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ARBITRATION

BY SAMUEL ESTREICHER AND STEVEN C. BENNETT

The Primary Jurisdiction of State Administrative Agencies

The U.S. Supreme Court, in its recent ruling in *Preston v. Ferrer*,[1] has reaffirmed its pro-arbitration stance on predispute arbitration agreements, emphasizing the pre-emptive effect of the Federal Arbitration Act (FAA).[2]

Specifically, the Court held that an arbitrator must rule on challenges to a contract as a whole—as opposed to claims of invalidity directed to the specific agreement to arbitrate—even if it means deciding upon an issue normally reserved for decision by an administrative agency.

The Court's holding reaffirms the "separability" doctrine, whereby the Court views the promise to arbitrate as separate from the overall agreement in which it is contained, and a party seeking to avoid arbitration must challenge the validity of the specific agreement to arbitrate rather than the validity of the arbitration promise itself.

Procedural History of 'Preston'

The underlying dispute in *Preston* concerned a contract between Arnold M. Preston, a California attorney who provided services to individuals in the entertainment industry, and Alex E. Ferrer, who appeared as "Judge Alex" on a Fox television network program. Mr. Preston claimed that Mr. Ferrer owed him fees under the contract and made a demand for arbitration pursuant to the contract's arbitration clause, which required the parties to arbitrate "any dispute…relating to the terms of [the contract]

Samuel Estreicher *Steven C. Bennett*

or the breach, validity, or legality thereof…in accordance with the rules [of the American Arbitration Association (AAA).]"[3]

Mr. Ferrer countered Preston's arbitration demand with a petition to the California labor commissioner. In his petition, Mr. Ferrer claimed that Mr. Preston acted as a talent agent but did not posses the license required under the California Talent Agencies Act (the TAA). Mr. Ferrer argued that Mr. Preston's unlicensed status rendered the entire contract void and unenforceable under the TAA. Mr. Ferrer sought to stay arbitration. The labor commissioner's hearing officer denied Mr. Ferrer's motion to stay arbitration but noted that Mr. Ferrer had stated a colorable basis for the labor commissioner's jurisdiction under the TAA.

Mr. Ferrer then filed suit in Los Angeles Superior Court seeking a declaration that the issue of validity of the contract was not subject to arbitration and to enjoin arbitration. Mr. Preston moved to compel arbitration, which the Superior Court denied, enjoining Mr. Preston from proceeding before the arbitrator until the labor commissioner determined whether she had jurisdiction over the dispute. Mr. Preston appealed the Superior Court's ruling. The California Court of Appeal affirmed the lower court's ruling. The California Supreme Court denied review, but the U.S. Supreme Court granted Mr. Preston's certiorari petition.

The Majority Opinion

The Court (8-1) reversed. Justice Ruth Bader Ginsberg's opinion for the Court framed the issue as who would decide, the arbitrator or the labor commissioner, whether Mr. Preston acted as a personal manager not regulated by the TAA or a talent agent under the TAA.

The Court began its analysis by noting that Mr. Ferrer sought invalidation of the contract as a whole and did not challenge the validity of the arbitration promise itself or application of the FAA. In its view, the matter was, therefore, largely resolved by the Court's prior rulings in *Prima Paint Corp. v. Flood & Conlkin Mfg. Co.*[4] and *Buckeye Check Cashing Inc. v. Cardegna*.[5] In *Prima Paint*, which originated in federal court, the Court held that when a party seeks to avoid arbitration by arguing that the agreement containing the arbitration clause was procured by fraud, the case must go to arbitration unless the challenge is directed to the arbitration clause itself. *Prima Paint* is the origin of the "separability" doctrine, that the arbitration promise should be viewed separately from the overall agreement of which it is a part. In *Buckeye*, the Court made clear that the doctrine applied even to cases that originate in state court.

Mr. Ferrer attempted to distinguish *Buckeye* on grounds that the TAA requires exhaustion of administrative as opposed to judicial remedies prior to arbitration. The Court disagreed, finding that the TAA conflicts with the FAA in two respects:

(1) the TAA grants the labor commissioner exclusive jurisdiction to decide an issue that the parties had agreed to arbitrate, i.e., whether Mr. Preston was a talent agent under the TAA; and

(2) the TAA imposes certain prerequisites to arbitration in lieu of proceeding before the labor commissioner, including notice to the labor commissioner and the right of the labor commissioner to attend all hearings, which are not applicable to contracts generally.

Mr. Ferrer further argued that the TAA simply postponed arbitration until the labor commissioner exercised her primary jurisdiction, at which point the losing party could file for de novo review in Superior Court and either

Samuel Estreicher *is Dwight D. Opperman Professor at New York University School of Law and counsel to Jones Day.* **Steven C. Bennett** *is a partner at Jones Day and the author of "Arbitration: Essential Concepts (ALM)."* **Joseph J. Bernasky,** *an associate in the labor and employment group at Jones Day, assisted with the preparation of this article. The views expressed are solely those of the authors, and should not be attributed to the authors' firm or its clients.*

party could seek to compel arbitration. The Court held that, such a course of events would contravene a "prime objective of an agreement to arbitrate…to achieve 'streamlined proceedings and expeditious results…'"[6] as well as "Congress' intent 'to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible.'"[7] The Court expressed further concern that if the parties were to proceed before the labor commissioner and then appealed to the California Superior Court before proceeding with arbitration, judicial findings of fact and conclusions of law would be binding on the parties and could preclude the arbitrator from making any contrary rulings.

