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IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF CALIFORNIA

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|--|---|----------------------------|
| DOUGLAS K. McDANIEL and BRYAN CLARK, on behalf of themselves, all others similarly situated, and the general public,   | ) | Case No. 10-4916 SC        |
|  | ) |                            |
|  | ) | ORDER GRANTING DEFENDANTS' |
|  | ) | <u>MOTION TO DISMISS</u>   |
| Plaintiffs,  | ) |                            |
|  | ) |                            |
| v.   | ) |                            |
|  | ) |                            |
| WELLS FARGO INVESTMENTS, LLC, a Delaware limited liability company, WELLS FARGO BANK, N.A., a National Association, WELLS FARGO ADVISORS, LLC, a Delaware limited liability company, and DOES 1 through 50, inclusive, | ) |                            |
|  | ) |                            |
|  | ) |                            |
| Defendants.  | ) |                            |
|  | ) |                            |
|  | ) |                            |

**I. INTRODUCTION**

On July 9, 2010, Plaintiffs Douglas K. McDaniel ("McDaniel") and Bryan Clark ("Clark") (collectively, "Plaintiffs") filed this action in San Francisco County Superior Court on behalf of themselves and all others similarly situated against Defendants Wells Fargo Investments, LLC, Wells Fargo Bank, N.A., and Wells Fargo Advisors, LLC (collectively, "Wells Fargo" or "Defendants"). ECF No. 1 ("Notice of Removal") Ex. A ("Compl."). Wells Fargo removed the action on October 29, 2010, pursuant to the Class Action Fairness Act, 28 U.S.C. § 1332(d). See Notice of Removal.

1 Plaintiffs filed a First Amended Complaint on April 6, 2011. ECF  
2 No. 18 ("FAC"). Wells Fargo now moves to dismiss the FAC pursuant  
3 to Federal Rule of Civil Procedure 12(b)(6), arguing that  
4 Plaintiffs' state law claim is preempted by federal law. ECF No.  
5 22 ("Mot."). The Motion is fully briefed. ECF Nos. 24 ("Opp'n"),  
6 27 ("Reply"), 30 ("Surreply").<sup>1</sup> Pursuant to Civil Local Rule 7-  
7 1(b), the Court finds the Motion suitable for determination without  
8 oral argument. For the reasons stated below, the Court GRANTS  
9 Wells Fargo's Motion and dismisses this action with prejudice.

10  
11 **II. BACKGROUND**

12 Plaintiff McDaniel alleges that he was formerly employed as a  
13 financial consultant by Wells Fargo Investments, LLC, and Wells  
14 Fargo, N.A. FAC ¶¶ 5, 21. Plaintiff Clark alleges he is a former  
15 employee of Wells Fargo Advisors, LLC. Id. ¶ 6 In their FAC,  
16 Plaintiffs allege a single claim for violation of California's  
17 Unfair Competition Law ("UCL"), Cal. Bus. and Prof. Code § 17200.  
18 Id. ¶¶ 25-30. Specifically, Plaintiffs allege that "defendants  
19 violated section 450 of the California Labor Code by requiring  
20 plaintiffs and other California employees to maintain their  
21 securities brokerage accounts with and/or obtain their other  
22 investment-related services from defendants." Id. ¶ 27. Section  
23 450 of the California Labor Code provides in pertinent part: "No  
24 employer . . . may compel or coerce any employee . . . to patronize  
25 his or her employer, or any other person, in the purchase of any  
26 thing of value." Cal. Lab. Code § 450.

27  
28 <sup>1</sup> Plaintiffs filed a Motion for Leave to File a Surreply and  
attached a Surreply to the Motion. ECF No. 30. The Court GRANTS  
leave to file the Surreply and has considered the arguments therein  
in reaching its decision.

