No. 08-56394

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JENNIFER L. LASTER, *et al.*,
Plaintiffs – Appellees,

v.

AT&T MOBILITY LLC,
Defendant – Appellant.

Appeal from an Order of the United States District Court
for the Southern District of California, No. 3:05-cv-01167-DMS-AJB

OPENING BRIEF OF AT&T MOBILITY LLC

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CORPORATE DISCLOSURE STATEMENT

AT&T Mobility LLC has no parent company. Its members are all privately held companies that are wholly-owned subsidiaries of AT&T Inc., which is the only publicly held company with a 10 percent or greater ownership stake in AT&T Mobility LLC.

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JURISDICTIONAL STATEMENT

The district court has jurisdiction under 28 U.S.C. § 1332(d)(2)(A). The diversity-of-citizenship requirement is satisfied because plaintiffs-appellees Vincent and Liza Concepcion and all of the members of the putative class are California citizens (ER358-59, ER362), and defendant-appellant AT&T Mobility LLC ("ATTM"), which until January 2007 was known as Cingular Wireless LLC ("Cingular"), is a limited liability company of Delaware, Georgia, and Texas citizenship.[1] The amount-in-controversy requirement is satisfied because the Concepcions allege that the aggregate claims of the putative class exceed the sum or value of $5,000,000, exclusive of interests and costs. ER359.

The district court issued its order denying ATTM's motion to compel arbitration on August 11, 2008. ER1-25. ATTM timely filed a notice of appeal on August 19, 2008. ER60-62 This Court has jurisdiction under 9 U.S.C. § 16(a)(1)(B), which authorizes an immediate appeal from the denial of a motion to compel arbitration.

ISSUES PRESENTED

When the Concepcions activated wireless service with ATTM (then Cingular), they agreed to its standard wireless service agreement. That agreement

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[1] ATTM has five members: two Delaware corporations with principal places of business in Georgia, a Delaware corporation with its principal place of business in Texas, a Georgia corporation with its principal place of business in Georgia, and a Delaware limited liability company whose sole member is a Delaware corporation with its principal place of business in Texas.

includes an arbitration provision that requires the parties to pursue their disputes in individual arbitration or small claims court. Under the agreement, the customer is not responsible for any costs and may choose whether arbitration will be conducted in person (in the county of his or her billing address), by telephone, or by mail. In addition, if the arbitrator awards a customer more than ATTM's last written settlement offer, ATTM must pay the customer a minimum of $7,500, plus double attorneys' fees.

Acknowledging that ATTM's arbitration provision "is on the low end of the spectrum of procedural unconscionability" and that "there is nothing unfair about the tradeoff that ATTM's customers make" in agreeing to individual arbitration, the district court nonetheless denied ATTM's motion to compel arbitration because ATTM had failed to prove that individual dispute resolution under its arbitration provision is as effective as class actions in deterring corporate misconduct.

ATTM's appeal presents two issues:

(1) Whether ATTM's arbitration provision is enforceable under California law.

(2) If not, whether, particularly as applied to ATTM's unprecedentedly consumer-friendly arbitration provision, California law is preempted by the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16.

STATEMENT OF THE CASE

On March 27, 2006, the Concepcions filed a putative class action against ATTM (then Cingular) in the United States District Court for the Southern District of California. ER357-73. After the Concepcions filed an amended complaint, ATTM moved to consolidate the case with *Laster v. T-Mobile USA, Inc.*, No. 05cv1167 DMS (AJB), which had been stayed pending the outcome of appeals by T-Mobile and ATTM of an order denying their respective motions to compel arbitration of their respective customers' claims.[2] ER6-7, ER349-53. The district court granted the motion to consolidate the cases and stayed the consolidated action pending the resolution of the appeals. ER6-7, ER349-53.

After the appeals were resolved and the stay lifted, ATTM moved to compel the Concepcions to arbitrate their claims under 9 U.S.C. § 4. ER66-69. The district court denied ATTM's motion. ER1-20.

STATEMENT OF FACTS

A. The Concepcions' Service Agreement.

ATTM is a wireless service provider that was known as Cingular until January 2007. ER73. The Concepcions are California residents who entered into a wireless service agreement with ATTM (then Cingular) in February 2002 in order

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[2] ATTM voluntarily dismissed its appeal (No. 06-55008) after this Court held in *Shroyer v. New Cingular Wireless Services, Inc.*, 498 F.3d 976 (9th Cir. 2007), that the version of ATTM's arbitration provision at issue in *Laster* was unenforceable. ER7. That version had been superseded in late 2006. *See* page 7, *infra*.

to obtain cellular phones at a discounted rate and activate them for use on ATTM's network. ER78-79. In May 2003, February 2005, and May 2006, the Concepcions obtained new cellular phones by entering into new service agreements. ER79.

Each of the Concepcions' service agreements incorporated ATTM's then-current Terms of Service, which contained, *inter alia*, a provision stating that "Cingular and you * * * agree to arbitrate all disputes and claims * * * arising out of or relating to this Agreement, or to any prior or written agreement, for Equipment or services between Cingular and you." ER145, ER148, ER151, ER170-72. The provision requires the parties to pursue their disputes in individual arbitration or small claims court. *Id.* The Terms of Service also contained choice-of-law provisions selecting the law of the state of the customer's billing address or wireless telephone number. ER145, ER148, ER151, ER170-72.[3] In addition, the Terms of Service contained a change-in-terms provision, which authorized ATTM to "change any terms, conditions, rates, fees, expenses, or charges regarding your service at any time" and states that ATTM would "provide [the customer] with notice of such changes * * * either in [his] monthly bill or separately." ER145, ER148, ER151, ER165-66.

[3] The Concepcions' February 2002 and May 2003 contracts specify that the "[a]pplicable laws of the state associated with the wireless number will govern this Agreement." ER145, ER148. The Concepcions' February 2005 and May 2006 contracts specify that "[t]he law of the state of your billing address shall govern this Agreement except to the extent that such law is preempted by or inconsistent with applicable federal law." ER151, ER173. There is no dispute in this case that the Concepcions have a California area code and billing address.

B. ATTM's Revised Arbitration Provision.

In December 2006, ATTM (then Cingular) mailed a new arbitration provision to all of its customers, including the Concepcions. ER73-74, ER80. The revised provision states:

> [ATTM] and you agree to arbitrate all disputes and claims between us. This agreement to arbitrate is intended to be broadly interpreted. It includes, but is not limited to: claims arising out of or relating to any aspect of the relationship between us * * * [and] claims that arose before this or any prior Agreement (including, but not limited to, claims relating to advertising) * * *.

ER89-90. Like the Concepcions' previous arbitration provisions, the revised provision specifies that arbitration must be conducted on an individual basis and that arbitrators may not conduct class-wide proceedings. ER89, ER91, ER145, ER148, ER151, ER170-72.

The arbitration provision sent to the Concepcions in December 2006 was the product of the second major revision of ATTM's arbitration provision. Like other early consumer-arbitration provisions, ATTM's original arbitration provision (implicitly) required consumers to pay an equal share of arbitration fees; required that arbitration be kept confidential; and precluded arbitrators from awarding punitive damages. *See* ER145. Because some customers complained—and some courts held—that these features made it impossible to arbitrate small claims on an individual basis, ATTM and other companies revised their early arbitration agreements to address that concern.

Specifically, in Spring 2003 ATTM introduced its second-generation arbitration provision, which specified that ATTM would pay the entire cost of arbitrating any non-frivolous claim, eliminated the confidentiality requirement, and eliminated the prohibition against awarding punitive damages. *See* ER148, ER170-72. Many courts have upheld second-generation arbitration provisions, like ATTM's, concluding that such provisions are not unconscionable merely because they require that arbitration be conducted on an individual basis.[4] For example, a Missouri trial court and the U.S. District Court for the Eastern District of Pennsylvania upheld ATTM's second-generation arbitration provision.[5] Likewise, the Florida District Court of Appeal and two federal district courts upheld an arbitration provision that AT&T Wireless Services (a predecessor of ATTM) used in 2003.[6] But other courts, including this one, have invalidated ATTM's and other companies' second-generation provisions, concluding that those provisions still did

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[4] *See, e.g.*, *Pleasants v. Am. Express Co.*, 541 F.3d 853 (8th Cir. 2008) (upholding arbitration agreement under Missouri law); *Jenkins v. First Am. Cash Advance*, 400 F.3d 868, 878 (11th Cir. 2005).

[5] *See Blitz v. AT&T Wireless Servs., Inc.*, 2005 WL 6177327 (Mo. Cir. Ct. Nov. 28, 2005); *Weinstein v. AT&T Mobility Corp.*, 2008 WL 1914754 (E.D. Pa. Apr. 30, 2008).

[6] *See Fonte v. AT&T Wireless Servs., Inc.*, 903 So. 2d 1019 (Fla. Dist. Ct. App. 2005); *Crandall v. AT&T Mobility, LLC*, 2008 WL 2796752 (S.D. Ill. July 18, 2008); *Schultz v. AT&T Wireless Servs., Inc.*, 376 F. Supp. 2d 685 (N.D. W. Va. 2005).

not go far enough to make individual arbitration a realistic means of resolving small claims.[7]

In an effort to respond to the decisions rejecting second-generation arbitration provisions—and in particular, the California Supreme Court's decision in *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005)—ATTM promulgated the current version of its arbitration provision in late 2006. In creating this provision, ATTM consulted with, among others, Richard Nagareda, a law professor at Vanderbilt University whose scholarship focuses on aggregate dispute resolution. ER74. Professor Nagareda has "never seen an arbitration provision that has gone as far as this one to provide incentives for consumers and their prospective attorneys to bring claims" on an individual basis. ER213. As a result, although he has expressed the view that second-generation arbitration provisions generally should be unenforceable because they tend to preclude the vindication of statutory rights, he believes that ATTM's third-generation provision should be fully enforceable because it provides adequate incentives for consumers and their lawyers to pursue small claims on an individual basis. ER212-13. Indeed, the district court recognized that ATTM's revised arbitration provision has

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[7] *See Shroyer*, 498 F.3d at 981-86; *Scott v. Cingular Wireless*, 161 P.3d 1000 (Wash. 2007); *see also, e.g.*, *Lowden v. T-Mobile USA, Inc.*, 512 F.3d 1213 (9th Cir. 2008), *cert. denied*, 129 S. Ct. 45 (2008); *Ford v. Verisign, Inc.*, 252 F. App'x 781 (9th Cir. 2007), *cert. denied sub nom. T-Mobile USA, Inc. v. Ford*, 128 S. Ct. 2503 (2008).

