IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

Court of Appeals Docket 09-4200

EMMANUEL D. KEPAS, Plaintiff/Appellant, vs. **eBAY, INC.** Defendant/Appellee.	**APPELLANT'S REPLY BRIEF** **ORAL ARGUMENT NOT REQUESTED**

Appeal from the United States District Court, District of Utah, Central Division
Honorable Dee Benson

2:06-cv-00612-DB

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REPLY REGARDING STANDARD OF REVIEW

eBay does not dispute that the standard of review regarding the validity and scope of a contract is *de novo*. In addition, however, eBay cites to an unpublished California decision that purports to provide a separate abuse of discretion standard "regarding the severability or limitation of a contractual provision." eBay Brief at 23. The case to which eBay cites, however, has no bearing on this matter. While it is correct that the Arbitration Agreement at issue here is to be interpreted under California substantive law pursuant to the Arbitration Agreement, it does not follow that this Court should also apply California procedural law to the standard of review here. *See* Appx. 0060 ("This Agreement shall be governed by and shall be interpreted in accordance with the laws of the State of California.")

Furthermore, eBay's point regarding the abuse of discretion standard of review is not supported by the case law to which it cites. The reasoning in the case, and the case to which the unpublished case cites, derives from the decision in *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669; 99 Cal. Rptr. 2d 745 (Cal. 2000). In *Armendariz*, the trial court voided an arbitration agreement rather than sever the offending provisions. The court of appeals then found the agreement at issue to be unconscionable, but decided to sever the offending provisions rather than find the entire

agreement to be invalid. 99 Cal. Rptr.2d at 751. The California Supreme Court then reversed the court of appeals, finding that the agreement should have been found to be invalid. The *Armendariz* decision does not specifically provide a standard of review. Furthermore, it engages in a lengthy discussion of the reasons why the agreement at issue in that case is unconscionable, and therefore it appears to be relying on its own *de novo* review rather than an abuse of discretion standard.

REPLY ARGUMENT

The Arbitration Agreement at issue in this case is not bilateral, and contains several unconscionable provisions. Moreover, unconscionability permeates the Agreement. These are precisely the factors that California has determined indicate that an arbitration agreement should not be enforced. *Armendariz v. Foundation Health Psychcare Servs., Inc.,* 99 Cal. Rptr. 2d at 772 (Cal. 2000). Accordingly, the district court erred in this case by attempting to reform the contract at issue here by rewriting it rather than invalidating it.

In response to Kepas' Opening Brief, eBay argues generally that the Arbitration Agreement at issue here meets the five requirements of *Armendariz*, and that it is neither procedurally nor substantively unconscionable. To the extent that any of the Agreement's provisions are

unconscionable, eBay argues that they are severable from the Agreement. As explained below, Kepas disputes each of these points.

As an initial matter, eBay's first point raised in its brief – that "arbitration is a highly favored means of dispute resolution" – merits a clarification. *See* Brief of Appellee ("eBay Brief") at 24.[1] The California Supreme Court states that

> Code of Civil Procedure section 1281 makes clear that an arbitration agreement is to be rescinded on the same grounds as other contracts or contract terms. In this respect, arbitration agreements are neither favored nor disfavored, but simply placed on an equal footing with other contracts.

Armendariz, at 776-777. Thus, when determining whether the unconscionability of certain provisions in the Arbitration Agreement here render the Agreement unenforceable, there is no presumption in favor of arbitrability to overcome.

I. The Agreement Does not Satisfy the *Armendariz* Requirements

Kepas argued in his Opening Brief that the Agreement here does not meet the requirement articulated in *Armendariz* that an arbitration agreement "not require employees to pay either unreasonable costs or any arbitrators' fees or expenses as a condition of access to the arbitration forum." Opening

[1] Cites herein to the page numbers of eBay's Brief will refer to the page number created by the electronic filing system, in the upper right corner of the page, as opposed to the page number printed at the bottom of the page.

Brief at 17. Kepas' argument is based upon the language in the Agreement that provides that the arbitrator can award:

> any type of legal or equitable relief that would be available in a court of competent jurisdiction including, but not limited to, the costs of arbitration, attorneys' fees and punitive damages, when such damages and fees are available under the applicable statute and/or applicable authority.

