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Protecting the Public, Not Anyone's Turf: The Unlicensed Practice of Law in Securities Arbitration

John P. Cleary*

I. INTRODUCTION

In the late-1980s, the United States Supreme Court determined that mandatory arbitration clauses in broker-dealer customer agreements are binding on investors.¹ As a result, in the last decade, securities arbitration has become the primary method of resolving disputes between investors and broker-dealers.² The emergence of private arbitration as the most common dispute resolution mechanism for disgruntled investors, together with the accessibility of the stock market to the masses, has created a booming cottage industry for nonlawyer advocates who openly solicit investors to pursue claims against their stockbrokers to recover losses.

Notwithstanding each state's proscription against the unlicensed practice of law, nonlawyers nationwide freely represent investors pursuing claims against

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1. See *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 480-81 (1989); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 225 (1987).

2. See ARBITRATION POLICY TASK FORCE, *SECURITIES ARBITRATION REFORM: REPORT OF THE ARBITRATION POLICY TASK FORCE 6* (1996) [hereinafter *TASK FORCE REPORT*]. When an investor opens a brokerage account, he or she is invariably presented with a customer agreement containing a pre-dispute arbitration clause wherein the investor agrees to arbitrate any dispute arising out of the account. See Constantine N. Katsoris, *The Level Playing Field*, 17 *FORDHAM URB. L.J.* 419, 423 (1989).

broker-dealers in arbitration.³ These nonlawyers state and maintain legal claims, construct theories of damage, participate in motion practice (both oral and written), conduct discovery and settlement negotiations, sometimes take depositions, and ultimately represent investors at hearings.⁴ At the hearing, these representatives make opening and closing statements, legal objections, and examine and cross-examine witnesses.⁵ Although none of this activity occurs before a court of law, it clearly constitutes the “practice of law” under relevant California case law.

Statistically, California has the highest presence of nonlawyer representatives.⁶ The time has come for the California Supreme Court to enjoin this practice. Since the U.S. Supreme Court sanctioned the privatization of securities disputes, investor representation in arbitration has come to require legal skill and knowledge of the law greater than that possessed by the average citizen. Today, more than ever before, pursuing claims through nonlawyer representatives seriously disadvantages investors. Equally important, nonlawyer representation also harms the public by allowing unethical conduct and malpractice to go unpunished and undeterred because nonlawyer representatives, unlike licensed attorneys, are wholly unregulated and unsanctionable.⁷

This Article states a case for an advisory opinion in California precluding nonlawyers from representing investors for compensation in securities arbitration. The Article first discusses the legal standards for determining what activities constitute the practice of law in California, including an analysis of the Supreme Court of California’s recent decision expanding the definition of the “practice of law” to include representation in the private arbitration context.⁸ Next, it discusses the nature of investor representation in securities arbitration and details the extent to which nonlawyer representation compromises the rights of investors.⁹ Finally, this Article addresses the various harms to the public that result from nonlawyer representation in arbitration, including an analysis of the arguments maintained by nonlawyer representatives in favor of the status quo.¹⁰

3. See SICA, *Report of the Securities Industry Conference on Arbitration on Representation of Parties in Arbitration by Non-Attorneys* [hereinafter SICA REPORT], 22 FORDHAM URB. L.J. 507, 512-13 (1995). Currently, only Florida, Ohio, Michigan and Illinois preclude nonlawyer representation in securities arbitration.

4. See The Florida Bar Re Advisory Opinion On Nonlawyer Representation In Securities Arbitration, 696 So.2d 1178, 1180 (Fla. 1997) [hereinafter *Florida Bar*].

5. See *id.*

6. See Justin P. Klein, *Non-Attorney Representation*, 63 FORDHAM L. REV. 1605, 1607 (1995) (stating that “most, if not all, of these groups seemed to be located in Florida and California”).

7. See *Florida Bar*, 696 So.2d at 1181.

8. See *infra* notes 11-50 and accompanying text.

9. See *infra* notes 51-97 and accompanying text.

10. See *infra* notes 98-117 and accompanying text.

II. THE UNLICENSED PRACTICE OF LAW IN CALIFORNIA AND THE *BIRBROWER* DECISION

In 1927, the California Legislature enacted Business and Professions Code section 6125 as part of the State Bar Act, a comprehensive scheme regulating the practice of law in the state.¹¹ Section 6125 provides that “[n]o person shall practice law in California unless the person is an active member of the State Bar.”¹² The legislature enacted this provision specifically to ensure that those performing legal services do so competently.¹³ Although not apparent from this definition, individual parties may represent themselves and their own interests regardless of State Bar membership.¹⁴ The proscription against the unlicensed practice of law only extends to an unlicensed person’s representation of another.¹⁵

Because section 6125 does not define what it means to “practice law,” courts have grappled with the breadth of the proscription. In the seminal case of *People v. Merchants’ Protective Corp.*,¹⁶ the California Supreme Court defined the practice of law as follows:

