DAVID A. WEINTRAUB
P.A.

7471 West Oakland Park Boulevard
Suite 110
Ft. Lauderdale, Florida 33319

www.stockbrokerlitigation.com

Admitted to Practice in:
Florida
Nebraska
New York

Telephone: (954) 746.8180
Facsimile: (954) 746.7820
Toll Free: (800) 718.1422

Securities Law Update – October 2008

This e-mail is intended to bring you timely information about recent developments in securities law and related topics. Previous issues of the Securities Law Update are available at www.stockbrokerlitigation.com. If you do not wish to receive future Updates, please contact us by clicking on the following link: vescobar@stockbrokerlitigation.com

Proceedings Ancillary to Arbitration

A Connecticut federal court recently allowed a plaintiff to pursue prejudgment attachment remedies against UBS Financial Services. The plaintiff, who had a pending arbitration, sought a prejudgment attachment of $150 million. UBS unsuccessfully argued that FINRA Rule 12209 precluded ancillary proceedings of this nature. The decision in this case provides plaintiffs' attorneys in large cases with the potential for a very valuable tool.

Think Twice Before Dismissing Your Arbitration

The *Bernard* matter, decided by a Louisiana state court, addresses the impact of a claimant's attempt to dismiss a pending FINRA arbitration without prejudice, and later file those claims in court. The defendant argued that newly filed court claims should be dismissed with prejudice, a position that the trial court adopted. By voluntarily dismissing their case, the claimant assumed the risk that the dismissal would be regarded as having been made with prejudice. The appellate court directed further proceedings for the purpose of determining whether the claimant would have the opportunity to pursue its claims a second time in arbitration.

Never try a case against a 96 year old deaf and blind client

In this Delaware state court proceeding, the broker dealer respondents sought to vacate a seven figure award entered in favor of a 96 year old client who had more than $400,000.00 stolen from him by his former broker. The broker was subsequently indicted but fled the United States. So how does this type of case ever get tried? The initial broker dealer was ultimately found liable under Delaware's consumer fraud statute, thus leading to a treble damage award. The second broker dealer involved in the chain of events was found liable for contribution to the initial award. Ultimately, the court only modified the award to avoid a quadrupling of damages, rather than a mere trebling.

IRA Custodian's Liability

In this California state court proceeding, Fiserv, as IRA Custodian, was held to owe fiduciary duties to its IRA clients. Fiserv's fiduciary duties were based upon the parties' contractual relationship, not upon common law. The court also ruled that the plaintiffs had stated a cause of action under California's consumer fraud statute. The court based its decision on the fact that the alleged misconduct did not relate to the purchase or sale of securities, but rather, mismanagement of accounts subsequent to the purchases.

ARNOLD CHASE FAMILY, LLC, et al., Plaintiffs, v. UBS AG; UBS SECURITIES, LLC, and UBS FINANCIAL SERVICES, LLC, Defendants.

No. 3:08cv00581 (MRK)

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF CONNECTICUT

2008 U.S. Dist. LEXIS 58697

August 4, 2008, Decided
August 4, 2008, Filed

CORE TERMS: arbitration, finra, prejudgment, provisional remedies, customer, judicial proceedings, arbitrator, injunction, attachment, http, Federal Arbitration Act, arbitration award, securities industry, preliminary injunction, predecessor, barring, org, pending arbitration, broad language, several reasons, citations omitted, probable cause, pro-arbitration, manifested, arbitrable, successor, ancillary, entertain, touching, issuance

COUNSEL: For Arnold Chase Family LLC, Chase Enterprises Holding LLC, Cheryl Chase Family LLC, DTC Family Investments LLC, Cheryl Anne Chase Grantor Trust, Darland Trust, Plaintiffs: Richard P. Weinstein, LEAD ATTORNEY, Weinstein & Wisser, P.C., West Hartford, CT; Robert A. Izard, Jr., LEAD ATTORNEY, Izard Nobel PC-Htfd, Hartford, CT.

For UBS Financial Svc Inc, Defendant: Kurt W. Hansson, LEAD ATTORNEY, Matthew R. Paul, Paul, Hastings, Janofsky & Walker, Stamford, CT.

JUDGES: Mark R. Kravitz, United States District Judge.

OPINION BY: Mark R. Kravitz

OPINION

RULING AND ORDER

Defendant UBS Financial Services, Inc.'s ("UBS") [1] Motion to Dismiss [doc. # 15] and Plaintiffs' Amended Application for Prejudgment Remedy in Aid of Arbitration [doc. # 16] raise an interesting and apparently undecided issue regarding arbitration of securities claims under the rules of the Financial Industry Regulatory Authority ("FINRA"), the successor to the National Association of Securities Dealers ("NASD"). [2] Specifically, UBS contends that FINRA rules governing customer arbitrations prohibit Plaintiffs from asking a court for a prejudgment remedy in aid of a pending arbitration. While the answer to the question UBS poses is far from clear, the Court disagrees with UBS, and therefore DENIES its Motion to Dismiss [doc. # 15].

1 Plaintiffs have dismissed the action against UBS AG and UBS Securities, LLC. *See* Notice of Voluntary Dismissal of Application for Prejudgment Remedy against UBS AG and UBS Securities, LLC [doc. # 27].

2 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 ("SEC"). 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.

In April 2008, Plaintiffs commenced an arbitration against UBS before FINRA regarding their claim that they invested funds in securities that were allegedly represented to be "cash alternatives," when they were not, and as a consequence, Plaintiffs were injured financially. At or around the same time, Plaintiffs filed this action seeking an attachment of UBS assets of approximately $ 150 million to secure any award they may receive from the arbitration. UBS responded by moving to dismiss Plaintiffs' application for an attachment under Rule 12(b)(6) of the *Federal Rules of Civil Procedure* because the rules of FINRA "prohibit judicial proceedings concerning matters pending in arbitration." *See* Mem. of Law in Support of Mot. to Dismiss [doc. # 15-1] ("UBS Memorandum") at 6. In particular, UBS relied on FINRA Rule 12209, which states as follows:

> During an arbitration, no party may bring any suit, legal action, or proceeding against any other party that concerns or that would resolve any of the matters raised in the arbitration.

UBS Memorandum [doc. # 15-1], Ex. B (Code of Arbitration Procedure for Customer Disputes (as of Dec. 27, 2007)).[3]

3 Rule 12209 is the successor to Rule 10106, which provided as follows: "No party shall, during the arbitration of any matter, prosecute or commence any suit, action or proceeding against any other party touching upon any of the matters referred to arbitration pursuant to this Code." According to a comparison of old and new rules on FINRA's website, the change in language from Rule 10106 to Rule 12209 was not intended to effectuate any "substantive change" in the rule. *See* http://www.finra.org/ArbitrationMediation/Arbitration/CodeofArbitrationProcedure/p009566.

According to UBS, the broad language of Rule 12209 evidences FINRA's intent to bar any ancillary legal proceedings involving claims in arbitration. Furthermore, UBS contends that prejudgment remedies are unnecessary in connection with FINRA arbitrations because FINRA rules require payment of all awards within thirty days of issuance. *See* Rule 12904(I). FINRA members must certify in writing that an arbitration award was paid, *see* NASD Notice to Members 00-55 (Aug. 2000), and

FINRA can sanction a member that fails to pay an arbitration award, NASD Procedural Rule 9554, *available at* http://finra.complinet.com/finra. [4] In this regard, UBS notes that the SEC approved FINRA's arbitration rules as adequate to protect securities customers such as Plaintiffs. *See* Securities Industry and Financial Markets Association, White Paper on Arbitration in the Securities Industry (2007), *available at* http://sifma.org/regulatory/pdf/arbitration-white-paper.pdf.

4 Indeed, UBS asserts that arbitrators lack the power to order such relief.

During a conference call with counsel for the parties on July 7, 2008, the Court asked them for further briefing regarding FINRA's intent in adopting Rule 12209 and also invited UBS to determine if FINRA wished to submit a brief to the Court regarding its position on the proper interpretation of Rule 12209. While the parties filed additional briefs, the Court has not received any submission from FINRA.

All parties agree that Plaintiffs are bound by Rule 12209; the only question is what judicial proceedings does Rule 12209 prohibit. While UBS's position is plausible, the Court rejects it for several reasons.

First, Rule 12209 needs to be considered in the context of governing Second Circuit law regarding the relationship between pending arbitrations and certain ancillary judicial proceedings, such as requests for prejudgment remedies or injunctions. As this Court has previously observed,

> [The] Second Circuit has made it clear in a series of decisions that the Court has both the power and duty to entertain a motion for preliminary injunction pending the results in [an] arbitration. And this is true even though, as is the case here, the parties are entitled under the rules of the arbitral tribunal they have chosen to seek *pendente lite* relief directly from the arbitrator.

Discount Trophy & Co., Inc. v. Plastic Dress-Up Co., No. 3:03cv2167(MRK), 2004 WL 350477, at *8 (D. Conn. Feb. 19, 2004) (citing *Am. Express Fin. Advisors, Inc. v. Thorley,* 147 F.3d 229, 231 (2d Cir. 1998); *Blumenthal v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 910 F.2d 1049, 1053 (2d Cir. 1990); *Roso-Lino Beverage Distribs., Inc. v. Coca-Cola Bottling Co.,* 749 F.2d 124, 125 (2d Cir. 1984)). Indeed, in *Thorley,* the Second Circuit reversed a district court that had declined to grant an injunction on the grounds that the parties could obtain one from the arbitrators themselves. The Second Circuit stated, "the expectation of speedy arbitration does not absolve the district court of its responsibility to decide requests for preliminary injunctions on their merits. Nor is this duty affected by the pro-arbitration policy manifested in the [Federal Arbitration Act]." *Thorley,* 147 F.3d at 231 (citations omitted); *Blumenthal,* 910 F.2d at 1053 ("[T]he pro-arbitration policies reflected in the foregoing Supreme Court decisions [regarding the Federal Arbitration Act] are furthered, not weakened, by a rule permitting a district court to preserve the meaningfulness of the arbitration through a preliminary injunction.").

As this Court has also previously noted, the Second Circuit has taken a similar approach regarding provisional remedies in aid of arbitration, such as prejudgment remedies. *See Bahrain*

Telecommunications Co. v. DiscoveryTel, Inc., 476 F. Supp. 2d 176, 181 (D. Conn. 2007). Thus, in *Borden Inc. v. Meiji Milk Prods., Inc.,* 919 F.2d 822 (2d Cir. 1990), the Second Circuit explained as follows:

> In the instant case, far from trying to bypass arbitration, Borden sought to have the court *compel* arbitration. New York law specifically provides for provisional remedies in connection with an arbitrable controversy, ... and the equitable powers of federal courts include the authority to grant it. Entertaining an application for such a remedy, moreover, is not precluded by the Convention but rather is consistent with its provisions and spirit.

Id. at 826 (citations omitted) (referencing a provision of New York law that permits a court to order an attachment or an injunction in aid of arbitration). The decision in *Borden* expressly relied upon and quoted from Judge Learned Hand's decision in *Murray Oil Prods. Co. v. Mitsui & Co.,* 146 F.2d 381, 384 (2d Cir. 1944), where the court permitted a district court to continue a prejudgment attachment pending completion of an arbitration. As Judge Hand explained, the desire for prompt decisions in arbitration, as manifested in both the Convention and the FAA, "is entirely consistent with a desire to make as effective as possible recovery upon awards, after they have been made, which is what provisional remedies do." *Murray Oil,* 146 F.2d at 384; *see also Bahrain Telecommunications,* 476 F. Supp. 2d at 181. Therefore, at least in the Second Circuit, courts have historically entertained requests for provisional remedies during the pendency of arbitrations and have viewed the judicial consideration of such requests as consistent with, and not contrary to, the spirit of the Federal Arbitration Act and a party's right to submit a dispute to arbitrators and not courts.

