No. 19-875

IN THE

Supreme Court of the United States

OTO, LLC,

Petitioner,

v.

KEN KHO;
JULIE A. SU, CALIFORNIA LABOR COMMISSIONER,

Respondents.

On Petition for a Writ of Certiorari to the California Supreme Court

BRIEF OF WASHINGTON LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether the Federal Arbitration Act preempts a state from invalidating an arbitration agreement as substantively unconscionable on the ground that it provides procedural protections akin to civil litigation, rather than to the streamlined administrative proceeding that would be available under state law in the absence of the agreement.

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INTEREST OF *AMICUS CURIAE*[*]

Washington Legal Foundation is a nonprofit, public-interest law firm and policy center with supporters nationwide. WLF promotes free enterprise, individual rights, limited government, and the rule of law. It has appeared as *amicus curiae* before this Court in important Federal Arbitration Act cases. See, e.g., *Epic Systems Corp. v. Lewis*, 136 S. Ct. 1612 (2018); *DIRECTV, Inc. v. Imburgia*, 136 S. Ct. 463 (2015). It has also published many articles on arbitration—including articles on the California courts' struggles to follow this Court's FAA rulings—by outside experts. See, e.g., John F. Querio, *Courts in California Enable End-Run of Federal Arbitration Act by Expanding Obscure State Labor Law*, WLF Legal Backgrounder, www.bit.ly/2vNjfDn (June 16, 2017).

The FAA "establishes a federal policy favoring arbitration." *Shearson/Am. Exp. Inc. v. McMahon*, 482 U.S. 220, 226 (1987). To operate properly, however, the FAA must apply consistently across the nation. The California Supreme Court has repeatedly created *in*consistency. It has done so in this case, using its own precedents to flout *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011),

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[*] No party's counsel authored any part of this brief. No person or entity, other than Washington Legal Foundation and its counsel, helped pay for the brief's preparation or submission. At least ten days before the brief was due, WLF notified each party's counsel of record of WLF's intent to file the brief. Petitioner's counsel and Respondent Su's counsel consented in writing to the brief's being filed. Respondent Kho has filed a blanket consent to the filing of *amicus* briefs.

American Express Co. v. Italian Colors Restaurant, 570 U.S. 228 (2013), and other rulings by this Court. The California high court plainly needs to be told—again—how to apply the FAA. WLF urges this Court to grant review.

STATEMENT OF THE CASE

While working as a service technician for One Toyota of Oakland, Ken Kho signed an arbitration agreement. (Pet. App. 3a.) After OTO terminated his employment (*id.* at 93a), Kho filed a claim for unpaid wages with the California Labor Commissioner (*id.* at 5a). The Commissioner scheduled a hearing. (*Id.*) OTO, meanwhile, went to Superior Court to enforce the arbitration agreement. (*Id.*)

The Commissioner conducted the hearing—over OTO's objection and in its absence—and awarded Kho more than $150,000 in wages, liquidated damages, interest, and penalties. (*Id.*) The Superior Court vacated the award, concluding that the Commissioner should not have proceeded without OTO (*id.* 141a-143a); but it denied OTO's motion to compel arbitration (*id.* at 127a-140a). The Court of Appeal reversed the order on arbitration and, in consequence, saw no need to consider the order vacating the Commissioner's award. (*Id.* at 92a-119a.)

California's administrative wage-dispute procedure has several employee-friendly features. The pleading process is streamlined; no discovery occurs; simplified rules of evidence apply; the officer who presides at the hearing—known as a "Berman" hearing—may tutor the employee in basic aspects of

the law; and a translator attends the hearing, free of charge, when needed. (*Id*. at 8a.) Appeals go to the Superior Court. Although the court reviews the Commissioner's ruling *de novo*, a one-way fee-shifting rule requires an employer-appellant to pay attorney's fees to the employee if the court awards her so much as a single cent. (*Id*. at 9a.)

The arbitration agreement Kho signed set forth procedures that look less like the Berman process, and more like conventional civil litigation. The arbitration would be conducted by a retired California trial judge, who would apply the normal pleading rules, allow discovery, and enforce the state's evidence code and much of its code of civil procedure. (*Id*. at 4a.) In accord with *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83 (2000), OTO would cover most of the arbitration's cost. (*Id*. at 28a.) Attorney's fees could be awarded under state-law rules friendly to Kho (though not quite as friendly to him as under the Berman rules). (*Id*. at 29a-30a.)

