

## RECENT CASE

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### DIRECTV, INC. V. IMBURGIA

#### *Supreme Court Holds California Court's Interpretation Preempted by Federal Arbitration Act*

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#### INTRODUCTION

It is no secret that alternative dispute resolution (ADR) has become an important part of the contemporary American legal system. Compared to full-fledged judicial proceedings, ADR methods, including arbitration, offer a more cost-effective alternative. Both private and public entities have embraced the chance to address legal disputes while using resources more effectively. In 1998, for example, President Clinton issued a memorandum to the heads of executive departments and agencies encouraging the use of ADR “[a]s part of an effort to make the Federal Government operate in a more efficient and effective manner.”<sup>1</sup> In spite of all of the benefits of ADR, concerns about the innate fairness of these methods of dispute resolution still abound. Nowhere are such concerns more evident than in the context of arbitration agreements between large, sophisticated entities and individual consumers.

Despite concerns as to the implicit fairness of ADR, the enforcement of arbitration agreements in American courts has been markedly strengthened by one important piece of legislation: the Federal Arbitration Act (FAA).<sup>2</sup> The FAA was proclaimed as “[a]n Act [t]o make valid and enforceable written provisions or agreements for arbitration of disputes arising out of contracts, maritime transactions, or commerce among the

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<sup>1</sup> Memorandum from President Clinton to the Heads of Executive Departments and Agencies (May 1, 1998), <http://www.justice.gov/sites/default/files/olp/docs/1998.05.01CLINTON.pdf>.

<sup>2</sup> Pub. L. No. 68-401, 43 Stat. 883 (1925) (codified as amended at 9 U.S.C. §§ 1–15 (2012)).

States or Territories or with foreign nations.”<sup>3</sup> This single piece of legislation has been the subject of a number of Supreme Court cases, including the important *Southland Corp. v. Keating*<sup>4</sup> decision. In *Southland*, the Supreme Court held that the FAA applies in state courts and preempts conflicting state law.<sup>5</sup> On December 14, 2015, the Supreme Court added an additional chapter to the history of the FAA through its decision in *DIRECTV, Inc. v. Imburgia*.<sup>6</sup> The Supreme Court in *DIRECTV* held that California law making arbitration waivers unenforceable is preempted by the FAA.<sup>7</sup>

## I. BACKGROUND

At issue in *DIRECTV* were sections 9 and 10 of DIRECTV’s service agreement. Section 9 of the agreement provided that any claim would be resolved only by binding arbitration<sup>8</sup> and stated that “if ‘the law of your state’ made the waiver of class arbitration unenforceable, then the entire arbitration provision” would be unenforceable.<sup>9</sup> Section 10 provided that the FAA governs section 9 of the agreement.<sup>10</sup>

Section 9 was of particular relevance in the state of California. In 2005, the California Supreme Court decided *Discover Bank v. Superior Court*,<sup>11</sup> holding that waivers of class arbitration in consumer adhesion contracts were unconscionable, and thus not enforceable.<sup>12</sup> This holding was eventually dubbed California’s “*Discover Bank* rule.”<sup>13</sup> It was within this legal context that, in 2008, Amy Imburgia and Kathy Greiner commenced a lawsuit in California state court against DIRECTV.<sup>14</sup> About three years of litigation ensued, but then in 2011 the United States Supreme Court issued its opinion in *AT&T Mobility LLC v. Concepcion*.<sup>15</sup>

*Concepcion* held that the FAA preempted California’s *Discover Bank* rule.<sup>16</sup> Given the development produced by *Concepcion*, DIRECTV asked

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3 Federal Arbitration Act, 43 Stat. at 883.

4 465 U.S. 1 (1984).

5 *Id.* at 16–17.

6 136 S. Ct. 463 (2015).

7 *Id.* at 471.

8 *Id.* at 466 (citing Joint Appendix at 128, *DIRECTV*, 136 S. Ct. 463 (No. 14-462)).

9 *Id.* (quoting Joint Appendix, *supra* note 8, at 129).

10 *Id.* (citing Joint Appendix, *supra* note 8, at 129).