Appx. 0059-60. Because this language indicates that an employee could be held responsible for paying all of the costs of arbitration, which may be significantly higher than the costs of court[2], this provision in the Agreement does not meet the *Armendariz* requirement.

eBay responds that the "Agreement is not susceptible to Kepas' strained interpretation." eBay Brief at 29. This is not just Kepas' interpretation, however. The contract specifically states that the "Employer" will pay the arbitration costs in one paragraph, and then later states that the arbitrator can order either party to pay the costs. Appx. 0059-60. As the district court noted, the "costs" are defined as "including the arbitrator's fees." Appx. 0182. When eBay's counsel stated in oral argument that "what this language I believe is intended to say is you as the employee under California law and under Armendariz can get everything in arbitration that you could get in a court of law," the district court responded, "Well that is

[2] *Armendariz* at 763.

what you want to say, but that is not necessarily what it says." Appx. 0179. The court went on to state that the language of the Agreement leaves open the possibility that an arbitrator "could make an award against the plaintiff, at the end of which the plaintiff is stuck with the arbitrator's fees. That is what they are worried about." Appx. 0180; *see also,* Appx. 0182 (court describes the language in the Agreement as "a little squishy.")

Regardless of what eBay now states its intent was in drafting the contract, on its face, the Agreement allows for the possibility that an employee could ultimately be held responsible for paying all of the costs of arbitration, to include the arbitrator's fees. "The mere inclusion of the costs provision in the arbitration agreement produces an unacceptable chilling effect," even if the employer later is willing to strike it. *Martinez v. Master Protection Corp.*, 12 Cal. Rptr. 3d 663, 671 (Cal. Ct. App. 2004).
It is the perceived "*risk* that the claimant may have to bear substantial costs that deters the exercise of the constitutional right of due process." *Armendariz* at 764. Accordingly, the Agreement here does not meet the requirements of *Armendariz* because it allows for the possibility that the employee could have to pay arbitration costs and arbitrator's fees, which violates the letter of *Armendariz* as well as its spirit, by acting as a deterrent to arbitration for the employee.

II. The Agreement is Unconscionable

A. Procedural Unconscionability

Regarding the unconscionability of the Agreement here, this "analysis begins with an inquiry into whether the contract is one of adhesion." *Armendariz* at 766-767. A contract is one of adhesion if it is presented by an employer to an employee as "an essential part of a 'take it or leave it' employment condition." *Martinez* at 669 (internal cites omitted).

eBay argues here that Kepas has not shown that the Arbitration Agreement is one of adhesion because Kepas "has never argued that he had any qualms about signing the Agreement, that he asked any questions about it (and was refused an answer), that he asked for additional time to review it (and was denied), that he asked if he could discuss it with an attorney before signing (and was denied), that he attempted to negotiate the Agreement (and was denied), or that he felt oppressed in any way in signing it." eBay Brief at 38. eBay's argument, however, assigns an incorrect burden of proof to Kepas. California case law is clear that when the language of a contract indicates that an arbitration clause is "a specific 'condition of employment,'" it is the employer's burden to show that the employee actually had some opportunity to negotiate. *Martinez* at 669. *Martinez* states: "An arbitration agreement that is an essential part of a 'take it or leave it' employment

condition, *without more*, is procedurally unconscionable." (*emphasis added)*. The fact that the arbitration agreement was part of a take it or leave it conditions creates a presumption that the contract is procedurally unconsionable. The employer then has the burden to show that the agreement did not actually mean "take it or leave it," despite such appearances.

eBay distinguishes the facts in this case from those in *Fitz v. NCR Corp*., 13 Cal. Rptr. 3d 88 (Cal Ct. App. 2004), because, for instance, the employee in *Fitz* was provided a "take it or leave it" arbitration agreement after 14 years of employment. eBay Brief at 37. This distinction is correct, but not dispositive of the issue. The court in *Armendariz* explained why arbitration agreements required at the beginning of an employment relationship are also contracts of adhesion:

> In the case of preemployment arbitration contracts, the economic pressure exerted by employers on all but the most sought-after employees may be particularly acute, for the arbitration agreement stands between the employee and necessary employment, and few employees are in a position to refuse a job because of an arbitration requirement.

Armendariz at 768; *see also, Martinez* at 669 (arbitration agreement presented to employee as a prerequisite to employment was procedurally unconscionable).

The situation at issue here is similar to that in *Martinez*, except that

the circumstances here weigh even more in favor of a finding that the arbitration agreement was a contract of adhesion because at the time he was required to sign the Agreement, Kepas had already worked for eBay as a probationary employee, with the intention of becoming permanent. eBay seems to argue that the provision in the Agreement here that stated "I understand that I would not be hired by the Employer if I did not sign this Agreement" does not mean what it says because Kepas "was hired three months *before* he was even presented with the Agreement." eBay Brief at 38. This Argument is specious, however, given that it is undisputed that Kepas was a probationary employee up until the time he was presented with the Agreement. eBay Brief, Statement of Facts, ¶ 2. Moreover, eBay's argument, if true, would mean that the statement in the Agreement was meaningless. In reality, Kepas was in precisely the same situation as the plaintiff in *Martinez*, who was required to sign an arbitration agreement in order to obtain employment, except that Kepas was more invested in his job because he had worked it for over three months already. Without any evidence that the arbitration provision was up for negotiation, it is considered by California courts to be a contract of adhesion, and therefore, procedurally unconscionable.