Homing in on the differences between the administrative wage-dispute rules and the OTO arbitration-agreement rules, the California Supreme Court, in a 6-1 ruling, reversed. The court found that the arbitration agreement was both procedurally and substantively unconscionable. The court gave a nod to the traditional "shocks the conscience" standard of unconscionability. (*Id*. at 20a.) Concluding, however, that the "agreement's execution involved an extraordinarily high degree of procedural unconscionablility"—a notion that Justice Chin, in dissent, vigorously disputed (*id*. at 48a-55a)—the court, breaking new ground, ruled that it could toss the

agreement based on "a relatively low degree of substantive unconscionability" (*id.* at 14a).

The court centered its analysis of substantive unconscionability around a discussion of "what Kho gave up and what he received in return." (*Id.* at 31a.) The Berman process was treated, in other words, as the standard against which the arbitration agreement was to be judged. The civil litigation-like procedures in the agreement were not, in the court's view, as advantageous to Kho as the Berman process. The agreement's ordinary litigation rules created a "barrier," therefore, to the "vindication" of Kho's state-law rights. (*Id*. at 33a.) The upshot was that Kho had entered "an unfair bargain" that could be set aside. (*Id*. at 31a.)

Even the majority, Justice Chin noted in dissent, acknowledged that the arbitration agreement's procedure was "carefully crafted to ensure fairness on both sides." (*Id*. at 79a.) Justice Chin objected to striking down the agreement simply because, in the majority's view, that procedure was "not *as* advantageous for Kho as the Berman procedure." (*Id*.) Although it tried "to disguise [it]s obvious preference for the Berman procedure under the cloak of unconscionability," Justice Chin wrote, the majority could not hide that its ruling impermissibly "frustrate[d] the FAA's purpose to ensure that private arbitration agreements are enforced according to their terms." (*Id*. at 85a (quoting *Concepcion*, 563 U.S. at 347 n.6).)

SUMMARY OF ARGUMENT

The Supremacy Clause is simple. It says that federal law trumps contrary state law. Const. art. VI, cl. 2. The FAA is simple too. It says that an arbitration clause in a contract involving commerce is valid and enforceable. 9 U.S.C. § 2. True, the FAA contains a saving clause, but it as well is pretty unpretentious. It says that an arbitration clause may be invalidated based on any ground "for revocation of any contract"—based, that is, on a generally applicable contract defense. *Id*. Like every other area of law, arbitration law is sure to generate the occasional thorny question. On the whole, however, arbitration clauses should cause little fuss in state court. Enforce them, Congress has instructed, unless you spot one that is a sham, a fraud, a travesty, or the like.

For years now the California Supreme Court has insisted on making things complex. It has upheld state laws that disfavor arbitration; invented reasons to let state law obstruct the FAA; created rules that apply only to arbitration clauses; and, when applying ostensibly neutral rules, held arbitration agreements to a higher standard. None of this is allowed under the FAA, and this Court has repeatedly said so. Yet the California high court just can't (or won't) keep it simple.

The decision below is another new cog in the California justices' Rube Goldberg approach to arbitration. The arbitration agreement here is not a sham, a fraud, a travesty, or the like. No one could claim otherwise with a straight face. Yet the California Supreme Court still declared the

agreement unconscionable. Why? Because it offers the signatories *too much* procedure. Because it offers dispute resolution that *too closely* resembles ordinary civil litigation. As every law student learns, the unconscionability defense excuses a party from complying with a contract clause that "shocks the conscience." The court below concluded, in effect, that it "shocks the conscience" to resolve a wage dispute using the rules that govern ordinary legal disputes. That is mind-bending.

The California high court reached its desired destination by setting its state's administrative mechanism for resolving wage disputes, the Berman procedure, as the standard by which the fairness of a wage-dispute arbitration clause is to be judged. The court declared the arbitration agreement here invalid, not because it flunked some objective test of unconscionability, but because by the court's lights it did not compare favorably to the court's state-law-centric Berman-process benchmark. As OTO explains in its petition, the California Supreme Court's ruling fails to place "arbitration clauses"—in particular, wage-dispute arbitration clauses—"on equal footing with all other contracts." *Imburgia*, 136 S. Ct. at 468 (quoting *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006)). The decision below is markedly out of step with the FAA and this Court's precedents. The Court should dispatch it.

