
IN THE SUPREME COURT OF THE STATE OF WASHINGTON

AT&T CORP.,

Defendant/Appellant,

vs.

MICHAEL McKEE,

Plaintiff/Respondent.

BRIEF OF AMICUS CURIAE
WASHINGTON STATE TRIAL LAWYERS ASSOCIATION
FOUNDATION

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I. IDENTITY AND INTEREST OF AMICUS CURIAE

The Washington State Trial Lawyers Association Foundation (WSTLA Foundation) is a not-for-profit corporation organized under the laws of Washington, and a supporting organization of the Washington State Trial Lawyers Association (WSTLA). WSTLA Foundation, which operates the amicus curiae program formerly operated by WSTLA, has an interest in the rights of injured persons seeking legal redress, including the right of such persons to pursue or participate in class actions or class-wide arbitration to recover small damage claims under the Washington Consumer Protection Act, Ch. 19.86 RCW (CPA).

II. INTRODUCTION AND STATEMENT OF THE CASE

This case involves the enforceability of a ban on class actions and class-wide arbitrations in a dispute resolution clause in a long-distance telephone carrier's consumer contract. The plaintiff/respondent is Michael McKee (McKee), and the defendant/appellant is AT&T Corporation (AT&T). The underlying facts are drawn from the briefing of the parties. See AT&T Br. at 4-16 & Appendices; McKee Br. at 3-8; AT&T Reply Br. at 1-3; AT&T Supp. Br. at 9-11; McKee Supp. Br. at 8-9, 14. For purposes of this amicus curiae brief, the following facts are relevant:

McKee, a Washington resident, brought this class action in Chelan County Superior Court against AT&T, a New York corporation doing business in Washington. The action includes a CPA claim on behalf of Washington long-distance telephone customers of AT&T. To date, the

class has not been certified. McKee alleges unfair or deceptive acts and practices by AT&T in charging certain utility taxes and late fees, resulting in potential small-dollar value claims by a large number of Washington customers.

The relevant agreement between AT&T and McKee, and similarly situated customers, contains two key provisions at issue in this appeal: 1) a dispute resolution clause that prohibits class actions or class-wide arbitrations (class action ban); and 2) a choice of law clause designating that the agreement is governed by New York law.¹ This latter clause is significant because under New York law a contract dispute resolution clause with a class action ban is enforceable. See AT&T Br. at 44-46.

In response to McKee's putative class action, AT&T moved the superior court to compel arbitration under the consumer services agreement. It contended that arbitration was required by the agreement, and further argued that any superior court CPA action was preempted by federal law under the Federal Arbitration Act, 9 U.S.C. §1 et seq. (FAA), and the Federal Communications Act, 47 U.S.C. §201 et seq. (FCA). In turn, McKee sought an order staying arbitration, contending the class

¹ The briefing reflects that several different agreements were used by AT&T at times pertinent to this case, all of which apparently contain the class action ban. See AT&T Br. at 6-12, 15, 35-38; McKee Br. at 32-33 n.10. However, AT&T asserts its agreement effective November 1, 2002 governs McKee's claim. See AT&T Br. at 15. This contract, which is referred to in the briefing as the "December 2002 Agreement," because it was included in customers' December 2002 billing statements, is attached to AT&T's opening brief in the Court of Appeals. See AT&T Br. at 17 & Appendix B. This amicus curiae brief assumes, for purposes of argument, the December 2002 Agreement applies in this case. Extracts of the dispute resolution and choice of law provisions from this agreement (hereafter "consumer services agreement") are reproduced in the Appendix to this brief, with the text enlarged to make it easier to read.

action ban was unconscionable under Washington law, and that there was no federal preemption. In conjunction with the motions, McKee submitted declarations by expert witnesses regarding the necessity of class actions in cases such as this, and the unlikelihood of qualified legal counsel taking on these small-dollar value CPA claims on an individual basis. See McKee Br. at 4-6. AT&T presented a declaration providing facts and figures regarding actual small claims court proceedings and arbitrations brought against AT&T. See AT&T Supp. Br. at 9-11.

The superior court ruled there is no federal preemption, and that the dispute resolution provision is procedurally and substantively unconscionable under Washington law. See AT&T Br. at Appendix A (Court's Oral Decision at 11-16). The court denied AT&T's motion to compel arbitration, and granted McKee's motion to stay. See id. (superior court order).

AT&T appealed to Division III of the Court of Appeals. That court stayed the appeal pending disposition of appeals by this Court in Scott v. Cingular Wireless, LLC (S.C. #77406-4), and Dix v. ICT Group, Inc. (S.C. #77101-4). See McKee Supp. Br. at 1. This Court issued its opinions in Scott and Dix in July 2007. See Scott v. Cingular Wireless, 160 Wn.2d 843, 161 P.3d 1000 (2007); Dix v. ICT Group, Inc., 160 Wn.2d 826, 161 P.3d 1016 (2007). Division III lifted the stay and, after supplemental briefing by the parties, transferred the case to this Court.

III. ISSUES PRESENTED

- 1.) Is the class action ban in AT&T's consumer service agreement substantively unconscionable under Washington law, because it undermines the public policy of the CPA and essentially exculpates the long distance carrier from liability for claims involving small damage amounts?
- 2.) Is the AT&T choice of law provision unenforceable in Washington courts, because application of New York law upholding class action bans in consumer contracts would violate Washington public policy favoring class-based CPA litigation for recovery of small damage amounts?

