No. 07-

IN THE

Supreme Court of the United States

T-MOBILE USA, INC., OMNIPOINT COMMUNICATIONS, INC. D/B/A T-MOBILE, AND TMO CA/NV, LLC,
Petitioners,

v.

JENNIFER L. LASTER, ANDREW THOMPSON, ELIZABETH VOORHIES, ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED AND ON BEHALF OF THE GENERAL PUBLIC,
Respondents.

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

PETITION FOR A WRIT OF CERTIORARI

JAMES C. GRANT
SHELLEY M. HALL
STOKES LAWRENCE, P.S.
800 Fifth Avenue
Suite 4000
Seattle, WA 98104-3179
(206) 626-6000

CARTER G. PHILLIPS*
PAUL J. ZIDLICKY
PETER C. PFAFFENROTH
JAMES C. OWENS
SIDLEY AUSTIN LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000

Counsel for Petitioners

* Counsel of Record

January 23, 2007

QUESTION PRESENTED

Whether, under the Federal Arbitration Act, a federal court may refuse to enforce the terms of an agreement to arbitrate based upon a state-law policy that individual arbitration is unconscionable in cases involving small claims by a consumer.

LIST OF PARTIES AND AFFILIATES

In addition to the parties listed in the caption, the following also were involved in the proceedings below: Verizon Communications, Inc., Cellco Partnership d/b/a Verizon Wireless, Verizon Wireless (VAW) LLC, Airtouch Cellular, Cingular Wireless LLC, Go Wireless, and New Cingular Wireless PCS d/b/a Cingular Wireless.

Pursuant to Rule 29.6 of the Rules of this Court, petitioner T-Mobile USA, Inc. is a wholly-owned subsidiary of T-Mobile Global Holding GmbH, which is a wholly owned subsidiary of T-Mobile International AG, which, in turn, is a wholly owned subsidiary of Deutsche Telekom AG. Deutsche Telekom AG is a publicly traded company, of which approximately 14.83% and 16.87% is owned by the Federal Republic of Germany and the Kreditanstalt für Wiederaufbau (a bank controlled by the Government of the Federal Republic of Germany), respectively. No other publicly-held company owns 10% or more of T-Mobile USA, Inc.

Petitioner Omnipoint Communications, Inc. is a wholly-owned subsidiary of T-Mobile USA, Inc.

Petitioner TMO CA/NV, LLC, is a wholly-owned subsidiary of TMO CA/NV Holdings LLC. TMO CA/NV Holdings LLC is a wholly-owned subsidiary of Omnipoint Communications, Inc., which, as noted, is a wholly-owned subsidiary of T-Mobile USA, Inc.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners T-Mobile USA, Inc., OmniPoint Communications, Inc. d/b/a T-Mobile, and TMO CA/NV, LLC (collectively, "T-Mobile") respectfully request that this Court grant the petition for a writ of certiorari to review the decision and judgment of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The opinion of the Ninth Circuit is unreported and is reproduced in the Appendix to this Petition ("Pet. App.") at 1a to 3a. The decision of the District Court denying T-Mobile's motion to compel arbitration is published at 407 F. Supp. 2d 1181 (S.D. Cal. 2005), and is reproduced at Pet. App. 4a-33a.

JURISDICTION

This lawsuit originally was filed in California Superior Court and was removed to federal court in May 2005. Plaintiff Jennifer Laster thereafter filed an amended complaint invoking federal jurisdiction based upon diversity of citizenship under the Class Action Fairness Act of 2005. The district court had jurisdiction under 28 U.S.C. §§ 1332(d) and 1453(b). The Ninth Circuit had appellate jurisdiction over the district court's denial of T-Mobile's motion to compel arbitration under 9 U.S.C. § 16(a)(1). This Court has jurisdiction over this petition for review of the Ninth Circuit's October 25, 2007 decision under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Sections 2 and 4 of the Federal Arbitration Act ("FAA") are reproduced in the Appendix at Pet. App. 34a-35a.

STATEMENT OF THE CASE

This case presents the recurring question whether Section 2 of the FAA permits federal courts to refuse to enforce agreements to arbitrate claims individually based on a state-law policy that individual arbitration of consumer claims is substantively unconscionable. Respondent Jennifer Laster purchased a T-Mobile phone and entered into a written agreement to resolve disputes with T-Mobile through individual arbitration. Notwithstanding that agreement, Laster filed a class action on behalf of herself and all similarly situated California consumers claiming that T-Mobile violated California law by charging California sales tax on the full retail value of discounted wireless telephones. The court below, applying prior Ninth Circuit and California Supreme Court precedent in *Shroyer* v. *New Cingular Wireless Services, Inc.*, 498 F.3d 976 (9th Cir. 2007), and *Discover Bank* v. *Superior Court*, 113 P.3d 1100 (Cal. 2005), held that Laster's arbitration agreement with T-Mobile was unenforceable because it provided for individual and not class-wide arbitration.

The Ninth Circuit's decision is in direct conflict with the Third Circuit's ruling in *Gay* v. *CreditInform*, ___ F.3d ___, 2007 WL 4410362 (3d Cir. Dec. 19, 2007). Indeed, the Ninth Circuit has expressly declined "to follow the Third Circuit's holding in *Gay*." *Lowden* v. *T-Mobile USA, Inc.*, ___ F.3d ___, 2008 WL 170279, at *8 n.3 (9th Cir. Jan. 22, 2008). In *Gay*, the Third Circuit, relying on this Court's decision in *Perry* v. *Thomas*, 482 U.S. 483 (1987), has ruled that the FAA precludes a court from refusing to enforce an agreement to arbitrate individually based upon a state-law determination that individual arbitration of small consumer claims is unconscionable. 2007 WL 4410362, at *20. The

Gay Court concluded that state unconscionability standards are preempted to the extent that they would render individual arbitration unenforceable. Denying enforcement on those grounds, the *Gay* Court explained, would be tantamount to "'rely[ing] on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable.'" *Id.* (quoting *Perry*, 482 U.S. at 492 n.9).

