08-4103

IN THE

United States Court of Appeals

FOR THE THIRD CIRCUIT

KEITH LITMAN and ROBERT WACHTEL,
Individually and on behalf of all others similarly situated,

Appellants,

—v.—

CELLCO PARTNERSHIP d/b/a Verizon Wireless,

Appellee.

ON APPEAL FROM THE OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY, TRENTON AT NO. 07-CV-4886 (FLW)

BRIEF OF *AMICI CURIAE* AMERICAN FINANCIAL SERVICES ASSOCIATION, CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AND CONSUMER BANKERS ASSOCIATION IN SUPPORT OF APPELLEE CELLCO PARTNERSHIP D/B/A VERIZON WIRELESS

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Fed. R. App. P. 26.1 and Third Circuit Rule 26.1, *Amici Curiae* American Financial Services Association, Chamber of Commerce of the United States of America and Consumer Bankers Association certify that they have no parent corporations and no publicly held company owns 10 percent or more of their stock.

Amici Curiae American Financial Services Association ("AFSA"), Chamber of Commerce of the United States of America ("U.S. Chamber") and Consumer Bankers Association ("CBA") respectfully submit this brief in support of Appellee Cellco Partnership d/b/a Verizon Wireless ("Verizon"). All parties have consented to the filing of this brief.

***AMICI'S* INTEREST IN THIS CASE**

AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA has a broad membership, ranging from large international financial services firms to single office, independently owned consumer finance companies. The association represents financial services companies that hold a leadership position in their markets and conform to the highest standards of customer service and ethical business practices. AFSA has provided services to its members for more than 90 years. The association's officers, board, and staff are dedicated to continuing this legacy of commitment through the addition of new members and programs, and increasing the quality of existing services.

The U.S. Chamber is the world's largest business federation, representing an underlying membership of more than 3,000,000 businesses and organizations of all sizes. U.S. Chamber members operate in every sector of the economy and transact business throughout the United States, as well as in a large number of countries

around the world. A central function of the U.S. Chamber is to represent the interests of its members in important matters before the state and federal courts, legislatures and executive branches. To that end, the U.S. Chamber has filed *amicus* briefs in numerous cases that have raised issues of vital concern to the nation's business community. In particular, the U.S. Chamber has been involved in a wide variety of cases relating to the interpretation of the Federal Arbitration Act ("FAA"), 9 U.S.C. §1, *et seq.*

The CBA is the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in consumer, auto, home equity and education finance, electronic retail delivery systems, privacy, fair lending, bank sales of investment products, small business services and community development. The CBA was founded in 1919 to provide a progressive voice in the retail banking industry. The CBA represents over 750 federally-insured financial institutions that collectively hold more than 70% of all consumer credit held by federally-insured depository institutions in the United States.

Many of *Amici*'s members, constituent organizations and affiliates (collectively, "Members") have independently adopted as standard features of their business contracts provisions that in appropriate circumstances mandate the individual arbitration of disputes arising from or relating to those contracts. They use arbitration because it is a prompt, fair, inexpensive and effective method of

resolving disputes with consumers and other contracting parties and because arbitration minimizes the disruption and loss of good will that often results from litigation. Indeed, based on the U.S. Supreme Court's consistent endorsement of arbitration over the past several decades, Members have entered into arbitration agreements with tens of millions of customers.

The Court's decision in this case will impact most consumer arbitration agreements which require individual arbitration and prohibit class proceedings in court or in arbitration. A finding that Verizon's arbitration agreement is invalid due to its prohibition on class actions would seriously undercut the value of arbitration to Members who use such agreements. The reality and threat of class action proceedings would predictably raise the cost to Members of providing goods and services to their customers and would thus raise the cost of such goods and services to consumers. Accordingly, *Amici* have a compelling interest in the issues at stake in this case.

SUMMARY OF ARGUMENT

Gay v. CreditInform, 511 F.3d 369 (3d Cir. 2007), *rehearing denied* (Jan. 29, 2008), correctly holds that *Thibodeau v. Comcast Corp.*, 912 A.2d 874 (Pa. Super. 2006), and *Lytle v. CitiFinancial Servs.*, 810 A.2d 643 (Pa. Super. 2002), were preempted by the FAA when they refused to enforce arbitration agreements with class action prohibitions. However, two days ago, a panel of this Court, in

Homa v. Am. Express Co., No. 07-2921, 2009 WL 440912 (3d Cir. Feb. 24, 2009), refused to follow the prior panel decision in *Gay* and held that *Muhammad v. County Bank of Rehoboth Beach, Del.*, 912 A.2d 88 (N.J. 2006), *cert. denied*, 549 U.S. 1338 (2007), was *not* preempted by the FAA. The *Homa* panel violated Third Circuit Internal Operating Procedure 9.1 ("IOP 9.1") and also erred on the merits.

The district court below correctly held that the FAA preempts the rule established by *Muhammad* that, in the context of a standard-form small-dollar retail contract, the parties may not select individual arbitration over class-action proceedings. Individual arbitration provides important benefits to consumers. By contrast, class arbitration was not contemplated by the framers of the FAA, raised significant Due Process concerns and is not practicable. Far from being "neutral" as between litigation and arbitration, *Muhammad's* imposition of judicial procedures on arbitration would substantially curtail the use of arbitration nationwide.

