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The Participation of Unlicensed Advocates in California in the Resolution of Disputes Between Investors and Stockbrokers

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L'Estrange and Nevitt: The Participation of Unlicensed Advocates in California in the Re
**THE PARTICIPATION OF UNLICENSED ADVOCATES
IN CALIFORNIA IN THE RESOLUTION OF
DISPUTES BETWEEN INVESTORS AND STOCKBROKERS**

JOHN H. L'ESTRANGE, JR.*
AND WILLIAM R. NEVITT, JR.**

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INTRODUCTION

On June 8, 1987, the United States Supreme Court decided *Shearson/American Express, Inc. v. McMahon*.¹ *McMahon* validated the enforceability of pre-dispute arbitration agreements² between stock brokerage

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The authors thank attorney H. Thomas Fehn of Fields, Fehn and Sherwin in Los Angeles for supplying the pleadings and other papers from the *Bentley* case.

1. 482 U.S. 220 (1987), *reh'g denied*, 483 U.S. 1056 (1987).

2. A "pre-dispute arbitration agreement" is an agreement, often part of a written contract, between a broker and investor in which each agrees to arbitrate any dispute arising from the broker's services.

firms and their customers.³ After *McMahon*, and the 1987 stock market crash, there were fewer court challenges to the enforceability of securities industry arbitration agreements.⁴ This increase in the use of arbitration as a dispute resolution mechanism has caused the emergence of non-lawyer advocates who openly solicit business from disgruntled investors to pursue grievances with the investors' stockbrokers.⁵ Although certain lawyers and groups in the securities industry have unsuccessfully attempted to halt the activities of these unlicensed advocates,⁶ as of the beginning of 1994, most of the self-regulatory organizations ("SROs") of the securities industry that administer arbitrations and the American Arbitration Association ("AAA") permitted unlicensed advocates to represent parties in securities arbitrations.⁷

The issue is the subject of controversy. In January, 1993, the Los Angeles County Superior Court dismissed a claim seeking rescission of a contract based on the theory that the defendant unlicensed arbitration advocates were illegally practicing law.⁸ The court ruled that while no precedent explicitly permitted unlicensed arbitration advocates, federal courts favor arbitration and, therefore, would permit unlicensed arbitration advocates to enter binding contracts to represent clients. If the Superior Court's ruling in *Bentley* is upheld on any appeal, it will permit unlicensed advocates to continue representing parties in non-judicial securities industry arbitrations in California.

Recently, the securities industry has considered whether the SROs should continue to allow unlicensed advocates to represent investors in arbitration

3. *McMahon*, 482 U.S. at 239.

4. Theodore A. Krebsbach, *Securities Arbitration Today: Defense Counsel Perspective*, SEC. NEWS, Summer 1994, at 28.

5. See Brigid McMenamin, *Friends of the Shafted*, FORBES, Apr. 26, 1993, at 185; Richard P. Ryder, *Desperately Seeking SICA: Factionalism in Arbitration Rulemaking or Who Will Propose The Rules Governing SRO Arbitration*, SEC. NEWS, Summer 1994, at 19.

6. "Unlicensed advocates," as that term is used in this article, is meant to include lay persons and disbarred or suspended lawyers. It does *not* include lawyers licensed in jurisdictions other than California who participate in arbitration proceedings in California without sanction from the State Bar of California. In 1990, an unsuccessful effort was made to interest the Los Angeles District Attorney in filing a criminal complaint against a non-attorney advocate in a securities arbitration for the unauthorized practice of law. *SICA Meets*, SEC. ARB. COMMENTATOR, March 1991, at 6.

7. There are 10 SROs. They are organized pursuant to Sections 6 and 15A of the 1934 Securities and Exchange Act, 15 U.S.C. §§ 78o-3, 78b (1988), ("the Act"), under the auspices of the Securities and Exchange Commission (SEC) pursuant to Section 19 of the Act (15 U.S.C. § 78s (1988)). The organizations are the American Stock Exchange, Inc.; the Boston Stock Exchange, Inc.; the Chicago Board Options Exchange, Inc.; the Cincinnati Stock Exchange, Inc.; the Midwest Stock Exchange, Inc.; the Municipal Securities Rule-Making Board; the National Association of Securities Dealers, Inc. (NASD); the New York Stock Exchange, Inc.; the Pacific Stock Exchange, Inc.; and the Philadelphia Stock Exchange, Inc. Each of these organizations has a similar but separate procedure for resolving disputes through an alternative dispute resolution process, primarily arbitration. See also AMERICAN ARBITRATION ASSOCIATION, *SECURITIES ARBITRATION RULES* (1993) [hereinafter "AAA RULES"].

8. *Bentley v. Investors Arb. Serv., Inc.*, No. BC 072979 (Los Angeles Cty. Sup. Ct., Jan. 18, 1993) See discussion *infra* part I(A).

proceedings against their member organizations and associates.⁹ There are, in fact, a number of such advocates throughout the United States (principally in California and Florida) who advertise and offer their services to represent investors who wish to recover investment losses through arbitration.¹⁰ A company in Los Angeles advertises it can train unlicensed advocates to represent claimants in securities arbitration disputes.¹¹ Its advertisement indicates that after attending a two-day training course, a lay person can become an effective securities advocate.¹²

In addition to SROs, there are a number of other organizations now examining the concept of lay persons filling the role of an advocate or providing assistance in fields traditionally occupied by lawyers. The American Bar Association has formed the Commission on Non-Lawyer Practice and has been holding hearings with a view to presenting a report to the ABA House of Delegates in February, 1995.¹³ The Securities Industry Conference on Arbitration ("SICA") is also examining the matter of non-lawyer representation of customers in SRO-sponsored arbitrations. A proposed change to Section 15 of the Uniform Code of Arbitration would severely limit the role of non-lawyer advocates.¹⁴ Public hearings on the proposal were held in January, 1993.¹⁵ The topic was again raised at the October, 1994, SICA meeting amidst a broader controversy between SICA and a newly-formed committee set up by the National Association of Securities Dealers ("NASD").¹⁶

This article addresses what constitutes the practice of law in California, the activities of securities arbitration advocates, a comparison of the relative strengths and weaknesses of unlicensed advocates compared to attorneys, and a proposal for regulation of unlicensed advocates.

9. The rules of the SROs provide for the representation "by counsel," and make no mention of representation by "unlicensed advocates" or "other persons." See e.g., NATIONAL ASSOCIATION OF SECURITY DEALERS, CODE OF ARBITRATION PROCEDURE § 27 (1993) [hereinafter NASD CODE OF ARB. PRO.]. However, the *Arbitrator's Manual* drafted by the Securities Industry Conference on Arbitration (SICA) provides: "Parties need not be represented by an attorney in arbitration. They may choose to appear *pro se* (on their own) or be represented by a person who is not an attorney, such as a business associate, friend or relative. . . ." SECURITIES INDUSTRY CONFERENCE ON ARBITRATION, ARBITRATOR'S MANUAL 6 (May 1992). The SECURITIES ARBITRATION RULES, Rule 23 provides "Any party may be represented by counsel or other authorized representative." AMERICAN ARBITRATION ASSOCIATION, SECURITIES ARBITRATION RULES § 23 (1993). An examination of the policies and procedures of the American Arbitration Association ("AAA") is beyond the scope of this article.

10. See McMenamain, *supra* note 5, at 185-86.

11. Advertisement, *Valcor Arbitration Services*, ENTREPRENEUR, Feb. 1994.

12. *Id.*

13. *SAC Report on Non-Attorney Representation*, SEC. ARB. COMMENTATOR, Jan. 1994, at 7.

14. *Non-Attorney Representation In Arbitration*, SEC. ARB. COMMENTATOR, Sept. 1993, at 11.

15. *Letters to the Editor*, SEC. ARB. COMMENTATOR, Feb. 1994, at 16.

16. Lynnette Khalfni, *Two Panels Vie to Settle Securities Issues. Newcomer Accused of Usurping Older Group's Role*, WALL ST. J., Sept. 2, 1994, at A5A.

Section I will discuss the *Bentley* case and its implications for consumers who are harmed by arbitration advocates. Section II will lay out the legal standards for what activities constitute the practice of law in California. Section III will examine the various acts of arbitration advocates which may constitute the practice of law in California. Section IV will compare the activities of arbitration advocates with those of licensed lawyers to examine whether advocates provide a significant benefit over lawyers and how closely the activities of arbitration advocates resemble those activities of securities lawyers engaged in similar representations. Section V will propose restrictions on the activities of arbitration advocates that could improve the services rendered by the industry.

I. THE *BENTLEY* CASE AND OTHER RECENT DEVELOPMENTS

A. *Bentley*

Now, years after *McMahon*, a California court is hearing a challenge to the use of unlicensed advocates in *Bentley v. Investors Arbitration Services, Inc.*¹⁷ *Bentley* is styled as a class action lawsuit filed on behalf of "all persons who, within the three years prior to the filing of this action, have entered into an agreement with defendant IAS to retain IAS for the purpose of providing expert advice, assistance, and arbitration preparation regarding disputes with stockbrokers."¹⁸ The *Bentley* complaint alleged that 77-year-old Ms. Bentley had engaged IAS to assist her in the evaluation and resolution of potential claims against her broker, Prudential-Bache Securities, Inc.,¹⁹ relating to her purchase of securities known as the VMS Mortgage Investment Fund.²⁰ IAS allegedly "represented its services and expertise as being at least equal to attorneys who prosecute claims in arbitration against stockbrokers."²¹

After entering into a \$1,000 fixed-fee agreement with IAS to pursue a claim against Prudential for the losses in her VMS investment, but before she filed an arbitration claim or a lawsuit, Ms. Bentley allegedly received a notice from the federal district court in Chicago informing her of a settlement of the VMS class action. This notice stated that she could opt out of the VMS class action if she wanted to pursue an individual action or, if she wanted to participate in the settlement, she could complete a claim form and return it to the court before a specified date.²² According to her complaint, Ms. Bentley's IAS representative advised her not to respond to the notice.

