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 AMICUS CURIAE OF PACIFIC LEGAL FOUNDATION IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether the Federal Arbitration Act preempts States from conditioning the enforcement of an arbitration agreement on the availability of particular procedures—here, class-wide arbitration—when those procedures are not necessary to ensure that the parties to the arbitration agreement are able to vindicate their claims.

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INTEREST OF AMICUS CURIAE[1]

PLF was founded more than 35 years ago and is widely recognized as the largest and most experienced nonprofit legal foundation of its kind. PLF litigates matters affecting the public interest at all levels of state and federal courts and represents the views of thousands of supporters nationwide. Among other things, PLF's Free Enterprise Project defends the freedom of contract, including the right of parties to agree by contract to the process for resolving disputes that might arise between them. To that end, PLF has participated as amicus curiae in many important cases involving the Federal Arbitration Act (FAA) and contractual arbitration in general, including this case at the petition stage. *See, e.g.*, *Athens Disposal Co., Inc. v. Franco*, 130 S. Ct. 1050 (2010); *Stolt-Nielsen S. A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758 (2010); *DHL Express (USA), Inc. v. Ontiveros*, 129 S. Ct. 1048 (2009); *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008); *Preston v. Ferrer*, 552 U.S. 346 (2008); *Circuit City Stores, Inc. v. Gentry*, 552 U.S. 1296 (2008); and *Cingular Wireless, LLC v. Mendoza*, 547 U.S. 1188 (2006).

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[1] Pursuant to this Court's Rule 37.3(a), all parties have consented to the filing of this brief. Letters evidencing such consent have been filed with the Clerk of the Court.

Pursuant to Rule 37.6, Amici Curiae affirm that no counsel for any party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than Amici Curiae, their members, or their counsel made a monetary contribution to its preparation or submission.

INTRODUCTION AND SUMMARY OF ARGUMENT

This case was brought under diversity jurisdiction in the federal courts, but the Ninth Circuit below applied California law and it is, in fact, the California courts' open hostility to arbitration that is the crux of the problem exemplified in this case.

Just weeks ago, this Court reaffirmed that Congress enacted the Federal Arbitration Act (FAA), 9 U.S.C. §§ 1-16, to overcome judicial resistance to arbitration and that the savings clause of Section 2 embodies the national policy favoring arbitration and places arbitration agreements on equal footing with all other contracts. *Rent-a-Center v. Jackson*, docket no. 09-497, slip op. at 3 (decided June 21, 2010). *See also Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006). Under this federal substantive law, arbitration contracts are to be construed as any other contract, not subjected to more stringent review or disfavor because the subject matter is arbitration. *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984).

These matters have been settled law for 25 years. California courts, however, still scrutinize arbitration with suspicion and dislike, and invalidate arbitration contracts with distressing regularity. Most commonly, California courts invoke unconscionability principles to invalidate the contracts. However, the unconscionability doctrine is not applied neutrally among all types of contracts, resulting in the disproportionate invalidation of arbitration provisions as opposed to other contracts. For example, parties to an arbitration contract are held to a higher standard of "mutuality" than parties to other types of contracts, and the "sliding scale" of unconscionability analysis does not

apply to arbitration contracts: a low level of procedural unconscionability should require a high level of substantive unconscionability, but in California, a finding of the most minimal suggestion of both types will do. Additionally, California courts analyzing arbitration contracts hold the existence of market alternatives to be irrelevant to whether the contract formation was marred by procedural unconscionability, but do consider the availability of market alternatives to be a significant factor in the analysis of other types of contracts. These features of California jurisprudence, which infect federal courts exercising diversity jurisdiction, as in this case, interfere with the normal and proper functioning of the California marketplace, injuring businesses and consumers alike.

ARGUMENT

I

CALIFORNIA'S UNCONSCIONABILITY DOCTRINE UNIQUELY DISFAVORS ARBITRATION CONTRACTS

This Court has recognized that the freedom to make and enforce contracts reflects a fundamental element of free choice and should be protected for that reason. *See, e.g.*, *Stolt-Nielsen*, 130 S. Ct. at 1774 ("Underscoring the consensual nature of private dispute resolution, we have held that parties are '"generally free to structure their arbitration agreements as they see fit."'") (citation omitted); *Advance-Rumely Thresher Co., Inc. v. Jackson*, 287 U.S. 283, 288 (1932) ("[F]reedom of contract is the general rule and . . . [t]he exercise of legislative authority to abridge it can be justified only by the existence of exceptional circumstances."); *Twin City*

Pipe Line Co. v. Harding Glass Co., 283 U.S. 353, 356 (1931) ("The general rule is that competent persons shall have the utmost liberty of contracting and that their agreements voluntarily and fairly made shall be held valid and enforced in the courts."). For this reason, state law grounds for invalidation must not "take[] [their] meaning precisely from the fact that a contract to arbitrate is at issue . . . . A court may not . . . rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987) (holding that the FAA preempts California Labor Code § 229 insofar as the statute allowed litigation in court to collect wages without regard to the existence of any private arbitration agreement). Or, as the Court rephrased the point in *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996), "Courts may not . . . invalidate arbitration agreements under state laws applicable only to arbitration provisions." Yet this is *exactly* the tactic adopted by the Ninth Circuit below, applying California law.

