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PERSPECTIVE

California's latest assault on arbitration agreements

By Deborah J. La Fetra and Wencong Fa

The U.S. Supreme Court recently granted certiorari in *DIRECTV Inc. v. Imburgia*, a case that represents the latest assault by California courts on the integrity of contracts that call for arbitration of business disputes.

In the case, the 2nd District Court of Appeal unjustifiably invalidated a contract arbitration provision that prohibited class actions. The U.S. Supreme Court took the case after California's Supreme Court denied review.

In 2007, Amy Imburgia, a customer of DirecTV, filed a class action against the satellite provider, alleging DirecTV improperly charged early termination fees to its customers. Imburgia had signed a contract agreeing that disputes would be governed under the Federal Arbitration Act, and resolved through individual, not class action, arbitration, but that meant little to the 2nd District. It compelled DirecTV to participate in the class action litigation in court, despite the contractual provision providing for individual, arbitral resolution.

The 2nd District based its decision on a contractual provision stating, if "the law of your state would find this agreement to dispense with class action procedures unenforceable, then this entire [arbitration agreement] is unenforceable." Class action waivers in arbitration agreements, like the one here, were previously unenforceable under California case law. In *Discover Bank v. Superior Court* (2005), the California Supreme Court held that arbitration agreements with class action waivers could not be enforced because they were "unconscionable." But, in *AT&T Mobility v. Concepcion* (2011), the U.S. Supreme Court held that the Federal Arbitration Act preempted the Discover Bank rule. Despite this, the 2nd District in *DIRECTV* held that it had to construe "the law of your state" to include California precedents preempted by federal law, thus resurrecting the *Discover Bank* rule.

Two problems. First, the decision mandates exactly what the parties agreed to avoid: a class action in court. Second, and more fundamentally, the supremacy clause of the U.S. Constitution nullifies state laws — whether statutes or judge-created common law rules — that are inconsistent with federal law. A nullified statute or common law rule has no legal effect. Therefore, the "law of your state," as stated in the contract, must give way to the Federal Arbitration Act and the federal substantive law of arbitration, both of which permit class action waivers.

> These cases are part of a disturbing trend of California court rulings openly ignoring the federal policy favoring arbitration.

For nearly a century, the Federal Arbitration Act has explicitly instructed courts to respect the decision of people agreeing to resolve their disputes by arbitration. California's long history of hostility toward arbitration serves as an example of why federal legislation demanding state judicial respect for the freedom of contract is necessary. *DIRECTV* is the latest in a long line of anti-arbitration decisions from the California courts, demonstrating the California courts' persistence and creativity in generating new reasons to invalidate contracts providing for arbitration of disputes. The 9th U.S. Circuit Court of Appeals had already interpreted the exact contractual provision at issue in this case — and came out the exact opposite way. In *Murphy v. DIRECTV*, the 9th Circuit held it "nonsensical" to argue that contractual reference to "state law" would resurrect preempted state statutes and doctrines invalidated by federal law.

These cases are part of a disturbing trend of California court rulings openly ignoring the federal policy favoring arbitration. Since 1984, the U.S. Supreme Court has flat-out reversed four decisions of the California courts that invalidated arbitration contracts, and vacated two others for remand and reconsideration. In *Southland Corp. v. Keating* (1984), the U.S. Supreme Court reversed a California Supreme Court opinion holding the state Franchise Investment Law required judicial resolution rather than arbitral resolution because it directly conflicted with the Federal Arbitration Act.

Just three years later, the Supreme Court reversed a California court decision giving effect to a California law stating that wage collection actions may be maintained "without regard to the existence of any private agreement to arbitrate." *Perry v. Thomas* (1987). Fifteen years later, in *Preston v. Ferrer*, the high court rebuffed California's attempt to invoke state labor law administrative hearings as a "required" means of dispute resolution that would have to be exhausted before an arbitration contract would be enforced. And of course, *Concepcion* eviscerated the *Discover Bank* doctrine that invalidated virtually every class action waiver.

Worse, all this hostility reflects unwarranted skepticism about the ability of people to make decisions that are best for themselves. As such, the 2nd District's decision in *DIRECTV* is not just inconsistent with constitutional structure, it is incompatible with individual rights. The freedom to contract — including the freedom to agree that disputes will be resolved through arbitration — is an essential part of both individual liberty and the free enterprise system.

Federal policy in this instance is more grounded in reality. It reflects awareness that, out of the millions of contracts entered into every year, arbitration may be the wisest option in many cases. People legitimately may prefer the benefits of arbitration, which provide many advantages over formalized judicial adjudication of disputes. For one, arbitration allows parties to resolve disputes in an informal setting. Without the expense, delay and stress of being "taken to court," parties are more likely to continue mutually beneficial business relationships. Arbitration also allows parties to bypass the backlog in courts, leading to speedy resolution of disputes, and the predictability necessary to any business enterprise.

On April 1 — after the Supreme Court granted certiorari in *DIRECTV* — the California Supreme Court agreed to review *McGill v. Citibank*, presenting the question of whether *Concepcion* preempts another judicial doctrine that invalidates arbitration contracts in cases that raise claims under statutes that permit public injunctive relief. That case is just underway so the parties — and the state court — will undoubtedly have the benefit of a new ruling by the U.S. Supreme Court to guide its decision.

With their continuing hostility to arbitration agreements, California state courts deprive the millions of Californians of the ability to take advantage of the benefits of arbitration. The U.S. Supreme Court should send an unmistakable message to California courts to respect the sanctity of arbitration contracts, as well as the supremacy clause of the U.S. Constitution.

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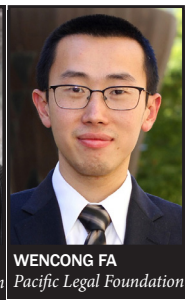

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