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May 22, 2008

Joseph A. Lane, Clerk
California Court of Appeal
Second Appellate District, Division Three
300 South Spring Street
Second Floor, North Tower
Los Angeles, CA 90013-1213

Re: *The Brown Family Trust et al. v. Wells Fargo Bank, NA et al.*, Court of Appeal Case No. B196258 (L.A.S.C. BC352728)

***Amici Curiae* Letter Brief of the Securities Industry and Financial Markets Association, The Chamber of Commerce of the United States of America, the American Bankers Association, the ABA Securities Association, The Clearing House Association L.L.C., and the Financial Services Roundtable**

Dear Clerk of the Court:

We represent the above-referenced trade associations (collectively, *Amici Curiae*).[1] The *Amici Curiae* welcome the Court's invitation to submit this letter brief. The question at issue in this appeal—whether banks and broker-dealers have an obligation to provide advance oral notice of arbitration clauses in customer account

[1] For a description of each of these trade associations, see Appendix. We understand that the California Bankers Association (CBA) is also submitting a letter brief in this case. The *Amici Curiae* join in the arguments set forth in the CBA's brief.

agreements—is an issue of critical importance to securities firms as well as the investing public. Both securities firms and their customers depend on our well-developed national securities arbitration system, which is supervised and monitored by the Securities and Exchange Commission (SEC), to provide expeditious, cost-effective, and fair dispute resolution. Our national securities arbitration system will remain effective only if states do not erect procedural barriers that threaten to burden securities firms and their customers with the kind of litigation delays and expenditures that arbitration is designed to avoid. A ruling from this Court establishing an oral notice requirement would spur a wave of meta-litigation on the content and adequacy of oral disclosures, and undermine the SEC-approved securities arbitration system by forcing parties to resort to costly litigation even where they have signed agreements to arbitrate.

As Justice Kitching observed during oral argument, the outcome of this case could have significant ramifications for the financial services industry. *Amici Curiae* have a vital interest in the predictable enforcement of arbitration agreements, which have proven to be a fair and economic means of dispute resolution; in preventing a system of mini-trials on the enforceability of arbitration agreements from swamping the courts and depriving parties of the benefit of agreements to arbitrate; in maintaining the national uniformity of the arbitration system supervised by the SEC; in enforcing the Federal Arbitration Act, which prohibits states from adopting principles that discriminate against agreements to arbitrate; and in enforcing the California Arbitration Act, which like its federal counterpart makes it unlawful to treat arbitration agreements differently from any other contract.

I. THE FEDERALLY REGULATED SECURITIES ARBITRATION SYSTEM

The securities industry's national arbitration system operates under the framework established by the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (the Exchange Act). The Exchange Act authorizes self-regulatory organizations (SROs), such as NASD Regulation and the New York Stock Exchange (NYSE), to promulgate their own governing rules and regulations, subject to SEC oversight. In 2007, NASD Regulation consolidated with the regulatory unit of the NYSE to form the Financial Industry Regulatory Authority (FINRA). Currently, FINRA administers securities arbitrations between member firms and their customers.

Since 1975, when Congress granted the SEC expansive power to approve, reject, and modify SRO rules, the SEC has closely regulated the arbitration practices of the SROs. *See SIFMA White Paper on Arbitration in the Securities Industry* 7-13 (2007) (hereinafter *White Paper*), *available at* http://www.sifma.org/regulatory/pdf/arbitration-white-paper.pdf. Any proposed change to SRO arbitration rules must be submitted to the SEC. Before granting or denying approval, the SEC is required to publish the proposed

rule for public comment. 15 U.S.C. § 78s(b)(1). The SEC will approve a rule change only after determining that it is "consistent with the requirements of [the Exchange Act]" and designed to "protect investors and the public interest." 15 U.S.C. §§ 78s(b)(2)(B), 78f(b)(5). In addition to rulemaking oversight, the SEC has engaged in frequent review of arbitration facilities, encouraged meetings and conferences on arbitration practices, developed guidelines to make arbitration documents more user-friendly, and commissioned studies on the adequacy of arbitration procedures. Such oversight efforts have, with the cooperation of SROs, resulted in ever-continuing improvements to the securities arbitration system. *See White Paper* at 10-13.

Arbitration benefits both the investing public and the securities industry by providing a more expeditious and cost-effective means of resolving disputes than litigation. In contrast to the time-consuming discovery procedures used in court, FINRA arbitration rules provide specific lists of presumptively discoverable material, which must be produced even in the absence of a request from the claimant. *Id.*; NASD Code of Arbitration Procedure § 12506. Moreover, in the interest of expediting a hearing on the merits, arbitration rules restrict the availability of interrogatories, depositions, and motion practice.[2] These streamlined procedures allow more arbitration claimants to have their cases heard on the merits. In 2005, 20% of all NASD arbitrations closed were decided after a hearing. *Id.* at 33. In contrast, in California courts, only 10.9% of civil claims over $25,000 were decided after trial by a judge or jury in fiscal 2005. Judicial Council of California, *2007 Court Statistics Report* 48 (2007). That figure is even lower in the federal courts, where only 1.3% of civil claims were tried by a judge or a jury. *White Paper* at 33.

Arbitration also results in reduced litigation expenses for all parties. One study has found that, in 1987 and 1988, average legal costs were $12,000 less in arbitration than in litigation. *Id.* at 29. Since litigation costs have grown substantially since the 1980s, the cost advantage of arbitration is likely to have widened. *Id.* Similarly, a former president of the American Bar Association has found that "a reasonable expectation is that the cost of an arbitration will not be in excess of half the cost of litigating." *Id.* Reduced expenses are beneficial to individual investors, who are likely to have more limited financial resources than securities firms. That is particularly so for small claimants. Approximately a quarter of all securities arbitrations involve

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[2] Interrogatories are generally not permitted, and depositions are available only in very limited circumstances, such as illness. NASD Code of Arbitration Procedure §§ 12507(a)(1), 12510. In addition, FINRA recently proposed rule amendments to significantly limit the number of dispositive motions filed in arbitration. *See White Paper* at 27.

claims of less than $10,000, and nearly half involve claims of less than $50,000. *See id.* at 66. Such claims are likely to be too small to justify the expense of civil litigation.

