No. S113725
IN THE SUPREME COURT OF CALIFORNIA

DISCOVER BANK,

Petitioner,

v.

THE SUPERIOR COURT OF LOS ANGELES COUNTY,

Respondent;

CHRISTOPHER BOEHR,

Real Party in Interest.

After an Order by the Court of Appeal, Second Appellate District, Case No. B161305, Granting Petition for a Writ of Mandate from the Order of the Superior Court of Los Angeles County, Case No. BC256167, Granting a Motion for Reconsideration, The Honorable Carolyn Kuhl

REPLY BRIEF ON THE MERITS

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Discover's principal argument is that Delaware has such a strong interest in protecting its banks, that this interest overrides California's interest in protecting consumers. Discover ignores this Court's direction that choice-of-law clauses are to be treated differently in contracts of adhesion than in other contracts. Where a choice-of-law provision effectively operates as an exculpatory clause, denying consumers any meaningful opportunity to vindicate their rights under any state deceptive trade practices act, that choice-of-law provision works substantial injustice and should not be enforced.

Discover also argues that California law may place no limits upon contractual bans of class actions when those bans are embedded in an arbitration clause, because the entire concept of a class action is anathema to the concept of arbitration. The U.S. Supreme Court's decision in *Green Tree Financial Corp. v. Bazzle* (June 23, 2003) __ S. Ct. __, 2003 WL 21433403 puts this argument to rest. In *Bazzle*, the Court held that state law, not federal law, governs the application of contract law principles to the question of class actions in arbitration; and that nothing inherently bars class actions in arbitration.

I. A CHOICE OF LAW PROVISION THAT DENIES CALIFORNIA CONSUMERS ANY MEANINGFUL OPPORTUNITY TO OBTAIN REDRESS FOR DECEPTIVE ACTS COMMITTED AGAINST THEM MAY NOT BE ENFORCED.

This Court has held that it will not enforce any choice-of-law clause that violates a fundamental policy of California, where California has a materially greater interest than the other state. *Washington Mutual Bank v. Superior Court* (2001) 24 Cal. 4th 906, 917, 103 Cal. Rptr. 2d 320, 328 (*citing Nedlloyd Lines B.V. v. Superior Court.* (1992) 3 Cal. 4th 459, 11 Cal. Rptr. 2d 330). This Court has also made clear that in applying these tests, great weight will be put on protecting the interests of consumers in contracts of adhesion. *See, id.,* 24 Cal. 4th at 917, 103 Cal. Rptr. 2d at 329 (test "contains safeguards to protect contracting parties, including consumers. . . .")[1]

In *Washington Mutual*, this Court extended the *Nedlloyd* analysis to a "broader range of contract transactions," but did so with the understanding that *Nedlloyd* provides extra protection to the weaker party in adhesive contracts. *Id.* at 918, 103 Cal. Rptr. 2d at 329 ("the weaker party in an adhesive contract may seek to avoid enforcement of a choice-of-law provision therein by establishing that 'substantial injustice' would result from its enforcement"). *Washington Mutual* effectively incorporated the substantial injustice analysis provided in Restatement (Second) of Conflict

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[1] Discover cites Restatement (Second) of Conflict of Laws § 122. Brief n. 12. In fact, this section indicates that this Court need not even reach the *Washington Mutual* factors, because it indicates that the forum court should apply its own procedural issues (the comments describe these as "administration of justice" rules) regardless of any contractual choice of law provision.

of Laws § 187, comment b into the California choice-of-law analysis in the context of adhesive contracts.

Discover claims that Plaintiff asks this Court to disregard *Nedlloyd* "whenever contractual choices of law 'would cause substantial injustice to California consumers and consumers suing in California.'" Brief at 35. In fact, plaintiff simply follows *Nedllloyd* in concluding that contracts that cause substantial injustice must not be enforced.

