CASE NO. 09-16703

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MATTHEW C. KILGORE and WILLIAM BRUCE FULLER,

Plaintiffs-Appellees,

v.

KEYBANK, NATIONAL ASSOCIATION and
GREAT LAKES EDUCATIONAL LOAN SERVICES, INC.,

Defendants-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA
NO. 3:08-CV-02958-TEH

APPELLEES' RESPONSE BRIEF

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I. STATEMENT OF THE ISSUES

1. Whether applying Ohio Law in determining the arbitrability of class-action claims solely for injunctive relief under California's Unfair Competition Law predicated on a violation of a federal consumer protection regulation contravenes a fundamental policy of California.

2. Whether Ohio Law, which bars consumer claims for unfair and deceptive business practices against financial institutions domiciled in Ohio, is contrary to a fundamental policy of California.

3. Whether the mandatory pre-dispute class action ban in the Arbitration Provision is contrary to a fundamental California policy.

4. Whether the absence in Ohio Law of a mutuality of remedy for the recovery of attorneys' fees in contract actions is contrary to a fundamental California policy.

5. Whether the Arbitration Provision is procedurally and substantively unconscionable thereby barring its enforceability.

6. Whether California has a materially greater interest than Ohio in the determination of the enforceability of the Arbitration Provision

Each of these issues is subject to *de novo* review. *Hoffman v. Citibank, N.A.*, 546 F.3d 1078, 1082 (9th Cir. 2008).

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II. STATEMENT OF THE CASE

This class action seeks to declare unlawful and to remedy an ongoing scheme of unconscionable, predatory lending practices perpetrated by KeyBank.[1] Purporting to hide behind the shield of Ohio's anti-consumer laws, KeyBank partners with private, unlicensed and unregulated sham vocational schools (in this case Silver State Helicopters ("SSH")) to induce unwitting prospective students into accepting loans, the funds of which are paid directly to the school long before their education is completed. These practices fuel the schools' illicit enrollment schemes. When the schools shutter their doors because the scheme collapses, the students are left with no education, no accreditation and no employment prospects but still obligated to repay the loans which are not dischargeable in bankruptcy.

Appellees (hereinafter referred to as Plaintiffs) seek to enjoin KeyBank from 1) enforcing more than $7 million in student loans made to Plaintiffs in violation of California Business and Professions Code sections 17200, *et seq.* (the "UCL") through KeyBank's predicate violation of the F.T.C. Holder Rule, and 2) continuing to engage in unfair and deceptive acts and practices committed against the residents of the State of California by its systemic violation of the UCL and the Holder Rule in consumer transactions. The action seeks only injunctive relief. No monetary damages or restitution are sought. The action is based on the grounds

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[1] Appellants KeyBank, N.A. and its loan servicing agent Great Lakes Educational Loan Services, Inc. will collectively be referred to as "KeyBank".

that at the time KeyBank made the loans it violated the unlawful, unfair, and fraudulent prongs of the UCL and aided and abetted SSH in violating the UCL.

On February 4, 2008, SSH abruptly closed its doors and filed bankruptcy leaving more than 2600 students nationwide without their fully paid-for education but still obliged to repay three successive lenders that provided private, non-federally guaranteed student loans (referred to herein as "FFELP" loans).

KeyBank became SSH's first lending "partner" (KeyBank's word) in February 2003.[2] This provided the initial spark and fueled the "legitimacy" that propelled SSH to become the largest failed private vocational school in U.S. history. [KIL. ER 282-284] As was the case with KeyBank's numerous other partner vocational schools, SSH was nothing more than a ponzi scheme totally dependent on the pipeline of student loan proceeds to sustain its meteoric growth. In barely more than two years, KeyBank loaned more than $50 million to unsuspecting SSH students nationwide.

Even though this class action is brought by California residents only, on behalf of California SSH students only, under California's consumer protection law and requests injunctive relief only, KeyBank seeks to compel each of the 120

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[2] Plaintiffs have reached a tentative nationwide settlement with one of the other lenders, Student Loan Xpress, Inc., a defendant in this action before recently being dismissed to allow the settlement to go forward in a companion Florida case. The settlement has been preliminarily approved in *Holman v. Student Loan Xpress, Inc.* 8:08-cv-00305-SDM-MAP (M.D. Fla.). The third lender was Citibank. After being sued in a Related Case to this matter (*Benedict v. Citibank* 08-04230 TEH), Citibank agreed to forgive 100% of its loans and that action was dismissed.

students to individually arbitrate his/her claim in one of two private arbitration tribunals under Ohio law.

III. STATEMENT OF RELEVANT FACTS

A. Silver State Helicopters.

As a result of its partnership with KeyBank, SSH became the largest private helicopter flight school in the country and one of the fastest growing companies in any industry in the United States. Tuition for the school – which promised commercial helicopter pilot certification within 18 months of enrollment – was nearly $60,000 per student. Because of SSH's exponential growth and the fact that its executives siphoned off tens of millions of dollars[3], SSH knew it did not have, and never would have, sufficient equipment, trainers or maintenance personnel to meet its obligations under the Service Contracts. Because student loan proceeds were SSH's principle source of revenue, SSH's "business model" was dependent on recruiting ever-larger pools of new students to finance the training of earlier ones. The success of that recruitment was, in turn, dependent on KeyBank's deliberate and calculated willingness to look the other way from SSH's numerous red flags.

