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Management Alert

Ninth Circuit Finds California Arbitration Law Preempted

Relying on the U.S. Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*, the Ninth Circuit Court of Appeals recently held that California's rule against compulsory arbitration of claims for public injunctive relief was preempted by the Federal Arbitration Act ("FAA"). The Court also underscored the key points of an enforceable arbitration clause. *Kilgore v. KeyBank* (March 7, 2012).

Case Background

Plaintiffs Matthew Kilgore and William Fuller, former students at a bankrupt helicopter vocational school, filed a putative class action against KeyBank, the school's preferred tuition lender. Plaintiffs alleged that KeyBank was aware the school was moving toward bankruptcy, but continued loaning tuition money to students in violation of California's Unfair Competition Law ("UCL"). Plaintiffs sought exclusively injunctive relief, including an order preventing KeyBank from enforcing the student loan agreements Plaintiffs and other students had signed with KeyBank. The agreements contained an arbitration clause, as well as language on how to opt out of the arbitration provision. Neither Plaintiff opted out of arbitration.

KeyBank first removed the case to federal court, then moved to compel arbitration under the arbitration clause. The District Court denied the motion, holding that California's rule prohibiting arbitration of injunctive relief claims rendered the arbitration clause unenforceable. The District Court issued its ruling prior to the U.S. Supreme Court's *Concepcion* decision. The District Court also declined to address whether the arbitration clause was unconscionable, having first determined that the Plaintiffs' claims were not arbitrable.

KeyBank appealed, arguing that the District Court erred in denying its motion to compel arbitration. The parties also invited the Court of Appeals to address the concsionability of the arbitration clause.

The Court's Holding

The Ninth Circuit reversed the District Court. In doing so, it recognized that the District Court properly decided the issues before it based on pre-*Concepcion* law. Under prior California precedent, arbitration agreements were not enforceable in cases where a plaintiff was seeking injunctive relief as a "private attorney general" on behalf of the general public or public injunctive relief under California's UCL. These decisions were premised on the assumption that the California Legislature could avoid FAA preemption if it did not intend the type of injunctive relief provided for in the legislation to be arbitrated. These decisions were also based on criticisms of private arbitration in cases where there was something at stake for the general public. In 2007, the Ninth Circuit adopted this reasoning in *Davis v. O'Melveny & Meyers*, holding that actions seeking public injunctions cannot be subject to arbitration, even under a valid arbitration clause.

The U.S. Supreme Court's decision in *Concepcion* mandated a new analysis and a new result, however, according to the Ninth Circuit. The panel held that California's rule could not survive *Concepcion* because it "prohibits outright the arbitration

of a particular type of claim." The Court reasoned that such a blanket rule violated the principles of *Concepcion*. *Concepcion* rejected state laws that prohibit arbitration in particular kinds of cases – there class action cases – because they create schemes inconsistent with the principles of the FAA favoring arbitration.

In further support of its position, the Court also cited the U.S. Supreme Court's recent decision in *Marmet Health Care Center, Inc. v. Brown*. There, the Supreme Court held that the FAA preempted a state law prohibiting arbitration of patient/nursing home disputes on public policy grounds because the state law impermissibly excluded a specific kind of claim from arbitration.

Kilgore and Fuller argued that the California Legislature's decision to allow individuals to bring injunctive relief claims on behalf of the public was not preempted by the FAA, so long as the primary purpose of the injunctive relief was to protect the public. Plaintiffs alleged that to hold otherwise would violate California's public policy of allowing litigants to enforce public rights in a public venue, not through a private arbitrator. In rejecting those arguments, the Court cited *Concepcion's* dismissal of public policy arguments, noting "states cannot require a procedure that is inconsistent with the FAA, even if it desirable for unrelated reasons."

The Ninth Circuit also upheld the arbitration clause against Plaintiffs' argument that it was unconscionable. It stated that the following points rendered it permissible under California law: (1) the clause was in a conspicuous place, in its own section of the agreement; (2) borrowers were allowed to opt out of the arbitration provision; (3) the agreement provided clear instructions regarding how to opt out; (4) the agreement stated more than once and in plain language the rights borrowers would waive if they did not opt out; and (5) the agreement warned borrowers to read the agreement carefully before signing it and requested a promise from the borrower to read the agreement, even if advised not to.

What *Kilgore* Means for Employers

Kilgore provides a strong basis for California employers to move to compel arbitration in line with *Concepcion*, even in cases where employees are exclusively seeking public injunctive relief, such as under California's UCL. *Kilgore* also provides additional guidance regarding the features that should be included in arbitration agreements to prevail in the face of employee arguments regarding unconscionability.

However, the Ninth Circuit's decision in *Kilgore* seems inconsistent with a recent Court of Appeal decision last year in *Brown v. Ralph's Grocery Co.*, in which a split appellate panel of three justices refused to enforce an arbitration agreement that provided for waiver of claims under the California Private Attorneys General Act ("PAGA"). The majority in *Brown* held that the U.S. Supreme Court's opinion in *Concepcion* does not affect PAGA actions, because PAGA actions are essentially public actions to enforce a public policy. The California Supreme Court has declined to review the *Brown* case, but eventually will have to address whether it was correctly decided. (We think it was not.)

By: *Hayley Macon*

Hayley Macon an associate in Seyfarth's Los Angeles office. If you would like further information, please contact your Seyfarth attorney, or Hayley Macon at *hmacon@seyfarth.com*.