Discover argues that any rule of law that attaches significance to the fact that a contract is one of adhesion fails to "address the practical realities of modern life." Brief at 2. According to Discover, "real-world circumstances" require this Court to ignore the fact that this is a contract of adhesion. *Id.* This theory (for which it cites no authority) is convenient for Discover, who drafted this contract and imposed it upon its customers on a take-it-or-leave-it basis. Nonetheless, this theory runs counter to this Court's decisions, *e.g., Little v. Auto Stiegler, Inc.* (2003) 29 Cal. 4th 1064, 130 Cal. Rptr. 2d 892, and to U.S. Supreme Court decisions:

> Our holding, of course, is not controlling precedent for other facts of other cases. For example, where the contract is one of adhesion, where there is great disparity in bargaining power, and where the debtor receives nothing for the cognovit provision, other legal consequences may ensue.

D.H. Overmyer Co., Inc. v. Frick Co. (1972) 405 U.S. 174, 188.

Finally, Discover confuses the substantial injustice test with a test for determining unconscionability. *See* Brief at 32. However, plaintiff has merely said that the two tests are similar, not identical. Plaintiff's Opening Brief at 9. No one has argued that the latter test should be applied instead

of, or prior to, the latter.[2]

In this case, Discover claims (based on cites to a state trial court and some federal courts guessing at Delaware law, and by ignoring the reasoning of a Delaware Supreme Court decision involving a non-mutual arbitration clause, Opening Brief at 7) that Delaware law permits it to bar its customers from bringing or joining class actions, even where such a ban on class actions would amount to an exculpatory clause in the context of consumers with uniform but extremely modest claims. This Court should hold that California has a materially greater interest in protecting its consumers and members of class actions brought by its consumers from deceptive and abusive business practices than Delaware has in protecting the interests of Delaware banks who commit such abusive acts. This Court should make clear that in this context, enforcing such a choice-of-law provision will work substantial injustice, and therefore that California law should apply to the question of whether Discover's contractual ban on class actions is unconscionable.

This Court should accord limited weight to Delaware's supposed desire to protect the revenue stream of its home state banks from meaningful accountability to their customers when those banks engage in

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[2] Discover also contends that plaintiff must show that he was defrauded in order for the choice-of-law provision to result in substantial injustice. Brief at 35-36. This assertion is mistaken. As set forth in our Opening Brief at 10, a choice-of-law provision in a contract of adhesion will be found to be substantially unjust where it "substantially diminishes" customers' rights to vindicate their rights under consumer protection laws. While there are indeed some cases where claims of fraud gave rise to the claim that a given contract was unjust, no case has held that this is the only way that a contract may be held to be unjust.

deceptive practices.[3] Discover's proposed approach to choice-of-law issues poses a troubling specter of a regulatory "race to the bottom." As one illustration of how such a race might look, consider the following illustration. In *Badie v. Bank of America* (1998) 67 Cal. App. 4th 779, 79 Cal. Rptr. 2d 273, the court held that a mandatory arbitration clause sent out to credit card customers in a bill stuffer did not form a binding contract because the arbitration provision was a newly added term (where the bank's change-of-terms provision only allowed it to amend the existing terms, not add new terms). Within a few weeks, the Delaware legislature (after being lobbied by its banks) rewrote the Delaware code to provide that banks may amend their agreements "in any respect" whether a change was originally contemplated by the parties or not. Del. Code Ann. Tit. 5, § 952. It is troubling that the Delaware Legislature sought to assuage its banking clients by pretending that contract language says something it does not. Some commentators have suggested that Delaware's over-accommodation of banks poses public policy concerns. *See* Jonathan Chait, *Rogue State: The Case Against Delaware*, The New Republic August 19, 2002 ("Delaware also utilizes its appallingly lax regulation of banks and corporations to enrich itself while undermining its neighbors. . . . Delaware's enticement of much of the banking industry to relocate within its borders . . . [u]ndoubtedly has spurred Delaware's economy. . . . But it has also made it nearly impossible for other states to regulate even the most predatory kinds

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[3] This sort of interest cannot override the interest of other states to protect consumers. *Cf. Ting v. AT&T*, 182 F. Supp. 2d 902, 931 n.16 (N.D. Cal. 2002), *aff'd and rev'd in part*, 319 F.3d 1126 (9th Cir. 2003) ("the notion that it is to the public's advantage that companies be relieved of legal liability for their wrongdoing so that they can lower their cost of doing business is contrary to a century of consumer protection laws.") (citations omitted).

of loan-sharking.")

