**08-4103**

IN THE

# United States Court of Appeals

**FOR THE THIRD CIRCUIT**

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

*Appellants*,

—v.—

CELLCO PARTNERSHIP d/b/a Verizon Wireless,

*Appellee*.

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

## BRIEF FOR APPELLANTS AND JOINT APPENDIX VOLUME I OF II (Pages A-1 to A-18)

WILLIAM R. WEINSTEIN, ESQ.
SANFORD WITTELS & HEISLER, LLP
950 Third Avenue, 10th Floor
New York, New York 10022
(646) 723-2451

*Attorneys for Appellants*

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## STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

The District Court's subject matter jurisdiction is based on diversity of citizenship pursuant to the Class Action Fairness Act of 2005, 28 U.S.C. § 1332(d), because Plaintiffs allege that the matter in controversy in this class action exceeds $5 million, and that the putative class includes millions of members residing outside of New Jersey, the state where Defendant's principal place of business is located (Cmp. ¶ 5 (A-28-29)).[1]

This Court has appellate jurisdiction pursuant to 9 U.S.C. § 16(a)(3), because Plaintiffs appeal from the September 29, 2008 final Order of the United States District Court for the District of New Jersey (Wolfson, J.) compelling arbitration and dismissing the action in its entirety (A-16) (the "Order"), and the District Court's September 29, 2008 Opinion (A-1-15) (the "Opinion") on which the Order was based. *See, e.g., Alexander v. Anthony Int'l, L.P.*, 341 F.3d 256, 263 (3d Cir. 2003); *Blair v. Scott Specialty Gases*, 283 F.3d 595, 602 (3d Cir. 2002).

Plaintiffs timely filed their Notice of Appeal on October 2, 2008 (A-17-18, Docket # 36 (A-25)), within thirty days of entry on September 30, 2008 of both the Order and the Opinion appealed from (Docket ## 34, 35 (A-25)).

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[1] Plaintiffs-Appellants Keith Litman and Robert Wachtel are collectively referred to herein as "Plaintiffs," and Defendant-Appellee Cellco Partnership d/b/a Verizon Wireless is referred to herein as "Defendant" or "Verizon Wireless." References to the Joint Appendix are denoted "A-__." Plaintiffs' Class Action Complaint (A-26-42) (the "Complaint") is referred to as "Cmp. ¶ __ (A-__)."

## STATEMENT OF ISSUES ON APPEAL

I. Did the District Court err in granting Defendant's petition pursuant to § 4 of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 4, seeking to compel Plaintiffs to individually arbitrate their claims (Docket # 10 (A-21)) (the "Petition")?

A. Did the District Court err in failing to hold that Defendant is bound by the express term of its arbitration agreement requiring this case to be litigated in court, as mandated by the decision of the United States Supreme Court in *Volt Info. Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468 (1989) (*"Volt"*)?

B. Did the District Court err in holding that the decision of the New Jersey Supreme Court in *Muhammad v. County Bank of Rehoboth Beach, Del.*, 189 N.J. 1 (N.J. 2006) ("*Muhammad*"), is preempted by the FAA, and that the determination of the *Muhammad* preemption issue is controlled by this Court's decision in *Gay v. CreditInform*, 511 F.3d 369 (3d Cir. 2007) ("*Gay*")?[2]

## STATEMENT OF THE CASE

Plaintiffs' action was commenced by the filing of their Class Action Complaint against Defendant on October 9, 2007 (A-26-42, Docket # 1 (A-20)). As further described in the Statement of Facts, *infra*, Plaintiffs assert claims based on Defendant's practices in connection with the imposition of a monthly

[2] The District Court's Opinion (A-1-15) is reported at 2008 WL 4507573 (D.N.J. Sept. 29, 2008).

"administrative charge" on Defendant's wireless telephone customers beginning on and after October 1, 2005 (*id.*).

On December 10, 2007, Defendant filed two motions: (i) its Petition pursuant to FAA § 4 seeking to compel Plaintiffs to individually submit their claims to arbitration (Docket # 10 (A-21)); and (ii) a motion seeking dismissal of the Complaint in its entirety, pursuant to Fed. R. Civ. P. 12(b)(6) for failure to state a claim and Fed. R. Civ. P. 9(b) for failure to plead claims of fraud with particularity (Docket # 9 (A-20-21)).

In support of its Petition, Defendant filed the Certification of Daniel Malutich (A-43-47) (the "Malutich Certification") with exhibits including, *inter alia*, copies of two versions of Defendant's wireless telephone contract containing certain uniform terms and provisions governing Plaintiffs' customer relationship with Defendant (Ex. A at A-51-55, Ex. D at A-69-72). The customer contracts, in turn, include an agreement to arbitrate with a class arbitration waiver provision (Ex. A at A-54-55, Ex. D at A-71-72).

The *only* issue raised by Defendant in support of its Petition was whether *Muhammad* is preempted by the FAA. As Defendant candidly conceded in its District Court brief in support of its Petition (A-78):

> Verizon does not challenge, for purposes of this [Petition], that the New Jersey Supreme Court's decision in *Muhammad* applies to Verizon's arbitration agreement. Moreover, Verizon is in agreement with Plaintiffs that, if *Muhammad* controls, Plaintiffs are entitled to

> proceed with this lawsuit. To resolve this dispute, this Court therefore must determine whether *Muhammad* is preempted under the FAA.

Defendant's Petition asserted two separate grounds: (i) first, that *Muhammad* is predicated on an impermissible hostility to arbitration agreements, in contravention of the FAA; and (ii) that, under the FAA, a state law unconscionability defense to an arbitration agreement is limited solely to "procedural unconscionability," and not the "substantive unconscionability" prong also applied by the New Jersey Supreme Court in *Muhammad* as part of its unconscionability analysis in striking down the *Muhammad* class waiver.

Defendant's Petition and motion to dismiss were filed on December 10, 2007; nine days later the Third Circuit issued its decision in *Gay*. Briefing on the Petition and motion – including the applicability of *Gay* -- was completed by mid-February, 2008 (Docket at A-22-23), and supplemental submissions were filed by the parties in the ensuing months (Docket at A-23-25).

By Order dated September 29, 2008 and entered September 30, 2008, the District Court (i) granted Defendant's Petition, (ii) denied Defendant's motion to dismiss as moot, and (iii) dismissed Plaintiffs' action in its entirety (A-16, Docket # 35 (A-25)). In the Opinion on which the Order was based, the District Court held that *Muhammad* was preempted by the FAA, and that the District Court's holding was controlled by *Gay* (A-1-15, Docket # 34 (A-25)). Plaintiffs timely filed their Notice of Appeal on October 2, 2008 (A-17-18, Docket # 36 (A-25)).

## STATEMENT OF FACTS

Because this is an appeal from the grant of a petition to compel arbitration pursuant to FAA § 4, the "facts" most pertinent to the resolution of the legal issues are the decisions of New Jersey Supreme Court in *Muhammad* and this Court in *Gay*, and the District Court Opinion that is the subject of the appeal. Nevertheless, for completeness of context, Plaintiffs begin with a description of the facts underlying Plaintiffs' claims and regarding the relevant terms of the arbitration agreement, before then discussing in some detail each of the three decisions identified above as a predicate to Plaintiffs' arguments on appeal.

### A. The Facts Underlying Plaintiffs' Complaint And Claims

Plaintiffs each reside in New Jersey, and Defendant maintains its principal place of business in New Jersey (Cmp. ¶¶ 7, 8 (A-29)). Defendant provides wireless communication services, including cellular telephone services (Cmp. ¶ 8 (A-29)). In October 2005, Defendant had almost 50 million wireless lines nationwide (Cmp. ¶ 2 (A-27)), and by March 15, 2007, the number had increased to more than 60 million customer lines (Cmp. ¶¶ 2, 8, 25 (A-27, A-30, A-36)).

Each of the Plaintiffs had been a wireless telephone customer of Defendant since before 2004 under a family calling plan that provided an agreed number of allowable call minutes for an agreed price for a prescribed duration, plus an agreed fixed monthly per-line price for the additional non-primary lines also included in

the family calling plan (Cmp. ¶ 20 (A-34-35)). At the time Plaintiffs entered into their fixed price family calling plans, Defendant did not charge an "administrative charge," and nothing in the standard customer agreement specifically authorized Defendant to charge the "administrative charge" challenged by Plaintiffs' action (Cmp. ¶ 21 (A-35)).

Effective on and after October 1, 2005, Defendant unilaterally determined to begin assessing its existing and new customers with an "administrative charge" of $0.40 monthly per line (the "Administrative Charge") (Cmp. ¶ 21 (A-35)). One standard form prepared by Defendant to be provided to customers regarding the Administrative Charge stated the following**:**

> **Notice of Introduction of Administrative Charge**
>
> Verizon Wireless will begin assessing an Administrative Charge of 40¢ per line per month on October 1, 2005. This charge will help defray certain costs we incur, currently including:
>
> (i) fees and assessments on network facilities and services;
>
> (ii) charges we, or our agents, pay local telephone companies for delivering calls from our customers to their customers; and
>
> (iii) certain costs and charges associated with proceedings related to new cell site construction. (*Id.*)

Plaintiffs allege that the customer agreement was amended sometime after October 1, 2005 to include a specific reference to the Administrative Charge (Cmp. ¶ 23 (A-36)); that change, in fact, is reflected in the November 2006 customer

agreement included as Exhibit A to the Malutich Certification (A-52). The November 2006 customer agreement (A-52), and the September 2007 customer agreement (included as Exhibit D to the Malutich Certification (A-69-72 at A-70)), are identical with respect to the following relevant provision regarding the imposition of the Administrative Charge:

> **Charges and Fees We Set**
>
> *You agree to pay* all access, usage and other charges and fees we bill you or that the user of your wireless phone accepted, even if you weren't the user of your wireless phone and didn't authorize its use. These include Federal Universal Service, Regulatory and *Administrative Charges, and* may include *other charges* ***also*** ***related to our governmental costs***. We set these charges. They aren't taxes, aren't required by law, are kept by us in whole or in part, and are subject to change. . . . (emphasis added)

Plaintiffs allege that the imposition of the Administrative Charge is wrongful and deceptive, as follows (Cmp. ¶ 22 (A-35)) (emphasis in original):

> The stated basis for the imposition of the Administrative Charge confirms that these charges have *nothing* to do with the costs associated with any individual wireless line, and are entirely discretionary on the part of Defendant. Verizon Wireless simply decided that it was going to implement a unilateral price increase for all of its customers as a means of bettering its bottom line to the tune of **$20 million or more monthly**, and that various components of its general overhead costs sounding suitably "official" – comprised of certain "fees, assessments, charges, and costs" – would be the putative basis for its unilateral, and wrongful and deceptive, price increase.

The bottom-line of the cost of the new "Administrative Charge" to Defendant's then-existing 50 million customer lines when it was implemented on October 1, 2005 was *$20 million monthly* for the exact same services provided the

day before (Cmp. ¶¶ 2, 22 (A-27, A-35-36)). Not satisfied with the more than two hundred million dollars annually it was newly-collecting, Defendant then increased the Administrative Charge *less than 18 months later*, on March 15, 2007, by *75%***,** to $0.70 monthly, *purportedly to recover the same incurred costs*; the increase translates into **$42 million monthly** based on 60 million customer lines on that date – or **one-half billion dollars annually** (Cmp. ¶¶ 2, 25 (A-27, A-36)).

Plaintiffs' claims are two-fold. First, Plaintiffs assert a claim for breach of contract based on Defendant's unilateral imposition, and subsequent increase, of the Administrative Charge before the expiration of the fixed-price contracts of Defendant's existing customers, which Plaintiffs allege (i) violates the fundamental common law requirement for all contracts that any such mid-term price changes be accompanied by new and valuable consideration to make the modifications effective (Cmp. ¶ 27-28 (A-37)), and also (ii) violates the express contract term requiring the price term of the "calling plan" to control (Cmp. ¶ 29 (A-38)).

Second, Plaintiffs assert a claim for violations of the New Jersey Consumer Fraud Act, § 56:8-1, *et seq.*, based on Defendant's conduct including, *inter alia*, (i) its unilateral imposition, and subsequent increase, of the Administrative Charge on its existing customers in 2005, and 2007, respectively, (ii) Defendant's vague disclosures regarding the Administrative Charge that misleadingly and deceptively suggest that the Administrative Charge bears any legitimacy or is anything other

than a discretionary pass-through of Defendant's overhead, and (iii) Defendant's advertising of, and promising, prices less than the prices actually charged when the Administrative Charge is included (Cmp. ¶ 34 (A-39)).[3]

Importantly, notwithstanding the express provision of the customer agreement (quoted *supra*) that Defendant's charges "include Federal Universal Service, Regulatory and *Administrative Charges*, and may include other charges <u>also</u> *related to our governmental costs*" (A-52, A-70) (emphasis added), Defendant expressly admitted at pages 28-29 of its brief in support of its motion to dismiss (Docket # 9 (A-20)) that Defendant, in fact, "*was recovering general costs it incurred to provide service*," and expressly equated "costs and charges associated with proceedings related to new cell site construction" with "the costs of building

[3] Plaintiffs also originally asserted a claim for unjust enrichment (Cmp. ¶¶ 38-40 (A-40)), but agreed to withdraw and/or voluntarily dismiss that claim in connection with the briefing on Defendant's motion to dismiss.