We write in part to emphasize the breadth of the California Supreme Court's holding. Although the court claimed to limit its ruling to cases where an employer uses "unusually coercive" means to obtain an employee's consent to arbitration, no one who reads the opinion carefully, and who knows the

context in which it arises, can reasonably expect that qualification to have any bite. Well aware that the FAA blocks it from banning wage-dispute arbitration outright, the California Supreme Court has plainly tried to thread the needle, imposing a *de facto* ban without saying so in as many words.

The decision below is one of many by the California Supreme Court that misapply the FAA. Some of these decisions this Court has reversed; others have so far slipped by. Unfortunately, the California high court often makes a heroic effort to explain that this Court's latest and plainest word on arbitration—a word not infrequently written while reversing a decision out of California—has little or no effect on California's separate and not-so-simple body of arbitration law. *Concepcion*, 563 U.S. 333, for instance, says that a court must treat an arbitration clause like other contracts. And *Italian Colors*, 570 U.S. 228, strongly suggests—and its dissenting opinion asserts explicitly—that a court may not treat an arbitration clause *un*like other contracts as part of an effort to "vindicate" a state law or policy. Yet in *Sonic-Calabasas A, Inc. v. Moreno*, 57 Cal. 4th 1109 (2013) (*Sonic II*), the California Supreme Court distorted *Concepcion* and narrowed *Italian Colors* beyond recognition. The court then concluded, quite implausibly, both in *Sonic II* and elsewhere, that various of its own special arbitration rules survive both decisions. That mischief, in turn, left it free in this case to follow its usual routine, using rigged standards and discredited doctrines to disfavor arbitration. Not only should this Court grant review and reverse; it should tell the California high court to stop putting curlicues on this Court's straightforward FAA decisions.

We will also discuss the occasional subtlety of the California courts' bias against arbitration clauses. Although those courts often use a purportedly general rule—the unconscionability doctrine—to void an arbitration clause, a review of the case law as a whole reveals that they are "covertly . . . disfavoring contracts that (oh so coincidentally) have the defining features of arbitration agreements." *Kindred Nursing Ctrs. Ltd. P'ship v. Clark*, 137 S. Ct. 1421, 1426 (2017). This Court should remind California's courts once again of the FAA's demand that neutral rules be applied neutrally.

REASONS FOR GRANTING THE PETITION

I. THE DECISION BELOW IS A THINLY VEILED EFFORT TO BAR WAGE-DISPUTE ARBITRATION ALTOGETHER.

Before getting to the California Supreme Court's record of antipathy to the FAA, it is worth briefly clarifying what its most recent anti-arbitration ruling holds.

In the decision below, the California Supreme Court insisted that it was not banning arbitration agreements that deviate from the Berman process. Just "this particular agreement" was invalid, the court said, because it combined a deviation from the Berman process with an "unusually coercive" effort, by OTO, to get Kho to sign the agreement. (Pet. App. 31a.) Justice Chin disputed the notion that anything "unusual" occurred here. (*Id.* at 48a-55a.) But in any event, the court's finding of "extraordinary" procedu-

ral unconscionability (*id.* at 14a), and consequent lowering of the substantive-unconscionability threshold (*id.*), was a red herring.

Although the court "stress[ed]" that a "waiver of Berman procedures does not, by itself, render an arbitration agreement unconscionable" (*id.* at 21a), the rest of the decision gives every impression that, to the contrary, arbitration clauses that depart from the Berman procedure are now prohibited. In the California Supreme Court's view, an employee should not have to "surrender the benefits . . . of the Berman process" without receiving adequate "efficiencies or cost savings" in arbitration. (*Id.* at 25a.) Given their entrenched hostility to arbitration—more on that to follow—it is fair to assume that the California justices will not deviate from this conclusion just because an employer is careful to give an employee lots of time to read a well-written arbitration clause laid out in big print. As Justice Chin put it, "the majority's assurance that an identical arbitration provision 'might pass muster under less coercive circumstances' rings hollow." (*Id.* at 47a.)