IV. SUMMARY OF ARGUMENT

Re: Class Action/Class-Wide Arbitration Ban

Under Scott v. Cingular Wireless, 160 Wn.2d 843, 161 P.3d 1000 (2007), AT&T's consumer services agreement ban on class actions and class-wide arbitrations violates Washington's strong public policy favoring class-based relief for small-dollar value CPA claims, and is substantively unconscionable. AT&T has failed to prove by compelling evidence that Washington consumers have *in fact* meaningful individual CPA remedies under its consumer services agreement for these small damage claims.

Re: Choice of Law Provision

The AT&T choice of law provision requiring application of New York law is unenforceable in Washington courts because it violates a fundamental public policy of this state favoring class-based relief under the CPA for small-dollar value claims. AT&T has failed to prove by

compelling evidence that under these circumstances Washington consumers have *in fact* a meaningful alternative avenue for relief.

V. ARGUMENT

Introduction

This argument addresses whether the AT&T consumer services agreement class action ban is unenforceable because it is substantively unconscionable under Washington law, and the related question whether the agreement's New York choice of law provision is likewise unenforceable in Washington courts, on similar grounds. The issue of federal preemption under either the FAA or FCA is not addressed, and it is assumed for purposes of this argument that McKee's CPA claim is not preempted by federal law.

A.) Under *Scott*, The Consumer Services Agreement Class Action Ban Is Substantively Unconscionable As Violative Of Washington Public Policy; AT&T Has Not Proven By Compelling Evidence That Meaningful Individual CPA Remedies Otherwise Exist For Small-Dollar Value Claims.

Recently, in Scott v. Cingular Wireless, this Court struck down a class action ban in a consumer contract arbitration clause because of substantive unconscionability. See 160 Wn.2d at 851-57.² It found the provision unenforceable because it violated Washington's strong public policy favoring class relief for unfair or deceptive acts and practices under the CPA. Id. at 851-54. While this holding did not condemn all such class

² In so doing, the Court applied a de novo standard of review regarding the superior court's order compelling arbitration. See Scott, 160 Wn.2d at 851. The same standard of review applies here.

action bans, Scott suggests the circumstances under which a ban will be upheld are extremely narrow. Id. at 856-57. This case does not present one of those rare instances.

McKee relies on Scott in support of his claim the class action ban is substantively unconscionable. See McKee Supp. Br. at 4-15.³ In Scott, this Court found the arbitration clause class action ban unenforceable because it had the effect of exculpating Cingular Wireless from CPA liability for small-dollar value claims, because of the unlikelihood they would be pursued in individual arbitrations or small claims court. See 160 Wn.2d at 855-57.

In reaching this result, the Court concluded that the CPA, augmented by the remedial aspects of CR 23 class actions, represented a strong Washington public policy favoring class relief for consumer claims involving small damage amounts. Id. at 851-57. A CPA class-based remedy was deemed necessary to fulfill the deterrent effect of the act, uphold the private attorney general component of the CPA enforcement scheme, protect the public interest reflected in the act, and provide relief for small meritorious claims. Id. at 852-53. In the absence of CPA class relief, the Court questioned whether claims for small amounts would even be pursued in individual arbitrations or small claims court. Id. at 854-55.

³ McKee also relies on this Court's decision in Dix v. ICT Group, Inc., issued the same day, which struck down a forum selection clause that foreclosed CPA class action litigation by Washington citizens for claims involving small-dollar damage amounts, when no meaningful individual remedy was available. See McKee Supp. Br. at 1-2.

While this Court found substantive unconscionability in Scott, it did not establish a per se rule that all consumer contract class action bans are unenforceable. Instead, it held that such bans will be invalidated whenever they prevent vindication of rights under the CPA, which must be determined on a case-by-case basis. Id. at 860 n.7. Although the Court did not outline how this case-by-case assessment should be conducted, or enumerate the exact criteria to be applied, a number of markers in the opinion suggest a high threshold for overcoming a substantive unconscionability determination for class action bans involving small-value CPA claims.

First, the mere possibility of individual arbitration or small claims court adjudication is not enough. See Scott at 855. Second, arguably consumer friendly dispute resolution provisions, regarding legal fees and costs, are insufficient to save the class action ban from substantive unconscionability, particularly in the face of expert testimony challenging the practical availability of individual remedies, and the absence of proof that such remedies are actually being invoked by consumers. See id. at 849, 855-56.⁴ The Court concludes, regarding the favorable consumer fee and cost provisions exalted by Cingular Wireless: “While laudable, it

⁴ In Scott the Court placed the burden of proving the class action waiver is unenforceable on the plaintiff consumers, as the parties opposing arbitration. See 160 Wn.2d at 851. Once this showing is made, the Court should impose a burden-shifting mechanism, whereby the party seeking to uphold the class action ban must overcome substantive unconscionability by submitting evidence that the waiver does not undermine CPA public policy *in fact*. See infra. at 8-10.

appears to us that these provisions *do not ensure that a remedy is practically available.*” *Id.* at 856 (emphasis added). Lastly, in quoting Smith v. Behr Process Corp., 113 Wn.App. 306, 54 P.3d 665 (2002), the Court signals that any evidence regarding the actual availability of individual relief must remove any reasonable doubt as to the efficacy of individual remedies:

Washington courts favor a liberal interpretation of CR 23 as the [rule] avoid[s] multiplicity of litigation, “saves members of the class the cost and trouble of filing individual suits[,] and ... also frees the defendant from the harassment of identical future litigation.” “[A] primary function of the class suit is to provide a procedure for vindicating claims which, taken individually, are too small to justify individual legal action but which are of significant[t] size and importance if taken as a group.” As a federal court has stated, “the interests of justice require that in a doubtful case ... any error, if there is to be one, should be committed in favor of allowing the class action.”

