No. 09-893

In the Supreme Court of the United States

AT&T MOBILITY LLC, PETITIONER

v.

VINCENT AND LIZA CONCEPCION

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

BRIEF FOR THE NATIONAL ACADEMY OF ARBITRATORS AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Statutes:

Miscellaneous:

INTEREST OF AMICUS CURIAE

The National Academy of Arbitrators (NAA), a professional and honorary organization, was founded in 1947 "[t]o establish and foster the highest standards of integrity, competence, honor, and character among those engaged in the arbitration of labor-management disputes on a professional basis, including those who as a part of their professional practice hold hearings and issue written decisions in other types of workplace disputes." NAA Constitution, Art. II, § 1; see http://naarb.org/const_bylaws.asp.[1] The Academy is dedicated to the practice and study of arbitration and to the integrity and reputation of the arbitration process as a fair and effective way to resolve union-management and employment disputes. The Academy does not represent or promote the particular interests of employers, labor organizations, or employees.

The Academy currently has approximately 650 members in the United States and Canada. Aside from a small number of members selected as recognized authorities in the field of labor-management relations, the Academy requires each applicant for membership to demonstrate "substantial and current experience as an impartial arbitrator of labor-management disputes, so as to reflect general acceptability by the parties." See http://naarb.org/member

[1] The parties have consented to the filing of this brief. No counsel for a party authored this brief in whole or in part, and no counsel for a party nor any party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than amicus or its counsel made a monetary contribution to its preparation or submission.

_guidelines.asp. Academy members may not serve as advocates, or consultants, for labor or management, nor may they be members of firms that perform such work. NAA Bylaws, Art. VI, § 6; see http://naarb.org/const_bylaws.asp.

Although the labor arbitration that was the Academy's original focus involved grievance arbitration – resolving disputes arising from collective bargaining agreements – the Academy's educational activities have broadened to include employment arbitration more generally. The Academy was a prime mover in the 1995 multi-partite *Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising out of the Employment Relationship*. See http://naarb.org/protocol.asp. Some of the Academy's members now serve as arbitrators in employment cases. The Academy has appeared before this Court as amicus curiae in past arbitration cases, including *14 Penn Plaza LLC v. Pyett*, 129 S. Ct. 1456 (2009), *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001), *Eastern Associated Coal Corp. v. United Mine Workers*, 531 U.S. 57 (2000), *Wright v. Universal Maritime Service Corp.*, 525 U.S. 70 (1998), and *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643 (1986).

In May 2009, the Academy issued *Guidelines for Employment Arbitration*, http://naarb.org/due_process.asp The *Guidelines* note that cases arising under an employer-promulgated, pre-dispute arbitration plan "require particular vigilance on the part of arbitrators to ensure procedural fairness and to protect the integrity and reputation of workplace arbitration." As relevant here, the *Guidelines* are concerned with the risk that employers will promul-

gate pre-dispute arbitration plans that would misuse arbitration to obtain unfair advantage or, potentially, exculpation from small-claims liability. They suggest that an arbitrator, before taking a case, should ask whether the arbitrator

> can serve in light of . . [a]ny restrictions on class or group actions to the extent these might hinder particular grievants in pursuing their claims, especially where the monetary amount of each individual claim is relatively small, or hinder the vindication of the public purpose served by the particular claim.

This case concerns the attempted use of arbitration agreements to potentially exculpate the drafting party from small claims and hinder the vindication of what California has determined are important public purposes. Because those effects are inconsistent with the fairness, integrity, and reputation of arbitration, the Academy submits this brief in the hope that its perspective will be of assistance to the Court.

SUMMARY OF ARGUMENT

In this case, petitioner's contracts entirely eliminate the possibility that its customers can present claims on a class-wide basis. It accomplishes that end by first mandating that all disputes be resolved in arbitration, and then specifying that all arbitrations must be on a bilateral, claimant-versus-company basis. California law denies enforcement of contractual provisions that entirely eliminate class-based dispute resolution, where such provisions

would in effect eliminate all or most liability for claims that cannot feasibly be expected to be brought on a non-class basis. That rule is not preempted, because it is saved by the savings clause of Section 2 of the Federal Arbitration Act (FAA) and does not otherwise conflict with the purposes of the Act.

The savings clause of Section 2 imposes a rule of nondiscrimination, by preserving "grounds . . . for the revocation of *any* contract," 9 U.S.C. 2 (emphasis added). The California rule, which is an application of longstanding state-law principles of unconscionability and public policy, satisfies the nondiscrimination requirement. Under the California rule, *no* contract – regardless whether it channels its disputes to arbitration or litigation – may include the prohibited no-class-action provision.

The savings clause, however, has force beyond nondiscrimination, grounded on two competing principles. The first principle is that States do not have plenary authority to regulate arbitration procedures, even if they do so by using nondiscriminatory laws. If they did have such authority, they would be able to destroy arbitration by requiring arbitration agreements to provide for all the procedural niceties of litigation, including jury trials, plenary discovery, etc. The savings clause thus does not preserve even nondiscriminatory state laws that simply attempt to dictate arbitration procedure. The second principle is that the Federal Arbitration Act does not affect substantive liability, but instead merely permits parties to move disputes to a different, arbitral forum. If a party in petitioner's position could in effect exculpate itself by adopting arbitration procedures that made it infeasible to bring some category of

claims, the result would be a misuse of arbitration to eliminate substantive liability. To preserve substantive liabilities as the FAA intended, the savings clause preserves nondiscriminatory state laws that restrict exculpatory procedural clauses in all agreements.

The California rule applied in this case is based precisely on the need to restrict exculpatory clauses. As the California Supreme Court explained, because vindicating small claims can be infeasible on an individual basis, a contract of adhesion that eliminates all ability to resolve disputes on a class basis in effect exculpates the drafter from liability. The California rule preserves the ability of the State to regulate the conduct of actors in its marketplace through its liability rules. At the same time, the rule intrudes on arbitration procedure no more than necessary to accomplish that end. It does not require parties to include class-based or any other procedures in arbitration or litigation; it merely requires that, whatever methods of dispute resolution petitioner chooses must continue to allow for *some* means to vindicate the protected class-based claims.