Indeed, although *Sonic I* (*Sonic-Calabasas A, Inc. v. Moreno*, 51 Cal. 4th 659 (2011), vacated 565 U.S. 973 (2011)) held that the Berman process cannot be waived, the California Supreme Court acknowledged, in *Sonic II*, that that approach is foreclosed by *Concepcion*, 563 U.S. 333. So the California high court's "stress[ing]" that it was not creating a blanket bar on wage-dispute arbitration looks like so much fig-leafing over the fact that, actually, it aimed to do precisely that.

The state high court's attempt to "vindicate" state law, at the FAA's expense, further reveals the court's true goal. The Berman process is, of course, a state-law innovation. In holding that process up as the standard by which the arbitration agreement in question was to stand or fall, the court declared that arbitration may not act as a "barrier[] to the vindication" of Kho's rights under state law. (*Id.* at 26a.) The court then discussed at length the benefits of the Berman process. (E.g., *id.* at 26a-28a.) Those benefits were, in fact, the focus of the court's analysis (hardly surprising, given the alternative of trying to explain how ordinary litigation raises unconscionable barriers to the "vindication" of state-law rights). The decision is best understood, therefore, as holding that arbitration may not serve as a "barrier" to the "vindication" of an employee's state-law right to *the Berman process itself*.

II. THE CALIFORNIA SUPREME COURT NEEDS GUIDANCE ON APPLYING *CONCEPCION* AND *ITALIAN COLORS*.

For decades this Court has been reversing California court rulings that discriminate against arbitration. In spite of these frequent reversals, the California Supreme Court has persisted in giving the FAA short shrift. *Concepcion*, which bluntly demands compliance with the FAA, and *Italian Colors*, which forecloses the "vindication" method of bypassing the FAA, should have resolved almost every doubt about the FAA's scope and brought the California high court into line. But so far they haven't. If anything, California's outlier status has become even clearer.

A. The California Supreme Court Misinterprets The FAA.

Even before *Concepcion* and *Italian Colors*, it should have been obvious to the California Supreme Court that under federal law, an arbitration agreement must be treated like any other contract. As far back as *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987), this Court declared:

> A court may not . . . construe [an arbitration] agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law. Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable.

At issue in *Perry*, it is worth noting, was a California law that removed wage disputes from arbitration. In declaring that law preempted by the FAA, *Perry* rejected the state legislature's naked attempt to do precisely what the state high court did, by only slightly more subtle means, here.

Perry is, in fact, one in a series of pre-*Concepcion*/*Italian Colors* cases reversing a California court's misreading of the FAA. See *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984) (the FAA preempts a California law exempting franchise disputes from arbitration; contrary holding of the California Supreme Court reversed); *Perry*, 482 U.S. at 489-92 (the FAA preempts a California law exempting wage disputes from arbitration; contrary holding of the California Court of Appeal reversed); *Preston v. Ferrer*, 552 U.S. 346, 356 (2008)

(the FAA preempts a California law transferring certain disputes from arbitration to the state labor commissioner; contrary holding of the California Court of Appeal reversed).

Several of the California Supreme Court's pre-*Concepcion*/*Italian Colors* decisions—even apart from the ones this Court reversed—plainly disfavor arbitration agreements. *Armendariz*, 24 Cal. 4th 83, for example, creates criteria that arbitration agreements, but not other contracts, must satisfy to remain valid. "The *Armendariz* requirements," the California high court has openly acknowledged, "specifically concern arbitration agreements." *Little v. Auto Stiegler, Inc.*, 29 Cal. 4th 1064, 1079 (2003). And much as the decision below allows the state legislature to excuse from arbitration a group of litigants who enjoy special procedural privileges, *Broughton v. Cigna Healthplans of California*, 21 Cal. 4th 1066, 1083 (1999), empowers it to remove from arbitration all private civil remedies that can be understood to serve a public interest.

The pre-*Concepcion*/*Italian Colors* decisions draw heavily on an "effective vindication" theory—and a similar "inherent conflict" theory—found in this Court's FAA jurisprudence. The Court has said that the FAA applies "so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985). The FAA might *not* apply, in other words, when "an inherent conflict" exists "between arbitration and [a] statute's underlying purpose." *Shearson*, 482 U.S. at 226-27.