Plaintiffs' action is brought individually and as a class action pursuant to Fed. R. Civ. P. 23(a) and (b)(3) on behalf of three classes of similarly situated customers of Defendant: (i) Class I, comprised of all of Defendant's existing customers as of September 30, 2005 who thereafter were charged the $0.40 Administrative Charge before the expiration of their existing fixed-price contracts with Defendant; (ii) Class II, comprised of all of Defendant's existing customers as of March 15, 2007 who thereafter were charged the $0.70 Administrative Charge before the expiration of their existing fixed-price contracts with Defendant; and (iii) Class III, comprised of all of Defendant's customers who commenced, renewed and/or modified their fixed-price contracts with Defendant on or after October 1, 2005 and were charged the Administrative Charge as part of their monthly charges for Defendant's wireless telephone services. Excluded from the Classes are Defendant, and Defendant's directors, officers, parents, affiliates, subsidiaries and successors. *See* Cmp. ¶ 12 (A-31).

new cell sites." By contrast, a federal judge analyzing the same uniform contract and disclosure documents provided to Defendant's customers recently observed and concluded, without qualification, that the Administrative Charge is supposed to be a recovery of "governmental-surcharge-related costs." *See Smale v. Cellco P'shp*, 547 F. Supp. 2d 1181, 1186 (W.D. Wash. 2008).

## B. Plaintiffs' Allegations And Other Relevant Facts Regarding The Arbitration Agreement

Plaintiffs' Complaint expressly tackles the class waiver issue, by including a section entitled "This Class Action Is Not Subject To Arbitration," as follows (Cmp. ¶¶ 9-11 (A-30)):

> 9. Each of the Plaintiffs has been a Verizon Wireless customer since prior to 2004. Prior to January 2005, Defendant's standard customer agreement included arbitration provisions that required arbitration but did not preclude class action arbitrations.
>
> 10. [I]n or around January, 2005 and becoming effective shortly thereafter, Defendant adhesively changed the arbitration provisions in the standard customer agreement between Verizon Wireless and Plaintiffs and Defendant's other customers to include a provision precluding class arbitrations "even if [the American Arbitration Association] procedures or rules would." However, the revised arbitration provisions of the customer agreement also specifically provide that the agreement to arbitrate is not applicable if the class action preclusion clause is unenforceable:
>
> > IF FOR SOME REASON THE PROHIBITION ON CLASS ARBITRATIONS SET FORTH IN SUBSECTION 3 ABOVE IS DEEMED UNENFORCEABLE, THEN THE AGREEMENT TO ARBITRATE WILL NOT APPLY.[4]

[4] *See also* A-54-55 (2006 agreement), A-71-72 (2007 agreement).

> 11. In light of the location of Defendant's principal offices in New Jersey and/or the New Jersey area codes for Plaintiffs' wireless lines, New Jersey law controls the unconscionability and unenforceability of the class action preclusion clause in the arbitration provisions of Defendant's customer agreement. The New Jersey Supreme Court, in *Muhammad v. County Bank of Rehoboth Beach, Del.*, 189 N.J. 1, 912 A.2d 88 (N.J. 2006), squarely held that class action preclusion clauses like that engrafted by Verizon Wireless onto the standard customer agreement are unconscionable and unenforceable; this New Jersey law governs here.

Several other provisions are relevant to the arbitration agreement at issue. First, and as generally alluded to in Complaint ¶ 11 (quoted *supra*), the agreement contains a controlling law provision providing that "this agreement and disputes covered by it are governed by the laws of the state encompassing the area code assigned to your wireless phone number when you accepted this agreement . . . ." (A-55, A-72). Thus, Defendant has conceded the applicability of New Jersey law and *Muhammad* in connection with its Petition.

Second, the agreement expressly provides: "If any part of this agreement, *including any part of the arbitration provisions*, is held invalid, that part may be severed from this agreement" (A-55, A-72) (emphasis added). Thus, on its face, this severability provision, as well as the above-quoted provision voiding the arbitration agreement if the class waiver is unenforceable, *expressly contemplate that the arbitration agreement -- and each of its separate provisions* -- may be "parsed" to determine validity and enforceability.

## C. The Decision Of The New Jersey Supreme Court In *Muhammad*

The New Jersey Supreme Court in *Muhammad* is crystal clear, at the outset, exactly what issue it was deciding, and what it was holding, 189 N.J. at 6-7:

> In this appeal we must determine whether a provision in an arbitration agreement that is part of a consumer contract of adhesion is unconscionable and therefore unenforceable because it forbids class-wide arbitration. . . .
>
> Applying the controlling test for determining unconscionability for contracts of adhesion . . . , we hold that the class-arbitration waiver in this consumer contract is unenforceable. *Such a waiver would be unconscionable whether applied in a lawsuit or in arbitration.* We further conclude that the appropriate remedy in these circumstances is to sever the unconscionable provision and enforce the otherwise valid arbitration agreement. (emphasis added)

For its analysis, the *Muhammad* Court begins with a clear statement of its understanding of the purposes of the FAA, and of the *Muhammad* Court's role under the FAA in deciding the unconscionability issue before it, 189 N.J. at 11-12:

> Congress enacted the FAA, 9 U.S.C.A. §§ 1-16, "to abrogate the then-existing common law rule disfavoring arbitration agreements 'and to place arbitration agreements upon the same footing as other contracts.'" *Martindale v. Sandvik, Inc.*, 173 N.J. 76, 84, 800 A.2d 872 (2002) (quoting *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24, 111 S. Ct. 1647, 1651[] (1991)). Section 2 of the FAA provides that arbitration agreements covered by the Act "shall be valid, irrevocable, and enforceable save upon grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C.A. § 2. "In enacting section 2 of the FAA, 'Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.'" *Martindale, supra*, 173 N.J. at 84, 800 A.2d 872 (quoting *Southland Corp. v. Keating*, 465 U.S. 1, 10, 104 S. Ct. 852, 858[] (1984)). The FAA, however, does

> not preclude an examination into whether the arbitration agreement at issue is unconscionable under state law. *Id.* at 85-86, 800 A.2d 872.
>
> "[G]enerally applicable contract defenses, such as fraud, duress, or *unconscionability,* may be applied to invalidate arbitration agreements without contravening § 2." *Doctor's Assocs., Inc. v. Casarotto,* 517 U.S. 681, 687, 116 S. Ct. 1652, 1656 (1996) (emphasis added)[.]

Having set out its understanding of the statutory and decisional basis for its right to evaluate the unconscionability of the class waiver before it under the FAA based on controlling decisions of the U.S. Supreme Court, the *Muhammad* Court then proceeded to set forth the *general* doctrine of unconscionability concerning contracts of adhesion under New Jersey state law – *all* contracts of adhesion generally, and not just adhesive arbitration agreements. 189 N.J. at 15-16. Under New Jersey law, contracts of adhesion "invariably evidence some characteristics of procedural unconscionability," but nevertheless are valid unless "deemed unenforceable based on policy considerations." This policy inquiry involves a "case-by-case" "multi-factor analysis," including a "careful fact-sensitive examination into substantive unconscionability" – generally defined as the existence of "harsh or unfair one-sided terms." *Id*. (citations omitted).

Finding the relevant arbitration agreement to be "clearly a contract of adhesion," the *Muhammad* Court proceeded to consider the four relevant factors outlined in *Rudbart v. North Jersey Dist. Water Supply Comm'n,* 127 N.J. 344,

356 (1992). While the first three *Rudbart* factors (the subject matter of the contract, the parties' relative bargaining position, and the degree of economic compulsion motivating the adhering party) enhanced the degree of procedural unconscionability present, these three factors alone were "insufficient to render the contract unenforceable." 189 N.J. at 18-19. Rather, the *Muhammad* Court determined, "adhesive consumer contracts, which are ordinarily enforceable, may rise to the level of unconscionability when substantive contractual terms and conditions impact 'public interests' adversely." 189 N.J. at 19.

Hence, the *Muhammad* Court's unconscionability analysis hinged upon the fourth *Rudbart* factor – and the only one presenting a true question of substantive unconscionability (*i.e.*, the nature and effect of the challenged terms): the "public interests affected by the contract." In *Muhammad*, the application of this factor involved an assessment of whether the class arbitration waiver at issue essentially "preclude[d] any realistic challenge" to the terms of the plaintiff's underlying loan contract, thereby "shield[ing] defendants from compliance with the laws of this State." *Id.* Preliminarily, the Court noted the justifications for the class action vehicle and its long-recognized value "to litigants, to the courts, and to the public interest." 189 N.J. at 17. In particular, federal and state courts (including several New Jersey decisions) have widely recognized that class treatment of claims may often present the only genuine remedy to potential plaintiffs for the redress of

alleged wrongs. In low value cases, especially in complex matters, consumers have little if any incentive to pursue individual actions and may find it difficult or impossible to secure legal representation. 189 N.J. at 16-18, 20-21 (quoting *Carnegie v. Household Finance Int'l, Inc*. 376 F.3d 656, 661 (7th Cir. 2004) (Posner, J.) ("only a lunatic or fanatic sues for $30")). Therefore, class waivers are "almost equivalent to closing the doors of justice to all small claimants." 189 N.J. at 20. By rendering the possibility of relief illusory, class waivers "can act effectively as an exculpatory clause" – and thus may be "void as against public policy" under New Jersey law. 189 N.J. at 19-20.

> Accordingly, the *Muhammad* Court clearly reiterated its main holding:
>
> *As a matter of generally applicable state contract law*, it was unconscionable for defendants to deprive Muhammad of the mechanism of a class-wide action, *whether in arbitration or in court litigation*." (emphasis added). 189 N.J. at 22.

And, again, the *Muhammad* Court stressed that whether a class waiver is unconscionable depends on a "fact-sensitive analysis" including "the amount of damages being pursued," other relief and incentives available, and the complexity of the factual and legal issues involved in the claim. 189 N.J. at 22 n.5.

Importantly, the *Muhammad* Court expressly noted that its holding could further "New Jersey's public policy favoring arbitration," because "contracting parties and the various arbitration forums can fashion procedural rules specific to class arbitration . . . and allow for the development of innovative class-arbitration

procedures." 189 N.J. at 23-24. The *Muhammad* Court, conversely, rejected any purported justification for the enforceability of class arbitration waivers based on potential efficiencies resulting from "the likelihood that fewer individual consumers would seek redress than those who would be included as part of a class"; according to the Court, "[t]he purpose of arbitration . . . is *not* to discourage consumers from seeking vindication of their rights." 189 N.J. at 23.

Also importantly, the *Muhammad* Court observed that its state law unconscionability analysis pursuant to FAA § 2 can be *different* than the "vindication of statutory rights" test applied in such cases as *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 28 (1991), to determine the propriety of arbitration in actions authorized under federal statutes. In support of this observation, the *Muhammad* Court cited to cases including *Kristian v. Comcast Corp.*, 446 F.3d 25, 60 n.2 (1st Cir. 2006) (concluding that state unconscionability analysis, which is "based on the particulars of state contract law, may include considerations not present in the vindication of statutory rights analysis . . . which is not dependent on state law"). 189 N.J. at 25-26.

Finally, the *Muhammad* Court reached the issue of the appropriate remedy. Because, as a matter of state law, the invalid class waiver was severable from the arbitration clause as a whole, and because there was nothing rendering the entire arbitration agreement void, the *Muhammad* Court determined that the remainder

of the arbitration agreement *was enforceable*, and remanded for entry of an order *compelling arbitration*. *See* 189 N.J. at 26-27.[5]

**D. This Court's Decision In *Gay v. CreditInform***

*Gay* involved claims brought under the Credit Repair Organizations Act, 15 U.S.C. §§ 1679, *et seq.* ("CROA"), and the Pennsylvania Credit Services Act, 73 Pa. Cons. Stat. Ann. §§ 2181, *et seq.* ("CSA"). *See* 511 F.3d at 374. As Judge Greenberg felt compelled to precisely state Gay's principal contention on appeal *at least seven times* in his opinion on behalf of the *Gay* panel, it bears repeating here, at the outset of the discussion of that case:

> *Gay . . . contends that* under both the CROA and the CSA *she has a right to assert her claims in a judicial forum* and that under the CROA she has a right to bring her case as a class action. (emphasis added)

*See* 511 F.3d at 375. *See also* 511 F.3d at 377 (three times), 379, 381, 383, 383 n.10, 385. What the *Gay* plaintiff was seeking, plain and simple, was to avoid arbitration in any form. The Third Circuit, however, relying substantially on the decision of the U.S. Supreme Court regarding the arbitrability of a federal statutory claim in *Shearson/Amer. Express, Inc. v. McMahon*, 482 U.S. 220, 107

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[5] In a companion case decided the same day, the New Jersey Supreme Court determined that a class waiver was *not unconscionable* in a case involving a high value claim, and required the companion case to be arbitrated as well. *See Delta Funding Corp. v. Harris*, 189 N.J. 28, 46-47 (N.J. 2006). In fact, *Delta Funding* answered the state law unconscionability and severability questions certified to the New Jersey Supreme Court by the Third Circuit. *See Delta Funding Corp. v. Harris*, 426 F.3d 671, 675 (3d Cir. 2005).

S. Ct. 2332 (1987), and on the Third Circuit's own prior decision addressing similar statutory arguments under the Truth in Lending Act ("TILA") in *Johnson v. W. Suburban Bank*, 225 F.3d 366 (3d Cir. 2000), squarely rejected the *Gay* plaintiff's contentions that the CROA or the CSA provided a right to proceed in a judicial forum, and that the CROA provided the right to bring a class action -- thus concluding that there was "nothing for a consumer to waive." 511 F.3d at 377-383, 383 n.10.

Alternatively, the *Gay* plaintiff also asserted a fallback argument, if the Court rejected her claim of a "right to assert her claims in a judicial forum and . . . under the CROA . . . as a class action" -- that "*the arbitration provision is unconscionable" in its entirety* under applicable state law. *Id.* at 375, 388, 391, 391 n.14, 392 (emphasis added). Thus, the *Gay* Court also addressed this unconscionability issue -- electing to "trea[t] the statutes as creating rights to bring actions in judicial forums and, in the case of the CROA, to do so on a class action basis, though we have concluded that they do no such thing." *Id.* at 383 n.10.

