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NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SEVEN

DALE FIRCHOW, Plaintiff and Respondent, v. CITIBANK (SOUTH DAKOTA), N.A., Defendant and Appellant.	B187081 (Los Angeles County Super. Ct. No. BC287691)

APPEAL from an order of the Superior Court of Los Angeles County, Carl J. West, Judge. Affirmed.

Stroock & Stroock & Lavan, Julia B. Strickland, Andrew W. Moritz and Marcos D. Sasso for Defendant and Appellant.

Hagens Berman Sobol Shapiro, Lee M. Gordon and Steve W. Berman for Plaintiff and Respondent.

Citibank (South Dakota), N.A. appeals from an order denying its petition to compel arbitration of a putative statewide class action lawsuit filed by Dale Firchow, a Citibank credit card member. The lawsuit alleges Citibank and Ford Motor Company (Ford)[1] prematurely and improperly terminated a credit card rebate program in violation of the Consumer Legal Remedies Act (CLRA) (Civ. Code, § 1750 et. seq.) and California's false advertising and unfair competition laws (Bus. & Prof. Code, §§ 17500, 17200). Citibank unsuccessfully sought arbitration of the dispute in accordance with a provision in the applicable credit card agreement that subjects such disputes to individual binding arbitration and prohibits proceeding in arbitration on a class or representative basis.

On appeal Citibank contends the trial court erred in finding the class action waiver provision unconscionable under California law and denying the motion to compel arbitration. Citibank urges the trial court should have applied South Dakota law in accordance with the choice-of-law provision in the credit card agreement and contends under South Dakota law the arbitration clause, including the class action waiver provision, is enforceable. We affirm.

FACTUAL AND PROCEDURAL BACKGROUND

1. *Ford-Citibank's Rebate Program and Termination of the Program*

In February 1993 Citibank began issuing a co-branded Ford-Citibank credit card. According to the terms of the credit card agreement, users of the card (either a VISA or Mastercard) could earn with card purchases up to $700 in rebate credits annually, and up to $3,500 in rebate credits over a five-year period, to apply to the purchase of a new Ford vehicle. Rebate credits would expire five years from the calendar quarter in which they were earned.

In June 1997 Citibank notified cardholders, including Firchow, that it was terminating the rebate program effective December 31, 1997. According to the written notice of termination, after December 31, 1997 cardholders would no longer earn rebates

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[1] Ford is not a party to this appeal.

on purchases made with the Ford-Citibank card. Rebates that had already been earned would expire five years after the calendar year in which they had been earned -- but only if the cardholder kept the account open and in good standing. Card members who wished to close their accounts in light of the cancellation of the rebate program would receive Ford rebate certificates that would expire 45 days after the account was closed. Firchow did not close his account.

2. *Citibank's Modification of the Card Agreement by Requiring Arbitration and Waiver of a Card Holder's Right to Participate in a Class Action Proceeding*

In October 2001 Citibank mailed Firchow a "change of terms" document in the same envelope as his monthly billing statement.[2] At the top of the billing statement Citibank printed, "Please see the enclosed change in terms notice for important information about the binding arbitration provision we are adding to your Citibank credit card agreement." The change of terms included an arbitration clause and class action waiver provision in bold print and all capital letters: "**ARBITRATION: PLEASE READ THIS PROVISION OF THE AGREEMENT CAREFULLY. IT PROVIDES THAT ANY DISPUTE MAY BE RESOLVED BY BINDING ARBITRATION. ARBITRATION REPLACES THE RIGHT TO GO TO COURT, INCLUDING THE RIGHT TO A JURY AND THE RIGHT TO PARTICIPATE IN A CLASS ACTION OR SIMILAR PROCEEDING. IN ARBITRATION, A DISPUTE IS RESOLVED BY AN ARBITRATOR INSTEAD OF A JUDGE OR JURY. ARBITRATION PROCEDURES ARE SIMPLER AND MORE LIMITED THAN**

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[2] Prior to October 2001 Firchow's agreement with Citibank did not include an arbitration provision. However, that original agreement did provide that Citibank could change the terms of the agreement at any time by following specific procedures: "We can change this Agreement including the annual membership fee, finance charge and the annual percentage rate at any time. However, if we do, we will mail you written notice at least 15 days before the beginning of the billing cycle in which the changes become effective. If you do not agree to the changes, you must notify us in writing within 25 days after the effective date of the changes and pay us the balance, either all at once or under the existing terms of the unchanged Agreement. Otherwise, you will have agreed to the changes in the notice. Use of the card after the effective date of the change shall be deemed acceptance of the new terms, even if the 25 days have not expired."