17. Complaint at 4, *Bentley* (No. BC072979). See also *Faccio v. Investors Arb. Serv., Inc.*, (No. BC069834), (Los Angeles Cty. Sup. Ct., Nov. 18, 1992) (the companion case).

18. Complaint ¶ 10, at 4, *Bentley* (No. BC072979).

19. In 1993, Prudential-Bache Securities, Inc. changed its name to Prudential Securities, Inc.

20. Complaint ¶¶ 1, 10, 12, 15-18, *Bentley* (No. BC072979).

21. *Id.* ¶ 13.

22. *Id.* ¶¶ 19-22.

She allegedly followed the representative's advice and, as a result, lost her right to pursue an individual action (by being included in the class settlement) and reportedly missed the deadline to submit a claim form.²³ Instead of responding to the class action notice, IAS allegedly filed an arbitration claim, under the arbitration rules of the National Association of Securities Dealers ("NASD"), against Prudential for Ms. Bentley.²⁴

After IAS filed the claim against Prudential, Ms. Bentley's matter was assigned to another IAS case worker who allegedly advised her to dismiss the arbitration claim and submit a belated claim form in the class action pending in federal District Court in Chicago.²⁵ Allegedly, IAS kept the \$1,000 fee paid by Ms. Bentley on the basis that IAS had worked up the case.²⁶

Ms. Bentley's complaint against IAS alleged causes of action for rescission of an illegal contract, negligence, negligent misrepresentation, and fraud.²⁷ On June 11, 1993, in response to pre-answer motions by the defendants, the Los Angeles County Superior Court disallowed, without leave to amend, the cause of action for rescission of an illegal contract.²⁸ Ms. Bentley had based that cause of action on the allegations that IAS was engaged in the unauthorized practice of law.²⁹

The Superior Court's ruling was not based on any state or federal statute, any rule promulgated by one of the SROs of the securities industry, or any published California decision on point.³⁰ The ruling cited the Federal Arbitration Act and comments regarding that Act by the Ninth Circuit Court of Appeals in *Cohen v. Wedbush, Noble, Cooke, Inc.*,³¹ as well as the policy statements of state and federal courts encouraging the use of arbitration.³²

23. *Id.* ¶¶ 23-24.

24. *Id.* ¶¶ 25-27.

25. *Id.* ¶¶ 28-29.

26. *Id.* ¶¶ 31-33.

27. *Id.* ¶¶ 35-58.

28. Court's Ruling on Defs.' Mot. to Strike & Defs.' Dems., *Bentley v. Investors Arb. Serv., Inc.*, (No. BC072979) (Los Angeles Cty. Sup. Ct., Jan. 18, 1993) (Bentley's later petition to the appellate court for a writ of mandate was denied); Court's Ruling on Def.'s Mot. to Strike and Def.'s Dem., *Faccio v. Investors Arb. Servs., Inc.*, No. BC069834 (Los Angeles Cty. Sup. Ct., Nov. 18, 1992).

29. Complaint ¶¶ 35-37 *Bentley* (No. BC072979).

30. There are no published California decisions relating to the activities of unlicensed advocates in securities industry related disputes. In December, 1993, after the *Bentley* motions were decided, the Circuit Court of Genesee County, Michigan, granted a motion by Prudential Securities, Inc. to preliminarily enjoin lay advocates from pursuing claims on behalf of disgruntled investors on the ground that such activity constituted the unauthorized practice of law in Michigan. *See* Opinion/Order Granting Pls. Mot. for Prelim. Inj., *Prudential Sec. v. McQuillan*, No. 93-19858-CZ (Mich. Cir. Ct., Cty. of Genesee, Dec. 3, 1993).

31. 841 F.2d 282 (9th Cir. 1988).

32. Record at 5-7, *Faccio v. Investors Arb. Servs., Inc.*, BC069834 (Los Angeles Cty. Sup. Ct., June 11, 1993).

B. Does Federal Law Preempt California's Regulation Of The Practice Of Law?

The federal preemption argument articulated by the defendants in *Bentley* is that Congress required the SROs to draft rules and implement procedures to regulate themselves and discipline their members.³³ Congress also required the SEC to review and approve any proposed rule to ensure that such rule is consistent with the requirements and objectives of the Securities and Exchange Act before that proposed rule can take effect.³⁴ As a consequence of its oversight of the securities industry SROs,³⁵ the SEC may "abrogate, add to, and delete from any proposed rules that are not consistent with the requirements and objectives of the Securities and Exchange Act."³⁶ Therefore, the argument continues, the SEC's approval of the SROs' codes of arbitration binds the courts,³⁷ and the SICA Arbitrator's Manual is an approved part of that SEC-authorized arbitration framework.³⁸

The self-proclaimed purpose of the SICA Arbitrator's Manual is to provide general guidance in the interpretation of the Uniform Code of Arbitration ("UCA"), which was also drafted by SICA, to arbitrators conducting arbitrations under the auspices of the SROs.³⁹ The UCA does not itself specifically state that parties may be represented by unlicensed advocates. However, under the heading "REPRESENTATION BY COUNSEL", the Arbitrator's Manual states: "Parties need not be represented by an attorney in arbitration. They may choose to appear *pro se* (on their own) or be represented by a person who is not an attorney, such as a business associate, friend or relative."⁴⁰

33. 15 U.S.C. §§ 78o-83 (1988).

34. 15 U.S.C. § 78s(b)(2) (1988).

35. 15 U.S.C. § 776.

36. 15 U.S.C. § 78s(c) (1988).

37. *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 233-34 (1987); *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 286 (9th Cir. 1988).

38. *See* Order Approving Proposed Rule Change Relating to Enforcement of Arbitrators' Orders Under the NASD Code of Arbitration Procedure, Exchange Act Release No. 34-31464, 57 Fed. Reg. 55011 (Nov. 23, 1992); *Wall Street's Arbitration System: Friend Or Foe?*, N.Y. TIMES, Dec. 24, 1989, at 1. *Cf. Mastrobuono v. Shearson Lehman Hutton, Inc.*, 20 F.3d 713, 717-18 (7th Cir. 1994) (declining to follow a provision of the SICA Arbitrator's Manual which authorized the award of punitive damages because that provision was in conflict with New York law, selected by the parties to govern the dispute, and avoiding the preemption argument by relying on the choice of law clause in the agreement).

39. The Preface to the Manual states:

This manual has been compiled by members of the Securities Industry Conference on Arbitration (SICA) as a guide for arbitrators. It is designed to supplement and explain the Uniform Code of Arbitration as developed by SICA. The procedures and policies contained in this manual may be altered by the arbitrators and should not be used to restrict a panel's discretion.

SICA ARBITRATOR'S MANUAL, *supra* note 9, at ii.

40. *Id.* at 5.

The *Bentley* defendants pointed to a statement in a text by commentators on securities arbitrations to the effect that unlicensed advocates are permitted to represent parties in arbitrations before the SROs.⁴¹ Plaintiff Bentley argued that federal law, and particularly the Federal Arbitration Act and the Securities and Exchange Act, does not preempt the field of arbitration procedure.⁴² Ms. Bentley also argued that California law did not conflict with any federal law, claiming:

The only federal 'rule' cited by defendants to support their unauthorized practice of law before the industry arbitration fora is found in a handbook known as the *Arbitrator's Manual*. This handbook has never been approved by the SEC under the rule-making authority of Section 19 of the Exchange Act and no argument can possibly be made that it has the force of federal law for purposes of the Supremacy Clause.⁴³

The Los Angeles County Superior Court sustained the demurrer in *Bentley* without leave to amend, basing its holding on *Cohen v. Wedbush, Noble, Cooke, Inc.*,⁴⁴ in which Judge Kozinski "referred to the Federal Arbitration Act as a body of substantive law of arbitrability enforceable in both state and federal courts and preempting any state laws or policies to the contrary, and indicating that such arbitrations are under federal standards."⁴⁵

The *Bentley* court observed that securities industry arbitrations arise out of an act of Congress and are policed by the SEC, which has given considerable regulatory leeway to the SROs. It acknowledged there is no controlling case law, but noted that commentators support the view that unlicensed persons may act as advocates in securities arbitrations. The court also took into account that in other specialty areas unlicensed persons act as advocates in the arbitration framework.⁴⁶

Neither side in *Bentley* cited or relied upon *In re First Choice Securities Corporation*.⁴⁷ *First Choice* was a review by the SEC of certain disciplinary action taken by the NASD. The primary issue in *First Choice* was whether First Choice Securities Corporation was bound by a restriction agreement. However, the applicants in *First Choice* argued that they were

41. Mem. of P. & A., in Supp. of Dem. & Mot. to Strike, at p. 12 n. 13, *Bentley v. Investors Arb. Sevs., Inc.*, No. BC072979 (Los Angeles Cty. Sup. Ct. Jan. 18, 1993) (citing ANTHONY W. DJINIS & JOSEPH A. POST, *SECURITIES ARBITRATION* § 8.04[2] at 8-9 (1992)).

42. Mem. of P. & A. in Opp'n to Dem. & Mot. to Strike at 5-6, *Bentley* (No. BC072979) (citing Volt Info. Science v. Board of Trustees, 489 U.S. 468, 477 (1989); 15 U.S.C. § 78bb(a) (1989)).

43. *Id.* at 11-12.

44. 841 F.2d 282 (9th Cir. 1988).

45. Record at 5, *Faccion v. Investors Arb. Servs., Inc.*, Nos. BC072979 & BC069834 (Los Angeles Cty. Sup. Ct., June 1, 1993).