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**III. LEGAL STANDARDS**

A motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) "tests the legal sufficiency of a claim." Navarro v. Block, 250 F.3d 729, 732 (9th Cir. 2001). Dismissal can be based on the lack of a cognizable legal theory or the absence of sufficient facts alleged under a cognizable legal theory. Balistreri v. Pacifica Police Dep't, 901 F.2d 696, 699 (9th Cir. 1990). "When there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief." Ashcroft v. Iqbal, 129 S. Ct. 1937, 1950 (2009). However, "the tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions. Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." Iqbal, 129 S. Ct. at 1950 (citing Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555 (2007)).

**IV. DISCUSSION**

Defendants argue that Plaintiffs' claim is preempted by federal law because it conflicts with the securities regulatory framework established by Congress. Mot. at 17-20. Specifically, Defendants argue that federal regulators have granted firms like Wells Fargo discretion to restrict the external trading activities of their employees in order to prevent abusive practices such as insider trading. Id. at 2. Defendants contend that Plaintiffs' claim is preempted because, if successful, it would eliminate this discretion, thereby impeding the accomplishment of Congressional

1 objectives. Id. at 20. Plaintiffs counter by asserting that their  
2 claim is not preempted by federal regulations because Wells Fargo  
3 could change its policy in a manner that would comply with both  
4 federal regulations and California Labor Code Section 450. Opp'n  
5 at 3. The Court agrees with Defendants.

6 **A. Federal Preemption of State Law**

7 Federal laws preempt conflicting state laws under the  
8 Supremacy Clause, which states: "Laws of the United States . . .  
9 shall be the supreme Law of the Land." U.S. Const. art. VI, cl. 2.  
10 "The phrase 'Laws of the United States' encompasses both federal  
11 statutes themselves and federal regulations that are properly  
12 adopted in accordance with statutory authorization." City of New  
13 York v. FCC, 486 U.S. 57, 63, (1988) (quoting U.S. Const. art. VI,  
14 cl. 2.). As such, "[t]he statutorily authorized regulations of an  
15 agency will pre-empt any state or local law that conflicts with  
16 such regulations or frustrates the purposes thereof." Id. at 64.  
17 "[T]he purpose of Congress is the ultimate touchstone of pre-  
18 emption analysis." Cipollone v. Liggett Grp., Inc., 505 U.S. 504,  
19 516 (1992).

20 Federal law may preempt state law in three ways: (1) express  
21 preemption, where Congress explicitly defines the extent to which  
22 its enactments preempt state law; (2) field preemption, where state  
23 law attempts to regulate conduct in a field that Congress intended  
24 federal law exclusively to occupy; or (3) conflict preemption,  
25 where it is impossible to comply with both state and federal  
26 requirements or where state law "stands as an obstacle to the  
27 accomplishment and execution of the full purpose and objectives of  
28 Congress." Indus. Truck Ass'n, Inc. v. Henry, 125 F.3d 1305, 1309

1 (9th Cir. 1997).

2 **B. Federal Securities Law and Regulatory Scheme**

3 "The Securities Exchange Act of 1934 created a system of  
4 supervised self-regulation in the securities industry" by  
5 delegating government power to self-regulatory organizations  
6 ("SROs"), such as the New York Stock Exchange ("NYSE") and the  
7 National Association of Securities Dealers ("NASD").<sup>2</sup> Credit  
8 Suisse First Boston Corp. v. Grunwald, 400 F.3d 1119, 1128 (9th  
9 Cir. 2005). Within this framework, SROs are responsible for much  
10 of the day-to-day regulation of securities markets, while the  
11 Securities and Exchange Commission ("SEC") is charged with ultimate  
12 responsibility and control of the national market system for  
13 securities. See Silver v. N.Y. Stock Exch., 373 U.S. 341, 352  
14 (1963). SROs promulgate rules and regulations, subject to approval  
15 by the SEC, designed to enforce "compliance by members of the  
16 industry with both the legal requirements laid down in the Exchange  
17 Act and ethical standards going beyond those requirements."  
18 Grunwald, 400 F.3d at 1128 (internal citation omitted). Within  
19 this regulatory scheme, SROs are the primary regulators of  
20 securities broker-dealers. Sparta Surgical Corp. v. NASD, 159 F.3d  
21 1209, 1213-14 (9th Cir. 1998). The Ninth Circuit has made clear  
22 that "SRO rules approved by the [SEC] . . . preempt conflicting  
23 state law when the two are in conflict, either directly or because

