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PERSPECTIVE

9th Circuit speaks (twice) on arbitration agreements

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Three weeks ago, the same 9th U.S. Circuit Court of Appeals panel issued a pair of unanimous decisions that reached very different results on whether to enforce arbitration agreements. The first decision, *Ferguson v. Corinthian Colleges,* 2013 DJDAR 14344 (Oct. 28, 2013), upheld the arbitration agreement, declaring that the Federal Arbitration Act preempted a California rule that purports to exempt certain claims from arbitration. The second, *Chavarria v. Ralphs Grocery Co.*, 2013 DJDAR 14307 (Oct. 28, 2013), struck down an arbitration agreement, declaring that it "shocked the conscience" and therefore was unconscionable under California law. Each opinion was authored by Judge Richard Clifton, which might lead some to wonder — especially because the opinions were issued a couple of days before Halloween — if a strange case of Dr. Jekyll and Mr. Hyde was afoot.

But a closer look at the opinions reveals that they are fully consistent with each other — and with applicable Supreme Court precedent. Taken together, *Ferguson* and *Chavarria* underscore three key points for the enforceability of arbitration agreements in California:

» The FAA prohibits California (and every other state) from placing off-limits to arbitration particular types of claims or remedies — regardless of the asserted state policy interest.

» State unconscionability law remains available as a ground for refusing to enforce arbitration agreements, so long as the unconscionability principle being asserted is applicable to all types of contracts, rather than targeted towards or having a disproportionate impact on arbitration agreements.

» Courts will continue to strike down arbitration agreements as unconscionable when they contain features deemed extremely unfair.

Ferguson

The plaintiffs in *Ferguson* had filed two putative class actions against Corinthian Colleges, which "owns and operates a number of ... for-profit academic institutions." They alleged that Corinthian misled them about their future employment prospects and the availability of financial aid in violation of California's Unfair Competition Law, False Advertising Law, and Consumers Legal Remedies Act. They sought both damages and an injunction against Corinthian's allegedly improper practices. The district court held that the claims for money damages had to be arbitrated, but relied on the state Supreme Court's "*Broughton-Cruz*" rule in holding that claims for injunctions on behalf of the general public, a remedy available under those state statutes, could not be arbitrated. See *Broughton v. Cigna Healthplans of California*, 988 P.2d 67 (Cal. 1999); *Cruz v. PacifiCare Health Sys., Inc.,* 66 P.3d 1157 (Cal. 2003).

The 9th Circuit panel reversed. In his opinion for a unanimous court, Judge Clifton (joined by Judges Richard Tallman and Consuelo María Callahan) noted that the en banc 9th Circuit previously had left unaddressed in *Kilgore v. Key Bank*, N.A.,718 F.3d 1052 (9th Cir. 2013), whether the *Broughton-Cruz* rule is preempted by the FAA. The answer, the panel held, is yes, because "the *Broughton-Cruz* rule is clearly irreconcilable with subsequent United States Supreme Court decisions concerning the FAA." The court pointed to *AT&T Mobility LLC v. Concepcion*, in which the U.S. Supreme Court "state[d] that '[w]hen state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA.'" The *Ferguson* court concluded: "That rule also resolves this case. By exempting from arbitration claims for public injunctive relief under the CLRA, UCL, and FAL, the *Broughton-Cruz* rule similarly prohibits outright arbitration of a particular type of claim."

The court also rejected the plaintiffs' argument that the arbitration agreement should be invalidated on the ground that they were unable to "effectively vindicat[e]" their statutory rights under California law in arbitration. As Judge Clifton explained, the "effective vindication" principle — like the argument that there was an "inherent conflict" between public injunctions and arbitration — is "reserved for claims brought under federal statutes." Indeed, even the dissenting opinion in *American Express v. Italian Colors* — in which the U.S. Supreme Court required enforcement of an arbitration agreement and rejected a contention that the agreement precluded vindication of federal antitrust claims — "bluntly stated that ... '[w]e have no earthly interest (quite the contrary) in vindicating' a state law."

The court's decision in *Ferguson* does leave one question unanswered. As the case was presented to the 9th Circuit on appeal, there appears to have been some uncertainty over whether the particular arbitration agreement authorizes claims for public injunctions to be pursued in arbitration, or instead whether the arbitration agreement permitted only individualized injunctions and waived claims for public injunctions (just as Federal Rule 23(b)(2)-type injunctions are waived by an arbitration agreement that includes a class waiver.) The panel concluded that the arbitrator should decide whether he or she has the power to issue a public injunction; if not, the panel stated, the district court could consider anew whether the lack of such power had any consequences for the enforceability of the arbitration agreement.