Muhammad does not rest on any traditional ground for declaring a contract invalid, such as fraud, duress or illegality of subject matter, nor does it apply traditional common law unconscionability principles. Rather, it follows an inherently malleable case-by-case approach which permits the court to invalidate a small-dollar standard-form retail contract on the ground of any established or novel "public policy" the court may find.

The question raised by this case is whether the courts will enforce the pro-arbitration policy of the FAA or, instead, the New Jersey "public policy, discovered in *Muhammad,*" favoring class-wide disposition of small-dollar claims. Of course, in a conflict between federal and state policies, the Supremacy Clause dictates that the federal policy must prevail. Moreover, under the plain language of Section 2 of the FAA, 9 U.S.C. §2, the *Muhammad* rule is preempted because state law can be applied to override an arbitration contract only if the state law would provide for the revocation of "any contract." The *Muhammad* rule, of course, can only be applied to small-dollar, standard-form retail contracts – not to "any contract." More fundamentally, it applies by definition only to arbitration agreements containing bans on class proceedings, not to "any contract." Accordingly, Verizon's arbitration agreement should be enforced as written.

ARGUMENT

I. *Homa* Erred In Refusing To Follow *Gay*.

In re McDonald defines "*dictum*" as:

> a statement in a judicial opinion that could have been deleted without seriously impairing the analytical foundations of the holding – *that, being peripheral, may not have received the full and careful consideration of the court that uttered it.*

205 F.3d 606, 612 (3d Cir. 2000) (emphasis added; citations on quote omitted). Quoting the first half of this definition (the part without italics) and ignoring the

second half (in italics), the *Homa* panel stated that *Gay*'s discussion of FAA preemption of Pennsylvania law "appears" to be *dicta*. Slip op. at 10.

In fact, the relevant analysis in *Gay* was more than *twice* as long as the *entire* FAA discussion in *Homa*. It could *not* be deleted without impairing the analytical foundations of the decision and is certainly *not* a "peripheral" discussion that did not receive "full and careful consideration." Accordingly, it is *not dicta*.

Homa made no attempt to distinguish the Pennsylvania decisions preempted in *Gay* from the New Jersey decision *Homa* approved. *Homa*, slip op. at 10 ("Whatever is true of *Lytle* and *Thibodeau* . . ."). Rather, without explaining how it reads *Gay*, the *Homa* panel suggested that the broadest potential reading of the case is in direct conflict language in a Supreme Court . . ." decision *predating Gay*. Slip op. at 11 (quoting *Doctor's Associates, Inc. v. Casarotto,* 517 U.S. 681, 686-87 (1996)).

In effect, *Homa* concluded that *Gay* was incorrectly decided. This is not a decision the *Homa* panel was entitled to make under IOP 9.1. *Homa* should be disregarded on this basis alone.

Homa should be rejected for an independent reason: It reached the wrong result on the merits. *Homa* read *Gay* more broadly than necessary and then relied upon (indisputable) *dicta* from *Casarotto*. Slip op. at 11. But *Casarotto* nowhere touched upon a challenge to the *substantive* fairness of an arbitration agreement

and instead addressed a Montana statute requiring a special notice on arbitration agreements. *Homa*'s mis-reading of *Gay* and its unquestioning reliance on a broad reading of the quoted passage from *Casarotto* are mistaken for the reasons articulated by Verizon in the discussion in its brief (§II-B) of the same passage. Significantly, *Homa* nowhere addresses, in any manner whatsoever, the cogent arguments made by Verizon in its brief nor the (equally cogent) arguments made below. These arguments were not advanced by counsel to the appellee in *Homa*, undoubtedly because the district court decision predated *Gay* and relied upon the arbitration agreement's choice of Utah law as the basis for its decision.

II. Individual Arbitration Benefits Consumers.

The FAA was designed specifically "'to reverse the longstanding judicial hostility to arbitration agreements . . . .'" *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 288 (2002) (quoting *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991)). It embodies a liberal federal policy favoring arbitration agreements. *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002). Accordingly, Section 2 of the FAA provides that arbitration agreements are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. §2. Section 2 creates federal substantive law of arbitrability that is binding on state as well as federal courts. *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445 (2006).

"Congress, when enacting [the FAA,] had the needs of consumers, as well as others, in mind." *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 280 (1995). "The advantages of arbitration are many: It is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing . . . dealings among the parties." H.R. Rep. No. 97-542, at 3 (1982). These "advantages often would seem helpful to individuals, say, complaining about a product, who need a less expensive alternative to litigation." *Allied-Bruce,* 513 U.S. at 280.

The benefits of arbitration are not limited to Verizon customers who have disputes with Verizon. Rather, *all* Verizon customers benefit from the lower dispute resolution costs inherent in arbitration. This is because competition and economic forces cause Verizon to pass on to consumers, in whole or in part, the lower dispute resolution costs it incurs as a result of its arbitration agreements. Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements,* 2001 J. Disp. Resol. 89, 91-93; Richard A. Posner, *Economic Analysis of Law* 7 (6th ed. 2003). Thus, due to arbitration, Verizon customers receive lower prices for the services they receive.[1]

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[1] If faced with an unconstrained choice between lower costs or the right to pursue class actions, many consumers would undoubtedly choose lower costs. *See Stiles v. Home Cable Concepts, Inc.*, 994 F.Supp. 1410, 1412,

(continued...)