The *Gay* decision, in turn, builds on decisions by other federal circuits holding that individual arbitration is enforceable under the FAA as an entirely appropriate mechanism for resolving federal and state claims by consumers in cases involving relatively small individual amounts. See *Johnson* v. *West Suburban Bank*, 225 F.3d 366, 373 (3d Cir. 2000); *accord Jenkins* v. *First Am. Cash Advance of Ga., LLC*, 400 F.3d 868 (11th Cir. 2005), *cert. denied*, 546 U.S. 1214 (2006); *Livingston* v. *Associates Fin., Inc.*, 339 F.3d 553 (7th Cir. 2003); *Snowden v. CheckPoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002); *Randolph* v. *Green Tree Fin. Corp.*, 244 F.3d 814 (11th Cir. 2001). These courts hold that the FAA mandates enforcement of individual arbitration of claims by consumers notwithstanding the absence of class-wide procedures.

The instant case squarely implicates this conflict over the enforceability of agreements to arbitrate consumer claims individually. In the ruling below, the Ninth Circuit applied *Shroyer* to hold that the FAA does not mandate enforcement of these agreements. Pet. App. 2a-3a. In contrast, the Third Circuit in *Gay* ruled that the FAA does mandate enforcement of agreements requiring individual arbitration of consumer claims, and thus preempts state law to the contrary. Moreover, the Third,

Fourth, Seventh, and Eleventh Circuits all have held – unlike the decision below – that individual arbitration allows for the effective resolution of claims in cases involving consumers.

Resolution of this conflict is necessary because the proper application of the FAA to consumer arbitration agreements presents a recurring issue of fundamental and national importance. The enforceability of agreements to arbitrate under the FAA is a matter that affects the rights of tens of millions of consumers and businesses. Indeed, a state-law rule that arbitration must provide class-wide procedures directly undercuts the benefit of arbitration as a streamlined, low-cost *alternative* to litigation. Decisions by courts that invalidate the terms of these arbitration agreements directly undermine the "primary purpose" of the FAA: to counteract judicial hostility to arbitration and to ensure that arbitration remains a viable alternative to litigation through enforcement of agreements to arbitrate in accordance with their terms. See *Volt Info. Scis., Inc.* v. *Board of Trs.*, 489 U.S. 468, 479 (1989); 9 U.S.C. § 4.

Review is warranted so that the proper application of the FAA and the rights of tens of millions of individuals and businesses are not made to depend upon geography or on the prevailing construction of the FAA within an individual state or federal circuit.

STATUTORY BACKGROUND

In 1925, Congress enacted the FAA in response "to hostility of American courts to the enforcement of arbitration agreements." *Circuit City Stores* v. *Adams*, 532 U.S. 105, 111 (2001). Congress sought to promote arbitration as a meaningful alternative to litigation. "[B]y agreeing to arbitrate, a party 'trades

the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.'" *Gilmer* v. *Interstate/ Johnson Lane Corp.*, 500 U.S. 20, 31 (1991). Indeed, "it is typically a desire to keep the effort and expense required to resolve a dispute within manageable bounds that prompts [parties] to forgo access to judicial remedies." *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 633 (1985). For that reason, "Congress, when enacting [the FAA], had the needs of consumers, as well as others, in mind." *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. 265, 280 (1995).

The "primary purpose" of the FAA is to "ensur[e] that private agreements to arbitrate are enforced according to their terms." *Volt Info. Scis., Inc.* v. *Board of Trs.*, 489 U.S. 468, 479 (1989). Arbitration agreements must be "rigorously enforce[d]" even if "the result is 'piecemeal' litigation." *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213, 221 (1985). Indeed, Section 2 of the FAA "compels judicial enforcement of a wide range of written arbitration agreements," *Circuit City*, 532 U.S. at 111, "'notwithstanding any state substantive or procedural policies to the contrary.'" *Perry* v. *Thomas*, 482 U.S. 483, 489 (1987) (quoting *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

Under the FAA, "the underlying issue of arbitrability" is "a question of substantive federal law," *Southland Corp.* v. *Keating*, 465 U.S. 1, 12 (1984), that "must be addressed with a healthy regard for the federal policy favoring arbitration," *Moses H. Cone*, 460 U.S. at 24. In determining whether an agreement to arbitrate is enforceable, "the text of § 2 provides the touchstone for choosing between state-law principles and the principles of

federal common law." *Perry*, 482 U.S. at 492 n.9. As explained in *Perry*, "[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.'" *Id.* (quoting 9 U.S.C. § 2) (internal citation omitted; emphasis added by Court). "[S]tate law . . . is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." *Id.* at 493 n.9.

"Courts may not . . . invalidate arbitration agreements under state laws applicable *only* to arbitration provisions." *Doctor's Assocs. Inc.* v. *Casarotto*, 517 U.S. 681, 687 (1996); see *Perry*, 482 U.S. at 493 n.9. Likewise, courts may not (i) refuse enforcement based on state laws applicable only to certain types or categories of contracts, *Southland*, 465 U.S. at 16 n.11, or (ii) rely upon a fundamental aspect of arbitration as a basis for a ruling that arbitration is unconscionable, *Perry*, 482 U.S. at 493 n.9.

FACTUAL BACKGROUND

Petitioner T-Mobile markets and sells wireless telecommunications services, phones, and accessories throughout the United States. T-Mobile, which currently has more than 28 million customers, uses standardized contracts because it cannot realistically negotiate separate terms and conditions with each of these customers. Of course, no consumer is compelled to buy T-Mobile's service or accept its terms and conditions given the highly competitive market for wireless service.

a. Wireless service and phones often are sold together in "bundled" transactions, in which consumers receive a free or significantly discounted

phone in exchange for agreeing to wireless service contracts for a term of one or two years. When T-Mobile offers a free or discounted phone as part of a bundled transaction, some states (such as California) require that T-Mobile charge sales tax based on the full retail value of the phone.

