REVISED

OFFICIAL TRANSCRIPT
PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 86-566

TITLE BARCLAY PERRY AND JAMES JOHNSTON, Appellants
V. KENNETH MORGAN THOMAS

PLACE Washington, D. C.

DATE April 28, 1987

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IN THE SUPREME COURT OF THE UNITED STATES

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BARCLAY PERRY AND JAMES JOHNSTON, :

Appellants, :

V. : No. 86-566

KENNETH MORGAN THOMAS, :

Appellee :

- x

Washington, D.C.

Tuesday, April 28, 1987

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:59 o'clock a.m.

APPEARANCES:

PETER BROWN DOLAN, ESQ., Los Angeles, California; on behalf of the appellants.

BRUCE GELBER, ESQ., Los Angeles, California; on behalf of the appellee.

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P R O C E E D I N G S

CHIEF JUSTICE REHNQUIST: We will hear argument next in No. 86-566, Barclay Perry and James Johnston versus Kenneth Morgan Thomas.

Mr. Dolan, you may proceed whenever you are ready.

ORAL ARGUMENT BY PETER BROWN DOLAN, ESQ.,
ON BEHALF OF THE APPELLANTS

MR. DOLAN: Mr. Chief Justice, and may it please the Court, the issues on this appeal from a decision of the California Court of Appeals for the Second Appellate District are whether that court in affirming the order of the Los Angeles County Superior Court in denying the petition of appellants to compel arbitration of the claims asserted against them first incorrectly based its decision squarely on whether, which it says in so many words in the opinion itself, whether it disregarded the ruling of this Court in Southland versus Keating, whether it failed to follow the ruling of this Court in Dean Witter Reynolds versus Byrd by refusing to sever the nonwage claims which it felt were nonarbitrable under Labor Code Section 229, and referring the balance of the claims to arbitration, and whether it erred in applying Labor Code Section 229 in the first instance, contrary to the Federal

Arbitration Act and in violation of the supremacy clause.

I think it would be useful to recap very quickly the chronology of the case because we come to you not after a trial, and the record is very limited. Mr. Thomas, the appellee in this case, is employed by Kidder Peabody in August of 1982 as an account executive. In prior years he had also been employed by other New York Stock Exchange member firms, including Morgan Stanley, E.F. Hutton, and Kenner Fitzgerald. I make that observation because I think it is only fair to assume that Mr. Thomas either had or should have had a working knowledge of the rule which he says he read in signing the U4. He had been in the industry for many, many years.

Rule 347, which provides for the arbitration, is a long-standing rule. This Court addressed it in Ware in 1973 and it had been on the books many years before that. In August of 1982, Mr. Thomas signed the U4, which contains the express arbitration agreement upon which our position is based. In May of 1984, a dispute arose between Thomas and his colleague, Mr. Johnston, Kidder Peabody, his employer, and Barclay Perry, the manager of the Los Angeles office of Kidder Peabody.

QUESTION: There was an express provision for arbitration?

MR. DOLAN: Yes, Your Honor.

QUESTION: In his employment contract?

MR. DOLAN: That is found --

QUESTION: It wasn't just a reference to New York Stock Exchange rules or anything like that?

MR. DOLAN: No, Your Honor. It reads --

QUESTION: Well, that is all I really need.

MR. DOLAN: That is Page 33A. Now, the form of the U4 has varied over the years. There was a time when there was only an incorporation by reference.

QUESTION: But this is express?

MR. DOLAN: This particular one says, "I agree to arbitrate any dispute, claim, or controversy that may arise between me and my firm or a customer or any other person that is required to be arbitrated under the rules, constitutions, or bylaws of the organizations with which I register as indicated in Question 8." One of those organizations is the New York Stock Exchange.

QUESTION: Well, that is by reference.

MR. DOLAN: Well, the reference is only as to the ambit of the arbitration agreement. That is to say, whether he agrees to arbitrate wage disputes or working conditions or the dress that he has to wear to the

office or things of that sort. But there is an express agreement to arbitrate controversies with his employer and with any other person, which would include Perry and Johnston, and that language does not appear in other versions, earlier versions of the U4.

QUESTION: All right.

MR. DOLAN: And I might say there is no issue but that he signed it. Apart from the fact that his signature was notarized, his declaration, which is in the record, says that -- does not say he didn't sign it. It doesn't even say he didn't read it. It simply says that no one apprised him of the significance of it.

QUESTION: And your clients here claim to be third party beneficiaries to that agreement. Is that it?

MR. DOLAN: That's correct, and their standing in that situation had been established 12 years ago in Berman versus Dean Witter Reynolds in the state courts of California, and by the Ninth Circuit in 1986 in the Latitzia decision. It would have no meaning if they enter into an arbitration agreement with a corporation that can act only by its employees, officers, and directors, and then assert a claim against them individually and avoid the arbitration.

That issue has been raised and decided, as I

say, in our own state more than 12 years ago in the Berman decision of 1975. The Ninth Circuit decided it in 1986, also involving a registered representative --

QUESTION: But the court just assumed it in this case. It didn't really decide it, did it?

MR. DOLAN: In --

QUESTION: This particular litigation. They didn't -- they just assumed there was standing. They didn't really -- didn't they say in a footnote they assume it without reaching the question?

MR. DOLAN: That's correct, the Court of Appeals did.

QUESTION: Yes.

MR. DOLAN: Because Mr. Thomas contested that. He did not do so in the trial court, and therefore that issue was waived by the time he got to the Court of Appeals.

