No. 19-875

In the Supreme Court of the United States

OTO, L.L.C., PETITIONER

v.

KEN KHO; LILIA GARCIA-BROWER,
CALIFORNIA LABOR COMMISSIONER

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF CALIFORNIA

REPLY BRIEF FOR THE PETITIONER

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Respondents seek to defend the indefensible. In the decision below, the California Supreme Court declined to enforce a contract to arbitrate wage disputes based on a substantive unconscionability rule that is unquestionably applicable only to such arbitration agreements. In so doing, that court once again ignored this Court's clear and repeated mandates that the Federal Arbitration Act preempts state rules that discriminate against arbitration, whether by failing to place arbitration agreements on an equal footing with other agreements or by erecting preliminary litigating hurdles that undermine the key features of arbitration.

In an effort to evade further review, respondents simply rewrite the decision below, asserting that the California Supreme Court did nothing more than apply a general contract defense in an evenhanded manner. But the California Supreme Court admitted that it was adopting a comparative approach to substantive unconscionability unique to agreements to arbitrate wage disputes. That is precisely what this Court's line of decisions on the equal-treatment principle forbids.

Despite respondents' efforts to suggest otherwise, the California Supreme Court's comparative approach also erects a preliminary litigating hurdle barred by the FAA. That approach requires a fact-intensive analysis that necessarily interferes with the speed and efficiency of arbitration, as illustrated by the *four years* it took the California courts in this case to adjudicate the threshold question whether the claims were subject to arbitration.

Unable to save the decision below from itself, respondents seek to diminish the importance of this case, emphasizing the California Supreme Court's determination that the agreement at issue was procedurally unconscionable. But under California law, procedural unconscionability is insufficient to render an agreement invalid. The California Supreme Court's holding on substantive unconscionability was outcome-dispositive, and the ramifications of that holding reach well beyond the context of this case. Respondents have no answer to the Catch-22 the decision below creates for California employers seeking to adopt arbitration procedures covering wage disputes.

In short, there is no valid defense of the decision below, and no valid impediment to this Court's review. The Court should grant the petition for writ of certiorari to enforce its clear precedents and again invalidate an anti-arbitration rule devised by a state court whose hostility to arbitration is no longer open to reasonable debate.

A. The Decision Under Review Is Erroneous

Not for the first time, the California Supreme Court has defied this Court's mandate that arbitration agreements cannot be invalidated based on legal rules that overtly or covertly discriminate against arbitration. *AT&T Mobility LLC* v. *Concepcion*, 563 U.S. 333, 339 (2011); see Pet. 4-5; Cato Br. 5-9, 11-14. In the decision below, the California Supreme Court contravened the equal-treatment principle by applying a rule specific to arbitration agreements covering wage disputes. The court deemed the agreement at issue substantively unconscionable because the contemplated arbitration procedures were not as streamlined as the administrative proceeding that would be available to resolve wage disputes under state law absent the agreement. What is more, the court explicitly recognized that the comparative approach it adopted was "different" from the approach taken in other contexts, including even the "arbitration of other types of disputes." Pet. App. 13a, 26a.

Respondents' various defenses of the California Supreme Court's reasoning lack merit.

1. Respondents first seek to recharacterize the California Supreme Court's decision as a benign application of a "generally applicable contract defense to the particular circumstances of this case in an evenhanded manner." Comm'r Br. in Opp. 11; see Kho Br. in Opp. 18-20. That characterization is simply wrong.

a. As an initial matter, the Labor Commissioner suggests (Br. in Opp. 14-16) that at least one aspect of the California Supreme Court's substantive-unconscionability analysis did not involve a comparison to the Berman process. But that suggestion cannot be squared with the court's own explanation that "[t]he substantive fairness of this particular agreement must be considered in terms of

what Kho gave up and what he received in return." Pet. App. 31a.

In any event, as Kho acknowledges (Br. in Opp. 13), the only purportedly non-comparative aspect of the court's substantive-unconscionability analysis that the Commissioner identifies—that "the [arbitration] agreement does not explain how to initiate arbitration," Pet. App. 21a—is in fact comparative. The California Supreme Court expressly deemed that feature of the agreement to be "unlike," and "[i]n contrast" to, the Berman process. *Id.* at 21a-22a.