"dramatically changed" from the second-generation version that this Court found to be unconscionable in *Shroyer*. ER18.

The revised provision includes the following pro-consumer features (ER89-91):

- **Potential for $7,500 premium award:** If the arbitrator awards a California customer relief that is greater than ATTM's last "written settlement offer made before an arbitrator was selected" but less than $7,500, ATTM will pay the customer $7,500 rather than the smaller arbitral award;[8]

- **Double attorneys' fees:** If the arbitrator awards the customer more than ATTM's last written settlement offer, then ATTM will "pay [the customer's] attorney, if any, twice the amount of attorneys' fees, and reimburse any expenses, that [the] attorney reasonably accrues for investigating, preparing, and pursuing [the] claim in arbitration";[9]

- **Cost-free arbitration:** "[ATTM] will pay all [American Arbitration Association ("AAA")] filing, administration and arbitrator fees" unless the arbitrator determines that the claim "is frivolous or brought for an improper purpose (as measured by the standards set forth in Federal Rule of Civil Procedure 11(b))";[10]

- **ATTM disclaims right to seek attorneys' fees:** "Although under some laws [ATTM] may have a right to an award of attorneys' fees and expenses if it prevails in an arbitration, [ATTM] agrees that it will not seek such an

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[8] The amount of the minimum payment varies from state to state because it is tied to the jurisdictional maximum of the customer's local small claims court. ER90-91. In California, the jurisdictional limit for small claims court is $7,500. *See* Cal. Code Civ. Proc. § 116.221.

[9] This attorney premium "supplements any right to attorneys' fees and expenses [that the customer] may have under applicable law." ER91. Thus, a customer who does not qualify for this premium is entitled to an attorneys' fee award to the same extent as if the claim had been brought in court.

[10] In the event that an arbitrator concludes that a consumer's claim is frivolous, the AAA's consumer arbitration rules would cap a consumer's arbitration costs at $125. ER134.

award [from the customer]";

- **Small claims court option:** Either party may bring a claim in small claims court;

- **No confidentiality requirement:** The parties need not keep the arbitration confidential;

- **Full remedies available:** The arbitrator can award the same remedies to individual consumers (including punitive damages and injunctions) that a court could award;

- **Flexible consumer procedures:** Arbitration will be conducted under the AAA's Commercial Dispute Resolution Procedures and the Supplementary Procedures for Consumer-Related Disputes, which the AAA designed with consumers in mind;

- **Conveniently located hearing:** Arbitration will take place "in the county * * * of [the customer's] billing address"; and

- **Choice of in-person, telephonic, or no hearing**: For claims of $10,000 or less, customers have the exclusive right to choose whether the arbitrator will conduct an in-person hearing, a hearing by telephone, or a "desk" arbitration in which "the arbitration will be conducted solely on the basis of documents submitted to the arbitrator."[11]

C. ATTM's Dispute-Resolution Process In Practice.

A formal arbitration proceeding between ATTM and one of its customers (or an action in small claims court) is the last step of the dispute-resolution process—one that is rarely necessary because the overwhelming majority of disputes are resolved through less formal means. ER75-76. Like most large service providers, ATTM has a customer care department whose job it is to handle customer complaints. But unlike most companies, ATTM's arbitration provision makes

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[11] For claims exceeding $10,000, a hearing would be held unless both parties agreed to forgo it. ER133.

resolving complaints to customers' satisfaction particularly imperative. Because the provision requires ATTM to pay the full cost of any arbitration and could result in ATTM paying the customer $7,500 and double attorneys' fees, it is almost always in ATTM's interest for its customer service representatives to make adjustments to bills or provide credits against future bills in order to resolve customer complaints. Accordingly, between February 2007 and January 2008, ATTM's representatives dispensed over $1.3 billion in credits for customer concerns and complaints. ER76. In January 2008 alone, ATTM representatives provided about $120 million in credits. ER76.

It is only if a customer either doesn't contact the customer care department at all or is dissatisfied with the resolution offered by the customer care department that the arbitration provision comes directly into play. The first step of the process is to provide ATTM's legal department with notice of the dispute. ER76. That is as simple as sending a letter to ATTM or filling out and mailing a one-page Notice of Dispute form that ATTM has posted on its web site at http://www.att.com/arbitration-forms. ER75.

ATTM's legal department generally responds to a notice of dispute with a written settlement offer. ER76. As with ATTM's customer care representatives, the goal of ATTM's legal department is to resolve any colorable claim quickly and to the customer's satisfaction, without the need for the customer to initiate arbitration proceedings. ER65. When the customer is represented by an attorney,

this often means offering a reasonable amount to compensate the attorney for his or her time. ER65.

If the dispute cannot be resolved within 30 days, the customer may begin the arbitration process. ER77. To do so, the customer need only fill out a one-page Demand for Arbitration form and send copies to the AAA and to ATTM. Customers may obtain a copy of the form from the AAA's web site or use a simplified form that ATTM has posted on its web site, at http://www.att.com/arbitration-forms. ER75. To further assist its customers, ATTM's web site includes a layperson's guide on how to arbitrate a claim (at http://www.att.com/arbitration-information). ER74-75.

D. The Concepcions File A Putative Class Action Against ATTM.

In March 2006, the Concepcions filed a putative class action lawsuit against ATTM. ER357-73. In their complaint as subsequently amended, the Concepcions allege that ATTM improperly charged them (and other customers) sales tax based on the full retail price of cell phones that had been advertised as free or discounted. ER357. The Concepcions allege that this practice violates California's Unfair Competition Law (Cal. Bus. & Prof. Code §§ 17200 *et seq.*), False Advertising Law (*id.* §§ 17500 *et seq.*), and Consumer Legal Remedies Act (Cal. Civ. Code §§ 1750 *et seq.*), and constitutes fraud and unjust enrichment. ER363-72. On behalf of a putative class of ATTM customers in California, the Concepcions

demand damages, restitution, injunctive relief, and attorneys' fees and costs. ER362-63, ER372.

E. The District Court Denies ATTM's Motion To Compel Arbitration.

ATTM responded to the Concepcions' amended complaint by moving to compel arbitration under its revised arbitration provision. ER66-69. The Concepcions opposed ATTM's motion, arguing that the December 2006 revision to their arbitration agreements is unenforceable because they received the revised provision after they had filed suit. The Concepcions also argued that both their revised and their pre-existing arbitration provisions are unenforceable under California law, chiefly because they require that arbitration be conducted on an individual (as opposed to class-wide) basis.

The district court denied ATTM's motion to compel arbitration. The court first held that "[b]oth Federal and California law support ATTM's argument that the 2006 revision [to the arbitration agreement] applies [to the Concepcions]." ER9. The court explained that federal law permits expressly retroactive arbitration agreements, such as the revised arbitration provision, to be applied to existing lawsuits. ER9 (citing *e.g.*, *Enderlin v. XM Satellite Radio Holdings, Inc.*, 2008 WL 830262, at *7 (E.D. Ark. Mar. 25, 2008); *Goetsch v. Shell Oil Co.*, 197 F.R.D. 574, 577-79 (W.D.N.C. 2000)). In addition, the court held that California law permits a party to invoke a contractual change-in-terms provision in order to make its

customers' existing arbitration agreements more favorable to consumers. ER9-10 (citing, *e.g.*, *Badie v. Bank of Am.*, 79 Cal. Rptr. 2d 273 (Ct. App. 1998)).

The district court then considered whether ATTM's revised arbitration provision is unconscionable under California law because it requires arbitration on an individual basis. The court explained that parties seeking to avoid enforcement of contractual provisions on unconscionability grounds must establish both procedural and substantive unconscionability and that, under California's "sliding-scale" approach, high procedural unconscionability can make up for low substantive unconscionability and vice versa. ER10. The court noted, however, that, in the particular context of class waivers, unenforceability is established if (1) "the agreement is a consumer contract of adhesion"; (2) disputes "predictably involve small amounts of damages"; and (3) "it is alleged that" the drafter of the agreement has "scheme[d] to deliberately cheat large numbers of consumers out of individually small sums of money." ER11 (citing *Shroyer v. New Cingular Wireless Servs., Inc.*, 498 F.3d 976, 983 (9th Cir. 2007), in turn citing *Discover Bank v. Super. Ct.*, 113 P.3d 1100, 1110 (Cal. 2005)).

In applying the first prong of the *Shroyer/Discover Bank* test (which the court equated with procedural unconscionability), the court found that the Concepcions' arbitration agreement was a "contract of adhesion." ER13. Although the court therefore deemed the agreement to be procedurally unconscionable, it held that the agreement "is on the low end of the spectrum of

procedural unconscionability" because "the [original] contract was presented to the Plaintiffs at the time of purchase" and the revised provision sent as a bill insert "merely altered the existing agreement in a way that made the arbitration provisions more favorable to the Concepcions." ER13-14.

The district court next held that, in view of the features of ATTM's revised arbitration provision, the Concepcions could not satisfy the second prong of the test—*i.e.*, that "predictably small amounts of damages" are at issue. ER14-17. The court explained that "[w]hile the new arbitration provision does not change the amount of actual damages at issue ($30), it does exponentially change the amount of potential recovery in arbitration." ER14. Because of ATTM's commitment to pay all arbitration costs and the availability of special premiums in arbitration, "the new provision prompts ATTM to *accept liability*"—and to offer to settle for many times the customer's actual damages—"during the *informal claims process*" that precedes arbitration, "even for claims of questionable merit." ER15 (emphasis in original). The court therefore found that ATTM's provision "sufficiently incentivizes consumers" to pursue "small dollar" claims. ER16. In contrast, the court observed, "consumers who are members of a class do not fare as well." ER16. Accordingly, "a reasonable consumer may well prefer quick informal resolution with likely full payment over class litigation that could take months, if not years, and which may merely yield an opportunity to submit a claim for recovery of a small percentage of a few dollars." ER17. The court thus concluded

that ATTM's revised arbitration provision "is an adequate substitute for class arbitration as to this prong of *Discover Bank*." ER17.