As a starting point for its unconscionability analysis, the *Gay* Court summarized relevant federal authority establishing that "[f]ederal law determines whether an issue governed by the FAA is referable to arbitration." 511 F.3d at 388 (quoting *Harris v. Green Tree Fin. Corp.*, 183 F.3d 173, 178 (3d Cir. 1999)). Even so, the *Gay* Court recognized the role of state law under the FAA:

> Nevertheless, notwithstanding the supremacy of federal law, *courts repeatedly have held that* "in interpreting [arbitration] agreements, *federal courts may apply state law*, pursuant to section two of the FAA." *Harris,* 183 F.3d at 179. *In particular, "generally applicable contract defenses, such as* fraud, duress, or *unconscionability, may be applied* to invalidate arbitration agreements without contravening § 2." *Doctor's Assocs., Inc. v. Casarotto,* 517 U.S. 681, 687, 116 S. Ct. 1652, 1656[] (1996).

511 F.3d at 388 (emphasis added). Indeed, to support its understanding of the applicability of state law, the *Gay* Court cites to four Third Circuit cases, two examining the enforceability of arbitration provisions under the "vindication of statutory rights" framework, and two examining the enforceability of arbitration provisions under a state law unconscionability analysis. *Id*.[6]

The *Gay* Court then addressed the conflict of laws issue raised by the plaintiff's challenge to the application of Virginia law as provided in the contractual choice-of-law provision, rather than the Pennsylvania law she advocated in connection with the unconscionability analysis. 511 F.3d at 389-91. Holding that the Virginia law prescribed in the choice-of-law provision should apply, the *Gay* Court determined that the arbitration agreement was not unconscionable under Virginia law. *Id*. at 391-92.

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[6] These four cases are: *Parilla v. IAP Worldwide Services, VI, Inc.*, 368 F.3d 269, 276 (3d Cir. 2004) (analyzing unconscionability under Virgin Islands law); *Spinetti v. Service Corp. Int'l,* 324 F.3d 212, 214 (3d Cir. 2003) (vindication of statutory rights analysis); *Blair,* 283 F.3d at 605 (vindication of statutory rights analysis); *Harris,* 183 F.3d at 181-84 (analyzing unconscionability under Pennsylvania law).

Finally, the *Gay* Court opined that, "even if we disregard the Agreement's choice-of-law provision and apply Pennsylvania law in considering the enforceability of the arbitration clause . . . , we would reach the same result, largely because federal law requires that we do so and Pennsylvania law must conform with federal law." 511 F.3d at 392. In particular, the *Gay* Court held that two intermediate Pennsylvania appellate cases cited by the plaintiff,[7] although factually distinguishable and failing to represent a definitive pronouncement of Pennsylvania law, were preempted by the FAA:

> To the extent, then, that *Lytle* and *Thibodeau* hold that the inclusion of a waiver of *the right to bring judicial class actions* in an arbitration agreement constitutes an unconscionable contract, they are not based "upon such grounds as exist at law or in equity for the revocation of *any* contract" pursuant to section 2 of the FAA, and therefore cannot prevent the enforcement of the arbitration provision in this case. 9 U.S.C. § 2 (emphasis added).

511 F.3d at 394 (add'l emphasis added). Of particular importance to the instant appeal, the *Gay* Court further elaborated the basis for its conclusion, *id.* at 394-95:

> Certainly the Pennsylvania Superior Court panels were aware of *Perry* [*v. Thomas, infra*] and thought that they were reaching outcomes in considering the unconscionability issues consistent with it as well as other Supreme Court cases. We, however, reject *Lytle* and *Thibodeau* for we do not agree with them as there is no escape from the fact that they deal with agreements to arbitrate, rather than with contracts in general, and thus they are not in harmony with *Perry*. It would be sophistry to contend, in the words of *Perry*, that

[7] *Lytle v. CitiFinancial Services, Inc.*, 810 A.2d 642 (Pa. Super. Ct. 2002), and *Thibodeau v. Comcast Corp.*, 912 A.2d 874 (Pa. Super. Ct. 2006).

> the Pennsylvania cases do not "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." 482 U.S. at 492 n.9, 107 S. Ct. at 2527 n.9. After all, though *the Pennsylvania cases* are written ostensibly to apply general principles of contract law, they *hold that an agreement to arbitrate may be unconscionable simply because it is an agreement to arbitrate.* (emphasis added)

Thus, the *Gay* Court concluded that "the arbitration provision in this case is not unconscionable," and affirmed the order the district court staying the arbitration and compelling arbitration on an individual basis. 511 F.3d at 395.

**E. The Appealed-From Opinion Of The District Court**

After first setting out the relevant terms of the arbitration agreement (the "Agreement"), the District Court preceded its analysis by noting that "the parties agree that Plaintiffs may proceed with the law suit if *Muhammad* controls" (A-3). *See also* A-8 ("both parties agree that the Agreement's class arbitration waiver clause is unconscionable under New Jersey law"). Thus, according to the District Court, "the issue before this Court is whether the FAA preempts the holding of *Muhammad* here" (A-8). *See also* A-3 ("Defendant contends that, for a number of reasons, *Muhammad* is preempted by the FAA, the class arbitration waiver is valid, and Plaintiffs must arbitrate their claims individually.").

The District Court's legal analysis begins in a fashion highly reminiscent of the *Gay* decision, including *Gay's* reference to *Harris* for the proposition that "[f]ederal law determines whether an issue governed by the FAA is referable to

arbitration" (A-5). Like *Gay*, the District Court Opinion expressly recognizes that, under *Doctor's Assocs.*, *supra*, "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." A-5. And, quoting *Gay* (which, in turn, quotes *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987)), the District Court Opinion expressly notes that state "law, whether of legislative or judicial origin, is applicable if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." A-5.

The District Court, in its Opinion, nevertheless concluded that "the FAA requires enforcement of the arbitration agreement" (A-6-15). In the District Court's view, the "precise" controlling issue – "whether the FAA preempts the holding of *Muhammad* here" – was addressed by this Court "in *Gay*, where the court held that a state law determination that precludes, on unconscionability grounds, enforcement of an agreement to arbitrate low-value consumer claims on an individual basis is preempted by the FAA." A-8.

In the District Court's view, the *Gay* Court's rejection of the two Pennsylvania decisions proffered by the plaintiff therein applied to *Muhammad*, because in *Gay* "the Third Circuit noted it was neither bound by these lower state court decisions, nor would it be bound even if they were Pennsylvania Supreme Court cases, because the Circuit was bound by 'federal law that Congress set forth

in the FAA' and state law 'must conform with it.'" A-8. According to the District Court's reading of *Gay*, "the Circuit held that class waivers in arbitration agreements are 'valid, irrevocable, and enforceable' under the FAA notwithstanding state law to the contrary." A-8. Although specifically quoting the holding of the *Gay* Court rejecting Pennsylvania law insofar as "*Lytle* and *Thibodeau* hold that the inclusion of a waiver of the right to bring judicial class actions in an arbitration agreement constitutes an unconscionable contract," the District Court concluded that in *Gay*, "the Circuit left very little room for this Court to invalidate an arbitration clause on the basis of a class waiver provision, even if it is unconscionable under state law." A-8-9.

The District Court then proceeded to reject all of Plaintiffs' arguments as to why *Gay* was distinguishable and not controlling of the *Muhammad* FAA preemption issue here. First, the District Court rejected Plaintiffs' contention that, unlike *Lytle* and *Thibodeau*, *Muhammad* is "entirely neutral with respect to arbitration agreements," and does not "demonstrate hostility to the arbitral forum," concluding that the proffered "distinction does not hold water." A-9. According to the District Court, the *Muhammad* Court's class waiver unconscionability holding "as a matter of generally applicable contract law" was "*dicta*," because the New Jersey Supreme Court had before it only a class arbitration waiver, and not a "broad class action waiver." A-9-10. The District Court further relied on the fact

that, like *Muhammad*, *Thibodeau* included some language of general applicability to both "class wide litigation or class wide arbitration of consumer claims," but that the "Third Circuit found that the FAA preempted this state law interpretation, despite the fact that the state court purported to reject the waiver of class treatment in general and not just in the context of arbitration clauses." A-9.

The District Court further rejected the relevance of the fact that *Muhammad* is "a seemingly neutral holding involving an arbitration agreement 'written ostensibly to apply general principles of contract law'" -- based on language in *Gay* that a "finding that the arbitration provisions in [the Pennsylvania state] cases are unconscionable can be reached only by parsing the provisions themselves to determine what they provide." A-10. According to the District Court, under *Gay*, the need to "pars[e] the provisions themselves to determine what they provide" "appears to be enough to indicate that the New Jersey Supreme Court treats arbitration agreements differently from other contract provisions." A-10.

The District Court also rejected the relevance of any distinction based on that fact that the decisions in *Lytle* and *Thibodeau* were lower court decisions under Pennsylvania law while *Muhammad* was a decision of the New Jersey Supreme Court under New Jersey law. Noting that the *Gay* Court would have reached the same conclusion even if *Lytle* and *Thibodeau* had been Pennsylvania Supreme Court decisions, the District Court paraphrased *Gay*, 511 F.3d at 393, in

stating that "*Muhammad* does not bind this Court, since the issue here is the FAA, a federal law, and '[New Jersey] law must conform with it.'" A-11. Buttressing its conclusion in this respect, the District Court stated: "While the holding in *Muhammad,* if controlling, would render Defendant's class arbitration waiver unconscionable under New Jersey law, the Third Circuit has already held that such an arbitration provision is enforceable under § 2 of the FAA." A-12.

Thus, the District Court held, based on the Supremacy Clause of Article IV of the U.S. Constitution, "that, insofar as the FAA and *Muhammad* are inconsistent, federal law preempts the holding in *Muhammad*" A-13, and that, "[t]herefore, the FAA requires this Court to uphold the arbitration provision within Plaintiffs' service Agreement." A-14. The District Court, nevertheless, was sensitive to the negative real world effects resulting from its Opinion, A-14 at n.6:

> The Court recognizes the many hardships visited upon plaintiffs, such as in this case, based upon this ruling. First, it creates the opportunity for a different result depending on whether the case is brought in federal or state court. Second, it is also clear that compelling individual arbitration in this case will be tantamount to ending the Plaintiffs' pursuit of their claims, as there is very little possibility that these Plaintiffs or any other plaintiff will pursue individual arbitration for claims that amount only to several dollars in damages. While this outcome is harsh, this Court is bound by Third Circuit precedent.

## RELATED CASES AND PROCEEDINGS

Although not related in terms of parties or claims, the issue of whether *Muhammad* is pre-empted by the FAA is also one of the issues raised in the appeal

currently pending before this Court in *Homa v. Amer. Express Co.*, Appeal No. 07-2921. *Homa* was argued on December 1, 2008 to a panel comprised of Third Circuit Judges Ambro, Weis and Van Antwerpen, and is currently awaiting decision.

## STANDARD OF REVIEW

This Court exercises a plenary standard of review over legal questions "regarding the validity and enforceability of an agreement to arbitrate." *Edwards v. Hovensa, LLC,* 497 F.3d 355, 357 (3d Cir. 2007) (citing *Lloyd v. Hovensa, LLC,* 369 F.3d 263, 273 (3d Cir. 2004)); *see also Gay,* 511 F.3d at 376; *Harris*, 183 F.3d at 176; *Pritzker v. Merrill Lynch, Pierce, Fenner & Smith,* 7 F.3d 1110, 1113 (3d. Cir. 1993). As further articulated in *Martin v. Dana Corp.*, 114 F.3d 421, 423 (3d Cir. 1997) (quoting *Gluck v. Unisys Corp.*, 960 F.2d 1168, 1175 (3d Cir. 1992)), the proper inquiry under the plenary standard is "whether taking the allegations of the complaint as true, . . . and viewing them liberally, giving plaintiffs the benefit of all inferences which fairly may be drawn therefrom, . . . 'it appears beyond doubt that the plaintiff [s] can prove no set of facts in support of [their] claim[s] which would entitle them to relief.'"

## SUMMARY OF ARGUMENT

The District Court committed two fundamental errors in reaching its holding that *Muhammad* is preempted by the FAA.

First, the District Court essentially concluded that the presumption of arbitrability under the FAA renders the general state law unconscionability analysis irrelevant, notwithstanding the express language of the "savings clause" of FAA § 2 and extensive controlling precedent of the Supreme Court and this Court (among many others) interpreting FAA § 2 as allowing *generally* applicable contract defenses -- like the unconscionability defense in *Muhammad* -- to be applied to an arbitration agreement without contravening the FAA.

Second, the District Court erred in holding that its decision was squarely controlled by *Gay*, and in failing to closely read *Gay* and what it actually says and holds and the rationale on which it is based to make the proper determination with respect to *Muhammad* in this case. *Gay* is limited to Virginia and Pennsylvania law, and is factually distinguishable in several material respects. Furthermore, *Gay* does not make a broad-based ruling that all class waivers are enforceable under the FAA regardless of general state law unconscionability defenses -- nor could it in light of the express savings clause of FAA § 2. In any event, this Court should read *Gay* narrowly, pursuant to the Third Circuit's Internal Operating Procedure

9.1, so as to avoid having *Gay* potentially overrule numerous precedential opinions of previous panels of this Court holding directly to the contrary.

## ARGUMENT

### I. THE DISTRICT COURT ERRED IN GRANTING DEFENDANT'S PETITION TO COMPEL ARBITRATION

Although addressing whether *Muhammad* is preempted by the FAA and whether *Gay* controls that issue, the District Court wholly failed to address the gateway issue raised by Plaintiffs in opposition to the Petition – that Defendant is bound, under controlling Supreme Court precedent, by *its own choice not to arbitrate*, because the arbitration agreement expressly provides that it "will not apply" where "the prohibition on class arbitrations . . . is deemed unenforceable" under New Jersey law. This issue arguably renders the remaining issues superfluous and, thus, Plaintiffs begin with it, before addressing what the District Court did hold.