Moreover, published studies show significant additional benefits to arbitration, as well as high levels of satisfaction for individuals who participate in arbitration. *See, e.g.*, Harris Interactive, *Arbitration: Simpler, Cheaper and Faster Than Litigation* (Apr. 2005) (strong satisfaction with arbitration results and process, including speed and simplicity); Ernst & Young, *Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases* (Dec. 2004) ("consumers find the arbitration process beneficial to resolving disputes"); Lewis L. Maltby, *Private Justice: Employment Arbitration and Civil Rights,* 30 Colum. Hum. Rts. L. Rev. 29, 63 (1998) (director of ACLU's National Task Force on Civil Liberties in the Workplace concludes that employees collectively receive *10.4%* of their demand in litigation, compared with *18%* in arbitration, and "arbitration holds the potential to make workplace justice truly available to rank-and-file employees for the first time in our history").

In proper circumstances, class actions can be useful. But the existence of substantial problems with class actions cannot be disputed. *See Tomlin v. Dylan Mortgage, Inc.*, No. 99-CVS-3551, 2002 WL 32986130, at *1-2 (N.C. Super. Ct. Feb. 1, 2002) (citing Deborah R. Hensler et al., *Class Action Dilemmas: Pursuing Public Goals for Private Gain* 401 (RAND Institute for Civil Justice 2000)

(...continued)

1418 (M.D. Ala. 1998) (cardholder accepted amendment to cardholder agreement that lowered interest rate and imposed arbitration).

(leaving open the 'great big question' whether class actions, on balance, serve the public well); *In re Gen. Motors Corp.*, 55 F.3d 768, 778 (3d Cir. 1995) (noting that class actions can become a vehicle for collusive settlements); Remarks of Congressman Sensenbrenner, Sponsor of the Class Action Fairness Act, 151 Cong. Rec. H726 (Feb. 17, 2005) ("The class action judicial system has become a joke, and no one is laughing except the trial lawyers . . . all the way to the bank.").

Reasonable, well-informed consumers could certainly prefer cost savings and other arbitration benefits to the speculative prospect of "relatively paltry potential recoveries" in a class action.[2] *Amchem Prods., Inc. v. Windsor,* 521 U.S. 591, 617 (1997). This is particularly true when the arbitration agreement contains a number of consumer-friendly provisions, including free mediation, as well as free arbitration in specified circumstances. Verizon Br. at 33.

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[2] A borrower would suffer monetary loss by agreeing to individual arbitration only if more money could be recovered in a class action than through informal complaints, mediation, small claims lawsuits, arbitration or government action; *and* the lost recovery exceeded the initial cost savings resulting from arbitration. Appellants did not allege that they complained to Verizon or any government authority or requested mediation. Thus, there is no reason to believe that Appellants incurred (or will incur) *any* financial loss as a result of their agreements to individually arbitrate their disputes with Verizon.

III. The Benefits Of Arbitration Are Incompatible With Class Proceedings.

In light of the benefits that arbitration can provide, Congress has encouraged parties to arbitrate disputes in accordance with the contracts they have executed. *See* 9 U.S.C. §2. However, "the FAA's legislative history indicates that Congress was opening the door to a particular *kind* of non-judicial dispute resolution proceeding, and class arbitration is a different kind of proceeding – apart from its non-judicial nature, it has little in common with what Congress approved in 1925." D.S. Clancy and M.M.K. Stein, *An Uninvited Guest: Class Arbitration and the Federal Arbitration Act's Legislative History*, 63 Bus. Law. 55, 57 (Nov. 2007) ("*An Uninvited Guest*") (emphasis in original). In this regard, proponents of the FAA who testified before Congress described arbitration as: (1) purely voluntary; (2) "face to face" in nature; and (3) prompt, inexpensive and procedurally streamlined. *Id.* at 59-60.

One leading arbitration advocate characterized arbitration as "something so much cheaper than litigation that . . . its use would reduce the price of consumer goods . . . .'" *Id.* at 59 n.16 (citations omitted). Another leading advocate advised Congress that arbitration would avoid long delays resulting from court congestion, preliminary motions and other steps taken by litigants. *Id.* at 59. Accordingly, Congressional reports recommending adoption of the FAA made clear that, "when it enacted the FAA, Congress understood arbitration to be something inherently

prompt, inexpensive, and streamlined – in other words, just the type of proceeding that had been described by the witnesses during the pre-enactment hearings." *Id.* at 61-62.

Class arbitration, as imposed by *Muhammad*, shares *none* of the attributes of the arbitration contemplated by Congress. *Id.* at 62-66. It is certainly *not* voluntary and does not provide a company with an opportunity to meet "face-to-face" with putative class members who may (or may not) feel aggrieved. And class-action procedures inherently conflict with the speed, simplicity, cost savings, informality and a reduction in adversarial conduct arbitration was designed to achieve. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985).

Superimposing class-action procedures on arbitration "brings the burdens of litigation into the arbitral forum. . . . [T]he greatest advantages of arbitration are in many instances the greatest disadvantages of litigation, yet class-wide arbitration . . . lessens the distinction between the two processes." Jonathan R. Bunch, *To Be Announced: Silence from the United States Supreme Court and Disagreement Among Lower Courts Suggest an Uncertain Future for Class-Wide Arbitration*, 2004 J. Disp. Resol. 259, 272; *accord* Linsday R. Androski, *A Contested Merger: The Intersection of Class Actions and Mandatory Arbitration Clauses*, 2003 U. Chi. Legal F. 631, 649 (class arbitration "subjects arbitration to the very judicial

burden that the contracting parties sought to avoid through arbitration"). In attempting to combine two separate and distinct forms of dispute resolution, cases like *Muhammad* create an unworkable tangle inferior to *both* a true judicial or arbitral forum.