Contrary to the Commissioner's assertion, moreover, the California Supreme Court did not conclude that the agreement's silence on how to initiate arbitration "block[ed] a claimant from *all* avenues for resolving disputes," thereby triggering the effective-vindication exception to the FAA. Br. in Opp. 15. Nor could the court have so concluded: the mere absence of information on the initiation of arbitration is plainly not enough to trigger the exception, which applies only to arbitration agreements that "forbid[] the assertion of certain statutory rights" or impose "filing and administrative fees" that are "so high as to make access to the forum impracticable." *American Express Co.* v. *Italian Colors Restaurant*, 570 U.S. 228, 236 (2013).

b. Respondents next seek to defend the California Supreme Court's comparative approach on the ground that it is simply "part of the general test" for substantive unconscionability under California law. Comm'r Br. in Opp. 15; see Kho Br. in Opp. 19-20.

Not so. As Justice Chin observed in dissent, "[a]ny reader" of the California Supreme Court's decisions would conclude that "the unconscionability analysis and contract principles th[e] court applies in arbitration cases [are] very different from the analysis and principles the

court applies in nonarbitration cases." Pet. App. 85a-86a. Indeed, this Court has already called out California courts as being "more likely to hold contracts to arbitrate unconscionable than other contracts." *AT&T Mobility*, 563 U.S. at 342.

The cases respondents cite are not to the contrary. None of those cases supports the proposition that unconscionability analysis outside the arbitration context turns on the forum-specific "rights and remedies that otherwise would have been available to the parties." Pet. App. 32a. Instead, the cases reflect the unremarkable proposition that unconscionability analysis must account for the "general commercial background and the commercial needs of the particular trade or case," *Sanchez* v. *Valencia Holding Co.*, 353 P.3d 741, 749 (Cal. 2015), and for the "basis and justification" of the challenged terms, *Perdue* v. *Crocker National Bank*, 702 P.2d 503, 512 (Cal. 1985); see *De La Torre* v. *CashCall, Inc.*, 422 P.3d 1004, 1009 (Cal. 2018).

Some of the cases do not even involve the application of unconscionability as a contract defense or, if they do, do not purport to undertake any comparison at all. See, *e.g.*, *Okura & Co. (America), Inc.* v. *Careau Group*, 783 F. Supp. 482, 495 (C.D. Cal. 1991); *Grand Prospect Partners, L.P.* v. *Ross Dress for Less, Inc.*, 182 Cal. Rptr. 3d 235, 247 (Ct. App. 2015); *Cubic Corp.* v. *Marty*, 229 Cal. Rptr. 828, 834 (Ct. App. 1986). And in the sole remaining case, the California Court of Appeal made a comparison only in the most passing of ways, mentioning that a premarital agreement specified an amount of spousal support that was "manifestly inadequate." *In re Marriage of Facter*, 152 Cal. Rptr. 3d 79, 93 (2013).

2. The Commissioner disputes that the California Supreme Court has been "emboldened" by this Court's denial of certiorari in *Sonic-Calabasas A, Inc.* v. *Moreno*,

134 S. Ct. 2724 (2014) (*Sonic II*), noting that the court has since upheld several arbitration agreements. See Br. in Opp. 16-17. It is heartening that the California Supreme Court does not invalidate *every* arbitration agreement that comes before it. But in the context of agreements to arbitrate wage disputes, the court has been consistently hostile—as illustrated by *Sonic-Calabasas A, Inc.* v. *Moreno*, 247 P.3d 130 (Cal.) (*Sonic I*), vacated and remanded, 565 U.S. 973 (2011); *Sonic II*; and now the decision below.

By applying the comparative approach in this case, the California Supreme Court deemed the specified arbitration procedures substantively unconscionable because they "incorporate[d]" too many "intricacies of civil litigation," unlike the more "speedy, informal, and affordable" Berman hearing. Pet. App. 24a-26a (citation omitted). That is precisely the outcome the court tried to achieve in *Sonic I* before this Court vacated its decision. This Court's intervention is once again necessary to thwart the California Supreme Court's continued defiance.