QUESTION: Were these -- were your clients employed by the same employer at the time he signed this contract?

MR. DOLAN: Exactly. In fact, Barclay Perry also signed a U4 in his capacity as manager of the Los Angeles office of Kidder Peabody. Johnston was also employed as an account executive. They were colleagues. The relationship between Johnston and Thomas was one of

a commission-sharing sort, and the dispute has to do with which of them was entitled to commissions that were derived from the sale of securities owned by a particular customer who in the complaint Mr. Thomas alleges he introduced to the firm, and therein lies the dispute.

Of course, those commissions are payable by the firm, and we will get to that a little bit later as to who the employer is and whether or not either Perry or Johnston ought to be involved in the Labor Code dispute in the first place.

QUESTION: The standing issue really turns on state laws, doesn't it, how far -- what the extent of the contract between the two of you is, and how far the Cal Labor Code extends?

MR. DOLAN: I don't think the first question was ever raised or is a problem in this case. The extension of the California Labor Code, of course, is the centerpiece of this appeal, and I must say that 229 of the Labor Code, if read reasonably, will not conflict with the Federal Arbitration Act, and it will not raise the concerns that I know members of this Court have previously articulated when you extend the Federal Arbitration Act such as to overrule state regulatory policies.

QUESTION: The California Court of Appeals here unreasonably, I guess, in your view, read it so it did conflict.

MR. DOLAN: Well, the California Court of Appeals squarely based its decision on Ware and says so. And one of the most curious things about the opinion of the Court of Appeals, which is only four pages, found in the appendix at, I believe, Page 136, it makes no mention whatsoever of Southland. Now, we started relying on Southland in the very first set of papers we filed in the Superior Court. The original petition to compel arbitration and the motion for an order staying proceedings were based on the Federal Arbitration Act and the memorandum of points and authorities supporting that motion and petition expressly set forth, quoted, and cited both Southland and Moses Cohn, so it isn't as if the state courts of California were not aware of it. Indeed, I cannot explain to you why it is that the Court of Appeals decision simply ignored both Moses Cohn and Southland as well as its companion decision of a sister court, of the Fourth District Court of Appeals in Tenneti versus Shirley.

The complaint was filed in January, 1985, and the complaint is worthy of examination because it, Mr.

Chief Justice, will respond somewhat to your question as to the reach of 229 of the California Labor Code. The complaint cites -- is a form complaint which we are now using in California on an optional basis where you check the boxes and then put in some additional narrative statements. It is without question that it asserts only common law claims for conversion, for conspiracy to commit conversion, for the breach of a fiduciary duty, for breach of contract, and for a claim for exemplary and punitive damages.

Now, Judge O'Brien referred to these other claims as ancillary to the wage claim. The Court of Appeals describes them in terms of other theories, but there is a little bit more to it than that. The breach of contract -- we are talking about $40,000 in commissions claimed, sought damages only in the amount of $40,000. The conversion, conspiracy, and breach of fiduciary duty claims, however, seek $150,000, and as is not surprising, the exemplary and punitive damage claim seeks $1.5 million, something that I believe is well beyond the reasonable ambit of either ancillary claims or simply different theories.

QUESTION: How does this line of argument bear on the question presented here, whether 229 is preempted by the Arbitration Act?

MR. DOLAN: Because 229 by its very words is limited to actions provided in Article 1.

MR. DOLAN: But the California Court of Appeals held otherwise, didn't it?

MR. DOLAN: No, the California Court of Appeals simply said that this Court held otherwise in the 1973 decision in Ware, and based its decision squarely on Ware.

QUESTION: Well, are you saying that the interpretation that the California Court of Appeals made of Section 229 in this case, wherever it got it from, is wrong?

MR. DOLAN: Yes.

QUESTION: That is a question we just don't deal with here.

MR. DOLAN: But you did. You did deal with it in 1973 when you made the Ware decision, and that is the problem.

QUESTION: I would assume that the Ware decision took California law as it came from the California courts.

MR. DOLAN: Well, I regret to say, Your Honor, that 229 had not previously been construed before the Ware decision came down from this Court in 1973.

QUESTION: But your case doesn't depend on

that, does it?

MR. DOLAN: On Ware?

QUESTION: No, on the construction of the California statute.

MR. DOLAN: Absolutely. I mean, Mr. Thomas's case depends entirely on that, because without that statute then he has no shield of arbitration.

QUESTION: Well, that may be so, but you -- how about your case?

MR. DOLAN: No, my position --

QUESTION: That is what I am asking you.

MR. DOLAN: No, I could simply say --

QUESTION: Yes.

MR. DOLAN: -- that no matter how you construe it --

QUESTION: You are bound to get around to saying that.

(General laughter.)

MR. DOLAN: I think I have said it. I think I have said it, that no matter how you construe it it is still in violation of the Federal Arbitration Act.

QUESTION: Exactly.

MR. DOLAN: But I don't think you need to go that far.

QUESTION: We don't really much care, Mr.

Dolan, how California chooses to interpret Section 229. I mean, that's -- you know, that is what you are up against. We really don't care how California chooses to interpret 229.

MR. DOLAN: I appreciate that, except that --

QUESTION: You can't win -- you can't win -- you can't win except on this argument that that law is preempted, because as a case comes to us, we reach that law as a given.

MR. DOLAN: I have a bit of a dilemma which I will explain to you on that point. We have a California rule of court, 977, which prohibits us from citing or relying upon unpublished opinions in other cases. Our courts of Appeals have made a regular practice of issuing unpublished opinions. The issue that is being raised right now was addressed in an opinion by the California Court of Appeals in January of this year in a case involving Shearson Lehman/American Express.