While the FAA permits state courts to apply "ordinary principles of unconscionability," the FAA forbids state courts from implementing substantive state policies that undermine arbitration clauses. Moreover, "a state cannot evade FAA preemption simply by labeling procedures which are inconsistent with its substantive policies as unconscionable." Alan S. Kaplinsky & Mark J. Levin, *The Gold Rush of 2002: California Courts Lure Plaintiffs' Lawyers (but Undermine Federal Arbitration Act) by Refusing to Enforce "No-Class Action" Clauses in Consumer Arbitration Agreements*, 58 Bus. Law. 1289, 1295 (2003). Similarly, this Court's arbitration jurisprudence does

not permit a state to use unconscionability as a ground for voiding arbitration agreements in certain classes of disputes just because the state court believes those disputes are better handled by some other means of dispute resolution. *See Preston v. Ferrer*, 552 U.S. at 359 ("When parties agree to arbitrate all questions arising under a contract, the FAA supersedes state laws lodging primary jurisdiction in another forum, whether judicial or administrative."). As one commentator noted:

> [T]he United States Supreme Court surely would review state courts' unconscionability rulings to the extent necessary to prevent the unconscionability doctrine from effectively nullifying the FAA with respect to a huge class of contracts. Indeed, the Court has twice stated that state courts may not "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what . . . the state legislature cannot."

Stephen J. Ware, *Alternative Dispute Resolution* § 2.25(b), at 58 (West 2001) (citing *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. at 687-88 n.3; *Perry*, 482 U.S. at 492 n.9. That is, a court may not "decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause." *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265, 281 (1995).

Moreover, unconscionability is a notoriously flexible concept. *See* Joseph M. Perillo, *Corbin on Contracts: Avoidance & Reformation* § 29.1 (rev. ed. 2002) ("Unconscionability is one of the most amorphous

terms in the law of contracts."). The flexibility no doubt stems from the original purpose of the unconscionability doctrine: to protect consumers. Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J. L. & Econ. 293, 302 (1975) ("Ideally, the unconscionability doctrine protects against fraud, duress and incompetence, without demanding specific proof of any of them."). However, the doctrine was not written to enable courts to do justice by rewriting contracts. In fact, in the official comments to Uniform Commercial Code § 2-302 (2003), the drafters explained that the unconscionability principle "is one of prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power." *See id.*, official comment 1 (emphasis added); *accord* Cal. Civ. Code § 1670.5, Legis. Comm. Cmt. (same).

Nonetheless, California courts have found the unconscionability doctrine to be a valuable tool to invalidate arbitration contracts. In so doing, California has developed a deserved reputation as "hostile" to arbitration. An empirical analysis conducted by Stephen Broome revealed that unconscionability challenges in California succeed against arbitration provisions with far greater frequency than any other type of contract provision. 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 (2006). Broome identified 114 cases in which the California Courts of Appeal considered the unconscionability of arbitration contracts; in fifty-three of those cases, the arbitration provision was held unconscionable and unenforceable and another thirteen found some aspect of the

arbitration provision to be unconscionable and severed it. *Id*. at 44-45.[2] Forty-eight cases upheld the arbitration contract. By way of contrast, of the forty-six unconscionability claims made outside the context of arbitration, forty-one of the contracts were upheld by the courts, while only five were struck down as