B. Substantive Unconscionability

If an arbitration agreement is a contract of adhesion, a court must also analyze whether it is also substantively unconscionable in order to invalidate it. *Martinez* at 668. eBay argues in its Brief that the Arbitration Agreement here is not substantively unconscionable because: the "carve out" in the Agreement for intellectual property claims is bilateral, and the forum selection clause requiring the arbitration to take place in Santa Clara County, California is reasonable. eBay Brief at 40-44. Both of these arguments are incorrect.

1. "Carve-out" Provision

"In assessing substantive unconscionability, the paramount consideration is mutuality." *Fitz v. NCR Corp.,* 13 Cal. Rptr. 3d 88, 103 (Cal. Ct. App. 2004). In his Opening Brief, Kepas argued that the Agreement here was substantively unconscionable because it does not have the "modicum of bilaterality" required to be enforceable, as eBay exempted from the Arbitration Agreement "claims that arise out of the Employee Proprietary Information and Inventions Agreement." Opening Brief at 22-23. eBay responds that because the "carve-out" provision applies to both parties, it is bilateral. eBay Brief at 40. eBay is incorrect.

eBay does not cite any case law to support its position. Rather, it

argues that Kepas "misreads the *Mercuro* case" by not pointing out that the court found that the arbitration agreement's exception for intellectual property disputes was not really bilateral because it only applied to claims that included a request for injunctive or other equitable relief, which would favor the employer. eBay Brief at 40-41. This argument is a red herring, however, as eBay ignores the clear language in *Martinez* that is directly relevant to this discussion: "claims involving trade secrets . . . typically are asserted only by employers." *Martinez v. Master Protection Corp.*, 118 Cal. App. 4th 107, 115 (Cal. Ct. App. 2004). In order for such an advantage for the employer to be conscionable, there must be a legitimate justification for it:

> As has been recognized "`unconscionability turns not only on a "one-sided" result, but also on an absence of "justification" for it.'" If the arbitration system established by the employer is indeed fair, then the employer as well as the employee should be willing to submit claims to arbitration. Without reasonable justification for this lack of mutuality, arbitration appears less as a forum for neutral dispute resolution and more as a means of maximizing employer advantage. Arbitration was not intended for this purpose.

Armendariz at 770 (internal cites omitted). An employer must either explain its justification for such an advantage in the contract itself, or "factually establish[]" the basis for it. *Armendariz* at 769, citing *Stirlen v. Supercuts, Inc.*, 51 Cal. App. 4th 1519, 1536 (Cal. Ct. App. 1997).

eBay suggests that it has met its burden of providing a justification for

the lack of bilaterality in its contract. eBay Brief at 42. eBay cites to a statement made by its counsel to the district court during the oral argument on eBay's motion to enforce the Agreement: "This agreement in its context is being used by an employer in the technology industry where there are many employees who are inventors and have inventions and want to protect their own rights . . . ." Appx. 0164. eBay's counsel did not provide any factual basis for this conclusory statement, and it is not on its face persuasive. eBay's industry, which is commonly known, is not "technology." Rather, it provides a means for people to sell goods via the internet. It is not as if it is a software development company. At any rate, presumably any company that exempts intellectual property claims from arbitration could make the same general argument – that it is in a field in which its employees may have inventions that they want to protect. Nonetheless, in any such situation, employers would have the same interest in maintaining ownership of inventions created by their employees. eBay has not met its burden of proving that it has a special need in its particular circumstance for an exception to the arbitration agreement.

Since California has recognized that trade secret claims are typically asserted by employers, eBay's unsubstantiated suggestion that its employees are more likely to claim an interest in their inventions than in other fields is

not persuasive.[3] Accordingly, the "carve-out" provision in the Agreement here is unconscionable. Moreover, when an employer requires arbitration of those claims most likely to be brought by employees, but exempts claims that it is most likely to bring against employees, California courts find that this factor weighs in favor of invalidating the agreement. *See, e.g., Fitz v. NCR Corp.*, 13 Cal. Rptr. 3d 88, 105 (Cal. Ct. App. 2004).

