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California Supreme Court Upholds Auto Contract's Arbitration Clause

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Yesterday, the California Supreme Court handed car dealers and auto finance companies an important victory, upholding the arbitration clause in the standard form automobile purchase contract used by most dealers in the Golden State. (*Sanchez v. Valencia Holding Co., LLC.* (S199119; Aug. 3, 2015).)

Though the purchase contract entailed "some degree of procedural unconscionability" as an adhesion contract, the court held that the arbitration clause was not substantively unconscionable, and therefore upheld its enforceability under California law. (Slip opn., 14-25.)

The court found "nothing unconscionable" about exempting the self-help remedy of repossession from arbitration. (Slip opn., 24.)

The court also held that the contract's triggers for a three-arbitrator review of an initial single arbitrator's award were not so heavily weighted in the dealer's favor as to be unconscionable. The monetary triggers—an initial award of $0 or more than $100,000—do not, on their face, obviously favor the dealer. (Slip opn., 16.) The $0 trigger favors the car buyer; the $100,000 trigger favors the dealer. "But nothing in the record indicates that the latter [trigger] is substantially more likely to be invoked than the former." So the risks imposed on the parties are not one-sided. *(Ibid.)* The contract's allowing three-arbitrator review if the initial award includes injunctive relief favors the dealer but is justified by the "potentially far-reaching nature of an injunctive relief remedy." *(Id.*, 17.)

The contract also provided that the party invoking the three-arbitrator review process must front all the costs of that additional arbitration, subject to the arbitrators' determination of a fair apportionment of costs. This provision, the court said, "has the potential to deter the consumer from using the appeal process," but "the provision cannot be held unconscionable absent a showing that appellate fees and costs in fact would be unaffordable or would have a substantial deterrent effect in a [particular] case." (Slip opn., 21-22.) Because Sanchez bought a high-end luxury car and submitted no evidence to show he could not afford to pay appellate arbitration filing fees, he failed to prove that the provision was unconscionable as to him. *(Id.*, 23.)

Other car buyers may try to present the proof of unaffordability that Sanchez omitted, but even if they succeed in showing the provision unfairly deters them from seeking three-arbitrator review, the result may simply be that the three-arbitrator review provision will be severed and the rest of the arbitration clause will be enforced.

On a broader note, the six-justice majority held that no single formulation of the standard for substantive unconscionability enjoys any preferential status; they all mean essentially the same thing, "captur[ing] the notion that unconscionability requires a substantial degree of unfairness *beyond 'a simple old-fashioned bad bargain*.' " (Slip opn., 9.) Unconscionability is "highly dependent on context," requiring "inquiry into the 'commercial setting, purpose, and effect' of the contract or contract provision." *(Ibid.)* If justified by a legitimate commercial need, a contract may provide a "margin of safety" or "extra protection" for the drafting party without being unconscionable. *(Ibid.)* And, "the standard for substantive unconscionability—the requisite degree of unfairness beyond merely a bad bargain—must be as rigorous and demanding for arbitration clauses as for any [other] contract clause."(Slip opn., 10.)

As a whole, the *Sanchez* decision marks a major step forward for consumer arbitration, particularly in California, which until now has been one of the jurisdictions most hostile to it. Severson & Werson played an important role in *Sanchez*, filing an amicus brief for the American Financial Services Association, the California Financial Services Association, and the California Bankers Association which the court largely followed in upholding the exemption of self-help remedies from arbitration. The decision also vindicates the firm's role as an early advocate of including arbitration clauses in consumer and particularly consumer finance contracts.

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