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Securities Law Update – July 2008

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Unauthorized Practice of Law

In Goldberg v. Merrill Lynch Credit, the Florida Supreme Court held that a private right of action to recover attorneys fees based upon unauthorized practice of law does not exist until there has been a Supreme Court determination that unauthorized practice of law has occurred. While the Court's reasoning makes sense, it does not seem practical in light of the fact that the Supreme does not and cannot investigate and rule upon every instance of the alleged unauthorized practice of law. If a Florida Bar investigating attorney chooses not to initiate a proceeding, it is unclear how the issue would ever be brought to the Court's attention.

NASD Arbitration Award Vacated

In Kashner Davidson, the First Court vacated an NASD arbitration award where the Arbitrators used dismissal as a first sanction for discovery violations, in lieu of a lesser sanction. Because NASD rules required the use of a lesser sanction prior to dismissal, the Court held that the arbitrators' decision reflected a manifest disregard of the law – the law being the Arbitrators' obligation to act in accordance with NASD rules and procedures.

Unconscionability of Arbitration Clause

In Ontiveros, a California appellate court held that as unconscionable and unenforceable an arbitration provision in an employment contract where the provision required arbitration of disputes as to arbitrability.

Martin Act

In Caboara, a New York Appellate Division court held that New York's Martin Act did not supplant separate causes of action for common law fraud or breach of contract.

Where to Sue Your Lawyer?

In Walshon the plaintiff investor sued his former attorneys for legal malpractice related to an NASD arbitration. The suit was brought in Connecticut, where the plaintiff lived. The attorneys practiced in New York, where the arbitration was held. The lawyers did not advertise in Connecticut, and did not meet with the plaintiff in Connecticut. The only Connecticut contact was sending a fee agreement to Connecticut. The court held that the Connecticut court lacked jurisdiction over the New York law firm.

HAROLD GOLDBERG, ARLENE GOLDBERG, Appellants, v. MERRILL LYNCH CREDIT CORPORATION, Appellee. AMY SUE FORMAN, Appellant, v. WORLD SAVINGS BANK, FSB, Appellee.

CASE NO. 4D07-1490, CASE NO. 4D07-2436

COURT OF APPEAL OF FLORIDA, FOURTH DISTRICT

981 So. 2d 550; 2008 Fla. App. LEXIS 5875; 33 Fla. L. Weekly D 1134

April 23, 2008, Decided

PRIOR HISTORY:

Consolidated appeals from the Circuit Courts for the Fifteenth Judicial Circuit, Palm Beach County and Seventeenth Judicial Circuit, Broward County; David F. Crowe and Cheryl J. Aleman, Judges; L.T. Case Nos. 2006-CA-009462-AO and 2006-CA-014137-21.

CORE TERMS: practice of law, unauthorized, exclusive jurisdiction, preparation, practice law, services performed, affirmative claim, prerequisite, insurer, void, fees paid, class actions, injunctive relief, disgorgement, counterclaim, technically, non-lawyers, preparing, license, patent, punish, suit to recover, practically, mortgage, sword

LexisNexis(R) Headnotes

Civil Procedure > Dismissals > Involuntary Dismissals > Appellate Review
Civil Procedure > Appeals > Standards of Review > De Novo Review
Civil Procedure > Appeals > Standards of Review > Fact & Law Issues
[HN1]An appellate court reviews dismissal orders raising legal issues de novo.

Civil Procedure > Remedies > Injunctions > General Overview
Legal Ethics > Sanctions > General Overview
Legal Ethics > Unauthorized Practice of Law
[HN2]R. Regulating Fla. Bar ch. 10 governs the investigation and prosecution of the unlicensed practice of law. R. Regulating Fla. Bar 10-7.1 sets out the procedure to be followed to obtain civil injunctive relief. Pursuant to Rule 10-7.1(a), those proceedings begin with the Florida Bar filing a petition in the Supreme Court of Florida.

Civil Procedure > Remedies > Damages > General Overview
Legal Ethics > Unauthorized Practice of Law
[HN3]See R. Regulating Fla. Bar 10-7.1(d)(3).

Civil Procedure > Jurisdiction > Subject Matter Jurisdiction > Jurisdiction Over Actions > Exclusive Jurisdiction
Civil Procedure > Sanctions > Contempt > General Overview
Governments > Courts > Authority to Adjudicate
Legal Ethics > Unauthorized Practice of Law
[HN4]The Florida Bar has been tasked with the maintenance of the highest standards and obligations of the profession of law. This

includes filing a petition in the Florida Supreme Court for injunctive relief against those who perform services that constitute the unauthorized practice of law. Art. V, §15, Fla. Const., bestows exclusive jurisdiction on the supreme court to punish for contempt anyone indulging in the unauthorized practice of law.

COUNSEL: Keith A. Goldbaum of Friedman, Rosenwasser & Goldbaum, P.A., Boca Raton and Richard E. Shevitz and Vess A. Miller of Cohen & Malad, LLP, Indianapolis, for appellants.

Mark A. Brown of Carlton Fields, P.A., Tampa and Michael K. Winston and Dean A. Morande of Carlton Fields, P.A., West Palm Beach, for appellee.

JUDGES: MAY, J. SHAHOOD, C.J., and POLEN, J., concur.

OPINION BY: MAY

OPINION

MAY, J.

> *When may a party file suit to recover fees paid for the alleged unauthorized practice of law* -- that is the question.
>
> Our answer: *Only after the Supreme Court of Florida decides the conduct constitutes the unauthorized practice of law.*

In a consolidated appeal, the Goldbergs and Amy Sue Forman [plaintiffs] appeal two trial court orders dismissing class-actions against Merrill Lynch Credit Corporation and World Savings Bank, FSB, [defendants], respectively. The class actions sought to recoup fees paid for document preparation by non-lawyers. The plaintiffs argue the trial courts erred in dismissing their complaints because Rule 10-7.1 of the *Rules Regulating the Florida Bar* specifically provides for such claims. While we agree that the Rule provides for such claims, we hold that the claims must await a decision by the Supreme Court of Florida as to whether the conduct constitutes the unauthorized practice of law. We therefore affirm.

The plaintiffs filed class actions seeking to recover document preparation fees charged for services performed by clerical personnel in the processing of mortgage loans. The document preparation fees consisted of $ 50 charged by World Savings Bank and $ 150 charged by Merrill Lynch for preparation of promissory notes, mortgages, deeds, and other documents. The plaintiffs alleged that the defendants were prohibited from charging those fees for services performed by non-lawyers.

The defendants moved to dismiss the complaints. They argued that the trial court lacked jurisdiction over the claims because the Supreme Court of Florida possesses exclusive jurisdiction to determine what constitutes the unauthorized practice of law. Alternatively, the defendants argued that the complaint failed to state a cause of action because parties to a transaction are permitted to prepare their own documents without engaging in the unauthorized practice of law.

The trial court granted the motions to dismiss. It found that the supreme court's "authority to regulate the practice of law also encompasses the determination of what is or is not the practice of law." The trial court relied on *Dade-Commonwealth Title Insurance Co. v. North Dade Bar Ass'n,* 152 So. 2d 723 (Fla. 1963).

[HN1]We review dismissal orders raising legal issues such as the one before us *de novo. Sanchez v. Fernandez,* 915 So. 2d 192 (Fla. 4th DCA 2005).

Two provisions of Rule 10-7.1 of the *Rules Regulating the Florida Bar* provide the basis

for the debate. [HN2]Chapter 10 governs the investigation and prosecution of the unlicensed practice of law. Rule 10-7.1 sets out the procedure to be followed to obtain civil injunctive relief. Pursuant to subsection (a), those proceedings begin with the Florida Bar filing a petition in the Supreme Court of Florida. R. Regulating Fla. Bar 10-7.1(a).

Subsection (d)(3), entitled "Restitution" provides: "[HN3]Nothing in this section shall preclude an individual from seeking redress through civil proceedings to recover fees or other damages." R. Regulating Fla. Bar 10-7.1(d)(3). The Rule is silent, however, as to when such a claim for fees or other damages can be pursued.

The plaintiffs primarily rely on two cases to support their position that a supreme court determination on the unauthorized practice of law is not a prerequisite to filing suit: *Vista Designs, Inc. v. Melvin K. Silverman, P.C.*, 774 So. 2d 884 (Fla. 4th DCA 2001), and *Preferred Title Services, Inc. v. Seven Seas Resort Condominium, Inc.*, 458 So. 2d 884 (Fla. 5th DCA 1984). We find those cases distinguishable.

In *Vista Designs*, a registered patent attorney, and member of the New Jersey Bar, sued to collect unpaid invoices for consulting services performed in patent and trademark infringement litigation in Florida. 774 So. 2d at 885. Vista Designs counterclaimed for disgorgement of fees paid, alleging that its verbal agreement with the attorney was void because he lacked a valid license to practice law in Florida. *Id.*

The trial court found the contract void because the attorney was not licensed to practice law in Florida and awarded him nothing on his claim. The trial court also ruled against Vista Designs on its counterclaim, concluding that it could not order the "disgorgement of money paid under a void contract." *Id.* at 886.

This court affirmed the denial of fees to the attorney, but reversed the dismissal of Vista Design's counterclaim and remanded the case for a determination of fees to be repaid. In doing so, we stated "the trial court correctly determined that Silverman's actions constituted the unauthorized practice of law." *Id.* at 887-88.

The claim for attorney's fees in *Vista Design* was not based on the unauthorized practice of law, but rather the actual practice of law by a New Jersey Lawyer, who did not possess a license to practice law in Florida. The defendants relied on the unauthorized practice of law to defend against the claim. Thus, the issue was used as a shield and not as a sword as has been attempted in this case. And, because this court was not directly asked to decide when an affirmative claim based on the unauthorized practice of law may be filed, or whether a supreme court determination on the issue is a prerequisite, our statement in *Vista Design* is not the equivalent of a holding on the issue.

In *Preferred Title Services*, the Fifth District affirmed the dismissal of a title insurer's complaint seeking fees for document preparation. 458 So. 2d at 887. The Fifth District found the title insurer was not entitled to fees for its unauthorized practice of law. *Id.* at 886-87. Once again, the case did not involve an affirmative claim for fees as a result of the unauthorized practice of law. The allegation of the unauthorized practice of law was used as a defense to a claim by the title insurer to obtain fees for document preparation.

Here, however, the plaintiffs are pursuing an affirmative claim using the defendants' alleged unauthorized practice of law in preparing documents as the basis. No case has approved of using the alleged unauthorized practice of law as a sword prior to a determination by the Supreme Court of Florida that the services actually constitute the unauthorized practice of law. We are not compelled to be the first.

Requiring a supreme court determination on the unauthorized practice of law as a prerequisite for a suit to recover fees and costs makes sense, practically and technically. Practically, it insures consistency in what conduct constitutes the unauthorized practice of law. To allow other courts or juries to randomly make the decision would lead to inconsistent results on the same set of facts.

Technically, it reinforces the exclusive jurisdiction of the supreme court over the unauthorized practice of law. Since the integration of the bar, [HN4]The Florida Bar has been tasked with the "maintenance of the highest standards and obligations of the profession of law." *Dade-Commonwealth,* 152 So. 2d at 726. This includes filing a petition in the supreme court for injunctive relief against those who perform services that constitute the unauthorized practice of law. Section 15, Article V of Florida's Constitution bestows "exclusive jurisdiction" on the supreme court "to punish for contempt anyone indulging in the unauthorized practice of law." *Id.* at 724 (referring to then section 23 of Article V and citing *State ex rel. The Florida Bar v. Sperry,* 140 So. 2d 587 (Fla. 1962)).

And, when asked to address an issue similar to the one in this case, the supreme court affirmed the dismissal of a complaint and expressly guarded its exclusive jurisdiction. *Dade-Commonwealth,* 152 So. 2d at 724 (quoting Art. V, § 15, Fla. Const.). In that case, the North Dade Bar Association sued title companies, alleging that they were preparing legal documents. The bar association sought a declaration from the trial court that the defendants were involved in the unauthorized practice of law.

The chancellor held that neither the bar association nor an individual had standing to bring such a suit because the supreme court had exclusive jurisdiction of the issue. The Third District reversed, holding that the supreme court's exclusive jurisdiction to punish for the unauthorized practice of law did not preclude other courts from ruling on this issue. Our supreme court then reversed and held that the bar association could not bring the suit. To hold otherwise would require the court to "ignore the word 'exclusive' in the relevant Constitutional provision." *Id.* at 725. This it refused to do, and so do we.

For these reasons, the orders of dismissal are affirmed.

Affirmed.

SHAHOOD, C.J., and POLEN, J., concur.

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KASHNER DAVIDSON SECURITIES CORP.; VICTOR L. KASHNER; MATTHEW MEISTER; TIMOTHY VARCHETTO, Plaintiffs, Appellees, v. STEVEN MSCISZ; MARK MSCISZ; LYNDA MSCISZ, Defendants, Appellants.

