No. 14–55397

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

ARTHUR MERKIN AND JAMES SMITH,
Plaintiffs-Appellees

v.

VONAGE AMERICA, INC.,
Defendant-Appellant.

Appeal from an Order of the United States District Court for the Central District of California, Case No. 2:13-CV-08026

AMICUS CURIAE BRIEF OF NATIONAL ASSOCIATION OF CONSUMER ADVOCATES IN SUPPORT OF PLAINTIFFS-APPELLEES' PETITION FOR REHEARING *EN BANC*

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, the National Association of Consumer Advocates states that it has no parent corporation and that there is no publicly held corporation that owns 10% or more of its stock.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Other Authorities

STATEMENT OF AMICUS CURIAE

The **National Association of Consumer Advocates** ("NACA") is a nationwide non-profit corporation whose over 1,000 members are private, public-sector, legal services and non-profit lawyers, law professors, and law students, whose primary practices or interests involve consumer rights and protection. NACA is dedicated to furthering the effective and ethical representation of consumers and to serving as a voice for its members and for consumers in an ongoing effort to curb deceptive and exploitative business practices. NACA has furthered this interest in part by appearing as amicus curiae in support of consumer interests in federal and state courts throughout the United States. NACA has appeared as amicus curiae in support of consumer interests in many California courts, including *Loeffler v. Target Corp.*, 58 Cal. 4th 1081 (2014); *Kwikset Corp. v. Superior Court*, 51 Cal. 4th 310 (2011); *Californians For Disability Rights v. Mervyn's, LLC*, 39 Cal. 4th 223 (2006); *Hood v. Santa Barbara Bank & Trust*, 143 Cal. App. 4th 526 (2006); and *Am. Int'l Indus. v. Superior Court*, 72 Cal. App. 4th 1376 (ordered not to be officially published Oct. 20, 1999).[1]

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[1] Pursuant to Federal Rule of Appellate Procedure 29(c)(5), amicus affirms that no counsel for a party authored this brief in whole or in part and that no person other than amicus, its members, or its counsel has made any monetary contributions intended to fund the preparation or submission of this brief. All parties have consented to the filing of this brief.

SUMMARY OF THE ARGUMENT

For the reasons discussed in Plaintiffs-Appellees' petition for *en banc* review, this Court should reconsider the panel's decision in this case not only to correct its clear error but also to forestall any of the confusion that that decision might otherwise cause in this Circuit regarding preemption under the Federal Arbitration Act ("FAA"), 9 U.S.C. § 1, *et seq*..

NACA submits this *amicus* brief to highlight just how much of an outlier the panel's decision is. ***First***, the panel's decision amounts to an implicit rejection of the well-established doctrine that arbitration agreements are unconscionable if they lack a "modicum of bilaterality." California courts have long held that, like other exceptionally one-sided contract provisions, arbitration provisions that permit the drafter to choose whether to arbitrate or go to court but require consumers or employees to arbitrate all their claims are unconscionably one-sided. The panel decision would overrule years of California precedent.

Second, the panel's conclusion that the mutuality doctrine is preempted because it "appl[ies] only to arbitration or derive[s] [its] meaning from the fact that an agreement to arbitrate is in issue," *Merkin v. Vonage Am., Inc.*, No. 14-55397, 2016 WL 775620, at *1 (9th Cir. Feb. 29, 2016), relies on an overly simplistic understanding of California law and FAA preemption—one that this Court has already rejected. Consistent with Judge Wardlaw's carefully drawn dissent, the full

Court should clarify that the FAA means what it says: Arbitration agreements are unenforceable if they conflict with principles "as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. It is a generally-applicable principle of California contract law that a contract is unenforceable if it is unreasonably one-sided. It therefore does not conflict with the FAA to deny enforcement of an arbitration clause on that basis.

ARGUMENT

I. CALIFORNIA'S DOCTRINE AGAINST UNCONSCIONABLY ONE-SIDED CONTRACTS IS A WELL-ESTABLISHED, GENERALLY APPLICABLE PRINCIPLE OF CONTRACT LAW.

