No. 09-893

IN THE
Supreme Court of the United States

AT&T MOBILITY LLC,

Petitioner,

v.

VINCENT and LIZA CONCEPCION,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF *AMICI CURIAE* OF DISTINGUISHED LAW PROFESSORS IN SUPPORT OF PETITIONER

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INTEREST OF AMICI CURIAE[1]

Amici curiae are distinguished professors of law from several leading law schools across the country ("Amici Law Professors"). Amici Law Professors have lectured and written extensively on issues of contract law and arbitration. They support the enforcement of arbitration clauses as written and oppose California courts' distortion of unconscionability doctrines in order to refuse to enforce agreements to arbitrate. Amici Law Professors believe that this discrimination against agreements to arbitrate by California courts is preempted under the Federal Arbitration Act. A list of amici are set forth in the appendix hereto.

SUMMARY OF THE ARGUMENT

For centuries prior to the Federal Arbitration Act ("FAA"), courts systematically refused to enforce arbitration agreements. Ever protective of their jurisdiction, English courts—and American courts following their lead—treated agreements to arbitrate as a lower class of contract, refusing to enforce them under special doctrines applicable only to arbitration agreements.

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1. No counsel for a party authored this brief in whole or in part, and no such counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than the amici curiae, or their counsel, made a monetary contribution to its preparation or submission. The parties have consented to the filing of this brief.

In 1925, Congress enacted the FAA in order to remedy this longstanding judicial hostility to arbitration. The heart of the FAA—Section 2, 9 U.S.C. § 2—displaces otherwise applicable law, making arbitration agreements "valid, irrevocable, and enforceable," as a matter of federal law, "save upon such grounds as exist at law or in equity for the revocation of any contract."

As a consequence, Section 2 expressly displaces otherwise applicable contract law and creates a federal law of arbitrability. The twin purposes of the statute are to prohibit special rules for the interpretation or enforcement of arbitration agreements, such as were employed by courts prior to 1925, and to promote the use of more expeditious and inexpensive forms of conflict resolution. *See Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 510-11 (1974). Section 2 also has a savings clause, which preserves state contract law applicable to the "revocation" of "*any* contract." 9 U.S.C. § 2 (emphasis added). In other words, general principles of state contract law, applicable to the formation of *all contracts or all clauses in any contract* may be applied to agreements to arbitrate. Like any savings clause, the exceptions to preemption in Section 2 cannot be read to swallow the rule. *See AT&T Co. v. Cent. Office Tel., Inc.*, 524 U.S. 214, 228 (1998) ("[T]he act cannot be held to destroy itself." (citation omitted)).

"By enacting [Section] 2, Congress precluded States from singling out arbitration provisions," *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996), creating a kind of "equal protection clause" for contracts to prevent courts from discriminating against arbitration agreements as compared with other

contracts. In other words, state law may not be employed in a manner that disfavors—*de jure* or *de facto*—arbitration agreements as compared with other contracts. *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987). Indeed, even when employing state law doctrines of "general applicability," courts are not permitted to employ those general doctrines in ways that subject arbitration clauses to disfavored treatment. *See Iberia Credit Bureau, Inc. v. Cingular Wireless, LLC*, 379 F.3d 159, 167 (5th Cir. 2004).

But this is precisely what California courts do. Under the guise of applying generally applicable contract law, California courts have distorted the doctrine of unconscionability in order to erect an insurmountable barrier to bilateral arbitration in all consumer contracts. This new manifestation of the same hostility to arbitration involves an assumption that individual arbitration cannot vindicate consumer rights or deter wrongdoing and therefore requires the imposition of complex litigation procedures on arbitration. While prior to 1925 courts simply refused to enforce arbitration clauses in favor of a judicial forum, California courts (with the Ninth Circuit as a willing participant) simply attempt to convert arbitration into a judicial proceeding.

Unconscionability has two elements—procedural and substantive—and California courts distort them both. Instead of looking to all the circumstances surrounding the formation of the contract, California courts have adopted a *per se* rule under which arbitration agreements contained in standardized form contracts *are automatically considered procedurally unconscionable*. *See, e.g., Flores v. Transamerica*

HomeFirst, *Inc.*, 93 Cal. App. 4th 846, 853 (2001). As to the substantive side of the analysis, California's distortion of the law is even worse. Instead of the traditional "shock-the-conscience" test, California courts have imposed a "mutuality" test that requires mutuality of obligation with respect to arbitration. *See*, *e.g.*, *Armendariz v. Found. Health Psychcare Servs.*, *Inc.*, 24 Cal. 4th 83, 117-18 (2000). This mutuality test is not a general principle of contract law—ordinarily, not every term of a contract need be completely parallel if consideration supports both sides of the contract. Thus, the new test, applied by the court below, sets a much lower bar for substantive unconscionability.

Unconscionability is a defense to the enforcement of an otherwise valid contract. As such, the party asserting it bears the burden of proof. But California's new unconscionability test for arbitration clauses places the burden on the party attempting to enforce the arbitration clause. That party must demonstrate that the agreement to arbitrate will not operate as an "exculpatory clause," but instead will offer both vindication of individual rights and deterrence of alleged wrongdoing. *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 160-61 (2005). This mutuality test and the "exculpatory clause" analysis—with the shift in the burden of proof—*is only applicable to arbitration clauses*. In fact, the mutuality test has been repeatedly rejected by California courts outside the context of arbitration. *See*, *e.g.*, *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 672 n.14 (1988).

No less than a statutory provision, the new "unconscionability" doctrine created by the California courts is preempted by the plain language of Section 2 of the FAA. It discriminates against arbitration agreements, essentially banning them from an entire class of standard form contracts, and it imposes a complex judicial procedure on arbitration. If arbitration as envisioned by the FAA is to survive in the 21st century, the judgment of the Ninth Circuit must be reversed.