Petitioner argues that its arbitration agreement gives it a strong incentive to pay consumers' claims even before they go to arbitration. But it remains true that many consumers may be victimized by a single practice of petitioner's, while the dollar value of their claims may be sufficiently small to make it impractical for the vast majority of them to invoke petitioner's dispute-resolution process on other than a class-wide basis. The result, if petitioner's anti-class clause were enforced, would be exculpatory,

because it would eliminate potential liability – and petitioner's incentive to comply with the law.

Petitioner argues that class-based arbitration cannot be a fair means of resolving disputes, and that firms faced with the California rule would simply cease using arbitration. Given the potentially exculpatory effect of banning class actions entirely, petitioner naturally has an interest in making that claim. But class-based arbitration in fact continues to offer many of the same potential advantages as individual arbitration, such as the ability to choose expert or specialized arbitrators whose availability can be ensured, and to simplify procedural and evidentiary rules. To be sure, just as drafters of contracts may decide that the trade-off of the procedural rigor and appellate review of litigation against the benefits of arbitration is not worthwhile for any given class of cases, some may decide that the trade-off is unfavorable for large, or all, class actions. Because the FAA's foundational principle is consent, its purposes are served so long as the parties' choice between litigation and arbitration is honored.

ARGUMENT

The California rule applied in this case is an even-handed, non-discriminatory rule that represents a narrowly tailored attempt by the State of California to regulate its contracts – and, in turn, its marketplace – so as to ensure that firms comply with the law and do not evade legal liabilities. As such, it is well within the scope of state regulatory authority over contracts (and markets) preserved under the Federal Arbitration Act.

I. SECTION 2 OF THE FAA SAVES NONDISCRIMINATORY STATE LAWS THAT ARE DESIGNED TO PRESERVE STATE SUBSTANTIVE NORMS AND STATES' ABILITY TO REGULATE CONDUCT

Section 2 of the FAA is its "primary substantive provision." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991). It provides that "[a] written provision in any . . . contract . . . to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. 2.

The first clause of Section 2 provides that an arbitration provision "shall be valid, irrevocable, and enforceable." By its terms, it would directly conflict with, and hence preempt, any law that renders invalid or unenforceable an arbitration agreement or its provisions. Thus, while there are many types of agreements and contractual provisions that are ordinarily unenforceable under the law of any State, see

pp. 18-21, *infra*, the first clause of Section 2, taken alone, would immunize arbitration agreements from all such limitations.

To avoid that result, Congress added a savings clause to Section 2. Under the savings clause, agreements to arbitrate must be enforced "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. 2. Thus, notwithstanding the first clause of Section 2, arbitration agreements are unenforceable if they run afoul of "grounds" that are recognized under state law as sufficient to warrant the "revocation of any contract." "[A]ny contract" and "grounds" are the key words in the savings clause.

In light of the existence of the savings clause in Section 2, petitioner's repeated (Br. 16, 18, 23, 48, 49) appeal to the principle that the FAA was designed to enforce arbitration agreements "in accordance with their terms" is of no relevance. It is precisely the point of the savings clause to preserve some state laws that make arbitration agreements or their provisions *un*enforceable. None of this Court's cases can be read to suggest – and the very existence of the savings clause refutes – that terms of an arbitration agreement that are contrary to an applicable and non-preempted state law are somehow enforceable under the FAA. In a case like this one, where preemption of state law is the issue, petitioner's repetition of the "in accordance with their terms" language is of no help.

A. The Savings Clause Requires Arbitration Agreements To Be Treated The Same As Other Contracts

1. The phrase "any contract" provides a key criterion for distinguishing those state laws that are saved under Section 2 from those that are preempted. As this Court has explained, "state law, whether of legislative or judicial origin, is applicable *if* that law arose to govern the validity, revocability, and enforceability of contracts generally." *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987). While a law applicable to "any contract" would thus be saved, a state "law that takes its meaning precisely from the fact that a contract to arbitrate is at issue" does not come within the savings clause and remains unenforceable under the first clause of Section 2. *Ibid*. The savings clause does not preserve judicial decisions that "construe [an arbitration] agreement in a manner different from that in which it otherwise construes nonarbitration agreements" or that "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." *Ibid*.

The net result of the term "any contract" in the savings clause is to establish an equal footing, or nondiscrimination, requirement. That was clear from a passage this Court has often quoted, which notes that the FAA's purpose was that arbitration agreements be "placed upon the same footing as other contracts." H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924); see, *e.g.*, *Rent-A Center, West., Inc. v. Jackson*, 130 S. Ct. 2772, 2776 (2010); *Gilmer*, 500 U.S. at 24; *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511

(1974). Indeed, perhaps the central purpose of the FAA was to counteract the "ouster" doctrine, under which courts "traditionally viewed arbitration clauses as unworthy attempts to 'oust' them of jurisdiction" and thus refused to enforce them. *Vaden v. Discover Bank*, 129 S. Ct. 1262, 1274 (2009). The ouster doctrine discriminates against arbitration, because it applies a special rule of nonenforcement to arbitration agreements; a similar rule of nonenforcement is not applied to agreements under which disputes would be resolved in court.