Second, while parties may certainly contract away their right to invoke the historic jurisdiction of courts to provide provisional remedies in aid of arbitration, they should be clear and specific about what they are doing, since any such provision affects the jurisdiction of the courts and securities customers themselves do not have much say in writing of FINRA's rules. Despite the seemingly broad language of Rule 12209 (which, the Court might add, is narrower than the "touching upon" language of its predecessor), there is no indication whatsoever that the rule was intended, as UBS contends, to "prohibit judicial proceedings concerning matters pending in arbitration." *See* UBS Memorandum [doc. # 15-1] at 6. The Court says this for several reasons.

For one, nowhere in any of the explanatory materials regarding customer arbitrations published by FINRA -- and there is an abundance of such materials from lengthy lists of Frequently Asked Questions to Arbitration Guides -- does FINRA ever say that Rule 12209 bars all judicial proceedings while an arbitration is pending, let alone that the intent of Rule 12209 is to prevent customers from invoking the historic powers of courts to provide provisional remedies in aid of arbitration. Nor did FINRA when it amended Rule 12209 explain that the purpose of the rule is to prevent customers from seeking prejudgment remedies. Indeed, as UBS acknowledges, FINRA has never explained what judicial proceedings Rule 12209 is intended to prohibit.

For another, we know that Rule 12209 and its predecessor have not been construed by courts as barring *any* judicial proceeding while an arbitration is pending. Even UBS concedes that a party could go to court to compel a recalcitrant party to participate in a FINRA-commenced arbitration. *See, e.g., Prudential Securities, Inc. v. Yingling,* 226 F.3d 668, 672 (6th Cir. 2000) (holding that court has jurisdiction to consider securities firm's request for an injunction barring arbitration of stale claims); *Bopardikar v. Morgan Stanley & Co.,* No. 08cv01136, 2008 WL 2704491, at *1 (D. Colo. July 1, 2008) (holding that court has jurisdiction to entertain request for a judgment declaring that plaintiff is not obligated to arbitrate a claim before a FINRA arbitration); *O.N. Equity Sales Co. v. FINRA Dispute Resolution, Inc.,* No. 1:07cv804, 2008 WL 281788, at *2 (S.D. Ohio Feb. 1, 2008) (holding that court has jurisdiction to consider injunction barring pending FINRA arbitration); *Herbert J. Sims & Co., Inc. v. Roven,* 548 F. Supp. 2d 759, 764-66 (N.D. Cal. 2008) (same). The customer arbitration rules themselves contemplate that under some circumstances, judicial class actions involving the subject matter of an arbitrable claim may be pending while an arbitration proceeds. *See* Rule 12204. Finally, a party or arbitration panel may also conceivably need judicial assistance to enforce a subpoena of an unrelated third party or to gather information for a FINRA arbitration. Therefore, despite its arguments about the breadth of the language of Rule 12209, UBS cannot seriously maintain that the rule bars any and all judicial action.

Third, Rule 12209 can be construed in a way that allows courts to consider awarding the provisional remedies they have historically provided in aid of arbitration and still give meaning to the rule's language. For Rule 12209 can be construed to bar parties from submitting to courts the same "matters raised in the arbitration." *See* J. Long & S. Lipner, Securities Arbitration Desk Reference § 10106:1 (2007) (commenting that Rule 10106, the predecessor of Rule 12209, "is designed to promote efficiency by preventing parallel court proceedings and/or interlocutory 'appeals' to judicial authorities while an arbitration is pending."). Such a reading of Rule 12209 would not prohibit a request for a provisional remedy in aid of arbitration. As this Court noted explained recently in *Bahrain Telecommunications:*

> [A] prejudgment remedy . . . is designed to maintain the *status quo* -- namely, the parties' financial *status quo* pending issuance of a final judgment. *See E.J. Hansen Elevator, Inc. v. Stoll,* 167 Conn. 623, 629, 356 A.2d 893 (1975) (Prejudgment remedies are "primarily designed to forestall any dissipation of assets by the defendant and to bring them into the custody of the law to be held as security for the satisfaction of such judgment as the plaintiff may recover . . . ."). A prejudgment remedy does not interfere with the arbitral process but merely ensures that there will be assets available to satisfy any judgment the arbitrators themselves may render. Moreover, consideration of a motion for a prejudgment remedy normally will require a court to delve less deeply into

> the merits of the parties' disputes (and thus intrude less deeply into the domain of the arbitrators) . . . , since the standard for granting a prejudgment remedy-at least in Connecticut-is only probable cause and does not require a showing of likelihood of success on the merits and irreparable harm. *See, e.g., Three S. Dev. Co. v. Santore,* 193 Conn. 174, 175, 474 A.2d 795 (1984) ("probable cause is a flexible common sense standard. It does not demand that a belief be correct or more likely true than false.").

476 F. Supp. 2d at 182; *see also Orsini v. Tarro,* 80 Conn. App. 268, 272 (2003) ("[P]rejudgment remedy proceedings . . . are not involved with the adjudication of the merits of the action brought by the plaintiff or with the progress or result of that adjudication.") (quotation marks omitted); *Tyler v. Schnabel,* 34 Conn. App. 216, 219 (1994) ("Prejudgment remedy proceedings do not address the merits of the action.").

Fourth and finally, UBS's arguments about the need for provisional remedies in securities arbitrations and the role of the SEC might be sufficient to cause FINRA to adopt a rule that bars such relief. But it is far from clear to this Court that provisional remedies are completely unnecessary in securities arbitrations. While UBS undoubtedly has sufficient assets to respond to any arbitration award in this case, that is not necessarily true of every member broker. Not every member participant in FINRA arbitrations has the resources of UBS. Moreover, one only has to recall what happened recently with Bear Stearns to understand why some customers might like to have the security of knowing that if they prevail in arbitration, assets will be available to satisfy any award.

Therefore, the Court DENIES UBS's Motion to Dismiss [doc. # 15]. On August 15, 2008 at 9:00 am, the Court will hold a telephonic conference call with counsel to discuss scheduling of their Application for Prejudgment Remedy in Aid of Arbitration. Plaintiffs' counsel will be responsible for initiating the call.

IT IS SO ORDERED,

/s/ Mark R. Kravitz

United States District Judge

Dated at New Haven, Connecticut: August 4, 2008.

- Return to Page 1 –

CURLY AND COY BERNARD, GREGORY B. BONNETT, JUDY F. CASEY, LINDA S. AND RONALD C. CORLEY, DAVID C. AND JANE GALLIEN, MICKEY AND PEGGY GILCREASE, GORDIE GREENING, BILLY W. AND LINDA S. HOUSE, ROGER F. AND MARY B. HOUSE, GEORGE REED, AND MELINDA L. TERRY VERSUS GREGORY JAMES HILDEBRAND AND PETER E. DAHLSTROM

NUMBER 2008 CA 0268

COURT OF APPEAL OF LOUISIANA, FIRST CIRCUIT

2008-0268 (La.App. 1 Cir. 08/06/08); 2008 La. App. LEXIS 1079

August 6, 2008, Judgment Rendered

NOTICE:

THIS DECISION IS NOT FINAL UNTIL EXPIRATION OF THE FOURTEEN DAY REHEARING PERIOD.

PRIOR HISTORY:
Appealed from the 19th Judicial District Court in and for the Parish of East Baton Rouge, State of Louisiana. Docket Number 547,837. Honorable Curtis A. Calloway, Judge.

DISPOSITION: REVERSED AND REMANDED.

CORE TERMS: arbitration, submission agreements, arbitration agreement, withdrawal, arbitration panel, withdraw, res judicata, arbitrator, pre-dispute, arbitrate, default, prematurity, binding, withdrawn, answered, arbitration award, agreements to arbitrate, irrevocable, lawsuit, raising, brokers, undersigned, submit to arbitration, present matter, peremptory exception, enforceable, rendition, dilatory, confirm, pleaded

COUNSEL: Aub A. Ward, Baton Rouge, LA and Lee Bowie Jackson MS, Counsel for Plaintiffs/Appellants, Curly and Coy Bernard, Gregory B. Bonnett, Judy F. Casey, Linda S. and Ronald C. Corley, David C. and Jane Gallien, Mickey and Peggy Gilcrease, Gordie Greening, Billy W. and Linda S. House, George Reed, and Melinda L. Terry.

Thomas K. Potter, III, Nashville, TN and Ryan E. Jackson, Baton Rouge, LA, Counsel for Defendants/Appellees, Gregory James Hildebrand and Peter E. Dahlstrom.

JUDGES: BEFORE: PARRO, KUHN, AND DOWNING, JJ.

OPINION BY: KUHN

OPINION

[Pg 2] **KUHN, J.**

Plaintiffs appeal a trial court judgment dismissing their suit with prejudice. For the reasons that follow, we reverse and remand.

FACTUAL AND PROCEDURAL HISTORY

Plaintiffs herein are employees of Kansas City Southern Railroad and their spouses. They contracted with brokers, Gregory Hildebrand and Peter Dahlstrom, to manage their retirement accounts. Alleging fraud and negligence, plaintiffs filed a claim against their brokers on August 4, 2005 with the Dispute Resolution Division of the National Association of Securities Dealers (NASD) under its Code of Arbitration Procedure. In so doing, each of the plaintiffs voluntarily signed an NASD Arbitration Uniform Submission Agreement that contained the following language:

> The undersigned parties hereby submit the present matter in controversy, as set forth in the attached statement of claim, ... to arbitration in accordance with the Constitution, By-Laws, Rules, Regulations, and/or Code of Arbitration Procedure of the sponsoring organization.
>
> The undersigned parties hereby state that they have read the procedures and rules of the sponsoring organization relating to arbitration.
>
> * * * *
>
> The undersigned parties further agree to abide by and perform any award(s) rendered pursuant to this Submission Agreement....

Hildebrand and Dahlstrom answered the arbitration, also signing and submitting identical Uniform Submission Agreements. Thereafter, the parties selected an arbitration panel, participated in an initial prehearing conference, and began conducting discovery.

At some point, the arbitration panel requested that the parties produce any pre-dispute arbitration agreement existing between them. Neither of the parties was able to produce such an agreement. Consequently, by letter dated May 19, [Pg 3] 2006, the plaintiffs advised the arbitration panel that a pre-dispute agreement could not be found. Plaintiffs further informed the panel that, based upon the lack of any pre-dispute agreement, they were "withdraw[ing] their uniform submission agreements" and requesting that the arbitration proceeding be "dismissed without prejudice."

On May 31, 2006, NASD issued a letter to all of the parties advising them that it had been notified that the parties had "either settled or withdrawn" the matter and informing them that the matter was being removed from the arbitration docket. The letter continued:

> If this case has not settled or should not have been withdrawn, please notify this office by June 8, 2006. After June 8, 2006 has elapsed, NASD Dispute Resolution will not reopen this case.

On June 7, 2006, the defendants wrote to NASD forcefully objecting to the plaintiffs' request to withdraw their uniform submission agreements and to have their claims dismissed without prejudice. The defendants argued that the Uniform Submission Agreements constituted binding arbitration agreements in and of themselves. They further argued that because they had answered the arbitration and proceedings were already underway, the plaintiffs' claims could only be dismissed "with prejudice." [1] NASD's response, dated November 16, 2006, provided, in pertinent part, as follows:

> The Panel has determined that it does not have the authority to grant a dismissal with prejudice. In addition, the Panel has determined that there is insufficient evidence to grant any additional relief.
>
> [Pg 4] NASD Dispute Resolution procedure will permit a "Withdrawal without Prejudice" after Respondents have answered only if the parties agree to a "Withdrawal without Prejudice." Pursuant to NASD Dispute Resolution procedure, this matter has been closed as "Withdrawn with Prejudice."

1 Page 12 of NASD's Uniform Forms Guide sets forth the general guidelines for the withdrawal of a claim, as follows:

> If you wish to withdraw your claim after the claim has been served and filed, but before the respondent has served and filed the answer, you may withdraw the claim without prejudice by informing the respondent in writing and copying the designated NASD Dispute Resolution office and all other parties.
>
> If you wish to withdraw your claim after the claim has been served and filed but after the answer has been served and filed, [sic] by the respondent, you may not withdraw the claim without prejudice, unless the respondent agrees to a withdrawal without prejudice or with the arbitrator(s)' consent.
>
> After you receive the notice that identifies the selected arbitrator(s), you may withdraw your claim without prejudice either with the respondent['s] agreement or with the arbitration panel's consent.

