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)

SUPPLEMENTAL BRIEF ON THE MERITS

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

This Court's supplemental briefing questions ask nothing less than what does it mean for a contract or a contract term to be substantively unconscionable. Over the years, verbal formulations of the unconscionability doctrine have meandered both in California and across the country. But the core concept that they reflect has been the same. A contract (or a particular contract provision) is unenforceable only when it is so far outside the range of the expected norm that it can only be attributable to duress, deceit or delusion rather than to a hard bargain. Traditionally, that standard has been expressed as "shocks the conscience" or in similar terms. Occasionally, certain formulations, especially those framed in terms of fairness or harshness, have led courts astray, causing them to view the issue as a re-balancing of bargaining positions or an opportunity to impose a judicially determined "fairer" deal. That is not, and decidedly should not be, the approach. Indeed, such less strict interpretations appear to have been grounded in the traditional tests, but to have moved away from those tests not by conscious choice or analysis but simply by loose phrasing.

For the reasons discussed below, we urge the court to adopt a single standard and a single formulation of that standard. The best formulation is that a provision, when read in the context of the whole transaction at the time of contracting, is only unenforceable when it shocks the conscience, as reflected in some commercial or societal norm.

ARGUMENT

I. Any Selection Of A Legal Standard For Substantive Unconscionability Should Proceed From Fundamental Principles Of Uniformity, Objectivity, High Threshold And Contracting Context.

The Court has asked a series of questions about the proper standard for determining substantive unconscionability. Rather than address the questions piecemeal, petitioner believes that the issue is best understood by starting at fundamental principles. Those principles are, we submit, as follows:

Uniformity. There should be a single, uniform standard. A proliferation of standards leads to uneven application of principles and inconsistency in the law. If multiple formulations float around, neither courts nor parties will have any certainty as to what standard is to be applied. The natural result is for courts to form an I-know-it-when-I-see-it conclusion based on unarticulated or unexamined reasons, and then simply choose the label that best fits that conclusion, whether legitimate or not.

A proliferation in standards leads to inconsistent results and application and suggests that different standards can be applied to different issues and even to different types of contract clauses, e.g., one standard for arbitration provisions, another for other types of contract clauses. Multiple formulations lead to confusion regarding whether the different formulations are multiple expressions of the same concept or disjunctive, differing

standards. (Cf. *Briggs v. Eden Council for Hope & Opportunity* (1999) 19 Cal.4th 1106, 1117 ["Where different words or phrases are used in the same connection in different parts of a statute, it is presumed the Legislature intended a different meaning," citation omitted].) If the latter, then there is not one unconscionability standard, but several. Yet, our Constitution requires that "[a]ll laws of a general nature have uniform operation." (Cal. Const., art. IV, § 16.) That requirement applies as much to unconscionability (which is statutorily embodied in Civil Code section 1670.5) as to any other law of a general nature.

The need for a uniform standard is especially pressing because the applicable Federal Arbitration Act allows states to refuse to enforce an arbitration provision only on *the same grounds* applicable to other contract provisions. If there are multiple unconscionability standards, then arbitration provisions may well be subjected, in practice, to a different standard than other contract provisions. (See 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, 40 [decrying "disparate application of unconscionability doctrine in cases involving arbitration agreements as contrasted with cases involving 'ordinary' contracts," especially use of separate "mutuality" requirement].) Indeed, it would be almost inevitable that different standards would be applied with differing frequency in different contexts.

Objectivity. The standard should be an objective one. Whether a contract or a contract provision is unconscionable should not depend on

what judge or panel of justices is deciding a case. The decision should not be about what a particular judge thinks is fair or unfair. Judicial officers "'may not simply impose their own notions of the day as to what is fair or unfair.'" (*Morris v. Redwood Empire Bancorp* (2005) 128 Cal.App.4th 1305, 1316 (*Morris*) [unconscionability determination] quoting and analogizing to *Cel-Tech Communications, Inc. v. L.A. Cellular Telephone Co.* (1999) 20 Cal.4th 163, 182 (*Cel-Tech*) [unfair competition determination].) "'An undefined standard of what is 'unfair' fails to give businesses adequate guidelines as to what conduct may be challenged and thus enjoined and may sanction arbitrary or unpredictable decisions about what is fair or unfair.'" (*Morris*, *supra*, 128 Cal.App.4th at pp. 1316-1317, quoting *Cel-Tech*, *supra*, 20 Cal.4th at p. 185.) Rather, "fairness" must be measured by *objective* criteria. (*Cel-Tech*, *supra*, at pp. 185-186 [unfair competition law]; see *Morris*, *supra*, 128 Cal.App.4th at p. 1316 [*Cel-Tech* involved "an analogous context" to unconscionability].)

Cel-Tech, on which *Morris* relied, addressed the meaning of "unfair" in Business & Professions Code section 17200's ban on "unlawful, unfair, or fraudulent" practices in unfair competition cases between businesses. It first held that "unfair" practices extended beyond what was expressly prohibited (indeed, if a cause of action exists under a statutory scheme, the same claim could not be pursued under section 17200). At the other end of the spectrum, that which the Legislature by statute has expressly allowed or protected (e.g., conduct protected by the litigation or other privilege) cannot be "unfair." (20 Cal.4th at pp. 182-183.) But that left a large swath of

territory between those two poles. *Cel-Tech* holds that as to such conduct – neither expressly prohibited nor expressly allowed – courts do not have unbridled leeway to declare what is "fair" or "unfair." (*Id.* at p. 182.) *Cel-Tech* rejects a subjective, judicial reaction test. (*Ibid.*) It rejects "unfairness" standards such as "offends an established public policy" or "the practice is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers" as "too amorphous and provid[ing] too little guidance to courts and businesses." (*Id.* at pp. 184-185.)