The cost and speed advantages of arbitration do not come at the expense of fairness. FINRA maintains numerous procedural safeguards to ensure fairness throughout arbitration proceedings. All arbitration panels are required to have a majority composed of "public" arbitrators who are not affiliated with the securities industry. *Id.* at 17. To ensure neutral decision-making, FINRA prohibits a person from serving as a public arbitrator if she has associated with a securities firm in the past 20 years. *Id.* at 17-18. A recent rule change, approved by the SEC, further bars a professional such as an attorney or accountant from serving as a public arbitrator if her firm derived over $50,000 in revenue in the past two years from the securities industry. Order Approving Proposed Rule Change To Amend the Definition of Public Arbitrator, Exchange Act Release, No. 57,492, 73 Fed. Reg. 15,025 (Mar. 13, 2008). Moreover, claimants have significant input in the composition of the arbitration panel. *White Paper* at 19-20. Once a claim has been filed, parties receive a randomly generated list of potential arbitrators, along with extensive disclosures regarding each potential arbitrator. Each party has the right to peremptorily strike up to four candidates from the list and to rank the remaining candidates. The parties' rankings are combined and the highest-ranked candidates are then selected for the panel. *Id.*

FINRA's procedural protections extend beyond arbitrator selection. Pleading standards are relaxed in order to encourage claimants to file their disputes; the statement of claims only needs to "specify[] the relevant facts and remedies requested." NASD Code of Arbitration Procedure § 12302(a)(1). As noted above, parties are provided with lists of presumptively discoverable materials, and may also request additional documents and information. NASD Code of Arbitration Procedure §§ 12506-509. Discovery sanctions are available to deter and punish non-compliance. NASD Code of Arbitration Procedure § 12511. The arbitration panel further has the power to compel the appearance of any witness employed by or associated with a member firm of the NASD. NASD Code of Arbitration Procedure § 12513. Of course, parties have the right to cross-examine witnesses at the arbitration hearing.

Due to these rigorous procedural safeguards, the fairness of SRO arbitration has been recognized by the courts. In *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 30-31 (1991), the United States Supreme Court rejected as meritless an attack on the fairness of NYSE arbitration. The Court noted that NYSE rules on arbitrator disclosure and panel composition "provide protection against biased panels" and concluded that "[t]here has been no showing in this case that those provisions are inadequate to guard against potential bias." *Id.* Likewise, the Court of Appeal has found that "[arbitration] procedures outlined in the NYSE rules display beyond any doubt much more than" the

level of fairness and integrity required for enforcement of pre-dispute agreements to arbitrate. *Parr v. Superior Court*, 139 Cal. App. 3d 440, 447, 188 Cal. Rptr. 801, 805 (1983).

In sum, both the securities industry and the investing public have benefited from the expeditious, cost-effective, and fair method of resolving disputes provided by SRO arbitration. However, for reasons explained below, those benefits stand to be significantly undermined if the Superior Court's decision denying arbitration in this case is affirmed.

II. SUMMARY OF ARGUMENT

A decision affirming the Superior Court would in effect impose a duty—never before recognized in the law—on banks and securities brokerages to provide advance oral notice, before a customer signs an account agreement, of any arbitration clause in the agreement. That principle should not be adopted, for five reasons. *First*, any oral notice requirement that applies to arbitration clauses but not to all other terms in a contract would violate the Federal Arbitration Act and the California Arbitration Act by discriminating against arbitration clauses. *Second*, any such notice requirement would be separately preempted by the Exchange Act. An oral notice rule unique to California would interfere with the nationwide arbitration system regulated by the SEC and undermine investor protection by increasing the cost, complexity, and uncertainty of securities arbitration. *Third*, as a matter of California contract law, the Superior Court erred by basing its decision solely on procedural unconscionability, because a finding of substantive unconscionability is also required to void a contract on unconscionability grounds. *Fourth*, arbitration cannot be denied for constructive fraud, because neither Wells Fargo Bank nor Wells Fargo Investments (collectively, "Wells Fargo") had a fiduciary duty to orally alert the Browns to the arbitration clause. *Fifth*, as a prudential matter, an oral notice requirement would have a chilling effect on the provision of services to bank and brokerage customers, create confusion and uncertainty regarding the meaning of arbitration clauses, burden the courts with "he said, she said" litigation, and ultimately increase costs for all customers.

III. ARGUMENT

A. Any heightened notice requirement for arbitration clauses would contravene the Federal Arbitration Act and the California Arbitration Act

1. *The FAA preempts any heightened notice requirement for arbitration clauses that does not apply to other contract clauses*

Congress enacted the Federal Arbitration Act (FAA) "to replace judicial indisposition to arbitration with a national policy favoring [it] and plac[ing] arbitration agreements on equal footing with all other contracts." *Hall Street Associates v. Mattel, Inc.*, __ U.S. __, 128 S. Ct. 1396, 1402 (2008) (citation and quotation marks omitted). Accordingly, the FAA established "a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone Hospital v. Mercury Const. Corp.*, 460 U.S. 1, 24 (1983). The statute "preempts any contrary state law and is binding on state courts as well as federal." *Rosenthal v. Great Western Fin. Securities Corp.*, 14 Cal. 4th 394, 405 (1996). Disputes regarding the enforceability of arbitration clauses in brokerage account agreements are governed by the FAA. *Id.* at 419.

