# Client Alert

**December 2015**

## Supreme Court Rebukes Continued State-Court Efforts to Invalidate Class-Arbitration Waivers in *DirecTV v. Imburgia et al.*, Case No. 14-462 (Dec. 14, 2015)

On Monday, the Supreme Court once again upheld the enforceability of class-arbitration waivers contained in consumer contracts, this time against a state-court contract interpretation that the Court ruled was uniquely hostile to arbitration and thus preempted by the Federal Arbitration Act (FAA). *DirecTV* falls squarely in line with the Court's recent string of rulings emphasizing the federal policy in favor of arbitration, and strengthening companies' ability to insist that consumer and employment disputes be settled by individual arbitration. While the *DirecTV* decision recognizes contracting parties' ability to choose the governing law and courts' ability to invalidate arbitration provisions based on general contract principles, it removes yet another weapon from the plaintiffs' bar's holster of challenges to contractual class-arbitration waivers.

### I. Background of the Case

The *DirecTV* litigation arose in 2008 when a putative class of DirecTV customers filed a class action lawsuit in California state court claiming that the satellite television provider's early-termination fees violated state law. DirecTV asked the trial court to send the matter to arbitration, pointing to provisions in its service agreements that required disputes thereunder to be settled through individual arbitrations under the FAA. However, the arbitration provision also provided that "if … the law of your state would find this agreement to dispense with class arbitration procedures unenforceable, then this entire Section [] is unenforceable." At the time the customers entered into the service agreements, class-arbitration waivers were unenforceable as unconscionable under California state law. *See Discover Bank v. Super. Ct.*, 113 P.3d 1100, 1110 (Cal. 2005). However, in *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011), the Supreme Court held that the state law articulated in *Discover Bank* was preempted and invalidated by the FAA.

The trial court denied DirecTV's post-*Concepcion* motion to arbitrate, and the California Court of Appeals affirmed on the ground that "the law of plaintiffs' state would find the class action waiver unenforceable." 225 Cal. App. 4th 338, 342-45 (2014). The court based its analysis on two principles: first, "a choice of law provision in an arbitration agreement is, in general, enforceable to the same extent as a choice of law provision in any other contract," and second, "if 'parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA.' " The court then held that the "law of your state" reference in the class-arbitration waiver provision operated as a "specific *exception* to the arbitration agreement's *general* adoption of the FAA." Thus, the waiver provision was governed by "the law of your state without considering the preemptive effect, if any, of the FAA." The court bolstered its decision by finding that DirecTV's customer contracts were ambiguous and therefore were to be "construe[d] … against the interest of the party that drafted it."

The California Supreme Court denied discretionary review, and DirecTV filed a petition for a writ of certiorari with the U.S. Supreme Court, noting that the Ninth Circuit had reached the opposite conclusion on precisely the same question in *Murphy v. DirecTV, Inc.*, 724 F.3d 1218 (2013). The Supreme Court granted certiorari to consider the following issue:

> Whether the California Court of Appeal erred by holding, in direct conflict with the Ninth Circuit, that a reference to state law in an arbitration agreement governed by the Federal Arbitration Act requires the application of state law preempted by the Federal Arbitration Act.

**II. The Supreme Court's Decision**

On December 14, 2015, the Supreme Court held that the California state court's refusal to enforce DirecTV's arbitration provision was preempted by the FAA because the decision "does not rest 'upon such grounds as exist … for the revocation of any contract.' " *See* Slip op. at *1 (quoting 9 U.S.C. § 2). Six justices joined the opinion authored by Justice Breyer, and Justice Thomas dissented based solely on his longstanding view that the FAA does not apply to state-court proceedings.[1] In essence, the Court determined that the state court's interpretation of the "law of your state" language to include *invalid* state laws was so unreasonable as to suggest discrimination against arbitration in violation of the FAA.

Justice Breyer launched his analysis by reminding state courts that while they "are certainly free to note their disagreement with a decision of this Court, … the Supremacy Clause forbids state courts to dissociate themselves from federal law because of disagreement with its content or a refusal to recognize the superior authority of its source." *Id.* at *5. His comments stemmed from concerns—expressed by over half the justices at oral argument[2]—that state courts were attempting an "end run" around *Concepcion* and the FAA policy favoring arbitration.

Justice Breyer made clear that, because contract interpretation ordinarily is a matter of state law, the Supreme Court's duty was to "decide not whether [the Court of Appeals'] decision is a correct statement of California law but whether (assuming it is) that state law is consistent with the Federal Arbitration Act." Slip op. at *6. This included consideration of whether the state-court decision put arbitration contracts "on equal footing with all other contracts," as required by *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006), and rested upon "grounds as exist at law or in equity for the revocation of any contract," as required by 9 U.S.C. § 2. In making the latter determination, the Court stressed that reviewing federal courts look "not to grounds that the [state] court might have offered but rather to those it did in fact offer" to invalidate contractual arbitration provisions.