The mutuality doctrine is by now well defined: In the "absence of 'justification,'" contracts that have "'overly harsh' or 'one-sided' results" are substantively unconscionable. *A & M Produce Co. v. FMC Corp.*, 135 Cal. App. 3d 473, 487 (Cal. Ct. App. 1982). One example of this kind of one-sided contract arises "[w]here the party with stronger bargaining power has restricted the weaker party to the arbitral forum, but reserved for itself the ability to seek redress in either an arbitral or judicial forum." *Nagrampa v. MailCoups, Inc.*, 469 F.3d 1257, 1285 (9th Cir. 2006) (*en banc*). That is precisely the doctrine that Plaintiffs raised to defend against enforcement of the arbitration clause here and precisely the doctrine that the panel found preempted by the FAA.

The *amicus* brief filed by Public Justice sets out the number of ways in which the panel decision conflicts with precedent from state and federal courts around the country, including multiple decisions from this Court. The panel rejected this precedent without even citing to it, let alone carefully considering it. The panel's opinion thus creates a split not only between federal circuits but also between federal and state courts within this Circuit—federal courts bound by the panel's determination and state courts bound by the clear and careful precedent of their state supreme courts.

Also without citation or consideration, the panel opinion tosses aside multiple correct and carefully drawn California cases. California courts have long held that unreasonably one-sided contract terms arising from abuses in bargaining power are unenforceable. This generally-applicable contract doctrine did not arise in the context of arbitration, and it is not specific to arbitration. Indeed, the Uniform Commercial Code—indisputably a generally applicable source of contract law—itself defines the "basic test" of unconscionability as "whether the clauses involved are so one-sided as to be unconscionable." U.C.C. § 2-302, cmt. 1; *accord* Cal. Civ. Code § 1670.5, Leg. Cmt. 1 (California's unconscionability statute, which is identical to the Uniform Commercial Code).

California courts have repeatedly applied this test to all sorts of contracts—contracts for farm equipment, loans, checking accounts, used cars—none of which

had anything to do with arbitration. *See, e.g.*, *Lona v. Citibank, N.A.*, 202 Cal. App. 4th 89 (2011); *Donovan v. RRL Corp.*, 26 Cal. 4th 261 (2001); *Ilkhchooyi v. Best*, 37 Cal. App. 4th 395 (1995); *Perdue v. Crocker Nat'l Bank*, 38 Cal. 3d 913 (1985). For example, in *Lona v. Citibank*, the California Court of Appeal held that a jury could find that a loan contract with an "extreme disparity between the amount of the monthly loan payments and [the borrower's] income" was "overly harsh and one sided and thus substantively unconscionable." *Lona*, 202 Cal. App. 4th at 111.

In *Donovan v. RRL Corp.*, the California Supreme Court rescinded an auto sales contract where a newspaper had mistakenly advertised a used car for sale well below the intended sale price. *Donovan*, 26 Cal. 4th at 266. The dealer's "honest mistake," the Court found, "resulted in an unfair, one-sided contract," in which the dealer would receive much less for the car than it was worth. *Id.* at 293. Such "one-sided results," the Court held, were "sufficient to establish unconscionability entitling [the dealer] to rescission" of the contract. *Id.* at 292.

In the same way California courts have held that loan contracts or car sales contracts are unconscionable if they are unfairly one-sided, so too they have held unfairly one-sided arbitration contracts unconscionable.[2] Under California law, a

[2] *See, e.g.*, *Capili v. Finish Line, Inc.*, 116 F. Supp. 3d 1000, 1007 (N.D. Cal. 2015); *Poublon v. Robinson Co.*, No. 2:12-CV-06654-CAS MA, 2015 WL 588515, at *5-6 (C.D. Cal. Jan. 12, 2015); *ACORN v. Household Int'l, Inc.*, 211 F. Supp. 2d 1160 (N.D. Cal. 2002) (deeming arbitration agreement unconscionable in part

contract is not unconscionable solely because it results in unfair outcomes. Contracts, after all, allocate risks, and at the time a party seeks to enforce the contract, at least some of those risks will presumably have come to fruition. Rather, unconscionability doctrine turns on an "overly harsh allocation of risks or costs which is not justified by the circumstances under which the contract was made." *Carboni v. Arrospide*, 2 Cal. App. 4th 76, 83 (1991) (concluding that loan with 200% interest rate was unconscionable). Contracts where the drafter reserves the right to choose whether to go to court or arbitrate, but requires the other party to arbitrate exhibit such an "overly harsh" allocation of risks or costs." The California Supreme Court has explained:

> [i]f the arbitration system established by the [drafter] is indeed fair, then [both parties] should be willing to submit claims to arbitration. Without reasonable justification for this lack of mutuality, arbitration appears less as a forum for neutral dispute resolution and more as a means of maximizing [drafter] advantage. Arbitration was not intended for this purpose.

