

IN THE
Supreme Court of the United States

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OTO, L.L.C.

Petitioner,

v.

KEN KHO;
JULIE A. SU, CALIFORNIA LABOR COMMISSIONER,

Respondents.

◆
ON PETITION FOR A WRIT OF CERTIORARI TO THE
SUPREME COURT OF CALIFORNIA

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**BRIEF *AMICUS CURIAE* OF
ATLANTIC LEGAL FOUNDATION
IN SUPPORT OF PETITIONER**

◆

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QUESTION PRESENTED

Whether the Federal Arbitration Act preempts a State from invalidating an arbitration agreement as substantively unconscionable on the ground that it provides procedural protections similar to those provided in civil litigation, rather than a streamlined administrative proceeding that would be available under state law in the absence of the agreement.

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INTEREST OF AMICUS CURIAE¹

The Atlantic Legal Foundation is a non-profit public interest law firm founded in 1976 whose mandate is to advocate and protect the principles of less intrusive and more accountable government, a market-based economic system, and individual rights. It seeks to advance this goal through litigation and other public advocacy and through education. Atlantic Legal Foundation's board of directors and legal advisory committee consist of legal scholars, corporate legal officers, private practitioners, business executives, and prominent scientists. Atlantic Legal's directors and advisors are familiar with the role arbitration clauses play in the contracts entered into between companies and between companies and consumers. Some of Atlantic Legal's directors and advisers have decades of experience with arbitration – as legal counsel, as arbitrators, and as members or supporters of organizations that administer arbitration regimes.

¹ *Amicus* has provided the 10-day notice required by Rule 37.2. Counsel for Petitioner and for Respondent Kho have lodged “universal consents” with the Clerk; counsel for Respondent Su has separately consented to the filing of this brief. The parties have consented to the filing of this brief.

Pursuant to Rule 37.6, *amicus* affirms that no counsel for any party authored this brief in whole or in part and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief and no person other than *amicus* or its counsel made a monetary or other contribution to the preparation or submission of this brief.

They are familiar with the benefits of arbitration, especially the role of arbitration and other “alternative dispute resolution” mechanisms in facilitating business and commerce and in alleviating the burdens on courts and parties.

Atlantic Legal Foundation has appeared before this Court frequently as *amicus* or as counsel for *amici* in numerous cases concerning arbitration and the preemptive effect of the Federal Arbitration Act (“FAA”), including several cases cited in the petition and in this brief.

INTRODUCTORY STATEMENT

The petition should be granted to correct and, hopefully, deter the very “judicial hostility towards arbitration” *Nitro-Lift Techs., L.L.C. v. Howard*, 133 S. Ct. 500, 503 (2012) (per curiam); *Concepcion*, 563 U.S. at 339; *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991) on the part of California appellate courts which the FAA was intended to foreclose. This Court has recently stated that it would “be alert to new devices and formulas” used to effect “judicial antagonism toward arbitration.” *Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612, 1623 (2018).

In *AT&T Mobility LLC v. Concepcion*, 131S.Ct.1740 (2011), this Court held that the FAA requires courts to “place arbitration agreements on an equal footing with other contracts.” 563 U.S. 333, 339 (2011). Courts may not apply “legal rules that ‘apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue.’” *Kindred Nursing Ctrs. Ltd.*

P'ship v. Clark, 137 S. Ct. 1421, 1426 (2017) (quoting *Concepcion*, 563 U.S. at 339). The California courts, including the state's supreme court, nevertheless reaffirm and continue to apply the reasoning of apply a pre-*Concepcion* precedents such as *Armendariz v. Foundation Health Psychare Services, Inc.*, 6 P.3d 669 (Cal. 2000) that are plainly contrary to *Concepcion*.