On February 23, 2005, Plaintiff Laster purchased a wireless phone and wireless service at a T-Mobile store in San Diego, California. Pet. App. 8a-9a. As part of that transaction, Laster received the phone at no cost. California law requires that sales tax be paid on the full retail value of the phone when the sale is part of a bundled transaction. See Cal. Code Regs. tit. 18, § 1585(a)(4), (b)(3). These taxes were reflected on Laster's receipt, which showed that she was charged $28.22 in sales tax (based upon the $364.13 retail value of the phone). She paid the sales tax. Pet. App. 9a. Indeed, Laster admitted in her Complaint that when she made her purchase, her receipt disclosed the amount of tax and that "'[b]y law, some states impose a tax based on the retail price or cost of our product instead of the discounted price.'" First Am. Compl. ¶ 23 (9th Cir. Excerpts of Record ("ER") at 44).

At the time of her purchase, Laster also signed a Service Agreement and agreed to terms and conditions including "MANDATORY ARBITRATION." Pet. App. 9a; ER 123. Accompanying Laster's new phone was the T-Mobile Welcome Guide, which set forth in full the terms and conditions of service. The first paragraph advised, "IF YOU DON'T AGREE WITH THESE [TERMS AND CONDITIONS], DO NOT USE THE SERVICE OR YOUR UNIT." ER 109. The Agreement provided her with 30 days to cancel her service with no further obligation and return her phone for a full refund. ER

109. The trial period also was disclosed on Laster's sales receipt. ER 81. Laster chose to keep her phone, to continue her T-Mobile service, and to accept the corresponding terms and conditions. See ER 77.

Section 3 of the Terms and Conditions sets forth an arbitration agreement, which provides that it is governed by "the Federal Arbitration Act and federal arbitration law":

> Mandatory Arbitration: Dispute Resolution. YOU WILL FIRST NEGOTIATE WITH US IN GOOD FAITH TO SETTLE ANY CLAIM OR DISPUTE BETWEEN YOU AND US IN ANY WAY RELATED TO OR CONCERNING THE AGREEMENT, OR OUR PROVISION TO YOU OF GOODS, SERVICES, OR UNITS ("CLAIM"). . . . IF YOU DO NOT REACH AGREEMENT WITH US WITHIN 30 DAYS, INSTEAD OF SUING IN COURT, YOU AGREE THAT ANY CLAIM MUST BE SUBMITTED TO FINAL, BINDING ARBITRATION . . . .
>
> Neither you nor we may be a representative of other potential claimants or a class of potential claimants in any dispute, nor may two or more individuals' disputes be consolidated in one proceeding. . . . YOU AND WE ACKNOWLEDGE AND AGREE THAT THIS SEC. 3 WAIVES ANY RIGHT TO A JURY TRIAL OR PARTICIPATION AS A PLAINTIFF OR AS A CLASS MEMBER IN A CLASS ACTION.

Pet. App. 36a-37a (capitalization in original). The arbitration agreement further provides that the arbitrator can award Laster the same relief and remedies as a court, and that T-Mobile would pay all of the arbitrator fees for claims under $25, and all arbitrator fees, except $25, for claims valued between

$25 to $1000. *Id.* Finally, the arbitration agreement provided that Laster could seek relief in small claims court. *Id.* The arbitration agreement is reproduced at Pet. App. 36a-38a.

b. Notwithstanding this agreement, in May 2005, Laster filed a class action in California state court. Her lawsuit advanced three causes of action arising from her purchase of a wireless phone and service.

First, she claimed that T-Mobile was liable under California's False Advertising Law, Cal. Bus. & Prof. Code § 17500. According to the First Amended Complaint, T-Mobile and other defendants "failed to adequately disclose the fact that sales tax would be charged on the full value of the phone," and where disclosure was made, as it was in Laster's case, "the type-size, font, and location of the disclosure" were inadequate. First Am. Compl. ¶ 36 (ER 48). Second, Laster claimed that T-Mobile violated California's Consumer Legal Remedies Act, Cal. Civ. Code § 1780, because its advertising with respect to her phone was an unfair method of competition and an unfair or deceptive act or practice. First Am. Compl. ¶ 42 (ER 49). Finally, Laster sought recovery under California's Unfair Competition Law, Cal. Bus. & Prof. Code § 17200. First Am. Compl. ¶ 48 (ER 50). In connection with these claims, Laster sought injunctive relief, restitution, compensatory damages, "punitive damages," and "all attorneys' fees and litigation expenses." *Id.* ¶¶ 44-46, 53 (ER 50, 53).

c. After removal to federal court, T-Mobile moved to compel arbitration under the FAA. Pet. App. 5a. The district court denied that motion, ruling first that the arbitration agreement was contained in a form contract, and was therefore, *per se*, procedurally unconscionable. *Id.* at 15a-16a.

Relying on the California Supreme Court's decision in *Discover Bank* v. *Superior Court*, 113 P.3d 1100 (Cal. 2005), the district court also ruled that the agreement was substantively unconscionable because it required individual arbitration – *i.e.*, it did not allow class-wide arbitration. The district court explained that under *Discover Bank*, "a classwide arbitration bar is unconscionable" if: "(1) the class action waiver is contained in a consumer contract of adhesion, in which small amounts of damages are at issue; and (2) 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." Pet. App. 20a.

Because plaintiff Laster alleged claims that involved individually "small amounts of money," and because she alleged (despite disclosures, including on her sales receipt, that she knew she was paying the tax) that charging consumers sales tax on the full retail value of the phone was a "scheme to mislead consumers," the district court concluded that Laster had satisfied the *Discover Bank* test. Pet. App. 20-21a. The district court dismissed as irrelevant evidence that plaintiffs had significant incentives to arbitrate their individual claims because, if successful, they would be entitled to attorneys' fees and costs. *Id.* at 21a-22a.