Mr. Ferrer made yet another attempt to distinguish *Buckeye*, arguing that under *Volt Info. Sci. Inc. v. Bd. of Trustees of Leland Stanford Jr. Univ.*[8] the agreement's choice-of-law clause, which called for application of California state law, mandated application of California procedural law, including the TAA's grant of exclusive jurisdiction to the labor commissioner.

The Court provided two bases for rejecting Mr. Ferrer's argument. First, the arbitration in *Volt* was stayed to accommodate litigation involving third parties who were not party to the arbitration agreement. Because the agreement in that case did not address the order of proceedings (as between arbitrator and court) when pending litigation with third parties (not bound by arbitration) create the risk of inconsistent rulings, the *Volt* Court held that state law could properly play a "gap filler" role in such circumstances. By contrast, the agreement between Mr. Ferrer and Mr. Preston, which called for the arbitration of "any dispute…relating to…the breach, validity, or legality" of the agreement, directly addressed the dispute. Furthermore, unlike *Volt*, there was no related litigation with third parties that could result in conflicting rulings.

Second, the *Preston* Court pointed to its ruling in *Mastrobuono v. Shearson Lehman Hutton Inc.*,[9] which concerned a contract that contained both a choice-of-law clause providing for application of state law and a clause providing for arbitration in accordance with specified privately promulgated arbitration rules. The *Mastrobuono* Court held that the "best way to harmonize" the two clauses was to read the choice-of-law clause to encompass substantive principles of state law but not its special rules limiting the authority of arbitrators. The same rule applied to the agreement in *Preston*, which called for application of California law as well as arbitration in accordance with AAA rules.

Mr. Ferrer also relied on *EEOC v. Waffle House Inc.*,[10] in which the Court held that an arbitration agreement "does not bar the EEOC from filing an enforcement suit in its own name."[11] According to Mr. Ferrer, under the *Waffle House* precedent, the parties' arbitration agreement does not disturb the labor commissioner's independent authority to enforce the TAA. The Court rejected this argument because, unlike the EEOC, the California Labor Commissioner did not function "as an advocate advancing a cause before a tribunal" but rather "serves as an impartial arbiter."[12] The Court noted, moreover, that the "[e]nforcement of the parties' arbitration agreement…does not displace any independent authority the Labor Commissioner may have to investigate and rectify violations of the TAA."[13]

Justice Thomas' Dissent

Justice Clarence Thomas was the only member of the Court to dissent from the majority opinion in *Preston*. In his short dissenting opinion, Justice Thomas explained (as he has many time before) that he would affirm the Court of Appeals' decision because he "believe[s] that the [FAA] does not apply to proceedings in state court." Thus, Justice Thomas would have held that the "FAA cannot displace a state law that delays arbitration until administrative proceedings are completed."[14]

The Court reaffirmed the "separability" doctrine, whereby the Court views the promise to arbitrate as separate from the overall agreement, and a party trying to avoid arbitration must challenge the specific agreement to arbitrate rather than the validity of the arbitration promise itself.

Remaining Questions

The *Preston* opinion provides an ostensibly clear and precise holding: "when parties agree to arbitrate all questions arising under a contract, state laws lodging primary jurisdiction in another forum, whether judicial or administrative, are superseded by the FAA."[15]

In theory, the Court adverted to an alternative ground for its ruling since the TAA was found to violate the FAA because it provided special procedures applicable only to cases involving arbitration.

In practice, it is likely that the Court's reaffirmation of the "separability" doctrine is the holding, even if these special provisions were absent.

One area of possible open questions concerns the role of administrative agencies. It is clear from the Court's discussion of *Waffle House* that government agencies not signatory to an arbitration agreement will be able to investigate and possibly sue to enforce claims on behalf of individuals who have signed such agreements. What if the agency undertakes, pursuant to statutory authority, to provide its own administrative forum for adjudicating the dispute? Presumably arbitration could be compelled against a party agreeing to arbitration. Could the agency move in court to enjoin the arbitration pending resolution of its processes because of its authority "to investigate and rectify violations of the" statute? Another area to consider is whether parties can by contract modify the "separability" doctrine. Can they provide that courts, not arbitrators, rule on whether the overall agreement is valid or whether arbitrators have ability to enlarge proceedings to encompass additional claimants not before them?

Conclusion

The Court's decision in *Preston* provides further insight into the Court's pro-arbitration, and pro-FAA, view of predispute arbitration agreements. As the Court explained in *Preston*, the FAA provides "not simply a procedural framework applicable in federal courts; it also calls for the application, in state as well as federal courts, of federal substantive law regarding arbitration."[16] However, as with the Court's decision in *Hall Street Assoc. LLC v. Mattel Inc.*,[17] discussed in a prior column,[18] the Court did not indicate how, or whether, parties can deviate from the standards set by the FAA.

1. __U.S.__, 128 S.Ct. 978 (2008).
2. 9 U.S.C. §1 et seq.
3. 128 S.Ct. 978, 982.
4. 388 U.S. 395 (1967).
5. 546 U.S. 440 (2006).
6. 128 S.Ct. 978, 986 (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 473 U.S. 614, 633 (1985)).
7. 128 S.Ct. at 986 (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 22 (1983)).
8. 489 U.S. 468 (1989).
9. 514 U.S. 52 (1995).
10. 534 U.S. 279, 293-94 (2002).
11. 128 S.Ct. at 986.
12. Id. at 987.
13. Id. at 987 n.7.
14. Id. at 989.
15. Id. at 981.
16. Id. at 981.
17. 128 S.Ct. 1396 (2008).
18. Samuel Estreicher and Steven C. Bennett, "Parties Can't Modify FAA Standards for Judicial Review," NYLJ April 15, 2008.