#### A. The District Court Erred In Not Holding That Defendant Was Bound By The Express Terms Of Its Arbitration Agreement Under *Volt*

Defendant in this case seeks to evade its own contractual choice *not* to arbitrate, even though it was well aware in November 2006 that *Muhammad* and the New Jersey state law designated by Defendant as controlling render its class waiver "unenforceable." Indeed, in its brief in the District Court, Defendant

*conceded* that "*Muhammad* applies to [its] arbitration agreement" (A-78), including in particular the following provision:

> IF FOR SOME REASON THE PROHIBITION ON CLASS ARBITRATIONS SET FORTH IN SUBSECTION 3 ABOVE IS DEEMED UNENFORCEABLE, THEN THE AGREEMENT TO ARBITRATE WILL NOT APPLY.

Defendant concedes (A-78) that *Muhammad* is "some reason that the prohibition on class arbitrations [] is deemed unenforceable." Thus, in light of *Muhammad* and the above arbitration provision, any contention that giving effect to Defendant's own contract term is inconsistent with the FAA is meritless.

The facts in this case are highly analogous to, and controlled by, the decision and rationale of the U.S. Supreme Court in *Volt.* In *Volt,* Stanford University had entered into a construction contract, containing an arbitration provision, under which Volt was to install a system of electrical conduits on the Stanford campus. 489 U.S. at 470. The contract also contained a choice-of-law clause providing that "[t]he Contract shall be governed by the law of the place where the Project is located." *Id.* After a dispute developed regarding compensation for extra work, Volt made a formal demand for arbitration, and Stanford responded by filing an action against Volt in California Superior Court, alleging fraud and breach of contract; in the same action, Stanford also sought indemnity from two other companies involved in the construction project with whom it did not have arbitration agreements. *Id.* at 470-71. Volt petitioned the

California Superior Court to compel arbitration of the dispute. *Id* at 471. Stanford, in turn, moved to stay arbitration pursuant to Cal. Civ. Proc. Code Ann. § 1281.2(c), which permits a court to stay arbitration pending resolution of related litigation between a party to the arbitration agreement and third parties not bound by it, where "there is a possibility of conflicting rulings on a common issue of law or fact." *Id.* Both California lower courts denied Volt's petition to compel arbitration and granted Stanford's motion to stay arbitration, and the California Supreme Court declined review. *Id.* at 471-73.

The U.S. Supreme Court affirmed the decisions of the California state courts, and in so doing, squarely rejected virtually every possible argument that the FAA is undermined if this case does not proceed in arbitration. First, the Supreme Court rejected Volt's suggestion that the California state courts' "construction of the choice-of-law clause was in effect a finding that appellant had 'waived' its 'federally guaranteed right to compel arbitration of the parties' dispute,' a waiver whose validity must be judged by reference to federal rather than state law." *Id.* at 474. As the Supreme Court observed, *id.* at 474-75:

> [T]he Court of Appeal found that, by incorporating the California [law] into their agreement, the parties had agreed that arbitration would not proceed in situations which fell within the scope of Calif. Code Civ. Proc. Ann. § 1281.2(c) (West 1982). This was not a finding that appellant had "waived" an FAA-guaranteed right to compel arbitration of this dispute, but a finding that *it had no such right in the first place, because the parties' agreement did not require arbitration to proceed in this situation.* (emphasis added)

Second, the Supreme Court rejected Volt's argument that the state court result "violates the settled federal rule that questions of arbitrability in contracts subject to the FAA must be resolved with a healthy regard for the federal policy favoring arbitration," *id.* at 475-76:

> [T]he federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate. Interpreting a choice-of-law clause to make applicable state rules governing the conduct of arbitration - rules which are manifestly designed to encourage resort to the arbitral process - simply does not offend the rule of liberal construction set forth in *Moses H. Cone*, 460 U.S. 1, 24-25 (1983)), nor does it offend any other policy embodied in the FAA.

Finally, the Supreme Court rejected Volt's argument that enforcing the state law rules incorporated into the parties' agreement by the choice-of-law clause "would undermine the goals and policies of the FAA" and thus impliedly be preempted. *Id.* at 476-79. As the Supreme Court stated:

> [T]he FAA does not require parties to arbitrate when they have not agreed to do so . . . nor does it prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement . . . . It simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms. *Id.* at 478 (citations omitted) . . . By permitting the courts to "rigorously enforce" such agreements according to their terms . . . we give effect to the contractual rights and expectations of the parties, without doing violence to the policies behind by the FAA. *Id.* at 479 (citation omitted).

Defendant's Petition is really an attempt to renege on the plain terms of its arbitration agreement. The reason Plaintiffs filed this case in federal court rather

than in arbitration is because Defendant has chosen not to arbitrate, and rather to litigate where, under *Muhammad*, "the prohibition on class arbitrations . . . is deemed unenforceable." After all, it is not as if it would be unconscionable to enforce Defendant's own election not to arbitrate against it where (as here) "the prohibition on class arbitrations . . . is deemed unenforceable."

The bottom line, under *Volt*, is that the FAA entitles Plaintiffs to enforce the arbitration agreement under its terms as written, and as concededly understood by *all* parties. Defendant's attempt to evade those terms should have been rejected by the District Court at the outset, and should be rejected by this Court now.[8]

### B. The District Court Erred In Holding That *Muhammad* Is Preempted By The FAA

In essence, the District Court held, based on *Gay*, that all class arbitration waivers are enforceable as a matter of federal law under the FAA, and that *Muhammad* thus improperly contravened this federal enforceability: "[T]he Circuit held that class waivers in arbitration agreements are 'valid, irrevocable, and enforceable' under the FAA notwithstanding state law to the contrary." A-8.

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[8] As cogently observed by Judge Easterbrook of the United States Court of Appeals for the Seventh Circuit in *Stone v. Doerge*, 328 F.3d 343, 345 (7th Cir. 2003) (citations omitted):

> Nothing in the Federal Arbitration Act overrides normal rules of contractual interpretation[.] . . . There is no denying that many decisions proclaim that federal policy favors arbitration, but this differs from saying that courts read contracts to foist arbitration on parties who have not genuinely agreed to that device.

Putting aside for the moment whether *Gay* should or must be read as understood by the District Court (*but see* Argument I(C), *infra*), it is *clear* that the District Court is incorrect when stating that state law can be disregarded in a case like this.

### 1. FAA § 2, on its Face, and as Expressly and Consistently Construed by the Supreme Court and this Court and its Sister Circuits, Allows General Contract Defenses to an Arbitration Agreement, Including an Unconscionability Defense

FAA § 2, entitled "Validity, irrevocability, and enforcement of agreements to arbitrate," provides as follows:

> A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.* (emphasis added)

Even if the intent of Congress under FAA § 2 is not free of ambiguity, it nevertheless is beyond peradventure that, under FAA § 2, a general state law contract defense of unconscionability may be asserted as a challenge to the validity or enforceability of an arbitration agreement. As the Supreme Court clearly held *Doctor's Assocs.*, 517 U.S. at 686-687:

> [T]he text of § 2 declares that *state law may be applied* "*if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." 482 U.S., at 492, n.9, 107 S. Ct., at 2527, n.9. Thus, generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2. (emphasis added)

In fact, the quoted portion of *Doctor's Assocs.* reiterated what had previously been stated by the Supreme Court in *Perry v. Thomas*, 482 U.S. at 492 n.9, in which the Supreme Court first clarified that general state law unconscionability defenses do *not* contravene the FAA:

> We also decline to address *Thomas' claim that the arbitration agreement in this case constitutes an unconscionable, unenforceable contract of adhesion.* This issue was not decided below, . . . and *may likewise be considered on remand*. (emphasis added)
>
> We note, however, the choice-of-law issue that arises when defenses such as Thomas' so-called "standing" and unconscionability arguments are asserted. In instances such as these, the text of § 2 provides the touchstone for choosing between state-law principles and the principles of federal common law envisioned by the passage of that statute: An agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law*, . . . "save upon such grounds as exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2 (emphasis in original). Thus *state law, whether of legislative or judicial origin, is applicable if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.* (emphasis added)

In addition to the express language of FAA § 2 and the decisions of the Supreme Court in *Perry* and *Doctor's Assocs.*, the Third Circuit itself has issued a veritable brigade of decisions -- all recognizing the propriety under the FAA of considering and analyzing a generally applicable unconscionability defense. *See Delta Funding Corp.*, 426 F.3d at 674-75 (certifying case to N.J. Supreme Court to consider, *inter alia*, Harris' unconscionability arguments); *Parilla*, 368 F.3d at 276 (finding certain provisions of an arbitration clause substantively

unconscionable); *Alexander*, 341 F.3d at 264-265 (applying substantive unconscionability to find arbitration clause unconscionable); *Harris*, 183 F.3d 173 (applying both procedural and substantive unconscionability under FAA but finding against unconscionability). *Cf. Blair*, 283 F.3d at 611 (case law does not "foreclose the ability of courts to examine public policy arguments").[9]

The Third Circuit's decision in *Alexander, supra*, is representative of these cases, and includes the following statement of controlling law which *cannot* be reconciled with the District Court Opinion and analysis. As the *Alexander* Court observed, 341 F.3d at 264 (citations omitted):

> We are to look to the relevant state law of contracts in making this [unconscionability] determination. . . . An agreement to arbitrate may be unenforceable based on a generally applicable contractual defense, such as unconscionability. . . . According to the Supreme Court, courts must "remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.'" . . . Although possibly relevant, considerations of public policy and the loss of state statutory rights are not dispositive in the unconscionability inquiry. The generally applicable standards of this contractual doctrine continue to dictate the result of any analysis. Consistent with the Supreme Court's call, we have on several occasions dealt with claims that an arbitration contract is invalid on grounds of unconscionability or disparity in bargaining power.

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[9] *See generally Trippe Mfg. Co. v. Niles Audio Corp.*, 401 F.3d 529, 532 (3d Cir. 2005) ("The FAA instructs courts to refer to principles of applicable state law when determining the existence and scope of an agreement to arbitrate."); *First Liberty Inv. Group v. Nicholsberg*, 145 F.3d 647, 649 (3d Cir. 1998) ("A threshold inquiry under the Federal Arbitration Act *is to determine, under recognized principles of contract law, the validity of,* and the parties bound by, the arbitration agreement.") (emphasis added).

Furthermore, the Third Circuit in *Gay* expressly evaluates the potential unconscionability of the class arbitration waiver under Virginia and Pennsylvania state law. 511 F.3d at 391-95. And post-*Gay,* the Third Circuit again recently applied an unconscionability analysis under the FAA in response to a challenge to the fee shifting provision of the arbitration forum rules incorporated by the pertinent arbitration agreement -- this time *under New Jersey law, with Judge Greenberg* (the author of *Gay*) *sitting on the panel. See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Clemente,* 272 Fed. Appx. 174, 2008 WL 857756 (3d Cir. Mar. 21, 2008) (citing *Delta Funding, supra*, 189 N.J. 28, and *Rudbart, supra*).[10]

The Third Circuit is hardly unique in validating this Congressionally prescribed relationship between the FAA and the generally applicable state contract law of unconscionability. *See Lowden v. T-Mobile USA, Inc.*, 512 F.3d 1213 (9th Cir. 2008) (applying Washington state unconscionability analysis and invalidating class waiver); *Skirchak v. Dynamics Research Corp.*, 508 F.3d 49, 57-60 (1st Cir. 2007) (applying state unconscionability analysis and holding class waiver unfair and oppressive); *Dale v. Comcast Corp.*, 498 F.3d 1216 (11th Cir. 2007) (finding class waiver substantively unconscionable under Georgia law); *Shroyer v. New Cingular Wireless Services, Inc.*, 498 F.3d 976, 987-88 (9th Cir.

[10] Even the District Court referred to the oft-quoted language of *Doctor's Assocs.* in its Opinion, although it was unable to reconcile that language with certain other statements in *Gay*. *But see* Argument I(C), *infra.*

2007) (fact that class action waivers may be unconscionable as "unlawfully exculpatory" under California law not preempted by FAA); *Kristian v. Comcast Corp.*, 446 F.3d 25, 63-64 (1st Cir. 2006) (under FAA, state unconscionability doctrine is "part of the federal substantive law of arbitrability"); *Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*, 379 F.3d 159, 170 (5th Cir. 2004) (unconscionability not preempted under FAA unless used to "subject arbitration clauses to special scrutiny").

If anything, the District Court opinion is based on a presumption that -- under the FAA -- any provision of an arbitration agreement is *not* unconscionable. The FAA may favor arbitration, but the issue of unconscionability in a case like this is relegated to state law – assuming such state law does not run afoul of the purposes of the FAA.

### 2. Any FAA Preemption Analysis Must Be Based on the Well-Established Purposes of the FAA – To Eliminate Hostility to Arbitration and to Place Arbitration Agreements on the "Same Footing" as Other Contracts

In articulating the history and purposes of the FAA, and in particular § 2, the U.S. Supreme Court has repeatedly emphasized that the FAA is a federal legislative response to an anachronistic judicial trend of skepticism and hostility towards arbitration in lieu of a court's own jurisdiction. The FAA, accordingly, establishes a strong policy in favor of honoring the parties' contractual choice of dispute-resolution forum by placing agreements to arbitrate on the "same footing

as other contracts." *See, e.g., Doctor's Assocs.,* 517 U.S. at 687, 688 (FAA preempts state law that "places arbitration agreements in a class apart from 'any contract,' and singularly limits their validity"); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 270-271, 281 (1995) (state's policy may not "place arbitration clauses on an unequal 'footing,' directly contrary to the Act's language and Congress' intent"). *See also Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 112 (2001) (FAA is "pre-emptive of state laws hostile to arbitration"); *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984) (in enacting the FAA, "Congress . . . withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration"). *See also Muhammad,* 189 N.J. at 11-12.