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[2] Broome's survey included cases decided from 1982 to 2006. The starting date was set by California's adoption of the currently existing unconscionability doctrine in *A & M Produce Co. v. FMC Corp*., 135 Cal. App. 3d 473, 486 (1982). Broome, 3 Hastings Bus. L.J. at 44 n.33. Since 2006, court invalidation of arbitration clauses on grounds of unconscionability has, if anything, accelerated. *See Lhotka v. Geographic Expeditions, Inc*., 181 Cal. App. 4th 816, 826 (2010*)*; *Borison v. Gibbs, Giden, Locher, Turner & Senet*, No. B216428, 2010 Cal. App. Unpub. LEXIS 874 *16 (Feb. 5, 2010); *Parada v. Superior Court*, 176 Cal. App. 4th 1554, 1585 (2009); *Olvera v. El Pollo Loco, Inc.*, 173 Cal. App. 4th 447, 457 (2009)*; Sanchez v. W. Pizza Enters., Inc.*, 172 Cal. App. 4th 154, 181 (2009); *Duran v. Discover Bank*, No. B203338, 2009 Cal. App. Unpub. LEXIS 4947 *19 (June 19, 2009); *Fuentes v. Rent-A-Center, Inc.*, No. A121673, 2009 Cal. App. Unpub. LEXIS 6209 *44 (July 31, 2009)*; Aguilar v. F.S. Hotels (L.A.) Inc.*, No. B210159, 2009 Cal. App. Unpub. LEXIS 7007 *15 (Aug. 28, 2009)*; Vu v. Superior Court*, No. 213988, 2009 Cal. App. Unpub. LEXIS 9072 *14 (Nov. 17, 2009)*; Geller v. Wedbush Morgan Secs., Inc.*, No. 211579, 2009 Cal. App. Unpub. LEXIS 10117 *20 (Dec. 21, 2009); *Tourangeau v. LBL Ins. Servs., Inc.*, No. G038637, 2008 Cal. App. Unpub. LEXIS 3727 *12 (May 6, 2008); *Stiglich v. Jani-King of Cal., Inc.*, No. D051811, 2008 Cal. App. Unpub. LEXIS 9390 *35 (Oct. 28, 2008), *rev. denied*; *Kim v. Francesca's Collections of Cal., Inc.*, No. B207572, 2009 Cal. App. Unpub. LEXIS 2958 *15 (Apr. 16, 2009); *Murphy v. Check 'N Go of Cal., Inc.*, 156 Cal. App. 4th 138, 149 (2007). *Cf. D.C. v. Harvard-Westlake School*, 176 Cal. App. 4th 836, 869 (2009) (no procedural unconscionability where parents had opportunity to convince private school administrators to remove offending provision from enrollment contract containing an arbitration clause).

unconscionable. *Id.* at 47. By targeting arbitration provisions for exceptionally harsh review under the unconscionability doctrine, California courts violate Section 2 of the FAA, which demands that arbitration contracts be considered on "equal footing" with any other contract. *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 225-26 (1987). *See also Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 36 (1991).

II

CALIFORNIA COURTS APPLY SPECIAL TESTS TO ARBITRATION CONTRACTS, BUT NOT OTHER TYPES OF CONTRACTS

California courts and the Ninth Circuit below restate the definition that unconscionability means "shocks the conscience," traditionally meaning something no man would contemplate unless he were delusional. *Kinney v. United HealthCare Services, Inc.*, 70 Cal. App. 4th 1322, 1330 (1999) ("'Substantive unconscionability' focuses on the terms of the agreement and whether those terms are 'so one-sided as to "shock the conscience."'") (citations omitted); *Davis v. O'Melveny & Myers*, 485 F.3d 1066, 1075 (9th Cir. 2007). But these formulations are drained of all meaning if they can be applied to the extremely consumer-friendly arbitration contract in this case, containing provisions that "essentially guarantee that the company will make any aggrieved customer whole who files a claim." *Laster v. AT&T Mobility*, LLC, 584 F.3d 849, 856 n.9 (9th Cir. 2009). Moreover, the California courts employ an array of special tests to arbitration contracts—and only to arbitration contracts—all in the service of finding a reason to

strike them down. These tests, described more fully below, are: the "mutuality" test, the sliding scale that doesn't slide, and a refusal to consider marketplace alternatives.

A. California Uniquely Employs a "Mutuality Test" to Arbitration Contract Challenges

What accounts for the California courts' willingness to invalidate arbitration contracts as unconscionable as opposed to contracts in other contexts? Mostly, the culprit is a special test that California courts apply to unconscionability claims brought only against arbitration contracts. This test—the "mutuality test"—first appeared in *Stirlen v. Supercuts, Inc.*, 51 Cal. App. 4th 1519 (1997), in which the court held that a contract that requires one party to arbitrate but not the other is so "one-sided" as to be unconscionable. *Id.* at 1532. The *Stirlin* court repeatedly labeled the contract between the parties as a "contract of adhesion" (and element of unconscionability), implicitly contradicting earlier California law by assuming that the label would be dispositive of the legal issues. *Id.* at 1533; *see also Kinney*, 70 Cal. App. 4th at 1332 (invalidating "unilateral obligation to arbitrate"). Yet this disdain of adhesion contracts itself betrays a certain bias.

> "The contract of adhesion is a part of the fabric of our society. It should neither be praised nor denounced . . . ." That is because there are important advantages to its use despite its potential for abuse. These advantages include the fact that standardization of forms for contracts is a rational and economically efficient response to the

> rapidity of market transactions and the high costs of negotiations, and that the drafter can rationally calculate the costs and risks of performance, which contributes to rational pricing.

