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Supreme Court Reiterates That the Federal Arbitration Act Preempts State Bans on Class Arbitration Waivers

The U.S. Supreme Court recently issued another opinion affirming the broad scope of the Federal Arbitration Act (FAA) and its impact on state efforts to invalidate class action waivers in arbitration agreements. Although the case was decided in the consumer context, it also has important implications for the enforcement of arbitration agreements and class action waivers in the employment context. In *DIRECTV, Inc. v. Imburgia*, the U.S. Supreme Court evaluated whether the California Court of Appeal properly interpreted a class arbitration waiver in a consumer utility contract that precluded the plaintiffs from pursing claims against DIRECTV on a classwide basis, and instead required the plaintiffs to participate in individual arbitrations. In a 6–3 decision, the Court held that the California Court of Appeal's interpretation was preempted by the FAA, and reversed the California court's decision that the class arbitration waiver was unenforceable. Through this decision, the Court once again reaffirmed the federal policy that favors arbitration and warned states that attempts to creatively navigate around class arbitration waivers are preempted by the FAA.

Factual Background

DIRECTV and its customers entered into a service agreement that contained a binding arbitration agreement with a class arbitration waiver that required all disputes between DIRECTV and its customers to go to one-on-one arbitration rather than litigation. The agreement specified that if the "law of your state" made class action waivers unenforceable, the entire arbitration agreement was unenforceable. The contract also stated that the arbitration provision was governed by the FAA, which favors the enforcement of arbitration agreements according to their terms. At the time of the agreement, California law made class arbitration waivers unenforceable. In 2011, however, the U.S. Supreme Court held that the FAA preempted the California rule that invalidated class arbitration waivers in the case of *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 352 (2011). Consequently, following *Concepcion*, the law was clear that companies were free to insert class action waivers in consumer arbitration agreements.

California customers charged with unlawful early termination fees sued DIRECTV, which requested that the matter be submitted to individual arbitrations. The trial court denied DIRECTV's request, and the California Court of Appeal affirmed. The California Supreme Court denied discretionary review, and DIRECTV sought review by the U.S. Supreme Court, which granted the request. Ultimately, the Supreme Court held that the California Court of Appeal's interpretation was, in fact, preempted by the FAA, and that the California court must enforce the arbitration agreement.

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California Court of Appeal Decision

In deciding that the class arbitration waiver was unenforceable, the California court decided that the legal issue centered on the meaning of "law of your state"; so if California law made the class arbitration waiver unenforceable, the entire arbitration provision would be unenforceable in accordance with the arbitration provision in the service agreement. Indeed, the court determined that, notwithstanding the holding in *Concepcion*, California law made the class arbitration waiver unenforceable. According to the court, the FAA affords parties wide latitude in choosing what law governs, and the parties were free to choose pre-*Concepcion* California law (i.e., California law deeming class arbitration waivers unenforceable) as the applicable law. Therefore, according to the court, invalid California law holding class arbitration waivers unenforceable applied. Additionally, the court determined that the phrase "law of your state," as a specific provision, was "paramount to" the general provision requiring that the FAA govern the arbitration clause.

U.S. Supreme Court Decision

The Supreme Court took issue with the California court's interpretation and ultimately determined that California's ruling was preempted by the FAA, meaning the court was required to enforce the arbitration agreement. The Court acknowledged that while every state, including California, must follow the guidance of *Concepcion*, the parties to the DIRECTV agreement were free to choose the law governing the arbitration provision, and thus were able to choose pre-*Concepcion* California law. Consequently, the key issue before the Court was whether the application of invalid California law was consistent with the FAA.

The FAA preempts decisions that take their "meaning precisely from the fact that a contract to arbitrate is at issue." Therefore, in evaluating the lower court's reasoning, the Supreme Court analyzed whether California courts would interpret contracts other than arbitration contracts in the same way, ultimately concluding that the court's interpretation of "law of your state" did not place arbitration contracts on equal footing with other kinds of contracts but, rather, was restricted to the field of arbitration contracts. Furthermore, the Court determined that nothing in the contract was ambiguous, and the phrase "law of your state" presumably referred to valid state law, supported by the fact that nobody referred the Court to a case that interpreted similar language to refer to state law held to be invalid. As nothing in the lower court's reasoning suggested that a California court would reach the same interpretation of "law of your state" in a context other than arbitration, the Supreme Court held that the California court's interpretation was preempted by the FAA.

Implications for Arbitration Agreements in the Employment Context

The Supreme Court's holding in *DIRECTV* is important not only because it reaffirms the Court's *Concepcion* decision, but because it sends a unique message to states. The Court's message undoubtedly reaffirms the federal policy favoring arbitration, as well as the Court's protectiveness of arbitration provisions under the FAA, and the Court essentially cautioned states that creative attempts to work around the FAA will be met with a strong judicial hand. *DIRECTV* clarifies that states do not have the flexibility to craft their own arbitration rules that conflict with the FAA, whether by legislative action or court decision, and that attempts by states to circumvent class arbitration waivers will be quashed. *DIRECTV* thus gives employers peace of mind that well-drafted arbitration agreements containing class action waivers will effectively insulate them from class action suits. This decision is particularly noteworthy in the employment context, where arbitration agreements are commonplace in employer-employee contracts, and where employers want the security of knowing that the provisions in these agreements, including class action waivers, will be upheld.

Although *DIRECTV* clarifies the supremacy of the FAA in the context of class arbitration waivers, employers may still face potential impediments to enforcing arbitration waivers. One lingering issue we might see is the continuing viability of the California Supreme Court's decision in *Iskanian v. CLS Transportation LLC*, where the court held that an arbitration agreement requiring employees to give up the right to bring representative Private Attorneys General Act (PAGA) actions was unenforceable as contrary to public policy. With this holding, the California Supreme Court crafted an exception to *Concepcion* for PAGA claims. The U.S. Supreme Court declined to review *Iskanian* on December 14, 2015, meaning that, at least for now, the California court's ruling remains valid law. Another potential impediment to class action waivers in arbitration agreements is the National Labor Relations Board's position that requiring employees to sign arbitration agreements may violate the National Labor Relations Act, notwithstanding the FAA's clear policy preference in favor of arbitration agreements. Lastly, certain Executive Orders that apply to companies that contract with the federal government include prohibitions on mandatory arbitration agreements.

Even so, the takeaway for employers that utilize class arbitration waivers is that the *DIRECTV* decision protects them from class action, and that the policy favoring arbitration provisions as written is likely to grow even stronger as individual states recognize that hostility to class arbitration waivers is preempted.

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