Importantly, *only an equal footing* is called for; under the FAA, arbitration agreements are made "as enforceable as other contracts *but not more so*." *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967) (emphasis added). *See also Volt,* 489 U.S. at 478 (quoting *Prima Paint*).

For the District Court to conclude that a class waiver can be enforceable under the FAA notwithstanding the generally applicable state contract law of unconscionability to the contrary is legally erroneous. The FAA does not elevate arbitration agreements above all other agreements or entitle companies to entirely insulate themselves from liability simply by placing unconscionable terms within

the arbitration agreement – although that would be the result if the District Court Opinion is allowed to stand.

### 3. *Muhammad* Is Based on Generally Applicable Contract Law and Places Arbitration Agreements on the "Same Footing" as Other Contracts, and Is Not Preempted by the FAA

On its face, the primary holding of *Muhammad* is entirely neutral: "*As a matter of generally applicable state contract law*, it was unconscionable for defendants to deprive Muhammad of the mechanism of a class-wide action, *whether in arbitration or in court litigation.*" 189 N.J. at 22 (emphasis added).

Aside from the clear language of *Muhammad*'s holding and the even-handed analysis utilized by the New Jersey Supreme Court therein, the District Court also overlooked the fact that *Muhammad* directed the class claims therein *to proceed to arbitration* after declaring the class waiver unconscionable, and determined that its mandate of class arbitration was consistent with *New Jersey policy favoring arbitration*. 189 N.J. at 23-24. Additionally, the District Court overlooked the fact that on the same day the New Jersey Supreme Court issued *Muhammad*, it also issued its decision in *Delta Funding, supra, refusing* to strike a similar class waiver based on different circumstances *and* directing that matter to arbitration as well. As the New Jersey Supreme Court made clear in *Delta Funding*, 189 N.J. at 46-47, "under New Jersey law, the class-arbitration waiver in [an] arbitration agreement is not unconscionable per se." And in *Muhammad*, the

New Jersey Supreme Court stressed that whether a particular class waiver effectively amounts to an exculpatory clause and is thus unconscionable is dependent on a "fact-sensitive analysis" in each instance that includes "the amount of damages being pursued," other relief available, and the complexity of the factual and legal issues involved in the claim. 189 N.J. at 22 & n.5.

With all due respect to the District Court, it was absolutely wrong in its attempt to avoid the complete neutrality and pro-arbitration underpinnings of *Muhammad* by asserting that the *Muhammad* holding was "*dicta*" insofar as it applies both to arbitration and litigation and to arbitration agreements and non-arbitration agreements alike (A-9-10).

First, *Muhammad* expressly addressed class arbitration waivers in arbitration agreements, exactly like here, so in no way could its holding be considered "dicta" in this case. Second, *Muhammad* expressly states that it was decided "as a matter of generally applicable state contract law," 189 N.J. at 22, and there is nothing identified by the District Court (or to which the District Court could have cited) to undermine the *Muhammad* Court's express assertions of neutrality. And the only reason the *Muhammad* Court did not address the class waivers contained *both* within and outside of the arbitration agreement in the pertinent contract was because under *Prima Paint, supra,* issues of the enforceability of non-arbitration provisions are for the arbitrator, and are not a

"gateway" issue for the court to decide in determining whether, in fact, an arbitration agreement has been made under FAA § 4. 189 N.J. at 14. But in light of *Muhammad*, there can be no serious dispute that, after remand to arbitration, the arbitrator would have to reach the same conclusion under New Jersey law with respect to the class waivers not included within the arbitration agreement – the same as a New Jersey court analyzing a class waiver in an agreement with no arbitration provision. *Muhammad*'s general holding, simply stated, is not *dicta*.

It would be contrary to the purposes of FAA § 2, as consistently interpreted by the Supreme Court, this Court, and all other circuits, to conclude that the neutral, even-handed application of general contract unconscionability law by the New Jersey Supreme Court in *Muhammad* could be preempted by the FAA. And it would defy logic and common sense to hold that a decision which, on its face, is intended to promote arbitration in accordance with both federal and New Jersey policy could run afoul of the FAA. To paraphrase *Volt*, 489 U.S. at 476; "[A decision] which [is] manifestly designed to encourage resort to the arbitral process - simply does not offend the rule of liberal construction set forth in *Moses H. Cone*, . . . nor does it offend any other policy embodied in the FAA."

### C. The District Court Erred In Holding That Its Decision Was Controlled By *Gay*

Although the District Court held that its decision was controlled by *Gay*, *Gay* is readily distinguishable in several respects confirming that *Gay* does not

(and need not) control the outcome here – even though Plaintiffs concede that *Gay* is correct with respect to its holding under the Pennsylvania case law analyzed.

### 1. *Gay* Is Distinguishable Based on What Was Being Argued, and What *Gay* Actually Holds (as Opposed to What the District Court Says It Holds)

As noted in the Statement of Facts, *supra, Gay* repeatedly clarified what the plaintiff therein was contending, and what the *Gay* Court was deciding:

> *Gay* . . . *contends* that under both the CROA and the CSA *she has a right to assert her claims in a judicial forum* and that under the CROA she has a right to bring her case as a class action.

*See* 511 F.3d at 375 (emphasis added). *See also* 511 F.3d at 377, 379, 381, 383, 383 n.10, 385. The *Gay* Court also was clear in what it held – that neither statute provided the right to assert claims solely in a judicial forum, and that the CROA did not provide a right to bring the case as a class action. *See* 511 F.3d at 377-83. As a matter of law, that is "the holding" of *Gay.*

It is true, of course, that the *Gay* Court did continue its analysis, addressing whether the arbitration agreement as a whole was unconscionable – *holding* under the *Virginia* law it determined to control that the agreement was not unconscionable. 511 F.3d at 391-92.

And, of course, it is true that the *Gay* Court then continued its analysis to confirm that it would reach the same result under Pennsylvania law, but this time based on FAA preemption, 511 F.3d at 394 (add'l emphasis added):

> To the extent, then, that *Lytle* and *Thibodeau* hold that the inclusion of a waiver of *the right to bring judicial class actions* in an arbitration agreement constitutes an unconscionable contract, they are not based "upon such grounds as exist at law or in equity for the revocation of *any* contract" pursuant to section 2 of the FAA, and therefore cannot prevent the enforcement of the arbitration provision in this case. 9 U.S.C. § 2 (emphasis added).

Although the District Court actually quoted this portion of *Gay* (A-8-9), it failed to discern the significance of this particular passage and how it fit into the overall nature and context of what *Gay* actually decided. Instead, the District Court concluded the holding of *Gay* is that "class waivers in arbitration agreements are 'valid, irrevocable, and enforceable' under the FAA notwithstanding state law to the contrary." A-8.

As a legal matter, Plaintiffs initially must observe that the portion of *Gay* dealing with unconscionability under Pennsylvania law is *dicta* – indeed, *dicta* twice removed -- because the *Gay* Court had already held that there was no right to proceed by class action under the CROA which could be waived and, in any event, that Virginia law controlled and did not render the arbitration agreement as a whole unconscionable. *See* 511 F.3d at 377-83, 391-92.

But putting that fact aside, it also is clear that the issue of "the right to bring a *judicial* class action" addressed by *Gay* under Pennsylvania law is *not* what is at issue here, in this appeal. In this appeal, it is Defendant who has expressly determined that it would not be willing to arbitrate a class claim if the class waiver

is unenforceable "for some reason." Plaintiffs here, by contrast, merely seek to hold Defendant to its agreement as drafted, based on Defendant's express incorporation of controlling New Jersey law, *i.e.*, *Muhammad.* Plaintiffs, in other words, seek to enforce the intent of Congress under the FAA in expressly "saving" and preserving the general state law contract defense of unconscionability. And the analysis of unconscionability under generally applicable state contract law is distinctly different from the "vindication of statutory rights" analysis at issue in *Gay* and in the underlying decisions on which *Gay* was based. *See Muhammad*, 189 N.J. at 25-26; *Kristian*, 446 F.3d at 60 n.2 (state unconscionability analysis, which is "based on the particulars of state contract law, may include considerations not present in the vindication of statutory rights analysis . . . which is not dependent on state law").

Furthermore, the District Court simply has misread *Gay*'s conclusion under Pennsylvania law to be that all "class waivers in arbitration agreements are 'valid, irrevocable, and enforceable' under the FAA notwithstanding state law to the contrary." A-8. *Gay* certainly never goes that far, and it could not, without directly contravening the intent of Congress under the FAA and the numerous decisions of the Supreme Court and this Circuit and its sister Circuits expressly confirming the propriety of a general state law unconscionability analysis without contravening the FAA. *See* Argument I(B), *supra.*

### 2. *Gay* Is Distinguishable Because It Is Based on Pennsylvania Cases that Are Affirmatively Hostile to Arbitration

The District Court also held that the hostility to arbitration evidenced in the Pennsylvania cases of *Lytle* and *Thibodeau* addressed by *Gay* Court was, in effect, irrelevant to the *Gay* Court's determination under Pennsylvania law, because those decisions purported to be neutral, supposedly "like *Muhammad*." A-9. To reach such a holding, the District Court literally had to ignore the part of *Gay* which expressly held that the Pennsylvania decisions *were* hostile to arbitration, in contravention of the FAA. *See Gay,* 511 F.3d at 394-95. And not only did the District Court have to ignore what *Gay* states is the basis for its Pennsylvania law conclusion, but the District Court also had to ignore the indisputable fact that the Pennsylvania decisions, on their face, *are* impermissibly hostile to arbitration.

In *Lytle*, in a move that would be certain to provoke any federal court, the state court concluded -- *notwithstanding federal law to the contrary* (including Supreme Court precedent and the Third Circuit ruling in *Johnson, supra*) -- that the relevant arbitration agreement was improper under Pennsylvania law because it purportedly reserved only to the creditor but not the consumer the right to proceed in court rather than arbitration. 810 A.2d at 665 n.13.[11] In fact, notwithstanding its

[11] The *Lytle* arbitration agreement excluded foreclosure actions and matters involving less than $15,000 in aggregate damages from arbitration. 810 A.2d at 650. Such carve-outs, however, clearly are allowed under federal law including, *inter alia,* under *Volt*. *See* 489 U.S. at 478.

rejection of controlling federal law, the *Lytle* court remanded the case to allow the defendant "an opportunity to establish, if it can, an unavoidable 'business reality' which precludes its use of the arbitration forum." 810 A.2d at 665. But reaching a ruling under Pennsylvania law that is concededly contrary to controlling federal decisions is a sure ticket to the losing side of the FAA neutrality analysis.[12]

Impermissible hostility to arbitration was equally self-evident in *Thibodeau*, which held a class waiver to be unconscionable and upheld an order denying a petition to compel arbitration without regard to the issue whether the waiver was severable. 912 A.2d 874. Specifically with respect to the class waiver issue, the *Thibodeau* court affirmatively and *impermissibly* concluded that the arbitration forum was *inappropriate* for the determination of the propriety of class certification, and that "control of class action litigation is also of such public importance that the proper referral to class arbitration occurs *only after a Court determines whether certification is proper*." 912 A.2d at 882 (emphasis added).

In no possible fashion could the hostility to arbitration and controlling federal case law evidenced in *Lytle* and *Thibodeau* allow those decisions to be viewed the same as *Muhammad*, which is expressly based in part on New Jersey

[12] In *Zimmer v. CooperNeff Advisors, Inc.*, 523 F.3d 224, 230-31 (3d Cir. 2008), this Court recently observed that the Pennsylvania Supreme Court has now expressly abrogated the *Lytle* unconscionability analysis regarding the court carve-outs in arbitration agreements. The Pennsylvania Supreme Court, in other words, agrees with *Gay* regarding *Lytle*.

policy *favoring* arbitration, and is fastidiously neutral to arbitration in its analysis. The District Court's conclusion to the contrary is erroneous.[13]

### 3. *Gay*'s Reference to "Parsing" the Arbitration Agreement Cannot Apply to the Arbitration Agreement Here, which Expressly Contemplates that Each of Its Separate Provisions Can and Will be "Parsed"

Based on language in *Gay* that a "finding that the arbitration provisions in [the Pennsylvania state] cases are unconscionable can be reached only by parsing the provisions themselves to determine what they provide," *see* 511 F.3d at 395, the District Court concluded that, under *Gay*, the need to "pars[e] the provisions themselves to determine what they provide" "appears to be enough to indicate that the New Jersey Supreme Court treats arbitration agreements differently from other contract provisions." A-10.

The quoted "parsing" language from *Gay* is perhaps the most overbroad and delphic statement in the decision, and it is not precisely clear what Judge Greenberg meant by it. In context, it seems to refer to the failure of the Pennsylvania courts to treat arbitration agreements "on the same footing" as other agreements. On the other hand, the "parsing" language is not necessary to any of

[13] In *Lowden*, the Ninth Circuit read *Gay's* discussion of the Pennsylvania cases consistently with Plaintiffs' reading advocated herein, and distinguished the Pennsylvania cases from Washington law: "Unlike the Third Circuit's conclusion as to the applicable state law in *Gay*, we determine that the Washington Supreme Court in *Scott* does not hold 'that an agreement to arbitrate may be unconscionable simply because it is an agreement to arbitrate.'" 512 F.3d at 1221 n.3.

the *Gay* Court's analysis with respect to Pennsylvania law, and in this respect is truly *dicta* to the Pennsylvania *dicta*.