COURT PROCEDURES." The new terms also included the following explanation as to the effect of the class action waiver: "Claims and remedies sought as part of a class action, private attorney general or other representative action are subject to arbitration on an individual (non-class, non-representative) basis, and the arbitrator may award relief only on an individual (non-class, non-representative) basis." "If you or we require arbitration of a Claim, neither you, we, nor any other person may pursue the Claim in arbitration as a class action, private attorney general action or other representative action, nor may such Claim be pursued on your or our behalf in any litigation in any court. . . ."

Also included in the agreement to arbitrate is what Citibank denominates an "opt-out provision," allowing the card member to decline to accept the arbitration agreement and to continue to use his or her account under the existing terms until the end of his or her current membership year or the expiration date on the card, whichever is later, at which time the account would be cancelled and the member's credit card privileges revoked.[3] In addition, the change of terms provided that any dispute involving the credit card agreement was to be governed by the Federal Arbitration Act (FAA) (9 U.S.C. § 1 et seq.) and South Dakota law. Firchow did not notify Citibank that he did not wish to accept the arbitration agreement.

3. *The Instant Putative Statewide Class Action Lawsuit*

a. *The complaint*

On December 26, 2002 Firchow filed this putative statewide class action lawsuit on behalf of himself and "all California residents similarly situated" alleging three statutory claims arising from the premature cancellation of the rebate program:

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[3] The provision states: "If you do not wish to accept the binding arbitration provision contained in this change in terms notice, you must notify us in writing within 26 days after the Statement/Closing date indicated on your November 2001 billing statement stating your non-acceptance. . . . If you notify us by that time that you do not accept the binding arbitration provisions contained in this change in terms notice, you can continue to use your card(s) under your existing terms until the end of your current membership year or the expiration date on your card(s), whichever is later. At that time your account will be closed and you will be able to pay off your remaining balance under your existing terms."

(1) unfair competition (Bus. & Prof. Code, § 17200), (2) false and misleading advertising (Bus. & Prof. Code, § 17500) and (3) violations of the CLRA (Civ. Code, § 1750). The complaint also asserts claims for breach of contract and unjust enrichment.

b. *Citibank's motion to compel arbitration*

On July 18, 2003 Citibank filed a motion to compel Firchow to arbitrate his action on an individual rather than class action basis, citing the arbitration clause and class action waiver provision in the October 2001 change-of-terms document. Firchow opposed the motion, arguing the class action waiver was unconscionable under both South Dakota and California law and could not be severed from the arbitration clause.

On October 12, 2005 the trial court found the waiver provision was unconscionable and contrary to California's public policy as articulated in *Discover Bank v. Superior Court* (2005) 36 Cal.4th 148 (*Discover Bank*).[4] The trial court refused to apply South Dakota law, explaining, even if the class action waiver provision were enforceable under South Dakota law, California would not apply the foreign law when to do so would materially offend a fundamental public policy in California. The trial court denied the motion to compel arbitration, concluding the waiver provision could not be severed from the agreement to arbitrate.

CONTENTIONS

Citibank contends the trial court erred in denying its motion to compel arbitration because: (1) South Dakota law governs the interpretation of the arbitration clause containing the class action waiver, and the waiver provision is enforceable under South Dakota law; (2) the FAA preempts application of California law to interpret the class action waiver provision; and (3) even if California law applies, the inclusion of an opt-out

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[4] Initially, and at the parties' request, on October 24, 2003 the trial court stayed the motion to compel arbitration pending the outcome of the Supreme Court's decision in *Discover Bank*, *supra*, 36 Cal.4th 148. The stay was lifted and the motion renewed in July 2005, immediately following the Supreme Court's decision in *Discover Bank.*

provision distinguishes this agreement from the unconscionable agreements identified by the Supreme Court in *Discover Bank.*[5]

DISCUSSION

1. *Standard of Review*

When, as here, there are no material facts in dispute, we review the trial court's unconscionability and choice-of-law determinations de novo. (*Szetela v. Discover Bank* (2002) 97 Cal.App.4th 1094, 1099 [unconscionability determination]; *NORCAL Mutual Ins. Co. v. Newton* (2000) 84 Cal.App.4th 64, 71 [unconscionability determination]; *Hughes Electronics Corp. v. Citibank Delaware* (2004) 120 Cal.App.4th 251, 257 [choice of law]; *Hambrecht & Quist Venture Partners v. American Medical Internat., Inc.* (1995) 38 Cal.App.4th 1532, 1539, fn. 4 [choice of law].)

2. *Governing Law*: *Unconscionability and Discover Bank*

a. *Unconscionability*

Under both California law and the FAA an agreement to arbitrate must be enforced unless it is unconscionable or other grounds exist for the agreement's revocation. (*Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83, 98 (*Armendariz*); *Doctor's Associates, Inc. v. Casarotto* (1996) 517 U.S. 681, 686-687 [116 S.Ct. 1652, 134 L.Ed.2d 902] (*Doctor's Associates*); see also *First Options of Chicago, Inc. v. Kaplan* (1995) 514 U.S. 938, 944 [115 S.Ct. 1920, 131 L.Ed.2d 985] [FAA mandates that,"[w]hen deciding whether the parties agreed to arbitrate a certain matter (including arbitrability), courts generally . . . should apply ordinary state-law principles that govern the formation of contracts"].)

