

CASE STUDY PREPARED FROM ORIGINAL PUBLISHED OPINION

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Thomas v Westlake

Contractual Arbitration; Action Involving Third Party; FINRA Rules

Before her death, Katherine Thomas, an elderly widow, opened three investment accounts with defendants Ameriprise Financial Services, Inc. (AFSI). Defendant Westlake, AFSI's registered representative, acted as the securities broker and investment advisor for these accounts. Upon opening the accounts, Katherine signed various Brokerage Client agreements in which she acknowledged that all controversies would be settled by binding arbitration. She also signed Client Service Agreements providing for the same remedy in the event of a dispute.

Upon Katherine's death, her son, plaintiff John Thomas succeeded her as trustee of the Family Trust and became her successor in interest. He sued Westlake and his firm, along with AFSI. He later amended his complaint to name two insurance companies, IDS Life Insurance Company and RiverSource Life Insurance Company which allegedly sold Katherine certain insurance policies and annuities. The complaint alleged breach of fiduciary duty, negligence, fraud, violations of Civil Code section 1750 et seq., and elder abuse. The gist of the complaint was that defendants conspired to "churn" Katherine's investment accounts by inducing her to make unsuitable investments that increased defendants' commissions and profits and substantially reduced the value of the accounts.

Westlake, his firm and AFSI requested that John submit his claim to arbitration pursuant to the arbitration clauses in the account agreements signed by his mother. When John refused they petitioned the court to compel arbitration and stay the proceedings until the arbitration was completed. After the insurance

carrier defendants were added to the complaint, all defendants again sought an order compelling submission to binding arbitration before the Financial Industry Regulatory Authority (FINRA). John opposed the amended petition on the grounds that his claims against the various insurers are not subject to arbitration because they were not signatories to any arbitration agreement, and could not arbitrate before FINRA. He also argued that if ordered to arbitrate with Westlake and AFSI, there would be a possible conflict in rulings on common questions of law and fact.

On the basis that some defendants were signatories to the arbitration agreements while others were not, the trial court denied the petition to compel arbitration. Defendants appealed, contending that theories of agency entitled all defendants to enforce the arbitration provisions. The trial court relied on CCP section 1281.2(c) which excludes matters from arbitration where the action includes a third party, not bound by the arbitration agreement, and there is a possibility of conflicting rulings on a common issue of law or fact. A “third party” is any party to the action not bound by or entitled to enforce the arbitration agreement. (*Laswell v AG Seal Beach, LLC* (2010) 189 Cal.App.4th 1399) The Fourth DCA thus indicated that to decide the appeal it must identify which defendants are entitled to enforce the agreement.

Under the general rule, only a party to an arbitration agreement is bound by or may enforce the agreement. (*Jones v Jacobson* (2011) 195 Cal.App.4th 1) Here, only defendant AFSI is a party to the agreements containing the arbitration clauses. There are exceptions, such as when a plaintiff alleges a defendant acted as an agent of a party to an arbitration agreement, in which the defendant may enforce the agreement even though the defendant is not a party to the agreement. (*Dryer v Los Angeles Rams* (1985) 40 Cal.3d 406; *RN Solution, Inc. v Catholic Healthcare West* (2008) 165 Cal.App.4th 1511)

Here the complaint alleged that defendants, “...acted as an agent of each other Defendant in connection with the acts and omissions alleged herein.” It further alleged that Westlake was acting as the authorized agent of all the other defendants. Plaintiff contends that the allegations of agency in the complaint cannot be used to require him to arbitrate his claims against the defendants who are not parties to the arbitration agreements, as agency is only a theory by which

he may hold those defendants responsible for the wrongdoing he has alleged. The Justices disagreed.

Having alleged all defendants acted as agents of one another, plaintiff is bound by the legal consequences of his allegations. (Westra v Marcus & Millichap Real Estate Investment Brokerage Co., Inc. (2005) 129 Cal.App.4th 759) Plaintiff's allegations of an agency relationship among defendants is sufficient to allow the alleged agents to invoke the benefit of an arbitration agreement executed by their principal even though the agents are not parties to the agreement. The DCA stated it would be unfair to defendants to allow plaintiff to invoke agency principles when it is to his advantage to do so, but to disavow those same principles when it is not. (See Civil Code section 3521["He who takes the benefit must bear the burden."]; Avina v Cigna Healthplans of California (1989) 211 Cal.App.3d 1)

Plaintiff then argued that such a holding does not address the issue of the FINRA rules and for that reason the agency principles are not controlling. He argues that defendants cannot have arbitration ordered because they are not all members of FINRA entitled to proceed in that forum. When the parties to a contract agree to arbitrate any disputes before a particular forum, that provision becomes an integral part of their contract. If that forum is not available to hear the dispute, then a petition to compel arbitration may not be granted. (Provencio v WMA Securities, Inc. (2005) 125 Cal.App.4th 1028)

The Appellate Court noted the parties agreed AFSI is a member of FINRA. At oral argument, plaintiff conceded that Westlake and his firm are "associated persons" within the meaning of FINRA's rules. There is no dispute that Katherine was a "customer" within the meaning of FINRA Rule 1220 because she had an account with AFSI. Clearly then, the plaintiff's claims against AFSI, Westlake, and his firm may be arbitrated before FINRA. The only question is whether the two remaining insurer defendants, IDS and RiverSource, may also be included in the arbitration proceeding.

Here the complaint alleged that each defendant was the agent of every other defendant. For purposes of FINRA Rule 12200, courts hold that when an investor deals with a member's agent or representative, the investor deals with

the member. (*Multi-Financial Securities Corp. v King* (11th Cir. 2004) 386 F.3d 1364) Thus, the Justices found that in dealing with IDS and RiverSource, AFSI's alleged agents, Katherine was dealing with AFSI, a member of FINRA. In representing Katherine in this action, the plaintiff is asserting claims on behalf of a customer against a FINRA member. Such claims are arbitrable before FINRA under Rule 12200.

Accordingly, the 4th District holds that all defendants are parties, or alleged parties, to the various agreements Katherine signed, and on that basis are entitled to enforce the arbitration clauses contained in those account agreements and to arbitrate before FINRA. Since all of the parties involved in the lawsuit are bound by the arbitration agreement, the fundamental condition for the application of CCP section 1281.2(c) –a pending action or proceeding between a party to the arbitration agreement and a third party—is absent. The section does not apply and the trial court erred in denying arbitration on this ground. Because the defendants established the existence of a written agreement to arbitrate a controversy and John's "refusal to arbitrate such controversy," the trial court was required to order arbitration. (*Coast Plaza Doctors Hospital v Blue Cross of California* (2000) 83 Cal.App.4th 677) In addition, the stay must be granted. (CCP section 1281.4; *Heritage Provider Network, Inc. v Superior Court* (2008) 158 Cal.App.4th 1146)

The order denying the defendants' petition to compel arbitration is reversed. Defendants are entitled to costs on appeal.