To further the "federal policy favoring arbitration," the FAA expressly provides that states may refuse to enforce an arbitration agreement only on grounds that apply to "*any* contract." 9 U.S.C. § 2 (emphasis added).[3] "What States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. The Act makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal footing, directly contrary to the Act's language and Congress's intent." *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 686 (1996) (internal quotation marks and citations omitted).

That principle compels a decision in favor of arbitration here. Plaintiffs contend that the arbitration clause is unenforceable because Wells Fargo had a fiduciary duty to orally alert the Browns to it at the time they signed the brokerage agreement. However, even if Wells Fargo were a fiduciary (and it was not), no principle of California law would have required the fiduciary to volunteer a spoken explanation of other clauses in their account agreement. Singling out the arbitration clause for a

[3] 9 U.S.C. § 2 states: "A written provision in . . . a contract . . . to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

fiduciary spoken-explanation requirement would put the arbitration clause on an "unequal footing" with other terms of the contract—precisely the result forbidden by the FAA.

Indeed, the United States Supreme Court has squarely held that states may not "condition[] the enforceability of arbitration agreements on compliance with a special notice requirement not applicable to contracts generally." *Casarotto*, 517 U.S. at 687 (striking down Montana statute requiring notice of arbitrability to be typed in underlined capital letters). "[S]tate legislation requiring greater information or choice in the making of agreements to arbitrate than in other contracts is preempted." *Id.* (citation omitted). Such is the case here. Absent a requirement that a broker explain *every* contractual term to elderly investors, the enforceability of the arbitration clause cannot turn on whether Wells Fargo gave advance oral notice specific to arbitration.

2. ***The Superior Court impermissibly subjected the arbitration clause to special scrutiny***

Plaintiffs cannot save their case by arguing that the Superior Court merely applied a neutral principle of contract law—unconscionability—to invalidate the arbitration clause. "Even when using doctrines of general applicability, state courts are not permitted to employ those general doctrines in ways that subject arbitration clauses to special scrutiny." *Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 167 (5th Cir. 2004). Yet special scrutiny is precisely what the Superior Court applied.

The Superior Court warned that if the motion to compel was granted, "we are depriving the Browns of having a right to have a jury panel hear this." (*See* Los Angeles Superior Court Reporter's Hearing Transcript 01/04/07 (RT) 48:14-16.) However, "the loss of a right to a jury trial is a necessary and fairly obvious consequence of an agreement to arbitrate." *Sydnor v. Conseco Fin. Serv. Corp.*, 252 F.3d 302, 307 (4th Cir. 2001) (quotation marks and citation omitted). Considering the "liberal federal policy favoring arbitration," it was impermissible for the court to scrutinize an arbitration clause because it involved waiver of a right to a jury trial. The lower court's reasoning merely "expresses precisely the sort of general antipathy to arbitration already considered and rejected by the Supreme Court . . . ." *Am. General Life & Acc. Ins. Co. v. Wood*, 429 F.3d 83, 90 (4th Cir. 2005) (rejecting argument that arbitration abrogates constitutional right to a jury trial).

The Superior Court also commented at length on how it was "inappropriate" that the arbitration clause did not require the arbitrator to explain its reasoning, and that "any party's right to appeal . . . is strictly limited." (RT 44:8-10.) But

such limited judicial review is exactly what Congress prescribed. *See* 9 U.S.C. § 10.[4] "It is well settled that arbitrators are not required to explain an arbitration award and that their silence cannot be used to infer a grounds for vacating the award." *Sullivan, Long & Hagerty Inc. v. Local 559, Laborer's Int'l Union*, 980 F.2d 1424, 1427 (11 Cir. 1993). "[C]onfirmation [of the arbitrator's decision] is required even in the face of erroneous findings of fact or misinterpretations of law." *French v. Merrill Lynch*, 784 F.2d 902, 906 (9th Cir. 1986). Far from being a drawback, the limited scope of judicial review is an essential component of the federal policy favoring arbitration. As the United States Supreme Court has recently explained, "limited review [is] needed to maintain arbitration's essential virtue of resolving disputes straightaway." *Hall Street Associates*, 128 S. Ct. at 1405. Otherwise, "full-bore legal and evidentiary appeals . . . can render informal arbitration merely a prelude to a more cumbersome and time-consuming judicial review process." *Id.* (citations omitted).[5]

Clearly, the Superior Court scrutinized the arbitration clause because it regarded as "inappropriate" those aspects of arbitration that Congress has found to be beneficial. By "singling out arbitration provisions for suspect status," however, the Superior Court's decision contravenes the FAA and must be reversed. *Casarotto*, 517 U.S. at 687.

3. *The decision below further defies California's policy in favor of arbitration*

Like the United States, "California has a strong public policy in favor of arbitration and any doubts regarding the arbitrability of a dispute are resolved in favor of arbitration." *Coast Plaza Doctors Hosp. v. Blue Cross of California*, 83 Cal. App. 4th 677, 686, 99 Cal. Rptr. 2d 809, 816 (2000). As the Supreme Court has recognized, "arbitration has become an accepted and favored method of resolving disputes, praised by the courts as an expeditious and economical method of relieving overburdened civil calendars." *Madden v. Kaiser Foundation Hosp.*, 17 Cal. 3d 699, 706-07 (1976).

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[4] The FAA allows a federal court to vacate an arbitration award only on four specific, narrow grounds: "(1) where the award was procured by corruption, fraud, or undue means; (2) where there was evident partiality or corruption in the arbitrators, or either of them; (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy . . . ; (4) where the arbitrators exceeded their powers, or so imperfectly exercised them that a mutual, final, and definite award upon the subject matter submitted was not made." 9 U.S.C. § 10(a).

[5] It is important to note that limited judicial review applies equally to all parties in arbitration, and does not favor financial institutions over individual investors.