2. Forum Selection Clause

Regarding the issue of the forum selection clause, the Arbitration Agreement here provided that "arbitration shall be conducted in Santa Clara County." Appx. 0059. eBay argues that this provision is not unconscionable because Kepas had notice of this clause before he entered into the Agreement, and he has failed to show that by being forced to arbitrate in California, he would be "deprived of his day in court." eBay Brief at 43-44. As already explained, the Arbitration Agreement is a contract of adhesion because he did not have a realistic opportunity to negotiate its terms, so the fact that he had notice of the oppressive forum selection clause within the

[3] eBay's claim that Kepas did not challenge its "business justification" for its exclusion of claims involving the "Inventions Agreement" in district court (see eBay Brief at 42) is not true. Kepas' counsel stated during oral argument that it was eBay's burden to show that it had some legitimate justification for its carve-out provision, and noted that this burden was not met because "[i]n this case all we have are generalized arguments about eBay being a different type of company." Appx. 0189.

contract of adhesion does not make it less oppressive.

Furthermore, Kepas did make a showing that the California forum selection clause would deprive him of his day of court. Kepas argued before the district court that conducting the arbitration in California would cause him

> to incur significant costs to arbitrate this dispute in California . . . . This forum provision serves only to provide eBay with a tactical advantage, requiring Mr, Kepas to absorb the costs of travel and accommodations in order to arbitrate his claims. . . . If any witnesses did decide to testify [voluntarily, because they could not be subpoenaed], Mr. Kepas would be required to pay their travel and accommodation expenses. Such costs would be substantial and may preclude Mr. Kepas from proceeding with arbitration.

Appx. 0053. The district court agreed that the forum selection clause was "improper." Appx. 0191.

Kepas cited to *Bolter v. Superior Court* in his Opening Brief, because the court in that case found a forum selection clause that required franchisees in California to arbitrate their claims in Utah to be unconscionable. 87 Cal. Rptr. 2d 888 (Cal. Ct. App. 2001). eBay attempts to distinguishes *Bolter* from the facts here because when the parties in *Bolter* first began doing business together as franchisor and franchisees, their agreement did not contain an arbitration provision, so the change was not something that could have been anticipated. eBay Brief at 44. eBay also states that "the arbitration agreement in *Bolter* limited recoverable damages,

making it impossible for plaintiffs to recoup the expenses associated with traveling to another state for arbitration." *Id*. Actually, the *Bolter* decision does not state that it is *impossible* for the plaintiffs to recoup their expenses, only that their potential to do so is limited. Further, the decision in that case that the forum selection clause at issue was "unduly oppressive" was based on the totality of the hardships presented by the forum for the plaintiffs. The court noted, "The agreement requires franchisees wishing to resolve any dispute to close down their shops, pay for airfare and accommodations in Utah, and absorb the increased costs associated in having counsel familiar with Utah law." *Bolter* at 894. The court found that these circumstances made it such that it was "simply not a reasonable or affordable option for franchisees to abandon their offices for any length of time to litigate a dispute several thousand miles away." *Id*. at 895.

eBay simply ignores the other case cited by Kepas, *Wilmot v. McNabb*, which holds that a forum selection clause that required the plaintiffs, who were California residents, to arbitrate their claims against defendant investment firm in Colorado, was unenforceable under California law. 269 F. Supp. 2d 1203 (N.D. Cal. 2003). Importantly, the court noted that the fact that it was applying California law was determinative in that case, as Colorado law would have allowed the venue provision despite the

fact that it was "an inconvenient venue for Plaintiffs." *Id*. at 1210. The Court held:

> the arbitration provision of the First Trust IRA application does not satisfy the criteria for unconscionability under Colorado law but that its venue provision satisfies the criteria for unconscionability under California law.

Id. at 1212.

The cases eBay cites do not support its argument that the forum selection clause here is not unconscionable. In *Aral v. Earthlink, Inc.*, for instance, the court found the forum selection clause, which required consumers in California to bring claims for relatively small amounts against EarthLink in Georgia, to be "patently unreasonable." 36 Cal. Rptr. 3d 229 at 230, 242 (Cal. Ct. App. 2005). The *Aral* decision noted that the *Carnival Cruise Lines v. Superior Court* [4] case to which eBay cites, only has "direct precedential value [] in cases governed by federal admiralty law. . . . " *Id.* at 240. The other case cited by eBay, *Spradlin v. Lear Siegler Management Services*, examines a forum selection clause in an employment agreement pursuant to federal law, as the agreement governed the employment in Saudi Arabia of an employee of a Delaware corporation. 926 F. 2d 865, 866-867 (9th Cir. 1991). There is no discussion of California law in that case.

