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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION TWO

NOEL CIANCI et al., Plaintiffs and Respondents, v. CENTAURUS FINANCIAL, INC., Defendant and Appellant.	B222474 (Los Angeles County Super. Ct. No. BC423690)

APPEAL from an order of the Superior Court of Los Angeles County. Rita Miller, Judge. Affirmed.

Edgerton & Weaver, Samuel Y. Edgerton and Brian P. Harlan for Defendant and Appellant.

Caldwell Leslie & Proctor, Michael R. Leslie, David K. Willingham, Jeanne A. Fugate, and Lennette W. Lee for Plaintiffs and Respondents.

Centaurus Financial, Inc. (appellant) appeals from an order denying its petition to compel arbitration. Twenty-three individuals alleged 13 causes of action against appellant arising from appellant's alleged failure to take appropriate steps to supervise Michael McCready (McCready), a broker associated with appellant. Appellant sought to compel arbitration with 12 of the 23 plaintiffs, and to stay the civil action as to the remaining plaintiffs. The trial court denied appellant's motion to compel arbitration pursuant to Code of Civil Procedure section 1281.2, subdivision (c) (section 1281.2(c)), on the ground that there was a "significant possibility of inconsistent rulings" if it granted the petition.[1] We affirm.

CONTENTIONS

Appellant contends that the trial court erred in denying its petition to compel arbitration pursuant to section 1281.2(c). Appellant argues that there is no possibility of conflicting rulings under that statute because the respondents have a relationship with appellant that renders them legally distinct from the remaining plaintiffs. Appellant argues that, because of this distinction, rulings as to the respondents cannot conflict with rulings as to the remaining plaintiffs as a matter of law.

FACTUAL BACKGROUND

Plaintiffs are individuals or entities who invested money with McCready. McCready was the mastermind behind a fraudulent investment scheme. He defrauded plaintiffs out of more than $7.5 million.

Appellant is a company that provides brokerage and investment advisory services. McCready was a registered broker with appellant from June 2007 until sometime after the fraud was revealed on August 6, 2009.

Prior to June 2007, McCready worked as a broker at Brookstreet Securities Corporation (Brookstreet). Plaintiffs allege that as Brookstreet crumbled due to heavy losses from mortgage-backed securities, and faced scrutiny from the Securities and

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[1] The 12 plaintiffs who were subject to appellant's petition to compel arbitration will be referred to as "respondents." All 23 plaintiffs shall be referred to collectively as "plaintiffs."

Exchange Commission for fraudulent and deceptive trading practices, McCready was recruited by appellant, which disregarded any concern for McCready's questionable prior employment. Plaintiffs claim that appellant was attracted by McCready's large book of business from which appellant could profit. McCready then used his affiliation with appellant to recruit new clients and to convince existing clients to invest additional sums with McCready and appellant. Each plaintiff received assurances that McCready was working under a reputable brokerage firm that maintained rigorous compliance standards, and that their investments were safe.

McCready encouraged respondents to open other investment accounts with appellant's firm, such as IRAs, Roth-IRAs and Simplified Employee Pension IRAs, in addition to the brokerage-type accounts McCready purported to manage. Of the 12 arbitration agreements appellant submitted in support of its petition to compel arbitration, 8 of the 12 are included in account-opening documents for IRAs or other similar retirement accounts. The other four arbitration agreements involve investments that were separate from the accounts McCready used to misappropriate the money.

In August 2009, after several plaintiffs attempted to withdraw significant sums from their brokerage accounts, McCready admitted for the first time that the investments were a sham. McCready confessed that the plaintiffs' money was gone, that he had squandered the funds, and that he intended to turn himself in to federal authorities.

The complaint alleges that appellant was a knowing participant in the fraud or, at least, should have known about it.