Goodwin v. Ford Motor Credit Co., 970 F. Supp. 1007, 1015 (M.D. Ala. 1997) (citing *Roberson v. The Money Tree of Alabama, Inc.*, 954 F. Supp. 1519, 1526 n.6 & n.10 (M.D. Ala. 1997)).[3]

While expressing a purported concern for public policy, however, none of those advantages were even acknowledged by the California Supreme Court, and that court adopted the mutuality test in *Armendariz v. Foundation Health Psychcare Servs., Inc.*, 24 Cal. 4th 83, 117 (2000), announcing that arbitration

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[3] Richard Epstein explains why the "mutuality argument" cannot be a legitimate basis for declaring a contract unconscionable:

> A could not complain if B decided not to make him any offer at all; why then is he entitled to complain if B decides to make him *better off* by now giving him a choice when before he had none? If A does not like B's offer, he can reject it; but to allow him to first accept the agreement and only thereafter to force B to work at a price which B finds unacceptable is to allow him to resort (with the aid of the state) to the very form of duress that on any theory is prohibited. There is no question of "dictation" of terms where B refuses to accept the terms desired by A. There is every question of dictation where A can repudiate his agreement with B and hold B to one to which B did not consent; and that element of dictation remains even if A is but a poor individual and B is a large and powerful corporation. To allow that to take place is to indeed countenance an "inequality of bargaining power" between A and B, with A having the legal advantage as he is given formal legal rights explicitly denied B.

Epstein, *supra*, at 297.

agreements must contain a "modicum of bilaterality." Since *Armendariz*, more than two-thirds of the courts that invalidated arbitration provisions did so because the provisions lacked mutuality. Broome, 3 Hastings Bus. L.J. at 50-51; *see also* Michael Schneidereit, Note, *A Cold Night: Unconscionability as a Defense to Mandatory Arbitration Clauses in Employment Agreements*, 55 Hastings L.J. 987, 1002 (2004) ("[I]n *Armendariz*, the court honed California unconscionability law into a weapon that could be used against mandatory arbitration agreements."). Indeed, in *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 161 (2005), the California Supreme Court employed a form of the mutuality test to strike down class-arbitration waivers. In the court's view:

> [C]lass action or arbitration waivers are indisputably one-sided. "Although 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."

Id. (quoting *Szetela v. Discover Bank*, 97 Cal. App. 4th 1094, 1101 (2002), *cert. denied*, 537 U.S. 1226 (2003)). The court in *Gentry v. Superior Court*, 42 Cal. 4th 443, 470-72 (2007), *cert. denied* sub nom., *Circuit City Stores, Inc. v. Gentry*, 552 U.S. 1296 (2008), also relied on what it perceived as the one-sided nature of the contract in striking down Circuit City's class-arbitration waiver. Although some language in *Armendariz* suggests that lack of mutuality can be justified by "business realities," *Armendariz*, 24 Cal.

4th at 117, no lower California court has yet identified a business reality sufficient to justify lack of mutuality in an arbitration agreement. Broome, 3 Hastings Bus. L.J. at 54 (citing 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, 81 (2005)).[4] *See also Thomas H. Riske*, *No Exceptions: How the Legitimate Business Justification for Unconscionability Only Further Demonstrates California Courts' Disdain for Arbitration Agreements*, 2008 J. Disp. Resol. 591, 602-04 (2008) (The supposed "business realities" exception to the mutuality test, which uses terminology associated with general contract law, but which has been factually impossible to successfully invoke, provides another illustration of how California courts hold arbitration agreements to a unique standard.). The mutuality test thus makes it significantly easier to challenge arbitration agreements as unconscionable.

Yet this Court held that "[t]he 'goals and policies' of the FAA . . . are antithetical to threshold limitations placed specifically and solely on arbitration provisions." *Doctor's Assocs., Inc.*, 517 U.S. at 688. Given this straightforward holding, jurisdictions other than California have been unwilling to adopt a requirement

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[4] Some federal district courts, applying California law, will occasionally find that the mutuality requirement was met and uphold an arbitration agreement. *See Rutter v. Darden Rests., Inc.*, No. CV-08-6106, 2008 U.S. Dist. LEXIS 96170, at *19 (C.D. Cal. Nov. 18, 2008); *Rodriguez v. Sim*, No. C-08-3982, 2009 U.S. Dist. LEXIS 39445, at *12 (N.D. Cal. Apr. 10, 2009); *Ramirez-Baker v. Beazer Homes, Inc.*,636 F. Supp. 2d 1008, 1021 (E.D. Cal. 2008).

