The Second Circuit Continues Judicial Trend Towards Limiting Arbitrations

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Recent posts on this blog have discussed questions as to the continued viability of arbitration clauses that require consumer agreements to contain an arbitration clause and a waiver of the customer's right to bring a class action. Indeed, the United States Supreme Court is to decide in the upcoming term whether agreements barring class-wide arbitration can be invalidated under State law, and Congress may kill mandatory arbitration in consumer finance transactions. This judicial and legislative trend to limit, and even eliminate, the use of arbitrations has been continued by the U.S. Court of Appeals for the Second Circuit in its decision in *Fensterstock v. Affiliated Computer Services*, 09 CV 1562 (2d Cir. 7/12/10).

The Second Circuit struck down, under California law, the use of loan agreements that contain arbitration clauses and a waiver of the customer's right to bring a class action. The Second Circuit held that a lawyer who sued a student loan company over alleged hidden fees in loan agreements cannot be forced into arbitration and can pursue a class action. The Second Circuit ruled that the loan agreement's class action and class arbitration waiver clauses were unconscionable under California law because they are a "standard contract of adhesion drafted by a party that had superior bargaining power," and, therefore, are unenforceable. "Such a clause presented to the weaker party on a take-it-or-leave-it basis without the opportunity for meaningful negotiation is, under California law, oppressive, and satisfied the requirement that there be at least a minimal showing of procedural unconscionability." According to the Court, although the plaintiff was versed in complex financial transactions, there was nothing to suggest that he had any opportunity to negotiate that clause out of the contract. Further, applying the remainder of a three-part test under California law for determining whether a clause in a contract is unconscionable, the Court held that the disputes on the alleged damages "predictably involve small amounts of damages," and the plaintiff alleged the two companies were "deliberately carrying out a scheme to cheat large numbers of borrowers out of individually small amounts of money."

While the Second Circuit reiterated the Federal Arbitration Act's and "Congress' purpose in enacting the Federal Arbitration Act 'to reverse the long standing judicial hostility to arbitration agreements . . . and to place arbitration agreements upon the same footing as other contracts[,]'" judicial hostility, at least as applied under California law, appears to remain. The Second Circuit's interpretation of contract principles under California law, leading to its determination that the contract clauses were procedurally and substantively unconscionable, trumped the Federal Arbitration Act's purpose and principles, like many courts seemingly do today.

Whether the Supreme Court or Congress will continue that trend remains to be seen. Thus, companies that have consumer or employment contracts that contain such clauses should continue

to seek to enforce them in court; however, remember that their enforceability may be significantly limited. As noted previously in this blog, companies should continue to monitor developments at the federal and state level, and re-examine their consumer or employment agreement's arbitration and class action clauses to seek the best choice of law and jurisdiction for enforcement of such clauses. Please also remember to check back here for further updates.