The Arbitration Newsletter

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The Arbitration Newsletter is published periodically by Whitaker Chalk Swindle & Schwartz PLLC, Fort Worth, Texas, to explore the rapidly developing law and practice of commercial arbitration both in the U.S. and other countries.[1]
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Pre-emption or Consumer Protection?

DIRECTV, Inc. v. Imburgia, No. 14-462, 577 U.S. ___ (2015).[2]

This case concerns a class-arbitration waiver. The arbitration clause in a service contract stated "that '[n]either you nor we shall be entitled to join or consolidate claims in arbitration.'"[3] The clause further specified "if the 'law of your state' makes the waiver of class arbitration unenforceable, then the entire arbitration provision "is unenforceable."[4] Another clause states that the arbitration "shall be governed by the Federal Arbitration Act."[5]

In 2005 *Discover Bank v. Superior Court*, a California Supreme Court case, rendered class-arbitration waivers "in a 'consumer contract of adhesion'"[6] unenforceable as unconscionable.[7] In *AT&T Mobility LLC v. Concepcion*[8] the Supreme Court of the United States ("SCOTUS") held that the FAA pre-empted and invalidated the *Discover Bank* rule.[9] Initially, the trial court denied a motion to compel arbitration in *Imburgia*. The California Court of Appeal subsequently affirmed the denial. The California Supreme Court denied discretionary review.[10]

The California Court of Appeal held class-arbitration waivers unenforceable irrespective of *Concepcion*.[11] The lower court reasoned that parties, and their freedom to contract, could

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[1] Nothing in *The Arbitration Newsletter* is presented as or should be relied on as legal advice to clients or prospective clients. The sole purpose of *The Arbitration Newsletter* is to inform generally. The application of the comments in *The Arbitration Newsletter* to specific questions and cases should be discussed with the reader's independent legal counsel. My thanks to Macdonald A. Norman, a third-year law student at Texas A&M University School of Law, for his research and drafting assistance.
[2] 2015 U.S. LEXIS 7999, 136 S. Ct. 463, 193 L. Ed.2d 365.
[3] *DIRECTV, Inc. v. Imburgia*, No. 14-462, slip op. at 1 (alterations in original).
[4] *Id.* at 1–2.
[5] *Id.* at 2 (internal quotations omitted).
[6] *Discover Bank v. Superior Court*, 36 Cal.4th 148, 162–63 (2005).
[7] *Id.* The contract also had to meet other criteria not pertinent to the facts here. *Id.*
[8] 563 U.S. 333, 352 (2011).
[9] *DIRECTV, Inc.*, slip op. at 3.
[10] *DIRECTV, Inc.*, slip op. at 5.
[11] *DIRECTV, Inc. v. Imburgia*, 225 Cal.App.4th 338, 342 (2014).

specify a law's application without regard to pre-emption.[12] The contract law of California applies without regard to the preemptive effect, if any, of the FAA. According to the court, the parties here specified California law applied without regard to FAA preemption.[13] The court based this reasoning on two principles. First, the clause specifying FAA governance was a general provision in the arbitration clause.[14] Second, the arbitration voiding phrase "law of your state" was a "specific provision" that "is paramount to" the general FAA adoption and, therefore, governs the general FAA adoption.[15] The court also said that the clause, though specific, was also ambiguous, and under California construction rules should be construed against the drafter.[16]

Justice Breyer's majority opinion started with the obvious principle: "lower courts must follow this Court's holding in *Concepcion*" because of the Supremacy Clause.[17] Since contract interpretation is a state law domain, the court stated: "[W]e must decide not whether [the California Court of Appeal's] decision is a correct statement of California law whether (assuming it is) that state law is consistent with the Federal Arbitration Act."[18] The underlying contract question with the California Court of Appeal was whether "'the law of your state' included *invalid* California law."[19] Therefore, the ultimate question before the Court was whether the California court's interpretation of the parties' arbitration clause "places arbitration contracts 'on equal footing with all other contracts.'"[20] This required the Court to determine whether the Court of Appeal's decision, using the actual grounds on which it based its opinion, rested on "grounds as exist at law or in equity for the revocation of any contract."[21]

The court reasoned that the contract language was unambiguous.[22] The phrase "law of your state" rests on the obvious assumption that this language refers, absent language otherwise, to *valid* law. California case law further dispels any ambiguity.[23] According to *Doe v. Harris*, California contract principles includes the state legislature's power to retroactively change the law.[24] The Supreme Court then concluded the Court of Appeal's reasoning was limited to the arbitration context. The Supreme Court was unable to find any California case that interpreted "law of your state" to include invalid state law. The Court of Appeal's language focused solely on arbitration. Therefore, the Court of Appeal's holding was limited to the subject matter at issue and not a sweeping pronouncement of general contract principles.[25]

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[12] *DIRECTV, Inc.*, slip op. at 4.
[13] *Id.*
[14] *Id.*
[15] *Id.*
[16] *Id.*
[17] *Id.* at 5.
[18] *Id. at 6.*
[19] *Id.* (alteration in original).
[20] *Id.* at 6.
[21] *Id., citing* 9 U.S.C. §2.
[22] *Id.* at 7.
[23] *Id.*
[24] *Doe v. Harris*, 57 Cal. 4th 64, 69–70 (2013).
[25] *DIRECTV, Inc.*, at 7–8.

Ultimately, the Supreme Court held California's interpretation of the phrase "law of your state" places arbitration contracts unequally lower than all other contracts and the Court of Appeal's interpretation is preempted by the FAA.[26] "[L]aw of your state" means "*valid* state law" not "*invalid* state law" at the time "the Court of Appeal made its decision"[27] or at the time "that a contract to arbitrate is at issue."[28]

Justice Ginsburg, joined by Justice Sotomayor, dissented in defense of consumers like *Imburgia*. Ginsburg felt the current opinion expanded past *Concepcion* and *Italian Colors*, especially since the court "misread the FAA to deprive consumers of effective relief against powerful economic entities…[that write such clauses into contracts]."[29] Further, these adhesion contracts and unequal bargaining power have infested the current system, and the consumer is not even able to "shop" around to avoid these arbitration mandates.[30] Thus, the majority has sided starkly against the average consumer. As noted by Ginsburg, the FAA was passed to force judges to enforce arbitration agreements "between merchants with relatively equal bargaining power," and there is no way the 1925 Congress could anticipate how far the FAA has been stretched.[31]

OBSERVATIONS

1. This case demonstrates the importance of clarifying in a pre-dispute arbitration clause the applicable law – substantive and arbitration law – that prevails at the time that the future dispute arises.

2. Every word, phrase, clause, and sentence in a pre-dispute arbitration clause must be given thoughtful and considered attention, especially the clause's unintended consequences.

3. This combination of adhesive contract and waiver of class arbitration actions in consumer contracts has generated an unfortunate opposition to other kinds of arbitration.

4. This case highlights the unintended consequences of poor or intentional arbitration clause drafting. The use of class arbitration waivers in mass consumer contracts is generating increasing attention and opposition but much of the current opposition makes no distinction between consumer arbitration and non-consumer arbitration as an alternative dispute resolution method.

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[26] *Id.* at 9–10.
[27] *Id.* at 7.
[28] *Id.* at 11 (quoting *Perry v. Thomas*, 482 U.S. 483, 493, n. 9 (1987).
[29] *Id.* at 9.
[30] *Id.* at 11.
[31] *Id.* at 12–13.