3. The California Supreme Court's approach violates this Court's precedents for the additional reason that it erects a fact-intensive "preliminary litigating hurdle" that impermissibly frustrates the speed and efficiency promised by arbitration, in violation of the FAA. *Italian Colors*, 570 U.S. at 238-239.

a. Respondents' primary response is a warmed-over version of their equal-treatment argument: they contend that, because the FAA permits the invalidation of arbitration agreements by "general contract defenses," the application of one of those defenses—here, unconscionability—cannot amount to an impermissible litigating hurdle. Comm'r Br. in Opp. 19-20; Kho Br. in Opp. 24.

That misapprehends petitioner's argument. Petitioner is not arguing that *any* consideration of "general

contract defenses," including unconscionability, violates the FAA. Rather, petitioner simply argues that the California Supreme Court's arbitration-specific approach to unconscionability analysis violates the FAA because it demands a detailed, fact-intensive comparison of the specified arbitration procedure and the Berman procedure. See Pet. App. 20a-31a. That analysis, which triggered a multiyear delay in this case, amounts to the very type of "judicially created superstructure" that *Italian Colors* precludes. 570 U.S. at 238-239; see California New Car Dealers Ass'n et al. Br. 5-9.

b. Respondents attempt to shift the blame for the delay in this case to petitioner. That attempt fails.

The Commissioner first suggests (Br. in Opp. 19) that petitioner is responsible for the delay because it waited to file a petition to compel arbitration until nearly nine months after settlement talks broke down. But the timing of that filing was inconsequential, because it occurred *before* the Berman hearing—which the Commissioner scheduled. Regardless of precisely when petitioner had sought judicial relief, the duration of the ensuing litigation on arbitrability would have been the same, and the Commissioner does not suggest otherwise. See Pet. App. 5a, 128a. And that litigation took *four years*—surely much longer than the arbitration itself would have taken. See *id.* at 25a.

The Commissioner further contends (Br. in Opp. 20) that, if petitioner had only crafted an agreement that was less procedurally unconscionable, the unconscionability inquiry would have been "less complicated" and the outcome "different." But as the Commissioner's own cases demonstrate, California's sliding-scale approach requires a court to analyze substantive unconscionability so long as there is a hint of procedural unconscionability. See *Sanchez*, 353 P.3d at 751; *Martinez* v. *Vision Precision*

Holdings, LLC, Civ. No. 19-1002, 2019 WL 7290492, at *8 (E.D. Cal. Dec. 30, 2019). Because a detailed, fact-intensive substantive-unconscionability analysis would be required in any such case involving an agreement to arbitrate wage disputes, the California Supreme Court's approach creates a preliminary litigating hurdle that undermines the goals of the FAA.*

B. The Decision Under Review Presents An Exceptionally Important Question That Warrants The Court's Review

This Court's intervention is essential because the California Supreme Court's decision imperils a broad range of arbitration agreements. Respondents' attempts to play down the decision's significance are unavailing.

1. Respondents assert that the court's decision will affect only the particular agreement at issue or, at most, only California's automotive industry. See Comm'r Br. in Opp. 23; Kho Br. in Opp. 22-23. As to the former assertion: for all the Commissioner's talk of procedural unconscionability, see, *e.g.*, Br. in Opp. 1, 5-6, 13-14, 21, the Commissioner is using that part of the California Supreme Court's opinion as a fig leaf. It is undisputed that California law requires *both* procedural unconscionability *and*

* As noted in the petition, the judiciary is not California's only branch of government that has shown a hostility to arbitration: just last year, the California Legislature enacted Assembly Bill 51, which prohibits employers from requiring, as a condition of employment, an employee's waiver of a forum for adjudicating a violation of any provision of the California Labor Code. See Pet. 20-21 (citing 2019 Cal. Stat. ch. 711). Since the petition was filed, a district court has enjoined the law from going to effect, reasoning that it is preempted by the FAA. See *Chamber of Commerce* v. *Becerra*, Civ. No. 19-2456, 2020 WL 605877, at *10-*13 (E.D. Cal. Feb. 7, 2020), appeal pending, No. 20-15291 (9th Cir.).

substantive unconscionability. See *Armendariz* v. *Foundation Health Psychcare Services, Inc.*, 6 P.3d 669, 690 (Cal. 2000); p. 7, *supra*. For that reason, the California Supreme Court's holding that the arbitration agreement was substantively unconscionable is outcome-dispositive here. And because substantive unconscionability is a pure question of law, see *Ting* v. *AT&T*, 319 F.3d 1126, 1147 (9th Cir. 2003), that holding not only invalidates the agreement at issue here, but will apply in similar cases in the future.