But this exception applies only when the FAA runs into "a contrary *congressional* command." *Id.* at 226 (emphasis added). After all, only a federal law can displace another federal law. The Supremacy Clause demands that a state law not be "vindicated" at a federal law's expense, and that an "inherent conflict" between a state law and a federal law not be resolved in the state law's favor. Yet long before it did so in the decision below, the California Supreme Court repeatedly used the "vindication" rationale to raise state law above the FAA. See *Broughton*, 21 Cal. 4th at 1083 ("[the state] legislature may restrict a private arbitration agreement when it inherently conflicts with a public statutory purpose"); *Armendariz*, 24 Cal. 4th at 101 (a party must "be able to fully vindicate his or her [state] statutory cause of action in the arbitral forum").

B. *Concepcion* and *Italian Colors* Confirm And Highlight The California Supreme Court's Errors.

Any lingering confusion about the need to treat an arbitration agreement like any other contract, or about the vindication theory's inapplicability to state law, should have been laid to rest by *Concepcion* and *Italian Colors*.

A court, *Concepcion* declares, "must place arbitration agreements on an equal footing with other contracts." 563 U.S. at 339 (quoting *Buckeye*, 546 U.S. at 443). A state law that "prohibits outright the arbitration of a particular type of claim" is, therefore, "displaced by the FAA." *Id.* at 341. So is a rule that has "a disproportionate impact on arbitration agreements." *Id.* at 342. And so is a rule

that "rel[ies] on the uniqueness of an agreement to arbitrate." *Id.* at 341 (quoting *Perry*, 482 U.S. at 493 n.9).

Concepcion is, by the way, yet another of this Court's decisions striking down yet another of California's many efforts to limit arbitration. The Court lamented the "great variety of devices and formulas" that some courts, in their "hostility towards arbitration," have invented to "declar[e] arbitration against public policy." *Id.* at 342. And California's courts in particular, the Court noted, seem "more likely to hold contracts to arbitrate unconscionable than other contracts." *Id.* (citing Stephen A. Broome, *An Unconscionable Application of the Unconscionability Doctrine: How the California Courts are Circumventing the Federal Arbitration Act*, 3 Hastings Bus. L.J. 39, 54, 66 (2006), and Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 Buffalo L. Rev. 185, 186-87 (2004)).

Italian Colors discusses the "judge-made" "vindication exception" to the FAA. 570 U.S. at 235. The exception "originated as dictum," the Court observed, and, every time it has come up, the Court "has declined to apply it to invalidate the arbitration agreement at issue." *Id.* More than that: in *Italian Colors* all nine justices treated the exception as one that governs *federal* law. *Id.* at 235 n.2; see also *id.* at 240-41, 252 (Kagan, J., dissenting).

C. After *Concepcion* And *Italian Colors*, The California Supreme Court Continues To Misinterpret The FAA.

Concepcion and *Italian Colors* make three things clear. A state may not (1) subject an arbitration agreement to special rules, (2) use ostensibly neutral rules to disfavor an arbitration agreement, or (3) invalidate an arbitration agreement in order to "vindicate" a state-law-created public policy. In the decision below, the California Supreme Court elided each of these principles. It openly acknowledged using a "different approach" for wage-dispute arbitration clauses (Pet. App. 26a); it applied to the arbitration agreement before it a funhouse-mirror sense of unconscionability; and its overriding aim was plainly to vindicate the state-law Berman process.

But the decision at hand is no one-off. It is the latest in a string of post-*Concepcion*/*Italian Colors* decisions in which the California high court has "thumbed its nose at the Federal Arbitration Act and this Court." (Pet. at 2.)

Begin with *Sonic II*, 57 Cal. 4th 1109, which claims that *Concepcion* instructs a court merely to protect the "fundamental attributes of arbitration," *id.* at 1143-45, 1151. This reading is flatly contradicted by *Concepcion* itself. A rule of unconscionability could easily have "a disproportionate impact on arbitration agreements" (forbidden under the real *Concepcion*) without interfering with arbitration's "fundamental attributes" (the only constraint in *Sonic II*'s version of the case). 563 U.S. at 342; 57 Cal. 4th at 1143. Look no further than the

result in *Sonic II*, which requires that an employee receive a wage-dispute arbitration hearing at least as "accessible" and "affordable" as a Berman hearing before a deputy labor commissioner. 57 Cal. 4th at 1150. Enforcing this requirement clearly disfavors and disproportionately affects arbitration agreements. In singling out, and treating as suspect, any arbitration clause that does not confer the benefits of a Berman hearing (e.g., a free translator for the employee), *Sonic II* defies *Concepcion*. *Id*. at 1146.