Unfortunately, it is an unpublished opinion. It in fact does distinguish and construe 229 in the fashion that we would suggest, and I only raise the construction question in anticipating the concern of the Court for aligning the Federal Arbitration Act with legitimate state policies, and the reason I make reference to the complaint is not --

QUESTION: If you want to say you lose if Ware's construction of this section is correct --

MR. DOLAN: No.

QUESTION: You don't want to say that, do you?

MR. DOLAN: I do not want to say it. I don't believe I have said it. And I don't believe that anything in the record should suggest it will. All I am saying is, Your Honor, is that the California Court of Appeals in its decision made no attempt itself as a California Court to construe 229. It simply accepted --

QUESTION: Well, I am not going to spend a lot of my time in deciding this case on what the construction of 229 is.

MR. DOLAN: I understand. I don't mean to get off on a tangent.

QUESTION: Well, you have been.

MR. DOLAN: Well, the reason I raised it is with respect to the complaint.

QUESTION: And you are still on a tangent.

MR. DOLAN: If the complaint does not allege claims under Article 1 of the Labor Code, then 229 simply doesn't apply, no matter how you construe it. It simply doesn't apply by its own terms.

The complaint also alleges that at all times

herein material the defendant, referring to Perry and Johnston, were acting in the course and scope of their employment for defendant Kidder Peabody. The answer was filed by the appellants on the 13th of February. A written demand was sent the same day for arbitration. The answer was a short form general denial answer which asserted as an affirmative defense the entitlement to arbitration. On the 19th of February, and this becomes important in the scheme of things as to why we split between Kidder Peabody and the two individuals in going to state and Federal Court, the Court of Appeals issued its initial decision in the other case that I referred to, Tenneti versus Shirley. In that case they ruled against Kidder Peabody and Shirley, who was the manager of its Newport Beach office, and did not allow arbitration of their claims. We petitioned for rehearing. The rehearing order was granted, and ultimately the Tenneti case went the other way.

The motion for order staying proceedings and the arbitration petition were both filed on the 22nd of February. A separate petition was filed in the United States District Court on behalf of Kidder Peabody. The order granting the rehearing in Tenneti came down on the 21st of March, a little less than a month later. The hearing was conducted by Judge O'Brien in the Superior

Court on the 5th of April of '85. He issued his minute order on the 10th of April of '85. We requested a statement of decision. We got one.

On the 25th of April, 1985, Judge Kelleher in the District Court, based on Judge O'Brien's decision, dismissed Kidder Peabody's petition. We then filed a notice of appeal of Judge O'Brien's decision. We went to the Court of Appeals. In October of 1985 the second Tenneti opinion came down. That opinion is very important because it upholds the supremacy of the Federal Arbitration Act in California in these arbitration questions. It did not do so in the earlier version that came down in February of 1985.

The opinion of the Court of Appeals which we are appealing here was issued on the 10th of April, and as I indicated is very short, and makes no mention whatsoever of Southland or Moses Cohn. It doesn't attempt to distinguish it or explain it. It simply makes no mention of it. It says in so many words that its decision is based squarely on Ware. It rejected the severance of claims after noting our citation to Dean Witter Reynolds versus Byrd and made no mention whatsoever of Tenneti.

As I previously indicated, Perry and Johnston are beneficiaries to the agreement by virtue of the

well-established case law, and that frankly was not challenged in the trial court and is not on appeal here. It is our position that Southland, the decision of this Court in January, 1984, is the controlling authority in this case, not Ware, and that position is simply based on the fact that our petition does not contend and has never contended that 229 of the California Labor Code is preempted by Rule 347 of the New York Stock Exchange. That was the position in Ware.

Rather, our position is that there is little difference between California Labor Code Section 229 and California Corporations Code Section 31512, which this Court held was preempted by the Federal Arbitration Act in the Southland decision. Ware did not decide the preemption question from the standpoint of the Federal Arbitration Act. Indeed, the California Supreme Court in its decision in Keating made that determination.

It may well be a gratuitous observation so far as this Court is concerned, but it certainly was not insofar as the California Court of Appeals was concerned. There was no attempt by the California Court of Appeals to distinguish Southland because it didn't even mention it, and it was briefed to it fairly well and it was just left alone.

QUESTION: Mr. Dolan, before you -- can I go

back to standing for just a second? I believe you answered me earlier by quoting this provision of the agreement, the third party beneficiary agreement, as a matter of California law they are third party beneficiaries of the contract and therefore have standing. Is that your argument?

MR. DOLAN: No, the position is, the Berman case says that nonsignatories --

QUESTION: Which is the Berman case?

MR. DOLAN: Berman versus Dean Witter Reynolds is the 1975 California Court of Appeals case.

QUESTION: As a matter of California law nonsignatories may enforce an agreement of this kind as third party beneficiaries?

MR. DOLAN: That's correct, and it was an agreement of this very kind. It was the same kind of agreement.

QUESTION: But is it not true that as a matter of California law insofar as this agreement provides for the recovery of wages, it is unenforceable -- it is not unenforceable, just unenforceable in arbitration? That's what it is.

MR. DOLAN: I would differ with that.

QUESTION: In fact it is -- no, the agreement to arbitrate is unenforceable as a matter of California

law.

MR. DOLAN: Well, that is where I think that -- that assumption is made but that is not what the statute says.

QUESTION: Isn't that what 229 says?