Armendariz v. Found. Health Psychcare Servs., Inc., 24 Cal. 4th 83, 118 (2000).

(continued . . .)

because it required the consumer to submit all claims to arbitration but allowed the lender to pursue foreclosure proceedings outside of arbitration); *O'Hare v. Mun. Res. Consultants*, 107 Cal. App. 4th 267, 274 (2003) (arbitration agreement lacked "modicum of bilaterality" where it allowed employer to pursue injunctive and equitable relief against the employee in a public forum); *Fitz v. NCR Corp.*, 118 Cal. App. 4th 702, 725 (2004).

For example, in *Jarmillo v. JH Real Estate Partners, Inc.*, residential tenants brought claims against their landlords related to "water incursion and dangerous and unhealthful levels of moisture in walls and ceilings, mold, mold mycotoxins, airborne mold spores, fungus, and bacteria in the rental unit." 111 Cal. App. 4th 394, 397 (2003). The defendants invoked an arbitration requirement in their standard form lease that said that "any dispute between the parties relating to a claim for personal injury, directly or indirectly relating to, or arising from, the condition of the leased premises, or the apartment community, shall be resolved by arbitration conducted by the American Arbitration Association." *Id.* at 398 (internal quotation marks omitted). The contract also stated, however, that nothing in it "limited the landlord's rights in the event of a resident's breach or default under this agreement, including the landlord's right to bring an action for unlawful detainer." *Id.* The appellate court affirmed the trial court's denial of the defendant's motion to compel arbitration. The court noted that "the reality is that personal injury claims arising from the condition of the leased premises are largely, if not exclusively, tenant claims." *Id.* at 405. By denying tenants the right to go to court, but allowing the landlord the advantages of judicial procedure, the arbitration agreement lacked even the modicum of bilaterality required in an enforceable contract.

On the other hand, in *Sanchez v. Valencia Holding Co., LLC,* 61 Cal. 4th 899 (2015), the California Supreme Court rejected a consumer's argument that the arbitration clause in his auto-financing contract was unconscionable because it allowed the dealership to use self-help to repossess the car without going to arbitration, but required the car-buyer to arbitrate his claims against the dealer. The court recognized the principle that "arbitration provisions are unconscionable if they provide for the arbitration of claims most likely to be brought by the weaker party but exempt from arbitration claims most likely to be filed by the stronger party." *Id.* at 921. But the court rejected the consumer's argument because self-help repossession is authorized by statute and sought outside of litigation. *Id.* at 922.

Hewing to California unconscionability law requiring courts to closely scrutinize contracts to determine whether they are unreasonably one-sided in the circumstances presented, California courts have sometimes found arbitration clauses unconscionable when they seek to impose arbitration on a weaker party while allowing the stronger party to benefit from the judicial process. But California courts have also held that other arbitration clauses do not run afoul of that principle. In both kinds of cases, California courts have addressed the question carefully and thoughtfully and in accordance with the state's generally applicable

contract law. The panel's opinion conflicts with this substantial and consistent precedent without citation.

II. THE PANEL ERRED IN CONCLUDING THAT THE FAA PROHIBITS CALIFORNIA FROM APPLYING ITS GENERALLY APPLICABLE DOCTRINE AGAINST ONE-SIDED CONTRACTS TO ARBITRATION AGREEMENTS.