B. KeyBank's History of Predatory Student Lending Practices.

KeyBank has the dubious distinction of being one of the Nation's most

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[3] The FBI, the U.S. Attorney and multiple states' Attorneys General are investigating SSH and its executives, including their relationship with the defendant lenders. [KIL. ER 119-120]

notorious predatory student loan providers. For more than 15 years it has funded hundreds of millions of dollars in private student loans for failed private vocational schools leaving the students without their education and facing KeyBank's "debtor's prison" because such loans are not dischargeable in bankruptcy. [KIL. ER 232-269] Commentators have chronicled KeyBank's involvement in numerous prior situations identical to SSH and consumer rights advocates have even testified before Congress about KeyBank's *modus operandi*. The SSH story is merely one – albeit the largest one – of more than a dozen cases where KeyBank was the sole financial backer of a failed vocational school and thereafter sought to hide behind a cornucopia of legal arguments in aggressively pursuing the student victims of these sham schools. [KIL. ER 340-398]

KeyBank has continued unabated its pattern of unlawful, unfair, and predatory conduct by 1) refusing to include the F.T.C. Holder Rule Notice in its non-federally guaranteed student loan notes,[4] 2) ensuring that its vocational school partner omits the Holder Rule Notice from its agreements, 3) enabling the school to accept the purchase money loan proceeds knowing that the school is in violation of the Holder

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[4] The F.T.C. Holder Rule, 16 C.F.R. part 433, was expressly enacted to provide consumers (including student borrowers) with the ability to assert against purchase money creditors such as KeyBank the same defenses the consumer would be able to assert against the provider of the goods or service for which the money was loaned. KeyBank contends that the Rule is a "voluntary" regulation which, if the seller and lender choose not to include in the transaction documentation, forecloses the consumer from asserting his or her defenses against the credit provider. Although KeyBank contends it does not apply to banks, the Federal Deposit Insurance Corporation disagrees. [KIL. ER 274]

Rule, 4) imposing anti-consumer Ohio choice-of-law and forum selection clauses on the student regardless of where the student resides or the loan proceeds are used, and 5) including an unconscionable arbitration provision which bars class actions, bars the recovery of attorneys fees even if the student prevails, unduly limits discovery, has an egregious fee-splitting provision and a one-sided confidentially provision, all of which combine to effectively eviscerate the students' ability to vindicate their rights thereby exculpating KeyBank from any liability.

C. KeyBank's Partnership with SSH.

In February 2003, KeyBank accepted SSH as a "partner" in its educational loan program and loaned more than $50 million to SSH students. However, KeyBank's own documents confirm KeyBank 1) violated its own due diligence policies, 2) knew that it was "hemorrhaging" with its non-FFELP schools, especially with the high-risk aviation schools, 3) failed to follow its internal plan to eliminate risky schools such as SSH (by March 2005, KeyBank had identified SSH as one its "highest risk schools"), and 4) ignored red flags about SSH's graduation rates, placement rates, student/aircraft ratios, student/flight instructor ratios, mechanic/aircraft ratios. *See c*omplaint, [KIL. ER 324-333]

D. Means and Manner by Which the Arbitration Provision was Conveyed to Students.

An important consideration on this motion is the manner and means by which KeyBank conveyed the Arbitration Provision to the students. The

Declaration of Jody Pidruzny, SSH's Student Finance Manager throughout its relationship with KeyBank, describes the process in detail. [KIL. ER 34-38] In short, KeyBank never conveyed any information to the student; rather, SSH employees handled the loan application and Note execution process from start to finish. Moreover, KeyBank provided no information about the Note or the Arbitration Provision to SSH. Even though she was in charge of financial aid, Ms. Pidruzny was unaware of the arbitration provision and no one at SSH ever discussed the arbitration provision with the students. KeyBank not only failed to offer any guidance on what to do in the event a student had a question about the Note, but it actively discouraged SSH personnel from having students contact the Bank directly. *See also* Kilgore and Fuller Declarations, [KIL. ER 39-41; 289-297] Not surprisingly, not a single SSH borrower exercised his/her opt-out right.

IV. PROCEDURAL POSTURE

At the time KeyBank filed its Motion to Compel Arbitration (the denial of which is the subject of this appeal), the operative Complaint was Plaintiffs' Second Amended Complaint [KEY E.R. 102-130]. Although KeyBank appealed the District Court's Order, KeyBank insisted on being allowed to move to dismiss the action while this appeal was pending. The District Court, therefore, ordered a limited stay of the proceedings permitting KeyBank to file a motion to dismiss and allowing Plaintiffs to conduct documentary discovery. [KIL. ER 298]

In response to KeyBank's motion to dismiss the Second Amended Complaint *and before KeyBank filed its Opening Brief in this appeal*, Plaintiffs moved for leave to file an amended complaint to address certain issues raised in KeyBank's motion to dismiss and to clarify the scope of the injunctive relief sought. [KIL. ER 299-304] KeyBank opposed the motion. The District Court granted Plaintiffs leave to file the proposed amended complaint. In its Order the Court further observed that "the Third Amended Complaint may in fact expedite the litigation by addressing issues preemptively." [KIL. ER 309, ln. 11] Plaintiffs promptly filed their Third Amended Complaint. [KIL. ER 310-339] On January 11, 2010, KeyBank filed a motion to dismiss. [KIL. ER 415] Because the Third Amended Complaint is the operative Complaint and KeyBank has not sought to augment or refile its Opening Brief, all references in this brief to the Complaint shall be to the Third Amended Complaint unless otherwise specified.

