); C. Edward Fletcher, III, *Privatizing Securities Disputes Through The Enforcement of Arbitration Agreements*, 71 Minn. L. Rev. 393, 458 (1987) ("Arbitration is . . . considerably cheaper than litigation – about one-third the cost, even taking into consideration that both parties may be represented by counsel"); Ruder Report at ¶ 87,438 ("Arbitration offers investors a more efficient, faster, and cheaper process than court litigation").[3] Arbitration not only benefits the parties, but also promotes broader interests by reducing the strain on crowded court dockets.[4] C. Edward Fletcher, III, *Privatizing Securities Disputes Through The Enforcement of Arbitration Agreements*, 71 Minn. L. Rev. 393, 458 (1987).

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[3] Accordingly, an added benefit from the customers' perspective is that claims that are too small to pursue in litigation can be cost-effectively prosecuted in arbitration. *See* Perino Report at 7.

[4] Indeed, if such disputes are forced into litigation, the time (and thus the resources) required to resolve these issues is only likely to increase.

In the securities context, there is at least one additional significant advantage to arbitration: the arbitrators' expertise and familiarity with the industry. Indeed, "a hallmark of arbitration is the presence of one or more decisionmakers with pertinent knowledge or experience." Thomas J. Stepanowich, *Rethinking American Arbitration*, 63 Ind. L.J. 425, 435-36 (1988). This familiarity "with the commercial context of the dispute, including industry customs and vocabulary," can be critical:

> Expert arbitrators should require little in the way of education on technical points, thereby saving valuable hearing time. Moreover, a pertinent technical or legal background should enhance the ability of the arbitrator to identify the significant issues in a particular case and to sharpen the focus of the hearing to deal with those issues. A knowledgeable arbitrator may be able to prevent unnecessary delay where an advocate's ignorance or lack of preparedness leads to unhelpful lines of questioning. Arbitrator expertise should reduce the possibility that the final decision will be arbitrary or ill-informed. Arbitrators with pertinent commercial background and understanding should also be less susceptible to lawyer artifice or emotion.

Id. at 436-37. In the securities industry, arbitrator expertise pays off not only in terms of relative efficiency in resolving cases, but also in the fairness with which such disputes are resolved. *See, e.g.*, David S. Ruder, *Elements of A Fair and Efficient Securities Arbitration System*, 40 Ariz. L. Rev. 1101, 1102-03 (1998); *see also, e.g., Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145, 150 (1968) (White, J., concurring) ("It is often because they are men of affairs, not apart from but of the marketplace, that they are effective in their adjudicatory function.").

Parties also benefit from arbitration's emphasis on equity: "Principles of equity and fairness are frequently applied in arbitrations, whereas such principles are not usually taken into account for investors in courts of law." Paul Joseph Foley, *The National Association of Securities*

Dealers' Arbitration of Investor Claims Against Its Brokers, 7 N.C. Banking Inst. 239, 251 (2003) (quoting the NASD arbitrators' manual to the effect that "[e]quity is justice in that it goes beyond the written law . . .[;] the arbitrator keeps equity in view, whereas the judge looks only to the law . . ."). Because in many instances the applicable securities law may not favor the investor, the application of equity can work to an investor's advantage, by allowing arbitrators to award him or her partial damages where a court of law might be constrained to award the same claimant nothing. *Id.*; Perino Rep. at 7, n.11.[5]

Finally, securities arbitration procedures are carefully monitored for fairness. Although Petitioner claims to need the California Standards to "obtain fair neutral arbitrators to conduct their arbitration," there is no evidence that the Standards are necessary to ensure fairness and neutrality in securities arbitration.[6] To the contrary, studies support the SEC's express finding that the existing SRO rules serve to protect investors; indeed, studies by the General Accounting Office and the SEC uniformly have concluded that the system is neither biased in favor of the industry nor likely to result in smaller recoveries than litigation. *See, e.g.*, Steven A. Ramirez, *Arbitration and Reform in Private Securities Litigation: Dealing With The Meritorious As Well As the Frivolous*, 40 Wm. & Mary L. Rev. 1055, 1062, 1102-04, nn.22, 234-248 (collecting studies); Ruder Report at

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[5] Similarly, "[t]he less stringent arbitration rules do not present many of the harsh obstacles investors face when attempting to pursue a judicial remedy." Paul Joseph Foley, *The National Association of Securities Dealers' Arbitration of Investor Claims Against Its Brokers*, 7 N.C. Banking Inst. 239, 251 (2003) (citing the stringent pleading requirements of the Private Securities Litigation Reform Act as one such obstacle).