The district court nonetheless held that ATTM's arbitration provision is unenforceable under the facts of this case because ***ATTM*** had not satisfactorily disproven the third prong of the *Shroyer/Discover Bank* test, which the court characterized as focusing on "whether the arbitration provision is an adequate substitute for the deterrent effect of the class action mechanism." ER19. The court noted that ATTM had submitted evidence that it dispensed over $1.3 billion in credits in one year to resolve customers' disputes and that 570 customers had invoked the arbitration process. ER19. But the court held that ATTM had failed to prove the existence of a market for settlement of deceptive advertising claims on an individual basis and that any such market would be an adequate substitute for class actions in deterring ATTM from engaging in wrongdoing. ER19. The court proceeded to hold that "[f]aithful adherence to California's stated policy of favoring class litigation and [class] arbitration to deter alleged fraudulent conduct * * * compels the Court to invalidate" ATTM's revised arbitration provision. ER20.

Finally, the district court rejected ATTM's argument that "the FAA preempts any holding that ATTM's arbitration provision is unenforceable under California law." ER20 n.11.

STANDARD OF REVIEW

"The validity * * * of an arbitration clause [is] reviewed de novo." *Nagrampa v. MailCoups, Inc.*, 469 F.3d 1257, 1267 (9th Cir. 2006) (en banc). The "factual findings underlying the district court's decision," however, are reviewed for "clear error." *Id.* at 1267-68.

SUMMARY OF ARGUMENT

The FAA requires courts to enforce arbitration agreements as written. The sole exception is when the party resisting arbitration demonstrates the existence of a generally applicable contract defense—*i.e.*, a ground "for the revocation of ***any*** contract." 9 U.S.C. § 2 (emphasis added).

Here, the district court determined that such a ground exists because, even though "there is nothing unfair about the tradeoff that ATTM's customers make" in agreeing to ATTM's current arbitration provision (ER17 (internal quotation marks and alterations omitted)), California's "stated policy of favoring class litigation and arbitration to deter alleged fraudulent conduct" mandates a finding that the provision is unconscionable (ER20). That holding is fundamentally mistaken as a matter of California law and, in any event, is preempted by the FAA.

1. Both this Court and the California Supreme Court have made clear that California law ***does not*** impose an across-the-board rule barring class waivers in arbitration provisions. The district court's holding that ATTM's arbitration provision is unenforceable runs counter to those decisions because it leaves no

room for any consumer contract to require disputes to be resolved through individual arbitration.

Under California law, the party seeking to avoid enforcement of a contractual provision on unconscionability grounds must show that the provision is both procedurally and substantively unconscionable and must make up for a weak showing on one element with a strong showing on the other. Because the district court correctly found that the Concepcions' arbitration agreement was "on the low end of the spectrum of procedural unconscionability" (ER14), under generally applicable California unconscionability law the Concepcions should have been required to show a high degree of substantive unconscionability in order to avoid enforcement of their arbitration provision.

In finding ATTM's arbitration provision to be substantively unconscionable, the district court chiefly relied upon *Discover Bank*, in which the California Supreme Court announced a three-part test for evaluating the enforceability of class waivers, and *Shroyer*, in which this Court deemed an earlier version of ATTM's arbitration provision to be unenforceable under *Discover Bank*. In *Shroyer*, this Court explained that class waivers are unconscionable "when the potential for individual *gain* [for the consumer] is small." 498 F.3d at 986 (emphasis in original).

ATTM's current arbitration provision creates a significant potential for individual gain by providing for a minimum award of $7,500 and double attorneys'

fees if the arbitrator awards the customer more than ATTM's last written settlement offer. The provision also specifies that ATTM will pay the full cost of arbitration and that the customer has sole discretion to choose between a conveniently located in-person arbitration, arbitrating by telephone, or arbitrating by mail. Together, these pathbreaking features provide powerful incentives for consumers to pursue their disputes with ATTM in individual arbitration, and for ATTM to resolve those disputes to the customers' satisfaction.

The district court recognized that "a reasonable customer may well prefer" ATTM's arbitration provision to a contract without it (ER17)—a finding that should have led the court to enforce the provision, given the modest level of procedural unconscionability. But, applying a newly-minted standard, the court held that the provision is unenforceable because ***ATTM*** had not proven that dispute resolution under the provision is as effective as the class-action device in apprising customers that they might have a claim and thereby "deterring corporate wrongdoing." ER19-20.

In so holding, the district court assumed not only the validity of the Concepcions' allegations of fraud, but also that a class would be certified and that many customers would learn of the alleged fraud as a result of the class notice sent after certification. As a practical matter, ATTM can overcome these presumptions only by litigating—at the motion-to-compel-arbitration stage—a host of class certification, class notice, and merits-related issues, and introducing evidence

comparing the number of consumers likely to receive, read, understand, and respond to a hypothetical class notice issued after a hypothetical class certification with the number likely to pursue individual dispute resolution if the class waiver were enforced. Not only is this kind of burden entirely unprecedented in California, but it also is impossible to square with the Supreme Court's repeated admonition that the purpose of the FAA was to move the parties to an arbitration agreement out of court and into arbitration "as quickly and easily as possible." Indeed, by erecting such an onerous and insurmountable standard of proof, the district court effectively imposed an across-the-board ban on agreements to arbitrate on an individual basis. That outcome is directly contrary to the case-by-case approach to unconscionability required by *Shroyer* and *Discover Bank*, and, moreover, ignores that, under *Shroyer*, the question is whether the ***plaintiffs themselves*** have an adequate incentive to pursue arbitration.

2. Even if the district court had accurately interpreted California law, such an interpretation is preempted by the FAA.

To begin with, the district court impermissibly deviated from California's generally applicable unconscionability standard. Under that standard, contractual terms are unenforceable only if they shock the conscience. As the district court recognized, ATTM's arbitration provision represents a bargain that "a reasonable consumer would prefer," even though it requires individual arbitration. ER17. *A fortiori*, it does not shock the conscience. Moreover, insofar as the sliding-scale

test and the subsequent three-part *Discover Bank* test constitute legitimate refinements of the shock-the-conscience standard, the district court deviated from them too. There can be no doubt that an arbitration provision that "a reasonable customer would prefer" does not rise high enough on the spectrum of substantive unconscionability to make up for the fact that it is low on the spectrum of procedural unconscionability. Hence, the district court's interpretation of California law dramatically deviates from the sliding-scale approach. The court also deviated from the three-prong *Discover Bank* test by elevating the public policy favoring class actions into a factor that trumps all others. In short, the district court's interpretation of California law bears no resemblance to generally applicable unconscionability principles. Accordingly, it violates the FAA's command that arbitration agreements be enforced "save upon such grounds as exist at law or in equity for the revocation of ***any*** contract." 9 U.S.C. § 2 (emphasis added).

Recharacterizing the district court's rationale as "public policy" rather than "unconscionability" would make no difference. Congress enacted the FAA for the very purpose of forbidding courts from refusing to enforce arbitration agreements on malleable "public policy" grounds. Preemption that does not override state "public policy" is not preemption at all. Accordingly, "public policy" may not be treated as a ground that exists at law or equity for the revocation of any contract without completely gutting the FAA.

Finally, the district court's holding—that under California law a class-arbitration waiver is unenforceable even when the agreement provides substantial opportunities for "individual gain"—would directly conflict with the FAA's purpose of fostering arbitration agreements. As the Supreme Court has reiterated, "[a] prime objective of an agreement to arbitrate is to achieve streamlined proceedings and expeditious results." *Preston v. Ferrer*, 128 S. Ct. 978, 986 (2008) (internal quotation marks omitted). If, as the district court effectively held, there is nothing companies can do to have an enforceable waiver of class arbitration in California, companies will simply abandon arbitration rather than subject themselves to the worst-of-both-worlds scenario of class arbitration. Because nothing could more clearly frustrate the purpose of the FAA, the rule embraced by the district court is preempted for that reason as well.

ARGUMENT

The FAA provides that written agreements to arbitrate disputes "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. Congress enacted the FAA to "reverse the longstanding judicial hostility to arbitration agreements * * *[,] to place [these] agreements upon the same footing as other contracts[,] * * * [and to] manifest a liberal federal policy favoring arbitration agreements." *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 289 (2002) (internal quotation marks omitted). Accordingly, "questions of arbitrability must be

addressed with a healthy regard for the federal policy favoring arbitration." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).

There is no dispute here that the FAA applies and that the Concepcions' claims fall within the scope of their agreement to arbitrate. The district court nevertheless refused to enforce ATTM's arbitration provision. As we discuss below, that decision is erroneous as a matter of California law. Moreover, even if the district court's interpretation of California law were correct, that law is preempted by the FAA.

I. THE CONCEPCIONS' ARBITRATION AGREEMENT IS FULLY ENFORCEABLE UNDER CALIFORNIA LAW.

Under California law, the party seeking to avoid enforcement of a contractual term has the burden of proving both procedural and substantive unconscionability. *See*, *e.g.*, *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 690 (Cal. 2000); *Engalla v. Permanente Med. Group, Inc.*, 938 P.2d 903, 915-16 (Cal. 1997). Procedural unconscionability involves "oppression" or "surprise" in the making of the agreement (*Armendariz*, 6 P.3d at 690), while substantive unconscionability focuses on whether the contractual term in question is so "overly harsh" or "one-sided" (*id.*) as to "shock the conscience." *Belton v. Comcast Cable Holdings, LLC*, 60 Cal. Rptr. 3d 631, 649-50 (Ct. App. 2007); *Aron v. U-Haul Co.*, 49 Cal. Rptr. 3d 555, 564 (Ct. App. 2006). Put another way, the bargain that the term represents must be one that "'no man in his senses, and

not under delusion, would make on the one hand, and [that] no honest and fair man would accept on the other.'" *Herbert v. Lankershim*, 71 P.2d 220, 257 (Cal. 1937) (quoting *Odell v. Moss*, 62 P. 555, 557 (Cal. 1900) (quoting in turn 1 JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE § 244 (14th ed. 1918)); *see also Cal. Grocers Ass'n, Inc. v. Bank of Am.*, 27 Cal. Rptr. 2d 396, 402 (Ct. App. 1994). As we explain below, the Concepcions did not meet their burden of proving that ATTM's arbitration provision is unenforceable under California's sliding-scale approach to unconscionability.

A. Because The Arbitration Agreement Entails No More Than A Minimal Degree Of Procedural Unconscionability, The Concepcions Were Required To Show A High Degree Of Substantive Unconscionability.