MR. DOLAN: No. See, the California Court of Appeals in its opinion, which is found at 139 et sec of the joint appendix, it quotes in a curious fashion in Footnote 2 at the bottom of Page 140 Labor Code 229. It says Labor Code Section 229 states in pertinent part, "Actions...for the collection of due and unpaid wages claimed by an individual may be maintained without regard to the existence of any private agreement." Well, let me tell you what the ellipses provides.

QUESTION: Whatever it provides, apparently the author of the opinion didn't think the ellipses were very important.

MR. DOLAN: Well, I think this Court should. Again we are getting drawn into the construction question, but whether or not it applies or whether you should concern yourself with it, it says "the actions to enforce the provisions of this article," "the provisions of this article." In other words, this is not a general statute that says any arbitration agreement in respect of wages is unenforceable in California. The article is

very precise in the kinds of actions that are authorized.

QUESTION: Well, let me ask you -- put my question this way. If we read the Court of Appeals opinion as assuming that 229 made this agreement to arbitrate unenforceable as a matter of California law then would it not be correct that your basis for standing as third party beneficiaries relies on a contractual provision that as a matter of state law is unenforceable?

MR. DOLAN: No, the arbitration agreement itself is not otherwise unenforceable. It is simply as it relates to the wage claim on the --

QUESTION: Well, insofar as it has relevance to this litigation, which I take it from the California opinion is assumed to be a wage claim within the meaning of the statute.

MR. DOLAN: Well, therein lies the problem. See, the complaint does not allege a Labor Code wage claim, but it alleges a lot of these common law torts which would not otherwise be exempted from the arbitration agreement even if the 229 analysis you just made were to apply. That is our problem.

QUESTION: The common law torts and the like aren't covered by the Arbitration Act.

MR. DOLAN: No, but California case law has unequivocally held that torts are subject to arbitration. The problem we have -- the problem is very similar to that in Byrd. In Byrd you were concerned with the arbitrability of a '34 Act claim and how that intertwined with the state law pendent claims in the District Court in the Byrd case. At that point --

QUESTION: I don't think it was a question of standing in that case, was it?

MR. DOLAN: No.

QUESTION: All of my inquiry is not directed to the merits, but merely as to whether there is standing as a matter of Federal constitutional law, which as I understand it you rely for -- the predicate for your whole standing argument is a California rule of law which makes this contract unenforceable insofar as it relates to this controversy.

MR. DOLAN: Well, the case in controversy existed well before we ever got to the California decision. As soon as they were made involuntary defendants in the complaint they were involved in a case in controversy. They then sought to enforce the arbitration provision and have that resolved elsewhere.

So I think we pass muster under Article 3 without any question at all.

An analysis of the Labor Code Sections I mentioned would indicate that there are a number of other provisions that are enforceable only by the state, and some only in the name of the state, and some of the penalties that are recoverable can only be recovered and paid to the state, and actions can only be brought in the name of the Labor Commission, so 229 in my view applies to those actions and not to private litigants.

It also talks about the Labor Commissioner's hearings that are held under Labor Code Section 206, another action which we do not contend would be frustrated by the Court reversing the Court of Appeals. We don't contend that forcing Mr Thomas to arbitrate his common law claims against Perry and Johnston should in any way be regarded as undercutting the California Labor Commissioner's statutory authority to inquire into the wage disputes and to conduct hearings and to make awards as appropriate.

In conclusion, I would like to reserve my time to respond.

QUESTION: Do me one favor. That thing on Page 33A of your appendix, which is very hard to read, "I agree to arbitrate any dispute, claim, or controversy that may" -- that may what? -- "arise between me and my firm or a customer or any other person that is required

to be arbitrated under the rules," blah, blah, blah.

MR. DOLAN: That's right.

QUESTION: Now, you really have to refer to the rules to see what a claim by any other person means, and how does any other person mean a co-employee under the arbitration rules to which this provision refers?

MR. DOLAN: The decision of the California Court of Appeals in Berman versus Dean Witter Reynolds. And the decision in the Ninth Circuit in Latitzia versus Prudential Bache. Those are the authorities that we rely on to extend this particular agreement to include the nonsignatories, Perry and Johnston. For the sake of your eyesight, Justice Scalia, that language is reproduced on Page 21A, which we put it into our original papers.

QUESTION: Twenty-one. I've got you. Right.

MR. DOLAN: Unfortunately, when they took a picture of this to reduce it for the size of the brief, it got a lot smaller. But you will find in the middle of that --

QUESTION: That question that you just answered for Justice Scalia is a question of California contract law, I take it, whether this particular agreement embraces a particular situation.

MR. DOLAN: Or specifically whether or not

Johnston and Perry are the beneficiaries of the arbitration agreement.

QUESTION: Yes.

MR. DOLAN: Yes. I wonder if I can reserve the balance of my time to rebut.

CHIEF JUSTICE REHNQUIST: Yes, you may.

We will hear now from you, Mr. Gelber.

ORAL ARGUMENT BY BRUCE GELBER, ESQ.,

ON BEHALF OF THE APPELLEE

MR. GELBER: Mr. Chief Justice, and if it please the Court, there are certain rights which are sacred and fundamental in the law, and as this Court recognized in 1973 in its unanimous decision in Ware, foremost amongst those is a wage earner's rights to the fruits of his labor, not to just part of the fruits of his labor, but to all of the fruits of his labor.

Now, in enacting Labor Code Section 229, the California legislature in its wisdom felt that arbitration was less than an adequate remedy for redressing disputes over wages, and when this matter came before this Court in 1973, all eight Justices who participated saw clearly that California had a historical constitutional prerogative to protect its wage earners in this matter.

