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THIRD READING

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Bill No: SB 33  
Author: Dodd (D), et al.  
Amended: 5/16/17  
Vote: 21

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SENATE JUDICIARY COMMITTEE: 5-2, 5/2/17  
AYES: Jackson, Hertzberg, Monning, Stern, Wieckowski  
NOES: Moorlach, Anderson

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**SUBJECT:** Arbitration agreements

**SOURCE:** John Chiang, Treasurer, State of California  
Consumer Attorneys of California  
Consumer Federation of California

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**DIGEST:** This bill adds an additional determination to the list of exclusions from compelled arbitration. This bill provides arbitration is not compelled when the court determines that a petitioner is a financial institution that seeks to apply a written agreement to arbitrate, contained in a contract consented to by a consumer, to a purported contractual relationship with that consumer created fraudulently by the petitioner without the consumer's consent and by unlawfully using the consumer's personal identifying information.

*Senate Floor Amendments* of 5/16/17 refine the types of relationships that are considered by the bill and narrow the types of financial institutions to which the bill applies.

**ANALYSIS:**

Existing law:

- 1) Governs, through the California Arbitration Act (CAA), arbitrations in California, including the enforcement of arbitration agreements, rules for

neutral arbitrators, the conduct of arbitration proceedings, and the enforcement of arbitration awards. (Code Civ. Proc. Sec. 1280 et. seq.)

- 2) Provides, through the Federal Arbitration Act (FAA), that a written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract. (9 U.S.C. Sec. 2.)
- 3) Provides that on petition of a party to an arbitration agreement alleging the existence of a written agreement to arbitrate a controversy and that a party thereto refuses to arbitrate such controversy, the court shall order the petitioner and the respondent to arbitrate the controversy if it determines that an agreement to arbitrate the controversy exists, unless the court determines that:
  - the right to compel arbitration has been waived by the petitioner;
  - grounds exist for the revocation of the agreement; or
  - a party to the arbitration agreement is also a party to a pending court action or special proceeding with a third party, arising out of the same transaction or series of related transactions, and there is a possibility of conflicting rulings on a common issue of law or fact. A pending court action or special proceeding includes an action or proceeding initiated by the party refusing to arbitrate after the petition to compel arbitration has been filed, but on or before the date of the hearing on the petition. (Code Civ. Proc. Sec. 1281.2.)
- 4) Defines “personal identifying information,” for purposes of Title 1.81.3 of Part 4 of Division 3 of the Civil Code, as a person’s name, address, telephone number, driver’s license number, social security number, place of employment, employee identification number, mother’s maiden name, demand deposit account number, savings account number, or credit card number. (Civ. Code Sec. 1798.92.)

This bill:

- 1) Adds an additional determination to the list of exclusions from compelled arbitration. A court is required to compel arbitration unless it determines that the petitioner is a financial institution that, on or after January 1, 2018, seeks to

apply a written agreement to arbitrate, contained in a contract consented to by a consumer, to a purported contractual relationship with that consumer created fraudulently by the petitioner without the consumer's consent and by unlawfully using the consumer's personal identifying information, as defined in Section 1798.92 of the Civil Code.

2) Defines "Financial institution" as:

- a) a federally chartered depository institution;
- b) a broker, dealer, or investment advisor required to register with the SEC; or
- c) a person who is licensed or regulated pursuant to Division 1.1 (commencing with Section 1000), Division 5 (commencing with Section 14000), or Division 7 (commencing with Section 18000) of the Financial Code, or Division 1 (commencing with Section 25000) of Title 4 of the Corporations Code.

## **Background**

This bill arises in response to a now infamous scheme carried out by employees of Wells Fargo Bank. Much of the bank growth that was occurring was through banking institutions cross-selling customers on more products and services. As part of this trend, Wells Fargo built an incentive-compensation program but failed to properly monitor or limit the program. These circumstances allowed and encouraged employees to pursue underhanded sales practices. Thousands of bank employees found ways to game the system by secretly signing up existing clients for new services that were never requested.

The Wells Fargo employees misused consumer names and personal information to create new checking and credit card accounts to inflate their sales figures to meet their sales targets and claim higher bonuses without the customers' knowledge or consent. According to the bank's own analysis, employees opened more than two million deposit and credit card accounts that may not have been authorized by consumers. Employees funded the deposit accounts by transferring funds from existing accounts. Wells Fargo employees also requested and activated debit cards without consumers' knowledge or consent, going so far as to create PINs for consumers without telling them. Some employees concocted email addresses that did not belong to their customers and used those new addresses to enroll people in online-banking services without their knowledge or consent. Wells Fargo employees targeted Mexican immigrants who spoke little English, older adults

with memory problems, college students opening their first bank accounts, and small-business owners with several lines of credit.