46. *Id.* at 5-7.

47. Exchange Act, Release No. 31,089, Fed. Sec. L. Rep. (CCH) ¶ 85,044 (Aug. 25, 1992) [hereinafter SEC Rel. No. 31,089].

denied the right to be represented by a securities consultant who was not an attorney. They asserted that the Administrative Procedure Act⁴⁸ provides that any person compelled to appear before any agency shall be accorded the right to be accompanied, represented and advised by counsel or a qualified representative. Rejecting that argument, the SEC stated:

However, *the Administrative Procedure Act does not apply to the proceedings before the NASD, as it is not a federal agency.* Proceedings before the NASD are governed by Article II, Section 7(c) of the NASD's Code of Procedure, which provides that a respondent in an NASD disciplinary proceeding shall be entitled to appear personally or to be represented 'by counsel.' *We believe that the plain meaning of the term 'counsel' is attorney.* We note further that Applicants have not demonstrated any prejudice from the NASD's action. Applicants were represented by an attorney at the hearing and thereafter. Further, the consultant testified and argued, unencumbered and without objection, as a witness at the District hearing and advised Applicants' attorney during that hearing.⁴⁹

Whether federal law preempts California's regulation of the practice of law appears to remain uncertain.

C. *Is A Private Contract Arbitration Subject To State Law Concerning The Licensing Of Attorneys?*

Recent Court decisions have expressed a strong policy in favor of enforcing arbitration agreements.⁵⁰ The United States Supreme Court has instructed state and federal courts to be very liberal in their construction and enforcement of arbitration agreements. The terms of the agreement are deemed to include the rules of the arbitration forum designated in the agreement or contemplated by the parties.⁵¹

The issue is whether unlicensed advocates are exempt from state statutory prohibitions against the unauthorized practice of law when parties contractually agree to arbitration, and that agreement invokes, explicitly or implicitly, rules of a forum that allow unlicensed advocates to assist and/or represent parties.

48. 5 U.S.C. § 555(b) (1988).

49. SEC Rel. No. 31,089, *supra* note 47, at 8 (emphasis added) (footnote omitted).

50. *See* Volt Info. Sciences v. Board of Trustees, 489 U.S. 468 (1989); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987), *reh'g denied*, 483 U.S. 1056 (1987).

51. *See, e.g., Lee v. Chica*, 983 F.2d 883 (8th Cir. 1993) (upholding an award of punitive damages in an AAA securities arbitration even though Minnesota law prohibited arbitration panels from awarding such damages), *cert. denied*, 114 S. Ct. 287 (1993); *Todd Shipyards Corp. v. Cunard Line*, 943 F.2d 1056, 1062-63 (9th Cir. 1991); *Schulze & Burch Biscuit Co. v. Tree Top, Inc.*, 642 F. Supp. 1155, 1157 (N.D. Ill. 1986) (incorporating AAA rules into the contract because the drafters contemplated AAA arbitration), *aff'd*, 831 F.2d 709 (7th Cir. 1987); *Moncharsh v. Heily & Blase*, 832 P.2d 899 (Cal. 1992) (the scope of arbitration is a matter of agreement between the parties).

In *Bentley*, the defendants argued that as a matter of federal law, “the rules of the arbitration forum apply over state or federal law.”⁵² However, the Los Angeles County Superior Court did not base its ruling on that argument. This issue remains unsettled.

The issue is broader than the ability of investors and stockbrokers to contract around state regulation of the practice of law. As the *Bentley* case illustrates, the role of an advocate in a dispute between an investor and a stockbroker is more involved than arguing and presenting evidence at a hearing. Likewise, the state regulation of the practice of law has a much wider scope than courtroom activities.

It is naive to say that federal law preempts state regulation of the practice of law based solely on the SICA Arbitrators Manual of suggested procedures. The SICA manual states only that a party to a securities arbitration may either appear pro se or be represented by a person who is not an attorney. If that statement means an unlicensed person is permitted to act as an advocate in any arbitration between an investor and a stockbroker, then it is not limited to those instances where an investor has signed a pre-dispute arbitration agreement. Even in the absence of an agreement to arbitrate disputes, the stockbroker is required to submit all disputes to binding arbitration upon demand of the customer.⁵³ The implication is that an unlicensed advocate can legitimize his role by convincing the client/investor to demand arbitration rather than file a complaint in court. This suggests a need to identify and examine all activities of a person who aspires to act as an advocate for an investor in a dispute with his or her stockbroker. Only then can it be determined whether state or federal law should control.⁵⁴

To provide guidance in answering this question, Section II identifies the different types of activities California courts have found to constitute the practice of law. Section III has a detailed examination of the types of activities normally done by an advocate in a securities dispute from the first identification of the problem, preparation of the claim, pre-hearing activities through the hearing and afterwards. Section IV examines the consequences of using a lawyer and an unlicensed advocate in a securities dispute. Section V contains a proposal.

52. Mem. of P. & A. in Supp. of Dem. & Mot. to Strike at 10, *Bentley* (No. BC072979) (citing *Lee*, 983 F.2d 883; *Todd Shipyards*, 943 F.2d at 1062-63).

53. NASD Code of Arbitration Procedure § 12(a) provides that members of the NASD (brokerage firms) and associated persons (registered persons who work for brokerage firms) are required to submit customer disputes to binding arbitration upon the demand of the customer even in the absence of a pre-dispute agreement to arbitrate. NASD CODE OF ARB. PRO., *supra* note 9, at 9.

54. It is assumed in this article that in most instances the industry participant in a securities arbitration will utilize a licensed attorney as its advocate.

II. WHAT CONSTITUTES "THE PRACTICE OF LAW" IN VIOLATION OF THE CALIFORNIA STATE BAR ACT?

A key issue that has yet to be resolved by any California appellate court is whether the activities of unlicensed advocates in private securities arbitrations constitute the practice of law in violation of the California State Bar Act.⁵⁵

The California State Bar Act states "No person shall practice law in California unless the person is an active member of the State Bar."⁵⁶ There is no statutory definition of what constitutes the practice of law in California. However, California courts have defined a number of activities which fall within the definition. In the frequently cited case of *People v. Merchants' Protective Corp.*,⁵⁷ the California Supreme Court, in adopting a definition of the practice of law from an Indiana case, stated:

As the term is generally understood, the practice of law is the doing and performing services in a court of justice in any matter depending therein throughout its various stages and in conformity with 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 pending in a court.⁵⁸

In determining what constitutes the practice of law in California, it is the character of the act, not where it is performed, that is determinative.⁵⁹ The California Supreme Court stated in 1970: "In close cases, the courts have determined that the resolution of legal questions for another by advice and action is practicing law 'if difficult or doubtful legal questions are involved which, to safeguard the public, reasonably demand the application of a trained legal mind.'"⁶⁰ The court went on to say: "[I]f the application of legal knowledge and technique is required, the activity constitutes the practice of law, even if conducted before an administrative board or commission."⁶¹ It takes very little to constitute the practice of law. A single act is all that is required, not a course of conduct.⁶²

55. CAL. BUS. & PROF. CODE § 6125 (West 1994).

56. *Id.*

57. 209 P. 363 (Cal. 1922).

58. *Id.* at 365 (quoting *Eley v. Miller*, 34 N.E. 836, 837-38 (Ind. App. 1893)). See also *Farnham v. State Bar of California*, 552 P.2d 1445 (Cal. 1976); *Bluestein v. State Bar of California*, 529 P.2d 599 (Cal. 1974); *Baron v. City of Los Angeles*, 469 P.2d 353 (Cal. 1970); *Crawford v. State Bar of California*, 355 P.2d 490 (Cal. 1960); *People v. Landlords Professional Services*, 264 Cal. Rptr. 548 (Ct. App. 1989); *People v. Sipper*, 142 P.2d 960 (Cal. Ct. App. 1943).

59. *Baron*, 469 P.2d at 358.

60. *Id.* (citations omitted).

61. *Id.*

62. *Sipper*, 142 P.2d at 962; *People v. Ring*, 70 P.2d 281, 284 (Cal. Ct. App. 1937).

In accord with these principles, California courts have analyzed different fact patterns and concluded that a variety of activities by lay persons may constitute the practice of law. For example, in *Morgan v. State Bar*,⁶³ the California Supreme Court held that conducting settlement negotiations constitutes the practice of law.⁶⁴ Advising a person what type of document to complete to obtain a loan⁶⁵ and assisting clients in the preparation, filing and resolution of unlawful detainer actions also have been characterized as practicing law in California.⁶⁶ California's regulation of those who purport to practice law within its borders is not limited to activities concerning state law. Whenever a person gives advice on any law, including the law of California, federal law, or the law of any other state or country, it can constitute the practice of law.⁶⁷

There are no reported California appellate decisions that address whether appearance in a private arbitration conducted according to a pre-dispute arbitration provision between the participating parties constitutes the practice of law. Federal courts outside California are divided on the issue. In *American Automobile Association v. Merrick*,⁶⁸ the court stated, "We are not, therefore, prepared to hold that a creditor may not attempt through an agent a peaceful collection of a liquidated claim, or that a creditor may not agree through an agent to an arbitration of his claim."⁶⁹ However, in considering pre-filing settlement negotiations, the *Merrick* court specifically held that "the giving of advice prior to collection of a claim and the urging of legal propositions in discussions with the person from whom collection is attempted does involve the practice of law and may be performed only by lawyers who possess the required skill."⁷⁰ However, in *Williamson P.A. v. John D. Quinn Construction Corp.*,⁷¹ the District Court for the Southern District of New York held that the representation of a party in an arbitration does not constitute the practice of law.⁷²

State courts are similarly split. In *State ex rel. Pearson v. Gould*,⁷³ the Indiana Supreme Court held that representing an employee before the State Employees' Appeals Commission was not the practice of law. However, in *Prudential Securities, Inc. v. McQuillan*, a Michigan County Circuit Court

63. 797 P.2d 1186 (Cal. 1990).