Pending the foregoing response by NASD, the plaintiffs had filed suit against Hildebrand and Dahlstrom in the Nineteenth Judicial District Court, asserting the same facts and claims that they originally had submitted to arbitration. The defendants responded to the lawsuit by filing a motion to stay and compel arbitration proceedings; however, after receiving NASD's response, the defendants filed a revised motion to stay and to dismiss. Therein, the defendants argued that the Uniform Submission Agreements bound the plaintiffs to arbitrate their claims. They further claimed that NASD's act of closing the arbitration as "withdrawn with prejudice" "operate[d] as an adjudication on the merits." Accordingly, they did not seek to have the trial court compel arbitration, but rather requested that the trial court "mirror" what the arbitration panel did and dismiss the plaintiffs' claims.

Following a hearing, the trial court denied the defendants' motion to stay but granted their motion to dismiss. According to its written reasons for judgment, the trial court concluded that the Uniform Submission Agreements constituted binding, irrevocable agreements to arbitrate. Because the plaintiffs withdrew the matter from arbitration, the forum in which it should have been heard, the trial court decided to dismiss the suit. Thus, on April 12, 2007, the trial court signed a judgment dismissing the plaintiffs' claims with prejudice. Plaintiffs filed a motion for new trial that was subsequently denied. This anneal followed.

DISCUSSION

The purpose of arbitration is to allow parties to achieve speedy settlement of their differences out of court. The positive law of Louisiana favors arbitration, and any doubt concerning the scope of arbitrable issues should be resolved in favor of [Pg 5] arbitration. **Arkel Constructors, Inc. v. Duplantier & Meric, Architects, L.L.C.,** 2006-1950, 2006-1951, p. 7 (La.App. 1 Cir. 7/25/07), 965 So.2d 455, 459. Such favorable treatment echoes the Federal Arbitration Act (FAA), 9 U.S.C. § 1, *et seq.,* which unquestionably embodies a liberal federal policy favoring arbitration agreements. ***Id.***

On appeal, plaintiffs argue that the trial court erred in finding that, by virtue of the Uniform Submission Agreements they executed, they were bound to arbitrate their claims. Rather, they contend that a pre-dispute arbitration agreement is required. We respectfully disagree.

Pursuant to LSA-R.S. 9:4201:

> A provision in any written contract to settle by arbitration a controversy thereafter arising out of the contract, or out of the refusal to perform the whole or any part thereof, or an agreement in writing between two or more persons to submit to arbitration any controversy existing between them at the time of the agreement to submit, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract. (Emphasis added.)

In addition, LSA-C.C. art. 3099 provides:

> A *submission* is a covenant by which persons who have a lawsuit or difference with one another, name arbitrators to decide the matter and bind themselves reciprocally to perform what shall be sarbitrated.

Louisiana Civil Code article 3102 further states:

> Parties may submit either all their differences, or only some of them in particular; and likewise they may submit to arbitration a lawsuit already instituted or only in contemplation, and generally every thing which they are concerned in, or which they may dispose of.

Despite plaintiffs' assertions to the contrary, the plain language of the foregoing provisions clearly allows for post-dispute agreements to arbitrate. [2] Thus, parties may agree to the submission to arbitration of existing controversies without any [Pg 6] previous contract to do so. **General Motors Corp. v. Pamela Equities Corp.,** 146 F.3d 242, 246 (5th Cir. 1998).

> 2 Indeed, pre-dispute arbitration agreements actually were invalid in Louisiana until 1928. See 1928 La. Acts, No. 262. See also Saint v. Martel, 127 La. 73, 98, 53 So. 432, 440 (1910).

Moreover, numerous courts have found Uniform Submission Agreements containing the exact same language as those executed herein to constitute binding, irrevocable, and enforceable agreements to arbitrate. See **Dean Witter Reynolds Inc. v. Fleury,** 138 F.3d 1339, 1342 (11th Cir. 1998); **Benacquisto v. American Express Financial Corp.,** 373 F.Supp.2d 966, 968 (D.Minn. 2005); **Mayo v. Dean Witter Reynolds, Inc.,** 258 F.Supp.2d 1097, 1116 (N.D.Cal. 2003); **First Montauk Securities Corp. v. Menter,** 26 F.Supp.2d 688, 689 (S.D.N.Y. 1998). Accordingly, we agree with the trial court's finding that, by virtue of their Uniform Submission Agreements, the plaintiffs obligated themselves to arbitrate their claims against their brokers.

Nevertheless, we do find merit in the plaintiffs' assertion that the trial court erred in dismissing the present matter with prejudice. [3] According to Louisiana's Binding Arbitration Law, LSA-R.S. 9:4201-4217, when a valid arbitration agreement exists, **pending** an arbitration award, a court is expressly authorized to stay proceedings and/or compel the parties to proceed to arbitration upon the application of one of the parties. [4] See LSA-R.S. 9:4202-4203. Once an arbitration award has been rendered, the award is *res judicata* and must be confirmed unless [Pg 7] grounds are established, in accordance with arbitration law, for the vacation, modification, or correction of the award. See **Farmers Cotton Co., Inc. v. Savage,** 30,289, p. 4 (La.App. 2 Cir. 6/26/98), 714 So.2d 926, 928, writ denied, 98-2322 (La. 11/20/98), 728 So.2d 1288; **Louisiana Physician Corp. v. Larrison Family Health Ctr., L.L.C.,** 2003-1721 p. 3 (La.App. 3 Cir. 4/7/04), 870 So.2d 575, 578. Thus, **subsequent** to the rendition of an arbitration award, a court may only confirm, vacate, or modify and/or correct an award. See LSA-R.S. 9:4209-4211.

> 3 The plaintiffs contest the arbitration panel's decision to deem the withdrawal of their claims to be "with prejudice," and, for the first time on appeal, argue that such a designation was improper as to six of the ten plaintiffs who withdrew their claims before the defendants answered the arbitration. The plaintiffs further maintain that, despite the "withdrawal with prejudice," under the arbitration rules, they may still arbitrate their claims albeit with a new case number and arbitration panel. However, whether NASD will allow the plaintiffs to challenge the classification of their

withdrawal or to re-file a new arbitration suit are matters to be determined by NASD, not this court.

4 We are fully cognizant of the jurisprudence stating that the failure of a party to arbitrate in accordance with the terms of an agreement also may be raised through a dilatory exception raising the objection of prematurity, although typically, the exception is often pleaded alternatively or in addition to a party's motions to stay and/or compel. In the event an exception of prematurity is sustained, the suit is dismissed without prejudice. See LSA-C.C.P. art. 933(A).

The defendants herein have not filed a dilatory exception raising the objection of prematurity. or can their motion seeking dismissal of the suit with prejudice be construed as one. A suit is premature only if it is brought before the right to enforce the claim sued on has accrued. LSA-C.C.P. art. 423. Moreover, the exception of prematurity is intended merely to retard the progress of the action rather than to defeat it. LSA-C.C.P. arts. 923 and 926. In the instant matter, the defendants simply do not argue that the matter is not yet ripe for judicial determination. Indeed, they argue exactly the opposite.

An award, ordinarily, concludes and binds the parties as to the merits of all matters properly within the scope of the award and intended by the arbitrators to be finally decided. **Housing Authority of New Orleans v. Henry Ericsson Co.,** 197 La. 732, 756, 2 So.2d 195, 203 (1941). Furthermore, LSA-R.S. 9:4208 requires that an award "be in writing and ... be signed by the arbitrators or by a majority of them." (Emphasis added.) In the instant case, there has been no award. [5] The defendants' argument on appeal that NASD's November 16, 2006 letter constituted an "award" is belied by the fact that defendants did not file a motion to confirm the alleged award or an exception of *res judicata* in the trial court.

5 It would be expected that any award comply with the applicable provisions of the Code of Arbitration Procedure which were not admitted into evidence. We note that the codal provisions submitted by the defendants are only applicable to actions filed on or after April 16, 2007.

Accordingly, by default, the defendants' remedy in this matter is controlled by LSA-R.S. 9:4202 and 4203. See **Lincoln Builders, Inc. v. Raintree Investment Corporation Thirteen,** 37,965 (La.App. 2 Cir. 1/28/04), 866 So.2d 326 (where the court refused to lift stay and allow the parties to litigate even though the arbitrator closed the case and dismissed the arbitration prior to the rendition of an award, because the parties had failed to pay arbitration fees. The court noted that the proper remedy in such a situation is set forth in LSA-R.S.9:4203).

[Pg 8] According to LSA-R.S. 9:4202, a court shall stay the trial of an action in order for arbitration to proceed if any party applies for such a stay and shows (1) that there is a written arbitration agreement, and (2) the issue is referable to arbitration under that arbitration agreement, as long as the applicant is not in default in proceeding with the arbitration. **International River Center v. Johns-Manville Sales Corp.,** 2002-3060, p. 3 (La. 12/3/03), 861 So.2d 139, 141. Pursuant to LSA-R.S. 9:4203, a party in default is a party who has "fail[ed] or refus[ed] ... to perform under a written agreement for arbitration."

Id. In the case *sub judice,* we find the plaintiffs' withdrawal of their claims to be tantamount to a default.

Pursuant to LSA-R.S. 9:4203, which addresses the "remedy in case of default," the court must determine (1) whether there is a dispute as to the making of the agreement, and (2) whether a party has failed to comply with the agreement. If it determines that those two facts are not in issue, the court "shall issue an order directing the parties to proceed to arbitration in accordance with the terms of the agreement." Because dismissal with prejudice is a result not contemplated by the applicable statutes, we find the trial court's judgment to be in error. [6]

6 On appeal, the defendants posit the alternative argument that the decision in **Greening v. Western Reserve Life Assurance Co. of Ohio,** 439 F.Supp.2d 612 (M.D.La. 2006), is *res judicata* to the present suit. Although the defendants referenced this argument in their motion to stay and dismiss, we note that they did not file a peremptory exception raising the objection of *res judicata* in the trial court or in this court. Such an exception must be specially pleaded and cannot be raised by the court on its own motion. LSA-C.C.P. art. 927(B).

Even so, our courts consistently look beyond the caption, style, and form of pleadings to determine from the substance of the pleadings the nature of the proceeding; thus, a pleading is construed for what it really is, not for what it is erroneously called. See **Draten v. Winn Dixie of Louisiana, Inc.,** 94-0767 p. 3 (La.App. 1 Cir. 3/3/95), 652 So.2d 675, 676; **Murrell v. Murrell,** 42, 070, p. 3 (La.App. 2 Cir. 4/25/07), 956 So.2d 697, 700. However, even according the most liberal interpretation to the defendants' motion and assuming that the defendants did properly raise the peremptory exception pleading the objection of *res judicata,* we find it to be without merit.

Ordinarily, to determine whether *res judicata* bars an issue, the court should examine both the pleadings and the entire record in the first suit. However, in the present matter, the defendants failed to present any evidence to definitively establish the parties and the claims involved in **Greening.** Moreover, **Greening** only dealt with the prescriptive period applicable to the plaintiffs' claims, an issue that has not been raised in the instant suit. Finally, the court in **Greening** merely ruled that the plaintiffs' claims in that case had prescribed and, therefore, never addressed the merits of those claims.

[Pg 9] **CONCLUSION**

Accordingly, we reverse the judgment and remand the matter for further proceedings consistent with the opinions expressed herein. Costs of this appeal are to be shared equally by the parties.

REVERSED AND REMANDED.

- Return to Page 1 –

AMERITRADE, INC., Plaintiff, v. McLAUGHLIN, PIVEN, VOGEL SECURITIES, INC., STEVEN D. IRCHA, and WILLIAM J. PICKERT, Defendants.