of mutuality for arbitration agreements. *See*, *e.g.*, *Ex Parte McNaughton*, 728 So. 2d 592, 598 (Ala.), *cert. denied,* 528 U.S. 818 (1999) (A mutuality approach relies on the "uniqueness of the concept of arbitration," "assigns a suspect status to arbitration agreements," and therefore "flies in the face of *Doctor's Associates*."). *See also Harris v. Green Tree Fin. Corp.*, 183 F.3d 173, 180 (3d Cir. 1999) ("[S]ubstantive federal law stands for the proposition that parties to an arbitration agreement need not equally bind each other with respect to an arbitration agreement if they have provided each other with consideration beyond the promise to arbitrate"); *In re Pate*, 198 B.R. 841, 844 (S.D. Ga. 1996) (same result under Georgia law); *Munoz v. Green Tree Fin. Corp.*, 542 S.E.2d 360, 365 (S.C. 2001) ("[T]he doctrine of mutuality of remedy does not apply here. An agreement providing for arbitration does not determine the *remedy* for a breach of contract but only the *forum* in which the remedy for the breach is determined.").[5]

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[5] *See also State ex rel. Vincent v. Schneider*, 194 S.W.3d 853, 859 (Mo. 2006) ("There is no reason to create a different mutuality rule in arbitration cases. Both parties to this contract exchanged consideration in this sale of a home. The contract will not be invalidated for lack of mutuality of obligation of the arbitration clause."); *Stenzel v. Dell, Inc.*, 870 A.2d 133, 144 (Me. 2005) ("[T]he agreement is not unconscionable because, even though the arbitration clause lacks mutuality of obligation, the underlying contract for the sale of Dell computers is supported by adequate consideration."); *In re Lyon Financial Servs., Inc.*, 257 S.W.3d 228, 233 (Tex. 2008); *Walther v. Sovereign Bank*, 386 Md. 412, 433 (Md. 2005); *McKenzie Check Advance of Miss., LLC v. Hardy*, 866 So. 2d 446, 453 (Miss. 2004). Other than California, only Arkansas routinely invokes mutuality as a reason to invalidate arbitration contracts. *See, e.g.*, *Advance America Servicing of Ark., Inc. v. McGinnis*, 375 Ark. 24, 35 (2008).

Meanwhile, outside the arbitration context, California courts do not demand mutuality either. *See Principal Mut. Life Ins. Co. v. Vars, Pave, McCord & Freedman*, 65 Cal. App. 4th 1469, 1488-89 (1998) (unilateral mortgage agreement upheld because "[w]here sufficient consideration is present, mutuality is not essential"); *Hillsman v. Sutter Cmty. Hosp.*, 153 Cal. App. 3d 743, 752 (1984) (upholding unilateral employment contract where consideration requirement is properly met; a "mutuality of obligation" is unnecessary). Thus, California's "mutuality" approach to determining substantive unconscionability in arbitration provisions differs from the standard used to analyze ordinary contractual provisions for unconscionability. Under the mutuality test, the court relies on its own speculation that the arbitral proceeding itself might impede a party's ability to obtain the requested relief.

For nonarbitration contractual provisions, California courts invalidate contracts as unconscionable only upon evidence of measurable, inevitable hardship if the disputed term is enforced. *See Phoenix Leasing Inc. v. Johnson*, No. A089871, 2001 Cal. App. Unpub. LEXIS 2201, at *16-17 (Oct. 29, 2001) (invalidating provision that would have given lender $208,000 of unaccrued interest); *Ilkhchooyi v. Best*, 37 Cal. App. 4th 395, 411 (1995) (invaliding landlord's attempt to appropriate a portion of the sale price of a lease); *Carboni v. Arrospide*, 2 Cal. App. 4th 76, 83 (1991) (invalidating interest rate of 200% per annum on a secured $99,000 loan); *Ellis v. McKinnon Broadcasting Co.*, 18 Cal. App. 4th 1796, 1806 (1993) (invalidating contract that gave employer all of employee's sales commissions (which were the employee's sole compensation) that were received after

the employee left the company when the sales were generated by the employee prior to his voluntary departure); *Johnisee v. Kimberlite Corp.*, No. A107341, 2003 Cal. App. Unpub. LEXIS 11228, at *27-28 (Nov. 26, 2003) (same).[6]

B. California Courts Pay Lip Service to the Sliding Scale Test of Unconscionablity, but Routinely Ignore It in Application

Under California law, a finding of unconscionability requires both procedural and substantive unconscionability, as measured on a sliding scale (the more substantively unconscionable the contract term, the less procedurally unconscionable it need be to be unenforceable and vice versa). Thus, adhesiveness—an element of procedural unconscionability— should never be sufficient to render a contract unenforceable in California law; there must be some element of substantive unconscionability as well. *See Graham v. Scissor-Tail, Inc.*, 28 Cal. 3d 807, 819-20 (1981). The decision below recites this rule, and claims that *Discover Bank* merely refined, but did not alter it. *AT&T Mobility*, 584 F.3d at 853, 857 (citing *Shroyer v. New Cingular Wireless Servs., Inc.,* 498 F.3d 976, 981 (9th Cir. 2007)). Yet as a practical matter, California courts do not distinguish between greater or lesser levels of unconscionability—even the slightest hint of judicially perceived unfairness will suffice to meet