Instead, *Cel-Tech* requires that "any finding of unfairness to competitors under section 17200 be tethered to some legislatively declared policy or proof of some actual or threatened impact on competition." (*Id.* at pp. 186-187.) It does so because "[a]n undefined standard of what is 'unfair' fails to give businesses adequate guidelines as to what conduct may be challenged and thus enjoined and may sanction arbitrary or unpredictable decisions about what is fair or unfair." (*Id.* at p. 185.)

This Court has neither applied nor rejected the same objective standard to section 17200 unfair business practice claims in the consumer context. (*Zhang v. Superior Court* (2013) 57 Cal.4th 364, 380 fn. 9.) But the same policy considerations apply equally to unconscionability. An undefined standard fails to provide guidance to contracting parties as to what is or is not enforceable. *Morris* so holds, and correctly so. At least one of the tests formulated in California for unconscionablity is "whether contractual provisions reallocate risks in an *objectively* unreasonable or unexpected manner. (*Jones v. Wells Fargo Bank* (2003) 112 Cal.App.4th

1527, 1539.)" (*Serpa v. California Surety Investigations, Inc.* (2013) 215 Cal.App.4th 695, 703, emphasis added.) Another objective way to measure a contract is whether its "terms are 'so extreme as to appear unconscionable *according to the mores and business practices of the time and place.*'" (*Williams v. Walker-Thomas Furniture Co.* (D.C. Cir. 1965) 350 F.2d 445, 450, emphasis added, quoting 1 Corbin, Contracts (1963) § 128.)

If an objective standard is not applied, the result is chaos. Parties – both contracting and litigant – are left to the whims of individual judicial officers. What is unconscionable in one courtroom may well not be unconscionable in another. The result will be uncertainty, uncertainty for those drafting contracts and uncertainty for those who wish to challenge provisions. California courts have recognized repeatedly the public-policy need for certainty and predictability regarding contract enforcement. (See, e.g., *Freeman & Mills, Inc. v. Belcher Oil Co.* (1995) 11 Cal.4th 85, 94-103 [emphasizing the importance of predictability in contractual relationships]; *Applied Equipment Corp. v. Litton Saudi Arabia Ltd.* (1994) 7 Cal.4th 503, 515 [important to "encourage contractual relations and commercial activity" by enabling parties to calculate the financial risks of their relationship]; *Foley v. Interactive Data Corp.* (1988) 47 Cal.3d 654, 683 ["predictability about the cost of contractual relationships plays an important role in our commercial system"]; *Harris v. Atlantic Richfield Co.* (1993) 14 Cal.App.4th 70, 81 ["predictability of the consequences of actions related to contracts is important to commercial stability"].)

Only an *objective* standard affords uniform operation of unconscionability principles and promotes the certainty and predictability that California public policy demands. Judging is a human process and perfect uniformity in applying even objective principles is likely not possible. But an *objective* standard creates a *more* uniform process, *more* uniform results, and *greater* certainty and predictability.

More Than A Hard Or Bad Bargain. Throughout a host of formulations, one theme is clear: the threshold for unconscionability is more than an unfair or one-sided bargain. "All of the[] formulations point to the central idea that unconscionability doctrine is concerned not with 'a simple old-fashioned bad bargain' . . . ." (*Sonic-Calabasas A, Inc. v. Moreno* (2013) 57 Cal.4th 1109, 1145.) The unconscionability doctrine should not "thrust [a] court into 'the paternalistic role of intervening to change contractual terms that the parties have agreed to merely because the court believes the terms are unreasonable.'" (*Deleon v. Verizon Wireless, LLC* (2012) 207 Cal.App.4th 800, 814, internal quotation marks omitted.) The legislative comment to Civil Code section 1670.5 makes that clear: "The principle is one of the prevention of oppression and unfair surprise [citation] and not of disturbance of allocation of risks because of superior bargaining power."

One-sided contract outcomes resulting from bargaining power are *not* unconscionable where supported by a reasonable business justification. "'[A] contract can provide a 'margin of safety' that provides the party with superior bargaining strength a type of extra protection for which it has a

legitimate commercial need without being unconscionable.'" (*Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83, 117 quoting with approval, *Stirlen v. Supercuts, Inc.* (1997) 51 Cal.App.4th 1519, 1536.)

The bottom line is that whatever the substantive unconscionability standard is, it must present a substantial hurdle to overcome before a court declares a contract or contact clause unenforceable. Even moderate variations from the norm, or what might be considered a perfectly balanced result, should not be deemed unconscionable.

The Bargain As A Whole. By whatever formulation is adopted, the determination of unconscionability must be made by examining the bargain *as a whole*. No doubt, section 1670.5 allows particular contract provisions to be judged unconscionable without requiring a court to strike an entire contract. But any contract must be interpreted as a whole. (Civ. Code, § 1641 ["The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other"].)

It may well be unconscionable if an online consumer checks a "terms of service" box that has a buried provision allowing the seller access to all of the consumer's computer information in the course of a five-dollar computer application purchase. On the other hand, it may well not be unconscionable for an entertainer, a ballplayer or a high-level corporate or non-profit executive to sign an employment contract containing a non-negotiable "morals" clause that may restrict the new employee's private

life. Why? Because in the latter case, the overall deal, as a whole, makes sense. There is a fair quid pro quo. And, there is another reason. The entertainer's/executive's morals clause relates to – protects performance of – the underlying deal. The posited privacy disclosure has no relationship to the purchase being made. The unconscionability of any particular contract provision should be judged similarly.