Scott, 160 Wn.2d at 856-57 (quoting Smith, 113 Wn.App. at 318-19 (some alterations in original) (original citations omitted) (quoting Brown v. Brown, 6 Wn.App. 249, 256-57, 253, 492 P.2d 581 (1971); Esplin v. Hirschi, 402 F.2d 94, 101 (10th Cir. 1968)).

This “doubtful case” criteria dictates that there be compelling evidence presented that individual consumers are actually pursuing small-dollar CPA remedies to such a degree that it can reasonably be said the public policy underlying the CPA is being fulfilled under the circumstances. This proof should include specific information regarding: the number of claims involved versus the number of consumers subject to the contract provision; the monetary value of the claims; whether the

claims in which individual remedies have been pursued are substantially similar to those subject to the class action ban; and the extent to which such claims have been successful.

In this case, AT&T seeks to defend its dispute resolution class action ban on the basis that some individual claims were in fact pursued against it through individual arbitration or small claims court, also noting that a number of these claims have been successful. See AT&T Supp. Br. at 9-11. It contends this is enough to sustain a class action ban under the circumstances, urging that McKee “has presented no persuasive evidence that small claims court, an FCC complaint, or an arbitration” are not meaningful remedies for small-dollar CPA claims. Id. at 11.⁵

AT&T, not McKee, should have the burden of proving that meaningful individual CPA remedies for small-value claims exist *in fact*, in order to spare the class action ban from a determination of substantive unconscionability. AT&T in all likelihood maintains business records

⁵ The adequacy of an individual remedy in Washington small claims court is assumed in the briefing before the Court. Therefore, this brief has also assumed for purposes of argument that it is theoretically possible to vindicate the CPA public policy in a Washington small claims court, although this is less than clear. First, there is no definitive ruling by a Washington appellate court that a CPA claim is cognizable in small claims court. See Streng v. Clarke, 89 Wn.2d 23, 569 P.2d 60 (1977) (plurality opinion suggesting recovery for CPA violation is available in small claims court). Further, lawyers are not permitted in small claims court, except a lawyer may represent a plaintiff if he or she was the attorney of record before the case was transferred from the regular district court docket. See RCW 12.40.025 & .080. Lastly, appeals are not permitted on small claims court judgments for less than \$250, and an unappealable small claims court judgment does not subject a defendant to collateral estoppel. See State Farm Mut. Auto. Ins. Co. v. Avery, 114 Wn.App. 299, 57 P.3d 300 (2002).

Regarding AT&T’s reference to the availability of a FCC remedy, this should be irrelevant if there is no preemption because, as McKee argues, with detarriffing the FCC contemplates that consumers are entitled to invoke state consumer protection law remedies. See McKee Br. at 23-25.

from which this information can be easily gleaned. All in all, given the disfavored status of class action bans, the burden of proof on this issue should be placed upon AT&T. Cf. Hubbard v. Spokane County, 146 Wn.2d 699, 707, 718, 50 P.3d 602 (2002) (imposing a burden-shifting mechanism regarding tort of wrongful discharge in violation of public policy, requiring employer to prove that established public policy violation was not cause-in-fact of dismissal); America Online, Inc. v. Superior Court, 108 Cal. Rptr. 2d 699, 706-07 (Cal. App. 2001) (placing initial burden on internet service provider to prove enforcement of forum selection clause would not result in significant diminution of statutory rights of California consumers, in violation of anti-waiver provision; cited with approval in Dix, 160 Wn.2d at 839-40).

It remains for the Court to determine whether the evidence provided by AT&T, see AT&T Supp. Br. at 9-11, is sufficiently compelling to conclude that absent class actions or class-wide arbitrations Washington consumers have meaningful individual CPA remedies for small damage claims arising under the consumer services agreement. See Scott, 160 Wn.2d at 854-55; see also Dix at 840-41 (concluding CPA public policy violated where it is economically unfeasible for individual consumers to pursue small-value claims).

If the record evidence on individual consumer remedies is no more precise than the recitations in AT&T's briefing, then AT&T has failed to prove by compelling evidence that Washington consumers have

meaningful individual CPA remedies under the consumer services agreement. There is little context against which to measure AT&T's facts and figures. It is unclear whether any small claims court actions or individual arbitrations involved similar, small-dollar claims. Nor does the briefing reflect how many Washington customers AT&T had at times pertinent. The information provided in the supplemental brief is far from compelling, and provides inadequate assurances that the strong public policy of the CPA is being fulfilled under these circumstances. See Scott at 856. Ultimately, the evidence offered is not substantially different than that presented in Scott. This is a "doubtful case," and the superior court's determination of substantive unconscionability should be affirmed.

B.) The Consumer Services Agreement Choice Of Law Provision Is Unenforceable Because It Violates This State's Fundamental Public Policy Favoring Class-Based Relief Under The CPA For Small Damage Claims, Leaving Washington Consumers Without A Meaningful Alternative Avenue For Individual Relief.

