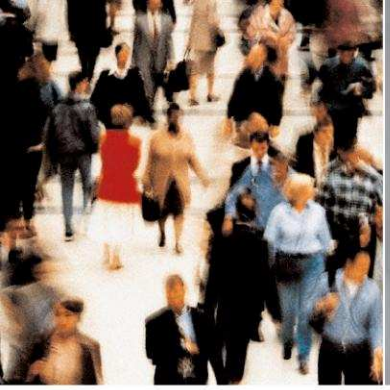

Class Action Alert
Recent developments in class action law

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Ninth Circuit applies *Concepcion* to invalidate California's "public injunction" exception to arbitration and further upholds KeyBank's "opt-out" clause

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The Supreme Court's pro arbitration message from *Concepcion* has once again reached the Ninth Circuit U.S. Court of Appeals with a direct impact on California's Unfair Competition Law. In its March 7, 2012, decision in the putative class action captioned *Kilgore, et al. v. KeyBank, National Association*, No. 09-16703, a three-judge panel of the Ninth Circuit[1] scuttled a line of California cases[2] mandating that arbitration agreements in California are not enforced where the plaintiff is "functioning as a private attorney general" in that the only relief sought is an injunction "enjoining future deceptive practices on behalf of the general public." *Id.* at 2645 (quoting *Broughton v. Cigna Health-plans of California*, 988 P.2d 67, 76 (Cal. 1999)). Despite misgivings that the ruling might reduce the effectiveness of California's robust consumer protection laws, the Ninth Circuit concluded that, following the Supreme Court's recent decision in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011), there could be no doubt that the Federal Arbitration Act ("FAA") preempts the California law. The Ninth Circuit also ruled that the plaintiffs could not prevail on their alternative argument that the arbitration clause was unconscionable because KeyBank provided its borrowers with a meaningful opportunity to "opt-out" of arbitration.

The *Kilgore* lawsuit was brought by two disgruntled students of Silver State Helicopters, LLC ("SSH"), a national aviation school that closed operations and declared bankruptcy in February 2008. KeyBank had been one of the lenders to SSH students. The plaintiffs, seeking to represent a class of former California-based SSH students, claimed that SSH did not deliver on the education it promised, and that under California's Unfair Competition Law ("UCL"), KeyBank, as a preferred lender, should be held liable for SSH's failures. Seeking a judicial forum for their class action, the plaintiffs filed four different complaints, the last one of which contained carefully crafted allegations to trigger California's public injunction exception. Rather than seeking damages from KeyBank, the plaintiffs

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[1] Circuit Judges Stephen S. Trott and Carlos T. Bea, and District Judge Rebecca R. Pallmeyer, sitting by designation.

[2] *Broughton v. Cigna Health-plans of California*, 988 P.2d 67 (Cal. 1999); *Cruz v. Pacificare Health Systems, Inc.*, 66 P.3d 1157 (Cal. 2003). *See also Davis v. O'Melveny & Myers*, 485 F.3d 1066, 1082 (9th Cir. 2007) (applying California rule against arbitrating actions seeking public injunctions).

asked for an order enjoining KeyBank from enforcing its SSH promissory notes and from reporting delinquencies to the credit reporting agencies. Each of those promissory notes contained an arbitration clause providing that either party could elect binding arbitration of any disputes.

KeyBank elected to arbitrate the dispute and filed a motion asking the U.S. District Court for the Northern District of California to stay the *Kilgore* lawsuit and compel arbitration. Judge Thelton E. Henderson denied KeyBank's motion based on California's policy against arbitrating cases seeking a public injunction. KeyBank preserved the arbitration issue by immediately filing for interlocutory appeal pursuant to the FAA, but the district court retained jurisdiction and ruled on KeyBank's alternative motion to dismiss.[3] Ironically, the district court granted KeyBank's motion to dismiss, ruling that the National Bank Act and the regulations of the Office of the Comptroller of the Currency preempt plaintiffs' UCL claims. Plaintiffs appealed the district court's dismissal order to the Ninth Circuit and that appeal was consolidated with KeyBank's appeal of the arbitration decision.