There are trade-offs in every contract. Lien and security rights favor one party. Payment favors the seller; required delivery of goods favors the buyer. Notice and an opportunity to cure usually favor the party in the position to default. But these types of provisions are almost inevitably *not* unconscionable, because in the context of the transaction as a whole, they are fair and reasonable. So, too, a forum-selection clause choosing a far-away state may be unconscionable in a small-value consumer transaction but enforceable in a multi-million-dollar deal amongst entities with presences in varied locations. The bottom line is that the transaction as a whole needs to be examined.

The same is true of arbitration provisions. They, too, must be evaluated as a whole. The provision itself may contain trade-offs, e.g., one side pays certain fees, the other side gains a measure of protection from outlier results, such that the entire provision needs to be examined based on its overall effect. And, even then the arbitration provision needs to be evaluated in the context of the overall transaction.

At The Time Of Contracting. Statutorily, unconscionability must be determined "at the time [the contract] was made . . . ." (Civ. Code,

§ 1670.5.) The materialized dispute's specifics are *irrelevant.* "The critical juncture for determining whether a contract is unconscionable is the moment when it is entered into by both parties–not whether it is unconscionable in light of subsequent events." (*American Software, Inc. v. Ali* (1996) 46 Cal.App.4th 1386, 1391; accord, *Morris, supra,* 128 Cal.App.4th at p. 1324.) The question is whether a reasonable person not knowing what the future would bring would inevitably have found the provision repugnant at the time he or she signed the contract.

II. Over The Years A Wide Range Of Substantive Unconscionability Formulations Have Proliferated.

As the Court's supplemental briefing order indicates, a number of different formulations for the concept of substantive unconscionability have emerged over time.

Civil Code Section 1670.5. We start with the statutory formulation. In California, the doctrine of unconscionability was codified in 1979 in Civil Code section 1670.5. The Legislature adopted as generally applicable to all contracts the Uniform Commercial Code concept of unconscionability. (See Appendix to Petitioner's Request for Judicial Notice, Volume I, at RJN94 [Assembly Committee on Judiciary, Staff Analysis after Senate amendment]; *Perdue v. Crocker Natl. Bank* (1985) 38 Cal.3d 913, 925, fn. 10.) The statute employs language identical to that in

U.C.C. section 2-302, and the legislative comment is identical to the comment to U.C.C. section 2-302.[1]

The statute itself says only that if the court finds "the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result." (Civ. Code, § 1670.5(a).) The Legislative Committee Comment does not explicate the standard much: "The basic test is whether, in the light of the general background and the needs of the particular case, the clauses involved are *so one-sided as to be unconscionable* under the circumstances existing at the time of the making of the contract." (Emphasis added.) The problem, of course, is that this "definition" is tautological. A clause is "unconscionable" if it is "so one-sided as to be unconscionable." The concept is defined with itself. "If reading this section makes anything clear it is that reading this section alone makes nothing clear about the meaning of 'unconscionable' except perhaps that it is pejorative." (Leff, *Unconscionability and the Code-The Emperor's New Clause* (1967) 115 U. Pa. L. Rev. 485, 487 [describing U.C.C. § 2-302, which California enacted verbatim as Civil Code section 1670.5].)

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[1] The Restatement Second of Contracts, section 208 likewise allows for courts to find contracts or portions thereof unenforceably unconscionable, but again it provides no definitive standard for determining unconscionability.

Section 1670.5 was enacted as part of legislation directed at curtailing certain scam home improvement transactions that led to home foreclosures. (Appendix to Petitioner's Request for Judicial Notice, Volume I, at RJN79–RJN82, RJN90–RJN93; see also Prince, *Unconscionability in California: A Need for Restraint and Certainty* (1995) 46 Hastings L.J. 459, 492-493.) The legislative history indicates that the statute was "designed to protect ignorant customers who enter into patently unreasonable contracts after having been conned by an unscrupulous dealer . . . . An unconscionable contract has been defined as one in which the terms are onerous, oppressive, or one-sided *and* which do not bear any reasonable relationship to the business risks involved in the transaction." (Appendix to Petitioner's Request for Judicial Notice, Volume I, at RJN82 [Assembly Committee on Judiciary, Bill Digest], emphasis added; RJN93 [Assembly Committee on Judiciary, Bill Digest, following Senate amendment], emphasis added.) It was believed that "[a] multitude of cases exist which give the concept a well-understood meaning." (See *id.* at RJN82 [Assembly Committee on Judiciary, Bill Digest], RJN93 [Assembly Committee on Judiciary, Bill Digest, following Senate amendment]; *Graham v. Scissor-Tail, Inc.* (1981) 28 Cal.3d 807, 820 fn. 19 [section 1670.5 merely codified existing California case law].)

In sum, the statute and its legislative history are of little help in defining what should be deemed unconscionable. Instead, the Legislature relied upon existing case-law formulations of the concept.

"Such As No Man In His Senses And Not Under Delusion Would Make On The One Hand, And As No Honest And Fair Man Would Accept On The Other." The seminal case-law definition of an unenforceable unconscionable contract comes from *Earl of Chesterfield v. Janssen*, 2 Ves.Sen. 125, 155, 28 Eng.Rep. 82, 100 (Ch. 1750): an unconscionable contract is one "such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other." This test was adopted by the United States Supreme Court in *Hume v. United States* (1889) 132 U.S. 406, 406, and it is still acknowledged there. (See *AT&T Mobility, LLC v. Concepcion* (2011) 563 U.S. ___ [131 S.Ct. 1740, 1755, fn *] (conc. opn. of Thomas, J.).) It has been acknowledged in California as a traditional test. (*California Grocers Assn. v. Bank of America* (1994) 22 Cal.App.4th 205, 214; see *Williams v. Walker-Thomas Furniture Co., supra*, 350 F.2d at p. 450 fn. 12 [recognizing the traditional test, citing *Henningsen v. Bloomfield Motors, Inc.* (1960) 32 N.J. 358, 161 A.2d 69]; cf. *Sonic-Calabasas, supra*, 57 Cal.4th at p. 1143 [citing *Williams* and *Henningsen* as support for "unreasonably harsh, oppressive, or one-sided" tests].) And it remains a formulation in general use in numerous other states.[2] (Cf. *Missouri*

