No. 09-893

In the Supreme Court of the United States

AT&T MOBILITY LLC,

Petitioner,

v.

VINCENT AND LIZA CONCEPCION,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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QUESTION PRESENTED

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

RULE 29.6 STATEMENT

Petitioner AT&T Mobility LLC, a limited liability company, has no parent company. Its members are all privately held companies that are either wholly owned subsidiaries of AT&T Inc., which is publicly traded, or are also limited liability companies whose members are wholly owned subsidiaries of AT&T Inc. No other publicly held corporation has a 10% or more ownership interest in AT&T Mobility LLC.

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MISCELLANEOUS

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-16a) is reported at 584 F.3d 849. The order of the district court (Pet. App. 17a-54a) is unreported, but is available at 2008 WL 5216255.

JURISDICTION

The judgment of the court of appeals was entered on October 27, 2009. Pet. App. 1a. This Court's jurisdiction rests on 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The constitutional and statutory provisions involved are set forth at App., *infra*, 1a-2a.

STATEMENT

The arbitration agreement in the wireless service contract between respondents Vincent and Liza Concepcion and AT&T Mobility LLC ("ATTM") contains, in the words of one federal district judge, "perhaps the most fair and consumer-friendly provisions this Court has ever seen." *Makarowski* v. *AT&T Mobility, LLC*, 2009 WL 1765661, at *3 (C.D. Cal. June 18, 2009). Among other things, the arbitration agreement specifies that the Concepcions may arbitrate for free and are entitled to a minimum recovery of $7,500, plus double attorneys' fees, if the arbitrator awards them more than ATTM's last settlement offer.

The district court in this case found that the arbitration provision "sufficiently incentivizes consumers" to pursue "small dollar" claims and "prompts ATTM" to make generous settlement offers "even for claims of questionable merit." Pet. App. 39a-40a. The Ninth Circuit agreed that the incentives created

by this provision "essentially guaranteed" that ATTM would make whole any customer who submits a claim. *Id.* at 11a n.9. Nonetheless, both courts felt "compel[led]" (*id.* at 46a) to hold that ATTM's arbitration provision is unconscionable under California law—not because it is unfair to the named plaintiffs or would prevent them from vindicating their own claims—but because it would prevent them from representing a putative class of ATTM subscribers with allegedly similar state-law claims.

If allowed to stand, the Ninth Circuit's decision applying California law will be the death knell for consumer arbitration in California, and possibly in many other States within that Circuit. For if an arbitration agreement that contains "perhaps the most fair and consumer-friendly provisions" that one judge has ever seen is unenforceable under California law, then no agreement providing for bilateral arbitration will be enforceable under California law. As we explain, however, the Ninth Circuit's decision cannot stand. The California rule applied by the Ninth Circuit is preempted by the Federal Arbitration Act ("FAA").

1. The Federal Arbitration Act. 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). In preserving the benefits of arbitration, "Congress * * * had the needs of consumers, as well as others, in mind." *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. 265, 280 (1995). Indeed, because it "allow[s] parties to avoid the costs

of litigation," arbitration benefits individuals with "smaller" claims, such as employees (*Circuit City Stores, Inc.* v. *Adams*, 532 U.S. 105, 123 (2001)), or "the typical consumer" who otherwise 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).

Section 2 of the FAA commands that "[a]n agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law*, * * * 'save upon such grounds as exist at law or in equity for the revocation of *any* contract.'" *Perry* v. *Thomas*, 482 U.S. 483, 492 n.9 (1987) (quoting 9 U.S.C. § 2; emphasis added by the Court). "That is, as a matter of federal law, arbitration agreements and clauses are to be enforced *unless* they are invalid under principles of state law that govern all contracts." *Iberia Credit Bureau, Inc.* v. *Cingular Wireless LLC*, 379 F.3d 159, 166 (5th Cir. 2004) (emphasis in original).

2. California's Unconscionability Law And Its Unique Test For Contracts Requiring That Disputes Be Resolved On An Individual Basis. Under California law, courts "may refuse to enforce" any contract found "to have been unconscionable at the time it was made," or sever or "limit the application of any unconscionable clause" in order "to avoid any unconscionable result." CAL. CIV. CODE § 1670.5(a). The proponent of unconscionability must prove both "procedural" and "substantive" unconscionability. *Armendariz* v. *Found. Health Psychcare Servs., Inc.*, 24 Cal.4th 83, 114 (2000). Procedural unconscionability focuses on the fairness of the contracting process, while substantive unconscionability focuses on whether the contract "shock[s] the

conscience" (*Belton* v. *Comcast Cable Holdings, LLC*, 151 Cal.App.4th 1224, 1245 (2007)) or is one that a person would have to be "under delusion" to accept (*Herbert* v. *Lankershim*, 9 Cal.2d 409, 484 (1937); *Odell* v. *Moss*, 130 Cal. 352, 358 (1900); *Cal. Grocers Ass'n* v. *Bank of Am.*, 22 Cal.App.4th 205, 214-215 (1994)).

Under California's "sliding scale" approach to unconscionability, if "the procedural unconscionability, although extant, [is] not great," the party attacking the term must prove "a greater degree of substantive unfairness." *Marin Storage & Trucking, Inc.* v. *Benco Contracting & Eng'g, Inc.*, 89 Cal.App.4th 1042, 1056 (2001).

In the particular context of agreements to resolve disputes on an individual basis, however, the California Supreme Court has adopted a unique three-part test. Under that test, such an agreement is unenforceable if it "[(i)] is found in a consumer contract of adhesion [(ii)] in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and [(iii)] when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money." *Discover Bank* v. *Super. Ct.*, 36 Cal.4th 148, 162-163 (2005).

3. ATTM's Arbitration Provision. ATTM, which was known as Cingular Wireless until January 2007, provides wireless service to more than 90 million subscribers, with over 10 million in California alone. The wireless service agreements between ATTM and its customers long have required the parties to resolve any disputes they may have via bilateral arbitration. The agreements expressly prohibit

arbitrators from conducting class-wide proceedings. See Pet. App. 3a, 57a, 61a.

ATTM has revised its arbitration provision over time in order to make bilateral arbitration a realistic and effective dispute-resolution mechanism for consumers. The version at issue in this case was promulgated in late 2006.[1]

The arbitration provision affords customers fair, inexpensive, and convenient procedures and, in addition, provides them with affirmative incentives to pursue even small claims on an individual basis.

The procedural safeguards include:

- **Cost-free arbitration for non-frivolous claims:** "[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))";[2]
- **Convenience:** Arbitration takes place "in the county * * * of [the customer's] billing address," and 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

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[1] The arbitration provision is set forth at Pet. App. 55a-62a.

[2] Even if 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. Pet. App. 21a n.2.

"the arbitration will be conducted solely on the basis of documents submitted to the arbitrator."

- **Flexible consumer procedures:** Arbitration is conducted under the AAA's Commercial Dispute Resolution Procedures and the Supplementary Procedures for Consumer-Related Disputes, which the independent, non-profit AAA designed with consumers in mind;
- **Small claims court option:** Either party may bring a claim in small claims court in lieu of arbitration;
- **Full remedies available:** The arbitrator may award the claimant any form of individual relief (including statutory attorneys' fees, statutory damages, punitive damages, and injunctions) that a court could award; and
- **No confidentiality requirement:** Customers and their attorneys are not required to keep the results of the arbitration confidential.

The features that are designed to encourage consumers to pursue claims through bilateral arbitration include:

- **$7,500 minimum recovery if arbitral award exceeds ATTM's last settlement offer:** 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;[3]

- **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";[4] and
- **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 award [from the customer]."

Moreover, ATTM has made its arbitration procedures easy to use. A customer need only fill out and mail a one-page Notice of Dispute form that ATTM

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[3] Under the 2006 provision, the amount of the minimum payment is tied to the jurisdictional maximum of the customer's local small claims court. Pet. App. 60a. In California, the jurisdictional limit for small claims court is $7,500. CAL. CODE CIV. PROC. § 116.221. In 2009, ATTM revised this aspect of its arbitration provision to make the minimum payment a uniform amount—$10,000—across the country. See http://www.att.com/disputeresolution.

[4] This contractual right to double attorneys' fees "supplements any right to attorneys' fees and expenses [that the customer] may have under applicable law." Pet. App. 61a. Thus, a customer who does not qualify for this contractual award is entitled to an attorneys' fee award to the same extent as if the claim had been brought in court.

has posted on its web site. Pet. App. 22a-23a. ATTM's legal department generally responds to a notice of dispute with a written settlement offer. *Id.* at 23a. If the dispute is not resolved within 30 days, the customer may invoke the arbitration process by filling out a one-page Demand for Arbitration form (also available on ATTM's web site) and sending copies to the AAA and to ATTM. To further assist its customers, ATTM's web site includes a layperson's guide on how to arbitrate a claim. *Ibid.*

4. The Concepcions' Lawsuit. Customers of most wireless carriers, including ATTM, typically purchase cell phones and subscribe to wireless service as a bundled transaction, in which the phone is free or steeply discounted in exchange for a commitment to subscribe to service for a specified term (usually one or two years). Pet. App. 18a-19a.

The respondents, Vincent and Liza Concepcion, are ATTM customers who filed a putative class action against ATTM in the United States District Court for the Southern District of California. *Id.* at 20a. They allege that they entered into a bundled transaction for wireless service and free or heavily discounted phones. *Id.* at 18a-19a. California requires that sales tax be paid on the full retail value of a phone when it is sold as part of a bundled transaction. CAL. CODE REGS. tit. 18, §§ 1585(a)(4), (b)(3). Despite this requirement, the Concepcions allege that when ATTM charged them sales tax based on the full retail price of phones that were free or discounted, it violated California's unfair competition and false advertising laws (CAL. BUS. & PROF. CODE §§ 17200 *et seq.*; *id.* §§ 17500 *et seq.*) and Consumer Legal Remedies Act (CAL. CIV. CODE §§ 1750 *et seq.*).

Pet. App. 17a-18a; ER 363-370.[5] They also allege that ATTM committed fraud and unjustly enriched itself. ER 370-372.