[T]he practice of law is the doing or performing services in a court of justice, in any matter depending therein, throughout its various stages, and in conformity to the adopted rules of procedure. But in a larger sense it includes legal advice and counsel, and the preparation of legal instruments and contracts by which legal rights are secured, although such matter may or may not be depending in a court.¹⁷

In accordance with the *Merchants’* holding, California courts have consistently held that it is the character of the act, not the forum, that determines whether an activity constitutes the “practice of law.”¹⁸ In *Morgan v. State Bar*,¹⁹ the court held that participating in settlement negotiations constitutes the practice of law.²⁰ In

11. See *J.W. v. Superior Court*, 22 Cal. Rptr. 2d 527, 530 (Ct. App. 1993).

12. CAL. BUS. & PROF. CODE § 6125 (West 1998).

13. See *J.W.*, 22 Cal. Rptr. 2d at 533.

14. See, e.g., *Johns v. County of San Diego*, 114 F.3d 874, 877-78 (9th Cir. 1997) (noting that a non-licensed person may represent oneself but not others).

15. See *J.W.*, 22 Cal. Rptr. 2d at 533 (refusing to permit a mother to represent her son in court).

16. 209 P. 363 (Cal. 1922).

17. *Id.* at 365 (quoting *Eley v. Miller*, 34 N.E. 836 (Ind. App. 1893)).

18. See, e.g., *Bluestein v. State Bar of California*, 529 P.2d 599, 606 (Cal. 1974); *Baron v. City of Los Angeles*, 469 P.2d 353, 356 (Cal. 1970); *Crawford v. State Bar of California*, 355 P.2d 490, 495 (Cal. 1960); *Agran v. Shapiro*, 273 P.2d 619, 622-23 (Cal. 1954).

19. 797 P.2d 1186 (Cal. 1990).

20. See *id.* at 1188.

People v. Landlords Professional Services,²¹ the court held that assisting in the preparation of unlawful detainer complaints amounted to the practice of law.²² Finally, in *In re Anderson*,²³ the court found that a paralegal's advice to potential bankruptcy petitioners constituted the practice of law because such advice required an "exercise of legal judgment beyond the knowledge and capacity of the lay person."²⁴

No California appellate court has addressed the precise issue of whether a nonlawyer's representation of an investor in a private securities arbitration constitutes the unlicensed practice of law. However, the California Supreme Court recently held that representation of a party in private arbitration proceedings constitutes the "practice of law."²⁵ In *Birbrower, Montalbano, Condon & Frank, P.C. v. Superior Court*, a New York law firm entered into a fee agreement with ESQ Business Services, Inc. (ESQ), a California corporation, to represent it in a contract dispute.²⁶ The dispute was pending before the American Arbitration Association (AAA) in California when the parties reached a settlement.²⁷ After settlement, ESQ brought a suit for malpractice and refused to pay its attorney's fees.²⁸ Birbrower counterclaimed for breach of contract and *quantum meruit* for time spent and services rendered.²⁹

The Santa Clara Superior Court found the parties' fee agreement unenforceable because Birbrower had engaged in the unlicensed practice of law in California by representing ESQ in the arbitration proceedings.³⁰ After the court of appeal denied the firm's request for a writ of mandate, the California Supreme Court granted review on the sole issue of whether Birbrower's actions while representing ESQ in California constituted the practice of law under section 6125.³¹

The court began its analysis by recognizing that the Legislature did not define the key phrase "practice of law."³² It then specifically adopted the *Merchants'* definition, stating that the "practice of law" includes "giving . . . legal advice and counsel" regardless of the forum.³³ Because the Birbrower lawyers flew to California, discussed and advised on strategy, conducted settlement negotiations, initiated the arbitration, and helped draft the settlement agreement, the court held

21. 264 Cal. Rptr. 548 (Ct. App. 1989).

22. *See id.* at 553.

23. 79 B.R. 482 (S.D. Cal. 1987).

24. *See id.* at 485.

25. *See Birbrower, Montalbano, Condon & Frank, P.C. v. Superior Ct.*, 949 P.2d 1, 9-10 (Cal. 1998).

26. *See id.* at 3.

27. *See id.*

28. *See id.* at 4.

29. *See id.*

30. *See id.* Although the persons representing ESQ in the arbitration were licensed attorneys, they did not have a California license and, hence, were unlicensed for purposes of section 6125. *See id.*

31. *See id.* at 5.