ARGUMENT

I. THE FAA PREEMPTS STATE LAW THAT UNIQUELY DISFAVORS ARBITRATION AGREEMENTS.

A. Congress Enacted The Federal Arbitration Act To Remedy Longstanding Judicial Hostility To Arbitration Agreements.

For centuries, English and American courts routinely refused to enforce agreements to arbitrate. This hostility was a product of jurisdictional jealousy and a distrust of both arbitrators and arbitration procedures that began in "'ancient times,'" when English courts fought "'for extension of jurisdiction—all of them being opposed to anything that would altogether deprive every one of them of jurisdiction.'" *Bernhardt v. Polygraphic Co. of Am., Inc.*, 350 U.S. 198, 211 n.5 (1956) (Frankfurter, J., concurring) (quoting *U.S. Asphalt Refining Co. v. Trinidad Lake Petroleum Co.*, 222 F. 1006, 1007 (S.D.N.Y. 1915) (quoting *Scott v. Avery*,

5 H.L. Cas. 811 (1856) (Campbell, L.J.))). *See also* H.R. Rep. No. 96, 68th Cong., 1st Sess., 1-2 (1924) ("[C]enturies ago, because of the jealousy of the English courts for their own jurisdiction, they refused to enforce specific agreements to arbitrate[.] This jealousy survived for so long that the principle became firmly embedded in the English common law and was adopted with it by the American courts.").

Congress enacted the FAA to "revers[e] centuries of judicial hostility to arbitration agreements," *Scherk*, 417 U.S. at 510-11, and in so doing, "place[d] arbitration agreements 'upon the same footing as other contracts'" as a matter of federal law, *id.* (quoting H.R. Rep. No. 68-96, at 1 (1924)); *see* S. Rep. No. 536, 68th Cong., 1st Sess. (1924); Michael G. McGuinness & Adam J. Karr, *California's "Unique" Approach To Arbitration: Why This Road Less Traveled Will Make All The Difference On The Issue Of Preemption Under The Federal Arbitration Act*, 2005 J. Disp. Resol. 61, 65 (2005) ("The FAA was enacted as remedial legislation intended to thwart judicial hostility to arbitration and force courts to assess the enforceability of arbitration agreements just as they do all other contractual provisions."). The legislative history of the FAA "establishes that the purpose behind its passage was to ensure judicial enforcement of privately made agreements to arbitrate." *Dean Witter Reynolds*, *Inc. v. Byrd*, 470 U.S. 213, 219 (1985). The House Report accompanying the FAA "makes clear that its purpose was to place an arbitration agreement 'upon the same footing as other contracts, where it belongs,' H.R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924), and to overrule the judiciary's

longstanding refusal to enforce agreements to arbitrate." *Dean Witter Reynolds*, 470 U.S. at 219-20.

The 68th Congress also wished to promote arbitration as a cheaper and less adversarial alternative to litigation. "It is practically appropriate that the action should be taken at this time when there is so much agitation against the costliness and delays of litigation. These matters can be largely eliminated by agreements for arbitration, if arbitration agreements are made valid and enforceable." H.R. Rep. No. 96, at 2. Thus, the FAA also creates a presumption *in favor of* arbitration. *Moses H. Cone Mem'l Hosp. v. Mercury Constr.*, 460 U.S. 1, 24 (1983).

B. Section 2 Of The FAA Preempts State Law That Discriminates Against Arbitration Agreements.

The heart of the FAA is Section 2. Section 2 provides:

> 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.

Section 2 displaces otherwise applicable law by making any written agreement to arbitrate "valid, irrevocable, and

enforceable" as a matter of federal law, "save upon such grounds as exist at law or in equity for the revocation of *any contract*." 9 U.S.C. § 2 (emphasis added); *see also Perry*, 482 U.S. at 492 n.9. Per the text of Section 2, any state law that serves as a basis for revocation is preempted unless it is applicable to "*any* contract." 9 U.S.C. § 2. As the "*any* contract" limitation connotes, only generally applicable contract defenses that provide a basis for revocation of any contract of any kind survive the reach of preemption under Section 2.[2] Any other state-law requirement that bears on arbitration "must give way." *Perry*, 482 U.S. at 490-491; *see also Doctor's Assocs.*, 517 U.S. at 687 ("Courts may not . . . invalidate arbitration agreements under state laws applicable only to arbitration provisions.").

Section 2 thus created what is essentially an "equal protection clause" for contract provisions, such that arbitration agreements would be treated at least as well as all other contracts. Stephen A. Broome, *An Unconscionable Application Of The Unconscionability Doctrine: How The California Courts Are Circumventing The Federal Arbitration Act*, 3 Hastings Bus. L.J. 39, 43 (2006); *see Oblix, Inc. v. Winiecki*, 374 F.3d 488, 492 (7th Cir. 2004) ("If a state treats arbitration differently, and imposes on form arbitration clauses more or different requirements from those imposed on other clauses, then its approach is preempted by § 2 of the Federal Arbitration Act."). In other words, state laws or doctrines that

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2. For example, a state-law rule requiring particularized notice (e.g., minimum font size, boldface type) for jury-trial waivers in any contract would fall within Section 2's savings clause because it would be "grounds . . . for the revocation of any contract." 9 U.S.C. § 2.

discriminate against arbitration—under whatever rubric—are preempted by Section 2.

Indeed, this Court has so stated: "By enacting [Section] 2, Congress precluded States from singling out arbitration provisions," *Doctor's Assocs.*, 517 U.S. at 687, and therefore "place[d] arbitration agreements 'upon the same footing as other contracts,'" *Scherk*, 417 U.S. at 510-11 (quoting H.R. Rep. No. 96, at 1). Moreover, the same rules of construction as apply to any contract on any subject must be applied to arbitration agreements. *Perry*, 482 U.S. at 492 n.9. Nor can a state single out a class of contracts for which arbitration is specially disfavored. *Doctor's Assocs.*, 517 U.S. at 687. "[A]ny rule of state law disfavoring or prohibiting arbitration for a class of transactions is preempted[.]" *Stone v. Doerge*, 328 F.3d 343, 345 (7th Cir. 2003).