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[6] These five cases are the only ones identified by Stephen Broome where California appellate courts invalidated contracts as unconscionable outside the arbitration context. *See* Broome, 3 Hastings Bus. L.J. at 56-58. *See also Dalis v. Reinhard*, No. H031637, 2009 Cal. App. Unpub. LEXIS 2806 at *51 (Apr. 8, 2009) (upholding nonrecourse provision of a promissory note).

either prong of the test. Contrary to the mandate to treat arbitration contracts the same as any other contracts, California courts do not employ this "slightest hint" approach in unconscionability cases outside the context of arbitration; the sliding scale approach prevails in other contexts.

An extreme example of the failure to apply the sliding scale in an arbitration case was the California Supreme Court's decision in *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007). There, the California Supreme Court declared an arbitration agreement unconscionable because it waived an employee's right to bring a class action lawsuit. It did so despite the fact that the employees were given an information packet on the effect of the arbitration agreement, were required to watch a video providing information on the arbitration process, were told to consult an attorney before signing if they were unclear on its legal effect, and were not only *given the choice not to sign*, but were given a grace period in which to *change their minds after signing*. *See id.* at 474 (Baxter, J., dissenting). In addition, the court ignored the fact that California workers who disapprove of arbitration requirements have many other options for seeking employment. Theodore Eisenberg & Geoffrey P. Miller, *The Flight from Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies*, 56 DePaul L. Rev. 335, 361 (2007).

The *Gentry* court admitted that the employer did not compel workers to sign, but concluded that the agreement was "not entirely free from procedural unconscionability" because employees "felt at least some pressure" to sign it. *Gentry*, 42 Cal. 4th at 472. Such minimal—one might argue, illusory—procedural

unconscionability should have required an extremely high level of substantive unconscionability to result in an overall finding of unconscionability under the sliding scale test. But the court instead simply latched onto the class action waiver, which one would be hard pressed to describe as "extremely" unconscionable given the number of jurisdictions that find it perfectly legitimate.

As the dissenting justice observed, the court's justifications for resisting the use of arbitration in lieu of class action litigation may have made good policy arguments, but the Legislature had chosen to enact a procedure allowing for arbitration, and declared that public policy *favored* arbitration. The *Gentry* court simply "elevat[ed] a mere judicial affinity for class actions as a beneficial device for implementing the wage laws above the policy expressed by both Congress and our own Legislature." *Id.* at 477 (Baxter, J., dissenting). The court below similarly elevated the California judiciary's preference for class action lawsuits to serve as a veto for any arbitration provision, no matter how pro-consumer in every other respect, if that provision required individual adjudication.

C. California Courts Hold That the Existence of Market Alternatives Defeats a Claim of Procedural Unconscionability—Except for Arbitration Contracts

The court below began its analysis by finding that the arbitration agreement was a contract of adhesion (defined simply as a "standardized contract" with non-negotiable terms). *Laster v. AT&T Mobility LLC*, 584 F.3d at 855. This Court, however, has refused to

invalidate arbitration agreements solely on the grounds that an individual must take-it-or-leave-it. *See Gilmer*, 500 U.S. 20 ("Mere inequality in bargaining power, however, is not a sufficient reason to hold that arbitration agreements are never enforceable in the employment context."); *see also Pritzker v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 7 F.3d 1110, 1118 (3d Cir. 1993) (arbitration agreements are enforceable even if they involve unequal bargaining power). *Cf. Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 596-97 (1991) (upholding a forum-selection clause in cruise-line ticket). Even California has no such requirement outside the context of arbitration. *Cubic Corp. v. Marty*, 185 Cal. App. 3d 438, 449 (1986) (holding in a case involving a patent ownership dispute, "[t]he determination that a contract is adhesive is only 'the beginning and not the end of the analysis insofar as enforceability of its terms is concerned'") (citation omitted); *Holmes v. City of Los Angeles*, 117 Cal. App. 3d 212, 217 (1981) (same, in case involving pension contributions to public employees). As the Seventh Circuit noted in *IFC Credit Corp. v. United Bus. & Indus. Fed. Credit Union*, 512 F.3d 989, 992-93 (7th Cir. 2008), form contracts are "common and enforceable" and serve an economically efficient purpose: "As long as the price is negotiable and the customer may shop elsewhere, consumer protection comes from competition rather than judicial intervention." *Id.* at 993.