32. *See id.*

33. *See id.* at 6.

that its “activities clearly constituted the practice of law’ in California.”³⁴ The court even went so far as to characterize Birbrower’s actions as “extensive practice in this state.”³⁵

After Birbrower lost the next battle on whether its activities constituted the practice of law “in California,”³⁶ it sought an exception to section 6125’s proscription for work incidental to private arbitration.³⁷ Birbrower argued that arbitration rules involved “fundamental differences” from litigation relating to discovery, evidence, compulsory process, and other procedures.³⁸ Birbrower also pointed to the California rule of procedure allowing nonlawyers to represent parties in international conciliation or arbitration proceedings.³⁹ The court rejected both arguments, specifically declining the firm’s “invitation to craft an arbitration exception to section 6125’s prohibition of the unlicensed practice of law.”⁴⁰ After stating that such an exception for private arbitration proceedings is strictly within the province of the legislature, the court added that “private arbitration and other alternative dispute resolution practices are important aspects of our judicial system.”⁴¹

In dissent, Justice Kennard opined that the majority relied on “an overbroad definition of the term ‘practice of law.’”⁴² Citing *Baron v. City of Los Angeles*,⁴³ Justice Kennard supported a narrower definition of the “practice of law”; one limited to “the representation of another in a judicial proceeding or an activity requiring the application of that degree of legal knowledge and technique possessed only by a trained legal mind.”⁴⁴ Speaking directly to the arbitral forum, Justice Kennard stated that “[r]epresenting another in an arbitration proceeding does not invariably present difficult or doubtful legal questions that require a trained legal

34. See *id.* at 7 (quoting *Birbrower, Montalbono, Condon & Frank v. Superior Ct.*, 56 Cal. Rptr. 2d 857, 862 (Ct. App. 1996) (alteration in original)).

35. See *id.*

36. See *id.* at 8. The firm argued that section 6125’s purpose, to protect California residents from incompetent attorneys, is not furthered by enforcing the statute against out-of-state attorneys because they have demonstrated that they possess the knowledge and competency to obtain and maintain a license to practice law in another jurisdiction. See *id.* The court rejected this argument, stating that “other states’ laws may differ substantially from California law” and “[c]ompetence in one jurisdiction does not necessarily guarantee competence in another.” See *id.*

37. See *id.*

38. See *id.* (citing *Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 57-58 (1974)).

39. See *id.* at 9; see also CAL. CIV. PROC. CODE § 1297.351 (West 1998).

40. See *Birbrower*, 949 P.2d at 9.

41. See *id.* (citing *Moncharsh v. Heily & Blase*, 832 P.2d 899 (Cal. 1992)).

42. See *id.* at 13 (Kennard, J., dissenting).

43. 469 P.2d 363 (Cal. 1970).

44. See *Birbrower*, 949 P.2d at 13 (Kennard, J., dissenting).

mind for their resolution.”⁴⁵ The majority called Justice Kennard’s proposed definition a “fanciful interpretation” of the relevant cases that “ignores *Merchants*’ altogether, and, in so doing, substantially undermines the legislature’s intent to protect the public from those giving unauthorized legal advice and counsel.”⁴⁶

By specifically holding that the “practice of law” includes the giving of “legal advice and counsel” in connection with a private arbitration,⁴⁷ the *Birbrower* opinion has opened the door to challenge nonlawyer representation of investors in securities arbitration. Given the litigious nature of securities arbitration today, investor representation clearly falls within the *Birbrower* definition. This, together with securities arbitration reforms proposed by the National Association of Securities Dealers, Inc. (NASD), supports a very strong argument that investor representation in arbitration even falls within Justice Kennard’s very limited definition requiring the “legal knowledge and technique” possessed by a licensed attorney.⁴⁸

In accordance with the *Birbrower* holding, the California Legislature amended the Code of Civil Procedure to require out-of-state attorneys to meet certain obligations before representing parties in private arbitrations in California.⁴⁹ Effective January 1, 1999, non-California attorneys wishing to represent a party in a California arbitration proceeding must certify his or her admission in another state and retain a licensed California attorney to act as the “attorney of record” in the case.⁵⁰ Although the new statute is silent on nonlawyer, as opposed to out-of-state lawyer representation in private arbitration proceedings, its mandate for a California “attorney of record” in all California arbitrations suggests the need for California-licensed attorney representation.

III. THE EMERGENCE OF A LITIGIOUS SECURITIES ARBITRATION SYSTEM

In 1979, each of the various Self-Regulatory Organizations (SROs)⁵¹ that serve

45. *See id.* at 17 (Kennard, J., dissenting).

46. *See id.* at 6.

47. *See id.*

48. *See id.* at 13 (Kennard, J., dissenting).

49. *See* CAL. CIV. PROC. CODE § 1282.4 (West Supp. 1999).