On October 14, 2009, McCready entered a guilty plea in the United States District Court for the Central District of California to the felony of securities fraud, and was sentenced to 108 months in federal prison. In his plea agreement, McCready admitted that he defrauded at least twenty-five clients of at least $9 million during the course of the phony investment scheme. McCready stated that he marketed "brokerage and investment advisory services" to plaintiffs, and "purported to invest client funds in traditional securities [and] in more complex investment instruments." McCready further admitted that the funds were not invested as he represented, but were misappropriated for his

personal use, including serving as payment to "maintain the operations of his investment advisory business, including payments of office rent, employee salaries, seminars and marketing expenses, and other overhead costs." Plaintiffs allege that none of these misrepresentations or activities would have been possible without McCready's affiliation with appellant.

PROCEDURAL HISTORY

On the same day that McCready entered his guilty plea plaintiffs filed this action against appellant, McCready, and McCready's company, McCready & Associates. Plaintiffs asserted 10 causes of action against all defendants, and three more causes of action against appellant alone.[2]

On November 20, 2009, appellant filed its petition to compel arbitration. In support of the petition, appellant attached exhibits A through L, the new account agreements executed by the 12 respondents. Each of these agreements contained a predispute arbitration clause, under which respondents agreed that "any and all controversies or claims" between respondents and appellant shall be submitted to and determined by arbitration.

Respondents opposed appellant's petition, arguing: (1) because the arbitration provisions are contained in agreements related to investment accounts, such as IRAs, that are not at issue in this action, plaintiffs' claims are not within the scope of the arbitration clauses; (2) the boilerplate arbitration provisions are unconscionable and unenforceable; and (3) the trial court should exercise its discretion under section 1281.2(c) to decline to

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[2] The causes of action plaintiffs have alleged against appellant are: (1) violation of section 10(b) of the Securities Exchange Act and rule 10(b)5 there under; (2) violation of rule 20(a) of the Securities Exchange Act (15 U.S.C. § 78t(a)) (brought against appellant only); (3) violation of section 1961 et seq. of title 18 of the United States Code (RICO); (4) violation of Corporations Code section 25501; (5) breach of fiduciary duty; (6) aiding and abetting breach of fiduciary duty; (7) fraud; (8) aiding and abetting fraud; (9) negligence; (10) violation of Business and Professions Code section 17200 et seq.; (11) civil conspiracy; (12) respondeat superior (brought against appellant only); and (13) negligent hiring, training, and retention of unfit employee (brought against appellant only).

compel arbitration, since the litigation involves third parties not subject to arbitration, and the division of parties between arbitration and court proceedings would create a possibility of conflicting rulings on common issues of law or fact.

A hearing on the petition took place on February 23, 2010. The trial court announced its position that the criteria set forth in section 1281.2(c) had been met because "there is a pending court action with third parties arising from the same series of related transactions." The court further found that there "certainly is a possibility of conflicting rulings on common issues of law and fact." For example, the court explained, there exists a possibility of conflicting rulings on central questions of liability such as the question of "whether [appellant] negligently supervised McCready or allowed him to use their name to mislead people based on his affiliation with them." The court pointed out that "the arbitrators might find that there wasn't negligent supervision or use of the affiliation to mislead people, whereas in the court case, the jury might find the opposite." In addition, "to the extent there may be an apportionment of damages between [appellant] and McCready, there's a clear possibility of inconsistent rulings on that."

After hearing argument, the trial court denied appellant's motion to compel arbitration. Appellant filed its notice of appeal the same day.

DISCUSSION

I. Relevant law

Code of Civil Procedure section 1281.2 provides, in pertinent part:

> "On petition of a party to an arbitration agreement alleging the existence of a written agreement to arbitrate a controversy and that a party thereto refuses to arbitrate such controversy, the court shall order the petitioner and the respondent to arbitrate the controversy if it determines that an agreement to arbitrate the controversy exists, unless it determines that: . . .
>
> "(c) A party to the arbitration agreement is also a party to a pending court action or special proceeding with a third party, arising out of the same transaction or series of related transactions and there is a possibility of conflicting rulings on a common issue of law or fact.
>
> [¶] . . . [¶]

> "If the court determines that a party to the arbitration is also a party to litigation in a pending court action or special proceeding with a third party as set forth under subdivision (c) herein, the court (1) may refuse to enforce the arbitration agreement and may order intervention or joinder of all parties in a single action or special proceeding; (2) may order intervention or joinder as to all or only certain issues; (3) may order arbitration among the parties who have agreed to arbitration and stay the pending court action or special proceeding pending the outcome of the arbitration proceeding; or (4) may stay arbitration pending the outcome of the court action or special proceeding."