[6] Petitioner's Reply Brief at 16.

¶ 87,438 ("neither the independent studies conducted, nor the statistics on the results of customer-broker arbitrations, support" a finding of bias); *see also* Rep. No. GAO/GGD-00-115, at 44 (June 15, 2002) (*available at* www.gao.gov).[7] Indeed, while many of the claims brought in arbitration are resolved by settlement or mediation, well over 50% have resulted in awards to customers, *see* www.nasdadr.com/statistics.asp, and from 1995 through May of 2004, NASD arbitrators have awarded over $1 billion in damages, *see* www.nasdadr.com/statistics.asp.[8]

Those findings are corroborated by the parties to securities arbitrations. An initial 15-month study of the arbitrations carried out by the NASD (which handles over 90% of the securities arbitration cases in the United States) demonstrated that the parties to such arbitrations were "overwhelmingly satisfied with the fairness of the forum." Gary Tidwell, Kevin Foster & Michael Hummel, *Party Evaluation of Arbitrators: An Analysis of Data Collected from NASD Regulation Arbitration*, 3-4 (1999) (*available at* www.nasdadr.com/pdf-text/arbeval99.pdf) (noting also that participants gave high ratings to the arbitrators' ability to understand the material presented and analyze the issues, as well as their knowledge of the securities industry, NASD rules and regulations). Indeed, after the Securities Industry Conference on Arbitration initiated a two-year pilot program allowing investors to elect to arbitrate their claims in certain non-SRO forums, only 8 out of 277 eligible cases were submitted for arbitration

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[7] The GAO has also found no statistically significant difference between SRO-sponsored arbitrations as compared to arbitrations in non-SRO forums. *See* Perino Report at 31-32 (citing GAO, Securities Arbitration: How Investors Fare, Rep. No. GAO/GD-92-74 (May 1992)).

[8] In 2003 alone, the SROs awarded damages in excess of $162 million. *See* www.sia.com.

in a non-SRO forum. *See* Perino Report at 33-34. Investors prefer SRO forums in part because the securities industry subsidizes SRO arbitrations *to the benefit of customers*. Non-SRO forums not only lack the institutional expertise of the SROs, but are also much more expensive.

Another reason why arbitration remains the preferred means of dispute resolution is the close monitoring of the arbitration process. The SROs and the SEC scrutinize arbitrations carefully in order to identify areas where procedures could and should be strengthened and to encourage remedial steps through rule changes. *See* Perino Report at 8-9; SEC Rel. No. 34-40109, 63 Fed. Reg. 35299, 35303 n.53 (June 29, 1998). The Securities Industry Conference of Arbitration, which includes representatives of the SROs, the SIA and members of the public, also reviews and revises securities arbitration procedures. Thus, emerging industry-specific trends can be identified, and consistent, appropriate responses can be incorporated into the national scheme.

III. The Adoption Of The California Standards Has Led To Widespread Confusion.

This national scheme was disrupted when, overreaching its statutory authority under Code of Civil Procedure § 1281.85(a), the California Judicial Council promulgated a new set of standards governing the disclosures arbitrators must make and the circumstances in which they may be disqualified. When the California Standards became effective, the SEC immediately asked the Legislature to exempt SROs from their application because, in the agency's considered view, "adjusting a national program to the specific requirements of any state or every state will unnecessarily burden the administration of SRO arbitration programs to the detriment of investors." *See* Exh. A attached hereto. When the Legislature failed to

accommodate these federal concerns, the NASD and NYSE filed suit against the Judicial Council to have the California Standards declared inapplicable to SRO arbitrations. *See NASD Dispute Resolution, Inc. v. Judicial Council of California*, 232 F. Supp. 2d 1055 (N.D.Cal. 2002), *appeal pending*.

In September 2002, pending judicial resolution of the validity of the California Standards as applied to SRO arbitrations, both the NASD and NYSE adopted interim rules permitting California arbitrations to proceed if the parties agree to: (1) waive application of the California Standards; or (2) hold the arbitration outside of California. *See* NASD Rule IM-10100 (2003) (*available at* www.nasdadr.com/arb_code/arb_code.asp);[9] NYSE Rule 600(g) (2003) (*available at* www.nyse.com/pdfs/rules.pdf) (the "Interim Rules"). The SEC expressly approved these Interim Rules as consistent with both investor protection and the public interest,[10] and has repeatedly stated its view that federal law preempts application of the California Standards to SRO arbitrations conducted in California. The Interim Rules leave investors (indeed, all the parties) in precisely the same position as before the Standards became effective – *i.e.*, with the contractually agreed-upon SRO rules, which have repeatedly been approved as fair by courts.

