Upcoming oral argument in Sanchez v. Valencia Holding Company on arbitration agreement enforcement

On May 5, 2015, the Supreme Court of California will hear arguments in *Sanchez v. Valencia Holding Company, LLC*. The case will address whether an arbitration clause from a car purchase contract is enforceable.

The events of the case arose when plaintiff Gil Sanchez learned that the used Mercedes-Benz car he had purchased could not be repaired despite several attempts by the dealer. Sanchez later discovered that the car he purchased had previously been in an accident and was inadequately repaired. Sanchez sued, seeking class action status, for improper disclosures and other misconduct in the sale. The defendant car dealer, Valencia Holding Company ("Valencia Holding"), filed a motion to compel arbitration.

The Arbitration Clause:

Valencia Holding's arbitration clause requires that any claim or dispute be arbitrated before a single arbitrator on an individual basis and not as a class action. Then, if the single arbitrator awards damages in excess of $100,000, both parties can appeal to a panel of three arbitrators. Likewise, if the arbitrator grants injunctive relief, either party can appeal. The appealing party is required to pay filing fees and other arbitration costs, subject to later apportionment by the arbitrator. With an exception for action to repossess the car, the arbitration clause requires injunctive claims be arbitrated.

The arbitration clause also provides that if any provision of the clause is unenforceable, that specific provision may be severed without jeopardizing the enforceability of the remaining provisions. However, if the class action waiver provision of the arbitration clause is found unenforceable, then the entire arbitration

clause is unenforceable.

Analysis:

The California Consumers Legal Remedies Act ("CLRA") provides a statutory right to maintain violations as a class action. On this basis, the trial court found the arbitration clause unenforceable, concluding that Sanchez had a statutory right to maintain a class action. Furthermore, the finding that Sanchez had a statutory right to maintain a class action rendered the arbitration clause's class action waiver provision unenforceable, making the entire arbitration clause unenforceable by its own terms.

Will the trial court ruling under the CLRA pass muster? The Federal Arbitration Act ("FAA") provides for enforcement of arbitration agreements. The FAA broadly applies to contracts affecting interstate commerce. Because the FAA is a federal statute, it preempts conflicting state laws in our federal system. In 2011, the U.S. Supreme Court held in *AT&T Mobility, LLC v. Concepcion* that a state judicial decision barring enforcement of a class action waiver in an arbitration provision was preempted by the FAA. Meanwhile, in *Discover Bank v. Superior Court*, SCOCA held, in 2005, that a class action waiver in an arbitration clause embedded in a consumer contract was unconscionable and therefore unenforceable.

But there is more at play than preemption of the CLRA. By its own terms, section 2 of the FAA also provides that arbitration agreements will not be enforced if grounds "exist at law or in equity for the revocation of [the] contract". The grounds for revocation must be applicable to contracts generally, rather than to specific types of contracts. One of the recognized grounds for revocation of contracts under the FAA is the doctrine of unconscionability.

California courts recognize unconscionability as grounds for voiding enforcement of arbitration clauses (*see, e.g., Armendariz v. Foundation Health Psychcare Services, Inc.*). Under established case law, proof of unconscionability requires both procedural and substantive unconscionability. Procedural unconscionability, which addresses the formation of the agreement, usually examines issues of oppression or surprise. Oppression is established through "take it or leave it" contracts (that is, adhesion contracts), while surprise is usually established through fraudulent or

hidden provisions. Substantive unconscionability examines whether the arbitration provision is overly harsh or one-sided and falls outside the reasonable expectations of the weaker party. Lack of mutuality, such as provisions favoring or applying predominantly to one side, is often a hallmark of substantive unconscionability.

In this case, SCOCA is likely to examine the factual record for the presence and strength of procedural and substantive unconscionability. On procedural unconscionability, Sanchez will contend that the arbitration provision was presented in a stack of paperwork to sign at the last minute, similar to a "take it or leave it" approach. Valencia Holding will undoubtedly contend that the arbitration provisions were readily apparent. On substantive unconscionability, the parties may be expected to argue whether the provisions are overly favorable toward Valencia Holding and thus outside the realm of reasonableness. Then, if certain provisions are unconscionable, the court must decide whether to sever those provisions and enforce arbitration, or to alternatively toss the entire arbitration provision due to its permeating unconscionability.

Another perhaps overriding issue awaiting decision is one of appellate procedure. Namely, the trial court did not rule on either the factual or legal issues regarding unconscionability. For this reason, Valencia Holding argues that the appellate courts cannot adjudicate the unconscionability and severance issues not addressed first by the trial court. Sanchez, meanwhile, will contend that the record evidence be reviewed and that the appellate court decide unconscionability on its own review. Section 1670.5 of the California Civil Code provides that "the court may refuse to enforce the contract … to avoid any unconscionable result." Therefore, the court will ultimately decide whether Sanchez can seek class action status and have his claims heard in a court, or instead require that his claim of an undisclosed wrecked car be heard on an individual basis before an arbitrator.

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