In sum, section 1281.2(c) "authorizes the court to refuse to enforce a contractual arbitration provision if arbitration threatens to produce a result that may conflict with the outcome of related litigation not subject to the arbitration." (*Mount Diablo Medical Center v. Health Net of California, Inc.* (2002) 101 Cal.App.4th 711, 717.) While there is a strong public policy favoring contractual arbitration, that policy "'"'does not extend to those who are not parties to an arbitration agreement.'"' [Citation.]" (*Molecular Analytical Systems v. Ciphergen Biosystems, Inc.* (2010) 186 Cal.App.4th 696, 704.) Thus, contractual arbitration "'may have to yield if there is an issue of law or fact common to the arbitration and a pending action or proceeding with a third party and there is a possibility of conflicting rulings thereon.' [Citation.]" (*Ibid.*)

II. Standards of review

The parties disagree as to the appropriate standard of review of the trial court's decision under section 1281.2(c). Appellant argues that the trial court's decision involves a legal question as to the applicability of the statute, and therefore should be reviewed de novo. Respondents disagree, citing *Henry v. Alcove Investment, Inc.* (1991) 233 Cal.App.3d 94, 101 for the proposition that the standard of review for an order denying arbitration under section 1281.2(c) is "the well-known test for abuse of discretion."

Appellant's position is that the issue on appeal is whether the trial court properly interpreted and applied the first sentence of section 1281.2(c). Appellant cites *Birl v. Heritage Care, LLC* (2009) 172 Cal.App.4th 1313, 1318 for the proposition that "the proper interpretation and application of section 1281.2, subdivision (c), is a legal question

reviewed de novo. [Citations.]" Appellant points to *Rowe v. Exline* (2007) 153 Cal.App.4th 1276 as an example. The issue in *Rowe* was whether individual defendants, who were not signatories to a contract containing an arbitration provision but were sued as alter egos to a corporate defendant that was a signatory, could compel another signatory party to arbitrate the controversies raised in the complaint. The court clarified that "[w]hether [the non-signatory parties] were 'third part[ies],' such that section 1281.2 subdivision (c) applied, is . . . a question of law that we review de novo." (*Id.* at p. 1283; see also *Robertson v. Health Net of California, Inc.* (2005) 132 Cal.App.4th 1419, 1425 ["the interpretation and application of a statutory scheme presents a pure question of law and is subject to independent review by the courts of appeal"]; but see *Molecular Analytical Systems v. Ciphergen Biosystems, supra*, 186 Cal.App.4th at p. 705 ["[a]pplication of section 1281.2(c) is discretionary with the trial court"].)

As in *Rowe* and *Robertson*, appellant argues, the question of whether the different rulings as to the two groups of plaintiffs involved in this case -- those who have signed arbitration agreements, and those who have not -- could possibly be "conflicting" as the word is used in the statute, is a question of statutory interpretation that should be reviewed de novo. In other words, it is appellant's position that the central issue in this appeal is whether section 1281.2(c) applies.

Respondents counter that the trial court's decision regarding the possibility of conflicting rulings presents a mixed question of law and fact. Respondents point to appellant's own arguments, which reveal that this issue turns on factual determinations.

For the purposes of this appeal, we accept the plaintiffs' factual allegations as true.[3] As appellant requests, our inquiry will focus on whether the term "conflicting rulings" can include the possible conflicts which might arise from separate adjudications of the allegations in plaintiffs' complaint. Under *Birl v. Heritage Care LLC*, *supra*, 172 Cal.App.4th at page 1318, our interpretation of this language will be de novo.

