Special Alert: California Supreme Court Invalidates Widely Used Arbitration Provisions and Curtails the Scope of Proposition 64

On April 6, the California Supreme Court published its opinion in *McGill v. Citibank, N.A.,* finding unenforceable arbitration agreements that purport to waive claims for public injunctive relief brought under California's Consumer Legal Remedies Act (CLRA), Civ. Civ. Code, § 1750 et seq., its Unfair Competition Law (UCL)(Bus. & Prof. Code, § 17200), and its false advertising law (*id*., § 17500 et seq.). In so holding, the court resisted arguments that the Federal Arbitration Act (FAA) preempts California state law, notwithstanding the United States Supreme Court's landmark holding in *AT&T Mobility v. Concepcion (Concepcion)*. In a second significant holding, the court materially limited the effect of Proposition 64 on claims brought under the UCL, finding that actions for public injunctive relief need not satisfy California requirements for class certification. The court's decision presents significant questions as to the validity of widely used consumer arbitration clauses, creates the prospect of considerable future litigation regarding the scope of preemption under the FAA, and narrows the effect of Proposition 64 on future litigation under the UCL.

The Court's Holding

In *McGill*, a borrower sought monetary damages, restitution, and injunctive relief in a class action against a credit card lender. The California Court of Appeal held that the lender was entitled to require the borrower to arbitrate all claims, including claims for injunctive relief under the CLRA and the UCL, based on the arbitration provision in her account agreement. However, the California Supreme Court reversed unanimously, finding the arbitration agreement invalid and unenforceable because it purported to waive McGill's right to pursue public injunctive relief in any forum. The court's ruling continues a long line of California cases that have imposed state law limitations on consumer arbitration agreements.

In a second significant aspect of the decision, the court held that a plaintiff who otherwise meets the standing requirements of Proposition 64 may seek public injunctive relief under the UCL and CLRA without satisfying California class action certification requirements. This marks a significant narrowing of Proposition 64 and may increase the volume of claims brought under the UCL and the CLRA.

The Court's Reasoning

A. Enforcement of Arbitration Agreements

The court's analysis was grounded in Civil Code, § 3513, which provides that "a law established for a public reason cannot be contravened by a private agreement." *McGill*, Slip. Op, at 14. The court held that an arbitration agreement that "purports to waive [the] right to request *in any forum* [] public injunctive relief, [] is invalid and unenforceable under California law." Slip. Op, at 14 (emphasis added). At oral

argument, the lender conceded that McGill's arbitration provision precluded her from seeking public injunctive relief "in any forum," i.e., in arbitration or in court. Accordingly, the court found McGill's arbitration provision invalid and unenforceable under California law.

Turning to the question of preemption under the FAA, the court then held that the anti-wavier provision of Civil Code, § 3513, is not subject to preemption under the Federal Arbitration Act or the United States Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*. 563 U.S. 333 (2011). In so concluding, the court relied on a provision of the FAA known as the "saving clause," which "permits arbitration agreements to be declared unenforceable 'upon such grounds as exist at law or in equity for the revocation of any contract.' " *McGill*, Slip. Op. at 15 (citing *Concepcion*, at 339). The court held that Civil Code § 3513 is a rule of general applicability that does not discriminate against arbitration agreements, and, therefore, fits within the "saving clause" and is not preempted by the FAA.

The court sidestepped one of the key questions briefed by the parties – whether the United States Supreme Court's decision in *Concepcion* overruled the California Supreme Court's decisions in *Broughton v. Cigna Healthplans*, 21 Cal.4th 1066, 1077 (1999) and *Cruz v. PacifiCare Health Systems*, *Inc.*, 30 Cal.4th 303, 315-316 (2003). Under what is known as the *Broughton-Cruz* Rule, the California court declared non-arbitrable claims for public injunctive relief. However, many post-*Conception* federal and state decisions (including the Court of Appeal in *McGill*) concluded that the *Broughton-Cruz* rule was overruled by *Concepcion*.