V. SUMMARY OF ARGUMENT

The Ohio choice-of-law provision in each student's Master Student Loan Promissory Note ("Note") is unenforceable because Ohio law is in conflict with several fundamental consumer protection policies of California. Therefore, this Court should apply California law to the question of whether the Arbitration Provision in the Note is enforceable.

First, California has long permitted its residents to sue financial institutions under the UCL. Ohio's consumer protection statute, by contrast, expressly

exempts financial institutions from consumer lawsuits. Second, under California law, claims for injunctive relief under the UCL are not arbitrable. In contrast, Ohio permits arbitrators to decide claims for injunctive relief under its consumer law statute. Third**,** whereas California has a judicially declared fundamental policy prohibiting class action bans in consumer adhesion contracts, Ohio does not. Fourth, California has a fundamental policy requiring that any attorneys' fee provision in a contract be reciprocal. At best, Ohio law is unclear on this subject and KeyBank's attorney fee clause in the Notes is decidedly one-sided.

Because California law should be applied and Plaintiffs seek only injunctive relief, their claims are, as a matter of law, not arbitrable and the District Court's Order should be affirmed on that ground alone. But any analysis of the Arbitration Provision under California law compels the conclusion that it is both procedurally and substantively unconscionable and must be stricken in its entirety.

VI. ARGUMENT

A. Introduction.

The Federal Arbitration Act ("FAA") provides that "a written provision in any . . . contract evidencing a transaction involving interstate commerce to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. A court may not order arbitration until it is satisfied that a valid arbitration agreement exists. *See* 9 U.S.C.

§ 4. Any claim of fraud, duress or unconscionability in the formation of the arbitration agreement is a gateway matter to be decided by the court. *See Green Tree Financial Corp. v. Bazzle,* 539 U.S. 444, 452 (2003).

B. This Court Should Apply California's Choice of Law Analysis to Determine The Enforceability of The Arbitration Clause.

Federal courts sitting in diversity look to the law of the forum state when making choice of law determinations. *Hoffman v. Citibank, N.A.*, 546 F.3d 1078, 1082 (9th Cir. 2008). In *Hoffman,* this Court, after accepting there was a "substantial relationship" between the defendant and its chosen state, analyzed whether the "'chosen state's law is contrary to a *fundamental* policy of California'," and if so, whether "California has a materially greater interest than the chosen state in the determination of the particular issue." *Id.* (emphasis in original).

Because KeyBank is domiciled in Ohio, the threshold "substantial relationship" test is satisfied. Thus, this Court need undertake only the second and third steps of the conflict of law analysis described above – determining whether Ohio's law is contrary to a fundamental policy of California, and if so, whether California has a materially greater interest than Ohio in the determination of the enforceability of the Arbitration Provision. Because the answers to these questions are emphatically affirmative for numerous reasons, California law should be applied and the Arbitration Provision held invalid.

C. Applying California Choice of Law Rules, Ohio Law is Contrary to Fundamental Policies of California.

1. Ohio's Consumer Protection Law Expressly Evades and Runs Contrary to the UCL's Policy of Allowing Consumers to Sue Financial Institutions for Unlawful, Fraudulent and Deceptive Conduct.

For more than 30 years this Court has said that a contractual choice of law provision will be disregarded where application of the law of the chosen state would 1) run contrary to a California public policy, or 2) evade a California statute. *See Sarlot-Kantarjian v. First Pennsylvania Mortgage Trust*, 599 F.2d 915, 917 (9th Cir. 1979); *General Signal Corp. v. MCI Telecommunications Corp*., 66 F.3d 1500, 1506 (9th Cir. 1995); *Duvall v. Galt Med. Corp.,* 2007 U.S. Dist. LEXIS 89587 (N.D. Cal. 2007). Applying Ohio law in this case will do both of these things.

Since its enactment more than seven decades ago[5], the UCL has been the embodiment of California's unwavering public policy to protect unwary consumers from being duped by unscrupulous businesses through unlawful, fraudulent and unfair business practices. Indeed, recognizing that consumers, rather than competitors, need the greatest protection from sharp business practices, the California legislature intentionally framed the statute in broad, sweeping language, precisely to enable judicial tribunals to deal with the innumerable "'new schemes

[5] The expansion of legal remedies against deceptive business practices can be traced to a 1938 amendment to the Federal Trade Commission Act ("FTC"), which gave the FTC jurisdiction over unfair business practices that harmed the public. Later, the states followed suit, enacting a host of 'little FTC Acts,' including Civil Code section 3369. *Cel-Tech*, *supra*, at 196.