50. *See id.*

51. Various stock exchanges and the NASD serve as SROs for the resolution of securities disputes. Currently, there are seven SROs that serve as arbitration forums: the NASD, the New York Stock Exchange (NYSE), the Boston Stock Exchange, Inc., the Chicago Board Options Exchange, Inc., the Cincinnati Stock Exchange, Inc., the Midwest Stock Exchange, Inc., and the Pacific Stock Exchange, Inc. Just recently, the Philadelphia Stock Exchange, Inc. (PHLX) and the American Stock Exchange (AMEX) effectively transferred their arbitration programs to the NASD. AMEX merged with the NASD for all purposes, and plans a “gradual phase-out of [its] arbitration program to NASD regulation.” *See* Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 thereto by the American Stock Exchange, Inc. Relating to Changes to the Combination of the American Stock Exchange, Inc. and the National Association of Securities Dealers, Inc., 63 Fed. Reg. 49,766, 49,771 (1998), available in 1998 WL 633317. The PHLX remains a separate SRO, but, as of October 1, 1998, it will not accept any new arbitration claims and has given the NASD

as forums for securities arbitration adopted the Uniform Code of Arbitration (Uniform Code), a set of rules drafted and proposed by the Securities Industry Conference on Arbitration (SICA). SICA is a representative group of all of the SROs, the Securities Industry Association (SIA)⁵² and the general public that evaluates and addresses concerns expressed about the effectiveness of securities arbitration.⁵³ SICA drafted the Uniform Code to enhance fairness by creating uniformity in all SRO arbitrations involving investors and broker-dealers.⁵⁴

Since the United States Supreme Court sanctioned the privatization of securities disputes in the late-1980's, SICA has significantly revised and reworked the Uniform Code.⁵⁵ These revisions have stemmed from valid complaints by investors that mandatory pre-dispute arbitration agreements unfairly force them to waive all rights appurtenant to litigation.⁵⁶ The SROs almost automatically adopt SICA's revisions,⁵⁷ and, as a result, the procedural rules for securities arbitration now read much like a typical state's code of civil procedure.

The NASD, which handles practically all investor/broker securities disputes,⁵⁸ now deals with extensive pre-hearing motion practice relating to discovery, statutes of limitations, and other purely legal matters.⁵⁹ The NASD Code of Arbitration Procedure (NASD Code) also has departed from the relaxed evidentiary and procedural standards that guided securities arbitration prior to the 1990s. Furthermore, the NASD publicly acknowledged "[t]he increasingly litigious nature of securities arbitration."⁶⁰ Securities arbitration, once considered the quickest, simplest, and most cost-effective means of investor-broker dispute resolution,⁶¹

jurisdiction over all disputes. See *Philadelphia Stock Exchange Proposal to End Its Arbitration Program Approved by SEC*, 10 SEC. ARB. COMMENTATOR, Oct. 1998, at 10 [hereinafter *Philadelphia*].

52. SIA is a trade association for the securities industry. See Constantine N. Katsoris, *Securities Arbitration After McMahon*, 16 FORDHAM URB. L.J. 361, 362 n.9 (1988).

53. See U.S. GEN. ACCOUNTING OFFICE, PUB. NO. GAO/GGD-92-74, SECURITIES ARBITRATION: HOW INVESTORS FARE 15 (1992).

54. See Christopher J. Moeller, Comment, *Your Forum or Mine? Where to Arbitrate Investor-Broker Securities Claims*, 1 J. DISP. RESOL. 63, 67 (1991).

55. See Constantine N. Katsoris, *Punitive Damages in Securities Arbitration: The Tower of Babel Revisited*, 18 FORDHAM URB. L.J. 573, 581 (1991).

56. See TASK FORCE REPORT, *supra* note 2, at 8-9.

57. See Katsoris, *supra* note 2, at 451-52.

58. See TASK FORCE REPORT, *supra* note 2, at 7 (reporting that the NASD receives eighty-five percent of all SRO arbitrations); see also Michael Siconolfi, *Street Eager for Arbitration Superforum*, WALL ST. J., Aug. 24, 1990, at C1. The NASD's virtual monopoly over securities arbitration disputes will certainly rise in 1999 because two other SRO's with historically active arbitration dockets have recently transferred their arbitration jurisdiction to the NASD. See *Philadelphia*, *supra* note 51, at 10.

59. See TASK FORCE REPORT, *supra* note 2, at 7.

60. See *id.*

61. See Moeller, *supra* note 54, at 68-69.

now resembles the "lumbering behemoth" better known as litigation.⁶²

Much to the chagrin of SICA, in 1994 the NASD appointed a "blue-ribbon task force"⁶³ to further address the various problems that undermine customer confidence in the fairness of securities arbitration.⁶⁴ Two years later, the nine person task force issued a 156-page report entitled "Securities Arbitration Reform" containing more than seventy-five recommended revisions to the NASD Code.⁶⁵ The NASD has yet to implement most of the recommendations and currently awaits approval from the Securities Exchange Commission (SEC) on the most significant proposals.⁶⁶

When implemented, these NASD recommendations will further enhance the litigiousness of securities arbitration and render legal skill and expertise even more crucial to representing investors. One of the task force's primary goals was to provide investors in arbitration with the "rights they would have had in civil litigation."⁶⁷ Its recommendation concerning discovery would make documents discoverable only if they are "reasonably likely to be relevant and important to the resolution of the issues in dispute."⁶⁸ This purely legal standard for discovery is universally employed by courts to determine discoverability on a case-by-case basis based on the arguments of counsel. Additionally, the task force's recommendation concerning the eligibility of claims would "direct the arbitrators to resolve statute of limitations issues based on applicable law."⁶⁹ This obviously requires both knowledge and understanding of the various issues surrounding a particular state's statutes of limitations.