24 \_\_\_\_\_  
25 <sup>2</sup> In 2007, the NASD and the NYSE consolidated their member-  
26 regulation operations into one self-regulatory organization known  
27 as the Financial Industry Regulatory Authority ("FINRA"). See  
28 Karsner v. Lothian, 532 F.3d 876, 879 n.1 (D.C. Cir. 2008). NASD  
rules and incorporated NYSE rules remain in effect until superseded  
by new consolidated FINRA rules. See FINRA Information Notice,  
"Continuing Application of NASD Rules and Incorporated NYSE Rules,"  
December 8, 2008,  
<http://www.finra.org/Industry/Regulation/Notices/2008/P117507>.

1 the state law stands as an obstacle to the accomplishment of the  
2 objectives of Congress." Grunwald, 400 F.3d at 1128.

3 The SEC and SROs require securities firms to monitor their  
4 employees' personal securities transactions and maintain procedures  
5 that each firm determines to be reasonably designed to prevent  
6 potential securities violations by employees. For example, NYSE  
7 Rule 342.21(a) requires member firms to subject trades in listed  
8 securities by its employees "to review procedures that the member .  
9 . . determines to be reasonably designed to identify trades that  
10 may violate" securities laws or NYSE rules against conduct such as  
11 insider trading. NYSE Rule 342.21(a). It further mandates that  
12 member firms conduct prompt internal investigation into any trade  
13 that may have violated any securities law or rules. Id.  
14 Similarly, NASD Rule 3010 requires each member to "establish and  
15 maintain a system to supervise the activities of each registered  
16 representative . . . that is reasonably designed to achieve  
17 compliance with applicable securities laws and regulation and all  
18 applicable NASD rules." NASD Rule 3010. Likewise, FINRA Rule 3130  
19 requires each member to designate a principal or principals to  
20 establish and maintain supervisory control policies. See FINRA  
21 Rule 3130.

22 The federal securities regulatory framework grants member  
23 firms the discretion to determine how to oversee and supervise  
24 their employees' trading activities, including the discretion to  
25 require employees to maintain their security accounts in house.  
26 For example, in 2002, the SEC approved NYSE Rule 407, which  
27 expressly provides member firms with discretion to determine if and  
28 when an employee may be permitted to open a brokerage account

1 outside the firm. NYSE Rule 407.<sup>3</sup> Under Rule 407, employees of  
2 member firms have a legal obligation either to maintain their  
3 accounts with their employer's firm or to obtain consent before  
4 opening an account or placing trades outside the firm. See, e.g.,  
5 Defs' RJN Ex. T, James Giannino, Former Non-Registered Employee,  
6 NYSE Hearing Panel Dec. 01-7 (NYSE Jan. 17, 2001) (sanctioning  
7 former employee of PaineWebber, Inc., and Charles Schwab & Co.,  
8 Inc. for maintaining an account at another firm).<sup>4</sup> Rule 407's  
9 requirement of "consent" from the firm, rather than mere "notice"  
10 by the employee, shows that the rule grants the firm discretion to  
11 determine its own compliance policies and to withhold consent for  
12 outside accounts.

13 The legislative history of other rules within the federal  
14 securities regulatory scheme leaves no doubt that firms have  
15 discretion to require employees to maintain their accounts in-  
16 house. For example, in 1988, Congress amended the Exchange Act  
17 through the Insider Trading and Securities Fraud Enforcement Act  
18 ("ITSFEA"), which provided that:

19  
20  
21 <sup>3</sup> NYSE Rule 407(b) provides: "No member . . . or employee  
22 associated with a member organization shall establish or maintain  
23 any securities or commodities account or enter into any securities  
24 transaction with respect to which such person has any financial  
25 interest or the power, directly or indirectly, to make investment  
26 decisions, at another member or member organization, or a domestic  
27 or foreign non-member broker-dealer, investment advisor, bank,  
28 other financial institution, or otherwise without the prior written  
consent of another person designated by the member or member  
organization under Rule 342(b)(1) to sign such consents and review  
such accounts."