64. *Id.* at 1188.

65. *Sipper*, 142 P.2d at 962.

66. *People v. Landlords Professional Services.*, 264 Cal. Rptr. 548, 553 (Ct. App. 1989).

67. *Bluestein v. State Bar of California*, 529 P.2d 599, 606 (Cal. 1974). There is a specific provision in California law for the registration and certification of foreign-registered legal consultants who are permitted, after passing certain requirements, to provide advice within the state of California regarding foreign law in certain limited circumstances. CAL. R. CT. 988.

68. 117 F.2d 23 (D.C. Cir. 1940).

69. *Id.* at 25.

70. *Id.*

71. 537 F. Supp. 613 (S.D.N.Y. 1982).

72. *Id.* at 616.

73. 437 N.E.2d 41 (Ind. 1982).

granted a motion by Prudential Securities to preliminarily enjoin lay advocates from pursuing claims on behalf of disgruntled investors on the ground that such activity constituted the unauthorized practice of law in Michigan.⁷⁴ The Circuit Court said:

Lawyers counsel and advise clients on their problems, remedies that may be available and then recommend a certain plan of action. The very essence of practicing law is not compiling paper work, filing such documents as coming to court, but rather is giving advice to clients who present problems to you for resolution.⁷⁵

In sum, it is unclear how California appellate courts will ultimately resolve the issue. However, the consequences of an unlicensed person either practicing law or holding himself out as authorized to practice law in California include possible criminal prosecution as a misdemeanor offense.⁷⁶

III. THE ACTIVITIES OF SECURITIES ARBITRATION ADVOCATES THAT BEAR UPON THE ISSUE OF WHETHER THEY ENGAGE IN THE PRACTICE OF LAW

Given the relatively broad standard for what activities constitute the practice of law, it is insightful to examine the wide range of activities arbitration advocates engage in while representing consumers. This section will examine the entire process of representation from pre-filing claim evaluation through post-hearing claim resolution to examine the many activities that may constitute the practice of law.

74. Order Granting Pls., Req. for Preli. Inj., Prudential Securities, Inc. v. McQuillan (No. 93-19858-CZ) (Mich. Cir. Ct., Cty. of Genesee, Dec. 3, 1993).

75. *Id.* at 2.

76. Section 6126 of the California Business and Professions Code states:

a. Any person advertising or holding himself or herself out as practicing or entitled to practice law or otherwise practicing law who is not an active member of the state bar, is guilty of a misdemeanor.

b. Any person who has been involuntarily enrolled as an inactive member of the state bar or has been suspended from membership from the state bar, or has been disbarred, or has resigned from the state bar with no charges pending, and thereafter advertises or holds himself or herself out as practicing law or entitled to practice law, is guilty of a crime punishable by imprisonment in the state prison or county jail. However, any person who has been involuntarily enrolled as an inactive member of the state bar pursuant to paragraph 1 of subdivision E of section 6007 and who knowingly thereafter advertises or holds himself or herself out as practicing law or otherwise entitled to practice law, is guilty of a crime punishable by imprisonment in the state prison or county jail.

c. The willful failure of a member of the state bar, or one who has resigned or been disbarred, to comply with an order of the Supreme Court to comply with Rule 955 constitutes a crime punishable by imprisonment in the state prison or county jail.

A. Pre-Filing Activities

Most claims in securities arbitrations originate with a dissatisfied customer who has lost money in a securities transaction.⁷⁷ Typically, after inquiring about possible restitution but failing to receive satisfaction from the brokerage firm which handled the transaction, the customer considers the possibility of suing the brokerage firm to recover his damages.

The customer may seek assistance from either a lawyer or an unlicensed advocate. Alternately, the customer can pursue the claim on his own behalf without assistance. It is at this early stage of the relationship between advocates and disgruntled customers that the advocates begin to provide services that can be construed as the practice of law. The advertisements and promotional material created by unlicensed advocates encourage customers to use their services to evaluate and pursue claims against brokerage firms.⁷⁸

After being attracted to an advocate either by a public advertisement or someone's recommendation, the customer relies on the advocate to analyze the potential claim and assist in making decisions.⁷⁹ Initially, the advocate must determine whether there are damages and whether the securities broker violated a legal duty owed to the customer. In making this threshold decision, the customer and the advocate must necessarily analyze the legal duties owed by securities brokers to customers. Such analysis requires a basic knowledge of tort and contract law and federal and state statutes pertaining to the sale of securities.⁸⁰

When analyzing the customer's damages, the advocate should have some familiarity with remedies, conflict-of-law principles, relevant statutes of

77. Infrequently, such claims are initiated by the broker-dealer against the private customer for failure to repay money borrowed in a margin loan. Sometimes, in such claims, the customer will file a counterclaim seeking damages for losses in related securities transactions.

78. The Retainer Agreement in *Bentley* states that the client retained IAS as its agent to "act on Client's behalf in the investigation, preparation, negotiation, presentation, and arbitration of Client's complaints against Third Party(ies) and to act as Client's agents." Retainer Agreement, attached as Ex. A to Compl., at 1, *Bentley v. Investors Arb. Sevs., Inc.*, No. BC072979 (Los Angeles Cty. Sup. Ct., Jan. 18, 1993).

79. At this early stage, involving analysis of monthly statements and other brokerage firm documents, the assistance of a person knowledgeable in securities industry matters is often much more valuable than legal advice from an attorney, especially if it is a small claim. PHILIP J. HOBLIN, JR., *SECURITIES ARBITRATION - PROCEDURES, STRATEGIES, CASES 3-4* (2d ed. 1992). [hereinafter HOBLIN].

80. For example, a client may attempt to pursue a claim against a brokerage house based on a firm's misleading advice. As a result, the client did *not* purchase a new issue of stock, and that stock had a dramatic rise in the immediate after-market. These facts probably would *not* give rise to a compensable claim—because it did not arise in connection with the purchase or sale of securities. *See, e.g., Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). A person unfamiliar with the applicable securities laws may not immediately recognize that the client's complaint would not be the basis for a valid securities claim in arbitration or court.

limitations, and many other potential legal issues.⁸¹ Sometimes different remedies apply depending upon what types of claim a customer makes. For example, the remedy may be different if a customer chooses to pursue a claim for a sale of securities by an unlicensed salesman, rather than pursuing a claim based on the theory of fraud or negligent misrepresentation under the common law of the state where the transaction occurred.⁸² The most favorable legal theory for the customer also may involve a statute of limitation different from that of other potential legal theories; and the more favorable legal theory could be lost if the advocate does not make the claim quickly.⁸³

Another issue that may confront the customer is whether there is an enforceable arbitration agreement.⁸⁴ Resolution of this issue involves such sub-issues as whether the contract that includes the arbitration clause is valid, whether the contract was induced by fraud and whether that may be a basis to avoid arbitration, and whether there is a connection between the transaction that led to the customer's losses and the contract that contains the arbitration clause. If there is a choice between arbitration and a lawsuit, it may be more desirable for the customer to pursue his remedy via arbitration rather than via a lawsuit.⁸⁵

81. For example, if the client was solicited in Texas by a securities salesman based in California who happened to be on vacation in Texas, and then had the order executed through the Texas office of the salesman's firm, the client might be entitled to rescission under the Blue Sky laws of Texas inasmuch as the solicitation occurred in Texas by a securities salesman not licensed by the State of Texas. See TEX. CIV. CODE ANN. § 581-29(A) (West 1964) (the violation) and TEX. CIV. CODE ANN. § 581-33(A)(1) (West 1964) (customer entitled to rescission).

82. Compare remedies available under Texas Securities Act, Art. 581-33A(1) (allowing rescission); TEX. CIV. CODE ANN. § 581-33 (West 1964); see also *Berry Petroleum Co. v. Adams & Peck*, 518 F.2d 402, 409 (2d Cir. 1975); Section 10(b)(5) of the 1934 Act, 15 U.S.C. § 78 (1988); and SEC Rule 10b-5 17 C.F.R. 240.106-5 (1994) (allowing out of pocket expenses).

83. Compare and contrast the statutes of limitations for Texas securities violations, California securities violations, violations of Section 12 (1933 Act) and violations of Section 10b (1934 Act). The calculation of when the statute of limitations begins to run becomes more legally complex if there is a related class action pending, as in *Bentley*. *Bentley v. Investors Arb. Servs., Inc.*, No. BC072979 (Los Angeles Cty. Sup. Ct., Jan. 18, 1993). Under both federal and California law, the statute is tolled while the class action is pending. *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538 (1974); *Crown, Cork & Seal Co. v. Parker*, 462 U.S. 345 (1983); *Jolly v. Eli Lilly & Co.*, 751 P.2d 923 (Cal. 1988). However, there is doubt as to whether or not the statute begins to run again if there is a denial of class certification. See, e.g., *Andrews v. Orr*, 851 F.2d 146, 149 (6th Cir. 1988).

84. For example, if the securities broker's discussions with the investor are conducted in Spanish, the contract containing the arbitration clause might be void if the securities broker failed to provide a Spanish language translation. See CAL. CIV. CODE § 1632 (West 1994). Whether a dispute is arbitrable can be a very complex legal issue. See, e.g., H. WARREN KNIGHT ET AL., CAL. PRAC. GUIDE: ALTERNATIVE DISPUTE RESOLUTION 4-46 to 4-54 (The Rutter Group, 1993).

85. Even if there is no agreement to arbitrate, the customer normally has the option to compel the securities salesman or brokerage firm into arbitration if they are members of one of the self-regulatory organizations that requires its members to submit to arbitration demanded by a public customer. See, e.g., NASD CODE OF ARB. PRO., *supra* note 9, § 12(a).