No. 07-1231

UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

2008 U.S. App. LEXIS 13562

June 27, 2008, Decided

PRIOR HISTORY:

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MASSACHUSETTS. Hon. Joseph L. Tauro, U.S. District Judge.

CORE TERMS: arbitrator's, manifest, arbitration, arbitration award, lesser sanctions, discovery, counterclaim, discovery order, disregarded, ineffective, proven, willful, arbitration proceeding, discovery requests, counter-claims, common law, arbitration hearing, executive session, failure to comply, deference, finra, arbitrator's decision, arbitration agreement, arbitration panel, sanction of dismissal, agreement to arbitrate, unambiguous language, contravention, noncompliance, withdraw

COUNSEL: John A. Sten, with whom Jason C. Moreau, Greenberg Traurig, LLP, and William P. Corbett, Jr., were on brief, for appellees.

Richard J. Babnick Jr., with whom Marc J. Ross and Sichenzia Ross Friedman Ference LLP, were on brief, for appellant.

JUDGES: Before Lipez and Howard, Circuit Judges, and Oberdorfer, * Senior District Judge.

* Of the District of Columbia, sitting by designation.

OPINION BY: LIPEZ

OPINION

LIPEZ, *Circuit Judge*. Courts must accord substantial deference to the decisions of arbitrators. Nevertheless, there are limits to that deference. This case tests those limits in an appeal arising from a National Association of Securities Dealers, Inc. ("NASD") arbitration proceeding between defendants-appellants Steven Mscisz, Mark Mscisz, and Lynda Mscisz ("appellants" or "Mscisz") and plaintiffs-appellees Kashner Davidson Securities Corporation, Victor L. Kashner, Matthew Meister, and Timothy Varchetto (together "appellees"). In the course of resolving a contract and

securities dispute between the parties, the arbitration panel ("Panel") dismissed several of appellants' counter-claims against Kashner Davidson Securities Corp. ("Kashner Davidson") and third-party claims against Kashner, Meister, and Varchetto ("Third-Party Appellees"). The Panel first stated in the presence of the parties that its decision to dismiss these claims involved consideration of the merits. Then, after recessing for a brief executive session, the Panel announced that the dismissal was a sanction pursuant to NASD Code Rule 10305. After the dismissal, the Panel took evidence on the remaining claims and entered an arbitration award in favor of appellees.

Appellees filed a motion with the District Court of Massachusetts to Confirm the Arbitration Award, which appellants opposed. Appellants also filed a cross-motion seeking vacatur of the Award. The district court granted appellees' motion and denied the appellant's cross-motion. On appeal, Mscisz asserts, inter alia, that the Panel deprived them of a fundamentally fair hearing by sua sponte dismissing their counterclaims and third-party claims with prejudice on the merits or, alternatively, that the Panel acted in manifest disregard of the law by dismissing the claims with prejudice as a sanction.

After carefully reviewing the provisions of the NASD Code (the "Code"), which were incorporated into the parties' arbitration agreement, and the Panel's explanation of its decision, we hold that the Panel manifestly disregarded the law by dismissing appellants' counterclaims and third-party claims as a sanction in contravention of the explicit terms of the Code, which specify that such a sanction can be entered only after lesser sanctions have been imposed and have proven ineffective. We therefore reverse the decision of the district court and remand the case for entry of an order vacating the arbitration award.

I.

The relationship between Mscisz and Kashner Davidson, a broker-dealer registered with the U.S. Securities and Exchange Commission ("SEC") and a member of the NASD, began in 2003 when Mscisz opened several non-discretionary brokerage accounts with Kashner Davidson. The accounts, one established solely by Steven Mscisz and another jointly by Mark and Lynda Mscisz, each held a large number of shares in the initial public offering of Vaso Active Pharmaceuticals, Inc. ("Vaso"). In early 2004, the appellants purchased additional shares of Vaso, using margin credit previously established with Kashner Davidson and its clearing firm, Sterne, Agee & Leach, Inc. ("Sterne"). For reasons unrelated to this dispute, the SEC suspended trading in Vaso's stock in April 2004, and subsequently lifted that suspension several weeks later, causing the price of Vaso's common stock to drop significantly. The decline created a margin debt in appellants' accounts and led Sterne to issue margin call notifications to Steven Mscisz and Mark and Lynda Mscisz.

On May 25, 2004, Kashner Davidson initiated the NASD [1] arbitration proceeding at issue in this appeal, asserting claims of breach of contract and fraud in connection with the approximately $ 350,000 in alleged margin debt owed by appellants in connection with their investment in Vaso. In August, appellants submitted their answer, denying Kashner Davidson's allegations and raising a number of defenses and claims against Kashner Davidson as well as against the Third-Party Appellees, all registered representatives of Kashner Davidson at the time these events were occurring. Specifically, Mscisz alleged in their answer that Kashner Davidson, through its representatives, committed fraud in contravention of several state and federal securities laws, as well as a number of common law violations. [2] Both parties agreed to submit the dispute to arbitration "in accordance with the Constitution, By-Laws, Regulations and/or Code of Arbitration

Procedures of the sponsoring organization," the NASD, and each accepted the three arbitrators appointed to the Panel, including Arthur Giacommara, who served as the Panel's Chairperson.

1 The NASD was the primary self-regulatory organization responsible for the regulation of the securities industry in the United States, with delegated authority from the U.S. Securities and Exchange Commission. In July 2007, the NASD was consolidated with the enforcement, arbitration, and member regulation arm of the New York Stock Exchange, known as NYSE Regulation, Inc., to create the Financial Industry Regulatory Authority (FINRA). *See* About FINRA, http://www.finra.org/AboutFINRA/CorporateInformation/index.htm (last visited May 27, 2008).

2 Specifically, appellants asserted twelve counter-claims against Kashner Davidson and third-party claims against Kashner, Meister, and Varchetto, including: (1) violations of Section 7 of the Securities Exchange Act of 1934 [15 U.S.C. ß 78g], Section 9 [15 U.S.C. ß 78i], and Section 10(b) [15 U.S.C. ß 78j(b)]; (2) violations of the Florida Securities Act [Fla. Stat. ß 517.301]; (3) violations of the Massachusetts Uniform Securities Act [Mass. Gen. Laws ch. 110A]; (4) violations of NASD Business Conduct Standards; (5) common law fraud; (6) unjust enrichment; (7) conversion; (8) breach of contract; (9) violations of the Racketeer Influenced and Corrupt Organization Act [18 U.S.C. ß 1962]; (10) abuse of process; and (11) violations of the Massachusetts Consumer Protection Act [Mass. Gen. Laws ch. 93A, ß 2].

In December 2004, the parties filed discovery requests seeking documents and other information related to their respective claims. [3] Both parties subsequently filed oppositions to each other's motions. On February 1, 2005, Giacommara issued a discovery order granting some of the parties' discovery requests and denying others. The order required the parties to comply by February 10, 2005.

3 The NASD Discovery Guide (the "Guide") supplements the section in the Securities Industry Conference on Arbitration publication entitled *The Arbitrator's Manual* and provides guidance to the arbitrators on a wide-range of commonly encountered discovery issues. *See* FINRA Discovery Guide, http://www.finra.org/web/groups/med_arb/documents/mediation_arbit ration/p009420.pdf (last visited June 2, 2008).

Days before the February 10 deadline, appellants filed an emergency motion asking the Panel for an additional seven days to produce the requested documentation and declaring their "inten[t] to comply fully with the Chairman's order directing them to provide information to the Third Party Respondents and Claimant/Respondent-Counter-claim." Mscisz contemporaneously filed an Emergency Motion to Postpone the Hearing, which was scheduled to begin on March 2, 2005. The Panel granted both of appellants' motions, extending the production deadline a week and postponing the arbitration hearing to May.

On February 22, 2005, after the extended time period for compliance with the discovery order had lapsed, Kashner Davidson sent a letter to the Panel, informing it of appellants' failure to comply with the discovery order and seeking a sanction against appellants for such failure. That same day, however, Kashner Davidson received 320 pages of documents from Mscisz pursuant to the discovery request, along with several emails questioning the veracity and ethics of appellees'

counsel. The accusations contained in these emails, as well as a number of others, were also included in a letter sent by appellant to the Panel the following day.

On February 24, appellants followed up the letter with a Motion for Reconsideration of the February 1 Discovery Order, a Motion to Compel Appellees' Compliance with the same Discovery Order, and a Motion to Withdraw their Counter-claims and Third-Party Claims Without Prejudice. Appellants argued in their Motion to Withdraw that the Panel's denial of discovery requests essential to their defenses deprived them of a fundamentally fair hearing. Kashner Davidson responded on February 28 with a second motion for sanctions against Mscisz for their deliberate disobedience of the order compelling production.

Mscisz opposed the Motion for Sanctions on two grounds. First, they argued that their refusal to produce documents was a result of their intention to have the counter-claims withdrawn from the arbitration, which would remove "any basis for the [appellee]'s attempt to rummage through their personal financial records." Second, appellants asserted that their noncompliance was justified by their recent filing of a Motion for Reconsideration of the Discovery Order, and they maintained that they would comply fully with any Panel order once their motion was addressed.

On March 30, the Panel denied Appellants' Motions to Withdraw their Counter-claims and Third-Party Claims Without Prejudice, and instead dismissed the claims *with prejudice*. [4] On May 11, appellants' counsel sent a letter to the NASD in which he challenged the Panel's decision to dismiss his party's claims with prejudice and inquired as to the basis of the decision. The explanation was provided on May 17 when the parties began the arbitration hearing. After the appellants again inquired as to the basis of the Panel's decision to dismiss counterclaims and third-party claims with prejudice at the outset of the hearing, the following exchange ensued between appellants' attorney and Giacommara:

> Appellants: Rule 10305 of the [NASD] Code allows dismissal under three circumstances: You can dismiss an entire proceeding with the agreement of the parties; you can dismiss the claims at issue without prejudice at the request of the parties, which is what we requested; or you can dismiss claims with prejudice, but only after, as a sanction, when other sanctions have proven ineffective for eliminating willful disobedience with panel authority.
>
> There's never been a finding of willful disobedience of a panel order by the Msciszes, there's never been a sanction assessed against them, and this [Order] was not phrased in terms of a sanction either.
>
> Giacomarra: I think you're missing the point. I think we do have authority beyond what you've quoted, and that was what our ruling was based on. It was after thoughtful consideration that the panel reviewed that and made that ruling. So we feel we do have authority.
>
> Appellants: Did the Panel consider the merits of the counterclaim?
>
> Giacomarra: We did.
>
> Appellants: When? They weren't briefed, they weren't argued. I never had an opportunity --

> Giacomarra: We had the claim in front of us, but we had -- we'll go off the record, take an executive session for a moment here, and if you could leave the room again.
>
> (Brief Recess)
>
> Giacomarra: We're going back on the record. After review of the matter, the panel is upholding their decision of dismissing the counterclaims with prejudice. We feel it's within our rights under rule 1035 -- 10305.

After the colloquy, the hearing continued on the remaining claims, with appellants having the opportunity to present testimonial and documentary evidence in support of its defenses.

> 4 The Panel's order dismissing appellants' claims with prejudice was inadvertently omitted from the district court record. However, the parties agree that the order included the following elements: (1) the arbitration hearing was postponed until May 17-20, 2005; (2) appellants' motion to withdraw its claims was denied; and (3) appellants' counter-claims and third-party claims were dismissed with prejudice.

After the hearing, the appellees were awarded $ 421,000.00 by the Panel, inclusive of attorneys' fees and costs. Kashner Davidson and the Third-Party Appellees then filed an Amended Complaint in the District of Massachusetts in July 2005, seeking to confirm the arbitration award and modify its allocation among the various appellants. Appellants responded by raising a number of affirmative defenses and counterclaims attacking the arbitration award, and requested that the award be vacated. In November 2006, the district court confirmed the arbitration award and declined to modify the allocation of damages among appellants. This appeal ensued. [5]

> 5 Although not raised in this appeal, appellants also sought to have the arbitration award vacated by the Massachusetts Supreme Judicial Court (SJC), arguing that Kashner Davidson was improperly represented by out-of-state attorneys at the arbitration hearing. After the Panel rejected Appellants' Motions to Disqualify Counsel in late 2004 and early 2005, Mscisz filed a petition before a single Justice of the SJC, raising similar claims. The Justice rejected appellants' claims, declaring "I conclude that the lawyer defendants will not engage in the unauthorized practice of law by representing [Kashner Davidson] at this particular arbitration hearing in Massachusetts . . . ." *Mscisz v. Kashner Davidson Sec. Corp.*, No. SJ-05-0088 (Mass. May 6, 2005). On appeal to the entire SJC after the arbitration award had been handed down by the Panel, the court held that "even if an out-of-State attorney's representation of a party at an arbitration proceeding in Massachusetts might constitute the practice of law, this conduct does not provide a basis to vacate the arbitration award, and, as such, the plaintiffs are not entitled to relief." *Mscisz v. Kashner Davidson Sec. Corp.*, 844 N.E.2d 614, 616 (Mass. 2006).

II.