Civil Action No. 3603-CC

COURT OF CHANCERY OF DELAWARE, SUSSEX

2008 Del. Ch. LEXIS 97

June 13, 2008, Submitted
July 24, 2008, Decided

NOTICE:

THIS OPINION HAS NOT BEEN RELEASED FOR PUBLICATION. UNTIL RELEASED, IT IS SUBJECT TO REVISION OR WITHDRAWAL.

CORE TERMS: arbitration panel, arbitration award, arbitrator, arbitration, vacate, manifest, modify, treble damages, vacated, deposition, vacatur, hear, Federal Arbitration Act FAA, modified, jointly, servant, compensatory damages, summary judgment, scope of employment, judicial review, mathematical error, evidentiary, exceeded, evident, double, novo, quadruple, stolen, owed, Delaware Uniform Arbitration Act

COUNSEL: Arthur L. Dent and Scott B. Czerwonka, of POTTER ANDERSON & CORROON LLP, Wilmington, Delaware; OF COUNSEL: Theodore R. Snyder, of KREBSBACH & SNYDER, P.C., New York, New York, Attorneys for TD Ameritrade, Inc.

Aimee M. Czachorowski, of DUANE MORRIS LLP, Wilmington, Delaware; OF COUNSEL: Loren Schechter and John Dellaportas, of DUANE MORRIS LLP, New York, New York; David E. Robbins, of KAUFMANN, FEINER, YAMIN, GILDIN & ROBBINS, LLP, New York, New York, Attorneys for McLaughlin, Piven, Vogel Securities, Inc. and Steven D. Ircha.

Stephen A. Hampton, of GRADY & HAMPTON, LLC, Wilmington, Delaware, Attorney for William J. Pickert.

JUDGES: CHANDLER, Chancellor.

OPINION BY: CHANDLER

OPINION

CHANDLER, Chancellor

I. BACKGROUND

William J. Pickert is ninety-six years old, nearly blind, extremely hard of hearing, and confined to a wheelchair. Starting in 1987, Pickert held an investment account with MPV Securities. At different times, various brokers handled his account, and in 1993 it was assigned to Steven D. Ircha. Shortly thereafter, a junior associate of Ircha, Vikram Manhas, took over Pickert's account. Manhas remained Pickert's sole broker until he left MPV in 2005. While acting as Pickert's broker, Manhas swindled Pickert out of $ 400,000. This duplicity occurred in two stages. First, in 2001, Manhas transferred bonds valued at approximately $ 160,000 from Pickert's MPV account to an account that Manhas had opened at Ameritrade under the false name of "Emmanuel Tramond." Manhas controlled the Tramond account and used the funds therein for his own purposes. Second, in 2004, Manhas transferred bonds valued at approximately $ 240,000 from Pickert's MPV account to another account that Manhas had opened at Ameritrade under Pickert's name without Pickert's knowledge and through the use of forged documents. As with the Tramond account, Manhas used the $ 240,000 for himself. Pickert did not realize anything had happened at the time of either transfer. The illegal transfers were not discovered until after Manhas had left MPV in 2005. Ultimately, the state of Delaware brought criminal charges against Manhas, but he has since fled the United States.

On May 17, 2006, Pickert filed a complaint against MPV and Ameritrade in the Superior Court, asserting claims for violations of the Delaware Consumer Fraud Act, the Delaware Securities Act, and the federal Rule 10b-5, as well as common law claims of negligence and breach of contract. Because Pickert had entered into a predispute arbitration agreement in connection with his status as a customer of MPV, Pickert was forced to amend his suit on August 2, 2006, dropping MPV Securities from the complaint. Ameritrade offered to participate in the arbitration in order to resolve the entire dispute in one proceeding, but Pickert rejected that offer. On October 13, 2006, Ameritrade moved to dismiss the amended complaint or, in the alternative, to stay the lawsuit pending the resolution of the arbitration. The court agreed to stay the suit and it remains stayed today.

On September 5, 2006, Pickert commenced an arbitration before the National Association of Securities Dealers ("NASD") against MPV. On November 17, 2006, MPV submitted its answer to Pickert's claims denying liability and alleging a third-party claim for contribution against Ameritrade. Although Ameritrade was not a party to any sort of arbitration agreement with MPV or Pickert, Ameritrade was obligated by NASD rules to arbitrate the claim alleged against it by MPV because both MPV and Ameritrade were NASD member firms. Ameritrade unsuccessfully sought to have the contribution claim asserted against it dismissed, and the arbitration panel proceeded with the case. The panel refused, over the objection of MPV and Ircha, to compel Pickert to testify, and instead allowed, again over the objection of MPV and Ircha, a videotaped deposition of Pickert into evidence.

On February 8, 2008, the arbitration panel issued its decision. The panel concluded that MPV and Ircha were negligent, that "the Delaware Consumer Fraud Act applied to these facts and that MPV and Ircha are jointly liable for those actions." The panel directed MPV to pay Pickert compensatory damages of $ 160,000 with respect to the bonds stolen in 2001, plus interest in the sum of $ 49,082.98; compensatory damages of $ 240,000 for the bonds stolen in 2004, plus interest in the sum of $ 43,839.27; attorneys' fees of $ 55,187.50 pursuant to the Delaware Consumer Fraud statute and the contract between

Pickert and MPV; $ 1,200,000 of "treble damages" pursuant to the Consumer Fraud Act; and reimbursement of Pickert's $ 250 filing fee. With respect to the third-party contribution claim against Ameritrade, the panel determined that Ameritrade was liable to MPV for 50% of the damages it owed to Pickert.

On March 7, 2008, Ameritrade commenced this action for vacatur of the Award. One month later, Pickert filed an answer, counterclaim, and third-party claim against MPV. On April 18, 2008, MPV filed an answer, counterclaim, and cross claim. Following negotiations between counsel, the parties agreed that all of the outstanding claims, counterclaims, and cross claims could be resolved through motions for summary judgment.

The parties' contentions may be briefly summarized. Pickert asks the Court to uphold the award of the arbitration panel. Pickert argues that Ameritrade and MPV are impermissibly seeking *de novo* review of the award and stresses that neither Ameritrade nor MPV has met the statutory requirements for vacatur. MPV and Ircha contend that the arbitration award must be modified for three reasons. First, they argue that the arbitration panel exhibited a manifest disregard of the law by finding them liable for a violation of the Delaware Consumer Fraud Act when the panel only found them to be negligent. Second, they argue that the arbitration panel ignored key evidence by refusing to compel Pickert's testimony during the evidentiary hearing. Third, they contend that the panel clearly disregarded the law by awarding, in effect, quadruple damages instead of triple damages. Finally, Ameritrade challenges the panel's decision to hold it liable for half of the damages awarded under the Consumer Fraud Act, arguing that the panel decided an issue that was not properly before it because no party made a claim at arbitration against Ameritrade under that Act.

II. STANDARDS

Summary judgment is appropriate where "there is no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law." [1] A motion for summary judgment is the "common [method] for this court to determine whether to vacate or confirm an arbitration award." [2] This is true under either the Delaware Uniform Arbitration Act [3] or the Federal Arbitration Act ("FAA"). [4] Although Ameritrade filed its complaint pursuant to 10 *Del. C.* § 5714, [5] the parties have briefed this dispute as though the FAA applies. [6] The Federal Arbitration Act provides that a court must confirm an arbitration award "unless the award is vacated, modified, or corrected as prescribed" by other provisions of the Act. [7] Those other provisions enumerate specific circumstances under which an arbitration award may be vacated or modified; the FAA does not provide for a "general review for an arbitrator's legal errors." [8] Under the FAA, a court may vacate an arbitration award:

> (1) where the award was procured by corruption, fraud, or undue means;
>
> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
>
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence

> pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
>
> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made. [9]

Moreover, the FAA authorizes courts to modify arbitration awards in the following circumstances:

> (a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.
>
> (b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.
>
> (c) Where the award is imperfect in matter of form not affecting the merits of the controversy. [10]

The Supreme Court has recently held that these statutorily enumerated circumstances are the only circumstances under which a court may grant vacatur or modification under the FAA. [11] Of course, "[n]either the FAA nor the Delaware Uniform Arbitration Act derogates this Court's inherent equity jurisdiction to enforce, modify or vacate arbitration awards." [12]

1 Ct. Ch. R. 56(c).
2 *Beebe Med. Ctr., Inc. v. InSight Health Servs. Corp.,* 751 A.2d 426, 431 (Del. Ch. 1999).
3 *See, e.g., Blank Rome LLP v. Vendel,* C.A. No. 19355, 2003 Del. Ch. LEXIS 84, 2003 WL 21801179, at *3 (Del. Ch. Aug. 5, 2003) ("Summary judgment is an appropriate vehicle to review an arbitration award, because the complete arbitration record is before the Court and a *de novo* hearing is not available to determine whether any statutory exception authorizing vacating the award is applicable.").
4 *See, e.g., Sullivan v. El Paso Corp.,* No. H-06-2948, 2007 U.S. Dist. LEXIS 24233, 2007 WL 1032349, at *2 (S.D. Tex. Apr. 2, 2007).
5 Section 5714 is a provision of the Delaware Uniform Arbitration Act, which applies only when the parties enter "an agreement . . . providing for arbitration in this state." 10 *Del. C.* § 5702(a); *see also Orner v. Country Grove Inv. Group, LLC,* C.A. No. 2245-VCS, 2007 Del. Ch. LEXIS 144, 2007 WL 3051152, at *6 (Del. Ch. Oct. 12, 2007). Although none of the parties submitted a copy of the arbitration agreement to the Court, it appears that the agreement did not specifically call for arbitration in Delaware; it just happened to occur here because Pickert lives here.
6 *See, e.g.,* TD Ameritrade's Mot. for Summ. J. at 10 n.4 ("There is no dispute among the parties that the FAA applies in this state court proceeding."); *cf. Pers. Decisions, Inc. v. Bus. Planning Sys., Inc.,* C.A. No. 3213-VCS, 2008 Del. Ch. LEXIS 55, 2008 WL 1932404, at *6 (noting that state arbitration laws displace the Federal

Arbitration Act only when the parties "clearly evidence their intent to be bound by such rules"). Because all of the parties here have cited and relied on the Federal Arbitration Act, and because there is no evidence on the record whatsoever that the parties intended to be bound by the Delaware Act instead, I will apply the rules of the FAA. *See Moss v. Prudential-Bache Securities, Inc.,* 581 A.2d 1138, 1139 (Del. 1990) ("The Federal Arbitration Act clearly vests concurrent subject matter jurisdiction in both the state and federal district courts.").

7 9 U.S.C. § 9 (West 2008).

8 *Hall St. Assocs., L.L.C. v. Mattel, Inc.,* 128 S.Ct. 1396, 1404, 170 L. Ed. 2d 254 (U.S. 2008).

9 9 U.S.C. § 10(a).

10 9 U.S.C. § 11.

11 *Hall St. Assocs., L.L.C. v. Mattel, Inc.,* 128 S.Ct. 1396, 1404, 170 L. Ed. 2d 254 (U.S. 2008) ("[T]he text compels a reading of the §§ 10 and 11 categories as exclusive. To begin with, even if we assumed §§ 10 and 11 could be supplemented to some extent, it would stretch basic interpretive principles to expand the stated grounds to the point of evidentiary and legal review generally."); *see also Rogers v. KBR Technical Servs. Inc.,* No. 08-20036, 2008 U.S. App. LEXIS 12320, 2008 WL 2337184, at *2 (5th Cir. 2008) ("The Supreme Court has recently held that the provisions of the FAA are the exclusive grounds for expedited vacatur and modification of an arbitration award, which calls into doubt the non-statutory grounds which have been recognized by this Circuit."); Thomas E.L. Dewey and Kara Siegel, *'Hall Street' and the Shrinking Scope of Judicial Review of Arbitral Awards,* N.Y. L.J., May 15, 2008, at 24 ("In a 6-3 decision, the Court held that the statutory grounds for vacating or modifying an arbitral award, laid out in §§ 10 and 11 of the FAA, respectively, are the sole grounds for judicial review of an award. In so doing, the Court also appeared to question a doctrine called "manifest disregard of the law." That doctrine has been applied by federal courts in various circuits, including the U.S. Court of Appeals for the Second Circuit in New York, to provide substantive judicial review of last resort to arbitration awards that willfully and clearly depart from well-established law.").