Sonic II also relies heavily on the vindication theory. In fact, the decision frames the issue before the court as "whether any barrier to vindicating" the employee's "right to recover unpaid wages" would "make the arbitration agreement unconscionable." *Id*. at 1142.

The California Supreme Court again misapplied *Concepcion* and *Italian Colors* in *Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th 348 (2014). At issue was California's Private Attorney General Act, which empowers an employee to sue her employer for state labor code violations against her and other employees. A PAGA lawsuit is "a type of *qui tam* action"; 75 percent of a recovery goes to the government. *Id*. at 380, 382. *Iskanian* thus concludes that "a PAGA claim lies outside the FAA's coverage" because "it is a dispute between an employer and the *state*." *Id*. at 386. But this begs the question. An *employee* signs a contract waiving PAGA rights. Regardless of whom a California court says a PAGA action is ultimately "between," *that* employee has agreed, by contract, not to be the one driving such a lawsuit. State law can reverse that

employee's agreement only by using state public policy to override the FAA.

The state high court continued to misapply the vindication theory in *McGill v. Citibank, N.A.*, 2 Cal. 5th 945 (2017). *McGill* describes *Italian Colors* as teaching that "the FAA does not require enforcement of a provision in an arbitration agreement that . . . eliminates the right to pursue a statutory [right or] remedy." *Id*. at 963. Having thus denuded the vindication exception of its federal-law grounding, *McGill* concludes that the FAA must yield to a state public policy barring an arbitration-clause waiver of the right to seek injunctive relief under various state consumer-protection laws. *Id*. at 952, 963.

The California Supreme Court has taken an "any stick to beat a dog" approach to striking down arbitration clauses. As the FAA, *Concepcion*, and *Italian Colors* show, that approach is untenable.

III. THE CALIFORNIA COURTS NEED A REMINDER THAT ARBITRATION AGREEMENTS MUST NOT BE SUBJECTED TO A SPECIAL STANDARD OF UNCONSCIONABILITY.

Although many of the contradictions between the California Supreme Court's arbitration jurisprudence and the *Concepcion* and *Italian Colors* decisions are clear, it is important not to overlook the California courts' more general distortion of the unconscionability doctrine as applied to arbitration agreements.

"It is well known that unconscionability is generally a loser of an argument." Aaron-Andrew P.

Bruhl, *The Unconscionability Game: Strategic Judging and the Evolution of Federal Arbitration Law*, 83 N.Y.U. L. Rev. 1420, 1442 (2008). This is unsurprising, given the rigor of the classic unconscionability test. Under the traditional rule, an unconscionable contract is one that "no man in his senses, not under duress, would make," and that "no fair and honest man would accept." *Hume v. United States*, 132 U.S. 406, 406 (1889). A contract is unconscionable, in other words, if it "shock[s] the conscience." *Eyre v. Potter*, 56 U.S. 42, 60 (1853).

The "shocks the conscience" phrase is still alive in California. (Pet. App. 20a.) But the words "so one-sided as to shock the conscience" are now used in tandem with—and are even declared to mean the same thing as—the self-evidently weaker words "unreasonably one-sided." *Sonic II*, 57 Cal. 4th at 1159-60. This muddying of the standard may or may not be a deliberate part of a push by California's courts to apply a looser unconscionability test to arbitration agreements. But a looser test they have unmistakably applied—a test that has in turn encouraged ever more attacks on arbitration clauses. Consider a pre-*Concepcion* study. It found that in a three-year period, three California appellate districts addressed unconscionability in 119 cases. Paul Thomas, Note, *Conscionable Judging: A Case Study of California Courts' Grapple with Challenges to Mandatory Arbitration Agreements*, 62 Hastings L.J. 1065, 1083 (2011). The courts found unconscionability in 50.6% of the arbitration cases, but in only 16.7% of the non-arbitration cases. *Id.* And, remarkably, three out of four cases in the sample involved an arbitration agreement. *Id.*

And California's courts continue to strike down arbitration clauses at a rapid clip. Many post-*Concepcion*/*Italian Colors* decisions use discriminatory rules targeting arbitration, the vindication theory, or both to declare an arbitration agreement unconscionable. See, e.g., *Ramos v. Superior Court*, 28 Cal. App. 5th 1042, 1060-62, 1064-67 (2018); *Penilla v. Westmont Corp.*, 3 Cal. App. 5th 205, 221, 223 (2016); *Pinela v. Neiman Marcus Group, Inc.*, 238 Cal. App. 4th 227, 250-56 (2015); *Serafin v. Balco Properties Ltd., LLC*, 235 Cal. App. 4th 165, 183 (2015); *Carmona v. Lincoln Millennium Car Wash, Inc.*, 226 Cal. App. 4th 74, 85-89 (2014).