5. Proceedings In The District Court. ATTM responded to the Concepcions' complaint by moving to compel arbitration. The Concepcions opposed ATTM's motion, contending principally that ATTM's arbitration provision is unconscionable under California law because it requires arbitration on a bilateral (as opposed to class-wide) basis. Pet. App. 30a-35a. The district court agreed, holding that, despite its pro-consumer features, the provision failed *Discover Bank*'s three-pronged test for such provisions. *Id.* at 35a, 42a-46a.

In applying the first element of the *Discover Bank* test, the court found that the Concepcions' arbitration agreement was a "contract of adhesion." *Id.* at 35a. 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." *Id.* at 36a (internal quotation marks omitted).

The district court next held that the Concepcions could not satisfy the second element of the test—*i.e.*, that "predictably small amounts of damages" are at issue. *Id.* at 36a-42a. The court explained that, although ATTM's arbitration provision "does not change the amount of actual damages at issue ($30), it does exponentially change the amount of potential recovery in arbitration." *Id.* at 37a.

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[5] "ER __" refers to the Excerpts of Record in the court of appeals.

In so doing, the arbitration clause provides customers with a powerful incentive to pursue their claims on an individual basis. As the district court observed:

> If ATTM denies an informal claim (*i.e.,* the Notice of Dispute) or offers less than the consumer requests—which are the only scenarios that would prompt a consumer to pursue arbitration—the amount of the consumer's award upon prevailing at arbitration jumps to $7,500 (the "Premium") plus double attorney's fees, if the consumer is represented by counsel. With the potential to recover two hundred fifty times one's actual damages, * * * individual claimants are much more likely to pursue arbitration if they are unsatisfied with ATTM's offer during the informal claims process.

Id. at 37a-38a.

Because ATTM has committed to pay all arbitration costs and makes special premiums available in arbitration, the district court further found that the 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." *Id.* at 39a (emphasis in original). Moreover, the threat of having to pay the premiums gives ATTM "an incentive to include reasonable attorney's fees in its settlement offers," and as a result it "has a policy of doing so." *Id.* at 38a n.7.

The district court accordingly concluded that, "under the revised arbitration provision, nearly all consumers who pursue the informal claims process

are very likely to be compensated promptly and in full." *Id.* at 40a-41a. Indeed, depending on the size of the claim, "a consumer is virtually guaranteed a payment by ATTM of up to twenty times * * * his or her actual damages simply by filling out a one-page form to initiate the informal claims process." *Id.* at 39a. "The process is quick, easy to use, and prompts full or, as described by Plaintiffs, even excess payment to the customer *without* the need to arbitrate or litigate." *Ibid.* (emphasis in original).

"In contrast," the district court found, "consumers who are members of a class do not fare as well." *Id.* at 41a. The court cited "studies that show [that] class members rarely receive more than pennies on the dollar for their claims, and that few class members (approximately 1-3%) bother to file a claim when the amount they would receive is small," and noted that the Concepcions "do not dispute these statistics." *Ibid.*

The district court accordingly found that "the record * * * demonstrates that 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." *Id.* at 42a. The court thus concluded that ATTM's revised arbitration provision "sufficiently incentivizes consumers" to pursue "small dollar" claims (*id.* at 39a-40a) and "is an adequate substitute for class arbitration as to this prong of *Discover Bank*" (*id.* at 42a).

The district court nonetheless held that ATTM's arbitration provision is unenforceable under California law because ATTM had not disproven the third element of the *Discover Bank* test. As the court in-

terpreted that aspect of *Discover Bank*, the allegations in the complaint must be taken as true and—contrary to the ordinary burden of proof in unconscionability cases—*the party seeking to compel arbitration* must demonstrate that "the arbitration provision is an adequate substitute for the deterrent effect of the class action mechanism." *Id.* at 45a. The court noted that ATTM had submitted evidence that it dispensed over $1.3 billion in credits in one year to resolve customers' disputes. *Id.* at 44a. But the court held that ATTM had not shown that its arbitration provision was an adequate substitute for class actions in deterring ATTM from engaging in wrongdoing of the nature alleged (but not proven) by the Concepcions. *Ibid.*[6] The court proceeded to hold that, although the Concepcions "arguably would be better off" in arbitration, "[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. *Id.* at 46a & 47a n.10.

Finally, the district court rejected ATTM's argument that "the FAA preempts any holding that ATTM's arbitration provision is unenforceable under California law." *Id.* at 47a n.11.

6. The Ninth Circuit's Decision. The Ninth Circuit affirmed, holding that ATTM's arbitration provision is unconscionable under the *Discover Bank* test because it requires customers to arbitrate small consumer claims on an individual basis. Pet. App. 2a. The court reasoned that "[t]he *Discover Bank*

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[6] The court merely accepted, at face value, the Concepcions' assertion that class actions are necessary for deterrence. We discuss below (at pages 45-47) why that assumption is misguided.

rule focuses on whether damages are predictably small, and in the end, the premium payment provision [in ATTM's arbitration clause] does not transform a $30.22 case into a predictable $7,500 case." *Id*. at 9a-10a.

The Ninth Circuit ignored the Concepcions' concession that it would be economically rational for ATTM to offer to settle modest claims for up to 20 times their value and the district court's finding that ATTM's arbitration provision may prompt "excess payment to the customer" (*id.* at 39a). The Ninth Circuit instead stated flatly that "if a customer files for arbitration against AT & T, predictably, AT & T will simply pay the face value of the claim before the selection of an arbitrator to avoid potentially paying $7,500. Thus, the maximum gain to a customer for the hassle of arbitrating a $30.22 dispute is still just $30.22." *Id*. at 10a. The court also dismissed the district court's finding that the arbitration provision provides ATTM compelling incentives to resolve customers' complaints as soon as the customer submits a notice of dispute, stating that "[w]e must determine only whether the premium provides adequate incentive to pursue individual *arbitration*, not informal resolution." *Id*. at 10a n.7 (emphasis in original).

The Ninth Circuit recognized that ATTM's provision "essentially guarantee[s] that the company will make any aggrieved customer whole who files a claim." *Id*. at 11a n.9. But the court continued that "the problem with [the provision] under California law—as we read that law—is that not *every* aggrieved customer will file a claim." *Ibid.* (emphasis added).

In sum, as the Ninth Circuit understood *Discover Bank*, because "[t]he actual damages a customer will

recover remain predictably small, * * * AT & T's class action waiver is in effect an exculpatory clause, hence substantively unconscionable." *Id.* at 11a. Like the district court, the Ninth Circuit made no effort to explain why, given the low level of procedural unconscionability found by the district court, the degree of substantive unconscionability was sufficient to preclude enforcement of ATTM's arbitration provision. Instead, it stated that "[t]he best way to read *Discover Bank* in light of the sliding-scale approach is that, if a contract clause is, in practice, exculpatory, as long as there is any degree of procedural unconscionability, the element of substantive unconscionability is generally adequate, as a matter of law." *Id.* at 13a.

The Ninth Circuit rejected ATTM's FAA preemption argument, declaring that "*Shroyer* [v. *New Cingular Wireless Services, Inc.*, 498 F.3d 976 (9th Cir. 2007)] controls this case because [ATTM] makes the same [preemption] arguments we rejected there." Pet. App. 12a. The *Shroyer* court had held that the *Discover Bank* rule "'is simply a refinement of the unconscionability analysis applicable to contracts generally in California'" and therefore does not run afoul of Section 2 of the FAA and this Court's cases interpreting it. *Id.* at 12a-13a (quoting *Shroyer*, 498 F.3d at 987).

Turning to ATTM's argument that the court's interpretation of California law would obstruct the purposes of the FAA, the Ninth Circuit indicated that in *Shroyer* it had "identified two purposes: first, to reverse judicial hostility to arbitration agreements by placing them on the same footing as any other contract, and second, to promote the efficient and expeditious resolution of claims." *Id.* at 13a-14a.

Shroyer held that "California unconscionability law did not stand in the way of either of these identified purposes." *Id*. at 14a. As to the former purpose, *Shroyer* reasoned that "'*Discover Bank* placed arbitration agreements with class action waivers on the *exact same footing* as contracts that bar class action litigation outside the context of arbitration.'" *Ibid*. (quoting *Shroyer*, 498 F.3d at 990; emphasis in *Shroyer*). As to the second purpose, *Shroyer* "rejected the 'contention that class proceedings will reduce the efficiency and expeditiousness of arbitration in general.'" *Ibid.* (quoting *Shroyer*, 498 F.3d at 990).

Finally, the Ninth Circuit rejected ATTM's argument that this Court's decision in *Preston* v. *Ferrer*, 552 U.S. 346 (2008), "supercedes [sic] *Shroyer*'s reasoning on this point." Pet. App. 15a. As the Ninth Circuit saw it, "by its terms, *Preston* is inapplicable to our case because the Concepcions are not challenging the validity of the service contract with AT & T as a whole, but only the validity of the arbitration agreement. Likewise, nothing in *Preston* undercuts the rationale of *Shroyer* that the FAA does not impliedly preempt California unconscionability law, because the plaintiffs in *Shroyer* were also challenging only the validity of the arbitration agreement." *Id*. at 16a.

SUMMARY OF THE ARGUMENT

As applied to ATTM's arbitration provision, California's near-categorical ban on arbitration agreements that do not allow for class-wide dispute resolution is preempted by the FAA.

A. Section 2 of the FAA declares that agreements to arbitrate disputes "shall be valid, irrevocable, and enforceable" except under limited circums-

tances. Section 4 of the FAA emphasizes the duty of courts to compel arbitration "in accordance with the terms of the [arbitration] agreement" when the making of such an agreement is not in issue And Section 3 of the FAA requires courts to stay litigation of arbitral claims pending arbitration of those claims "in accordance with the terms of the [arbitration] agreement."

Together, these provisions of the FAA embody an overarching federal policy "to ensure that private agreements to arbitrate are enforced according to their terms." *Stolt-Nielsen S.A.* v. *AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1773 (2010) (internal quotation marks omitted). The Court has emphasized repeatedly that the FAA entitles parties to tailor the procedures of arbitration to their needs (see, *e.g.*, *Hall St. Assocs., L.L.C.* v. *Mattel, Inc.*, 552 U.S. 576, 586 (2008)) and that protestations that the procedures in arbitration are "more streamlined" than in litigation "do not offer a credible basis" for refusing to enforce arbitration provisions as written (*14 Penn Plaza LLC* v. *Pyett*, 129 S. Ct. 1456, 1471 (2009)).