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[2] **Alabama:** *Pullum v. Pullum* (Ala. 2010) 58 So.3d 752, 760 n.3; *Layne v. Garner* (Ala. 1992) 612 So.2d 404, 408; **Arkansas:** *LegalZoom.com, Inc. v. McIllwain* (Ark. Oct. 3, 2013), No. CV-12-1043, ___ S.W.3d ___ [2013 WL 5497717, at *6] (citing standard and noting substantive unconscionability "generally involves excessive price"); **Indiana:** *Weaver v. American Oil Co.* (Ind. 1971) 276 N.E.2d 144, 146; **Iowa:** *In re Marriage of Shanks* (Iowa 2008) 758 N.W.2d 506, 514-515 (citing *Janssen* standard as well as "harsh, oppressive, and one-sided"

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Department of Social Services, Division of Aging v. Brookside Nursing Center, Inc. (Mo. 2001) 50 S.W.3d 273, 277 [unconscionability requires "an inequality so strong, gross, and manifest that it must be impossible to state it to one with common sense without producing an exclamation at the inequality of it"].)

Shocks the Conscience. The "shocks the conscience" standard has almost equal time-tested lineage. "The traditional standard of unconscionability, as set forth in *Osgood v. Franklin* (1816 N.Y.Ch.) I Johns. Ch. 1, 21, is that 'the inequality amounting to fraud must be so strong and manifest as to *shock the conscience* and confound the judgment of any man of common sense.'" (*California Grocers Assn., supra,* 22 Cal.App.4th at p. 214 [emphasis added].) On its face, the "shocks the

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[2] (...continued)
formulation); *Casey v. Lupkes* (Iowa 1979) 286 N.W.2d 204, 207; **Kentucky:** *Energy Home v. Peay* (Ky. 2013) 406 S.W.3d 828, 836; **Massachusetts:** *Waters v. Min Ltd.* (Mass. 1992) 587 N.E.2d 231, 233-234 (citing *Janssen* standard and noting "[g]ross disparity in the values exchanged is an important factor"); **Mississippi:** *Entergy Mississippi, Inc. v. Burdette Gin Co.* (Miss. 1998) 726 So.2d 1202, 1207; **Missouri:** *Brewer v. Missouri Title Loans, Inc.* (Mo. 2012) 364 S.W.3d 486, 500 (citing standard and noting that substantive unconscionability analysis asks whether "a contract provision is so substantively unfair that 'no man in his senses' would agree to it"); **New York:** *Matter of Friedman* (N.Y. 1978) 64 A.D.2d 70, 84-85 (*Janssen* is the "classic definition"); **Utah:** *Resource Management. Co. v. Weston Ranch* (Utah 1985) 706 P.2d 1028, 1041 (citing language and noting "standard for determining unconscionability is high, even if not precise"); **West Virginia:** *Brown ex. rel. Brown v. Genesis Healthcare Corp.* (W.Va. 2011) 724 S.E.2d 250, 284; **Wyoming:** *Iberlin v. TCI Cablevision of Wyoming, Inc.* (Wyo. 1993) 855 P.2d 716, 728; Lonegrass, *Finding Room for Fairness in Formalism: The Sliding Scale Approach to Unconscionability*, (2012) 44 Loy. U. Chi. L.J. 1, 11 (*Janssen* standard "parroted by most courts" and "has remained unchanged for 250 years"); but see **New Mexico:** *Cordova v. World Finance Corp. of N.M.* (N.M. 2009) 208 P.3d 901, 909-910 (rejecting *Janssen* standard).

conscience" test "after all, is merely derivative of the term 'unconscionable.'" (*Id.* at p. 215.) This, too, is a standard that has widespread acceptance. (E.g., *Christian v. Christian* (N.Y. 1977) 365 N.E.2d 849, 855 [requiring inequality so "strong and manifest as to shock the conscience and confound the judgment of any (person) of common sense"], internal quotation marks omitted.)[3]

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[3] E.g., **Florida:** *Gainesville Health Care Ctr., Inc. v. Weston* (Fla.Dist.Ct.App.2003) 857 So.2d 278, 284-285 (to "determine whether a contract is substantively unconscionable, a court must look to the terms of the contract itself, and determine whether they are so outrageously unfair as to shock the judicial conscience"); **Georgia:** *Results Oriented, Inc. v. Crawford* (Ga.App. 2000) 538 S.E.2d 73, 80 ("unconscionable contract is one abhorrent to good morals and conscience"); *Hall v. Wingate* (Ga. 1924) 126 S.E. 796, 813 (same); **Kansas:** *Aves v. Shah* (Kan. 1995) 906 P.2d 642, 653 ("contract is only unconscionable if it is so unfair that it shocks the conscience of the court"); **Maine:** *Bither v. Packard* (Me. 1916) 98 A. 929 (for courts of equity to interfere in contract enforcement, "such unconscionableness . . . should be made out as would (to use an expressive phrase) shock the conscience"); *see also Bezio v. Draeger* (1st Cir. 2013) 737 F.3d 819, 825 (citing *Bither* as Maine law); **Maryland:** *Cannon v. Cannon* (Md. 2005) 865 A.2d 563, 588 (even though "one term of the Agreement was described as draconian, we agree with the intermediate appellate court that such does not sink to the level of unconscionability" because "a basic aspect of unconscionability is that it must 'shock the conscience' of the court when it considers the terms and results at the time the contract is entered"); **Michigan:** *Clark v. DaimlerChrysler Corp.* (Mich. App. 2005) 706 N.W.2d 471, 475 ("a term is substantively unreasonable" and thus substantively unconscionable, "where the inequity of the term is so extreme as to shock the conscience"); *see also Gillam v. Michigan Mortgage-Investment Corp.* (1923) 224 Mich. 405, 409 (cited in *Clark*); **New Mexico**: *Huckins v. Ritter* (N.M. 1983) 661 P.2d 52, 54 (exception to enforcement of real estate contract where "enforcement of the literal terms of the contract would result in a forfeiture or in unfairness which shocks the conscience of the court"); **New Jersey:** *Sitogum Holdings, Inc. v. Ropes* (N.J. Super. 2002) 800 A.2d 915, 921 (substantive unconscionability describes an exchange of promises "so one-sided as to shock the court's conscience"); **New York:** *Rowley v. Amrhein* (N.Y. App. Div. 2007) 46 A.D.3d 489, 489 ("Plaintiff contends that even if the agreement is valid, it is unconscionable. However, nothing in the agreement shocks the