The district court in this case agreed that the Agreement's requirement

[4] 286 Cal. Rptr. 323 (Cal. Ct. App. 1991)

that arbitration be conducted in California was "improper," but instead of invalidating the agreement, the court rewrote it to allow Kepas to arbitrate in Utah. If the forum selection clause was the only problem with this Agreement, the district court's decision might have been correct. Given all the deficiencies in this Agreement, however, the district court's decision to change the Agreement rather than invalidate it was an error.

III. The Agreement Should be Invalidated Rather Than Reformed

The district court acknowledged that the Agreement was unenforceable as written, and altered it in an attempt to make it acceptable. For instance, the court amended the contract to state that the arbitration costs that could be awarded are limited to the same type of costs that could be granted by this court under the Rules of Civil Procedure and the local rules of the court, and clarified that those costs may not include the arbitrator's fees and the other costs of arbitration such as rental of the physical facility. The Court further amended the Agreement to change the forum selection clause to include Utah. Appx. 0190-91. The district court erred in rewriting the contract in an attempt to reform it, rather than invalidating it, as rewriting the contract is not permissible under contract law.[5] This is particularly so in

[5] eBay argues that the decision to sever parts of a contract is subject to an "abuse of discretion" standard. Kepas disagrees, for the reasons set forth in the Reply Regarding Standard of Review section above. Even if "abuse of

a situation like this where the contract at issue has many deficiencies in addition to the provisions changed by the court, including its lack of bilaterality and its failure to meet the basic requirements articulated in *Armendariz.*

"There is no [] provision in the arbitration statute that permits courts to reform an unconscionably one-sided agreement," *Armendariz* at 776. Thus, when an unconscionable provision cannot be cured by severing it, such as the "carve-out" provision here, the court "must void the entire agreement." *Id*. As explained above, the carve-out provision is unconscionable, but not only is it unconscionable, the defect cannot be cured simply by striking it, because its presence causes the contract to be inherently unfair by creating an advantage for the employer. In such circumstances, the California Code requires that the contract be invalidated:

> Civil Code section 1670.5 makes clear . . . that an arbitration agreement permeated by unconscionability, or one that contains unconscionable aspects that cannot be cured by severance, restriction, or duly authorized reformation, should not be enforced.

Armendariz at 776.

Based upon this language, the lack of bilaterality in the Agreement

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discretion" were the proper standard, however, the district court in this case abused its discretion in failing to invalidate the Agreement at issue here, for the reasons set forth in this section.

here, in and of itself, could invalidate the Agreement. The contract therefore clearly should have been invalidated in light of all the other deficiencies, as the unconscionable nature of these problems permeates the entire agreement. "[P]ermeation is indicated by the fact that there is no single provision a court can strike or restrict in order to remove the unconscionable taint from the agreement." *Armendariz* at 775. "[M]ultiple defects indicate a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage." *Id*.

Under the facts in *Armendariz*, the court held, "two factors weigh against severance of the unlawful provisions" – the fact that there were multiple unlawful provisions, and that the agreement was permeated with "lack of mutuality," such that "there is no single provision a court can strike or restrict in order to remove the unconscionable taint from the agreement." *Armendariz* at 775. Considered in its totality, the Agreement here is similar in deficiencies to the agreement invalidated by the court in *Armendariz. See also, Fitz v. NCR Corp.* Like the agreement in *Armendariz,* the Arbitration Agreement at issue here should be found to be void as a matter of public policy.

CONCLUSION

Based on the foregoing arguments, the Court should reverse the District Court's decision to compel arbitration in this case. This Court should find that the Arbitration Agreement is invalid due to its multiple defects and its lack of bilaterality. Accordingly, this Court should remand Mr. Kepas' claims for a trial on the merits.

Dated this 14th day of June, 2010.

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CERTIFICATE OF COMPLIANCE

I certify that this brief contains 4,644 words based upon the information calculated by Word 1997. Therefore, it complies with Rule 32(a)(7) of the Rules of the United States Court of Appeals for the Tenth Circuit.

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CERTIFICATE OF DIGITAL SUBMISSIONS

I certify that 1) all required privacy redactions have been made; 2) with the exception of those redactions, every document submitted in Digital Form or scanned PDF format is and exact copy of the written document filed with the Clerk; and 3) the digital submissions have been scanned for viruses with the most recent version of Norton Antivirus 2008, and according to the program, are free of viruses.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of **APPELLANT'S REPLY BRIEF** was served via the Court of Appeals' electronic filing system this 14th day of June 2010, on the following:

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