Now, our case is based first on Ware. We have

discussed Ware, whether or not it is on all fours and completely applicable. I like to think of Ware as being 80 percent on point. We are dealing with a wage earner who has brought a civil action to recover his wages. The employer and co-employees who have defended on the case have raised that form U4, claiming that he has agreed to arbitrate any dispute that may arise.

QUESTION: Are we dealing with the Federal Arbitration Act in Ware? Unfortunately, that is the 20 percent, isn't it? --

MR. GELBER: That I think you foresaw that that is the 20 percent --

QUESTION: Yes, that's the 20 percent.

MR. GELBER: -- that may be in dispute, but let me answer it this way. First, as the Court here found in Byrd, the Federal Arbitration Act is a matter of substantive law, so that whether Merrill Lynch back in the days of Ware relied on the Federal Arbitration Act or the state Arbitration Act in bringing its motion to compel arbitration should make no cognizable difference.

QUESTION: Oh, that is not so. I mean, perfectly valid issues of substantive law are given away all the time by failure of litigants to raise them.

MR. GELBER: Well, it would --

QUESTION: The fact is, this wasn't raised or addressed in Ware, was it?

MR. GELBER: Your Honor, I would like to point out that this Court was fully mindful of the Federal Arbitration Act as it cited it at Footnote 15 of the Ware decision, and it is difficult to believe that the Ware case would have turned on whether or not the attorneys for Merrill Lynch were perceptive enough to raise the Federal Arbitration Act instead of just the state Arbitration Act.

QUESTION: The treatment of Ware -- the Federal Arbitration Act in Ware may suggest that the Moses Cohn decision and the Southland decision were somewhat unforeseeable, but I think you have a hard time saying that -- reading the Ware opinion in saying that that court viewed the Federal Arbitration Act the same way the Court viewed it in Southland.

MR. GELBER: Well, the Federal Arbitration Act, Mr. Chief Justice, has been in effect long before Ware, and any impact it would have would have been fully available to this Court.

QUESTION: Yes, but it was rediscovered in Southland.

MR. GELBER: Well, as things get rediscovered, the legislative intent does not change with the passage

of time. In Southland, we have a very interesting dissent that you joined in which you felt that the Federal Arbitration Act didn't even apply to a state action such as this, and perhaps that should be reconsidered.

QUESTION: But that lost, of course. That lost.

QUESTION: Yes, but that view did not prevail.

QUESTION: So I wouldn't rest my argument on the dissent if I were you.

MR. GELBER: But, Justice O'Connor, it was a very perceptive opinion.

QUESTION: Well, of course.

MR. GELBER: I felt that perhaps you could persuade your brethren on the bench.

QUESTION: Without doubt. But what do you say to the view of the majority in Southland?

MR. GELBER: I say to the majority --

QUESTION: You really have a problem.

MR. GELBER: I say to the majority that when we are dealing with a commercial dispute, perhaps that is appropriate for arbitration, but if we look at Section 2 of the Federal Arbitration Act, there is a savings clause which says that certain disputes are not going to be arbitrated where they fall within a matter

of law or equity and are revocable on those grounds.

Now, the question is, do the states have a right to establish those perimeters? Now, I am aware of the fact that in Byrd and Southland you have indicated, that is, the Court has indicated that the states are denied the right to carve out exceptions to the Federal Arbitration Act, and therefore it falls upon this Court as a matter of Federal common law to carve out those exceptions to the Federal Arbitration Act that Congress intended when it enacted the savings clause in Section 2 of the Federal Arbitration Act.

Now, while Ware may not be directly on point because of Merrill Lynch's use of the state Arbitration Act rather than the Federal Arbitration Act, nevertheless the policy language which is throughout Ware points out the fact that there are certain circumstances in which an Arbitration Act used by an employer in advance of an employee's dispute can have an undesirable economic effect, and I feel that that is just as applicable today as it was when the Court reviewed Ware back in 1973.

QUESTION: But it is one thing for the Court to say that, as it did, I believe, in Ware, that California was entitled to reconcile its Section 229 in its state Arbitration Act in a particular way and this

Court would accept it, but it is another thing to say that the same reconciliation would have to take place between the Federal Act and the California statute.

MR. GELBER: Your Honor, that would presuppose that there is a difference in the policy between the Federal Arbitration Act and the Securities and Exchange Act. After all, when you decided the case in Ware, the first point that you raised is that we are dealing with the issue of preemption. Preemption was the Federal Act, Securities Act versus Labor Code Section 229, and it is the same analysis that applies in this case. We are dealing with the preemption model. That is, is the Federal Act, the Federal Arbitration Act inconsistent with Labor Code Section 229 or do the states have that constitutional prerogative to create certain exceptions for the benefit of its wage earners?

QUESTION: (Inaudible) particular argument if the promise to arbitrate here made no reference whatsoever to the New York Stock Exchange rules, but the arbitration provision said, I agree to arbitrate, and then they listed all the agreements, all the kinds of disputes that were to be arbitrated, and that this case involved one of those listed. Would you be making this argument?

MR. GELBER: If it involved one other than for

wages?

QUESTION: No, just whatever -- it involved the very dispute that is here, which is for what? The dispute is over what here?

MR. GELBER: The dispute is over wages and different theories for recovering wages and different remedies for the --

QUESTION: All right. Let's assume that that kind of a dispute is one of the disputes that was listed, expressly listed in the contract to be arbitrated.