(continued...)

The "shocks the conscience" standard has long roots in California. For over one hundred years, this Court has refused to enforce in equity contracts that "shock the conscience." (E.g., *Sunrise Land Co. v. Root* (1911) 160 Cal. 95; see *State Finance Co. v. Smith* (1941) 44 Cal.App.2d 688, 691-692 [refusing to enforce contract "[w]here the inadequacy [of consideration] is so gross as to shock the conscience and common sense of all men, it may amount both at law and in equity to proof of fraud, oppression and undue influence"]; *Jacklich v. Baer* (1943) 57 Cal.App.2d 684, 693 [equity will not enforce contract "so manifestly harsh and oppressive as to shock the conscience"].) More recently, the "shock the conscience" test has been used to determine whether an attorney's fee is unconscionable. (*Tarver v. State Bar of California* (1984) 37 Cal.3d 122, 134 [test for whether fee is unconscionable is whether it is so high "as to

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[3] (...continued)
conscience." [citing *Christian v. Christian, supra*, 42 N.Y.2d at p. 71]); **North Carolina:** *Tillman v. Commercial Credit Loans, Inc.* (N.C. 2008) 655 S.E.2d 362, 369 (contract is deemed unconscionable if the "inequality of the bargain is so manifest as to shock the judgment of a person of common sense" [internal quotation marks omitted]); **South Dakota:** *Tsiolis v. Hatterscheidt* (S.D. 1971) 187 N.W.2d 104, 106 ("[g]enerally speaking . . . in the absence of any mistake, fraud or oppression, the courts are not interested in the wisdom or impolicy of contracts . . . . It is only when the inequality of the bargain is 'such as to shock the conscience of the court['] that relief will be granted.") **Utah:** *Woodhaven Apartments v. Washington* (Utah 1997) 942 P.2d 918, 925 (court must find the disparity between liquidated and actual damages "shock[s] the conscience or produce[s] a profound sense of injustice before there can be a determination of unconscionability" of the term); **Virginia:** *Management Enterprises, Inc. v. Thorncroft Co.* (Va. 1992) 416 S.E.2d 229, 231 ("inequality" in contract "must be so gross as to shock the conscience"); *Gay v. Creditinform* (3d Cir. 2007) 511 F.3d 369, 391 (citing *Thorncroft* as Virginia law); **Washington:** *Hill v. Garda CL Nw., Inc.* (Wash. 2013) 308 P.3d 635, 638 ("a term is substantively unconscionable where it is overly or monstrously harsh, is one-sided, shocks the conscience, or is exceedingly calloused").

shock the conscience," internal quotation marks omitted]; *Bushman v. State Bar of California* (1974) 11 Cal.3d 558, 563 [same].) Most recently, *Pinnacle Museum Tower Assn. v. Pinnacle Market Development (US), LLC* (2012) 55 Cal.4th 223, 246, employed the "shocks the conscience" test. And, in *Sonic-Calabasas*, three justices of this Court expressly cleaved to "shocks the conscience" as the exclusive standard for unconscionability. (57 Cal.4th at p. 1172 (conc. opn. of Corrigan, J.); 57 Cal.4th at pp. 1177-1178 (dis. opn. of Chin, J.).)

Notably, the "conscience" at issue under this standard is not an individual judge's conscience, but a collective "conscience," a conscience of any person of common sense. (See *California Grocers Assn.*, *supra*, 22 Cal.4th at p. 214.) And, what shocks the collective conscience is a result outside of *the range of results that a reasonable person might view as available*. An appellate court must uphold a verdict supported by substantial evidence even if it reads the evidence differently, or must uphold a discretionary decision by a trial judge that falls within the range of reasonable judicial determinations even if the appellate justices would have ruled differently. (E.g., *Rupf v. Yan* (2000) 85 Cal.App.4th 411, 429, fn. 5 [substantial evidence]; *Estate of Hammer* (1993) 19 Cal.App.4th 1621, 1634 [abuse of discretion].) So, too, a court cannot deem unconscionable a contract provision that falls within the range of reasonable trade-offs that parties negotiating freely might arrive at, even if the court personally believes the parties could have reached a fairer or more equitable ideal.

"Shocks the conscience" means *no* reasonable person would ever willingly agree to the terms, not that some reasonable people might reject the terms.

