No. 14-1458

IN THE

Supreme Court of the United States

MHN GOVERNMENT SERVICES, INC., AND MANAGED HEALTH NETWORK, INC.,

Petitioners,

v.

THOMAS ZABOROWSKI, ET AL.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITIONERS' REPLY BRIEF

Timothy J. Long
Lauri A. Damrell
ORRICK, HERRINGTON & SUTCLIFFE LLP
400 Capitol Mall
Suite 3000
Sacramento, CA 95814

Rachel Wainer Apter
ORRICK, HERRINGTON & SUTCLIFFE LLP
51 West 52nd Street
New York, NY 10019

Robert M. Loeb
Counsel of Record
ORRICK, HERRINGTON & SUTCLIFFE LLP
Columbia Center
1152 15th Street, NW
Washington, DC 20005
(202) 339-8400
rloeb@orrick.com

Counsel for Petitioners

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

ARGUMENT

Respondents ignore the basis of the petition for a writ of certiorari and blithely assert that California severability law treats all contracts equally. Then, clutching feigned ignorance, Respondents declare that the Ninth Circuit's decision does not conflict with this Court's precedents or those of other courts of appeals, and cite a recent California Supreme Court decision, *Sanchez v. Valencia Holding Co., LLC*, 353 P.3d 741 (Cal. 2015), as a reason for denying review. But Respondents cannot simply wish away California's arbitration-specific rule disfavoring severance. The brief in opposition only confirms that this Court should grant review, or, at a minimum, grant, vacate and remand to allow the Ninth Circuit to reconsider its decision in light of *Sanchez*.

I. California Courts Apply A Different Severance Rule For Agreements To Arbitrate Than For Contracts Generally.

As the petition explains (at 12-14), when it comes to contracts generally, California law takes a very liberal view of severability, holding that if the "illegality is collateral to the main purpose of the contract, and the illegal provision can be extirpated from the contract by means of severance or restriction, then such severance and restriction are appropriate." *Marathon Entm't, Inc. v. Blasi*, 174 P.3d 741, 743 (Cal. 2008), as modified (Mar. 12, 2008) (citation omitted).

Not so when it comes to agreements to arbitrate. Instead, "[i]n *Armendariz* [*v. Found. Health*

Psychcare Servs.] the California Supreme Court held that more than one unlawful provision in an arbitration agreement weighs against severance." *Fitz v. NCR Corp.*, 13 Cal. Rptr. 3d 88, 106 (Cal. Ct. App. 2004). Why? Because where an "arbitration agreement contains more than one unlawful provision," that in and of itself "indicate[s] a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage." *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 696-97 (Cal. 2000). Therefore, a California court may refuse to enforce the entire arbitration agreement as "permeated by an unlawful purpose." *Id.* at 697.

Rather than try to justify this *Armendariz* arbitration-specific anti-severance rule, or the district court and court of appeals' reliance on it, Respondents ignore it altogether. Although the petition quotes *Armendariz*'s rule five times, Pet. 8-9, 14, 15-16, 26-27, the brief in opposition never mentions it.

Instead, Respondents choose to wish it away. They declare, on the basis of nothing but their own say-so, that California severance rules "appl[y] to all contracts equally." Opp. 2; *see also* Opp. 10 (same); Opp. 14-15 (while the severability "doctrine happens to have been distilled in a case involving an arbitration agreement … it applies even-handedly to contracts of all sorts."); Opp. 15 (same); Opp. 20 ("Petitioners' claim that there is a special severance standard for arbitration contracts has no basis in California law").

Even worse, the brief in opposition incorrectly asserts, without explanation, that "[n]either *Armendariz* nor the district court here even hinted—much less held—that the presence of multiple unlawful provisions had special significance for arbitration agreements alone." Opp. 19 n.4. Respondents must not have read *Armendariz* or the district court opinion. The California Supreme Court in *Armendariz* did not only hint that the "presence of multiple unlawful provisions had special significance for arbitration agreements," *id.*, it explicitly so held. In the words of *Armendariz*, where an "arbitration agreement contains more than one unlawful provision," that "indicate[s] a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage," and allows a court to conclude, on that basis alone, that the "arbitration agreement is permeated by an unlawful purpose." 6 P.3d at 696-97.