Furthermore, it could not possibly be contrary to the FAA to parse the individual provisions of Defendant's arbitration agreement *in this case* – because as noted in the Statement of Facts, *supra,* the arbitration agreement expressly contemplates that the enforceability of the class waiver and the other provisions of the arbitration agreement may be separately considered (and, at least with respect to the provisions other than the class waiver, severed if determined to be unenforceable).[14]

As in *Volt,* nothing under the FAA prohibits the arbitration agreement and its various provisions from being analyzed and enforced (or not) according to the agreement's express terms, including its severability terms. The District Court's suggestion that merely examining the provisions of the arbitration agreement runs afoul of the FAA, or that *Gay* necessarily requires such an outcome *in this case,* is legally erroneous.[15]

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[14] In addition to the class waiver provision expressly contemplating that its enforceability may be considered under state law, the customer agreement also expressly provides: "If any part of this agreement, *including any part of the arbitration provisions,* is held invalid, that part may be severed from this agreement" (A-55, A-72) (emphasis added).

[15] In *Lowden,* the Ninth Circuit expressly rejected T-Mobile's analogous contention that the FAA precludes an examination of the enforceability of the class waiver merely because it is included in the arbitration agreement, and held that

### 4. In Any Event, *Gay* Must Be Read Narrowly to Avoid Running Afoul of Third Circuit Internal Operating Procedure 9.1

Finally, if the Court still is not totally convinced that the District Court erred in holding that *Gay* must control the outcome here and that *Gay* requires finding that *Muhammad* is preempted under the FAA, then the Court's own internal operating procedures require *Gay* to be read narrowly to avoid a direct conflict with prior Third Circuit decisions to the contrary. Specifically, Third Circuit Internal Operating Rule 9.1 provides as follows:

> **Policy of Avoiding Intra-Circuit Conflict of Precedent.**
>
> It is the tradition of this court that the holding of a panel in a precedential panel is binding on subsequent panels. Thus, no subsequent panel overrules the holding in a precedential opinion of a previous panel. Court en banc consideration is required to do so.

To read *Gay* as precluding an unconscionability analysis of the enforceability of an arbitration provision under generally applicable state contract

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such a conclusion would violate the requirement under the FAA that arbitration agreements be placed on "equal footing" with non-arbitration agreements – no better, and no worse. 512 F. 3d at 1222. The Ninth Circuit's conclusion is clearly correct under controlling Supreme Court precedent, and provides additional justification for rejecting the District Court's overbroad reading of the "parsing" language in *Gay*.

Similarly, in the recent decision of this Court in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Clemente*, the panel – including Judge Greenberg – expressly considered the unconscionability of the fee shifting provision of the rules incorporated by the pertinent arbitration agreement under New Jersey law, without any suggestion that "parsing" this separate provision somehow violated the FAA. 272 Fed. Appx. at 177-78, 2008 WL 857756 at *3.

law would directly conflict with all of the earlier decisions of this Court which expressly allow such an analysis under the FAA. *E.g.*, *Harris*, *supra; Parilla*, *supra; Alexander*, *supra; Delta Funding*, *supra.* Indeed, to read *Gay* as the District Court did would conflict with *Gay* itself, which engaged in an unconscionability analysis under both Virginia and Pennsylvania law, while expressly observing that such an analysis is allowed under Supreme Court precedent, including *Doctor's Assocs.* *See* 511 F.3d at 388, 391-95. This Court should be naturally hesitant to presume such "cognitive dissonance" on the part of the *Gay* panel.

Similarly, reading *Gay* to preclude any analysis or "parsing" of the separate provisions of an arbitration agreement under the FAA would run afoul of Third Circuit decisions expressly holding that the severability of such provisions is governed by general state law principles. *E.g.*, *Delta Funding*, 426 F.3d at 675 (certifying unconscionability and severability questions to New Jersey Supreme Court); *Alexander*, 341 F.3d at 270-71 (declining to apply severance and holding entire arbitration agreement unconscionable and unenforceable under law of Virgin Islands); *Spinetti*, 324 F.3d at 219 (holding fee provision unenforceable and severable under Pennsylvania law even though no express severability provision in agreement).

Under Third Circuit decisions interpreting the application of Internal Operating Procedure 9.1, a decision must be read narrowly or as *dicta* to avoid

overruling a prior precedential opinion. *E.g., U.S. v. Parker*, 462 F.3d 273, 277 n.4 (3d Cir. 2006); *U.S. v. Monaco*, 23 F.3d 793, 803 (3d Cir. 1994). Such a result should obtain here as well -- if the Court does not otherwise conclude that *Gay* is distinguishable, and that the District Court's failure to distinguish *Gay* is legally erroneous.

## II. THERE IS NO LEGAL SUPPORT FOR DEFENDANT'S "SUBSTANTIVE UNCONSCIONABILITY" ARGUMENT RAISED IN THE DISTRICT COURT

As noted in the Statement of the Case, *supra*, Defendant's Petition asserted two separate grounds: (i) first, that *Muhammad* is predicated on an impermissible hostility to arbitration agreements, in contravention of the FAA; and (ii) that, under the FAA, a state law unconscionability defense to an arbitration agreement is limited solely to "procedural unconscionability," and not the "substantive unconscionability" prong also applied by New Jersey courts, including the New Jersey Supreme Court in *Muhammad* as part of its unconscionability analysis striking down the *Muhammad* class waiver under general contract law.

Plaintiffs have thoroughly addressed the purported hostility of *Muhammad*, and are confident that this Court will recognize *Muhammad* as the neutral, non-hostile, pro-arbitration, application of the general state contract law of unconscionability that it is.

As for Defendant's alternate argument, it remains to be seen whether Defendant will continue to press it on appeal in light of how the District Court ruled, and why. Nevertheless, at this point, suffice to say that there is not a single case out there (including *Gay*) which has held what Defendant argued. Instead, *all* courts have applied both the procedural and substantive unconscionability prongs of a generally applicable state contract law unconscionability analysis under the FAA – including substantial controlling Third Circuit authority. *See, e.g., Gay, supra* (evaluating substantive unconscionability of class waiver under Virginia and Pennsylvania state law); *Delta Funding Corp.,* 426 F.3d at 674-75 (certifying case to N.J. Supreme Court to consider, *inter alia,* Harris' substantive unconscionability arguments); *Parilla*, 368 F.3d 269 (finding certain provisions of an arbitration clause substantively unconscionable); *Alexander*, 341 F.3d at 264-265 (applying substantive unconscionability to find arbitration clause unconscionable); *Harris*, 183 F.3d 173 (applying both procedural and substantive unconscionability under FAA but finding against unconscionability).

In fact, it appears that the District Court rejected Defendant's "no substantive unconscionability" argument as well. Without expressly describing Defendant's argument, the District Court did refer to Plaintiffs' response that the FAA does not preclude a state's use of "substantive unconscionability" to invalidate a class waiver in an arbitration agreement, and also noted that under

*Muhammad* "a court must consider both the procedural and the substantive unconscionability of an agreement." A-13 n.6.

Nevertheless, the District Court continued its analysis, and stated the following, A-13 n.6:

> the other factors do not indicate that the entire Agreement is substantively unconscionable under the FAA; while Verizon clearly has more bargaining power as between the two parties, Plaintiffs were free to do business with any number of cell phone companies, choose not to obtain a cell phone, or discontinue their Verizon phone service.

The quoted part of the District Court's analysis is wrong, first, because Defendant has *conceded* that the class waiver is governed by *Muhammad* and thus substantively unconscionable (A-78). Further, the unconscionability issue here relates only to the class waiver and not to the arbitration agreement as a whole, because Defendant's agreement to arbitrate rises and falls based on the enforceability of the class waiver.

Second, the three factors described by the District Court in the quoted passage relate only to the "procedural unconscionability" prong, and not "substantive unconscionability" -- which addresses such considerations as the harshness or unfairness of the challenged term and its possible impact on public policy. *See Muhammad,* 189 N.J. at 15, 19-20.

Third, the District Court ignores the fact that the class waiver was imposed by Defendant during the middle of the existing terms of Plaintiffs' contracts (Cmp.

¶¶ 9-10 (A-30)), and also ignores the substantial per-line termination fee imposed under the customer agreement for early terminations if Plaintiffs were to "discontinue their Verizon phone service" (A-51, A-69), as suggested by the District Court.

Finally, contrary to the conclusion of the District Court, every one of the major wireless phone companies includes a class waiver in its standard form contract, so doing business with a different company will not avoid the potential unconscionability issue – there are no alternatives. *E.g.*, *Lowden*, *supra* (T-Mobile class waiver unconscionable under Washington law); *Shroyer*, *supra* (Cingular-ATT class waiver unconscionable under California law). As for Sprint, Plaintiffs' counsel currently is counsel to a New York class in an arbitration against Sprint pending in the JAMS arbitration forum where Plaintiffs' counsel had to seek an order compelling Sprint to arbitrate pursuant to FAA § 4 when Sprint ran to state court to try to circumvent the ongoing arbitration after the arbitrator first ruled against Sprint with respect to the unenforceability of Sprint's class waiver under Kansas law, and then ruled against Sprint with respect the potential *res judicata* effect of a nationwide settlement Sprint tried to assert as a defense to the ongoing class arbitration. *See Emilio v. Sprint Spectrum, L.P.*, No. 08-CV-7147, 2008 WL 4865050 (S.D.N.Y. Nov. 5. 2008) and exhibits filed therein.

Cingular-ATT, T-Mobile, Sprint and Defendant – there is no other major dependable wireless provider. And contrary to the suggestion of the District Court, wireless communications in today's society are a necessity, not a luxury that can be done without. That is why Defendant, alone, has more than 60 million subscriber lines.

In any event, Defendant has tacitly conceded by its unconscionability argument in the District Court that courts *can* engage in some form of state law unconscionability analysis without running afoul of the FAA. The great weight of controlling case law, both within and without this Circuit, mandates such a conclusion.

## CONCLUSION

The District Court erred in holding that *Muhammad* is preempted by the FAA, and that the District Court's conclusion in this regard was controlled by *Gay*. For all of the reasons stated herein, the Opinion and Order of the District Court must be reversed, and the case remanded to the District Court for further proceedings on the merits.

Dated: January 6, 2009

Respectfully submitted,

SANFORD WITTELS & HEISLER, LLP

By: /s/ William R. Weinstein
William R. Weinstein
950 Third Avenue, 10th Floor
New York, NY 10022
(646) 723-2947

ATTORNEYS FOR PLAINTIFFS-APPELLANTS

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The undersigned hereby certifies that:

1. I am admitted to and in good standing with the United States Court of Appeals for the Third Circuit.

2. This brief complies with the type-volume limitation of Rule 32(a)(7)(B) of the Federal Rules of Appellate Procedure because it contains 12,906 words, excluding the parts of the brief exempted by Rule 32(a)(7(B)(iii).

3. This brief complies with the typeface requirements of Rule 32(a)(5) and the type style requirements of Rule 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word 2003 in Times New Roman 14-point font.

Dated: January 6, 2009

SANFORD WITTELS & HEISLER, LLP

By: /s/ William R. Weinstein
William R. Weinstein
950 Third Avenue, 10th Floor
New York, NY 10022
(646) 723-2947

ATTORNEYS FOR PLAINTIFFS-APPELLANTS

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I, Jacqueline Gordon, hereby certify that:

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**LITMAN V. CELLCO PARTNERSHIP**

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Andrew G. McBride, Esq.
Elbert Lin, Esq.
Wiley Rein LLP
1776 K Street NW
Washington, DC 20006
(202) 719-7000

Philip R. Sellinger, Esq.
Todd L. Schleifstein, Esq.
Greenberg Traurig, LLP
200 Park Avenue
Florham Park, New Jersey 07932
(973) 360-7900

*Attorneys for Appellee*

I also certify that the original brief and nine copies were also shipped via Federal Express (Overnight) delivery to:

Clerk of Court
United States Court of Appeals, Third Circuit
United States Courthouse Independence Mall West
601 Market Street
Philadelphia, Pennsylvania 19106
(215) 597-2995

on this 7th day of January 2009.

/s/ Jacqueline Gordon
Jacqueline Gordon

# JOINT APPENDIX
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**UNITED STATES DISTRICT COURT**
**DISTRICT OF NEW JERSEY**

| | | |
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| LITMAN, et al., Plaintiffs, v. CELLCO PARTNERSHIP d/b/a VERIZON WIRELESS, Defendant. | : | Civil Action No.: 07-CV-4886(FLW) **OPINION** |

**WOLFSON, United States District Judge:**

Plaintiffs Keith Litman and Robert Wachtel (collectively "Plaintiffs"), Verizon customers since at least 2004, bring this class action lawsuit against Defendant Cellco Partnership d/b/a Verizon Wireless ("Defendant" or "Verizon") alleging Defendant improperly imposed an administrative charge on their cellular telephone accounts. In accordance with the Customer Agreements between the Plaintiffs and Verizon, which included arbitration provisions, Defendant files the current Motion to Compel Arbitration in lieu of an Answer.[1] Plaintiffs argue that the arbitration provisions' preclusion of class arbitration should be invalidated because they are unconscionable under New Jersey law. On the other hand, Defendant claims that the Federal Arbitration Act ("FAA"), as interpreted by the Third Circuit, preempts New Jersey law. For the reasons discussed below, the Court finds that the arbitration agreement is enforceable and Defendant's Motion to Compel Arbitration is granted.

[1]Defendant simultaneously files a Motion to Dismiss Plaintiffs' claims. Having determined that the parties must arbitrate their claims, this case is dismissed, and the separate Motion to Dismiss is moot.

**I. Factual Background and Procedural History**

The Court will only recount facts relevant for the purpose of this motion. On October 9, 2007, Plaintiffs filed this suit against Verizon on behalf of other similarly situated Verizon customers claiming that they were unlawfully charged an "administrative charge" of $0.40 and/ or $0.70, as part of the monthly charges for each of their Verizon phone lines. Complaint ("Compl.") ¶ 1. Verizon provides wireless communication services to over 60 million customers and telephone lines nationally. Id. ¶ 8(b). Plaintiffs allege that at the time they became Verizon customers and entered into their fixed price contracts with Verizon, Verizon did not charge an administrative charge and nothing in the service agreements specifically authorized Verizon to add such a charge. Id. ¶ 21(a). Plaintiffs, however, allege that in October 2005, Defendant unilaterally decided to assess an administrative charge to all customers and informed all customers of this change with a standard notice form. Id. ¶ 21(b).

