United States Supreme Court Considering A California Appellate Court Opinion Invalidating A Class Action Arbitration Waiver

By: Roland C. Goss

August 31, 2015

On October 6, 2015, the second day of this fall's term, the United States Supreme Court will hear oral argument in a case arising out of the California state courts in which a contractual waiver of the right to class arbitration was held to be unconscionable and unenforceable, resulting in the invalidation of the entire agreement to arbitrate. On March 23, 2015, the United States Supreme Court granted a Petition for Writ of Certiorari in *DIRECTV, Inc. v. Imburgia*, Case No. 14-462. This case has drawn a lot of interest, with 15 amicus briefs being filed. This article provides a preview of this case.

The question presented in *DirecTV* is:

> 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.

The underlying dispute arose from the acquisition by consumers of a DirectTV high definition receiver at a retail store, such as Best Buy. DirecTV's position was that such acquisitions were not purchases of the receivers, but rather leases, which were subject to additional lease fees, a required multi-year purchase of DirecTV programming and termination fees for "early" termination. Some consumers contended that this was a misleading transaction, with inadequate disclosure, and a number filed individual or class action lawsuits.

Although the case as to which the Supreme Court granted certiorari came up through the California state courts, culminating in an opinion by the California Court of Appeals,[1] there is another case which addresses the same basic alleged wrongs which was filed in California state

[1] *Imburgia v. DirecTV*, 170 Cal.Rptr.3d 190 (2014). The California Supreme Court denied discretionary review in an unreported order.

court, removed to federal court and resulted in an opinion by the Ninth Circuit Court of Appeals which upheld and enforced the same contractual class arbitration waiver.[2]

The Pertinent Contract Provisions

The dispute in *DirecTV* arises out of the interplay between several provisions of DirecTV's Customer Agreement, which generally provides, in Section 9, that if "any legal or equitable claim relating to this Agreement, any addendum, or your Service" cannot be resolved informally such disputes shall be resolved through binding arbitration under the JAMS arbitration rules. Customer Agreement, section 9(b).

There are three other provisions of the Customer Agreement which are implicated in these lawsuits, one of which relates to consolidation and class action procedure:

> 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.

Customer Agreement, section 9(c).

> Section 10(b) provides for the law applicable to the Customer Agreement:
>
> Applicable Law. The interpretation and enforcement of this Agreement shall be governed by the rules and regulations of the Federal Communications Commission, other applicable federal laws, and the laws of the state and local area where Service is provided to you. This Agreement is subject to modification if required by such laws. Notwithstanding the foregoing, Section 9 shall be governed by the Federal Arbitration Act.
>
> Section 10(d) contains a severability provision:
>
> [I]f any provision is declared by a competent authority to be invalid, that provision will be deleted or modified to the extent necessary, and the rest of the Agreement will remain enforceable.

[2] Meanwhile, different plaintiffs filed similar lawsuits against DirecTV in at least seven different United States district courts. On October 9, 2009, the Judicial Panel on Multidistrict Litigation issued an order transferring all of the pending federal cases to the Central District of California, where the case which resulted in the Ninth Circuit opinion was pending. *See In re: DirecTV, Inc., Early Cancellation Fee Marketing and Sales Practices Litigation*, MDL No. 2093. DirecTV moved for a stay of the state court *Imburgia* case pending the disposition of the MDL matter, but the state court denied the motion for stay.

The Dispute and the Opinions Below

John Murphy filed a class action Complaint in California state court on May 25, 2007, seeking damages and injunctive relief based upon alleged violations of California common law and California statutes. DirecTV removed the action to the United States District Court for the Central District of California. *Murphy v. DirecTV*, Case No. 07-cv-06465, in the United States District Court for the Central District of California ("the Federal Action"). On February 11, 2008, Plaintiff filed a First Amended Complaint in the Federal Action, and shortly thereafter DirecTV moved to compel arbitration in the Federal Action. The district court denied the motion to compel arbitration on May 9, 2008, finding the class arbitration waiver to be unconscionable and unenforceable.