12 *SBC Interactive, Inc. v. Corporate Media Partners,* C.A. No. 16397, 1998 Del. Ch. LEXIS 192, 1998 WL 749446, at *1 (Del. Ch. Oct. 7, 1998); *see also Hall St. Assocs.,* 128 S.Ct. at 1406 ("In holding that §§ 10 and 11 provide exclusive regimes for the review provided by the statute, we do not purport to say that they exclude more searching review based on authority outside the statute as well.").

Arbitration awards, however, are not lightly disturbed, and "Courts must accord substantial deference to the decisions of arbitrators." [13] When considering "whether the arbitrator exceeded its authority," the Court must "resolve all doubts in favor of the arbitrator." [14] In fact, "[a] court's review of an arbitration award is one of the narrowest standards of judicial review in all of American jurisprudence." [15] When "an arbitration award rationally can be derived from either the agreement of the parties or the parties' submission to the arbitrator, it will be enforced." [16] Moreover, there is a presumption that the arbitration panel acted within the scope of its authority, and "this presumption may not be rebutted by an ambiguity in a written opinion." [17] To successfully convince the Court to vacate the award of an arbitration panel, the movant must show "something beyond and different from a mere error in the law or failure on the part of the arbitrators to understand or apply the law." [18] This Court has noted that an arbitration panel's decision may be vacated if the panel, "in manifest disregard of the law, [was] cognizant of the controlling law but clearly chose to ignore it in reaching [its] decision" [19] This Court has also noted, however, that "[m]ere error of law or fact is . . . not sufficient grounds to vacate and award," and that "[i]t is recognized that inaccuracies as to the law or facts are possible and their existence is accepted implicitly be an agreement to submit the dispute to arbitration." [20] In sum, "the Court is not to pass an independent judgment on the evidence or applicable law," and "[i]f any grounds for the award can be inferred from the facts on the record, the Court must presume that the arbitrator did not exceed his authority and the award must be upheld." [21]

13 *Kashner Davidson Sec. Corp. v. Mscisz,* No. 07-1231, 2008 U.S. App. LEXIS 13562, 2008 WL 255337, at *1 (1st Cir. June 27, 2008); *see also Totes Isotoner Corp. v. Int'l Chem. Workers Union Council,* No. 07-3577, 2008 U.S. App. LEXIS 14603, 2008 WL 2699923, at *6 (6th Cir. July 8, 2008) ("[C]ourts play only a limited role when asked to review the decision of an arbitrator." (quoting *Tenn. Valley Auth. v. Tenn. Valley Trades & Labor Council,* 184 F.3d 510, 514 (6th Cir. 1999) (per curiam)).

14 *Executone Info. Sys., Inc. v. Davis,* 26 F.3d 1314, 1320 (5th Cir. 1994).

15 *Way Bakery v. Truckdrivers, Local No. 164,* 363 F.3d 590, 593 (6th Cir. 2004).

16 *Brennan v. CIGNA Corp.,* Nos. 06-5027, 06-5124, 2008 U.S. App. LEXIS 13045, 2008 WL 2441049, at *4 (3d Cir. June 18, 2008).

17 *Metromedia Energy, Inc. v. Enserch Energy Servs., Inc.,* 409 F.3d 574, 580 (3d Cir. 2005) (quoting *Roadway Package Sys., Inc. v. Kayser,* 257 F.3d 287, 301 (3d Cir. 2001)).

18 *Westerbeke Corp. v. Daihatsu Motor Co., Ltd.,* 304 F.3d 200, 208 (2d Cir. 2002) (quoting *Saxis S.S. Co. v. Multifacs Int'l Traders, Inc.,* 375 F.2d 577, 582 (2d Cir. 1967)).

19 *Daisy Const. Co. v. Mumford & Miller Concrete, Inc.,* C.A. No. 661-N, 2005 Del. Ch. LEXIS 98, 2005 WL 1653943, at *3 (Del. Ch. June 30, 2005).

20 *Falcon Steel Co. v. HCB Contractors, Inc.,* C.A. No. 11557, 1991 Del. Ch. LEXIS 69, 1991 WL 50139, at *2 (Del. Ch. Apr. 4, 1991).

21 *Audio Jam, Inc. v. Fazelli,* C.A. No. 14368, 1997 Del. Ch. LEXIS 40, 1997 WL 153814, at *1 (Del. Ch. Mar. 20, 1997).

III. ANALYSIS

The motions for summary judgment filed by MPV and TD Ameritrade ask the Court to vacate and modify the arbitration panel's award based on several theories. First, MPV and Ircha seek to vacate the arbitration award because the panel refused to compel Pickert to testify at the evidentiary hearing, and therefore failed to consider pertinent evidence. Second, MPV and Ircha seek to vacate the portion of the award based on the Delaware Consumer Fraud Act ("DCFA"), arguing that the act was inapplicable because there was no finding of fraud. Third, to the extent the award under the DCFA is valid, MPV and Ircha seek to modify it, claiming that the panel miscalculated the treble damages. Finally, TD Ameritrade seeks to vacate the portion of the award directing it to pay 50% of the trebled damages because no party to the arbitration filed a claim against Ameritrade under the DCFA. I will address each argument in turn.

A. Pickert's Testimony

MPV and Ircha contend that the arbitration award should be vacated because "the arbitrators were guilty . . . in refusing to hear evidence pertinent and material to the controversy." [22] Specifically, the arbitration panel refused to compel the 96-year-old, wheelchair-bound, nearly deaf and blind Pickert to testify at the evidentiary hearing and instead admitted into evidence a videotaped deposition over the objection of MPV and Ircha. The deposition was taken in the course of Pickert's litigation against TD Ameritrade and Pickert was cross-examined by counsel for Ameritrade. Moreover, counsel for MPV and Ircha were invited to attend and participate in that deposition but they declined to do so.

22 9 U.S.C. § 10(a)(3).

Certainly, in refusing to compel Pickert to testify and subject himself to cross examination by counsel for MPV and Ircha, the arbitration panel did refuse to hear evidence pertinent to the controversy. However, the mere "refusal to hear evidence does not automatically require the vacatur of an award: '[i]t is well settled that arbitrators are afforded broad discretion to determine whether to hear evidence.'" [23] Although cross-examining an adverse witness is a fundamental right, [24] "[o]nly the most egregious error which resulted in adversely affecting the rights of a party would justify . . . and require vacatur of an award." [25]

23 *Fiero Bros., Inc. v. Sw. Sec., Inc.,* No. 99 Civ. 3613(SWK), 2000 U.S. Dist. LEXIS 5566, 2000 WL 510899, at *2 (S.D.N.Y. Apr. 28, 2000) (quoting *Areca, Inc. v. Oppenheimer & Co., Inc.,* 960 F. Supp. 52, 55 (S.D.N.Y. 1997)).
24 *See, e.g., Torres v. Allen Family Foods,* 672 A.2d 26, 31-32 (Del. 1995).
25 *Pompano-Windy City Partners v. Bear Stearns & Co.,* 794 F. Supp. 1265, 1277 (S.D.N.Y. 1992).

Here, MPV and Ircha have failed to prove that they were "denied a fundamentally fair hearing and consequently suffered prejudice." [26] Most importantly, the arbitration panel's written award itself states that "[t]he Panel ruled that Claimant's sworn testimony was, at best, neutral for Claimant." [27] Consequently, there is no evidence that MPV and Ircha "suffered prejudice" as a result of the admission of Pickert's deposition testimony. Moreover, there is no evidence that the Arbitration panel's refusal to compel the feeble and elderly Pickert to testify in person constituted a "most egregious error." MPV and Ircha complain that they were denied the fundamental right to cross examine an adverse witness, but the evidence here shows that counsel for both MPV and Ircha were given an opportunity to cross examine Pickert at his videotaped deposition; MPV and Ircha simply declined to do so. Because they have failed to demonstrate that the hearing was fundamentally unfair, MPV and Ircha's motion for summary judgment under 9 U.S.C. § 10(a)(3) is denied.

26 *In re Consol. Arbitrations Between A.S. Seateam v. Texaco Panama, Inc.,* No. 97 CIV. 0214 (MBM), 1997 U.S. Dist. LEXIS 6869, 1997 WL 256949, at *7 (S.D.N.Y. May 16 1997) (noting that "an arbitration award will be vacated for misconduct in refusing to hear evidence "only if the losing party shows that he was denied a fundamentally fair hearing and consequently suffered prejudice" (quoting *Grinnell Hous. Dev. Fund Corp. v. Local 32B-32J. SEIU,* 767 F. Supp. 63, 67 (S.D.N.Y. 1991)).

27 Answer, Countercl. and Third-Party Compl. of William J. Pickert, Ex. B at 3 [Hereinafter "Award"].

B. The Delaware Consumer Fraud Act

MPV and Ircha further argue that the portion of the award granting damages under the Delaware Consumer Fraud Act must be vacated because the arbitration panel acted in manifest disregard of the law. In support of this argument, MPV and Ircha point to the written award issued by the panel. In it, the panel concluded that "Respondents MPV and Ircha were negligent," that "[t]he Delaware Consumer Fraud Act applied to these facts and Respondents MPV and Ircha are jointly liable for those actions," and that "[a]ll of Claimant's other claims are denied." [28] MPV and Ircha argue that these three statements demonstrate that the arbitration panel acted in manifest disregard of the law, because the Delaware Consumer Fraud Act does not punish acts of mere negligence. [29] It was Manhas, they contend, who perpetrated the fraud; not MPV and not Ircha.

28 Award at 4.

29 6 *Del. C.* § 2513(a) (imposing liability for "deception, fraud, false pretense, misrepresentation, or the concealment, suppression, or omission of any material fact with intent that others rely upon such concealment, suppression or omission . . . .").

Nevertheless, MPV and Ircha concede that they could be held accountable for Manhas's deception by virtue of *respondeat superior* liability, but they argue that they cannot be vicariously liable for Manhas's actions because those actions were not performed within the scope of his employment. The seminal case in Delaware on vicarious liability is the 1962 decision of the Supreme Court in *Draper v. Olivere Paving & Construction Co.* [30] There, the Court held that an employer is liable "only when those torts are committed by the servant within the scope of his employment . . . ." [31] The Court elaborated, explaining that it would "impose liability upon the master for his servant's intended tortious harm 'if the act was not unexpectable in view of the duties of the servant.'" [32] Furthermore, the Court specifically approved section 228 of the Restatement (Second) of Agency, which states that an employee's conduct is within the scope of employment if:

(a) it is of the kind he is employed to perform;

(b) it occurs substantially within the authorized time and space limits;

(c) it is actuated, at least in part, by a purpose to serve the master; and

(d)if force is intentionally used by the servant against another, the use of force is not unexpectable by the master. [33]

More recently, the Superior Court has cited section 229 of the Restatement to list factors a court should consider in determining whether an employee's conduct is within the scope of employment. Those factors include "whether or not the act is one commonly done by such servants; the time, place and purpose of the act; whether or not the act is outside the enterprise of the master; whether or not the master has reason to expect that such an act will be done; the similarity in quality of the act done to the act authorized; the extent of departure from the normal method of accomplishing an authorized result; and whether or not the act is seriously criminal." [34]

30 54 Del. 433, 181 A.2d 565, 4 Storey 433 (Del. 1962).
31 *Id.* at 569.
32 *Id.* (quoting RESTATEMENT (SECOND) OF AGENCY § 245).
33 *Draper,* 181 A.2d at 570 (quoting RESTATEMENT (SECOND) OF AGENCY § 228(1)).
34 *Simms v. Christina School Dist.,* C.A. No. 02C-07-043 JTV, 2004 Del. Super. LEXIS 43, 2004 WL 344015, at *5 (Del. Super. Jan. 30, 2004).

