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California Supreme Court Enforces Arbitration Provision in Form Consumer Contract

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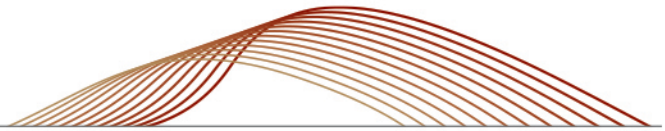
The California Supreme Court last week upheld an arbitration provision in a consumer contract, including a class-action waiver and defendant-favoring appeal terms. The plaintiff claimed the agreement was unconscionable and one-sided, and asked that it be set aside. The California Court of Appeal agreed with the plaintiff, but the California Supreme Court did not. A *bad* bargain is not the same thing as an *unconscionable* bargain, the Supreme Court explained, and it required plaintiff to arbitrate his claim on an individual basis.

The case is *Sanchez v. Valencia Holding Co.*, S199119, 2015 WL 4605381 (Cal. Aug. 3, 2015). To businesses and lawyers in other states, the decision may seem unremarkable. It follows the United States Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011), and recognizes that (i) arbitration agreements normally should be enforced according to their terms, and (ii) states may not apply to arbitration agreements different rules from those that apply to other contracts. But this is California. Because California has historically shown a reluctance to enforce arbitration provisions despite the Federal Arbitration Act's command to do so, the decision is important, particularly for those facing consumer and employment litigation in California's state courts.

Sanchez, however, left open the possibility that a different arbitration provision with different facts may well be unconscionable, the Federal Arbitration Act notwithstanding. While the California High Court now has bowed in the direction of the U.S. Supreme Court's pro-arbitration rulings upholding arbitration terms even in form consumer contracts and standardized employment agreements, we expect continued disputes in California over what agreements are and are not enforceable.

Background and the Court's Decision: California Adheres to Federal Arbitration Act Preemption

Sanchez arose from the purchase of a 2006 "preowned" Mercedes-Benz in 2008 from a dealership Valencia owned. Slip op. at 2. In March 2010, Sanchez brought a consumer class action against Valencia alleging various California consumer-protection laws, including the Consumer Legal Remedies Act (CLRA). *Id.* at 2-3. After Sanchez sued, Valencia moved to compel arbitration, citing an arbitration clause in the sales contract. *Id.* This arbitration agreement included a class-action waiver. *Id.* The trial court denied Valencia's motion to compel arbitration, finding the class waiver unenforceable under the CLRA. *Id.* at 3.



Thereafter, however, the U.S. Supreme Court decided *Concepcion*, which held that the Federal Arbitration Act preempts state laws that would invalidate class-action waivers in arbitration agreements. *Id.* at 6.

On appeal, the California Court of Appeal declined to decide whether the class waiver was enforceable in light of *Concepcion*, but nonetheless affirmed on other grounds the trial court's decision that the arbitration agreement was procedurally and substantively unconscionable. *Id.* Procedurally, the Court of Appeal found the agreement marked by both oppression and surprise. *Id.* The Court of Appeal noted that arbitration clause was on the back side of the purchase agreement; the seller did not explain the purpose or effect of the arbitration clause; and the buyer claimed that he was not invited to negotiate the clause. *Id.* Substantively, the Court of Appeal found several provisions in the arbitration agreement unconscionable, including a provision limiting appeals to instances where the arbitration award was zero, exceeded $100,000, or included injunctive relief; a provision requiring the appealing party to advance the filing fees and costs of the appeal; and a provision that exempting from arbitration repossession of the automobile. *Id.* at 6-7.

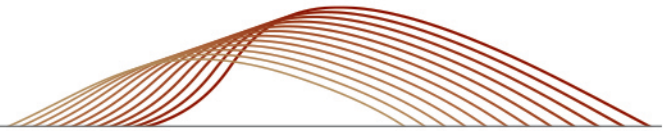
The California Supreme Court granted review and reversed. *Id.* at 2. A litigant claiming a contract is unconscionable faces a high burden: "Commerce depends," the Court explained, "on the enforceability, in most instances, of a duly executed written contract. A party cannot avoid a contractual obligation merely by complaining that the deal in retrospect, was unfair or a bad bargain. Not all one-sided contract provisions are unconscionable[.]" *Id.* at 9.

The Court reiterated California's black-letter law that "the doctrine of unconscionability has both a procedural and substantive element, the former on oppression or surprise due to unequal bargaining power, the latter on overly harsh terms." *Id.* at 7 (internal quotation marks omitted).