When employing state law doctrines of "general applicability," courts thus are not permitted to employ those general doctrines in ways that subject arbitration clauses to disfavored treatment. As one federal appellate court put it, "[t]hat a state decision employs a general principle of contract law, such as unconscionability, is not always sufficient to ensure that the state-law rule is valid under the FAA." *Iberia Credit Bureau*, 379 F.3d at 167. "[S]tate courts are not permitted to employ those general doctrines in ways that subject arbitration clauses to special scrutiny." *Id.*

II. CALIFORNIA COURTS HAVE DISTORTED THE UNCONSCIONABILITY DOCTRINE TO DISFAVOR ARBITRATION AGREEMENTS.

As explained above, states may not apply laws of general applicability in ways that target arbitration agreements for disfavored treatment. Nor may they designate a particular class of contracts where arbitration clauses are disfavored. Yet that is exactly what California has done. The elements of the unconscionability analysis and the relative burdens of proof in the arbitration setting bear absolutely no relationship to those generally applied to contracts in California. Moreover, these new rules are born of a demonstrable hostility to arbitration—an assumption that arbitration cannot vindicate the public interest to the same extent as judicial class actions. Thus, both the text and the purpose of the FAA are violated by California's "unconscionability" analysis to the same extent as if California had enacted a statute to this effect.

Unconscionability "is nothing new . . . . It has been a part of Anglo-American jurisprudence of contracts for at least three centuries." Howard Hunter, Modern Law of Contracts § 19:39 (rev. ed. 1999). This Court first defined an unconscionable contract as one that "no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other." *Hume v. United States*, 132 U.S. 406, 411 (1889) (quoting *Earl of Chesterfield v. Janssen*, 2 Ves. Sr. 125, 155 (1750)). *Hume* is the starting point for American courts, as "[t]he modern definition of unconscionability comes directly" from the standard it adopted from English common law. Hunter, *supra*, § 19:39.

Generally, unconscionability is broken into two separate elements—procedural and substantive. *See* 8 Richard A. Lord, Williston on Contracts § 18:10 (4th ed. 1998); *Am. Software*, *Inc. v. Ali*, 46 Cal. App. 4th 1386, 1390 (1996). Substantive unconscionability "focuses on the actual terms of the agreement, while procedural unconscionability focuses on the manner in which the contract was negotiated and the circumstances of the parties." *Am. Software*, 46 Cal. App. 4th at 1390; Lord, *supra*, § 18:10. While courts generally require both substantive and procedural unconscionability in order to find a contract unconscionable, courts have differed over the degree of each element required. While some courts have required "a sufficient showing of both factors in finding a contract unconscionable," *see Sitogum Holdings*, *Inc. v. Ropes*, 800 A.2d 915, 921 (N.J. Super. Ct. Ch. Div. 2002) (listing cases), other courts, such as California, use a "sliding scale," in which "the more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa." *Armendariz*, 24 Cal. 4th at 114. Like other contractual defenses, the general rule is that "[t]he party asserting unconscionability as a defense has the burden of establishing that condition." *Woodside Homes of Cal.*, *Inc. v. Superior Court*, 107 Cal. App. 4th 723, 727-28 (2003); E. Allen Farnsworth, Farnsworth on Contracts § 4.28 (2d ed. 2001).

A. California Courts Have Distorted Procedural Unconscionability By Labeling Standard Form Contracts Per Se Procedurally Unconscionable In The Arbitration Context.

As per the traditional rule, outside of the arbitration context, California courts generally undertake a multifaceted inquiry into contract formation to determine whether an agreement is procedurally unconscionable. As California courts have recognized, procedural unconscionability "focuses on two factors: 'oppression' and 'surprise.'" *A&M Produce Co. v. FMC Corp.*, 135 Cal. App. 3d 473, 486 (1982) (citation omitted); *accord* U.C.C. § 2-302, comment 1 ("The principle is one of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power."). Oppression "arises from an inequality of bargaining power which results in no real negotiation and 'an absence of meaningful choice.'" *A&M Produce Co.*, 135 Cal. App. 3d at 486 (quoting *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449 (D.C. Cir. 1965)). Surprise "involves the extent to which the supposedly agreed-upon terms of the bargain are hidden in a prolix printed form drafted by the party seeking to enforce the disputed terms." *Id.*

Under these general principles, California courts will not conclude a contract to be procedurally unconscionable simply because it is a so-called "adhesion contract."[3] Instead, procedural unconscionability

3. In truth, standard form retail contracts—although sometimes pejoratively termed "adhesion contracts"—have numerous benefits to businesses and consumers. *See* Randy E. (Cont'd)

requires an examination of "all the circumstances." *See Walker-Thomas Furniture Co.*, 350 F.2d at 449 ("Whether a meaningful choice is present in a particular case can only be determined by consideration of all the circumstances surrounding the transaction."); *M.F. Kemper Constr. Co. v. City of L.A.*, 37 Cal. 2d 696, 702-03 (1951) (holding that "under all the circumstances" enforcement of the contract would be unconscionable).