The FAA provides that written agreements to arbitrate shall be enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. To reconcile this "savings clause" with the protections that the FAA was intended to afford against "judicial hostility to arbitration agreements," *Shearson/Am. Exp., Inc. v. McMahon*, 482 U.S. 220, 225 (1987), the Supreme Court and this Court have described two FAA-based restrictions on courts' authority to deny enforcement of arbitration agreements: (1) courts must not treat arbitration agreements with disfavor relative to other agreements, *see, e.g.*, *DIRECTV, Inc. v. Imburgia*, 136 S. Ct. 463, 468 (2015) (arbitration clauses must be placed on "equal footing with other contracts" (internal quotation marks omitted)), or arbitration with disfavor relative to resolution in a public forum, *see, e.g*, *Marmet Health Care Ctr.*, 132 S. Ct. 1201 (2013); *Ferguson v. Corinthian Colleges, Inc.*, 733 F.3d 928, 934 (9th Cir. 2013) (state rule must not "prohibit[] outright arbitration of a particular type of claim"); and (2) courts must not employ generally applicable laws or rules of decision—meaning rules that do not on their face single out arbitration—to prohibit a fundamental attribute of arbitration.

Concepcion, 563 U.S. 333, 344 (2011); *see also Smith v. Jem Grp., Inc.*, 737 F.3d 636, 641 (9th Cir. 2013).

There can be no argument that *exempting* certain claims from arbitration is a fundamental attribute of arbitration. And so the only way the mutuality doctrine can be preempted is if it disfavors arbitration agreements. It clearly does not.

First, as explained above, California law treats arbitration contracts the same as all other contracts: Egregiously one-sided contracts are unconscionable, regardless of whether or not they involve arbitration. The refusal to enforce an unconscionable arbitration contract no more takes its meaning from the fact that arbitration is involved than the refusal to enforce a loan contract with an unreasonably high interest rate takes it meaning from the fact that a loan is involved. *Cf. Carboni*, 2 Cal. App. 4th at 84 (concluding that 200% interest rate was substantively unconscionable because it was one-sided without justification).

In other words, the mutuality doctrine is not preempted where courts' articulation of it involves mention of arbitration. *See Chavarria v. Ralphs Grocery Co.*, 733 F.3d 916, 927 (9th Cir. 2013). Under California law, if a contract is unfairly one-sided, it is unconscionable—regardless of whether that contract is an arbitration contract or not. *A&M Produce*, 186 Cal. Rptr. at 487. If this Court were to "immunize" arbitration clauses from the general principle that contracts may not be unfairly one-sided, it would "elevate" arbitration contracts over other contracts,

which would be "inconsistent with the" FAA's mandate that arbitration contracts not be treated differently than other agreements. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967).

Second, California law does not impermissibly assume that arbitration is inferior to litigation. While the vast majority of courts have held that the FAA does not preempt state unconscionable doctrines like California's,[3] a single court of appeals—the Tenth Circuit—has held that state law holding asymmetrical arbitration contracts unconscionable may impermissibly depend on the view that arbitration is inferior to litigation. *THI of New Mexico at Hobbs Ctr., LLC v. Patton*, 741 F.3d 1162, 1170 (10th Cir. 2014). The panel decision in this case did not reference *THI*, nor did it suggest that the reason for its ruling was that it believed California law impermissibly depended on the view that arbitration is inferior to litigation. Nor could it: California law does not, in fact, depend on such a view.

As the dissent in this case points out, there is no need to assume that arbitration is inferior to conclude that a contract is unfairly one-sided if it reserves

[3] *See, e.g.*, *Noohi v. Toll Bros.*, 708 F.3d 599, 612-13 (4th Cir. 2013); *Glob. Client Sols., LLC v. Ossello*, No. DA 15-0301, 2016 WL 825140, at *9 (Mont. Mar. 2, 2016); *Berent v. CMH Homes, Inc.*, 466 S.W.3d 740, 752 (Tenn. 2015); *Alltel Corp. v. Rosenow*, 2014 Ark. 375, 11 (2014); *Brewer v. Missouri Title Loans*, 364 S.W.3d 486, 495 (Mo. 2012); *Dan Ryan Builders, Inc. v. Nelson*, 230 W. Va. 281, 291 (2012);

to just one party the right to choose the forum for its most likely claims, while giving that party the right to unilaterally require the other party to arbitrate her claims. This principle assumes not that litigation is *better* than arbitration but rather that it is *different* than arbitration—that each form of dispute resolution has advantages and disadvantages.[4] That premise is entirely consistent with the FAA.