California courts of appeals have interpreted this language to mean exactly what it says—"more than one unlawful provision in an arbitration agreement weighs against severance." *Fitz*, 13 Cal. Rptr. 3d at 106. In other words, the existence of even two substantively unconscionable provisions in an arbitration agreement is *per se* "a circumstance considered by [the California] Supreme Court to 'permeate' the agreement with unconscionability." *Trivedi v. Curexo Tech. Corp.*, 116 Cal. Rptr. 3d 804, 813 (Cal. Ct. App. 2010). Indeed, many California courts of appeals candidly admit that while severance is appropriate "where only one clause in an arbitration agreement [is] found to be substantively unconscionable," it is

"not appropriate" where "multiple provisions" are found unconscionable. *Pinela v. Neiman Marcus Grp., Inc.*, 190 Cal. Rptr. 3d 159, 183-84 (Cal. Ct. App. 2015), reh'g denied (July 29, 2015), review filed (Aug. 11, 2015). Others simply quote the language from *Armendariz* and summarily refuse to sever. *See, e.g., Martinez v. Master Prot. Corp.*, 12 Cal. Rptr. 3d 663, 673 (Cal. Ct. App. 2004); *Ontiveros v. DHL Exp. (USA), Inc.*, 79 Cal. Rptr. 3d 471, 488-89 (Cal. Ct. App. 2008).

This rule applies exclusively to, and disfavors, arbitration agreements. No comparable rule exists for other contracts. California courts do not hold that more than one unconscionable provision in any other type of contract indicates a systematic effort to take advantage of the weaker party, and therefore automatically allows a court to throw out the entire contract. Instead, outside of the arbitration context, "California cases take a very liberal view of severability, enforcing valid parts of an apparently indivisible contract where the interests of justice or the policy of the law would be furthered." *In re Marriage of Facter*, 152 Cal. Rptr. 3d 79, 95 (Cal. Ct. App. 2013) (citation omitted).

None of the cases cited in the opposition brief call the *Armendariz* arbitration-specific rule into question. Respondents cite six cases for the proposition that "California courts have applied the state's" neutral "severability standard" to arbitration and nonarbitration agreements alike. Opp. 16-17. But none show that California's severability standard is "arbitration-neutral," Opp. 3. None hold that outside the context of arbitration agreements, multiple un-

conscionable provisions indicate some sort of systematic unlawful purpose and allow a court to refuse severance. And none disclaim that rule for arbitration agreements.

Indeed, some of the cases Respondents cite have nothing to do with multiple illegal or unconscionable provisions, *see, e.g., Templeton Dev. Corp. v. Superior Court*, 51 Cal. Rptr. 3d 19, 26 (Cal. Ct. App. 2006) (cited at Opp. 17). And others show that outside of arbitration, California courts grant severance unless a contract has "a single, unlawful object," or unless it is so permeated by illegality "as to render the entire agreement void." *MKB Mgmt., Inc. v. Melikian*, 108 Cal. Rptr. 3d 899, 907 (Cal. Ct. App. 2010); *see also Shopoff & Cavallo LLP v. Hyon*, 85 Cal. Rptr. 3d 268 (Cal Ct. App. 2008) (cited at Opp. 16).

The cases that Respondents cite in order to prove that California courts routinely "sever multiple unconscionable provisions in order to save an arbitration agreement" are even further afield. Opp. 20. All but one are not actually from California courts—they are from federal district courts that are located in California. Opp. 20-21. Federal district courts have no power to make California state contract law, and their decisions on questions of California state law are of course not binding on California state courts. *See, e.g., Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938).

And the one case that is from a California state court does not actually sever "three provisions" as Respondents assert. Opp. 21. Instead, *Bolter v. Superior Court* severed only the "provisions of the

agreement mandating that all arbitrations take place in the State of Utah," namely: "[A]rbitration proceedings shall be conducted in Salt Lake City, Utah." 104 Cal. Rptr. 2d 888, 894, 896 (Cal. Ct. App. 2001), as modified on denial of reh'g (Mar. 30, 2001).

That does nothing to disprove the petition's central contention: California courts hold that *for agreements to arbitrate, but not for other agreements*, multiple unconscionable provisions in and of themselves "indicate a systematic effort to impose arbitration on [the weaker party] not simply as an alternative to litigation, but as an inferior forum that works to the [stronger party's] advantage," and thus allow a court to conclude that the "arbitration agreement is permeated by an unlawful purpose." *Armendariz*, 6 P.3d at 696-97.

Respondents argue, as a policy matter, that this type of penalty is necessary to prevent employers from "overreach[ing]," secure in the knowledge that the "worst" they could suffer for deliberately inserting illegal clauses into their employment contracts "is the severance of the clause after the employee has litigated the matter." Opp. 12-13 (quoting *Armendariz*, 6 P.3d at 697 n.13); *see also* Opp. 25 n.7. But outside of arbitration, such penalties apply only where contract terms are drafted in bad faith, i.e., with knowledge of their illegality. *See Data Mgmt., Inc. v. Greene*, 757 P.2d 62, 64-65 (Alaska 1988), cited in *Armendariz*, 6 P.3d at 697 n.13. Respondents do not even allege that the Provider Services Task Order Agreement ("Agreement") was drafted in bad faith. Instead, Respondents acknowledge that after they objected to seven separate provisions in the

Agreement, MHN immediately redrafted it to omit all of them. Opp. 3. California's arbitration-only rule cannot be justified on this basis.