11 113 P.3d 1100 (Cal. 2005), *abrogated by* AT&T Mobility LLC v. Concepcion, 563 U.S. 333 (2011).

12 *Id.* at 1103, 1108.

13 *Concepcion*, 563 U.S. at 340.

14 *DIRECTV*, 136 S. Ct. at 466. Imburgia and Greiner sought damages for early termination fees that they alleged violated California law. *Id.*

15 563 U.S. 333 (2011).

16 *Id.* at 352.

the trial court to send the matter to arbitration pursuant to section 9 of the service agreement.<sup>17</sup> The trial court, however, denied DIRECTV's request, and the company appealed.<sup>18</sup> The California Court of Appeal affirmed the trial court's decision, noting that under California law as existing when DIRECTV drafted the agreement, such prohibition on class arbitration was unenforceable.<sup>19</sup> Furthermore, the court of appeal found that while *Concepcion* invalidated California's rule, the FAA gives the parties the freedom to choose governing law irrespective of federal preemption.<sup>20</sup> To support its conclusion, the court of appeal set forth two reasons: (1) the provision stating that the FAA governed was a general provision of the service agreement, while the provision voiding arbitration if the "law of your state" found a class arbitration waive unenforceable was a specific provision; and (2) the common law rule that ambiguous language in a contract should be construed against the drafter of the contract.<sup>21</sup> The California Supreme Court denied discretionary review and DIRECTV filed a petition for a writ of certiorari, which was granted.<sup>22</sup>

## II. ANALYSIS

Justice Breyer delivered the opinion for the majority. The majority framed the issue as "not whether [the California Court of Appeal's] decision is a correct statement of California law but whether (assuming it is) that state law is consistent with the Federal Arbitration Act."<sup>23</sup> In particular, as the majority explained, the issue was whether the California Court of Appeal's decision rested upon "grounds as exist at law or in equity for the revocation of any contract" as prescribed by the FAA.<sup>24</sup> The majority's opinion answered this question in the negative.

According to the majority, the California Court of Appeal interpreted the language "law of your state" to include invalid state law.<sup>25</sup> Such interpretation was deemed unacceptable by the Court because it precludes arbitration contracts from standing on equal footing with other types of contracts.<sup>26</sup> In support of its conclusion, the majority outlined six reasons.

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17 *DIRECTV*, 136 S. Ct. at 466.

18 *Id.*

19 *Id.* at 467 (citing *Imburgia v. DIRECTV, Inc.*, 170 Cal. Rptr. 3d 190, 194 (Cal. Ct. App. 2014), *rev'd*, 136 S. Ct. 463 (2015)).

20 *Id.*

21 *Id.*

22 *Id.* at 467–68.

23 *Id.* at 468.

24 *Id.* (quoting 9 U.S.C. § 2 (2012)).

25 *Id.* at 469.

26 *Id.* ("After examining the grounds upon which the Court of Appeal rested its decision, we conclude that California courts would not interpret contracts other than arbitration contracts the same way.").

First, contrary to the opinion of the California Court of Appeal, the majority found that the contract language was not ambiguous.<sup>27</sup> In the majority's view, absent any other indication in the contract, the contract's provision for "the law of your state" is governed by its ordinary meaning: *valid* state law, not including *invalid* state law.<sup>28</sup> Second, California law itself clarified how to interpret the language in question.<sup>29</sup> Citing *Doe v. Harris*,<sup>30</sup> the majority noted that California law incorporates the California Legislature's power to change the law retroactively, and thus the law as announced in *Harris* would govern the scope of the phrase "law of your state."<sup>31</sup> Third, from the majority's perspective, the California Court of Appeal's reasoning did not suggest that it would apply the same reasoning in any other context outside of arbitration.<sup>32</sup> According to the majority, there is

nothing in [the court of appeal's] opinion (nor in any other California case) suggesting that California would generally interpret words such as "law of your state" to include state laws held invalid because they conflict with, say, federal labor statutes, federal pension statutes, federal antidiscrimination laws, the Equal Protection Clause, or the like.<sup>33</sup>