Courts thus will consider, for example, "the experience, intelligence, and education of the parties, their relative bargaining power, the presence or absence of meaningful choice on the part of the weaker party, the conspicuousness and clarity of the contract terms, and other factors." U.C.C. § 2-302, comment; *see also* Restatement (Second) of Contracts § 208, cmt. d (1981)

(Cont'd)

Barnett, The Oxford Introduction to U.S. Law: Contracts 105 (2010) ("Most contract law professors and practitioners . . . know that form contracts make the world go round."); *id.* at 105-114 (explaining the commercial advantages of form contracts and why their enforcement is consistent with contractual consent). Even those critical of standard form contracts recognize that this is so. *See, e.g.*, Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 Colum. L. Rev. 629, 631-32 (1943) ("In so far as the reduction of costs and production and distribution thus achieved is reflected in reduced prices, society as a whole ultimately benefits from the use of standard contracts."); *Morris v. Redwood Empire Bancorp*, 128 Cal. App. 4th 1305, 1317 n.5 (2005) ("Adhesion contracts are, of course, a familiar part of the modern legal landscape. They are also an inevitable fact of life for all citizens—businessman and consumer alike." (citation and alteration omitted)).

(describing the various "[f]actors which may contribute to a finding of unconscionability in the bargaining process"). *See*, *e.g.*, *Dean Witter Reynolds*, *Inc. v. Superior Court*, 211 Cal. App. 3d 758, 767-68 (1989) ("Also relevant under [procedural unconscionability] is the buyer's sophistication, or lack of same."); *Belton v. Comcast Cable Holdings*, 151 Cal. App. 4th 1224, 1245 (2007) (finding no procedural unconscionability in part because the plaintiff was performing a nonessential recreational activity (listening to music) and so did not lack a meaningful choice).

Applying these principles, California courts have repeatedly held that "[t]he availability of alternative sources from which to obtain the desired service defeats any claim of oppression, because the consumer has a meaningful choice." *Belton*, 151 Cal. App. 4th at 1245. *See also Wayne v. Staples*, *Inc.*, 135 Cal. App. 4th 466, 482 (2006) ("There can be no oppression establishing procedural unconscionability, even assuming unequal bargaining power and an adhesion contract, when the customer has meaningful choices."); *Dean Witter Reynolds*, 211 Cal. App. 3d at 768 ("[A]ny claim of 'oppression' may be defeated if the complaining party had reasonably available alternative sources of supply from which to obtain the desired goods or services free of the terms claimed to be unconscionable."); *Morris v. Redwood Empire Bancorp*, 128 Cal. App. 4th 1305, 1320 (2005) (same); *Aron v. U-Haul Co. of Cal.*, 143 Cal. App. 4th 796, 809 (2006) (same). As California has recognized, if all standardized contracts were procedurally unconscionable, then "every form contract not subject

to negotiation between the parties would be deemed oppressive, totally disregarding the undisputed ability of a contracting party to choose to obtain that for which he bargained from other sources." *Dean Witter Reynolds*, 211 Cal. App. 3d at 769; *Morris*, 128 Cal. App. 4th at 1319 ("To describe a contract as adhesive in character is not to indicate its legal effect. A contract of adhesion is fully enforceable according to its terms unless certain other factors are present which, under established legal rules—legislative or judicial—operate to render it otherwise." (citation and alteration omitted)).

Thus, California courts often find standardized form contracts not procedurally unconscionable, at least in non-arbitration cases. For example, in *Kurashige v. Indian Dunes, Inc.*, 200 Cal. App. 3d 606 (1988), the plaintiff, before riding his motorcycle into a park, signed a "General Release" agreement relieving the park of liability. After the plaintiff was injured, he sought to hold the contract unconscionable. Although "the record show[ed] there was no real negotiation" because "the 'General Release' agreement was preprinted and all users of Indian Dunes Park were required to sign it before using the park," the court found no procedural unconscionability. *Id.* at 613-14. The court noted that "[t]he meaningfulness of a party's choice is based not only on his relationship to the other party but also on his ability to obtain the goods or services which are the subject of the parties' contract from others." *Id.* In *Indian Dunes*, the record did "not show plaintiff had no meaningful choice in deciding to sign the agreement"

because there was "no evidence plaintiff could not have ridden his motorcycle elsewhere without the constraints imposed upon him by defendants." *Id.*; *see also Freeman v. Wal-Mart Stores, Inc.*, 111 Cal. App. 4th 660, 670 (2003) ("[P]laintiff was not subjected to a take-it-or-leave-it situation in which there was no reasonable alternative but to accept the shopping card terms. Plaintiff could simply decline to purchase a shopping card and make purchases by other means."); *Olsen v. Breeze, Inc.*, 48 Cal. App. 4th 608, 621 (1996) (finding no unconscionability—even though the form waiver provisions in the ski equipment service agreement were industry standard and could not be avoided by taking business elsewhere—because the plaintiff did not need to ski). In other words, California courts generally give standardized form contracts traditional procedural unconscionability analysis and will not find unconscionability if meaningful alternatives exist.

But the "meaningful choice" analysis simply disappears in the arbitration context. California courts will deem an arbitration agreement to be procedurally unconscionable if it is contained in a standardized form contract. As the Ninth Circuit demonstrated below, *Laster v. AT&T Mobility LLC*, 584 F.3d 849, 854-55 (9th Cir. 2009), California courts dispense with the traditional procedural unconscionability analysis entirely—spotting an arbitration agreement in a standardized contract is enough. *See, e.g.*, *Aral v. EarthLink, Inc.*, 134 Cal. App. 4th 544, 557 (2005) (describing an adhesion contract containing an arbitration clause as "quintessential procedural unconscionability"); *Szetela v. Discover Bank*, 97 Cal. App. 4th 1094, 1100 (2002) ("When the weaker party is presented the [arbitration] clause and told to 'take it or leave it' without the opportunity for meaningful

negotiation, oppression, and therefore procedural unconscionability, are present."); *Flores*, 93 Cal. App. 4th at 853 ("A finding of a contract of adhesion is essentially a finding of procedural unconscionability."); *Wilson v. Bally Total Fitness Corp.*, No. D039355, 2003 WL 21398324, at *4 (Cal. Ct. App. June 18, 2003) ("The fact the Agreement is an adhesion contract is sufficient to establish that the Agreement is procedurally unconscionable and there is no need for [the plaintiff] to present evidence showing that she attempted to negotiate the arbitration requirement or other terms of the agreement."); *see also Gatton v. T-Mobile USA, Inc.*, 152 Cal. App. 4th 571, 593, 597 (2007) (Jones, J., concurring and dissenting) ("I recognize that a number of cases have implied, if not stated outright, that a contract of adhesion is inherently procedurally unconscionable."); Broome, *supra*, at 63 ("[I]n California, in both the employment and the commercial context, adhesive arbitration agreements are procedurally unconscionable per se.").