State-law rules that purport to dictate the procedures that apply in arbitration must overcome two high hurdles: the FAA's express mandate that courts enforce arbitration agreements according to their terms, subject to only narrow exceptions; and the principle of conflict preemption. California's rule conditioning enforcement of arbitration provisions on the inclusion of a term authorizing class-wide dispute resolution cannot overcome either hurdle.

B. Section 2 of the FAA affirmatively preempts any state-law limitation on the enforceability of arbitration agreements contained in written contracts involving commerce unless that limitation is based

on a ground that exists at law or equity for the revocation of *any* contract. See, *e.g.*, *Doctor's Assocs., Inc.* v. *Casarotto*, 517 U.S. 681, 687 (1996). The Ninth Circuit held that California's rule invalidating arbitration provisions that do not authorize class-wide dispute resolution is saved from preemption under this exception. That holding is wrong.

1. The Ninth Circuit opined that, because California's rule nominally applies both to arbitration provisions and to other kinds of dispute-resolution contracts, it places arbitration agreements on an even footing and therefore is not preempted. That rationale fails for several reasons.

To begin with, Section 2 specifies that the state-law ground must be applicable to all contracts (*Buckeye Check Cashing, Inc.* v. *Cardegna*, 546 U.S. 440, 443-444 (2006)), not just the small subset of contracts pertaining to dispute resolution. A state-law rule limiting enforceability of arbitration provisions accordingly may escape preemption only if "that law *arose* to govern issues concerning the validity, revocability, and enforceability of contracts *generally*." *Perry*, 482 U.S. at 492 n.9 (emphasis added). California's rule invalidating provisions that don't allow for class-wide dispute resolution plainly did not arise to govern contracts generally.

Moreover, construing the savings clause to allow States to dictate the procedures applicable in arbitration so long as the same procedures are required in litigation would result in the exception swallowing the rule. States could demand that arbitration include all of the procedures of litigation and thereby "chip away at [the FAA] by indirection." *Adams*, 532 U.S. at 122.

Indeed, Congress enacted the FAA in order to overturn the age-old rule that agreements that oust courts of jurisdiction are unenforceable. *Vaden* v. *Discover Bank*, 129 S. Ct. 1262, 1274 (2009). That rule applied equally to arbitration agreements and to other kinds of dispute-resolution agreements. See *M/S Bremen* v. *Zapata Off-Shore Co.*, 407 U.S. 1, 9-10 & n.10 (1972). The Ninth Circuit's rationale thus would permit resuscitation of the very rule that Congress sought to overturn.

2. The Ninth Circuit also justified California's rule on the ground that it "'is simply a refinement of the unconscionability analysis applicable to contracts generally in California.'" Pet. App. 12a-13a (quoting *Shroyer*, 498 F.3d at 987). As applied in this case, however, California's rule bears no resemblance whatever to the traditional unconscionability principles that apply to contracts generally. California has created a special legal rule applicable only to arbitration agreements.

First, in the context of all contracts other than arbitration agreements, California equates unconscionability with terms that are shocking to the conscience—terms to which only a person under delusion would agree. See pages 3-4, *supra*. Yet the courts below invalidated ATTM's arbitration provision under the *Discover Bank* test even while acknowledging that any customer who invokes ATTM's arbitration provision is likely to obtain full relief (if not more) and that "a reasonable person may well prefer" dispute resolution under ATTM's arbitration provision over participating in a class action. Pet. App. 11a n.9, 39a-42a. Obviously, a person would not be acting under delusion to accept a contract term that "a reasonable person may well prefer."

Second, outside the arbitration context, California courts evaluate the fairness of the contract at issue only with respect to the parties before the court. Here, both courts below agreed that the Concepcions could obtain full relief under ATTM's arbitration provision. *Id.* at 11a n.9, 39a-41a, 47a n.10. In other words, it is fair to them. The courts nonetheless invalidated the arbitration provision because of the perceived impacts of the requirement of bilateral arbitration on *non-parties*. That is a new rule, not a mere refinement of traditional unconscionability analysis.

Third, California's generally applicable unconscionability doctrine turns on the "substantive unfairness" of the challenged contract provision. *Marin Storage*, 89 Cal.App.4th at 1056. But California's rule invalidating arbitration provisions that don't include a term authorizing class-wide dispute resolution turns on social policy concerns relating to deterrence, not substantive unfairness.

Fourth, in cases not involving arbitration provisions, "[t]he critical juncture for determining whether a contract is unconscionable is the moment when it is entered into by both parties—not whether it is unconscionable in light of subsequent events." *Am. Software, Inc.* v. *Ali*, 46 Cal.App.4th 1386, 1391 (1996). By contrast, the *Discover Bank* test requires courts to ignore the many circumstances under which consumers might benefit from ATTM's arbitration provision and focus only on the allegations of the plaintiff's complaint, virtually ensuring that the arbitration provision will be invalidated.

For all of these reasons, affixing the "unconscionability" label cannot salvage California's arbitration-specific rule.

3. The California Supreme Court also sought to support its rule by invoking a statute that bars enforcement of exculpatory clauses. That rationale falls outside Section 2's savings clause as well.

To begin with, it is dubious whether public-policy rules of this sort qualify as a ground at law or equity for the revocation of any contract. Public-policy rules by their nature are targeted at particular kinds of contracts and arise out of concerns that are specific to those categories of contracts. Moreover, public policy is a highly elastic concept that was once the basis for refusing to enforce arbitration agreements. Deeming it a basis for the revocation of any contract would risk undoing through the savings clause what Congress sought to accomplish through the direct command of Section 2.

The Court need not decide here whether a public-policy basis for refusing to enforce an arbitration agreement ever can come within the savings clause, however, because the *Discover Bank* rule does not constitute an even-handed application of California's exculpatory-clause doctrine. To the contrary, it is gerrymandered to target arbitration provisions.

The Ninth Circuit acknowledged that any customer who invokes ATTM's arbitration provision is likely to be made whole, but said that the arbitration clause was exculpatory under California law because not every customer will choose to pursue a claim. In no other context does California deem contracts to be exculpatory merely because non-parties who are ensured redress if they pursue it may nonetheless voluntarily choose not to. All of the cases in which contracts have been declared exculpatory involve provisions that affirmatively limit remedies.

The requirement of bilateral arbitration in ATTM's arbitration provision does not do that. As this Court recently explained, "[i]t is undoubtedly true that some plaintiffs who would not bring individual suits for the relatively small sums involved will choose to join a class action. That has no bearing, however, on [the defendant's] or the plaintiffs' legal rights." *Shady Grove Orthopedic Assocs., P.A.* v. *Allstate Ins. Co.*, 130 S. Ct. 1431, 1443 (2010). With or without a class action, ATTM remains liable to any customer with a valid claim.

C. California's rule conditioning enforcement of arbitration provisions on the inclusion of a term authorizing class-wide dispute resolution is preempted for the additional reason that it conflicts with the purposes of the FAA as reflected in the text and structure of that statute. It does so in two ways, each of which is independently sufficient to require reversal.

1. The overarching purpose of the FAA—which is evident in the text of Sections 2, 3, and 4—is to ensure enforcement of arbitration agreements according to their terms, particularly terms specifying the procedures to be employed in arbitration. California's rule barring enforcement of agreements that require bilateral arbitration is fundamentally at war with" (*Stolt-Nielsen*, 130 S. Ct. at 1775) that core purpose. Indeed, if California can insist that parties to arbitration agreements allow for class-wide dispute resolution, it equally can insist that they allow for all manner of procedures that are the hallmarks of litigation, but the antithesis of arbitration. It could, in other words, kill arbitration by converting it into litigation.

This Court held in *Preston* that the FAA preempts California's requirement that certain kinds of disputes be submitted to the Commissioner of Labor prior to arbitration because that requirement would "frustrate[]" the FAA's purpose of allowing parties to arbitration agreements to "achieve streamlined proceedings and expeditious results." 552 U.S. at 357-358 (internal quotation marks omitted). California's requirement that parties to arbitration agreements allow for class-wide dispute resolution is preempted for the same reason.

2. More broadly, the text and structure of the FAA embody a "federal policy favoring arbitration." *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). That policy would be wholly thwarted by California's rule that parties to arbitration agreements must allow for class-wide dispute resolution.

This Court has recognized that the "changes brought about by the shift from bilateral arbitration to class-action arbitration" are "fundamental." *Stolt-Nielsen*, 130 S. Ct. at 1776. In a class-wide arbitration, the cost-savings of bilateral arbitration are entirely lost; the risks are multiplied exponentially; yet judicial review is as limited as in a traditional, bilateral arbitration. Moreover, the defendant does not even enjoy certainty that the ultimate arbitral award will have preclusive effect on absent class members. Because class-arbitration is a lose-lose proposition for businesses, no rational business will agree to it. If told that the only way they can have an enforceable arbitration agreement is to allow for class-wide dispute resolution, businesses will give up on arbitration entirely. As Justice Thomas has observed, a "result [that] discourages the use of arbitration

agreements [is] completely inconsistent with the policies underlying the FAA." *Waffle House*, 534 U.S. at 310 (Thomas, J., dissenting). For this reason as well, California's rule conditioning enforcement of arbitration provisions on the inclusion of a term authorizing class-wide dispute resolution is preempted by the FAA.

ARGUMENT

THE FAA PREEMPTS CALIFORNIA'S RULE INVALIDATING ARBITRATION AGREEMENTS THAT DO NOT AUTHORIZE CLASS-WIDE DISPUTE RESOLUTION.

A. The FAA Mandates That Arbitration Provisions Be Enforced According To Their Terms.

Section 2 of the FAA provides that:

> A written provision in * * * a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, * * * or an agreement in writing to submit to arbitration an existing controversy arising out of such contract, transaction, or refusal, *shall be valid, irrevocable, and enforceable*, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2 (emphasis added). "Section 2 is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary. The effect of the section is to create a body of federal substantive law of arbitrability, applicable to

any arbitration agreement within the coverage of the Act." *Moses H. Cone,* 460 U.S. at 24.