which the fertility of man's invention would contrive.'" *Cel-Tech Commc'ns, Inc. v. Los Angeles Cellular Tel. Co.*, 20 Cal. 4th 163, 180-81 (1999). Nearly 40 years ago the California Supreme Court observed that protection of consumers is "an exigency of the utmost priority in contemporary society." *Vasquez v. Superior Ct.*, 4 Cal. 3d 800, 808 (Cal. 1971). This was a particularly prescient prediction of the havoc that financial institutions would wreak on America in the early years of the 21st Century with their securitization schemes and reckless predatory lending practices. Even the passage of Proposition 64, which changed the standing requirement for bringing a UCL consumer action, did nothing to alter the UCL's "fundamental purpose of protecting consumers from unfair businesses practices." *In re Tobacco II Cases*, 46 Cal. 4th 298, 324 (Cal. 2009); *see also Doe 1 v. AOL LLC, supra.*

California consumers have long been permitted to invoke the broad remedial reach of UCL to challenge unlawful, unfair, and fraudulent practices of banks. *See Chern v. Bank of America,* 15 Cal. 3d 866, 875 (1976); *Gibson v. World Sav. & Loan Ass'n*, 103 Cal. App. 4th 1291 (2002); *Smith v. Wells Fargo Bank, N.A.*, 135 Cal. App. 4th 1463 (2005); *Hood v. Santa Barbara Bank & Trust,* 143 Cal. App. 4th 526 (2006); *Van Slyke v. Capital One Bank,* 503 F.Supp 2d 1353 (2007).

Recently, this Court in *Hauk v. JP Morgan Chase Bank United States,* 552 F.3d 1114, 1122 (9th Cir. 2009) endorsed the broad reach of the UCL against a national bank observing that "California's UCL has a broad scope that allows for

"violations of other laws to be treated as unfair competition that is independently actionable" while also "sweep[ing] within its scope acts and practices not specifically proscribed by any other law."

In direct contrast to California's strong public policy permitting consumers to use the UCL to address unlawful lending practices, Ohio law not only lacks a comparable legislative scheme but its closest analogue - the Ohio Consumer Sales Practices Act, O.R.C. § 1345, *et seq*. (hereafter "OCSPA") - expressly exempts financial institutions from liability in consumer credit transactions. See O.R.C § §1345.01(A) and 5725.01(A). Right on cue, KeyBank drafted its Note to expressly state it is a "consumer credit transaction." [Key E.R. 71; 79 at ¶ B]. Consequently, if Ohio law is applied here KeyBank will succeed in evading the "sweeping" reach of the UCL and eviscerate California's long-standing consumer protection policies underlying the UCL.

2. The OCSPA Violates a Fundamental California Policy Embodied in the Particular UCL Claim Asserted By Plaintiffs In this Case.

Because this case is brought solely on behalf of California residents, solely under California law for injuries suffered only in California, if applying Ohio law offends a "fundamental" policy of California, the Ohio choice-of-law provision is unenforceable. Despite the indisputable conclusion that the OCSPA and the UCL are irreconcilably in conflict because of the former's shield of financial institutions from consumer lawsuits, the District Court declined to find that the UCL is a

"fundamental" policy of California because Plaintiffs offered inadequate authorities for this proposition. Order, [KEY E.R. 8. lns. 17-18]. That shortfall is corrected here.

Given the breadth, scope and longevity of the UCL, its interpretative case law and scholarly commentary, it is hard to imagine a more pronounced, practical and overarching "fundamental" California policy than protecting its consumers against "any unlawful, unfair or fraudulent business act or practice."

The California Supreme Court "has repeatedly recognized the importance" of UCL class actions in the enforcement of consumers' rights and "to protect the public and restore to the parties in interest money or property taken by means of unfair competition." *In re Tobacco II Cases,* 46 Cal. 4th at 313 (citation and quotes omitted). *See also Cel-Tech, supra,* at 180-181.

With respect to the "unlawful" prong of the UCL, the UCL "'borrows' from other laws, treating violations of those laws as unlawful practices independently actionable." *Stop Youth Addiction v. Lucky Stores, Inc.,* 17 Cal.4th 553, 566 (Cal. 1998). Virtually any federal, state, local, regulatory, or court-made law, including criminal provisions, can serve as the predicate for an UCL action based upon unlawful business practices. *Id.* at 562. The liability and remedial provisions of the UCL are "cumulative to all other" rights and remedies. *Id.*

Moreover, whether a predicate statute confers a private right of action is "immaterial" to determining whether the plaintiff can state a claim under the UCL.

Id. The UCL itself confirms the right to seek and obtain injunctive and other equitable relief for any violation. Bus & Prof Code §17204.

"To achieve its goal of deterring unfair business practices in an expeditious manner, the Legislature limited the scope of the remedies available under the UCL" to equitable relief. *Tobacco II, supra,* at 312 ("To permit individual claims for compensatory damages to be pursued as part of such a procedure would tend to thwart this objective by requiring the court to deal with a variety of damage issues of a higher order of complexity.") Moreover, "the overarching legislative concern" of the UCL was "to provide a streamlined procedure for the prevention of ongoing or threatened acts of unfair competition." *Korea Supply Co. v. Lockheed Martin Corp.,* 29 Cal. 4th 1134, 1150 (2003).

