No. S199119

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

GIL SANCHEZ, Plaintiff and Respondent vs. VALENCIA HOLDING COMPANY, LLC, Defendants and Appellant.	B228027 (Los Angeles County Super. Ct. No. BC433634)

REPLY TO ANSWER TO PETITION FOR REVIEW

California Court of Appeal, Second District, Division One
Case No. B228027
Los Angeles Superior Court Case No. BC433634
Honorable Rex Heeseman

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INTRODUCTION

The Answer to the Petition for Review advocates, in essence, that arbitration should not be enforced in consumer contracts, at least not unless it is favorable to the consumer in the particular instance. But federal law is otherwise. Supreme federal law requires enforcement of arbitration agreements as written, even in consumer contracts. The United States Supreme Court has specifically rejected challenges based on the adhesive nature of consumer contracts, the limiting of issues to be arbitrated, or the choice of particular procedures: "[W]e have held that parties may agree to limit the issues subject to arbitration" and "to arbitrate according to specific rules" even though "the times in which consumer contracts were anything other than adhesive are long past." (*AT&T Mobility, Inc. v. Concepcion* (2011) 563 U.S. ___, 131 S.Ct. 1740, 1748, 1749, 1750.)

The Answer, in effect, asks this Court to ignore the controlling development of the law by the United States Supreme Court. It ignores – does not even cite – that the United States Supreme Court granted certiorari, vacated and remanded this Court's decision in *Sonic-Calabasas A, Inc. v. Superior Court*, S174475. (See *Sonic-Calabasas A, Inc. v. Moreno* (2011) ___ U.S. ___, 2011 WL 2148616, vacating *Sonic–Calabasas A, Inc. v. Moreno* (2011) 51 Cal.4th 659.) It ignores that *Sonic-Calabasas A, Inc.* does not involve a class action waiver and that this Court recently requested further briefing in *Sonic-Calabasas A, Inc.* as to *Concepcion*'s effect on unconscionability analysis in the arbitration context generally.

Rather than demonstrating that there is no issue of important unresolved law, the Answer demonstrates that there is hotly contested, unresolved law. The Answer asks this Court to allow inconsistency and disparity in the law to continue. That is the antithesis of this Court's role.

WHY REVIEW IS NECESSARY

I. Contrary To The Answer, And As Demonstrated By The United States Supreme Court's Remand Of *Sonic-Calabasas A, Inc.* To This Court For Reconsideration In Light Of *Concepcion*, An Important Issue Remains As To How Federal Law Constrains Application Of Unconscionability Principles In Attacking Arbitration Provisions.

The Answer seizes upon one sentence, out of context, in the United States Supreme Court's *Concepcion* decision to argue that judicial review of arbitration provisions under an unconscionability standard remains unrestrained. It argues that *Concepcion* "affirmed that unconscionability . . . remains a valid defense to the formation of an agreement to arbitrate." (Ans. at p. 2.) It then ignores the rest of *Concepcion*. *Concepcion disapproved* this Court's use of an unconscionability analysis to defeat an arbitration provision in *Discover Bank v. Superior Court* (2005) 36 Cal.4th 148.

Concepcion made clear that the Federal Arbitration Act ("FAA") places substantial limits on the use of the unconscionability doctrine to

bypass arbitration provisions. Under the FAA, enforcing arbitration provisions *as written* is the rule, not the exception:

- "The 'principal purpose' of the FAA is to 'ensur[e] that private arbitration agreements are enforced *according to their terms*.' [Citations.]"
- "parties may agree to *limit the issues subject to arbitration*, [citation],"
- [parties may agree] *to arbitrate according to specific rules*, [citation], and
- [parties may agree] to limit *with whom* a party will arbitrate its disputes, [citation]."
- parties may limit the risks associated with outlier results or "high stakes" arbitral determinations.