That policy is reinforced in Section 4 of the FAA, which states that "the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement" unless "the making of the agreement for arbitration or the failure to comply therewith" are called into question. 9 U.S.C. § 4. See also *ibid.* (limiting any jury trial to consideration of the same two issues: "[i]f the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof").

And Section 3 of the FAA requires courts to stay litigation of arbitral claims so that arbitration may be had "in accordance with the terms of the [arbitration] agreement." 9 U.S.C. § 3.

These provisions of the FAA "are integral parts of a whole" (*Bernhardt* v. *Polygraphic Co. of Am., Inc.*, 350 U.S. 198, 201 (1956)), and as such must be read together. This Court accordingly has "said on numerous occasions that the central or 'primary' purpose of the FAA is to ensure that 'private agreements to arbitrate are enforced according to their terms.'" *Stolt-Nielsen*, 130 S. Ct. at 1773 (quoting *Volt Info. Scis., Inc.* v. *Board of Trustees*, 489 U.S. 468, 479 (1989)); see also *Rent-A-Center, West, Inc.* v. *Jackson*, 130 S. Ct. 2772, 2776 (2010); *Green Tree Fin. Corp.* v. *Bazzle*, 539 U.S. 444, 453 (2003) (plurality op.); *First Options of Chicago, Inc.* v. *Kaplan,* 514 U.S. 938, 947 (1995); *Mastrobuono* v. *Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57-58 (1995).

That means that "parties are generally free to structure their arbitration agreements as they see fit. Just as they may limit by contract the issues which they will arbitrate, so too may they specify by contract *the rules under which that arbitration will be conducted*." *Volt*, 489 U.S. at 479 (citation omitted; emphasis added); see also *Stolt-Nielsen*, 130 S. Ct. at 1774 (the parties "may agree on rules under which any arbitration will proceed").

The Court has specifically identified "procedure" as one of the "features of arbitration" that "the FAA lets parties tailor * * * by contract." *Hall St.*, 552 U.S. at 586; see also *Scherk v. Alberto-Culver Inc.*, 417 U.S. 506, 519 (1974) ("[a]n agreement to arbitrate * * * is, in effect, a specialized kind of forum-selection clause that posits not only the situs of suit but also the procedure to be used in resolving the dispute"). Indeed, the whole point of entering into an arbitration agreement is to "trade[] the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration." *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985).

It is thus "clear from [this Court's] precedents and the contractual nature of arbitration that parties may specify *with whom* they choose to arbitrate their disputes" and that "a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so." *Stolt-Nielsen*, 130 S. Ct. at 1774-1775 (emphasis in original).

Accordingly, "the recognition that arbitration procedures are more streamlined than federal litigation is *not* a basis for finding the forum somehow inadequate; the relative informality of arbitration is

one of the chief reasons that parties select arbitration." *Pyett*, 129 S. Ct. at 1471 (emphasis added). Precisely because the entire purpose of arbitration is to provide a less expensive, less time-consuming, and less adversarial alternative to litigation, "objections centered on the nature of arbitration do not offer a credible basis for discrediting the choice of that forum to resolve" claims. *Ibid.*

In short, the FAA creates a powerful presumption that parties to arbitration agreements may select the procedures that will govern their arbitration and that courts may not refuse to enforce those agreements merely because they disagree with the procedures so selected.

The statute enforces this presumption by imposing two distinct but related limits on state-law rules applicable to arbitration agreements—the express requirements of Sections 2 and 4 that courts enforce such agreements according to their terms, subject to only narrow exceptions, and the principle of conflict preemption. The state-law rule applied by the courts below to invalidate the arbitration agreement here is invalid under both principles.

B. California's Rule Invalidating Agreements That Require Bilateral Arbitration Is Preempted By Section 2 Of The FAA Because It Is Not A "Ground[] * * * At Law Or In Equity For The Revocation Of Any Contract."

Section 2 of the FAA places "only two limitations on the enforceability of arbitration provisions governed by the Federal Arbitration Act: they must be part of a written maritime contract or a contract evidencing a transaction involving commerce and such

clauses may be revoked upon grounds as exist at law or in equity for the revocation of any contract." *Southland Corp.* v. *Keating*, 465 U.S. 1, 10-11 (1984) (internal quotation marks and footnote omitted). Any state-law impediment to arbitration that does not fall within one of these exceptions is preempted by the FAA and "must give way." *Perry*, 482 U.S. at 490-491; see also *Casarotto*, 517 U.S. at 687.

The arbitration agreement between ATTM and the Concepcions expressly requires bilateral arbitration. Pet. App. 61a ("You and AT&T agree that each may bring claims against the other only in your or its individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding. * * * [T]he arbitrator may not consolidate more than one person's claims, and may not otherwise preside over any form of a representative or class proceeding.") (emphasis omitted).

The courts below refused to enforce the agreement in accordance with its terms, invoking the savings clause at the end of Section 2, which specifies that courts may decline to enforce arbitration provisions on "such grounds as exist at law or in equity for the revocation of any contract." Their invocation of that exception to declare the requirement of bilateral arbitration unenforceable was fundamentally erroneous.

This Court has recognized that Section 2's savings clause does not protect state laws that discriminate against arbitration agreements. In *Casarotto*, for example, the Montana law imposed a disclosure requirement that applied only to arbitration contracts. This Court deemed the savings clause inapplicable and the statute preempted by Section 2, "because the State's law conditions the enforceability of

arbitration agreements on compliance with a special notice requirement *not applicable to contracts generally*." 517 U.S. at 687 (emphasis added); see also *Preston*, 552 U.S. at 356; *Perry*, 482 U.S. at 491-492 & n.9; *Southland*, 465 U.S. at 10-16.

Here too, California's rule conditioning the enforcement of arbitration agreements on the inclusion of a terms authorizing class-wide dispute resolution runs afoul of this fundamental nondiscrimination principle.

1. The fact that California's rule ostensibly applies to both arbitration and litigation is not sufficient to bring it within the savings clause.

The Ninth Circuit held that, because California's rule invalidating provisions that require bilateral dispute resolution applies equally to arbitration agreements and "contracts that bar class action litigation outside the context of arbitration," the rule places arbitration agreements "'on the *exact same footing*'" as other contracts and therefore is not preempted. Pet. App. 14a (quoting *Shroyer*, 498 F.3d at 990) (emphasis in original). That holding is erroneous for several reasons.

To begin with, Section 2 specifies that the savings clause applies to "grounds * * * for the revocation of *any* contract. " 9 U.S.C. § 2 (emphasis added). "Section 2 embodies the national policy favoring arbitration and places arbitration agreements on equal footing with *all other contracts*." *Buckeye Check Cashing*, 546 U.S. at 443 (emphasis added). Accordingly, a state-law defense may be applied to invalidate an arbitration provision only if "that law *arose* to govern issues concerning the validity, revocability,

and enforceability of contracts *generally*." *Perry*, 482 U.S. at 492 n.9 (emphasis added); accord *Casarotto*, 517 U.S. at 686-687. Needless to say, a rule applicable only to dispute-resolution agreements is not one that "arose to govern * * * contracts generally."

This Court has never held or even hinted that the antidiscrimination principle embodied in Section 2's "any contract" requirement is satisfied so long as the state rule in question nominally applies to both litigation and arbitration. And for good reason. Such a reading of the savings clause would result in the exception swallowing the rule, because States intent on "chip[ping] away at [the FAA] by indirection" (*Adams*, 532 U.S. at 122) easily could devise facially neutral state laws that have the effect of superimposing all manner of procedural requirements on arbitration.

For example, what if California adopted a law precluding any contractual limitations on discovery rights in judicial proceedings and requiring that the same discovery procedures apply in arbitrations? Such a law would apply equally to both arbitral and judicial dispute resolution, but its effect would be to drain arbitration of its benefits. It is inconceivable that Congress could have intended to permit States to burden arbitration in that manner. See also pages 41-42, *infra* (discussing additional examples).

Indeed, the very point of Section 2 was to eliminate an anti-arbitration rule that also applied to other types of dispute-resolution clauses. As this Court has repeatedly explained, before enactment of the FAA, "courts traditionally viewed arbitration clauses as unworthy attempts to 'oust' them of jurisdiction" and so "guard[ed] against encroachment on their domain" by "refus[ing] to order specific enforcement

of agreements to arbitrate." *Vaden*, 129 S. Ct. at 1274 (citing H.R. REP. NO. 96, 68th Cong., 1st Sess., 1-2 (1924)). "The origins of those refusals lie in 'ancient times,' when the English courts fought 'for extension of jurisdiction—all of them being opposed to anything that would altogether deprive every one of them of jurisdiction.'" *Allied-Bruce*, 513 U.S. at 270 (quoting *Bernhardt*, 350 U.S. at 211 n.5 (Frankfurter, J., concurring) (quoting in turn *United States Asphalt Ref. Co.* v. *Trinidad Lake Petroleum Co.*, 222 F. 1006, 1007 (S.D.N.Y. 1915) (quoting in turn *Scott* v. *Avery*, 5 H.L. Cas. 811 (1856) (Campbell, L.J.))).

This judge-made rule against contractual "ousters" of jurisdiction proscribed not only arbitration clauses, but also forum-selection clauses, which were similarly deemed "'contrary to public policy'" because "their effect was to 'oust the jurisdiction' of the court." *M/S Bremen*, 407 U.S. at 9-10; *see also id.* at 10 n.10 (citing cases). Thus, the "ouster" doctrine applied to contractual dispute resolution generally, and was not expressly limited to arbitration. The Congress that enacted Section 2 of the FAA specifically to "attend[] to the problem" posed by "the ancient 'ouster' doctrine" (*Vaden*, 129 S. Ct. at 1274) could not possibly have understood the savings clause to salvage the very rule it sought to overturn.

