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UNITED STATES DISTRICT COURT FOR THE

NORTHERN DISTRICT OF CALIFORNIA

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| DARCY TING, Individually, and on behalf of all others similarly situated, and CONSUMER ACTION, a non-profit membership organization, both as private attorneys general,<br><br>Plaintiff,<br><br>vs.<br><br>AT&T, a New York corporation,<br><br>Defendant. | Case No. C 012969 BZ ADR<br><br>**CLASS ACTION**<br><br>**PLAINTIFFS' TRIAL BRIEF**<br><br>Trial Date: November 13, 2001<br>Time: 9:00 a.m.<br>Dept: G<br><br>The Honorable Bernard Zimmerman |

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## I. INTRODUCTION AND SUMMARY OF ARGUMENT.

A number of provisions of AT&T's Consumer Service Agreement ("CSA") are plainly unconscionable under well settled principles of California state law, and thus should be declared illegal under the Declaratory Judgment Act and enjoined by this Court as a violation of the Unfair Competition Law.

First, the CSA was promulgated in a procedurally unconscionable manner. There is no dispute that it was a contract of adhesion, sent to consumers by a more powerful entity on a take it or leave it basis. There is also no dispute that consumers had very little choice about submitting to an arbitration clause like that contained in the CSA, as nearly all of AT&T's major competitors have adopted nearly identical clauses.

Second, the CSA was sent to AT&T's customers in a way that will lead the overwhelming majority of them to be surprised when they learn of it, because it is outside of their reasonable expectations. Plaintiffs in this case commissioned a public opinion survey of 800 AT&T California customers by one of the most respected pollsters in the United States, Lake Snell Perry. This poll found that AT&T's customers did not recall seeing the CSA or the arbitration clause, and do not believe they agreed to the provisions of the CSA.

These findings merely reaffirm what is clear from AT&T's own internal documents and witnesses – AT&T set about to communicate with its customers about the CSA with the idea of "reassuring them" that nothing had changed and there was nothing they needed to do. To effectively anesthetize its customers and prevent them from becoming "concerned," AT&T set out – in its own employees' words – to "position detariffing as a non-event," and to have a "low key" public relations strategy. AT&T's own internal marketing studies informed the company that if the cover letter to the CSA stressed this "reassuring" message in bold print, the vast majority of their customers would glance at the letter and then throw away the rest of the mailing.

AT&T's internal information is fully consistent with the testimony of plaintiffs' expert Todd Hilsee, a nationally recognized marketing and class action notice expert. Mr. Hilsee will testify "that the Arbitration Notice was poorly designed and could not have resulted in consumer awareness," and that the "documents were written in a manner that would 'soften the blow' so that consumers knew less

and thought less about the consequences of the arbitration agreement . . . ."

Third, in addition to being procedurally unconscionable, the CSA is permeated with substantively unconscionable terms. Despite a long line of California cases stating that arbitration clauses may not waive or prohibit the substantive remedies provided by California's consumer protection statutes, the CSA sharply limits the remedies that AT&T's customers may receive from AT&T. AT&T argues to this Court that it did not intend this result, but the language of the CSA is explicit and unambiguous. The CSA also permits AT&T to recover punitive damages from its customers (while denying this right to its customers), an imbalance which is also unconscionable under California law.

The CSA prohibits AT&T's customers from bringing suit on a class action basis, which the California Supreme Court has squarely stated is counter to the reasonable expectations of consumers, and is therefore unconscionable. In addition, a series of undisputed facts and testimony of three experts demonstrate that a number of successful or viable class actions have been brought against AT&T and other telecommunications companies that could not have been pursued on an individual basis, either in or out of arbitration. Finally, the record shows that for those of AT&T's customers with larger disputes, or who wish to present their case in person, the costs of arbitration under the CSA are likely to be enormous. In addition, the possibility of loser-pays awards of arbitral expenses and arbitrator fees provided for by the CSA renders AT&T's arbitration provision unconscionable.

Separate and apart from being unconscionable on its terms, the CSA simply never took effect for AT&T's customers. First, AT&T's customers have not manifested their assent to the CSA, as is required to create a contract under California law. Second, despite clear California law requiring the voluntary, knowing and intelligent agreement to any contract purporting to waive constitutional rights, as demonstrated above few of AT&T's customers have read or understood the CSA.

AT&T argues that the Federal Communications Act ("FCA") preempts California's consumer protection laws. AT&T's argument is contrary to the language of the FCA and its legislative history, and ignores the fact that the FCA's Savings Clause explicitly preserves state consumer protection laws from preemption. AT&T also argues that the Federal Arbitration Act ("FAA") preempts California law. Several U.S. Supreme Court decisions provide that the generally applicable state law of conscionability is preserved by the FAA, however, and the Ninth Circuit has recently held that state law striking down

a non-mutual arbitration clause as unconscionable is not preempted by the FAA.

## II. THE FORMATION AND TERMS OF THE CSA's MANDATORY ARBITRATION PROVISIONS DEMONSTRATE PROCEDURAL UNCONSCIONABILITY.

### A. Courts Must Examine Contracts to See If They Are Procedurally Conscionable.

It is well-settled California law that a court may refuse to enforce any facially valid contract on the ground that it is unconscionable. Courts applying California contract law have recognized that unconscionability has both "procedural" and "sustantive" components. The Ninth Circuit recently described the relevant considerations for each of these prongs:

> The procedural aspect is manifested by (1) 'oppression,' which refers to an inequality of bargaining power resulting in no meaningful choice for the weaker party, or (2) 'surprise,' which occurs when the supposedly agreed-upon terms are hidden in a document. Substantive unconscionability, on the other hand, refers to an overly harsh allocation of risks or costs which is not justified by the circumstances under which the contract was made.

*Navellier v. Sletten*, 262 F.3d 923, 940 (9th Cir. 2001) (citations omitted); *see also A&M Produce Co. v. FMC Corp.*, 135 Cal.App.3d 473, 493 (1982) ("When nonnegotiable terms on preprinted form agreements combine with disparate bargaining power, resulting in the allocation of commercial risks in a socially or economically unreasonable manner, the concept of unconscionability...furnishes legal justification for refusing enforcement of the offensive result.")

Both the procedural and substantive elements must be present before a court will hold that a contract is unenforceable, but they need not be present to the same degree. Instead, there is a "sliding scale relationship between the two concepts: the greater the degree of substantive unconscionability, the less the degree of procedural unconscionability that is required to annul the contract or clause," and vice versa. *Carboni v. Arrospide*, 2 Cal.App.4th 76, 83 (1991); *see also Armendariz v. Foundation Health Psychare Services, Inc.*, 24 Cal.4th 83, 114 (2000).

### B. The CSA Is a Contract of Adhesion Imposed by a Stronger Party.

A contract provision may be found procedurally unconscionable in the face of unequal bargaining power between parties "which results in no real negotiation and 'an absence of meaningful choice'" in the formation of a contract. *A&M Produce*, 135 Cal.App.3d at 486-87 (citations omitted). In *A&M*

*Produce*, the parties were "an enormous diversified corporation . . . and a relatively small but experienced farming company." *Id.* at 489. The court found that the contrast between the two parties, especially as to commercial experience and expertise, was so great as to render the corporation's contractual liability waiver unconscionable. The judiciary generally shies away from finding unequal bargaining power in contracts between two business entities, "probably because courts view businessmen as possessed of a greater degree of commercial understanding and substantially more economic muscle than the ordinary consumer." *Id*. Inequality of bargaining power was also an animating factor behind the *Armendariz* decision, 24 Cal.4th at 115.

In the present case, the record demonstrates that the CSA is a contract of adhesion. *See* Undisputed Facts ("UF")[1] 22 and 10; Undisputed Facts - Relevance Disputed ("UF-RD")[2] 1).

**C. The CSA's Mandatory Arbitration Provisions Are Procedurally Unconscionable Based on the Lack of Meaningful Choice by Consumers.**

AT&T's customers had no meaningful choice but to continue service with AT&T, given that nearly every major long distance telephone company requires arbitration on nearly identical terms. A consumer's absence of meaningful choice in contract formation is a key element of procedural unconscionability because it tends to exacerbate the inequality of bargaining power between the consumer and the business. In *Carboni v. Arrospide*, 2 Cal.App.4th 76 (1991), the court held that a 200% interest rate in a consumer loan was unconscionable in part because the plaintiff had "no alternative for obtaining credit." 2 Cal.App.4th at 86. In *Ellis v. McKinnon Broadcasting Co.*, 18 Cal.App.4th 1796 (1993), the court determined that a commission forfeiture provision between an advertising salesman and his former employer, a television station, was procedurally unconscionable due in part to the fact that the employee had moved across the country to work at the station, and had no other job offers when he arrived. "Ellis was in no position to negotiate where the written contract was first presented to him two weeks after he had moved . . . to begin work." 18 Cal.App.4th at 1804. In an argument strikingly similar to one AT&T makes in the present case, the defendant in *Ellis* argued that it did indeed offer some of its employees contracts without the forfeiture provision, and thus that the

[1] Undisputed facts refers to the Joint Pre-trial Statement, section (2)(A)(1).

[2] Undisputed facts - relevance disputed refers to the Joint Pre-trial Statement, section (2)(A)(2).

plaintiff did have a meaningful choice. The court insisted that this fact was of "no consequence" because "Ellis was never made aware of that option." *Id.* at 1805.