The use of a distinct and more severe unconscionability test to disfavor arbitration clauses can be subtle. An egregiously one-sided contract can, after all, be unconscionable even under the conventional unconscionability rule. But as the abiding ubiquity of arbitration clauses in the California courts' unconscionability jurisprudence shows—and as the words-have-no-meaning version of the term "unconscionable" employed in this case confirms—the conventional rule and the California arbitration-clause rule are not the same.

One factor creating the divide between the shocking unfairness needed under the conventional unconscionability test, on the one hand, and the mild unfairness needed under California's special test for arbitration clauses, on the other, is the matter of *ex ante* benefits. Under California law, a court may void a contract that was unconscionable "at the time it was made." Cal. Civ. Code § 1670.5(a); Restatement (Second) of Contracts § 208 (same). A key aspect of a form arbitration agreement, *when it is made*, is the

benefits it stands to provide to the many contracting parties who never have a dispute. The use of arbitration lowers a company's dispute-resolution costs, and these cost-savings are generally passed on in the form of higher salaries for employees and lower prices for consumers. Cf. *Carnival Cruise Line, Inc. v. Shute*, 409 U.S. 585, 593-94 (1991) (discussing the *ex ante* benefits of a form contract's forum selection clause). An unconscionability analysis that ignores these gains has a "glaring flaw." Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. Chi. L. Rev. 1203, 1273-74 (2003).

Consider the point this way: a company pays for its arbitration rights. OTO "paid [Kho] to do a number of things; one of the things it paid [him] to do was agree to non-judicial dispute resolution." *Oblix, Inc. v. Winiecki*, 374 F.3d 488, 491 (7th Cir. 2004) (Easterbrook, J.). Viewed *ex ante*, the arbitration agreement Kho signed is no more suspect, and no less enforceable, than an agreement setting forth his other conditions of employment. *Id.*

California's courts are perfectly capable of conducting this type of examination. Take *Chretian v. Donald L. Bren Co.*, 151 Cal. App. 3d 385 (1984). A real-estate developer contracted to pay a salesperson one commission for finding a house buyer, and another for "servicing" the buyer's purchase "through successful close of escrow." *Id.* at 388. After resigning, the salesperson sued for the second commission on each of his sales for which escrow was *pending*. The salesperson argued that the "servicing" portion of his job was "perfunctory," and that his contract was therefore unconscionable to the extent

it permitted the developer to withhold the second commissions on the uncompleted sales. Disagreeing, the Court of Appeal insisted that the contract be "examined prospectively." *Id.* at 389. Looking at the contract this way made it clear that the developer had "negotiated the second commission as a financial incentive for its salespersons to remain with [it] during pendency of escrows." *Id.* The court took account of this *ex ante* incentive, notwithstanding the plaintiff's choice to ignore it by resigning. *Id.*; see also *Am. Software, Inc. v. Ali*, 46 Cal. App. 4th 1386, 1392-94 (1996) (similar).

When it comes to arbitration agreements, however, this type of inquiry into *ex ante* benefits generally disappears from the California Reports. *Armendariz*, 24 Cal. 4th 83, creates arbitration-only criteria that exclude consideration of such benefits by definition. 24 Cal. 4th at 102, 117-18, 124. *Sonic II* discusses only the expected *expenses* that exist when an arbitration agreement is signed. 57 Cal. 4th at 1164. And the decision below discusses what procedural rights Kho "surrendered" (Pet. App. 26a, 31a), and what procedural rights he "received in return" (*id.*), but not what he might have gained in the form of better perks or higher wages from the widespread use of arbitration.

It is clear, in short, that in California's courts, "'unconscionable' means something quite different when the validity of an arbitration agreement is at issue." Broome, supra, 3 Hastings Bus. L.J. at 67. The Court should put an end to that discrimination. The FAA—and the Supremacy Clause—demands it.

CONCLUSION

The petition should be granted.

Respectfully submitted,

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