But respecting Judge Henderson's desire for even more potent authority, Plaintiffs have identified several recent cases which directly address the question of under what circumstances the UCL embodies a fundamental policy of California thereby trumping the Ohio choice-of-law provision.

In *Cardonet, Inc. v. IBM Corp*. 2007 WL 518909 (N.D.Cal. 2007), Judge Whyte was faced with the question of whether applying New York's unfair business practices statute which, like California's UCL, prohibits deceptive and unfair business practices, would conflict with fundamental California policy. Plaintiff argued that there was a policy conflict because under California's UCL "the overarching legislative concern [was] to provide a streamlined procedure for

the prevention of ongoing or threatened acts of unfair competition." The court rejected Plaintiff's argument holding that whether a UCL claim implicates a "fundamental" California policy depends on the substantive predicate violation, not a procedural difference.

In reaching this conclusion, the court noted that in *Application Group, Inc. v. Hunter Group Inc*., 61 Cal. App. 4th 881, 907-08, (1998) the UCL embodied a fundamental California policy prohibiting the use of covenants not to compete that were unlawful under California law but not under the chosen state law. Judge Whyte contrasted this with the holding in *Nibeel v. McDonald's Corp.* 1998 U.S. Dist. LEXIS 13425 (N.D. Ill. 1998), where section 17200 was found to not embody a fundamental policy because the protections afforded by California law and those of the state designated by the choice-of-law clause were similar.

It's Just Lunch Int'l LLC v. Island Park Enter. Group, Inc., 2008 U.S. Dist. LEXIS 89194, 7-9 (C.D. Cal. 2008) ("*IJL*"), involved a dispute under a franchise agreement containing a Nevada choice of law provision. Plaintiffs argued that Nevada's laws violated California's fundamental policies under both the California Franchise Investment Law ("CFIL") and the UCL. After noting that there is no "bright-line" definition of a "fundamental policy" the court, relying on comment g to Section 187 of the *Restatement Second of Conflict of Laws* and two prior cases involving the CFIL, determined that the CFIL does embody a fundamental California policy because it "[p]rotects franchisees against franchisors who may

have superior bargaining power" and was "'enacted to protect the statute's beneficiaries from deceptive and unfair business practices'"). *Id.* at 8-9 citing *America Online, Inc., v. Superior Court*, 90 Cal. App. 4th 1, 11 (2001).

With respect to Plaintiff's UCL claim the court observed that the language of the UCL "hews close to the spirit of a fundamental policy in Restatement 187 comment g." *Id*. at 9. Citing *Cardonet, supra,* however, Judge Phillips noted that courts have differed on whether the UCL embodies a fundamental policy, depending on the underlying violation. However, because the counterclaimant (the party which sought to establish the fundamental policy) failed to state with any precision which of Plaintiffs' alleged actions or violations were predicates for the UCL claim, Judge Phillips declined to find that counterclaimants sustained their burden of proving under the facts alleged that the UCL embodies a fundamental policy in California.

Plaintiffs' complaint here suffers no such infirmity. It clearly alleges that KeyBank's UCL violation is predicated on its knowing and intentional violation of the Holder Rule - a federal consumer protection regulation that defines a specific unfair and deceptive act or practice and which is expressly designed to protect consumers against creditors who, because of their affiliation with, but transactional separation from the seller, are in a far stronger position than the consumer. 16 C.F.R. § 433.2.

Both the CFIL and the Holder Rule were intended and designed to protect their respective beneficiaries from unfair and deceptive acts and practices. *See, Bencharsky v. Cottman Transmission Systems, LLC,* 625 F.Supp.2d 872, 879 and 16 C.F.R. § 433.2. And as discussed above, the protection of the consumer in California has always been of paramount legislative and judicial importance. To conclude, as did Judge Phillips in *IJL,* that a law (the CFIL) which protects sophisticated franchisees from deceptive and unfair business practices is "fundamental," but California's most potent consumer protection law and a federal consumer protection regulation are not, turns both the law and logic on their head.

3. Ohio Law Violates California's Fundamental Policy Barring Arbitration of Consumer Claims for Injunctive Relief In Class Actions Under the UCL.

The only relief sought by Plaintiffs in this case is class-wide injunctive relief under the UCL. Specifically, Plaintiffs seek to prohibit KeyBank from 1) taking any action against the putative class to enforce their Notes or with the credit reporting agencies, and 2) continuing to violate the Holder Rule by enabling sellers to accept purchase money loan proceeds where KeyBank knows the seller has violated the Holder Rule. The District Court found, and KeyBank concedes, that Ohio law irreconcilably conflicts with California's fundamental policy against the arbitrability of UCL class claims for injunctive relief. Order, [KEY E.R. 8-10]; KeyBank's Opening Brief, p. 18 – 20.

KeyBank nevertheless attacks the District Court's conclusion that California law bars arbitration of KeyBank's claims for class-wide injunctive relief under the UCL in this case. This attack derives from KeyBank's misrepresentation about how the UCL operates, what its available remedies are and what relief Plaintiffs seek in this case. Specifically, KeyBank is wrong that Plaintiffs' case is an "individual" one for injunctive relief; KeyBank is wrong that this is a case for damages disguised as injunctive relief and KeyBank is wrong that the UCL requires irreparable harm as a predicate for injunctive relief.