IV. COMPROMISING THE RIGHTS OF INVESTORS: NONLAWYER REPRESENTATIONS FROM THE INITIAL CONSULTATION THROUGH THE ARBITRATION HEARING

Just like any lawsuit, investor claims in securities arbitration originate from persons who feel that they have been wronged. These investors have lost money

62. See David E. Robbins, *The NASD's Proposed Changes to Its Arbitration Procedures Would Affect Rules on Eligibility, Punitive Damages, Discovery and the Selection of Arbitrators*, NAT'L L.J., Feb. 12, 1996, at B6.

63. See Michael Siconolfi, *New Arbitration Rules: Mixed Bag for Investors*, WALL ST. J., Jan. 23, 1996, at C1.

64. See Lynnette Khalfani, *Two Panels Vie to Settle Securities Issues; Newcomer Accused of Usurping Older Group's Role*, WALL ST. J., Sept. 2, 1994, at A5 (reporting SICA's criticism of the NASD for attempting to usurp its delegated function to manage, oversee, and make rules governing SRO arbitration).

65. The NASD also specifically implored the other SROs to adopt the recommendations. See TASK FORCE REPORT, *supra* note 2, at 1.

66. See Linda D. Feinberg, et al., *NASDR Dispute Resolution: Status of Arbitration Policy Task Force Recommendations*, in 1 SEC. ARBITRATION 29, 33 (1998).

67. See TASK FORCE REPORT, *supra* note 2, at 38.

68. See *id.* at 84.

69. See Feinberg, *supra* note 66, at 43.

in a securities transaction and usually feel that their broker is to blame for that loss. When an investor first presents the case to a potential representative, he or she expects that person to analyze the claim and make a decision whether it is a "winner." The investor also may inquire about the possibility of punitive damages against the broker.

At this point, the representative must determine whether the broker-dealer violated any legal duty owed to the investor, and, if so, whether that violation caused any damages. This requires the representative to analyze the legal duties broker-dealers owe to their customers, consider the relevant statutes of limitations for claims based on violations of those duties, and discuss the various remedies that exist. This requires a knowledge of the law exceeding that possessed by the general public or those knowledgeable in the securities market.

Once the representative determines that an investor's claim is worth pursuing, he or she then drafts and submits a demand for arbitration, setting forth what duties the broker-dealer allegedly violated.⁷⁰ Once the participating SRO serves the demand on the responding broker-dealer, issues concerning settlement of the dispute arise. In order to protect investor's rights during settlement negotiations, a representative must have knowledge of the elements required to prove the claims asserted and a familiarity with any legal precedent that affects the viability of those claims.

Perhaps most importantly, during settlement negotiations, the investor's representative should be able to justify the theory of damage to opposing counsel. Particularly in the securities industry, this requires an understanding of the purely legal concept of causation. The representative must persuasively explain why the conduct of the broker-dealer, and not market conditions, the investor's own decisions, or a third party's wrongdoing, caused the investor's loss. If the representative cannot adequately explain the damages alleged, the broker-dealer is unlikely to consider the claim seriously or offer any payment to settle the claims.⁷¹

If the parties do not immediately reach a settlement, the broker-dealer then proceeds to file its response to the demand for arbitration.⁷² Just like a typical code of civil procedure, the NASD Code allows various responses. First, the broker-dealer may file an answer to the demand for arbitration setting forth its various

70. See NATIONAL ASS'N. OF SEC. DEALERS, INC., CODE OF ARBITRATION PROCEDURE [hereinafter NASD CODE] § 10314(a) (1998).

71. If and when the parties reach a settlement, the investor's representative should participate in drafting the settlement agreement, and, in doing so, should have knowledge of the various legal ramifications of the settlement terms. For example, the representative should be prepared to advise the investor about the various tax implications that can arise, and be avoided by the characterization of the settlement funds.

72. See NASD CODE, *supra* note 70, § 10314(b).

legal defenses.⁷³ The customary defenses asserted by broker-dealers include: ratification, account stated, estoppel, waiver, laches, statute of limitations, and mitigation. The broker-dealer may also file a counterclaim against the investor, a cross-claim against any other named respondent, or a third-party claim against an unnamed person or entity.⁷⁴ The NASD Code also allows the broker-dealer to file the California state court equivalent of a demurrer, challenging the demand for arbitration on the grounds that it fails to state a claim and/or is barred by the applicable statute of limitations.⁷⁵

The investor's representative must be prepared to respond to the legal issues that arise at this stage, such as whether the statute of limitations is tolled, whether the broker-dealer has a valid defense, or whether to move for severance of the broker-dealer's cross-claim or third-party claim. This requires effective and considerable legal research, a skill only learned by lawyers during a required one year course in law school and necessarily perfected by the everyday practice of law.