McKee argues the AT&T consumer services agreement choice of law provision is unenforceable in Washington courts because, unlike Washington law, New York law allows a class action ban such as the one in the dispute resolution clause here. See McKee Br. at 42-46; see also AT&T Br. at 44-46 (explicating New York law). Because the ban is unenforceable under Washington law, see §A, supra, it is necessary for the Court to reach this question. Under a choice of law analysis that largely parallels the substantive unconscionability inquiry, the consumer services agreement requirement that New York law applies violates fundamental

Washington public policy. Thus, if other requirements for applying Washington law are met, as appears to be the case, the New York choice of law provision is unenforceable in Washington courts.

In determining the enforceability of a choice of law provision, Washington courts turn to the Restatement (Second) Conflict of Laws, §§187-188 (1971). See Erwin v. Cotter Health Ctrs., 161 Wn.2d 676, 690-700, 167 P.3d 1112 (2007); O'Brien v. Shearson Hayden Stone, 90 Wn.2d 680, 684-88, 586 P.2d 830 (1978).⁶

Under Restatement §187, the power of contracting parties to designate the applicable choice of law is not unqualified. In particular, McKee invokes the exception found in §187(2)(b), under which the designated choice of law will not be applied when:

Application of the law of the chosen state would be contrary to a **fundamental policy** of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of §188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

(Emphasis added).⁷

In the context of this case, the Court must decide three questions under §187(2)(b):

⁶ Generally, the validity of a choice of law provision is a question of law, and is reviewed de novo on appeal. See Erwin, 161 Wn.2d at 691.

⁷ The full text of §187 is reproduced in the Appendix to this brief, along with the official comments to this section. The reference in §187(2)(b) to “§188” is to Restatement (Second) Conflict of Laws, §188 (1971), which sets forth the “most significant relationship” test for determining governing law under a contract, when there is no designation by the parties. The text of §188 is also reproduced in the Appendix to this brief.

- Is New York law permitting a ban on class actions/class-wide arbitrations contrary to a fundamental policy of Washington?
- Does Washington, as the forum state, have a materially greater interest than New York in the determination of whether the ban is enforceable?
- Under §188's "most significant relationship" test, would Washington or New York law apply in the absence of the choice of law provision in the contract?

McKee contends, without any meaningful counterargument by AT&T, that the latter two requirements are met, viz. Washington has the materially greater interest in the class action ban issue than New York, and is otherwise the state with the most significant contacts under §188. Compare McKee Br. at 42-46 with AT&T Reply Br. at 1-3, and AT&T Supp. Br. at 9-11. Due to the lack of serious dispute on these two issues, it is assumed for purposes of argument that Washington has a materially greater interest than New York in determining the validity of the class action ban and that Washington law would apply under a §188 analysis.

The proper focus here, under §187(2)(b), is whether New York law permitting a class ban is contrary to Washington's fundamental policy. This inquiry is essentially the same question asked in §A, regarding substantive unconscionability. As noted in §187, Comment g., "a fundamental policy may be embodied in a statute which makes one or more kinds of contracts illegal or *which is designed to protect a person against the oppressive use of superior bargaining power.*" (Emphasis added). In Scott, this Court struck down a ban on class actions because it

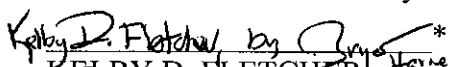
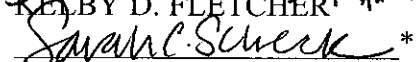
violated the strong public policy of Washington supporting CPA class actions for small-dollar damage claims. See 160 Wn.2d at 851-57. The ban was deemed exculpatory in nature, and substantively unconscionable. Id. at 857; see also Dix, 160 Wn.2d at 836, 837 (explaining that forum selection clauses contravening the “strong public policy of the forum in which suit is brought” may be invalid, and holding that a forum selection clause designating Virginia as the forum is unenforceable against Washington citizens asserting small-dollar CPA claims, where Virginia does not permit class actions).


The strong CPA public policy favoring class adjudication of small-dollar CPA claims recognized in Scott and Dix is the type of “fundamental policy” contemplated by §187(2)(b). See also O’Brien, 90 Wn.2d at 686 (concluding that Washington statutory scheme regarding usury constitutes “the type of fundamental policy contemplated by section 187”). The public policy of the CPA is of equal or greater magnitude. Thus, the New York choice of law provision is unenforceable in Washington courts under §187(2)(b).

VI. CONCLUSION

The Court should adopt the arguments advanced in this brief and resolve this appeal accordingly.

DATED this 12th day of February, 2008.

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On Behalf of WSTLA Foundation

*Brief transmitted for filing by e-mail; signed original retained by counsel.

APPENDIX

AT&T Consumer Services Agreement Extract

7. DISPUTE RESOLUTION.

IT IS IMPORTANT THAT YOU READ THIS ENTIRE SECTION CAREFULLY. THIS SECTION PROVIDES FOR RESOLUTION OF DISPUTES THROUGH FINAL AND BINDING ARBITRATION BEFORE A NEUTRAL ARBITRATOR INSTEAD OF IN A COURT BY A JUDGE OR JURY OR THROUGH A CLASS ACTION. YOU CONTINUE TO HAVE CERTAIN RIGHTS TO OBTAIN RELIEF FROM A FEDERAL OR STATE REGULATORY AGENCY.

a. Binding Arbitration. The arbitration process established by this section is governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16. You have the right to take any dispute that qualifies to small claims court rather than arbitration. All other disputes arising out of or related to this Agreement (whether based in contract, tort, statute, fraud, misrepresentation or any other legal or equitable theory) must be resolved by final and binding arbitration. This includes any dispute based on any product, service or advertising having a connection with this Agreement and any dispute not finally resolved by a small claims court. The arbitration will be conducted by one arbitrator using the procedures described by this Section 7. If any portion of this Dispute

Resolution Section is determined to be unenforceable, then the remainder shall be given full force and effect.