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[3] We may rely on the allegations of the complaint to determine whether there is a possibility of conflicting rulings if appellant's petition to compel arbitration were granted. (*Abaya v. Spanish Ranch I, L.P.* (2010) 189 Cal.App.4th 1490, 1499.)

However, if we determine that the statute is properly invoked, "then we review under the abuse of discretion standard the trial court's decision to refuse to compel arbitration." (*Birl v. Heritage Care LLC, supra*, 172 Cal.App.4th at p. 1318.) Appellant concedes that the trial court's decision as to which of the four options set forth under section 1281.2(c) it chooses to apply should be reviewed under an abuse of discretion standard. (*Rowe v. Exline, supra*, 153 Cal.App.4th at p. 1290 ["because section 1281.2, subdivision (c) does not apply to this case as a matter of law, we need not determine whether the trial court's selection among the alternative dispositions offered by the subdivision was an abuse of discretion"].)

III. Section 1281.2(c) is applicable

Appellant's argument that section 1281.2(c) is inapplicable concerns the first sentence in the statute, which requires that:

> "A party to the arbitration agreement is also a party to a pending court action or special proceeding with a third party, arising out of the same transaction or series of related transactions and there is a possibility of conflicting rulings on a common issue of law or fact."

Appellant does not dispute that a party to the arbitration agreements at issue is also a party to a pending court action with a third party. Nor does appellant dispute that the pending court action arises out of the same transaction or series of related transactions. Thus, we accept without further discussion that these criteria are met.

Appellant's assertion of error concerns the court's determination that "there is a possibility of conflicting rulings on a common issue of law or fact." Appellant asks that we interpret the words "conflicting rulings" to mean "a situation in which two tribunals reach different results as to two groups of Plaintiffs for which there were no distinguishing factors." Appellant argues that any possibility of conflicting rulings is eliminated by the distinguishing factors between the two groups of plaintiffs. As set forth below, we reject appellant's argument under the circumstances of this case.

A. Appellant's attempt to distinguish the plaintiffs

Appellant claims that the plaintiffs in this case should be distinguished by their legal relationship with appellant. Appellant divides the plaintiffs into two groups: clients and non-clients. Appellant explains that the 12 respondents subject to its petition are clients of appellant, and therefore have a relationship with appellant that is legally distinct from the relationship that the other 11 plaintiffs have with appellant. Appellant argues that its rigorous and comprehensive process related to opening client accounts serves to delineate this clear distinction between the two classes of plaintiffs it describes. Contrary to the trial court's reasoning, appellant submits, the clients and non-clients cannot be subjected to conflicting rulings because they have different legal standing.[4]

At this stage of the litigation, appellant cannot show that the legal distinction it draws is relevant. None of the causes of action at issue requires the existence of a written client agreement such as those entered into by respondents. And, as respondents point out, a legal duty may exist outside of a written agreement, and can arise based on the parties' relationship with one another. (*National Union Fire Ins. Co. of Pittsburgh, PA v. Cambridge Integrated Services Group, Inc.* (2009) 171 Cal.App.4th 35, 45; see also *Twomey v. Mitchum, Jones & Templeton, Inc.* (1968) 262 Cal.App.2d 690, 707-12 [fraud may arise "'on a breach of duty by one in a confidential or fiduciary relationship to another which induces justifiable reliance by the latter to his prejudice . . . [s]uch a confidential relationship may exist whenever a person with justification places trust and confidence in the integrity and fidelity of another'"].) Appellant concedes that in the absence of privity of contract, courts employ a checklist of factors to consider in assessing the existence and scope of a legal duty of care. (*Weseloh Family Ltd. Partnership v. K.L. Wessel Construction Co., Inc.* (2004) 125 Cal.App.4th 152, 164.) These factors, which include the foreseeability of harm and the degree of certainty that

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[4] We will use the terms "clients" and "non-clients" in this discussion in order to easily address appellant's arguments. We do not, however, make any finding with respect to the nature of appellant's relationship with those plaintiffs who did not sign new account agreements with appellant.

the plaintiff suffered injury, have not been considered in this case, thus no ruling has been made as to whether appellant had a legal duty to the non-client plaintiffs.