FACTUAL BACKGROUND

Petitioner is an auto dealership. Respondent Kho worked at the dealership as a service technician. During his employment Kho and petitioner entered an arbitration agreement that provided that all disputes arising from Kho's employment, including wage disputes, would be resolved through arbitration. The agreement also provided that the arbitration would be conducted by a retired California Superior Court judge in accordance with certain provisions of the California Code of Civil Procedure and Code of Evidence applicable to civil litigation. Under the agreement, the employee was entitled to "full discovery." App. at 4a. Under California law, petitioner, as the employer, would cover most arbitration costs and, potentially, attorney's fees. See App. at 28a-29a; *Armendariz*, 6 P.3d at 687.

In the absence of an arbitration agreement, California law allows for an administrative procedure to resolve unpaid wage disputes. Cal. Lab. Code §§ 98-98.8, 218. Under this procedure, an employee ay file a claim with the California Labor Commissioner, who may (I) decline to take any

further action, (ii) prosecute a civil action on the employee's behalf, or (iii) conduct an administrative proceeding with limited pleadings, no discovery, and no formal rules of evidence (a so-called Berman hearing." After the Labor Commissioner renders a decision after the Berman hearing, either party may appeal to the California Superior Court for de novo review. App. 7a-9a.

After Petitioner terminated him, Kho initiated an administrative proceeding to resolve an unpaid wage dispute, rather than following the procedure prescribed by the arbitration agreement, Petitioner sought to compel arbitration under that agreement.

The California Superior Court denied the petition for arbitration, holding that the arbitration agreement was procedurally and substantively unconscionable. App. 127a-140a. The court concluded that the agreement was procedurally unconscionable because of "unequal bargaining power" of the contracting parties. App. at 131a. It also concluded that the agreement was substantively unconscionable because it resembled civil litigation and "has virtually none of the benefits afforded by the Berman hearing procedure." App. at 139a, and effectively "restores the procedural rules and procedures that create expense and delay in civil litigation." *Id.* at 139a-140a. The court vacated the Commissioner's award, however, on the ground that she should not have conducted the hearing in petitioner's absence. *Id.* at 141a-143a.

The California Court of Appeal reversed. App. 92a-119a. While the court agreed that Kho had established procedural unconscionability, it held that the agreement was not substantively unconscionable because the procedures specified in the arbitration agreement provided a suitable process for resolving wage disputes. App. 106a-116a. Even under a comparative approach contemplated by the California Supreme Court in *Sonic-Calabasas A, Inc. v. Moreno*, 311 P.3d 184 (Cal. 2013), cert. denied, 134 S. Ct. 2724 (2014) (*Sonic II*), the court reasoned, the specified arbitration procedure was not so different from the administrative procedure that would apply in the absence of an arbitration agreement: because it “anticipates” a subsequent de novo proceeding in Superior Court that is subject to the ordinary rules of civil litigation. App. 114a.

A divided California Supreme Court reversed the Court of Appeal. App. 1a-91a. It held that the arbitration agreement was both procedurally and substantively unconscionable. App. 14a-31a.

The California Supreme Court determined that there was procedural unconscionability, based principally on the size of the agreement’s print and the manner in which the document was presented to Kho. App. 14a-20a. As to substantive unconscionability, the court explained that, in the unique context of “compelled arbitration of wage claims,” the “substantive unconscionability of an arbitration agreement” must be “viewed in the context of the rights and remedies that otherwise

would have been available to the parties.” App. 26a, 32a. That comparative approach, the court acknowledged, is “different” from the approach used in evaluating unconscionability in other contexts, including “the arbitration of other types of disputes,” such as wrongful-discharge claims that would not otherwise be subject to a “Berman-like administrative process.” App. 26a. The “substantive fairness” of wage-dispute arbitration agreements “must be considered in terms of what the employee gave up and what he received App. 31a.

The court acknowledged that civil litigation is a “system of statutory and common law designed to “ensure fairness to both sides,” the arbitration procedures at issue substantively unconscionable because they “incorporate[d]” too many “intricacies of civil litigation,” unlike the more “speedy, informal, and affordable” Berman hearing. App. 24a-26a.