Accordingly, the California Arbitration Act ("CAA"), like the FAA, provides that arbitration agreements are "valid, enforceable and irrevocable, save upon such grounds as exist for the revocation of *any* contract." Cal. Code Civ. Proc. § 1281 (emphasis added). Thus, any heightened notice requirement for arbitration clauses that does not apply to all other clauses in a contract contravenes the CAA for the same reasons it violates the FAA.

The Superior Court's criticism of the inevitable consequences of arbitration—waiver of jury trial and limited judicial review—are as inconsistent with the CAA as they are inconsistent with the FAA. "The speed and economy of arbitration, in contrast to the expense and delay of jury trial, could prove helpful to all parties." *Madden*, 17 Cal. 3d at 711. Moreover, like the FAA, the CAA narrowly circumscribes the scope of judicial review of arbitrators' decisions. *See* Cal. Code Civ. Proc. § 1286.2 (arbitration award may be vacated only for such grounds as fraud, corruption, arbitrator misconduct, or if the arbitrators exceeded their powers). "[A]n arbitrator's decision cannot be reviewed for error of fact or law." *Moncharsh v. Heily & Blaise*, 3 Cal. 4th 1, 11 (1992). Otherwise, "[e]xpanding the availability of judicial review of such decisions would tend to deprive the parties to the arbitration agreement of the very advantages the process is intended to produce." *Id.* at 10 (citation and internal quotations omitted).

B. Any heightened notice requirement would also be preempted by the Exchange Act because it would frustrate statutory objectives by increasing the uncertainty, cost, and complexity of the SEC-approved national securities arbitration system

Aside from the FAA and the CAA, an oral notice requirement would be separately preempted by the Exchange Act. SRO rules that have been approved by the SEC preempt state law if "the state law could prevent or impair accomplishment of the purposes and objectives of [the Exchange Act]." *Jevne v. Superior Court*, 35 Cal. 4th 935, 956-60 (2005) (holding that NASD rules preempted California standards for arbitrator disqualification); *see also Credit Suisse First Boston Corp. v. Grunwald*, 400 F.3d 1119, 1135 (9th Cir. 2005) ("[P]ermitting each state to regulate NASD arbitration procedures would create a patchwork of laws that would interfere with Congress's chosen approach of delegating nationwide, cooperative regulatory authority to the [SEC] and the NASD."). An oral notice requirement for arbitration would frustrate and undermine the national arbitration scheme approved by the SEC.

The procedure for giving notice of arbitration clauses in brokerage account agreements is prescribed by NASD Rule 3110(f). That rule does not require oral notice. Instead, it mandates that notice be given through a highlighted statement of arbitrability immediately preceding the customer signature line, and that customers must be provided

a copy of the agreement containing the arbitration clause within 30 days of signing, or within 10 days of a customer request. *See* NASD Rule 3110(f)(2)(A) & (B).

This form of notice has been approved by the SEC. *See* Order Granting Approval of Proposed Rule Change Relating to the Delivery of Customer Agreements Containing Predispute Arbitration Clauses, Exchange Act Release No. 51,526, 70 Fed. Reg. 20,407 (April 12, 2005). In approving the 30-day window for delivering the account agreement, the SEC explained that "the proposed rule change balances the need for protecting investors with the need for minimizing the administrative burden on [brokerage firms] and is consistent with the requirements of the [Exchange Act]." *Id.* at 20,409. Thus, the SEC has already struck the proper balance in approving the form of notice for arbitration clauses.

An oral notice requirement would inevitably frustrate this SEC-approved scheme by increasing the uncertainty, cost and complexity of the arbitration process to the ultimate detriment of investors. Different brokers would undoubtedly give differing, inconsistent explanations of the arbitration clause, and customers would remember the oral notice in conflicting ways when testifying years later, spawning a wave of pre-enforcement litigation on the adequacy of the broker's oral notice. Since the oral notice requirement would be contingent on the presence of fiduciary duties, litigation would inevitably arise over whether fiduciary relationships had been formed. And given that "the *scope* and *extent* of the fiduciary obligation . . . depends on the facts of the case," *Duffy v. Cavalier*, 215 Cal. App. 3d 1517, 1535, 264 Cal. Rptr. 740, 752 (1989) (emphasis in original), there would be widespread and protracted disputes over whether the broker's alleged fiduciary obligation encompassed giving advance oral notice of arbitration clauses. *Compare Twomey v. Mitchum Jones & Templeton, Inc.*, 262 Cal. App. 2d 690, 69 Cal. Rptr. 222 (1968) (broker had duty to advise against speculative investments) *with Caravan Mobile Home Sales, Inc. v. Lehman Bros Kuhn Loeb, Inc.*, 769 F.2d 561 (9th Cir. 1985) (broker had no duty to continually advise customer after customer purchased recommended securities).

As a result, enforcement of arbitration agreements in California would become more inconsistent, unpredictable, and costly. As the SEC explained in an analogous context, increases in the cost and uncertainty of arbitration proceedings "would serve the interest of well-financed brokerage firms, while the average investor would suffer from protracted and costly proceedings." *Jevne*, 35 Cal. 4th at 959-60; *see also Grunwald*, 400 F.3d at 1135-36 ("[T]hese problems could significantly undermine a primary Congressional purpose in enacting the Exchange Act—investor protection—because the average investor is less likely than the average brokerage firm to be able to afford the costs of protracted litigation."). Even customers not engaged in litigation

would lose, because higher costs of doing business for brokerage firms would ultimately be charged back to the customer.

In order to avoid a ruling that would "impair accomplishment of the purposes and objectives of the [Exchange Act]," *Jevne*, 35 Cal. 4th at 956, the order of the Superior Court must be reversed.