Finally, the district court adopted the conclusion from *Discover Bank* that the FAA did not preempt California law refusing to enforce individual arbitration because that court had invoked state unconscionability law. Pet. App. 24a. The court ruled that "unconscionability . . . may be employed as a principle of general applicability to invalidate an arbitration agreement without contravening § 2 of the FAA." *Id.*

d. The Ninth Circuit affirmed. It concluded, in an unpublished per curiam decision, that T-Mobile's arbitration agreement was "not substantively distinguishable" from an agreement that the Ninth Circuit had previously refused to enforce in *Shroyer* v. *New Cingular Wireless Services, Inc.*, 498 F.3d 976 (9th Cir. 2007). Pet. App. 2a. The panel below explained that *Shroyer* "rejected the argument that California law is preempted by the Federal Arbitration Act" and that it lacked "the authority to revisit the decision of a prior three-judge panel." *Id.* at 3a.

Specifically, in *Shroyer*, Judge Reinhardt, joined by Judges Nelson and Rymer, adopted the California Supreme Court's state-law unconscionability analysis in *Discover Bank*. *Shroyer* further held that the ability of a party to recover attorneys' fees and arbitration costs in individual arbitration did not alter the conclusion that individual arbitration was unconscionable under California law. 498 F.3d at 986. Finally, as to preemption under the FAA, the *Shroyer* Court adopted *Discover Bank*'s analysis and held that the FAA "does not bar federal or state courts from applying generally applicable state contract law principles and refusing to enforce an unconscionable class action waiver in an arbitration clause." *Id.* at 987.

REASONS FOR GRANTING THE PETITION

Review is warranted because this case squarely implicates a conflict on an important and recurring issue of federal law: Whether the FAA requires enforcement of agreements to arbitrate consumer disputes on an individual basis, or whether such agreements can be invalidated based on state-law policy in favor of class actions.

The California Supreme Court in *Discover Bank*, followed by the Ninth Circuit in *Shroyer* and other state supreme courts, have held that the FAA permits them to refuse to enforce the terms of agreements to arbitrate based on a state-law determination that the absence of class-action procedures available in litigation is "unconscionable." In stark contrast, the Third Circuit in *Gay* has ruled that to the extent state law holds that arbitration agreements are unconscionable because they lack class-wide procedures, then state law must give way to the requirements of the FAA. Since then, the Ninth Circuit has considered, but "declined to follow the holding in *Gay*." *Lowden* v. *T-Mobile USA, Inc.*, ___ F.3d ___, 2008 WL 170279, at *8 n.3 (9th Cir. Jan. 22, 2008). In contrast, other circuits have held that individual arbitration agreements involving claims by consumers must be enforced under the FAA. See *supra* at 3.

Further, the ruling below conflicts with this Court's decisions such as *Perry* v. *Thomas*, which ruled that a court may not rely upon the "uniqueness" of arbitration to hold that an arbitration agreement is "unconscionable." 482 U.S. 483, 493 n.9 (1987). This Court has explained that the FAA was enacted to ensure that arbitration remains a meaningful *alternative* to litigation. That is why the FAA requires not simply enforcement of arbitration, but enforcement of arbitration in accordance with the terms agreed to by the parties. See *Volt Info. Scis., Inc.* v. *Board of Trs.*, 489 U.S. 468, 479 (1989); 9 U.S.C. § 4.

The decision below threatens the continued viability of agreements to arbitrate in a broad range of consumer transactions. The benefits of arbitration as an alternative to litigation are lost when state law

requires that the procedures agreed to by parties in their contracts must give way to the more formal, expensive and time-consuming procedures found in courtroom litigation. Under the FAA, a state-law requirement that arbitration must replicate courtroom litigation is preempted.

Here, the arbitration agreement was deemed unenforceable even though (i) T-Mobile agreed to pay virtually all arbitrator costs, (ii) plaintiff could recover attorneys' fees if she prevailed on her claims, and (iii) plaintiff retained the option of filing suit in small claims court. Nevertheless, individual arbitration was ruled unenforceable because the parties agreed to an alternative to the complex, costly and time-consuming class-wide procedures in litigation and declined to subject their agreement to the "greater degree of court involvement" and "external supervision" necessary to implement class arbitration. *Discover Bank* v. *Superior Court*, 113 P.3d 1100, 1106 (Cal. 2005) (internal quotes omitted).

Resolution of this dispute is critical to the proper and uniform application of the FAA to the rights of tens of millions of consumers and businesses throughout the country. Individual dispute resolution lies at the heart of agreements to arbitrate that have been adopted by consumers and businesses across the country, including for banking, credit cards, internet sales, cable television, and wireless and wireline phone services. The decision below, however, threatens to undermine the ability of consumers and businesses to reject the delay and expense of traditional litigation in favor of "the simplicity, informality, and expedition of arbitration." *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 31 (1991).

If arbitration under the FAA is to remain a meaningful alternative to litigation, state law should not be permitted to bar enforcement of agreements to arbitrate simply because they do not provide for the same procedures associated with litigation. To require that arbitration mirror litigation in this fashion is nothing less than the "judicial hostility" that Congress intended to eliminate through the FAA.

I. THE DECISION BELOW IMPLICATES A CONFLICT AMONG STATE AND FEDERAL COURTS OVER THE ENFORCEABILITY OF INDIVIDUAL ARBITRATION UNDER THE FAA.

This case presents a conflict on the recurring question whether, under the FAA, courts may refuse to enforce private agreements to arbitrate that require individual resolution of claims by consumers. Resolution of this conflict is necessary to ensure that the rights of tens of millions of individuals and businesses are not made to depend on the prevailing interpretation of the FAA in a particular state or federal circuit.

a. The decision below adopts the analysis set forth by the Ninth Circuit in *Shroyer*, 498 F.3d 976, which, in turn, adopts the California Supreme Court's decision in *Discover Bank*, 113 P.3d 1100. Both *Shroyer* and *Discover Bank* hold that the FAA does not mandate enforcement of form agreements with consumers calling for individual arbitration. Pet. App. 2a-3a.