Thousands of arbitrations between SIA members and customers have proceeded under the Interim Rules. But a handful of customers have

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[9] The NASD Rule does not expressly address the possibility of out-of-state hearings, but staff guidance indicates that such hearings are possible.

[10] SEC Rel. No. 34-46562, 67 Fed. Reg. 62,085 (Oct. 3, 2002); SEC Rel. No. 34-47631, 68 Fed. Reg. 17,713 (Apr. 10, 2003); SEC Rel. No. 34-48187, 68 Fed. Reg. 43,553 (July 23, 2003); SEC Rel. No. 34-46816, 67 Fed. Reg. 69,793 (Nov. 12, 2002).

objected to "waiving" the California Standards even though they did just that in signing their arbitration agreements and again in submitting the Uniform Submission Agreements, under which they invariably agreed to arbitrate pursuant to SRO rules. Both federal courts to reach the merits of these disputes have ruled that the Standards cannot be applied to SRO arbitrations. *See Mayo v. Dean Witter Reynolds, Inc.*, 258 F. Supp. 2d 1097 (N.D.Cal. 2003); *Credit Suisse First Boston v. Grunwald* (N.D.Cal. Mar. 31, 2003) No. 02-2051 SBA, (*appeal pending*, No. 03-15695 (9th Cir. filed Apr. 18, 2003)). Before review was granted, the decision below was the only published state-court decision reaching the merits of the preemption issue, and like the federal court in *Mayo*, the court of appeal held that the Standards are inconsistent with the Securities and Exchange Act of 1934. This case presents the Court with the opportunity to settle this issue once and for all within the state-court system.

IV. Permitting State Interference With Federally-Regulated Securities Arbitrations Would Strip Arbitration Of The Very Benefits That Recommend It.

Petitioners argue that the California Standards are at worst innocuous and at best helpful. As Interveners make plain, the relevant issue is not whether the particular Standards proposed are wise, but whether they are consistent with the SROs' regulations. They are not.

Many of the acknowledged benefits of securities arbitration are imperiled by the prospect of state interference with federally-approved arbitration procedures – by states imposing additional, potentially conflicting obligations and regulations, resulting in a patchwork of competing and sometimes conflicting subsystems, which cannot be

responsive to the national needs of the securities markets.[11] This loss of uniformity risks an accompanying loss of efficiency, the costs of which ultimately will be born by customers. Moreover, to the extent that individuals cannot simply rely on a single, uniform set of procedures, but must instead navigate their way between multiple sets of separate rules and regulations, the ability of claimants to pursue their claims *pro se*, or with the aid of someone who is not a lawyer, is likely to be severely handicapped. This, in turn, is likely to impose significant additional costs on customers.

Application of the California Standards also threatens to undermine other benefits of arbitration, such as finality and cost-effectiveness. With

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[11] Petitioner poses the question: "If neither the SEC's or SRO's Rules require customer arbitrations, or even limit customer arbitrations to fora following SRO Rules, then how is it possible for the California Standards to conflict with Federal Securities laws with regard to customer securities arbitrations?" Petitioner's Reply Brief at 1. The answer is straightforward. Most (if not all) SIA members have determined that arbitration is the preferable means of handling disputes with customers, and the Supreme Court has specifically approved arbitration in this context. Accordingly, most contracts with customers contain an arbitration provision. At the same time, most (if not all) SIA members are also members of NASD and/or the NYSE. The SROs require that their members include certain information, designed for investor awareness and protection, in their arbitration clauses. With the exception of some pilot programs, the SROs also require that their members avail themselves of the SRO arbitration fora. It is therefore not surprising that the vast majority of contracts between SIA members and customers call for arbitration pursuant to NASD and/or NYSE rules. Those rules have been approved by the SEC and apply uniformly to securities arbitrations nationwide. This benefits SIA members, most of whom do business on a nationwide scale. It also benefits investors, who receive equal treatment regardless of geographical location. Through the interlocking scheme of federal securities regulation, the SRO arbitration rules are part and parcel of the course of dealing between SIA members and customers. Inconsistent rules, such as the California Standards, would conflict with this nationwide system.