Finally, even if nominally neutral, state rules targeting only dispute-resolution clauses predictably and inevitably will have a far greater impact on arbitration agreements—whose entire purpose is to allow parties to "specify by contract the rules under which that arbitration will be conducted" (*Volt*, 489 U.S. at 479)—than on any other type of contract. To hold that the savings clause encompasses state rules that apply only to dispute-resolution clauses thus would

as a practical matter allow use of "the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable"—precisely what Section 2 prohibits. *Perry*, 482 U.S. at 492 n.9.

For all of these reasons, California's near-categorical ban on provisions requiring bilateral arbitration is not saved from preemption merely because it ostensibly applies equally to "contracts that bar class action litigation outside the context of arbitration." Pet. App. 14a (internal quotation marks omitted).[7]

2. The fact that unconscionability broadly speaking is a defense applicable to all contracts is not sufficient to bring California's rule within the savings clause.

The Court has identified "fraud, duress, [and] unconscionability" as examples of the state-law grounds that may fall within Section 2's savings clause. *Casarotto*, 517 U.S. at 687. Latching onto the reference to unconscionability in *Casarotto*, the Ninth Circuit held that California's rule invalidating agreements to arbitrate on a bilateral basis is saved from preemption under Section 2's savings clause "'because unconscionability is a generally applicable contract defense.'" Pet. App. 12a (quoting *Shroyer*, 498 F.3d at 988). Here again, the Ninth Circuit was mistaken.

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[7] If a rule limited to dispute-resolution clauses were not invalid on these grounds, moreover, it would still fall outside the savings clause for the same reasons that California may not justify its rule as an ostensibly neutral application of its exculpatory-clause statute. See pages 40-48, *infra*.

"That a state decision employs a general principle of contract law, such as unconscionability, is not always sufficient to ensure that the state-law rule is valid under the FAA. Even when using doctrines of general applicability, state courts are not permitted to employ those general doctrines in ways that subject arbitration to special scrutiny." *Iberia Credit Bureau*, 379 F.3d at 167 (citing *Perry*, 482 U.S. at 492 n.9); see also *Oblix, Inc.* v. *Winiecki*, 374 F.3d 488, 492 (7th Cir. 2004) (Easterbrook, J.) ("no state can apply to arbitration (when governed by the Federal Arbitration Act) any novel rule"). Yet that is precisely what California has done in the case of provisions requiring bilateral arbitration.

To state the obvious, the three-prong *Discover Bank* test bears no resemblance to California's traditional unconscionability standard. Although the Ninth Circuit stated that the *Discover Bank* test "is simply a refinement of the unconscionability analysis applicable to contracts generally in California" (Pet. App. 12a-13a (internal quotation marks omitted)), nothing could be further from the truth. The *Discover Bank* test deviates in at least four significant ways from the traditional unconscionability principles applied by California courts outside the arbitration context.

First, when it comes to all contracts other than ones requiring resolution of disputes on a bilateral basis, California equates unconscionability with terms that shock the conscience and to which no person who is not acting under delusion would agree. See pages 3-4, *supra*. That standard is the same one that prevailed throughout the country at the time of enactment of the FAA. See, *e.g.*, *Hume* v. *United States*, 132 U.S. 406, 411 (1889) (unconscionable con-

tract is one that "no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other"); *Eyre* v. *Potter*, 15 How. (56 U.S.) 42, 60 (1853) (doctrine of unconscionability was concerned with "such an unconscionableness or inadequacy in a bargain, as to demonstrate some gross imposition or some undue influence; and in such cases courts of equity ought to interfere, upon satisfactory ground of fraud; but then, such unconscionableness or such inadequacy should be made out as would, to use an expressive phrase, shock the conscience, and amount in itself to conclusive and decisive evidence of fraud") (citing J. STORY, COMMENTARIES ON EQUITY JURISPRUDENCE §§ 244, 246 (1835)).

The *Discover Bank* test abandons this traditional standard. The present case proves the point. The district court expressly found that, because of its unique premium provisions, ATTM's arbitration clause "prompts early payment of small dollar claims." Pet. App. 42a.[8] Accordingly, the court found, "a reasonable consumer may well prefer quick informal resolution with likely full payment [under ATTM's arbitration provision] over class litigation that could take months, if not years, and which may

[8] The Ninth Circuit deemed it irrelevant that ATTM has an overwhelming incentive to resolve all colorable claims prior to the actual commencement of arbitration, reasoning that under California law "[w]e must determine only whether the premium provides adequate incentive to pursue individual *arbitration*, not informal resolution." Pet. App. 10a n.7 (emphasis in original). That statement serves only to highlight how far California has strayed from the traditional unconscionability standard.

merely yield an opportunity to submit a claim for recovery of a small percentage of a few dollars." *Ibid.*

By definition, a contractual term that "a reasonable consumer may well prefer" cannot be conscience shocking. And it certainly cannot be so extremely conscience shocking as to make up for it being "on the low end of the spectrum of procedural unconscionability," as the district court found ATTM's arbitration provision to be. *Id.* at 36a (internal quotation marks omitted).

Second, when California courts evaluate unconscionability challenges outside the context of provisions that require bilateral arbitration, they consider the fairness of the challenged provision *to the parties* to the agreement before the court: They refuse to enforce contracts that are shockingly unfair to those parties;[9] and they uphold contracts when such shocking unfairness does not exist.[10]

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[9] See, *e.g.*, *Ilkhchooyi* v. *Best*, 37 Cal.App.4th 395, 410 (1995) (invalidating clause conditioning transfer of lease for dry cleaning business on tenant's payment to landlord of 75% of the purchase price of the business because the landlord's "attempt to appropriate a portion of the sale price of the business was blatant overreaching"); *Carboni* v. *Arrospide*, 2 Cal.App.2d 76, 83-84 (1991) (holding that 200% annual interest on a secured loan was unconscionable to borrower); *Ellis* v. *McKinnon Broad. Co.*, 18 Cal.App.4th 1796, 1805-1807 (1993) (invalidating as unconscionable to employee a provision entitling employer to keep commissions received after employee left company).

[10] See, *e.g.*, *Aron* v. *U-Haul Co. of Cal.*, 143 Cal.App.4th 796, 809 (2006) ("$20 fueling fee" and "additional charges for fuel used but not replaced" in truck rental contract "do not shock the conscience as a matter of law" as applied to renter); *Wayne* v. *Staples, Inc.*, 135 Cal.App.4th 466, 483 (2006) (charging customer "a 100 percent markup on [excess-value insurance] cov-

Here, by contrast, the courts below effectively found that ATTM's arbitration provision is fair to the Concepcions (and, indeed, any customer who invokes it). Pet. App. 11a n.9, 39a-41a, 47a n.10. Numerous other courts have reached the same conclusion.[11]

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erage for which UPS charged only $0.35 per $100" was not unconscionable to customer); *Morris* v. *Redwood Empire Bancorp*, 128 Cal.App.4th 1305, 1324 (2005) (bank's termination fee was not "so harsh or oppressive as to 'shock the conscience'" in light of costs "for all of the services provided by the bank" and "the value [that was] conferred upon the plaintiff"); *Ali*, 46 Cal.App.4th at 1392 (contract terms that allocated the risk of lack of sales between salesperson and employer were not "so unfair or oppressive in [their] mutual obligations" on the parties to be unconscionable); *Vance* v. *Villa Park Mobilehome Estates*, 36 Cal.App.4th 698, 710-711 (1995) (lease term "provid[ing] for periodic increases in rent based on periodic increases in costs" was not unconscionably unfair to tenant).

[11] See, *e.g.*, *Wince* v. *Easterbrooke Cellular Corp.*, 681 F.Supp.2d 679, 685 (N.D. W. Va. 2010) (ATTM's provision gives each customer "incentive to bring his or her claim, regardless of whether classified as 'high' or 'small' dollar," and "in light of these remaining incentives, the class action restriction cannot be deemed unfair"); *Moffat* v. *Commc'ns, Inc.*, 2010 WL 451033, at *2 (E.D. Mich. Feb. 5, 2010) (because of the premiums available under ATTM's provision, a consumer's "potential recovery" in arbitration "exceeds the value in time and energy required to arbitrate her claims"); *Makarowski*, 2009 WL 1765661, at *3 (ATTM's arbitration clause "contains perhaps the most fair and consumer-friendly provisions this Court has ever seen"); *Strawn* v. *AT&T Mobility, Inc.*, 593 F.Supp.2d 894, 900 n.6 (S.D. W. Va. 2009) (ATTM's arbitration clause is "unusually consumer-centered"); *Francis* v. *AT&T Mobility LLC*, 2009 WL 416063, at *5 (E.D. Mich. Feb. 18, 2009) (ATTM's clause is "fair" to consumers); see also *Cruz* v. *Cingular Wireless, LLC*, 2008 WL 4279690, at *3 (M.D. Fla. Sept. 15, 2008) ("[i]n this case, there is no limitation on attorneys' fees, and under certain circumstances, customers may be entitled to double their attorneys' fees," and "there is no question that the arbitration agreement provides all the same remedies available to plaintiffs under

Because ATTM's arbitration provision undeniably is fair to the Concepcions, the finding of "unconscionability" rests entirely on concern for the rights of persons *other than* the parties to the agreement before the court: the third parties who would be included within a hypothetical class action. That standard finds no support in California's generally applicable unconscionability principles.

We have not located a single precedential California decision holding a contract term unconscionable because of its effects on non-parties to the litigation. Indeed, in an unpublished, non-precedential decision, the California Court of Appeal itself recently observed that it was not aware of "any statute or case authorizing application of the doctrine of unconscionability for the benefit of nonparties to the contract," and criticized the attempt to "us[e] a contract doctrine to vindicate social policy." *Lynwood Redevelopment Agency* v. *Angeles Field Partners, LLC*, 2009 WL 4690213, at *8 (Cal. Ct. App. Dec. 10, 2009) (rejecting contention that contract between local development agency and developers was unenforceable because it allegedly was unconscionably unfair to voters).