The Ninth Circuit panel viewed the arbitration appeal as a threshold issue. Analyzing the text of the FAA, the panel recognized that where the parties to a contract have agreed to arbitration, the FAA "leaves no place for the exercise of discretion by a district court, but instead mandates that district courts *shall* direct the parties to proceed to arbitration." *Id.* at 2640 (quoting *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 218 (1985)). The limited exception to this mandate is where the arbitration clause would be unenforceable "upon such grounds as exist at law or in equity for the revocation of *any* contract." *Id.* at 2641 (emphasis added) (quoting 9 U.S.C. § 2). Thus, "a state statute or judicial rule that applies only to arbitration agreements, and not to contracts generally, is preempted by the FAA." *Id.*

As the Ninth Circuit acknowledged, the recent ruling in *Concepcion* is just the latest in a line of Supreme Court cases that have vigorously applied FAA preemption against state laws that are hostile to arbitration. In *Concepcion*, the Supreme Court threw out California's *Discover Bank* rule, which had prohibited as unconscionable all arbitration clauses that require a consumer to arbitrate all disputes in an individual bilateral arbitration and never as part of a plaintiff or class member in a class action proceeding.[4] The Court ruled that the FAA preempted California's anti-class action waiver rule because "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA." *Id.* at 2644 (quoting *Concepcion*, 131 S. Ct. at 1748). Notably, the Court stated that states "cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons." *Id.* (quoting *Concepcion*, 131 S. Ct. at 1753).

The Ninth Circuit recognized that the rationale of *Concepcion* also mandates the end of California's public injunction rule. That rule prohibits arbitration of claims that seek an injunction for the benefit of the public. Because the California rule "prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA." *Id.* at 2643 (quoting *Concepcion*, 131 S. Ct. at 1747); *see also Id.* at 2650 (citing *In Marmet Health Care Center, Inc. v. Brown*, Nos. 11-391 and 11-394, 2012 U.S. LEXIS 1076 (Feb. 21, 2012) (per curiam) (preempting West Virginia law that prohibited arbitration of personal injury and wrongful death claims). In other

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[3] Unlike the majority of other circuits, in the Ninth Circuit the district court is not divested of jurisdiction upon a timely filed interlocutory appeal. That situation resulted in further proceedings before the district court while the appeal was pending.

[4] *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005).

words, Congresses' judgment, embodied in the text of the FAA, that all valid agreements to arbitrate should be enforced trumps any state legislature's conclusion that arbitration is not suitable in some cases.

The Ninth Circuit recognized, however, that *Concepcion* did not overthrow general common law contract defenses like unconscionability. The Court ruled that KeyBank's arbitration clause was not procedurally unconscionable because it was conspicuously displayed in the promissory note and was written in plain language. *Id.* at 2655. More importantly, the promissory note provided a meaningful opportunity for the borrower to opt-out of the arbitration agreement by submitting an opt-out notice to KeyBank in writing within 60 days. The promissory note set forth in plain language, in multiple locations in the document, the rights that plaintiff would waive by failing to opt-out. *Id.* The panel rejected plaintiffs' arguments that KeyBank did not go far enough. The opt-out instructions were clear and easy to follow, and, even to the extent that "Plaintiffs claim that they were so 'intoxicated by helicopters' that they never saw the arbitration clause, [the Court] refer[s] them to the end of the Note. Immediately above each Plaintiff's signature line is a warning that the student should read the contract carefully before signing, as well as a promise from the student that he would do so 'even if otherwise advised.'" *Id.* at 2656. Finding that the arbitration clause was not procedurally unconscionable, the Court did not address whether the terms of the clause were substantively unconscionable. *Id.*

Having concluded that the motion to compel arbitration should have been granted, the Ninth Circuit found that the district court's dismissal order was a nullity. The Ninth Circuit vacated the judgment in favor of KeyBank and remanded to the district court with instructions to enter an order staying the case and compelling arbitration. Thus, by winning its arbitration argument, KeyBank's favorable judgment on the merits based also on preemption was vacated. But given the broad repercussions of this ruling, including the expansion of *Concepcion* and the Ninth Circuit's explicit validation of KeyBank's arbitration clause and opt-out provision, it was a worthwhile exchange. Additionally, while the two *Kilgore* plaintiffs may continue to pursue their claims, they must do so as individuals as the arbitration agreement has a class waiver.

For consumer-facing companies with arbitration agreements, the *Kilgore* opinion is an important read to assess whether your provision would pass the unconscionability filter applied by this Court. Also, if you are managing cases in which efforts to compel arbitration have been defeated because injunctive relief is involved, this authority gives new vitality to your argument.

Nixon Peabody was counsel to KeyBank in this proceeding.

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