2. Each of the cases in which the Court has addressed the scope of the Section 2 savings clause has turned on whether the state law in question was specifically applicable to – and discriminated against – arbitration. In *Perry*, a state law permitted judicial actions to collect wages "without regard to the existence of any private agreement to arbitrate." 482 U.S. at 484. It thereby treated arbitration agreements distinctly less favorably than agreements under which disputes would wind up in court. In *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996), the Court held preempted a state law requiring arbitration agreements to be printed in large type on the first page of a contract, thus clearly applying a special rule to arbitration agreements. See *id*. at 687 ("By enacting § 2, . . . Congress precluded States from singling out arbitration provisions for suspect status."). In *Southland Corp. v. Keating*, 465 U.S. 1, 5 (1984), a state court construed a state law to require "judicial" – *i.e.*, not arbitral – "consideration of claims" brought under a state franchise law. This Court held that such a law, which clearly disfavored arbitration agreements, was preempted and not saved

under Section 2. In each case, the state law did not put arbitration agreements on the "same footing" as other agreements, under which disputes would go to court. For that reason, the state law in each case was preempted.

B. While State Laws That Simply Attempt To Control Arbitration Procedures Are Preempted, The Savings Clause Preserves State Laws Aimed At Exculpatory Procedures

This Court has not previously had occasion to consider the scope of the term "grounds" in the savings clause, nor has it had the occasion to consider nondiscriminatory state laws that affect arbitration procedures. While an overly broad construction of "grounds" would give States the power to eliminate arbitration entirely by requiring arbitration to take on all the trappings of litigation, an overly narrow construction would enable parties to evade substantive liabilities by establishing exculpatory "arbitration" procedures that in effect gut substantive state liability rules. Accordingly, the "grounds" that are saved under Section 2 must be limited to avoid either of those results.

1. *The parties have substantial control over the procedures to be used in arbitration*. It is an important feature of arbitration that the parties may "specify by contract the rules" for resolving their disputes. *Volt Info. Scis., Inc. v. Board of Trustees*, 489 U.S. 468, 479 (1989); see *Hall Street Assocs. LLC v. Mattel*, 552 U.S. 576, 586 (2008) ("[T]he FAA lets parties tailor some, even many features of arbitration by

contract."). One of the benefits that arbitration offers is that the parties may tailor various aspects of the arbitration procedure to the type of dispute involved.

As petitioner argues (Br. 29, 41, 47), if States had plenary authority to apply nondiscriminatory state laws to arbitration, they would be able to eliminate arbitration entirely. To take a few of petitioner's examples, state laws requiring that disputes arising under any contract be resolved through the use of jury trials, plenary litigation-like discovery, or the state rules of civil procedure would be nondiscriminatory; such laws would apply entirely equally to arbitration agreements and all other agreements. But such laws would nonetheless in effect give States the power to destroy arbitration, because they would permit only "arbitrations" that resemble civil trials in all but name and courthouse.

It is a longstanding principle that a savings clause should not be construed so that the statute of which it is a part "destroy[s] itself." *American Telephone and Telegraph v. Central Office Telephone*, 524 U.S. 214, 228 (1998); see *United States v. Locke*, 529 U.S. 89, 106-107 (2000); *Morales v. Trans World Airlines*, 504 U.S. 374, 384-385 (1992). Accordingly, the "grounds" that may come within the savings clause – or the savings clause as a whole – should be understood not to include those that simply represent a State's view that litigation-specific procedures are preferable for resolving disputes. See, *e.g.*, *Carter v. SSC Odin Operating Co., LLC*, 927 N.E.2d 1207, 1220 (Ill. 2010) (("[W]e simply do not believe that this is the kind of defense Congress had in mind when it provided for a defense to preemption based on 'grounds as exist at law or in equity for the revocation

of any contract.'"). Even if it does not discriminate against arbitration – and therefore applies to "any contract" under the savings clause – a state rule requiring such procedures would not be a "ground" saved under Section 2.

2. *State law may affect arbitration procedures to ensure the enforcement of substantive liabilities and thereby regulate the State's marketplace.* The "grounds" that are saved under Section 2 must, however, include at least some state laws that have some effect on arbitration procedure. While a rule entirely preempting state laws that affect procedure would eliminate the threat that States could gut arbitration entirely, it would create the distinct, and at least equally troubling, specter that parties – especially drafters of adhesive contracts with control over their provisions – could use the FAA to contract their way out of substantive liabilities of all kinds.

This Court has long recognized that the FAA was not intended to affect laws imposing liability on parties for their conduct and thereby regulating the operation of its marketplace. After all, "[b]y agreeing to arbitrate . . . , 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. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985); see *14 Penn Plaza LLC v. Pyett*, 129 S. Ct. 1456, 1469 (2009); *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 123 (2001); *Gilmer*, 500 U.S. at 26. If an arbitration agreement "only determines the choice of forum," *EEOC v. Waffle House*, 534 U.S. 279, 295 n. 10 (2002), then it necessarily leaves substantive state laws unaffected.

If substantive state law is to remain unaffected by the FAA, then States must have some ability to forbid "exculpatory" procedures – *i.e.*, those that would in terms or in effect eliminate substantive liability. The Court has made that point clear in the context of federal law, where it has explained that the FAA does not require enforcement of provisions in arbitration agreements that, while purporting to govern procedural matters, in fact have the effect of eliminating substantive liability. See *Mitsubishi*, 473 U.S. at 637 (FAA serves its function "so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum"); see also *Vimar Seguros Y Reaseguros, S.A. v. M/V Sky Reefer*, 515 U.S. 528, 540-541 (1995); *Gilmer*, 500 U.S. at 31 (arbitration procedure must give parties "fair opportunity to present their claims"). Because the FAA was not intended to affect either federal or state substantive liabilities, the same need to preserve substantive liability – and to ensure that the procedures will make the State's liability rules effective – applies to state laws.

Indeed, even petitioner grudgingly concedes that a State could consistently with the FAA exercise *some* control over arbitration procedures, noting in a footnote that States could impose "a requirement that the parties' chosen procedures ensure that claims feasibly can be vindicated." Pet. Br. 49 n.16. Petitioner cannot have it both ways, and its concession is fatal to its adjacent claim that the FAA precludes state law from having *any* affect on procedures in arbitration.