This plainly discriminatory application of California's unconscionability principles—basing a finding of unconscionability solely on the impact of the

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[Florida's consumer-protection statute"), *appeal pending*, No. 08-16080-CC (11th Cir. argued Nov. 17, 2009); *Davidson* v. *Cingular Wireless LLC*, 2007 WL 896349, at *8 (E.D. Ark. Mar. 23, 2007) (finding that ATTM's arbitration clause "requires Cingular to pay the full cost of arbitrating any non-frivolous claims," "does not require confidentiality," "does not prohibit punitive damages," and "affords subscribers a convenient arbitral forum").

challenged provision upon third parties—is precluded by Section 2.

Third, California's generally applicable unconscionability test looks to the "substantive unfairness" of the challenged contract provision. *In re Marriage of Bonds*, 24 Cal.App.4th 1, 16 (2000); *Marin Storage*, 89 Cal.App.4th at 1056; see also pages 34-35 and notes 9-10, *supra* (discussing cases).

The inquiry with respect to provisions that require bilateral arbitration, by contrast, turns—as the district court put it—on "California's stated policy of favoring class litigation and [class] arbitration to deter alleged fraudulent conduct." Pet. App. 46a. This sharp difference in the governing standard—looking to social policy concerns relating to deterrence rather than fairness to the contracting parties—also demonstrates impermissible discrimination.

Fourth, California's codification of its unconscionability principle states that "[i]f the court as a matter of law finds the contract or any clause of the contract to have been unconscionable *at the time it was made*[,] the court may refuse to enforce the contract." CAL. CIV. CODE § 1670.5(a) (emphasis added). Applying this rule in a case involving a provision that specified that commissions would not be paid to former employees on sales completed 30 days after the end of employment, the California Court of Appeal explained that "[t]he critical juncture for determining whether a contract is unconscionable is the moment when it is entered into by both parties—not whether it is unconscionable in light of subsequent events." *Ali*, 46 Cal.App.4th at 1391.

The court there rejected the unconscionability claim, which rested "largely on events that occurred

several years after the contract was entered into," because "[w]hen viewed in light of the circumstances as they existed * * * when the instant contract was executed, we cannot say the contract provision with respect to compensation after termination was so unfair or oppressive in its mutual obligations as to 'shock the conscience.'" *Id*. at 1392; see also *West* v. *Henderson*, 227 Cal.App.3d 1578, 1588 (1991) (challenged "provision * * * was not unconscionable when [plaintiff] signed the lease").

Under the *Discover Bank* test, by contrast, the unconscionability of a provision requiring bilateral arbitration is determined in view of the allegations made in a particular lawsuit. See 36 Cal.4th at 162-163 (third factor is whether "it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money").

This distinction makes a huge difference. Evaluating an agreement as of the time of contracting—*i.e.*, *ex ante*—requires a court to assess the fairness of the challenged contractual provision in the context of all of the circumstances in which it could apply. Here, for example, ATTM's arbitration provision provides customers with significant benefits, in comparison to the litigation system, with respect to claims that are not susceptible to class treatment. See *Makarowski*, 2009 WL 1765661, at *3; cf. Pet. App. 41a-42a, 47a n.10 (even customers whose claims are susceptible to class treatment may be better off with bilateral arbitration under ATTM's arbitration provision). The ease of obtaining subsidized access to an impartial decisionmaker, augmented by the premium provisions, enable a customer to press claims that would be uneconomical to pursue in court. Cf. *Oblix*,

374 F.3d at 491 ("Employees fare well in arbitration with their employers—better by some standards than employees who litigate, as the lower total expenses of arbitration make it feasible to pursue smaller grievances and leave more available for compensatory awards.").

An assessment as of the time of contracting might conclude that these benefits more than outweigh the impact upon the customer—and even upon third parties (but see pages 34-37, *supra*)—of the preclusion of class procedures. In contrast, by basing the analysis on the allegations raised in a particular lawsuit months or years after contracting—*i.e.*, *ex post*—the *Discover Bank* test requires courts to ignore the range of possible circumstances to which the provision at issue might apply, greatly increasing the likelihood of the bargain being struck down. Because California takes an *ex post* approach to determining unconscionability *only* when provisions requiring bilateral arbitration are at issue, the *Discover Bank* test represents an extreme departure from generally applicable unconscionability principles, not "simply a refinement" (Pet. App. 12a) of those principles. It therefore does not come within Section 2's savings clause.

3. The fact that California's rule is ostensibly derived from California's prohibition against exculpatory contracts is not sufficient to bring it within the savings clause.

The *Discover Bank* Court justified its rule by reference to a state law declaring exculpatory contracts contrary to the State's public policy. 36 Cal.4th at 162-163. That statute provides:

> All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law.

CAL. CIV. CODE § 1668.

As a threshold matter, it is not at all clear that a state-law rule of this type—declaring a particular type of contract or contract provision invalid on public-policy grounds—qualifies as a "ground[] * * * at law or in equity for the revocation of any contract" within the meaning of Section 2. Certainly, this Court has never recognized it as such. Cf. *Casarotto*, 517 U.S. at 687 (identifying "fraud, duress, [and] unconscionability" as examples of such grounds).

Public-policy rules targeting specific types of contract provisions do not apply to "any contract," as Section 2 requires. Rather, each rule focuses on a particular type of contract or contract provision. And—in contrast to doctrines such as unconscionability, duress, and fraud, which (properly construed) involve the application of general principles to all contracts—each public-policy rule rests upon policy concerns specific to the type of contract or clause to which it applies, and different from the policy concerns underlying other public-policy rules.

In addition, the breadth and malleability of "public policy" would enable States to target arbitration agreements, while purporting to advance a neutral policy. This is no idle concern. 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 basis for refusing to enforce an arbitration provision would invite the resuscitation of judicial hostility to arbitration.

Because "public policy" is so malleable—and thus subject to manipulation—States easily could identify policy reasons for requiring arbitrators to conduct jury trials, employ the rules of civil procedure and evidence, publish their decisions, and give collateral estoppel effect to prior arbitral decisions, thereby effectively converting arbitration into litigation. Cf. *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.*, 271 F.2d 402, 406 (2d Cir. 1959) (the FAA was enacted to overrule "a great variety" of judicial "devices and formulas" declaring arbitration agreements "against public policy").[12]

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[12] The contract principles that the Court has referenced in connection with Section 2—fraud, duress, and unconscionability—all relate to whether enforcing the agreement is consistent with the party-autonomy principle underlying contract law. An early decision interpreting the parallel provision of the New York arbitration statute on which Section 2 of the FAA is based referred to another provision of New York law that focused on whether "the making of the contract * * * [was] in issue." *In re Gen. Silk Importing Co.*, 194 N.Y.S.2d 15, 19-20 (App. Div.), aff'd *sub nom. Gen. Silk Importing Co.* v. *Gerseta Corp.,* 234 N.Y. 513 (1922) (per curiam); see also 9 U.S.C. § 4 (district court "shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement" unless the

However, the Court need not resolve here the question whether public-policy rules ever may come within the scope of Section 2's savings clause, because, even if they could, Section 2 would bar the application of such rules in a manner that discriminates against arbitration agreements. Just as the *Discover Bank* rule cannot be justified as an even-handed application of California's unconscionability principle, it similarly cannot be justified as a nondiscriminatory application of the exculpatory-clause statute. Rather, the State has devised a special legal rule for this particular context. That is precisely what Section 2 prohibits.

The district court found that the Concepcions likely would be better off pursuing bilateral arbitration under ATTM's arbitration clause than participating in a class action. Pet. App. 39a-41a, 47a n.10. The Ninth Circuit agreed that "[t]he provision does essentially guarantee that the company will make any aggrieved customer whole who files a claim." *Id.* at 11a n.9. Thus, ATTM's arbitration provision is not "exculpatory" in any ordinary sense of the term.

Yet both courts nonetheless held the arbitration provision to be an unenforceable exculpatory clause under *Discover Bank*. As the Ninth Circuit understood it, a provision requiring bilateral arbitration is

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"making of the agreement for arbitration" or the failure to comply with the agreement's terms are in issue). Public-policy rules do not implicate the party autonomy principle. 2 E. FARNSWORTH, FARNSWORTH ON CONTRACTS § 5.1, at 3 (3d ed. 2004) (contract law principles relating to "misrepresentation, duress, and undue influence" are "intended to assure that bargaining has taken place in a manner compatible with the public interest in party autonomy," while public-policy rules serve different purposes).

"exculpatory" and hence unenforceable under *Discover Bank* so long as "not every aggrieved customer will file a claim." *Ibid.* In other words, because some customers may not feel aggrieved—a high likelihood in this particular case (see *id.* at 45a (acknowledging this possibility))—an arbitration clause that provides a powerful means of redress for those who do feel aggrieved is nonetheless deemed "exculpatory" under *Discover Bank*'s application of Section 1668. This is a wildly idiosyncratic interpretation of the exculpatory-clause statute that applies only to provisions that require bilateral arbitration.

In the first place, this application of the exculpatory-clause statute is "novel" (*Oblix*, 374 F.3d at 492) because it focuses on potential impacts on non-parties, as opposed to solely the party before the court. California courts applying the statute in other contexts base their decisions on whether the challenged contract provision impermissibly infringes a contracting party's ability to vindicate *his or her* rights. See, *e.g.*, *Tunkl* v. *Regents of the Univ. of Cal.*, 60 Cal.2d 92 (1963) (hospital patient's waiver of malpractice claims as a condition of treatment); *Smoketree-Lake Murray, Ltd.* v. *Mills Concrete Constr. Co.*, 234 Cal.App.3d 1724, 1741 (1991) (Section 1668 "applies to exculpatory clauses, releases or other provisions seeking to obtain an exemption or waiver of liability from the injured party"). Indeed, we have not located any decision outside the context of provisions requiring that disputes be resolved bilaterally in which a contract provision was held invalid under Section 1668 based solely on its effect on an alleged wrongdoer's liability to non-parties.

