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Steven P. Caplow

1. Introduction

If you reside in California and enter into a consumer contract controlled by the "law of your state," it would not seem to require the involvement of US Supreme Court to determine what law the parties agreed would govern their agreement. The obvious answer is California. But what if the relevant California law was overturned between the time of the making of the contract and dispute arising from it? In that eventuality, did the parties intend to apply the original law (now invalid), or the current (valid) version?

In its recent decision *DIRECTTV v Imburgia*,[1] the US Supreme Court examined the contractual phrase "law of your state" in a case in which the law related to class arbitration waivers in fact changed midcourse. When Amy Imburgia signed up for satellite television service through DIRECTTV, California law prohibited class arbitration waivers. However, in a separate and unrelated decision, after the parties' execution of the arbitration agreement, the US Supreme Court held in 2011 that federal law, the Federal Arbitration Act (FAA), preempted the applicable California statute.

The contractual nature of arbitration agreements granted the DIRECTTV and Ms Imburgia considerable leeway to select the procedural and substantive law applied during arbitration. Using a somewhat extreme example, DIRECTTV observes the FAA could allow parties to "bind themselves by reference to the rules of a board game."[2] Consistent with its recent decisions upholding class arbitration waivers, the US Supreme Court held in *DIRECTTV* that in selecting the "law of your state," the parties agreed to apply California law as subsequently preempted by the FAA, rather than California law in effect when Ms Imburgia signed the contract. Two Justices filed a dissent contending the Court's holding fails to apply traditional tools of state contract law and continues an inappropriate trend of expanding the scope of the FAA at the expense of consumers.

2. Procedural History: California Courts Consider Whether the "Law of Your State" is a "Chameleon Term"[3]

The California Supreme Court's 2005 decision in *Discover Bank* set the stage for these events. In that case, California's highest court held that waiver of class arbitration in a consumer contract of adhesion that predictably involves small amounts of damages is "unconscionable under California law and should not be enforced."[4]

In the wake of the California Supreme Court's *Discover Bank* decision, DIRECTTV adopted a nationwide binding arbitration clause with a carve-out for jurisdictions, like California, that prohibited the waiver of class arbitration. This 2007 version of DIRECTTV's arbitration provision contains a class arbitration waiver, but provides that if the "law of your state" makes the waiver of class arbitration unenforceable, the entire arbitration provision "is unenforceable." The arbitration clause further provided that it was governed by the FAA.

In 2008, two DIRECTTV customers, including Ms Imburgia, filed a putative class action against DIRECTTV in California state court seeking damages for early termination fees.

[1] *DIRECTTV v Imburgia* 136 S.Ct. 463 (2015).
[2] *DIRECTTV* 136 S.Ct. 463, 474 (2015) (dissent) (internal quotations and citation omitted).
[3] *DIRECTTV* 136 S.Ct. 463, 475 (2015) (dissent).
[4] *Discover Bank v Superior Court* 36 Cal. 4th 148, 162–163, 113 P.3d 1100, 1110 (2005).

The named plaintiffs contended the fees violated California law, including the Consumers Legal Remedies Act (CLRA), which invalidates class actions waivers for claims asserted under the statute.[5]

In 2011, the US Supreme Court issued its watershed *Concepcion* decision,[6] which held the FAA pre-empts and invalidates the California Supreme Court's ruling in *Discover Bank*. As a result of FAA preemption, notwithstanding state law to the contrary, class arbitration waivers seemingly could again be enforced in California.

Relying on *Concepcion*, DIRECTTV promptly moved to halt Ms Imburgia's class action lawsuit, still winding its way through California state court, and compel bilateral arbitration. The trial court, however, denied DIRECTTV's motion to compel arbitration.[7] The California court of appeals reached the same result based on its interpretation of the phrase the "law of your state" in DIRECTTV's arbitration clause.[8] Since California law unequivocally prohibits the enforcement of class action waivers, the question for the California court of appeals was whether the parties had selected California law *with* consideration of FAA preemption, or *without* consideration of FAA preemption.