See, *e.g.*, Pet. Br. 49.[2] Both parties in this case thus agree that state law may have *some* effect on procedures in arbitration. It is our submission, with which at least petitioner's footnote appears to agree, that the line should be drawn at protecting substantive liability and the State's ability to regulate primary conduct.

3. *The savings clause protects state laws that are aimed at exculpatory provisions that systematically reduce liability, in terms or in effect*. In sum, the "grounds" that are preserved under the savings clause of Section 2 include nondiscriminatory state laws that are aimed at protecting the State's ability to control primary conduct and impose liability, even if such laws limit the parties' choices of procedures to be used in arbitration. Such state laws are aimed at exculpatory provisions that systematically reduce liability, in terms or effect, without regard to the merits of a claim.

Of course, many procedural mechanisms could easily have an effect on the result in any given case. *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 130 S. Ct. 1431, 1442 (2010) (plurality opinion)

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[2] To be precise, petitioner asserts that "conditioning enforcement of an arbitration provision on inclusion of a term adopting a particular procedure is 'fundamentally at war with the foundational FAA principle that arbitration is a matter of consent.'" Pet. Br. 49 (quoting *Stolt-Nielsen*, 130 S. Ct. at 1775). As noted below, the rule applied in this case in no sense conditions the enforceability of arbitration on the "inclusion of a term adopting a particular procedure." Petitioner may include in its contracts whatever provision regarding class arbitration it wants, so long as it permits *some* outlet – either court or arbitration – for the protected class actions. See pp. 26-27, *infra*.

(noting that "most procedural rules do" "affect[] a litigant's substantive rights").[3] The choice of such mechanisms is generally left to the contracting parties, not state law, under the FAA. It is only when the procedure becomes systematically exculpatory that it exceeds the authority of the parties under the FAA.

Petitioner's example (Pet. Br. 29, 41) of a state law requiring jury trials in arbitration provides a useful illustration. As exemplified by the Sixth and Seventh Amendments, American law generally recognizes the importance of the right of jury trial. But it also recognizes that reasonably fair decisions can be made by other kinds of impartial factfinders, who are equally required to decide liability in accordance with the facts and the law. See *Schriro v. Summerlin*, 542 U.S. 348, 356 (2004) ("For every argument why juries are more accurate factfinders, there is another why

[3] In *Shady Grove*, the Court held that Federal Rule of Civil Procedure 23, not a conflicting state law, governs class action practice in federal court in diversity cases. The plurality reasoned that, because a Federal Rule governed the issue, "it is not the substantive or procedural nature or purpose of the affected state law that matters, but the substantive or procedural nature of the Federal Rule." 130 S. Ct. at 1444. That is because the Federal Rules were intended generally to govern, even if their application affects the outcome of a case. See *Hanna v. Plumer*, 380 U.S. 460 (1965). The FAA, however was *not* intended to operate regardless of its effect on substantive state-law legal obligations. Accordingly, unlike in *Shady Grove*, the "substantive or procedural nature or purpose of the affected state law" *is* crucial in applying the Section 2 savings clause. Cf. *Guaranty Trust Co. v. York*, 326 U.S. 99 (1945). State laws prohibiting impermissibly exculpatory clauses by definition have a substantive bite, and they accordingly are enforceable under Section 2.

they are less accurate."). Thus, it could not be concluded that a procedure that entrusts factfinding to a single impartial arbitrator or arbitration panel, rather than to a jury, would *systematically* work to exculpate wrongdoers.

The same is true for the other procedural mechanisms to which petitioner refers: plenary discovery, publication of decisions, and motion practice. See Pet. Br. 29, 41, 47. States could perhaps determine that procedures with *no* discovery, *no* opportunity to learn the basis of the arbitrator's decision, or *no* opportunity to bring an issue before the arbitrator are actually lightly disguised exculpatory provisions, designed to make it impossible that claims "feasibly can be vindicated." Pet. Br. 49 n.16. They could also likely determine that requiring an impossibly high filing fee would be similarly exculpatory. States could perhaps thus refuse to enforce arbitration agreements containing such provisions. But States could not generally require arbitrations to be free of *any* fee, or to include plenary discovery, publication of decisions, and litigation-style motion practice. Because arbitration procedures that do not systematically favor one side or the other can be had with or without those mechanisms, their choice must be left to the parties under the FAA.

II. THE *DISCOVER BANK* RULE IS NONDISCRIMINATORY

As explained above, a state law comes within the savings clause only if it does not discriminate against arbitration agreements – *i.e.*, only if it applies uniformly to arbitration agreements as to other contracts

under which disputes are to be settled by litigation. The rule applied in this case satisfies that standard.

A. The Unconscionability And Public Policy Doctrines In Contract Law Are Nondiscriminatory Rules

1. This Court has frequently explained that unconscionability, as well as related contract defenses such as fraud and duress, are the types of rules of contract law that, so long as they do not specifically discriminate against arbitration agreements, may be applied to render arbitration agreements or provisions in such agreements invalid. See *Casarotto*, 517 U.S. at 687 ("[G]enerally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2."); *Rent-a-Center West,* 130 S. Ct. at 2776 (same); *Mitsubishi*, 473 U.S. at 627 ("Of course, courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.'"); see *Southland,* 465 U.S. at 16 n.11 (1984) ("We agree, of course, that a party may assert general contract defenses such as fraud to avoid enforcement of an arbitration agreement.").

2. While the Court has not had occasion to address it in connection with the FAA, the public policy rule too is a rule of contract law applicable to "any contract," and it accordingly may be preserved by the Section 2 savings clause. Under the public policy rule, contracts or contract provisions against public policy are unenforceable. That rule has long been a

central feature of contract law in most (or all) jurisdictions. See *W.R. Grace and Co. v. Local Union 759*, 461 U.S. 757, 766 (1983); see also *Eastern Associated Coal Corp. v. United Mine Workers*, 531 U.S. 57, 61-62 (2000); Restatement (Second) of Contracts § 178 (1981). Under that rule, for example, contracts for the doing of an act that would be illegal or tortious under state law, see 8 Richard A. Lord, Williston on Contracts § 19:9 at 178, § 19:23 at 291 (4th ed. 1998), or charging interest that would be usurious under state law, see 9 Williston on Contracts, *supra*, § 20:54, at 154, have frequently been held to be unenforceable as against public policy.