(131 S. Ct. pp. 1748-1749, emphases added; see also *id.* at p. 1752 ["(a)rbitration is poorly suited to the higher stakes . . . litigation"].) *Concepcion* rejects the notion that there can be a state-by-state landscape of what are considered fair or necessary arbitration provisions.[1]

Yet, the Opinion here refused to enforce the arbitration provision at issue according to its terms (1) *because* the parties limited the issues subject to arbitration (e.g., no self-help remedies or small claims court issues),

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[1] The need for national uniformity in the enforcement of arbitration provisions reflected in the FAA applies as much to consumer contracts as to any other type of contract affecting interstate commerce. A company or industry doing business with consumers across the country needs to know that arbitration provisions are being equally enforced.

(2) *because* the parties agreed to arbitrate according to specific rules (e.g., three-arbitrator panel for certain results; losing party bears the initial expense of the three-arbitrator panel), and (3) *because* the parties limited the risks involved with outlier results ($0 and greater than $100,000 awards, injunctive relief) by affording an additional level of arbitration in that event.

The question is not *whether* the Federal Arbitration Act limits the application of California's unconscionability doctrine to arbitration provisions (a question to which the Answer claims a negative response) – *Concepcion* and its predecessors undoubtedly have answered that question in the affirmative. Rather, the question is *how and to what extent* the FAA does so. The Answer can't avoid that question by assuming that it does not exist. *That* question remains unresolved.

The Court of Appeal, at most, paid lip service to that question, reading *Concepcion* as limited to class action waiver provisions. But neither the FAA nor *Concepcion* is so limited. We know that because the United States Supreme Court remanded *Sonic-Calabasas A, Inc.* for reconsideration in light of *Concepcion*, even though *Sonic-Calabasas A, Inc.* has no class action waiver issue. This Court has asked for briefing in *Sonic-Calabasas A, Inc.* as to the significance of *Concepcion* to unconscionability analysis of arbitration provisions generally. Yet, the Answer acts as if neither the impending decision in *Sonic-Calabasas A, Inc.* nor *Concepcion*'s clear, broad constraint on unconscionability doctrine has any relevance to this case.

The Answer argues, in effect, that California courts can go on blithely ignoring the constraints that the United States Supreme Court and the FAA have imposed on unconscionability analysis. But *Concepcion* undoubtedly limits judicial unconscionability vetting of the agreed-upon arbitral *process*, at least so far as that process reflects "procedures tailored to the type of dispute." (131 S.Ct. at p. 1749.) *Concepcion* disapproved of "California's courts [history of being] more likely to hold contracts to arbitrate unconscionable than other contracts." (*Id.* at p. 1747, citing Broome, *An Unconscionable Application of the Unconscionability Doctrine: How the California Courts are Circumventing the Federal Arbitration Act* (2006) 3 Hastings Bus. L. J. 39, 54, 66.)

"Unconscionability" in the arbitration context is not and cannot be a magic incantation that a court can use to disregard a provision that it does not like or, in retrospect, does not think is as fair as it might be, that much *Concepcion* holds. The unconscionability doctrine that *Concepcion* "affirmed . . . remains a valid defense to the formation of a contract to arbitrate" is necessarily a bounded, limited concept. Under the Opinion here, it is not. The Opinion here is not the "mere[] appli[cation] [of an] uncontested rule" (Ans. at p. 2). Rather, it is a continuation of an approach that the United States Supreme Court has said is overbroad and must be revisited.[2]

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[2] Even plaintiff claims that the Opinion is groundbreaking in "explain[ing] . . . the continuing validity of general contract defenses, including unconscionability, to arbitration clauses post-*Concepcion* . . . ." (continued...)

An amorphous substantive unconscionability test that courts are to determine on a case-by-case basis whether a particular combination of arbitration terms, on balance, are "too one-sided" (the test the Answer proposes, Ans. at p. 13) doesn't cut it under *Concepcion.* Nor is that the test that the Opinion applied. The Opinion did not examine the *balance* of the arbitration provision (noting three-person arbitration of greater than $100,000 and injunctive awards, *but not examining that the same appeal right is provided for $0 awards*; noting that losing party initially pays for three-person arbitration, *but not examining its own finding that it is the dealer who is most likely to pay*; noting no arbitration of self-help remedies, *but not examining that claims within small claims jurisdiction are also excluded*).[3] Rather the unconscionability test that it applied is whether, taken in isolation, an arbitration provision or provisions might on occasion disadvantage a consumer. That would appear to be a test that *Concepcion* rejects.