We acknowledge that, under this Court's interpretation of California law, the Concepcions' agreement to arbitrate involves a modest degree of procedural unconscionability. Although the Concepcions readily could have obtained wireless service elsewhere (ER229-31), this Court held in *Shroyer* that "a contract may be procedurally unconscionable under California law when the party with substantially greater bargaining power presents a 'take-it-or-leave-it' contract to a customer—even if the customer has a meaningful choice as to service providers." 498 F.3d at 985 (internal quotation marks omitted).[12] As the California Court of

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[12] Although the panel in this case is bound by this aspect of *Shroyer*, we submit that the *Shroyer* court erred in "follow[ing] the [California] courts that reject the notion that the existence of 'marketplace alternatives' bars a finding of procedural

Appeal has made clear, however, the non-negotiable nature of an agreement suffices only to establish "a minimal degree of procedural unconscionability." *Gatton v. T-Mobile USA, Inc.*, 61 Cal. Rptr. 3d 344, 356 (Ct. App. 2007), *cert. denied*, 128 S. Ct. 2501 (2008). Accordingly, the district court correctly found that "ATTM's arbitration agreement with the Concepcions is on the low end of the spectrum of procedural unconscionability." ER14.

Consequently, under California law the Concepcions were required to establish "a high degree of substantive unconscionability" in order to avoid enforcement of their arbitration provision. *Gatton*, 61 Cal. Rptr. 3d at 356 (citing *Armendariz*, 6 P.3d at 690); *see also Marin Storage & Trucking, Inc. v. Benco Contracting & Eng'g, Inc.*, 107 Cal. Rptr. 2d 645, 656-57 (Ct. App. 2001) (when

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unconscionability," rather than the conflicting line of California cases holding that there can be no procedural unconscionability when the customer has alternatives to contracting with the defendant. 498 F.3d at 985. The two competing lines of published decisions reveal an unmistakable pattern. The cases finding procedural unconscionability all involve arbitration provisions. *See Gatton v. T-Mobile USA, Inc.*, 61 Cal. Rptr. 3d 344, 353-56 (Ct. App. 2007), *cert. denied*, 128 S. Ct. 2501 (2008); *Szetela v. Discover Bank*, 118 Cal. Rptr. 2d 862, 867 (Ct. App. 2002); *Villa Milano Homeowners Ass'n v. Il Davorge*, 102 Cal. Rptr. 2d 1, 5-6 (Ct. App. 2000). The decisions that do not all involve other types of contractual provisions. *See Belton*, 60 Cal. Rptr. 3d at 650 (requirement that cable music subscribers receive basic cable television); *Wayne v. Staples, Inc.*, 37 Cal. Rptr. 3d 544, 556 (Ct. App. 2006) (declared-value insurance for package shipping); *Aron*, 49 Cal. Rptr. 3d at 564 (rental truck refueling policy); *Morris v. Redwood Empire Bancorp*, 27 Cal. Rptr. 3d 797, 807 (Ct. App. 2005) (termination fee); *Dean Witter Reynolds, Inc. v. Super. Ct.*, 259 Cal. Rptr. 789, 795 (Ct. App. 1989) (termination and annual fee). Because the conflict hinges on whether an arbitration provision is at issue, reliance on the arbitration-specific unconscionability rule violates the FAA's requirement that state law cannot single out arbitration for suspect status. *See, e.g.*, *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987).

"procedural unconscionability, although extant, [is] not great," "a greater degree of substantive unfairness" must be established). As the balance of the district court's order reflects, that they did not do.

B. ATTM's Arbitration Provision Is Not Substantively Unconscionable At All, Much Less Highly So.

The district court found that "there is nothing unfair about the tradeoff that ATTM's customers make" in agreeing to arbitration under ATTM's revised provision and that "the record * * * demonstrates that a ***reasonable consumer may well prefer***" ATTM's provision to retaining the right to pursue a class action. ER17 (internal quotation marks and alterations omitted; emphasis added). In nevertheless holding that the Concepcions had met their burden of proving that ATTM's revised arbitration provision is substantively unconscionable, the district court misapplied California unconscionability law.

As this Court explained in *Shroyer*, under *Discover Bank* an agreement to arbitrate on an individual basis is unconscionable if (1) it is contained in a "consumer contract of adhesion"; (2) disputes between the contracting parties are "predictably small"; and (3) the weaker party alleges that the party with superior bargaining power engaged in a scheme to defraud large numbers of consumers out of small sums of money. *Shroyer*, 498 F.3d at 982-84. The district court correctly held that claims under ATTM's arbitration provision are not "predictably small" because of the availability of potential premium recoveries. But the court went on

to hold that ATTM's arbitration provision is unenforceable because ATTM had failed to establish that the provision passes muster under the court's interpretation of the third prong of the *Discover Bank* test. As we discuss below, the district court's assessment of the second prong was correct, but its transformation of the third prong into a new, independent test was erroneous.

1. ATTM's Revised Arbitration Provision Is Enforceable Under California Law Because It Provides The Concepcions With The Potential For Substantial Individual Gain.

The district court found that the Concepcions had not satisfied their burden of establishing the second prong of the *Discover Bank* test because, "[w]hile the new arbitration provision does not change the amount of actual damages at issue ($30), it does exponentially change the amount of potential recovery in arbitration." ER14. As the court found, ATTM's arbitration provision "provides sufficient incentive for individual consumers with disputes involving small damages to pursue" individual claims. ER17. That finding is correct, and therefore should have led the district court to enforce the Concepcions' arbitration agreement.

In *Shroyer*, this Court explained that the central concern in *Discover Bank* was the adequacy (or inadequacy) of the incentives for consumers to "pursue individual arbitration." 498 F.3d at 986. In *Discover Bank*, the California Supreme Court held that the class waiver in a credit-card issuer's arbitration provision—one that was far less favorable to consumers than ATTM's current

provision—was substantively unconscionable because it effectively ***"insulate[d]" the company from liability*** for the $29 claims at issue in that case. 113 P.3d at 1109 (emphasis added). The court explained that class actions "'overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights'" by "'aggregating the relatively paltry recoveries into something worth someone's (usually an attorney's) labor.'" *Id.* at 1105-06 (quoting *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 617 (1997)). But the court made clear that it was not holding "that ***all*** class action waivers are necessarily unconscionable." *Id.* at 1110 (emphasis added). Rather, whether such a provision is substantively unconscionable turns on a case-by-case analysis of whether the plaintiff may feasibly vindicate "small" claims without using the class-action mechanism and, conversely, whether the class waiver threatens to insulate the company from liability for cheating its customers. *Id.*

Applying *Discover Bank*, this Court held in *Shroyer* that a previous version of ATTM's arbitration provision—the one that was superseded by the revision sent to the Concepcions in December 2006—was substantively unconscionable. 498 F.3d at 986-87. As interpreted by this Court, that version specified that ATTM (then Cingular) would pay the full cost of arbitration and, in addition, would pay the plaintiff's attorneys' fees ***if*** the arbitrator awarded the plaintiff the amount of his or her demand or more. *Id.* at 986. The *Shroyer* Court concluded that those features were insufficient to render the class waiver enforceable under *Discover*

Bank, explaining: "[W]hen the potential for individual *gain* is small, very few plaintiffs, if any, will pursue individual arbitration or litigation," even if they would not "experience a net loss (including attorneys' fees and costs)." *Id*. (emphasis in original).

As noted above (at page 8), ATTM has built the necessary "individual gain" into its revised arbitration provision by providing that any California customer who obtains an arbitral award in excess of ATTM's last written settlement offer will receive at least ***$7,500***, while the customer's counsel (if any) will receive ***double*** their attorneys' fees. For several reasons, these amounts are more than sufficient to ensure that the Concepcions have adequate incentives to pursue their claims in individual arbitration.

a. **The Concepcions' potential recovery in individual arbitration exceeds the amounts that Congress and the California Legislature have deemed sufficient to encourage private suits.**

Legislative judgments confirm the district court's finding that ATTM's revised arbitration provision "provides sufficient incentive for individual consumers with disputes involving small damages to pursue" their claims (ER17): The Concepcions' potential recovery in arbitration under ATTM's provision far exceeds the amounts that Congress and the California Legislature have deemed sufficient to encourage individuals and their counsel to pursue statutory claims.

For example, Congress has authorized an award of statutory damages of between $100 and $1,000, plus attorneys' fees, to consumers who sue under the Fair Credit Reporting Act. 15 U.S.C. § 1681n(a). Many federal and California laws provide for statutory damages of $1,000 along with attorneys' fees.[13] The California Legislature also has determined that awards of $1,000 are enough to encourage recipients of prohibited junk faxes to sue—$500 under California law (Cal. Bus. & Prof. Code § 17538.43(b)) and $500 under the federal Telephone Consumer Act (47 U.S.C. § 227(b)(3)(B)). Neither of those statutes authorizes an award of attorneys' fees.

Even statutes that seek to vindicate weighty public policies against discrimination offer plaintiffs smaller incentives to pursue claims than the potential recoveries available under ATTM's arbitration provision. For example, California's Unruh Civil Rights Act, which prohibits discrimination on the basis of "sex, race, color, religion, ancestry, national origin, disability, medical condition, marital status, or sexual orientation" (Cal. Civ. Code § 51(b)), authorizes statutory damages of $4,000, plus attorneys' fees. *Id.* § 52(a).

Such legislative determinations of the amount needed to encourage vindication of statutory rights are entitled to great (if not dispositive) weight. *See*

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[13] *See*, *e.g.*, 47 U.S.C. § 551(f)(2)(A) (Cable Communications Policy Act); Cal. Civ. Code § 54.3(a) (California Disabled Persons Act); Cal. Civ. Code § 56.36(b)(1) (statute barring negligent release of confidential medical information); Cal. Penal Code § 423.4(a) (California Freedom of Access to Clinic and Church Entrances Act).