<sup>4</sup> Both parties filed requests for judicial notice asking the Court  
to take notice of various statutes, regulations, and associated  
legislative histories. ECF Nos. 23 ("Defs.' RJN"), 26 ("Pls.'  
RJN"), 28 ("Defs.' Supp. RJN"). Because the documents submitted  
are publicly available and not subject to reasonable dispute, the  
Court GRANTS both RJNs pursuant to Federal Rule of Evidence 201.

1 Every registered broker or dealer shall  
2 establish, maintain, and enforce written  
3 policies and procedures reasonably designed,  
4 taking into consideration the nature of such  
5 broker's or dealer's business, to prevent the  
6 misuse in violation of this chapter ... of  
7 material, nonpublic information by such broker  
8 or dealer or any person associated with such  
9 broker or dealer.

10 15 U.S.C. § 78o(g). In passing the ITSFEA, Congress expressed its  
11 expectation "that a firm's supervisory system would include, at a  
12 minimum, employment policies such as those requiring personnel to  
13 conduct their securities trading through in-house accounts or  
14 requiring that any trading in outside accounts be reported  
15 expeditiously to the employing firm." H.R. Rep. 100-910, at \*22  
16 (1988), as reprinted in 1988 U.S.C.C.A.N. 6043, 6058-59 (emphasis  
17 added).

18 Similarly, when approving NASD Rule 3050, which requires  
19 employees to provide written notice to the member firm before  
20 opening a securities account with another member, the SEC stated:

21 [T]he NASD is of the opinion that the amendment  
22 would prevent instances in which trades may be  
23 made on inside information because the employer  
24 member was not aware of the existence of the  
25 account with another member. The NASD  
26 acknowledges the fact that there may be  
27 circumstances which dictate that an associated  
28 person hold an account with someone other than  
their employer member, and this amendment would  
not serve to prevent that.

23 Order Approving Proposed Rule Relating to Written Notification of  
24 Employer Members By Associated Person Regarding Relations With Each  
25 Member, 56 Fed. Reg. 10,931-932 (Mar. 14, 1991) (emphasis added).  
26 The SEC's statement suggests that it expected that members would  
27 require employee accounts to be held in house except in limited  
28 circumstances. Indeed, in 1990, the SEC's Division of Market

1 Regulation "undertook a comprehensive review of broker-dealer  
2 policies and procedures." SEC Div. of Mkt. Regulation, Broker-  
3 Dealer Policies and Procedures Designed to Segment the Flow and  
4 Prevent the Misuse of Material Nonpublic Information 1-2 (1990).  
5 The review found that "almost all firms require[d] employees to  
6 maintain accounts with the firm" and that "[t]his restriction  
7 generally extend[ed] to accounts of family members." Id. at 8 n.  
8 21. The SEC did not criticize such policies, instead determining  
9 that "at this time, no aspect of current procedures require  
10 Commission rulemaking." Id. at 18.

11 **C. Plaintiffs' UCL Claim Is Preempted by Federal Law**

12 Plaintiffs argue that California Labor Code Section 450  
13 requires Wells Fargo to permit its California employees to open and  
14 maintain securities accounts outside the firm, or at least to  
15 refrain from charging employees for in-house services. Opp'n at 3.  
16 They argue that because no regulation specifically requires Wells  
17 Fargo to impose an in-house account requirement, there is no  
18 conflict between the federal regulatory scheme and Section 450.  
19 Id. In other words, Plaintiffs argue that conflict preemption does  
20 not bar their claim because it is not impossible for Wells Fargo to  
21 comply with federal securities regulations and Section 450. Courts  
22 in this circuit have recently rejected this argument in cases  
23 similar to this one. See Bloemendaal v. Morgan Stanley Smith  
24 Barney LLC, No. 10-1455, 2011 WL 2161325, at \*7 (C.D. Cal. May 23,  
25 2011); Heilemann v. Bank of America Corp., No. 10-8623, 2011 U.S.  
26 Dist. LEXIS 68155, \*5 (C.D. Cal. June 6, 2011). For the same  
27 reasons set forth in those decisions, the Court concludes that  
28 Plaintiffs' claim is preempted.