Ellis is similar to our case in several ways: first, like the plaintiff in Ellis, Ms. Ting was presented with a contract only after her relationship with AT&T was established. Second, Ms. Ting had no meaningful choice of long distance carriers, as the Undisputed Facts establish that all but one of the long-distance providers have similar arbitration clauses. *See* Undisputed Facts 1, 17 and 24. AT&T specifically communicated this fact to inquiring customers. [*See* Plaintiff's Exhibits ("PE") 151, 152, 154, 155, 158, 159, 160, 164, 166, 167, 168, 169]

The fact that the vast majority of long distance telephone carriers require arbitration on similar terms to those in AT&T's demonstrates an absence of consumer choice that supports a finding of procedural unconscionability. In *American General Finance, Inc. v. Branch*, __ So.2d __, 2000 WL 1868516 (Ala. Dec. 22, 2000), *cert. denied*, 70 U.S.L.W. 3038 (Oct. 9, 2001) (No. 00-1934), the Alabama Supreme Court examined a factual record showing that all but one or two sub-prime lenders in the plaintiff's home city of Tuscaloosa, Alabama required borrowers to agree to binding arbitration as a condition for obtaining any loan. *Id*. at *12. Finding that "the market was virtually closed to consumers seeking comparable financing without agreeing to arbitration provisions," the court held that the plaintiff had demonstrated procedural unconscionability under Alabama contract law. *Id*. at *12 and 13.[3]

AT&T has earlier pointed to another fact contained in the Undisputed Facts in this case: "Customers with local telephone service may use AT&T's long distance service without being subject to the terms of the CSA by using AT&T's "dial-around" service, 10-10-345. This service allows consumers to make long distance calls with AT&T that are billed to them by their local phone company." The CSA does not inform AT&T's customers of this option for preserving their constitutional and statutory rights, however, nor does the cover letter to the detariffing package or the FAQs that accompanied the package. In short, there has not been a sufficient disclosure to permit plaintiffs to exercise this choice. The Undisputed Facts also demonstrate that AT&T has actively

[3] The possibility that one or two long distance companies might not require arbitration should not alter this conclusion. The Alabama Supreme Court in *Branch* based its finding that consumers had no meaningful choice as to arbitration on a market where 14 or 15 out of 16 sub-prime lenders required arbitration. *Id*.

exploited this absence of consumer choice by consistently reminding its customers that all its major competitors have adopted similar clauses. *See* UF 22, 23 and 24. *See* PE 151, 152, 154, 155, 158, 159, 160, 164, 166, 167, 168, 169.

### D. The CSA Is Procedurally Unconscionable Due to Surprise.

#### 1. "Surprise" Is A Major Element of Procedural Unconscionability under California Law.

Another element of procedural unconscionability is "surprise" in the appearance of contractual terms. "'Surprise' involves the extent to which the supposedly agreed-upon terms of the bargain are hidden in a prolix printed form drafted by the party seeking to enforce the disputed terms." *A&M Produce,* 135 Cal.App.3d at 486. Evidence of surprise is sufficient, although it is not necessary, to support a finding that a contract is procedurally unconscionable.[4] In this case, however, the evidence of surprise in the appearance of AT&T's arbitration clause is abundant.

California courts have held that contracts are unconscionable in several cases where a party had the *opportunity* to read the contract, but did not do so. In the foundational case, *A&M Produce*, the contract terms at issue (a clause limiting damages and a warranty disclaimer) were on the back of a pre-printed form, and were never pointed out to the buyer. The court made clear that the burden should have been on the seller to point out any "unusual or unconscionable terms" included in the contract, and thus that it was reasonable that the buyer was unaware of these terms. *A&M Produce*, 135 Cal.App.3d at 490 (citation omitted).[5]

Similarly, in *Ilkhchooyi v. Best*, 37 Cal.App.4th 395 (1995) the plaintiff, a commercial tenant, was given a new lease containing an objectionable profit-sharing clause that had not been in the previous lease. The court found the clause procedurally unconscionable because it was buried in the lease and not "clearly set out," as were the other terms that had changed from the old lease to the new. *Ilkhchooyi*,

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[4] In *Carboni*, for instance, the California Court of Appeal found that a consumer loan agreement with a 200% interest provision was unconscionable even though the plaintiff had clearly read and understood the terms of his contract. 2 Cal.App.4th at 85.

[5] This case concerns a buyer-seller contract and thus falls under the UCC. However, the court is quick to note that the definition of unconscionability applies in all contract cases. "Unconscionability is a doctrine fundamental to the operation of contract law, irrespective of the particular application." *A&M Produce*, 135 Cal.App.3d at 488 n.12.

37 Cal.App.4th at 410. And in *Ellis*, the court went even further, holding that the fact that the plaintiff had not even read his employment contract until just before termination did not signify, because "he was asked to sign the contract without warning and told it was a mere 'formality.' He had no reason to *suspect* it contained a forfeiture term which had never been discussed with him previously." *Ellis*, 18 Cal.App.4th at 83-84. For the court, this was enough evidence to find procedural unconscionabilty. *Id.*

**2. AT&T Crafted Its Communications to Reassure Its Customers that They Did Not Need To Worry About of Scrutinize the CSA.**

The focus of AT&T's communications effort with respect to the CSA was to keep its customers,[6] and to achieve this end by making sure that they were not worried or concerned in any way by the communications that surrounded the CSA. Accordingly, several of AT&T's documents and testimony of several of its witnesses establish that AT&T's primary message to its customers was that they did not need to take any action, that nothing had changed. Plaintiffs Memo of Proposed Facts and Conclusions of Law ("PS Memo") ,Fact 89, 90, 91-96.

AT&T's plan was to convince customers that they should take no action upon receiving the CSA. *E.g.*, PS Memo, Facts 89, 90, 91-96 (urging communications strategy clarifying "[t]he fact that no action is required on the part of the customer needs to be made. A strong link establishing that this information is not a 'call to action' on the part of the customer should be clearly stated in the letter. . . . Customers should understand that the mailing is being sent to comply with a federal mandate and does not imply any change in their relationship with AT&T.") AT&T crafted its communications to "reassure" its customers and keep them from becoming "nervous." PS Memo, Facts 89, 90, 91-96. AT&T's customer service representatives are also directed to stress the "no changes" message to customers who wanted to change phone service. PS Memo, Facts 89, 90, 91-96. AT&T wanted consumers to see the CSA as a non-event, so as not to "rattle our customers unnecessarily." PS Memo, Fact 97. Similarly, AT&T''s communications plan called for "low-key publicity." *Id.* at Fact 98. AT&T's press strategy was to avoid having people talk about or mention the arbitration provision. *Id.* at Fact 99. The project leader on the

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[6] The person responsible for managing the communications associated with the detariffing effort was Denise Janiec-Domino. Janiec-Domino Depo. at 6. She is a marketing manager in the "retention marketing group," Dep. at 1, meaning the marketing group charged with retaining AT&T's existing customers. Her division handles customer base management, and customer "loyalty programs." *Id.* at 5. In crafting communications relating to detariffing, she wanted to make sure that people were retained as customers and did not leave AT&T. *Id.* at 23.

detariffing team, Ms. Ellen Reid, expressed that AT&T did not want the FCC to issue a press release that would cause its customers to "pay attention to" the details of the CSA. *Id.* at Fact 100. AT&T's motive to keep its customers from reading through the details of the CSA is obvious – the more they read through the details and saw that their remedies were limited, that class actions were prohibited, that limitations periods were shortened, that they could not speak publicly about major disputes, etc., the greater the risk that AT&T's customers would become unhappy. An AT&T marketing study quotes one participant as saying about the CSA's arbitration provisions: "The more you read, the more nervous you get." ATT 50114.[7]

An in-house AT&T marketing study involving the use of nine focus groups, called "The Qualitative Study" by its author, concluded that after reading the bolded text to the effect that consumers "don't have to do anything," that "[a]t this point most would stop reading and discard the letter." ATT 50076.[8] The author of the study did not find this conclusion to be a cause of concern, and no one on the detariffing team ever expressed concern to her about this conclusion. Herster Dep. at 17:7-17:25. In fact, the Qualitative Study went on to recommend:

> To provided quick reassurance to those who do not want to read a formal letter, the bolding of the key reassuring information that nothing has changed regarding the customer's service or pricing should be maintained.

ATT 50078. This is crucial, as the cover letter that actually went out to AT&T's customers contained the following "reassuring" language in bold letters:

> **Please be assured that your AT&T service or billing will not change under the AT&T Consumer Services Agreement; there's nothing you need to do.**

Under the heading "Initial reaction to the Package," the Qualitative Study found that "Most skimmed the letter and glanced at the Service Agreement without reading it." ATT 50092. This conclusion was not a concern to the author of the study, Herster Dep at 20:6-20:10, and no one else on

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[7] There are also suggestions in the record that another reason that AT&T didn't want consumers to become interested in the details of the CSA may have been that it wanted to minimize the number of telephone calls relating to detariffing that its live consumer service representatives (the people who field calls into the "channel," as opposed to the automatic recordings that were available to people who called into the "IVR") would have to handle. PS Memo, Fact 102.

[8] AT&T's marketing people were well aware of the significance of putting the "reassuring information" in bolded text -- more people would read it. PS Memo, Fact 80.

the detariffing team ever expressed concern to her about that finding. *Id.* at 20.[9] The Qualitative Study found that "Few noticed and virtually no one spontaneously read [the Arbitration] section." ATT 50089. *See also* PS Memo, Facts 81 and 82. The author of the study expects that AT&T customers would not read the final Service Agreement from cover to cover and the data supported that conclusion. Another AT&T in-house study found that only 10% of AT&T's customers would read/skim or glance at the Limitations of liability section/subsection, and only 9% would read/skim or glance at the Dispute resolution section/subsection. ATT0337.[10]

AT&T was also aware that the small print used with the CSA package would reduce the number of people who read it. PS Memo, Fact 77. In order to study its customers reactions to the CSA itself, AT&T did a "forced reading" (its own phrase). To accomplish this, as the Undisputed Facts establish, the persons performing AT&T's focus group study would first show the participants the CSA in the font in which it was ultimately sent to AT&T's seven million California customers. Then, after getting their comments on the normal version, the researchers would show the participants a second version of the agreement in significantly larger print. AT&T thus chose to communicate the CSA in a method that it knew would result in many customers not reading it.

AT&T also gave "very narrow search criteria" to Internet search engines so that fewer customers could find the web page with the Consumers Services Agreement. *Id.* at 101. AT&T sharply limited the information available to consumer service representatives about arbitration, making it impossible for most customers to talk to a live human being about this issue. PS Memo, Facts 102-103, 105. With respect to AT&T's website on detariffing, one of AT&T's marketing people stated "we know that much of this content was not written *primarily* with the customer in mind!" *Id.*

### 3. The Lake Snell Perry Report Demonstrates that the CSA was Communicated in Such a Way as to Be a Complete Surprise to the Overwhelming Majority of AT&T's Customers.