By contrast, Discover gives little weight to California's interest in protecting consumers against the predations and deceptive practices of corporations. As Plaintiff's Opening Brief established at page 10, for example, in *America Online, Inc. v. Superior Court* (2001) 90 Cal. App. 4th 1, 108 Cal. Rptr. 2d 73 ("*AOL*"), the court recognized that a choice-of-law clause that would strip California consumers of their rights to pursue a class action worked substantial injustice and should not be enforced. Discover responds that *AOL* involved the Consumer Legal Remedies Act, while the plaintiff in this case has not advanced claims under a California statute. Brief at 21-22. In fact, the *AOL* court based its holding on two "independent" reasons – the non-waivability of CLRA protections and California's fundamental public policy to allow consumer class actions.

II. THE U.S. SUPREME COURT'S DECISION IN *GREEN TREE v. BAZZLE* STRONGLY SUPPORTS THE CONSUMER PLAINTIFF IN THIS CASE.

As our Opening Brief recounted at 30-32, the Court of Appeal below ruled that California law could not find unconscionable a contractual ban on class actions that was embedded in an arbitration clause, because it was unthinkable that any arbitration could proceed on a class action basis. This position was a swing and a miss, as the U.S. Supreme Court made clear in *Bazzle*.

In *Bazzle*, the South Carolina Supreme Court had followed the lead of this Court over various opposing decisions by some federal courts, and had held that where an arbitration clause is silent on the question of whether or not a class action was permitted, state law provided that a class action was permitted in arbitration. 2003 WL 21433403 at *4. Green Tree argued

that federal law preempted South Carolina's state law on the matter, and a host of corporate *amici* for Green Tree argued that the very idea of class actions was anathema to the concept of arbitration.[4]

The U.S. Supreme Court rejected the positions of Green Tree and its *amici*. The majority opinion, written by Justice Breyer and joined by Justices Ginsburg, Souter and Scalia, held that the arbitrator (not the court) should be empowered to determine whether an arbitration could proceed on a class action basis.[5] Far from embracing Discover's vision that the law of arbitration clauses is dominated by federal law, the majority opinion states that this question is "a matter of state law. . . ." 2003 WL 21433403 at *3. Plaintiff acknowledges that the *Bazzle* case involved a somewhat different issue than the one posed here, because the arbitration agreement there did not directly prohibit class actions. The question in *Bazzle* was one of interpreting the terms of a contract, not judging whether or not those terms were unconscionable and unenforceable. Nonetheless, the Court's approach is consistent with the position taken by the plaintiff here. The majority opinion notes that Chief Justice Rehnquist's dissent so strongly agreed with

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[4] *See, e.g.,* the Amicus Brief of the American Bankers Association in *Bazzle*, (February 23, 2003) 2003 WL 721688. That brief describes the state court's decision that class actions are permissible in arbitration as "forced arbitration," much in the same way that consumer advocates describe pre-dispute binding mandatory arbitration in contracts of adhesion as "forced arbitration," and the Bankers argued that "Forced class arbitration proceedings violate the Federal Arbitration Act...., and are inherently unfair to defendants. . . ."

[5] Justice Stevens concurred with the result in Justice Breyer's opinion for two reasons: because he thought it was important that there would be a majority opinion commanding five votes, and because there was little difference between his view of the matter (which is discussed below) and the discussion in Justice Breyer's opinion. *Id.* at *8.

Green Tree's proposed reading of the contract language that the dissent would have held that "we should ignore the fact that state law, not federal law, normally governs such matters. . . ." 2003 WL 21433403 at *4. The import of this statement for this case is clear – generally applicable state contract law governs arbitration agreements even as that law relates to the question of class actions in arbitration.

