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REPORT FROM WASHINGTON

Supreme Court Hears Argument in its Second Significant Arbitration Case this Term

January 17, 2008

TO VIEW A TRANSCRIPT OF THE ORAL ARGUMENTS BEFORE THE SUPREME COURT OF THE UNITED STATES IN THE *PRESTON* CASE, PLEASE CLICK HERE.

Monday, the Supreme Court heard oral arguments in another significant arbitration case, *Preston v. Ferrer,* which tests whether the Federal Arbitration Act preempts a provision of the state law otherwise requiring that certain claims be adjudicated by an administrative tribunal.[1] The Petitioner argues that the federal arbitration statute requires that an arbitrator decide whether a contract is valid under the Court's recent decision in *Buckeye Check Cashing, Inc. v. Cardegna*,[2] whereas the Respondent, TV's "Judge Alex" Ferrer, claims that the parties' entire agreement is void under California's Talent Agencies Act and therefore their dispute must be resolved in front of the Labor Commission.[3] The Court's decision may affect the ability of contracting parties to agree to arbitrate disputes that state law otherwise requires be determined by judicial or administrative means.

BACKGROUND

The *Preston* appeal arises from a lawsuit that Arnold Preston brought against Alex Ferrer, a former Florida superior court judge, alleging that Ferrer failed to perform his obligations under a 2002 management contract. The contract, which contained a standard arbitration clause, awarded Preston a percentage of Ferrer's earnings from his television show "Judge Alex." In 2005, Preston commenced an arbitration proceeding against Judge Alex, claiming that he failed to pay Preston's fees under the contract. Judge Alex then

[1] No. 06-1463 (U.S. argued Jan. 14, 2008). The first this term was *Hall Street Assoc. v. Mattel, Inc.*, No. 06-989 (U.S. argued Nov. 7, 2007).

[2] 546 U.S. 440, 449 (2006) (holding that arbitrators, not courts, should hear challenges to the validity of an arbitration agreement).

[3] *See On Today's Docket: 'Judge Alex" Does The Supreme Court*, WALL ST. J., Jan. 14, 2008, at A1.

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filed a complaint in the Superior Court of Los Angeles County seeking a declaration that the dispute is not subject to arbitration and requesting injunctive relief to prevent Preston from proceeding with arbitration.

In his complaint, Judge Alex alleged that Preston acted as an unlicensed talent agent instead of a manager, in violation of the California Talent Agencies Act, and thus the entire contract is invalid. The Talent Agencies Act regulates the activities of a "talent agency" and assigns jurisdiction over disputes brought under the Act to the Labor Commissioner. As a general matter, under the law, a party who solicits employment for an artist is a "talent agent," subject to regulation by the Labor Commissioner.

Accordingly, Judge Alex claimed that the Commissioner should determine the validity of the contract instead of the arbitrator because, he claimed, Preston acted as a "talent agency." Preston responded that the contract's validity should be determined by the arbitrator because the Federal Arbitration Act ("FAA") provides that a written arbitration provision in any contract "evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." The trial court granted Judge Alex's motion to enjoin Preston from preceding with arbitration, finding that, under the Talent Agencies Act, Preston must exhaust his administrative remedies before the Labor Commission.

The California intermediate court of appeal affirmed the trial court, finding that the Commissioner has exclusive jurisdiction over cases arising under the Talent Agencies Act. The court rejected Preston's argument that the FAA preempts the California statute because of the Supreme Court decision in *Buckeye*, which held that arbitrators, not courts, should hear challenges to the validity of a contract containing an arbitration clause. While the majority distinguished *Buckeye* on the grounds that it neither involved an administrative agency nor considered whether the FAA "preempts application of the exhaustion doctrine," a dissenting judge agreed that the FAA and *Buckeye* preempted the majority's decision.

After the Supreme Court of California denied review, the U.S. Supreme Court granted certiorari in September 2007. The U.S. Chamber of Commerce filed a brief *amicus curiae* in support of the Petitioner, arguing that the lower court's decision deprives Preston of the "full benefits of arbitration" and provides a blueprint for "eviscerating the FAA and *Buckeye* in other state courts."