Justice Chin, dissenting, agreed that there was some procedural unconscionability, he concluded that the majority’s substantive-unconscionability analysis violates the FAA’s equal-treatment principle. App. 84a. In his view, the majority used its “unconscionability” criterion to apply an arbitration-specific rule to arbitration agreements covering wage disputes. App. 85a. The majority’s framework established a “preliminary litigating hurdle” that “stands as an obstacle” to the “purposes and objectives” of the FAA, including “the prospect of speedy resolution.” App. 87a. He concluded that the FAA preempted the rule applied

by the majority because that rule discriminated against arbitration and undermined its benefits.

The California Supreme Court's decision flouts this Court's consistent FAA jurisprudence. Its unconscionability approach applies only to agreements to arbitrate employment disputes and places certain arbitration agreements on an unequal footing with other contracts, violating the equal-treatment principle. Ironically, this approach led California court to invalidate as unconscionable arbitration agreements that provide more, not fewer, procedural protections.

SUMMARY OF ARGUMENT

The California courts have too frequently defied this Court's clear rulings on arbitration. In *Concepcion*, this Court held that the FAA requires courts to "place arbitration agreements on an equal footing with other contracts." 563 U.S. 333, 339 (2011). Courts may not craft "legal rules that 'apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue.'" *Kindred Nursing Ctrs. Ltd. P'ship v. Clark*, 137 S. Ct. 1421, 1426 (2017) (quoting *Concepcion*, 563 U.S. at 339).

This Court has found it necessary to confront anti-arbitration obstruction repeatedly and to announce that "lower courts must follow this Court's holding in *Concepcion*." See, e.g., *DirecTV, Inc. v. Imburgia*, 136 S. Ct. 463, 468 (2015).

This Court should grant review to reenforce its clear precedents and once again overrule an arbitration-averse state court.

ARGUMENT

THE FAA AND CASES REQUIRE THAT ARBITRATION AGREEMENTS BE TREATED ON EQUAL FOOTING WITH ALL OTHER CONTRACTS, BUT CALIFORNIA LAW PLACES UNIQUE BURDENS ON ARBITRATION AGREEMENTS AND CALIFORNIA LAW TREATS EMPLOYMENT ARBITRATION AGREEMENTS MUCH LESS FAVORABLY THAN OTHER CONTRACTS.

Amicus urges the Court to grant certiorari, to confirm its holdings in *Concepcion*, *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, 559 U.S. 662 (2010) and other cases which recognize the overriding Congressional policy of encouraging arbitration, and reverse the California Supreme Court.

This Court has repeatedly held that the “fundamental principle [is] that arbitration is a matter of contract,” *Concepcion*, 563 U.S. at 339 (quoting *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63, 67 (2010)); see also *Stolt-Nielsen*, 559 U.S. 662, 681 (2010); *Volt Information Sciences, Inc. v. Board of Trs. of Leland Stanford Jr. Univ.*, 489 U.S. 468, 479 (1989), and that courts must enforce arbitration agreements according to their terms, *Volt*, 489 U.S. at 478; *Stolt-Nielsen*, 559 U.S. at 682; and “courts must ‘rigorously enforce’ arbitration

agreements according to their terms.” *American Express Co. v. Italian Colors Restaurant*, 133 S.Ct. 2304, 2309 (2013); *Stolt-Nielsen*, 559 U.S. at 683. The California Supreme Court’s decision frustrates these principles and this Court’s teaching that the FAA “embodies . . . [a] national policy favoring arbitration,” *Buckeye Check Cashing Inc. v. Cardegna*, 546 U.S. 440, 443 (2006); see also, *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).

The FAA was enacted to “reverse the longstanding judicial hostility to arbitration agreements.” *Gilmer*, 500 U.S. 20, 24 (1991) and reflects “a liberal federal policy favoring arbitration.” *Concepcion*, 563 U.S. at 339 (internal quotation marks and citation omitted).