Once the broker-dealer files its response, discovery inevitably becomes an issue. Similar to rules of civil procedure, the NASD Code allows written discovery in the form of interrogatories and document requests.⁷⁶ During discovery, an investor's representative must determine whether the information or documents requested by the broker-dealer are relevant or protected from discovery by privilege. In order to protect an investor's interests at this stage, a representative must understand the legal concept of relevancy and be aware of and understand the parameters of the attorney-client privilege,⁷⁷ the marital privilege⁷⁸ and the physician-patient privilege.⁷⁹

Regardless of the legal knowledge or experience of a nonlawyer representative, an investor represented by a nonlawyer sacrifices crucial legal rights during the discovery process. The attorney-client privilege, which, with certain exceptions, shields from discovery all confidential communications between a lawyer and client, presupposes that the party seeking its protection is represented by a licensed attorney and not a layperson.⁸⁰ Because the privilege does not apply to an investor-nonlawyer relationship, an investor's confidential communications with his or her representative are discoverable. SICA has specifically declared that the SROs have no power to extend the attorney-client privilege to investor-nonlawyer communications.⁸¹ Although arbitrators often extend the protections of the attorney-client privilege for reasons of fundamental fairness,

73. *See id.*

74. *See id.*

75. *See id.* § 10305.

76. *See id.* § 10321.

77. *See* CAL. EVID. CODE §§ 950-962 (West 1994).

78. *See id.* §§ 980-987.

79. *See id.* §§ 990-999.

80. *See id.* § 950 (defining a "lawyer" as "a person authorized, or reasonably believed by the client to be authorized, to practice law in any state or nation").

81. *See* SICA REPORT, *supra* note 3, at 519.

investors have no way to assure themselves that their communications with nonlawyers will be safe from disclosure.⁸²

Equally important, the attorney work product doctrine, which protects from disclosure the attorney's mental processes and strategies, does not apply to a nonlawyer representative.⁸³ As such, respondents may freely discover the nonlawyer's communications with potential witnesses and other fact finding processes.

Just like rules of civil procedure, the NASD Code also provides for the filing of a motion to compel responses to discovery requests that have garnered an objection.⁸⁴ In connection with a motion to compel, the investor's representative must persuasively argue, both in writing and orally, the legal discoverability of the documents or information sought. This exercise is the essence of litigation and legal training, and a nonlawyer seriously undermines an investor's interests at this juncture when faced with an experienced, trained lawyer on the opposing side.

The NASD Code now allows for the taking of depositions in certain circumstances.⁸⁵ In 1996, the NASD adopted specific procedures for "large and complex" cases.⁸⁶ If the claim at issue involves more than \$1 million, including a claim for punitive damages, or if the parties simply agree, the "large and complex" procedures apply.⁸⁷ These procedures allow for more pre-hearing interaction with the arbitrators, and they specifically contemplate "the deposition of . . . persons who may possess information relevant to the disposition of an eligible matter and who may not be available to testify at the hearings."⁸⁸ Because deposition practice oftentimes involves a matching of wits between counsel, where even a relatively experienced lawyer can be "steamrolled," a nonlawyer will be seriously disadvantaged in either taking or defending depositions. Additionally, if a third party witness refuses to attend the deposition, a nonlawyer is helpless in having a court issue a subpoena for that person's appearance.⁸⁹

Investors represented by nonlawyer representatives are perhaps most disadvantaged at the hearing. Securities arbitration hearings typically last several

82. *See id.*

83. *See* CAL. CIV. PROC. CODE § 2018 (West 1998).

84. *See* NASD CODE, *supra* note 70, § 10321(d)(1).

85. *See id.* § 10334(f)(2).

86. *See id.* § 10334(a)(1).

87. *See id.*

88. *See id.* § 10334(f)(2). The "large and complex" procedures also allow for disposition by summary judgment. *See id.* § 10334(f)(3).

