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.	**PETITION FOR PANEL REHEARING**

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

Honorable Dee Benson

2:06-cv-00612-DB

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PETITION FOR PANEL REHEARING

Pursuant to Federal Rule of Appellate Procedure 40, Appellant Emmanuel Kepas ("Mr. Kepas") respectively petitions the judges of this Honorable Court for a rehearing of the appeal in the above-entitled cause. In its decision on November 2, 2010, the majority panel, in reaching its conclusion that the Arbitration Agreement at issue was bilateral, and therefore, enforceable, improperly distinguished and disregarded California precedent, *Fitz v. NCR Corp.,* 118 Cal. App. 4th 702 (Cal. Ct. App. 2004), and misapplied the mutuality analysis established therein and by other California courts. As a consequence of these actions, the parties' burdens of proof were improperly shifted. Importantly, there is no precedent under California law for enforcing an arbitration agreement that includes a carve-out provision like the one at issue here, when it also fails to meet at least one of the requirements of *Armendariz v. Foundation Health Psychcare Servs., Inc.,* 6 P.3d 669 (Cal. 2000), as the majority panel found to be the case here.

STATEMENT OF THE ISSUES

1. Whether the majority panel improperly distinguished and disregarded California precedent, *Fitz*, a controlling case on the issue of substantive unconscionability, which invalidated an arbitration agreement between an employer in a technology industry and its employee that included a carve-out

provision exempting certain claims related to intellectual property rights from arbitration on grounds that the agreement was unilateral.

2. Whether the majority panel misapplied California's mutuality analysis.

3. Whether the majority panel improperly shifted the parties' burden of proof, when it failed to follow *Fitz* and to properly apply the mutuality analysis, and as a result, did not require eBay to factually substantiate its claim that it is a technology company and that this provides the necessary "business justification" for the intellectual property carve-out.

STATEMENT OF THE RELEVANT FACTS AND MAJORITY PANEL'S OPINION

Mr. Kepas is a former employee of eBay. After completing his probationary period, eBay offered Mr. Kepas a management position that was contingent upon Mr. Kepas signing a standard Arbitration Agreement (the "Agreement"). Mr. Kepas signed the Agreement. Thereafter, Mr. Kepas brought suit in federal court in the District of Utah to recover damages related to eBay's treatment of him. Relying on the Agreement, eBay moved to compel arbitration and dismiss or stay the proceedings. The District Court granted eBay's motion to compel arbitration, and the parties proceeded to arbitration. The arbitrator entered an order dismissing Mr. Kepas' claim and the District Court confirmed this order. Mr. Kepas appealed to this Court.

On appeal, Mr. Kepas contended, among other things, that the Agreement was substantively unconscionable due to lack of mutuality. Specifically, Mr. Kepas argued that the Agreement lacked a "modicum of bilaterality" because it compelled the arbitration of claims most typically brought by employees while allowing eBay to litigate claims most typically brought by employers. Indeed, although the Agreement requires both parties to arbitrate any dispute "which arises from the employment relationship between Employee and Employer," it specifically exempts from arbitration "claims that arise out of the Employee Proprietary Information and Inventions Agreement." Mr. Kepas noted that California expressly recognizes that intellectual property claims and the like are typically brought only by the employer, and as such, carve-outs of such claims are inherently unilateral. Since the Agreement expressly carves-out intellectual property claims, while requiring arbitration of employment-related claims, Mr. Kepas contended the Agreement was only cloaked in the appearance of bilaterality and was thus substantively unconscionable.

In response, eBay's counsel asserted that eBay operates in a technology industry and therefore had a business justification for the intellectual property carve-out. However, eBay provided no factual or evidentiary proof to support this assertion. Mr. Kepas pointed out that where an agreement is

unfairly one-sided, California requires, in order for such an advantage to be considered conscionable, that the party with superior power establish a "business reality" to justify the lack of mutuality. Having failed to provide any factual support for its assertion, Mr. Kepas contended that eBay did not satisfy its burden of proof.

In addressing whether the Agreement was substantively unconscionable, the majority panel held that it was "sufficiently bilateral based on its plain language." Maj. Op. 14. The majority further concluded that Mr. Kepas had not supported his contention that the Agreement lacked mutuality because Mr. Kepas "failed to identify the types of claims excluded from arbitration pursuant to the Employee Proprietary Information and Inventions Agreement." Maj. Op. 15. The majority panel acknowledged the *Fitz* decision, even noting that the agreement in *Fitz* was "more analogous to the arbitration agreement at issue." Still, the majority panel distinguished *Fitz* from the instant case on ground that that eBay's is a "technology company." Maj. Op. 16. The majority panel also dismissed Mr. Kepas' argument that eBay had failed to meet its burden of establishing its asserted business justification, stating that Mr. Kepas' argument "in this context" was misplaced. Maj. Op. 16. The majority panel then concluded that the claims excluded from arbitration were likely to be pursued by both parties, rendering the Agreement

sufficiently bilateral. *Fitz* involved a technology company, however, and that decision and other California cases hold that the employer must demonstrate its "business necessity" for a carve-out provision with evidentiary support.