Thus, under California law, contracts *in general* are not held to be procedurally unconscionable (a necessary element of an overall finding of unconscionability) when the non-drafting party had a choice whether to enter the contract at all; that is,

when market alternatives exist to provide the same good or service under contracts that have different or negotiable terms. *See Madden v. Kaiser Found. Hosps.*, 17 Cal. 3d 699, 712 (1976) ("[T]he principles of adhesion contracts . . . do not bar enforcement of terms of a negotiated contract which neither limit the liability of the stronger party nor bear oppressively upon the weaker."); *Spinello v. Amblin Entm't*, 29 Cal. App. 4th 1390, 1396-97 (1994); *Dean Witter Reynolds, Inc. v. Superior Court*, 211 Cal. App. 3d 758, 766-67 (1989). In *Spinello*, the court of appeal found that a form arbitration agreement was not adhesive because the plaintiff "had the opportunity to go elsewhere . . . [by] submitt[ing] his script to . . . other producers." 29 Cal. App. 4th at 1397. And in *Dean Witter*, the court recognized that "any showing of competition in the marketplace as to the desired goods and services defeats, as a matter of law, any claim of unconscionability." 211 Cal. App. 3d at 772. *See also Belton v. Comcast Cable Holdings, LLC*, 151 Cal. App. 4th 1224, 1246 (2007) (noting that availability of other cable providers defeated claim of unconscionability); *Morris v. Redwood Empire Bancorp*, 128 Cal. App. 4th 1305, 1320 (2005) ("'[P]rocedural element of unconscionability may be defeated[] if the complaining party has a meaningful choice of reasonably available alternative sources of supply from which to obtain the desired goods and services free of the terms claimed to be unconscionable'" (citing *Dean Witter*, 211 Cal. App. 3d at 772).).

Courts' consideration of marketplace alternatives reflects sound public policy. Freedom of contract is based on the premise that people have preferences they wish to memorialize in the way they do business.

Individual consumers and employees place different values on the various provisions in a contract. Some consumers may be concerned about cost above all else. Others may pay particular heed to penalties for late payments or potential fees that may be incurred. Still others may place the highest value on being able to pursue future disputes in court rather than in arbitration. When companies in a competitive marketplace offer contracts that differ in these particulars, consumers and employees can choose the contract that best reflects their own values. Thus, the existence of marketplace alternatives is properly held to vitiate a claim of procedural unconscionability. And as noted above, if there is no procedural unconscionability, then a claim of overall unconscionability must fail.

In California, however, this general rule is wholly ignored in the context of arbitration contracts. For example, in *Dotson v. Amgen, Inc.*, 181 Cal. App. 4th 975 (2010), a patent attorney employed by a multinational corporation filed a wrongful termination lawsuit against his employer. Amgen moved to compel arbitration, based on a provision in the employment contract. The court held that, even though the attorney was not "an uneducated, low-wage employee without the ability to understand that he was agreeing to arbitration," the contract was procedurally unconscionable "only because the offer was presented on a take-it-or-leave-it basis." *Id.* at 981.[7] *See also*

[7] The court made this holding even while describing the plaintiff as belonging to that rare class of "'sought-after employees' who are positioned to reject offers of employment" if Amgen's contract was not to his liking. *Dotson*, 181 Cal. App. 4th at 981 n.2 (citing *Armendariz*, 24 Cal. 4th at 115). Ultimately, the court upheld the (continued...)

Parada v. Superior Court, 176 Cal. App. 4th at 1573 (finding low to medium degree of procedural unconscionability in arbitration contract despite "many realistic alternatives"); *Gatton v. T-Mobile USA, Inc.*, 152 Cal. App. 4th 571, 586 (2007) (finding procedural unconscionability even where market alternatives existed because the contract was drafted by the party with significantly greater bargaining power and was presented on a take-it-or-leave-it basis); *Aral v. EarthLink, Inc.*, 134 Cal. App. 4th 544, 557 (2005) (finding "quintessential procedural unconscionability" where an arbitration agreement is presented on a take-it-or-leave-it basis with no opportunity to opt out); *Szetela v. Discover Bank*, 97 Cal. App. 4th at 1100 (holding that market alternatives giving the customer the ability to walk away rather than sign the offending contract was not dispositive); *Jackson v. S.A.W. Entm't, Ltd.*, 629 F. Supp. 2d 1018, 1023 (N.D. Cal. 2009) (applying California law to invalidate arbitration provision in employment contract because there was no "opportunity to negotiate or to opt out of the arbitration provision and still be hired"). Even in a case involving nonessential recreational services—a subject for which California courts have found the availability of market alternatives to be an important factor in denying claims of procedural unconscionability[8]—the California Court of Appeal held that an arbitration contract containing a class-action waiver

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[7] (...continued)
arbitration contract, based largely on the sophistication of the plaintiff and the lack of substantive unconscionability. *Id.* at 985, 987.

[8] *See, e.g.*, *Belton v. Comcast Cable Holdings, LLC*, 151 Cal. App. 4th at 1246.

was procedurally unconscionable. *Lhotka v. Geographic Expeditions, Inc.*, 181 Cal. App. 4th at 823 (contract to participate in Mount Kilimanjaro hiking expedition).