II. The Ninth Circuit's Holding Conflicts With This Court's Precedents And With Decisions Of Other Courts Of Appeals.

Respondents' refusal to grapple with the critical language from *Armendariz* and with California courts' embrace of the arbitration-only rule derails the remainder of the brief in opposition.

Respondents' assertion that "the Ninth Circuit's decision does not conflict with this Court's precedent" is based on the faulty premise that the district court and the Ninth Circuit simply applied a "generally applicable contract defense," "drawn from general contract law, for contracts generally." Opp. 21, 23-24. But as earlier noted, the *Armendariz* anti-severance rule does not apply to contracts generally. It applies only to arbitration agreements.

Because there is no comparable rule that more than one unconscionable provision in any contract indicates a systematic effort to take advantage of the weaker party and thus allows a court to throw out the entire agreement, this is not "such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Moreover, this Court has held that the Federal Arbitration Act ("FAA") also preempts state law rules purporting to apply to all contracts when they "have a disproportionate impact on arbitration agreements," or when a "generally applicable contract defense" applies, in practice, "only

to arbitration," or "derive[s] [its] meaning from the fact that an agreement to arbitrate is at issue." *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1746-47 (2011). Here, California's arbitration-only anti-severance rule applies in practice only to agreements to arbitrate and "derive[s] [its] meaning from the fact that an agreement to arbitrate is at issue." *Id.* Therefore, as Judge Gould explained in dissent, it is properly deemed preempted by the FAA. Pet. App. 7a-8a. The Ninth Circuit's contrary holding conflicts with this Court's decisions. Pet. 16-17.

The Ninth Circuit's decision also conflicts with the decisions of other courts of appeals.[1] Had this case arisen in the Seventh Circuit, the court would have held *Armendariz's* arbitration-only anti-severance rule preempted by the FAA. Pet. 18-19. In *Oblix, Inc. v. Winiecki*, the Seventh Circuit held that any portion of *Armendariz* that "create[s] special requirements" for arbitration clauses beyond those that exist for other "form contracts" is preempted by the FAA. 374 F.3d 488, 492 (7th Cir. 2004). Respondents assert that the Seventh Circuit "did not

[1] Respondents contend that the Ninth Circuit's unpublished memorandum disposition cannot create a circuit split because it is nonprecedential. Opp. 24-25. But the petition never asserted that the Ninth Circuit's disposition in this case by itself created a circuit split. The conflict with the Seventh Circuit (Pet. 18-19), relies on prior Ninth Circuit precedent, namely *Chavarria v. Ralphs Grocery Co.*, 733 F.3d 916, 926-27 (9th Cir. 2013), Pet. App. 5a-6a. And the conflict regarding express severability clauses is not only with the Ninth Circuit but also with precedential decisions from the California state courts. Pet. 19-21.

notice" any split with the Ninth Circuit because it cited *EEOC v. Luce, Forward, Hamilton & Scripps*, 345 F.3d 742 (9th Cir. 2003) (en banc), in support of its decision. But *Luce* says nothing about whether *Armendariz* imposes special requirements for arbitration clauses, or whether any such requirements would be preempted by the FAA. *See* 345 F.3d at 752 (citing *Armendariz*, once, on an unrelated proposition of law).

The petition also pointed out that the Ninth Circuit here, and California state courts, routinely fail to honor severability clauses in arbitration agreements or to give them any weight—they simply apply the *Armendariz* anti-severance rule no matter what the agreement says. Pet. 19-21. This disregard for contractual severability clauses conflicts with courts of appeals that have recognized that enforcing such clauses honors the federal policy requiring enforcement of arbitration agreements "according to their terms." *Id.* (quoting *Concepcion*, 131 S. Ct. at 1745).

Respondents first offer a nonresponse. They say that no circuits hold that under federal law the presence of a severability clause always requires severance. Opp. 26-27. True, but other courts honor severance clauses when possible, and at least give them weight, Pet. 19-21, whereas a severance clause in an arbitration agreement means nothing in California if a court finds more than one unconscionable term.

As to particular cases, Respondents contend that *Morrison v. Circuit City Stores, Inc.*, does not conflict

with the Ninth Circuit's decision because it was based on Ohio law, not the FAA. Opp. 27. But in *Morrison*, the Sixth Circuit held that the question was unclear under Ohio law. 317 F.3d 646, 675 (6th Cir. 2003). It therefore relied on "[U.S.] Supreme Court precedent dictat[ing] that we resolve any doubts as to arbitrability in favor of arbitration," and the federal policy favoring arbitration. *Id.* (internal quotation marks omitted).