In *Discover Bank*, the California Supreme Court held that "at least in some circumstances, . . . class action waivers in consumer contracts of adhesion are unenforceable, whether the consumer is being asked

to waive the right to class action litigation or the right to classwide arbitration." 113 P.3d at 1103. That court further held that the FAA does not "preempt[] California law in this respect." *Id.*

In reaching that conclusion, the *Discover Bank* Court acknowledged that class-wide arbitration necessarily requires a "greater degree of court involvement" than traditional arbitration, and, in fact, was better characterized as a "*hybrid procedure* of classwide arbitration." *Id.* at 1106 (emphasis added). Under that "hybrid procedure," a "court would have to make initial determinations regarding certification and notice to the class, and if classwide arbitration proceeds it may be called upon to exercise a measure of external supervision in order to safeguard the rights of absent class members to adequate representation and in the event of dismissal or settlement." *Id.* (quoting *Keating* v. *Superior Court*, 645 P.2d 1192, 1209 (Cal. 1982)). Nevertheless, the "judicial intrusion" into private arbitration was appropriate, the court concluded, given the "important role of class action remedies in California law." *Id.*

Discover Bank disagreed with the rulings by other courts that the "potential availability of attorney fees to the prevailing party in arbitration or litigation ameliorates the problem posed by such class action waivers." *Id.* at 1109-10. In particular, the court rejected the Fourth Circuit's conclusion that the availability of attorneys' fees or other forms of redress, including "informal resolution," were "adequate substitute[s]" for the "class action or arbitration mechanism." *Id.* at 1110 (disagreeing with *Snowden* v. *Checkpoint Check Cashing*, 290 F.3d 631, 638 (4th Cir. 2002)).

Finally, the court rejected the argument that the FAA mandated enforcement notwithstanding contrary state policies in favor of class actions because "the FAA does not federalize the law of unconscionability or related contract defenses except to the extent that it forbids the use of such defenses to discriminate against arbitration clauses." *Id.* at 1112-13. Because California law favored class-wide litigation of certain consumer claims, the court concluded that imposition of a similar preference in favor of class-wide arbitration reflected no "discrimination" against arbitration. *Id.* at 1113.

The Ninth Circuit embraced *Discover Bank*'s analysis in *Shroyer* v. *New Cingular Wireless Servs., Inc.*, 498 F.3d 976 (9th Cir. 2007). Writing for the panel, Judge Reinhardt applied *Discover Bank*'s test and found that a class waiver in an arbitration agreement was unconscionable under California law to resolve the claims of a plaintiff who sought to represent a class of wireless phone consumers. *Id.* at 984-86. In doing so, the Ninth Circuit rejected Cingular's argument that its agreement to arbitrate "does not deter customers from arbitrating individual small-value claims" or "insulate Cingular from liability" even though Cingular had agreed to pay the full costs of arbitration and permitted recovery of attorneys' fees. *Id.* at 986.

Finally, the *Shroyer* court rejected the argument that the FAA preempted a finding that the agreement to arbitrate was unenforceable because it concluded that, as a blanket matter, "'unconscionability is a generally applicable contract defense [that] may be applied to invalidate an arbitration agreement without contravening § 2 of the FAA.'" *Id.* at 988 (quoting *Ting v. AT&T Corp.*, 319 F.3d 1126, 1150 n.15 (9th Cir. 2003)).

The First Circuit has likewise followed *Discover Bank* in ruling that an agreement to arbitrate individually was unenforceable with respect to federal and state antitrust claims because it denied consumers class-wide procedures. See *Kristian* v. *Comcast Corp.*, 446 F.3d 25, 59 (1st Cir. 2006). In doing so, the First Circuit held that enforceability of agreements to arbitrate is an issue of federal law because "state contract law doctrines, by operation of the FAA, become part of the federal substantive law of arbitrability." *Id.* at 63.

A number of state courts of last resort have followed *Discover Bank*'s and *Shroyer*'s basic approach to the enforcement of arbitration agreements under the FAA. Most recently, in *Scott* v. *Cingular Wireless*, 161 P.3d 1000 (Wash. 2007) (en banc), Washington's Supreme Court held that *all* class waivers in consumer arbitration agreements are unenforceable because "class actions are a critical piece of the enforcement of consumer protection law." *Id.* at 1006. The *Scott* Court also followed *Discover Bank* in holding that state law "striking a class action waiver in an arbitration clause does not violate the FAA." *Id.* at 1008.[1]

Three Justices dissented in *Scott*. They concluded that the majority approach "disfavors arbitration, contradicting the strong legislative public policy favoring arbitration of disputes embodied in the

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[1] Applying *Scott*, the Ninth Circuit has held that "T-Mobile's class action waiver is substantively unconscionable, and unenforceable, under Washington law," *Lowden* v. *T-Mobile USA, Inc.*, ___ F.3d ___, 2008 WL 170279, at *5 (9th Cir. Jan. 22, 2008), and that the FAA "does not preempt Washington's unconscionability law," *id.* at *7. In doing so, the Ninth Circuit was presented with and declined "to follow the Third Circuit's holding in *Gay*." *Id.* at *8.

Federal Arbitration Act." *Id.* at 1009 (Madsen, J., dissenting). The dissenters concluded that the "refusal to enforce this agreement as written is, without any doubt whatsoever, contrary to the federal policy favoring arbitration" and contrary to "the many courts that have rejected arguments that class action waivers are substantively unconscionable." *Id.* at 1014 (citing cases).[2]

b. In direct conflict with these cases, the Third Circuit in *Gay* v. *CreditInform*, ___ F.3d ___, 2007 WL 4410362 (3d Cir. Dec. 19, 2007), has ruled that state unconscionability law is preempted by the FAA to the extent that it would render individual arbitration of consumer claims unenforceable.

In *Gay*, a Pennsylvania consumer who had entered into a contract to purchase "credit repair services" challenged the provision of her agreement that required mandatory arbitration of any dispute "on an individual basis not consolidated with any other claim." *Id.* at *2. In spite of this agreement, Gay filed a class action advancing claims under the federal Credit Repair Organizations Act and the Pennsylvania Credit Services Act. *Id.* at *1. The district court compelled arbitration of Gay's claims.