The California Supreme Court’s decision in this case exemplifies the “judicial hostility” the FAA condemns and is certainly not a faithful application of federal arbitration law. *Nitro-Lift Technologies L.L.C. v. Howard*, 568 U. S. 17 (2012) (per curiam), quoting *Concepcion*, 131 S. Ct. at 1745, 1747, 1757; see also *Gilmer*, 500 U.S. 20, 24 (1991)

FAA § 2, the “primary substantive provision of the Act,” *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983), provides that arbitration agreements are “valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U.S.C. § 2. “That provision creates substantive federal law regarding the enforceability of

arbitration agreements,” requiring courts “to place such agreements upon the same footing as other contracts.” *Arthur Andersen LLP v. Carlisle*, 556 U.S. 624, 630 (2009) (internal quotations omitted); see also *Preston v. Ferrer*, 552 U.S. 346, 349 (2008). The last clause of section 2 preserves the ability of States to apply “generally applicable contract defenses, such as fraud, duress, or unconscionability,” to the enforcement of arbitration agreements, but it precludes application of any state-law “defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue.” *Concepcion*, 131 S. Ct. at 1746 (quoting *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996)).²

Under the FAA, “parties are generally free to structure their arbitration agreements as they see fit.” *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995) (internal quotations omitted). “[T]he FAA lets parties tailor ... many features of arbitration by contract, including which issues are arbitrable, along with procedure and choice of

² FAA sections 3 and 4 implement the substantive pro-arbitration policy of section 2. Section 3 requires courts to stay litigation of arbitrable claims so that arbitration may proceed “in accordance with the terms of the [arbitration] agreement.” 9 U.S.C. § 3. Section 4 provides that “the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement” unless “the making of the agreement for arbitration or the failure to comply therewith” are called into question. *Id.* § 4.

substantive law,” as well as the way arbitrators are chosen, and their qualifications. *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 586 (2008). Arbitrators are often chosen for their subject matter technical expertise, and arbitration often is preferred, because it provides confidentiality. See Jean Baker, *Arbitration insights*, CORPORATE COUNSEL BUSINESS JOURNAL 7,8 (January - February 2020).

Arbitration permits parties to design “efficient, streamlined procedures tailored to the type of dispute” at issue. *Concepcion*, 563 U.S. 333, 344 (2011); it produces “expeditious results.” *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 633 (1985); and it “reduc[es] the cost” of dispute resolution. *Concepcion*, 563 U.S. at 345.

Parties that choose an arbitral forum do so principally to “trade[] the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.” *Mitsubishi*, 473 U.S. at 628. The parties’ freedom to fashion their own arbitration agreements includes not only the ability to define “by contract the issues which they will arbitrate,” but also the right to delineate the procedural “rules under which that arbitration will be conducted.” *Volt*, 489 U.S. at 479; see also *14 Penn Plaza LLC v. Pyett*, 556 U.S. 247, 269 (2009) (informality of arbitral proceedings is “not a basis for finding the forum somehow inadequate”).

The “federal substantive law of arbitrability,” is the “body of federal substantive law” interpreting and effectuating FAA § 2, the statute’s “primary substantive provision reflects “a liberal federal policy favoring arbitration.”. *Concepcion*, 563 U.S. 333, 339 (2011) (citation omitted). Section 2 requires courts to “place[] arbitration agreements on an equal footing with other contracts and [to] * * * enforce them according to their terms.” *Rent-A-Center, West, Inc.*, 561 U.S. 63, 67 (2010). A court may invalidate an arbitration agreement based on “generally applicable contract defenses,” but not on legal rules that “apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue.” *Concepcion*, 563 U.S. at 339. Nothing in the body of federal arbitration law suggests that it is appropriate for courts to create exceptions to the FAA based on their view of “substantively unconscionability.” *Moses H. Cone Mem’l Hosp.*, 460 U.S. at 24.

The equal-treatment requirement applies to state-law rules that facially treat arbitration agreements differently, see *Marmet Health Care Center, Inc. v. Brown*, 565 U.S. 530, 533 (2012) (per curiam), and to rules that “have the defining features of arbitration agreements,” *Kindred Nursing Centers L.P.*, 137 S. Ct. 1421, 1426 (2017). The federal law of arbitration does not countenance rules that frustrate the FAA’s purposes, Just as *Concepcion* held that the FAA preempts state-law rules that require class arbitration as a condition of enforcement, California’s “substantive

unconscionability”rule also violates the federal substantive law of arbitrability.