Plaintiffs' Exhibit 209 is the report of Lake Snell Perry. Ms. Lake, who heads the firm, is one

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[9] Similarly, speaking of the detarrifing letter, an e-mail from Siobhain L. Towell to Denise Janiec-Domino, August 22, 2000, ATT11071, states "Most consumers will read it for 2 seconds (if that at all) and then throw this letter away."

[10] AT&T has already had a clear demonstration that many of its customers did not understand how the CSA worked. Shortly after the CSA was sent out, AT&T learned that it had "customers writing into the Arbitration Center without understanding the process." E-mail from Janiec-Domino to Amey, et al., July 18, 2001, ATT 15302.

of plaintiffs' experts in this case. Ms. Lake has more than 25 years of experience in survey research. She has done polling work for U.S. News and World Report and the Wall Street Journal, in political science ranging from Presidential campaigns to state and local initiatives, for commercial businesses and for various non-profit organizations. She is one of the best known and most highly regarded polling experts in the United States. Lake Snell Perry polled 800 AT&T customers in California.

The survey's first finding is that "AT&T customers say they are unlikely to read solicitations they receive in the mail. Only 14 percent of customers say they are extremely or very likely to read solicitations, while 87 percent say they are less likely to read solicitations, including 37 percent who say they are not at all likely to read them." It also found that AT&T's California customers "are also unlikely to read solicitations they receive from AT&T."

AT&T hired Professor Joel Steckel to attack Ms. Lake's work. Professor Steckel assaults the study at some length for asking the question of whether people are likely to read solicitations, claiming that this question improperly communicated to the persons being polled that the CSA was itself a solicitation. In fact, the survey separated out the questions relating to the CSA and identifying it by name and type of document ("Agreement"), and does not suggest that the respondents link the two. Moreover, plaintiffs had asked Lake Snell Perry to study the reactions of customers to solicitations because the evidence will show that a great many of AT&T's customers would associate the package including the CSA with a business solicitation. AT&T's focus groups told AT&T that they assumed the CSA was an offer from AT&T and that the envelope looked like "junk mail." PS Memo, Fact 74. Although AT&T's marketing people warned it that fewer people would read the CSA if it was combined with a marketing message, the cover letter did have a marketing message in a P.S. and the FAQs included marketing information before the arbitration information. In addition, Plaintiffs' Exhibit 210, the Report of Todd Hilsee, confirms that the CSA was communicated in a manner similar to that used for many types of commercial solicitations.

The Lake Snell Perry Report goes on to find that most AT&T customers do not remember receiving the CSA, supporting plaintiffs' contention that the various limitations on the constitutional and statutory rights contained in the CSA would come as a great surprise to the vast majority of AT&T's customers. Professor Steckel attacked this conclusion by saying that the survey was too late – the CSA's

were mailed out several months before the survey was performed. His argument is that consumers may well have read the CSA, agreed that it was appropriate for them to waive various constitutional and statutory rights, and simply forgotten all this by the time they were surveyed. The assumption that most Americans take their constitutional rights so lightly is highly questionable, however, and more likely reflects the fact (established below) that AT&T intended and expected that the overwhelming majority its customers would glance at the cover letter (at most), draw the conclusion that the enclosures made no significant changes and did not require any action, and throw the remainder of the package away. Professor Steckel's point also does not address the legal question raised with respect to conscionability – that AT&T's California customers will find the limitations in the CSA to be a surprise.

The Lake Snell Perry Report further found that few customers recalled seeing the arbitration provision. Professor Steckel alleges that the Lake Snell Perry poll was biased for using the word "arbitration," instead of the euphemism "dispute resolution." However, the CSA itself and its surrounding materials themselves use the word "arbitration" repeatedly. The Lake Snell Perry Report goes on to find that most AT&T customers do not think that the CSA formed a contract, and do not think they agreed to various terms contained in it. Professor Steckel argues that whether a contract exists is something that only a lawyer would know, and that it was improper to ask what the consumer believes. However, California law directs this Court to inquire into the expectations of consumers.[11]

Finally, Lake Snell Perry read excerpts of the CSA to consumers to jog their memory, but found that "Hearing parts of the arbitration provision does not jog customers' memories about receiving information." Professor Steckel attacks this question as proof of bias, arguing that the excerpts from the arbitration provision do not include positive information about what he considers to be pro-consumer provisions in the CSA. This attack is somewhat unfair, as the 14th question is tailored to the provisions challenged in this case, and plaintiffs are not challenging some of the provisions that Professor Steckel felt should have been asked to consumers. In addition, Lake Snell Perry's 14th question necessarily had to excerpt from the CSA – no one offering their time to a pollster would sit through a reading of the entire dispute resolution and limitation of liability provisions of the CSA. Moreover, the 14th question

[11] Similar evidence as to expectations comes from Lake Snell Perry's conclusion that "Customers believe they should still have the right to take the company to court and the right to talk to others about their dispute," and that "Customers do not believe that continued use of service or paying a bill shows agreement with the Consumer Service Agreement."

does not mention a good many troubling provisions of the CSA, such as (a) the fact that the limitations period set forth is shorter than the limitations period under California's consumer protection laws; (b) the arbitrators may award fees and expenses to prevailing defendants, when this would not be possible under California's consumer protection laws; (c) the CSA prohibits consumers from obtaining punitive damages from AT&T but permits AT&T to obtain punitive damages from consumers.

In short, the Lake Snell Perry report is powerful evidence that AT&T's customers would find the limitations in the CSA a great surprise. Its findings are consistent both with the Report of Todd Hilsee and with AT&T's own marketing plan and marketing data.

## III. THE CSA's MANDATORY ARBITRATION PROVISIONS ARE SUBSTANTIVELY UNCONSCIONABLE UNDER GENERALLY APPLICABLE PRINCIPLES OF CALIFORNIA CONTRACT LAW.

### A. The One-Sided Limitations on Liability in the CSA Are Substantively Unconscionable.

#### 1. Under California Law, Arbitration Clauses May Not Strip Consumers of Their Statutory Rights Under the State's Consumer Protection Statutes.

AT&T's mandatory arbitration clause contains a sweeping limitation on the damages remedies that are available to consumers in their disputes with the company. The arbitration clause appears in the Customer Service Agreement and states explicitly that "**THE ARBITRATOR MAY NOT AWARD DAMAGES THAT ARE NOT EXPRESSLY AUTHORIZED BY THIS AGREEMENT**" and that "**YOU AND AT&T BOTH WAIVE ANY CLAIMS FOR AN AWARD OF DAMAGES THAT ARE EXCLUDED UNDER THIS AGREEMENT.**" CSA § 7(a) (emphasis in original). This damages limitation thus incorporates into the arbitration clause the separate CSA provision entitled "**LIMITATIONS OF LIABILITY**," which purports to describe the "**FULL EXTENT**" of AT&T's liability to consumers:

> **IF OUR NEGLIGENCE CAUSES DAMAGE TO PERSON OR PROPERTY WE WILL BE LIABLE FOR NO MORE THAN THE AMOUNT OF DIRECT DAMAGES TO THE PERSON OR PROPERTY. FOR ANY OTHER CLAIM, WE WILL NOT BE LIABLE FOR MORE THAN THE AMOUNT OF OUR CHARGES FOR THE SERVICES DURING THE AFFECTED PERIOD. FOR ALL CLAIMS, WE WILL NOT BE LIABLE FOR INDIRECT OR CONSEQUENTIAL DAMAGES, INCLUDING BUT NOT LIMITED TO, LOST PROFITS OR REVENUE OR INCREASED COSTS OF OPERATION. WE WILL ALSO NOT BE LIABLE FOR PUNITIVE, RELIANCE OR SPECIAL DAMAGES. THESE LIMITATIONS APPLY EVEN IF THE DAMAGES WERE**

**FORESEEABLE OR WE WERE TOLD THEY WERE POSSIBLE, AND THEY APPLY WHETHER THE CLAIM IS BASED ON CONTRACT, TORT, STATUTE, FRAUD, MISREPRESENTATION, OR ANY OTHER LEGAL OR EQUITABLE THEORY.**

*Id*. at § 4 (emphasis in original). This provision would displace the remedial provisions of California's consumer protection statutes and the provisions of § 7 of the CSA.

These liability limiting provisions in AT&T's mandatory arbitration clause are unconscionable under established California contract law. The court in *A&M Produce Co.* held that a manufacturer's express disclaimer of all warranties and exclusion of consequential damages in a sales contract with a commercial customer were substantively unconscionable and refused to enforce them because they resulted in an "allocation of commercial risks in a socially or economically unreasonable manner." *A&M Produce*, 135 Cal.App.3d at 492-93. This same principle applies to contracts involving arbitration, and indeed it applies with additional force to consumer contracts where such liability limitations would undermine statutory protections of consumer rights. In *Broughton v. Cigna Healthplans of California*, 21 Cal.4th 1066 (1999), a case arising in part under the Consumer Legal Remedies Act, the court held that "[w]hen parties agree to resolve statutory claims through arbitration, it is reasonable to infer that they consent to abide by the substantive and remedial provisions of the statute." *Id*. at 1087 (finding that CLRA's fee and cost-shifting provisions for prevailing consumer plaintiffs override fee provisions of California's arbitration statute).

The strongest statement of California law prohibiting businesses from using adhesive mandatory arbitration contracts to diminish the statutory remedies available to weaker individual parties is found in *Armendariz*. That case addressed an employer's mandatory arbitration contract that limited an employee's potential damages recovery on any statutory or breach of contract claim to the value of lost wages. 24 Cal.4th at 103-04. The court proclaimed repeatedly that this damages limitation was unlawful and against public policy because it would eviscerate the remedies available to employees under the Fair Employment and Housing Act. *Id*. at 100-01 ("It is indisputable that an employment contract that required employees to waive their rights under the FEHA to redress sexual harassment or discrimination would be contrary to public policy.") Although the facts of *Armendariz* arose out of an employment contract, the court's discussion of statutory rights is not so limited and should therefore

apply with equal force to consumer contracts involving rights and remedies under the CLRA and UCL. *See id*. at 91 ("We conclude that the agreement possesses a damages limitation that is contrary to public policy, and that it is unconscionably unilateral"); 99-100 (U.S. Supreme Court precedent "disallows forms of arbitration that in fact compel claimants to forfeit certain substantive statutory rights"); 101 ("an arbitration agreement cannot be made to serve as a vehicle for the waiver of statutory rights created by the FEHA. *We suggested as much in our recent discussion* [in *Broughton*] *of rights derived from the Consumer Legal Remedies Act which the legislature had declared to be unwaivable*.") (citation omitted) (emphasis added). The damages limitation was an important part of the court's substantive unconscionability analysis. *Id*. at 121.