ARGUMENT

I. THE MAJORITY PANEL IMPROPERLY DISTINGUISHED AND DISGREGARDED APPLICABLE CASE LAW

In reaching its conclusion that the Arbitration Agreement between eBay and Mr. Kepas was bilateral, and therefore, fully enforceable, the majority panel improperly distinguished and disregarded *Fitz v. NCR Corp.*, 118 Cal. App. 4th 702 (Cal. Ct. App. 2004) [1], a controlling case on the issue of

[1] *Fitz* embodies a long line of California cases, which have concluded, in essence, that arbitration provisions that carve-out claims arising from noncompetition agreements, trademark infringement, or intellectual property rights, are inherently unilateral. See *Martinez v. Master Protection Corp.*, 118 Cal.App.4th 107 (2004) (invalidating arbitration agreement that required the employer and employee to arbitrate claims for wages, compensation, state and federal statutory claims, contract and tort claims, and discrimination claims, but exempted the employer's claims " 'for injunctive and/or other equitable relief for unfair competition and/or the use and/or unauthorized disclosure of trade secrets or confidential information"); *Mercuro v. Superior Court* 116 Cal.Rptr.2d 671 (2002) (invalidating an arbitration agreement that required all breach of contract, discrimination, and state or federal statutory claims to be arbitrated but exempted from arbitration injunctive and equitable claims for "intellectual property violations, unfair competition and/or the use and/or unauthorized disclosure of trade secrets or confidential information); *Stirlen v. Supercuts, Inc.* 51 Cal.App.4th 1519, 60 Cal.Rptr.2d 138 (1997) (invalidating arbitration agreement that reserved for employer the right to bring equitable claims for patent infringement and improper use of confidential information in state or federal court, but required arbitration of any dispute arising out of employment); *Doubt v. NCR Corporation,* 2010 WL 3619854 (N.D. Cal. 2010) (not reported) (invalidating internal resolution

substantive unconscionability. In *Fitz,* the court found an agreement that compelled arbitration of wrongful termination, discrimination, and harassment claims, but allowed a choice of forums for claims arising from noncompetition agreements or trademark infringement, to be unfairly one-sided because it compelled arbitration of the claims more likely to be brought by the employee, but exempted from arbitration the types of claims more likely to be brought by the employer. *Fitz,* Cal. App. 4th at 725. Likewise, in the instant case, the Agreement requires both parties to arbitrate any dispute "which arises from the employment relationship between Employee and Employer," but specifically exempts from arbitration "claims that arise out of the Employee Proprietary Information and Inventions Agreement." Looking solely at the "plain language" of the Agreement, it is clear that the provisions at issue are sufficiently analogous in scope and application to the provisions addressed in *Fitz* that its decision, which speaks directly to the issue of substantive unconscionability, in the context of employment, should not have been disregarded by the majority panel.

While the majority panel agreed that the agreement in *Fitz* was more analogous to the Agreement in the instant case, it erroneously distinguished

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dispute agreement that exempted trade secret, noncompetition, and intellectual property disputes).

Fitz on grounds that eBay is a "technology company," which "employs many individuals that develop their own inventions." Maj. Op. at 15-16. eBay made this assertion, but did not substantiate it. The majority panel accepted and relied on eBay's assertion, using this fact as a basis to disregard *Fitz*, even though eBay provided no factual support for its assertion and its truthfulness was disputed by Mr. Kepas.[2] Nonetheless, even assuming that eBay qualifies as a technology company, *Fitz* is still controlling. As noted by the dissent, the majority panel fails to recognize that the employer in *Fitz*, NCR or National Cash Register Corporation, is also a "technology company," a fact that was considered by that court. Maj. Op. at 23.

Indeed, NCR defended its agreement by arguing that its employees could submit disputes regarding non-compete agreements and intellectual property rights to the courts. NCR even cited cases where employees had filed actions against employers over non-compete agreements and intellectual property claims. *Fitz,* Cal. App. 4th at 725. Notwithstanding, *Fitz* rejected the notion that the arbitration agreement, as a whole, was bilateral just because *some* employees could bring their intellectual property claims in court, emphasizing the well-established fact that "it is far more often the case that

[2] The error of the majority panel in accepting eBay's bald assertion that it is a technology company is discussed in more detail below.

employers, not employees, will file such claims." *Id.* at 725. Since eBay's assertions regarding its unique status as a technology company are, in all relevant respects, identical to the technology-driven arguments presented and expressly rejected by the court in *Fitz,* it was erroneous for the majority panel to distinguish *Fitz*, and subsequently disregard it, as a case that did not address substantive unconscionability in the technology industry context.