MR. GELBER: Yes, Your Honor. I would make the same argument because it violates public policy.

QUESTION: All right, but you couldn't be making an argument based on Congressional intent not to preempt in the securities laws. Then you would have to face up squarely to the Federal Arbitration Act.

MR. GELBER: Your Honor, we believe that there is a Federal common law that would protect the wage earner on this case and that Section 2 of the Federal Arbitration Act says that there are exceptions. It does not define what the exceptions are --

QUESTION: I think you are missing Justice White's point.

MR. GELBER: I am sorry.

QUESTION: I think the point is that it is sort of the tail wagging the dog. If we are going to let our interpretation of a Federal securities arbitration provision and as to its preemptive effect determine what the preemptive effect of the much broader Federal Arbitration Act is going to be. That is what you are asking us to do. You are asking us to say, since we determine that this little Federal securities law didn't preempt any state law, which covers, you know, relatively -- I know to you people here it seems like the whole world, but it is a small aspect of human endeavor. You are saying that the determination we made on that has to govern our interpretation of the Federal Arbitration Act, which covers everything.

MR. GELBER: Your Honor, I believe the policies are the same or similar as they relate to the two. After all, the Federal Arbitration Act basically abrogates the common law hostility towards enforcing arbitration agreements. The securities exchange provisions do not differ greatly. The policy is fairly similar, and appellants have certainly not shown us how the policy under the Federal Arbitration Act, which was in full force and effect at the time of Ware, is any different than under the Securities and Exchange Act.

Now, if I may address some issues that the

Court raised during my opponent's presentation, we have in regard to standing two points I wish to make. First, the issue of standing was raised at the trial level before the California Superior Court and, I direct the Court's attention to Pages 78A and 120A of the Joint Appendix.

QUESTION: Mr. Gelber, what do you mean by the issue of standing in this case?

MR. GELBER: What I mean by the issue of standing is that where we have a controversy over the right to compel arbitration, the party compelling arbitration has to have some vested interest or vested right such as a third party beneficiary right to raise --

QUESTION: That party has to have a contractual right to compel arbitration?

MR. GELBER: Correct.

QUESTION: And where do we look for a determination of that question?

MR. GELBER: I was going to get to that. I just wanted you to know that we did raise that at the trial level and that the Court of Appeals erred on that point. Now, moving to your question, Mr. Chief Justice, I believe if we just construe the agreements that we have here we look first to Form U4.

QUESTION: But it is a matter of California

law, isn't it? It is a contract executed in California.

MR. GELBER: Right, but I believe the interpretation would apply to this Court sitting in view of the agreements. If I may --

QUESTION: But we don't have any independent law of contracts here, since Erie Railroad against Tompkins, it is up to California to decide what a California contact means.

MR. GELBER: Unfortunately, the Court of Appeals didn't address the issue, and --

QUESTION: They certainly did by implication.

MR. GELBER: Because they felt that it was not timely raised, and they were in error on that point, as I have pointed out by reference to the record here. But if I might just point out that the arbitration clause that Mr. Thomas signed states that he agrees to arbitrate any dispute which is required to be arbitrated by the Exchange Act rules. However, Rule 347 of the exchange does not require Mr. Thomas to arbitrate any dispute with these appellants. It only says that he must arbitrate a dispute arising between him and a member firm of the exchange, which is what Kidder Peabody is.

Now, counsel --

QUESTION: Are you saying that the -- is your point that the Exchange Act rules, their scope is a question of Federal law rather than California law?

MR. GELBER: I would have to defer on -- I do not have the answer for you as to what rule of construction would apply. I am simply saying, under any rule of construction if the agreement in black and white says that Mr. Thomas will arbitrate any disputes as required by the Exchange, and the Exchange does not require him to arbitrate disputes with co-employees, but only with a member firm, then there is no language there requiring him to arbitrate a dispute with a co-employee.

QUESTION: What about the cases that Mr. Dolan referred us to, Becker and another California --

MR. GELBER: And Berman. Let's talk about Berman, because Berman was a case in 1975 where the stock exchange company moved to compel arbitration in the same proceeding as the co-employees, but we don't have that here because Kidder Peabody is not before this Court. They brought a separate action in the Federal District Court which these co-employees did not join.

QUESTION: What difference would that make as to whether --

MR. GELBER: Well, because they are an indispensable party to the agreement. They are the

contracting party. It is through the contracting party that these beneficiaries are seeking as appendages of the corporation to get the benefit of arbitration.

QUESTION: What about Becker?

MR. GELBER: I am not familiar with that enough to respond, Your Honor. But I was -- certainly on the case of Berman and the other cases that they had relied in the court below, that is, Ross versus Mathis, there was no such situation where the Corporation goes off to the Federal court and runs the motion up the Federal flagpole and the co-employees bring the same motion in the state court and run it up the state flagpole, so here we are over in the Federal Court with Kidder Peabody, we are in the state court with the co-employees. I think they lack standing --

QUESTION: But this promise to arbitrate that was written in the contract does on its face and under California law refer to disputes with co-employees.

MR. GELBER: That's right but, it incorporates by reference --

QUESTION: I know, but it incorporates by reference just the kind of disputes.

MR. GELBER: It actually mandates the arbitration --

QUESTION: The kind, the type of -- the

description of the arbitrable disputes in the rules, the Stock Exchange rules.

MR. GELBER: What it says is that the -- Mr. Thomas need only arbitrate those disputes which are required by the Exchange.