Our review of an arbitration panel award is bifurcated. *Bull HN Info. Sys., Inc. v. Hutson*, 229 F.3d 321, 330 (1st Cir. 2000). Although we review the district court's decision de novo, *McCarthy v. Citigroup Global Mkts. Inc.*, 463 F.3d 87, 91 (1st Cir. 2006), we remain "exceedingly deferential" to the decisions of the arbitrator because the arbitrator's decision is the product of a contract

between the parties to have their dispute settled by an arbitrator, *Bull*, 229 F.3d at 330; *see also Teamsters Local Union No. 42 v. Supervalu, Inc.*, 212 F.3d 59, 61 (1st Cir. 2000).

An arbitration award, however, is not "utterly impregnable." *Cytyc Corp. v. DEKA Prods. Ltd. P'ship*, 439 F.3d 27, 32 (1st Cir. 2006); *Georgia-Pacific Corp. v. Local 27, United Paperworkers Int'l Union*, 864 F.2d 940, 944 (1st Cir. 1988) ("[C]oncluding that our role is limited is not the equivalent to granting limitless power to the arbitrator."). Although we "do not sit to hear claims of factual or legal error by an arbitrator as an appellate court does in reviewing decisions of lower courts," *United Paperworkers Int'l Union AFL-CIO, v. Misco, Inc.*, 484 U.S. 29, 38 (1987), there are limited "exceptions to the general rule that arbitrators have the last word," *Cytyc*, 439 F.3d at 33. Specifically, we must ensure that arbitration decisions comply with section 10 of the Federal Arbitration Act ("FAA"), 9 U.S.C. ß 10, and certain common law principles. *See id*.

"[S]ection 10 authorizes vacatur of an award in cases of specified misconduct or misbehavior on the arbitrators' part, actions in excess of arbitral powers, or failures to consummate the award." *Advest, Inc. v. McCarthy*, 914 F.2d 6, 8 (1st Cir. 1990). The common law requires vacatur if the party opposing confirmation of an award can show that the "award is '(1) unfounded in reason and fact; (2) based on reasoning so palpably faulty that no judge, or group of judges, ever could conceivably have made such a ruling; or (3) mistakenly based on a crucial assumption that is concededly a non-fact.'" *Id.* at 8-9 (quoting *Local 1445, United Food & Commercial Workers v. Stop & Shop Cos.*, 776 F.2d 19, 21 (1st Cir. 1985)). We have subsumed these common law grounds into a general evaluation of whether a panel has acted in "manifest disregard of the law." *See McCarthy*, 463 F.3d at 91; *Advest*, 914 F.2d at 9. We have further explained that "[a]n award is in manifest disregard of the law if either 'the award is contrary to the plain language of the contract,' or 'it is clear from the record that the arbitrator recognized the applicable law, but ignored it.'" *Wonderland Greyhound Park, Inc. v. Autotote Sys., Inc.*, 274 F.3d 34, 36 (1st Cir. 2001) (quoting *Gupta v. Cisco Sys., Inc.*, 274 F.3d 1, 3 (1st Cir. 2001)); *see also* 1 Martin Domke, *Domke on Commercial Arbitration*, ß 38:9 (2007) ("Although subject to slight variations in wording, courts generally apply the following two part test in determining if the award should be vacated for manifest disregard of the law: (1) Did the arbitrator know of the governing legal principal yet refused to apply it or ignored it all together? and (2) Was the law ignored by the arbitrators well defined, explicit and clearly applicable to the case? Only if the court determines that both prongs of this test are satisfied will it overturn an award for manifest disregard of the law." (footnotes omitted)).

III.

Acknowledging the significant deference that we must afford an arbitrator's decision, Mscisz nonetheless urges us to vacate the Panel's decisions denying appellants' discovery requests and dismissing their counterclaims and third-party claims with prejudice. Although appellants cite numerous grounds upon which the arbitration award should be vacated, echoing the various standards set forth in FAA section 10 and our common law decisions, their claims, in essence, boil down to two. First, Mscisz claims that the Panel acted in manifest disregard of the law by inappropriately relying on NASD Rule 10305, which specifies that claims can be dismissed with prejudice as a sanction only if lesser sanctions have failed to achieve the compliance the panel seeks. [6] Alternatively, Mscisz contends that if the Panel did not rely on Rule 10305, but rather dismissed their claims on the merits, it deprived appellants of a fundamentally fair hearing by

deciding these claims without the benefit of the parties' briefing or oral arguments. Accordingly, appellants contend vacatur of the arbitration award is required.

6 In full, NASD Rule 10305 states:

> (a) At any time during the course of an arbitration, the arbitrators may either upon their own initiative or at the request of a party, dismiss the proceeding and refer the parties to their judicial remedies, or to any dispute resolution forum agreed to by the parties, without prejudice to any claims or defenses available to any party.
>
> (b) The arbitrators may dismiss a claim, defense, or proceeding with prejudice as a sanction for willful and intentional material failure to comply with an order of the arbitrator(s) if lesser sanctions have proven ineffective.
>
> (c) The arbitrators shall at the joint request of all parties dismiss the proceedings.

In response, Kashner Davidson asserts that the decision of the Panel was based on its interpretation of Rule 10305, not on the merits of the claims, and that the Panel did not act in manifest disregard of the law by dismissing the claims. Appellees argue that the panel's decision to dismiss must be evaluated within the context of the entire arbitration proceedings, including their prior motions for sanctions and appellants' willful disregard of the Panel's discovery orders. According to the appellees, these elements, in addition to the Panel's statement after its "thoughtful consideration" of the issues, indicate that the dismissal was a sanction rather than a decision on the merits of appellants' various claims.

A. The Basis for the Panel's Dismissal of the Appellants' Counterclaims and Third-Party Claims with Prejudice

We agree that the Panel dismissed appellant's counterclaims and third-party claims primarily as a sanction. When initially asked at the May hearing to justify its decision to dismiss, the Panel stated that the decision included consideration of the merits of those claims. After being challenged on this point by appellants' counsel, who asserted that the merits of these claims had not even been briefed or argued, the Panel, before explaining its decision further, recessed to review the matter. After its executive session was completed, the Panel reconvened and stated that its decision to dismiss the counterclaims and third-party claims with prejudice was based on the dismissal provisions of Rule 10305, which permit dismissal as a sanction "for willful and intentional material failure to comply with an order of the arbitrator(s) if lesser sanctions have proven ineffective."

The sanction issue was certainly before the Panel at the time of its ruling. The appellees' numerous petitions in the months leading up to the hearing were framed as requests for sanctions rather than as arguments contesting the viability of appellants' claims. That the appellees would seek a sanction in response to the appellants' conduct during discovery is not surprising. The appellants readily admit that they had failed to comply fully with the discovery requests in February and March of 2005. The discovery material that the appellee did receive, on February 22, was

"unintentionally convoluted." Further, Kashner Davidson had sought a sanction against appellants on several separate occasions.

Nevertheless, we cannot ignore the Panel's own statement, offered immediately before the executive session, that it considered the merits of appellants' claims in deciding to dismiss them. That consideration could not plausibly disappear during the brief executive session. Thus, in some fashion, the Panel's assessment of the merits of these claims informed its decision to dismiss them as a sanction.

B. Manifest Disregard of the Law

We review the Panel's decision to invoke section 10305(b) of the Code as the basis for its dismissal decision. Both sections (a) and (c) are silent on the issue of sanctions, and address only dismissals without prejudice. According to Rule 10305(b), the Panel may dismiss a claim with prejudice if two elements are satisfied. First, the dismissal must be a response to the "willful and intentional material failure to comply with an order of the arbitrator(s)." Second, it may be imposed only "if lesser sanctions have proven ineffective." The Guide confirms these elements. Noting that a Panel has "wide discretion to address noncompliance with discovery orders," the Guide states that in "extraordinary cases, the panel . . . may, pursuant to Rule 10305(b), dismiss a claim . . . with prejudice as a sanction for intentional failure to comply with an order of the arbitrator(s) *if lesser sanctions have proven ineffective.*" NASD Discovery Guide 18 (emphasis added).

Although the first element was arguably satisfied here because the Panel could have concluded that the appellants willfully and materially failed to comply with an order, the second element was not met. The Panel had not previously imposed lesser sanctions on the appellant and therefore had not demonstrated that sanctions short of a dismissal were ineffective. Indeed, only weeks before the claims were dismissed in March, the Chairman of the Panel expressly denied the appellees' requests for sanctions. It is clear, therefore, that the unambiguous language of the Rule was disregarded. *Cf. Bradley v. Davis*, 777 So. 2d 1189, 1190 (Fla. 4th Dist. Ct. App. 2001) (suggesting that plaintiff would have "in all likelihood" won her appeal challenging the dismissal of her arbitration claims with prejudice under 10305(b) because no lesser sanctions had proven ineffective).

Acknowledging this fact in their brief, the appellees nevertheless raise several arguments in defense of the Panel's action. First, they contend that the Panel could not have acted in manifest disregard of the law because the NASD Code is a set of private dispute resolution rules, not a body of law. Accordingly, the Panel's disregard of the Code cannot constitute manifest disregard of the law.

The "manifest disregard" standard is most often applied to the arbitrator's decision on the merits of the dispute that requires resort to the arbitral forum. For example, there may be a claim that the arbitral award is in manifest disregard of the law because it is contrary to the plain meaning of the contract that the arbitrator has been asked to apply. *See, e.g., Cytyc*, 439 F.3d at 33. However, the manifest disregard standard can also be applied to the agreement to arbitrate itself. All arbitrations are conducted pursuant to a contract between the parties. *See First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995) ("[A]rbitration is simply a matter of contract between the parties; it is a way to resolve those disputes-but only those disputes-that the parties have agreed to submit to arbitration."). That agreement to arbitrate often determines the procedural rules that the arbitrator applies in resolving the underlying dispute. If the arbitrator ignores the plainly stated procedural rules incorporated in the agreement to arbitrate while arriving at the arbitral award, that award is

subject to a manifest disregard of the law challenge. *See Patten v. Signator Insurance Agency, Inc.*, 441 F.3d 230, 235 (4th Cir. 2006) (finding that an arbitrator "acted in manifest disregard of the law" where she "disregarded the plain and unambiguous language of the governing arbitration agreement"); *cf. Cytyc*, 439 F.3d at 32 ("[T]he award must 'draw its essence from the contract' that underlies the arbitration proceeding." (quoting *Misco*, 484 U.S. at 38)).

In this case, the parties agreed to "submit the present matter in controversy . . . to arbitration in accordance with the Constitution, By-Laws, Regulations, and/or Code of Arbitration Procedure of the sponsoring organization," in this case, the NASD. *See* NASD Rule 10331 ("This Code shall be deemed a part of and incorporated by reference in every agreement to arbitrate under the Rules of the Association including a duly executed Submission Agreement."). Thus, the NASD rules became part and parcel of the arbitration contract, serving as the procedural rules governing the arbitration proceeding. *See* 11 Richard A. Lord, *Williston on Contracts* ß 30:25 (4th ed. 2008) ("Where a writing refers to another document, that other document, or the portion to which reference is made, becomes constructively a part of the writing, and in that respect the two form a single instrument. The incorporated matter is to be interpreted as part of the writing."). If the Panel disregarded those rules, it necessarily disregarded the arbitration contract as well. *See George Watts & Son, Inc. v. Tiffany and Co.*, 248 F.3d 577 (7th Cir. 2001) (hypothesizing that if an arbitration agreement specifies that a dispute is to be resolved under Wisconsin law, and the arbitrator states that she prefers New York law, or no law at all, that the award could be deemed a "manifest disregard of the law" or, alternatively, as exceeding the arbitrator's powers). [7] Thus, if "the [Panel] disregarded the plain and unambiguous language of the governing arbitration agreement . . . ., [it] acted in manifest disregard of the law and failed to draw [its] award from the essence of the agreement." *Patten*, 441 F.3d at 235.

> 7 We acknowledge that there may be instances when the various statutory and common law grounds for reviewing an arbitration award overlap, leading courts to evaluate different standards, or different iterations of the same standard. For example, if an arbitration panel has acted in contravention of the clear, unambiguous language of the arbitration contract, it has arguably both manifestly disregarded the applicable law and exceeded its power as arbitrators. We think that the manifest disregard of the law approach works well here. We are not suggesting that the "exceeding its power" rationale could not work as well. As we have stated before, the "standard of judicial review has taken on various hues and colorations in its formulations in this, and other, circuits." *Advest, Inc.*, 914 F.2d at 9.

The appellees also argue that even if the NASD code was the governing law in the arbitration proceeding, the Panel did not "intentionally or willfully" disregard the law because its decision was made in good-faith after thoughtful consideration and based on its overall interpretation of the Code provisions and authority. Appellees cite Rule 10324 [8] as providing authority for the Panel's interpretation of 10305(b) and their actions taken in accordance with that interpretation. According to appellees, Rule 10324 provides the Panel with authority to interpret Rule 10305(b) broadly in order to "obtain compliance with any ruling by the arbitrators." Because the Panel was merely interpreting, in a good-faith manner, the text of Rule 10305(b) in accordance with Rule 10324, appellees argue, it could not have "intentionally or willfully" disregarded the law in this case.