The arbitration of any dispute shall be conducted in accordance with the American Arbitration Association's ("AAA") Supplementary Procedures for Consumer-Related Disputes, as modified by this Agreement, which are in effect on the date a dispute is submitted to the AAA. You have the right to be represented by counsel in an arbitration. In conducting the arbitration and making any award, the arbitrator shall be bound by and strictly enforce the terms of this Agreement and may not limit, expand, or otherwise modify its terms.

NO DISPUTE MAY BE JOINED WITH ANOTHER LAWSUIT, OR IN AN ARBITRATION WITH A DISPUTE OF ANY OTHER PERSON, OR RESOLVED ON A CLASS-WIDE BASIS. THE ARBITRATOR MAY NOT AWARD DAMAGES THAT ARE BARRED BY THIS AGREEMENT AND MAY NOT AWARD PUNITIVE DAMAGES OR ATTORNEYS' FEES UNLESS SUCH DAMAGES OR FEES ARE EXPRESSLY AUTHORIZED BY A STATUTE. YOU AND AT&T BOTH WAIVE ANY CLAIMS FOR AN AWARD OF DAMAGES THAT ARE EXCLUDED UNDER THIS AGREEMENT.

b. Arbitration Information and Filing Procedures. Before you take a dispute to arbitration or to small claims court, you must first contact our customer account representatives at the customer service number on your AT&T bill for the Services, or write to us at AT&T, P.O. Box 944078, Maitland, Florida 32794-4078, and give us an opportunity to resolve the dispute. Similarly, before AT&T takes a dispute to arbitration, we must first attempt to resolve it by contacting you. If the dispute cannot be satisfactorily resolved within sixty days from the date you or AT&T is notified by the other of a dispute, then either party may then contact the AAA in writing at AAA Service Center, 134555 Noel Road, Suite 1750, Dallas, Texas 75240-6620 and request arbitration of the dispute. Information about the arbitration process and the AAA's Arbitration Rules and its fees are available from the AAA on the Internet at www.adr.org, or by contacting us at www.att.com/serviceguide/home or AT&T, P.O. Box 944078, Maitland, Florida 32794-4078. The arbitration will be based only on the written submissions of the parties and the documents submitted to the AAA relating to the dispute, unless either party requests that the arbitration be conducted using the AAA's telephonic, on-line, or in-person procedures. Additional charges may apply for these procedures. Any in-person arbitration will be conducted at a location that the AAA selects in the state of your primary residence. Arbitrations under this Agreement shall be confidential as permitted by federal law. By notifying AT&T within twenty days after commencing an arbitration proceeding, you may elect to relieve both parties to the arbitration of confidentiality obligations.

c. Fees and Expenses of Arbitration. You must pay the applicable AAA filing fee when you submit your written request for arbitration to the AAA. The AAA's filing fee and administrative expenses for a document arbitration will be allocated according to the AAA's Rules, except as stated herein, for claims of less than \$10,000, you will only be obligated to pay a filing fee of \$20 and we will pay all of the AAA's other costs and fees. For claims between \$10,000 and \$75,000, you will pay a fee to the AAA of no more than \$375, and we will pay all of the AAA's other costs and fees. If you elect an arbitration process other than a document ("desk") or telephone arbitration, you must pay your allocated share of any higher administrative fees and costs for the process you select. If you request such an alternative process, or for claims of \$10,000 or greater, AT&T will also consider, upon receiving your request and on a case-by-case basis, paying some or all of the AAA's fees and expenses that you would otherwise be allocated under the AAA's rules. You also may ask the AAA about the availability of a pro bono arbitrator and/or a waiver or deferment of fees and expenses from the AAA; more information about the AAA's rules and policies is available at the AAA's website, which is www.adr.org. Unless applicable substantive law provides otherwise, each party will pay its own expenses to participate in the arbitration, including attorneys' fees and expenses for witnesses, document production and presentation of evidence. If you prevail before the arbitrator, however, you may seek to recover the AAA's fees and the expenses of the arbitrator from us. If we prevail before the arbitrator, and if we show that you acted in bad faith in bringing your claim, then we may seek to recover the AAA's fees and

8. MISCELLANEOUS.

f. Governing Law. This Agreement is governed by the Federal Communications Act to the full extent applicable, and otherwise by the law of the State of New York, without regard to its choice of law rules. The arbitration provisions in Section 7 are also governed by the Federal Arbitration Act. This governing law provision applies no matter where you reside, or where you use or pay for the Services.

Restatement (Second) Conflict of Laws

Ch. 8

CONTRACTS

§ 187

§ 187. Law of the State Chosen by the Parties

(1) The law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue.

(2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either

(a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or

(b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

(3) In the absence of a contrary indication of intention, the reference is to the local law of the state of the chosen law.