respect to the former, because the California Standards provide more broadly for challenges, and because the recordkeeping requirements are relatively expansive, the California Standards might encourage parties after the fact to search for any hint of potential conflict to use as a pretext for vacating an award. *Cf.*, *e.g.*, *Commonwealth Coatings*, 393 U.S. at 151 (White, J., concurring). This would also increase the burdens on the court system. With respect to the latter, producing information necessarily involves expense, and the Standards impose a duty on arbitrators to collect, maintain and update a daunting array of information. *See*, *e.g.*, California Standards; Cal. R. Ct. App. Div. VI at 7(b)(6)(A) and 7(b)(4). Those same arbitrators, however, receive relatively small honoraria in SRO arbitrations, and may choose not to serve under these circumstances. Perino Report at 45. As Professor Perino concluded, "[t]he end result may well be to increase the cost and complexity of arbitrations, to increase the time they take to resolve, and to impair substantially their traditional finality advantages." Perino Report at 44, n.147.

Nor can application of the California Standards be tolerated on the pretext that they merely augment the federal regime, instead of undermining it. If a state can impose disclosure and disqualification requirements that are inconsistent with the SRO rules, then it could also regulate other aspects of arbitrations such as pleading requirements, discovery and motion practice, and the like. Furthermore, even if state-imposed requirements simply supplement the SROs' nationally applicable procedures, the consequences of allowing such supplementation cannot be evaluated in light of only one state's choices. A significant part of the problem is that different states may reach very different decisions about appropriate procedures and policy. If states can permissibly supplant the

SROs' arbitration scheme, those choices might not only imperil the flexibility, efficiency, and finality that recommends arbitration over litigation, but also result in widely varying procedures depending on the particular state in which an arbitration was held. This non-uniformity itself would be fundamentally inconsistent with the federal securities regime. It also would encourage forum shopping, as well as protracted procedural wrangling of the kind that has already occurred. In the end, it would only delay (and increase the cost of) the resolution of particular disputes, to the ultimate disadvantage of customers.

As the SEC and SROs have persuasively argued, NASD and the NYSE, as national organizations with particular expertise in the securities industry, are best placed to monitor and respond to emerging concerns and industry-specific issues. Indeed, they have structures in place to do exactly that. By contrast, allowing any single state's generic arbitration rules to be grafted onto the comprehensive, carefully developed national scheme used by the SROs puts a premium on the policy choices of a single state, whether or not those choices are appropriate in the context of a national system for securities arbitration. Such a result is inconsistent with basic principles of preemption.

The California Standards are – expressly – a "one size fits all" device. But the Judicial Council recognized when it promulgated the Standards that they were unnecessary where there was a preexisting system of comprehensive regulation. See, *e.g.*, California Standards; Cal. R. Ct. App. Div. VI at 3(b). The staff, however, refused to extend a similar exemption to SRO arbitrations on the mistaken assumption that they were not subject to a regulatory scheme. *See* Exh. B attached hereto, at 22. As explained above and by the Interveners, SRO arbitrations take place within

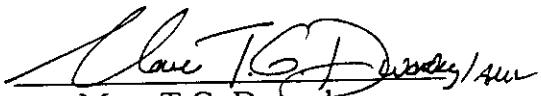
a highly structured and regularly scrutinized regulatory framework designed specifically to deal with the intricacies of securities regulation. The California Standards, by contrast, are *not* designed for securities cases. They may well represent a reasonable "background principle" where the parties have not otherwise specified procedures for arbitrator selection, disclosure, and disqualification. But where, as here, the parties contractually agree to adhere to a different system, there is no justification for forcing them to use a set of rules to which they did not agree.

V. Conclusion

Notwithstanding Petitioners' unsupported assertions to the contrary, securities arbitrations are widely recognized as being fair, efficient, and cost-effective. While they offer significant advantages over litigation, particularly for claimants, those very advantages are at risk if states can impose their own views of generally advisable procedure in arbitration on top of the comprehensive, carefully monitored and industry-specific scheme run by the SROs and regulated by the SEC. Accordingly, this Court should find that the California Standards are preempted.