QUESTION: But your position renders with any other person just -- in the contract just makes it surplusage.

MR. GELBER: Well, that is the -- they are the drafters of that agreement.

QUESTION: Well, I know, but I think the reference to the New York Stock Exchange rules could certainly mean that just referring to the types of disputes that would be arbitrable.

MR. GELBER: Well, I believe the exchange rules specifically say that you need only arbitrate those disputes with a member corporation and let me show you a different --

QUESTION: That is a different point. That is a different point.

MR. GELBER: Okay, but let me tell you how I think it would apply here, Justice White. We have a situation where Mr. Thomas feels sorely aggrieved by not having received his wages. As a side note you need not plead violation of Labor Code in bringing such an

action. You bring an action for denial of your wages. And so I think that counsel has raised a red herring in that regard.

Now, if these appellants, these co-employees are acting in the course and scope of their employment in the course of denying my client his wages, then the only liability is on the member corporation, and quite obviously under the rules of the New York Stock Exchange then there would be some application there, but these are co-employees who have taken from him his money. They have allegedly taken his wages, and for them to claim that they are entitled to the benefit of the agreement doesn't follow.

Now, I have one more important issue that I wish to address and I believe that this is perhaps the most important issue we have. And that is, is that the rules of the New York Stock Exchange which appellants are proferring here are simply unfair. Now, in Justice Marshall's decision for the Court in Byrd, noted in Footnote 2, the Court did not address that issue. It said that Byrd had not raised the adhesive nature of the contract in the court below and that this Court would not address it.

We feel that the rules of the New York Stock Exchange are unfair in two regards. First, the

arbitrator who is going to sit in judgment of this case and make a binding decision is appointed by the New York Stock Exchange of which appellants' corporation is a nember firm. We feel that there is an institutional bias, and it is not simply that the arbitrator would be unfair. We are not saying that the arbitrator would be fair -- would be unfair, but as this Court has noted in many other contexts, it simply the appearance of unfairness that so offends constitutional notions.

If the rules of the New York Stock Exchange was to use what we use in California such as retired judges, or the auspices of the American Arbitration Association, it would not be so offensive as the present rules. Secondly, the rules of the New York Stock Exchange do not allow a meaningful opportunity for discovery. There is only one provision in there regarding discovery, and that says that the parties will exchange such documents as will expedite the proceeding. There is no judicial review. Each side would have unfettered control over which documents would be divulged and which ones would not be, and this simply turns hundreds of years of judicial --

QUESTION: I don't understand what you are saying. This is unconstitutional? This isn't government action. This is private action. I assume

two parties -- suppose two parties agree by contract that if there is any dispute between them it shall be resolved by a flip of the coin. Is that unconstitutional?

MR. GELBER: Yes, Your Honor, that --

QUESTION: It is.

MR. GELBER: That would simply, to my thinking, that would simply --

QUESTION: It is perfectly constitutional.

MR. GELBER: -- turn the judicial system on its head. That would --

QUESTION: This is a private contract. It is not a judicial system. You and I enter a contract, and we decide, look, lawyers are too expensive, if we have a dispute we will resolve it by a flip of the coin. It is one of the things we agreed to. It is part of the deal.

MR. GELBER: Well, Your Honor, I could only draw an analogy, perhaps, to a different area that may raise the Court's suspicion. That would be if an individual was to move into a, say a condominium, and sure, he signs an agreement to arbitrate any dispute. I could not believe that this Court would say that there was a restrictive covenant in that condominium agreement that the Court would not look with suspicion at the

agreement and say we don't care the fact that these people agreed to the things. There are certain things that so offend our sense of justice that we wouldn't tolerate it, and I think the same applies here, that to say that a -- that a wage earner must abide by some agreement that even you had difficulty reading, and it is not much larger than the original, and that by doing so he waives not just important constitutional rights to jury trial and discovery and the like but perhaps the recovery itself.

I don't think it would be tolerated, and I don't think it should be tolerated. And if the Court has nothing further --

QUESTION: (Inaudible) Federal constitutional law of void contracts -- contracts void because of undue influence or -- you know, there are a lot of state laws that make certain contracts unenforceable because they are oppressive or one-sided or something, but I never heard of a theory that as a matter of constitutional law we are going to go around picking out those contracts that are just so egregious that they can't be enforced. Do you have any case that says anything anywhere near that?

I mean, California can do that if it wants. It can say you can't enter into a contract like this.

You can't provide to resolve a contractual dispute by a flip of the coin. They may well say that, but I never heard of Federal constitutional policing of private contracts.

MR. GELBER: Well, I believe it falls upon the judiciary to fashion the limitations on the Federal Arbitration Act --

QUESTION: You want us to take a run at it.

MR. GELBER: -- as a matter of Federal common law, and I believe in so fashioning such a remedy that the Court would draw upon basic senses of fairness and fair play. And if the Court has nothing further --

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Gelber.

Mr. Dolan, you have six minutes remaining

ORAL ARGUMENT BY PETER BROWN DOLAN

ON BEHALF OF THE APPELLANTS

MR. DOLAN: Very briefly, I would like to respond to the points raised by Mr. Gelber. I am pleased that his reliance on Ware has shrunk from 100 percent, where it was two years ago, now down to 80 percent, but I still don't think that that is the appropriate controlling authority. Southland clearly is, and it falls unfortunately to this Court to tell the California Court of Appeals that it is, and it made no

attempt to deal with it itself, and regrettably that is what brings us here.