> 8 In full, NASD Rule 10324 states:

> The arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code and to take appropriate action to obtain compliance with any ruling by the arbitrator(s). Such interpretations and actions to obtain compliance shall be final and binding upon the parties.

The appellees also offer the Guide as additional support for their claim. The Guide specifically contains a section discussing sanctions in connection with discovery disputes. Confirming that a panel maintains "wide discretion to address noncompliance with discovery orders," it encourages the use of sanctions "if any party fails to produce documents or information required by a written order." NASD Discovery Guide 18; *see Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 85 (2002) ("[T]he NASD arbitrators, comparatively more expert about the meaning of their own rule, are comparatively better able to interpret and to apply it."). Further, the Guide repeats the language of 10305(b) as an option "in extraordinary cases." NASD Discovery Guide 18.

We agree that Rule 10324 establishes two distinct and independent grants of authority -- first, the authority to "interpret" the Code, and second, the authority to "take appropriate action to obtain compliance with any ruling by the arbitrators." Nevertheless, these grants of authority do not save the Panel's dismissal decision. With respect to the authority to interpret, the Panel's disregard of the unambiguous text of a Code provision cannot be deemed a mere interpretation. To find otherwise and expand the concept of "interpretation" to include the Panel's dismissal decision in this case would be tantamount to giving NASD arbitration panels a blank check to dismiss claims with prejudice in contravention of an explicit provision of the Code. Our deference to the decisions of arbitrators does not extend that far.

With respect to the authority to use sanctions to achieve compliance with panel orders, Rule 10324 authorizes "appropriate action to obtain compliance with any ruling by the arbitrator(s)." The sanction of dismissal imposed by the Panel was not intended to obtain compliance with any ruling by an arbitrator. Indeed, it was a sanction that made compliance with outstanding orders by the Panel irrelevant by removing the underlying claims of appellants from the case. The dismissal ordered by the Panel has no grounding in Rule 10324.

Therefore, the dismissal sanction imposed by the Panel reflects its intentional and willful disregard of the clear and unequivocal language of Rule 10305(b). That language permits dismissal with prejudice as a sanction only after lesser sanctions have failed to achieve compliance with the order(s) at issue. [9] There was no history of lesser sanctions having been tried in this case. [10] The Panel, having rejected numerous requests for sanctions from appellees, certainly knew this to be so, yet it chose to impose the ultimate sanction of dismissal without taking the preliminary steps required by the rule. Although the Panel's negative view of the merits of appellants' claims, alluded to by the Panel immediately before the executive session, may help explain the Panel's decision to invoke Rule 10305 as a basis for dismissing appellants' claims with prejudice, this negative view did not justify invoking a rule, "well defined, explicit, and clearly applicable to this case," 1 Domke, *supra*, 38:9, that did not support the sanction rationale offered by the Panel. This misapplication of the clear language of the rule can only be deemed an intentional and willful disregard of the law.

9 The Guide also explicitly contemplates imposing less severe sanctions prior to an outright dismissal with prejudice pursuant to Rule 10305(b). Additionally, it offers examples of such

sanctions, including "mak[ing] an adverse inference against a party" or assessing various fees resulting from noncompliance. NASD Discovery Guide 18.

10 Courts adopt a similar approach of using lesser sanctions to encourage a party's compliance with a court order and reserving the sanction of dismissal until others have proven unsuccessful. *See Crossman v. Raytheon Long Term Disability Plan*, 316 F.3d 36, 39-40 (1st Cir. 2002); *Velazquez-Rivera v. Sea-Land Serv., Inc.*, 920 F.2d 1072, 1076 (1st Cir. 1990) ("[D]ismissal should be employed only if the district court has determined that it could not fashion an 'equally effective but less drastic remedy.'" (quoting *United States v. Pole No. 3172, Hopkinton*, 852 F.2d 636, 642 (1st Cir. 1988))); *Richman v. Gen. Motors Corp.*, 437 F.2d 196, 199 (1st Cir. 1971) ("Dismissal is a harsh sanction which should be resorted to only in extreme cases.").

IV.

There may well have been grounds for the Panel's frustration with the discovery conduct of appellants. We are not questioning the authority of a panel established pursuant to the NASD Code to use sanctions to achieve compliance with its discovery order. Rule 10305 of the Code specifically provides for the use of sanctions to achieve such compliance. But that rule requires that lesser sanctions be used first in an attempt to achieve compliance before the ultimate sanction of dismissal is imposed. The Panel ignored this unmistakable directive. Our considerable deference to an arbitrator's decision does not permit us to endorse such a manifest disregard of a rule that the parties agreed should apply to the resolution of their dispute. Therefore, we reverse the decision of the district court and remand the case for entry of an order vacating the arbitration award.

So ordered.

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GINA ONTIVEROS, Plaintiff and Respondent, v. DHL EXPRESS (USA), INC., Defendant and Appellant.

A114848

COURT OF APPEAL OF CALIFORNIA, FIRST APPELLATE DISTRICT, DIVISION TWO

2008 Cal. App. LEXIS 964

June 30, 2008, Filed

PRIOR HISTORY:
Superior Court of Alameda County, No. RG05245114, Kenneth M. Burr, Judge.

CORE TERMS: arbitrator, arbitration, unconscionable, arbitration agreement, discovery, unconscionability, arbitrate, substantively, arbitrability, compel arbitration, arbitration provision, discovery provisions, contract of adhesion, enforceability, unenforceable, severance, deposition, present case, enforceable, agreement to arbitrate, permeated, lawsuit, arbitration-related, applicability, bargaining, illegality, repeat, void, harassment, substantive unconscionability

COUNSEL: Littler Mendelson, P.C., Henry D. Lederman, Marlene S. Muraco, Neda N. Dal Cielo for Appellant.

The Lucas Law Firm, Kathleen M. Lucas, Michelle T. Duval, Law Offices of Lawrence A. Organ, Lawrence Anthony Organ for Respondent.

JUDGES: Opinion by Kline, P. J., with Lambden and Richman, JJ., concurring.

OPINION BY: Kline

OPINION

KLINE, P. J.--Defendant DHL Express (USA), Inc. (defendant or DHL) appeals the trial court's order denying its motion to compel arbitration after plaintiff Gina Ontiveros (plaintiff) filed a lawsuit against defendant DHL and four other defendants, [1] raising various claims related to sex discrimination, harassment, and retaliation arising from her employment with defendant. Defendant claims that plaintiff's lawsuit is precluded by an arbitration agreement previously entered into by both parties. Because we conclude the trial court properly found the arbitration agreement was unconscionable, and therefore unenforceable, we shall affirm the order.

1 Plaintiff filed the lawsuit against defendant (erroneously named as "DHL Express"); Airborne Express, Inc. (which had been acquired by defendant); Deutsche Post World Net, Ken Hafner; and Liny Schwahn. Apparently, defendant DHL was the only defendant served in this action.

PROCEDURAL BACKGROUND

On December 5, 2005, plaintiff filed a complaint for damages, in which she alleged (1) sex/gender discrimination and harassment, (2) failure to prevent sex/gender discrimination and harassment, (3) retaliation for opposing

forbidden practices, and (4) aiding and abetting discrimination and harassment.

On June 2, 2006, defendant filed a petition to compel arbitration and motion to stay judicial proceedings.

On July 6, 2006, the trial court denied defendant's motion to compel arbitration.

On July 19, 2006, defendant filed a notice of appeal.

FACTUAL BACKGROUND

Plaintiff began working as a hazardous materials inspector at Airborne Express in May 1998 as a contract employee. In October 1999, she was hired as a permanent employee by Airborne Express to work as a field service supervisor.

In April 2000, plaintiff was promoted to aircraft operations supervisor for the Northern Bay Area, including Oakland International Airport. She later held the same position in another area that included San Francisco International Airport. In August 2003, defendant DHL acquired Airborne Express as a wholly owned subsidiary and, in January 2005, Airborne Express was dissolved and its employees, including plaintiff, became employees of defendant DHL.

According to plaintiff, after her April 2000 promotion, she was subjected to ongoing severe sexual harassment and retaliation.

In 2004, plaintiff took a short-term disability leave and apparently left defendant's employ in 2005.

DISCUSSION

I. *Background*

A. *Terms of the Arbitration Agreement*

Plaintiff signed a "Mutual Agreement to Arbitrate Claims" (arbitration agreement or agreement) on October 18, 1999, upon being hired as a permanent employee by Airborne Express. The agreement consists of a single-page document in a small font. No representative of Airborne Express signed the agreement.

In her declaration in opposition to the motion to compel, plaintiff stated that she received the arbitration agreement as part of a packet of hiring paperwork, which her manager said to fill out; sign; and return in order to start her new job and get paid. Plaintiff further stated: "At no time did [my manager] explain or describe the contents of the documents in that hiring packet. The hiring packet contained documents like an Immigration Form I-9, documents pertaining to health care coverage, documents relating to my base compensation, documents welcoming me to the company and other documents the content of which I do not recall. The hiring packet came in a binder file. At no time did anyone inform me that I was signing an Agreement to Arbitrate Claims or explain what that was or how it affected my substantive rights. At no time did anyone inform me that I was required to give up any rights I might have to a jury trial in order to work for Airborne. When I was hired, I was informed that I needed to sign the paperwork in order to get paid and start my new job, and I was not afforded an opportunity [to] negotiate further the terms of my employment. I was already working long hours at that point in time and did not have any real opportunity to review the documents I was told to sign. I was not told that I should review the documents with a lawyer or discuss my rights with a lawyer. The first time I can recall knowing about the Agreement to Arbitrate Claims was when DHL raised this issue in this lawsuit. I had not been given a copy of the agreement prior to filing this lawsuit."

The agreement to arbitrate covered all claims between the parties, whether or not arising out of plaintiff's employment or its termination, including, but not limited to, claims for wages or benefits, claims for breach of contract or covenant, tort claims, claims for

discrimination, and claims for violation of any governmental law or regulation. In addition, the agreement provided that "[t]he Arbitrator, and not any federal, state, or local court or agency, shall have exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation of this Agreement, including but not limited to any claim that all or part of this Agreement is void or voidable." The agreement stated that arbitration would be held under the auspices of either the American Arbitration Association (AAA) or Judicial Arbitration and Mediation Services, Inc. (JAMS), "with the designation of the sponsoring organization to be made by the party who did not initiate the claim."

The agreement further stated that each party would have the right to take the deposition of one individual and any expert witness designated by another party. "Additional discovery may be had only where the Arbitrator selected pursuant to this Agreement so orders, upon a showing of substantial need." The agreement also stated that plaintiff and defendant would share the costs of the arbitrator and that each party would pay its own costs and attorney fees, with the exception, inter alia, that if a party prevails on a statutory claim that affords the prevailing party attorney fees, the arbitrator may award reasonable fees to the prevailing party.

At the conclusion of the agreement was a sentence in all capital letters stating, "I understand that by signing this agreement I am giving up my right to a jury trial," with a line underneath where plaintiff wrote her initials. Just above her signature was another sentence in all capital letters stating, "I further acknowledge that I have been given the opportunity to discuss this agreement with my private legal counsel and have availed myself of that opportunity to the extent I wish to do so."

B. ***The Trial Court's Ruling***

The trial court based its order denying the motion to compel arbitration on various factors, including, first, that defendant did not establish that it was a successor in interest to Airborne Express under the arbitration provision at issue and, second, that the written agreement was not signed by Airborne Express and defendant did not show that Airborne Express agreed to be bound by the written agreement.

In addition, the court determined that "[t]he clause in the agreement providing that the arbitrator must decide disputes relating to applicability, enforceability or formation of the agreement is not sufficient to require the Court to compel arbitration if the contract is unconscionable. The Court finds that it is required, in the first instance, to determine whether the contract is unconscionable, despite any provision requiring arbitration of issues relating to arbitrability."

The court further stated, inter alia, that its ruling was "supported by important public policy concerns distinct from the policy against enforcing unconscionable agreements. The Court finds that the integrity of the contractual arbitration procedures requires that the initial threshold determination that there is a valid contract to arbitrate must be made by an actual neutral [i.e., the Court], rather than one with a direct financial interest in the matter remaining in arbitration."

The court then stated: "Having found that it is necessary for the Court to review the arbitration agreement to determine whether it is unconscionable, the Court concludes that the arbitration provision offered by DHL is permeated with [procedural and substantive] unconscionability and will not be enforced."

II. ***Public Policy and the Doctrine of Unconscionability***

In Mandatory Employment Arbitration Agreements

In *Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83, 102 (*Armendariz)*, our Supreme Court articulated the five minimum requirements for lawful arbitration of nonwaivable statutory civil rights in the workplace pursuant to a mandatory employment arbitration agreement: "Such an arbitration agreement is lawful if it '(1) provides for neutral arbitrators, (2) provides for more than minimal discovery, (3) requires a written award, (4) provides for all of the types of relief that would otherwise be available in court, and (5) does not require employees to pay either unreasonable costs or any arbitrators' fees or expenses as a condition of access to the arbitration forum.'"