On appeal, the Third Circuit affirmed. The court of appeals emphasized that "'[f]ederal law determines whether an issue governed by the FAA is referable to arbitration.'" *Id.* at *14 (alteration in original) (quoting *Harris* v. *Green Tree Fin. Corp.*, 183 F.3d

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[2] *See also Muhammad* v. *County Bank*, 912 A.2d 88, 99 (N.J. 2006) (following *Discover Bank* and holding that agreements to arbitrate individually were unconscionable and unenforceable under Section 2 of the FAA), *cert. denied*, 127 S. Ct. 2032 (2007); *accord Coady* v. *Cross Country Bank*, 729 N.W.2d 732 (Wis. Ct. App.), *review denied*, 737 N.W.2d 432 (Wis. 2007).

173, 178 (3d Cir. 1999)). As a "matter of pure federal common law," the court saw "no reason to conclude that the arbitration provision is unconscionable." *Id.* at *17 n.14. The Third Circuit acknowledged, however, that "two Superior court panels recognized that under Pennsylvania law, class actions are . . . of great public importance as the essential vehicle for vindicating consumer rights." *Id.* at *19 (citation and internal quotation marks omitted). The court explained, however, that "those cases are hardly the end point of our unconscionability analysis because we are concerned with the federal law that Congress set forth in the FAA; the federal law is controlling here and Pennsylvania law must conform with it." *Id.*[3]

Indeed, under binding precedent, "[w]hatever the benefits of class actions, the FAA 'requires piecemeal resolution when necessary to give effect to an arbitration agreement.'" *Id.* at *20 (alternation in original, emphasis omitted) (quoting *Moses H. Cone*, 460 U.S. at 20). The Third Circuit explained that although the "Pennsylvania cases are written ostensibly to apply general principles of contract law, they hold that an agreement to arbitrate may be unconscionable simply because it is an agreement to arbitrate." *Id.* Specifically, Pennsylvania unconscionability law was preempted by the FAA because the state decisions improperly "'rely on the unique-

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[3] The court also concluded that, under Virginia law, an agreement to "arbitrate disputes on an individual basis" does not "constitute an unconscionable bargain," *Gay,* 2007 WL 4410362, at *17, because even where plaintiffs "'lack the procedural right to proceed as part of a class, they retain the range of rights' created by the relevant statute . . . 'in individual arbitration proceedings.'" *Id.* (quoting *Johnson*, 225 F.3d at 373).

ness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable.'" *Id.* (quoting *Perry*, 482 U.S. at 492 n.9).

As a result, the Third Circuit ruled that it would not "apply state law" because to do so would "interfere with the appropriate application of the FAA." *Id.* at *21. The *Gay* Court noted that a contrary conclusion could extend "to arbitration provisions in all sorts of contracts between vendors of goods and services on the one hand and consumers on the other hand" and thus "result in a significant narrowing of the application of the FAA." *Id.* The Third Circuit rejected that course because "[i]f the reach of the FAA is to be confined then Congress and not the courts should be the body to do so." *Id.*[4]

Other federal circuits likewise have rejected the conclusion that individual arbitration denies consumers the ability effectively to vindicate their statutory claims even in cases involving relatively small amounts. The analysis by these federal courts conflicts directly with the California Supreme Court's and Ninth Circuit's conclusions that individual

[4] The Seventh Circuit has voiced similar skepticism about the use of "unconscionability" as a means for avoiding arbitration under the FAA. *See Oblix, Inc.* v. *Winiecki*, 374 F.3d 488, 491-92 (7th Cir. 2004) (rejecting on FAA grounds unconscionability challenge to arbitration agreement under California law because the state "routinely enforces limited warranties and other terms found in form contracts" and "[i]f a state treats arbitration differently, and imposes on form arbitration clauses more or different requirements from those imposed on other clauses, then its approach is preempted by § 2 [of the FAA]").

arbitrations are ineffective in resolving small claims by consumers.[5]

Thus, the Eleventh Circuit has held that a class waiver is not substantively unconscionable in a lawsuit involving claims based on small personal loans under federal law and Georgia RICO law. *Jenkins* v. *First Am. Cash Advance of Ga., LLC*, 400 F.3d 868, 878 (11th Cir. 2005), *cert. denied*, 546 U.S. 1214 (2006); see also *Randolph* v. *Green Tree Fin. Corp.*, 244 F.3d 814, 818 (11th Cir. 2001) (same). The *Jenkins* Court explained that the denial of a class-action mechanism was not unconscionable because the availability of attorney's fees under the arbitration agreement provided plaintiffs with effective access to legal representation, and therefore "arbitration agreements prohibiting class action relief do not necessarily choke off the supply of lawyers willing to pursue claims on behalf of debtors." 400 F.3d at 878 (internal quotation marks omitted).

The Eleventh Circuit's ruling in *Jenkins*, in turn, relied on the Fourth Circuit's decision in *Snowden* v. *Checkpoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002). There, the Fourth Circuit enforced an arbitration agreement and rejected the consumer's claim that the agreement was unconscionable on the alleged ground that "without the class action vehicle,

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[5] The First Circuit has noted the close relationship between these methods of analysis because "the unconscionability analysis always includes an element that is the essence of the vindication of statutory rights analysis." *Kristian*, 446 F.3d at 60 n.22; *see Faber* v. *Menard, Inc.*, 367 F.3d 1048, 1053 (8th Cir. 2004) (applying "vindication of statutory rights" analysis to assess unconscionability argument); *Booker* v. *Robert Half Int'l, Inc.*, 413 F.3d 77, 84 (D.C. Cir. 2005) (applying "vindication of statutory rights" analysis to assess enforceability of arbitration agreement applied to state law claims).