89. Although the NASD Code gives arbitrators the power of the subpoena process as provided by law, this power only extends to directing "the appearance of any person employed [by] or associated with" an NASD member. *See* NASD CODE, *supra* note 70, § 10322(b).

days⁹⁰ and proceed just like a trial. The hearing begins with opening statements, followed by direct examination and cross-examination of witnesses, the offering of documentary evidence, and finally closing argument.⁹¹ This process is very familiar for experienced litigators who have studied trial strategies in law school and continuing education courses and have utilized these strategies in court numerous times. Experienced attorneys have developed examination techniques to elicit certain evidence at the most effective time, while avoiding the introduction of facts adverse to their case.⁹² As a result of this training and experience, licensed attorneys will have an immeasurable advantage over nonlawyers at the most crucial stage of the dispute. Indeed, even inexperienced and unskilled attorneys will have a significant advantage over nonlawyers as a result of training and education.⁹³

Although the NASD Code attests that the Rules of Evidence do not strictly guide arbitrators during the hearing,⁹⁴ arbitration panels, which usually include at least one licensed attorney, routinely sustain evidentiary objections as to relevancy, hearsay, privilege, foundation, and form of the question. Without a thorough understanding of these legal principles, nonlawyer representatives will compromise the interests of their investor-clients during testimony by inviting otherwise objectionable and prejudicial testimony.

After the arbitrators have issued their award, a party may seek confirmation, modification, correction, or vacation of the award pursuant to applicable law.⁹⁵ The party must direct these requests to a court of law, thus precluding a nonlawyer representative from protecting an investor's interests at this juncture.⁹⁶ Additionally, where the arbitrators issue an award in favor of the investor and the broker-dealer does not voluntarily write a check to pay the award, the investor will have to resort to an action at law to collect the award.

Beginning with the initial consultation and continuing through the post-hearing procedures, nonlawyer representation in securities arbitration violates the primary public policy underlying the strictures against the unlicensed practice of law; protecting the public "from being advised and represented by persons who are not qualified to practice law."⁹⁷ The tasks required by a representative in connection with a securities arbitration are purely legal and require an understanding of

90. See TASK FORCE REPORT, *supra* note 2, at 7.

91. See Philip J. Hoblin, Jr., *Securities Arbitration - Procedures, Strategies, Cases* 10-7 (2d ed. 1992).

92. See John H. L'Estrange, Jr., et al., *The Participation of Unlicensed Advocates in California in the Resolution of Disputes Between Investors and Stockbrokers*, 31 CAL. W. L. REV. 73, 93 (1994).

93. See *id.* at 93.

94. See NASD CODE, *supra* note 70, § 10323.

95. See 9 U.S.C. §§ 9-13 (1994); CAL. CIV. PROC. CODE §§ 1285-1287.6 (West 1997 & Supp. 1998).

96. However, the client of course can petition the court for such relief on his or her own, or *pro per*. But under that scenario, the client hardly receives any benefit of the representation he or she has paid for in retaining the nonlawyer representative.

97. See *Russell v. Dopp*, 42 Cal. Rptr. 2d 768, 772 (Ct. App. 1995) (citing *Gerhard v. Stephens*, 442 P.2d 692, 731 (1968)).

numerous complex legal principles. Thus, in many circumstances, nonlawyer representatives cannot represent an investor's interests competently. California's tacit approval of nonlawyer representation in securities arbitration compromises investor's rights and endangers their financial interests. For this reason, such representation should be enjoined.

V. THE FALLACY THAT NONLAWYER REPRESENTATION IN SECURITIES ARBITRATION PROVIDES A PUBLIC GOOD

In response to numerous complaints concerning the unethical conduct of nonlawyer representatives in securities arbitration, in 1993 SICA considered an amendment to the Uniform Code that would preclude nonlawyers from representing a party in arbitration for a fee.⁹⁸ In connection with this proposed amendment, SICA held two special meetings in California and Florida where it heard arguments and comments from various nonlawyer representatives in favor of the status quo.⁹⁹

Nonlawyer representatives primarily argued that they can represent investors more effectively than most attorneys.¹⁰⁰ Concluding that securities arbitration is fact driven and not legal, they asserted that their experience in the securities industry provides investors more of a benefit than a legal education or license to practice law.¹⁰¹ Admittedly, a representative with industry expertise benefits investors because it allows for the evaluation of claims without the cost of expert consultation. However, this argument is flawed in its assumption that securities arbitration is fact driven and requires no knowledge or application of law. As set forth above, securities arbitration now significantly resembles litigation, and requires the skills and training possessed by a licensed attorney.¹⁰² The benefit to investors derived from industry experience does not outweigh the detriments that come with representation by a person ill-equipped to competently handle the legal issues that inevitably arise in securities arbitration.