As to the latter assertion: the large group of business and trade associations supporting petitioner—representing a wide variety of industries—belies the notion that the decision will at most affect only the automotive industry. See Civil Justice Ass'n of California Br. 1-2; California New Car Dealers Ass'n et al. Br. 1-2. Not only are arbitration agreements for employment disputes prevalent across industries, they are particularly common in California, where they are used by more than two-thirds of employers. See Pet. 21-22.

The Commissioner gives assurances that the California Supreme Court's decision "pose[s] no problems" to employers as long as they "use arbitration agreements" that "facilitate the fair, streamlined, and expeditious resolution of" wage claims. Br. in Opp. 22. In fact, however, the decision below creates a Catch-22 for employers: it requires that employers adopt arbitration procedures dissimilar to civil litigation, while preexisting California law demands that they do just the opposite. See *Armendariz*, 6 P.3d at 682.

Respondents do not directly address that predicament. Instead, the Commissioner cites two federal cases in which arbitration agreements were enforced despite the decision below. See Br. in Opp. 21-22 (citing *Martinez, supra*, and *Lefevre* v. *Five Star Quality Care, Inc.*,

Civ. No. 15-1305, 2019 WL 6001563 (C.D. Cal. Nov. 12, 2019)). Yet neither of those courts considered *Armendariz*'s mandate to adopt procedures similar to civil litigation.

2. Respondents also contend that review is unwarranted because petitioner has not identified a conflict among the decisions of lower courts. See Comm'r Br. in Opp. 20-21; Kho Br. in Opp. 22. But petitioner seeks this Court's review based not on a lower-court conflict, but rather on a conflict with multiple decisions of the Court itself. See S. Ct. R. 10(c). This Court has not hesitated to intervene when state courts—particularly California courts—have issued decisions that plainly contravene this Court's arbitration decisions. See Pet. 12 (collecting cases); Cato Br. 9-11.

3. Faced with an erroneous decision with significant consequences, respondents attempt to paint this case as a suboptimal candidate for review. That effort is futile.

a. Kho contends (Br. in Opp. 27-32) that this Court lacks jurisdiction because petitioner never demonstrated that the arbitration agreement "evidenc[es] a transaction involving commerce," as is required for the FAA to apply. 9 U.S.C. 2. But the applicability of the FAA does not present a jurisdictional question. See, *e.g.*, *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U.S. 1, 25 n.32 (1983). In any event, as Kho recognized in his state-court briefing, he expressly "agree[d]" that "the arbitration and th[e] Agreement shall be controlled by the [FAA]." Pet. App. 122a; see Kho Cal. Ct. App. Br. 38 n.27. Having made that concession below, Kho cannot now challenge the FAA's applicability. See *Cutter* v. *Wilkinson*, 544 U.S. 709, 718 n.7 (2005).

b. Kho next asserts (Br. in Opp. 15-17) that review is unnecessary because the agreement would never have been held unconscionable if petitioner had consistently

made the argument that the arbitration agreement called for a procedure identical to a Berman hearing. But such an argument, which the California Supreme Court in any event rejected on the merits, see Pet. App. 23a-24a n.14, would have been irreconcilable with the FAA's requirement that arbitration agreements be "enforce[d]" "according to their terms." *Rent-A-Center, West, Inc.* v. *Jackson*, 561 U.S. 63, 67 (2010).

c. Finally, the Commissioner suggests that petitioner would ultimately not "be entitled to the relief it seeks" even if this Court were to reverse. Br. in Opp. 23. That suggestion is misplaced. To be sure, the California Supreme Court may consider on remand whether petitioner forfeited its right to arbitrate—an argument the Court of Appeal previously rejected, see Pet. App. 116a-119a, but the Supreme Court itself did not reach, see *id.* at 31a. But this Court routinely grants review on a federal question where a state court has yet to decide a question of state law. The mere "possibility" that the state court might reach the same result on remand does not rise to the level of an adequate and independent state ground. See *United Air Lines, Inc.* v. *Mahin*, 410 U.S. 623, 630-631 (1973).

* * * * *

The petition for a writ of certiorari should be granted. The Court may wish to consider the possibility of summary reversal; in the alternative, the Court should grant plenary review and set the case for briefing and oral argument.

Respectfully submitted.

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