C. Plaintiffs have failed to establish both substantive and procedural unconscionability

1. *The FINRA arbitration system, which has been approved by the SEC and the courts, is not substantively unconscionable*

Even if the decision below did not conflict with the FAA, the CAA, or the Exchange Act, reversal would still be warranted because the Superior Court erred in applying California contract law. The only basis the Superior Court articulated to justify its decision was procedural conscionability. (RT 59:1-7.) But that is not enough. "[P]rocedural and substantive unconscionability must *both* be present in order for a court to exercise its discretion to refuse to enforce a contract or clause under the doctrine of unconscionability." *Gentry v. Superior Court*, 42 Cal. 4th 443, 469 (2007) (emphasis added). "[A] finding of procedural unconscionability does not mean that a contract will not be enforced, but rather that courts will scrutinize the substantive terms of the contract to ensure they are not manifestly unfair or one-sided." *Id.* The Superior Court made no finding that the arbitration clause was substantively unconscionable. That is sufficient ground for reversal.

In any event, a finding of substantive unconscionability would have been implausible. "The substantive element of unconscionability focuses on the actual terms of the agreement and evaluates whether they create 'overly harsh' or 'one-sided results,' that is, whether contractual provisions reallocate risks in an objectively unreasonable or unexpected manner." *Baker v. Osborne Development Corp.*, 150 Cal. App. 4th 884, 894, 71 Cal. Rptr. 3d 854, 862 (2008) (citation omitted). In other words, "to be substantively unconscionable, a contractual provision must shock the conscience." *Id.* As described earlier, all proposed FINRA arbitration rules must be approved by the SEC before they take effect. It is unlikely that the SEC would approve arbitration terms so unfair as to "shock the conscience." *See Parr*, 139 Cal. App. 3d at 447, 188 Cal. Rptr. at 805 ("Without some basis for doing so, we are reluctant to find unconscionable procedures which have been approved by the SEC.").

As the *Parr* court has already found, FINRA's procedures[6] are "beyond doubt" *not* substantively unconscionable. *Id.* The court explained:

> We note that a person such as petitioner is guaranteed the right to a panel of arbitrators a majority of whom must not be from the securities industry; the right preemptorily to challenge one of the arbitrators; the right to a hearing and to present evidence; the right to counsel; and the right to a verbatim record. Even without the SEC's imprimatur, we believe these rules measure up to the "minimum levels of integrity [required to withstand an allegation of substantive unconscionability]."

Id. The same reasoning fully applies here.

Both plaintiffs and the Superior Court have dwelled on the limited scope of judicial review for arbitration decisions. (Rsp't Opening Br. 29; RT 44:5-23.) But as explained above, such limitations are specifically *mandated* by the FAA and the CAA. If plaintiffs are right, then all arbitration agreements would be substantively unconscionable by definition—which is impossible given the federal and California policies favoring arbitration.

2. *An arbitration clause is not procedurally unconscionable merely because a signer neglected to read it*

Given the absence of any substantive unconscionability, this Court need not reach the question of procedural unconscionability to reverse the decision below. In any event, the facts here simply do not support a finding of procedural unconscionability. Importantly, procedural and substantive unconscionability are analyzed according to an inverse sliding scale. *Gentry*, 42 Cal. 4th at 469. "[T]he more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa." *Id.*

Procedural unconscionability focuses on the factors of "oppression" and "surprise." *Coast Plaza Doctors Hospital v. Blue Cross of California*, 83 Cal. App. 4th 677, 688, 99 Cal. Rptr. 2d 809, 817 (2000). Oppression results from unequal bargaining power, while "surprise involves the extent to which the supposedly agreed-upon terms of the bargain are hidden in a prolix printed form drafted by the party seeking to enforce the disputed terms." *Id.*

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[6] *Parr* involved arbitration administered by the NYSE, a predecessor to FINRA.

The uniform arbitration clause at issue here was far from "hidden" or a "surprise." Rather, it was highlighted by a notice of arbitrability that was prominently printed in capital letters immediately above the signature line where Mr. and Mrs. Brown signed their names. (Vol. 1, Clerk's Transcript (CT) 39.) They, or Mrs. Brown at the minimum, could and should have read the disclosure before signing.[7] It is irrelevant whether or not Mr. Brown was legally blind, because Mrs. Brown had full powers to bind the trust, and she did so.

Plaintiffs emphasize that Mrs. Brown was elderly and inexperienced in business matters. That merely confirms that she is a perfectly ordinary investor like millions of others across the country. In fact, prior to the Wells Fargo Investments account, she and Mr. Brown maintained a brokerage account at Ameritrade, whose customer agreement contained an arbitration provision similar to that of Wells Fargo Investments. (Vol. 3, CT 578.) There is no allegation that the Browns were coerced or tricked into signing the brokerage agreement, or of any affirmative misrepresentation by Wells Fargo. Wells Fargo's only alleged "unconscionable act" was that it did not volunteer an oral explanation of the arbitration clause. That is not enough to void the arbitration clause. "[T]he mere fact that a contract is not read or understood by the nondrafting party or that a drafting party occupies a superior bargaining position will not authorize a court to refuse to enforce a contract." *A & M Produce Co. v. FMC Corp.*, 135 Cal. App. 3d 473, 486, 186 Cal. Rptr. 114, 122 (1982); *see also Macaulay v. Norlander*, 12 Cal. App. 4th 1, 6, 15 Cal. Rptr. 2d 204, 207 (1992) ("Respondents, like other [brokerage firm] clients, were bound by the provisions of the client agreement regardless of whether they read it or were aware of the arbitration clause when they signed the document.")