DATED: July 21, 2004

Respectfully submitted,
MUNGER, TOLLES & OLSON LLP

By: 
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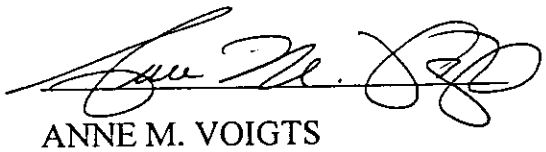
CERTIFICATE OF WORD COUNT

(Cal. Rules Of Court, Rule 28.1(e)(1))

The text of this brief (including footnotes) consists of 3,871 words as counted by the Microsoft Word word processing program used to prepare this brief.



ANNE M. VOIGTS

EXHIBIT A

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
MARKET REGULATION

July 1, 2002

The Honorable John Burton
Senate President Pro Tempore
California State Senate
State Capitol, Room 205
Sacramento, California 95814

The Honorable Herb Wesson, Jr.
Speaker of the Assembly
California State Assembly
State Capitol, Room 219
Sacramento, California 94249

The Honorable James Brulte
Senate Republican Leader
California State Senate
State Capitol, Room 305
Sacramento, California 95814

The Honorable Dave Cox
Minority Floor Leader
California State Assembly
State Capitol, Room 3104
Sacramento, California 94249

Re: Ethics Standards for Neutral Arbitrators in Contractual Arbitration

Dear Senator Burton, Assemblyman Wesson, Senator Brulte, and Assemblyman Cox:

We understand that the State of California has adopted legislation, Senate Bill No. 475, intended to ensure public confidence in the arbitration process. We also understand that this legislation requires the Judicial Council to adopt ethics standards by July 1, 2002, which may apply to arbitrators participating in arbitrations administered by the securities self-regulatory organizations ("SROs"), such as the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers ("NASD"). While we recognize the State of California's interest in promoting arbitration that is fair for consumers, for the reasons discussed below, we believe that arbitration programs administered by the SROs should be exempted from these ethics standards.

SRO arbitration programs are national in scope and are subject to a comprehensive system of federal regulation. The Securities and Exchange Commission ("Commission") actively oversees SRO arbitration programs through its oversight of all SRO rulemaking, including rules governing arbitration, and its program to inspect SROs. Under the Securities Exchange Act of 1934, all SRO rules are required to be filed with the Commission and published for public comment in the Federal Register. In approving SRO rules, the Commission is required to find that, among other things, the rules are designed to protect investors and the public interest, and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers. In addition, SRO arbitration programs, like all SRO activities, are subject to continuing federal oversight beyond the rulemaking process. This oversight includes regular inspections by the Commission of SRO arbitration programs, including issues associated with the qualifications and selection of arbitrators.

The Honorable John Burton
The Honorable Herb Wesson, Jr.
The Honorable James Brulte
The Honorable Dave Cox

The SRO arbitration programs have been under strict Commission scrutiny for more than twenty years. Under Commission supervision, the SROs have been leaders in the arbitration industry in providing fair procedures, including the prominent disclosure of arbitration provisions in customer agreements, convenient hearing locations, availability of broad relief, access to counsel, access to mediation, and other important procedural protections. With this in mind, we believe that the burdens imposed on the SRO arbitration process by the new California ethics standards would provide few, if any, corresponding benefits. Indeed, we believe that the framework created by the Commission and the SROs for securities industry arbitration already addresses many of the issues that led the State of California to enact this new legislation.

For example, we understand that the disclosure obligations in new ethics Standard 7 are designed to provide parties with information that might affect an arbitrator's ability to be impartial. Both the NASD and NYSE impose disclosure obligations on arbitrators. The type and extent of disclosure focus on the specialized nature of securities arbitration, which often requires the expertise of participants in the securities industry. The SRO rules are designed to address the potential conflicts that could arise by using securities industry participants in arbitrations involving public customers.

For example, under NASD rules, all persons willing to be arbitrators are categorized as industry arbitrators or public arbitrators. Unless the parties elect otherwise, NASD rules provide that a case involving a single arbitrator is heard by a public arbitrator, and a case involving three arbitrators is heard by two public arbitrators and one industry arbitrator. From the pool of potential arbitrators, the NASD, using an automated selection process developed at the request of lawyers representing public customers, provides the parties with a list from which parties can select their panel. Before providing the parties this list, however, the NASD checks for conflicts of interest through both an automated and manual process. In approving these rules, the Commission determined, among other things, that allowing parties greater input into the selection of the arbitrators to hear their cases would help ensure a more fair and neutral arbitration process, and that the conflict of interest checks provided adequate measures to identify potential or actual conflicts of interest between a party and an arbitrator.