Santisas v. Goodin, 951 P.2d 399, 413 (Cal. 1998) (noting court's "reluctan[ce] to declare contractual provisions void or unenforceable on public policy grounds without firm legislative guidance"); *People v. Mun. Ct.*, 574 P.2d 425, 427 (Cal. 1978) (the courts' "common law powers * * * should never be exercised in such a manner as to * * * frustrate legitimate legislative policy") (internal quotation marks omitted). To conclude that the greater amounts available under ATTM's arbitration provision are insufficient would be to reject the judgments of Congress and the California Legislature that lower amounts suffice to encourage private suits to vindicate the important public policies underlying these statutes. The Unruh Civil Rights Act is particularly pertinent: Not only is the public policy it aims to serve of unquestionable importance, but claims under this Act are often not subject to class-action treatment. For example, claims of employment or housing discrimination based on race are often individual, not class, claims.[14] If the legislature believed that $4,000 was enough to spur a victim of discrimination to sue despite an inability to bring a class action, *a fortiori* the prospect of $7,500 and double attorneys' fees should be sufficient to motivate the Concepcions to pursue their claims in individual arbitration. These judgments are confirmed by real-

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[14] Other California statutes that create private rights of action that are not typically susceptible to class treatment also provide for statutory damages of less than $7,500. For example, the minimum statutory damages available to wiretap victims is $5,000. Cal. Penal Code § 637.2(a). And so-called "invention developers" who commit fraud or fail to maintain their client's secrets are liable for statutory damages of $3,000. Cal. Bus. & Prof. Code § 22386.

world evidence: Each year, Californians file hundreds of thousands of small-claims-court actions even though California law caps damages in such cases at $7,500 and attorneys cannot participate, much less recover a fee award.[15]

b. The Concepcions are better off in individual arbitration than as class representatives.

The Concepcions' argument that ATTM's revised arbitration provision is substantively unconscionable also rings hollow because, as the district court recognized, they are better off invoking that provision than pursuing a class action. ER20 n.10. ***First***, the premiums available under ATTM's revised arbitration provision substantially exceed the typical incentive payments awarded to class representatives as part of court-approved settlement agreements. *See* Theodore Eisenberg & Geoffrey P. Miller, *Incentive Awards to Class Action Plaintiffs: An Empirical Study*, 53 UCLA L. REV. 1303, 1333 & tbl. 5 (2006) (finding median incentive award for class representatives in consumer and consumer credit cases to be $2,089 and $1,045, respectively).

Second, the time and effort required to pursue a claim are substantially lower under ATTM's dispute-resolution process than in litigation. As a general

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[15] *See* Cal. Code Civ. Proc. §§ 116.221, 116.530; *see also* Judicial Council of California, *2007 Court Statistics Report: Statewide Caseload Trends 1996-1997 through 2005-2006* 46, *available at* http://www.courtinfo.ca.gov/reference/documents/csr2007.pdf.

matter, arbitration is much swifter than judicial dispute resolution.[16] But customers like the Concepcions are likely to obtain a successful resolution of their claims with even less effort than it takes to pursue a formal arbitration—perhaps only a few hours' worth—simply by providing ATTM with notice of their dispute. That is because, as the district court recognized, the terms of the arbitration provision "prompt[] ATTM to *accept liability*" before arbitration "(even for claims of questionable merit and for claims it does not owe)," so that it can avoid the risk of having to pay the premiums and the substantial costs of subsidizing arbitration.[17] ER15 (emphasis in original). If the Concepcions were dissatisfied with ATTM's settlement offer, they could arbitrate by telephone or by mail. *See* page 9, *supra*. By bringing a class action, by contrast, the Concepcions would have to invest much more time to pursue their claim. Working with a lawyer, filling out affidavits, being deposed, and attending the class certification hearing would

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[16] Consumer arbitrations administered by the AAA proceed to an award in an average of four to six months. *See* AAA, *Analysis of the American Arbitration Association's Consumer Arbitration Caseload*, *available at* http://www.adr.org/si.asp?id=5027. By contrast, federal civil cases average 23.2 months before reaching trial. *See United District Court—Judicial Caseload Profile*, *available at* http://www.uscourts.gov/cgi-bin/cmsd2006.pl. A study of state courts' dockets showed that contract suits averaged 25 months before a verdict was obtained. *See* Thomas H. Cohen, Bureau of Justice Statistics, *Contract Trials and Verdicts in Large Counties, 2001*, at 2 (Jan. 2005), *available at* http://www.ojp.usdoj.gov/bjs/pub/pdf/ctvlc01.pdf. Of course, class actions take even longer to reach a final resolution.

[17] If a customer selects an in-person hearing, ATTM must pay at least $1,700 in arbitration costs: $750 in administrative fees, a $200 case service fee, and $750 in arbitrator fees. ER134-35.

doubtlessly entail many days of missed work—and that lost time would stretch into weeks should the case actually proceed to trial.

Third, as noted above, the Concepcions are particularly likely to achieve a satisfactory outcome if they invoke ATTM's dispute-resolution process. Indeed, the district court observed that, under ATTM's arbitration provision, customers likely will obtain "excess payment * * * *without* the need to arbitrate or litigate." ER16 (emphasis in original). Even if arbitration were necessary, consumers typically prevail more often in arbitration than in litigation. For example, recent statistics compiled by the AAA show that consumers prevail in almost half (48 percent) of the approximately 40 percent of arbitrations that are not settled or withdrawn.[18] AAA, *Analysis of the American Arbitration Association's Consumer Arbitration Caseload*, *available at* http://www.adr.org/si.asp?id=5027. By contrast, in court, virtually all consumer actions that are not settled or voluntarily withdrawn are dismissed, with only 1.3 percent of federal civil cases ever reaching trial, much less a verdict for the plaintiff.[19]

Moreover, although the interests of absent class members are logically irrelevant to the unconscionability inquiry (*see* page 38, *infra*), the district court agreed with ATTM that "consumers who are members of a class do not fare as

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[18] It goes without saying that a substantial percentage of settlements in consumer-initiated arbitrations benefit the consumer.

[19] *See* Admin. Office of U.S. Courts, *2006 Judicial Facts and Figures* tbl. 4.10, *at* http://www.uscourts.gov/judicialfactsfigures/2006/Table410.pdf.

well" as consumers who arbitrate. ER16. That finding is well supported. About four-fifths of putative class actions are not certified. Thomas E. Willging & Shannon R. Wheatman, *Attorney Choice of Forum in Class Action Litigation: What Difference Does It Make?*, 81 NOTRE DAME L. REV. 591, 635-36 (2006). In those cases, the absent class members get nothing. Of the 20 percent of putative class actions that are certified, the overwhelming majority settle. *Id.* at 638. And in those cases, class counsel's fees often eat up much of the settlement, leaving absent class members to receive pennies on the dollar.[20] Unsurprisingly, studies show that very few consumers bother to file a claim when the amount that they would receive is small.[21] Indeed, in several recent cases, far fewer than one percent of the absent class members submitted claims.[22] This phenomenon caused

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[20] *See, e.g.*, John Bronsteen, *Class Action Settlements: An Opt-In Proposal*, 2005 U. ILL. L. REV. 903, 911; Jill E. Fisch, *Class Action Reform, Qui Tam, and the Role of the Plaintiff*, 60 L. & CONTEMP. PROBS. 167, 168 (1997); Susan P. Koniak & George M. Cohen, *Under Cloak of Settlement*, 82 VA. L. REV. 1051, 1053-89 (1996).

[21] *See*, *e.g.*, James Tharin & Brian Blockovich, *Coupons and the Class Action Fairness Act*, 18 GEO. J. LEGAL ETHICS 1443, 1445-46 (2005) (noting that the redemption rate of class-action coupons ranges from one to three percent); Christopher R. Leslie, *A Market-Based Approach to Coupon Settlements in Antitrust and Consumer Class Action Litigation*, 49 UCLA L. REV. 991, 1035 (2002) (reporting a study of ten consumer class-action settlements in which the redemption rates varied from 3 to 13.1 percent); Gail Hillebrand & Daniel Torrence, *Claims Procedures in Large Consumer Class Actions and Equitable Distribution of Benefits*, 28 SANTA CLARA L. REV. 747, 753 (1988) (discussing three settlements in which the claims rates were 3, 10.5, and 18 percent).

[22] *See, e.g.*, *Palamara v. Kings Family Rests.*, 2008 WL 1818453, at *2 (W.D. Pa. Apr. 22, 2008) ("approximately 165 class members" out of 291,000 "had

Congress to find that "[c]lass members often receive little or no benefit from class actions, and are sometimes harmed." Class Action Fairness Act of 2005, PUB. L. NO. 109-2 § 2(a)(3), 119 Stat 4.

As Congress's findings illustrate, these features of the modern consumer class action are widely recognized. The district court therefore correctly determined that "a reasonable consumer may well prefer" ATTM's revised arbitration provision to the right to pursue a class action, and that the Concepcions cannot establish that claims against ATTM are "predictably small" under *Discover Bank*. ER17. Those findings underscore that, taken as a whole, ATTM's arbitration provision is not conscience-shocking and a customer need not be "under delusion" to accept it. *A fortiori*, ATTM's arbitration provision does not entail the "high degree of substantive unconscionability" (*Gatton*, 61 Cal. Rptr. 3d at 356) necessary to make up for its minimal level of procedural unconscionability. In nevertheless refusing to enforce the provision because ATTM did not demonstrate to the court's satisfaction that ATTM's arbitration provision is just as effective as

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obtained a voucher" under the settlement, yielding a take rate of under 0.06 percent); *Yeagley v. Wells Fargo & Co.*, 2008 WL 171083, at *2 (N.D. Cal. Jan. 18, 2008) ("less than one percent of the class chose to participate in the settlement"); *Moody v. Sears, Roebuck & Co.*, 2007 WL 2582193, at *5 (N.C. Super. Ct. May 7, 2007) ("only 337 valid claims were filed out of a possible class of 1,500,000," yielding a take rate of just over 0.02 percent), *rev'd*, 664 S.E.2d 569 (N.C. Ct. App. 2008); *see also, e.g.*, *Synfuel Techs., Inc. v. DHL Express (USA), Inc.*, 463 F.3d 646, 649-50 (7th Cir. 2006) (only a "paltry three percent" of class members filed claims).

class actions in deterring corporate misconduct, the district court adopted a novel standard that misinterprets *Shroyer* and *Discover Bank*.

2. The District Court Erred In Holding That Arbitration Provisions Containing Class Waivers Are Unenforceable Unless The Drafter Proves That Individual Arbitration Deters Corporate Misconduct As Effectively As Class Actions.