What is the allowable unconscionability test is after *Concepcion*? That is the issue. Is it any "one-sided" provision or whatever a court in retrospect decides, on balance, to be a "one-sided" process, as the Opinion and the Answer suggest? Or, is the unconscionability test limited to a

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[2] (...continued)
(Plaintiff's February 1, 2012, Letter Opposing Depublication at p. 2.)

[3] Of course, another part of the balance is that an enforceable arbitration provision that limits the risk of outlier results (without prohibiting any result in a particular individual's case) allows consumers to negotiate a better overall contract price, because the dealer's risk of a bet-the-company result is reduced.

process untethered to typical disputes or a process that cannot be reconciled with the "parties[']discretion in designing arbitration processes . . . allow[ing] for efficient, streamlined procedures tailored to the type of dispute" and limiting the risk of outlier results, as *Concepcion* appears to require? (131 S.Ct. at pp. 1749, 1752.) Even plaintiff admits that the Opinion trods unplowed ground as to how traditional unconscionability doctrine applies "post-*Concepcion.*" (See Plaintiff's February 1, 2012 Letter Opposing Depublication at p. 2.) The answer to that question remains uncertain and unresolved.

The constraints imposed by the FAA and *Concepcion* on California's substantive unconscionability doctrine is precisely what is contested, uncertain, and unresolved. That is why review is necessary and why this case, with its arbitration provision reflecting trade-offs favoring both sides, has set up the issue so cleanly.

II. The Continued Vitality Of The *Broughton-Cruz* Non-Arbitrability Rationale Is Directly At Issue Here.

The Answer does not dispute the split (indeed chasm) in authority and confusion regarding the continuing vitality of the *Broughton-Cruz* line of cases. (See Petition for Review at pp. 21-22.) The Opinion undoubtedly relies on *Broughton*, quoting it for a page and a half. (Opn. at pp. 28-30.) It does so in finding the arbitration provision unconscionable because "the requirement that the buyer seek injunctive relief from the arbitrator is inconsistent with the [California Legal Remedies Act]" (Opn. at p. 28), the

very issue *Broughton* addressed. The Answer claims, though, that the Opinion does not cite *Broughton* for its holding, just for its reasoning (i.e., that arbitration of injunctive claims is bad policy) and that therefore no issue regarding the *Broughton-Cruz* line of authority's continuing vitality is presented. But *Broughton*'s *reasoning* is precisely what is at issue and in dispute. *Broughton* holds that certain types of claims – e.g., CLRA claims – can *never* be arbitrated. The Opinion says that *Broughton*'s nonarbitrability rationale means that a provision allowing for arbitration of injunctive claims is presumptively unconscionable or, at least, to be judicially disfavored. (Opn. at pp. 28-30.) If *Broughton* is wrong, then there is no basis to presume unconscionability or to disfavor arbitration of injunctive claims.

Concepcion holds that California, for reasons of public policy, could not require arbitration of class action claims or of certain class action claims nor could it accomplish the same end by deeming unconscionable an arbitration provision that did not encompass class action claims. *Concepcion* is clear: "When state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA." (131 S.Ct. at p. 1747.) And, *Concepcion* is equally clear that what a state cannot do directly (e.g., bar waiver of class action claims in arbitration, bar arbitration of injunction claims), it cannot do indirectly under the guise of unconscionability. Indeed, that is *Concepcion*'s *holding*.

Concepcion would seem to prohibit a requirement that injunctive claims not be arbitrated. Certainly a number of courts have so held. (See

Petition for Review at pp. 18-19, 22.) As such, *Concepcion* would bar a rationale that allowing arbitration of injunctive claims is unconscionable. Doing what the law specifically allows and protects cannot be unconscionable. Whether allowing arbitration of statutory injunction relief is unconscionable remains an open question after *Concepcion*. Review should be granted to resolve that question.

The *Broughton-Cruz* doctrine is undeniably a central pillar in the Opinion's unconscionability analysis. Its continued vitality is directly at issue. That question is hotly disputed. Review should be granted.