Another example of where the California ethics standards evidence the same goal as the SRO requirements is in award disclosure. The disclosure obligations in the ethics standards will require arbitrators to maintain information about previous awards in cases where the arbitrator served. Under SRO rules, however, information about awards has long been publicly available. Indeed, the NYSE and NASD provide information about awards on their websites.

We understand that some commentators on the draft ethics standards noted that the complexity of some of the disclosure obligations might cause inadvertent noncompliance, which in turn could undermine the stability and finality of the arbitration process through

The Honorable John Burton
The Honorable Bert Weston, Jr.
The Honorable James Brulte
The Honorable Dave Cox

like requests for disqualifications or motions to vacate awards. In securities arbitration, investors are most frequently claimants. Securities industry defendants are often well funded and can afford to litigate over any procedural requirement. Thus, we believe this possibility disproportionately threatens investors. Furthermore, as the SROs have pointed out, the burdens associated with complying with some of the disclosure requirements may have a deleterious effect on SRO arbitration programs by causing some arbitrators to resign rather than comply. Finally, adjusting a national program to the specific requirements of any state or every state will unnecessarily burden the administration of SRO arbitration programs to the detriment of investors.

We appreciate your considering these issues. We would be happy to discuss any questions that you, your staff, other members of the California legislature, or any interested parties might have. Please feel free to call me at (202) 942-0090, or Catherine McGuire, the Chief Counsel of the Division of Market Regulation, at (202) 942-0061.

Sincerely,

Annette L. Nazareth
Director

EXHIBIT B

JUDICIAL COUNCIL OF CALIFORNIA
ADMINISTRATIVE OFFICE OF THE COURTS
455 Golden Gate Avenue
San Francisco, California 94102-3660

Report Summary

TO: Members of the Judicial Council

FROM: Michael Bergeisen, General Counsel
Melissa Johnson, Assistant General Counsel
Heather Anderson, Senior Attorney, 415-865-7691

DATE: April 9, 2002

SUBJECT: Ethics Standards for Neutral Arbitrators in Contractual Arbitration (adopt Cal. Rules of Court, division VI of the appendix) (Action Required)

Issue Statement
Code of Civil Procedure section 1281.85, which was enacted in late September 2001 as part of Senate Bill 475, cosponsored by the Judicial Council, the Governor, and Senator Martha Escutia, the chair of the Senate Judiciary Committee, requires the Judicial Council to adopt ethics standards, effective July 1, 2002, for all neutral arbitrators serving in arbitrations pursuant to an arbitration agreement.

Recommendation
Staff recommends that to comply:

1. The Judicial Council, effective July 1, 2002, adopt, as division VI of the appendix to the California Rules of Court, all the proposed ethics standards for neutral arbitrators in contractual arbitration except standard 7(b)(12).

2. The Judicial Council, effective January 1, 2003, adopt proposed standard 7(b)(12) requiring that, in consumer arbitrations, arbitrators disclose information about their relationship with any dispute resolution provider organization that is administering the arbitration and any financial or professional relationship between that provider organization and parties or attorneys in the arbitration.

3. The Judicial Council direct staff to solicit comments on these standards and report to the council on recommended amendments to the standards.

Ms. Hartmann, and Ms. Fienberg). In response to these comments, staff eliminated the references to representing an officer, director, or trustee of a party from this definition. References to officers, directors, or trustees of a party now appear only in the portions of standard 7 that mirror current statutory disclosure requirements.

Standard 3. Application and effective date
This proposed standard provides that the ethics standards adopted by the council apply to all arbitrators appointed to serve on or after July 1, 2002, in any arbitration under an arbitration agreement subject to the California Arbitration Act (CAA) or in which the arbitration hearing is to be conducted in California or one of the parties is a consumer party who resides in California. The intent is to include within the scope of these standards not only arbitrations that are explicitly subject to the CAA but also other contractual arbitrations that take place in California or involve California consumer parties. Staff believes that this is consistent with Code of Civil Procedure section 1281.85, which requires any person "serving as a neutral arbitrator pursuant to an arbitration agreement" to comply with the standards adopted by the council.

