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9th Circuit: Federal Arbitration Act Preempts California's *Broughton-Cruz* Rule on Claims for Injunctive Relief

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Following the U.S. Supreme Court's decision favoring arbitration clauses in AT&T Mobility LLC v. Concepcion*, the Ninth Circuit Court of Appeals has now held in* Kilgore v. KeyBank, N.A. *that the Federal Arbitration Act ("FAA") preempts the California* Broughton-Cruz *rule that prohibited arbitration of claims for injunctive relief under California's Unfair Competition Law. The Ninth Circuit also rejected the plaintiffs' claim that the arbitration clause was unconscionable, noting that the clause was conspicuous and contained an opt-out provision.*

In *Kilgore v. KeyBank, N.A.*, No. 09-16703, 2012 WL 718344 (Mar. 7, 2012), the Ninth Circuit upheld an arbitration clause in an injunctive relief case brought under California's Unfair Competition Law ("UCL"). The Ninth Circuit held that the FAA preempted California's "*Broughton-Cruz* rule" – named after the decisions in *Broughton v. Cigna Healthplans*, 21 Cal. 4th 1066 (1999) and *Cruz v. Pacificare Health Systems, Inc.*, 30 Cal. 4th 1157 (2003), in which the California Supreme Court refused to enforce arbitration clauses in cases seeking public injunctive relief. The *Kilgore* decision reflects the continuing impact of, and debate over, the U.S. Supreme Court's recent decision in *AT&T Mobility LLC v. Concepcion*, 563 U.S. ___, 131 S. Ct. 1740 (2011) ("*Concepcion*").

Background of the Underlying Dispute and District Court Proceedings

Plaintiffs, former students of a private helicopter vocational school, had taken out loans with KeyBank to pay for their helicopter training. Before Plaintiffs completed their training, the school filed for bankruptcy. KeyBank had paid the school the full amount of each Plaintiff's loan. Plaintiffs alleged that the school was a "sham aviation school" that targeted limited-income individuals who could not afford to pay for their pilot training without taking out student loans. Because the school filed for bankruptcy protection, Plaintiffs filed a putative class action lawsuit against the school's "preferred lender," KeyBank. Plaintiffs asserted claims of unfair competition under the UCL. Plaintiffs did not seek damages, but instead sought only an order enjoining KeyBank from (1) reporting any default by class members under the loan's promissory note

("Note"), (2) enforcing the Notes against class members, and (3) "engaging in false and deceptive acts and practices" with respect to consumer credit contracts involving purchase money loans.

KeyBank moved to compel arbitration. The Notes contained an arbitration clause, included in a separate section entitled "**ARBITRATION**." The arbitration clause informed Plaintiffs that they could opt out of the clause within 60 days of signing, and that if they did not opt out, they would give up their right to litigate any claim in court and to proceed with any claim on a class basis. Conspicuous statements immediately above Plaintiffs' signature lines restated that the student understood that the Note contained an arbitration clause, warned of the importance of thoroughly reading the Note before signing, and stated that the student would not sign the Note before he or she read it.

The district court, applying California law, denied KeyBank's motion to compel arbitration. It held that the *Broughton-Cruz* rule prohibited the arbitration of Plaintiffs' injunctive relief claims, and therefore the arbitration clause was unenforceable. While KeyBank's appeal was pending, the U.S. Supreme Court issued its *Concepcion* decision.

Concepcion's Effect on the *Broughton-Cruz* Rule

On appeal, the Ninth Circuit first noted that the FAA allows private arbitration agreements to be invalidated only "upon such grounds as exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2 (emphasis *Kilgore*'s). A state statute or judicial rule that applies only to arbitration agreements, and not to contracts generally, is preempted by the FAA. It next noted that *Concepcion* identified two situations in which a state law rule will be preempted by the FAA. First, "when a state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA." A second, and more complex, situation occurs when a state law rule takes a generally applicable doctrine, such as unconscionability, and applies it in a fashion that "stand[s] as an obstacle" to the FAA's objectives of ensuring that "private arbitration agreements are enforced according to their terms."

Applying this framework to determine whether the FAA preempts California's *Broughton-Cruz* rule, the Ninth Circuit concluded that the federal law prevailed. Although the district courts in California had reached different conclusions, the Ninth Circuit held that the *Broughton-Cruz* rule prohibited outright the arbitration of a particular type of claims, and therefore "the analysis is simple: The conflicting [*Broughton-Cruz*] rule is displaced by the FAA. *Concepcion*, 131 S. Ct. at 1747. *Concepcion* allows for no other conclusion."

The Court disagreed with the argument that preemption would reduce the effectiveness of state laws like the UCL and frustrate state legislatures. First, *Concepcion* rejected the notion that state public policy rationales – however worthy – can be used to invalidate an otherwise enforceable arbitration agreement. The Court pointed out that "the Supreme Court recently relied on *Concepcion* to reaffirm the FAA's preemption of state public policy justifications" in *Marmet Health Care Ctr., Inc. v. Brown*, Nos. 11-391 & 11-394 (Feb. 21, 2012) (per curiam). Second, the Court reiterated that the motivation of state legislators is irrelevant to determining whether federal law preempts state legislation, because the FAA withdrew the power of the states to require a judicial forum for claims the contracting parties agreed to resolve by arbitration. A separate exception to the FAA applied only to *federal* statutory claims, which Plaintiffs did not assert.

Unconscionability

Having concluded that the *Broughton-Cruz* rule is no longer viable post-*Concepcion*, the Ninth Circuit addressed Plaintiffs' unconscionability argument. It noted that unconscionability under California law has both a procedural and a substantive element, both of which must be satisfied for a court to hold an arbitration agreement unenforceable.

The Court held that the procedural unconscionability element was lacking, and therefore the arbitration agreement would be enforced. The arbitration clause was conspicuous and appeared in its own section of the Note. The Note contained more than one statement setting forth in plain language the rights that Plaintiffs would waive if they did not opt out, and provided clear, easy-to-follow instructions for opting out if Plaintiffs chose to do so. The court therefore did not reach the substantive unconscionability element. "It is enough that when faced with a 60-day opt-out provision and a conspicuous and comprehensive explanation of the arbitration agreement, Plaintiffs did not reject the agreement."

Conclusion

Kilgore is significant for several reasons. First and foremost, it clearly holds that the *Broughton-Cruz* rule has not survived *Concepcion* – an issue on which the district courts of California had reached different conclusions. Second, it suggests additional guidance for maximizing the likelihood of arbitration agreements and class action waivers being upheld. Plaintiffs are increasingly attacking arbitration agreements through the "generally applicable" defense of unconscionability, and *Kilgore* identifies factors that were sufficient for the Ninth Circuit to uphold the agreement. Clients might be well-served to review their arbitration agreements in light of *Kilgore*.

Click here to read *Kilgore v. KeyBank, N.A.*, No. 09-16703 (Mar. 7, 2012)

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