The Court's conclusion that the arbitrator had the power to determine if arbitration should proceed on an individual or a class action basis undermines the core assumption of Discover's FAA preemption argument. As set forth in our Opening Brief at 13-15, the FAA does not preempt generally applicable state contract law. California's normal law of contracts provides that exculpatory clauses in contracts of adhesion are unconscionable. Discover argued, and the Court of Appeal below agreed, that the FAA overrides this normal rule of contract law as it might apply to a ban on class actions, because class actions are inherently unworkable in arbitration. The gist of Discover's argument is this: "if this Court says we can't ban class actions, it might as well be saying that we can't have arbitration at all." *Bazzle* shows that there is nothing inherently inconsistent between class actions and arbitration. If Discover wants to arbitrate its consumer disputes, it can arbitrate them whether they are individual disputes or class actions. If Discover wants to ban class actions because it doesn't want its customers to be able to join their small claims together, that is a different story. As our Opening Brief established at 30-31, nothing in the FAA permits Discover to evade normal principles of California law that exculpatory clauses are unconscionable and therefore unenforceable, merely by sticking such a clause into a section of a contract labeled "arbitration."

Two other Justices also wrote opinions in *Bazzle* that support our

position here that state law governs. Justice Stevens' opinion concurring in part and dissenting in part would not even have permitted the matter to go to the arbitrator. Instead, Justice Stevens would have affirmed the ruling of the South Carolina Supreme Court on the grounds that "There is nothing in the Federal Arbitration Act that precludes" the state court's determinations that class-action arbitrations are permissible if not prohibited by the arbitration agreement and that the agreement between the parties in that case was silent. *Id.* at *7. Justice Stevens also thus rejected the argument that federal law overrides normal principles of state contract law as they apply to the question of the interrelationship of class actions and arbitration.

Justice Thomas's dissenting opinion, similarly, stated that he "continue[s] to believe that the Federal Arbitration Act . . . does not apply to proceedings in state courts." *Id.* at *11. Under this principle, the FAA places no limits upon this Court's application of California contract law to the arbitration clause in this case.

Taken together, then, six members of the U.S. Supreme Court rejected the position taken by the banks in *Bazzle* and by Discover and the Court of Appeal below here.

Chief Justice Rehnquist's dissent concluded that the proper interpretation of the arbitration contract was a question of federal law. It did not address, however, the question of what would be the effect of the law of state contract defenses such as unconscionability upon a contract. Even if Chief Justice Rehnquist's position had been that of the majority of the Court, therefore, it would not be dispositive here. In addition, the Chief Justice's dissent states that "the FAA does not prohibit parties from choosing to proceed on a class-wide basis." *Id.* at *10. As set forth above, this concession undermines the basis for any claim of FAA preemption.

Discover's Supplemental Brief is unpersuasive on this point. The FAA is structured as a rule (arbitration agreements are enforceable) and an exception (except when unconscionable). *Bazzle* is a case involving the rule, and not the exception. Discover pretends that statements of the rule in *Bazzle* mean that the Court was abandoning the exception, which is wrong.

Discover also cites from the transcript of the *Bazzle* argument. This is inappropriate and misleading. Justices often play Devil's Advocate, and the language cited by Discover reflects one unidentified Justice on a court where arbitration issues are repeatedly resolved by 5-4 and 6-3 votes by a divided court.

One other important new case has also been decided since plaintiff's filed their opening brief. In *Ingle v. Circuit City Stores, Inc.,* 328 F.3d 1165 (9th Cir. 2003), the court rejected the Court of Appeal opinion below in this case and held that a contract term barring class actions was unconscionable.

III. THIS CASE SHOULD BE REMANDED FOR PROCEEDINGS IN THE SUPERIOR COURT, INSTEAD OF BEING SENT TO ARBITRATION ON A CLASS-WIDE BASIS.