Once the advocate identifies the appropriate legal theory and determines the amount of damages⁸⁶ and whether an arbitration or a lawsuit will provide the most favorable forum for the customer, the advocate must decide which parties to name in the arbitration or lawsuit (the brokerage firm alone, the brokerage firm and the securities salesman, or the branch office manager, etc.), and whether personal jurisdiction can be obtained over all parties.⁸⁷

The advocate and customer may also want to consider the possibility of initiating both an arbitration and a parallel lawsuit in state or federal court so the customer can obtain the discovery benefits available in the court proceeding that would not otherwise be available in the arbitration but which could be used in the arbitration. If there is a choice to simultaneously pursue remedies in dual forums, this would put an unlicensed advocate at a disadvantage inasmuch as he would not be permitted to practice in a parallel court proceeding and licensed counsel would have to be hired to assist.⁸⁸

In addition to the basic proceeding, be it in arbitration or lawsuit, the customer also may want to seek provisional relief as an adjunct to the main proceeding. In some cases, it might be appropriate to seek an injunction or prejudgment attachment. In California arbitrations, such provisional remedies must be obtained through a parallel court proceeding.⁸⁹ These issues dovetail with the basic proceeding and should not be considered as independent issues.

There are many other issues to be considered prior to actually drafting and filing an arbitration claim. One such issue is whether to pursue pre-filing settlement negotiations with the prospective respondents/defendants.

86. There are many legal considerations in regard to the calculation of damages. For example, which law governs: federal or state, and if state, which state? Is the claimant entitled to pre-award interest, at what rate and how is it measured? *See, e.g.*, *First Commercial Fin. Group, Inc. v. Baghdoian* [Current Binder] *Comm. Fut. L. Rep. (CCH) ¶ 25,565* (N.D. Ill. 1993). Does the claimant have to offset losses on the investment which is the subject of his claim to account for profits in other investments? *See, e.g.*, *Kane v. Shearson Lehman Hutton, Inc.*, 916 F.2d 643 (11th Cir. 1990); *Nesbit v. McNeil*, 896 F.2d 380, 385-86 (9th Cir. 1990). It is very important to present the correct damage theory, because if there is a mistake in the award, it is very difficult to have it changed. *See McIlroy v. PaineWebber, Inc.*, 989 F.2d 817 (5th Cir. 1993); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Burke*, 741 F. Supp. 191 (N.D. Cal. 1990).

87. As part of the decision on what persons and entities to name as respondents or defendants, the client and his advocate will necessarily have to consider legal issues such as: (i) whether a non-signatory agent of a contracting party can be compelled to arbitrate (*see, e.g.*, *Letizia v. Prudential Bache Sec., Inc.*, 802 F.2d 1185, 1187-88 (9th Cir. 1986)); and (ii) whether he can obtain personal jurisdiction over all the individual defendants if the choice is to file a lawsuit (*e.g.*, *San Mateo County Transit Dist. v. Dearman, Fitzgerald & Roberts, Inc.*, 979 F.2d 1356 (9th Cir. 1992)).

88. Joint representation by an unlicensed advocate and a lawyer raises other problems, especially if the unlicensed advocate is representing the client on a contingent fee basis. In California, licensed attorneys are barred from splitting fees with unlicensed persons. CAL. R. PROF. CONDUCT § 1-320 (1994). The Investors Arbitration Services ("IAS") retention agreement attached to the *Bentley* complaint provides: "Where the services of a licensed attorney are required to further the client's cause, IAS is authorized to employ an attorney at no additional expense to the client." Retainer Agreement, attached as Ex. A to compl., *Bentley v. Investors Arb. Sevs., Inc.*, No. BC072979 (Los Angeles Cty. Sup. Ct., Jan. 18, 1993).

89. CAL. CIV. PROC. CODE § 1281.8 (West 1994).

To effectively pursue settlement negotiations, the customer or his advocate must be prepared to describe to the prospective respondents/defendants their breaches of duties and the consequences of those breaches, including the damages that could be awarded to the customer. If a settlement is achieved during these negotiations, it will be necessary to draft and negotiate the settlement documentation with appropriate disclosures, releases, and other terms.

In addition to possible settlement, the customer and his advocate also may find it advantageous to coordinate with other claimants who have similar claims against the same respondents/defendants. If those claimants have stronger claims, it might be in the interest of the customer to wait until those other claims are pursued to a successful conclusion in another arbitration or lawsuit. The results of those other arbitrations may then be used as offensive collateral estoppel against the respondents, thus easing the customer's burden.⁹⁰ If the advocate and the customer exhaust the possibility of settlement or elect not to pursue pre-filing settlement, assuming there is no need to coordinate with any parties with similar claims, and further assuming that arbitration, rather than litigation, is determined to be the appropriate course, the next step is to draft the statement of claim and submit it to the appropriate forum.

Since the end result of the arbitration will be an award which can be converted into a final judgment, it is important that the customer-claimant state his claim as completely and accurately as possible. Moreover, the rules of most of the SROs provide that the claimant is restricted to proving at the arbitration only those things which are alleged in the statement of claim.⁹¹ For that reason, it is important that the claimant and his advocate prepare the liability and damages section of the claim with the appropriate specificity so as to give the claimant the maximum latitude in proving his claim at the hearing, but not so narrowly as to jeopardize his ability to effectively change his position at the hearing if he discovers additional facts or an additional legal theory.

Part of the decision in filing the claim is also the choice of situs. When making the initial filing, a claimant has the ability to request a specific hearing situs, which may be an important strategic consideration.

During this initial consideration process, the advocate is necessarily providing advice to the claimant about different strategy considerations. Whether those communications are oral or in writing, they may be subject to discovery later during the hearing if the advocate is not a lawyer and the

90. The results of a completed arbitration can have a collateral estoppel effect on the party participants. *ACMAT Corp. v. International Union of Operating Eng'rs*, 442 F. Supp. 772, 783-84 (D. Conn. 1977). The collateral estoppel effect of an arbitration award can take effect even prior to the confirmation of that award into a final judgment. *Clark v. Bear Stearns & Co.*, 966 F.2d 1318 (9th Cir. 1992); *Wellons, Inc. v. T.E. Ibberson Co.*, 869 F.2d 1166, 1169 (8th Cir. 1989).

91. See, e.g., NASD CODE OF ARB. PRO., *supra* note 9, § 25(a).

communications are not protected by the cloak of privilege applicable to lawyer-client communications.⁹²

Finally, in the course of making his decisions on what claims to pursue, the client and his advocate should be cognizant of certain issues that are beyond the scope of the arbitration itself. For example, if the claimant has made undisclosed tape recordings of telephone communications with his stockbroker, those recordings may contain very useful information helpful to proving his claim. However, in California it is a misdemeanor to record communications without the consent of *all* parties involved in the communication.⁹³ By alleging the existence of those recordings in the statement of claim, a claimant may unintentionally incriminate himself.

Furthermore, claimants are sometimes not completely candid with the IRS when reporting profits and losses in connection with securities transactions. By making certain allegations in the statement of claim, the claimant may obtain a short-term benefit but may also expose himself to tax liability and other consequences with the taxing authorities. All of these considerations should be discussed with the claimant as part of the process of determining whether and how to pursue the claim.

Thus, the pre-filing activities, if properly done, are not to be taken lightly by either an attorney or an unlicensed advocate. There are many issues, with concomitant tactical and strategic ramifications, to be considered.

B. Post-Filing Activities

The submission of a completed claim begins the dispute resolution process in an arbitration.⁹⁴ The SRO or other agency receiving the claim first reviews the paperwork to ensure it is in compliance with applicable administrative rules. If it is not, the claim may be returned to the claimant and his advocate, who should be prepared to respond either by making adjustments in the claim to bring it into compliance with the rules or explaining to the agency why compliance is not necessary or possible.⁹⁵

92. See *Samuels v. Mitchell*, 155 F.R.D. 195 (N.D. Cal. 1994) (voluntary disclosure of privileged documents to an accountant, not specifically hired to assist an attorney, waives the privilege).

93. CAL. PENAL CODE § 632(a) (West 1994). But the admissibility of recorded evidence might be different if the call was made between California and Texas. See 18 U.S.C. § 2511 (1988); *United States v. Little*, 753 F.2d 1420, 1434-35 (9th Cir. 1984) ("Evidence obtained in violation of neither the Constitution nor federal law in admissible in federal court proceedings without regard to state law").

94. See, e.g., NASD CODE OF ARB. PRO., *supra* note 9, § 25.

95. For example, if the statement of claim requests punitive damages, the claimant should be aware of the conflicting decisions on this issue (*cf. Mastrobuono v. Shearson Lehman Hutton, Inc.*, 20 F.3d 713 (7th Cir. 1994), *cert. granted* 115 S. Ct. 305 (1994); and *J. Alexander Sec. v. Mendez*, 21 Cal. Rptr. 2d 826 (Ct. App. 1993), *cert. denied* 114 S. Ct. 2182) and be prepared to provide legal justification for the request. If the claim only states theories under Section 10(b) of the 1934 Securities and Exchange Act, 15 U.S.C. § 78 (1988) then a claim for punitive damages would not be legally appropriate. *Stone v. Kirk*, 8 F.3d 1079 (6th Cir. 1993).

After the paperwork and the appropriate fees have been submitted, the claim is then served directly on the respondents by the agency.⁹⁶ Upon receipt, the respondents will typically analyze the claim and decide whether to initiate settlement negotiations and/or engage counsel to represent their interests in the pre-hearing process and at the hearing itself.