III. The Answer Confirms That The Issue Here Affects A Wide Swath Of California Contracts And Cases; And It Cannot Refute That The Law Regarding What Is Or Is Not Substantively Unconscionable In An Arbitration Provision Remains Confused And Discordant.

The Answer does not dispute that the Court of Appeal's decision here directly affects hundreds of thousands or millions of California auto sales contracts. Rather, it appears to revel in that fact. Plaintiff acknowledges that the Opinion "involves a legal issue of continuing public interest." (Plaintiff's February 1, 2012 Letter Opposing Depublication at p. 2.)

The Answer suggests that wholesale disregard of a contract provision is acceptable because it appears on the back of the form. Nowhere, however, does the Answer discuss the fact that the provision is

specifically and directly referenced on the front of the form, above a signature line.[4] Nor would being on the back of the form, alone, suffice for unconscionability as *both* procedural *and* substantive unconscionability are required.

And, the Opinion is not limited to hundreds of thousands or millions of California auto sales contracts. Its rationale extends to any attempt in a consumer contract to afford an internal arbitral appeal mechanism for outlier results or otherwise to tailor the process to particular types of disputes. Its rationale extends to any such scheme that requires the initially losing party to bear the fees of an internal arbitral appeal without some, unspecified, mechanism for relief from such expenses. It applies to any contractual provision that carves out nonjudicial remedies as free from arbitration.

In doing so, the Answer asserts, "the Court of Appeal engaged in standard unconscionability analysis under California law." (Ans. at p. 15.) What "standard unconscionability analysis"? The Answer identifies none other than perhaps judicial gut reaction. As this case well illustrates, a court can take virtually any provision in an arbitration agreement and, viewing it in isolation, find that it disadvantages one party or the other. At the same time, other courts can find the *same* provision in context to be fair and

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[4] The Answer contains a number of factual assertions about the nature and operation of the arbitration provision here that are unsupported by any citation to the record. The lack of citation is no accident. The record on appeal contains no support for the assertions for which no citation is provided. Such assertions should be ignored.

reasonable. Essentially the *same* provisions that the Opinion here found unconscionable, other courts have found acceptable:

- *Three-person arbitration panel "appeal" for awards of $0 or over $100,000.* (Compare Opinion at pp. 18, 19-22 [provision unconscionable because it allows "a party who loses before the single arbitrator may appeal to a panel of three arbitrators if the award exceeds $100,000" (ignoring that the same right is afforded for a $0 award)] *with Htay Htay Chin v. Advanced Fresh Concepts Franchise Corp.* (2011) 194 Cal.App.4th 704, 713 [approving provision calling for three-arbitrator panel for claims of more than $150,000]; see *Little v. Auto-Steigler, Inc.* (2003) 29 Cal.4th 1064, 1073 [suggesting that appeal of $50,000 award only unconscionable because no corresponding right to appeal $0 award].)

- *Exclusion of certain remedies from arbitration.* (Compare Opinion at pp. 27-28 [excluding arbitration of self-help remedy unconscionable] with *Arguelles-Romero v. Superior Court* (2010) 184 Cal.App.4th 825, 834, fn. 21 [arbitration clause excluding self-help and small claims court remedies "is clearly bilateral, and not unconscionable"] and *Htay Htay Chin v. Advanced Fresh Concepts Franchise Corp., supra,* 194 Cal.App.4th at p. 712 [injunctive relief can be excluded from arbitration]; see Plaintiff's February 1, 2012 Letter Opposing Depublication at p. 2 [arguing that the Opinion here "addresses an apparent conflict in the law by explaining why it is reaching a different decision from the one reached in the published opinion in *Arguelles-Romero v. Superior Court* (2010) 184 Cal.App.4th 825"].)

- *A fee waiver requirement.* (Compare Opinion at pp. 24-27 [requiring consumer to advance fees without a fee waiver mechanism if he or she loses in the first round of arbitration and appeals to a three-arbitrator panel is unconscionable] with *Green Tree Financial Corp.-Alabama v. Randolph* (2000) 531 U.S. 79, 90-91 [speculative risk that party might be saddled with prohibitive costs cannot justify invalidating arbitration provision].)