Discover argues that it would be inappropriate to "subject" it to arbitration of this case as a class action. Plaintiff agrees that this case should not be returned to arbitration as a class action, as the trial court would have done. Instead, this Court should strike the unconscionable arbitration provision of Discover's contract and remand this case for further proceedings in court. As this Court has explained, "Whether classwide proceedings would prejudice the legitimate interests of the party which drafted the adhesion agreement must also be considered, and that party should be given the option of remaining in court rather than submitting to classwide arbitration." *Keating v. Superior Court*, (1982) 31 Cal.3d 584,

rev'd on other grounds sub nom., *Southland Corp. v. Keating* (1984) 465 U.S. 1.

Plaintiff suggests that a useful model may be found in federal securities regulation, which supports the enforcement of arbitration agreements in individual cases, but which simultaneously recognizes and preserves the rights of investors to pursue class-wide relief in court notwithstanding agreements to arbitrate. *See* NASD Code of Arbitration Procedure, § 10301(d)(3) (prohibiting arbitration of class claims even where putatively covered by arbitration agreement in favor of litigation of all such claims).

IV. DISCOVER'S MISCELLANEOUS ARGUMENTS ARE WITHOUT MERIT.

A. This Court Should Disregard Discover's Statements About the Merits.

Discover offers several factual defenses, claiming among other things that the practice set forth in the complaint only applies to a "small sliver" of consumers, Brief at 5, n.3, and that Mr. Boehr, the putative named class representative, has weak claims. Brief at 8. If this were an appeal over the merits, plaintiff would respond fully to Discover's incomplete and often erroneous assertions as to the facts. Discover has consistently insisted that plaintiff may not be heard in court on the merits of this case, however, and that plaintiff's sole forum for his claims is in arbitration. Accordingly, this appeal – as recognized by the question upon which this Court took review – exclusively revolves around the question of the set of rules under which the merits of this case may be adjudicated. Because Discover's factual attacks as to the merits are unrelated to the issue before the Court, plaintiff will not here respond to them.

B. Plaintiff Does Not Claim that Class Actions Are Universally Appropriate in All Cases, But Merely that in Some Category of Cases a Ban On Class Actions Amounts to an Exculpatory Clause.

In our Opening Brief, at 13-15, plaintiff established that California's general contract law holds that exculpatory clauses contained in contracts of adhesion are unconscionable. Instead of addressing this issue, Discover has constructed a Straw Man version of plaintiff's claims. Seizing upon a stray phrase in Plaintiff's Opening Brief, Discover intones that plaintiff's position wrongly "suggests that class actions are unwaivable and appropriate in all contexts." Brief at 41.

Discover is certainly correct that class actions are not "universally appropriate." *Id.* at 42. California law specifies the limited circumstances in which class actions are appropriate, and makes clear that when the required elements are not present, a case may not proceed as a class action. *See Dean Witter Reynolds, Inc. v. Superior Court* (1989) 211 Cal. App. 3d 758, 772, 259 Cal. Rptr. 789 ("The suitability of the unfair competition claims for class action treatment must be tested by principles developed under the general class action statute, Code of Civil Procedure section 382.").

From the modest starting point that not every case can be handled as a class action, however, Discover goes on to deduce that it is allowable for it to bar its customers from *ever* bringing a class action. Here, Discover goes too far. In the course of setting forth its various quibbles with the merits of this case, Discover argues that the damages in this case are only 33 cents to 86 cents per plaintiff. Brief at 8. As Plaintiff's Opening Brief established at pages 14-16, and 27-28, and as the next section of this brief will further demonstrate, this Court and numerous other courts have

concluded that claims of such small magnitude can *only* be effectively vindicated through the class action device.

C. Discover's Claim that Its Class Action Ban Is Not an Exculpatory Clause Because Its Consumers Have Many Other Remedies Is Simply Not Credible.

Notwithstanding the modest damages to individual customers (which arise from a practice that is uniform with respect to all of its customers, and which involves standardized documents that are all deceptive in the same manner), Discover insists that it is not necessary for its customers to resort to the class action device for them all to vindicate their claims.