If the respondents elect to actively pursue settlement negotiations, both the claimant and his advocate should be prepared to evaluate settlement proposals. If an agreement is reached, the advocate should participate in the process of drafting the appropriate paperwork and effecting the settlement, making sure that all the claimant's rights are protected. Settlement negotiations and documentation are routinely handled by licensed lawyers. There are continuing education seminars to update lawyers on various techniques used in settlement negotiations to protect the client and provide the best possible result. For example, it is sometimes possible to structure the settlement in such a way so as to provide for the most favorable tax treatment of the settlement proceeds received by the client.⁹⁷

If the respondents and their counsel⁹⁸ elect not to pursue settlement negotiations, or if settlement negotiations do not result in an agreement, the next step in the process is for the respondents to file a statement of answer as provided in the rules⁹⁹ and/or a written challenge to the statement of claim. Challenges to the statement of claim can involve such things as a motion to strike extraneous documents—such as correspondence evidencing pre-filing settlement negotiations between the parties or newspaper articles, etc.¹⁰⁰ The defendants also may move to dismiss the claim entirely, if on its face it is barred by an applicable statute of limitations.¹⁰¹ The claimant and his advocate should be prepared to respond to all these procedural maneuvers.¹⁰²

Typically, these pre-hearing motions are resolved either by one of the staff attorneys with the arbitration office of the arbitration administrator, a

96. NASD CODE OF ARB. PRO., *supra* note 9, § 25(a).

97. *See, e.g.,* Sandy Kasten & Brad Seligman, *Tax Considerations in Settling Employment Cases*, CAL. LAW., Oct. 1985, at 13; Paul R. McDaniel et al., *Damage Awards and Settlement and Insurance Recoveries*, in FEDERAL INCOME TAXATION—CASES AND MATERIALS 240 (3d ed. 1994).

98. The respondents almost always hire licensed lawyers to represent their interests either from their in-house legal staffs or from private lawyers engaged for the particular dispute. HOBLIN, *supra* note 79, at 54.

99. NASD CODE OF ARB. PRO., *supra* note 9, § 25(b).

100. HOBLIN, *supra* note 79, at 7-7.

101. NASD CODE OF ARB. PRO., *supra* note 9, § 15; *Castellano v. Prudential Bache Sec., Inc.* [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,321, at 96,534 (July 18, 1990).

102. If, for example, there is a challenge to the entire claim based on the statute of limitations, the claimant and his advocate should be prepared to file the appropriate legal papers describing why the statute of limitations was tolled because of such theories as fraudulent concealment, or possibly making the argument of why the statute of limitations cited by the respondent does not apply, and why the arbitrator should apply some longer statute of limitations.

single arbitrator, or the chairman of the panel in conjunction with one other panel member.¹⁰³ The resolution of these pre-hearing motions normally involves consideration by a lawyer. To present the most effective arguments, the claimant and his advocate should be prepared to submit a legal brief on the issues raised in whatever challenge is made to the pleadings by the respondents.

Even if the respondents do not challenge the claim itself, they may file some collateral pleading, such as a third-party claim, cross-claim or a counterclaim.¹⁰⁴ If that happens, the advocate and his customer should be prepared to analyze the new pleadings and determine whether it is appropriate to move to strike them, move for a severance and separate hearing, or pursue the arbitration.¹⁰⁵ This analysis requires knowledge of the applicable rules and underlying legal principles.

In addition to possible disputes which may arise in connection with the pleadings, the time period between filing of the claim and the commencement of the hearings is likely to involve some discovery. The methods to obtain discovery are slightly different under the AAA and securities industry arbitration rules. In both forums, though, there is an opportunity for formal fact investigation.¹⁰⁶

Under the AAA rules, there is a preference for a preliminary hearing during which the arbitrator and the parties will discuss an orderly process for limited discovery, including the exchange of pertinent documents, identification of witnesses to be called, whatever depositions may be allowed, and other matters.¹⁰⁷ As a part of that AAA process, arbitrators have authority to issue interim orders to safeguard properties which are the subject matter of the arbitration and other matters.¹⁰⁸ This process involves collateral issues of spoliation of evidence which may give rise to different substantive claims, contacts with witnesses, and gathering evidence by way of affidavit.¹⁰⁹ There are rules which provide the format for affidavits and declarations which are obtained and used in court proceedings in California.¹¹⁰ A declaration which fails to adhere to the appropriate format may not be admissible in an arbitration proceeding—so it must be artfully drafted.

103. See, e.g., HOBLIN, *supra* note 79, at 7-2 *et seq.*

104. NASD CODE OF ARB. PRO., *supra* note 9, § 25.

105. HOBLIN, *supra* note 79, at 6-12.

106. See, e.g., NASD CODE OF ARB. PRO., *supra* note 9, § 32(a)-(b); AAA RULES, *supra* note 9, Rule 11.

107. AAA RULES, *supra* note 9, Rule 10.

108. *Id.* Rule 35.

109. Under AAA Commercial Arbitration Rule 32, evidence by way of affidavit can be submitted at the hearing without regard to evidentiary hearsay problems that would be encountered in a trial in a conventional court setting. AMERICAN ARBITRATION ASSOCIATION, COMMERCIAL ARBITRATION RULES, Rule 32 (1993). See also *Bell Aerospace Co. v. Local 516, UAW*, 500 F.2d 921, 923 (2d Cir. 1974).

110. See CAL. CIV. PROC. CODE §§ 2009-2015.6 (1983); 28 U.S.C. § 1746 (1988).

Under both AAA and SRO rules, parties are permitted to take depositions in very limited circumstances.¹¹¹ Typically, those are instances where a potential witness with relevant testimony will be unable to attend the hearing because of serious illness or difficulty in coming to the place of the hearing. In those instances, someone representing the claimant should attend the deposition either as the principal interrogator or as a secondary interrogator to protect the interests of the claimant. If the deposition is to be taken of an uncooperative or unwilling witness, a subpoena will be required.

Likewise, during the pre-hearing discovery period there could be useful information available to a claimant in other related proceedings that could be found through a review of court records or other sources. Legal knowledge on the part of the claimant and his advocate will be required to determine whether this material is relevant, whether it can be obtained, and whether it might have some collateral estoppel benefit. All these considerations require legal analysis.

During the pre-hearing discovery proceedings, it is very likely that some of the discovery requested either by or from the claimant could be subject to a privilege such as the attorney-client privilege,¹¹² the marital privilege,¹¹³ the physician-patient privilege,¹¹⁴ or some other privilege. This too requires legal analysis.

The claimant and his advocate need to be aware of the scope of the various legal privileges in determining whether to provide information or to pursue such information that has been requested but not produced by the respondents. To the extent such information is not produced, it can have adverse consequences at the hearing—such as a preclusion order.¹¹⁵ Inadvertent disclosure of such information in the discovery phase of an arbitration can also have far-reaching consequences for a party in later proceedings.¹¹⁶

In responding to the motion to compel, the claimant has to make a number of important choices which necessarily require a knowledge of the law. A threshold decision is to determine whether there is a privilege which enables the claimant to withhold his tax returns from production to the respondent. Under California law, tax returns are privileged from discovery in most court proceedings.¹¹⁷ Under federal law, however, the taxpayer's

111. HOBLIN, *supra* note 79, at 10-14; *United Nuclear Corp. v. General Atomic Corp.*, 597 P.2d 290 (N.M. 1979); Constantine Katsori, *The Arbitration of a Public Securities Dispute*, 53 *FORDHAM L. REV.* 279, 287 n.52 (1984).

112. CAL. BUS. & PROF. CODE § 6068(e) (West 1994); CAL. EVID. CODE § 952 (West 1994); FED. R. EVID. 501.

113. CAL. EVID. CODE §§ 980-987 (West 1994).

114. CAL. EVID. CODE §§ 990-999 (West 1994).

115. *SICA ARBITRATOR'S MANUAL*, *supra* note 9, at 14-16.

116. *E.g.*, *Cheever v. Southern Clays, Inc.*, 128 F.R.D. 128 (M.D. Ga. 1989).

117. *Sav-On Drugs v. Superior Court*, 538 P.2d 739, 742 (Cal. 1975).

privilege is much weaker and is rarely available to a party.¹¹⁸ Because the sale of securities often involves interstate commerce, an argument could be made that securities arbitration falls within the coverage of the Federal Arbitration Act,¹¹⁹ and accordingly federal law may apply,¹²⁰ but to a certain degree, state law also could apply if there is a state choice of law clause in the parties' contract.¹²¹ It is a complicated choice of law issue as to whether tax returns must be produced by a claimant in an arbitration proceeding held in California arising out of the sale of securities. All of these complicated legal issues normally require the skill of a lawyer for effective resolution.

C. The Hearing

Most securities arbitrations held by either the AAA or the SROs include a lawyer as the chairman of the panel, one of the panel members, or possibly a staff attorney from the SRO or the AAA present or on call to resolve legal issues that arise at the hearing.¹²² Notwithstanding the rules in both the AAA and the SROs that the Rules of Evidence are not strictly followed,¹²³ the hearing is usually patterned after the basic structure of a trial, with opening statements, closing arguments and examination of witnesses.¹²⁴ The method of examining witnesses is very similar to that used in a trial, with direct examination, cross-examination, identification and offering of documentary evidence. All of these procedures are familiar to lawyers who have studied them in law school and in continuing education courses and utilized them in court.¹²⁵

As a result of their training and experience, many lawyers develop effective techniques for examining witnesses to elicit the most complete and accurate testimony and at the same time avoid the introduction of facts adverse to their case. Even in arbitrations, lawyers often utilize the Rules

118. *Heathman v. District Court*, 503 F.2d 1032 (9th Cir. 1974); *Smith v. Bader*, 83 F.R.D. 437 (S.D.N.Y. 1979); *Weiner v. Bache Halsey Stuart, Inc.*, 76 F.R.D. 624 (S.D. Fla. 1977).

119. 9 U.S.C. §§ 1-208 (1988).