Similarly, the public policy doctrine has always had a particular concern with certain exculpatory contracts, such as those that "unreasonably exempt . . . a party from the legal consequences of a misrepresentation," Restatement, *supra*, § 196, or those that release a party from the consequences of its own negligence, see, *e.g.*, *Vodopest v. MacGregor*, 913 P.2d 779 (Wash. 1996). This Court has recognized a similar rule against exculpatory clauses in federal maritime law. See *Bisso v. Inland Waterways Corp.*, 349 U.S. 85, 90-91 (1955) (noting "general rule long used by courts and legislatures to prevent enforcement of release-from-negligence contracts in many relationships," in order "to discourage negligence" and "to protect those in need of goods or services from being overreached by others who have power to drive hard bargains"); *The Kensington*, 183 U.S. 263, 168 (1902) ("It is settled in the courts of the United States that exemptions limiting carriers from responsibility for the negligence of themselves or their servants are both unjust and unreasonable, and . . . are in conflict

with public policy" and citing cases for that "frequently reiterated" rule).

3. Petitioner asserts that it is "dubious" that "public policy" rules are saved by Section 2, Pet. Br. 20, because "[p]ublic policy rules targeting specific types of contract provisions do not apply to 'any contract,' as Section 2 requires." Pet. Br. 40. Petitioner's doubt, however, is not supportable. This Court rejected it in *Mitsubishi*. See 473 U.S. at 637 n.19 (noting that if the arbitration provisions of a contract "operated . . . as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy"); *Vimar Seguros*, 515 U.S. at 540-541 (same). Moreover, if contracts involving usurious interest or the commission of torts – or exculpatory clauses like those at issue in *Bisso* and *The Kensington* – are not generally enforceable in the courts of a State, it is not plausible that a drafter of a contract could reverse that result simply by providing for enforcement in a contract provision generally mandating arbitration. Section 2 was designed to put arbitration agreements on the "same footing" as other contracts, not to give parties a means to immunize themselves from ordinary contract (or other) law, including nondiscriminatory rules that declare certain contractual provisions against public policy.

More generally, it is impossible to make sense of petitioner's notion of "any contract," because many contract doctrines apply in petitioner's sense only to particular types of contracts. For example, many jurisdictions recognize that "contracts for liquidated damages, when reasonable in their character . . . may

be enforced between the parties," while "agreements to pay fixed sums plainly without reasonable relation to any probable damage which may follow a breach will not be enforced." *Kothe v. R.C. Taylor Trust*, 280 U.S. 224, 226 (1930) (internal quotation marks omitted); see 24 Williston on Contracts, *supra*, § 65:1 at 215-225. Of course, not every contract includes a liquidated damages provision. But the liquidated damages rule, like many other similar rules, governs "any contract" and therefore comes within FAA Section 2, because it informs all contracting parties that, *if* they want to include an enforceable provision of a certain type in their contract, it must not violate the rule. A firm could not avoid the liquidated damages rule by providing that a liquidated damages provision would be enforceable in an arbitration regardless of whether it imposes a penalty.

B. Applying Those Doctrines, The *Discover Bank* Rule Treats Arbitration Agreements Just As Other Agreements

In this case, the court of appeals applied the California law of unconscionability and public policy, as set forth in *Discover Bank v. Superior Ct.,* 113 P.3d 1110 (Cal. 2005). The *Discover Bank* rule, as announced or as applied in this case, does not discriminate against arbitration.

1. *The* Discover Bank *rule.* Under California law, courts "may refuse to enforce" any contract found "to have been unconscionable at the time it was made," or may sever or "limit the application of any unconscionable clause" in order "to avoid any unconscionable result." Cal. Civ. Code § 1670.5(a). A finding of

unconscionability under that statute requires both "procedural" and "substantive" components.

"Procedural" unconscionability "generally takes the form of a contract of adhesion, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it." *Discover Bank*, 113 P.3d at 1108 (internal punctuation omitted). "Substantive" unconscionability "may take various forms, but may generally be described as unfairly one-sided." *Ibid*. Not surprisingly, among such one-sided contracts are those that "operate effectively as exculpatory contract clauses that are contrary to public policy" under Section 1668 of the California Civil Code. *Ibid*. Section 1668 provides:

> Certain contracts unlawful. 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..

Discover Bank involved a class ban in a consumer credit card agreement that included a mandatory arbitration provision. The California Supreme Court held that at least "an element of procedural unconscionability [was] present" because the credit card agreement was a contract of adhesion, though that alone would be insufficient to render it unenforceable. 113 P.3d at 1108. The court also concluded that such class-action bans may be substantively unconscionable under Section 1668 because they are impermissibly exculpatory. *Ibid*. The court explained that, where a business cheats numerous

consumers out of small amounts of money, "the class action is often the only effective way to halt and redress such exploitation," 113 P. 3d at 1105, because "small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights," *ibid*. (quoting *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591 (1997)). Because class actions are thus "inextricably linked to the vindication of substantive rights," 113 P.3d at 1109, a contract clause that precludes class actions may operate to exculpate the drafter from liability for small frauds or other illegal conduct. If so, it is contrary to public policy under Section 1668 and substantively unconscionable (and unenforceable) under California law.