KeyBank's arguments ignore one of the most important distinctions of the UCL: The statute has always been intended to protect both competitors *and* consumers from unfair practices. *Cruz v. Pacificare Health Systems, Inc.*, 30 Cal. 4th 303, 315 (2003). In this case, the request for injunctive relief seeks to protect members of the class by enjoining the defendants' wide-spread unfair business practices against California consumers generally.

Here, the complaint and the exhibit thereto document the long-standing pattern and practice of KeyBank to intentionally flaunt the Holder Rule and aid and abet trade schools like SSH by circumventing the rule which enabled KeyBank to securitize its student loan portfolio and sell the loans into the secondary market. A judgment enjoining KeyBank from collecting on Plaintiffs' notes because it violated the Holder Rule will not only afford relief for at least 120 California

consumers,[6] it will undeniably protect *in futuro* all California consumers from KeyBank's unlawful, unfair, and fraudulent lending practices proscribed by the Holder Rule. Such a judgment will prevent KeyBank from "partnering" with proprietary trade schools that fail to include the Holder Notice in their contracts.

In positing that this is an "individual" UCL action for damages, KeyBank ignores the consumer/competitor dichotomy of the UCL, ignores that this case is brought as a class action and ignores that damages are not recoverable under the UCL. *Cruz*, *supra*, at 317. In effect, KeyBank urges this Court to define a "public" injunction under the UCL as one in which the plaintiff class must exceed the arbitrary numerical threshold for certification and cannot personally benefit monetarily from a permanent injunction. Such an interpretation would completely eviscerate the UCL's injunctive remedy, intended both to regulate ongoing conduct and deter future acts of unfair competition.

KeyBank also suggests that the number of putative class members should be outcome determinative as to whether injunctive relief on a class-wide basis is for a "public" or individual benefit. Opening Brief at p. 24- 25 (citing *Cruz, supra*). No case supports this analysis. Nor should there be. There is no rationale basis to deprive 100 or 1000 California consumers of their right to a judicially mandated,

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[6] Because very little discovery has been undertaken on either class or merits issues and because KeyBank made identical loans to thousands of California residents who attended failed vocational schools funded by KeyBank, it is entirely possible that the defined class will be greatly expanded.

supervised and enforced injunction that, if issued, will alter the behavior of the defendant far beyond the plaintiffs in the case. *See e.g. Davis v. O'Melveny & Myers,* 485 F.3d 1066, 1082 (9th Cir. 2007) ("public injunction" where one employee of a law firm brought several labor related claims individually and on behalf of similarly situated employees.)

In its quest to force its California customers to succumb to Ohio's pro-bank/anti-consumer laws, KeyBank proposes that this Court jettison the holdings in numerous cases, including a recent one by this Court[7], which have refused to order arbitration of UCL class action injunctive relief claims even though the class plaintiffs were relatively small in number and/or had monetary "skin in the game" because "the request for injunctive relief is clearly for the benefit of consumers and the general public by seeking to enjoin [defendant's] alleged deceptive practices." *Cruz*, *supra*, 30 Cal.4th at 315.

KeyBank is so desperate to avoid the class-wide injunctive relief remedy of the UCL because of its inarbitrability under California law that it makes an argument (injunctive relief improper where there is an adequate remedy at law) for which not only is there no legal authority in a UCL case, but which runs contrary to the UCL's focus on the defendant's conduct, rather than the plaintiff's damages,

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[7] *See*, *Davis v. O'Melveny & Myers, supra,* at 1080; s*ee also*, *Guadagno v. E*Trade Bank*, 592 F. Supp. 2d 1263, 1272 (C.D. Cal. 2008); *Ramirez v. Cintas Corp.*, 2005 U.S. Dist. LEXIS 43531, 13-14 (N.D. Cal. 2005)(comparing California and Ohio law).

in service of the statute's larger purpose of protecting the general public against unscrupulous business practices. *Tobacco II,* 46 Cal. 4th at 312.

The UCL is intended to stop unfair business practices. While its scope is broad its remedies are narrow and limited. It was long ago settled that a plaintiff is entitled to an injunction under the UCL if necessary "to prevent the use or employment" of the unfair practice. *Committee on Children's Television, Inc. v. General Foods Corp.*, 35 Cal.3d 197, 209 (1983).

Predictably, not one of the three cases cited by KeyBank in support of its "adequate remedy at law" argument even hints at the dramatic departure from well-settled law it seeks. In contrast, numerous cases have directly rejected KeyBank's argument. *Hall v. Nat'l Union Fire Ins. Co.*, 2009 U.S. Dist. LEXIS 113996 (S.D. Cal. 2009) (because plaintiff was seeking only an injunction under the UCL, he had no adequate remedies at law); *Monarch Plumbing Co. v. Ranger Ins. Co.*, 2006 U.S. Dist. LEXIS 68850, *21, fn. 10. (noting the requirement that plaintiff have no adequate remedy at law is not found in the text of the statute).

4. Ohio Law Conflicts with California's Fundamental Policy Prohibiting Class Action Waivers in Consumer Adhesion Contracts.