However, in light of the concession at oral argument that McGill arbitration clause waived McGill's right to pursue public injunctive relief "in any forum," i.e., in arbitration or in court, the Court held that it need not decide whether public injunctive relief claims were arbitrable and thus concluded that "the *Broughton-Cruz* rule is not at issue in this case." *McGill*, Slip. Op. at 7.

The *Broughton-Cruz* rule is potentially broader than the holding in *McGill,* which, turns ultimately on whether the language of a particular arbitration agreement purports to waive claims for public injunctive relief. In contrast, under *Broughton-Cruz*, claims for public injunctive relief are non-arbitrable and thus only may be heard in court. *McGill* may create an opening for arbitration of public injunctive relief claims provided that the language of the arbitration agreement allows such claims to be heard in arbitration.

B. Proposition 64's Class Action Requirements.

In 2004, California voters passed Proposition 64, which amended California's Business and Profession Code provisions that previously authorized suit by "any person acting for the interests of itself, its members or the general public" to a far narrower population: those who have "suffered injury in fact and [have] lost money or property as a result of" their alleged violations. *See e.g.*, Cal. Bus. & Prof. Code, §§ 17204, 17535. Additionally, Proposition 64 authorized these injured-in-fact individuals to "pursue representative claims or relief on behalf of others only if [they] meet[] [these] standing requirements . . . and compl[y] with Section 382 of the Code of Civil Procedure," which contains California's class action requirements. *See e.g.*, Cal. Bus. & Prof. Code, §§ 17203, 17535.

This language in Proposition 64 became critically relevant to the *McGill* case in January 2017, when the court requested the parties to address whether Proposition 64 bars private plaintiffs from seeking public injunctive relief, as such a claim may constitute a "representative claim or relief on behalf of others."

In its *McGill* opinion, however, the court held that Proposition 64 does not bar private plaintiffs from seeking public injunctive relief. The court reasoned that "representative claims or relief on behalf of others" are instead those that seek monetary remedies on behalf of others, such as claims for disgorgement or restitution, and do not include claims that seek public injunctive relief. To support this finding, the court relied on a 2000 opinion in *Kraus v. Trinity Management Services, Inc*., 23 Cal.4th 116, 121 (2000), defining the term "representative action" to mean a "UCL action that is not certified as a class action in which a private person is the plaintiff and seeks disgorgement and/or restitution." Given this definition, the court reasoned that voters who supported Proposition 64 likely interpreted "representative action" to mean those seeking monetary relief on behalf of others, and thus were not voting on claims like McGill's that seek public injunctive relief. Accordingly, the court appears to have held that McGill may still seek public injunctive relief under California's consumer protection statutes and need not meet the class action requirements to do so.

Potential Impact of the Court's Decision

Depending on the precise language used, the court's decision raises significant questions as to the validity and enforceability of arbitration provisions that are contained in many consumer contracts. It also raises the question of whether California's federal courts will follow the California Supreme Court's lead or independently determine the preemptive effect of the FAA on claims for public injunctive relief. This issue is likely to play out over several years in the California courts and may ultimately lead to yet another showdown between the California Supreme Court and the United States Supreme Court regarding the preemptive effect of the FAA. In the meantime, parties to arbitration agreements in California will want to review carefully the language of their agreement to determine whether it waives altogether the right to pursue public injunctive relief.

Additionally, although the California Supreme Court stated in *McGill* that compliance with California's class certification requirements had never been required with respect to "requests to enjoin future wrongful business practices that will injure the public" (McGill, Slip Op. at 13), that proposition was, at best, unsettled prior to the court's ruling in *McGill*. *See, e.g. Arce v. Kaiser Foundation Health Plan, Inc.* (2010) 181 Cal. App. 4th 471, 486 (discussing class certification requirements in the context of claims for public injunctive relief). Accordingly, the court's narrowing of Proposition 64 appears to return California, in part, to the pre-Proposition 64 era and thus further widen the door to litigation under the UCL and CLRA.

If you have questions about the court's holding or other related issues, visit our Complex Civil Litigation and Class Actions practices for more information, or contact a Buckley Sandler attorney with whom you have worked in the past.