Market alternatives did exist in this case. Declaration of Joanne Savage in Support of Defendant AT&T Mobility LLC's Motion to Compel Arbitration and to Dismiss Claims of *Concepcion* Plaintiffs Pursuant to the Federal Arbitration Act, Ninth Circuit Excerpts of Record at 291-413 (providing documentation that when the Concepcions first contracted for wireless service from Cingular (now AT&T), Sprint and Nextel permitted class arbitration and Virgin Mobile did not require arbitration of disputes at all; when the Concepcions renewed their service in 2006, neither Virgin Mobile nor TracFone required arbitration of disputes).

Applying the market alternatives factor to procedural unconscionability claims differently, depending on whether the contract involves arbitration or not, violates this Court's command that courts cannot "rely on the uniqueness of an agreement to arbitrate as the basis for a state-law holding that enforcement would be unconscionable." *Perry v. Thomas*, 482 U.S. at 492 n.9.

III

CALIFORNIA'S HOSTILITY TO ARBITRATION INFECTS CONTRACTS NATIONWIDE

The courts' greater receptivity to unconscionability arguments has led to the expected result: Where unconscionability challenges once appeared in less than 1% of all arbitration-related cases, more

recently they have appeared in 15-20% of all cases involving arbitration. Aaron-Andrew P. Bruhl, *The Unconscionability Game: Strategic Judging and the Evolution of Federal Arbitration Law*, 83 N.Y.U.L. Rev. 1420, 1441 (2008). The issue presented by this case does not just affect California and the Ninth Circuit, however, because federal courts will also invalidate any arbitration contract choice-of-law provision that does not specify California law as controlling. *Omstead v. Dell, Inc.*, 594 F.3d 1081, 1086 (9th Cir. 2010), adopting the reasoning of *Oestreicher v. Alienware Corp.,* 322 Fed. App'x 489 (9th Cir.), *aff'g* 502 F. Supp. 2d 1061, 1065-69 (2009). This is another maneuver targeted specifically at arbitration contracts.

The general rule is that where a choice of law provision exists in a private contract, California courts will honor the provision. *See Nedlloyd Lines B.V. v. Superior Court*, 3 Cal. 4th 459, 464-65 (1992) ("In determining the enforceability of arm's-length contractual choice-of-law provisions, California courts shall apply the principles set forth in Restatement section 187, which reflect a strong policy favoring enforcement of such provisions."). The contract challenged in *Omstead* had a choice-of-law provision that all disputes would be resolved under Texas law, but the Ninth Circuit held that "class action waiver is unconscionable under California law because it satisfies the *Discover Bank* test, and California has a materially greater interest than Texas in applying its own law." *Omstead*, 594 F.3d at 1086. *See also Hoffman v. Citibank (South Dakota), N.A.*, 546 F.3d 1078, 1083 (9th Cir. 2008) (holding that "if Citibank's class arbitration waiver is unconscionable under California law, enforcement of the waiver under South

Dakota law would be contrary to a fundamental policy of California" and remanding to district court for findings as to procedural unconscionability given the ability of cardholders to opt-out of the arbitration provision); *Tamayo v. Brainstorm United States*, 154 Fed. App'x. 564, 566 (9th Cir. 2005) ("To the extent that Ohio law would enforce the class-action waiver at issue, . . . it would be contrary to California public policy and thus not applicable."); *Davis v. Chase Bank USA, N.A.*, 299 Fed. App'x. 662, 664 (9th Cir. 2008) (disregarding Delaware choice of law provision because it would permit a class action waiver in an arbitration agreement, contrary to California law).

Moreover, because class action waivers are upheld in most other courts, consumers who wish to sue national corporations (and their counsel) can circumvent those waivers by the simple mechanism of initiating a class action lawsuit in California. They need only to find a plaintiff in California to take the lead and file suit in state court, and then, once the lawsuit is under way, broaden the class action to include plaintiffs from around the country. *See* Aaron C. Gundzik & Rebecca Gilbert Gundzik, *Will California Become the Forum of Choice for Attacking Class Action Waivers?*, 25 Franchise L.J. 56, 59 (2005). Thus, consumers and businesses nationwide are adversely affected by the California courts' refusal to enforce class action waivers in arbitration.

CONCLUSION

The California courts consistently hold arbitration agreements to a different standard when it comes to unconscionability, and the decision below represents

the latest, and most extreme, example. California courts, and federal courts applying California law, are employing a special unconscionability analysis to arbitration contracts to thwart the use of arbitration. This Court should reverse the decision below and enforce the pronouncements in *Perry* and *Doctor's Associates* that unconscionability analysis may not single out arbitration contracts and treat them differently than other kinds of contracts.

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Respectfully submitted,

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