Similarly, in *Gannon v. Circuit City Stores, Inc.*, the Eighth Circuit held that enforcing a severability clause was consistent with the "FAA's policy favoring the enforcement of arbitration agreements." 262 F.3d 677, 683 (8th Cir. 2001). Respondents assert that *Gannon* "join[ed] the Ninth Circuit in recognizing that courts can, consistent with the FAA … refuse to sever when there is too much overreaching by the drafter." Opp. 29. But *Gannon* actually *rejected* the plaintiff's assertion that severance would "encourage[] employers to include improper terms in arbitration agreements." 262 F.3d at 682 n.7.

So did *Booker v. Robert Half Int'l, Inc.* The plaintiff maintained that severing "illegal provisions in arbitration agreements" would "leave[] employers with every incentive to 'overreach' when drafting such agreements." 413 F.3d 77, 84 (D.C. Cir. 2005). The court disagreed, and held that honoring the parties' severability clause was "faithful to the federal policy which requires that we rigorously enforce agreements to arbitrate." *Id.* at 84-86 (citation and internal quotation marks omitted).

All of these decisions conflict with the Ninth Circuit's, and the California courts', disregard for severability clauses in agreements to arbitrate.

III. This Case Is A Good Vehicle For Rejecting The *Armendariz* Anti-Severance Rule.

Respondents finally assert that "[n]ow is not an opportune time for this Court to take up the issue presented here," and "this Court would do better" to let the effects of *Sanchez v. Valencia Holding Co., LLC*, "take shape before deciding whether the issue presented … merits review." Opp. 31, 33.

In *Sanchez*, the California Supreme Court revisited California's unconscionability doctrine, reversing a finding of substantive unconscionability as to four provisions and clarifying that California's "unconscionability standard is, as it must be, the same for arbitration and nonarbitration agreements." 353 P.3d at 749. *Sanchez*, on the surface at least, heeds *Concepcion's* commands. It says nothing, however, about the *Armendariz* anti-severance rule. In fact, it says nothing about severability at all. Therefore, *Sanchez* provides no basis for denying review here. This Court should grant review and reject the *Armendariz* anti-severance rule (which Respondents do not even defend) as being contrary to the FAA and this Court's precedents.

If this Court, however, believes that *Sanchez* calls the Ninth Circuit's decision in this case into question, the proper response is to grant the petition and vacate and remand to the Ninth Circuit for fur-

ther consideration in light of *Sanchez*. As this Court has explained, a grant, vacate and remand is appropriate "[w]here intervening developments … reveal a reasonable probability that the decision below rests upon a premise that the lower court would reject if given the opportunity for further consideration." *Lords Landing Vill. Condo. Council of Unit Owners v. Cont'l Ins. Co.*, 520 U.S. 893, 896 (1997). Here, the Ninth Circuit never acknowledged that California's unconscionability standard "must be … the same for arbitration and nonarbitration agreements." *Sanchez*, 353 P.3d at 749. It did not grapple with the fact that "the standard for substantive unconscionability—the requisite degree of unfairness beyond merely a bad bargain—must be as rigorous and demanding for arbitration clauses as for any contract clause." *Id.* And it never addressed how *Armendariz's* arbitration-only severance rule could be compatible with *Sanchez*. Instead, the Ninth Circuit simply rubber stamped the district court's holding that "multiple aspects of the arbitration provision are substantively unconscionable" and could not be severed. Pet. App. 3a-5a.[2] There is a reasonable probability that the Ninth Circuit would assess the

[2] These include a six-month limitations period (which purportedly did not give Respondents enough time to discover that they were being treated as independent contractors instead of employees, even though the Agreement Respondents signed spells this out at Pet. App. 52a-53a); a clause awarding fees and costs to the substantially prevailing party; a $2600 filing fee; and a punitive damages waiver (even though the Fair Labor Standards Act does not actually provide for punitive damages).

provisions differently, and decide the entire case differently, in light of *Sanchez*.

CONCLUSION

The petition for a writ of certiorari should be granted, or, in the alternative, this Court should grant, vacate and remand to allow the Ninth Circuit to reconsider its ruling in light of *Sanchez v. Valencia Holding Co*.

Respectfully submitted,

Timothy J. Long
Lauri A. Damrell
ORRICK, HERRINGTON & SUTCLIFFE LLP
400 Capitol Mall
Suite 3000
Sacramento, CA 95814

Robert M. Loeb
Counsel of Record
ORRICK, HERRINGTON & SUTCLIFFE LLP
Columbia Center
1152 15th Street, NW
Washington, DC 20005
(202) 339-8400
rloeb@orrick.com

Rachel Wainer Apter
ORRICK, HERRINGTON & SUTCLIFFE LLP
51 West 52nd Street
New York, NY 10019

September 8, 2015