1 Conflict preemption applies not only where it is impossible to  
2 comply with both state and federal law, but also where state law  
3 "stands as an obstacle to the accomplishment and execution of the  
4 full purpose and objectives of Congress." Henry, 125 F.3d at 1309.  
5 The federal securities regulatory framework unmistakably provides  
6 discretion for firms to decide how best to monitor the trading  
7 activities of employees. That discretion is plain from the text of  
8 NYSE Rule 407, as well as from the legislative histories of  
9 numerous other regulations.<sup>5</sup> Plaintiffs seek to use Section 450 to  
10 eliminate that discretion. Controlling case law prohibits the use  
11 of state law to such end. See Grunwald, 400 F.3d at 1133-34  
12 (finding California Judicial Council's disqualification rules  
13 preempted because they would remove discretion given to NASD  
14 Director of Arbitration); Chae v. SLM Corp., 593 F.3d 936, 942-43,  
15 946 (9th Cir. 2010) (finding UCL claim challenging billing  
16 statements used by student loan servicer preempted by federal  
17 regulations that provided servicers with flexibility concerning  
18 billing statements).

19 Grunwald and Chae both involved situations in which regulatory  
20 rules granted discretion to the defendant and the Ninth Circuit  
21 held that plaintiffs could not use state law to impinge upon that  
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23 <sup>5</sup> Plaintiffs argue that even if NYSE Rule 407 preempts their claim  
24 against Wells Fargo Bank, N.A. and Wells Fargo Advisors, LLC, its  
25 preemptive effect does not extend to their claim against Wells  
26 Fargo Investments, LLC, because that entity was not a member of the  
27 NYSE during the relevant time period. Opp'n at 10-11. This  
28 argument fails because it is not only NYSE Rule 407 that preempts  
29 Plaintiffs' claim. The preemptive effect of the Exchange Act,  
30 ITSFEA, and NASD rules also bar Plaintiffs' claim. See  
31 Bloemendaal, 2011 WL 2161352, at \*7 ("[p]reventing Defendant from  
32 creating and enforcing a policy that Congress and the [SEC] have  
33 expressly and implicitly approved undoubtedly frustrates the  
34 Congressional goals behind the Exchange Act and ITSFEA, namely  
35 preventing insider trading.").

1 discretion. The same applies here. The comprehensive federal  
2 regulatory scheme requires securities firms to monitor their  
3 employees' trading activities and grants firms discretion in  
4 determining effective methods for doing so. Both Congress and the  
5 SEC have recognized that one such method is requiring employees to  
6 conduct their securities trading in-house. Furthermore, nowhere  
7 does the regulatory scheme limit firms' discretion to require  
8 employees who open in-house accounts to incur the normal charges  
9 paid by all customers. Plaintiffs' attempt to eliminate firms'  
10 discretion would pose a formidable "obstacle to the accomplishment  
11 and execution of the full purpose and objectives of Congress."  
12 Henry, 125 F.3d at 1309.

13

14 **V. CONCLUSION**

15 For the foregoing reasons, the Court GRANTS the Motion to  
16 Dismiss filed by Wells Fargo Investments, LLC, Wells Fargo Bank,  
17 N.A., and Wells Fargo Advisors, LLC. The Court DISMISSES  
18 Plaintiffs Douglas McDaniel and Bryan Clark's action WITH  
19 PREJUDICE.

20

21 IT IS SO ORDERED.

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23 Dated: July 22, 2011

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UNITED STATES DISTRICT JUDGE

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