Unconscionability has both procedural and substantive elements. (*Armendariz, supra,* 24 Cal.4th at p. 99.) Procedural unconscionability focuses on the elements of

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[5] The enforceability of a class action waiver provision in an arbitration clause contained in a credit card agreement that includes a purported "opt-out provision" identical to the one in this case is an issue currently pending before the Supreme Court in *Jones v. Citigroup, Inc.* (2006) 135 Cal.App.4th 1491, review granted April 26, 2006, S141753.

oppression and surprise. (*Discover Bank, supra,* 36 Cal.4th at p. 160.) "'"Oppression arises from an inequality of bargaining power which results in no real negotiation and an absence of meaningful choice . . . . Surprise involves the extent to which the terms of the bargain are hidden in a 'prolix printed form' drafted by a party in a superior bargaining position."'" (*Crippen v. Central Valley RV Outlet* (2004) 124 Cal.App.4th 1159, 1165; *Mercuro v. Superior Court* (2002) 96 Cal.App.4th 167, 174 ["[p]rocedural unconscionability focuses on the oppressiveness of the stronger party's conduct"].) Procedural unconscionability is often found in contracts of adhesion, which are drafted and imposed by the party with superior bargaining power and offered to the subscribing party on a take-it-or-leave-it basis. (*Little v. Auto Stiegler, Inc.* (2003) 29 Cal.4th 1064, 1071.) Substantive unconscionability, on the other hand, focuses on the actual terms of the agreement and evaluates whether they create "'"overly harsh"'" or "'"one-sided"'results." (*Armendariz,* at p. 114; *Little*, at p. 1071.)

Both procedural and substantive unconscionability must appear for a court to invalidate a contract or one of its individual terms (*Armendariz, supra*, 24 Cal.4th at p. 114; *Mercuro v. Superior Court, supra*, 96 Cal.App.4th at p. 174), but need not be present in the same degree: "[T]he more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa." (*Armendariz,* at p. 114.)

The party opposing arbitration on grounds of unconscionability has the burden of proving the arbitration provision is unconscionable. (*Engalla v. Permanente Medical Group, Inc.* (1997) 15 Cal.4th 951, 972.)[6]

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[6] Firchow claimed below he was a "member of the plaintiff class" in a federal multidistrict litigation (MDL) proceeding challenging the cancellation of the rebate program, which was pending at the time Citibank added the arbitration provisions to its credit card agreements. Although the MDL action was ultimately dismissed, Firchow argued the arbitration agreement should not be applied retroactively to govern this dispute. Citibank insisted Firchow was not a plaintiff in the MDL action. In this appeal Firchow argues only the issue of unconscionability.

b. *Discover Bank*

In *Discover Bank, supra*, 36 Cal.4th 148, the Supreme Court addressed the question whether a class action waiver contained in an arbitration provision that had been added to an existing credit card agreement was unconscionable under California law. As in the instant case, the initial credit card agreement between the plaintiff (Christopher Boehr) and Discover Bank contained neither an arbitration provision nor a class action waiver. In 1999, after Boehr had been a Discover Bank credit card holder for several years, Discover Bank added an arbitration clause and class action waiver to its credit card agreement pursuant to a change-of-terms document that it mailed to Boehr (and other Discover Bank cardholders) in the same envelope with Boehr's monthly billing statement. Boehr was advised in the change-of-terms document if he did not wish to accept the new arbitration clause, he would have to notify Discover Bank of his objections and cease using his account at the end of a designated grace period. Boehr's continued use of the account after the stated ending date would be deemed by Discover Bank to constitute acceptance of the new terms. Boehr did not notify Discover Bank of any objection to the arbitration and continued to use his account after the stated deadline. (*Id.* at pp. 153-154.)

In 2001 Boehr filed a putative nationwide class action complaint alleging Discover Bank had unlawfully imposed a late fee on payments it received on the payment due date but after an arbitrarily imposed 1:00 p.m. "cut-off time," in violation of several Delaware consumer protections statutes. (*Discover Bank, supra,* 36 Cal.4th at p. 154.) Discover Bank promptly moved to compel Boehr to individually arbitrate his claims pursuant to the arbitration and class action waiver provisions contained in the 1999 change-of-terms document. Boehr opposed the motion, contending the class action waiver was unconscionable and unenforceable under California law. (*Ibid.*)

The Court found the class action waiver provision in Discover Bank's cardholder agreement unconscionable under California law. The Court began its analysis by observing both the adhesive and substantively unconscionable aspects of the agreement: "[W]hen a consumer is given an amendment to its cardholder agreement in the form of a