Not only is class arbitration inconsistent with the streamlined procedures that are the *sine qua non* of the individual arbitration contemplated by the FAA, class arbitration generates unique costs. For example, the "clause construction" determination, which addresses whether a particular agreement permits class arbitration, has no counterpart in the courts. Clause construction disputes can be time-consuming and costly. *See An Uninvited Guest*, at 63-64. Moreover, arbitrators bill their time to the parties at rates amounting to hundreds of dollars per hour (thousands of dollars per hour for three-arbitrator panels). *Id.* at 64. Thus, class arbitration is likely to be *more* expensive than class litigation and often prohibitively so.

The cost disadvantages of class arbitration are hardly the only (or worst) ones. Any class-wide arbitral award would be reviewable only for fraud, bias or gross misbehavior of the arbitrator. *See* 9 U.S.C. §10; *Dominion Video Satellite, Inc. v. Echostar Satellite L.L.C.*, 430 F.3d 1269, 1275 (10th Cir. 2005) (standard for vacating an arbitral award is "among the narrowest known to law") (citation omitted); *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 128 S. Ct. 1396 (2008) (holding

that parties may not contractually expand the grounds for appealing arbitration awards).

Many companies are willing to risk an erroneous decision in an individual arbitration because of the cost savings inherent in arbitration and the desire to pursue a less adversarial way of resolving customer disputes. However, the calculus changes dramatically if the arbitration provision must allow for class proceedings. As one U.S. Supreme Court Justice commented in referring to class arbitration proceedings: "You might not want to put your company's entire future in the hands of one arbitrator." *See Oral Argument in Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444 (2003), *available at* 2003 WL 1989562, at *29.

Finally, the lack of judicial involvement and oversight of classwide arbitration raises significant due process concerns about the protection of absent class members. See *An Uninvited Guest*, at 75-78. In enacting the FAA in 1925, well before Rule 23 was added to the Federal Rules of Civil Procedure in 1966, Congress clearly did not contemplate classwide arbitration.

In short, the inevitable consequence of conditioning the enforcement of consumer arbitration provisions on the availability of class-wide arbitration is that businesses will stop including arbitration provisions in their contracts with consumers. This "frustrate[s] the purpose" of the FAA, *Livadas v. Bradshaw*, 512 U.S. 107, 116 (1994) (citation omitted), and "stands as an obstacle to the

accomplishment and execution of the full purposes and objective of Congress" in enacting the FAA. *United States v. Locke*, 529 U.S. 89, 109 (2000) (internal quotation marks and citation omitted).

IV. A Prohibition Against Class Proceedings Does Implicate Traditional Standards Of Unconscionability.

Many courts have created a "new brand of unconscionability" in the arbitration context. *See* M. McGuiness and A. Karr, *California's 'Unique' Approach to Arbitration: Why This Road Less Traveled Will Make All the Difference on the Issue of Preemption under the Federal Arbitration Act*, 2005 J. Disp. Resol. 61, 62 (criticizing California state courts and federal courts in the Ninth Circuit for failing to comply with Section 2 of the FAA). Indeed, Appellants acknowledged in their brief, pp. 45-47, that, in *Thibodeau* and *Lytle*, Pennsylvania state courts likewise applied "unconscionability" principles hostile to arbitration. Other courts, as well, have shown a fairly blatant hostility to arbitration, notwithstanding the pro-arbitration policy of the FAA. *See, e.g., Arnold v. United Companies Lending Corp.*, 511 S.E. 2d 854, 862 (W.Va. 1998) (treating arbitration agreement as "a substantial waiver of the borrower's rights, including access to the courts" and failing to articulate any waived rights other than the "right" of access to the courts); *Iwen v. U.S. West Direct*, 977 P.2d 989, 996 (Mont. 1999) (finding arbitration agreement "unconscionable" because "U.S. West Direct pointedly protected itself by preserving its constitutional right of access to the judicial system

while at the same time completely removed that right from the advertiser"; failing to articulate why arbitration is less effective than litigation). While other courts are more circumspect in the language they choose when addressing whether arbitration agreements are unconscionable, there can be no question that modern-day arbitration cases depart radically from traditional conceptions of unconscionability outside the arbitration context.

The original common law formulation of an "unconscionable" agreement emphasized the limited and egregious circumstances in which the concept could apply: An unconscionable contract was one that "no man in his senses and not under delusion would make on the one hand, and [that] no honest and fair man would accept on the other." *Earl of Chesterfield v. Janssen*, 28 Eng. Rep. 82, 100 (Ch. 1750) (cited in *Abel Holding Co. v. American Dist. Tel. Co.*, 350 A.2d 292, 303 (N.J. Super. 1975)). *See generally Hume v. United States*, 132 U.S. 406 (1889) (discussing the English authorities).

Pre-dispute agreements requiring individual arbitration of legal claims simply are not "unconscionable" under this standard. In fact, the cost savings and other benefits inuring to consumers who agree to arbitration, whether voluntarily or through standard-form contracts, fully support the reasonableness of individual arbitration. Because the *Muhammad* rule applies solely to small-value claims, where individual consumers by definition have very little to lose, the concern

expressed by the court below, slip op. at 14 n.6, that enforcing a class action prohibition in an arbitration agreement might be "harsh," is unfounded. Moreover, the FAA recognizes that a "business . . . which enters into transactions bringing it very small revenues under any particular contract . . . has a legitimate reason to seek to avoid expensive litigation to resolve disputes with its customers and instead resolve its disputes less formally and probably less expensively in arbitration." *Gay*, 511 F.3d at 393 n.17.