The court then discussed the "judicially created doctrine of unconscionability," which "'has both a "procedural" and a "substantive" element,' the former focusing on "'oppression'" or "'surprise'" due to unequal bargaining power, the latter on "'overly harsh'" or "'one-sided'" results. [Citation.] 'The prevailing view is that [procedural 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.' [Citation.] But they need not be present in the same degree. . . . In other words, the 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." (*Armendariz, supra,* 24 Cal.4th at pp. 113-114.)

The court explained that, in the context of an agreement between an employer and employee to arbitrate disputes, "[u]nconscionability analysis begins with an inquiry into whether the contract is one of adhesion. [Citation.] 'The term [contract of adhesion] signifies a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it.' [Citation.] If the contract is adhesive, the court must then determine whether 'other factors are present which, under established legal rules--legislative or judicial--operate to render it [unenforceable].' [Citation.]" (*Armendariz, supra,* 24 Cal.4th at p. 113.) The court then noted that when an arbitration agreement is imposed on an employee as a condition of employment and there is no opportunity to negotiate, the arbitration agreement is adhesive. (*Armendariz,* at pp. 114-115.)

The court further observed that while arbitration is favored in this state as a voluntary means of resolving disputes and while it "may have its advantages in terms of greater expedition, informality, and lower cost, it also has, from the employee's point of view, potential disadvantages" and is generally advantageous to employers "not only because it reduces the costs of litigation, but also because it reduces the size of the award that an employee is likely to get, particularly if the employer is a 'repeat player' in the arbitration system. [Citations.]" (*Armendariz, supra,* 24 Cal.4th at p. 115.) The court further observed that, "[g]iven the lack of choice and the potential disadvantages that even a fair arbitration system can harbor for employees, we must be particularly attuned to claims that employers with superior bargaining power have imposed one-sided, substantively unconscionable terms as part of an arbitration agreement." (*Ibid.*)

III. *Standard of Review*

On appeal from the denial of a motion to compel arbitration, "'we review the arbitration agreement de novo to determine whether it is legally enforceable, applying general principles of California contract law. [Citations.]' [Citation.]" (*Baker v. Osborne Development Corp.* (2008) 159 Cal.App.4th 884, 892.) With respect to unconscionability, the trial court's findings "are reviewed de novo if they are based on declarations that raise 'no meaningful

factual disputes.' [Citation.] However, where an unconscionability determination 'is based upon the trial court's resolution of conflicts in the evidence, or on the factual inferences which may be drawn therefrom, we consider the evidence in the light most favorable to the court's determination and review those aspects of the determination for substantial evidence.' [Citation.] The ruling on severance is reviewed for abuse of discretion. [Citations.]" (*Murphy v. Check 'n Go of California, Inc.* (2007) 156 Cal.App.4th 138, 144 (*Murphy*).)

IV. *The Trial Court's Jurisdiction and Unconscionability of the Provision that the Arbitrator Will Determine Whether the Contract Is Enforceable*

Defendant contends that, in light of the provision in the arbitration agreement that the arbitrator "shall have exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation" of the agreement, an arbitrator, not the trial court, should have determined whether a valid agreement to arbitrate exists.

The United States Supreme Court has explained: "Courts should not assume that the parties agreed to arbitrate arbitrability unless there is 'clea[r] and unmistakabl[e]' evidence that they did so. [Citations.]" (*First Options of Chicago, Inc. v. Kaplan* (1995) 514 U.S. 938, 944.) California law is consistent with federal law on this question. In *Freeman v. State Farm Mut. Auto. Ins. Co.* (1975) 14 Cal.3d 473, 480, the California Supreme Court stated: "It is, of course, possible for the parties to agree that the arbitrator may determine the scope of his authority. 'The arbitrability of a dispute may itself be subject to arbitration if the parties have so provided in their contract.' [Citation.] Even then, it is necessary for the court to examine the contract to ascertain whether the parties 'have so provided.' [Citations.]" (Accord, *Dream Theater, Inc. v. Dream Theater* (2004) 124 Cal.App.4th 547, 552 (*Dream Theater*).) [2]

2 Plaintiff claims that these cases regarding the parties' power to agree in their contract that an arbitrator, rather than the trial court, shall determine gateway questions of arbitrability, apply only to questions regarding the scope of an indisputably enforceable arbitration agreement, not to the question presented here: whether an enforceable agreement to arbitrate exists. Plaintiff cites *Buckeye Check Cashing, Inc. v. Cardegna* (2006) 546 U.S. 440, 445-446 ["unless the challenge is to the arbitration clause itself, the issue of the contract's validity is considered by the arbitrator, in the first instance"] and *Nagrampa v. Mailcoups, Inc.* (9th Cir. 2006) 469 F.3d 1257, 1263 [en banc panel held that "it was error to hold that consideration of the unconscionability of the arbitration provision was to be determined by the arbitrator"] in support of this proposition. Defendant counters that these two cases did not involve a provision that an arbitrator, rather than the trial court, would decide enforceability questions, and therefore are irrelevant to the issue at hand.

In light of our conclusion that any such rule (i.e., that the parties may agree for the arbitrator to decide questions regarding the validity of the agreement to arbitrate) is not applicable to the particular circumstances of the present case (see text, *post*), we need not definitively resolve the parties' disagreement regarding precisely what these cases stand for.

In the recent case of *Murphy, supra,* 156 Cal.App.4th 138, Division One of this District addressed a situation nearly identical to the present one, in which a plaintiff who sued her former employer had previously signed a "Dispute Resolution Agreement" as a condition of employment. Pursuant to the agreement,

covered claims included, inter alia, "'any assertion by you or us that this Agreement is substantively or procedurally unconscionable.'" (*Id.* at p. 142.) The plaintiff had opposed the employer's motion to compel arbitration on unconscionability grounds, arguing that a class action waiver in the agreement was substantively unconscionable. (*Id.* at p. 143.) The trial court had denied the motion to compel, concluding that it had the power to rule on unconscionability issues; the agreement was a contract of adhesion; the agreement's class action waiver was substantively unconscionable; the agreement's provisions for arbitration of unconscionability issues and pre-existing claims were also substantively unconscionable; and the unconscionable terms would not be severed from the agreement. (*Ibid.*)

The appellate court affirmed the trial court's rulings, explaining: "While the language of the agreement [regarding arbitration of unconscionability issues] could not be clearer, plaintiff's alleged assent to this provision was vitiated by the fact that it was set forth in a contract of adhesion, i.e., a standardized contract drafted by the stronger party and presented to the weaker party on a take it or leave it basis [citation]." (*Murphy, supra,* 156 Cal.App.4th at p. 144.) The court further concluded that both of two judicial limitations on the enforcement of adhesion contracts [3] were present in that (1) parties would not ordinarily expect an arbitrator, rather than the court, to determine his or her own jurisdiction, and (2) regardless of the reasonable expectations of the parties, the provision for arbitrator determinations of unconscionability was itself substantively unconscionable. (*Id.* at p. 145.) The court noted that substantively unconscionable terms can be generally described as unfairly one sided or lacking in mutuality. (*Ibid.*) The agreement was "facially mutual insofar as it covers assertions of unconscionability by 'you or us' but, as plaintiff points out, the provision is entirely one sided because defendant cannot be expected to claim that it drafted an unconscionable agreement." (*Ibid.*)

> 3 The court described these two limitations as follows: "'Generally speaking, there are two judicially imposed limitations on the enforcement of adhesion contracts or provisions thereof. The first is that such a contract or provision which does not fall within the reasonable expectations of the weaker or "adhering" party will not be enforced against him. [Citations.] The second--a principle of equity applicable to all contracts generally--is that a contract or provision, even if consistent with the reasonable expectations of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive or "unconscionable."' [Citations.]" (*Murphy, supra,* 156 Cal.App.4th at p. 145.)

The court therefore agreed with the trial court that, "in this contract of adhesion, the provision for arbitrator determinations of unconscionability is unenforceable. Under the circumstances of this case, the judge is the proper gatekeeper to determine unconscionability." (*Murphy, supra,* 156 Cal.App.4th at p. 145.)

We agree with the analysis of the appellate court in *Murphy* and find, in the present case--which also indisputably involves a contract of adhesion [4] --that the provision in the arbitration agreement giving the arbitrator exclusive authority to decide enforceability issues is unconscionable and, therefore, unenforceable. [5] We have a genuine concern about the potential for the inequitable use of such arbitration provisions in areas, such as employment, where the parties are not at arm's length and do not have equal bargaining power. In such situations, in which one party tends to be a repeat player, the arbitrator has a unique self-interest in deciding that a dispute is arbitrable.

(Cf. *Mercuro v. Superior Court* (2002) 96 Cal.App.4th 167, 178 (*Mercuro*) ["The fact an employer repeatedly appears before the same group of arbitrators conveys distinct advantages over the individual employee. These advantages include knowledge of the arbitrators' temperaments, procedural preferences, styles and the like and the arbitrators' cultivation of further business by taking a 'split the difference' approach to damages"], citing *Armendariz, supra,* 24 Cal.4th at p. 115.) [6]

4 Indeed the agreement itself states that "the Company's agreement to consider my employment application and any subsequent employment offer to me provide consideration for my promise to arbitrate disputes in accordance with this Agreement."

5 We also agree with the *Murphy* court's conclusion that two cases cited by the employer there, and by defendant here, in support of their position are unpersuasive. (See *Dream Theater, supra,* 124 Cal.App.4th 547; *Anderson v. Pitney Bowes, Inc.* (N.D.Cal., May 4, 2005, No. C 04-4808 SBA) [nonpub. opn.] 2005 U.S. Dist. LEXIS 37662, 2005 WL 1048700 (*Anderson*).) First, as the court in *Murphy* observed, the agreement at issue in *Dream Theater*--for the sale of a multimedia and entertainment business--was not a contract of adhesion, and is therefore inapplicable to the present case. (See *Murphy, supra,* 156 Cal.App.4th at p. 146.) Second, the agreement in *Anderson was* an adhesive employment contract that, as here, gave the arbitrator "'exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation of this Agreement, including but not limited to any claim that all or any part of this Agreement is void or voidable.'" (*Anderson, supra,* 2005 U.S. Dist. LEXIS 37662 at *3.) The federal district court in *Anderson* concluded that, because this clause "clearly and unmistakably provides an arbitrator with exclusive jurisdiction to decide issues of arbitrability," it was for the arbitrator to decide questions of unconscionability in the agreement, and it therefore granted the employer's motion to compel arbitration. (*Id.* at *5.) The *Murphy* court disagreed with the district court's conclusion, noting that, "[w]hile that conclusion is at odds with the one we reach, *Anderson* is also distinguishable because the plaintiff there, unlike plaintiff here, did not argue that the provision giving the arbitrator power to determine arbitrability was itself unconscionable. (*Id.* at *5, fn. 4; [citation].)" (*Murphy, supra,* 156 Cal.App.4th at p. 146.)

In the present case, plaintiff did not argue that the provision giving the arbitrator the power to decide enforceability issues is itself unconscionable. Nor did the trial court expressly find that this provision was unconscionable, although it did so in effect when it ruled that "the integrity of the contractual arbitration procedures" required the trial court, rather than an arbitrator, to make the threshold determination regarding whether the agreement "is unconscionable or otherwise unenforceable for reasons of public policy, as in this case." At our request, both parties have submitted supplemental briefing on the applicability of *Murphy*. Given that we have determined that this issue, which raises only a question of law, is relevant to the present matter, plaintiff is not precluded from arguing on appeal that the provision in question is itself

unconscionable. (See, e.g., *In re P.C.* (2006) 137 Cal.App.4th 279, 287.)

6 The *Mercuro* court also cited Isbell, *Compulsory Arbitration of Employment Agreements: Beneficent Shield or Sword of Oppression? Armendariz v. Foundation Health Psychcare Services, Inc.* (2001) 22 Whittier L.Rev. 1107 (Isbell): "On the defense side of the ledger, . . . attorneys who represent that same client, or clients, on many occasions will have a sense of what to expect from the list of 'available neutrals' promulgated by the arbitration association of choice. Moreover, large corporations that arbitrate claims nationwide are more likely to select a national arbitration association to handle *all* of its claims for the purpose of efficiency. This practice, by its inherent nature, creates a sense of security within the selected association of the repeat business. The arbitration association, national or otherwise, is in fact, in business to make a profit. It relies on statutes such as the FAA [(Federal Arbitration Act)] and the CAA [(California Arbitration Act)], as well as 'repeat' clients, for its continued existence. However, what would happen to the success of the associations if decisions began going badly, on a consistent basis, for their biggest clients? Perhaps to avoid this bedlam, arbitrators developed the practice that opinion and treatise alike have defined as the Solomonic 'splitting of the difference.' In the final analysis, common sense requires that we question the possibility of an arbitrator that is truly neutral. As long as there exists little accountability for arbitrators--or while 'repeaters' are involved--and if one or the other of the parties is directly paying the fees for the arbitrator, actual neutrality should not be counted upon." (Isbell, at pp. 1144-1145, fns. omitted.)