On a parallel track, Amy Imburgia and Kathy Greiner filed similar class actions against DirecTV in state court in Los Angeles in September 2008, and they filed a joint First Amended Complaint on March 16, 2009 (the "State Action").

After the United States Supreme Court issued its opinion in *AT&T Mobility LLC v. Concepcion*, - U.S. -, 131 S.Ct. 1740 (2011), DirecTV filed a motion in the Federal Action seeking reconsideration of the denial of its motion to compel arbitration. The motion to reconsider was granted and DirecTV's motion to compel arbitration was granted. The district judge in the Federal Action held that under *Concepcion* the class arbitration waiver was not unconscionable and was enforceable, in part because in *Concepcion* the Supreme Court found the California *Discover Bank*[3] rule to be preempted by the Federal Arbitration Act ("the FAA"). Murphy appealed, and on July 30, 2013 the Ninth Circuit issued an opinion which held that the arbitration provision, including the class arbitration waiver, was enforceable under *Concepcion*, and affirmed the district court's ruling granting DirecTV's motion to compel arbitration.[4] *Murphy v. DirecTV Inc.*, 724 F.3d 1218 (9th Cir. 2013).

Meanwhile, the State Action proceeded. DirecTV initially did not move to compel arbitration in the State Action because in 2006 a California Court of Appeal had held its arbitration provision to be unconscionable and unenforceable based on the California Supreme Court's *Discover Bank* rule. After the United States Supreme Court found the *Discover Bank* rule to be pre-empted by the FAA in 2011 in *Concepcion*, DirecTV then moved to compel arbitration in the State Action. The Superior Court denied the motion. DirecTV appealed,

[3] The *Discover Bank* rule is a rule of unconscionability based on the holding of the California Supreme Court in *Discover Bank v. Superior Ct.*, 113 P.3d 1100 (Cal. 2005).

[4] The Court of Appeals reversed the district court's ruling that retailer Best Buy, which was named as an additional defendant as a retail store at which the plaintiff acquired a DirecTV receiver, could compel arbitration, because Best Buy was not a party to DirecTV's Customer Agreement. The district court subsequently granted Best Buy's motion for summary judgment, which ruling is on appeal to the Ninth Circuit.

contending that *Concepcion* required that its motion to compel arbitration be granted. The California Court of Appeal disagreed, found the class arbitration waiver provision to be unenforceable under California law, and held that under section 9 of the Customer Agreement the entire arbitration provision became unenforceable. After the California Supreme Court denied review, DirecTV filed a petition for writ of certiorari, which was granted by the United States Supreme Court.

The Arguments of the Parties

In the words of the question accepted for review, the issue is whether a reference to state law in the arbitration agreement, which is governed by the FAA, requires the application of state law which has been preempted by the FAA. Both Petitioners and Respondents contend that they are faithfully interpreting and enforcing the terms of the DirecTV Customer Agreement, yet they come to opposing results.

DirecTV contends that the interpretation of the Customer Agreement by the California Court of Appeals makes no sense, and that whatever the merits of the state court's decision as a matter of state law, the court violated federal law by denying the motion to compel arbitration. It argues that the Ninth Circuit's opinion in the Federal Action correctly decided this issue, and that the parties clearly agreed to arbitrate any disputes, agreed to waive the right to class arbitration and agreed to have the FAA apply to such arbitrations. DirecTV maintains that the opinion below cannot be reconciled with the FAA's strong policy of promoting arbitration and enforcing contractual arbitration provisions and the holdings of *Concepcion* and other recent arbitration decisions from the Supreme Court.