Plaintiffs have been Verizon customers since at least 2004 and concede that, prior to January 2005, Verizon used a standard customer agreement ("Agreement") with an arbitration provision. Id. ¶ 9.[2] The Agreement required Plaintiffs and Verizon "TO SETTLE DISPUTES (EXCEPT CERTAIN SMALL CLAIMS) ONLY BY ARBITRATION." Defendant's Motion to Compel Arbitration ("Def. Mot.") Ex. A, CA-7; D, 12 (emphasis in original). Plaintiffs allege

[2]Defendant claims that the November 2006 Agreement governs Litman's Verizon account and the September 2007 Agreement governs Wachtel's Verizon account. Defendant's Motion to Compel Arbitration ("Def. Mot.") Ex. A, D. While Plaintiffs state that"Defendant needlessly confuses the question of what version of Verizon's Agreements control each Plaintiff's account and when," Plaintiffs agree that their continued use of Verizon's services made the revised Agreements effective. Plaintiffs' Brief in Opposition to Defendant's Petition to Compel Arbitration ("Pl. Opp.") at 2 n. 2. Because Verizon's customer service agreements have the same language regarding arbitration, FAA applicability, and the class arbitration waiver, they are addressed as one, "the Agreement," in this Opinion.

that, in January 2005, Verizon "adhesively" modified the Agreement's arbitration provision. Id. ¶¶ 9, 10. The modification stated that the "THE FEDERAL ARBITRATION ACT APPLIES TO TH[E] AGREEMENT" and that the Agreement "DOESN'T PERMIT CLASS ARBITRATION." Def. Mot. at Ex. A, CA-8; D, 12 (emphasis in original). This revised Agreement also states that "IF FOR SOME REASON THE PROHIBITION ON CLASS ARBITRATIONS . . . IS DEEMED UNENFORCEABLE, THEN THE AGREEMENT TO ARBITRATE WILL NOT APPLY." Id. at Ex. A, CA-9 (emphasis in original).

In accordance with the Agreement's arbitration provision, Verizon has moved to compel Plaintiffs to individually arbitrate their claims, consistent with the requirements of the Federal Arbitration Act ("FAA"). In response, Plaintiffs argue that because the New Jersey Supreme Court, in Muhammad v. County Bank of Rehoboth Beach, Del., 189 N.J. 1 (2006), has held that an arbitration provision in a consumer contract of adhesion that precludes class arbitration of low-value claims is unconscionable under New Jersey law, similarly, the arbitration provision in their Agreement is unenforceable. On the other hand, while the parties agree that Plaintiffs may proceed with this lawsuit if Muhammad controls, Defendant contends that, for a number of reasons, Muhammad is preempted by the FAA, the class arbitration waiver is valid, and Plaintiffs must arbitrate their claims individually. This Court agrees.

## II. Discussion

### A. The Federal Arbitration Act ("FAA")

"[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." AT&T Tech., Inc. v. Communications Workers of Am., 475 U.S. 643, 648 (1986) (citations omitted); see also

Laborers' Int'l Union of N. Am. v. Foster Wheeler Corp., 868 F.2d 573, 576 (3d Cir. 1989) (per curiam). "The question whether the parties have submitted a particular dispute to arbitration . . . is an issue for judicial determination unless the parties clearly and unmistakably provide otherwise." Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79, 83 (2002) (internal quotations and citations omitted); see also Laborers' Int'l Union of N. Am., 868 F.2d at 576. The court does not consider the merits of the claim, but "decides only whether there was an agreement to arbitrate, and if so, whether the agreement is valid." Great W. Mortgage Corp. v. Peacock, 110 F.3d 222, 228 (3d Cir. 1996) (citing 9 U.S.C. § 2). If the court finds there is an agreement to arbitrate, the disposition of the merits is left to the arbitrator. Id. The Third Circuit has set forth a two-prong inquiry for courts to use when determining whether to compel arbitration. Under this two-prong test, the questions posed are: "(1) Did the parties seeking or resisting arbitration enter into a valid arbitration agreement? (2) Does the dispute between those parties fall within the language of the arbitration agreement?" John Hancock Mut. Life Ins. Co. v. Olick, 151 F.3d 132, 137 (3d Cir. 1998) (citations omitted).

With respect to the first prong, "[f]ederal law determines whether an issue governed by the FAA is referable to arbitration." Harris v. Green Tree Fin. Corp.. 183 F.3d 173, 178 (3d Cir. 1999). Similarly, the interpretation and construction of arbitration agreements is determined by reference to federal substantive law. See Id. at 179; see also Moses H. Cone Mem'l Hosp. v. Mercury Const. Corp., 460 U.S. 1, 25 n. 32 (1983). While federal law is used to interpret such agreements, state law may be applied, pursuant to § 2 of the FAA. Harris, 183 F.3d at 179. Section 2 of the FAA provides that arbitration agreements are "valid, irrevocable, and enforceable save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The FAA was implemented "to reverse the longstanding judicial

hostility to arbitration agreements that had existed at English common law and had been adopted by American courts, and to place arbitration agreements upon the same footing as other contracts." Gay v. CreditInform, 511 F.3d 369, 378 (3d Cir. 2007) (quoting Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 24 (1991)). As such, the FAA creates a "strong presumption in favor of arbitration, and doubts 'concerning the scope of arbitrable issues should be resolved in favor of arbitration.'" Great W. Mortg. Corp. v. Peacock, 110 F.3d 222, 228 (3d Cir. 1997) (quoting Moses H. Cone Mem'l Hosp., 460 U.S. at 24-25). Nonetheless, "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." Doctor's Assoc., Inc. v. Casarotto, 517 U.S. 681, 687 (1996). "The party challenging a contract provision as unconscionable generally bears the burden of proving unconscionability." Harris, 183 F.3d at 181.

The Third Circuit has recently reaffirmed that "[t]he text of § 2 provides the touchstone for choosing between state-law principles and the principles of federal common law envisioned by the passage of the FAA: An agreement to arbitrate is valid, irrevocable, and enforceable, as a matter of federal law, 'save upon such grounds as exist at law or in equity for the revocation of any contract.'" Gay, 511 F.3d 369 at 394 (quoting Perry v. Thomas, 482 U.S. 483, 492 n. 9 (1987)) (emphasis in original). "[S]tate law, whether of legislative or judicial origin, is applicable if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." Id. In Perry, the Supreme Court found:

> A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of § 2. A court may not, then, in assessing the rights of litigants to enforce an arbitration agreement, construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law. Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what we hold today the state legislature cannot.

483 U.S. at 492 n. 9 (internal citations omitted). Confirming that the "FAA reflects a liberal federal policy favoring arbitration agreements," the Third Circuit, in addressing class action waivers in arbitration agreements, held that "whatever the benefits of class actions, the FAA requires piecemeal resolution when necessary to give effect to an arbitration agreement." Gay, 511 F.3d at 394 (internal citations and quotations omitted) (emphasis in original). Therefore, the Third Circuit has found that class action waivers in arbitration agreements are not per se unconscionable, but rather are valid, irrevocable, and enforceable under 9 U.S.C. § 2. Id.

The second part of the two-prong test requires the Court to determine if the dispute between the parties falls within the language of the arbitration agreement. See John Hancock Mut. Life Ins. Co., 151 F.3d at 137. Because Plaintiffs do not dispute that the Agreement's arbitration provision, if valid, applies to them, the Court need not conduct an in-depth analysis of this second question.

**B. The FAA Requires Enforcement of the Arbitration Agreement**

Although the FAA requires enforcement of valid arbitration agreements that include class action waivers, nonetheless Plaintiffs argue that the Agreement's arbitration clause is unenforceable because its class arbitration waiver renders it unconscionable pursuant to Muhammad. In Muhammad, the New Jersey Supreme Court held that, under state law, class arbitration waivers may be unconscionable and unenforceable when they are in an arbitration agreement that is part of a consumer contract of adhesion. 189 N.J. at 6-7. Muhammad was a customer of a payday loan company who received a short-term unsecured loan. Id. at 7. She brought suit on behalf of herself and other consumers similarly situated claiming that the terms

of the loan violated the New Jersey Consumer Fraud Act ("CFA"). Id. at 6. The parties' agreement included an arbitration provision requiring all disputes to be "resolved by binding individual (and not class) arbitration," and that the plaintiff "not bring, join or participate in any class action as to any claim, dispute or controversy [the plaintiff] may have." Id. at 8. First, the Court separated these two clauses and only examined the class arbitration clause, leaving the validity of the rest of the agreement to be determined by the arbitrator. Id. at 9-10. Next, the Court determined that the arbitration agreement was part of a contract of adhesion and therefore had some element of procedural unconscionability. Id. at 15. Finally, the Court found that the arbitration clause acted as an exculpatory clause in cases where claims were likely to be of low-value. Id. at 20.

In Muhammad, the Court distinguished its case from Gras v. Associates First Capital Co., 346 N.J.Super. 42 (2001), cert. denied, 171 N.J. 445 (2002), which held that class action waivers in arbitration agreements are not per se unconscionable. Instead, the Court observed what it declared to be a crucial factual distinction, which merited a different result: "Gras, however, did not present the precise issue before the Court in this matter: whether the small amount of damages being pursued is this action involving complicated financial arrangements and multiple out-of-state entities effectively prevents plaintiffs from being able to vindicate the public interests protected by the CFA." Id. at 22.[3] Thus, the Court held that the class arbitration waiver at issue, which barred class arbitration in obviously low-value claims, acted as an exculpatory clause and, hence, was unconscionable and unenforceable under state law despite New Jersey's public policy favoring arbitration. See Id. at 20-23. As a result, here, where the Plaintiffs'

[3]The New Jersey Supreme Court's ruling arguably makes all class arbitration waivers in consumer contracts involving low-value claims per se unconscionable and unenforceable.

claims involve low-dollar value consumer claims, both parties agree that the Agreement's class arbitration waiver clause is unconscionable under New Jersey law. However, Defendant argues that Muhammad's holding is inconsistent with, and therefore preempted by, the FAA. Moreover, Verizon cites the Third Circuit's recent decision in Gay v. CreditInform, 511 F.3d 369, 378 (3d Cir. 2007), as further and definitive support for that proposition. On the other hand, if Muhammad controls, the parties agree that Plaintiffs may proceed with this lawsuit, as opposed to pursing its class action in arbitration. See Pl. Opp. at 3; Df. Mot. at 9. Therefore, the issue before this Court is whether the FAA preempts the holding of Muhammad here.

The Third Circuit addressed this precise issue in Gay, where the court held that a state law determination that precludes, on unconscionability grounds, enforcement of an agreement to arbitrate low-value consumer claims on an individual basis is preempted by the FAA. 511 F.3d 369. In Gay, even though two Pennsylvania lower state court cases, Lytle v. Citifinancial Services, Inc., 810 A.2d 643 (Pa. 2002) and Thibodeau v. Comcast Corp., 912 A.2d 874 (Pa. 2006), supported the plaintiff's argument that the class arbitration waiver was unenforceable, the Third Circuit noted it was neither bound by these lower state court decisions, nor would it be bound even if they were Pennsylvania Supreme Court cases, because the Circuit was bound by "federal law that Congress set forth in the FAA" and state law "must conform with it." Id. at 393-94 n. 18. In that connection, the Circuit held that class waivers in arbitration agreements are "valid, irrevocable, and enforceable" under the FAA notwithstanding state law to the contrary. Id. at 394. Specifically, the court in Gay held "[t]o the extent, then, that Lytle and Thibodeau hold that the inclusion of a waiver of the right to bring judicial class actions in an arbitration agreement constitutes an unconscionable contract, they are not based 'upon such grounds as exist at law or in equity for the revocation of any contract' pursuant to § 2 of the FAA, and

therefore cannot prevent the enforcement of the arbitration provision in this case." Id. (citing 9 U.S.C. § 2). The Third Circuit applied the language of § 2 to class arbitration waivers and rejected the claim that such waivers are unconscionable. See Id. at 395. Instead, the Third Circuit held that the Commerce and Supremacy Clauses of the United States Constitution require the application of the FAA and the FAA strongly favors upholding arbitration agreements. Id. (citing U.S. Const., Art I, § 8 cl. 3; IV, cl. 2). Thus, the Circuit left very little room for this Court to invalidate an arbitration clause on the basis of a class waiver provision, even if it is unconscionable under state law.

That would seem to end the analysis here, but Plaintiffs argue that Gay does not require this Court to find that the FAA preempts Muhammad. Plaintiffs contend that the cases discussed in Gay, namely Lytle and Thibodeau, are distinguishable from Muhammad because Muhammad is "entirely neutral with respect to arbitration agreements," as the Court rejected class-litigation waivers generally, not just class-arbitration waivers; that the New Jersey Supreme Court decided Muhammad on general contract principles and did not demonstrate hostility to the arbitral forum, whereas the two Pennsylvania state cases found that an agreement to arbitrate may be per se unconscionable. See Gay, 511 F.3d at 395; Muhammad, 189 N.J. at 22. That distinction does not hold water. "A court may not . . . in assessing the rights of litigants to enforce an arbitration agreement, construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law." Perry, 482 U.S. at 492. However, in Muhammad, the New Jersey Supreme Court only looked at a class arbitration waiver and did not look at broad class action waivers; the Court said:

> In this matter . . . there are two types of class-action waivers in the contracts Muhammad signed: the class-arbitration waivers and the broad class-action waivers. The broad class-action waivers could be considered distinct from the arbitration agreement in the

> contracts, and thus could be considered part of the 'contract as a whole.' . . . That situation is not before us, however, because there are distinct class-arbitration waivers, . . . [which] based on their location and subject matter[] are part of the arbitration agreements, and not part of the contracts as a whole.