"Terms . . . 'So Extreme as to Appear Unconscionable According to the Mores and Business Practices of the Time and Place.'" This is the test formulated in what is considered the landmark case of *Williams v. Walker-Thomas Furniture Co.*, *supra*, 350 F.2d at p. 450. (See Prince, *supra*, 46 Hastings L.J. at p. 477 [describing *Walker-Thomas* as "landmark" case]; *A&M Produce Co. v. FMC Corp.* (1982) 135 Cal.App.3d 473, 486 [relying on *Williams*].) *Williams* adopted this standard from 1 Corbin, Contracts § 128 (1963). In its analysis, *Williams* used the short-hand phrase "unreasonably one-sided contract terms which are unreasonably favorable to the other party" (*Williams*, *supra*, 350 F.2d at p. 449), and that phrase was adopted by some later courts (see *A&M Produce Co. v. FMC Corp.*, *supra*, 135 Cal.App.3d at p. 486). But *Williams* also further explained that it meant by that phrase extreme terms compared to the mores and business practices of the time and place:

> In determining reasonableness or fairness, the primary concern must be with the terms of the contract considered in light of the circumstances existing when the contract was made. The test is not simple, nor can it be mechanically applied. The terms are to be considered 'in the light of the general commercial background and the commercial needs of the particular trade or case.' Corbin suggests the test as being whether the terms are 'so extreme as to appear

unconscionable according to the mores and business practices of the time and place.' [Citation.] *We think this formulation correctly states the test to be applied in those cases where no meaningful choice was exercised upon entering the contract.* (*Williams*, *supra*, 350 F.2d at p. 450, emphasis added.)

"Gross Disparity in Values Exchanged." This formulation comes from section 208, comment c of the Restatement (Second) of Contracts: "Inadequacy of consideration does not of itself invalidate a bargain, but gross disparity in the values exchanged may be an important factor in a determination that a contract is unconscionable and may be sufficient ground, without more, for denying specific performance." (Rest.2d Contracts, § 208, com. c, p. 108, quoted in *Donovan v. RRL Corp.* (2001) 26 Cal.4th 261, 291-292.)

Unfairly One-Sided / Overly Harsh / Unduly Oppressive / Unreasonably Favorable / Modicum of Bilaterality. A number of other formulations have popped up in California law. The majority opinion in *Sonic-Calabasas*, *supra*, 57 Cal.4th at p. 1145, catalogued a number of them: "Unconscionability doctrine ensures that contracts, particularly contracts of adhesion, do not impose terms that have been variously described as """*overly harsh*""" (*Stirlen v. Supercuts, Inc.*, *supra*, 51 Cal.App.4th at p. 1532), "*unduly oppressive*" (*Perdue v. Crocker National Bank*, *supra*, 38 Cal.3d at p. 925), . . . "*unfairly one-sided*" (*Little v. Auto Stiegler* (2003) 29 Cal.4th 1064, 1071)." (Emphasis added.)

Almost uniformly, these formulations are descendants of, or began as short-hand for, the more traditional, previously discussed phrasings.

The terms one-sided and overly harsh appear to derive from *A&M Produce Co. v. FMC Corp.*, *supra*, 135 Cal.App.3d at p. 487. *A&M Produce Co.* emphasized that the phrases did not stand alone but had to be linked to "an absence of 'justification' for" the one-sidedness or harshness, i.e., that there had to be a lack of a legitimate business interest that the benefitting party was protecting. (*Ibid.*) For example, a deed of trust or auto financing lien is completely one sided, but it protects a lender's legitimate business interest. So, too, an appeal process for outlier arbitration results may protect parties' interests in quick, simple resolution of most disputes, but legitimately limits risks of untoward decisions in those instances that fall outside the scope of ordinary disputes.

In pronouncing its "one-sided" and "overly harsh" standards, *A&M Produce* relied on *Schroeder v. Fageol Motors, Inc.* (1975) 86 Wash.2d 256 and *Weaver v. American Oil Company* (1972) 257 Ind. 458 [276 N.E.2d 144]. (*A&M Produce*, *supra*, 135 Cal.App.3d at p. 487.) *Schroeder* addressed primarily procedural unconscionability. Its statement of the standard for substantive unconscionability, however, derived from *Williams*, discussed above. (*Schroeder*, *supra*, 86 Wash.2d at pp. 259-260.)

Likewise, *Weaver* described its substantive unconscionability standard in the same terms as discussed above:

> "An 'unconscionable contract' has been defined to be such as no sensible man not under delusion, duress or in distress

> would make, and such as no honest and fair man would accept. There exists here an 'inequality so strong, gross and manifest that it is impossible to state it to a man of common sense without producing an exclamation at the inequality of it.' 'Where the inadequacy of the price is so great that the mind revolts at it the court will lay hold on the slightest circumstances of oppression or advantage to rescind the contract.'" (276 N.E.2d at p. 146.)

The *A&M* phrasings, thus, reflected nothing less than the standards recognized in *Williams* and *Hume/Janssen.*

The term *unduly oppressive* appears to have its genesis in *Graham v. Scissor-Tail, supra*, 28 Cal.3d at p. 820. *Graham*, in turn, cites *Jacklich v. Baer* (1943) 57 Cal.App.2d 684, a "shocks the conscience" case, as a basis for this formulation.[4] In practice, what *Graham* found "unduly oppressive" was an arbitration provision that was "illusory" because it designated the opposing-party musicians' union as the arbitrator and the union required such a provision in all union member contracts. (28 Cal.3d at p. 824.) That is a term that would truly shock the collective conscience, as it would offend the common sense of any reasonable person.

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[4] The other case *Graham* cites, *Steven v. Fidelity & Casualty Co.* (1962) 58 Cal.2d 862, 878-879, holds an insurance carrier's practice unconscionable, but does not set forth a standard by which that is determined.