Appellant also makes the conclusive statement that "it will be impossible for the non-customers to establish that any of their trades and/or transactions could have been reviewed or approved by [appellant]." We decline to accept this prediction as proven fact. The scope of appellant's obligations to the plaintiffs has yet to be determined.

Appellant cannot, at this stage of the litigation, differentiate its legal duties to clients and non-clients for the purposes of this litigation. We therefore find that the legal distinction appellant attempts to draw between the two groups of plaintiffs is insignificant for the purposes of the section 1281.2(c) analysis.[5]

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[5] Appellant cites *Software Design & Application, Ltd. v. Hoefer & Arnett, Inc.* (1996) 49 Cal.App.4th 472 as support for its position that it owes no duty to "non-clients." In *Software Design*, defendant banks and brokerage firms successfully demurred to a complaint filed by plaintiffs who had been defrauded by a financial consultant. However, while the financial consultant had opened accounts with the defendants, he did not hold himself out as a representative of those entities, as McCready did. *Asplund v. Selected Investments in Financial Equities, Inc*. (2000) 86 Cal.App.4th 26 (*Asplund*) is also distinguishable. In *Asplund*, the individual who defrauded the plaintiffs was a registered representative of the defendant, but the defendant's sole purpose was to act as a management company for a single mutual fund. The Court of Appeal affirmed the trial court's decision that the defendant had no liability to the plaintiffs as a matter of law, since the investment products at issue were products in which the defendant had no financial interest and were outside the scope of the representative's agency relationship with the defendant. In other words, the financial representative was not acting in his capacity as a registered representative of the defendant when he sold the investments at issue, which were unrelated to the mutual fund which the defendant managed. Appellant, in contrast, has made no factual showing that McCready was not acting in his capacity as appellant's registered broker at the time he defrauded the plaintiffs. Further, we decline to accept appellant's conclusive argument that, like the broker-dealers in *Asplund* and *Hauser v. Farrell* (9th Cir. 1994) 14 F.3d 1338, appellant did not know that McCready was selling the fraudulent investments. The findings in *Asplund* and *Hauser* were made on summary judgment, not in a petition to compel arbitration. The extent of appellant's knowledge of McCready's fraudulent scheme is yet to be determined in this matter.

B. The claimed distinction between the plaintiffs does not eliminate the possibility of conflicting rulings on common issues of law or fact

Even assuming that the legal distinction appellant attempts to draw between clients and non-clients is legally and factually supportable appellant's argument that there can be no conflicting rulings is unconvincing. Appellant does not illustrate the significance of the "client/non-client" distinction with regard to each of the 13 causes of action alleged against it. Instead, it uses just a few examples. As one example, appellant explains that "a favorable ruling as to the clients on the issue of supervision would not be in conflict with a ruling denying the non-clients' supervision claims." Appellant declines to discuss the possibility of a conflict resulting from the opposite outcome: an arbitrator's ruling denying the clients' supervision claim, with a judge or jury finding favorably as to the non-clients. These differing outcomes would conflict, as the non-clients would have greater rights than the clients. Appellant simply ignores this possibility of conflicting rulings.

Appellant also addresses the possibility of inconsistent findings on the question of whether appellant allowed McCready to use its name to mislead people. Referencing only plaintiffs' respondeat superior cause of action, appellant argues that this issue will focus on McCready's apparent authority to sell the disputed investments. Citing *Asplund, supra*, 86 Cal.App.4th at page 48, appellant then concludes that plaintiffs will have to show that a reasonable person would have believed that McCready had been granted authority to sell the disputed investments, and that this inquiry will be fact-specific as to each plaintiff. Thus, appellant concludes, a differing result as to the two groups of plaintiffs will not be in conflict.