Because the district court correctly determined that the Concepcions had not satisfied the second prong of *Discover Bank*'s unconscionability test, it should have enforced their agreement to arbitrate. Instead, it held that their agreement is unenforceable under *Discover Bank*'s third prong. In the district court's view, the third prong addresses "whether – given the allegations in this case – the elimination of a class action remedy in exchange for ATTM's proposed dispute resolution mechanism would * * * vitiate the 'therapeutic effect' of class actions in 'halting' fraudulent conduct." ER18. The court held that ***ATTM*** had not proven that dispute resolution under its arbitration provision is as effective as a class action in providing notice to unsuspecting customers that they might have a claim and hence had not shown that its arbitration provision is "an adequate substitute for the deterrent effect of the class action mechanism." ER19. In refusing to enforce ATTM's arbitration provision solely because ATTM had not proven that its provision has the same deterrent force as class actions, the district court departed from California law in several respects.

To begin with, the district court erroneously shifted the burden of proof. It is clear as day that the party seeking to avoid enforcement of a contractual provision bears the burden of proving that it is unconscionable. *Engalla*, 938 P.2d at 915-16.[23] If the relative deterrent effect of class actions and individual arbitration under ATTM's provision were relevant to the analysis, it would be the Concepcions' burden to prove that the latter is less effective than the former, not ATTM's burden to disprove it.

Burdens of proof aside, the court failed to recognize that the second and third prongs of the *Discover Bank* test are not independent grounds for invalidating an arbitration provision. To the contrary, if the claims at issue are not "predictably small," then the arbitration provision does not operate as an exculpatory clause because consumers and their attorneys have an adequate incentive to pursue large claims. Indeed, this Court recognized in *Shroyer* that the *Discover Bank* test boils down to whether a consumer's potential recovery is "predictably small." As this Court explained, the California Supreme Court "was concerned that when the potential for individual *gain* is small, very few plaintiffs, if any, will pursue individual arbitration or litigation, which greatly reduces the aggregate liability a

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[23] *See also*, *e.g.*, *Brown v. Wells Fargo Bank, N.A.*, 85 Cal. Rptr. 3d 817, 831 (Ct. App. 2008) ("Plaintiffs, as the party opposing arbitration, ha[ve] the burden of establishing that the arbitration provision was unconscionable."); *Higgins v. Super. Ct.*, 45 Cal. Rptr. 3d 293, 301-02 (Ct. App. 2006) (same); *Crippen v. Cent. Valley RV Outlet, Inc.*, 22 Cal. Rptr. 3d 189, 192 (Ct. App. 2004) (same).

company faces when it has exacted small sums from millions of consumers." 498 F.3d at 986 (emphasis in original).

In addition, the district court erred in focusing its analysis on ATTM's other customers rather than the Concepcions themselves. In California, as elsewhere, a contractual term is unconscionable only if the party challenging that term can show that enforcing it under the specific circumstances of the case would shock the conscience, not simply that applying the term to other, imagined persons under other, "hypothetical situation[s]" might be "unconscionable." *West v. Henderson*, 278 Cal. Rptr. 570, 576 (Ct. App. 1991) (rejecting tenant's argument that contractual six-month limitations period would unjustifiably limit the assertion of defenses to potential lawsuit by landlord as a "hypothetical observation" "irrelevant to this case").[24] The Concepcions have never denied that, if ***they*** were to pursue arbitration, they would be likely to obtain full relief for themselves, or at least fare better than they would in litigation. Indeed, the district court expressly found that "the Concepcions arguably would be better off to individually pursue

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[24] *Cf. Am. Software, Inc. v. Ali*, 54 Cal. Rptr. 2d 477, 480 (Ct. App. 1996) (rejecting employee's procedural unconscionability attack on her employment agreement because employee was sophisticated and "had the benefit of counsel" before accepting the agreement); *accord, e.g.*, *Pleasants v. Am. Express Co.*, 541 F.3d 853, 859 (8th Cir. 2008) (under Missouri law, "whether ***other*** consumers have elected to arbitrate claims under ***other*** contracts is not material to the determination of [the plaintiff's unconscionability] claim") (emphasis added); *Cline v. H.E. Butt Grocery Co.*, 79 F. Supp. 2d 730, 733 (S.D. Tex. 1999) (arbitration agreement imposing some costs on plaintiff is not unconscionable because "[p]laintiff offers no information as to * * * ***his*** ability to pay for the cost of arbitration") (emphasis added).

their claim in arbitration" than to pursue a class action. ER20 n.10. ATTM's arbitration provision therefore is not unconscionable—which is to say, shockingly unfair—as to them.

Moreover, in holding that ATTM had the burden of proving that its arbitration provision is an adequate substitute for class-action notice, the district court created a standard that is inherently biased against the enforcement of arbitration agreements containing class waivers. For purposes of this new standard, the court not only accepted as true the Concepcions' allegations of fraud (ER19), but also assumed that a class would be certified. After all, if a class were not certified, there would be no class notice and hence nothing with which to compare the deterrent effect of ATTM's arbitration provision. But nothing in California law authorizes courts to indulge whatever assumptions will result in striking down contractual provisions as unconscionable. And as we have already discussed, the assumption that classes are routinely certified is demonstrably false. *See* page 34, *supra*.

In addition to creating a presumption of unenforceability, the district court made it nearly impossible to overcome that presumption. It is undeniable that "[ATTM's] agreement does not require consumers to execute a confidentiality agreement, thereby allowing consumers the option of disseminating the information in the manner of their choosing." *Cruz v. Cingular Wireless LLC*, 2008 WL 4279690, at *4 (M.D. Fla. Sept. 15, 2008) (rejecting "notice" argument

identical to the once accepted by the district court here in holding that ATTM's requirement of individual arbitration does not violate Florida's public policy), *appeal pending*, No. 08-16080-C (11th Cir.). Accordingly, nothing would stop an enterprising lawyer from recruiting clients to file notices of dispute against ATTM and then taking advantage of the incentives in the arbitration provision to obtain significant settlements. Nor would anything prevent customers who believe that they have been cheated from posting their complaints on blogs, YouTube, or Internet consumer bulletin boards. Yet under the district court's standard, the absence of any impediments to the dissemination of information about allegedly unlawful practices isn't enough. Instead, as the court (mis)construed California law, ATTM had to prove that enterprising lawyers are soliciting clients and disgruntled customers are making postings online with sufficient regularity to reach as many ATTM customers as a class action notice.

The upshot is that the district court has placed the onus on ATTM to prove—in the context of moving to compel arbitration—some or all of the following "facts": (i) that a class wouldn't be certified; (ii) that if a class were certified, few customers would receive or pay attention to the class notice; (iii) that ATTM would prevail on the merits; (iv) that if it elected to settle the case, few customers would submit claims; (v) that there are attorneys who are ready, willing, and able to represent customers in individual arbitration under ATTM's provision; and (vi) that attorneys and/or consumers would publicize the alleged misconduct

enough to reach the same number of customers as a hypothetical class notice would. In other words, ATTM cannot satisfy the district court's standard without litigating the entire case (as well as introducing "evidence" comparing the number of customers who would likely receive, read, understand, and respond to a hypothetical class notice with the number who would likely pursue individual dispute resolution if the class waiver were enforceable) ***at the motion-to-compel-arbitration stage***.

This burden has no antecedent in California unconscionability law and contravenes the Supreme Court's admonition that "Congress's clear intent, in the Arbitration Act, [was] to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible." *Moses H. Cone*, 460 U.S. at 22; *see also Preston*, 128 S. Ct. at 986 (citing *Moses H. Cone*, 460 U.S. at 22). Subsuming the merits of the underlying dispute into the arbitrability inquiry also intrudes upon the province of the arbitrator. *See John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 557 (1964) (question whether party seeking arbitration complied with the contractual grievance procedure, which "depends to a large extent on how one answers questions bearing on" the merits, is for the arbitrator to resolve because "[i]t would be a curious rule which required that intertwined issues * * * growing out of a single dispute and raising the same questions on the same facts had to be carved up between two different forums, one deciding after the other"); *see also Preston*, 128 S. Ct. at 985 (FAA precludes California from

requiring party seeking to compel arbitration to concede that he is a talent agent—the dispositive issue in the underlying dispute—in order to invoke exception to statutory requirement that all disputes arising under Talent Agencies Act be resolved in first instance by Commissioner of Labor).

Finally, although the district court said that it was "balancing the relative procedural and substantive unconscionability of the revised arbitration provision" (ER20), in practical effect it read the sliding scale out of California law. Under the sliding-scale approach, the party seeking to avoid enforcement of a contractual provision must establish "a high degree of substantive unconscionability" (*Gatton*, 61 Cal. Rptr. 3d at 356) when, as here, the contract is "on the low end of the spectrum of procedural unconscionability" (ER14). The district court recognized that ATTM's arbitration provision creates adequate incentives for customers to pursue small claims, that "there is nothing unfair about the tradeoff that ATTM's customers make," and that consumers might well prefer arbitrating under ATTM's provision to being members of a class action. ER17 (internal quotation marks and alterations omitted). These findings surely are hallmarks of a favorable bargain for the consumer—not one that is substantively unconscionable (much less greatly so). Yet the court offered no explanation as to why its concerns about deterrence not only negate these indicia of no (or low) substantive unconscionability, but affirmatively move ATTM's arbitration provision to the high end of the spectrum. Instead, it simply assumed that under California law every arbitration provision

containing a class waiver is unenforceable unless the party seeking to enforce the arbitration provision has proven that individual arbitration is a perfect substitute for class actions, writing out of California law both the three-prong *Discover Bank* test and the sliding-scale standard with a single stroke of the pen.

In short, the district court effectively imposed a categorical ban on arbitration agreements that require individual resolution of disputes—in contravention of both *Discover Bank* and *Shroyer*. In *Discover Bank*, the California Supreme Court made clear that it was not holding "that all class action waivers are necessarily unconscionable." 113 P.3d at 1110. And this Court confirmed in *Shroyer* that arbitration provisions with such waivers are "not necessarily in all cases" unconscionable under California law. 498 F.3d at 982. The district court's requirement that ATTM prove that individual arbitration is as effective a deterrent as a class action (which, we repeat, has nothing to do with substantive unfairness to the party seeking to avoid enforcement of the arbitration provision) accordingly cannot be squared with *Discover Bank* and *Shroyer*.