D. There was no constructive fraud because neither Wells Fargo Bank nor Wells Fargo Investments had a fiduciary duty to orally explain the arbitration clause

At the outset, it should be noted that the Superior Court misapprehended the role of the fiduciary obligation issue in this litigation. The court found that fiduciary obligations existed, yet expressly declined to determine whether plaintiffs have proven fraud. (RT 54:28-55:2) ("I don't think I am in any position right now to make any adjudication with respect to the issues of fraud and that sort of thing."). However, the

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[7] The Superior Court's finding of Mr. Brown's blindness was based exclusively on the slanted appearance of Mr. Brown's signature. (RT 59:1-7.) That reasoning is an anachronism in the context of procedural unconscionability. The broker could not have been aware of the appearance of the signature until after Mr. Brown executed the agreement.

question of fiduciary duty is relevant *only because* of the fraud allegation. Under *Rosenthal*, fraud in the execution may be alleged as a general contract law defense to the enforcement of an arbitration agreement.[8] "To make out a claim of fraud in the execution . . . plaintiffs must show their apparent assent to the contracts—their signatures on the client agreements—is negated by fraud so fundamental that they were deceived as to the basic character of the documents they signed and had no reasonable opportunity to learn the truth." 14 Cal. 4th at 425. Since plaintiffs do not allege any affirmative misrepresentation by Wells Fargo, they can show that they were "deceived" only by claiming constructive fraud, *i.e.* that Wells Fargo breached an affirmative fiduciary obligation to orally alert the Browns to the arbitration clause.

In any event, even if the Superior Court had properly decided the fraud issue, reversal is still warranted because the record simply does not support any finding that the Browns were constructively "deceived."

1. ***Wells Fargo Bank had only a debtor-creditor relationship, and Wells Fargo Investments had no agency relationship, with the Browns at the time of the alleged fraud***

It is well-settled that "the relationship between a bank and its depositor is *not* a fiduciary relationship, but that of debtor-creditor." *Copesky v. Superior Court*, 229 Cal. App. 3d 678, 692, 280 Cal. Rptr. 338, 347 (1991) (emphasis in original). Before the Browns opened a brokerage account, the relationship between the Browns and Wells Fargo Bank was nothing more, and nothing less, than that between a debtor and a creditor.

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[8] As discussed above, even if the trial court had correctly applied California contract law to the facts of this case, any principle of law that imposes heightened notice for arbitration clauses would contravene the FAA, the CAA, and the Exchange Act. *Rosenthal* is not in conflict with those statutes. Both of the plaintiffs whom the Court found to have produced sufficient evidence of fraud had alleged affirmative misrepresentations. *See* 14 Cal. 4th at 427-29. Obviously, the rule against affirmative misrepresentation is as applicable to arbitration clauses as it is to any contractual term. However, the case at bar involves only allegations of omission, and a ruling for plaintiffs would inevitably establish a duty to orally disclose arbitration clauses that does not extend to other contractual terms. The *Rosenthal* court did note *in dicta* that a plaintiff afflicted with Alzheimer's, who did not allege an affirmative misrepresentation, might "possib[ly]" have a claim of constructive fraud, but the Court had no occasion to consider that issue. *Id.* at 430. "[T]he facts of her case are so unclear and in such dispute that legal analysis of the question would be premature." *Id.*

Moreover, before the Browns opened their brokerage account, there was *no* fiduciary relationship between the Browns and Wells Fargo Investments. A fiduciary duty cannot possibly arise *before* the customer appoints the broker as her agent. As the Supreme Court explained in *Rosenthal*, a debtor-creditor relationship is not transmuted into a fiduciary, agent-principal relationship merely because an affiliate of the debtor (bank) solicits the creditor (depositor) for other business. 14 Cal. 4th at 425. Instead, when a bank's broker-dealer affiliate solicits brokerage business from a depositor, no fiduciary obligations could attach until the customer has established an agency relationship by signing a brokerage account agreement. *Id.*

In *Rosenthal*, long-time customers of a bank opened brokerage accounts with the bank's sister broker-dealer, and then complained that they were not given oral notice of the arbitration clause in the brokerage account agreement. The Supreme Court quickly dismissed that argument.

> At the time the claimed nondisclosures occurred, no agency relationship had been formed, and those aspects of a broker's duty that derive from his or her role as the investor's agent are therefore not applicable. Under these circumstances, we find no authority for the proposition the fiduciary obligations of a broker extends to orally alerting the customer to the existence of an arbitration clause or explaining its meaning or effect.

Id. See also Bissell v. Merrill Lynch & Co., Inc., 937 F. Supp. 237, 247 (S.D.N.Y. 1996) (where disputed practice is governed by the parties' contract, the conduct does "not arise from affairs entrusted to the broker as a fiduciary" and, thus, "there can be no claim for breach of fiduciary duty").

Plaintiffs seize on the fact that the *Rosenthal* court remanded the claim of a legally blind plaintiff for further fact-finding. *Id.* at 428-29. But the situation of the Browns is easily distinguishable. First, whether or not Mr. Brown was legally blind, Mrs. Brown could and did execute the arbitration agreement on behalf of the trust. Second, and more importantly, the *Rosenthal* Court did not hold that the bank had fiduciary obligations because the plaintiff was legally blind. Rather, the Court held that she had produced evidence of "reasonable reliance for purposes of showing fraud in the execution of the agreement," and the alleged fraud was not premised on a nondisclosure, but on an affirmative misrepresentation—the broker purportedly told her that the account agreement she signed was "just a signature card." *Id.* at 429. Thus, there was evidence that the plaintiff was "deceived as to the basic character of the documents [she] signed." *Id.* at 425. But the plaintiffs here do not allege any such misrepresentation. Like other

brokerage customers in *Rosenthal* who were compelled to arbitrate their claims, plaintiffs here must abide by the arbitration agreement they voluntarily signed.