Indeed, Justice Black spoke to this concern over 40 years ago in *Prima Paint v. Flood & Conklin* (1967) 388 U.S. 395, 403-406 (*Prima Paint*), which involved the question whether a claim of fraud in the inducement of an entire contract (rather than just the arbitration clause itself) may be left to the arbitrator to decide, in the absence of evidence that the contracting parties had intended to withhold that issue from arbitration. Speaking as well for Justices Douglas and Stewart, Justice Black stated: "The only advantage of submitting the issue of fraud to arbitration is for the arbitrators. Their compensation corresponds to the volume of arbitration they perform. If they determine that a contract is void because of fraud, there is nothing further for them to arbitrate. I think it raises serious questions of due process to submit to an arbitrator an issue which will determine his compensation." (*Id.* at pp. 407, 416 (dis. opn. of Black, J.), citing *Tumey v. Ohio* (1927) 273 U.S. 510, 523, 535 [defendant's due process right to an impartial judge was violated where judge received fee for convicting defendant, which he would not have received had defendant been acquitted].)

Justice Black's concerns are relevant to the issue we face today: whether arbitrators should be permitted to decide the issue of unconscionability in an arbitration agreement, particularly one, like that before us, which is a contract of adhesion. Indeed, an arbitrator who finds an arbitration agreement unconscionable would not only have nothing further to arbitrate, but could also reasonably expect to obtain less business in the future, at least from the provider in question. [7] (See *Prima Paint, supra,* 388 U.S. at p. 416; see also Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration,* 1997 Wis. L.Rev. 33, 60-61 ["[I]ndividual arbitrators have an economic stake in being selected again, and

their judgment may well be shaded by a desire to build a 'track record' of decisions that corporate repeat-users will view approvingly. Even the independent arbitration companies have an economic interest in being looked on kindly by large institutional corporate defendants who can bring repeat business"], cited in *Armendariz, supra,* 24 Cal.4th at p. 115.)

> 7 Placing an arbitrator in such a position seems to us to compromise one of the minimum requirements set forth by our Supreme Court for lawful arbitration of nonwaivable statutory civil rights in the workplace pursuant to a mandatory employment arbitration agreement--to provide for neutral arbitrators--and therefore contravenes public policy. (See *Armendariz, supra,* 24 Cal.4th at p. 102.)

Our conclusion is further supported by the recent decision in *Bruni v. Didion* (2008) 160 Cal.App.4th 1272 (*Bruni*), in which Division Two of the Fourth District addressed the question of what issues can be reserved to the arbitrator. The court noted that, "[r]egrettably, 'arbitrability' is an ambiguous term that can encompass multiple distinct concepts. [Citation.] It seems clear that the parties can agree to have 'arbitrability'--in the sense of the *scope* of the arbitration provisions--decided by the arbitrator." (*Id.* at p. 1286.) The court continued: "But can the parties agree to have 'arbitrability'--in the sense of whether the arbitration clause is valid, binding, and enforceable--decided by the arbitrator?" (*Id.* at p. 1287.) The court went on to discuss this question generally, concluding that the precise nature of the claims must be examined before a determination can be made. (*Ibid.*) For example, if the party resisting arbitration is not denying that it agreed to an arbitration provision, but instead is claiming the provision is unenforceable (e.g., due to illegality or fraud in the inducement), an arbitrator must decide the question. If, on the other hand, the party is claiming it never agreed to the arbitration provision at all (e.g., due to forgery or fraud in the factum), a court must consider the claim. (*Ibid.*)

The *Bruni* court then addressed the specific question of who should decide the plaintiffs' unconscionability claim in light of the arbitration provisions empowering the arbitrator to determine arbitrability. [8] The court stated: "We may assume, without deciding, that if plaintiffs were admitting that they knowingly agreed to the arbitration provisions, they could be required to arbitrate an unconscionability claim." (*Bruni, supra,* 160 Cal.App.4th at p. 1290.) The plaintiffs in *Bruni*, however, had claimed they never knowingly agreed to the provisions: "As in most, if not all, adhesion contract cases, they deny ever reading them." (*Id.* at pp. 1290-1291.) The court concluded that "whatever may be the case with respect to claims of unconscionability in general, here plaintiffs are asserting that they never actually agreed to the arbitration provisions. They cannot be required to arbitrate *anything*--not even arbitrability--until a court has made a threshold determination that they did, in fact, agree to arbitrate *something." (Id.* at p. 1291; accord, *Bouton v. USAA Cas. Ins. Co.* (2008) Cal.4th , 2008 WL 2332004 ["a trial court has no power to order parties to arbitrate a dispute that they did not agree to arbitrate"].) [9] The court then analyzed the plaintiff's unconscionability claims, finding multiple instances of unconscionability, including, inter alia, that the provision purporting to require that disputes over arbitrability be decided by the arbitrator was substantively unconscionable because it "was well beyond a layperson's reasonable expectations." (*Id.* at p. 1295.)

> 8 In *Bruni*, the arbitration agreement provided "[a]ny disputes concerning the interpretation or the enforceability of this arbitration agreement, including[,] without limitation, its revocability or voidability for any cause, the scope of

arbitrable issues, and any defense based upon waiver, estoppel or laches, shall be decided by the arbitrator." (*Bruni, supra,* 160 Cal.App.4th at p. 1281.)

9 A panel of the same Division that decided *Bruni* had, a short time earlier, held in *Baker v. Osborne Development Corp., supra,* 159 Cal.App.4th 884, 893-894 that, where an arbitration agreement did not "'clearly and unmistakably'" reserve to the arbitrator the issue of whether the arbitration agreement was enforceable, it was for the court to make that determination, apparently assuming that, otherwise, the arbitrator would consider the issue. (See *First Options of Chicago, Inc. v. Kaplan, supra,* 514 U.S. 938, 943 ["a court must defer to an arbitrator's arbitrability decision when the parties submitted that matter to arbitration"]; see also *Stewart v. Paul, Hastings, Janofsky & Walker, LLP* (S.D.N.Y. 2002) 201 F.Supp.2d 291 [district court enforced an agreement to arbitrate defense of unconscionability based on arbitration agreement provision that arbitrator was to resolve disputes as to whether agreement was void or voidable], cited by *Baker* court.) In *Baker,* the court did not directly address the question raised here and decided a short time later in *Bruni:* whether, in the context of a contract of adhesion, it is for the court, rather than the arbitrator, to decide the issue of unconscionability even if the arbitration agreement reserves that question to the arbitrator.

In the present case, as in *Bruni,* plaintiff denied knowing she had signed an agreement to arbitrate disputes until after she filed her lawsuit. The undisputed circumstances in which plaintiff received and signed the arbitration agreement--including her receipt of the one-page document in a binder file along with numerous other employment-related documents, the lack of time for any real review of the documents, and the failure of anyone to explain the significance of the agreement--support her assertion.

Hence, the reasoning and holding of the court in *Bruni, supra,* 160 Cal.App.4th 1272, as in *Murphy, supra,* 156 Cal.App.4th 138, supports our conclusion that the trial court properly concluded it had the authority to determine the unconscionability issues raised by plaintiff. We therefore turn now to plaintiff's additional claims regarding unconscionability.

V. Additional Unconscionability Issues

A. Trial Court Background

Plaintiff argued, in her opposition to defendant's motion to compel arbitration, that the arbitration agreement was unconscionable because (1) it requires an employee to share the costs of the arbitration; (2) it does not provide for adequate discovery; (3) it limits a plaintiff's remedies and may extend a defendant's remedies under statute; (4) it allows the party against whom the claim is lodged to pick more favorable procedural rules and more sympathetic arbitrators; and (5) the confidentiality provisions of the AAA rules favor repeat-player employers. [10]

10 The trial court's substantive unconscionability findings were based on the initial three claims only. The latter two claims apparently were not raised in the trial court.

In its order denying defendant's motion to compel arbitration, the trial court stated: "Having found that it is necessary for the Court to review the arbitration agreement to determine whether it is unconscionable, the Court concludes that the arbitration provision offered by DHL is permeated with unconscionability and will not be enforced. The provision relating to discovery improperly limits discovery in a FEHA [(Fair Employment and Housing Act (Gov. Code, ß 12900 et seq.)] action to an extent that is likely to deprive a

claimant, including Plaintiff, of adequate discovery. The provision that requires Plaintiff to pay fees that are unique to the arbitration is also unconscionable. That provision deprives Plaintiff of recovery for costs and expert witness fees in a FEHA proceeding in which she prevails. The Court finds that in light of the multiple provisions that are substantively unconscionable, the agreement shows on its face an intent to impose upon Plaintiff, as the weaker party, an inferior forum that works to the employer's advantage. [(*Armendariz, supra*, 24 Cal.4th 83, 124.)]

"Plaintiff also offers substantial evidence of procedural unconscionability. The agreement is adhesive, since Plaintiff was in a weak bargaining position. The agreement is lengthy, and consists of single-spaced and small print. The agreement was not explained and was presented along with other documents for Plaintiff to sign. [(See the declaration of Ontiveros, para. 3.)]

"For these reasons, the agreement is both procedurally and substantively unconscionable, and is unenforceable."

B. *Legal Analysis*

First, as already discussed, it is undisputed that the arbitration agreement is a contract of adhesion and is therefore procedurally unconscionable. (See *Armendariz, supra*, 24 Cal.App.4th at pp. 114-115; *Murphy, supra*, 156 Cal.App.4th at pp. 144-145; pt. IV., *ante*.) Second, we have previously concluded that the provision requiring that the arbitrator decide enforceability issues is substantively unconscionable. (See *Murphy*, at pp. 144- 145; pt. IV., *ante*.)

We now address the trial court's additional unconscionability findings, which defendant challenges as erroneously decided.

1. *Requirement that Plaintiff Share Fees and Costs Related to Arbitration*

The arbitration agreement provides that "[t]he Company and I shall equally share any filing fee and the fees and costs of the Arbitrator" with certain caps on the employee's share. [11]

> 11 Specifically, the agreement provides that the employee's "maximum contribution will be the lesser of (i) 1 weeks' [*sic*] pay at my regular base rate, or (ii) 10% of the amount at issue. I understand that the Arbitrator has the authority upon motion to further reduce my share of the costs and fees upon showing of substantial need."

"[W]hen an employer imposes mandatory arbitration as a condition of employment, the arbitration agreement or arbitration process cannot generally require the employee to bear any *type* of expense that the employee would not be required to bear if he or she were free to bring the action in court. This rule will ensure that employees bringing FEHA claims will not be deterred by costs greater than the usual costs incurred during litigation, costs that are essentially imposed on an employee by the employer." (*Armendariz, supra*, 24 Cal.4th at pp. 110-111.)

Defendant contends the trial court wrongly ruled that this provision requiring plaintiff to pay fees unique to arbitration is unconscionable. That is because, according to defendant, the cap contained in the agreement on the total amount payable by plaintiff would result in her share of the fees being small; her costs in a court action would be much greater than the arbitrator-related fees required by the agreement; and the agreement requires that the arbitration be held in accordance with AAA or JAMS rules, which both state that the employee may not be required to pay costs that are unique to arbitration.

First, whether plaintiff's required contribution is small and whether her court costs in the event of a trial would be greater are

irrelevant. Because an employee may not be required to pay fees unique to arbitration, the provision in the agreement requiring such payment is unlawful and hence substantively unconscionable. (See *Armendariz, supra,* 24 Cal.4th at p. 111 ["Although it is true that the costs of arbitration are on average smaller than those of litigation, it is also true that [the] amount awarded is on average smaller as well. [Citation.] The payment of large, fixed, forum costs, especially in the face of expected meager awards, serves as a significant deterrent to the pursuit of FEHA claims"].)

Second, defendant fails to note that the agreement specifically states that the parties "agree that, *except as provided in this Agreement,* the arbitration shall be in accordance with the AAA's then-current Model Employment Arbitration Procedures (if AAA is designated) or the then-current JAMS Employment Arbitration rules (if JAMS is designated)." (Italics added.) Thus, because a specific provision of the agreement, by its very terms, trumps the otherwise applicable AAA and JAMS rules, those rules do not apply to the question of employee payment of arbitration-related fees. [12]

> 12 Defendant also observes that both AAA and JAMS rules provide that in the event of an inconsistency between their administrative rules and the terms of an arbitration agreement, their administrative rules govern. Thus, according to defendant, their rules regarding payment of arbitration-related fees govern here. (See *Wilks v. Pep Boys* (M.D.Tenn. 2003) 241 F.Supp.2d 860, 864-865 and *DeGroff v. Mascotech Forming Techns.-Fort Wayne* (N.D.Ind. 2001) 179 F.Supp.2d 896, 908-909. We disagree. As the appellate court in *Fitz v. NCR Corp.* (2004) 118 Cal.App.4th 702, 720 (*Fitz*) held in similar circumstances, an adverse material inconsistency between the discovery provisions of an arbitration agreement and AAA rules "cannot make the AAA discovery provisions trump the limits on discovery that [the employer] deliberately established in the [arbitration agreement]." The court concluded that the employer had "deliberately replaced the AAA's discovery provision with a more restrictive one, and in so doing failed to ensure that employees are entitled to discovery sufficient to adequately arbitrate their claims. [The employer] should not be relieved of the effect of an unlawful provision it inserted in the [arbitration agreement] due to the serendipity that the AAA rules provide otherwise. [Citation.]" (*Id.* at p. 721.) The same reasoning is directly applicable to defendant's insertion of an unlawful fee-sharing provision in its agreement.