Worse still, California courts follow this per se rule for arbitration agreements even when they appear to consider the relevant factors. For example, in *Gentry v. Superior Court*, the California Supreme Court found an arbitration agreement in an adhesion contract procedurally unconscionable, even though employees received ample information on arbitration, were *not required* to sign the agreement, and could even opt out within a grace period if they changed their mind after signing. 42 Cal. 4th 443, 471-72 (2007). The Court found this contract procedurally unconscionable because the company "preferred that the employee participate in the arbitration program" and so the employee "felt at

least some pressure not to opt out of the arbitration agreement." *Id.* Additionally, "the lack of material information about the disadvantageous terms of the arbitration agreement" demonstrated that the contract "was, at the very least, not entirely free from procedural unconscionability." *Id. See also Ferguson v. Countrywide Credit Indus.*, 298 F.3d 778, 784 (9th Cir. 2002) (finding procedural unconscionability even if the employee had "ample time to consider alternatives to [the employer's] terms of employment" and the contract was "written in plain language"); *McManus v. CIBC World Mkts. Corp.*, 109 Cal. App. 4th 76, 91-92 (2003) (finding procedural unconscionability when an agreement to arbitrate was found in a form agreement approved by the SEC and required under the federal and state securities laws).

In sum, California courts are not applying generally applicable procedural unconscionability law to arbitration agreements. *See* Broome, *supra*, at 64-65 (citing cases to demonstrate that "in the non-arbitration context adhesion contracts are frequently held not to be procedurally unconscionable," whereas for arbitration agreements "adhesion alone is enough to satisfy the California courts that the agreement is procedurally unconscionable"). For non-arbitration cases California courts apply their generally applicable law, examining all the circumstances to determine whether there was oppression or surprise. But for arbitration cases they apply a different law—the mere presence of an adhesion contract creates per se procedural unconscionability. This discrimination is prohibited by Section 2 of the FAA.

B. California Courts Apply The Concept Of Substantive Unconscionability In A Manner That Uniquely Disfavors Arbitration Agreements.

1. To Be Substantively Unconscionable, Contract Terms Must "Shock The Conscience."

Because freedom of contract is "regarded as part of the common law heritage," courts generally will hold individuals to their contracts, no matter how "unwise and even foolish" the terms may be. Lord, *supra*, § 18:1; *see also Printing & Numerical Registering Co. v. Sampson*, L.R. 19 Eq. 462, 465 (1873) ("[I]f there is one thing which more than another public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice."); *Transamerica Corp. v. Parrington*, 115 Cal. App. 2d 346, 357 (1953) (same); *Smith v. San Francisco & N.P. Ry. Co.*, 115 Cal. 584, 600 (1897) (same). Accordingly, courts should invalidate an agreement only when "enforcement of the terms of a contract [would be] so unconscionable that no decent, fair-minded person would view the ensuing result without being possessed of a profound sense of injustice." Lord, *supra*, § 18:1 (quotation marks omitted).

Substantive unconscionability analysis concerns the terms of the contract. It requires a showing of harsh, one-sided or oppressive terms, *see*, *e.g.*, *24 Hour Fitness*, *Inc. v. Superior Court*, 66 Cal. App. 4th 1199,

1213 (1998); *Walker-Thomas Furniture Co.*, 350 F.2d at 450, and generally involves an undue appropriation of money or property by the party of superior bargaining power. *See* Restatement (Second) of Contracts § 208, cmt. c (1981) (citing "gross disparity in the values exchanged" as an "important factor in a determination that a contract is unconscionable").

Unreasonableness is not enough. Under the traditional rule—which California courts follow—substantive unconscionability requires contract terms that "shock the conscience." *Cal. Grocers Ass'n v. Bank of Am.*, 22 Cal. App. 4th 205, 214 (1994) ("The traditional standard of unconscionability, as set forth in *Osgood v. Franklin* (1816 N.Y. Ch.) I Johns. Ch. 1, 21, is that '. . . the inequality amounting to fraud must be so strong and manifest as to *shock the conscience* . . . .'") (emphasis in original); *Hicks v. Superior Court*, 115 Cal. App. 4th 77, 93 (2004) ("To be substantively unconscionable, a contractual provision must shock the conscience."); *cf.* Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J. L. & Econ. 293, 294 (1975) (noting that unconscionability should not "allow courts to act as roving commissions to set aside those agreements whose substantive terms they find objectionable"). Indeed, California courts have expressly rejected the lower bar of unreasonableness. *See Morris*, 128 Cal. App. 4th at 1322 ("The phrases 'harsh,' 'oppressive,' and 'shock the conscience' are not synonymous with 'unreasonable.' Basing an unconscionability determination on the reasonableness of a contract provision would inject an inappropriate level of judicial subjectivity into the analysis."); *Am. Software*, 46 Cal. App. 4th at 1391 ("With a concept as nebulous as 'unconscionability' it is

important that courts not be thrust in the paternalistic role of intervening to change contractual terms that the parties have agreed to merely because the court believes the terms are unreasonable. The terms must shock the conscience.").