'bill stuffer' that he would be deemed to accept if he did not close his account, an element of procedural unconscionability is present. [Citation.] Moreover, although adhesive contracts are generally enforced [citation], class action waivers found in such contracts may also be substantively unconscionable inasmuch as they may operate effectively as exculpatory contract clauses that are contrary to public policy," particularly in cases by consumers involving individually small amounts of damages. (*Discover Bank, supra,* 36 Cal.4th at pp. 160-161.) In those cases, the class action is the "'only effective way to halt and redress such exploitation.'" The Court also observed class action waivers are "indisputably one-sided" as "'credit card companies typically do not sue their customers in class action lawsuits.'" (*Id.* at p. 161.)

The consumer's potential ability to obtain a different credit card without the class action waiver provision, although often a significant factor in an analysis of unconscionability (see, e.g., *Wayne v. Staples, Inc.* (2006) 135 Cal.App.4th 466, 482 [oppression establishing unconscionability is minimized or nonexistent when the customer has meaningful choices]; *Dean Witter Reynolds, Inc. v. Superior Court* (1989) 211 Cal.App.3d 758, 768 ["[A]ny claim of 'oppression' may be defeated if the complaining party has reasonably available alternative sources of supply from which to obtain desired goods or services free of the terms claimed to be unconscionable."]; *Marin Storage & Trucking, Inc. v. Benco Contracting & Engineering, Inc.* (2001) 89 Cal.App.4th 1042, 1056 [alternative sources rendered procedural unfairness of adhesive contract minimal]), was not addressed by the Court, presumably because in *Discover Bank* the arbitration and class action waiver provisions were added to an existing cardholder's account, forcing the cardholder to change credit card companies midstream. Under those circumstances the Court concluded the class action waiver was both procedurally and substantively unconscionable. (See *Discover Bank, supra,* 36 Cal.4th at pp. 160-163; see also *Szetela v. Discover Bank, supra,* 97 Cal.App.4th at p. 1100 [whether plaintiff "could have found another credit card issuer who would not have required his acceptance of a similar clause is not a deciding factor" as to whether new terms were unconscionable].)

The Court also rejected the argument (made by Citibank in the instant case) that the class action device is merely a procedural right, the waiver of which cannot be unconscionable. The Court explained, "class actions and arbitrations are, particularly in the consumer context, often inextricably linked to the vindication of substantive rights. Affixing the 'procedural' label on such devices understates their importance and is not helpful to resolving the unconscionability issue." (*Discover Bank, supra*, 36 Cal.4th at p. 161.)

In concluding the class action waiver in Discover Bank's cardholder agreement was unconscionable, the Court was careful to qualify its holding, explaining that not all class action waivers are necessarily unconscionable. (*Discover Bank, supra*, 36 Cal.4th at p. 162.) However, "when the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then, at least to the extent the obligation at issue is governed by California law, the waiver becomes in practice the exemption of the party 'from responsibility for [its] own fraud, or willful injury to the person or property of another.' (Civ. Code, § 1668.) Under these circumstances, such waivers are unconscionable under California law and should not be enforced." (*Discover Bank*, at pp. 162-163.)

Because the cardholder agreement in *Discover Bank* contained a choice-of-law provision mandating application of Delaware law, the Court remanded the matter for a determination under *Nedlloyd Lines B.V. v. Superior Court* (1992) 3 Cal.4th 459 (*Nedlloyd*) whether the law of California or Delaware (which enforced class action waivers in credit card agreements) governs the agreement's interpretation. (*Discover Bank*, *supra*, 36 Cal.4th at pp. 174-175.) On remand, the Court of Appeal upheld the Delaware choice-of-law provision in the credit card agreement, concluding California did not have a materially greater interest than Delaware in a lawsuit alleging violations of

Delaware's own consumer protection statutes. (*Discover Bank v. Superior Court* (2005) 134 Cal.App.4th 886, 894 (*Discover Bank II*).)

Here, Citibank's credit card agreement provides it is to be governed by South Dakota and federal law. Echoing the reasoning of *Discover Bank II*, *supra*, 134 Cal.App.4th 886, Citibank urges that we apply the parties' choice-of-law provision and find the class action waiver enforceable under South Dakota law. Because enforcement of the class action waiver provision conflicts with a fundamental California public policy and California has a materially greater interest than South Dakota in this putative class action by California residents seeking redress under California's consumer protection statutes, however, whatever the result might be under South Dakota law, the waiver provision is unenforceable in this case.