The Answer argues that it is the number of points that could be identified as potentially unfair to the consumer (while ignoring the number of times trade-offs might operate in the consumer's favor) that establishes unconscionability. But if that is so, it means that the law's uncertainty as to *any* of the four aspects of the arbitration provision that the majority found unconscionable warrants review. Justice Rothschild, concurring, found only two unconscionable aspects, impliedly rejecting unconscionability as to the other two aspects. That means that there is review-worthy uncertainty as to at least half of the grounds on which the majority relies.

The fact is, as the law currently exists in California, there is no standard for determining unconscionability of arbitration provisions. Rather, there are idiosyncratic judicial reactions (as demonstrated here by the split between the majority and concurring opinions) which may or may not reflect federally prohibited judicial antipathy toward enforcement of arbitration either generally or in particular areas (e.g., in consumer contracts).

The Answer's solution to the lack of any consistent standard? Leave the law unsettled and confused; reserve review for the next case, when another court disagrees with *Sanchez* on the same facts, as the Answer implicitly recognizes could easily happen. That is not creating uniformity in the law. Rather, it suggests confusion as to what the applicable rules and guiding principles are and should be. Already, there are pending appeals in at least two other cases raising the same issues (and on which trial courts came to opposite conclusions). (See *Caron v. DCFS USA, Inc.*, G044550 [California Court of Appeal, Fourth District, Division Three]; *Barnes v. Bakersfield Dodge*, No. F063370 [California Court of Appeal, Fifth District].) The issue is not going to go away. That is precisely the circumstance that calls for this Court's intervention and review, especially where, as here, combined with widespread impact.

The time to act is now. Review should be granted

IV. The Answer Sidesteps The Appellate Role Issue For Review: Do Appellate Courts Have Power In The First Instance To Make Factual Findings And Inferences And To Weigh Countervailing Equities Regarding Unconscionability And Severability?

The Answer asserts that the law is settled that there is no reason for remand where there could be only one result within a court's discretion. (Ans. at p. 20.) We don't disagree. But that's not the issue here. The issue is (1) whether appellate courts get to make, in the first instance, the *factual*

determinations that are inherent in any unconscionability determination and (2) whether a trial court truly has *discretion* to determine severability by coming to a conclusion within a reasonable range of choices but which might not be that which the appellate court reaches on its own. This issue is whether unconscionability and severance decisions are so constrained that deference to trial court discretion is to be the exception rather than the rule.

Unconcionability factual determinations. The Answer does not dispute, because it cannot dispute, that there are factual elements to the unconscionability determination. Such elements range from (1) credibility: whether to believe the plaintiff's declaration that, in making a $50,000 purchase, he did not read anything versus the signed documentary evidence expressly stating that he understood that there was and agreed to the arbitration provision on the form's reverse side[5] to (2) materiality: whether the "appeal" provision only addressed claims beyond those that were typical in an automobile sale dispute to (3) likelihood: whether the financial condition of someone (i.e., plaintiff here) purchasing a $50,000 luxury automobile was such that he would even be a candidate for a fee waiver in the event of an arbitral appeal. Does the trial court get to make such factual determinations and judgments, resolving "conflicts in the evidence, or [making] factual inferences which may be drawn therefrom," which are to be reviewed on appeal "in the light most favorable to the court's determination" and "for substantial evidence"? (*Gutierrez v. Autowest, Inc.*

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[5] This is especially true given the conclusory, standard form nature of that declaration.

(2003) 114 Cal.App.4th 77, 89.) Or, as the Opinion effectively holds, are those factual determinations and inferences something that an appellate court typically can decide?

That is the issue. It is important. The Court of Appeal's usurpation of the trial court's role in this instance is groundbreaking. It opens the door for appellate courts to take over factfinding in a broad range of circumstances. It requires review.