Respondents contend that the California Court of Appeals correctly interpreted the Customer Agreement, according appropriate deference to the FAA. They maintain that the Customer Agreement expressly incorporates California law, including the California Consumer Legal Remedies Act's prohibition on class action waivers, without regard to whether the FAA would preempt such state law. They also contend that the last sentence of Section 9 of the Customer Agreement, which reads "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" is an "anti-severability clause," which reflects an agreement by the parties not to arbitrate any dispute if the class arbitration waiver is unenforceable.

Some have characterized respondent's position as including the position that the parties can agree by contract to apply to a contract a state law rule of decision which has been pre-empted by the FAA. The response to this position generally is two-fold: (1) that once a rule of law has been preempted by federal law, that rule of decision is no longer a part of state law and cannot be applied to a contract; and (2) that while state law may be incorporated into or may apply to a contract, if a state principle of law is void as a result of being preempted, the finding that the principle is void also is incorporated into or applied to the contract.

The Ninth Circuit, in the Federal Action, treated this issue as one of the supremacy of federal law over state law. It held that federal law always supersedes inconsistent state law, and that the consequence of the nullification of the *Discover Bank* rule by *Concepcion* is that the *Discover Bank* rule is not, and never was, part of California state law. 724 F.3d at 1226. Since *Concepcion* nullified the *Discover Bank* rule, "[s]ection 9 of the Customer Agreement provides only that the arbitration agreement will be unenforceable if the 'law of your state' disallows class waivers, which California law does not – and could not – under the FAA as interpreted in *Concepcion*." *Id.* Therefore, the Ninth Circuit concluded that the entire arbitration provision of the Customer Agreement was enforceable, including the class arbitration waiver.

The Amicus Briefs

The amicus briefs take several approaches to the issue before the Court. Many of the amicus briefs address whether the California Court of Appeals correctly interpreted the arbitration provisions of the Customer Agreement, in particular the "anti-severability clause" of section 9(c) of the Customer Agreement, and the impact of *Concepcion* on that analysis. Amicus briefs supporting the respondent generally contend that this issue provides a state law basis for affirming. Amicus briefs supporting the petitioner generally contend that the court below incorrectly interpreted the contractual provisions in a manner that runs afoul of the FAA.

Some of the amicus briefs submitted in support of the petitioner contend that *DirecTV* is but the latest of a series of California appellate opinions which are hostile to arbitration, and which have declined to respect and follow the guidance of the United States Supreme Court concerning the supremacy of the FAA. These briefs are more strident in tone, developing an argument contained in DirecTV's petition for writ of certiorari.

Sanchez v. Valencia Holding Company, LLC

After both petitioners and respondents filed their briefs with the Supreme Court, the California Supreme Court issued an opinion which may have a bearing on the consideration of this case. In *Sanchez v. Valencia Holding Company, LLC*, --- P.3d ---, 15 Cal. Daily Op. Serv. 8433, 2015 WL 4605381 (Cal. Aug. 3, 2015), the trial court found a class arbitration waiver to be unconscionable and unenforceable and, in turn, the entire arbitration agreement unenforceable. The United States Supreme Court issued it opinion in *Concepcion* after the trial court had ruled. In a post-*Concepcion* appeal, the California Court of Appeals affirmed, but declined to address whether the class arbitration waiver was enforceable, instead finding the arbitration agreement as a whole unenforceable as unconscionably one-sided. The California Supreme Court reversed, finding that *Concepcion* required the enforcement of the class arbitration waiver but does not limit the unconscionability rules applicable to other provisions of the arbitration agreement.

The arbitration agreement in *Sanchez* included the following:

> If a dispute is arbitrated, you will give up your right to participate as a class representative or class member on any class claim you may have against us including the right to class arbitration or any consolidation of individual arbitrations.
>
> * * *
>
> If any part of this Arbitration Clause, other than waivers of class action rights, is deemed or found to be unenforceable for any reason, the remainder shall remain enforceable. If a waiver of class action rights is deemed or found to be unenforceable for any reason in a case in which class action allegations have been made, the remainder of this Arbitration Clause shall be unenforceable.