This standard also specifically provides that the standards are not applicable to international, judicial, automobile warranty, attorney-client fee dispute, workers compensation, or contractor state license board arbitrations, or to arbitrations conducted under or arising out of public or private sector labor-relations laws, regulations, ordinances, statues, or agreements. These specific exemptions were included for a variety of reasons. In the case of international, judicial, workers compensation, and contractor state license board arbitrations, the statutes governing these arbitrations either explicitly provide that these schemes are separate from the CAA[22] or, based upon the content of the provisions themselves, they appear to be independent statutory arbitration schemes, not contractual arbitrations.[23] In addition, there are existing sets of mandatory ethics-related provisions that apply to both international and judicial arbitration.[24] Automobile warranty disputes and attorney-client fee arbitrations are exempted because, unlike contractual arbitration, the awards are not binding; parties are generally free to

[22] See Code Civ. Proc., §§ 1297.17, relating to international arbitrations, and 1141.30, relating to judicial arbitration.

[23] Under their respective statutory schemes, some of the workers compensation and contractor state license board arbitrations are mandated and thus would not fall within the scope of these standards at all, since the standards only apply to arbitrations "under an arbitration agreement." Even where these schemes permit arbitration under their provisions to occur by the agreement of the parties, both establish procedures that differ in significant ways from the scheme established under the CAA.

[24] See Code Civ. Proc. §§ 1297.121–1297.144, relating to international arbitrations, and Code Civ. Proc., §1141.18(d), Ca. Rules of Court, rule 1606; and Cal. Code Jud. Ethics, canon 6D, relating to judicial arbitration

reject the arbitrator's award and seek judicial review.[25] As noted in the comments of Alan L. Cohen of the Council of Better Business Bureaus, the automobile warranty dispute resolution processes have been found by courts not to constitute "arbitration" within the meaning of the Federal Arbitration Act.[26] Finally, collective bargaining arbitration is already excluded from the existing statutory requirements relating to arbitrator disclosure and there is pending legislation to clarify the legislative intent that these standards not apply to such arbitrations.[27]

As circulated for comment, subdivision (a) of this standard provided that the ethics standards adopted by the council would apply in any arbitration that was to be conducted in California. Ms. Margaret A. Farrow of the Office of Administrative Hearings noted that there was an inconsistency between the authorizing legislation, which refers to arbitrations under arbitration agreements, and this language. Two other commentators, Professor Roger Haydock of California Western School of Law and Mr. Keith Maurer of National Arbitration Forum, noted that the phrase "conducted in California" was not clear. In response to these comments, staff modified subdivision (a) of this standard to clarify that the standards apply only in arbitrations conducted under arbitration agreements, including those where the arbitration hearing is to be conducted in California or one of the parties is a consumer party who resides in California.

Ms. Hartmann also raised a number of concerns about the potential application of these standards to cases pending prior to the standards' effective date of July 1, 2002. In response to these comments, staff amended subdivision (a) to clarify that the standards only apply to arbitrators appointed on or after July 1, 2002. and added proposed subdivision (c) stating that these standards do not apply in arbitrations in which the arbitrator was appointed before July 1, 2002.

As circulated for public comment, subdivision (b) of this standard included exemptions only for international, judicial, attorney-client fee dispute, and collective bargaining arbitrations. Several commentators asked that other specific types of arbitrations be added to this list of exemptions, including automobile warranty dispute resolution programs (Ms. Natalie C. Fleury of DeMars & Associates and Mr. Cohen of the Council of Better Business Bureaus), securities industry arbitration programs (Mr. Richard P. Bernard of the New York Stock Exchange, Ms. Linda D. Fienberg of the National Association of Securities

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[25] See Civ. Code, § 1793.22, relating to auto warranty dispute resolution programs, and Bus. & Prof. Code, §§ 6203 and 6204, relating to the attorney-client fee arbitration program. Parties in attorney-client fee arbitrations may enter into an agreement to be bound by the arbitrator's decision, but only after the fee dispute has arisen (Bus. Prof. Code, § 6204).

[26] *Harrison v. Nissan Motor Corp.* 111 F.3d. 343 (3rd Cir. 1997).

[27] See Code Civ. Proc., § 1281.9(e) and Senate Bill 1707 (Committee on Judiciary), as introduced February 21, 2002.

Dealers, and Mr. Michael Lempres of the Pacific Exchange), workers compensation arbitration under Labor Code section 5270 et seq. and 5308 (Mr. Richard P. Gannon of the Department of Industrial Relations) the Public Works Contract Arbitration program under Public Contract Code section 10240 et seq. and the Contractor's State License Board arbitration program under Business and Professions Code section 7085 et seq. (Ms. Margaret Farrow of the Office of Administrative Hearings).