The real concern of parties concerned about the supposed unconscionability of agreements requiring individual arbitration is not the impact on individual consumers but rather the fear that companies that are not threatened by class actions will be exculpated from liability for any wrongs they commit. *See, e.g.*, *Muhammad*, 912 A.2d at 99 (stating that, in the context of small-value claims, "a class-action waiver can act effectively as an exculpatory clause"); *Thibodeau*, 912 A.2d at 885 ("Should the law require consumers to litigate or arbitrate individually, defendant corporations are effectively immunized from redress of grievances."); *Dale v. Comcast Corp.*, 498 F.3d 1216, 1224 (11th Cir. 2007) ("Corporations should not be permitted to use class action waivers as a means to exculpate themselves from liability for small value claims.").

The *Muhammad* court simply assumed, without any evidence before it, that individual arbitration could not vindicate consumers' rights. This assumption

engages in the type of speculation expressly rejected by the U.S. Supreme Court, *see Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 91 (2000) (risk perceived by lower court without evidentiary foundation was "too speculative to justify the invalidation of an arbitration agreement"), and conflicts with the recognition by a host of courts that fee-shifting statutes such as the New Jersey law at issue in the instant case, N.J.S.A. §56:8-19, will frequently permit consumers to obtain counsel and bring individual arbitration proceedings vindicating their rights. *See, e.g., Johnson v. West Suburban Bank*, 225 F.3d 366, 374 (3d Cir. 2000), *cert. denied*, 531 U.S. 1145 (2001) (arbitration clause that prohibited class actions would not choke off the supply of lawyers willing to represent debtors because federal Truth-in-Lending Act ("TILA") permits successful plaintiffs to recover attorneys' fees); *Pleasants v. American Express Co.*, 541 F.3d 853 (8th Cir. 2008) (enforcing arbitration agreement with class action prohibition in part because of TILA fee-shifting language); *Jenkins v. First American Cash Advance of Ga., LLC*, 400 F.3d 868 (11th Cir. 2005), *cert. denied*, 546 U.S. 1214 (2006) (concluding that, where arbitration agreement permits fee shifting, lawyers will be willing to represent the consumer on an individual basis and the company will not be immunized against unlawful conduct); *Gipson v. Cross Country Bank*, 294 F.Supp.2d 1251, 1261-62 (M.D. Ala. 2003) (class action was not necessary for

plaintiff to vindicate her statutory rights because she could recover her attorneys' fees if successful in the arbitration).

Even putting aside a consumer's ability to obtain counsel under a fee-shifting statute, the reality of the matter is that the threat of government enforcement provides a powerful brake on improper conduct and an effective remedy for any wrongdoing that does occur. Thus, the defendant bank in *Muhammad* was sued by the New York Attorney General over the very same loan program at issue in *Muhammad*. *See Matter of People of State of New York v. County Bank of Rehoboth Beach, Del.*, 45 A.D.3d 1136 (N.Y. App. Div. 2007).

As to the instant case, if and when a provider of telecommunications services engages in unjust or unreasonable practices, the Federal Communications Commission ("FCC") has broad authority under the Communications Act of 1934, 47 U.S.C. §151, *et seq.*, to: (1) investigate the provider, 47 U.S.C. §§154(i), 154(j), and 403; (2) adjudicate complaints regarding its conduct, 47 U.S.C. §208; (3) issue a ruling ordering it to pay damages, 47 U.S.C. §209; and (4) assess forfeitures.[3] 47 U.S.C. §503.

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[3] There is another equally important constraint on wireless carriers' conduct – the threat of customer loss in a competitive market. For this reason, both Congress and the FCC have adopted rules strongly favoring market forces over governmental rate regulation. *See, e.g.*, 47 U.S.C. §332(c)(3) (prohibiting state regulation of wireless rates); *Implementation of Sections 3(n) and 332 of the Communications Act;*

(continued...)

The FCC has aggressively employed these powers, issuing notices of apparent liability for forfeiture or entering into consent decrees with numerous telecommunications companies that have allegedly violated laws designed to protect consumers, including laws prohibiting overcharges. For example, in January 2009, AT&T "voluntarily" provided refunds of overcharges (some amounting to less than $1.00) to all of its existing customers and then consented to pay the U.S. Treasury over $10 million to terminate the FCC enforcement action. *See* FCC Consent Decree & Order, In the Matter of AT&T Inc. Compliance with the Rules and Regulations Customer Proprietary Network Information and Universal Service Fund Line-Item Charges (Jan. 9, 2009), *available at* http://www.fcc.gov/eb/Orders/ 2009/DA-09-16A1.html.

Similarly, in 1990 the FCC entered into a consent decree with Nynex Corporation after the FCC learned that Nynex had overcharged for interstate phone services. Under the terms of the agreement, Nynex refunded ***$35.5 million in overcharges*** and back interest and agreed to contribute $1.4 million to the U.S. Treasury. *See* Edmund L. Andrews, Settlement for Nynex and F.C.C., N.Y.

(...continued)

Regulatory Treatment of Mobile Services, Second Report and Order, 9 F.C.C.R. 1411 (1994) (rejecting any form of tariffs in wireless context based on competitive state of market). If a carrier has a particular charge that irks consumers or a dispute resolution mechanism that leaves them frustrated and dissatisfied, customers can and will migrate to another carrier.