This contractual language is similar to that found in the DirecTV Customer Agreement, including what has been termed an "anti-severability clause."

In addressing the issue of whether the agreement to arbitrate would survive the striking of the class arbitration waiver provision, the California Supreme Court stated:

> Finally, Sanchez contends that the language of the arbitration agreement — "If a waiver of class action rights is deemed or found to be unenforceable *for any reason* . . . , the remainder of this Arbitration Clause shall be unenforceable" — means that once a class action waiver is deemed unenforceable, as the trial court ruled here, then the rest of the agreement is likewise unenforceable. But plainly the quoted provision was not meant to apply when a trial court *erroneously* holds the class waiver unenforceable and the error is corrected on appeal. Rather, the provision is most reasonably interpreted to permit the parties to choose class litigation over class arbitration in the event that the class waiver turns out to be legally invalid. Because we conclude in light of *Concepcion* that the FAA preempts the trial court's invalidation of the class waiver on unconscionability grounds, the agreement's poison pill provision is inoperable.

Id. at * 15. Six justices joined in this opinion, and one wrote a separate opinion which agreed with the result, but which disagreed with the majority's analysis of whether portions of the arbitration agreement other than a class arbitration waiver were unconscionable post-*Concepcion*.

This portion of the California Supreme Court's *Sanchez* opinion appears to support the petitioner's argument in *DirecTV* for the reversal of the decision of the California Supreme Court, yet the California Supreme Court denied review of the *DirecTV* case. It will be interesting to see how the California Supreme Court's *Sanchez* opinion is treated in *DirecTV*.

Conclusion

The issue of the supremacy of the FAA over state law, and over interpretations of state law by state courts, has been at the heart of a number of the opinions of the United States Supreme Court concerning arbitration issues over the past number of years in addition to *Concepcion*.[5] California state courts have had a reputation, with some, for resisting the pre-emptive effect of the FAA or exhibiting a disapproval of arbitration.[6] To the extent that the Supreme Court views *DirecTV* as merely the latest example of a state court failing to accord the FAA supremacy over state law, petitioner may fare well. However, to the extent that the Supreme Court treats *DirecTV* as presenting an issue of the interpretation of a contract by a state court, the respondent may fare well. The California Supreme Court's *Sanchez* opinion may provide support for the petitioner's position, and it will be interesting to see how that case is presented in argument and what consideration, if any, *Sanchez* is accorded by the Supreme Court.

* * * * *

This article reflects the views of the author, and does not constitute legal or other professional advice or service by Carlton Fields Jorden Burt, PA and/or any of its attorneys.

Roland C. Goss is the office managing shareholder of the Washington, DC office of Carlton Fields Jorden Burt, PA.

[5] *See e.g.*, *Marmet Health Care Center, Inc. v. Brown*, - U.S. -, 132 S.Ct. 1201 (2012) (In a post-*Concepcion per curiam* opinion, the Supreme Court vacated a decision of the Supreme Court of Appeals of West Virginia which had held that West Virginia's public policy superseded the Federal Arbitration Act. The Supreme Court noted the Supremacy Clause of the U.S. Constitution and its holding in *Concepcion*, and stated that "[w]hen state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA.")

[6] *See Southland Corp. v. Keating*, 465 U.S. 1, 5, 7 (1984) (reversing holding of California Supreme Court which effectively nullified an arbitration agreement); *Perry v. Thomas*, 482 U.S. 483, 491 (1987) (reversing California Court of Appeal decision and holding that the FAA preempted a California labor law); *Preston v. Ferrer*, 552 U.S. 346 (2008) (reversing California Court of Appeal decision and holding that the FAA preempted California dispute resolution laws); *see also Sonic-Calabasas A, Inc. v. Moreno*, 57 Cal.4th 1109, 311 P.3d 184 (2013) (Chin, J. dissenting – contending that the result of the majority opinion was preempted by the FAA).