3. *California, Not South Dakota Law, Governs the Unconscionability Determination in This Case*

In *Nedlloyd*, *supra*, 3 Cal.4th at pages 464-465, the Supreme Court held, when a contract designates the law of another state to govern its interpretation, California applies the analysis under the Restatement Second of Conflict of Laws section 187 to determine whether the choice-of-law provision should be enforced. (See also *Washington Mutual Bank v. Superior Court* (2001) 24 Cal.4th 906, 916 (*Washington Mutual*).) This approach requires the court to determine whether the chosen state has a substantial relationship to the parties or their transaction or whether there is any other reasonable basis for the parties' choice of law. "If neither of these tests is met, that is the end of the inquiry, and the court need not enforce the parties' choice of law. If, however, either test is met, the court must next determine whether the chosen state's law is contrary to a *fundamental* policy of California. If there is no such conflict, the court shall enforce the parties' choice of law. If, however, there is a fundamental conflict with California law, the court must then determine whether California has a 'materially greater interest than the chosen state in the determination of the particular issue . . . .' (Rest[.2d Conf. of Laws,] § 187, subd. (2).) If California has a materially greater interest than the chosen state, the choice of law shall not be enforced, for the obvious reason that in such

circumstance we will decline to enforce a law contrary to this state's fundamental policy." (*Nedlloyd*, at p. 466, fns. omitted.)

The first prong of the *Nedlloyd* test is unquestionably satisfied. As Citibank's principal place of business, South Dakota has a substantial relationship to the parties or their transaction. Likewise, as to the second prong of the *Nedlloyd* analysis, as a general matter there would appear to be no conflict between South Dakota and California law: South Dakota, like California, recognizes the doctrine of unconscionability. (See *Rozeboom v. Northwestern Bell Tel. Co.* (S.D. 1984) 358 N.W.2d 241, 242-243 [refusing to enforce limited liability clause in consumer contract under principles of both substantive and procedural unconscionability; the contract was both adhesive and unfairly one-sided]; see also S.D. Codified Laws § 57A-2-302 ["if the court as a matter of law finds the contract or any clause of the contract to have been unconscionable as the time it was made" the contract is not enforceable].)

According to Citibank, this is the end of the analysis. If there is "no conflict" between California and South Dakota law, South Dakota law must apply. And, it argues, under South Dakota law arbitration provisions in consumer agreements have been rigorously enforced. (See, e.g., *Rossi Fine Jewelers, Inc.* (S.D. 2002) 648 N.W.2d 812, 814; see also Ops. S.D. Attorney Gen. (May 7, 2002) [South Dakota "encourages the use of arbitration to resolve disputes, and it permits credit card issuers to add arbitration clauses to their contracts by sending written notices to their cardholders"].)

The question of unconscionability, however, is directed not to the arbitration provision per se but to the legality of the class action waiver portion of the arbitration agreement. South Dakota has not addressed that issue, in either its statutory or case law. And, while South Dakota's recognition of general principles of substantive and procedural unconscionability suggests that, in fact, there is no conflict between California and South Dakota law and South Dakota would likely find the class action waiver provision unconscionable for the reasons identified in *Discover Bank, supra*, 36 Cal.4th 148, we need not decide that issue. The California Supreme Court has stated that under the circumstances presented in this case -- a consumer contract of adhesion involving

allegations the party in the superior bargaining position cheated large numbers of consumers out of small sums of money -- the class action waiver in the credit card agreement violates a fundamental California public policy. (*Discover Bank,* at p. 162; see also *Klussman v. Cross Country Bank* (2005) 134 Cal.App.4th 1283, 1298 [the "reasoning of the *Discover Bank* court leave[s] no doubt that Delaware's approval of class action waivers, especially in the context of a 'take it or leave it' arbitration clause is contrary to a fundamental policy in California"].) Accordingly, we must decide, pursuant to the third prong of the *Nedlloyd* analysis, whether California has a materially greater interest than South Dakota in the litigation.[7] Plainly, it does.

Unlike the situation in *Discover Bank II, supra,* 134 Cal.App.4th at page 894 in which the plaintiff asserted substantive claims under Delaware law, the jurisdiction specified in the choice-of-law provision of the parties' agreement, Firchow, a California resident, seeks redress for violations of California's consumer protection statutes. In similar circumstances, several courts of appeal, relying on *Discover Bank, supra,* 36 Cal.4th 148, have held California has a materially greater interest in the litigation involving alleged violations of its own consumer protection statutes than the chosen foreign state. (See, e.g., *Aral v. Earthlink, Inc.* (2005) 134 Cal.App.4th 544, 563, 564 ["There is a significant distinction between the present case and the situation in *Discover Bank* [*II*]. Plaintiff there was 'not seeking to enforce an obligation imposed by the CLRA