Moreover, “California courts have been more likely to hold contracts to arbitrate unconscionable than other contracts.” *Concepcion*, 563 U.S. at 342. The California Supreme Court has repeatedly refused to enforce arbitration agreements that displace the administrative procedure for resolving wage disputes, primarily by applying the unconscionability doctrine. In *Sonic-Calabasas A, Inc. v. Moreno*, 247 P.3d 130 (2011) (*Sonic D*), for example, the California Supreme Court held that arbitration agreements waiving Berman hearings were substantively unconscionable as a matter of law. See App. 144-146. Subsequent to that decision, this Court handed down *Concepcion*, holding that the FAA preempted a California rule classifying most class-arbitration waivers in consumer contracts as unconscionable because that rule violated the “equal-treatment” principle of the FAA. 563 U.S. at 339, 344. After its *Concepcion* decision, this Court vacated the California Supreme Court’s decision in *Sonic I* and remanded for further proceedings. 565 U.S. 973 (2011). On remand, the California Supreme Court recognized that its blanket rule against arbitration agreements waiving Berman hearings did not survive *Concepcion*, and held that such agreements were not substantively unconscionable where the arbitral process approximates the benefits of the Berman procedure by “provid[ing] employees with an accessible and affordable process for resolving wage disputes.” *Sonic-Calabasas A, Inc. v. Moreno*, 311

P.3d 184, 204 (Cal. 2013) (*Sonic II*). But the court remanded for a determination of whether the particular agreement at issue was unconscionable. *Id.* at 203, 221. This Court denied certiorari review. See 134 S. Ct. 2724 (2014).

The California Supreme Court's decision in this case is inconsistent with the FAA's equal-treatment principle because it discriminates against arbitration on substantive unconscionability grounds applicable only to certain arbitration agreements. The California labor law imposes a preliminary step – the Berman hearing – and de novo judicial review that negates the speed and efficiency of arbitration and renders the “streamlining” of the California wage-dispute process chimerical. . The California Supreme Court employed the Orwellian reasoning that the arbitration agreement was substantively unconscionable because it provided to disputants, from the beginning of the process, more (not fewer) of the protections of civil litigation than does the state law.

The California Supreme Court has repeatedly adopted anti-arbitration doctrines and has repeatedly been overruled by this Court. See, *e.g.*, *DIRECTV*, 136 S. Ct. at 468-471. In *Concepcion*, this Court reversed the California Supreme Court in a case in which it invoked substantive unconscionability to invalidate a class-arbitration waiver in a consumer arbitration agreement. The Court concluded that the application of the unconscionability doctrine violated the

equal-treatment principle because it “relies on the uniqueness of an agreement to arbitrate” as its “basis.” 563 U.S. at 341. The class-arbitration rule also impermissibly interfered with the fundamental attributes of arbitration – informality, speed, and reduced cost. See *id.* at 346-351.

In the aftermath of its decision in *Concepcion*, this Court vacated the California’s Supreme Court’s decision in *Sonic-Calabasas A, Inc. v. Moreno*, 247 P.3d 130 (2011) (*Sonic I*), which invalidated as substantively unconscionable all agreements to arbitrate wage disputes that waived the state-law administrative procedure. After its decision on remand in *Sonic-Calabasas A, Inc. v. Moreno*, 311 P.3d 184 (2013) (*Sonic II*) and this Court’s denial of review, the California Supreme Court has effectively reached the same result, invalidating the arbitration agreement at issue because it bore more resemblance to civil litigation than to the administrative proceeding provided by state law. That result places arbitration agreements on inferior footing compared with other contracts, thus contravening the FAA.

The Court has not hesitated to grant review when state courts are unwilling to follow the FAA’s mandate to enforce arbitration agreements according to their terms. See, e.g., *Kindred Nursing Centers, supra*; *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006).

CONCLUSION

The petition for a writ of certiorari should be granted and, on the merits, the judgment of the California Supreme Court should be vacated.

Respectfully submitted,

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