Here, the employee, Manhas, was charged with maintaining and managing the investment accounts of Pickert, a client of the employer, MPV. In the course of his employment, Manhas necessarily had access to Pickert's investments, and Manhas necessarily traded those investments. In the process of his dealings with Pickert's accounts, Manhas helped to generate commissions of $ 290,336.00 for MPV. On two occasions while dealing with Pickert's accounts, Manhas stole bonds. One might reasonably argue that the circumstances track the language of the Restatement, because dealing with Pickert's bonds was the kind of work Manhas was "employed to perform," because his theft occurred "substantially within the authorized time and space limits" of MPV, and because the illegal activity was "actuated, at least in part, by a purpose to serve the master" since Manhas was generating commissions for MPV. [35] Furthermore, one might reasonably argue that Manhas's theft "was not unexpectable" [36] in light of the fact that MPV's own Compliance and Supervisory Procedures Manual warned of the need to supervise employees like Manhas lest violations occur. [37]

35 *See* RESTATEMENT (SECOND) OF AGENCY § 228(1).
36 *Draper,* 181 A.2d at 569.
37 *See* Pickert's Mot. for Summ. J., Ex. 3, at 13; *see also* RESTATEMENT (THIRD) OF AGENCY § 7.07 ("An employee acts within the scope of employment when performing work assigned by the employer or engaging in a course of conduct subject to the employer's control."). Here, Manhas was assigned to manage the Pickert account and MPV's compliance manual indicates that MPV thought it could control the conduct of its employees with respect to their dealings with client accounts.

Ultimately, however, this Court does not need to decide whether or not Manhas was acting within the scope of his employment because it need not engage in a *de novo* review of the arbitration panel. The question is close enough to conclude that the panel did not act in manifest disregard of the law when it held MPV and Ircha liable under the Delaware Consumer Fraud Act. [38] The written award issued by the panel did not articulate this vicarious liability theory and did say only that MPV and Ircha were negligent, but "[a] mere ambiguity in the opinion accompanying an award, which permits the inference that the arbitrator may have exceeded his authority, is not a reason for refusing to enforce the award." [39] Indeed, "[a]rbitrators have no obligation to the court to give their reasons for an award." [40] Consequently, the award will not be vacated.

38 *Cf. Screpesi v. Draper-King Cole, Inc.,* C.A. No. 95C-05-029, 1996 Del. Super. LEXIS 555, 1996 WL 769344 (Del. Super. Dec. 27, 1996). In *Screpesi,* Judge Graves denied an employer's motion for summary judgment after concluding that a jury could find the employee, a truck driver, was acting within the scope of his employment when he punched another motorist during a confrontation. Having determined that he could not rule the action was outside the scope of employment as a matter of law, Judge Graves allowed the case to move forward to trial. Analogously, I cannot conclude as a matter of law that Manhas was acting outside the scope of his employment when he stole bonds from Pickert and, therefore, I will not vacate the panel's award.

39 *United Steelworkers of Am. v. Enter. Wheel & Car Corp.,* 363 U.S. 593, 597, 80 S. Ct. 1358, 4 L. Ed. 2d 1424 (1960).

40 *Id.*

C. Treble Damages

MPV and Ircha also contend that the panel made a blatant error when calculating damages under the Delaware Consumer Fraud Act. The DCFA provides for treble damages in certain circumstances: "If a private cause of action is brought by the victim of a violation of this subchapter, and said victim was 65 years of age or older or a disabled person when the violation occurred, the victim shall be entitled to recover 3 times the amount of the victim's compensatory damages if a violation of this subchapter is established. Such treble damages shall be in addition to any other damages to which the victim is entitled pursuant to common law or other provisions of the Delaware Code." [41] Here, Pickert was over the age of 65 at the time of the offending conduct, and the arbitration panel apparently decided to award treble damages pursuant to this provision. In the award, the panel wrote, "Respondents MPV and Ircha are liable, jointly and severally, and shall pay to Claimant treble damages in the sum of $ 1,200,000.00 pursuant to the Delaware Consumer Fraud statute." [42] This declaration, however, was in addition to earlier statements instructing MPV and Ircha to pay compensatory damages for the bonds stolen in 2001 and 2004. In other words, the arbitration panel awarded quadruple damages.

41 6 *Del. C.* § 2583(b).

42 Award at 4.

The FAA authorizes courts to issue orders to modify or correct arbitration awards "[w]here there was an evident material miscalculation of figures." [43] Further, "the order may modify and correct the award, so as to effect the intent thereof and promote justice between the parties." [44] Courts apply the modification power carefully, and "[w]here no mathematical error appears on the face of the award . . . an arbitration award will not be altered." [45] However, "[w]hen an arbitration award orders a party to pay damages that have already been paid or which are included elsewhere in the award, a court may modify the award. Double recovery constitutes a materially unjust miscalculation which may be modified under section 11 of the Federal Arbitration Act." [46]

43 9 U.S.C. § 11(a); *see also Lewis v. Circuit City Stores, Inc.,* 500 F.3d 1140, 1147 n.8 (10th Cir. 2007) ("Section 11 permits a court to modify an award to correct a mistaken calculation or other factual error . . . .").
44 9 U.S.C. § 11.
45 *Apex Plumbing Supply, Inc. v. U.S. Supply Co.,* 142 F.3d 188, 194 (4th Cir. 1998).
46 *Eljer Mfg., Inc v. Kowin Dev. Corp.,* 14 F.3d 1250, 1254 (7th Cir. 1994).

Here, there was a mathematical error on the face of the award, and this error will result in a double recovery for Pickert. The award grants both compensatory damages for the stolen bonds *and* an additional award of treble damages. The DCFA, however, does not permit quadruple damages. The arbitration panel either committed a mathematical error or granted an impermissible double recovery. Either way, the award must be modified to provide for treble damages alone.

D. Contribution

TD Ameritrade asks the Court to vacate the portion of the award directing Ameritrade to pay 50% of the damages awarded under the DCFA because no party to the arbitration made a claim against Ameritrade pursuant to that statute. In its award, the arbitration panel wrote, "Third-Party Respondent Ameritrade is jointly liable to respondents MPV and Ircha for the damages of Claimant and shall indemnify Respondents MPV and Ircha for 50% of the damages owed to Claimant." [47] The award contemplates that 50% of the damages amounts to $ 879,737.22, and therefore holds Ameritrade accountable for 50% of the damages awarded under the DCFA. In so holding, Ameritrade argues, the arbitrators "exceeded their powers." [48] The basis of this argument is that neither Pickert, MPV, nor Ircha formally made a DCFA claim against Ameritrade in the arbitration. [49] Additionally, to the extent the panel found Ameritrade was a joint tortfeasor, Ameritrade argues that the panel acted in manifest disregard of the law because it owed no duties to a noncustomer.

47 Award at 4.
48 9 U.S.C. § 10(a)(4).
49 Pickert does, however, have a DCFA claim pending against Ameritrade in the Superior Court action.

Ameritrade's arguments, however, are unpersuasive. First, the mere fact that no one formally filed a claim under the DCFA against Ameritrade in the arbitration is irrelevant. Pickert filed a DCFA claim against MPV, and MPV filed a claim for contribution against Ameritrade; that contribution claim properly brought Ameritrade before the arbitration panel. [50] Second, Ameritrade has failed to prove that the panel acted in manifest disregard of the law. Although Ameritrade has argued strenuously--both before this Court and before the arbitration panel--that it owed no duty to Pickert because he was not a customer, there is authority to the contrary. [51] As the United States Court of Appeals for the Seventh Circuit has written, "[a]rbitration does not provide a system of 'junior varsity trial courts' offering the losing party complete and rigorous *de novo* review." [52] In the case of Ameritrade's argument regarding its duty or lack thereof to Pickert, the arbitrators were offered conflicting authority. The fact that arbitrators ultimately chose not to follow the cases cited by Ameritrade--even if they did so erroneously--is not manifest disregard of the law.

50 *Cf. Custom Decorative Moldings, Inc. v. Innovative Plastics Tech., Inc.,* C.A. No. 17592, 2000 Del. Ch. LEXIS 131, 2000 WL 1273301, at *8 (Del. Ch. Aug. 30, 2000) (refusing to vacate an arbitration award finding an individual respondent jointly and severally liable "after a full factual hearing at which [that individual respondent] was represented and had the opportunity to present evidence").

51 *See, e.g., Patrick v. Union State Bank,* 681 So.2d 1364 (Ala. 1996) (holding that a bank has a duty to protect a noncustomer from the criminal acts of a customer of the bank where the bank negligently allowed an imposter to open an account in the plaintiff's name).

52 *Eljer Mfg., Inc v. Kowin Dev. Corp.,* 14 F.3d 1250, 1254 (7th Cir. 1994) (quoting *Nat'l Wrecking Co. v. Int'l Bhd. of Teamsters, Local 731,* 990 F.2d 957, 960 (7th Cir. 1993)).

IV. CONCLUSION

The role of this Court when reviewing an arbitration award is narrow and limited. The Court must presume that the arbitrators acted appropriately, and this presumption cannot be rebutted by simply complaining of ambiguity in the arbitrators' written award. Here, MPV, Ircha, and Ameritrade have done no more than assail the reasons articulated in the arbitration panel's decision, but this showing is insufficient to vacate the award. Rather than demonstrate that the panel acted in manifest disregard of clear law, MPV, Ircha, and Ameritrade have shown only that the panel ultimately disagreed with their interpretations of the law. To disagree is not to disregard, and because they have failed to meet their heavy burden, the Court will not vacate the arbitration award. However, because the panel did make a clear mathematical error that would result in a double recovery, the amount of the award shall be reduced to treble rather than quadruple damages.

Counsel shall submit an Order that implements the above ruling within five days.

IT IS SO ORDERED.

- Return to Page 1 –

MERLE LADNER ADAMS et al., Plaintiffs and Appellants, v. FISERV, ISS et al., Defendants and Respondents.

D051778

COURT OF APPEAL OF CALIFORNIA, FOURTH APPELLATE DISTRICT, DIVISION ONE

2008 Cal. App. Unpub. LEXIS 6854

August 22, 2008, Filed

NOTICE: NOT TO BE PUBLISHED IN OFFICIAL REPORTS. CALIFORNIA RULES OF COURT, RULE 8.1115(a), PROHIBITS COURTS AND PARTIES FROM CITING OR RELYING ON OPINIONS NOT CERTIFIED FOR PUBLICATION OR ORDERED PUBLISHED, EXCEPT AS SPECIFIED BY RULE 8.1115(b). THIS OPINION HAS NOT BEEN CERTIFIED FOR PUBLICATION OR ORDERED PUBLISHED FOR THE PURPOSES OF RULE 8.1115.

PRIOR HISTORY:
APPEAL from a judgment of the Superior Court of San Diego County. Super. Ct. No. GIC837421. Richard E.L. Strauss, Judge.

DISPOSITION: Reversed.

CORE TERMS: investor, causes of action, demurrer, fiduciary duty, fraudulent, duty to disclose, aiding and abetting, leave to amend, actual knowledge, sustaining, customer, owed, entities, fiduciary relationship, fraudulent concealment, custodial, material facts, mismanagement, fiduciary, defaulted, promissory notes, fraudulent scheme, prohibited transactions, expressly provided, intent to deceive, corporate notes, distinguishable, administrator's, retirement, commingled

JUDGES: MCINTYRE, J.; HALLER, Acting P. J., MCDONALD, J. concurred.

OPINION BY: MCINTYRE

OPINION

Plaintiffs, 48 elderly individuals, brought this action against Fiserv ISS for: (1) breach of fiduciary duty; (2) fraudulent concealment; (3) aiding and abetting fraud; (4) violation of Corporations Code section 25504.1; and (5) violation of Business and Professions Code section 17200. (All undesignated statutory references are to the Business and Professions Code.) They appeal a judgment entered against them after the trial court sustained

Fiserv's demurrer to their claims without leave to amend, contending that their allegations were sufficient to state the asserted causes of action. We agree and reverse the judgment.