And if focusing on the impacts of a contract on liability to non-parties were not "novel" enough, the

Ninth Circuit's application of the exculpatory-clause rationale in this case depended on a prediction that non-party customers who would be assured full redress were they to pursue a claim nonetheless would elect not to. We have not located a single case outside the arbitration context in which a contractual provision was deemed "exculpatory" based on a prediction that someone will *voluntarily* elect not to pursue an available remedy. All of the cases applying the exculpatory-clause statute outside the arbitration context involve affirmative limitations on the ability to pursue legal rights and remedies.[13]

The arbitration agreement does *not* impose any such limitations. To the contrary, ATTM remains liable to all of its customers for all wrongdoing. As this Court recently explained:

> A class action * * * merely enables a federal court to adjudicate claims of multiple parties at once, instead of in separate suits. * * * [I]t leaves the parties' legal rights and duties intact and the rules of decision unchanged.
>
> [A defendant's] aggregate liability * * * does not depend on whether the suit proceeds as a class action. Each of the * * * members of the putative class could * * * bring a freestanding suit asserting his individual claim. It is undoubtedly true that some plaintiffs who would not bring individual suits for the relatively small sums involved will choose to

[13] To be completely precise, a few cases hold that Section 1668 invalidates provisions indemnifying parties for their willful misconduct, but they have been repudiated by the California Supreme Court. See *Safeco Ins. Co. of Am.* v. *Robert S.*, 26 Cal.4th 758, 767 (2001).

> join a class action. That has no bearing, however, on [the defendant's] or the plaintiffs' legal rights.

Shady Grove, 130 S. Ct. at 1443.

The district court understood *Discover Bank* as being predicated on the concern that a provision requiring traditional, bilateral arbitration "*may* 'serve[] as a disincentive for [a party with superior bargaining power] to avoid the type of conduct that might lead to class action litigation in the first place.'" Pet. App. 46a (quoting *Discover Bank*, 36 Cal.4th at 159) (alterations by the district court; emphasis added).

But a whole host of federal and state agencies—including the Federal Communications Commission, the Federal Trade Commission, the state attorneys general, and the state public utility commissions—are empowered to police systematic wrongdoing by telephone companies. See *Iberia Credit Bureau*, 379 F.3d at 175 (identifying the fact that Louisiana attorney general can seek restitution on behalf of a class of aggrieved customers as one reason why it was not unconscionable to require bilateral arbitration).

Although the California Supreme Court perfunctorily dismissed the notion that government regulation could serve as an "adequate substitute[]" for the deterrent effect of a class action (*Discover Bank*, 36 Cal.4th at 163), it offered nothing but *ipse dixit* to support its belief. This Court has held, however, that speculation is not a valid basis for refusing to enforce an arbitration clause. In *Green Tree Financial Corp.-Alabama* v. *Randolph*, 531 U.S. 79 (2000), the plaintiff argued that an arbitration agreement that did not specify who would bear the costs of the

arbitration was unenforceable because of the risk that consumers would be deterred from pursuing their claims under the Truth in Lending Act. Rejecting that contention, the Court explained that "[t]he 'risk' that [the consumer] will be saddled with prohibitive costs is too speculative to justify the invalidation of an arbitration agreement." 531 U.S. at 91. Rather, the party seeking to avoid enforcement of an arbitration agreement "bears the burden" of proving that the agreement is likely to thwart vindication of his or her claims. *Id.* at 91-92. Here too, the proposition that the threat of enforcement action by regulators, combined with full payment of all colorable individual claims (see Pet. App. 11a n.9, 39a-41a), might be insufficient to deter systematic wrongdoing is "too speculative to justify the invalidation of an arbitration agreement."[14]

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[14] The district court reasoned that because not all customers would pursue claims under ATTM's arbitration clause, "[f]aithful adherence to California's stated policy of favoring class litigation and arbitration to deter alleged fraudulent conduct," compelled it to invalidate the arbitration provision. Pet. App. 46a. But that court also expressly found that "few class members * * * bother to file a claim when the amount they would receive is small." *Id.* at 41a. And it is beyond peradventure that "[a] court's decision to certify a class * * * places pressure on the defendant to settle even unmeritorious claims." *Shady Grove*, 130 S. Ct. at 1465 n.3 (Ginsburg, J., dissenting). Accordingly, California's professed belief that class actions are necessary for deterrence boils down to the proposition that deterrence is served by imposing on all businesses—without regard to culpability—the massive costs of discovery that typically precede a class-certification motion and the inevitable multi-million-dollar fee award extracted by the class-action attorneys as the price of peace. In other words, because class actions *always* cost vast amounts to defend and eventually settle with a large transfer of wealth from the defendant to the class-action

In short, even accepting the Ninth Circuit's belief that ATTM's arbitration clause reduces ATTM's "aggregate liability" (*id.* at 11a), the clause does not immunize ATTM from all liability. In that respect as well, California's application of the exculpatory-clause statute here rests on principles different from the state-law rules applied outside the arbitration context.

* * * * *

Thus, it is only by applying a state-law rule that is "not applicable to contracts generally" (*Preston*, 552 U.S. at 356), but instead is aimed directly at agreements to resolve disputes—almost invariably, arbitration agreements—that the courts below could deem ATTM's arbitration provision unenforceable. If allowed to stand, California's distortion of contract-law principles in the context of agreements to arbitrate on a bilateral basis would rend a gaping hole in the FAA, as States could deem "unconscionable" or "exculpatory" any arbitration clause that fails to provide for particular favored procedures (such as trials by jury, plenary discovery, motion practice, or written rulings). Because California law "conditions the enforceability of arbitration agreements on compliance with a special [unconscionability rule] not applicable to contracts generally," the FAA "displac-

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lawyers no matter how guiltless the defendant may be, *all* businesses will be deterred from engaging in misconduct by the very existence of this externality-producing procedure. That kind of rationale has no more place here than it does elsewhere in the law. Cf. *State Farm Mut. Auto. Ins. Co.* v. *Campbell*, 538 U.S. 408, 417-418 (2003) ("'[T]he Due Process Clause does not permit a State to classify arbitrariness as a virtue.'") (quoting *Pac. Mut. Life Ins. Co.* v. *Haslip*, 499 U.S. 1, 59 (1991) (O'Connor, J., dissenting)) (alteration by the Court).

es" California law "with respect to arbitration agreements covered by the Act." *Casarotto*, 517 U.S. at 687.

C. California's Rule Invalidating Agreements To Arbitrate On A Bilateral Basis Is Preempted Because It Conflicts With The FAA.

California's rule is invalid for a second, independent reason. It is preempted under established principles of conflict preemption. As this Court recently explained, "[t]he FAA's displacement of conflicting state law is 'now well-established,' * * * and has been repeatedly reaffirmed." *Preston*, 552 U.S. at 353 (quoting *Allied-Bruce*, 513 U.S. at 272).

Here, California's rule conflicts with the FAA in two ways. Each conflict provides sufficient grounds for preemption of the state law.[15]

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[15] Justice Thomas recently expressed skepticism about "implied pre-emption doctrines that wander far from the statutory text." *Wyeth* v. *Levine*, 129 S. Ct. 1187, 1205 (2009) (Thomas, J., concurring in the judgment). In Justice Thomas's view, "[t]he Supremacy Clause * * * requires that pre-emptive effect be given only to those federal standards and policies that are set forth in, *or necessarily follow from*, the statutory text * * *." *Id.* at 1207. "Congressional and agency musings" do not satisfy that requirement. *Ibid.* Instead, "evidence of pre-emptive purpose must be sought in the text *and structure* of the provision at issue." *Ibid.* (internal quotation marks and brackets omitted; emphasis added).

The conflict-preemption argument here is not based on "generalized notions of congressional purpose," but instead is firmly rooted in "the text and structure" of the FAA. Specifically, Section 4 of the FAA emphasizes that when the making of an arbitration provision is not at issue, courts must "direct[] the parties to proceed to arbitration *in accordance with the terms of*

1. California's rule conflicts with the FAA's purpose—which is evident in the text and structure of the statute—of allowing parties to select their own dispute-resolution procedures.

As we have already discussed (see pages 24-26, *supra*), the core purpose of the FAA—reflected in the text of Sections 2, 3, and 4—was to ensure enforcement of agreements to arbitrate in accordance with their terms, especially the terms governing the procedures to be applied. California's rule conditioning the enforcement of arbitration provisions on the inclusion of a term permitting class-wide dispute resolution squarely conflicts with that core purpose.

To begin with, it is self-evident that conditioning enforcement of an arbitration provision on inclusion of a term adopting a particular procedure—here, class-wide dispute resolution—is "fundamentally at war with the foundational FAA principle that arbitration is a matter of consent." *Stolt-Nielsen*, 130 S. Ct. at 1775.[16]

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the agreement." (emphasis added). In combination with Section 2, which provides that arbitration agreements generally "shall be valid, irrevocable, and enforceable," Section 4 constitutes a statutory requirement that courts enforce arbitration provisions "according to their terms" (*Rent-A-Center*, 130 S. Ct. at 2776)—particularly when it comes to the procedures specified by the parties (*Pyett*, 129 S. Ct. at 1471). Preemption under the FAA is thus based not on "musing about goals or intentions" (*Wyeth*, 129 S. Ct. at 1215 (Thomas, J., concurring in the judgment), but rather on the very text and structure of the FAA.

[16] This is not to say that the FAA precludes States from imposing a general standard—such as a requirement that the parties' chosen procedures ensure that claims feasibly can be vindicated

Moreover, if States can "superimpos[e] class action procedures on a contract arbitration" (*Southland*, 465 U.S. at 8), there would be no end to the other procedures on which they could insist. Indeed, they could effectively condition enforcement of arbitration agreements on abandonment of all of the procedural efficiencies that make arbitration desirable in the first place.

For example, concerned that traditional arbitration hinders parties situated similarly to the plaintiff from learning of infringements of their legal rights, a State could condition enforcement of arbitration agreements on inclusion of a requirement that the arbitration decision be published. Or, convinced of the superiority of jury trials, a State could insist that arbitration agreements require arbitrators to convene juries (either with or without the assistance of the judiciary) to resolve factual issues. Or, dissatisfied with the more limited scope of discovery in traditional arbitration, a State might condition enforcement of arbitration agreements on their incorporation of the state or federal rules of civil procedure.