Id. at 14. Further, although the Court, in Muhammad, stated that "[a]s a matter of generally applicable state contract law, it was unconscionable for defendants to deprive Muhammad of the mechanism of a class-wide action, whether in arbitration or in court litigation," Id. at 22, nonetheless, the Court was not considering the validity of the broad class action waiver and considered the arbitration agreement separate from the contract. Thus, the Court's mention of "class-wide . . . in court litigation" is dicta. Id. Nevertheless, even if the Muhammad Court intended to rule that all class-action waivers of this nature were unconscionable, our conclusion would be the same because, in Thibodeau, the Pennsylvania court similarly held that "[t]he preclusion of class wide litigation or class wide arbitration of consumer claims, imposed in a contract of adhesion, [wa]s unconscionable and unenforceable." See Thibodeau, 912 A.2d at 886. The Third Circuit found that the FAA preempted this state law interpretation, despite the fact that the state court purported to reject the waiver of class treatment in general and not just in the context of arbitration clauses.

In Gay, the Third Circuit specifically addressed the issue of a seemingly neutral holding involving an arbitration agreement "written ostensibly to apply general principles of contract law" and ruled that "[a] finding that the arbitration provisions in [the Pennsylvania state] cases are unconscionable can be reached only by parsing the provisions themselves to determine what they provide." 511 F.3d at 395. The same can be said of the finding in Muhammad, as the New Jersey Supreme Court had to "pars[e] the provisions themselves to determine what they provide." Id. Under Gay, this appears to be enough to indicate that the New Jersey Supreme Court treats arbitration agreements differently from other contract provisions. Just as the Circuit

noted in Gay, the Plaintiffs here rely on the effect of the arbitration provisions to frame their unconscionability arguments: they "contend that the provision is unconscionable because of what it provides, i.e., arbitration of disputes on an individual basis in place of litigation possibly brought on a class action basis." Id. Thus, this Court is not persuaded by Plaintiffs' arguments that Muhammad is distinguishable from Lytle and Thibodeau such that this case is not subject to the holding in Gay that the federal law Congress set forth in the FAA "is controlling and the [state] law must conform with it." Id. at 393. Rather, I find that the facts of Gay itself belie the distinction Plaintiffs attempt to draw.

Plaintiffs also contend that the Pennsylvania state decisions did not set "definitive [state] precedent" binding the Third Circuit because Lytle, a Pennsylvania Superior Court case, was remanded for reasons related to class certification instead of the arbitration issue. The Third Circuit acknowledged that "Lytle and Thibodeau [we]re Superior Court cases and thus even if [the Third Circuit] were concerned with pure state law they would not bind [the Third Circuit]," but it further stated "that even if they were Pennsylvania Supreme Court cases [the] result would [have been] the same." Id. at 394 n. 18 (citation omitted) (emphasis added). Similarly, Muhammad does not bind this Court, since the issue here is the FAA, a federal law, and "[New Jersey] law must conform with it." Gay, 511 F.3d at 393.

It is also of no consequence that Muhammad was decided under New Jersey law whereas Lytle and Thibodeau were interpretations of Pennsylvania law. In Thibodeau, a customer brought a class action lawsuit against a cable company claiming damages, also of such a minimal value that individual claims were unlikely to be brought, caused by subscribers being charged for equipment that they did not need. See 912 A.2d at 876. The customer agreement had an arbitration clause requiring individual arbitration and the court held that an arbitration

agreement containing a class waiver, which Plaintiffs challenged, was unconscionable under Pennsylvania law. Id. at 878. Muhammad is similar to Thibodeau in its holding and its reasoning. The New Jersey Supreme Court, like the Pennsylvania courts, found that the clause acted as an exculpatory clause protecting the stronger party. See Muhammad, 189 N.J. at 6. Similarly, in the instant case, Defendant's arbitration clause acts to preclude class action in any forum and the claims in this case are also of low-value. While the holding in Muhammad, if controlling, would render Defendant's class arbitration waiver unconscionable under New Jersey law, the Third Circuit has already held that such an arbitration provision is enforceable under § 2 of the FAA. See Gay, 511 F.3d at 376. Indeed, the Circuit specifically analyzed the holdings in Lytle and Thibodeau to demonstrate why the FAA preempts state law; the Circuit concludes its discussion of the Pennsylvania cases by noting its obligation to "honor the intent of Congress" and "[i]f the reach of the FAA is to be confined then Congress and not the courts should be the body to do so." Id. at 395.[4] Applying Gay's holding, at least two courts in this circuit, in accordance with § 2 of the FAA, have compelled arbitration in cases where the facts surrounding the Agreement, arbitration clause, and class arbitration waiver are substantially similar to this case. See Weinstein v. AT&T Mobility Corp., No. 07-2880, 2008 WL 1914754 (E.D.Pa. April

[4]Plaintiffs also argue that Gay does not preempt Muhammad based on Shroyer v. New Cingular Wireless Services, Inc., 498 F.3d 976 (9th Cir. 2007), a class action involving a wireless company. See Pl. Opp. at 18. The Ninth Circuit held that "[t]he Federal Arbitration Act does not bar federal or state courts from applying generally applicable state contract law principles and refusing to enforce an unconscionable class action waiver in an arbitration clause." Shroyer, 498 F.3d at 987. While the Ninth Circuit has held that the FAA does not preempt state contract law principles invalidating class action waivers in arbitration clauses in these cases, this Court is subject to the binding precedent of the Third Circuit. See also Steiner v. Apple Computer, Inc., No. 07-4486, 2008 WL 1925197, at *3 (N.D.Cal. Apr. 29, 2008). In Gay, the Third Circuit held that the presence of a class arbitration waiver, even where it is unconscionable under state law, is not grounds for rendering an arbitration clause unenforceable. 511 F.3d at 394.

30, 2008); Halprin v. Verizon Wireless Services, LLC, No. 07-4015, 2008 WL 961239 (D.N.J. April 8, 2008).[5] Therefore, this Court too holds that, insofar as the FAA and Muhammad are inconsistent, federal law preempts the holding in Muhammad. See U.S. Const., Art IV, cl. 2.

Moreover, the Third Circuit has recently reinforced that the FAA establishes a strong federal policy in favor of resolution of disputes through arbitration and, absent fraud or misrepresentation, requires enforcement of arbitration clauses within agreements for which parties freely contract. Morales v. Sun Constructors, — F.3d —, 2008 WL 3974059, at *2-3 (3d

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[5]In Weinstein, the court denied the plaintiff's arguments regarding procedural and substantive unconscionability and granted the defendant's motion to compel arbitration; the court held that, pursuant to the Third Circuit's ruling in Gay, the FAA preempted the state court application of state law that held class waiver provisions in arbitration agreements unconscionable. See 2008 WL 1914754 at *5.

In Halprin, dealing with a challenge to the class arbitration waiver in a Verizon customer service agreement, the court compelled arbitration in accordance with Gay's holding and application of the FAA. The Halprin Court found that it "must determine that the 'contract in general' is unenforceable, not just the individual 'agreement to arbitrate'" to invalidate a contract under state law pursuant to the language of the FAA. 2008 WL 961239 at *6 (quoting Gay, 511 F.3d at 395). While the court applied Virginia state law when it declined to find the agreement unconscionable, it stated that it was "dubious that Plaintiff would prevail even under New Jersey's unconscionability rubic." Id.

Plaintiffs argue that the FAA does not preclude a state's use of substantive unconscionability to invalidate a class waiver in an arbitration agreement. As stated in Muhammad, under New Jersey law, the Court must consider both the procedural and the substantive unconscionability of an agreement. See 189 N.J. at 15. When considering this standard, the Halprin court stated: "[i]f an agreement is one of adhesion, where an agreement is 'presented on a take-it-or-leave-it basis,' then it indicates procedural unconscionability. In addition to considering the adhesive nature of a contract, the Court must also consider the subject matter of the contract, the parties' relative bargaining position, the degree of economic compulsion motivating the 'adhering' party, and the public interests affected by the contract." 2008 WL 961239 at *7 (internal citations omitted). Given the facts presented here and the Third Circuit's decision in Gay, like in Haplrin, while the Agreement between Plaintiffs and Defendant bears the qualities of an adhesion agreement, the other factors do not indicate that the entire Agreement is substantatively unconscionable under the FAA; while Verizon clearly has more bargaining power as between the two parties, Plaintiffs were free to do business with any number of cell phone companies, choose not to obtain a cell phone, or discontinue their Verizon phone service. See Id. at *6-7. Therefore, when looking at prior case law applying the FAA, this Court too finds it necessary to compel arbitration.

Cir. 2008). In Morales, the Third Circuit held that an employee, who was illiterate, was nevertheless bound by an arbitration clause in an employment agreement that he signed; "the fact that an offeree cannot read, write, speak, or understand the English language is immaterial to whether an English-language agreement the offeree executes is enforceable." Id. at *3. Rather, the court held that it was the plaintiff's obligation to ensure he understood the agreement before he signed it, even where he is ignorant of the language in which the agreement was written. See Id. at *4. Morales amply demonstrates the force of the presumption in favor of arbitration.

In this case, Plaintiffs are customers who chose Verizon as their wireless provider at least four years ago and continue to use Verizon today. They signed the customer Agreement with the arbitration clause and agreed to subsequent terms of service as added by Verizon. Plaintiffs do not allege that they did not understand the Agreement that they voluntarily entered into nor do they allege fraud or misrepresentation. The parties agreed "to settle [their] disputes . . . only by arbitration," Def.'s Mot. at Ex. A, CA-7, and the "agreement doesn't permit class arbitration." Def.'s Mot. at Ex. A, CA-8. Therefore, the FAA requires this Court to uphold the arbitration provision within Plaintiffs' service Agreement.[6] Since the arbitration clause and class arbitration waiver are valid, Plaintiffs must bring their claims against Defendant through individual

[6]The Court recognizes the many hardships visited upon plaintiffs, such as in this case, based upon this ruling. First, it creates the opportunity for a different result depending on whether the case is brought in federal or state court. Second, it is also clear that compelling individual arbitration in this case will be tantamount to ending the Plaintiffs' pursuit of their claims, as there is very little possibility that these Plaintiffs or any other plaintiff will pursue individual arbitration for claims that amount only to several dollars in damages. While this outcome is harsh, this Court is bound by Third Circuit precedent. As the Gay court noted, any other ruling "could result in a significant narrowing of the application of the FAA. We express no view on whether that might be a desirable result as it is not our function to do so. Rather, our obligation is to honor the intent of Congress and that is what we are doing. If the reach of the FAA is to be confined then Congress and not the courts should be the body to do so." 511 F.3d at 395.

arbitration.

**IV. Conclusion**

For the foregoing reasons, Defendant's Motion to Compel Individual Arbitration is granted and the case is dismissed.

Dated September 29, 2008

/s/ Freda L. Wolfson
Honorable Freda L. Wolfson
United States District Judge

**UNITED STATES DISTRICT COURT**
**DISTRICT OF NEW JERSEY**

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| LITMAN, et al., Plaintiffs, v. CELLCO PARTNERSHIP d/b/a VERIZON WIRELESS, Defendant. | Civil Action No.: 07-CV-4886(FLW) **ORDER** |

**THIS MATTER** having been opened to the Court by Philip R. Sellinger, Esq., counsel for Defendant Cellco Partnership d/b/a Verizon Wireless, on a Motion to Compel Arbitration and a Motion to Dismiss; it appearing that Plaintiffs Keith Litman and Robert Wachtel, through their counsel, Steven Wittels, Esq., have opposed Defendant's Motions; the Court having reviewed the moving, opposition, and reply papers, and having considered the Motion pursuant to Fed.R.Civ.P. 78; for the reasons set forth in the Opinion filed on this date, and for good cause shown;

**IT IS** on the 29th day of September, 2008,

**ORDERED** that Defendant's Motion to Compel Arbitration is GRANTED; and it is further

**ORDERED** that Defendant's Motion to Dismiss is DENIED as MOOT; and it is further

**ORDERED** that this case is DISMISSED.

/s/ Freda L. Woflson
Honorable Freda L. Wolfson
United States District Judge

**UNITED STATES DISTRICT COURT**
**DISTRICT OF NEW JERSEY**

| | | |
|---|---|---|
| KEITH LITMAN and ROBERT WACHTEL, individually and on behalf of all others similarly situated, | : | Civil Action No. 07-CV-4886 (FLW) |
| | : | Hon. Freda L. Wolfson |
| Plaintiffs, | : | |
| vs. | : | **ECF Filed** |
| CELLCO PARTNERSHIP d/b/a/ VERIZON WIRELESS, | : | |
| Defendant. | : | |

**NOTICE OF APPEAL**

Notice is hereby given that Plaintiffs Keith Litman and Robert Wachtel, individually and on behalf of all others similarly situated, hereby appeal to the United States Court of Appeals for the Third Circuit from: (i) the Order dated September 29, 2008 and entered in the above-captioned action on September 30, 2008; and (ii) the Opinion dated September 29, 2008 and entered in the action on September 30, 2008, on which the Order is based. Plaintiffs appeal from each and every part of the Order and the Opinion in their entirety.

Dated: Fort Lee, New Jersey
October 2, 2008

SANFORD WITTELS & HEISLER, LLP

By: /s Steven L. Wittels
Steven L. Wittels (SW-8110)
440 West Street
Fort Lee, New Jersey 07024
(201) 585-5288

SANFORD WITTELS & HEISLER, LLP

William R. Weinstein
(admitted *pro hac vice*)
950 Third Avenue, 10th Floor
New York, NY 10022
(646) 723-2947

ATTORNEYS FOR PLAINTIFFS

TO:

Philip R. Sellinger
Todd L. Schleifstein
GREENBERG TRAURIG, LLP
200 Park Avenue
Florham Park, New Jersey 07932

ATTORNEYS FOR DEFENDANTS