II. AS INTERPRETED BY THE DISTRICT COURT, CALIFORNIA LAW IS PREEMPTED BY THE FAA.

Accepting *arguendo* that the district court correctly interpreted California law to require invalidation of class waivers whenever the defendant cannot establish that individual arbitration deters corporate misconduct as well as class

actions, so construed California law is preempted by the FAA, both expressly and under the doctrine of conflict preemption.

A. In Declaring ATTM's Revised Arbitration Provision Unconscionable, The District Court Deviated From California's Generally Applicable Unconscionability Doctrine In A Manner That Is Expressly Precluded By The FAA.

The district court ran afoul of Section 2 of the FAA by distorting California unconscionability law beyond recognition. Section 2 specifies that arbitration provisions "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 (emphasis added). Under Section 2, "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements." *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996). But Section 2 forbids states from "impos[ing] prerequisites to enforcement of an arbitration agreement that are not applicable to contracts generally." *Preston*, 128 S. Ct. at 985. Accordingly, a state-law rule, "whether of legislative or judicial origin," that "takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of [Section] 2." *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987). As this Court has recognized, this principle means that a law that applies only to "a limited set of transactions * * * is not a law of 'general applicability'" and therefore is preempted by Section 2. *Ting v. AT&T*, 319 F.3d 1126, 1148 (9th Cir. 2003). Indeed, Section 2 preempts even "general

principle[s] of contract law, such as unconscionability" if "those general doctrines" are "employ[ed] * * * in ways that subject arbitration clauses to special scrutiny." *Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 167 (5th Cir. 2004).

Under California's generally-applicable unconscionability principles, the party seeking to avoid enforcement of a contractual provision on unconscionability grounds must establish both substantive and procedural unconscionability, and must prove "a high degree of substantive unconscionability" when the degree of procedural unconscionability is modest. *Gatton*, 61 Cal. Rptr. 3d at 356. Moreover, a contractual term is substantively unconscionable only if it so "shock[s] the conscience" (*Belton*, 60 Cal. Rptr. 3d at 650) that a person would have to be "under delusion" (*Herbert*, 71 P.2d at 257) to agree to it.

In *Shroyer*, this Court held that "[t]he rule announced in *Discover Bank* is simply a refinement of the unconscionability analysis applicable to contracts generally in California." 498 F.3d at 987. We respectfully disagree with that conclusion.[25] But even if the three-part class-waiver test articulated in *Discover*

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[25] We preserve for possible future review our contention that *Shroyer* conflicts with the Supreme Court's decision in *Perry*. In *Perry*, the Court held that states cannot "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." 483 U.S. at 492 n.9. The "lack of class relief" is a "unique characteristic[] of the arbitration process." Christopher R. Drahozal, *Arbitration Costs and Contingent Fee Contracts*, 59 VAND. L. REV. 729, 776 (2006); *see also* David S. Clancy & Matthew M.K. Stein, *An Uninvited Guest: Class Arbitration and the Federal Arbitration Act's*

Bank and *Shroyer* was a mere "refinement" of California's generally-applicable "shock the conscience" standard, the same cannot be said of the district court's further holding that ATTM's ***current*** arbitration provision, which offers unprecedented opportunities for "individual gain" (*Shroyer*, 498 F.3d at 986 (emphasis omitted)), fails that test merely because ATTM did not prove that its arbitration provision deters corporate misconduct as effectively as class actions.

We have already demonstrated that the district court's standard deviates markedly from prior California law, including *Discover Bank* and *Shroyer*. *See* pages 22-43, *supra.* By pinning its ruling ***entirely*** on "deterrence," the court shifted the focus of California unconscionability law away from fairness to the party before the court to a wholly new emphasis on policing corporate conduct. This new focus applies ***only*** to class waivers; it is self-evidently not "a law of 'general applicability.'" *Ting*, 319 F.3d at 1148.

As the Seventh Circuit has explained, "no state can apply to arbitration (when governed by the Federal Arbitration Act) any novel rule." *Oblix, Inc. v. Winiecki*, 374 F.3d 488, 492 (7th Cir. 2004). The district court's "deterrence-

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Legislative History, 63 BUS. LAW. 55, 57 (2007) ("[T]he FAA's legislative history indicates that Congress was opening the door to a particular *kind* of non-judicial dispute resolution proceeding, and class arbitration is a different kind of proceeding—apart from its non-judicial nature, it has little in common with what Congress approved in 1925.") (emphasis in original). Thus, a state-law rule against individual-arbitration agreements—like a rule against waivers of the right to a jury trial—is a proxy for a rule that broadly invalidates arbitration agreements. Section 2 of the FAA preempts such rules. *See Gay v. CreditInform*, 511 F.3d 369, 395 (3d Cir. 2007).

trumps-all" standard is the epitome of a "novel rule." Not only was it newly minted for this case (in which the district court acknowledged that ATTM had satisfied *Shroyer*'s "potential-for-individual-gain" standard), but it self-evidently applies only to one narrow category of contractual terms—namely, class waivers. Accordingly, the district court's holding is preempted by Section 2 of the FAA. *See Preston*, 128 S. Ct. at 985; *Ting*, 319 F.3d at 1148; *Perry*, 482 U.S. at 492 n.9; *Iberia*, 379 F.3d at 167; *Oblix*, 374 F.3d at 492.

Nor can the district court's holding be salvaged by recharacterizing it as rooted in California public policy rather than unconscionability principles. Section 2 also preempts any invocation of state public policy as a ground for refusing to enforce an arbitration agreement. The Supreme Court has declared that "[w]hat States may not do is 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. The [FAA] makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal 'footing,' directly contrary to the [FAA's] language and Congress' intent." *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 281 (1995); *see also Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 446 (2006) ("in *Southland*, * * * [w]e simply rejected the proposition that the enforceability of the arbitration agreement turned on the state legislature's judgment concerning the forum for enforcement of the state-law cause of action").

Enacted in 1925, the FAA's "purpose was to reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991). Specifically, "early common law * * * regard[ed] arbitration agreements with extreme disfavor as being contrary to public policy and as ousting the courts of their legitimate jurisdiction." *Atl. Fruit Co. v. Red Cross Line*, 276 F. 319, 321 (S.D.N.Y. 1921), *aff'd*, 5 F.2d 218 (2d Cir. 1924). To construe Section 2 of the FAA to include "public policy" as a valid basis for refusing to enforce an arbitration provision would permit the resuscitation of judicial hostility to arbitration.

As Justice Ginsburg observed in warning against "open[ing] the door" to state public-policy challenges to arbitration agreements, "public policy has been called an unruly horse." Tr. of Oral Argument, *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2005) (No. 04-1264), 2005 WL 3370429, at *35. Given the malleability of "public policy," deeming "public policy" to be a ground that exists at law or equity for the revocation of any contract would eviscerate the FAA's protections against hostility to arbitration. Accordingly, the Concepcions cannot clear the hurdle of Section 2 preemption by riding this "unruly horse."

B. The District Court's Interpretation Of California Law Is Preempted Because It Frustrates The Purposes Of The FAA.

The district court's interpretation of California law to preclude enforcement of ATTM's arbitration provision notwithstanding the court's finding that "there is nothing unfair about the tradeoff that ATTM's customers make" in agreeing to that provision (ER17 (internal quotation marks and citations omitted)) is preempted for the independent reason that it "stands as an obstacle to the accomplishment and execution of the full purposes and objective of Congress" in enacting the FAA. *United States v. Locke*, 529 U.S. 89, 109 (2000) (internal quotation marks omitted). When federal law encourages private parties to engage in or refrain from a certain activity, as the FAA does in "declar[ing] a liberal federal policy favoring arbitration agreements" (*Moses H. Cone*, 460 U.S. at 24), state laws producing contrary incentives must yield.[26]

We recognize that this Court rejected a similar argument in *Shroyer*, concluding that Congress did not intend the FAA to "encourage individual

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[26] *See*, *e.g.*, *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 157 (1989) (state-law protection of unpatentable inventions was preempted because it "could essentially redirect inventive efforts away from the careful criteria of patentability developed by Congress over the last 200 years"); *Edgar v. MITE Corp.*, 457 U.S. 624, 635 (1982) (holding that federal securities laws preempt state tender offer regulation, which gave "incumbent management * * * a powerful tool to combat tender offers," because "[t]hese consequences are precisely what Congress determined should be avoided"); *see also New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 668 (1995) (ERISA, which has the purpose of promoting regulated plans' flexibility in providing coverage, would preempt a state law that "produce[s] such acute, albeit indirect, economic effects, by intent or otherwise, as to force an ERISA plan to adopt a certain scheme of substantive coverage").

arbitration and disfavor class arbitration." 498 F.3d at 990. But *Preston* supersedes *Shroyer*'s reasoning on this point—reasoning that would equally exclude from preemption a state requirement that all arbitrations fully conform to the rules of civil procedure. *Preston* makes clear that even a state-law rule that applies equally to arbitration and litigation is preempted if it conflicts with a "prime objective" of the FAA.[27]

In *Preston*, the Supreme Court held that the FAA preempted a provision of California's Talent Agencies Act "grant[ing] the Labor Commissioner exclusive jurisdiction to decide an issue that the parties agreed to arbitrate"—namely, whether a person is a "talent agent" for purposes of that law. 128 S. Ct. at 982, 984-85. In an effort to salvage the California statute, the respondent contended that the Talent Agencies Act was "compatible with the FAA because" it was no more than an exhaustion requirement—*i.e.*, it "merely postpones arbitration until after the Labor Commissioner has exercised her primary jurisdiction." *Id*. at 985. The respondent contended that, because the statute allowed for a *de novo* appeal of the Labor Commissioner's decision to California superior court, "either party could move to compel arbitration." *Id.* Accordingly, he argued that the delay imposed by "[r]equiring initial reference of the parties' dispute to the Labor Commissioner"

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[27] This Court is bound to follow *Preston* rather than *Shroyer*, as a court of appeals decision is abrogated whenever a Supreme Court decision "undercut[s] the theory or reasoning underlying the prior circuit precedent in such a way that the cases are clearly irreconcilable," even if "the issues" in the two cases are not "identical." *Miller v. Gammie*, 335 F.3d 889, 900 (9th Cir. 2003).

(*id.* at 986) would apply equally to litigation ***and*** arbitration, and that such equal treatment was consistent with the FAA.