Times, Oct. 5, 1990. The FCC web site reveals a host of similar enforcement proceedings for conduct the FCC deemed illegal or deceptive.[4]

Wireless carriers also have exposure to state enforcement proceedings. For example, under the New Jersey Consumer Fraud Act (the "NJCFA"), N.J.S.A. §56:8-1, *et seq.*, the New Jersey Attorney General ("NJAG") can pursue: (1) penalties of up to $20,000 for each offense (other than the first offense, which carries a penalty of "only" $10,000), N.J.S.A. §56:8-13; (2) an additional penalty of up to $10,000 for each offense where the defendant should have known that the victim was a senior citizen or disabled, N.J.S.A. §56:8-14.3; (3) an injunction

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[4] *See, e.g.*, FCC Press Release, FCC Issues $2,591,500 Forfeiture Against The Hot Lead LLC...for Violation of the Telephone Consumer Protection Act – Unsolicited Junk Faxes (Mar. 19, 2008); FCC Consent Decree & Order, In the Matter of Talk America, Inc. (December 26, 2006), *available at* http://www.fcc.gov/eb/Orders/2006/FCC-06-187A1.html (requiring Talk America to "provide a brief, clear, non-misleading, plain language description of the charges contained on its bills" and to pay Treasury nearly $500,000 for failure "clearly and plainly to describe certain charges appearing on customers' bills"); FCC Press Release, $5,084,000 Forfeiture Proposed Against Horizon Telecom, Inc. Concerning Apparent Slamming Violations (Mar. 3, 2008); FCC Press Release, FCC and Sprint Enter Into $4 Million Consent Decree to Resolve Slamming Investigation (Mar. 11, 2005); FCC Press Release, FCC Fines FAX.COM Over $5 Million for Sending "Junk Faxes" (Jan 5, 2004); Verizon Admits Violations to Long Distance Marketing Ban – Company to Make $5.7 Million Payment to United States Treasury (Mar. 4, 2003); FCC Press Release, FCC and Two Wireline Carriers Enter into Consent Decree Regarding Deceptive Marketing Practices – NOS and ANI to Pay $1 Million (Dec. 26, 2002). Note that all of the press releases cited in this footnote are available at http://www.fcc.gov/headlines.html.

against unlawful practices, restitution and/or the appointment of a receiver, N.J.S.A. §56:8-8; (4) costs, N.J.S.A. §56:8-13; and (5) a $30,000 penalty for specified violations involving senior citizens. N.J.S.A. §56:8-14.3. The New Jersey Board of Public Utilities ("NJBPU") has its own enforcement powers under the New Jersey Public Utilities Law, N.J.S.A. §48:2-1, *et seq.*[5] While the Federal Trade Commission ("FTC") does not have enforcement authority over wireless carriers such as Verizon, 15 U.S.C. §45(a)(2), its power over other business entities is substantial.[6]

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[5] The NJBPU has authority to enforce New Jersey laws applicable to providers of wireless services by: (1) issuing orders commanding compliance with state laws and municipal ordinances, N.J.S.A. 48:2-16; (2) conducting investigations on its own initiative or after receiving a complaint from a consumer, N.J.S.A. §§48:2-19, 48:2-36.1; (3) ordering repayment of excessive surcharges, N.J.S.A. §48:2-29.4; and (4) ordering penalties of $100 per day for failure to comply with an order of the Board. N.J.S.A. §48:2-42.

[6] Under the FTC Act, the FTC can bring civil proceedings to obtain: (1) a penalty of up to $10,000 for each violation, 15 U.S.C. §45(m); (2) an injunction and ancillary relief, 15 U.S.C. §53(b); and/or (3) "such relief as the court finds necessary to redress injury to consumers . . . [including] rescission or reformation of contracts, the refund of money or return of property, [and] the payment of damages . . . ." 15 U.S.C. §57b(b). *See also FTC v. H.N. Singer, Inc.*, 668 F.2d 1107, 1113 (9th Cir. 1982) (holding that, in an injunction proceeding, a court has the authority to grant any ancillary relief that is "necessary to accomplish complete justice," including the power to grant rescission); *FTC v. Gem Merch. Corp.*, 87 F.3d 466, 469 (11th Cir. 1996) (asset freeze).

In sum, even accepting for the sake of argument that the unavailability of class proceedings lessens to some extent the efficacy of private proceedings to redress corporate wrongdoing, the remaining array of enforcement mechanisms available to deter and counter misconduct ensure that a contractual prohibition against class actions does not serve as an exculpatory clause. A number of courts have relied upon government enforcement mechanisms in upholding the validity of arbitration agreements with class action prohibitions. *See, e.g., West Suburban Bank*, 225 F.3d at 375-76 (even if class actions are not available in arbitration, numerous administrative mechanisms exist to enforce TILA); *accord, Gay*, 511 F.3d at 381; *Randolph v. Green Tree Fin. Corp.-Ala.*, 244 F.3d 814, 818 (11th Cir. 2001).[7]

V. New Jersey Unconscionability Law Departs Even Further Than Pennsylvania Arbitration Cases From Traditional Notions Of Unconscionability And, If Applied To Arbitration Agreements, Would Allow New Jersey To Freely Substitute Public Policies Hostile To Arbitration For The Pro-Arbitration Policy Of The FAA.