Comment:

a. Scope of section. The rule of this Section is applicable only in situations where it is established to the satisfaction of the forum that the parties have chosen the state of the applicable law. When the parties have made such a choice, they will usually refer expressly to the state of the chosen law in their contract, and this is the best way of insuring that their desires will be given effect. But even when the contract does not refer to any state, the forum may nevertheless be able to conclude from its provisions that the parties did wish to have the law of a particular state applied. So the fact that the contract contains legal expressions, or makes reference to legal doctrines, that are peculiar to the local law of a particular state may provide persuasive evidence that the parties wished to have this law applied.

On the other hand, the rule of this Section is inapplicable unless it can be established that the parties have chosen the state of

See Appendix for Court Citation and Cross References

the applicable law. It does not suffice to demonstrate that the parties, if they had thought about the matter, would have wished to have the law of a particular state applied.

Illustration:

1. A contract, by its terms to be performed in state Y, is entered into in state X between A, a domiciliary of X, and B, a domiciliary of Y. The contract recites that the parties "waive restitution *in integrum* in case of *laesio enormis*." These notions are foreign to X local law. They exist, on the other hand, in Y local law which furthermore empowers the parties to waive such right of restitution. A court could properly find on these facts that the parties wished to have Y local law applied.

Comment:

b. Impropriety or mistake. A choice-of-law provision, like any other contractual provision, will not be given effect if the consent of one of the parties to its inclusion in the contract was obtained by improper means, such as by misrepresentation, duress, or undue influence, or by mistake. Whether such consent was in fact obtained by improper means or by mistake will be determined by the forum in accordance with its own legal principles. A factor which the forum may consider is whether the choice-of-law provision is contained in an "adhesion" contract, namely one that is drafted unilaterally by the dominant party and then presented on a "take-it-or-leave-it" basis to the weaker party who has no real opportunity to bargain about its terms. Such contracts are usually prepared in printed form, and frequently at least some of their provisions are in extremely small print. Common examples are tickets of various kinds and insurance policies. Choice-of-law provisions contained in such contracts are usually respected. Nevertheless, the forum will scrutinize such contracts with care and will refuse to apply any choice-of-law provision they may contain if to do so would result in substantial injustice to the adherent.

Illustrations:

2. A presents to B for signature a contract which embodies the terms of their prior agreement but which also provides that the rights of the parties under the contract shall be governed by the law of state X. A does not wish B to know of the provision calling for application of X law and therefore says that there is no reason for B to read the contract since it does no more than set forth their earlier

agreement. B signs the contract without reading it in reliance upon A's word. The forum will not give effect to the provision calling for application of X law.

3. In state X, A buys from the B company a ticket on one of B's steamships for transportation from X to state Y. The ticket recites that it shall be governed by Y law and also contains a provision stating that B shall not be liable for injuries resulting from the negligence of its servants. The latter provision is valid under Y local law, but invalid under that of X. In the course of the voyage, A is injured through the negligence of B's servants. A brings suit to recover for his injuries against B in state Z. In determining whether or not to give effect to the choice-of-law provision, the Z court will give consideration to the fact that the contract was drafted unilaterally by B, the dominant party, and then presented to A on a "take-it-or-leave-it" basis.

Comment on Subsection (1):

c. Issues the parties could have determined by explicit agreement directed to particular issue. The rule of this Subsection is a rule providing for incorporation by reference and is not a rule of choice of law. The parties, generally speaking, have power to determine the terms of their contractual engagements. They may spell out these terms in the contract. In the alternative, they may incorporate into the contract by reference extrinsic material which may, among other things, be the provisions of some foreign law. In such instances, the forum will apply the applicable provisions of the law of the designated state in order to effectuate the intentions of the parties. So much has never been doubted. The point deserves emphasis nevertheless because most rules of contract law are designed to fill gaps in a contract which the parties could themselves have filled with express provisions. This is generally true, for example, of rules relating to construction, to conditions precedent and subsequent, to sufficiency of performance and to excuse for nonperformance, including questions of frustration and impossibility. As to all such matters, the forum will apply the provisions of the chosen law.

Whether the parties could have determined a particular issue by explicit agreement directed to that issue is a question to be determined by the local law of the state selected by application of the rule of § 188. Usually, however, this will be a question that would be decided the same way by the relevant local

law rules of all the potentially interested states. On such occasions, there is no need for the forum to determine the state of the applicable law.

Illustrations:

4. In State X, A establishes a trust and provides that B, the trustee, shall be paid commissions at the highest rate permissible under the local law of state Y. A and B are both domiciled in X, and the trust has no relation to any state but X. In X, the highest permissible rate of commissions for trustees is 5 per cent. In Y, the highest permissible rate is 4 per cent. The choice-of-law provision will be given effect, and B will be held entitled to commissions at the rate of 4 per cent.

5. Same facts as in Illustration 4 except that the highest permissible rate of commissions in X is 4 per cent and in Y is 5 per cent. Effect will not be given to the choice-of-law provision since under X local law the parties lacked power to provide for a rate of commissions in excess of 4 per cent and Y, the state of the chosen law, has no relation to the parties or the trust.

Comment on Subsection (2):

d. Issues the parties could not have determined by explicit agreement directed to particular issue. The rule of this Subsection applies only when two or more states have an interest in the determination of the particular issue. The rule does not apply when all contacts are located in a single state and when, as a consequence, there is only one interested state. Subject to this qualification, the rule of this Subsection applies when it is sought to have the chosen law determine issues which the parties could not have determined by explicit agreement directed to the particular issue. Examples of such questions are those involving capacity, formalities and substantial validity. A person cannot vest himself with contractual capacity by stating in the contract that he has such capacity. He cannot dispense with formal requirements, such as that of a writing, by agreeing with the other party that the contract shall be binding without them. Nor can he by a similar device avoid issues of substantial validity, such as whether the contract is illegal. Usually, however, the local law of the state chosen by the parties will be applied to regulate matters of this sort. And it will usually be applied even when to do so would require disregard of some local provision of the state which would otherwise be the state of the applicable law.