2. *Ms. Tepper's relationship with the Browns did not impose on Wells Fargo an affirmative fiduciary duty to orally disclose the arbitration clause, and the Browns could not have reasonably relied on a "personal secretary" to render legal advice*

Plaintiffs contend that Ms. Tepper had gained the Browns' trust and confidence by assisting them as a "personal secretary" before the account was opened. (Resp't Opening Br. at 4.) However, it would violate long-standing rules of corporate structure to attribute Ms. Tepper's conduct as an employee of Wells Fargo Bank to the bank's broker-dealer affiliate, Wells Fargo Investments. A corporation is a legal entity separate and distinct from its stockholders, officers, directors, parent corporation, and by implication its corporate affiliates, all of whom have distinct liabilities and obligations. *Sonora Diamond Corp. v. Superior Ct.*, 83 Cal. App. 4th 523, 538, 99 Cal. Rptr. 2d 824, 835-36 (2000).

In any event, Ms. Tepper's actions did not establish a fiduciary relationship between her and the Browns. As the California Bankers Association (CBA) has ably explained in its *amicus* brief, the bare reposing of trust and confidence does not give rise to a fiduciary relationship. Rather, fiduciary duty arises only if the recipient voluntarily accepts the reposed trust and then uses it to control the affairs or property of the confiding party. *See, e.g., Richelle L. v. Roman Catholic Archbishop*, 106 Cal. App. 4th 257, 272 n.6, 130 Cal. Rptr. 2d 601, 610 (2003); *see also* CBA Brief at 9-10 and authorities cited therein. The record shows that Ms. Tepper helped to organize and file the Browns' financial documents, and referred them to a CPA, an attorney, and a stock broker. There is no evidence that Ms. Tepper exercised actual control over the Browns' affairs.

"[T]he scope of [fiduciary] duty varies with the facts of the relationship." *Rosenthal*, 14 Cal. 4th at 425. Any purported fiduciary obligation must correspond to the scope of the agency. *Cf. Twomey*, 262 Cal. App. 2d 690, (stock broker had fiduciary duty to recommend suitable investments). Mrs. Brown thought Ms. Tepper was "simply an administrative-type employee." (Vol. 1, CT 118:2.) Plaintiffs do not explain how a personal secretary's purported fiduciary obligation extends to advising the Browns about the costs and benefits of alternative dispute resolution arrangements. Indeed, consistent with her administrative role, Ms. Tepper was busy filing documents when the Browns signed the brokerage account agreement. (Vol. 3, CT 561:6-24.) Nothing in the record suggests that, prior to signing the account agreement, the Browns had indicated any interest in dispute resolution arrangements or expected advice from Ms. Tepper on that subject.

Moreover, the Browns could not have reasonably relied upon Ms. Tepper to provide *unsolicited* legal advice regarding the meaning and effect of contractual terms. Justifiable reliance is an "essential element[]" of constructive fraud. *Alliance Mortgage Co. v. Rothwell*, 10 Cal. 4th 1226, 1239 n.4 (1995); *see also Tyler v. Children's Home Society*, 29 Cal. App. 4th 511, 548, 35 Cal. Rptr. 2d 291, 312 ("Constructive fraud arises on a breach of duty by one in a confidential or fiduciary relationship to another which induces justifiable reliance by the latter to his prejudice. Actual reliance and causation must be shown.") (internal quotation marks and citations omitted). There is simply no evidence that the Browns expected Ms. Tepper to, in the absence of any request from them, spontaneously provide legal advice regarding arbitration clauses or other terms in the brokerage agreement. Common sense suggests that such services should not be expected from someone the Browns considered to be an "administrative-type employee." Such reliance is even more unreasonable in light of the fact that the Browns have previously maintained a brokerage account with an arbitration agreement. Absent a showing of reasonable reliance, plaintiffs' fraud claim must fail. *Rosenthal*, 14 Cal. 4th at 423 ("[O]ne party's *unreasonable* reliance on the other's misrepresentations, resulting in a failure to read a written agreement before signing it, is an insufficient basis, under the doctrine of fraud in the execution, for permitting that party to avoid an arbitration agreement contained in the contract.") (emphasis in original).

E. An oral notice requirement would force financial institutions to limit assistance to customers, cause customer confusion, increase compliance costs, and burden the courts with "he said, she said" litigation

Prudential considerations further counsel against the oral notice requirement plaintiffs seek to impose. First, any such requirement would have a chilling effect on the relationship between financial institutions and their customers. It is entirely commonplace, and indeed desirable, for bankers to refer customers to other professional advisors such as attorneys, accountants, or stock brokers. Such referrals benefit all sides; customers obtain information regarding services and advisors which they might otherwise not have, and bankers earn the opportunity to better service customers and thereby keep their business. If fraud can be established because a banker does not explain all terms in a contract that the customer has with a *different* advisor, the inevitable result would be that bankers would offer fewer services and make fewer referrals in order to avoid liability.

Moreover, since the scope of the oral disclosure requirement would depend on the scope of fiduciary obligations, which in turn would depend on the unique facts of each customer relationship, it would be very difficult for brokers and bankers to determine the precise disclosure duties they would owe to each customer. Holding

financial institutions to such an amorphous standard would only encourage them to limit the services and assistance they provide to customers. Ironically, the losers, among others, would probably be elderly customers who may need such assistance the most.

Second, it would be self-defeating to require brokerage employees to orally explain the terms of a brokerage agreement. Stock brokers are not trained lawyers. Their expertise lies in providing financial advice, not in opining on the meaning and effects of contractual terms. An oral disclosure requirement would result in ad hoc and often inconsistent explanations being given by different brokers. It is hard to see how this would benefit customers. Uniform, conspicuous written disclosures of arbitrability are already required by NASD Rules 3110(f)(2)(A) & (B). Requiring non-lawyers to speculate on the ramifications and effects of arbitration clauses would simply confuse customers, while undermining the benefit of consistency that written disclosures provide.