The centerpiece of KeyBank's Arbitration Provision is its class action ban. As a threshold matter, for purposes of choice-of-law determination, this clause violates California's fundamental policy and is unconscionable. "California has a fundamental policy against unconscionable class arbitration [bans]." *Hoffman v.*

Citibank (S.D.), N.A., 546 F.3d 1078, 1083 (9th Cir. 2008) (per curiam). Because banks can be sued under California's consumer protection laws, California courts have held that class-action bans in adhesion contracts with credit card companies are unconscionable. *Discover Bank v. Superior Court*, 36 Cal.4th at 148, 160-61 (Cal. 2005). The result should be no different because this case involves student loans.[8]

The fundamental policy at issue is the ability of California to ensure that its citizens have a viable forum in which to vindicate their unwaivable statutory rights under the UCL. Forcing each student to incur thousands of dollars in filing fees to arbitrate in separate locations (the arbitration must take place in each student's judicial district) while preventing them from relying on rulings in arbitrations with other students and depriving them of any hope of conducting even a modicum of discovery will pose an insurmountable barrier to challenging KeyBank's deceptive and predatory lending practices. Such a result would indisputably undermine the historic protections of the UCL. As discussed in Plaintiffs' Brief in Opposition to KeyBank's Motion to Compel Arbitration in the District Court [KIL. ER 15-17], this case presents a classic example of how a class action ban, if applied, will

[8] As stated in Statement of Relevant Facts above and confirmed in the Pidruzny, Kilgore and Fuller Declarations, KeyBank's claim its Note is not an adhesion contract because of an "opt-out" clause falls flat as there was no meaningful opt-out opportunity. As explained in Section III.D, *infra*, because the District Court did not address this issue, and mindful of 9th Cir. Rule 30-1.5, a discussion of KeyBank's illusory opt-out clause can be found in Plaintiff's opposition to the original motion which is included in Appellees' Excerpts of Record. [KIL. ER 28-30]

effectively preclude California residents from vindicating their rights against an out-of-state, proven serial predatory student lender.

In contrast to California's well-established "fundamental" policy against class action bans in consumer adhesion contracts involving fundamental statutory rights, there is no reported case articulating any such policy under Ohio law. To the contrary, the Ohio court in *Hawkins v. O'Brien*, 2009 Ohio App. LEXIS 73 (2009), recently rejected the plaintiff's argument that the arbitration clause was enforceable as against public policy because it purported to ban plaintiff's right to proceed as a private attorney general or through a class action, which are rights conferred on Ohio consumers by the OCSPA. *Hawkins* rejected the plaintiff's reliance on *Eagle v. Fred Martin Motor Co*., 157 Ohio App.3d 150 (2004), in which the court held that an arbitration clause containing restrictions against proceeding as a private attorney general and imposing a confidentiality requirement was violative of public policy because they vanquished the remedial provisions of the OCSPA. The *Hawkins* court repudiated the analysis in *Eagle* principally because Hawkins' arbitration clause did not contain a confidentiality clause which the *Hawkins* court believed was the principal reason for the *Eagle* court's holding.

Significantly, *Hawkins* found that nothing in the arbitration clause denied the plaintiff any of the substantive rights conferred on him by OCSPA (and the Federal Fair Debt Collection Practices Act) which does not preclude or limit arbitration of

claims brought under it. Similarly, *Price v. Taylor*, 575 F. Supp. 2d 845, 854-855 (N.D. Ohio 2008) and *Howard v. Wells Fargo,* 2007 U.S. Dist. LEXIS 70099, 10-14 (N.D. Ohio 2007), also upheld class action bans in consumer adhesion contracts.

Because California law is decidedly opposite, applying Ohio law to KeyBank's motion to compel arbitration would result in a determination under the Arbitration Provision that Plaintiffs waived their non-waiveable right to have their UCL injunctive relief claims litigated rather than arbitrated.

5. Contrary to California's Fundamental Policy Ohio Does Not Require Reciprocity in Recovery of Attorneys' Fees.

The Arbitration Provision provides that each party is to bear its own attorneys' fees incurred in the arbitration regardless of who prevails. But section K of the Note ("Collection Costs") also provides that if KeyBank sues the student to enforce the Note if the student is in default, KeyBank alone is entitled to attorneys' fees. Thus, under no circumstance is a student able to recover his or her attorneys' fees. And KeyBank alone controls whether it is able to recover fees by choosing to file suit for collection.

It has long been recognized that California Civil Code section 1717(a) represents a basic and fundamental policy choice by the state of California that nonreciprocal attorneys' fees contractual provisions create reciprocal rights to such fees. "The language is mandatory, unavoidable and emphatic." *PLCM Group, Inc.*

v. David Drexler, 22 Cal. 4th 1084, 1090-91 (2000). *Section* 1717(a) is not a default provision or gapfiller, subject to override by the parties. Rather, it represents a basic and fundamental policy choice by the state of California that nonreciprocal attorney's fees contractual provisions create reciprocal rights to such fees." *Ribbens Int'l, S.A. de C.V. v. Transport Int'l Pool, Inc.*, 47 F. Supp. 2d 1117, 1122 (C.D. Cal. 1999).