[plaintiff] will be unable to maintain her legal representation given the small amount of her individual damages." *Id.* at 638. The Fourth Circuit explained that plaintiff's fears about the loss of her legal representation were unfounded because "'[a]ttorneys' fees'" were recoverable by a prevailing plaintiff in arbitration. *Id.* at 638-39. The court of appeals further rejected the argument that "forcing consumers . . . to arbitrate consumer protection claims [was] against public policy relating to consumer protection." *Id.* at 639.

The Fourth Circuit's decision in *Snowden* expressly followed the Third Circuit's decision in *Johnson* v. *West Suburban Bank*, 225 F.3d 366 (3d Cir. 2000). In *Johnson*, the court of appeals, through Judge Becker, explained that although individual arbitration of consumer claims under the Truth in Lending Act ("TILA") "that might have been pursued as part of class actions potentially reduces the number of plaintiffs seeking to enforce the TILA against creditors, arbitration does not eliminate plaintiff incentives to assert rights under the Act." *Id.* at 374. Accordingly, the FAA mandated enforcement of individual arbitration. *Id.* at 374-75. *See also Livingston* v. *Associates Fin., Inc.*, 339 F.3d 553, 559 (7th Cir. 2003) (following *Johnson* and *Randolph* and compelling arbitration of agreement that precludes "class action arbitration" of TILA claims).

c. Resolution of this conflict is of critical importance because the enforceability of agreements to arbitrate individually under the FAA is an issue that affects the rights set forth in consumer agreements entered into by individuals and businesses across the country.

As noted, private agreements to arbitrate are protected by federal law because they provide for a

lower-cost, streamlined means of resolving disputes that benefits both individual consumers and businesses. Indeed, "Congress, when enacting [the FAA], had the needs of consumers, as well as others, in mind." *Allied-Bruce Terminix Cos.* v. *Dobson*, 513 U.S. 265, 280 (1995). Recognizing these benefits, arbitration agreements are contained in countless agreements between individual consumers and the businesses that compete to provide them internet service, cable service, banking and credit card services, computers and software, and wireless and wireline telephone service.

The decision below, however, adopts an interpretation of the FAA that undermines the enforceability of these ubiquitous agreements and threatens the mutual benefits that they provide to consumers and businesses. "Standard-form agreements are a fact of life," *Oblix, Inc.* v. *Winiecki*, 374 F.3d 488, 491 (7th Cir. 2004); they "reduce transaction costs and benefit consumers because, in competition, reductions in the cost of doing business show up as lower prices," *Carbajal* v. *H&R Block Tax Servs., Inc.*, 372 F.3d 903, 906 (7th Cir. 2004) (Easterbrook, J.). As the Seventh Circuit has explained, state law should not be permitted to trump federal law in this area because "[t]he cry of 'unconscionable!' just repackages the tired assertion that arbitration should be disparaged as second-class adjudication." *Id.* Indeed, legal commentators have explained that courts are applying new forms of "unconscionability" doctrine in an effort to strike down or rewrite agreements to arbitrate.[6]

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[6] *See* Michael G. McGuinness & Adam J. Karr, *California's "Unique" Approach to Arbitration: Why This Road Less Traveled Will Make All the Difference on the Issue of Preemption Under the Federal Arbitration Act*, 2005 J. Disp. Resol. 61, 62 (2005)

In this case, the district court and court of appeals applied *Shroyer* and *Discover Bank* to hold that individual arbitration of consumer disputes is "unconscionable" under California law and that the FAA's liberal policy in favor of enforcing arbitration agreements must give way to the requirements of state law. *Shroyer*, 498 F.3d at 988; *Discover Bank*, 113 P.3d at 1106. Likewise, the Washington Supreme Court and First Circuit both have followed *Discover Bank* and refused to enforce agreements to arbitrate that do not provide class procedures in claims involving consumers. See *Kristian*, 446 F.3d at 59-60; *Scott*, 161 P.3d at 1006.

In direct conflict, the Third Circuit in *Gay* has ruled that the enforceability of agreements to arbitrate is an issue of federal law and state unconscionability law cannot be used to avoid individual arbitration of consumer claims. *Gay*, 2007 WL 4410362, at *21. The Ninth Circuit, after expressly considering the Third Circuit's contrary analysis, "declined to follow the Third's Circuit's holding in *Gay*." *Lowden*, 2008 WL 170279, at *8 n.3.

Further, the suggestion that individual arbitration is "unconscionable" likewise cannot be reconciled with other decisions of the Third Circuit, as well as those

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("California has created a new brand of unconscionability. It is far more demanding—and it is unique to arbitration."); Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 Buff. L. Rev. 185, 186 (2004) ("increased receptivity to claims of unconscionability in the context of arbitration agreements suggests judicial hostility to arbitration"); Stephen J. Ware, *Arbitration and Unconscionability After Doctor's Associates, Inc. v. Casarotto*, 31 Wake Forest L. Rev. 1001, 1034 (1996) ("Judicial decisions apply unconscionability, and other common law doctrines, more aggressively to arbitration agreements than to other contracts.").

of the Fourth, Seventh, and Eleventh Circuits. Each of those federal circuits has held that that individual arbitration is enforceable under the FAA in cases involving small claims by consumers notwithstanding the absence of class-wide procedures of the sort required by *Shroyer* and *Discover Bank*. See*, e.g.*, *Johnson*, 225 F.3d at 373; *Jenkins*, 400 F.3d at 878; *Livingston*, 339 F.3d at 559; *Snowden*, 290 F.3d at 638-39.

Resolution of this conflict is of paramount importance because, as noted, the FAA governs the rights of tens millions of individuals and businesses across the country that have adopted agreements to arbitrate as an alternative to litigation in a broad range of transactions affecting interstate commerce. The enforceability of these agreements to arbitrate individually has been, and is being, challenged across the country based on *Discover Bank* and *Shroyer*, decisions which attempt to mask "judicial hostility" to individual arbitration under the cover of state-law "unconscionability."

The enforceability of these agreements should not be made to depend on which of the competing interpretations of the FAA has been adopted by a particular state or federal circuit. Accordingly, this Court should grant review in this case to ensure the uniform application of the FAA in an area of fundamental practical importance.