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[7] Because the credit card agreement has an express choice-of-law provision, the trial court erred in applying the "governmental interest approach" to traditional conflict-of-laws analysis to determine whether California or South Dakota law governed interpretation and enforcement of the arbitration clause and the class action waiver provision. (See *Washington Mutual, supra,* 24 Cal.4th at pp. 914-915 ["California has two different analyses for selecting which law should be applied in an action. When the parties have an agreement that another jurisdiction's law will govern their disputes, the appropriate analysis for the trial court to undertake is set forth in *Nedlloyd, supra,* 3 Cal.4th 459, which addresses the enforceability of contractual choice-of-law provisions. Alternatively, when there is no advance agreement on applicable law, but the action involves the claims of residents from outside California, the trial court may analyze the governmental interests of the various jurisdictions involved to select the most appropriate law."].)

or any other California statute." "Here . . . Aral resides in California, seeks to represent only California consumers, and relies solely on California's [unfair competition law] to support his claim. The fundamental policy at issue is not simply the right to pursue a class action remedy, but the right of California to ensure that its citizens have a viable forum in which to recover minor amounts of money allegedly obtained in violation of the [unfair competition law]. . . . There is no doubt that California has a 'materially greater interest' than [Georgia] in the determination of [this] particular issue . . . ."]; *Klussman v. Cross Country Bank, supra*, 134 Cal.App.4th at pp. 1299-1300 [in putative statewide class action against Delaware bank and its servicing company alleging bank cheated large numbers of consumers out of individually small amounts of money and asserting California statutory claims, class action waiver in credit card agreement violated California public policy and California had a materially greater interest than Delaware in the action]; *America Online, Inc. v. Superior Court* (2001) 90 Cal.App.4th 1, 17 [despite the parties' choice of Virginia law, the unavailability of class action relief in Virginia contravenes a fundamental public policy in California, which has a materially greater interest than Virginia in a litigation involving a putative statewide class action asserting internet service provider violated California's consumer protection statutes].) We agree with those decisions and apply California law to the question of the enforceability of the class action waiver provision.

4. *Under California Law the Class Action Waiver Is Unconscionable*

Even if California law applies, Citibank argues, because the arbitration agreement contains what it describes as an opt-out provision, it was not offered on a "take it or leave it" basis and therefore is distinguishable from the type of agreements found to be unconscionable in *Discover Bank, supra*, 36 Cal.4th 148. (Cf. *Aral v. Earthlink, Inc.*, *supra*, 134 Cal.App.4th at p. 557 [finding "quintessential procedural unconscionability" where the "terms of a [software] agreement were presented on a 'take or leave it' basis . . . with no opportunity to opt out"].)

Citibank is correct that the method by which it added the arbitration provision to agreements with existing cardholders is less oppressive than that used by Discover Bank:

The Citibank agreement allows a card member who objects to the proposed new terms to decline to be bound by the arbitration agreement while continuing to use the card under the existing terms until the card's current expiration date. Nonetheless, because in the circumstances of this case the waiver provision, like the waiver provision at issue in *Discover Bank,* is in practice an attempt by Citibank to exempt itself from responsibility for its own fraud or willful injury to another in violation of Civil Code section 1668 (see *Discover Bank, supra,* 36 Cal.4th at pp. 162-163) -- that is, because the degree of substantive unconscionability is so high under governing California law -- this lessening of the level of procedural oppression is not sufficient to validate the class action waiver provision. (See *Armendariz, supra,* 24 Cal.4th at p. 114.)[8] While the cardholder who elects to accept the new provisions may continue to use his or her card indefinitely (because, as a practical matter, the card will be renewed automatically and a new

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[8] It is at least arguable, even without any additional finding of procedural unconscionability, enforcement of a class action waiver provision in a consumer contract of adhesion would violate Civil Code section 1668, which prohibits all contracts that *directly or indirectly* exempt anyone from responsibility for his or her own fraud or willful injury to another, and California public policy in the context of a lawsuit in which it is alleged the party with superior bargaining power has defrauded a large number of consumers with small individual claims. (See, e.g., *Gavin W. v. YMCA of Metropolitan Los Angeles* (2003) 106 Cal.App.4th 662, 674 ["the cases cited in *Tunkl* [*v. Regents of University of California* (1963) 60 Cal.2d 92] established that an exculpatory provision is void as against public policy when it *either* concerns a matter of great importance to the public or is the result of unequal bargaining power."].) As discussed, in *Discover Bank, supra,* 36 Cal.4th at page 161, the Supreme Court concluded in circumstances substantively identical to those in the case at bar, class action waiver provisions "may operate effectively as exculpatory contracts that are contrary to public policy." (See also *Szetela v. Discover Bank, supra,* 97 Cal.App.4th at p. 1101 [one-sided, substantively unconscionable nature of class action waiver provision "violates public policy by granting Discover a 'get out of jail free' card while compromising important consumer rights"].) In view of our conclusions the class action waiver provision in this case contains significant elements of procedural unconscionability and (using the *Armendariz* "sliding scale" analysis) the combined elements of procedural and substantive unconscionability preclude enforcement of the provision, resolution of the question whether the class action waiver provision violates Civil Code section 1668 properly awaits another case and another day.