Indeed, the United States Supreme Court itself has repeatedly acknowledged the trade-offs of arbitration. *See, e.g.*, *Concepcion*, 56 U.S. at 344. By agreeing to arbitration, the Court has explained, parties "forgo the procedural rigor and appellate review of the courts" in favor of the "lower costs, greater efficiency and speed, and the ability to choose expert adjudicators" provided by arbitration. *Id*. While this trade-off is often worthwhile, there are also circumstances in which the benefits of informal, expeditious dispute resolution are not worth the costs of giving up the procedural safeguards of the court system. *See id.* (explaining that "[t]he absence of multilayered review makes it more likely that errors will go uncorrected" in arbitration than in court, and therefore a corporation is likely to favor arbitration for individual claims against it, but may be unwilling to accept the risk of error for larger class-wide claims). It does not discriminate against

[4] Large merchants and lenders have themselves recognized this fact. *System Slowdown: Can Arbitration Be Fixed?*, Inside Counsel, May 2007, at 50–58, *available at* http://accord-adr.com/Arbitration%20Slowdown-Inside%20Counsel-May%2007.pdf.

arbitration to say that it is unfair for a company to reserve for itself—but not its consumers—the right to choose when to make these trade-offs.[5]

This is precisely the analysis that California courts have applied when concluding that mutuality doctrine is not preempted by the FAA. In *Malone v. Superior Court*, for example, the California Court of Appeal explicitly rejected the idea that state law holding one-sided arbitration contracts are unconscionable depends on the view that arbitration is inferior to litigation. *Malone v. Superior Court*, 226 Cal. App. 4th 1551 (2014). That idea, the court explained, is "too simplistic," *id.*:

> While we would not, as a general rule, take issue with a forum selection clause choosing Alaska courts to resolve disputes under a contract, we would look with skepticism at a clause providing that a California employee's claims against its Alaskan employer must be brought in Alaska court, while the employer's claims against its employee must be brought in California court. That the two fora are courts of equal dignity cannot be denied; however, the application of the clause would clearly be unfair to a California employee who cannot easily go to a distant forum to pursue his or her claims. Similarly, while arbitration is not inferior to litigation in the abstract, an agreement with an arbitration clause that does not operate bilaterally may be unfair in its application.

Id. at 1568 n. 15; *see also Carlson v. Home Team Pest Def., Inc.*, 239 Cal. App. 4th 619, 638 (2015).

[5] Even the Tenth Circuit has recognized that a choice of whether to arbitrate or litigate is preferable to being required to arbitrate (or, for that matter, litigate) in all cases. *See THI*, 741 F.3d at 1170.

Finally, as Judge Wardlaw wrote in dissent here,

> The FAA rejects the view that arbitration is inherently inferior to litigation. However, a choice between arbitration and litigation is superior to arbitration with no alternative. That is because choice yields strategic flexibility—here, the opportunity to assess the circumstances of any particular dispute and determine which forum would be most advantageous. This is a valuable choice that Vonage, as the drafter of this adhesive agreement, reserved for itself but denied its customers. The unfairness of a provision that greatly favors the party with all the bargaining power is not unique to arbitration, and the FAA does not require its enforcement.

Merkin, 2016 WL 775620, at *3 (Wardlaw, *J.* dissenting) (internal citations omitted). The Court should revisit the panel's determination and adopt Judge Wardlaw's reasoning.

CONCLUSION

For these reasons, the Court should grant *en banc* review.

Respectfully submitted,

Dated: March 31, 2016

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CERTIFICATE OF COMPLIANCE

(Fed. R. App. P. 32(a) & 9th Cir. Rule 32-l)

This brief complies with the type-volume limitation of Federal Rule of Appellate Procedure 32(a) because this brief contains less than 4200 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Federal Rule of Appellate Procedure 32(a)(5), and the type style requirements of Federal Rule of Appellate Procedure 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2010 word processing program, a 14-point font size, and the Times New Roman type style.

Respectfully submitted,

Dated: March 31, 2016

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