Fourth, the California Court of Appeal's language focused exclusively on arbitration, which suggested to the majority that the court of appeal meant to limit its holding to the particular subject matter of arbitration.<sup>34</sup> Fifth, the Court outright rejected the suggestion that state law, in this case California's *Discover Bank* rule, maintains independent force after prior invalidation by a Supreme Court decision.<sup>35</sup> Sixth, no additional principle was invoked by the court of appeal suggesting that the same interpretation of the phrase "law of your state" would be applied by California courts in other contexts outside of arbitration.<sup>36</sup> While the majority recognized the court of appeal's invocation of the specific exception to the agreement's general adoption of the FAA, such a reading "tells us nothing about how to interpret the words 'law of your state' elsewhere."<sup>37</sup>

Justice Thomas provided a brief dissent in which he restated his belief that the FAA does not apply in state courts, and as such he would affirm

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27 *Id.*

28 *Id.*

29 *Id.*

30 302 P.3d 598, 601–02 (Cal. 2013).

31 *DIRECTV*, 136 S. Ct. at 469.

32 *Id.*

33 *Id.* at 469–70.

34 *Id.* at 470.

35 *Id.*

36 *Id.*

37 *Id.*

the decision of the California Court of Appeal.<sup>38</sup> The more detailed critique of the majority's opinion was presented by Justice Ginsburg, who, joined by Justice Sotomayor, took a more critical view of the FAA's expanding scope. In her dissent, Justice Ginsburg explained that given the precedent on the subject of the FAA, she "would take no further step to disarm consumers, leaving them without effective access to justice."<sup>39</sup>

Justice Ginsburg's dissent focused on the role of DIRECTV as the drafter of the agreement, and she considered it "particularly appropriate" to interpret any ambiguity against DIRECTV.<sup>40</sup> This common law rule of interpretation had "particular force" because the California Court of Appeal applied it to a standardized contract.<sup>41</sup> Furthermore, according to Justice Ginsburg, the plaintiffs were unlikely to anticipate in 2007—when they entered into the agreement with DIRECTV—the Supreme Court's 2011 *Concepcion* decision invalidating their state's *Discover Bank* rule.<sup>42</sup> In Justice Ginsburg's view, the interpretation of the contract given by the California Court of Appeal was "not only reasonable, [but also] entirely right."<sup>43</sup>

As a preliminary matter, Justice Ginsburg framed arbitration as "a matter of 'consent, not coercion.'"<sup>44</sup> Accordingly, in Justice Ginsburg's view, "[a]llowing DIRECTV to reap the benefit of an ambiguity it could have avoided would ignore not just the hugely unequal bargaining power of the parties, but also their reasonable expectations at the time the contract was formed."<sup>45</sup> Moreover, Justice Ginsburg noted that historically the

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38 *Id.* at 471 (Thomas, J., dissenting). Justice Thomas's belief that the FAA only applies in federal courts, and not in state courts, stems from disagreement with the Supreme Court's decision in *Southland*. Justice Thomas's reasoning on this point was further detailed in his dissent in *Allied-Bruce Terminix Cos. v. Dobson*, where he stated:

[N]ot until 1959—nearly 35 years after Congress enacted the FAA—did any court suggest that § 2 [of the FAA] applied in state courts. . . . The explanation for this delay is simple: The statute that Congress enacted actually applies only in federal courts. At the time of the FAA's passage in 1925, laws governing the enforceability of arbitration agreements were generally thought to deal purely with matters of procedure rather than substance, because they were directed solely to the mechanisms for resolving the underlying disputes.

513 U.S. 265, 286 (1995) (Thomas, J., dissenting) (citing *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402, 407 (2d Cir. 1959)).

39 *DIRECTV*, 136 S. Ct. at 471 (Ginsburg, J., dissenting).

40 *Id.* at 472.

41 *Id.* at 475.

42 *Id.* at 472 (quoting *Imburgia v. DIRECTV, Inc.*, 170 Cal. Rptr. 3d 190, 196 (Cal. Ct. App. 2014)).

43 *Id.* at 473.

44 *Id.* (quoting *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 681 (2010)).

45 *Id.* at 475.