The *Discover Bank* rule is designed not only to ensure that those who violate their contractual commitments pay damages and those who suffer loss are compensated. It is also designed as an important mechanism to police the State's commercial marketplace. As *Discover Bank* explained, the rule provides "aid to legitimate business enterprises by curtailing illegitimate competition." 113 P.3d at 1105. Without the risk of liability for overcharging its customers or otherwise failing to live up to its promises, a wrongdoing firm would actually have a competitive advantage in the marketplace, putting legitimate competitors at risk.[4] At bottom, the rule is thus designed

[4] That is the same theory that underlies the Fair Labor Standards Act, 29 U.S.C. 201 *et seq*. See, *e.g.*, *Citicorp Industrial Credit, Inc. v. Brock*, 483 U.S. 27, 36-37 (1987) (noting that FLSA "reflects Congress' desire to eliminate the competitive advantage enjoyed by goods produced under substandard conditions"); *Tony & Susan Alamo Found. v. Sec'y of Labor*, 471 U.S. 290, 302 (1985) (nonenforcement would "exert a general downward pressure on

substantively to regulate the State's commercial marketplace.

The California Supreme Court made clear that it "d[id] not hold that all class action waivers are necessarily unconscionable." 113 P.3d at 1110. "But when the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages," *ibid*. and when the case involves "a scheme to deliberately cheat large numbers of consumers out of individually small sums of money," *ibid*., the waiver is "in practice the exemption of the party 'from responsibility for [its] own fraud, or willful injury to the person or property of another,'" *ibid*. (quoting Cal. Civ. Code § 1168), and unconscionable under California law.

2. *The* Discover Bank *Rule is non-discriminatory and operates independently of arbitration.* The rule of *Discover Bank* is nondiscriminatory and applies to "any contract" under the savings clause of FAA Section 2. As *Discover Bank* explained, "the principle that class action waivers are, under certain circumstances, unconscionable as unlawfully exculpatory is a principle of California law that does not specifically apply to arbitration agreements, but to contracts generally." 113 P.3d at 1112. That principle "applies equally to class action litigation waivers in contracts without arbitration agreements as it does to class arbitration waivers in contracts with such agreements." *Ibid*.; see Pet. App. 12a-13a, 14a (same); *America Online v. Superior Court*, 108 Cal. Rptr. 2d

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wages in competing businesses"); *Overnight Motor Transport Co. v. Missel*, 316 U.S. 572, 576-577 (1942).

699 (Cal. Ct. App. 2001) (class waiver invalid in nonarbitration agreement); see also *In re Yahoo! Litigation*, 251 F.R.D. 459 (C.D. Cal. 2008) (applying *Discover Bank* test to non-arbitration agreement).

Petitioner argues (Br. 32) that the *Discover Bank* rule "deviates in at least four significant ways from the traditional unconscionability principles applied by California courts outside the arbitration context." But petitioner advances no support whatever for the proposition that California courts would treat bans on class-based arbitration in any way differently from bans on class actions "outside the arbitration context," *i.e.*, ordinary contracts under which disputes would be resolved in litigation. Respondents explain that the *Discover Bank* rule is simply an application of the settled law of unconscionability and public policy in California. See Resp. Br. 38-47. But even if *Discover Bank* had marked more of a break with past state law, that would not affect the Section 2 analysis. So long as the *Discover Bank* rule puts all contracts – *i.e.*, those under which disputes will be settled in arbitration and those under which disputes will be settled in court – on the same footing, it applies to "any contract" under the Section 2 savings clause.

3. *The* Discover Bank *Rule is based on the State's need to protect its substantive liability rules.* The sole rationale of the *Discover Bank* rule is to keep companies drafting adhesive contracts from in effect exculpating themselves from small-claims liability by using arbitration clauses to eliminate class-based procedures entirely. See 113 P.3d at 1110. The rule is not designed merely to regulate procedure in arbitration cases or to impose litigation-like procedures

on arbitration, on the ground that the State believes that such procedures are a preferable means for resolving disputes. Instead, it is designed to protect the State's substantive liability rules and its ability to regulate conduct in its marketplace.

Petitioner argues extensively (Br. 4-8, 35-36) that the arbitration scheme it employs in its contracts is not exculpatory, because it offers incentives to consumers to bring claims. Most of the provisions cited by petitioner, however, merely ensure that the arbitration process will not be costly to consumers and will give a premium payment of up to $7,500 to a consumer who recovers more in arbitration than petitioner's last pre-arbitration "written settlement offer." Pet. Br. 6-7. The scheme thus may well give petitioner a substantial incentive to "simply pay the face value of the [$30.22 average] claim before the selection of an arbitrator to avoid paying $7,500" as a premium. Pet. App. 10a. But paying a handful of small claims would not deter petitioner from continuing to overcharge the vast balance of its customers. And petitioner's scheme does not affect the practical feasibility of bringing a claim – even to petitioner's internal pre-arbitration process – because it does not alter the fact that "the maximum gain to a customer . . . is still just $30.22." *Ibid* Accordingly, petitioner's arbitration scheme continues to operate as an exculpatory clause with respect to small consumer claims, since consumers still have little reason to expend the effort to bring such claims. It therefore comes well within the rationale of the *Discover Bank* rule to prohibit exculpatory contracts.

Moreover, although petitioner repeatedly characterizes the *Discover Bank* rule as a rule that

"dictate[s] the procedures that apply in arbitration," Pet. Br. 15; see Pet. Br. 21-22, 49-52, in fact the rule plainly does not do so. Consistently with *Discover Bank*, drafting parties may continue to provide for arbitration of whatever categories of disputes – bilateral or multilateral – they want. What a drafting party may not do, at least in an adhesive contract, is to use the FAA to eliminate class-based dispute resolution entirely if such elimination would have the effect of exculpating itself from substantive legal obligations under state law.