Appellant's focus on respondeat superior alone is inadequate. The question of whether appellant allowed McCready to use its name to mislead people will not turn solely on each plaintiff's view of the situation. For example, McCready's use of appellant's name may come up in consideration of the cause of action for aiding and abetting fraud. The elements of the tort are (1) knowledge that another's conduct constitutes a breach of duty, and (2) substantial assistance or encouragement of the other

to so act. (*Schulz v. Neovi Data Corp.* (2007) 152 Cal.App.4th 86, 93.) Thus, the analysis will focus on what appellant knew or should have known about McCready's tortious acts, and whether appellant provided substantial assistance or encouragement to McCready in carrying out those actions. There is no question that two separate forums could answer these questions differently.

Finally, appellant addresses the court's position that there is a possibility of conflicting rulings with respect to the allocation of damages. Appellant distinguishes *C. V. Starr & Co. v. Boston Reinsurance Corp.* (1987) 190 Cal.App.3d 1637, arguing that here, there is no "finite" amount of money which a trier of fact is seeking to divide on a percentage basis. Appellant misses the point -- here, the concern is that there is a possibility of conflicting rulings as to allocation of damages between the *defendants* -- appellant, McCready, and any other defendants found liable. If the plaintiffs were divided into two forums, conflicting rulings on this issue are certainly possible.

Appellant's conclusive arguments do not persuade us that the possibility of conflicting legal and factual findings is nonexistent. The possibility of such conflicting rulings is real.[6]

The language of section 1281.2(c) is unambiguous. (*Whaley v. Sony Computer Entertainment America, Inc.* (2004) 121 Cal.App.4th 479, 486.) Therefore, "we presume the Legislature meant what it said, and the plain meaning of the statute governs." (*People v. Robles* (2000) 23 Cal.4th 1106, 1111.) We conclude that the drafters of section 1281.2(c) meant the terms "conflicting rulings on a common issue of law or fact"

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6 In support of its argument that there is no risk of inconsistent rulings under the facts of this case, appellant relies on two cases interpreting the propriety of class action certification in securities fraud cases under Federal Rules of Civil Procedure, rule 23(b)(1)(A). (*Contract Buyers League v. F & F Investment* (N.D.Ill. 1969) 48 F.R.D. 7; *In re Dennis Greenman Sec. Litigation* (11th Cir. 1987) 829 F.2d 1539). Appellant argues that these cases are instructive because courts applying this federal statute to class action securities fraud cases must ask whether splitting up the numerous plaintiffs would create a risk of conflicting adjudications. Appellant cites no authority suggesting that these cases may be consulted as persuasive authority in determining the applicability of section 1281.2(c). We find that the cases have no relevance and decline to address them.

to include conflicting rulings on the myriad of legal and factual issues presented by plaintiffs' complaint. Regardless of each plaintiff's specific relationship with appellant, the possibility of such conflicting rulings exists. "'The existence of this possibility of conflicting rulings on a common issue of fact is sufficient grounds . . .' to deny a motion to compel pursuant to section 1281.2, subdivision (c). [Citation.]" (*Abaya v. Spanish Ranch I, L.P., supra*, 189 Ca.App.4th at p. 1499.) Thus, we find that the matter fits within the plain language of section 1281.2(c), and the trial court correctly applied the statute.

IV. The trial court did not abuse its discretion in denying the petition to compel arbitration

We have determined that the trial court properly applied section 1281.2(c) in deciding appellant's petition to compel arbitration. Appellant does not argue that the trial court abused its discretion in choosing to refuse to enforce the arbitration agreement. If asked to determine this question, we would find that the trial court acted well within its discretion in choosing to deny the motion under the circumstances of this case.[7]

DISPOSITION

The order is affirmed. Respondents are entitled to their costs of appeal.

NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS.

_____, J.
CHAVEZ

We concur:

_____, Acting P. J.
DOI TODD

_____, J.
ASHMANN-GERST

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[7] Because we have determined that the trial court did not err in denying appellant's petition to compel arbitration on the basis of section 1281.2(c), we decline to address the issues concerning the scope of the arbitration agreements and unconscionability.