As a result of these illegal deposit and credit card practices, many consumers were hit with annual fees, overdraft-protection charges, finance charges, late fees, and other costs. The Consumer Financial Protection Bureau levied a fine against Wells Fargo of \$100 million for this widespread practice and ordered Wells Fargo to refund fees and charges that were paid because of these unauthorized accounts. However, when customers attempted to assert their rights against Wells Fargo in state and federal courts across the country, the bank responded by repeatedly and successfully compelling arbitration. Some media reports indicate that Wells Fargo may have been moving these disputes regarding unauthorized accounts into arbitration for years, which may have kept the overall fraudulent scheme from coming into wider public view sooner.

This bill seeks to prevent this litigation strategy. It creates an exception to the general requirement that a court enforce valid arbitration agreements when such agreements are being applied to purported contractual relationships between the parties that were created fraudulently without the consumers' consent and by unlawfully using the consumers' personal identifying information.

## **Comments**

The author writes:

It's been tough to avoid news stories about the Wells Fargo fraud scandal. Starting in 2011, the bank's employees opened more than 2 million phony bank and credit card accounts without the knowledge or consent of customers across the nation. Customers learned of the scheme only when they started getting socked by fees for those phony accounts or they noticed their credit was inexplicably being affected. But when they sought to hold Wells Fargo accountable, their path to the courthouse was blocked. Arbitration clauses were hidden in the fine print of the original, legitimate contracts they had signed, sometimes years before, to open a bank account. So instead of fighting Wells Fargo in the fairer and public forum of a courthouse, the bank's customers were forced into secret, binding arbitrations overseen by an arbitrator hired by the bank. Most disturbing of all, Wells Fargo was able to successfully argue that the arbitration clauses hidden in the original, legitimate banking contracts could be used to force disputes over the fictitious accounts into closed-door arbitration. With the fraud cases locked behind closed doors, Wells Fargo kept the scheme hidden from broader public disclosure, allowing it to mushroom.

SB 33 will help prevent such a rampant campaign of deception from ever happening again in California. It is a simple and very direct bill. It covers only the activities of banks and financial institutions like Wells Fargo. It's not anti-arbitration. It only prohibits arbitrations in cases involving fraud or identity theft. SB 33 will also act as a deterrent against future fraud. Companies will be on notice that if they commit fraud against a customer, they will lose any legal advantage they might have enjoyed in arbitration. Instead, they will have to fight it out in the far more equitable forum of a public courtroom.

*Narrowly tailored measure to address an identified issue.*

Despite fraudulently creating millions of accounts in its customers' names without their consent or knowledge, Wells Fargo was consistently successful in keeping its customers' claims out of courts. As a general matter, arbitrations provide an alternative method of dispute resolution, outside of the courts, wherein a neutral third party, known as the arbitrator, renders a decision after a hearing to which both parties have had an opportunity to be heard. Under California law, there are two distinguishable types of arbitration: judicial arbitration (also known as court-annexed arbitration, governed under Code of Civil Procedure Sections 1141.10 - 1141.31) and private arbitrations (also commonly known as "contractual," "voluntary," or "nonjudicial" arbitrations; governed under the California Arbitration Act, Code of Civil Procedure Section 1280 et seq.).

In regards to private arbitration, the increased use of mandatory arbitration clauses in consumer contracts has been highly controversial for a variety of reasons, including alleged issues surrounding concerns of "repeat players," whereby a repeat defendant, such as a corporate defendant, may, conspicuously or not, receive preferential treatment or rulings from arbitrators who rely on being selected by the corporate defendant to earn a living as an arbitrator. As is generally the custom in the industry, Wells Fargo's consumer contracts included these sorts of private arbitration agreements that required the parties to arbitrate their disputes.

In connection with the scheme discussed above, when customers sought to bring claims arising from the fraudulent accounts opened in their names, Wells Fargo successfully asserted that the arbitration agreements contained in the customers' original contracts should be enforced with respect to the claims arising from the fraudulent accounts. Despite widespread condemnation in the media, the litigation tactic was incredibly successful and kept these cases from being litigated publicly and on a class basis.

In order to ensure that consumers are more thoroughly protected against this sort of fraud in the future and that they will have their day in court, this bill makes clear that such arbitration agreements cannot be applied to these types of relationships.

Currently, when a plaintiff brings suit against a defendant based upon claims covered by an arbitration agreement, the defendant may petition the court to compel the plaintiff to arbitrate the controversy. The court is required to order the petitioner and the respondent to arbitrate the controversy if it determines that an agreement to arbitrate the controversy exists. Although there are currently several exceptions, none directly address the circumstances posed by a Wells Fargo-type situation. Under the circumstances of those cases, a valid arbitration agreement, created with the consent of the customer in connection with the initiation of a valid account with a financial institution, exists. The financial institution can then point to this valid and existing agreement between the parties in its petition to compel arbitration, even when the underlying claims arise from an entirely fraudulent relationship between the parties that only came into being through the unlawful use of the consumer's personal identifying information.