The trial court did not err when it ruled that the agreement's provision regarding arbitration-related fees is substantively unconscionable.

2. *Discovery Provisions*

The arbitration agreement provides that "[e]ach party shall have the right to take the deposition of one individual and any expert witness designated by another party. Each party also shall have the right to make requests for production of documents to any party. The [parties' 'right to subpoena witnesses and documents for the arbitration'] shall be applicable to discovery pursuant to this paragraph. Additional discovery may be had only where the Arbitrator selected pursuant to this Agreement so orders, upon a showing of substantial need."

"Adequate discovery is indispensable to vindication of statutory claims. [Citation.] '"[A]dequate" discovery does not mean unfettered discovery. . . .' [Citation.] And parties may 'agree to something *less than* the full panoply of discovery provided in Code of Civil Procedure section 1283.05.' [Citation.]

However, arbitration agreements must 'ensure minimum standards of fairness' so employees can vindicate their public rights. [Citation.]" (*Fitz, supra,* 118 Cal.App.4th at pp. 715-716; accord, *Armendariz, supra,* 24 Cal.4th at pp. 104-106.)

Defendant contends the trial court was wrong when it ruled that the discovery provision in the agreement "improperly limits discovery in a FEHA action to an extent that is likely to deprive a claimant, including Plaintiff, of adequate discovery." Defendant observes that the *Armendariz* court stated that, "whether or not [employees] are entitled to the full range of discovery provided in Code of Civil Procedure section 1283.05, [13] they are at least entitled to discovery sufficient to adequately arbitrate their statutory claim, including access to essential documents and witnesses, *as determined by the arbitrator(s)* . . . ." (*Armendariz, supra,* 24 Cal.4th at p. 106, italics added.) Thus, according to defendant, it is for the arbitrator, not the court, to exercise authority regarding discovery in an employment matter such as this one.

> 13 Code of Civil Procedure section 1283.05, subdivision (a), which is part of the CAA, provides that "the parties to the arbitration shall have the right to take depositions and to obtain discovery regarding the subject matter of the arbitration, and, to that end, to use and exercise all of the same rights, remedies, and procedures, and be subject to all of the same duties, liabilities, and obligations in the arbitration with respect to the subject matter thereof, . . . as if the subject matter of the arbitration were pending before a superior court of this state in a civil action . . . ."

In *Fitz, supra,* 118 Cal.App.4th 702, the arbitration agreement limited discovery to the sworn deposition statements of two individuals and any expert witnesses expected to testify at the arbitration hearing, unless the arbitrator found a "compelling need" to allow other discovery, i.e., unless the parties could demonstrate that a fair hearing would be "impossible" without additional discovery. (*Id.* at pp. 709, 716.) The appellate court held that the discovery provision was unlawful, explaining: "Though [the employer] contends that the [arbitration agreement's] limits on discovery are mutual because they apply to both parties, the curtailment of discovery to only two depositions does not have mutual effect and does not provide Fitz with sufficient discovery to vindicate her rights. 'This is because the employer already has in its possession many of the documents relevant to an employment discrimination case as well as having in its employ many of the relevant witnesses.' (*Mercuro, supra,* 96 Cal.App.4th at p. 183; see also *Kinney v. United HealthCare Services, Inc.* (1999) 70 Cal.App.4th 1322, 1332 ['Given that [the employer] is presumably in possession of the vast majority of evidence that would be relevant to employment-related claims against it, the limitations on discovery, although equally applicable to both parties, work to curtail the employee's ability to substantiate any claim against [the employer]'].)" (*Fitz,* at p. 716.)

The court further stated that the only way Fitz could "gain access to the necessary information to prove the claim is to get permission from the arbitrator for additional discovery. However, the burden the [arbitration agreement] imposes on the requesting party is so high and the amount of discovery the [agreement] permits by right is so low that employees may find themselves in a position where not only are they unable to gain access to enough information to prove their claims, but are left with such scant discovery that they are unlikely to be able to demonstrate to the arbitrator a compelling need for more discovery." (*Fitz, supra,* 118 Cal.App.4th at pp. 717-718.)

In the present case, the agreement permits plaintiff to take the deposition of only one individual while plaintiff's trial counsel has estimated that plaintiff will need to take at least 15 to 20 depositions, given that "[t]he case involves harassing conduct directed at plaintiff at two job sites" and that "the conduct took place from approximately 2000 to 2004 and involved numerous employees." Defendant has not disputed counsel's estimate. Moreover, the burden the agreement places on plaintiff to obtain further discovery is quite high, permitting additional discovery only by order of the arbitrator upon a showing of "substantial need."

We conclude that, as in *Fitz*, the permitted amount of discovery is so low while the burden for showing a need for more discovery is so high that plaintiff's ability to prove her claims would be unlawfully thwarted by the discovery provision in the agreement. (See *Fitz, supra*, 118 Cal.App.4th at pp. 716-718; *Kinney v. United HealthCare Services, Inc., supra*, 70 Cal.App.4th at p. 1332.) [14] Accordingly, the trial court did not err when it ruled that the agreement's discovery provision is substantively unconscionable. [15]

14 Defendant cites *Martinez v. Master Protection Corp.* (2004) 118 Cal.App.4th 107 (*Martinez*) and *Mercuro, supra*, 96 Cal.App.4th 167, in support of its claim that the discovery provision in this case is not unlawful. In *Martinez*, the appellate court had already held that several other provisions in the arbitration agreement were unconscionable. (*Martinez*, at p. 119.) With respect to the employee's claim that the provision restricting discovery--absent a demonstration of substantial need--to a single deposition and single document request was unlawful, the court stated that it agreed with that argument "in principle," but could not conclude that the limitation necessarily would prevent the employee form vindicating his rights, "given the relatively straightforward allegations of misconduct involved in this action, and the possibility that proof of Martinez's Labor Code claims will rest largely on documentation rather than testimony." (*Id.* at pp. 118-119.) In *Mercuro*, the arbitration agreement limited the parties to three depositions and an aggregate of 30 discovery requests of any kind, with additional discovery requests to be granted only upon a showing of "good cause." (*Mercuro*, at p. 182.) While the appellate court "conceded that Mercuro's concern over the discovery provisions is not totally unreasonable," it concluded that, "without evidence showing how these provisions are applied in practice, we are not prepared to say they would necessarily prevent Mercuro from vindicating his statutory rights." (*Id.* at p. 183.) In the present case, plaintiff's claims are not of the straightforward and limited nature described in *Martinez* and, unlike the plaintiff in *Mercuro*, she has shown that the discovery provisions in question would likely thwart her ability to vindicate her statutory rights.

15 Given our conclusion, in part V., B., 3, *post*, that the trial court did not err in finding the arbitration agreement unenforceable due to the combination of procedural unconscionability and at least three instances of substantive unconscionability, we need not address either plaintiff's additional claims of unconscionability or the court's other grounds for denying the motion to compel.

3. *Severance*

Defendant contends the trial court erred when it refused to sever the unconscionable provisions and determined, instead, that the entire agreement is unenforceable.

"[T]he Legislature expressly and directly recognizes judicial discretion to sever objectionable provisions. The governing statute provides: 'If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.'" (*Abramson v. Jupiter Networks, Inc.* (2004) 115 Cal.App.4th 638, 658, quoting Civ. Code, ß 1670.5, subd. (a); *Armendariz, supra,* 24 Cal.4th at p. 122 ["the statute appears to give a trial court some discretion as to whether to sever or restrict the unconscionable [or illegal] provision or whether to refuse to enforce the entire agreement"].) The question for us, therefore, is whether the trial court's refusal to save the arbitration agreement by severing the objectionable provisions was an abuse of discretion.

Armendariz points out that the case law implicitly identifies two reasons for severing illegal terms from an arbitration agreement rather than voiding the entire contract. "The first is to prevent parties from gaining undeserved benefit or suffering undeserved detriment as a result of voiding the entire agreement--particularly when there has been full or partial performance of the contract. [Citations.] Second, more generally, the doctrine of severance attempts to conserve a contractual relationship if to do so would not be condoning an illegal scheme. [Citations.]" (*Armendariz, supra,* 24 Cal.4th at pp. 123-124.) The "overarching" question for the court is whether severance serves the interests of justice. (*Id.* at p. 124.)

Armendariz identified three factors relevant to whether severance is appropriate. The first relates to the agreement's chief object. "If the central purpose of the contract is tainted with illegality, then the contract as a whole cannot be enforced. If the illegality is collateral to the main purpose of the contract, and the illegal provision can be extirpated from the contract by means of severance or restriction, then such severance and restriction are appropriate." (*Armendariz, supra,* 24 Cal.4th at p. 124.) A second factor is whether the agreement contains more than one objectionable term. The fact that an "arbitration agreement contains more than one unlawful provision" may "indicate a systematic effort to impose arbitration on an employee . . . as an inferior forum that works to the employer's advantage" and may justify concluding "that the arbitration agreement is permeated by an unlawful purpose. [Citation.]" (*Ibid.*, fn. omitted.) The third factor is whether "there is no single provision a court can strike or restrict in order to remove the unconscionable taint from the agreement." (*Id.* at pp. 124-125.) In that situation "the court would have to, in effect, reform the contract, not through severance or restriction, but by augmenting it with additional terms" (*id.* at p. 125), which exceeds judicial power to cure a contract's illegality. Where the taint of illegality cannot be removed by severance or restriction, the court "must void the entire agreement." (*Ibid.*)

Here, we have concluded that, in this contract of adhesion, at least three provisions of the arbitration agreement are substantively unconscionable, including the provision for arbitrator determinations of enforceability issues; the provision requiring that plaintiff pay a portion of the arbitration-related costs; and the provision severely limiting discovery. Given these multiple unlawful provisions, the trial court did not abuse its discretion in determining that the agreement is "permeated with unconscionability and will not be enforced." [16] (See *Armendariz, supra,* 24 Cal.4th at p. 124; *Baker v. Osborne Development Corp., supra,* 159 Cal.App.4th at p. 896; *Murphy, supra,* 156 Cal.App.4th at p.

149; *Fitz, supra,* 118 Cal.App.4th at pp. 726-727.) [17]

16 We also observe that severance of these unlawful terms would not be sufficient since replacing the agreement's provisions on arbitration-related fees and discovery with the rules of JAMS and/or AAA "would be in effect to rewrite the agreement. Courts cannot cure contracts by reformation or augmentation." (*Fitz, supra,* 118 Cal.App.4th at p. 727; accord, *Armendariz, supra,* 24 Cal.4th at pp. 124-125.)

17 This case is thus distinguishable from *McManus v. CIBC World Markets Corp* (2003) 109 Cal.App.4th 76, 101-102, cited by defendant, in which the appellate court held that an arbitration agreement with a single unconscionable provision was "not so 'permeated' with unconscionable provisions that it cannot be saved." Here, in light of the multiple unconscionable provisions, the trial court did not abuse its discretion in determining that the agreement was permeated with unconscionability and, therefore, was not enforceable.

DISPOSITION

The trial court's order denying the motion to compel arbitration is affirmed. Costs on appeal are awarded to plaintiff.

Lambden, J., and Richman, J., concurred.

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Thomas Caboara, et al., appellants, v Babylon Cove Development, LLC, et al., respondents, et al., defendant. (Index No. 10726/06)

2006-09372

SUPREME COURT OF NEW YORK, APPELLATE DIVISION, SECOND DEPARTMENT

2008 NY Slip Op 6281; 2008 N.Y. App. Div. LEXIS 6126

July 15, 2008, Decided

NOTICE:

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CORE TERMS: Martin Act, common-law, breach of contract, causes of action, sponsor, action to recover damages, preempted, artful, fraudulent, private right of action, abrogated, common law, inter alia, giving rise, statutory construction, condominium, supplanted, deceitful, vested, import, tenets

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Agovino & Asselta, LLP, Mineola, N.Y. (Joseph P. Asselta, Jean M. Smith, and Robert Buff of counsel), for respondents.

JUDGES: REINALDO E. RIVERA, J.P., DAVID S. RITTER, EDWARD D. CARNI, JOHN M. LEVENTHAL, JJ. RIVERA, J.P., CARNI and LEVENTHAL, JJ., concur.