It is important to note that California law already provides ample protections against affirmative fraud. A customer has every right to void an arbitration agreement if it was procured by a fraudulent misrepresentation, such that the customer was misled as to the basic character of the document she signed. *See Rosenthal*, 14 Cal. 4th at 417. But given that written disclosures are already required, to additionally require brokers to orally explain the arbitration clause every time an elderly customer opens an account is tantamount to inviting incorrect or ambiguous statements where none might otherwise have been made. Difficult questions would arise over the scope, adequacy, and fairness of the oral disclosure. If the broker describes the advantages of arbitration, for example by stating the federal and California policies favoring arbitration, would such advice be considered fair to the prospective customer? The evitable result of oral disclosures will be a wave of litigation and case-by-case adjudication that throws the entire national securities arbitration system into confusion and uncertainty.

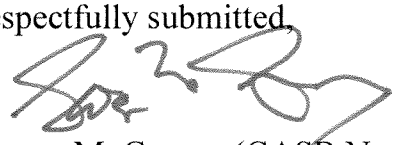
Third, such litigation would be burdened by intractable problems of proof. In many cases, brokerage accounts are maintained over a considerable length of time. Disputes may arise years or even decades after an account has been opened, long after the memory of witnesses have ceased to be reliable, or at a time when witnesses may not even be available due to death, illness, or relocation. An oral notice requirement would inevitably create "he said, she said" disputes that will be difficult to resolve. Normally, an arbitration agreement can be enforced simply by presenting documentary evidence of the agreement. But if oral disclosure was required, a mini-trial would be needed in every case to resolve conflicting accounts of who said what to whom. *Id.* at 414 ("[I]t's pretty difficult to weigh credibility without seeing the witnesses."). That is why California law has traditionally favored written instruments and disclosures in private contracting. *See e.g.*, Cal. Code of Civ. Proc. § 1856 (parol evidence rule). That is also why FINRA's uniform written-notice procedure for arbitration clauses, which the SEC has approved,

should not be undermined. To require a mini-trial just to enforce an arbitration agreement would negate the very purpose of arbitration and deprive the parties of the benefit of their bargain.

A natural consequence of these problems of proof is increased workload and administrative burdens for the courts, and for all parties involved. Parties who perceive tactical advantages to staying in court will likely argue that certain attributes or rules of FINRA arbitration (*e.g.*, availability of certain forms of discovery, availability and scope of judicial review) were not adequately described to them. The courts would have to decide in each instance if the implicated rule was sufficiently material that the broker should have informed the customer about it. This has the potential of clogging the courts with claims that otherwise should have gone to arbitration in accordance with executed arbitration agreements. Such litigation would also likely increase costs for financial institutions. These costs would ultimately be charged back to the customer, the vast majority of whom have no disputes with any bank or broker-dealer. Not only is the Superior Court's decision erroneous as a matter of law; it also makes for decisively unwise public policy.

For all of the foregoing reasons, the order of the Superior Court should be reversed.

Respectfully submitted,



George M. Garvey (CASB No. 089543)
Jeffrey Y. Wu (CASB No. 248784)

Appendix

Descriptions of *Amici Curiae*

The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that expand and improve markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

The Chamber of Commerce of the United States of America (Chamber) is the world's largest business federation. The Chamber's underlying membership includes more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country. Chamber members transact business throughout the United States, as well as a large number of countries around the world. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus curiae* briefs in cases that raise issues of vital concern to the nation's business community.

American Bankers Association (ABA) is the principal national trade association of the financial services industry in the United States. Its members, located in each of the fifty States and the District of Columbia, include financial institutions of all sizes and types, both federally and state-chartered. ABA members hold a majority of the domestic assets of the banking industry in the United States.

The ABA Securities Association is a separately chartered trade association and nonprofit affiliate of the ABA. Its mission is to represent the interests of banks that underwrite and deal in securities, proprietary mutual funds and derivatives in proceedings before Congress, federal and state governments, and the courts.

The Clearing House Association L.L.C. is an association of leading commercial banks dedicated to promoting the interests of its members and the commercial banking industry. It often presents the views of its members on important public policy issues that affect the commercial banking industry by, among other things, appearing as amicus curiae in state and federal courts.

The Financial Services Roundtable is a national association the membership of which includes 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer.

PROOF OF SERVICE BY MAIL

I, Annette Higa, declare:

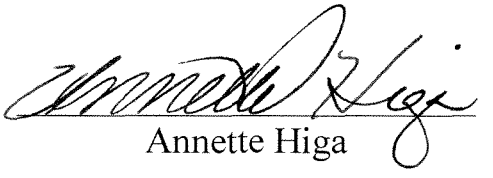
1. I am over the age of 18 and not a party to the within cause. I am employed by Munger, Tolles & Olson LLP in the County of Los Angeles, State of California. My business address is 355 South Grand Avenue, Thirty-Fifth Floor, Los Angeles, California 90071-1560.

2. On May 22, 2008, I served true copies of the attached document entitled **Amici Curiae Letter Brief of the Securities Industry and Financial Markets Association, the Chamber of Commerce of the United States of America, the American Bankers Association, the ABA Securities Association, the Clearing House Association L.L.C., and the Financial Services Roundtable** by placing it in addressed sealed envelopes clearly labeled to identify the persons being served at the addresses set forth on the attached service list and placed said envelopes in interoffice mail for collection and deposit with the United States Postal Service at 355 South Grand Avenue, Thirty-Fifth Floor, Los Angeles, California, on that same date, following ordinary business practices:

See attached SERVICE LIST

3. I am familiar with Munger, Tolles & Olson LLP's practice for collection and processing correspondence for mailing with the United States Postal Service; in the ordinary course of business, correspondence placed in interoffice mail is deposited with the United States Postal Service with first class postage thereon fully prepaid on the same day it is placed for collection and mailing.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed on May 22, 2008, at Los Angeles, California.



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