The damages limitation in AT&T's arbitration clause is almost identical to that in *Armendariz*. There the employer attempted to limit its liability to the value of an employee's lost wages; here, AT&T is attempting to limit its liability to the value of a consumer's lost service. Just as the court in *Armendariz* held that an employer cannot use a mandatory arbitration contract to eviscerate the remedial provisions of the FEHA for employees, so this Court should hold that AT&T cannot use a mandatory arbitration contract to rewrite the remedial provisions of the CLRA, UCL and other statutes designed to protect consumers.

**2. Under California Law, Arbitration Clauses May Not Strip Consumers of Rights and Remedies that The Clauses Preserve for the Business.**

Perhaps the most important indicator of substantive unconscionability under California law is an extremely uneven or one-sided allocation of risk. In *Ellis*, *supra,* the court held that a forfeiture provision in an employment contract between a television station and an advertising salesman was substantively unconscionable where it resulted in the salesman forfeiting $20,000 in commissions when he resigned his position but would only have guaranteed him $6,000 in salary had he not made any sales. 18 Cal.App.4th at 1807. The court concluded that "[a]s written, ...the provision is a commercially unreasonable forfeiture clause, exacting a penalty far in excess of any potential detriment suffered by KUSI." *Id*.

California courts have applied this principle to mandatory arbitration contracts holding, for example, that a one-way arbitration clause in which an employer preserves its own right to file suit in

court while imposing binding arbitration for its employees' claims is substantively unconscionable. *See, e.g., Armendariz*, 24 Cal.4th at 118 ("the doctrine of unconscionability limits the extent to which a stronger party may, through a contract of adhesion, impose the arbitration forum on the weaker party without accepting that forum for itself"); *Stirlen v. Supercuts, Inc.*, 51 Cal.App.4th 1519, 1541-42 (1997). The doctrine of unconscionability thus serves as a bulwark for employees and consumers alike against businesses that attempt to affect a substantial reallocation of the risk of dispute resolution in their own favor through the use of mandatory arbitration clauses or other contracts of adhesion.

### 3. The CSA Limits the Rights to Damages of AT&T's Consumers, But Does Not Limit the Rights of AT&T to Damages.

The CSA affects precisely the type of one-sided allocation of liability risks that California law prohibits. As set forth above, AT&T's arbitration clause prohibits arbitrators from awarding damages that are not expressly authorized by the CSA. Arbitrators are thus bound by the CSA's separate liability limitation section which prohibits awards of punitive, consequential, reliance, indirect, special or any other damages above the value of lost service **only in claims brought by consumers against AT&T**. *See* CSA § 4 ("We will not be liable for more than than the amount of our charges..."; "We will not be liable for indirect or consequential damages..."; "We also will not be liable for punitive, reliance, or special damages.") The CSA does not, however, so limit the potential liability of consumers to AT&T in the event that the company brings claims against any of them.[12]

In *Armendariz*, the court struck down as unconscionable an employer's almost identical mandatory arbitration contract. After discussing separately the issues of statutory damages limitations and non-mutual arbitration requirements, the court tied the two problems together and held that "*[t]he unconscionable one-sidedness of the arbitration agreement is compounded in this case by the fact that it does not permit the full recovery of damages for employees, while placing no such restriction on the employer*." 24 Cal.4th at 121 (emphasis added). *Armendariz* further held that such a one-sided arbitration system was not justified by the fact that the employer was unlikely to bring any legal claims

[12] The statement in the arbitration clause prohibiting arbitrators from awarding punitive damages and attorneys' fees that are not authorized by a statute, *see* CSA §7(a), must be read only to apply to claims brought by AT&T against consumers in light of the very next sentence purporting to waive damages prohibited elsewhere in the CSA, *Id*. Still, this Section 7(a) limitation on consumer liability to AT&T is dwarfed by the Section 4 limitation on AT&T's liability that is incorporated into the arbitration clause.

against the employee. *Id*. So it is here that AT&T's arbitration clause, by imposing a one-sided remedial scheme where arbitrators have no power *ever* to award punitive, consequential, reliance, indirect, or special damages to consumers but retain some power to award such damages to AT&T, is substantively unconscionable.

#### 4. Where, As Here, the Language of the CSA Is Unambiguous and Explicit, It is Of No Effect that AT&T Tells This Court that it Did Not Mean the Result Provided By Its Clause.

AT&T has urged this Court to read the CSA in such a way as to permit consumers to sue for statutory punitive damages and for exemplary damages in cases of intentional misconduct. California law will not permit a party to preserve an unambiguous contract by re-writing it. The employer in *Armendariz* attempted to avoid the most blatantly unlawful application of its arbitration contract by arguing that the damages limitation for employees only applied to breach of contract claims, and not to any statutory causes of action. *Armendariz*, 24 Cal.4th at 104. The court rejected this argument, citing the final sentence in the arbitration clause which recited on behalf of the employee that "I understand that I shall not be entitled to any other remedy" as evidence that the damages limitation applied to all of the employee's claims. *Id*.[13] AT&T's arbitration clause is even more unambiguous in its incorporation of the CSA's plainly unlawful limitation of the company's liability to consumers: **"YOU AND AT&T BOTH WAIVE ANY CLAIMS FOR AN AWARD OF DAMAGES THAT ARE EXCLUDED UNDER THIS AGREEMENT.**" CSA § 7(a) (emphasis in original). AT&T thus cannot attempt to salvage its unlawful arbitration clause by proffering to this Court an interpretation that is plainly contrary to its express terms.

### B. Under California Law, the CSA's Prohibition on Class Actions Is Unconscionable.

In our brief in connection with the motion for preliminary injunction, we cited a string of California Supreme Court cases to establish that California's public policy embraces the importance of class actions as an instrumentality of consumer protection. These authorities also established that the

[13] *Flyer Printing Co. v. Hill*, 2001WL 804065 at *4 (Fla. Ct. App. July 18, 2001) ("Flyer Printing points out that it offered to pay all the costs of arbitration notwithstanding the language of the agreement. Hill rejected this unilateral offer to amend the agreement, however, and we are not authorized to remake the parties' contract.").

fact that AT&T's class action prohibition appears in an arbitration clause does not make it any more permissible.[14] California law establishes that if AT&T's customers are barred from pursuing class litigation, they will likely be denied any meaningful remedy for most wrongs that AT&T might commit against them.[15]

In addition to the conclusive law of the State of California, the undisputed facts in this case establish the importance of class actions in holding AT&T accountable. A number of class actions raising serious allegations of wrongdoing, including some with very successful outcomes, would never have been brought on an individual basis if the CSA's prohibition on class actions had been in effect. *See* UF-RD 8-14.[16] These facts are further bolstered by the testimony of three expert witnesses. *See* Reports of Elizabeth Renuart, Mark Chavez and Michael Donovan.

### C. Under California Law, the CSA's Shortening of Limitations Periods Is a Substantial Factor in Finding That the CSA Permeated with Unconscionability.

As we established in our earlier briefing, the CSA also purports to shorten the limitations period applicable to its customers' claims in a way that will undeniably foreclose valid claims. AT&T's contractual limitations period diminishes statutory and other legal protections of consumers by

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[14] The California Supreme Court is not alone in recognizing the potentially unconscionable effects of a class action prohibition in an adhesive arbitration setting. *See Powertel, Inc. v. Bexley*, 743 So.2d 570, 576 (Fla. Dist. Ct. App. 1999) (declaring cellular telephone service provider's arbitration clause unconscionable based in part on its prohibition of consumer class actions); *Lozada v. Dale Baker Oldsmobile, Inc.*, 91 F. Supp.2d 1087, 1104-05 (W.D. Mich. 2000) (holding car dealer's arbitration clause unconscionable for violation of state consumer protection statute's explicit provision for class-wide recovery). The fact that some courts have upheld adhesive arbitration requirements despite their effect of precluding class actions, *see*, *e.g.*, *Med Ctr. Cars, Inc. v. Smith*, 727 So.2d 9 (Ala. 1998); *Stein v. Geonerco, Inc.*, 17 P.3d 1266 (Wash. App. 2001), does not alter California contract law on the relationship between class actions, arbitration, and adhesion.

[15] It is this aspect of many consumer cases that distinguishes AT&T's class action prohibition from the Supreme Court's suggestion in *Gilmer v. Interstate/Johnson Lane Corp*., 500 U.S. 20 (1991), that the right to bring a class action under the federal Age Discrimination in Employment Act (ADEA) might be waivable in an arbitration contract. *Id*. at 32. The ADEA provides for greater individual relief in the form of unpaid wages, reinstatement, other equitable relief, liquidated damages, attorney fees and costs. *See* 29 U.S.C. § 626(b) (incorporating remedies available under 29 U.S.C. § 216(b)). Additionally, class actions under the ADEA proceed on an "opt-in" basis and are not governed by Rule 23's opt-out provisions for mass claims. *See*, *e.g.*, *Allen v. Marshall Field & Co.*, 93 F.R.D. 438, 441 (N.D. Ill 1982). The waiver of class-wide relief in consumer cases thus poses a far greater threat to plaintiffs' ability to enforce their rights.