II. THE MAJORITY PANEL MISAPPLIED CALIFORNIA'S MUTUALITY ANALYSIS

Consistent with its disregard for *Fitz*, the majority panel, in considering Mr. Kepas' contention that the Agreement was substantively unconscionable, misapplied the mutuality analysis established by the California courts. The majority panel found the Agreement to be sufficiently bilateral based on its "plain language." Maj. Op. at 14. Quoting the language of the Agreement, the court notes that the provisions compelling arbitration, as well as the carve-out provision, apply equally to both parties. It further contends that the language of the carve-out provision would not preclude an employee terminated for stealing trade secrets from litigating an accompanying wrongful termination claim. Maj. Op. at 14.

There is no dispute that, under California law, an arbitration agreement imposed in an adhesive context lacks basic fairness and mutuality if it

requires one contracting party, but not the other, to arbitrate all claims arising out of the same transaction or occurrence or series of transactions or occurrences. *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 99 Cal. Rptr.2d 745 (Cal. 2000). However, this is not the only manifestation of an agreement's lack of mutuality. Indeed, the California courts have expressly stated that substantive unconscionability "may take various forms, but [is] generally . . . described as unfairly one-sided." *Little v. Auto Stiegler, Inc.*, 63 P.3d 979, 984 (Cal. 2003); see also *Armendariz*, 6 P.3d 669, 693 (Cal. 2000). Thus, an agreement may lack mutuality or be unfairly one-sided "if it compels arbitration of the claims more likely to be brought by the weaker party but exempts from arbitration the types of claims that are more likely to be brought by the stronger party." *Fitz*, 118 Cal. App. 4th at 723; see also *O'Hare v. Mun. Res. Consultants*, 107 Cal. App. 4th 267, 273 (Cal. Ct. App. 2003).

Moreover, the fact that a carve-out provision in an arbitration agreement has the appearance of bilaterality, in that it grants both parties the right to judicial relief, does not make the agreement bilateral, nor does it alter the mutuality analysis. Indeed, the carve-out provision in *Fitz* applied to both employer and employee claims, a fact specifically mentioned by the court. *Fitz,* at 724-725. Nevertheless, the court quickly dispelled any notion that this made the agreement bilateral. The court found the agreement lacked

mutuality because the employer "requires the weaker parties—its employees—to arbitrate their *most common claims* while choosing to litigate in the courts its own claims against its employees." *Id.* at 725 (emphasis added).

The United States District Court for the Northern District of California, in *Sheikh v. Cisco*, 2009 WL 890880 (N.D. Cal. 2009) (case not reported in federal supplement), provides further instruction on how the court is to analyze a lack of mutuality claim in this context. There, as in this case, the employer argued that a carve-out provision in its arbitration agreement was bilateral since it granted both parties the right to judicial relief when either party disputes rights to intellectual property. In rejecting this contention, the court emphasized that "[t]his alone … is not the test for mutuality." *Id.* at 6. "The court must *also* consider whether the [agreement] compels arbitration of claims more likely to be brought by the weaker party but exempts from arbitration claims more likely to be brought by the stronger party." *Id.* at 5 (emphasis added). In other words, the carve-out provision cannot be evaluated in isolation, but must be considered in conjunction with the other provisions of the agreement compelling arbitration, to determine whether the agreement, as a whole, lacks mutuality. "An agreement that allows for this discrepancy may be unfairly one-sided." *Id.* at 5.

Mr. Kepas directed the majority panel to several cases wherein California has judicially recognized that "[c]laims for unpaid wages, wrongful termination, employment discrimination and the like invariably are brought by employees, while claims involving trade secrets, misuse or disclosure of confidential information, and unfair competition typically are asserted *only* by employers." *Martinez,* 118 Cal. App. 4th at 115 (emphasis added); *see also Fitz*, Cal. App. 4th at 725. Notwithstanding this judicial precedence, the majority panel discounted the relevance of these decisions, finding that "Kepas merely asserts that these claims are more likely to be brought by the employer." Maj. Op. 15. Further, the majority panel indicated that Mr. Kepas had not met his burden to establish substantive unconscionability because he failed to "identify the types of claims excluded from arbitration pursuant to the Employee Proprietary Information and Inventions Agreement." Maj. Op. 15.