II. THE DECISION BELOW CONFLICTS WITH THIS COURT'S PRECEDENT.

Review also is warranted because the decision below conflicts with this Court's decisions on the fundamental relationship between the FAA and state-law substantive and procedural policies.

a. As this Court's decisions make plain, the FAA "creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate." *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 25 (1983). Under the FAA, "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Id.* at 24-25. That "liberal federal policy favoring arbitration" remains applicable "notwithstanding any state substantive or procedural policies to the contrary." *Id.* at 24.

To be sure, the FAA does not entirely displace state-law contract principles. Rather, Section 2 of the FAA provides that agreements to arbitrate "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. Thus, any treatment of arbitration agreements that is different from all other contracts is expressly forbidden, for "[a] state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of § 2." *Perry*, 482 U.S. at 493 n.9; see *Doctor's Assocs.*, 517 U.S. at 684, 687 (state law that required conspicuous disclosure of arbitration agreement preempted because it gave arbitration provisions a "suspect status"). Further, a court may not rely upon a state-law rule that applies to some, but not all, contracts as a basis for refusing to enforce an agreement to arbitrate. See *Southland Corp.* v. *Keating*, 465 U.S. 1, 16 n.11 (1984); *Perry*, 482 U.S. at 489-90.

b. Here, the Ninth Circuit's ruling, which adopts *Shroyer*, 498 F.3d at 984 – and with it *Discover Bank*,

113 P.3d at 1106 – conflicts with this Court's decisions. It conflicts with *Perry* because it is based upon the conclusion that an agreement to arbitrate is unconscionable because it does not provide class-wide procedures that might be available in litigation. That, however, is precisely what *Perry* explained was prohibited by the FAA: Reliance on the "uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." 482 U.S. at 493 n.9. It further conflicts with *Southland* because it adopts a standard applicable only to certain contracts, rather than a rule generally applicable to "any contract," as a basis for refusing to enforce the parties' agreement to arbitrate. See 465 U.S. at 16 & n.11.

In evaluating whether the FAA permits California law to refuse enforcement of the parties' agreement, the Ninth Circuit never addressed whether Laster could protect her rights under California law through individual arbitration. See, *e.g.*, *Shearson/Am. Express, Inc.* v. *McMahon*, 482 U.S. 220, 232 (1987) ("the streamlined procedures of arbitration do not entail any consequential restriction on substantive rights"). Indeed, the Ninth Circuit's decision in *Shroyer* makes plain that the availability of attorneys' fees and the payment of "the full cost of arbitration" by the defendant are, in that court's view, not relevant to a determination whether individual arbitration is unconscionable. 498 F.3d at 986. The court below followed *Shroyer*'s holding that an agreement to arbitrate individual claims was unconscionable based on the effect that it might have on the actions of third parties. *Id.* (asserting that few plaintiffs would pursue claims on an individual basis).

This Court, however, has explained that arbitration agreements must be enforced without regard to any effect on third parties. In *Moses H. Cone*, this Court explained that "an arbitration agreement must be enforced notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement." 460 U.S. at 20. Likewise, in *Dean Witter Reynolds, Inc.* v. *Byrd*, this Court held that principles of judicial efficiency must give way to the parties' agreement to arbitrate because "federal law *requires* piecemeal resolution when necessary to give effect to an arbitration agreement." 470 U.S. 213, 221 (1985) (internal quotes omitted).

Nor can the decision below be justified on the grounds, relied upon by *Shroyer* and *Discover Bank*, that California law mandates the availability of class-wide procedures for resolution of consumer claims both in litigation *and* arbitration. See *Shroyer*, 498 F.3d at 988 ("'[T]he principle that class action waivers are, under certain circumstances, unconscionable as unlawfully exculpatory is a principle of California law that does not specifically apply to arbitration agreements, but to contracts generally'") (quoting *Discover Bank*, 113 P.3d at 1112). To be sure, a state law that singles out arbitration for disfavored treatment directly violates the FAA. *Doctor's Assocs.*, 517 U.S. at 687. Under this Court's precedent, however, states cannot employ unconscionability principles to remake arbitration as the mirror image of litigation.

To the contrary, under the FAA, "parties are generally free to structure their arbitration agreements as they see fit," and to "specify by contract the rules under which that arbitration will be conducted." *Volt*, 489 U.S. at 479. The FAA favors

arbitration because it provides an alternative to litigation: a party "trades 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). The FAA mandates enforcement of an agreement to arbitrate even where the procedures chosen by the parties are different from those in litigation.

Insistence by states that arbitration replicate litigation undermines the role of arbitration as an alternative means of dispute resolution. Indeed, in *Discover Bank*, the California Supreme Court candidly acknowledged that its requirement of class-wide procedures in arbitration involving consumers would create a "hybrid" form of dispute resolution that "'would entail a greater degree of judicial involvement than is normally associated with arbitration.'" 113 P.3d at 1106. Under the FAA, Congress' "clear intent" was "to move the parties to an arbitrable dispute *out of court and into arbitration* as quickly and easily as possible." *Moses H. Cone*, 460 U.S. at 22 (emphasis added). State law cannot be used to pull parties who have agreed to arbitrate back into court.

In short, review also is warranted because the decision below conflicts with this Court's decision explaining that the FAA does not permit state contract law to condition enforcement of agreements to arbitrate on the parties' adoption of the procedures already available in litigation. *E.g.*, *Perry*, 482 U.S. at 493 n. 9; *Southland*, 465 U.S. at 16 & n.11.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

JAMES C. GRANT
SHELLEY M. HALL
STOKES LAWRENCE, P.S.
800 Fifth Avenue
Suite 4000
Seattle, WA 98104-3179
(206) 626-6000

CARTER G. PHILLIPS*
PAUL J. ZIDLICKY
PETER C. PFAFFENROTH
JAMES C. OWENS
SIDLEY AUSTIN LLP
1501 K Street, N.W.
Washington, D.C. 20005
(202) 736-8000

Counsel for Petitioners

* Counsel of Record

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