First, the court of appeals ruled that the "law of your state" was a specific provision voiding arbitration, which governed over the more general provision stating that the FAA governs the arbitration agreement. Secondly, adopting the common law rule of contract interpretation, the court of appeals ruled that ambiguities in contract language should be construed against the drafter, and held the rule held particular application in this case because it seemed unlikely that DIRECTTV would have anticipated in 2007 when it drafted the provision that the Supreme Court would hold in 2011 that the FAA preempts state-law class action waivers.

California's supreme court denied review of the California court of appeals decision. However, by this point, the Ninth Circuit had reached the opposite conclusion on the same interpretive question decided by the California court of appeals.[9] The US Supreme Court accepted certiorari and reversed the California court of appeals in a 6–3 decision.

3. The Majority: The Parties Selected "Valid" California State Law, Not California Law As Subsequently Invalidated by FAA Preemption

Although the majority and the dissent reach divergent conclusions, as an initial matter they agree that under the FAA, the phrase "law of your state" operates in the manner of a choice of law clause over which the parties have considerable discretion. The majority colorfully describes the parties' latitude to choose the law that will govern the arbitration clause, including the enforceability of the class arbitration waiver: "In principle, they might choose to have portions of their contract governed by the law of Tibet, [or] the law of prerevolutionary Russia." Closer to home, the question for the Court was whether the parties had selected California law as originally written, or as subsequently interpreted by the courts with reference to FAA preemption.

The majority acknowledges that California courts are the ultimate authority on the interpretation of California law.[10] However, adopting a multi-step review, the majority concludes the decision of the California court violates FAA s.2[11] because it fails to place

[5] Cal. Civ. Code Ann. §§1751, 1781(a) (West 2009).
[6] *AT&T Mobility LLC v Concepcion* 563 U.S. 333, 352 (2011).
[7] Super. Ct. Los Angeles Cty., Cal. Jan. 26, 2012.
[8] 225 Cal.App.4th 338, 170 Cal.Rptr.3d 190 (2014).
[9] *Murphy v DirectTV Inc* 724 F.3d 1218, 1226–1228 (2013).
[10] *DIRECTTV* 136 S.Ct. 463, 468 (2015).
[11] FAA s.2 states that a "written provision" in a contract providing for "settle[ment] by arbitration" of "a controversy … arising out of" that "contract … shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2.

arbitration contracts "on equal footing with all other contracts."[12] In particular, the majority analyses the words "law of your state" as involving a choice between *invalid* California state law (pre-dating *Concepcion*) or *valid* California state law (post-dating *Concepcion*). Under this framework, the Court rejects the notion of any ambiguity in the phrase "the law of your state," since the "ordinary meaning" of the phrase would only encompass "valid state law."[13] The Court further relies on common law principles that both contracts and statutes are typically deemed to incorporate subsequent changes or interpretation of the law. Against this backdrop, the Court holds that the view that "state law retains independent force even after it has been authoritatively invalidated by this Court," would never be accepted outside the context of FAA preemption.[14] For example, the Court suggests it would be inconceivable that a state court would interpret the words "law of your state" to include state laws held invalid because they conflict with non-arbitration federal law, like the federal labor statutes. Indeed, the Court emphasises it cannot locate any decision that interprets the words "law of your state" to include invalid state law. Finding the lower court would not reach the same conclusion outside the context of arbitration, the Court holds the FAA preempts the California court of appeals' interpretation of the "law of your state" provision in the arbitration agreement. The Court imposes FAA preemption in order to place the DIRECTTV arbitration agreement on the same footing as other contracts that do not provide for arbitration.