expiration date imposed), the cardholder who objects to the new terms loses the opportunity to use the card once the specified period expires. At that point, the objector's credit card privileges are revoked, forcing the cardholder to switch credit card companies midstream notwithstanding his or her good credit history with Citibank. Phrased more colloquially, there is no right to "opt out"; the cardholder still must take-it-or-leave it; he or she simply has a somewhat more extended period in which to make that decision. Thus, the so-called opt-out opportunity is largely illusory. (Cf. *Circuit City Stores, Inc. v. Mantor* (9th Cir. 2003) 335 F.3d 1101, 1107 [in light of "Circuit City's insistence that Mantor sign the arbitration agreement -- under pain of forfeiting his future with the company -- the fact that in 1995 Mantor was presented with an opt-out form does not save the agreement from being oppressive, for Mantor had no meaningful choice nor any legitimate opportunity, to negotiate or reject the terms of the arbitration agreement"].)

In sum, enforcement of the class action waiver provision in the arbitration agreement would offend this state's fundamental public policy in a matter over which California has a materially greater interest than South Dakota, the jurisdiction identified in the parties' agreement. Accordingly, applying California law as mandated by *Discover Bank, supra,* 36 Cal.4th 148, the class action waiver provision in Citibank's credit card agreement is unconscionable and may not be enforced.

5. *Application of California Law Does Not Violate the FAA*

Citibank also argues, because the agreement to arbitrate provides it is governed by the FAA, application of California law on this matter is preempted. Both the United States and California Supreme Courts have rejected similar preemption arguments, holding an arbitration agreement governed by the FAA may be invalidated on the same state law grounds that justify invalidation of any contract. (*Doctor's Associates, supra,* 517 U.S. at pp. 686-687; *Discover Bank, supra,* 36 Cal.4th at p. 173 ["FAA does not prohibit a California court from refusing to enforce a class action waiver that is unconscionable"]; see also 9 U.S.C. § 2 [states may invalidate an arbitration clause "upon such grounds as exist at law or in equity for the revocation of any contract," including unconscionability].)

Equally unavailing is Citibank's argument the doctrine of FAA preemption prohibits utilization of California law to invalidate one portion of the agreement, while enforcing other terms of the agreement under South Dakota law, as suggested by the trial court. According to Citibank, such a holding places the arbitration clause on an "unequal footing" with the rest of the agreement, an outcome prohibited by the United States Supreme Court in *Allied-Bruce Terminix Cos., Inc. v. Dobson* (1995) 513 U.S. 265, 281 [115 S.Ct. 834, 130 L.Ed.2d 753] (*Allied-Bruce*) ("States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause" under state unconscionability laws, but "[w]hat States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. The Act makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal 'footing,' directly contrary to the Act's language and Congress' intent.").

The language quoted by Citibank from *Allied-Bruce, supra,* 513 U.S. at page 281 does not support its position. Rather the Supreme Court simply recognized, as it has in many other cases, under the FAA states may not treat arbitration clauses differently from other provisions in the contract. (See, e.g., *Perry v. Thomas* (1987) 482 U.S. 483, 492-493, fn. 9 [107 S.Ct. 2520, 96 L.Ed.2d 426] [state court may not construe arbitration agreements "in a manner different from that in which it otherwise construes nonarbitration agreements under state law"]; *Doctor's Associates, supra,* 517 U.S. at p. 687 [state laws that apply to contracts generally can be applied to arbitration agreements, but "[c]ourts may not . . . invalidate arbitration agreements under state laws applicable *only* to arbitration provisions"].) In applying *Nedlloyd, supra,* 3 Cal.4th 459, as directed by the Supreme Court in *Discover Bank, supra,* 36 Cal.4th at pages 173 to 174, to determine whether and to what extent South Dakota law applies to the Citibank arbitration agreement, we are construing the parties' agreement under rules generally applicable to contracts in California. (See *Discover Bank,* at p. 174 [on remand the Court of Appeal must "resolve whether and to what extent Delaware law should apply"].) Our conclusion California's general laws of unconscionability apply and require invalidation

of the class action waiver, accordingly, is not preempted by the FAA. (See *Discover Bank*, at pp. 169-172; see also *Doctor's Associates, supra*, 517 U.S. at pp. 686-687.)

6. *The Trial Court Did Not Err in Concluding the Class Action Waiver Cannot Be Severed From the Agreement to Arbitrate*

The determination the class action waiver is unconscionable does not necessarily mean the entire arbitration agreement is void and the motion to compel arbitration properly denied. Civil Code section 1670.5, subdivision (a), provides, "If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result." "Comment 2 of the Legislative Committee comment on section 1670.5, incorporating the comments from the Uniform Commercial Code, states: 'Under this section the court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single clause or group of clauses which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results.'" (*Armendariz, supra,* 24 Cal.4th at p. 122; see also Civ. Code, § 1599 [when a contract has "several distinct objects, of which one at least is lawful, and one at least is unlawful, in whole or in part, the contract is void as to the latter and valid as to the rest"].)