[16] One other fact in the record demonstrating the importance of class actions is the fact that AAA has no rule or procedure for waiving its administrative fees for arbitrations conducted under its Consumer Rules. Zotto Dep. at 11. In light of this fact, if AT&T's customers are barred from banding together and sharing in the costs of pursuing a lawsuit, AT&T could wrongfully take money from all of its customers and escape any legal accountability so long as the damage to the consumers was less than $20 apiece.

eliminating a subset of their potential causes of action. Under California contract law, provisions shortening the limitations period in which individuals may file suit against a business party are relevant as evidence of substantive unconscionability. In *Stirlen v. Supercuts, Inc., supra*, the court held that an employer's arbitration contract was unconscionable based in part on a provision creating a uniform one-year limitations period for employees to file their claims:

> Having forfeited significant adjudicatory rights, employees are the beneficiaries of no compensating concessions in connection with the employment related claims against Supercuts which they must arbitrate. On the contrary, the concessions here again favor the employer. Employees agree to a one-year statute of limitation even as to claims to which a longer period would otherwise apply....

51 Cal.App.4th at 1542. Similarly, the Ninth Circuit has held that a franchisor's arbitration clause was unenforceable in part because it forced franchisees to file claims within either 90 days or six months rather than the one year period provided by the statute. *Graham Oil Co. v. ARCO Products Co.*, 43 F.3d 1244, 1247-48 (9th Cir. 1995).[17] Under these decisions, the provision in AT&T's adhesive arbitration clause shortening the limitations period in which consumers can file claims against the company is further evidence that the arbitration clause as a whole is unconscionable.

In *Soltani v. Western & Southern Life Ins. Co.*, 258 F.3d 1038 (9th Cir. 2001), the Ninth Circuit held that an employer's contract imposing a six-month limitations period for employees to file wrongful discharge claims was not by itself substantively unconscionable. *Id*. at 1045. The employees in *Soltani*, unlike Plaintiffs here, had signed the contracts shortening the relevant statutes of limitations so that there was less of an issue of surprise than there is in this case. *See id*. at 1043. More fundamentally, *Soltani* is not conclusive here because Plaintiffs are arguing that the shortened limitations provision is *relevant* even if it is not *determinative* as to substantive unconscionability. The two-year contractual limitations period is but one of many terms in the CSA that reallocate the risks of dispute resolution in the company's favor by diminishing or eliminating the statutory rights of consumers. It is in this light that the two-year limitations provision should be relevant to the determination that the entire arbitration clause is substantively unconscionable.

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[17] *See also*, *e.g.*, *In re Managed Care Litigation*, 132 F. Supp.2d 989, 1000-01 (S.D. Fla. 2000) (holding HMO's arbitration contract with insured members unenforceable based in part on its one-year limitations provision for members to file their statutory claims).

### D. Under California Law, the Excessive Fees in the CSA for Claims under AAA's Commercial Rules Are Unconscionable.

As plaintiffs set forth in our briefing related to the motion for preliminary injunction, AAA imposes substantial filing fees and its arbitrators impose hefty arbitral fees averaging nearly $2,000 a day for claimants who bring claims under AAA's Commercial Rules. We also cited a number of cases establishing that California law does not permit arbitration clauses to place such heavy financial burdens on individual claimants. There is one important recent case, however: *Phillips v. Associates Home Equity Servs.*, 2001 WL 1159216 (N.D. Ill. Sept. 28, 2001):

> It is true that the arbitration agreement provides that defendants agreed in the parties' contract to front this amount [AAA's filing fees of $4,000], but the agreement makes this subject to later allocation by the arbitrator. Furthermore, the initial filing fee is far from the only cost involved in the arbitration. . . . [D]efendants argue that the AAA's commercial rules contain certain safeguards to protect Philips against incurring exorbitant costs. These arguments are unavailing . . . [D]efendants note that the arbitrator at his or her discretion can assess all expenses to one party at the conclusion of the case . . . But that is nothing more than an argument that there exists some possibility that Phillips ultimately may not have to bear a prohibitively expensive portion of the arbitration costs.

All of these words apply with equal force here, except that here AT&T does not front all the arbitration fees and the most that will happen is that AAA may "defer" some portion of those fees. The last sentence of paragraph 7 of the CSA provides that the prevailing party may seek an award from the losing party of the arbitration expenses and arbitrator fees it has paid.

And the arbitrators' fees can be enormous. The Undisputed Facts in this case give a number of illustrations of cases in which AAA required individuals to pay hefty fees: $18,260 in an employment case (UF-RD 2), $15,000 in a legal malpractice case (UF-RD 3), $11,000 for a chicken farmer in a franchise case (UF-RD 4), $7,000 in a case against a pest control company (UF-RD 5), and $19,851.33 in a homeowner's case against a builder (PS Memo, Fact 70).

AAA has provided AT&T with an affidavit attempting to minimize the question of arbitral fees by pointing to its practice of reducing and deferring arbitral fees, and asserting that it nearly always grants request for fee reductions. There is far less to this practice than meets the eye, however. First, as the Undisputed Facts in this case establish, the waivers and deferrals relate only to the AAA's own

administrative fees, and not to the (usually much larger) fees charged by the arbitrators themselves.[18] Second, when AAA's representatives testify that they "grant" nearly all requests for fee waivers or deferrals, they do not mean that they agree to the relief from fees actually requested by the claimants requesting fee waivers or deferrals. AAA *defers* only a portion, and quite possibly a small portion of the fees sought to be w*aived*. *See* PS Memo, Fact 63. When fees are deferred (which is generally what happens, rather than being waived), AAA may and often does still collect the fees subsequently from the claimant. *Id.*

Finally, AAA will only waive or defer fees in cases of "extreme hardship." There are no publicly available documents that describe the criteria used for determining what constitutes extreme hardship. Zotto Dep. at 19. There are no internal documents within AAA that define or discuss how waivers or deferrals should be granted, Zotto Dep. at 19, Heelan Dep. at 9, and the last two people responsible for evaluating such requests received no training or instruction in how to evaluate such requests. Zotto Dep. at 33, Heelan Dep. at 16. AT&T's own documents demonstrate that these sorts of expenses are far outside of the reasonable expectations of its customers.

Finally, plaintiffs will introduce evidence demonstrating that AAA arbitrators at least sometimes follow a "Loser Pays" approach and award attorneys' fees to prevailing defendants, in addition to arbitral expenses and arbitrator fees. UF-RD 2. AAA denies that it can identify how often this is the case because of the way it has chosen to maintain its records. At least one court has held that such a Loser Pays approach is unconscionable. *See Sosa v. Paulos*, 924 P. 2d 357 (Utah 1996) (loser pays rule unconscionable in medical malpractice context). At least one state attorney general has expressed serious concerns over this issue. PS Memo, Fact 130 and 131. The demonstrated possibility that AAA arbitrators may award such ruinous fees renders the CSA unconscionable.

**E. The CSA's Secrecy Provision Is Unconscionable.**

Plaintiffs stand on their briefing in the motion for preliminary injunction on this issue.

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[18] AAA's representatives also seek to minimize the importance of high arbitral fees by pointing to the existence of pro bono panels of arbitrators. The AAA's Commercial Rules include no information from which a claimant could learn about the existence of its pro bono panels, or how to request that one be assigned to a pro bono arbitrator. Zotto Dep. at 11. AAA's designated representatives in this litigation on the subject of the waivers and deferrals of arbitration fees were unable to say how many arbitrators currently serve or have served on pro bono panels in California, or how many cases have been handled by pro bono arbitrators. Zotto Dep. at 12-13. The person who currently handles requests for fee waivers to AAA is not even aware that they have a panel of pro bono arbitrators. Heelan Dep. at 8.

## IV. THE FEDERAL COMMUNICATIONS ACT DOES NOT PREEMPT PLAINTIFFS' STATE STATUTORY CONSUMER PROTECTION AND COMMON LAW CONTRACT CLAIMS.

### A. Preemption Should Only Be Found Where Congress' Intent Is Manifestly Clear.

It is well established that federal law will not be found to preempt state law unless it is clear that Congress intended to do so. Because preemption constitutes a radical intrusion into state power, the U.S. Supreme Court has repeatedly cautioned courts to apply a strong presumption *against* preemption that may only be overcome by clear evidence of Congressional intent to preempt. As was reaffirmed in *Medtronic v. Lohr*, 518 U.S. 470, 485 (1996), a party seeking preemption of state law bears a heavy burden of overcoming the long-standing "presum[ption] that Congress does not cavalierly pre-empt state-law causes of action." In nearly all preemption cases, a court must start with the assumption "that the States' historic police powers cannot be superseded by a Federal Act unless that is Congress' clear and manifest purpose." *Id*. (citation omitted). This presumption stems from and protects the Constitutional system of federalism. *See, e.g., Jones v. Rath Packing*, 430 U.S. 519, 525 (1977) (the presumption against preemption "provides assurance that 'the federal-state balance' . . . will not be disturbed unintentionally by Congress or unnecessarily by the courts.") (citation omitted).

The normal presumption against preemption is even stronger in cases like this one involving consumer protection issues and basic contract law, where preemption would displace the traditional regulatory power of the states. *See, e.g.*, *Medtronic*, 518 U.S. at 485. The Ninth Circuit has explained that "if we are left with a doubt as to congressional purpose, we should be slow to find preemption, '[f]or the state is powerless to remove the ill effects of our decision, while the national government, which has the ultimate power, remains free to remove the burden.'" *Chevron U.S.A., Inc. v. Hammond*, 726 F.2d 483, 488 (9th Cir. 1984) (citation omitted). AT&T thus bears a heavy burden of proving that Congress intended to preempt Plaintiffs' causes of action.

### B. The Language, Structure and Legislative History of the Federal Communications Act Establishes That it Does Not Preempt Plaintiffs' Claims.

Nothing in the FCA preempts plaintiffs' claims that the CSA is unconscionable under generally applicable rules of California consumer protection and contract law . To meet its burden of establishing

that the FCA preempts plaintiffs' claims here, AT&T must establish either that the FCA "expressly preempts" those claims by its plain language, or that there is "implicit preemption" under the FCA. AT&T will be unable to meet either test.

The FCA's principal preemption provision is Section 253(a), and this provides AT&T's only avenue of arguing that there is express preemption. Section 253(a) prohibits states from enacting any regulation or requirement that "may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service." 47 U.S.C. § 253(a). This provision clearly does not bar plaintiffs' claims in this case. For AT&T to claim preemption under § 253(a), it would have the burden of establishing that the consumer protection provisions of the CLRA and the UCL will prohibit it from providing interstate telephone service in the State. AT&T has not even alleged this concept, which in any case is demonstrably untrue.

