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## U.S. Supreme Court Holds that State Court Contract Interpretation Finding Class Action Arbitration Waiver Unenforceable is Inconsistent with the FAA

On December 14, 2015, the Supreme Court issued *DIRECTV, Inc. v. Imburgia*, a 6-3 opinion delivered by Justice Breyer, holding that where an arbitration agreement waived class arbitration, but also provided that the agreement would be unenforceable if the class arbitration waiver were unenforceable under the law of the claimants' state, the Federal Arbitration Act (the "FAA") preempted that proviso, and thus required enforcement of the class arbitration waiver. This result, requiring individual arbitration while precluding class arbitration, is the latest decision of the Court enforcing arbitration agreements that eliminate both individual litigation and class actions in furtherance of the federal policy in favor of arbitration embodied in the FAA.<sup>1</sup>

### I. Background to *DIRECTV, Inc. v. Imburgia*

This litigation arose out of consolidated class actions filed by plaintiffs in California state court, alleging that the defendant DIRECTV had improperly charged early termination fees to its customers in violation of California law.

The terms and conditions of the Customer Agreement ("Agreement") plaintiffs signed contained a provision requiring that all disputes between customers and DIRECTV be resolved by binding arbitration under JAMS rules. The arbitration clause in Section 9 of the Agreement also included a class arbitration waiver with the following language:

"Neither you nor we shall be entitled to join or consolidate claims in arbitration by or against other individuals or entities, or arbitrate any claim as a representative member of a class or in a private attorney general capacity. Accordingly, you and we agree that the JAMS Class Action Procedures do not apply to our arbitration. If, however, the law of your state would find this agreement to dispense with class arbitration procedures unenforceable, then this entire Section 9 is unenforceable."

Plaintiffs sought class certification, which the state court granted. DIRECTV did not oppose this because at the time (in 2011), the law in California was that arbitration clauses containing class action waivers in consumer contracts were unconscionable and therefore invalid under *Discover Bank v. Superior Court*.<sup>2</sup>

<sup>1</sup> *DIRECTV, Inc. v. Imburgia*, 577 U.S. \_\_\_\_ (2015) (available at [http://www.supremecourt.gov/opinions/15pdf/14-462\\_2co3.pdf](http://www.supremecourt.gov/opinions/15pdf/14-462_2co3.pdf)). Justice Thomas filed a dissenting opinion. Justice Ginsburg filed a dissenting opinion, in which Justice Sotomayor joined.

<sup>2</sup> *Discover Bank v. Superior Court*, 36 Cal.4th 148 (2005).

One week after the state trial court granted the plaintiffs' motion for class certification, the U.S. Supreme Court invalidated California's *Discover Bank* rule in *AT&T Mobility LLC v. Concepcion*.<sup>3</sup> In *Concepcion*, the Court held that conditioning the enforceability of consumer arbitration agreements on the availability of class action procedures conflicts with the goal of the FAA to promote arbitration and is thus preempted by the FAA. Expanding on its decision the year before in *Stolt-Nielsen S.A. v. Animal Feeds International Corporation*,<sup>4</sup> the Court reiterated its view that permitting classwide arbitration threatens to fundamentally undermine the advantages of arbitration, which allows for a more expeditious dispute resolution process.

In light of the Court's decision in *Concepcion*, DIRECTV immediately moved to compel arbitration and decertify the class. The superior court denied the motion to compel arbitration and DIRECTV appealed to the California Court of Appeal.

The California Court of Appeal affirmed the decision of the superior court. It reasoned that although the "Applicable Law" provision in Section 10 of the Agreement specified that the arbitration clause "shall be governed by the Federal Arbitration Act," the explicit reference to the "law of your state" in the class action waiver portion of the arbitration clause, without any mention of FAA preemption, meant that the relevant question was whether California law found the class arbitration waiver unenforceable "*without considering the preemptive effect, if any, of the FAA.*"<sup>5</sup> Relying on the *Discover Bank* rule, the Court of Appeals found the class action waiver in the arbitration clause unenforceable, thereby invalidating the entire arbitration clause. The Supreme Court granted certiorari to resolve whether a reference to state law in an arbitration agreement governed by the FAA allows the independent application of state law preempted by the FAA.

## II. The Supreme Court's Decision

The Supreme Court reversed. The Court acknowledged that the parties to an arbitration agreement are free to choose the law that will govern that agreement. After expressing skepticism that California law would really treat the phrase "law of your state" in the arbitration agreement here to include a rule that had been invalidated by the Supreme Court itself under the FAA, the Court also acknowledged that this interpretation was an unreviewable matter of state law.

However, the Court found that this interpretation was preempted by the FAA because California would not generally treat as valid a state law which had been previously invalidated because it violated a federal statute, here the FAA. By taking a different approach to the

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<sup>3</sup> *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011); see also Cleary Gottlieb Alert Memo No. 46-2011, dated May 2, 2011.

<sup>4</sup> In *Stolt-Nielsen S.A. v. Animal Feeds International Corporation*, 559 U.S. 662 (2010), the Court held that imposing class action arbitration on parties that had not expressly agreed to it is inconsistent with the FAA. See Cleary Gottlieb Alert Memo No. 34-2010, dated April 28, 2010.

<sup>5</sup> *Imburgia et al. v. DIRECTV, Inc.*, Case No. B239361, at 6 (Cal. Ct. App., 2d App. Dist., Div. 1, Apr. 7, 2014) (emphasis added).

*Discover Bank* rule, a law applicable *only* to arbitration, the California court had violated the basic FAA principle that an arbitration agreement must be enforced, unless it violates some rule applicable to the enforcement of contracts in general. Since the California court's decision rested solely on its view that the *Discover Bank* rule remained part of California law, despite its invalidation in *Concepcion*, that decision had the effect of creating a special rule of invalidity applicable only to California law arbitration agreements, and not to California law contracts in general. That decision was therefore itself preempted by the FAA.

### III. Conclusion

The Supreme Court's decision in *DIRECTV v. Imburgia* is the latest in a long line of cases addressing the enforceability of class action waivers in arbitration clauses. Justice Breyer's opinion, however, rests on a broader principle – that states cannot enact (or here, treat as having continued vitality) laws that nullify Supreme Court decisions on federal law. In the particular context of arbitration law, this principle translates into a holding that a state cannot avoid the federal rule upholding class waivers in arbitration contracts, notwithstanding a contractual choice of state law to govern the enforceability of such waivers. This was true even though, at the time the arbitration agreement was written, it was presumably the intent of DIRECTV not to be bound to arbitrate at all if the class arbitration waiver were found unenforceable under the law of the claimant's state; once *Concepcion* was decided, it was entitled to take advantage of that decision and enforce the agreement to arbitrate along with the waiver.

Many assumed the Court's decision in *Concepcion* had settled the issue of the preemptive force of the FAA on class arbitration waivers, and this most recent case therefore will not strike many as surprising. From *Concepcion* to *Italian Colors*<sup>6</sup> to this most recent decision, the Court continues to emphasize the notion of a federal policy favoring arbitration and enforce arbitration agreements that waive class action rights.

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<sup>6</sup> *American Express v. Italian Colors Rest.*, 133 S. Ct. 2304 (2013).

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