Similarly, under South Dakota law a finding that one portion of an agreement is unconscionable or otherwise void does not necessarily preclude enforcement of the balance of the agreement. (Compare S.D. Codified Laws § 53-5-4 ["Where a contract has several distinct objects, one or more of which are lawful and one or more of which are unlawful in whole or in part, the contract is void as to the latter and valid as to the rest."] with S.D. Codified Laws § 53-5-3 ["Where a contract has but a single object and such object is unlawful in whole or in part, or wholly impossible of performance, or so vaguely expressed as to be wholly unascertainable, the entire contract is void."].) Although the question of severability depends in the first instance on the intent of the

parties entering the contract (see *Commercial Trust and Sav. Bank v. Christensen* (S.D. 1995) 535 N.W.2d 853, 857-858), a court may not treat portions of an agreement as severable if part of it is void and the agreement as a whole constitutes "an integrated scheme to contravene public policy." (*Id.* at p. 858, fn. 2; *Pauley v. Simonson* (S.D. 2006) 720 N.W.2d 665, 668.)

In determining whether an unconscionable provision permeates the entire agreement, courts look to the various purposes of the contract. If the central purpose of the contract is tainted with unconscionability, then the contract as a whole cannot be enforced. If the unconscionable provision is collateral to the main purpose of the contract and can be excised from the contract, however, then severance is appropriate. (*Armendariz, supra,* 24 Cal.4th at p. 124.)

Classwide arbitration has become a well-established alternative to class action litigation. (See *Discover Bank, supra,* 36 Cal.4th at pp. 172-173; see also *id.* at p. 167 ["there is nothing to indicate class action and arbitration are inherently incompatible"].) Accordingly, based on the language in the parties' arbitration agreement, as well as general principles governing arbitration, in an appropriate case it would be proper to conclude the class action waiver is collateral to the central purpose of the agreement and to sever the offending provision while enforcing the essential agreement to arbitrate. (Compare *Cohen v. DirectTV, Inc.* (2006) 142 Cal.App.4th 1442, 1446, 1448 [severance not an option when customer agreement expressly prohibits severance of class action waiver provision from remainder of arbitration clause].)

In the case at bar, however, the trial court found -- and both parties agree -- the waiver provision permeates the entire purpose of the agreement to arbitrate and cannot be severed.[9] Indeed, there is no single class action waiver provision in the agreement. Rather, the entire agreement contemplates that either party can elect binding arbitration only on an individual basis: The requirement that a claimant proceed on an individual

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[9] The trial court succinctly ruled, "Consistent with the position of the parties and the express language of the agreement, the [c]ourt finds the class waiver cannot be severed under these circumstances."

basis defines not only who can be a party to a dispute under the credit card agreement,[10] but also the scope of relief that may be afforded.[11] Under these circumstances the unconscionable aspects of the agreement "cannot be cured by merely extirpating the offending provisions -- we would have to rewrite the contract which we lack the power to do." (*Mercuro v. Superior Court, supra*, 96 Cal.App.4th at p. 185; see *Culhane v. Western Nat. Mut. Ins.* Co. (S.D. 2005) 704 N.W.2d 287, 297 [court may "neither rewrite the parties' contract nor add to its language"].) Accordingly, the trial court properly exercised its discretion in refusing to enforce the arbitration agreement in its entirety.

DISPOSITION

The order denying the motion to compel arbitration is affirmed. Firchow is to recover his costs on appeal.

NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

PERLUSS, P. J.

We concur:

JOHNSON, J. ZELON, J.

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[10] In the section of the arbitration agreement entitled "Who can be a party?," the agreement provides, "Claims must be brought in the name of the individual person or entity and must proceed on an individual (non-class, non-representative basis). The arbitrator will not award relief for or against anyone who is not a party. If you or we require arbitration of a Claim, neither you, we, nor any other person may pursue the Claim in arbitration as a class action, private attorney general action or other representative action . . . ."

[11] Under the heading "Claims Covered," the arbitration agreement provides, "Claims and remedies sought as part of a class action, private attorney general or other representative action are subject to arbitration on an individual (non-class, non-representative) basis, and the arbitrator may award relief only on an individual (non-class, non-representative) basis." Under the subheading "What procedures and law are applicable in arbitration?," the agreement states, "An award in arbitration shall determine the rights and obligations between the named parties only, and only in respect of the Claims in arbitration, and shall not have any bearing on the rights and obligations of any other person, or on the resolution of any other dispute."