FACTUAL AND PROCEDURAL BACKGROUND

In accordance with the principles governing our review of a ruling sustaining a demurrer, the following factual recitation is taken from the allegations of Plaintiffs' fourth amended complaint. *(Moore v. Regents of University of California* (1990) 51 Cal.3d 120, 125.)

Starting in 1995, Daniel Heath (Heath), Denis O'Brien and Larre Schlarmann, with the assistance of Attorney David Small (collectively, the Heath Defendants), offered and sold unqualified, nonexempt securities in numerous fraudulent entities to California investors, targeting funds held in individual retirement accounts (IRAs) of elderly investors. The Heath Defendants operated a Ponzi scheme, enticing new investors to invest in the fraudulent entities and using the incoming principal to pay initial investors artificially high returns. Investment money came into the scheme through the sale of promissory notes in Heath's company, Private Capital Management, Inc. (PCM), which, in turn, lent the money to fraudulent entities controlled by the Heath Defendants.

Fiserv successfully bid to become the custodial trustee for hundreds of IRAs seized by the Securities and Exchange Commission, including some of the Plaintiffs' accounts. At that time, Fiserv allegedly knew that the promissory notes in Plaintiffs' accounts were not allowable securities, but allowed the investments nonetheless. Thereafter, Fiserv allegedly knew about the fraudulent scheme and that the Heath Defendants were self-dealing in Plaintiffs' accounts and substantially assisted in the scheme by mismanaging Plaintiffs' accounts and violating its own internal policies.

The Securities and Exchange Commission shut down the Heath Defendants' fraudulent scheme in March 2004. Plaintiffs filed this action in October 2004 and added Fiserv as a defendant to its first amended complaint in March 2005. Thereafter, the trial court ruled on a series of demurrers filed by Fiserv. As relevant to this appeal, the trial court sustained, without leave to amend, Fiserv's demurrer to Plaintiffs' causes of action for breach of fiduciary duty, violation of Corporations Code section 25504.1 and violation of section 17200 as alleged in their second amended complaint. The trial court allowed Plaintiffs leave to amend their causes of action for fraudulent concealment and aiding and abetting fraud, but ultimately concluded that Plaintiffs' fourth amended complaint did not adequately plead these causes of action and entered a judgment in Fiserv's favor. Plaintiffs timely appealed.

DISCUSSION

I. *Standard of Review*

We review an order sustaining a demurrer without leave to amend de novo *(Blank v. Kirwan* (1985) 39 Cal.3d 311, 318), assuming the truth of all properly pleaded facts as well as facts inferred from the pleadings, and give the complaint a reasonable interpretation by reading it as a whole and its parts in context. *(Palacin v. Allstate Ins. Co.* (2004) 119 Cal.App.4th 855, 861.) However, we give no credit to allegations that merely set forth contentions or legal conclusions. *(Financial Corp. of America v. Wilburn* (1987) 189

Cal.App.3d 764, 768-769.) A complaint will be construed "liberally . . . with a view to substantial justice between the parties." (Code Civ. Proc., ß 452.) If the complaint states any possible legal theory, the trial court's order sustaining the demurrer must be reversed. *(Palestini v. General Dynamics Corp.* (2002) 99 Cal.App.4th 80, 86.) Whether a plaintiff will be able to prove its allegations is not relevant. *(Alcorn v. Anbro Engineering, Inc.* (1970) 2 Cal.3d 493, 496 *(Alcorn).)*

II. *Analysis*

A. Breach of Fiduciary Duty

A subset of Plaintiffs who held IRA accounts with Fiserv (the IRA Plaintiffs), alleged in the second amended complaint that Fiserv, as the custodial trustee of their IRA accounts, breached fiduciary duties owed to them. They contend that the trial court erroneously sustained Fiserv's demurrer to this claim because they alleged facts sufficient to show that Fiserv owed them a fiduciary duty. We agree.

The IRA Plaintiffs alleged in their second amended complaint that Fiserv concealed material facts affecting the value of their investments with the Heath Defendants and that had they known these facts, they would not have invested with the Heath Defendants. Relying on *Brown,* the trial court concluded that the IRA Plaintiffs failed to explain why their relationship with Fiserv gave rise to a duty to disclose and sustained the demurrer without leave to amend. *(Brown, supra,* 45 Cal.App.4th 333.) The IRA Plaintiffs contend that *Brown* is distinguishable because the Plan documents imposed on Fiserv disclosure duties related to the management of their own investments, particularly, that Fiserv had a duty to disclose that the Heath Defendants were directing their IRA funds into prohibited transactions and fraudulent securities. We reject this argument as review of the Plan documents reveals that Fiserv owed no such duties.

To plead a cause of action for breach of fiduciary duty, a plaintiff must show the existence of a fiduciary relationship, its breach, and damage caused by the breach. *(Pierce v. Lyman* (1991) 1 Cal.App.4th 1093, 1101.) "The key factor in the existence of a fiduciary relationship lies in control by a person over the property of another." *(Vai v. Bank of America* (1961) 56 Cal.2d 329, 338.) "[B]efore a person can be charged with a fiduciary obligation, he must either knowingly undertake to act on behalf and for the benefit of another, or must enter into a relationship which imposes that undertaking as a matter of law." *(Committee on Children's Television, Inc. v. General Foods Corp.* (1983) 35 Cal.3d 197, 221, superseded by statute on another ground as noted in *Californians for Disability Rights v. Mervyn's, LLC* (2006) 39 Cal.4th 223, 227.)

Fiserv contends, and we agree, that the duties of a directed IRA custodian are limited by the terms of the parties' written agreement. *(Brown v. California Pension Adm'rs & Consultants, Inc.* (1996) 45 Cal.App.4th 333, 337-338 *(Brown)* ["express provisions in the documents governing the business relationship between the parties limited the duties of the trustee and the administrator"]; *Van de Kamp v. Bank of America* (1988) 204 Cal.App.3d 819, 860 ["duty as [an] agent is limited to the scope of the agency set forth in the parties' agreement"].) Accordingly, to determine whether a fiduciary relationship existed between the IRA Plaintiffs and Fiserv, we must review the documents that created their relationship.

Here, the IRA Plan and Trust Agreement (the Plan) governing the parties' relationship expressly provided for the creation of a "trust" and stated that the Plan qualified as a retirement plan under section 408 of the Internal Revenue Code (26 U.S.C. ß 408). IRAs are "special deposits that constitute a trust relationship wherein the [trustee] owes a fiduciary duty to the depositor." *(Masi v. Ford City Bank and Trust Co.* (7th Cir. 1985) 779 F.2d 397, 401; *Richelle L. v. Roman Catholic Archbishop* (2003) 106 Cal.App.4th 257, 271 [a fiduciary relationship is a recognized legal relationship such as trustee and beneficiary].) None of the documents creating the relationship specifically provided that Fiserv owed no fiduciary duties to the IRA Plaintiffs. Rather, the Plan impliedly recognized the existence of a fiduciary relationship as the indemnification provision contained therein expressly provided that it did not relieve Fiserv from any liability for breach of fiduciary duty.

Accordingly, as a custodial trustee, Fiserv owed its customers a fiduciary duty under its own contract. Although section 408 of the Internal Revenue Code also recognizes that an IRA creates a trust (26 U.S.C. ß 408(a)), the IRA Plaintiffs need not rely on this statute to create a private cause of action.

Fiserv asserts that *Brown* conclusively disposed of the IRA Plaintiffs' claim for breach of fiduciary duty. *(Brown, supra,* 45 Cal.App.4th 333.) In *Brown,* investors in self-directed IRAs sued the custodial trustee and administrator of their IRAs alleging that the defendants failed to notify them that a borrower of their funds had defaulted in payment to *other investors.* They argued that had they been informed of the borrower's failure to pay, they would not have made further unsecured loans to him. *(Id.* at pp. 338-339.) The trial court sustained the defendants' demurrer to the cause of action for breach of fiduciary duty and the appellate court affirmed because the agreements between plaintiffs and defendants limited the administrator's contractual and common law duties, absolving it of any duty to investigate, select or monitor plaintiffs' IRA investments or notify them of the poor performance of similar investments held by other customers. *(Id.* at pp. 346-348.)

Fiserv correctly notes that the relevant provisions of the documents signed by the IRA Plaintiffs are substantially identical to those examined in *Brown,* to wit, that (1) as the custodial trustee Fiserv: (a) was not acting as the IRA Plaintiffs' investment advisor; (b) had no duty to question the IRA Plaintiffs' directions regarding the purchase, retention, or sale of any asset; and (2) each the IRA Plaintiffs had the "sole authority and discretion" to select and to direct the investment of all assets in his or her account and accepted "full and sole responsibility for the success or failure of any selection made." *(Brown, supra,* 45 Cal.App.4th at pp. 340-342.)

Here, however, the IRA Plaintiffs are not seeking to hold Fiserv liable for its failure to inform them about defaults in other investors' accounts. Rather, the IRA Plaintiffs allege that Fiserv mismanaged their accounts by, among other things: (1) inaccurately reporting account values to conceal the repeated defaults and delinquent interest payments of the Heath Defendants' related investments; (2) improperly calculating required minimum distributions, thereby concealing that the Heath Defendants' investors had insufficient funds in their accounts and making more funds available to the Heath Defendants to take from investors; (3) backdating statements to mislead the IRA Plaintiffs as to their true account values; (4) commingling investors' funds; and (5) continuing to allow reinvestments in the Heath Defendants' securities even after it acknowledged that the Heath Defendants were engaged in the sale of unlawful securities.

In light of the fact that, the Plan expressly provided that Fiserv would: (1) establish and maintain a separate account in the name of each participant; (2) distribute the account in accordance with certain minimum distribution requirements; and (3) that the assets entrusted under the Plan were not to be commingled with other property "except in a common trust fund or common investment fund," the IRA Plaintiffs have adequately alleged that Fiserv breached fiduciary duties owed to them and that these breaches caused their damages. Accordingly, the trial court erred in sustaining Fiserv's demurrer to this cause of action.

B. Fraudulent Concealment

The IRA Plaintiffs alleged in their fourth amended complaint that Fiserv concealed material facts affecting their investments with the intent to deceive and defraud and induce their reliance and had they known these facts they would not have continued to purchase or hold any Heath securities. Specifically, the IRA Plaintiffs allege that Fiserv failed to disclose the following material facts: (1) the Heath Defendants, as the IRA Plaintiffs' designated financial representative, was an interested party that was engaging in fraudulent transactions in their accounts; and (2) the Heath securities held by them defaulted and/or failed to make distributions into their accounts.

Relying on *Brown,* the trial court concluded that the IRA Plaintiffs failed to explain why their relationship with Fiserv gave rise to a duty to disclose and sustained the demurrer without leave to amend. *(Brown, supra,* 45 Cal.App.4th 333.) The IRA Plaintiffs contend that *Brown* is distinguishable because the Plan documents imposed on Fiserv disclosure duties related to the management of their own investments, particularly, that Fiserv had a duty to disclose that the Heath Defendants were directing their IRA funds into prohibited transactions and fraudulent securities.

To recover for fraudulent concealment, a plaintiff must plead and prove that the defendant had a duty to disclose the fact to the plaintiff. *(Lovejoy v. AT&T Corp.* (2004) 119 Cal.App.4th 151, 157-158.) Here, the Plan documents limited Fiserv's liability by providing that it had no duty to question the directions of the IRA Plaintiffs or their authorized agents regarding the purchase, retention or sale of any asset and could not be held liable for transmitting or not transmitting "any information of any kind and from wherever derived concerning the authorized agent or concerning any investment." This disclaimer is sufficiently broad to bar the IRA Plaintiffs' assertion that Fiserv had a duty to disclose its alleged knowledge regarding the Heath Defendants' nefarious conduct. The disclaimer, however, does not bar the allegation that Fiserv had a duty to disclose that the Heath securities held by the IRA Plaintiffs defaulted and/or failed to make distributions into their accounts. Rather, the Plan documents imposed a duty upon Fiserv to furnish annual reports to the IRA Plaintiffs concerning the status of their account and a statement of the assets. Accordingly, because the IRA Plaintiffs sufficiently alleged that Fiserv fraudulently concealed information that it had a duty to disclose, the trial court erred is sustaining the demurrer to the fraudulent concealment claim.