Importantly, unconscionability is determined "at the moment when [the contract] is entered into by both parties—not . . . in light of subsequent events," *Am. Software*, 46 Cal. App. 4th at 1391; *see also* Cal. Civ. § 1670.5(a), and so California courts will not invalidate a contract "'merely because an aggrieved party believes that the contract has subsequently proved to be unfair or less beneficial than anticipated.'" *Morris*, 128 Cal. App. 4th at 1324 (quoting *Geldermann & Co. v. Lane Processing, Inc.*, 527 F.2d 571, 576 (8th Cir. 1975)). Finally, "[t]he party asserting unconscionability as a defense has the burden of establishing that condition." *Woodside Homes*, 107 Cal. App. 4th at 727-28.

2. In The Arbitration Context, California Courts Have Abandoned The "Shock-The-Conscience" Standard In Favor Of A Mutuality Test.

California courts have abandoned the traditional "shock-the-conscience" standard for substantive unconscionability in the arbitration context. Instead, they have devised a test for substantive unconscionability that is unique to arbitration. They examine whether the arbitration clause is "one-sided" by determining whether there is a lack of "mutuality" of obligation under the arbitration agreement. *See Discover Bank*, 36 Cal. 4th at 161; *Ingle v. Circuit City Stores*, 328 F.3d 1165, 1176 (9th

Cir. 2003); *Szetela*, 97 Cal. App. 4th at 1100-01; *Armendariz*, 24 Cal. 4th at 117-18; *Stirlen v. Supercuts, Inc.*, 51 Cal. App. 4th 1519, 1538-40 (1997).

Initially, the mutuality test required equality of obligation as to both parties to an arbitration clause, *i.e.*, that both parties agreed to be bound by arbitration. *See Stirlen*, 51 Cal. App. 4th at 1538. Without bilaterality of obligation, an arbitration clause would be presumed substantively unconscionable. *See Armendariz*, 24 Cal. 4th at 117-18. This strict mutuality is not required for other terms of a contract. Indeed, it is black letter law that, as long as the contract as a whole is supported by adequate consideration, there need not be mutuality in each individual term. *See* Lord, *supra*, § 7:14 (emphasizing that it is "imperative" to understand that "no requirement of mutuality exists so long as the requirement of consideration is met") (citing Restatement (Second) of Contracts § 79(c) (1981)).

The *Stirlen* court grounded this mutuality principle on its assumption that arbitration is an inferior mechanism for adjudicating claims. While acknowledging that "it may often be advantageous for employees to submit employment disputes to arbitration," the court struck down an arbitration clause that bound only the employee, not the employer, to arbitration. *Stirlen*, 51 Cal. App. 4th at 1537. The court emphasized that arbitration procedures are "disadvantageous" and, indeed, "inferior" in a number of ways, including that "arbitral discovery is ordinarily much more limited than judicial discovery, which may seriously compromise an employee's ability to prove discrimination or unfair treatment" and because "parties who submit a dispute

to private arbitration also give up their right to review of an adverse decision." *Id.* at 1537-38.

Other California courts soon extended this newly crafted mutuality requirement to arbitration clauses in consumer contracts. *See*, *e.g.*, *Flores*, 93 Cal. App. 4th at 858 (loan agreement); *Torigian v. Michael Cadillac, Inc.*, No. F039900, 2003 WL 21246609, at *5 (Cal. Ct. App. May 29, 2003) (automobile sales contract). Moreover, subsequent cases extended this mutuality requirement even further, invalidating arbitration clauses that bound both parties to arbitration if, in the court's predictive judgment, the agreement to arbitrate would apply in only one direction in practice. *See Ingle*, 328 F.3d at 1173-74 (disregarding the fact that both parties were subject to the same terms, stating: "[b]ecause the possibility that Circuit City would initiate an action against one of its employees is so remote, the lucre of the arbitration agreement flows one way: the employee relinquishes rights while the employer generally reaps the benefits of arbitrating its employment disputes.").

This "in practice" rationale was applied to agreements requiring individual arbitration in *Discover Bank*. There, the California Supreme Court extended its mutuality test to find class arbitration waivers "indisputably one-sided," noting that "[a]lthough styled as a mutual prohibition on representative or class actions, it is difficult to envision the circumstances under which the provision might negatively impact Discover [Bank], because credit card companies typically do not

sue their customers in class action lawsuits." *Discover Bank*, 36 Cal. 4th at 161 (citation omitted). Subsequent cases have relied on this reasoning to hold similar arbitration agreements presumptively one-sided. *See*, *e.g.*, *Gentry*, 42 Cal. 4th at 454 ("[C]lass action or arbitration waivers are indisputably one-sided."). More particularly, in striking down class arbitration waivers, California courts have reasoned that this "practical" or *de facto* lack of mutuality allows businesses to employ class arbitration waivers as weapons. That is, the "one-sided" nature of a class arbitration waiver permits it to be utilized as an "exculpatory" clause that enables a business to "carr[y] out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money." *Discover Bank*, 36 Cal. 4th at 163.

3. The Mutuality Test Bears No Resemblance To The Traditional "Shock-The-Conscience" Standard.

California's "mutuality test" departs fundamentally from its traditional substantive unconscionability analysis in three ways. First, California courts have expressly rejected this concept of mutuality outside of the arbitration context. *See Principal Life Mut. Ins. Co. v. Vars*, *Pave*, *McCord & Freedman*, 65 Cal. App. 4th 1469, 1489 (1988) (holding mortgage agreement provision enforceable despite unilateral nature and noting that "where sufficient consideration is present, mutuality is not essential"); *Hillsman v. Sutter Cmty. Hosp.*, 153 Cal. App. 3d 743, 752 (1984) (holding employment contract enforceable despite unilateral nature if consideration requirement is properly met and noting that "mutuality of obligation" is unnecessary).

Second, the mutuality requirement is a sharp break from the "shock-the-conscience" standard. This standard requires an examination of the *entire contract*—not just particular terms through the mutuality test. *See Oblix*, 374 F.3d at 492 ("That Oblix did not promise to arbitrate all of its potential claims is neither here nor there. . . . [A]rbitration was as much a part of this deal as Winiecki's salary and commissions, the rules about handling trade secrets, and other terms. All stand or fall together.").