The scope of the procedures that States could impose on arbitration would be limited only by their imagination. In the end, arbitration would be converted into litigation, and the FAA would be rendered a nullity. As the Fifth Circuit has explained, if States can insist that arbitration embody *any* characteristic of litigation, they can insist on "*all* of the procedural accoutrements that accompany a judicial proceeding," which would amount to "an attack on

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in arbitration—so long as it leaves it to the parties to select those procedures.

the character of arbitration itself." *Iberia Credit Bureau*, 379 F.3d at 175-176 (emphasis added).

That was the basis of the Court's preemption holding in *Preston*, which involved a provision of the California Talent Agents Act ("TAA") that required disputes under that Act to be submitted to California's Labor Commissioner in the first instance—prior to either litigation or arbitration.[17]

Noting that "[t]he FAA's displacement of conflicting state law is 'now well-established,'" the Court held that "the FAA supersedes" the California statute. *Preston*, 552 U.S. at 353, 359 (quoting *Allied-Bruce*, 513 U.S. at 272). As the Court observed, "[a] prime objective of an agreement to arbitrate is to achieve 'streamlined proceedings and expeditious results.'" *Id.* at 357 (quoting *Mitsubishi Motors*, 473 U.S. at 633). That objective "would be frustrated" by the TAA, the Court explained, because "[r]equiring initial reference of the parties' dispute to the Labor Commissioner would, at the least, hinder speedy resolution of the controversy." *Id.* at 358. Because of that clear conflict between the state-law rule and the federal-law principle, the state law was preempted.

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[17] The TAA did contain an exemption to this exhaustion requirement for arbitration agreements between talent agents and their customers if the agreements provided for notice to the Labor Commissioner and an opportunity to attend the hearing. But the Court found this exemption to be "of no utility" to the petitioner, who "would have been required to concede a point fatal to his claim for compensation—*i.e.*, that he is a talent agent, albeit an unlicensed one—and to have drafted his contract in compliance with a statute that he maintains is inapplicable." *Preston*, 552 U.S. at 356.

Here, as in *Preston*, California has insisted on superimposing its own preferred procedures on a contractual arbitration. In *Preston*, the respondent contended that enforcing his arbitration agreement without the overlay of the TAA's exhaustion requirement "would undermine the Labor Commissioner's ability to stay informed of potentially illegal activity * * * and would deprive artists protected by the TAA of the Labor Commissioner's expertise." 552 U.S. at 358. This time the proffered rationale is that the agreement to arbitrate on an individual basis interferes with the state policy of using class actions to "deter" corporate misconduct. But as in *Preston*, because the arbitration agreement requires the Concepcions to "relinquish[] no substantive rights" (*id.* at 359), state law must give way.[18]

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[18] Although not a preemption case, *Gilmer* reinforces *Preston*'s holding that state policy cannot trump the FAA when the arbitration provision does not require relinquishment of substantive rights. In *Gilmer*, this Court rejected a plaintiff's exhortation to declare claims under the Age Discrimination in Employment Act ("ADEA") non-arbitrable. The Court disagreed with the suggestion that the "important social policies" (500 U.S. at 27) of the ADEA would be undermined because of the inability to pursue claims on a class-wide basis, explaining that "even if the arbitration could not go forward as a class action or class relief could not be granted by the arbitrator, the fact that the [ADEA] provides for the possibility of bringing a collective action does not mean that individual attempts at conciliation were intended to be barred." *Id.* at 32 (alterations in original; internal quotation marks omitted). Instead, the Court held, "[s]o long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function." *Id.* at 28 (internal quotation marks omitted; alterations in original); see also *Randolph*, 531 U.S. at 90. If that is

2. California's rule will frustrate the FAA's purpose—reflected in the text and structure of the statute—of removing impediments to arbitration.

The entire text and structure of the FAA in general, and Section 2 in particular, embody a "federal policy favoring arbitration." *Moses H. Cone*, 460 U.S. at 24. If upheld, California's rule conditioning enforcement of arbitration provisions on the inclusion of a term authorizing class-wide dispute resolution will frustrate that policy because businesses will give up on arbitration altogether rather than subject themselves to the risk of a class arbitration. As this Court recently recognized, the "changes brought about by the shift from bilateral arbitration to class-action arbitration" are "fundamental." *Stolt-Nielsen*, 130 S. Ct. at 1775-1776.

To begin with, "[i]n bilateral arbitration, parties forgo the procedural rigor and appellate review of the courts in order to realize the benefits of private dispute resolution: lower costs, greater efficiency and speed, and the ability to choose expert adjudicators to resolve specialized disputes." *Id.* at 1775. By contrast, class-action arbitration is every bit as burdensome, expensive, and time-consuming as class-action litigation—if not more so.[19] Indeed, class arbitration

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so when federal policy is concerned, it is all the more so when state policy is concerned.

[19] For example, the AAA's class arbitration procedures largely duplicate 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, *Policy on Class Arbitrations*, *at* http://www.adr.org/Classarbitrationpolicy.

is the quintessential example of arbitration "mutat[ing] into a private judicial system that looks and costs like the litigation it's supposed to prevent." Todd Carver & Albert Vondra, *Alternative Dispute Resolution: Why It Doesn't Work and Why It Does*, HARV. BUS. REV. 120, 120 (May 1994).[20]

Meanwhile, "the commercial stakes of class-action arbitration are comparable to those of class-action litigation, even though the scope of judicial review is much more limited." *Stolt-Nielsen*, 130 S. Ct. at 1776 (citation omitted). Unlike in court, where appellate review of class-certification and merits determinations is robust, the standard for vacating an arbitrator's decision on such issues 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). Consistent with the "national policy favoring arbitration," the FAA provides only "the limited review needed to maintain arbitration's essential virtue of

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[20] That is why class arbitration was virtually unheard of before this Court's decision in *Bazzle*. As one academic reported in 2000, despite "an extensive effort" to locate attorneys who had participated in class arbitrations, her research "found just a handful," indicating that "very few arbitrations have been handled as class actions." Jean Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1, 38-41 & n.148 (2000). Indeed, it was not until 2003, in the wake of *Bazzle*—which raised the possibility that an arbitration agreement not expressly requiring parties to proceed on an individual basis might be construed to permit class arbitrations—that the major arbitration providers first promulgated rules for class arbitrations. David Clancy & Matthew Stein, *An Uninvited Guest: Class Arbitrations and the Federal Arbitration Act's Legislative History*, 63 BUS. LAW. 55, 56 & n.1 (2007).

resolving disputes straightaway." *Hall St. Assocs.*, 552 U.S. at 588. Accordingly, an arbitrator's rulings regarding class certification, the scope of any class, the admissibility of expert testimony or other important evidence, whether or not the claim was proven, and the amount of damages can rarely, if ever, be disturbed by a court.

Moreover, even if a defendant wins a class-wide arbitration, it can have no assurance of finality because absent class members may contend that they were not afforded the due process protections necessary to make a class-wide award binding on them. Because many courts have held that arbitrators designated by contracts between private parties are not bound by the U.S. Constitution's due process clauses (see Carole Buckner, *Due Process in Class Arbitration*, 58 FLA. L. REV. 185, 187 n.5 (2006) (citing cases)), there is a risk that courts will embrace such an argument. See also Edward Bilich, *Consumer Arbitration: A Class Action Panacea*, 7 CLASS ACTION LITIG. REP. (BNA) 768, 771 (2006) (because of the "deferential standard of review" of arbitrators' decisions there is "no assurance that the 'class' arbitration proceedings would be binding on absent class members").

Given the risks entailed in *class* arbitration and the absence of any offsetting benefits, no rational business would willingly subject itself to this worst-of-both-worlds scenario. Indeed, in response to prior decisions of the Ninth Circuit refusing to find California's policy favoring class actions preempted by the FAA, the nation's largest cable company, Com-

cast Corp., has already abandoned arbitration in California.[21]

Accordingly, California's rule conditioning the enforceability of arbitration provisions on the availability of class-wide arbitration is for all practical purposes a ban on consumer arbitration agreements. As such, California's rule cannot be reconciled with the FAA's policy of promoting arbitration. See *Waffle House*, 534 U.S. at 310 (Thomas, J., dissenting) (a "result [that] discourages the use of arbitration agreements * * * is * * * completely inconsistent with the policies underlying the FAA"); see also Tr. of Oral Argument at 53, *Green Tree Fin. Corp.* v. *Bazzle*, 539 U.S. 444 (No. 02-634) (Apr. 22, 2003) (Justice Scalia: "Why isn't the Federal Arbitration Act more reasonably interpreted as directed at those State laws that * * * are destructive of arbitration, that * * * are hostile not in the sense of any * * * mental intent, but that in their operation make it difficult for parties to enter into arbitration agreements?"), *available at* 2003 WL 1989562. Because it "stands as an obstacle to the accomplishment and execution of the full purposes and objective of Congress" (*United States* v. *Locke*, 529 U.S. 89, 109 (2000) (internal quotation marks omitted)) in enacting the FAA, California's near-categorical ban on provisions requiring bilateral arbitration is preempted.[22]

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[21] See Comcast Agreement for Residential Services § 13.k, *at* http://www.comcast.net/terms/subscriber/ ("IF YOU ARE A COMCAST CUSTOMER IN CALIFORNIA, COMCAST WILL NOT SEEK TO ENFORCE THE ARBITRATION PROVISION ABOVE UNLESS WE HAVE NOTIFIED YOU OTHERWISE.").

[22] 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

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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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) (federal securities laws preempted 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").

APPENDIX

APPENDIX A

Excerpts Of Relevant Constitutional And Statutory Provisions

The Supremacy Clause of the Constitution (Art. VI, cl. 2), provides in pertinent part:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof * * * shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 2 of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 2, provides in pertinent part:

> A written provision in * * * a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, * * * or an agreement in writing to submit to arbitration an existing controversy arising out of such contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Section 3 of the FAA, 9 U.S.C. § 3, provides in pertinent part:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending * * *

> shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement * * *.

Section 4 of the FAA, 9 U.S.C. § 4, provides in pertinent part:

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28 * * * for any order directing that such arbitration proceed in the manner provided for in such agreement. * * * [U]pon being satisfied that the making of the agreement for arbitration * * * is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. * * * If the jury find that an agreement was made in writing * * *, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.