Permitting the parties in the usual case to choose the applicable law is not, of course, tantamount to giving them complete freedom to contract as they will. Their power to choose the applicable law is subject to the two qualifications set forth in this Subsection (see Comments *f-g*).

e. Rationale. Prime objectives of contract law are to protect the justified expectations of the parties and to make it possible for them to foretell with accuracy what will be their rights and liabilities under the contract. These objectives may best be attained in multistate transactions by letting the parties choose the law to govern the validity of the contract and the rights created thereby. In this way, certainty and predictability of result are most likely to be secured. Giving parties this power of choice is also consistent with the fact that, in contrast to other areas of the law, persons are free within broad limits to determine the nature of their contractual obligations.

An objection sometimes made in the past was that to give the parties this power of choice would be tantamount to making legislators of them. It was argued that, since it is for the law to determine the validity of a contract, the parties may have no effective voice in the choice of law governing validity unless there has been an actual delegation to them of legislative power. This view is now obsolete and, in any event, falls wide of the mark. The forum in each case selects the applicable law by application of its own choice-of-law rules. There is nothing to prevent the forum from employing a choice-of-law rule which provides that, subject to stated exceptions, the law of the state chosen by the parties shall be applied to determine the validity of a contract and the rights created thereby. The law of the state chosen by the parties is applied, not because the parties themselves are legislators, but simply because this is the result demanded by the choice-of-law rule of the forum.

It may likewise be objected that, if given this power of choice, the parties will be enabled to escape prohibitions prevailing in the state which would otherwise be the state of the applicable law. Nevertheless, the demands of certainty, predictability and convenience dictate that, subject to some limitations, the parties should have power to choose the applicable law.

On occasion, the parties may choose a law that would declare the contract invalid. In such situations, the chosen law will not be applied by reason of the parties' choice. To do so would defeat the expectations of the parties which it is the purpose of the present rule to protect. The parties can be assumed to have intended that the provisions of the contract would be

binding upon them (cf. § 188, Comment *b*). If the parties have chosen a law that would invalidate the contract, it can be assumed that they did so by mistake. If, however, the chosen law is that of the state of the otherwise applicable law under the rule of § 188, this law will be applied even when it invalidates the contract. Such application will be by reason of the rule of § 188, and not by reason of the fact that this was the law chosen by the parties.

Illustrations:

6. In state X, P and D initial an agreement which calls for performance in state Y. The contract states that the rights of the parties thereunder shall be determined by Y law. In X, P sues D for breach of the contract, and D defends on the ground that the contract is void under the X statute of frauds, since it was not signed by him. The contract, however, is valid under Y local law. The X court will find for P.

7. H and W, husband and wife, are domiciled in state X. In state Y, W enters into a contract with C, who is domiciled and doing business in that state, in which C agrees to sell goods to H on credit in return for a guaranty from W in the amount of \$1,000.00. The contract recites that it shall be governed by X law. Under the local law of X, married women have full contractual capacity. Under the local law of Y, however, they lack capacity to bind themselves as sureties for their husbands. In an action by C against W, the contract will not be held invalid for lack of contractual capacity on the part of W.

8. A executes and delivers to B in state X an instrument in which A agrees to indemnify B against all losses arising from B's liability on a certain appeal bond on behalf of C, against whom a judgment has been rendered in state Y. The instrument recites that it shall be governed by the law of Y. It is valid and enforceable under the local law of Y but is unenforceable for lack of consideration under the local law of X. In an action by B against A, the instrument will not be held invalid for lack of consideration.

Comment:

f. Requirement of reasonable basis for parties' choice. The forum will not apply the chosen law to determine issues the parties could not have determined by explicit agreement directed to the particular issue if the parties had no reasonable

basis for choosing this law. The forum will not, for example, apply a foreign law which has been chosen by the parties in the spirit of adventure or to provide mental exercise for the judge. Situations of this sort do not arise in practice. Contracts are entered into for serious purposes and rarely, if ever, will the parties choose a law without good reason for doing so.

When the state of the chosen law has some substantial relationship to the parties or the contract, the parties will be held to have had a reasonable basis for their choice. This will be the case, for example, when this state is that where performance by one of the parties is to take place or where one of the parties is domiciled or has his principal place of business. The same will also be the case when this state is the place of contracting except, perhaps, in the unusual situation where this place is wholly fortuitous and bears no real relation either to the contract or to the parties. These situations are mentioned only for purposes of example. There are undoubtedly still other situations where the state of the chosen law will have a sufficiently close relationship to the parties and the contract to make the parties' choice reasonable.