Supreme Court has respected state court interpretations' of arbitration agreements.<sup>46</sup> Thus, in her view, the *DIRECTV* decision is "a dangerous first."<sup>47</sup>

In order to reach such a radically different conclusion from the majority's opinion, Justice Ginsburg's dissent reconciled the reasoning of the California Court of Appeal with the Court's decision in *Concepcion* by adopting a narrower reading of *Concepcion*. According to Justice Ginsburg's dissent, *Concepcion* "held only that a State cannot *compel* a party to engage in class arbitration when the controlling agreement unconditionally prohibits class procedures."<sup>48</sup> Thus, from Justice Ginsburg's perspective, the majority in *DIRECTV* oversteps the framework laid out in *Concepcion*. By overstepping *Concepcion*'s framework, the majority effectively maintains that "it no longer matters whether *DIRECTV* meant California's 'home state laws' when it drafted the 2007 version of its service agreement."<sup>49</sup>

Justice Ginsburg also underscored the fact that the FAA allows parties to choose governing law.<sup>50</sup> Accordingly, for Justice Ginsburg, the dispositive question is "whether the parties intended the 'law of your state' provision to mean state law as preempted by federal law . . . or home state law as framed by the California Legislature, without considering the preemptive effect of federal law."<sup>51</sup> The latter of these two alternative readings is deemed the more adequate reading in Justice Ginsburg's dissent.<sup>52</sup>

Justice Ginsburg's dissent does concede that the FAA has been construed as a "federal policy favoring arbitration."<sup>53</sup> However, she reminds readers of the limits of FAA application as voiced in the 2010 *Granite Rock Co. v. International Brotherhood of Teamsters*<sup>54</sup> decision. In *Granite Rock*, the Supreme Court cautioned that a presumption favoring arbitration should apply "only where it reflects, and derives its legitimacy from, a judicial conclusion that arbitration of a particular dispute is what the parties intended because their express agreement to arbitrate was validly formed and . . . is legally enforceable and best construed to encompass the dispute."<sup>55</sup> Given the disparity in bargaining power

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46 *Id.* at 473.

47 *Id.*

48 *Id.* (citing *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 351 (2011)).

49 *Id.*

50 *Id.*

51 *Id.* at 474.

52 *Id.*

53 *Id.* at 475 (quoting *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 476 (1989)).

54 561 U.S. 287 (2010).

55 *Id.* at 303.

between individual consumers and a sophisticated entity such as DIRECTV, Justice Ginsburg considers the majority's opinion not only a step beyond *Concepcion*, but also a misreading of the FAA that effectively deprives consumers of relief against entities that write prohibitions on class arbitration into their form contracts.<sup>56</sup> According to Justice Ginsburg, the decision in *DIRECTV* holds that “consumers lack not only protection against unambiguous class-arbitration bans in adhesion contracts. They lack even the benefit of the doubt when anomalous terms . . . could be construed to protect their rights.”<sup>57</sup>

Justice Ginsburg closes her critique of the majority's opinion with a reminder of the context in which the FAA was originally enacted, highlighting that the FAA was meant to enforce arbitration agreements between parties of relatively equal bargaining power.<sup>58</sup> According to Justice Ginsburg, “Congress in 1925 could not have anticipated that the Court would apply the FAA to render consumer adhesion contracts invulnerable to attack by parties who never meaningfully agreed to arbitration in the first place.”<sup>59</sup> Moreover, Justice Ginsburg also points to section 2 of the FAA—on which the majority relies—and its prescription that arbitration provisions ought to be treated like other contractual terms with the implication that such terms should not receive any type of preferential treatment.<sup>60</sup> Justice Ginsburg finally notes the marked divergence of *DIRECTV*'s holding with the way in which mandatory arbitration clauses in consumer contracts are treated abroad.<sup>61</sup> Citing a 1993 European Union Directive which forbids binding consumers to unfair contractual terms,<sup>62</sup> and a subsequent EU Recommendation interpreting the Directive,<sup>63</sup> Justice Ginsburg underscores how consumer disputes in the European Union are arbitrated only when the parties mutually agree on arbitration on a “post-dispute basis.”<sup>64</sup>

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56 *DIRECTV*, 136 S. Ct. at 476 (Ginsburg, J., dissenting).