Staff reviewed the statutes, regulations, and other materials relating to each of these specific arbitration programs to determine whether these were independent statutory arbitration schemes rather than contractual arbitration, whether the dispute resolution services provided were binding arbitration or some other dispute resolution process, and whether the neutrals were already covered by an existing set of comprehensive ethics standards mandated by statute or government regulation. Based on these criteria, staff added exemptions for automobile warranty programs, workers compensation arbitration, and the contractor's state license board arbitrations. An exemption was not added for securities industry disputes because these dispute did not fall within any of the categories warranting exemption. They are arbitrations conducted under arbitration agreements, not independent statutory schemes; they are binding arbitrations, not some other dispute resolution process; and, while the self-regulatory organizations that administer these arbitration programs are subject to oversight by the Securities and Exchange Commission, the specific procedures of their dispute resolution programs, including any applicable ethics requirements, do not appear to be mandated by statute or government regulation. Finally, staff did not add a specific exemption for arbitrations within the Public Works Arbitration Program because, while this too appears to be a distinct statutory arbitration scheme, the governing statutes specifically provide that the provisions of the CAA generally apply to its arbitrations.[28]

Standard 4. Duration of Duty
This proposed standard specifies that, except as otherwise provided, arbitrators must comply with the standards adopted by the council from acceptance of appointment as an arbitrator in a case until the conclusion of the arbitration.

Standard 5. General Duty
This proposed standard establishes arbitrators' overarching ethical duty to act in a manner that upholds the integrity and fairness of the arbitration process and to

[28] Public Contract Code section 10240.11 specifically provides that "Except as provided in this article and in the regulations adopted pursuant to Section 10240.5, the procedure governing the arbitrations shall be as set forth in Title 9 (commencing with section 1280) of Part 3 of the Code of Civil Procedure."

CERTIFICATE OF SERVICE

I am employed in the County of San Francisco, State of California. I am over the age of 18 and not a party to the within action. My business address is 33 New Montgomery Street, Nineteenth Floor, San Francisco, California 94105-9781.

On July 21, 2004, I served upon the interested parties in this action the foregoing document described as:

APPLICATION TO FILE *AMICUS CURIAE* BRIEF, AND BRIEF OF *AMICUS CURIAE* SECURITIES INDUSTRY ASSOCIATION IN SUPPORT OF REAL PARTIES IN INTEREST AND INTERVENERS

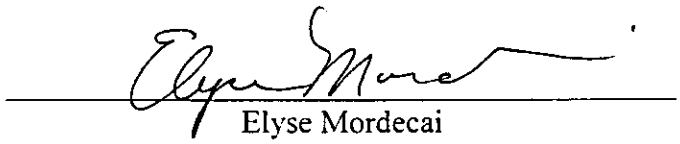
☒ By placing ☐ the original ☒ a true copy thereof enclosed in sealed envelope(s) addressed as stated on the attached service list.

☒ **BY MAIL (AS INDICATED ON THE ATTACHED SERVICE LIST)** I caused such envelope(s) to be deposited with postage thereon fully prepaid in the United States mail at a facility regularly maintained by the United States Postal Service at San Francisco, California. I am "readily familiar" with the firm's practice of collecting and processing correspondence for mailing. Under that practice it would be deposited with the U.S. Postal Service on that same day with postage thereon fully prepaid at San Francisco, California in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if postal cancellation dated or postage meter date is more than one day after dated of deposit for mailing, pursuant to this affidavit.

☒ **BY FEDERAL EXPRESS PRIORITY OVERNIGHT DELIVERY (STATE BAR OF CALIFORNIA ONLY AS INDICATED ON THE ATTACHED SERVICE LIST)** I caused such envelope(s) to be placed for Federal Express collection and delivery at San Francisco, California. I am "readily familiar" with the firm's practice of collection and processing correspondence for Federal Express mailing. Under that practice it would be deposited with the Federal Express office on that same day with instructions for overnight delivery, fully prepaid, at San Francisco, California in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if the Federal Express delivery date is more than one day after dated of deposit with the local Federal Express office, pursuant to this affidavit.

I declare under penalty of perjury that the foregoing is true and correct, and that I am employed in the office of a member of the bar of this court at whose direction the service was made.

Executed on July 21, 2004, at San Francisco, California.



Elyse Mordecai

Supreme Court of the State of California
Case No. S121532

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