The New Jersey Supreme Court's unconscionability jurisprudence establishes no practical limitation on the court's authority to invalidate standard-

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[7] *See also Pitchford v. AmSouth Bank*, 285 F.Supp.2d 1286, 1292 (M.D. Ala. 2003) (sustaining class action waiver in arbitration agreement in view of administrative enforcement mechanisms for ECOA violations and the federal policy favoring arbitration); *In re Universal Service Fund Tel. Billing Practices Lit.*, 300 F.Supp.2d 1107, 1137-1138 (D.Kan. 2003).

form contracts (or provisions therein) on grounds of "public policy" or the "public interest." Thus, recognition of New Jersey's substantive unconscionability principles as a basis for overriding arbitration agreements would allow New Jersey courts to impose through the back door the very hostility to arbitration the FAA was designed to eliminate.

Muhammad applied to the arbitration agreement at issue the "controlling test for determining unconscionability for contracts of adhesion" set forth in *Rudbart v. North Jersey District Water Supply Commission*, 605 A.2d 681 (N.J.), *cert. denied*, 506 U.S. 871 (1992). *Muhammad*, 912 A.2d at 91.

> [I]n determining whether to enforce the terms of a contract of adhesion, courts have looked not only to the take-it-or-leave-it nature or the standardized form of the document but also to [(1)] the subject matter of the contract, [(2)] the parties' relative bargaining positions, [(3)] the degree of economic compulsion motivating the "adhering" party, and [(4)] the public interests affected by the contract.

Muhammad, 912 A.2d at 97 (quoting *Rudbart,* 605 A.2d at 687).

As acknowledged in *Muhammad,* 912 A.2d at 102, *Rudbart* and the cases cited therein are "rooted in [a] fact-intensive public interest assessment." Accordingly, they impose no real constraint on the courts in declaring contracts to be substantively unconscionable. Indeed, *Rudbart* and the cases it cites make clear that a contract is substantively unconscionable whenever it violates any "public interest" or "public policy" the court chooses to recognize.

In *Rudbart*, the New Jersey Supreme Court instructed that, for a contract of adhesion, "nonenforcement of its terms may be justified on other than such traditional grounds as fraud, duress, mistake, or illegality." 605 A.2d at 685. For any such contract, enforceability is a "matter of policy" to be determined by the court. *Id.* at 686.

Surveying extant authority, the *Rudbart* court cited a number of standard-form contracts that could not be enforced due to "public policy" considerations. *Id.* at 686-87. Thus, *Rudbart* explained, *id.* at 686, that a commission provision in a real estate brokerage agreement was declared invalid in *Ellsworth Dobbs, Inc. v. Johnson*, 236 A.2d 843 (N.J. 1967), because it "would 'thwart' the judicially-declared public policy of the State."

Similarly, a termination provision of an oil company's lease and dealer agreement was held invalid in *Shell Oil Co. v. Marinello*, 307 A.2d 598 (N.J. 1973), *cert. denied*, 415 U.S. 920 (1974), because it "contravened 'the extant public policy of this State.'" *Rudbart,* 605 A.2d at 686 (quoting *Shell Oil*, 307 A.2d at 602).

According to the *Rudbart* court, 605 A.2d at 686-87, the lease termination provision in a migrant worker's contract addressed in *Vasquez v. Glassboro Serv. Ass'n*, 415 A.2d 1156 (N.J. 1980), was invalid because it "conflicted with the demonstrated policy of the New Jersey courts and Legislature."

And, finally, an exculpatory provision in a residential lease was invalid because it, too, violated "public policy." *Id.* at 687 (citing *Kuzmiak v. Brookchester, Inc.*, 111 A.2d 425 (N.J. Super. Ct. App. Div. 1955)).

In light of the sweeping (and undefined) nature of the unconscionability doctrine in New Jersey and the power it affords courts to declare any standard-form contract to be invalid if it offends some established or newly-discovered "public policy," *any* arbitration agreement could be declared invalid, despite FAA §2, for virtually any reason. For example, New Jersey courts could find an arbitration agreement to be against public policy, unconscionable and invalid because it denied a consumer a right to a jury trial, provided limited discovery or appeal rights or otherwise conflicted with the court's view of fair procedure. Yet all these departures from judicial procedures, like individual proceedings, are at the heart of most arbitration agreements.

Of course, "the fact that certain litigation devices may not be available in an arbitration is part and parcel of arbitration's ability to offer 'simplicity, informality, and expedition,' ... characteristics that generally make arbitration an attractive vehicle for the resolution of low-value claims." *Iberia Credit Bureau, Inc. v. Cingular Wireless LLC,* 379 F.3d 159, 174 (5th Cir. 2004) (rejecting claim that prohibition on class proceedings in arbitration provision was unconscionable). For parties to demand "all of the procedural accoutrements that accompany a judicial

proceeding" would completely undermine "the point of arbitration." *Id.* at 175-76. *Accord, Caley v. Gulfstream Aerospace Corp.*, 428 F.3d 1359 (11th Cir. 2005), *cert. denied*, 547 U.S. 1128 (2006); *S&G Electric, Inc. v. Normant Security Group, Inc.*, No. 06-3759, 2007 WL 210517, at *6 (E.D. Pa. Jan. 24, 2007) (where parties agreed to arbitrate dispute in Alabama, FAA preempted Pennsylvania statute prohibiting out-of-state arbitrations; because "[a]pplying Pennsylvania law would undermine the FAA goal of enforcing arbitration agreements according to their own terms..., the Court will hold the parties to their agreement and require them to arbitrate as per the terms of their subcontract").