Severance discretion. The Answer, and the Opinion, concede that trial courts have discretion, weighing the equities, to determine severability. But they claim that there should be an exception here or in any case where a court can identify more than one assertedly unfair clause. Why? Because, the Answer asserts, the arbitration provision is then "permeated" with unconscionability. (Ans. at p. 21.) But what does that mean? Is an arbitration provision "permeated" with unconscionability when the challenged clauses in the vast majority of instances will never come into play (because most automobile contract disputes do *not* involve amounts exceeding $100,000 or injunctive or even self-help remedies)? (See Dictionary.com <http://dictionary.com/browse/permeate> [as of Feb. 6, 2012] ["permeate": to "pervade," or to "saturate," that is, to be everywhere].) The Answer ignores that a single stroke of a pen – deleting the three-arbitrator appeal process – eliminates virtually all of the Opinion's complaints about the arbitration provision. There would no longer be an appeal from a greater than $100,000 award or from injunctive relief and no

concern with an appealing party having to bear the initial appeal costs as the appeal would no longer exist.[6]

Nor is there an answer to how can it be that *no* trial court could conceivably find the "appeal" provision unseverable when *this* Court found a comparable provision *severable, as a matter of law*, in *Little v. Auto-Stiegler, Inc., supra*, 29 Cal.4th at pp. 1074-1076. The Answer does not address how the Opinion's no-possibility-that-severance-is-within-a-trial-court's-range-of-discretion position can be reconciled with *Little.*

That leaves the exclusion of self-help remedies. Does that tail wag the entire severability dog? Does a trial court *never* have discretion to sever offending arbitral clauses if it takes two strokes of the pen instead of one? That is what the Answer argues. The result would hardly be a "jumbled" mess. (Ans. at p. 21.) The result would be an arbitration provision that calls for arbitration of all disputes (except, of course, class action claims) with no internal arbitral appeal. The parties would still have self-help rights, but that would not be written into the arbitration provision. Instead, it would be because *self*-help, by definition, does not involve resort to judicial or arbitral process.

Again, whether trial courts truly have discretion to make a severability determination or whether that discretion is in name only, limited to reaching the result that the appellate court independently decides

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[6] Of course, doing so would eliminate the *consumer's* right to appeal in those circumstances, as well as where there was a $0 award. But that suggests not that the provision is not severable, but that it is not unconscionable because it, in fact, is balanced.

is the correct one is an important issue with widespread implications. This case, *Little* and *Brown v. Ralphs Grocery Co.* (2011) 197 Cal.App.4th 489, certainly have differing, unreconciled views on that question. Review is necessary.

CONCLUSION

The Answer highlights rather than dispels the need for review here. Is *Concepcion* really to be read as approving a business-as-usual approach to California courts' rejection of consumer arbitration provisions as to everything other than class action waivers as the Answer and the Opinion argue? Can *Concepcion* be relevant to *Sonic-Calabasas A, Inc.*, but not here? Just what is the post-*Concepcion* "standard unconscionability analysis" for arbitration provisions?

These are important issues that the Answer admits affects hundreds of thousands if not millions of contracts. They remain unresolved.

Review should be granted.

Dated: February 6, 2012 Respectfully submitted,

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CERTIFICATE OF WORD COUNT

Pursuant to California Rules of Court, Rule 8.204(c), I certify that this **REPLY IN SUPPORT OF PETITION FOR REVIEW** contains **3,980** words, not including the tables of contents and authorities, the caption page, this Certification page and appendices.

Dated: February 6, 2012

Robert A. Olson

PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action; my business address is 5900 Wilshire Boulevard, 12th Floor, Los Angeles, California 90036.

On February 6, 2012, I served the foregoing document described as: **REPLY TO ANSWER TO PETITION FOR REVIEW** on the parties in this action by serving:

SEE ATTACHED SERVICE LIST

(X) BY MAIL: As follows: I am "readily familiar" with this firm's practice of collection and processing correspondence for mailing. Under that practice, it would be deposited with United States Postal Service on that same day with postage thereon fully prepaid at Los Angeles, California in the ordinary course of business. I am aware that on motion of party served, service is presumed invalid if postal cancellation date or postage meter date is more than 1 day after date of deposit for mailing in affidavit.

Executed on February 6, 2012, at Los Angeles, California.

(X) (State) I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Anita F. Cole

SANCHEZ
v.
VALENCIA HOLDING COMPANY, LLC
[California Court of Appeal Case No. B228027;
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