As discussed above, the phrase *unreasonably favorable* has its root in a short-hand phrase used in *Williams*. Nonetheless, some later cases have viewed it as less strong or exacting than "shocks the conscience." (See *Shvarts v. Budget Group, Inc.* (2000) 81 Cal.App.4th 1153, 1159; *California Grocers Assn., supra*, 22 Cal.App.4th at p. 215 ["so extreme," "gross overpricing," and "overly harsh" are "more specific, more exacting, and more demanding than an 'unreasonableness' standard, and are thus preferable" and are comparable to "shock the conscience"]; Lonegrass, *Finding Room for Fairness in Formalism: The Sliding Scale Approach to Unconscionability* (2012) 44 Loy. U. Chi. L.J. 1, 16 [courts have "visibly relaxed the strict requirements for substantive unconscionability" by using "unreasonably one-sided" or "commercially unreasonable" formulations instead of "conscience-shocking" or "outrageous"].)

The bottom line is that all of these remaining formulations ultimately derive from the *Janssen/Hume*, shocks-the-conscience, or *Williams* tests. They have, through imprecise usage, metamorphasized at times to be viewed as less strict than their origins, but such a construction is not fair. No case says that it intended to depart from the original principles or provides any reason to do so.

Finally, *Armendariz, supra*, 24 Cal.4th at p. 119, suggested that there has to be a "modicum of bilaterality." This may just be another way of phrasing the "unduly one-sided" prohibition as an affirmative obligation of some two-sidedness. Or, it may be a special arbitration-only requirement that may be suspect under *Concepcion, supra*, 563 U.S. ___ [131 S.Ct.

1740]. (See *THI of New Mexico at Hobbs Center, LLC v. Patton* (10th Cir. 2014) 741 F.3d 1162 [*Concepcion* bars state from declaring arbitration provision unconscionable because it does not encompass all potential disputes between the parties].)

Either way, it affords no independent basis for a different test.

Academic Commentary. The unconscionability doctrine has been subject to much academic commentary. (E.g., Leff, *supra*, 115 U. Pa. L.Rev. 485; Lonegrass, *supra*, 44 Loy. U. Chi. L.J. 1; Broome, *supra*, 3 Hastings Bus. L.J. 39; Marrow, *Squeezing Subjectivity from the Doctrine of Unconscionability* (2006) 53 Clev. St. L. Rev. 187; Korobkin, *A "Traditional" and "Behavioral" Law-and-Economics Analysis of Williams v. Walker-Thomas Furniture Company* (2004) 26 U. Haw. L. Rev. 441; Prince, supra, 46 Hastings L.J. 459.) But the commentary has been far from consistent. (Compare Korobkin, *supra*, 26 U. Haw. L. Rev. at p. 444 ["unreasonably favorable" terms standard "provides little specific guidance as to what facts should sum to a verdict of unenforceability"] with Lonegrass, *supra*, 44 Loy. U. Chi. L.J. at p. 61 [endorsing "commercially unreasonable"] and Marrow, supra, 53 Clev. St. L. Rev. at pp. 188, 192 [criticizing all of the standards and proposing a different approach altogether].) To be blunt, the academic commentary has not advanced the case law approaches. Rather, if anything, it has reinforced a proliferation of phrasings without any principled basis for using disparate terminology.

III. "Shocks The Conscience" Is The Best Formulation.

As discussed in section I.A., above, *one* formulation of the standard should apply. The arbitration provision at issue in this case is valid and enforceable – not unconscionable – under *any* relevant standard.[5] But, the best choice for a single, over-arching standard is "shocks the conscience." Here's why.

Any standard should not be overinclusive – that is, it should not extend to conduct, e.g., mere hard or bad bargains, that do not rise to unconscionability. And any standard adopted should not be underinclusive – that is, it should not exclude any conduct that is appropriately deemed unconscionable. "Shocks the conscience" does that. There is no contract provision that "shocks the conscience" that would not be unconscionable. And, contract provisions that do not shock the conscience, should not be deemed unconscionable. (See *California Grocers Assn.*, *supra*, 22 Cal.App.4th at p. 215 ["'shock the conscience' standard" is "derivative of the term 'unconscionable'"].)

The "shocks" element affords a sufficiently high hurdle protecting contract provisions that result from superior bargaining power but still fall within the range of reasonable outcomes under contemporary business practices and mores. And the standard, properly understood, is objective. The "conscience" at issue is not an individual jurist's conscience or

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[5] At a minimum, arbitration can be enforced in a manner so as to "limit the application of any unconscionable clause as to avoid any unconscionable result." (Civ. Code, § 1670.5, subd. (2).)

subjective views, but is and should be a collective conscience – what reasonable people of common sense find not just unfair or one-sided, but reflecting an outcome that no reasonable person would have voluntarily agreed to or that violates a norm tethered to a statute or administrative regulation. (See *California Grocers Assn.*, *supra*, 22 Cal.App.4th at p. 214 ["inequality . . . must be so strong and manifest as to shock the conscience and confound the judgment of *any man of common sense*"] [emphasis added].)

The tests enunciated in *United States v. Hume* – that which "no man in his senses and not under delusion would make on the one hand," and which "no honest and fair man would accept on the other" – and *Williams v. Walker-Thomas Furniture Company* – "terms . . .'so extreme as to appear unconscionable according to the mores and business practices of the time and place'" – likewise afford objective standards. They compare contract terms against the broad realm of what reasonable people might agree to. But they essentially are other ways of phrasing the shocks-the-conscience standard. Both explain that the correct standard for substantive unconscionability is not whether *a* reasonable person might find the provision repugnant (and not just merely one-sided) but whether *all or nearly all* reasonable people would so find. Both standards comport with a correct application of the "shock the conscience" test. The latter test has a long history of acceptance in California. Petitioner submits that the "shock the conscience" test is the best objective formulation to employ in California.