California's consumer protection laws apply to enterprises from all industries doing business in California, and literally millions of businesses comply with those statutes every day. While AT&T might occasionally face class action liability in California if it were to violate those statutes, there is no evidence whatsoever that this possibility would drive AT&T out of business in the state and prevent it from servicing its seven million California customers. In any case, since the same consumer protection laws apply to its competitors, there is no reason to suggest that being subject to California's consumer protection laws would "prohibit or have the effect of prohibiting" AT&T from providing telephone service in California. As the FCC has concluded, "requiring nondominant interexchange carriers to conduct their businesses as do other businesses in unregulated markets will not substantially increase their costs." *Order on Reconsideration*, 12 FCC Rcd. 15,014 at ¶ 15. This is particularly so when one considers the limited reach of California's consumer protection laws in this case – plaintiffs merely argue that the arbitration clause may not ignore established California law with respect to damages limitations, class actions, and limitations periods, and that AT&T must obtain assent to the formation of the contract. Neither of these reasonable propositions bars AT&T from doing business in the state, and thus there is no preemption under § 253(a), the only preemption provision in the FCA.

Even if AT&T had a colorable argument that § 253(a) preempts plaintiffs claims (which it does not), that argument would be erased by the Act's Savings Clause that expressly *preserves* application

of state consumer protection laws.[19] The FCA's Savings Clause appears immediately following the preemption provision and declares broadly that:

> Nothing in this section shall affect the ability of a State to impose, on a competitively neutral basis and consistent with section 254, requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and *safeguard the rights of consumers*.

47 U.S.C. § 253(b) (emphasis added).[20] Plaintiffs' claims here are to "safeguard the rights of consumers," and thus are within the plain language of the FCA's Savings Clause.

In light of the clear applicability of the Savings Clause, this Court must reject any express preemption argument from AT&T. As the Supreme Court has indicated, express preemption provisions must be interpreted narrowly in statutes where there are Savings Clauses. *See Geier v. American Honda Motor Co., Inc.*, 529 U.S. 861, 868 (2000) (reading express preemption provision of National Traffic and Motor Vehicle Safety Act narrowly not to reach any common law claims in light of Act's savings clause).[21] Under this Savings Clause, plaintiffs' consumer protection claims are saved so long as they are competitively neutral. This test is readily met here: plaintiffs' claims are based on theories that would apply equally to AT&T and any of its competitors. Those theories arise from consumer protection statutes that bear no unique relationship to telephone service. This body of state law has been used to regulate abuses in arbitration provisions that appear frequently in all types of consumer and employment contracts, and this law could hardly be said to discriminate against AT&T or in favor of its competitors.

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[19] In the hearing on the motion for preliminary injunction, this Court queried whether useful precedents might be drawn with respect to the federal preemption issue from the caselaw surrounding the Airline Deregulation Act. Upon reviewing that Act and the related caselaw, plaintiffs respectfully suggest that it is not helpful. The principal reason for this conclusion is that the Airline Deregulation Act contained no Savings Clause, and had a much broader preemption clause. Since the statutes are not remotely in *pari materia*, cases from that context lend no light here.

[20] Other provisions of the FCA also support the notion set forth in the FCA's Savings Clause. The fact that states have an important and co-equal role in guaranteeing consumer protection under the new regime is affirmed by Section 254(i): "The Commission and the States should ensure that universal service is available at rates that are just, reasonable, and affordable." 47 U.S.C. § 254(i). Furthermore, Section 261(c) provides that "[n]othing in this part [47 U.S.C. section 251, *et seq*] precludes a State from imposing requirements on a telecommunications carrier for intrastate services that are necessary to further competition in the provision of telephone exchange service or exchange access, as long as the State's requirements are not inconsistent with this part or the Commission's regulations to implement this part." 47 U.S.C. § 261(c).

[21] While the Supreme Court rejected Honda's express preemption argument in the Geier case, it did find the plaintiffs' tort claims in that case to be implicitly preempted. As is set forth below, AT&T is precluded from making an "implied preemption" argument here by the plain language of the FCA.

Accordingly, plaintiffs' claims are expressly preserved from federal preemption under the FCA.

Since the FCA expressly saves, rather than preempts, plaintiffs' claims, AT&T's only remaining avenue would be to argue an implied conflict preemption. Such an argument is foreclosed by the explicit terms of the FCA, however. Section 152 of the Act contains the following note: "Applicability of consent decrees and other law. Act of Feb. 8, 1996, P.L. 104-104, Title VI, Section 601, 110 Stat. 143, provides: . . . (c) Federal, State, and local law. (1) No implied effect. *This Act and the amendments made by this Act shall not be construed to modify, impair, or supersede Federal, State, or local law unless expressly so provided in such Act or amendments*." "History, Ancillary Laws and Directives" to 47 U.S.C. § 152 (emphasis added). The Conference Report clarifies that "[t]his provision prevents affected parties from asserting that the bill impliedly preempts other laws." Telecommunications Act of 1996, Conference Report 104-230, to accompany S. 652, 104th Cong., 2d Sess.

The inapplicability of federal preemption in this case is further borne out by the legislative history of the Federal Communications Act. The primary purpose of the 1996 Act was to remove the regulatory apparatus of the Federal Communications Commission. Senator Pressler, Chairman of the Commerce Committee which oversaw the 1996 legislation, explained that "this bill...will make it possible for the FCC immediately to forebear from economically regulating each and every competitive long-distance operator," 141 CONG. REC. 15,106, and that the purpose of deregulation was to allow the industry to function "without the heavy hand of bureaucratic control." *Telecommunications Oversight: Hearing on S.642 before the Committee on Commerce, Science, and Transportation*, 104th Cong. 42 (1995). Congressman Cox likewise proclaimed that deregulation would lead us out of the "regulatory thicket that has shackled the industry." *Telecommunications Law Reform: Hearings before the Subcommittee on Communications and Finance of the House of Representatives' Committee on Commerce*, 104th Cong. 15 (1995). The 1996 legislation thus brought about an end to the centralized regulatory authority of the FCC.

The withdrawal of FCC regulation, however, was not meant to herald an era of lawlessness in the telecommunications industry. Instead, supporters of the 1996 Act indicated that state law would play an important role in preserving consumer protections:

> [T]hereafter there follow two subsections that attempt to carve out reasonable exemptions to that State and local authority. One has to do specifically with telecommunications providers themselves and speaks in the general term of allowing States to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and *safeguard the rights of consumers, which are, of course, the precise goals of this Federal statute itself.*

*Id*. at 15,635 (statement of Senator Gorton) (emphasis added).[22]

Finally, Plaintiffs' claims would not have been preempted even before passage of the 1996 Act. In *Marcus v. AT&T Corp.*, 138 F.3d 46 (2nd Cir. 1998), the Second Circuit found in a consumer class action challenging AT&T's advertisements for failing to disclose its practice of billing calls by rounding up to the next full minute that claims for injunctive relief would not be barred. *Id*. at 62-63. The court stated:

> The FCA not only does not manifest a clear Congressional intent to preempt state law actions prohibiting deceptive business practices, false advertisement, or common law fraud, it evidences Congress's intent to allow such claims to proceed under state law.

*Id*. at 54. It also rejected AT&T's preemption defense with regard to the injunctive claims. The court found that the injunctive relief sought would result in neither price discrimination nor judicial entanglement in rate-making because the court would simply be ordering disclosures of the rates that the FCC had separately approved. *Id*. at 62. Since the relief Plaintiffs seek herein would not require this Court to make decisions regarding AT&T's actual rates, it is entirely likely that these claims would never have been preempted under the FCA.

These conclusions are bolstered by the fact, as established in our briefing with respect to the motion for preliminary injunction, that the FCC has repeatedly stated that consumer protection claims are preserved under the detariffed regime. *See also* PS Memo, Fact 26 (internal document shows that AT&T was well aware of the FCC's position that these consumer protection statutes were saved from preemption). These conclusions are further bolstered by the fact that state Attorneys General have repeatedly stated that claims of the sort involved here are not preempted. PS Memo, Facts 130 and 131.

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[22] An outside expert brought in by proponents to speak in favor of the 1996 Act in congressional hearings spoke more generally in stressing the importance of underlying state laws of the sort that plaintiffs invoke here: "let the telecommunications industry be a business. We have a healthy body of contract, corporate, and common law that can more readily and flexibly absorb the complexities of this industry in many cases than could regulatory agencies." *Telecommunications Policy Reform: Hearing on S.642 before the Committee on Commerce, Science, and Transportation*, 104th Cong. 108 (1995) (statement of Clay Whitehead, former Director of Office of Telecommunications Policy). The framers of the 1996 amendments to the FCA would thus have very little sympathy for the preemption argument that AT&T is putting forth in this case.

## V. THE FAA DOES NOT PREEMPT PLAINTIFFS' ARGUMENTS THAT AT&T'S ARBITRATION CLAUSE IS UNCONSCIONABLE UNDER CALIFORNIA LAW.

### A. The FAA Expressly Preserves Generally Applicable State Contact Law Defenses to the Enforcement of Arbitration Clauses.

Plaintiffs' argument that portions of the CSA are unconscionable as a matter of California contract law, falls squarely within the FAA's savings provision for general principles of state contract law. Section 2 of the FAA states that contractual arbitration clauses are valid and enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The FAA's primary purpose is to do no more than "place arbitration agreements upon the same footing as other contracts." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991). The Supreme Court has thus explicitly stated that "[t]he text of § 2 [of the FAA] declares that *state* law may be applied if that law arose to govern issues concerning the validity, revocability and enforceability of contracts generally." *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 687 (1996) (emphasis added), *quoting Perry v. Thomas*, 482 U.S. 483, 492 n. 9 (June 15, 1987). "Generally applicable contract defenses such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." *Id*. at 687. The Court has also stated that "'courts should remain attuned to well-supported claims that the agreement resulted from the sort of fraud or overwhelming economic power that would provide grounds for the revocation of any contract.'" *Gilmer*, 500 U.S. at 33 (quotation omitted). This is precisely the type of claim that Plaintiffs are asserting in this case.