Justice Breyer proceeded to highlight six ways in which the Court of Appeals' decision conflicted with general contract principles in California and likely would have been resolved differently had the contract provision at issue not concerned arbitration. *See* Slip op. at *7-10. Specifically, the Court stressed that the state court (1) improperly characterized DirecTV's arbitration provision as "ambiguous"; (2) identified no case "suggesting that California would generally interpret words such as 'law of your state' to include state laws held invalid because they conflict with [other federal laws]"; (3) framed the contract-interpretation question only in terms of arbitration; (4) offered no support for its assumption that the *Discover Bank* rule maintained independent legal force following its invalidation by *Concepcion*; and (5)

[1] A dissent authored by Justice Ginsburg and joined by Justice Sotomayor urges that arbitration provisions should be read in a light most protective of customers, who if subjected to class-arbitration waivers are left "without effective access to justice." *See* Slip op. (Ginsburg, J., dissenting), at *1.

[2] *See*, e.g., Oral Arg. Tr. (Oct. 6, 2015), at 28-29 (Roberts, J.) ("[W]hat could be more hostile to the FAA than to interpret a phrase that says nothing about the FAA to dispense with our holdings about—as they came about—our holdings about what the FAA has to say."), 30 (Scalia, J.) ("You're arguing that the—the FAA does not cover State gimmicks that disfavor arbitration so long as what they say is there is no arbitration agreement in the first place?"), 49-50 (Breyer, J.) ("I think there's some pretty good arguments that this particular interpretation, consciously or unconsciously, is flying in the face of an opinion of this Court, which I disagreed with. … I think it's an extremely important thing in a country which has only nine judges here and thousands of judges in other places who must follow our decisions—and think of the desegregation matters, et cetera—that we be pretty firm on saying you can't run around our decisions, even if they're decisions that I disagree with, okay?").

invoked no other contractual principle suggesting that California courts "would reach the same interpretation of the words 'law of your state' in other contexts." The Court also found that (6) general contract principles in California would apply a valid meaning retroactively to references to invalidated state laws. Taken together, these observations led Justice Breyer to conclude that the state court's holding was "limited to the specific subject matter of this contract—arbitration," and therefore was preempted by the FAA. *Id.* at *9, *10-11 (quoting *Perry v. Thomas*, 482 U.S. 483, 493 n.9 (1987) (noting that the FAA preempts decisions that take their "meaning precisely from the fact that a contract to arbitrate is at issue")).

**III. Implications for Companies Seeking to Compel Individual Arbitration**

Companies can glean several takeaways from the Supreme Court's decision in *DirecTV*.

1. *DirecTV* demonstrates, once again, how imprecise drafting of an arbitration clause can embroil parties in litigation. Indeed, the decision makes clear that state courts can still invalidate class-arbitration waivers under generally applicable contract grounds. The takeaway for companies should be to include class waivers in their arbitration provisions, and carefully comply with general contract principles by documenting acceptance of the contractual terms, refraining from burying or obscuring arbitration provisions within the contract, and refraining from imposing undue costs on consumers or otherwise biasing the arbitration clause to favor the company.

   Attention to detail during drafting will pay off, as it is apparent that at least eight of the nine Supreme Court justices will enforce a well-written class-arbitration waiver provision in state court, and all nine would do so in federal court. The *DirecTV* dissent indicates that Justices Ginsburg and Sotomayor would have upheld the class-arbitration waiver provision absent its problematic "law of your state" language, and that their disagreement was limited to the somewhat unique circumstances of the case.

2. *DirecTV* was decided narrowly on the record, and therefore it did not resolve several questions left outstanding by *Concepcion*, including (1) which "fundamental attributes of arbitration" state courts must avoid violating, (2) whether arbitrability is a gateway matter reserved for judicial determination, and (3) what test reviewing courts should apply to determine when the FAA justifies federal intervention in a state court interpretation of an arbitration clause. The Court will likely address the third question in the near future, as several justices expressed disappointment at the *DirecTV* oral argument when neither party could articulate a test for federal intervention.

3. *DirecTV* calls into question a number of state-court appellate decisions refusing to enforce arbitration clauses by declining to sever allegedly invalid contract provisions that would have been severed outside the arbitration context.

4. The decision in *DirecTV* does not foreclose all challenges to class-arbitration waivers based on state law. However, the remaining grounds seem narrow, and thus the plaintiffs' bar and consumer interest groups are eagerly awaiting rulemaking by the Consumer Financial Protection Bureau that is expected to set limits on arbitration agreements. It is critical that companies take part in the rulemaking process on this matter and prepare to challenge the CFPB's ultimate rulemaking decision.

Hunton & Williams' litigation team will stay apprised of these and other legal developments related to class-arbitration waivers, and has extensive experience advising clients on drafting arbitration clauses, litigation and arbitrating disputes that arise, and enforcing arbitral awards. If you need legal assistance in these areas, please contact us.

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