I would like to turn to the last wage claim question as to whether or not it is egregious to contemplate that a wage claim would be resolved by arbitration or by any other mechanism other than judicial proceeding. The very Article I that 229 refers to includes Section 206, which specifically talks about a labor commissioner mechanism for the recovery of wage claims, which is indeed the most common way that wage claims are asserted in California. The method is that the employee goes down to the labor commissioner, makes an assignment of the wage claim, fills out a form. The labor commissioner conducts a hearing within ten days, according to the statute, issues a ruling. You either -- the employer either pays the wage claim at that point in time or can seek judicial review, so the State of California itself has provided an alternative mechanism for Mr. Thomas to recover the contended wages without resorting to the courts and without regard to an arbitration agreement.

Now, our position, as I indicated earlier, is not that --

QUESTION: You said without regard to the arbitration agreement, why wouldn't that procedure be

preempted, too?

MR. DOLAN: Because that is the authority of the state. My --

QUESTION: No, but under Section 2 of the Federal Arbitration Act it seems to me it would preempt that procedure if the wage earner had signed an agreement to arbitrate.

MR. DOLAN: The question is whether or not the Federal Arbitration Act would preempt 206.

QUESTION: Would preempt the California procedure you just described. He couldn't use that procedure, could he, under your view of the case?

MR. DOLAN: Well, that -- our view of the case is that this is not essentially a wage claim, and the claims that occur in the case are not.

QUESTION: If it is a wage claim.

MR. DOLAN: If it is a wage claim --

QUESTION: In your view could your opponent use the California procedure you have just described?

MR. DOLAN: Well, or we could raise, perhaps, the arbitration agreement as a defense as a practical matter --

QUESTION: I am asking you whether that would be a good defense in such a proceeding. What is your view?

MR. DOLAN: Frankly, Your Honor, I haven't focused on it. We never have. It doesn't make -- the whole purpose of arbitration --

QUESTION: The answer is, you don't know. Is that what it is?

MR. DOLAN: No. Why do we want arbitration in the first place? We want arbitration in the first place to get a quick expeditious resolution of the claim. There is nothing quicker --

QUESTION: I don't care why you want it. I am asking you whether in your view of the case if you objected to using the statutory procedure that you just described, you think you should prevail or not.

QUESTION: I think there are only four answers: yes, no, I don't know, or I won't say.

(General laughter.)

MR. DOLAN: I appreciate those, Justice Scalia. The problem is that I am now being put in the position of serving as the Attorney General of California and arguing --

QUESTION: No, you are telling me what your view of the issue you have asked us to decide is. What is the extent of the preemption that flows from Section 2 of the Federal Arbitration Act?

MR. DOLAN: My position is that it would not

prevent the labor commissioner from making the inquiry.

QUESTION: I don't think that is an answer to my question.

MR. DOLAN: Well, I am trying to parse out the role of the state agency under the legislation.

QUESTION: Does it have the power to decide the issue in the face of an objection that the Federal statute has preempted this particular procedure?

MR. DOLAN: Because of the arbitration agreement.

QUESTION: Yes, and that is what you are arguing. You have preempted the procedure in state court, and now you have just said, well, there is another state procedure they should have taken, and I don't see how they could have taken that if you are right on your principal submission.

MR. DOLAN: The private litigant, Mr. Thomas, would be bound by the arbitration agreement, and we could contend that his claim presented to the labor commissioner was barred by the arbitration agreement and the Federal Arbitration Act.

QUESTION: I know you could contend that. I keep asking you, should you in your view of the case prevail when you make that contention? I think you are saying I don't know.

MR. DOLAN: I suppose the answer is yes.

QUESTION: All right.

MR. DOLAN: But, having said that --

QUESTION: Then it isn't available to them.

MR. DOLAN: Having said that, I am not saying that the labor commissioner is precluded from undertaking his statutory investigation with respect to all of the things covered in Article 1, and therein lies the difference in applying 229. 229 talks about the powers to enforce the provision. 217 gives enforcement powers to a state agency, not the --

QUESTION: In other words you say he has got to investigate but he couldn't make a decision. Why can't the trial judge here conduct a lot of discovery and say I think this is the way it looks but I can't decide it?

MR. DOLAN: No, among other things the labor commissioner can do is bring an action in the name of the State of California for a penalty. Let's assume under your scenario that the wages were owed to Mr. Thomas and we resisted Mr. Thomas's assignment to the labor commissioner under the arbitration agreement, and we said, I am sorry but the Federal Arbitration Act governs, and to the extent that 206 is inconsistent, you, Mr. Thomas, may not proceed. Fine.

Now the labor commissioner says that is fine with Mr. Thomas. He doesn't have a civil remedy, if you will, but I as the labor commissioner of California am not precluded from carrying out because of his arbitration agreement my statutory mandate, which include, among other things, suing for a civil penalty payable only to the State of California. My position is that that is what 229 is talking about, that the state agencies are not inhibited by a private arbitration agreement between Thomas and Kidder Peabody, with Thomas and Perry, or anybody else, and we don't contend they were, and no one ever has said that.

QUESTION: But it would be okay for them to collect a penalty, so is his punitive damage claim then not preempted?

MR. DOLAN: No, the penalty is payable to the State of California --

QUESTION: I see.

MR. DOLAN: -- expressly provided in the statute that the action is brought in the name of he labor commissioner and payable to the State of California.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Dolan.

The case is submitted.

(Whereupon, at 11:51 o'clock a.m., the case in the above-entitled matter was submitted.)

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KENNETH MORGAN THOMAS

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BY Paul A. Richardson

(REPORTER)