C. Aiding and Abetting Fraud

A civil aiding and abetting cause of action "necessarily requires a defendant to reach a conscious decision to participate in tortious activity for the purpose of assisting another in performing a wrongful act. A plaintiff's object in asserting such a theory is to hold those who aid and abet in the wrongful act responsible as joint tortfeasors for all damages ensuing from the wrong. [Citation.]" *(Howard v. Superior Court* (1992) 2 Cal.App.4th 745, 749.) Liability for aiding and abetting an intentional tort arises if the defendant substantially assists or encourages another party to act, with the knowledge that the other party's conduct constitutes a breach of duty. *(Casey v. U.S. Bank Nat. Assn.* (2005) 127 Cal.App.4th 1138, 1144 *(Casey).)* Significantly, "a defendant can only aid and abet another's tort if the defendant knows what 'that tort' is." *(Id.* at p. 1146.) In other words, "the defendant must have acted to aid the primary tortfeasor 'with knowledge of the object to be attained.' [Citation.]" *(Ibid.)*

In their fourth amended complaint, Plaintiffs alleged that Fiserv aided and abetted the Heath Defendants' fraud. The trial court sustained Fiserv's demurrer to this claim on the ground Plaintiffs failed to allege that Fiserv had actual knowledge of the primary wrong committed by the Heath Defendants. To analyze the sufficiency of Plaintiffs' claim, we must first identify precisely the fraud for which Plaintiffs seek to hold Fiserv liable. *(Casey, supra,* 127 Cal.App.4th at p. 1149.) We must then ascertain whether Plaintiffs have alleged generally that Fiserv had actual knowledge of the specific primary violation. *(Id.* at p. 1148, citing *Neilson v. Union Bank of California, N.A.* (C.D.Cal. 2003) 290 F.Supp.2d 1101, 1120 *(Neilson).)*

Here, Plaintiffs seek to hold Fiserv liable for a Ponzi scheme that the Heath Defendants were allegedly perpetrating. Generally, a Ponzi scheme involves using new investor money to pay artificially high dividends to original investors to thereby attract new investors, generally without any revenue-operating activity other than the continual raising of new funds. (Black's Law Dictionary (8th ed. 2004) p. 1198, col. 2.) Specifically, the complaint alleged that the scheme consisted of the Heath Defendants telling Plaintiffs that their funds would be invested in asset-backed corporate promissory notes when, in reality, the Heath Defendants used Plaintiffs' money to make unsecured advances to fraudulent entities that the Heath Defendants controlled or to pay initial investors artificially high returns and entice new investors.

Reviewing the complaint as a whole and assuming the truth of all pleaded facts and inferences therefrom, we conclude Plaintiffs have adequately alleged that Fiserv had actual knowledge of the Ponzi scheme being perpetrated by the Heath Defendants. Although Plaintiffs dedicated over 40 pages of allegations to Fiserv's role in the fraudulent scheme, we briefly summarize some facts generally showing Fiserv's actual knowledge that the Heath Defendants were defrauding investors.

Namely, Plaintiffs alleged that Fiserv had actual knowledge that the Heath Defendants targeted seniors with promises that their investments would be safe and earn secure investment returns. However, Fiserv's compliance manager, Kirk Merritt, schemed with Heath to create a shell limited liability company (PCM Fixed Income Fund LLC) to pass through and disguise PCM's illiquid promissory notes so that the prohibited security could be held in the IRA Plaintiffs' IRAs.

Fiserv executed subscription agreements for PCM Fixed Income Fund referring to the investments as secured corporate notes. Investors also received a brochure that described PCM Notes as secured corporate notes, when in fact the business entities that PCM lent money to were Heath's fraudulent entities, either non-existent or operating at significant losses with negative equities.

Although Heath supposedly had 16 different investments, Fiserv commingled most of Plaintiffs' funds into the PCM Fixed Income Fund investment and incoming investors funds were always funneled through PCM even where an IRA statement identified one of the other private placements offerings from Heath. Even where Fiserv was purchasing one of Heath's other investments for its customer, all checks Fiserv issued to Heath were for the PCM Fixed Income Fund.

Fiserv knew that the Heath Defendants were disqualified persons engaging in self-dealing in Plaintiffs' IRAs and that the Heath related securities were private debt instruments issued by Heath. Merritt also knew that the Heath Defendants were the servicing agents for PCM Fixed Income Fund, but falsely represented that another company was the servicing agent to conceal the Heath Defendants' self-dealing in Plaintiffs' IRAs.

Fiserv knew that PCM Fixed Income Fund was limited to 35 or fewer qualified investors, but its own documents and customer records revealed that Heath had oversubscribed the fund by more than $ 63 million and pocketed the excess for himself. Despite this knowledge and Heath's admission that of the $ 60,000,000 investment only about $ 15-20 million was left, Fiserv purchased more PCM Fixed Income Fund securities for Plaintiffs' accounts.

Fiserv had actual knowledge that Heath defaulted on the securities held in Plaintiffs' IRAs, at the same time that Heath was taking in additional retirement funds to make purchases in the same securities and that Heath was pocketing the investment moneys or redirecting the new investment moneys into other customer accounts that were in default to delay revelation of the fraudulent investment scheme. Fiserv allegedly knew that PCM Fixed Income Fund was a fraudulent security and that the Heath Defendants were defrauding Plaintiffs.

Fiserv substantially assisted in the scheme by, among other things, commingling investors' funds internally and with the Heath Defendants' accounts. It also worked in concert with the Heath Defendants to conceal the scheme by falsely attributing account statements to computer errors when email communications between it and the Heath Defendants revealed that the errors were actually due to the Heath Defendants' mismanagement and inaccurate reporting of investor funds.

Although Plaintiffs never directly allege that Fiserv knew the Heath Defendants were running a Ponzi scheme and stealing investor funds, "this is the net effect of allegations[.]" *(Neilson, supra,* 290 F.Supp.2d at p. 1121.) Whether Plaintiffs will be able to prove their allegations is not relevant at this stage of the litigation. *(Alcorn, supra,* 2 Cal.3d at p. 496.)

Fiserv relies heavily on *Casey,* arguing that Plaintiffs' allegations are insufficient. *Casey,* however, is distinguishable because the defendant was a bank and the *Casey* court relied on California banking law, making it clear that a bank's knowledge of suspicious account activities, even money laundering, does not give rise to tort liability. *(Casey, supra,* 127 Cal.App.4th at p. 1151.) Nonetheless, *Casey* also makes clear that if a plaintiff can allege that the banks knew that its account holders (fiduciaries of a corporation) were stealing corporate funds and knowingly assisted them in laundering this stolen money, such allegations would suffice to state a claim for aiding and abetting the theft or breach of fiduciary duty. *(Id.* at pp. 1151-1152.)

Here, Plaintiffs have alleged that Fiserv knew the funds in the IRAs belonged to them and giving them the benefit of reasonable inferences from their factual allegations, they have sufficiently alleged actual knowledge that the Heath Defendants were taking the funds for the Heath Defendants' own purposes. Accordingly, the trial court erred in sustaining the demurrer to the aiding and abetting fraud cause of action.

D. Violation of Corporations Code section 25504.1

Corporations Code section 25504.1 imposes liability on persons who "materially assists" certain violations of the Corporations Code "with [the] intent to deceive or defraud[.]" The trial court sustained Fiserv's demurrer to this cause of action on the ground Plaintiffs failed to allege that Fiserv acted with the necessary intent. We disagree.

Corporations Code section 25401 prohibits material misrepresentations or omissions in the offer or sale of a security. Among other things, Plaintiffs alleged that the Heath Defendants falsely represented that their investments were safe, secured and liquid corporate notes that paid a guaranteed return of 5.5 percent to 8 percent per year. They also alleged that all defendants materially assisted each other in violating Corporations Code section 25401 with the intent to deceive or defraud Plaintiffs.

This conclusory allegation, when read in conjunction with Plaintiffs other allegations that Fiserv executed subscription agreements containing false information, failed to maintain prospectuses for PCM Fixed Income Fund, backdated statements, miscalculated Required Minimum Distributions and knew that the Heath investments were prohibited transactions, adequately alleges a claim for liability under Corporations Code section 25504.1.

E. Violation of section 17200

Section 17200 prohibits unlawful competition, including an "unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising[.]" (ß 17200.) It is broad in scope and embraces "'anything that can properly be called a business practice and that at the same time is forbidden by law.' [Citations.]" *(Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal.4th 163, 180.) Section 17200 borrows violations of federal, state or local laws by making them independently actionable as unfair competitive practices. *(State Farm Fire & Casualty Co. v. Superior Court* (1996) 45 Cal.App.4th 1093, 1102-1103.)

Plaintiffs' second amended complaint alleged a violation of section 17200, seeking redress for Fiserv's "unlawful and fraudulent mismanagement of [their] investment accounts." Plaintiffs alleged that they suffered injury because Fiserv inaccurately reported their accounts, failed to timely settle trades causing lost interest, falsified Required Minimum Distributions and commingled their accounts.

Relying on this court's decision in *Bowen v. Ziasun Technologies, Inc.* (2004) 116 Cal.App.4th 777 *(Bowen),* the trial court sustained Fiserv's demurrer to this claim because section 17200 did not apply to "securities transactions." *(Id.* at p. 788.) In *Bowen,* the plaintiff alleged that defendant had sold him its stock and the stock of other publicly traded companies by making misstatements and omissions of material fact and failing to disclose that it was using the investors' funds to perpetrate a pyramid or Ponzi scheme. *(Id.* at p. 779.)

Plaintiffs claim the trial court erred because their section 17200 claim pertains to Fiserv's mismanagement of their accounts after it received their investments, not the buying or selling of securities. In other words, Plaintiffs assert that the trial court erroneously relied on *Bowen* because their section 17200 claim against Fiserv does not pertain to a transaction in securities. We agree.

In *Bowen,* this court concluded that section 17200 does not pertain to securities transactions because of the comprehensive regulatory umbrella of the Securities and Exchange Commission over such transactions. *(Bowen, supra,* 116 Cal.App.4th at pp. 786-789 & fn. 9.) Other courts, however, have noted that the holding in *Bowen* is limited to securities transactions, i.e., the buying or selling of a security, as that was what was at issue there, and claims merely implicating a securities transaction are not barred. *(Overstock.com, Inc. v. Gradient Analytics, Inc.* (2007) 151 Cal.App.4th 688, 715 [claims arose from allegedly defamatory stock reports]; *Strigliabotti v. Franklin Resources, Inc.* (ND Cal. 2005) 2005 WL 645529 [claims arose from alleged scheme to overcharge investors in the management of securities].) (Unpublished federal decisions may be considered as persuasive authority. *(Lam v. Ngo* (2001) 91 Cal.App.4th 832, 841, fn. 5.).) Here, Plaintiffs' section 17200 claim addresses Fiserv's alleged mismanagement of their accounts and is not barred. As Fiserv's demurrer to this cause of action was limited to whether Plaintiffs had stated facts sufficient to constitute a cause of action based on *Bowen,* we do not address any other possible challenges to this claim.

Finally, at oral argument Fiserv suggested that this cause of action and the cause of action for violation of Corporations Code section 25504.1 failed to state a cause of action as to those Plaintiffs that did not have a customer relationship with it. Fiserv, however, did not demur to these causes of action on this ground and it did not argue this issue on appeal; accordingly, we decline to address this issue.

DISPOSITION

The judgment is reversed and the trial court is directed to enter an order overruling Fiserv's demurrers to the challenged causes of action. Plaintiffs are entitled to recover their costs on appeal.

MCINTYRE, J.

WE CONCUR:

HALLER, Acting P. J.

MCDONALD, J.

- Return to Page 1 –