Mutuality requires no inquiry into the harshness of the clause or contract; it simply presumes substantive unconscionability from a "one-sided" promise and then reverses the traditional presumption onto the party seeking to enforce the agreement to arbitrate as written. *Compare Ingle*, 328 F.3d at 1174 ("Unless the employer can demonstrate that the effect of a contract to arbitrate is bilateral—as is required under California law—with respect to a particular employee, courts should presume such contracts substantively unconscionable.") (citing, among others, *Stirlen* and *Armendariz*), *with Woodside Homes*, 107 Cal. App. 4th at 727-38 ("The party asserting unconscionability as a defense has the burden of establishing that condition.").

Finally, mutuality is based on the assumption that arbitration is inferior to judicial proceedings as an adjudicatory process and that it is incapable of vindicating substantive rights. But the Court has barred this assumption of inferiority from serving as a basis for refusing to enforce an agreement to arbitrate. *See 14 Penn Plaza LLC v. Pyett*, 129 S. Ct. 1456, 1471 (2009) ("At bottom, objections centered on the nature

of arbitration do not offer a credible basis for discrediting the choice of that forum."). Moreover, the Court has emphasized that an agreement to arbitrate, i.e., to adopt certain adjudicatory *procedures*, does not affect underlying *substantive* rights. *See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985) ("By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral . . . forum."); *see also Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991).[4]

This distortion of the applicable standard is not merely an academic matter. It translates into a real and demonstrable difference in outcome. An empirical study of judicial decisions from California's intermediate courts of appeal over a 24-year period reveals the disparity with regard to unconscionability challenges as between arbitration agreements and all other contracts. "[U]nconscionability challenges succeeded in about fifty-eight percent of cases in the arbitration context. In the non-arbitration context, by contrast, unconscionability challenges succeeded only eleven percent of the time." Broome, *supra*, at 48.

California courts' hostility to arbitration is further illustrated by example. *Woodside Homes* involved the application of unconscionability doctrine to a "judicial reference clause" in a standard form contract, which "required consumer homebuyers who sue the builder

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4. This application of substantive unconscionability to procedural rights is another deviation from traditional contract law principles of the California courts.

to submit the dispute to binding judicial reference." 107 Cal. App. 4th at 727-28. The plaintiffs argued that several features of the judicial reference clause were unconscionable, including the fact that the building company could opt-out of judicial reference; the referee need not be a judge; the parties waived their right to a jury; the decision was to be confidential; the parties would share the costs and the referee's fees; and each party would be responsible for its own attorney's fees. *Id.* at 37.

The *Woodside Homes* court felt obliged to note that it was not dealing with an arbitration case: "we must point out that this is not an arbitration case, and therefore not all authorities dealing with arbitration agreements are directly relevant." *Id.* at 38. The court then proceeded to uphold the judicial reference clause. The court found no problem with the opt-out provision (despite its rendering of the judicial reference clause non-mutual) or the other challenged provisions, concluding that "none of these is of substantial weight." *Id.* at 41. The court explained that "a provision which favors one side is not substantively unconscionable if the advantage is completely collateral to the issues surrounding a fair resolution of the dispute." *Id.* at 42 n.11. On the other hand, California courts have held similar provisions in arbitration agreements to be unconscionable. *See, e.g.*, *Ting v. AT&T*, 319 F.3d 1126, 1151 (9th Cir. 2003) (applying California law and holding a provision splitting arbitrator fees unconscionable); *id.* at 1152 (finding a "confidentiality provision" unconscionable).

This distortion of unconscionability law has not been lost on commentators or courts. *See* McGuinness, *supra*, at 78 ("California courts—and the Ninth Circuit—have changed the unconscionability doctrine to strike down arbitration agreements."); Broome, *supra*, at 39 ("Although ostensibly applying the 'generally applicable' contract defense of unconscionability, in cases involving the validity of arbitration agreements the California courts routinely apply an entirely different test, requiring less of parties seeking to avoid arbitration."). In fact, *California courts themselves have recognized the discrimination. Gray v. Conseco, Inc.*, No. 00-CV-322, 2000 WL 1480273, at *4 (C.D. Cal. Sept. 29, 2000) ("Under California law, other non-mutual contract provisions are valid and not unconscionable. The language used by the California Supreme Court in the *Armendariz* opinion itself demonstrates that the rule singles out and imposes a special burden on arbitration agreements . . . ." (citation omitted)).

The exculpatory clause rationale—which is a particular manifestation of the mutuality requirements in the context of a class arbitration waiver, *see supra* section II.B.2—applies only after "it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money." *Discover Bank*, 36 Cal. 4th at 162-63. But this is not a proper application of unconscionability doctrine, as substantive unconscionability has always been determined *at the time of contracting*, *see*, *e.g.*, *Walker-Thomas Furniture Co.*, 350 F.2d at 448 ("[A] court may refuse to enforce a contract which it finds to be unconscionable *at the time it was made*.") (emphasis

added), even under the California Civil Code, *see* Cal. Civ. § 1670.5(a) ("If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable *at the time it was made* the court may refuse to enforce the contract.") (emphasis added). That it is *later* alleged that a party carried out a "scheme to deliberately cheat large numbers of consumers out of individually small sums of money" is irrelevant to the analysis. *See*, *e.g.*, *Am. Software*, 46 Cal. App. 4th at 1392 (holding not unconscionable an employment contract that terminated the employee's right to receive commissions on payments received on her accounts 30 days after severance of employment, even though she allegedly lost approximately $30,000 in unpaid commissions).