The Supreme Court disagreed. It explained that "[a] prime objective of an agreement to arbitrate is to achieve 'streamlined proceedings and expeditious results.'" *Id.* at 986 (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 633 (1985)). It then reasoned that this objective "would be frustrated" by the California Talent Agencies Act because "[r]equiring initial reference of the parties' dispute to the Labor Commissioner would, at the least, hinder speedy resolution of the controversy." *Id.*

Similar reasoning applies here. There can be no doubt that engrafting class proceedings onto arbitration would "hinder speedy resolution of the controversy" (*id.*) between the Concepcions and ATTM: Superimposing class-action procedures on arbitration "brings the burdens of litigation into the arbitral forum" and "lessens the distinction between the two processes." Jonathan R. Bunch, Note, *To Be Announced: Silence from the United States Supreme Court and Disagreement Among Lower Courts Suggest an Uncertain Future for Class-Wide Arbitration*, 2004 J. DISP. RESOL. 259, 272. Indeed, resolving this case as a class arbitration would take years.

The procedures for class arbitrations promulgated by the AAA parrot the Federal Rules of Civil Procedure—with the exception that they provide that, once the arbitrator issues a "class determination award," the parties may move to vacate

or confirm that interim award in the district court. *See generally* AAA, *American Arbitration Association Policy on Class Arbitrations*, *at* http://www.adr.org/Classarbitrationpolicy. Hence, just as in court, a class arbitration would entail (i) substantial discovery for purposes of determining such prerequisites as typicality and adequacy of the class representatives and commonality of the claims across class members; (ii) plenary briefing of the class certification issue; (iii) an evidentiary hearing; (iv) a written ruling; (v) cross-motions to confirm and vacate in the district court; and almost certainly (vi) a motion to vacate the class determination award by whichever party lost before the arbitrator. If, after all of that, a class is certified, the AAA rules require full and adequate notice to class members and an opportunity to opt out. Discovery commensurate with the now-increased stakes of the litigation would then begin and likely continue for years. Should the defendant then yield to the hydraulic pressure to settle that class certification creates, due process would necessitate another round of notice followed by a fairness hearing, complete with extensive briefing by both sides and by any objectors. And if the defendant chooses not to settle, there would need to be a class-wide arbitration.

In short, this process is every bit as burdensome as a judicial class action and effectively precludes "'streamlined proceedings and expeditious results'" (*Preston*, 128 S. Ct. at 986) (quoting *Mitsubishi*, 473 U.S. at 633) to a far greater degree than

the initial-reference requirement invalidated in *Preston*.[28] Indeed, conditioning the enforceability of arbitration agreements on the availability of class arbitration would do more than "hinder" arbitration's "speedy resolution" (*Preston*, 128 S. Ct. at 986): Such a requirement would force companies to abandon arbitration altogether.

When a business decides whether to include an arbitration provision in its agreements with its customers, it must consider the advantages and disadvantages of doing so. The advantages of arbitration are that it "saves time, saves trouble, saves money." *Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judiciary*, 68th Cong., 1st Sess. 7 (1924) (statement of Charles Bernheimer, N.Y. Chamber of Commerce). The risk is that the arbitrator will render an erroneous—yet unreviewable—decision. As the Tenth Circuit has observed, the standard for vacating an arbitral award is "among the narrowest known to law." *Dominion Video Satellite, Inc. v. Echostar Satellite L.L.C.*, 430 F.3d 1269, 1275 (10th Cir. 2005) (internal quotation marks omitted). Such awards

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[28] Of course, parties may ***agree*** to arbitrate under such cumbersome and self-defeating procedures without running afoul of the FAA. *See Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444, 451 (2003) (remanding for arbitrator to decide whether an arbitration provision that was not "completely obvious" on the point implicitly authorized class-wide arbitration); *Shroyer*, 498 F.3d at 992. "[T]he FAA lets ***parties*** tailor some, even many[,] features of arbitration by contract * * *." *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 128 S. Ct. 1396, 1404 (2008) (emphasis added). Under *Preston*, however, neither courts nor state legislatures may impose procedural requirements that impede the swift and efficient use of arbitration when the parties' agreement expressly precludes those very impediments, as the agreement to arbitrate on an individual basis does here.

may be vacated only for fraud, bias, or "manifest disregard" of the law. *See* 9 U.S.C. § 10; *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 128 S. Ct. 1396, 1403-04 (2008). Many businesses are willing to take that risk in an individual arbitration because of the cost savings and their desire for a less adversarial method of resolving disputes with customers.

That calculus changes dramatically, however, if the arbitration provision must allow for class-wide arbitration. As noted above, in a class arbitration the efficiencies of individual arbitration are lost. Moreover, the stakes of a class arbitration are exponentially higher than those of an individual arbitration. And to make matters worse, arbitrators have a massive economic incentive to certify a class, because the fee structure provides for much higher fees in such circumstances. *See* ER125-27; AAA, Supplementary Rules for Class Arbitrations, *at* http://www.adr.org/sp.asp?id=21936; *see also* Clancy & Stein, 63 BUS. LAW. at 73 (noting that arbitrators' rulings in class arbitration are "fraught with financial conflicts of interest" because "a decision to certify a class almost certainly would * * * increase the arbitrator's compensation for the case") (internal quotation marks omitted). No business could afford to subject itself to the risk that an arbitrator with an inherent bias in favor of class certification and subject to only very limited judicial review would certify a class and then proceed to render a massive class award. As one Supreme Court Justice has put it, "[y]ou might not want to put your company's entire future in the hands of one arbitrator." Tr. of

Oral Argument, *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444 (2003) (No. 02-634), 2003 WL 1989562, at *29.

The inevitable consequence is that businesses will stop including arbitration provisions in contracts with customers, employees, and franchisees. Nothing could more clearly "frustrate the purpose" (*Livadas v. Bradshaw*, 512 U.S. 107, 116 (1994)) of the FAA to "achieve 'streamlined proceedings and expeditious results.'" *Preston*, 128 S. Ct. at 986 (quoting *Mitsubishi*, 473 U.S. at 633).[29] Moreover, such an outcome would undermine Congress's goal of providing consumers with a practicable means of resolving the vast majority of their disputes, which are individualized and not susceptible to class-wide adjudication. As the Supreme Court has observed, if arbitration were not an option, "the typical consumer who has only a small damage claim (who seeks, say, the value of only a defective refrigerator or television set)" would be left "without any remedy but a court remedy, the costs and delays of which could eat up the value of an eventual small recovery." *Allied-Bruce*, 513 U.S. at 281. *See also id.* at 280 (arbitration's

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[29] The cost savings that result from individual arbitration benefit consumers as well as businesses. As the Seventh Circuit has explained, "arbitration offers cost-saving benefits" to businesses that "in competition are passed along to customers." *Boomer v. AT&T Corp.*, 309 F.3d 404, 419 (7th Cir. 2002) (internal quotation marks omitted); *see also* Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements—With Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251, 254-56 (2006) (arbitration "lower[s] [businesses'] dispute-resolution costs," and this "benefit to business is also a benefit to consumers" because "whatever lowers costs to businesses tends over time to lower prices to consumers").

"advantages often would seem helpful to individuals, say, complaining about a product, who need a less expensive alternative to litigation"). Accordingly, under *Preston*, any state-law rule requiring the availability of class arbitration is preempted by the FAA. *See also Gay v. CreditInform*, 511 F.3d 369, 395 (3d Cir. 2007) (Pennsylvania rule that individual-arbitration agreements are unconscionable "interfere[s] with the appropriate application of the FAA"); *accord Schultz v. AT&T Wireless Servs., Inc.*, 376 F. Supp. 2d 685, 691 (N.D. W. Va. 2005); *Blitz v. AT&T Wireless Servs., Inc.*, 2005 WL 6177327 (Mo. Cir. Ct. Nov. 28, 2005); *Pyburn v. Bill Heard Chevrolet*, 63 S.W.3d 351, 365 (Tenn. Ct. App. 2001).

CONCLUSION

The Court should reverse the order of the district court.

Respectfully submitted,

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January 5, 2009

CERTIFICATE OF COMPLIANCE PURSUANT TO FED. R. APP. P. 32(A)(7)(C) AND CIRCUIT RULE 32-1 FOR CASE NUMBER 08-15612

I certify that:

X 1. Pursuant to Fed. R. App. P. 32 (a)(7)(C) and Ninth Circuit Rule 32-1, the attached opening/answering/reply/cross-appeal brief is

☒ Proportionately spaced, has a typeface of 14 points or more and contains 13, 979 words (opening, answering, and the second and third briefs filed in cross-appeals must not exceed 14,000 words; reply briefs must not exceed 7,000 words),

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__2. The attached brief is **not** subject to the type-volume limitations of Fed. R. App. P. 32(a)(7)(B) because

☐ This brief complies with Fed. R. App. P. 32(a)(1)-(7) and is a principal brief of no more than 30 pages or a reply brief of no more than 15 pages;

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__3. *Briefs in Capital Cases*

This brief is being filed in a capital case pursuant to the type-volume limitations set forth at Circuit Rule 32-4 **and is**

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DATED: January 5, 2009

MAYER BROWN LLP

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STATEMENT OF RELATED CASES

Counsel for ATTM is aware of two related cases pending in this Court: *Kaltwasser v. Cingular Wireless LLC*, No. 08-15962, and *Stiener v. Apple Computer, Inc.*, No. 08-15612. *Kaltwasser* and *Stiener* are appeals from the denial of ATTM's motions to compel arbitration under the same arbitration provision involved in this case, and therefore raise some overlapping issues. Briefing in *Kaltwasser* was completed on October 28, 2008. Briefing in *Stiener* has been stayed as the parties engage in settlement discussions. Contemporaneous with the filing of this brief, we have submitted a motion requesting that the Court set oral argument in this case and *Kaltwasser* for the same day before the same panel.

Addendum 1

CERTIFICATE OF FILING AND SERVICE

I hereby certify that on this 5th day of January 2009, I electronically filed the foregoing brief with the Clerk of the Court of the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system. Participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system. I also deposited four copies of the Excerpts of record with a third-party commercial carrier for overnight delivery to the Clerk of the Court, and one copy of the Excerpts of Record to each of the addresses below.

I further certify that some of the participants in the case are not registered CM/ECF users. I have deposited the foregoing brief with a third party commercial carrier for delivery within 3 calendar days, to the following non-CM/ECF participants:

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