120. H. WARREN KNIGHT, ET AL., CAL. PRAC. GUIDE: ALTERNATIVE DISPUTE RESOLUTION 4-46 to 4-54 (The Rutter Group, 1993).

121. Many agreements between investors and their stockbrokers contain a New York choice of law provision. If the arbitration is initiated by a filing with the NASD in New York with a request for a California situs, is the privilege applicable to the provision of claimant's tax returns governed by New York law, by California laws or by federal law? The determination of this issue involves a complex choice of law analysis that is usually the subject of a full semester course in most law schools.

122. HOBLIN, *supra* note 79, at 12-5.

123. NASD CODE OF ARB. PRO., *supra* note 9, § 34; AAA RULES, *supra* note 9, Rule 32.

124. HOBLIN, *supra* note 79, at 10-7.

125. In *Moore v. Conliffe*, 871 P.2d 204 (Cal. 1994), the California Supreme Court reasoned that a private contractual arbitration proceeding is a "judicial proceeding" for purposes of making the testimony of witnesses in such proceedings privileged under California Civil Code Section 47. *Id.* at 211.

of Evidence to block the introduction of certain unfavorable material, such as by the assertion of privileges and reference to the rules of relevance.¹²⁶ These techniques are well known to lawyers, and subtleties of the techniques are often not appreciated by lay advocates. Likewise, in the opening statement and closing arguments, lawyers are trained both in school and in continuing education seminars on how best to present evidence in a way that will be effectively understood by a trier of fact. To be sure, there are many lawyers who are ineffective at using these skills; but, for the most part, even an unskilled lawyer will have an advantage over a lay advocate because of training and experience.

D. Post-Hearing Considerations

Normally in the AAA and sometimes in the SROs, the hearing is not completed at the time the parties finish their closing arguments. The arbitrators frequently ask for post-hearing briefs to resolve difficult issues of law or fact which have arisen during the hearing.¹²⁷ The normal process after the completion of final arguments is for the arbitrators to request closing briefs and then take the matter under submission.¹²⁸ The issues covered in these briefs often involve legal matters and require skill at legal research and legal writing. Most lawyers spend at least one semester and oftentimes a full year in law school studying legal research and writing. They normally put these skills to use in writing their post-hearing briefs by pulling together the law and applicable facts to make the best possible arguments for their client. Lay advocates may attempt to submit briefs based solely on logic (or logic mixed with emotion) without any reference to the law. When these matters are being resolved by a lawyer, chairperson or panel members who are legally trained, it is probable that the brief submitted by the lawyer will be the more persuasive.

Even after the arbitrators issue the award, there are still additional procedures available to a party dissatisfied with the result. That party can possibly seek confirmation, correction, modification or vacation of the award under both state¹²⁹ and federal¹³⁰ law. These procedures can only be pursued in court by a licensed lawyer or by the claimant acting as his own attorney.

126. Cf. *Sunshine Mining Co. v. United Steelworkers*, 823 F.2d 1289, 1295 (9th Cir. 1987) (arbitrators may rely on evidence that is *not* admissible under the Federal Rules of Evidence) and *Hunt v. Mobil Oil Corp.*, 654 F. Supp. 1487, 1511-12 (S.D.N.Y. 1987) (documents may be excluded from evidence at arbitration under FED. R. EVID. 408 as settlement negotiations).

127. SICA ARBITRATOR'S MANUAL, *supra* note 9, at 25-26.

128. *Id.*

129. CAL. CIV. PROC. CODE §§ 1285-1287.6 (West 1994).

130. 9 U.S.C. §§ 9-13 (1988).

IV. A COMPARISON OF THE CONSEQUENCES OF USING A LAWYER
 VERSUS AN UNLICENSED ADVOCATE IN PURSUING A
 SECURITIES CLAIM IN AN ARBITRATION PROCEEDING

Wholly apart from the practical implications of hiring an unlicensed advocate rather than a lawyer, there are legal implications that flow from the claimant's choice of "counsel."

In California, a party has a statutory right to counsel in an arbitration.¹³¹ There is no corresponding statutory right to a lay advocate.¹³² Lawyers are subject to licensing¹³³ and oversight¹³⁴ by the California Supreme Court (acting through the California State Bar). Normally, to be admitted to the Bar, there is a prerequisite that the lawyers have a certain amount of education from an accredited institution, pass a bar-administered examination after the first year of law school, or complete an approved course of study under the supervision of a licensed lawyer or judge.¹³⁵ There is no counterpart education or experience requirement for unlicensed lay advocates. In addition, there are other requirements to be able to practice law in California, such as being of good moral character.¹³⁶ No similar restrictions are imposed on lay advocates.

Once a client and a lawyer make contact, there are many restrictions on lawyers imposed by law that are designed to ensure that the client is treated fairly and honestly. After agreeing to represent a client, a lawyer is specifically prohibited from taking on representation that may be adverse to that client.¹³⁷ California lawyers are also required to take minimum continuing legal education to heighten their awareness of potential conflicts.¹³⁸ Often the identification of a conflict can be a complex matter for

131. CAL. CIV. PROC. CODE § 1282.4 (West 1994).

132. The rules of all the SROs provide that parties have the right to "counsel." Cf. NASD CODE OF ARB. PRO., *supra* note 9, § 27 with BOSTON STOCK EXCHANGE ARBITRATION CODE § 15 (1991). These rules are identical, but interpreted differently. The NASD follows the SICA Arbitrators Manual, allowing lay advocates to represent private customers in disputes between private customers and its members. However, the NASD does *not* allow lay advocates to represent its members or associated persons in its disciplinary proceedings which are similar to, but more informal than, its arbitrations. *In re First Choice Securities Corp.*, Release No. 31,089 [Transfer Binder] Fed. Sec. L. Rep. (CCH) (review of disciplinary action taken by NASD). The Boston Stock Exchange, on the other hand, takes the position that only licensed attorneys are permitted to represent parties in its customer/member arbitrations. See Letter from Max Mahoney, Staff Attorney, *Boston Stock Exchange*, to John H. L'Estrange, Jr. (Apr. 12, 1994) (on file with author).

133. CAL. BUS. & PROF. CODE § 6060 (West 1994).

134. CAL. BUS. & PROF. CODE § 6076 (West 1994).

135. CAL. BUS. & PROF. CODE § 6060(e) (West 1994).

136. CAL. BUS. & PROF. CODE § 6060(b) (West 1994).

137. CAL. RULES OF PROF. CONDUCT 3-300, 3-310 (1994).

138.

Each active member of the State Bar . . . shall, within 36-month periods designated by the State Bar, complete at least 36 hours of legal education approved by the State Bar or offered by a State Bar-approved provider. Eight of these hours shall address legal ethics or law practice management, four hours of which shall be legal ethics.

which the lawyer has resources available at the State Bar to ensure that the client receives full, honest and fair representation.¹³⁹ No similar restrictions apply to lay advocates.

In California, lawyers are required to have written engagement agreements with clients which must include certain elements.¹⁴⁰

Although it is not required by law, California lawyers typically have malpractice insurance which provides a financial resource if the lawyer is negligent in the performance of his professional duties. In addition, each attorney in California must make a disclosure in his mandatory written engagement agreement if he neither has malpractice insurance coverage nor “[h]as filed with the State Bar an executed copy of a written agreement guaranteeing payment of all claims against the attorney by his or her clients for errors or omissions arising out of the practice of law by the attorney” in a specified amount.¹⁴¹

In those instances where a licensed lawyer requires the client to post monies in advance to cover expenses, the client has some confidence that the funds will not be lost or misused. This is so, in part, because under California law, lawyers are required to maintain a client trust account¹⁴² into which attorneys must deposit all funds received or held for the benefit of clients, including advances for costs and expenses.¹⁴³

Under California law, a lawyer is required to maintain in confidence all confidential information received from his client.¹⁴⁴ The law also provides that confidential communications between a lawyer and a client are protected by a privilege from involuntary disclosure to third parties.¹⁴⁵ One of the prerequisites of the attorney-client privilege is that there be an attorney-client relationship.¹⁴⁶ In California, this same privilege does not apply to the relationship between a client and a non-lawyer advocate.¹⁴⁷

From the time of the initial contact with the client until the issuance of the final arbitration award, a lawyer is engaged in a number of activities such as communicating with the client, drafting the statement of claim, legal research, communication with potential witnesses, and other fact- and law-gathering processes. All of this activity by the lawyer is protected by a

CAL. R. CT. 958(c).

139. The State Bar Ethics Hotline (800-238-4427) is available to members of the California State Bar to provide information about ethics questions.

140. BUS. & PROF. CODE §§ 6147, 6148 (West 1994).

141. CAL. BUS. & PROF. CODE §§ 6147(a)(6), 6148(a)(4) (West 1994).

142. CAL. BUS. & PROF. CODE § 6210 (West 1994).

143. CAL. RULES OF PROF. CONDUCT § 4-100 (1994).

144. CAL. BUS. & PROF. CODE § 6068(e) (West 1994).

145. FED. R. EVID. 501; CAL. EVID. CODE § 952 (West 1994); *Upjohn Co. v. U.S.*, 449 U.S. 383, 391 (1981).

146. CAL. EVID. CODE §§ 950-952 (West 1994).

147. CAL. BUS. & PROF. CODE §§ 6125-6133 (West 1994).

qualified work-product privilege preventing involuntary disclosure of his work and industry to third parties.¹⁴⁸

In connection with an arbitration hearing, a qualified lawyer has the ability to handle all ancillary proceedings, such as discovery, in aid of arbitration.¹⁴⁹ The lawyer also can pursue provisional remedies available in ancillary court proceedings.¹⁵⁰ If appropriate, the lawyer can effectively fend off attempts by the respondent to stay the arbitration by some collateral court proceeding¹⁵¹ or to seek a consolidation of his client's arbitration with another related arbitration.¹⁵² At the hearing, a trained lawyer is charged by law with the responsibility to have sufficient knowledge to identify issues and effectively conduct the trial-like proceedings.¹⁵³

California law provides a number of other protections for a client. For example, the lawyer is obligated to deliver to the client all papers belonging to the client, with no expense to the client, at the conclusion of the engagement.¹⁵⁴ If there is any dispute over the amount of attorney's fees or compensation owed to the attorney, the attorney is obligated by law to submit that fee dispute to nonbinding arbitration at the election of the client.¹⁵⁵

Notwithstanding the extensive regulation of attorneys and statutory protections afforded to attorneys' clients, unlicensed securities advocates have urged a continuation of their own role in the securities arbitration system.¹⁵⁶ The principal argument advanced by lay advocates is that they have much more extensive knowledge of the securities industry and practical experience than most lawyers. This knowledge and experience is undoubtedly a benefit, but it affords the unlicensed advocates an advantage only with small claims.