OPINION BY: DAVID S. RITTER

OPINION

APPEAL by the plaintiffs, in an action, inter alia, to recover damages for common-law fraud and breach of contract, as limited by their brief, from so much of an order of the Supreme Court (Howard Berler, J.), dated October 20, 2006, and entered in Suffolk County, as granted those branches of the motion of the defendants Babylon Cove Development, LLC, Michael J. Posillico, Joseph K. Posillico, Paul F. Posillico, and Joseph D. Posillico III, which were pursuant to CPLR 3211(a)(1), (3), and (7) to dismiss the causes of action to recover damages for common-law fraud and breach of contract insofar as asserted against them.

OPINION & ORDER

RITTER, J. In 1921, the Legislature enacted the Martin Act, New York's version of blue sky laws (*see* General Business Law Article 23-A). The act prohibits a broad range of fraudulent and deceitful conduct as to securities. Enforcement of the act is vested exclusively with the Attorney General of the State of New York (hereinafter the Attorney General). Here, we are asked to determine whether the plaintiffs' causes of action to recover damages for common-law fraud and breach of contract are preempted by the Martin Act because the allegations giving rise to the same would support a Martin Act violation. We hold that they are not. While there is no express or implied private right of action under the Martin Act, private causes of action sounding in common-law fraud and breach of contract may rest upon the same facts that would support a Martin Act violation as long as they are sufficient to satisfy traditional rules of pleading and proof. Thus, here, the Supreme Court erred in dismissing the plaintiffs' common-law fraud and breach of contract causes of action as preempted by the Martin Act.

The defendant Babylon Cove Development, LLC (hereinafter the Sponsor), is the sponsor of a townhouse condominium project. The defendants Michael J. Posillico, Joseph K. Posillico, Paul F. Posillico, and Joseph D. Posillico III are its members (hereinafter referred to collectively as members). The plaintiffs are purchasers of individual units. One condition of the grant of the required zoning approval for the project was that all units be owner-occupied and not rented. However, this restriction was not set forth in the Offering Plan for the project. To the contrary, the Offering Plan stated that owners retained the right to rent units. The terms of the Offering Plan were incorporated by reference into the contracts for the sale of the units. After learning of this discrepancy, the plaintiffs commenced this action, inter alia, to recover damages for common-law fraud and breach of contract. The Sponsor and members moved to dismiss the complaint insofar as asserted against them pursuant to CPLR 3211(a)(1), (3), and (7), arguing, among other things, that the plaintiffs were seeking, in effect, to prosecute private causes of action under the Martin Act. In the order appealed from, the Supreme Court granted such relief. The plaintiffs appeal from so much of the order as granted those branches of the motion which were to dismiss the causes of action to recover damages for common-law fraud and breach of contract insofar as asserted against the Sponsor and members. We reverse the order insofar as appealed from.

The Martin Act prohibits a broad range of fraudulent and deceitful conduct in the advertisement, distribution, exchange, transfer, sale, and purchase of securities, including securities representing "participation interests" in condominium and cooperative apartment buildings (*see Kralik v 239 E. 79th St. Owners Corp.,* 5 NY3d 54, 58; *CPC Intl. v McKesson Corp.,* 70 NY2d 268; General Business Law ßß 352, 352-e). The Attorney General is vested with the exclusive authority to enforce the Martin Act, and is granted various investigatory, regulatory, and remedial powers aimed at detecting, preventing, and stopping fraudulent securities practices (*see Kralik v 239 E. 79th St. Owners Corp.,* 5 NY3d at 58-59; *CPC Intl. v McKesson Corp.,* 70 NY2d at 277). Unlike common-law fraud, the Attorney General need not allege or prove either scienter or intentional fraud to establish liability for fraudulent practices under the Martin Act (*see State of New York v Rachmani Corp.,* 71 NY2d 718, 725, n 6). The Court of Appeals has determined that there is neither an express nor an implied private right of action under the Martin Act (*see Vermeer Owners v Guterman*, 78 NY2d 1114; *CPC Intl. v McKesson Corp.,* 70 NY2d 268).

Here, the Sponsor and members argue that the plaintiffs' common-law fraud and breach of contract causes of action are preempted by the Martin Act because the allegations giving rise to the same would support a Martin Act violation, and "private plaintiffs [are not] permitted through artful pleading to press any claim based on the sort of wrong given over to the Attorney-General under the Martin Act" (*Whitehall Tenants Corp. v Estate of Olnick*, 213 AD2d 200, 200; *see also Keh Hsin Shen v Astoria Fed. Sav. & Loan*, 295 AD2d 319). However, this argument misapplies the prohibition against "artful pleading," and is contrary to both precedent from the Court of Appeals and basic tenets of statutory construction.

No case from the Court of Appeals holds that the Martin Act not only failed to provide, expressly or impliedly, for a private right of action, but also, abrogated or supplanted an otherwise viable private cause of action whenever the allegations would support a Martin Act violation (*see Kramer v W10Z/515 Real Estate Ltd. Partnership*, 44 AD3d 457; *Eagle Tenants Corp. v Fishbein*, 182 AD2d 610). To the contrary, in both *CPC Intl. v McKesson Corp.* (70 NY2d 268), and *Vermeer Owners v Guterman* (78 NY2d 1114), the Court considered, on the merits, the plaintiffs' common-law fraud causes of action, while dismissing as preempted their private causes of action under the Martin Act. Thus, under precedent from the Court of Appeals, the plaintiffs' common-law fraud and breach of contract causes of action are not preempted because they rest upon allegations that would support a Martin Act violation.

Further, properly read, the prohibition against "artful pleading" is completely consistent with this precedent. The purpose of the prohibition is "to prevent an end run" around the exclusive nature of the Martin Act rule by precluding a private plaintiff from bringing a cause of action, for example, that, "although styled as one for common-law fraud, lacks proof of an essential element of common-law fraud" (*Kramer v W10Z/515 Real Estate Ltd. Partnership*, 44 AD3d at 459). For instance, in *Whitehall Tenants Corp. v Estate of Olnick* (213 AD2d 200), which first announced the prohibition against "artful pleading," there was no evidence of reliance by the allegedly defrauded shareholder or intent to defraud by the sponsor (*see Whitehall Tenants Corp. v Estate of Olnick*, 213 AD2d at 200-201). Here, taking the facts as alleged in the complaint as true, and according the plaintiffs the benefit of every possible favorable inference, the complaint was sufficient to state causes of action to recover damages for common-law fraud and breach of contract (*see* CPLR 3211[a][7]; *Lama Holding Co. v Smith Barney*, 88 NY2d 413; *Leon v Martinez*, 84 NY2d 83; *Eagle Tenants Corp. v Fishbein*, 182 AD2d 610). Thus, the allegations are not mere artful pleading.

Finally, we note that the above determinations are in accord with basic tenets of statutory construction. The Legislature is presumed to be aware of the law in existence at the time of an enactment and to have abrogated the common law only to the extent that the clear import of the language of the statute requires (*see B & F Bldg. Corp. v Liebig*, 76 NY2d 689). Further, "[t]he general rule is and long has been that when the common law gives a remedy, and another remedy is provided by statute, the latter is cumulative, unless made exclusive by the statute'" (*Burns Jackson Miller Summit & Spitzer v Lindner*, 59 NY2d 314, quoting *Candee v Hayward*, 37 NY 653, 656). Here, nothing in the clear import of the language of the Martin Act requires a conclusion that the Legislature intended to abrogate any common-law remedy arising from conduct prohibited under the

act. Nor are the remedies afforded the Attorney General made exclusive by the Martin Act. Thus, the plaintiffs' common-law fraud and breach of contract causes of action were neither abrogated nor supplanted by the Martin Act (*see 511 W. 232nd Owners Corp. v Jennifer Realty Co.*, 98 NY2d 144; *Kramer v W10Z/515 Real Estate Ltd. Partnership*, 44 AD3d 457; *Eagle Tenants Corp. v Fishbein*, 182 AD2d 610). Consequently, the Supreme Court erred in dismissing the same.

The parties' remaining contentions are without merit.

Accordingly, the order is reversed insofar as appealed from, on the law, and those branches of the motion of the Sponsor and members which were to dismiss the causes of action to recover damages for common-law fraud and breach of contract insofar as asserted against them are denied.

RIVERA, J.P., CARNI and LEVENTHAL, JJ., concur.

ORDERED that the order is reversed insofar as appealed from, on the law, with costs, and those branches of the respondents' motion which were to dismiss the causes of action to recover damages for common-law fraud and breach of contract insofar as asserted against them are denied.

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Jay Walshon, M.D. v. Ballon Stoll Bader & Nadler, P.C. et al.

FSTCV064008323S

SUPERIOR COURT OF CONNECTICUT, JUDICIAL DISTRICT OF STAMFORD-NORWALK AT STAMFORD

2008 Conn. Super. LEXIS 1369

May 23, 2008, Decided
May 23, 2008, Filed

CORE TERMS: resident's, securities dealer, co-defendant, law firm, arbitration

JUDGES: John R. Downey, Judge.

OPINION BY: John R. Downey

OPINION

MEMORANDUM OF DECISION

By way of background, the plaintiff, Jay Walshon, a Connecticut resident, retained the defendant, Ballon Stoll Bader & Nadler. P.C., (BSB&N) to represent Walshon in a securities fee claim made by Fiserv Securities, Inc., against Walshon. A National Association of Securities Dealer (NASD) arbitration venue choice was made by BSB&N in New York. A letter of retention was sent by BSB&N to Walshon in Connecticut where he resides. BSB&N is a New York professional corporation and has no partners who live or are licensed to practice in Connecticut and have no officer or clients in Connecticut. See affidavit of Marshall B. Bellovin, Esq., March 14, 2006. The retainer letter in question was dated May 30, 2000 and signed by Walshon, with certain changes he made after receipt of the agreement from BSB&N. Ultimately, Walshon sued BSB&N for breach of contract to defend and counterclaim for Walshon against Fiserv in the NASD hearing in New York. The plaintiff also sued another law firm, Winget, Spadafora & Schwartzberg, LLP. That defendant has not moved to dismiss.

The defendant, BSB&N has moved to dismiss, March 15, 2006, claiming lack of personal jurisdiction. The plaintiff objected to the motion (March 22, 2007) and has submitted briefs in opposition dated March 31, 2002, and May 13, 2008 (Reply). The

defendant has also submitted a Reply dated May 1, 2008. Both sides argued their respective positions on May 5, 2008 short calendar.

Law

In *Ryan v. Cerullo,* 282 Conn. 109, 918 A.2d 867 (2007), the Supreme Court upheld a Superior Court decision granting the defendant's motion to dismiss for lack of jurisdiction. The Supreme Court declined to assert jurisdiction over a New York accounting firm engaged by a Connecticut resident to perform services in New York in connection with the preparation of the resident's tax returns. The court considered the facts that the defendant firm derived only minimal income from Connecticut residents, did not solicit business in Connecticut and performed all of its services exclusively in New York. In *Rosenblit v. Danaher,* 206 Conn. 125, 537 A.2d 15 (1988), the court sustained a dismissal for lack of jurisdiction over an out of state attorney, while the lawsuit continued against Connecticut co-defendant attorneys. In *Lombard Bros., Inc. v. General Asset Management Co.,* 190 Conn. 245, 460 A.2d 481 (1983), the court found that a New York securities dealer did not do business in this state, even though it executed securities trades on directions from its co-defendant, a Connecticut broker, because it did not do business in Connecticut, and was, therefore, not present in Connecticut for jurisdictional purposes. The action did continue against the remaining Connecticut defendants.

The Supreme Court of Connecticut has stated that "we construe the term 'transacts any business' to embrace a single purposeful transaction." *Zartolas v. Nisenfeld,* 184 Conn. 471, 474 (1981). In interpreting this provision, the courts "do not resort to a rigid formula . . . (but instead) balance considerations of public policy, common sense, and the chronology and geography of the relevant factors." *Id.*, 476.

Discussion

The defendant law firm has had no substantial contact with the State of Connecticut. The plaintiff hired the defendant, BSB&N, to practice law in New York, not Connecticut, in an arbitration proceeding before the NASD. The defendant did not meet with the plaintiff in Connecticut. They met in New York. The contract in question was sent to the plaintiff who changed it, signed it and sent it back to New York, when the defendant accepted it with the modifications. There are no assets of the defendant in Connecticut. The defendant has no personnel or offices in Connecticut. The defendant does not advertise in Connecticut. See affidavit of Bellovin, 3/14/02.

Under Connecticut law, it must be determined whether the non-resident defendant has "certain minimum contacts with [the forum] such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice." *Thomason v. Chemical Bank,* 234 Conn. 281, 287, 661 A.2d 595 (1995), citing *International Shoe Co. v. Washington,* 326 U.S. 310, 316, 66 S.Ct. 154, 90 L.Ed. 95 (1945).

Considering all the arguments of the parties, and weighing the nature of the contacts with Connecticut, as well as the practicalities and overall fairness issues, the court concludes that the motion to dismiss should be granted.

So ordered.

John R. Downey, Judge

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