The Ninth Circuit just resolved this precise question in *Ticknor v. Choice Hotels Intnat'l, Inc.*, 2001 WL 1044623, __ F.3d __ (9th Cir. Sept. 12, 2001). A trial court denied a motion to compel arbitration, holding that the arbitration clause was unconscionable under Montana law. The Ninth Circuit held that this Montana law was not preempted by the FAA 2001 WL 1044623 at *8.

As *Ticknor* implicitly recognizes, an argument that a contractual arbitration clause is unconscionable is a matter of generally applicable state contract law that is not answered by reference to the FAA. Many federal and state courts around the country have held that particular arbitration

contracts are unconscionable and declined to enforce them under the facts of a given case.[23] Likewise, California courts have repeatedly declined to enforce arbitration provisions that were deemed unconscionable as a matter of state contract law.[24] Plaintiffs' claims against enforcement of AT&T's mandatory arbitration clause are perfectly consistent with the arguments embraced by the courts in these dozens of cases, and should be decided under the generally applicable principles of California contract law.

### B. California's Doctrine of Contract Law That Unconscionable Contracts Will Not Be Enforced Is a Generally Applicable Rule That Does Not Single out Arbitration Clauses for Differential Treatment.

Unlike many states which have adopted the Uniform Commercial Code's section on unconscionable provisions in sales contracts, California has enacted a broad statutory prohibition against enforcement of unconscionable provisions in all contracts. *See* Cal. Civ. Code § 1670.5; *see also A&M Produce Co. v. FMC Corp.*, 135 Cal.App.3d 473, 485 (1982). It is this generally applicable prohibition, and not any rule singling out arbitration clauses for disfavored treatment, that Plaintiffs are attempting to enforce against AT&T.

California's law of unconscionability applies the same standards to arbitration clauses that it applies to all other types of contract provisions. Under these general standards, California courts have refused to enforce a wide array of contractual provisions not involving arbitration as unconscionable. *See, e.g., Perdue v. Crocker Nat'l Bank*, 38 Cal.3d 913, 927-28 (1985), *appeal dismissed* 475 U.S. 1001 (1986) (customer signature card allowing bank to vary charges and fees found subject to claim of unconscionability where bank imposed $6 charge for processing checks drawn on accounts with

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[23] *See*, *e.g.*, *Shankle v. Maint. Mgmt. of Colo., Inc.*, 163 F.3d 1230 (10th Cir. 1999); *Prevot v. Phillips Petroleum Co.*, 133 F. Supp.2d 937 (S.D. Tex. 2001); *Lozada v. Dale Baker Oldsmobile, Inc.*, 91 F. Supp.2d 1087 (W.D. Mich. 2000); *American General Finance, Inc. v. Branch*, __ So.2d __, 2000 WL 1868516 (Ala. Dec. 22, 2000), *cert. denied* 70 U.S.L.W. 3038 (Oct. 9, 2001) (No. 99-1934); *Worldwide Insurance Group v. Klopp*, 603 A.2d 788 (Del. 1992); *Powertel, Inc. v. Bexley*, 743 So.2d 570 (Fla. Dist. Ct. App. 1999); *Iwen v. U.S. West Direct*, 977 P.2d 989 (1999); *Teleserve Sys., Inc. v. MCI Telecomm. Corp.* 659 N.Y.S.2d 659 (N.Y. App. 1997); *Williams v. Aetna Finance Co.*, 700 N.E.2d 859 (Ohio 1998); *In re Turner Bros. Trucking Co.*, 8 S.W.3d 370 (Tex. App. 1999); *Sosa v. Paulos*, 924 P.2d 357 (Utah 1996); *Arnold v. United Co's Lending Corp.*, 511 S.E.2d 954 (W. Va. 1998).

[24] *See*, *e.g.*, *Armendariz v. Foundation Health Psychare Serv's, Inc.*, *supra*; *Graham v. Scissor-Tail, Inc.*, 28 Cal.3d 807 (1981); *Bolter v. Superior Court*, 87 Cal.App.4th 900 (2001); *McCoy v. Superior Court*, 87 Cal.App.4th 354 (2001); *Pinedo v. Premium Tobacco, Inc.*, 85 Cal.App.4th 774 (2000); *Villa Milano Homeowners Ass'n v. Il Davorge*, 84 Cal.App.4th 1041 (2000); *Stirlen v. Supercuts, Inc.*, *supra*, 51 Cal.App.4th at 1544-47, 1551-52; *Patterson v. ITT Consumer Finance Corp.*, 14 Cal.App.4th 1659 (1993).

insufficient funds); *A&M Produce*, 135 Cal.App.3d at 493 (manufacturer's commercial contract provisions disclaiming all warranties and *excluding consequential damages*); *Carboni, supra*, 2 Cal.App.4th at 83-84 (real estate broker's promissory note charging 200% interest on short-term loan); *Ellis, supra,* 18 Cal.App.4th at 1806-07 (employment contract provision forfeiting salesman's commissions on sales not collected at time his employment terminates); *Ilkhchooyi, supra*, 37 Cal.App.4th at 410-11 (commercial lease provision conditioning transfer of lessee's interest on payment of 75% of transfer's value to lessor). Since the standards of unconscionability under California law apply to arbitration clauses just as they do to all other contracts, striking down some while allowing enforcement of most others, there can be no question that the FAA preempts Plaintiffs' primary claims in this case.

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### C. California's Law That Arbitration Clauses May Not Deprive Individuals of Substantive Statutory Rights and Remedies That They Would Have in Court Is Consistent with Well Established Law Throughout the U.S.

The United States Supreme Court has conditioned its approval of private arbitration for the resolution of statutory claims on the requirement that arbitration provide all substantive rights and remedies that would be available to parties in court. "By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985). The Court has further mandated that arbitration must allow a party to "effectively vindicate his or her statutory cause of action." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 28 (1991).

Accordingly, private arbitration proceedings must offer "all of the types of relief that would otherwise be available in court" before a court may compel arbitration of a plaintiff's statutory causes of action. *Cole v. Burns Int'l Sec. Servs.*, 105 F.3d 1465, 1482 (D.C. Cir. 1997). Conversely, courts will

deny enforcement of arbitration contracts that diminish a party's statutory rights.[25] As the Ninth Circuit explained in refusing to enforce a franchisor's arbitration contract that, much like AT&T's, would have prohibited awards of exemplary damages and attorneys' fees and shortened the statutory limitations period for filing claims:

> [T]he fact that franchisees may agree to an arbitral forum for the resolution of statutory disputes in no way suggests that they may be forced by those with dominant economic power to surrender the statutorily-mandated rights and benefits that Congress intended them to possess.

*Graham Oil Co. v. ARCO Products Co.*, *supra*, at 1247.

It is likewise beyond dispute as a matter of California law that private arbitration proceedings must guarantee claimants access to all publicly recognized statutory rights and remedies that would be available to them in court. Section 1688 of California's Civil Code provides that "[a]ll contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law." Cal. Civ. Code § 1668. As set forth above, the California Supreme Court has thus held that businesses cannot use mandatory arbitration contracts to evade or limit their liability under the CLRA or other public interest statutes. *See Broughton*, 21 Cal.4th at 1086-87; *Armendariz*, 24 Cal.4th at 103.

The anti-waiver rule applied in *Broughton* and *Armendariz* is part of California's generally applicable substantive contract law. This rule is fully consistent with the FAA as the United States Supreme Court has repeatedly interpreted that Act to apply to statutory causes of action. As such, the anti-waiver rule applies in this case and provides a sufficient basis for this Court to declare AT&T's

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[25] *See*, *e.g.*, *Perez v. Globe Airport Security Services*, 253 F.3d 1280, 1286-87 (11th Cir. 2001) (holding arbitration clause that prevents prevailing Title VII plaintiff from recovering attorney's fees to be unenforceable); *Paladino v. Avnet Computer Technologies, Inc.*, 134 F.3d 1054, 1062 (11th Cir. 1998) (Cox, J., concurring for majority of court) ("When an arbitration clause has provisions that defeat the remedial purpose of the statute . . . the arbitration clause is not enforceable."); *DeGaetano v. Smith Barney, Inc.*, 983 F. Supp. 459, 469 (S.D.N.Y. 1997) (voiding arbitration clause disallowing attorneys' fees for prevailing Title VII plaintiff, concluding that "contractual clauses purporting to mandate arbitration of statutory claims . . . are enforceable only to the extent that the arbitration preserves the substantive protections and remedies afforded by the statute."); *Lozada v. Dale Baker Oldsmobile, Inc.*, 91 F.Supp.2d 1087, 1105 (W.D. Mich. 2000) (finding as to consumer Truth In Lending Act and state consumer protection act claims that "both federal and Michigan case law support a conclusion that an arbitration provision is substantively unconscionable because it waives class remedies, as well as declaratory and injunctive relief"); *Derrickson v. Circuit City Stores, Inc.*, 81 Fair Empl. Prac. Cas. 1533 (D. Md. 1999) (arbitration clause capping punitive damages and back pay remedies under Section 1981 is unenforceable), *aff'd*, 203 F.3d 821 (4th Cir.) (table), *cert. denied*, 530 U.S. 1276 (2000).

mandatory arbitration clause unenforceable as a matter of California law.

## VI. PLAINTIFF TING AND AT&T'S OTHER CUSTOMERS HAVE NOT AGREED TO THE PROVISIONS OF THE CSA.

### A. AT&T Has Not Obtained the Assent of Plaintiff Ting Nor of its Other Customers for the CSA.

AT&T claims that it can bind any customer to a newly created contract that compels the waiver of important constitutional and statutory rights merely by sending the customer a notice and having the customer (whether he or she saw the notice or not) do nothing to manifest consent other than placing a long distance call after midnight on August 1, 2001 or making a payment. This proposition is unsupported by California law.

In order for a contract to be binding on the parties, there must be both an offer and an acceptance. This basic rule of contract formation is no less true for agreements containing arbitration clauses. "[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." *United Steelworkers of America v. Warrior & Gulf Nav. Co.*, 363 U .S. 574, 582 (1960); *Volt Info. Sciences, Inc. v. Board of Trustees*, 489 U.S. 468, 478 (1988) ("[a]rbitration under the [FAA] is a matter of consent, not coercion"); *see also Victoria v. Superior Court*, 40 Cal.3d 734, 739 (1985) ("The policy favoring arbitration cannot displace the necessity for a voluntary agreement to arbitrate"); *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 648 (April 7, 1986) (same).