Here, the adhesive nature of the Defendant's contract provided some degree of procedural unconscionability. *Id.* at 14. This was unsurprising. As the Court of Appeal had noted, this was a form contract, and the plaintiff (the buyer) could not opt out of the arbitration provision or negotiate it. *Id.* at 12. A party alleging procedure unconscionability need not show that he or she attempted unsuccessfully to negotiate the disputed provision; a court will determine for itself from all the facts whether in fact the provision was adhesive and nonnegotiable. *See Id*. at 12-13.

Even so, the High Court rejected arguments litigants often make in claiming a trial court should not enforce an arbitration provision. The Court rejected the argument that there was procedural unconscionability because the defendant (the seller) had not called the arbitration provision to the plaintiff's attention: "Valencia was under no obligation," the Court explained, "to highlight the arbitration clause of its contract, nor was it required to specifically call that clause to Sanchez's attention. Any state law imposing such an obligation would be preempted." *Id.* at 13. Likewise, the High Court gave little weight to plaintiff's claim that he failed to read his contract: "As in many consumer transactions involving standard form contracts, Sanchez apparently did not read the entirety of his contract, including the arbitration clause." *Id.* That was of no moment, the Court said.

As for the arbitration provision's substantive terms, the Court explained that "the central idea" in substantive unconscionability analysis "is . . . not [whether the parties made] a simple old-fashioned bad bargain, but [whether there are] terms that are unreasonably unfavorable to the more powerful party." *Id.* at 8 (internal citations omitted). Previous courts had looked to whether the arbitration provision was "overly harsh," "unduly oppressive," or "so one-sides as to shock the conscience." The High Court explained these tests all meant the same thing. Thus, while the ultimate words courts use



to analyze the claim may differ, the Court reiterated that the plaintiff's burden was substantial. A deal a party later believes is a bad one or an unfair one is not necessarily unconscionable; the unfairness must be beyond tolerable.

Assessing the arbitration agreement provisions under this test, the High Court held that none of its requirements was substantively unconscionable. The Court explained, for example, that the right to appeal an injunction award (which plaintiff claimed unfairly favored the defendant) was not unconscionable given the "potentially far-reaching nature of an injunctive relief remedy." *Id.* at 17. Though leaving open the possibility that a future case might differ on its facts, the Court also held that the requirement that the appealing party must advance the costs of the appeal was not unconscionable given that the "case concern[ed] a high-end luxury item[,]" and "no evidence in the record suggests . . . that the cost of appellate arbitration filing fees were unaffordable for [the plaintiff.]" *Id.* at 23. The Court similarly dismissed the claim that the reservation of self-help remedies was too unfair, recognizing that "it [was] undisputed that the remedy of repossession of collateral is an integral part of the business of selling automobiles on credit and fulfills a legitimate commercial need." *Id.* at 25 (internal citations omitted). Finally, the Court confirmed that the Federal Arbitration Act preempted the CLRA's bar on class-action waivers, and as such, the arbitration provision's class-action waiver had no effect on the unconscionability analysis. *Id.* at 25-26.

Key Takeaways

As noted above, *Sanchez* bowed to and applied the U.S. Supreme Court's Federal Arbitration Act precedents. We do not, however, expect that disputes over enforceability in California will abate.

On the one hand:

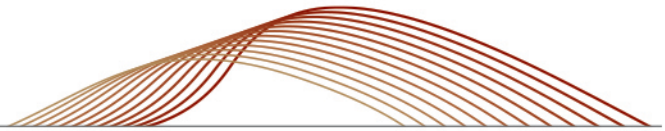
- *Sanchez* makes clear that the standards courts should apply to arbitration agreements must be the same as the standards for all contracts. A court may not burden the exercise of the arbitration right or otherwise apply heightened scrutiny. Parties defending their arbitration provisions should therefore look to see whether the party contesting the clause has otherwise acknowledged the validity of the rest of the contract (thus suggesting the arbitration clause itself is valid), or is otherwise applying a standard that would single out arbitration provisions for special treatment.

- A business has no obligation to call special attention to an arbitration provision in its contracts.

On the other hand:

- The Court explained that applying unconscionability rules will produce different results according to the context. Among other things, we expect plaintiffs to contend that the result in *Sanchez* is explainable by, and perhaps limited to, its unusual context (the purchase of a luxury good), and is not readily transferable to other consumer contracts, or to arbitration agreements covering the employment relationship. Though the Court's reasoning suggests its analysis should apply in most circumstances, we expect that plaintiffs will try to cabin *Sanchez* to its facts.

Sanchez confirms that unconscionability remains a viable challenge to unduly one-sided arbitration provisions. Companies that overreach, by drafting draft extreme provisions or those that impose excessive costs on consumers or employees, may do so at their peril.



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