In short, applying New Jersey substantive unconscionability or, rather, "public policy" principles would turn the FAA on its head and create a gaping loophole that would allow New Jersey courts to invalidate arbitration agreements at their whim.

VI. *Muhammad's* Rejection Of Individual Arbitration Is Preempted Because It Does Not Apply Universally To All Contracts.

Section 2 of the FAA mandates the enforcement of arbitration contracts "save upon such grounds as exist at law or in equity for the revocation of *any contract*." 9 U.S.C. §2 (emphasis added). *Muhammad* transgresses this limitation because it claims the power to decide *which* type of contracts may have individual arbitration clauses and which may not.

For a state contract principle to override an arbitration agreement, it is not sufficient that it avoids overt discriminate against arbitration. Rather, the principle must universally apply to "any" and every contract. Thus, in *Bradley v. Harris Research, Inc.*, 275 F.3d 884 (9th Cir. 2001), the Ninth Circuit enforced an arbitration clause that required disputes to be arbitrated in Utah notwithstanding a non-discriminatory California statute that required disputes to be resolved in California. It did so because the statute applied only to forum selection clauses in franchise agreements rather than to all contract terms in all types of contracts. A number of additional cases have reached the same result. *See, e.g., Stone v. Doerge,* 328 F.3d 343,345 (7th Cir. 2003); *KKW Enterprises, Inc. v. Gloria Jean's Gourmet Coffees Franchising Corp.*, 184 F.3d 42 (1st Cir. 1999); *OPE Int'l LP v. Chet Morrison Contractors, Inc.*, 258 F.3d 443 (5th Cir. 2001); *Doctor's Associates, Inc. v. Hamilton*, 150 F.3d 157, 163 (2d Cir. 1998), *cert. denied*, 525 U.S. 1103 (1999); *Management Recruiters Int'l, Inc. v. Bloor*, 129 F.3d 851, 856 (6th Cir. 1997); *Alphagraphics Franchising, Inc. v. Whaler Graphics, Inc.*, 840 F.Supp. 708 (D. Ariz. 1993); *Michael v. N.A.P. Consumer Electronics Corp.*, 574 F.Supp. 68 (D.P.R. 1983); *Provencher v. Dell, Inc.*, 409 F.Supp.2d 1196, 1206 (C.D. Cal. 2006); *Battle v. Nissan Motor Acceptance Corp.*, No. 05-C-0669, 2006 U.S. Dist. LEXIS 37916, at *14-15 (E.D. Wis. March 9, 2006).

Here, of course, the policy enunciated in *Muhammad* applies narrowly only to retail standard-form contracts involving small-dollar claims, *not* to all New Jersey contracts generally. Therefore, it is preempted by the FAA.

The *Muhammad* rule is preempted for the further (but related) reason that it applies only to contracts expressly or impliedly prohibiting class arbitration.[8] Simply put, *Muhammad's* "case-by-case approach" to the substantive unconscionability of contracts, 189 N.J. at 16 – or *any* substantive unconscionability argument – is flatly inconsistent with Section 2 of the FAA. "Whatever the advantages or disadvantages may be regarding two-party arbitration, courts that are declaring such two-party arbitration as inferior or inadequate are making negative judgments about arbitration that Congress intended to reverse and preclude when enacting the FAA." I.S. Szalai, *Aggregate Dispute Resolution Class and Labor Arbitration,* 13 Harv. Negotiation L. Rev. 399, 438 (Spring 2008).

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[8] Verizon persuasively argued in Section II-B of its brief that the "revocation" language in Section 2 of the FAA should not be construed to encompass state-law substantive unconscionability principles. *Amici* agree with Verizon's analysis and reach the same conclusion by focusing on Section 2's "any contract" language.

In effect, Appellants are arguing that there must be class arbitration of small-dollar consumer claims in standard-form contracts or no arbitration at all. It is hard to imagine a clearer violation of the FAA's text and pro-arbitration policy.

CONCLUSION

Verizon's arbitration agreement provides real benefits to its customers and does not exculpate Verizon from wrongdoing. This case presents a stark choice between the FAA policy promoting individual arbitration and the New Jersey policy favoring class actions. It would violate the Supremacy Clause and turn the FAA on its head to apply New Jersey policy, applicable only to: (1) retail small-dollar standard-form contracts; and (2) contracts containing prohibitions against class proceedings, rather than the pro-arbitration policy of the FAA. Accordingly, *Amici* respectfully request that the decision of the district court be affirmed.

Respectfully submitted,

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COMBINED CERTIFICATIONS

I, Alan S. Kaplinsky, hereby certify as follows:

I. I am a member in good standing of the Bar of the United States Court of Appeals for the Third Circuit.

II. The forgoing Brief complies with (i) the type-volume limitations of Fed. R. App. P. 29(d) and 32(a)(7)(B) because it contains 6,839 words, excluding the parts of the Brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii) and (ii) with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2003 in size 14, Times New Roman style.

III. On this date, ten hard copies of the foregoing Brief were sent to the Clerk's Office. Pursuant to Local Appellate Rules 31.1(d) and 113.4(a), I caused the foregoing Brief to be served upon counsel to the Appellants and the Appellee via the Notice of Docket Activity that is generated by the court's electronic filing system (i.e., cm/ecf) and via electronic mail.

IV. The text of the foregoing Brief is identical in its electronic and paper forms.

V. A virus detection program, McAfee VirusScan Version 8.0, has been run on the electronic version, and no virus was detected.

Dated: February 26, 2009

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