In any case, the interests of third parties are irrelevant. Unconscionability concerns only the parties to the agreement, no one else. *See Reibold v. Simon Aerials*, *Inc.*, 859 F.Supp. 193, 199 (E.D. Va. 1994) ("[W]hether any agreement is unconscionable or not can only be examined with reference to the original parties to the bargain."); *Lynwood Redevelopment Agency v. Angeles Field Partners*, *LLC*, No. B210165, 2009 WL 4690213, at *8 (Cal. Ct. App. Dec. 10, 2009) ("Respondent has not directed our attention to any statute or case authorizing application of the doctrine of unconscionability for the benefit of nonparties to the contract.").

Perhaps more importantly, the exculpatory clause rationale, like the mutuality test to which it relates, is based upon the twin prohibited assumptions that arbitration is an inferior procedure for vindicating

claims and that it thus forecloses substantive rights. As this Court has emphasized, "the recognition that arbitration procedures are more streamlined than federal litigation is not a basis for finding the forum somehow inadequate." *14 Penn Plaza LLC*, 129 S. Ct. at 1471.[5] "[B]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum." *Mitsubishi Motors Corp.*, 473 U.S. at 628.[6]

Finally, the exculpatory clause rationale suffers from a flawed premise—that the alleged inability of consumers to pursue low-value claims will result in companies escaping liability and undermine general deterrence. This theory neglects the fact that state attorneys general, *see*, *e.g.*, Cal. Bus. & Prof. §§ 17204, 17206 (authorizing the California Attorney General to enforce state consumer protection law through civil penalties and injunctive relief), and appropriate federal agencies have oversight over sellers of consumer products, *see*, *e.g.*, *Gilmer*, 500 U.S. at 32 ("[I]t should be remembered that

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5. Bilateral arbitration in fact yields demonstrable benefits for both consumers and businesses. *See* Chamber of Commerce Amicus Curiae Brief in Support of Petition for Certiorari at 6-16.

6. Because arbitration does not expunge substantive rights, California courts' reliance on California Civil Code section 1668 in invalidating arbitration clauses is misplaced. *See* Cal. Civ. § 1668 ("All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law.").

arbitration agreements will not preclude the EEOC from bringing actions seeking class-wide and equitable relief.").

III. CALIFORNIA'S DISTORTION OF UNCONSCIONABILITY LAW TO STRIKE DOWN ARBITRATION CLAUSES IS PREEMPTED UNDER THE FAA.

California courts' distortion of state unconscionability law to uniquely disfavor arbitration agreements is preempted by Section 2 of the FAA. *See Perry*, 482 U.S. at 492 n.9 ("A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with [the text of § 2]."). The FAA simply does not permit states to "singl[e] out arbitration provisions for disfavored treatment." *Doctor's Assocs.*, 517 U.S. at 687;[7] *see*, *e.g.*, *Enderlin v. XM Satellite Radio*

7. There is a strong argument that the reference in the savings clause to "revocation" applies only to defects in the formation of contracts (procedural defects affecting offer and acceptance) rather than substantive "public policy." Congress used three terms to describe the status of arbitration agreements under federal law: "valid, irrevocable, and enforceable." 9 U.S.C § 2. Each of these terms must be assigned a distinct meaning. *See Conn. Dep't of Income Maint. v. Heckler*, 471 U.S. 524, 530 n.15 (1985). Moreover, Congress's use of the noun "revocation" in the same sentence as its adjectival antonym "irrevocable" further evidences that the latter term must be given a different meaning than "valid" and "enforceable." This textual argument is reinforced by the language of Section 4, indicating that upon being satisfied "that the making of the agreement for arbitration . . . is not at issue" a court should order arbitration. *See*, *e.g.*, *Nat'l R.R. Passenger Corp. v. Consol. Rail Corp.*, 892 F.2d 1066, 1070 (D.C. Cir. 1990) ("[T]he language (Cont'd)

Holdings, *Inc.*, No. 06-CV-0032, 2008 WL 830262, at *10 (E.D. Ark. Mar. 25, 2008) ("The Court agrees with Defendants' contention that Arkansas law requiring mutuality within the arbitration paragraph itself is preempted by the FAA because it places the arbitration clause on unequal footing with other contract terms that do not each have to be mutual.").

Nor can California hide this distortion by dressing it in the garb of general unconscionability law. It is no less a violation of the FAA that California courts purport to apply its general law. For the FAA forbids states from doing covertly what they are prohibited from doing overtly. *See Iberia Credit Bureau*, 379 F.3d at 167 ("[S]tate courts are not permitted to employ those general doctrines in ways that subject arbitration clauses to special scrutiny.").

(Cont'd)

of § 2 (which speaks to revocation . . .), especially when read in conjunction with § 4 . . . , indicates that Congress created an exception to the general rule (that an arbitration clause will be enforced by its terms) only when there is a flaw in the formation of the agreement to arbitrate."). This reading of the statute also accords with the understanding of the concept of "revocation" at the time of the adoption of the FAA, which was short hand for formation defects, not public policy objections to contracts. *See* Wesley A. Sturges, A Treatise on Commercial Arbitrations & Awards § 15(1)-(2) (1930) ("An agreement of this character induced by fraud, or overreaching, or entered into unadvisedly through ignorance, folly or undue pressure might well be . . . disregarded . . . . But [otherwise], it is not easy to assign at this day any good reason why the contract should not stand[.]") Petitioner supplies additional support for this argument in New York law at the time of the adoption of the FAA. *See* AT&T Br. at 41 & n.12.

Thus, the Ninth Circuit's application of the unconscionability doctrine to void AT&T Mobility's arbitration clause violates the FAA. This new doctrine—which just happens to be labeled "unconscionability"—has no roots in the common law and does not apply to "any contract." It violates both the plain text and the purpose of the FAA, and thus is preempted. *Oblix*, 374 F.3d at 492 ("[N]o state can apply to arbitration (when governed by the Federal Arbitration Act) any novel rule.").

CONCLUSION

For the reasons set forth herein, the judgment of the court of appeals should be reversed.

Respectfully submitted,

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APPENDIX

APPENDIX

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