First, Discover says that there is no need for consumer protection class actions because its customers could just "contact" Discover. Brief at 25. Discover seems to suggest that it would just voluntarily refund all of the money improperly charged to its customers if they would merely ask for it. This argument is outlandish. There is no basis in the record or in common experience to suggest that there is no need for any private right of action under consumer protection statutes, because any time that a large bank hits its customers with an illegal or deceptive charge, it will just voluntarily pay all the money back. Discover's suggestion that exculpatory clauses are conscionable because it is just such a trustworthy company is very hard to swallow.

Second, Discover helpfully suggests that its customers could bring individual actions in small claims court. Brief at 25. Discover offers no plausible explanation for why any rational consumer would bring a court case to recover such a small sum, when any small claims court will charge a filing fee that is many times that sum. Indeed, as this Court and many other courts have recognized, if claims of this magnitude may not be joined through the class action device, they will always or nearly always be lost

because no consumers will be able to pursue them. *See* Plaintiff's Opening Brief at 24-25.

Third, Discover suggests that its customers do not need class actions, because they could initiate individual arbitrations. Brief at 25. Discover further adds that it is willing to "advance" the costs of arbitration. *Id.* This argument again requires this Court to imagine that all or nearly all of the millions of persons with valid deceptive practice act claims would realize this fact, would take affirmative steps upon realizing that fact, and would be willing to spend the time and effort (and take the risk of having the arbitration fees advanced by Discover ultimately levied against them) to recover such a modest sum. Discover's proposed "solution" offers meaningful remedy to few, if any, customers.

Discover next suggests that its customers could bring individual actions in federal court under the Truth in Lending Act. Brief at 25-26. This proposed solution is also entirely unrealistic. Again, only a tiny number of consumers will ever discover the wrong complained of here, few of those persons will have heard of the Truth in Lending Act much less bring an action under it for the minimum statutory damages, and there is simply not a bar of attorneys who bring individual Truth in Lending Act cases for sums of less than $1 in the hope of receiving their hourly rate at the end of the case.

Finally, Discover suggests that its customers could always contact some state or federal regulator and ask them to get their money back. The clear import of Discover's argument is that there is no need for state laws creating private rights of action for deceptive trade practices, because those practices are already adequately controlled and remedied by government regulation. The logical ramification of this argument is that this Court's

prohibition against exculpatory clauses in adhesive contracts is unnecessary and wrong-headed, because government agencies offer all the remedy that any consumer needs. Discover offers no authority for this proposition, however, nor could it do so. As many courts have recognized, private rights of action under consumer protection statutes have filled a large void in consumer protection in the United States. *E.g., Eshaghi v. Hanley Dawson Cadillac Co.* (Ill. Ct. App. 1991) 574 N.E.2d 760, 766 ("The alternatives to the class action-- private suits or governmental actions--have been so often found wanting in controlling consumer frauds that not even the ardent critics of class actions seriously contend that they are truly effective.").

CONCLUSION

This Court should reverse the decision of the Court of Appeal.

Respectfully submitted,

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CERTIFICATION REGARDING
LENGTH OF BRIEF

I hereby certify that this brief contains 4199 words, including footnotes, as established by the work count of the computer program used for the preparation of this brief.

I declare and certify under the laws of the State of California that the foregoing statement is true and correct and that this certification was executed on July __, 2003, in Oakland, California.

By:

_____
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PROOF OF SERVICE BY MAIL

I, the undersigned, certify and declare that I am a citizen of the United States, over the age of 18 years, employed in the City of Oakland, County of Alameda, and not a party to this action. My business address is One Kaiser Plaza, Suite 275, Oakland, California, 94612.

I am readily familiar with Trial Lawyers for Public Justice's practice for collection and processing of documents for mailing with the United States Postal Service, being that the documents are deposited with the United States Postal Service with postage thereon fully prepaid the same day as the day of collection in the ordinary course of business.

On July __, 2003, I caused to be mailed the within **REPLY BRIEF** on the parties in this action listed below by placing a true copy thereof in a sealed envelope and depositing with the U.S. Postal Service, addressed as follows:

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