This bill narrowly targets this specific situation with precise language. Pursuant to this bill, a court is not required to compel arbitration even if a petition by a financial institution adequately establishes that an existing, written agreement to arbitrate, contained in a contract consented to by a consumer, exists, if the petitioner is seeking to apply such an agreement to a relationship between the parties fraudulently created by the financial institution, without the consumer's consent and through the unlawful use of the consumer's personal identifying information.

Therefore, as written, this exception to the enforcement of arbitration agreements applies only to financial institutions and only when the financial institutions have (1) unlawfully used a customer's personal information; (2) fraudulently created the relevant relationship with the consumer; and (3) done so without the consumer's consent. Furthermore, "financial institution" has been defined to include a narrow list of organizations. These include federally chartered depository institutions; a broker, dealer, or investment advisor required to register with the SEC; and certain state-regulated financial entities such as corporations engaging in commercial banking or trust business, credit unions, and industrial loan companies.

**FISCAL EFFECT:** Appropriation: No Fiscal Com.: No Local: No

**SUPPORT:** (Verified 5/16/17)

John Chiang, Treasurer, State of California (co-source)

Consumer Attorneys of California (co-source)  
Consumer Federation of California (co-source)  
ACCE Action  
Bet Tzedek Legal Services  
California Advocates for Nursing Home Reform  
California Alliance for Retired Americans  
California Commission on Aging  
California Conference Board of the Amalgamated Transit Union  
California Conference of Machinists  
California Dispute Resolution Council  
California Employment Lawyers Association  
California Labor Federation  
California Low-Income Consumer Coalition  
California Professional Firefighters  
California Public Interest Research Group  
California Reinvestment Coalition  
California Teamsters Public Affairs Council  
Coalition for Humane Immigrant Rights  
Center for Responsible Lending; Centro Legal de La Raza  
Consumer Action  
Consumer Federation of America  
Consumer Watchdog  
Consumers for Auto Reliability and Safety  
Consumers Union  
Courage Campaign  
East Bay Community Law Center  
Engineers & Scientists of California, IFPTE Local 20, AFL-CIO  
Housing and Economic Rights Advocates  
International Longshore and Warehouse Union  
The Justice & Diversity Center  
Law Foundation of Silicon Valley  
Legal Aid Society of San Bernardino  
National Association of Consumer Advocates  
National Consumer Law Center  
Our Family Coalition  
Privacy Rights Clearinghouse  
Professional & Technical Engineers, IFPTE Local 21, AFL-CIO  
Public Counsel  
Public Law Center  
ReFund America Project

South Asian Network  
Riverside Legal Aid  
Student Senate for California Community Colleges  
Utility Workers Union of America  
Voices for Progress Education Fund  
Watsonville Law Center

**OPPOSITION:** (Verified 5/18/17)

American Insurance Association  
Association of California Insurance Companies  
Association of California Life & Health Insurance Companies  
California Ambulance Association  
California Apartment Association  
California Bankers Association  
California Building Industry Association  
California Business Property Association  
California Business Roundtable  
California Chamber of Commerce  
California Community Banking Network  
California Credit Union League  
California Delivery Association  
California Employment Law Council  
California Forestry Association  
California Hospital Association  
California Land Title Association  
California Restaurant Association  
California Retailers Association  
Camarillo Chamber of Commerce  
Civil Justice Association of California  
Claremont Chamber of Commerce  
Computing Technology Industry Association  
Consumer Data Industry Association  
Culver City Chamber of Commerce  
El Centro Chamber of Commerce  
Electronic Transactions Association  
First American Corporation  
Greater Conejo Valley Chamber of Commerce  
Internet Coalition  
Investment Company Institute  
Long Beach Area Chamber of Commerce



NAIOP Commercial Real Estate Development Association Inland Empire and  
SoCal Chapters  
National Federation of Independent Business  
Orange County Business Council  
Oxnard Chamber of Commerce  
Redondo Beach Chamber of Commerce  
Santa Maria Valley Chamber of Commerce Visitor & Convention Bureau  
Securities Industry and Financial Markets Association  
Simi Valley Chamber of Commerce and Visitor Center  
South Bay Association of Chambers of Commerce  
Southwest California Legislative Council

**ARGUMENTS IN SUPPORT:** Writing in support, California State Treasurer John Chiang states that although his office took action against Wells Fargo for the widespread fraud by suspending all relationships with the bank, the actions did not provide relief for the customers who had already been defrauded. He, along with many of the organizations in support, argue that this bill will rectify this problem by giving customers their day in court when a financial institution commits fraud or identity theft against them.

**ARGUMENTS IN OPPOSITION:** The California Chamber of Commerce and a coalition of other groups state that the bill is likely preempted under the FAA; is ambiguous in its application; and allows class actions favoring attorneys over consumers. They also argue that the definition of “financial institution” is too broad.

Prepared by: Christian Kurpiewski / JUD. /  
5/18/17 14:50:39

\*\*\*\* END \*\*\*\*