Greatly deficient consideration also provides a measurable standard. But such a test is likely underinclusive. It is hard to apply to nonmonetary contract terms, e.g., forum-selection, notice, lien, dispute resolution, delivery time and place, etc.

The other standards that have developed – unreasonably favorable, unduly oppressive, unfairly one-sided, overly harsh etc. – are more problematic than "shocks the conscience" and its cognates. To begin with, these standards all descend from shock the conscience and its cognates. To the extent that they are viewed as different, the difference is a matter of semantic corruption, *not* principled decisionmaking.

Equally important, they are unduly amorphous, with no objective content or standard. (*California Grocers Assn.*, *supra*, 22 Cal.App.4th at pp. 214–215.) Contracting parties, litigants, and courts are left with "unreasonably," "unduly," "overly," etc., but *compared to what.* Those are not viable, objective standards. Rather, they are an invitation to judges to exercise subjective personal judgment as to what they personally think is fair or unfair. (See *Morris*, *supra*, 128 Cal.App.4th at pp.1316-1317 [disfavoring standards that lead to "arbitrary or unpredictable decisions about what is fair or unfair"].) That is a slippery slope that leads to judges rebalancing bargains and imposing their notions of fairness for those of the marketplace and the community as a whole. It destroys the certainty and predictability in enforcing contracts that California public policy favors and that the objective "shocks the conscience" standard better promotes.

IV. The Arbitration Provision Here Is Not Unconscionable.

As discussed at length in petitioner's Brief on the Merits and Reply Brief on the Merits (Opening Brief at 42-50; Reply Brief at 14-28), the arbitration provision here is far from unconscionable. That's true under a "shocks the conscience" test. (McGuiness & 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) 2005 J. Disp. Resol. 61, 90 ["Whether or not these contractual (arbitration) terms are 'unfair' in some general sense, they are a far cry from the overtly oppressive contracts traditionally policed by courts under the doctrine of unconscionability—i.e., they do not 'shock the conscience'"].) And, it is true under any other phrasing.

The provision is acceptable to a reasonable person and is simply not the endpoint of duress or coercion. There is no requirement of a biased arbitrator. (Cf. *Graham v. Scissor-Tail, supra*, 28 Cal.3d at pp. 821, 826-827.) The arbitrator is either a recognized neutral organization *or* a neutral of the buyer's choice subject to the dealer's consent. That consent will be subject to the covenant of good faith and fair dealing making it not unconscionable. (See *Serpa, supra*, 215 Cal.App.4th at p. 708 [employer's ability to unilaterally change arbitration provision in employee handbook does not create unconscionability because it is subject to good-faith standard].)

The dealer is to pay $2,500 towards the buyer's arbitration expenses. And, many arbitration agencies have provisions for parties who cannot afford fees. (See Reply Br. at 26, fn. 10.)

In the vast majority of cases – auto purchase claims with awards between $0 and $100,000 – single arbitrator, one-shot arbitration will be the sole, binding process. Only when a buyer gets awarded nothing, or the award is for $100,000 or more or includes injunctive relief, will there be the opportunity for further *arbitral* review. Layers of arbitral review are not outside the norm. (See *Cable Connection, Inc. v. DIRECTV, Inc.* (2008) 44 Cal.4th 1334 [parties can agree to make arbitration award subject to *judicial* review].) In that review, the losing party in the first round will have to front the arbitration costs, but that is not outside the norm. Losing parties typically have to bear the lion's share of review costs.

The only disputes excluded from arbitration – small claims court and self-help remedies – do not create unconscionability. Small claims court is an alternate low-cost, fast-track system. Self-help remedies simply are not adjudicative in nature. They are *self*-help. They would not be subject to arbitration even if not mentioned.

There is nothing here that shocks the conscience. There is nothing here that is outside the range of what a reasonable person, not under delusion or duress, *might* agree to. There is nothing "unduly," "unfairly" or "unreasonably," harsh, oppressive, or one-sided, to the extent that those terms have measurable content. Rather, there is a fair trade-off of advantages, a trade-off that recognizes the individuals and dealers gain

much by speedy and efficient arbitration but no one is comfortable using that process in a "bet-the-company"/"bet-your-life-savings" circumstance.

CONCLUSION

This Court should adopt a single, uniform unconscionability standard. That standard should be "shocks the conscience." Whatever standard the Court adopts, it should be uniform, so that it can be applied equally in all cases. And, it should be objective, so courts evaluating challenged contract provisions can measure them against a set, external standard. The standard should set a significant hurdle; otherwise, it will impinge on the allocation of risk and benefits that is the normal part of the bargaining process.

Whatever standard is adopted, the arbitration provision at issue here does not come close to being unconscionable.

Dated: March 12, 2014

Respectfully submitted,

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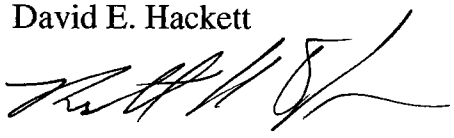
By: 

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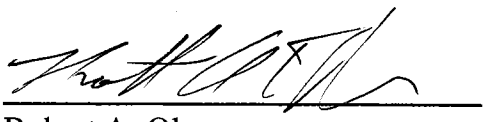
CERTIFICATE OF WORD COUNT

Pursuant to California Rules of Court, rule 8.204(c), I certify that this **SUPPLEMENTAL BRIEF ON THE MERITS** contains **7,453** words, not including the tables of contents and authorities, the caption page, graphics, this Certification page and appendices.

Dated: March 12, 2014



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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 March 12, 2014, I served the foregoing document described as: **SUPPLEMENTAL BRIEF ON THE MERITS** on the parties in this action by serving:

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(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

Anita F. Cole

SANCHEZ
v.
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Court of Appeal Case No. B228027;
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