Unlicensed advocates with prior securities industry experience are often able to evaluate small claims more quickly than a lawyer because they do not

148. CAL. CIV. PROC. CODE § 2018 (West 1994). See also FED. R. CIV. PROC. § 26(b)(3) (federal work product doctrine).

149. Discovery is permitted, in a limited sense, in arbitration proceedings. 9 U.S.C. § 7 (1989); CAL. CIV. PROC. CODE § 1983.1 (West 1994); *United Nuclear Corp. v. General Atomic Co.*, 597 P.2d 290, 302 (N.M. 1979); *McRae v. Superior Court*, 34 Cal. Rptr. 346, 350 (Ct. App. 1963); Constantine N. Kastoris, *Arbitration of a Public Securities Dispute*, 53 FORDHAM L. REV. 279, 287 n.52 (1984); Constantine N. Kastoris, Annotation, *Discovery in Aid of Arbitration*, 98 A.L.R.2d 1247 (1964).

150. 9 U.S.C. § 6 (1988); CAL. CIV. PROC. CODE § 1281.8 (West 1994).

151. W.J. Dunn, Annotation, *Disqualification of Arbitrator by Court or Stay of Arbitration Proceedings Prior to Award on Ground of Interest, Bias, Prejudice, Collusion, or Fraud of Arbitrators*, 65 A.L.R.2d 755 (1959).

152. SICA ARBITRATOR'S MANUAL, *supra* note 9, at 6-7.

153. A lawyer is charged with having the same degree of expertise possessed by others in the community exercising similar skills. *Lucas v. Hamm*, 364 P.2d 685, 689 (Cal. 1961).

154. CAL. BUS. & PROF. CODE § 6068(n) (West 1990); CALIFORNIA RULES OF PROF. CONDUCT § 3-700(D) (1994).

155. CAL. BUS. & PROF. CODE § 6200-6206 (West 1994).

156. See, e.g., Paul N. Young, SEC. ARB. COMMENTATOR, Feb. 1994, at 16 (letter to the editor by Paul N. Young, CEO of the Securities Arbitration Group, Inc.).

require the assistance of experts to evaluate the raw data. They are also often able to handle small claims more economically because they do not need to engage an expert to assist them in the formulation and presentation of the claim. However, these efficiencies are limited to unlicensed advocates with extensive prior industry experience. Persons with little or no prior industry experience who purport to represent investors in securities arbitrations against their brokers have no inherent advantage over lawyers.

The advantage of unlicensed advocates is directly related to the amount at stake. Whether the arbitration is being financed directly by the customer or with funds advanced by the advocate, the more that is at stake, the more likely it will be that the customer or advocate will be willing to spend the amount required to hire experts and consultants to evaluate and prepare the claim. There are many experts and consultants with industry experience who regularly offer their services in securities arbitrations. These circumstances suggest that the benefit of unlicensed advocates with demonstrable expertise can be best utilized in small cases.

V. PROPOSAL

Because of the dearth of appellate opinions in California on the issue, it remains unclear whether unlicensed advocates will continue to be challenged in California when they represent claimants securities arbitrations. The United States Congress could help resolve this problem by either amending the Federal Arbitration Act or adopting a statute explicitly addressing the issue. Though this article takes no stance on whether unlicensed advocates should be completely prohibited, some restrictions on the activities of unlicensed advocates could help protect the consumer from abuse by such advocates.

If unlicensed advocates are allowed, each advocate should disclose in writing to consumers (i.e., the prospective claimants or plaintiffs) that the advocate is not an attorney. This would, in principle at least, notify the consumer that the advocate's advice is not from one who has undergone the rigors of a legal education and passed the California bar examination and moral fitness requirements. It would also notify the consumer that communications with the advocate are not cloaked with the protection of the attorney-client privilege. Hopefully, the consumer would be better able to evaluate the advocate's advice and avoid the misconception that an advocate's assistance is the only option available.

Advocates should be required to have written engagement agreements with the "clients," and those agreements should have the same essential elements listed in California Business and Professions Code sections 6147 and 6148. As with lawyers, the absence of such an agreement should leave the advocate with a quantum meruit remedy to collect his fee for services rendered.

Advocates should also be required to obtain liability insurance and bonding in an amount reasonably adequate to provide for any negligence or

malfeasance by the advocate. This requirement not only helps protect the consumer from careless or unscrupulous advocates, but insofar as insurance helps spread the costs of misconduct to all advocates, it also serves as an incentive for advocates to offer only the highest quality of service, thereby improving their own effectiveness and reputation within the community. Though attorneys are not required to carry such insurance,¹⁵⁷ attorneys have other incentives sufficient to motivate a large majority of attorneys to carry malpractice insurance. Advocates have no similar incentives, and thus a requirement that they carry such insurance will likely be necessary to effectively help protect the consumer.

The advocates should be required to maintain fiduciary-type trust accounts which enable them to segregate client funds. It is not necessary that the advocates adhere to the same requirements imposed on lawyer trust accounts. It would be sufficient if they disclose the existence of the trust account in their engagement agreement, and attest to the existence of the separate trust account in their registration with the SRO.

Like attorneys who must undergo detailed scrutiny before being admitted to a state bar, advocates should be required to satisfy a minimum level of professional competence and integrity standards. One selling point advocates promote is their securities industry experience, which ostensibly makes them more effective at evaluating and representing clients in securities disputes. Since it is experience, and not formal education, that at least arguably makes advocates more effective than attorneys, advocates should be required to obtain minimum experience within the industry.

In addition, advocates should be required to meet certain minimum moral fitness standards. Specifically, persons who (a) have had either a securities license or a license to practice law revoked, (b) have voluntarily surrendered a securities license or a license to practice law with disciplinary charges pending, or (c) have been the subject of a consent decree or permanent injunction issued by a securities regulatory agency or court should not be permitted to become advocates. These measures would help eliminate known miscreants, thereby protecting the consumer and improving both the effectiveness and reputation of the industry.

In addition to minimum professional standards, advocates should also be required to register their practice with the arbitration departments of the individual SROs. Advocates should be required to show that they meet the above professional standards, that they are familiar with the securities laws of the United States and of the states in which they represent consumers, and that they are familiar with the arbitration procedures of each forum in which they will represent consumers. The SEC, with this new oversight responsibility, should establish provisions for criminal and civil liability for unlicensed advocates who violate any requirements. This would give the

157. See *supra* part IV.

SEC the ability to oversee and monitor registered advocates, as well as enforce the professional standards imposed.

Though this article does not propose a ban on the practices of unlicensed advocates, the establishment of limits on the value of controversies in which advocates can participate would seem appropriate. As explained above, the major purported benefit of unlicensed advocates is their ability to resolve smaller claims more efficiently than some attorneys. Advocates, with some prior experience, may be more efficient at evaluating small claims because lawyers relatively unfamiliar with the securities industry must rely on experts to evaluate data. As a practical matter, this makes many attorneys less effective when the overall recovery is small. However, where large amounts are at stake, an attorney can offer a more effective representation, since the relative expense of an expert is less and the need for a broad range of legal skills is great. Thus, advocates should be permitted to represent consumers in relatively small claims, perhaps those with damage claims of less than \$50,000, but should not be permitted to represent alone a consumer in disputes claiming more than that amount (Certain exceptions to this general rule may be appropriate, such as where the advocate is a relative or personal friend of the client.). This proposal would effectively allow advocates to practice where they are effective, but would protect the consumer where the advocate's narrow experience is not as large a factor in the overall balance of effective representation.

If advocates are permitted to practice in the United States, it should only be in conjunction with regulation, oversight, and professional standards. Such measures would not only protect the consumer from those few unscrupulous or reckless advocates, but would also serve to improve and legitimize a vocation that may provide significant benefits to the consumer.

CONCLUSION

The emergence of non-lawyer advocates demonstrates a need that the legal market has not effectively met. Most consumers have limited resources with which to pursue their relatively uncomplicated claims. Advocates may provide a means for fast and efficient resolution of these types of claims. However, as this article details, advocates typically cannot provide the level of representation that attorneys can, which may be needed in larger claims. In addition, consumers are vulnerable to negligent or reckless activities of advocates who generally are neither insured nor bonded. Moreover, consumers may be mistaken about the relative abilities of lawyers and unlicensed advocates, which may lead them to mistake less expensive representation for a bargain, when they may need much more expertise than an unlicensed advocate can provide. The proposals laid out herein would give the consumer the benefit of inexpensive resolution of uncomplicated disputes by an industry of experienced, regulated arbitration advocates. Yet, since not every potential arbitration is one appropriate for unlicensed advocates, at least some limitations should exist on their ability to represent

clients in arbitration. These innovations would ultimately serve both the consumer as well as the advocate industry by raising the level of service as well as the prestige of unlicensed arbitration advocates.