Finally, the *Discover Bank* rule accomplishes the substantive end of California law to preclude exculpatory contracts without otherwise intruding on the ability of contracting parties to choose their own arbitration procedures. In *Discover Bank* itself, the court recognized that there may be cases in which parties negotiating a non-adhesive commercial contract could validly decide that they wanted to resolve disputes only by means of bilateral arbitration. See 113 P.3d at 1110 ("We do not hold that all class action waivers are necessarily unconscionable."). Moreover, California law would likely permit class waivers to be given effect in cases where the claims are large enough to remain individually viable. See *ibid*. (applying rule only where "disputes . . . predictably involve small amounts of damages"). As a general matter, the *Discover Bank* rule does not attempt to interfere with the choice of procedure in arbitration. It steps in only when the drafting party of a contract of adhesion requires procedures that would in effect exculpate it from liability and thus frustrate the State's determinations about the rules that should

govern the conduct of marketplace transactions in the State.

III. CLASS-BASED ARBITRATION OFFERS ADVANTAGES FOR RESOLVING AT LEAST SOME CLASS-BASED DISPUTES, AND THE *DISCOVER BANK* RULE IS NOT A BAN ON CONSUMER ARBITRATION AGREEMENTS

Petitioner asserts that "California's rule conditioning the enforceability of arbitration provisions on the availability of class-wide arbitration is for all practical purposes a ban on consumer arbitration agreements," which "cannot be reconciled with the FAA's policy of promoting arbitration." Pet. 56. That assertion is mistaken. First, experience shows that class-based arbitration can be a fair and effective method of resolving class-based disputes. Second, California law does not "condition[] the enforceability of arbitration provisions on the availability of class-wide arbitration"; rather, it continues to permit businesses to tailor their arbitration agreements to include or exclude some or all class-based disputes – so long as they leave *some* forum open for class-based dispute resolution of small claims. That effect is entirely consonant with the FAA's purposes.

A. Class-based Arbitration Can Be A Fair And Effective Means Of Resolving Disputes

1. *The AAA Rules*. An important step in framing rules to address the issues that arise in class-based arbitration was the American Arbitration Associa-

tion's adoption of Supplementary Rules for Class Arbitrations (Supp. Rule) in October 2003. See http://www.adr.org/sp.asp?id=21936. As the Association informed this Court in its amicus brief in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758 (2010), it concluded that, under these rules, fairness to absent parties and the evenhanded protection of both sides could be achieved, while preserving many of the normal efficiencies and conveniences of the arbitration process. AAA Br. at 12.

The Rules divide the resolution of class arbitration issues into three distinct phases, giving the parties the opportunity at stated intervals – the Clause Construction award, the Class Determination award, and the Final Award – to obtain a stay of proceedings and ask a court to confirm or vacate a decision by the arbitrator. Supp. Rule 3, 5, 7. In light of the interests of absent class members, the Rules provide that all hearings and awards will be public, "subject to the authority of the arbitrator to provide otherwise in special circumstances." Supp. Rule 9(a). Thus, in each AAA class arbitration, the AAA posts the demand for arbitration, the identities of the parties, the names and contact information of counsel, all awards rendered in the case, and the date, time and place of any scheduled hearings. See http://www.adr.org/sp.asp?id=25562 (AAA docket of class arbitrations).

As the AAA's *Stolt-Nielsen* brief explains (at 21), the AAA's Rules are a "useful quasi-hybrid model" that combines "arbitrator autonomy with a laudable opportunity for judicial oversight at phases 1 and 2 of the process." One author has noted that the Rules "create a useful record and procedural guideline" that facilitates judicial review, while "minimiz[ing] expen-

ditures of time, money, and effort," and limiting delays and obstructions in class arbitration proceedings. S.I. Strong, *Enforcing Class Arbitration In The International Sphere: Due Process And Public Policy Concerns*, 30 U. Pa. J. Int'l L. 1, 41, 42 (2008).

In its *Stolt-Nielsen* brief (at 22-24), the AAA noted that, as of September 2009, it had administered 283 class arbitrations, of which 135 resulted in Clause Construction Awards and 48 in Class Determination Awards. While no cases had as of that date yet resulted in Final Awards, 162 of the cases had been settled, withdrawn, or dismissed, with a median time frame from filing to closure of 583 days and a mean of 630 days. While class arbitrations thus appear to take longer than simpler commercial arbitrations, even petitioner does not dispute that those time periods are likely substantially shorter than the average class action in court.

2. *Like individual arbitration, class-based arbitration continues to offer a package of benefits and costs.* Petitioner and its amici argue expansively that class-based arbitration is a "lose-lose proposition for businesses" that "no rational business will agree to." Pet. Br. 22; see Chamber of Commerce Br. 4-19. Given the potential to rid themselves of legal liability for small claims, it is understandable that petitioner and its amici would have a strong interest in eliminating class-based dispute resolution of all kinds. But the facts do not bear out petitioner's assertion.

a. Many of the complaints lodged by petitioner against class-based arbitrations are in fact complaints about *any* class-based resolution of disputes. The merits and utility of class-based resolution of

disputes has been the subject of an intense public debate, in which amicus itself takes no position. Responding to a perceived need for reform, Congress has enacted legislation. See, *e.g.*, Class Action Fairness Act of 2005, Pub. L. 109-2, 119 Stat. 4 (2005). Neither Congress nor California, however, has accepted petitioner's arguments that class actions should be eliminated entirely. Accordingly, insofar as is relevant to this case, this Court ought not to operate under petitioner's premise that class actions are inherently unjust. Instead, the Court should operate on the premise embodied in California (and federal) law: that class-based resolution of disputes can serve an important function in our system of justice in regulating conduct, adjudicating disputes, and remedying injuries. Petitioner's effort to have this Court stretch the FAA in order to achieve its goal of eliminating class actions should be rejected. The remedy, if any, for petitioner's complaints lies with Congress.

b. In any event, class-based arbitration can – and has – offered many of the benefits of arbitration, and, like arbitration generally, it can offer an appealing alternative to litigation. This Court has noted that arbitration generally can be cheaper and faster than litigation, and it can employ simpler procedural and evidentiary rules. *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 280 (1995). There are, however, tradeoffs. Parties that opt for arbitration in any category of cases forgo "the procedural rigor and appellate review" of litigation. *Stolt-Nielsen,* 130 S. Ct. at 1775. The policy of the FAA is to permit parties to weigh the costs and benefits of arbitration in

any class of cases, and to honor their determination of which disputes to channel to which forum.