While the majority panel's decision has language indicating that the panel was aware of the various bases upon which an arbitration agreement might lack mutuality, the majority panel's reasoning and statements regarding Mr. Kepas' burden of proof reveal that the majority did not engage in any meaningful consideration regarding whether the Agreement, as a whole, compelled the arbitration of claims more likely to be brought by Kepas and exempted claims more likely to be brought by eBay. Rather, the panel relied

primarily on the carve-out provision's appearance of bilaterality to reach its conclusion that the Agreement was mutual. In doing so, the majority panel misapplies the mutuality analysis and disregards established precedence.

III. THE MAJORITY PANEL IMPROPERLY SHIFTED THE PARTIES' BURDENS OF PROOF

The majority panel improperly shifted the parties' burdens of proof when it failed to require eBay to factually substantiate both its claim that it is a technology company, as well as its contention that this provides the necessary business justification for carving-out intellectual property claims. In the instant case, eBay's counsel asserted that eBay is an employer in a technology industry "where there are many employees who have inventions and want to protect their own rights." However, eBay did not provide any factual basis or support for these conclusory statements.

As indicated above, *Fitz* embodies a long line of California cases, which have concluded, in essence, that arbitration provisions that carve-out claims arising from noncompetition agreements, trademark infringement, or intellectual property rights, are inherently unilateral. See footnote 1. More importantly, *Fitz* speaks directly to the issue raised in the instant case—whether the fact that an employer is a technology company and that some employees might advance intellectual property claims renders an intellectual

property carve-out mutual. *Fitz* emphatically rejects this idea because "it is far more often the case that employers, not employees, will file such claims." *Fitz,* Cal. App. 4th at 725.

Only by disregarding *Fitz* can the majority panel reach the conclusion that "eBay's industry is not used here to justify a one-sided arbitration agreement, but rather to determine whether its employees are more likely to also pursue the claims excluded from arbitration." Maj. Op. 16. *Fitz* compels a finding that the carve-out provision in the instant case is one-sided, despite its appearance of bilaterality, and that eBay must proffer a business justification for such carve-out to make such advantage conscionable. "A contracting party with superior bargaining strength may provide 'extra protection' for itself within the terms of the arbitration agreement if 'business realities' create a special need for the advantage." *Fitz,* Cal. App. 4th at 723. However, "the 'business realities,' creating the special need, must be explained in the terms of the contract or *factually established*." *Id.* at 723 (emphasis added). In other words, the business justification (and arguably the nature of the business, itself) must be proven; bald assertions are insufficient.

Because the majority panel disregarded *Fitz* and did not properly analyze the mutuality claim, it found that Mr. Kepas had not met his burden of proof, and thus, the argument regarding eBay's failure to provide a business

justification was "misplaced." Maj. Op. 17. However, as explained above, it was erroneous for the majority panel to distinguish and disregard *Fitz*. Had *Fitz* been applied, as it should, it is evident from the outcome in that case that the burden of proof would have shifted to eBay, and that it would have had to substantiate its business justification for the carve-out with something more than bald assertions. In failing to require such proof from eBay, the majority panel effectively shifted the parties' burdens of proof – allowing eBay to rest on unsubstantiated claims that it is in a technology industry and has a business necessity for its carve-out provision, and requiring Kepas to prove that eBay was *not* entitled to special consideration because of its industry.

IV. THERE IS NO CALIFORNA PRECEDENT FOR SEVERING PROVISIONS IN AN AGREEMENT LIKE EBAY'S

The majority panel distinguishes certain cases relied upon by Kepas, *Mercuro* and *Fitz,* in which California courts refused to enforce arbitration agreements that had carve-out provisions. Maj. Op. 16-17. It is important, however, that there is no case law from California courts that provides precedent for the decision reached by the majority panel in this case. In *every* published decision from California in the employment context, where an arbitration agreement included a carve-out provision like the one in this case and at least one other defect, the court invalidated the agreement rather than

sever it. This reflects the strong policy argument articulated in *Armendariz* and its progeny, that "multiple 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." *Armendariz* at 775. In such cases of multiple defects, California cases have invariably invalidated the agreement at issue. While this might not be the approach the Tenth Circuit would generally take, the fact remains that under the law of California, which must be applied here, the only remedy determined to be appropriate when an arbitration agreement contains multiple defects (particularly when one is a lack of mutuality) is to invalidate the agreement.

CONCLUSION

For the foregoing reasons, Mr. Kepas' Petition for Panel Rehearing should be granted.

Dated this 16th day of November, 2010.

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CERTIFICATION OF SERVICE

I hereby certify that a true and correct copy of APPELLANT'S PETITION FOR PANEL REHEARING was served via the Court of Appeals' electronic filing system this 16th day of November, 2010, on the following:

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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.

Dated this 16th day of November, 2010.

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