The parties to a multistate contract may have a reasonable basis for choosing a state with which the contract has no substantial relationship. For example, when contracting in countries whose legal systems are strange to them as well as relatively immature, the parties should be able to choose a law on the ground that they know it well and that it is sufficiently developed. For only in this way can they be sure of knowing accurately the extent of their rights and duties under the contract. So parties to a contract for the transportation of goods by sea between two countries with relatively undeveloped legal systems should be permitted to submit their contract to some well-known and highly elaborated commercial law.

g. When application of chosen law would be contrary to fundamental policy of state of otherwise applicable law. Fulfillment of the parties' expectations is not the only value in contract law; regard must also be had for state interests and for state regulation. The chosen law should not be applied without regard for the interests of the state which would be the state of the applicable law with respect to the particular issue involved in the absence of an effective choice by the parties. The forum will not refrain from applying the chosen law merely because this would lead to a different result than would be obtained under the local law of the state of the otherwise applicable law. Application of the chosen law will be refused only (1) to protect

a fundamental policy of the state which, under the rule of § 188, would be the state of the otherwise applicable law, provided (2) that this state has a materially greater interest than the state of the chosen law in the determination of the particular issue. The forum will apply its own legal principles in determining whether a given policy is a fundamental one within the meaning of the present rule and whether the other state has a materially greater interest than the state of the chosen law in the determination of the particular issue. The parties' power to choose the applicable law is subject to least restriction in situations where the significant contacts are so widely dispersed that determination of the state of the applicable law without regard to the parties' choice would present real difficulties.

No detailed statement can be made of the situations where a "fundamental" policy of the state of the otherwise applicable law will be found to exist. An important consideration is the extent to which the significant contacts are grouped in this state. For the forum will be more inclined to defer to the policy of a state which is closely related to the contract and the parties than to the policy of a state where few contacts are grouped but which, because of the wide dispersion of contacts among several states, would be the state of the applicable law if effect were to be denied the choice-of-law provision. Another important consideration is the extent to which the significant contacts are grouped in the state of the chosen law. The more closely this state is related to the contract and to the parties, the more likely it is that the choice-of-law provision will be given effect. The more closely the state of the chosen law is related to the contract and the parties, the more fundamental must be the policy of the state of the otherwise applicable law to justify denying effect to the choice-of-law provision.

To be "fundamental," a policy must in any event be a substantial one. Except perhaps in the case of contracts relating to wills, a policy of this sort will rarely be found in a requirement, such as the statute of frauds, that relates to formalities (see Illustration 6). Nor is such policy likely to be represented by a rule tending to become obsolete, such as a rule concerned with the capacity of married women (see Illustration 7), or by general rules of contract law, such as those concerned with the need for consideration (see Illustration 8). On the other hand, a fundamental policy may be embodied in a statute which makes one or more kinds of contracts illegal or which is designed to protect a person against the oppressive use of superior bargaining power. Statutes involving the rights of an individual in-

sured as against an insurance company are an example of this sort (see §§ 192–193). To be “fundamental” within the meaning of the present rule, a policy need not be as strong as would be required to justify the forum in refusing to entertain suit upon a foreign cause of action under the rule of § 90.

Illustrations:

9. In state X, A and B, who are both domiciled in that state, negotiate the terms of a contract which is to be performed in X. The contract provides that it shall be governed by the law of state Y; it is signed first by A in X and then by B in Y. A suit involving the validity of the contract is brought before a court of state Z. The court will be more inclined to deny effect to the choice-of-law provision in deference to X policy than it would have been if the elements had not been massed to so great an extent in X.

10. In state X, the A insurance company issues a life insurance policy insuring the life of B. A is incorporated and has its “home office” in X while B is domiciled in state Y. The policy contains a provision stating that the rights of the parties thereunder shall be determined by X law. In his application for the policy, given by B to A’s agent in Y, B made a misstatement which under the local law of X would serve as a complete defense to the insurer in a suit on the policy, but would not have this effect under a statute of Y. B brings suit on the policy in a court in state Z. Under the rule of § 192, Y is the state whose local law would govern the validity of the contract in the absence of an effective choice of law by the parties. The Z court will deny effect to the choice-of-law provision.

Comment on Subsection (3):

h. Reference is to “local law” of chosen state. The reference, in the absence of a contrary indication of intention, is to the “local law” of the chosen state and not to that state’s “law,” which means the totality of its law including its choice-of-law rules. When they choose the state which is to furnish the law governing the validity of their contract, the parties almost certainly have the “local law,” rather than the “law,” of that state in mind (compare § 186, Comment *b*). To apply the “law” of the chosen state would introduce the uncertainties of choice of law into the proceedings and would serve to defeat the basic objectives, namely those of certainty and predictability, which the choice-of-law provision was designed to achieve.

i. *Choice of two laws.* The extent to which the parties may choose to have the local law of two or more states govern matters that do not lie within their contractual capacity is uncertain. For example, it is uncertain whether the parties may effectively provide that their capacity to make the contract shall be governed by the local law of one state and the question of formalities by the local law of another. When the parties are domiciled in different states and each has capacity to enter into the contract under the local law of his domicile, they should, subject to the conditions stated in the rule of this Section, be able effectively to provide in the contract that the capacity of each shall be determined by the local law of his domicile.

Restatement (Second) Conflict of Laws

§ 188. Law Governing in Absence of Effective Choice by the Parties

(1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in § 6.

(2) In the absence of an effective choice of law by the parties (see § 187), the contacts to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:

- (a) the place of contracting,
- (b) the place of negotiation of the contract,
- (c) the place of performance,
- (d) the location of the subject matter of the contract, and
- (e) the domicile, residence, nationality, place of incorporation and place of business of the parties.

These contacts are to be evaluated according to their relative importance with respect to the particular issue.

(3) If the place of negotiating the contract and the place of performance are in the same state, the local law of this state will usually be applied, except as otherwise provided in §§ 189-199 and 203.