THE ORAL ARGUMENT

"Well, that might be great as a means of informing the Labor Commissioner, but it virtually destroys the value of arbitration…"

JUSTICE SOUTER

Preston's counsel argued at the outset that finding in favor of Judge Alex would allow states to eliminate arbitration in "entire classes" of cases when the state has a relevant regulatory process in place. Though the general tenor of the Court's questions for Petitioner was mild—compared to the aggressive questioning of Judge Alex's counsel—Chief Justice Roberts quickly focused on a key issue in the case. "Well, it wouldn't eliminate

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JUSTICE SCALIA

[arbitration]," he said. "Your friend on the other side said it simply delays it…." Preston's counsel questioned this assertion, arguing that the process as envisioned by the Judge Alex would completely bar certain parties, who had entered into an agreement containing an arbitration clause, from ever having their case arbitrated.

Chief Justice Roberts and Justice Scalia pursued Preston's counsel on the core preemption issue in the case. Chief Justice Roberts asked: "When you say California law applies, you don't mean to the exclusion of Federal law?" Justice Scalia followed up by asking: "Nor do you mean that California applies even when it contradicts the express provisions of your agreement?" Preston's counsel agreed with both points. In essence, Chief Justice Roberts and Justice Scalia were probing the claim in Respondent's brief that the incorporation of California law into the original management agreement superseded the arbitration clause, requiring any dispute to go before the Labor Commissioner before any motion to compel arbitration could be filed. The Justices appeared skeptical of this argument, because, as Justice Souter later noted, it would significantly undercut the speedy resolution of disputes—the basic rationale for arbitration.

Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University, 489 U.S. 468 (1989), a case cited by both parties in their briefs, featured prominently in Monday's arguments. In *Volt*, a university filed suit against a contractor (who then made a formal demand for arbitration) but sought indemnity from two separate companies, both of whom would not be bound by the arbitration. Justice Rehnquist held that, in that situation, California law would permit the delay of arbitration while the case involving one of the parties works its way through the courts.

While Judge Alex's counsel claimed that the FAA, under *Volt*, does not preempt California procedural law when parties expressly agree to adopt the state's law, Preston's counsel distinguished the case by noting that it applied to a stay of arbitration pending the disposition of a separate case involving non-parties to the arbitration. Several Justices, including Justice Ginsburg, questioned the relevance of *Volt* precisely because it involved related litigation with parties not subject to the arbitration. Judge Alex's counsel also implicitly argued that, notwithstanding an express arbitration clause, California law applied, permitting parties to avoid arbitration while the dispute proceeded in the Labor Commissioner's administrative process.

The Court seemed wary of the TV Judge's arguments that California's Labor Code operates to nullify an express term in the parties' contract. "I used to teach contract law," Justice Scalia said, "and I am sure that when you say you'll arbitrate, it means you won't litigate. And even if I didn't teach contract law, it would still be the law."

When Judge Alex's counsel cited to the claimed purpose underlying the Labor Commissioner's duties to regulate talent agents proactively—that is, to deter unfair contracts—Justice Souter countered

that the procedural process might be "great as a means of informing the Labor Commissioner, but virtually destroys the value of arbitration." Justice Kennedy picked up this thread later when he asked Judge Alex's attorney whether Judge Alex should qualify the claim in his brief that the process it proposed would be "expeditious and informal." That statement, Justice Kennedy suggested, would be inaccurate in light of Judge Alex's argument that the case should wind its way through the administrative agencies and courts before settling in arbitration.

The Justices appeared concerned that the *de novo* review of the Labor Commissioner's decision, only after which one could move to compel arbitration, would be more onerous than Judge Alex's counsel suggested. Furthermore, the court focused heavily on the added expense and time in the process propounded by Judge Alex's counsel. To adopt such a position, as Justice Souter noted, would run counter to the rationale behind the FAA—to promote the expeditious and inexpensive resolution of disputes.

IMPLICATIONS

In *Preston*, the Supreme Court will again address the extent to which private parties to a contract involving interstate commerce may agree to arbitrate claims otherwise requiring judicial or administrative remedies under state law. A Supreme Court reversal would be consistent with the Court's past precedent requiring that disputes relating to the validity of an entire contract containing arbitration clauses be heard by the arbitrator, whereas an affirmation may signal a change in the Court's steadfast tack to enforce arbitration where the arbitration clause is not independently challenged. A decision in favor of Preston would clarify the thorny status of *Volt*, which has been interpreted in various, arguably inconsistent, ways over the years. There, unlike here, the related court case involved third-parties who would not be bound by the arbitration. A decision for Preston here would limit *Volt* to that particular (and relatively rare) situation, placing the question of arbitrability in the mine run of arbitration agreement disputes firmly in the hands of the arbitrator. It would also, almost always, require FAA preemption of state law in analogous situations.

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