Given Ohio's porous consumer protection laws, especially where financial institutions are involved, it is not surprising that there is no corresponding Ohio statute to Civil Code section 1717. Nor is there an Ohio court-articulated fundamental policy providing for reciprocal attorneys fees. Thus, if the Ohio choice-of-law were to control, KeyBank will be in the enviable "heads I win, tails you lose" position of recovering its fees if it sues the student while the students must arbitrate under a regime that bars their recovery of fees. This is patently violative of the fundamental policy of mutuality of contract underlying section 1717.

D. California Has a Materially Greater Interest in Allowing Plaintiffs to Have Access to a Judicial forum for their Injunctive Relief Claim than Ohio Does in Enforcing the Arbitration Provision.

Because applying Ohio law is contrary to several fundamental California policies, this Court must next determine whether California has a materially greater interest in applying its law than does Ohio. Plaintiffs represent only California

consumers and invoke solely California's consumer protection law. The loans were solicited through SSH at the latter's locations throughout California. California maintains a substantial interest in regulating commercial transactions that take place within its borders and in ensuring the protection of its consumers from predatory lenders.

In contrast, Ohio's sole interest in applying its law is limited to its general interest in enforcing the provisions of contracts made by one of its corporate citizens. Applying Ohio law under the circumstances here would deprive California borrowers the substantive and statutory protection California affords all of its other consumers. Ohio, on the other hand, has no policy which prevents its lenders from subjecting themselves to the statutory authority of other states. That is to say, nothing in Ohio law prevented KeyBank from fully complying with California law including the UCL, a law of general application. Given these circumstances, application of Ohio law would impair California's fundamental consumer protection interests to a far greater extent than application of California law would impair Ohio's interests. *Brack v. Omni Loan Co.,* 164 Cal. App. 4th 1312, 1329 (2008).

E. The FAA does not Preempt California Law That Invalidates the Arbitration Clause.

For the first time, KeyBank tepidly argues that application of California law in this matter is preempted by the FAA. Opening Brief, pp. 14-15. As this court

recently stated, issues raised for the first time on appeal will not be considered absent exceptional circumstances. *Hauk*, *supra*, at 1122 (fn 4). There are no circumstances present here, exceptional or otherwise, to permit this argument for the first time on appeal.

In any event, KeyBank's preemption argument is a nonstarter. Both the United States and California Supreme Courts have rejected similar arguments, holding that 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,* 517 U.S. 681, 686-687 (1996); *Discover Bank*, *supra*, at 173 ["FAA does not prohibit a California court from refusing to enforce a class action waiver that is unconscionable"]. Under 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." [Emphasis added]. The UCL's injunction is, of course, the trial court's most potent equitable remedy. *Korea Supply Co., supra*, 29 Cal. 4th at1149.

Equally unavailing is KeyBank's argument that the doctrine of FAA preemption prohibits utilization of California law to invalidate one portion of the agreement, while enforcing other terms of the agreement. In *Allied-Bruce* the Supreme Court simply recognized, as it has in many other cases construing 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.

Here, the District Court applied well-settled choice of law principles to an arbitration provision in the same manner it would to any contract. KeyBank's attempts to treat an arbitration agreement differently from other contracts in the context of a choice-of-law analysis has been roundly criticized by this Court. *See Oestreicher v. Alienware Corp.*, 322 Fed. Appx. 489, 493 (9th Cir. 2009).

F. KeyBank's Arbitration Provision is both Procedurally and Substantively Unconscionable and Thus Unenforceable.

The District Court declined to reach the question of whether the arbitration clause was unconscionable. Order at 11. [KEY ER 11] However, in light of the *de novo* standard of review on this appeal and in the interest of judicial economy, Plaintiffs join KeyBank in requesting that this Court resolve this question now if it determines the Arbitration Clause is not invalid based on the arguments above. In the interest of brevity and mindful of 9th Cir. Rule 30-1.5, Plaintiffs have included in Appellees' Excerpts of Record their opposition brief submitted to the District Court rather than repeating those arguments here. [KIL. ER 1-33]

There has, however, been one development since the Court's order denying KeyBank's motion to compel arbitration that has bearing on the unconscionability analysis. On July 14, 2009, the Minnesota Attorney General sued the NAF - one of only two arbitration providers under the arbitration clause - for consumer fraud, deceptive trade practices, and false advertising, detailing the NAF's conspiratorial partnership with banks and how the NAF acts as a rubber stamp for lenders against

consumers. NAF acquiesced to the Minnesota AG's demands only *three days* later in a consent decree which confirmed they no longer can administer consumer arbitration proceedings such as the one KeyBank demands here.[9] The lawsuit of the Minnesota Attorney General and the immediate response of NAF cast such a pall over the entire arbitration clause drafted by KeyBank, that it should be disregarded entirely.

VII. CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that the District Court Order be affirmed.

DATED: January 21, 2010

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[9] http://www.ag.state.mn.us/PDF/PressReleases/SignedFiledComplaintArbitrationCompany.pdf.

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January 21, 2010

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CERTIFICATE OF SERVICE

I hereby certify that on January 21, 2010, I electronically filed the foregoing **APPELLEES' RESPONSE BRIEF** with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system.

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I declare under penalty of perjury under the laws of the United States of America, that the foregoing is true and correct. Executed on January 21, 2010, at San Francisco, California.

/s/ Mike Terry
MIKE TERRY