The offeror has the power to designate a particular mechanism for assent within terms of the offer; however, such mechanism must be "reasonable in the circumstances." Rest. 2d of Contracts § 30(2). Furthermore, an offeror cannot make silence on the part of the offeree a sign of assent where, based on the parties' "previous dealings," the offeree has no way to understand that silence will constitute such acceptance. Rest. 2d of Contracts § 69(1)(c). AT&T's contract fails on both points. First, AT&T's offer included terms for assent that were not meaningful; and second, the prior dealings of the parties in the complete absence of any contract in no way could have indicated that making a telephone call or paying a bill would indicate assent to the formation of a contract. Therefore, plaintiffs never accepted AT&T's offer, and the contract is not valid.

#### 1. AT&T's "Opt-Out" Provision Did Not Provide a Meaningful Mechanism for Customers to Indicate

**Lack of Assent.**

AT&T sent its customers an offer indicating that they would be deemed to assent to the contract by merely making a telephone call or paying their long distance bills The only mechanism given for customers to reject the new terms was to act affirmatively by calling the company and discontinuing their service. In plaintiffs' briefing with respect to the motion for preliminary injunction, we discussed how the case of *Specht v. Netscape Commun. Corp.*, 150 F.Supp.2d 585 (S.D.N.Y. 2001) refutes this claim, and we continue to rely on that case.

In addition, this Court recently struck down a company's arbitration clause for consumers that was created through a markedly similar "opt-out" mechanism. *See Long v. Fidelity Water Systems, Inc.*, 2000 WL 989914 (N.D. Cal. May 26, 2000). In *Long*, the company tried to use a narrow "change of terms" provision in its original contract to impose arbitration through a later notice, which contained the following opt-out provision: "You may elect not to have this 'Arbitration' section apply if you write within 30 days of receipt of this notice . . . ." *Id*. at *2. If the customer did not write the company within 30 days, the arbitration clause became valid at the beginning of the next billing cycle. *Id*.

This Court in *Long* was adamant that Fidelity's "opt-out" provision did not provide a meaningful opportunity for customers to agree or disagree with the new contract terms:

> Defendants never obtained any affirmative consent from Mr. Continolo regarding incorporation of the arbitration clause as part of the existing contract. Rather, defendants required Mr. Continolo to take affirmative action if he wished to reject the incorporation of the 1998 unilateral arbitration clause. Defendants have cited no case that has upheld an arbitration agreement based on a plaintiff's failure to "opt-out" of a defendants' unilateral imposition of an arbitration clause. The Ninth Circuit has held that "[b]efore a party to a lawsuit can be ordered to arbitrate and thus be deprived of a day in court, there should be an express, unequivocal agreement to that effect." *Three Valleys Municipal Water Dist. v. E.F. Hutto & Co., Inc.*, 925 F.2d 1136, 1141 (9th Cir. 1991). Mr. Continolo gave no such express, unequivocal agreement to the 1998 arbitration agreement.

Id. at *3 (footnotes omitted). *See also Badie v. Bank of America*, 67 Cal.App.4th 779, 803 (1998). The same reasoning applies here with even greater force: AT&T attempted to use an opt out process to create a contract where none had previously existed. Since this Court has held that opt out mechanisms may not be sufficient to establish assent to contractual amendments, they should not be used to form new

contracts in the first instance.[26]

**2. AT&T Cannot Use a Customer's Placement of a Long Distance Call, the Status Quo of the Parties' Existing Relationship, to Signify Assent to a Newly Created Contract.**

By making a customer's placement of a long distance telephone call the hallmark of assent to the new Customer Service Agreement, AT&T has provided no way of differentiating between those customers who have read and agreed to abide by the CSA and those who have never even seen it. Under the relationship between customers and AT&T prior to the existence of any contract, the customer's placement of a long distance call was a status quo action. AT&T has thus effectively indicated that inaction on the part of its customers would constitute assent to the terms of the new contract. There are two problems with this. First, it is generally considered invalid for an offeror to tie acceptance to actions that the offeree would perform in the course of normal business. As stated in Corbin on Contracts:

> [A]n offeror cannot, merely by saying that the offeree's silence will be taken as acceptance, cause it to be operative as such. The offeror cannot force the offeree to take pen in hand, to use a postage stamp, or to speak, under penalty of being bound by a contract by not expressing a rejection. It is substantially the same case as where an offeror attempts to give the meaning of an acceptance to some other ordinary act of the offeree that the latter wishes to do without giving it such meaning. If A offers land to B for a price, saying that B may signify acceptance of the offer by eating breakfast . . . , does not and cannot thereby make such action by B operative as an acceptance against B's will.

Corbin on Contracts § 3.19 (Revised ed. 1993). A case on point is *Western Concrete Structures Co. v. James I. Barnes Constr. Co.*, 206 Cal.App.2d 1 (1962), where a subcontractor's bid to a contractor contained a clause stating that merely listing the subcontractor's name in a bid for a contract would operate as acceptance of that bid. The contract was deemed ineffective by the court. *Id*. at 13. So it is here that AT&T's contract cannot stand where the everyday act of placing a phone call was the only signal of the cutomer's acceptance.

Second, it is the general rule that inaction, or silence, can only manifest assent in exceptional circumstances, which are in part dependent on the prior dealings of the parties. *See* Restatement 2d of Contracts § 69 (1979). "'Silence in the face of an offer is not an acceptance, unless there is a relationship

[26] AT&T cites *Fosson v. Palace (Waterland), Ltd.*, 78 F.3d 1448 (9th Cir. 1996) in support of its contention that the offeror may require a particular form of assent. It is useful to note that in that case, the form of assent required by the company was a signed document, which had to be returned to the company in a pre-addressed, post-paid envelope. *Id*. at 1453. This kind of affirmative and knowing consent is exactly what AT&T has *failed* to require in the instant case.

between the parties or a previous course of dealing pursuant to which silence would be understood as acceptance." *Sorg v. Fred Weisz & Associates*, 14 Cal.App.3d 78, 81 (1970) (quoting *Southern Cal. Acoustics Co. v. C.V. Holder, Inc.*, 71 Cal.2d 719, 722 (1969)).

In this case, silence could not possibly be understood by the plaintiffs as acceptance of AT&T's entirely new contract. Plaintiffs had an ongoing relationship with AT&T in the absence of any service contract. Nothing in the prior dealings of the parties could reasonably have indicated to the plaintiffs that their continued use of AT&T's services, in exactly the manner in which they had been using these services since the beginning of the relationship, would constitute agreement to a brand new contract that fundamentally altered that relationship. An analogy might be drawn to insurance renewal cases, in which the insurer often sends out a renewal policy to the customer and then assumes that the renewal has been effected by the customer's silence. Several courts have indicated that, where the insurer and customer have had no history of renewal by silence, silence can not constitute acceptance to the new contract. *See, e.g., Phelan v. Everlith*, 173 A.2d 601, 603 (Conn.Cir. 1961) ("There had been no course of dealing between the parties which would lead the plaintiff to think that defendant's silence would result in the renewal of the policy . . . . In the absence of circumstances from which an acceptance may be implied, an acceptance will not be presumed from a mere failure to decline a proposal.") (citations omitted). In fact, some courts have even indicated that one prior renewal is not enough to establish a pattern whereby silence can be constituted as an acceptance to the continued contract. *See Roberts v. Buske*, 298 N.E.2d 795, 797 (Ill.App. 1973) ("However, as held in the cases above cited, we cannot find that acceptance of a single previous renewal in itself is sufficient to constitute an implied acceptance of a second renewal based solely on the silence of the offeree.").

If silence cannot be considered acceptance in these cases, where terms were substantially the same as they had been under earlier contracts, then silence certainly should not be deemed acceptance here, where contract terms reallocating the risks of liability in the relationship came into existence for the first time.

**B. AT&T Has Not Obtained the Voluntary, Knowing and Intelligent Assent of Plaintiffs Nor of Its Other Customers to Waive Their Constitutional Rights.**

Plaintiffs addressed this issue at some length in their briefing in connection with the motion for

a preliminary injunction, and stand on their legal argument on this point. The factual arguments will be bolstered enormously by the Lake Snell Perry Report, the testimony of Todd Hilsee and AT&T's own internal documents.

There have been two important new opinions on the subject, however. In *First Union National Bank v. U.S.*, __ F. Supp.2d __, 2001 WL 1042743 (E.D. Pa. 2001), the court stated:

> Although the right to a jury trial is guaranteed by the Seventh Amendment to the U.S. Constitution, like all constitutional rights, it can be waived by the parties. . . . Waiver can be either express or implied and requires only that the party waiving such right do so voluntarily and knowingly based on the facts of the case. . . . Courts do not uphold jury trial waivers lightly and the burden of proving that a waiver was done both knowingly and intelligently falls upon the party seeking enforcement of a waiver of a jury trial clause. . . . A waiver is knowing, voluntary and intelligent when the facts show that (1) there was no gross disparity in bargaining power between the parties; (2) the parties are sophisticated business entities; (3) the parties had an opportunity to negotiate the contract terms; and (4) the waiver provision was conspicuous.

2001 WL 1042743 at *1-2. The *First Union* case is not an arbitration case, but the generally applicable rules that it sets forth about contractual waivers of constitutional rights apply on their face to all other contracts of their sort (contracts that involve waivers of jury trial rights), and thus should apply to the CSA.[27] There can be no serious argument that the CSA would survive this test.

## VII. CONCLUSION.

For all the reasons set forth above, this Court should enter a declaratory judgment for the plaintiffs and permanently enjoin AT&T's CSA in California.

DATED: October 19, 2001

Respectfully submitted,

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[27] *See also Grasser v. United Healthcare Corp.*, 778 A.2d 521, 528 (N.J. Super Ct. July 24, 2001) (affirming denial of a motion to compel arbitration where defendant "did not meet its burden of demonstrating a knowing and binding waiver of plaintiff's right to maintain this suit . . ..").

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