57 *Id.* Highlighting that consumers have not always lacked “the benefit of the doubt,” Justice Ginsburg references two previous Supreme Court cases, one dating as far back as 1953. *Id.* at 476 n.3 (citing *Wilko v. Swan*, 346 U.S. 427, 435, 438 (1953); *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79, 90 (2000)).

58 *Id.* at 477 (citing Margaret L. Moses, *Arbitration Law: Who's in Charge?*, 40 SETON HALL L. REV. 147, 170–71 (2010)).

59 *Id.* at 477–78 (citing Judith Resnik, *Diffusing Disputes: The Public in the Private of Arbitration, the Private in Courts, and the Erasure of Rights*, 124 YALE L.J. 2804, 2860 (2015)).

60 *Id.* at 478.

61 *Id.*

62 Council Directive 93/13, art. 3, 1993 O.J. (L 95) 31.

63 Commission Recommendation 98/257, 1998 O.J. (L 115) 34.

64 *Id.* at 478 (quoting Jean R. Sternlight, *Is the U.S. Out on a Limb? Comparing the U.S. Approach to Mandatory Consumer and Employment Arbitration to That of the Rest of the World*, 56 U. MIAMI L. REV. 831, 847–48 (2002)).

## CONCLUSION

The majority in *DIRECTV* anchored its reasoning in the language of the FAA itself, and the status of California's *Discover Bank* rule vis-à-vis federal law. The outcome was not surprising, particularly for those that have followed recent FAA litigation before the Court. However, *DIRECTV* is significant in at least two aspects: (1) it reflects the Supreme Court's sensitivity to the "different" or more stringent treatment that state courts might give arbitration agreements, and (2) it suggests that under the current legal landscape consumer advocates' concerns might be more effectively addressed through legislative action rather than through litigation.

Consumer groups and individual consumers may find the "equal footing" reasoning by the majority to be a little ironic. The Supreme Court is forthcoming about ensuring the equal treatment of all contracts (whether they are arbitration agreements or not), but contrary to what many consumer advocate groups may wish, the majority in *DIRECTV* does not dwell on Justice Ginsburg's concerns regarding the disparity in bargaining power between individual consumers and more sophisticated entities. As caustic to individual consumer rights as such rationale may appear, it is difficult to fault the majority for deeming the language used by *DIRECTV* to be unambiguous, and applying the ordinary meaning of the phrase "law of your state." The reasoning used by the California Court of Appeal which interpreted "law of your state" to include invalid state law proved simply too odd of an argument for the Supreme Court to accept. After all, to hold that the California Court of Appeal reasonably read the phrase would have required the Supreme Court to dilute the force of its previous *Concepcion* decision, which struck down California's *Discover Bank* rule. Such a retreat would have undoubtedly opened the door to additional questions about the independent force of other state laws previously considered preempted by other Supreme Court decisions.

Regardless of whether or not the holding of *DIRECTV* truly makes consumer form contracts with prohibitions on class arbitration completely invulnerable to attack, as described in Justice Ginsburg's dissent, the outcome of *DIRECTV* should serve as a demarcation, a sort of tipping point, for consumer advocate groups. Justice Ginsburg's dissent echoes several of the practical concerns related to the asymmetric bargaining positions between individual consumers and companies that prohibit class arbitration in form contracts, and raises important questions about the legislative intent of the FAA. However, as time passes and the use of arbitration becomes more commonplace, it also becomes more difficult to ignore its attractive qualities—chiefly its time and cost efficiencies. Nonetheless, after *DIRECTV*, it should be rather clear that any desired rebalancing of bargaining power between individual consumers and sophisticated entities will not be effectuated through the courts, at least not any time soon. Instead, *DIRECTV* calls for consumer advocacy groups to

more aggressively focus their efforts on persuading the legislature to make any desired changes. Of course, legislative efforts would require a higher degree of concerted organization, and such efforts will likely face strong opposition from the entities who will continue to seek the benefits of cost-effective, legally enforceable methods of dispute resolution.