At the SICA hearings, nonlawyer representatives also argued that they provide a public good by increasing awareness of the arbitration process through advertisement.¹⁰³ This argument also is fallacious. While surely public awareness

98. See SICA REPORT, *supra* note 3, at 512.

99. See *id.* at 513. SICA held these meetings in Florida and California because it found those states to have the highest concentration of nonlawyer representatives. See *id.*

100. See *id.* at 521; see also L'Estrange, Jr., *supra* note 92, at 97.

101. See SICA REPORT, *supra* note 3, at 521-22. Most of the nonlawyer representatives that appeared at the special meetings had prior experience in the securities industry. See *id.*

102. SICA agreed. It stated that "securities arbitration today involves many legal judgments" that nonlawyer representatives cannot competently handle. See *id.*

103. See *id.* at 516-17.

of arbitration is good, SICA found that the typical advertisements from nonlawyer representatives mislead the public.¹⁰⁴ SICA identified and discussed various advertisements from nonlawyer representatives that distorted “success rates,” disparaged lawyers, and misrepresented legal affiliations.¹⁰⁵

The misleading advertisements detailed by SICA’s report are not isolated incidents. One business in San Diego now extols its practice on radio by claiming that it has “a proven track record, recovering money in over 90 percent of [their] cases.”¹⁰⁶ The advertisement does not specify the average amount recovered as a percentage of the investor’s loss, leaving one to wonder whether its clients ever recover more than the initial retainer. The same advertisement also claims that the business can “help you recover your investment losses, even if the investment was made up to six years ago.” This misstates the NASD’s eligibility rule, which explicitly provides that the applicable state’s statute of limitations governs all NASD arbitration claims.¹⁰⁷ For example, if an investor brings a suitability claim based on an investment made just three years ago, California’s two-year statute of limitations would bar the claim as untimely.¹⁰⁸

Finally, nonlawyer representatives argued before SICA that they provide a public good by taking the small cases that attorneys decline.¹⁰⁹ Even assuming this were true, and that nonlawyer representation allows broader access to arbitration, it does not justify the practice. As SICA correctly determined in 1993, the perils faced by investors with nonlawyer representation greatly outweigh the benefit of greater access.¹¹⁰ The Supreme Court of Florida, upon issuing its advisory opinion enjoining nonlawyer representation in securities arbitration, specifically found that any heightened awareness and greater access provided by nonlawyer representation is outweighed by their improper motivation to settle their client’s claims and overall “business-like” approach to the practice.¹¹¹

Perhaps most significant, SICA recognized that nonlawyer representatives, unlike lawyers, are not supervised or subject to discipline by a state bar or any other regulatory body.¹¹² As a result, instances of misleading advertising, ineffective representation and unethical conduct go unregulated and unsanctioned. Even the handling of a client’s money on deposit is not regulated. Under these

104. *See id.* at 516.

105. *See id.*

106. The thirty second advertisement currently runs on AM 540 XBACH in San Diego and offers the services of a nonlawyer, “professional staff of consumer protection and securities experts to assist you or someone you know that is a victim of misrepresentation, unauthorized trading, unsuitable recommendations, churning, and limited partnership fraud.”

107. *See* NASD CODE, *supra* note 70, § 10304 (providing that the six-year eligibility rule “shall not extend applicable statutes of limitations”).

108. *See, e.g.,* Calvi v. Prudential Securities, Inc., 861 F. Supp. 69, 70 (C.D. Cal. 1996) (applying California’s two-year statute of limitations for negligence).

109. *See* SICA REPORT, *supra* note 3, at 518.

110. *See id.* at 522.

111. *See Florida Bar*, 696 So.2d 1178, 1181 (Fla. 1997).

112. *See* SICA REPORT, *supra* note 3, at 518-19.

circumstances, the public faces potential harm from nonlawyer representation that can only be remedied by enjoining the practice.

SICA ultimately determined that nonlawyer representation in securities arbitration constitutes the unlicensed practice of law.¹¹³ However, rather than enacting its proposed rule prohibiting such representation, SICA decided to leave regulation up to the individual states.¹¹⁴ Recently, the Supreme Court of Florida acted upon SICA's suggestion and permanently enjoined nonlawyers from representing investors in securities arbitration for a fee.¹¹⁵ California, the only other state with a significant concentration of nonlawyer representatives,¹¹⁶ has yet to follow suit.¹¹⁷

VI. CONCLUSION

Although securities arbitration was developed as a cheaper, quicker, nonjudicial alternative for dispute resolution, the representation of an investor or broker-dealer in arbitration today clearly constitutes the practice of law. A representative must give legal advice and perform the traditional tasks of a lawyer at every stage of the arbitration proceeding. Such representation, when performed by nonlawyers, compromises the legal and financial interests of investors and endangers the public. As such, the California Supreme Court should permanently enjoin this practice.

113. *See id.* at 524.

114. *See id.*

115. *See Florida Bar*, 696 So.2d at 1184.

116. *See Klein, supra* note 6, at 1607.

117. In late-1997, the Santa Barbara Superior Court granted summary judgment in favor of seven broker-dealers in their injunctive relief action against a nonlawyer representative on the ground that the nonlawyer was engaged in the unlawful and unlicensed practice of law in violation of section 6125. *See Linsco/Private Ledger v. Sacks*, No. 210875 (Cal. Nov. 13, 1997); *Royal Alliance Associates, Inc. v. Sacks*, No. 210910 (Cal. Nov. 13, 1997). The nonlawyer has appealed this decision, and currently awaits a ruling.