That said, at least 11 federal judges in California have held that an agreement to arbitrate on an individual basis must be enforced as written, including when the effect is to preclude the pursuit of injunctions on behalf of the general public. That rule makes sense: Claims for public injunctions are just the same as claims for class-wide injunctions — indeed, the UCL requires that a plaintiff satisfy class certification standards to pursue such claims — and therefore fall squarely within *Concepcion*'s mandate. Of course, parties in California will continue to skirmish over this issue.

Chavarria

While *Concepcion* is a decision of enormous significance, some defendants have tried to take it too far — even arguing that it completely precludes plaintiffs from raising any unconscionability challenge to an arbitration agreement. But that broad argument conflicts with *Marmet Health Care Center, Inc. v. Brown*, in which the U.S. Supreme Court remanded the case to allow the state supreme court there to determine whether "the arbitration clauses … are unenforceable under state common law principles that are not specific to arbitration and pre-empted by the FAA." Although the FAA requires California unconscionability law to sweep far less broadly, generally applicable principles continue to provide grounds for challenging arbitration clauses that are extremely unfair to individual consumers and employees.

In *Chavarria*, the 9th Circuit concluded that Ralphs Grocery's employment arbitration procedures failed that test. As Judge Clifton noted, California requires a showing of both procedural and substantive unconscionability; the former deals with the manner in which the contract was formed and the latter examines the fairness of the challenged terms.

In holding that the arbitration provision was procedurally unconscionable, the panel pointed out that (1) the provision was part of a nonnegotiable form contract and (2) the terms of the provision were given to the plaintiff some weeks after she had assented to them — a factor that "enhanced" the "degree of procedural unconscionability."

But even with a heightened degree of procedural unconscionability, California law requires that a contract provision be enforced unless it also is substantively unconscionable. It was on this basis that Ralphs' arbitration agreement foundered. The panel pointed to at least two aspects of the provision that it considered fatal.

First, the 9th Circuit concluded that, under the clause's process for selecting an arbitrator, "Ralphs gets to pick the pool of potential arbitrators every time an employee brings a claim." Notably, the Ralphs provision "preclu[ded]" the use of "institutional arbitration administrators, namely [the American Arbitration Association] or JAMS, which have established rules and procedures to select a neutral arbitrator."

Second, the provision (at least as interpreted by the court) required the parties to split arbitrator fees that could amount to thousands of dollars per day — no matter which party prevailed, unless a U.S. Supreme Court decision dictated otherwise. The court expressed its displeasure with what it termed "pseudo 'AEDPA deference'" — referring to the law governing federal habeas corpus review — stating that it "has no place in employment claims governed by state law." Ultimately, the panel held that the fee-splitting requirement made "access to the forum impracticable" (quoting the *American Express* decision), because "administrative and filing costs ... effectively foreclose pursuit of the claim. Ralphs has constructed an arbitration system that imposes non-recoverable costs on employees just to get in the door."

These substantive unconscionability holdings were not preempted by the FAA, the court explained, because in addition to the "forum access costs" argument that *American Express* arguably leaves open, striking down the arbitrator-selection procedures "does not disfavor arbitration; it provides that the arbitration process must be fair." Indeed, the court suggested, if "state law could not require some level of fairness" — here, arbitrator neutrality — "in an arbitration agreement, there would be nothing to stop an employer from imposing an arbitration clause that ... made its own president the arbitrator of all claims brought by its employees."

While the decision in *Chavarria* may be disappointing to some employers, the vast majority of consumer and employment arbitration agreements in California would likely survive review under that decision. Most agreements select arbitration administrators like the AAA or JAMS, whose procedures are designed to ensure that costs and fees will be allocated fairly and that neutral arbitrators will be selected. The decision takes a far more balanced approach to unconscionability and FAA preemption than the 9th Circuit's pre-*Concepcion* cases, or — more troubling — the state Supreme Court's recent musings about unconscionability in *Sonic Calabasas A, Inc. v. Moreno*.

The bottom line: *Ferguson* and *Chavarria* leave room for optimism that federal courts will enforce arbitration agreements according to their terms, so long as those terms do not bear hallmarks of extreme unfairness.

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