The same trade-offs apply to class arbitration. Class arbitration can proceed more quickly than class actions in court, because the parties can control the availability of the arbitrators' time and scheduling of the proceeding in a way that would be impossible in court. An important benefit of arbitration is that "[t]he anticipated subject matter of the dispute may be taken into account when the arbitrators are appointed, and arbitral rules typically provide for the participation of experts either employed by the parties or appointed by the tribunal." *Mitsubishi*, 473 U.S. at 633-634. As with other types of arbitration, class arbitration may employ simpler procedural and evidentiary rules than class actions in court. The result of all of those differences is that parties can provide for class arbitrations that are more flexible, cheaper, and faster than class action litigation in court.

To be sure, class-based arbitration, like class action litigation, can in a given case be more complex, more expensive, and more time-consuming than simpler bilateral proceedings. In *Stolt-Nielsen* this Court reasoned that the added potential complexity of class-action litigation, along with the potentially high stakes that can be involved, meant that arbitrators should not "presume . . . that the parties' mere silence on the issue of class-action arbitration constitutes consent to resolve their disputes in class proceedings." 130 S. Ct. at 1776. But it is not the case – and the Court did not suggest in *Stolt-Nielsen* – that properly structured class-based arbitration can offer no advantages over class-action litigation.

Indeed, this Court has already rejected an argument much like that advanced by petitioner. In *Mitsubishi*, it was argued that antitrust cases – like class-based claims in this case – are too complex to be heard by arbitrators. The Court did not reject the factual premise that antitrust cases may indeed be more complex than other types of cases. 473 U.S. at 633. But the Court also reasoned that arbitration of antitrust cases may offer advantages as compared with litigation of antitrust cases. It concluded that "the factor of potential complexity alone does not persuade us that an arbitral tribunal could not properly handle an antitrust matter." *Id*. at 634. Nor can it be concluded that an arbitral tribunal could not properly handle a class-based arbitration.

B. Consistent With The FAA, The *Discover Bank* Rule Offers Firms The Choice Whether To Use Arbitration Or Litigation For Different Categories Of Cases

Petitioner argues that the *Discover Bank* rule "is for all practical purposes a ban on consumer arbitration in California." Pet. Br. 56. Petitioner contends that in response to the *Discover Bank* rule, "the nation's largest cable company, Comcast Corp., has already abandoned arbitration in California." Pet. Br. 55-56. Petitioner concludes (Br. 53) that permitting that result would conflict with the FAA's purpose "of remov[ing] impediments to arbitration."

That conclusion is mistaken. California law permits companies to exercise precisely the choice that petitioner did here: though they cannot entirely eliminate class-based claims, they can decide whether

such claims should be resolved in court or arbitration, just as they do with other types of claims. See Pet. App. 61a (opting for class litigation if class arbitration ban unenforceable). Arbitration retains certain advantages over litigation, and some firms would no doubt continue to require arbitration of at least some class-based claims under the *Discover Bank* rule. See, *e.g.*, *Fensterstock v. Education Finance Partners*, 611 F.3d 124, 140 (2d Cir. 2010) (firm prefers class arbitration to class action litigation); *Skirchak v. Dynamics Research Corp.*, 508 F.3d 49, 63 (1st Cir. 2007) (same); see also p. 30, *supra* (AAA had administered 283 class arbitrations as of September 2009).

But even if firms determined that all class-based claims should be resolved in court rather than arbitration, that would in no way contravene the purposes of the FAA. Entirely aside from class-based claims, a firm may decide that a given category of case may involve a particularly large sum of money or an unsettled legal issue of great importance, and that the benefits of litigation in such a case, including procedural rigor and full appellate review, outweigh the advantages of the arbitral forum. The firm may thus decide to require arbitration of garden-variety cases while requiring litigation of more troublesome categories. As this Court has noted, arbitration "is a way to resolve those disputes – but only those disputes – that the parties have agreed to submit to arbitration." *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995); accord *Volt*, 489 U.S. at 478; *Mitsubishi*, 473 U.S. at 628. Nothing in the FAA was designed to ensure that firms would find it beneficial to channel all categories of cases to arbitration.

The *Discover Bank* rule leaves firms with the same choice. A firm may decide that its calculus of costs and benefits demands that class-based claims, or class-based claims of a certain size, should be heard in court. If so, the firm could, for example, provide that all class-based claims, or class-based claims with more than *x* claimants, may not be brought in arbitration. Meanwhile, the firm can provide for bilateral or smaller class-based disputes to benefit from the flexibility, speed, and lower costs of arbitration. Because "the foundational FAA principle" is "that arbitration is a matter of consent," *Stolt-Nielsen*, 130 S. Ct. at 1775, the FAA's purposes are served so long as the free choices of the parties to channel disputes to arbitration – or to litigation – are honored.

If a firm genuinely believed that bilateral arbitration had advantages over litigation but that class-based arbitration did not, the firm would have no reason to terminate its arbitration agreements entirely in response to *Discover Bank*. It could instead simply eliminate arbitration of some or all class-based disputes. If instead, as petitioner and its amici argue, affirming the decision below would "cause businesses to give up arbitration entirely" (Chamber of Commerce Br. 21), that would merely demonstrate that those businesses had no real interest in arbitration in the first place. The fact that some businesses favor arbitration only if it would eliminate class actions (and thus exculpate themselves from some degree of substantive legal liability) provides no reason for stretching the terms of the FAA to invalidate the *Discover Bank* rule.

CONCLUSION

The decision of the court of appeals should be affirmed.

Respectfully submitted.

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