4. Dissenting Judgment: The Parties Selected California Law Without Reference to FAA Preemption

Ginsberg J joined by Sotomayor J filed a dissent.[15] Largely tracking the analysis of the lower court, the dissent begins with the assertion that the California court's interpretation of the "law of your state" provision is "not only reasonable, it is entirely right."[16] According to the dissent, irrespective of the *Concepcion* decision, by simply referring to the "law of your state," DIRECTTV omitted necessary reference to federal law. "If DIRECTTV meant to exclude the application of California legislation, it surely chose a bizarre way to accomplish that result."[17] The dissent further argues that the majority's interpretation allows DIRECTTV "to reap the benefit of an ambiguity it could have avoided" and defeat the reasonable expectations of the parties at the time of contract formation.[18] "[A]ny California customer who read the agreement would scarcely have understood that she had submitted to bilateral arbitration."[19]

But beyond the holding of this case, the dissent expresses alarm at the "Court's ever-larger expansion of the FAA's scope" to limit customer remedies by upholding the validity of class arbitration waivers.[20] "Today's decision steps beyond *Concepcion* and *Italian Colors*. There, as here, the Court misreads the FAA to deprive consumers of effective relief against powerful economic entities that write no-class-action arbitration clauses into their form contracts." [21] The dissent collects articles from the *New York Times* and academic studies to establish that the Court's recent decisions upholding class arbitration waivers operate to deprive consumers of redress for losses. In the dissent's view, the Court's use of FAA preemption to overcome state law restrictions on class arbitration waivers departs from the

[12] *DIRECTTV* 136 S.Ct. 463, 468 (2015), quoting *Buckeye Check Cashing Inc v Cardegna* 546 U.S. 440, 443 (2006).
[13] *DIRECTTV* 136 S.Ct. 463, 465 (2015).
[14] *DIRECTTV* 136 S.Ct. 463, 468 (2015)
[15] Thomas J, as in all such cases, filed a separate and brief dissent on the basis that in his view the FAA does not apply to proceedings in state courts. *DIRECTTV* 136 S.Ct. 463, 471 (2015).
[16] *DIRECTTV* 136 S.Ct. 463, 473 (2015).
[17] *DIRECTTV* 136 S.Ct. 463, 475 (2015).
[18] *DIRECTTV* 136 S.Ct. 463, 475 (2015).
[19] *DIRECTTV* 136 S.Ct. 463, 475 (2015).
[20] *DIRECTTV* 136 S.Ct. 463, 478 (2015).
[21] *DIRECTTV* 136 S.Ct. 463, 476 (2015).

text and purpose of the FAA. "The Court has abandoned all pretense of ascertaining congressional intent with respect to the Federal Arbitration Act, building instead, case by case, an edifice of its own creation."[22]

Finally, in what appears to be a special missive to Breyer J, the author of the majority opinion, the dissent also contrasts the expansion of the FAA's scope with how other countries address mandatory arbitration clauses in consumer contracts of adhesion. Concurrently with the issuance of the opinion, Breyer J published a book that adopts the position—controversial in the US—that in today's world, the US Supreme Court needs to understand foreign law.[23] The dissent points out that the Court's interpretation of the FAA departs from the EU which only authorises arbitration of consumer disputes when the parties mutually agree to arbitrate on a post-dispute basis.[24] However much Beyer J may have appreciated the sentiment, it failed to secure his vote. For now, the "law of your state" is infused with federal law, but remains untouched by international considerations.

[22] *DIRECTTV* 136 S.Ct. 463, 478 (2015) (dissent) quoting *Allied-Bruce Terminix Cos v Dobson* 513 U.S. 265, 283 (1995) (concurring opinion).

[23] Stephen Breyer, "The Court and the World: American Law and the New Global Realities" *Deckle Edge* (September 2015).

[24] *DIRECTTV* 136 S.Ct. 463, 478 (2015) (dissent) citing Council Directive 93/13 art.3 [1993] OJ L95/31; Commn'n Recommendation 98/257 [1998] OJ L115/34.