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Does the FAA Preempt California's Authority to Determine the Validity of a Performer's Personal Management Contract?

by Jay E. Grenig

PREVIEW of United States Supreme Court Cases, pages 180–185. © 2008 American Bar Association.

Case at a Glance

In this case, the Supreme Court is asked to determine whether the Federal Arbitration Act preempts the California Labor Commissioner's jurisdiction to conduct an administrative hearing and determine whether an individual has violated the California Talent Agencies Act.

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ISSUE

Does the Federal Arbitration Act preempt the California Supreme Court's decision holding that the California Talent Agencies Act precluded a manager from requiring a performer to arbitrate a dispute with a performer with respect to the performer's personal management contract?

FACTS

Respondent Alex Ferrer is a former Florida judge who is the star of *Judge Alex*, a syndicated television program, in which Ferrer arbitrates minor civil disputes as a form of entertainment. Petitioner Arnold M. Preston is an attorney who provides services as a personal manager, advising and counseling artistic personnel in the motion picture and television industry. He has never been a licensed talent agent.

In March 2002, Preston and Ferrer entered into a written management agreement providing for payment of a fee based on Ferrer's earnings from *Judge Alex*. According to

Ferrer, the management agreement was shown to Ferrer hours before a meeting between Ferrer and several television network executives and producers. The agreement also entitled Preston to a sizable commission stemming from any employment Ferrer obtained as a result of the meeting. Although Ferrer did not obtain employment as a result of the meeting, he was later employed in the television industry working with two of the producers he had met at the meeting.

The management agreement included a standard American Arbitration Association (AAA) provision calling for arbitration of disputes. The arbitration clause specifically provided that disputes about the "validity" and "legality" of the contract would be decided by arbitration. Ferrer resides in Florida and tapes the *Judge Alex* television program in Texas. Preston had his office in California. Ferrer was in Nevada when he signed the management agreement.

When *Judge Alex* went on the air, Ferrer allegedly refused to pay

PRESTON V. FERRER
DOCKET NO. 06-1463

ARGUMENT DATE:
JANUARY 14, 2008
FROM: SUPREME COURT
OF CALIFORNIA

Preston the management fee provided by the management agreement. On June 4, 2005, Preston filed a demand for arbitration with the AAA in Los Angeles, California. Ferrer responded on July 5, 2005, by filing an action with the California Labor Commissioner, challenging the legality of the entire management contract under the California Talent Agencies Act. Among other things, Ferrer asked for a declaration that the management agreement was void, and for an order staying the arbitration.

Under the Talent Agencies Act, anyone who procures or attempts to procure employment for an artist in the television, stage, or motion picture industry is a “talent agency” and must be licensed by the California labor commissioner. Ferrer claims that Preston is not a licensed talent agent and, moreover, that the contract Preston presented to Ferrer had not been approved by the labor commissioner as required by the Talent Agencies Act.

The labor commissioner’s hearing officer determined that the Ferrer petition asserted a “colorable basis for exercise of the Labor Commissioner’s jurisdiction.” However, the hearing officer also determined she lacked the authority to stay the arbitration.

The arbitrator set a hearing on the merits for January 26, 2006. On November 2, 2005, Ferrer filed suit in the Los Angeles Superior Court, seeking an injunction against the arbitration. Preston responded by filing a Motion to Compel Arbitration in the Superior Court. On December 7, 2005, the Superior Court denied Preston’s Motion to Compel Arbitration, issued the injunction against the arbitration, and ordered that the legality of the entire contract under the Talent Agencies Act be decided by the

labor commissioner, not the arbitrator. The Superior Court determined that under the Talent Agencies Act, the labor commissioner could proceed with the commissioner’s inquiry before the parties litigate or arbitrate their dispute.

In a 2-1 decision, the California Court of Appeal affirmed the Superior Court’s decision. *Ferrer v. Preston*, 145 Cal.App.4th 440 (2006). Relying on California Labor Code § 1700.44(a), the court held the labor commissioner had exclusive jurisdiction to hear disputes under the Talent Agencies Act. Acknowledging that the parties’ contract included a standard AAA arbitration clause, including a stipulation that the parties are to arbitrate any attack on the “validity or legality” of the contract, the court said that California Labor Code § 1700.44(a) nonetheless vests exclusive original jurisdiction in the labor commissioner to resolve issues arising under the act.

The dissenting opinion contended that the Federal Arbitration Act and *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006), preempted the majority decision, stating:

Because it is undisputed (correctly) that the contract before us is governed by the FAA ... it follows necessarily that the arbitrator and not the court must determine the gateway issues. My colleagues’ contrary conclusion—based on the fact that the *Buckeye* court did not consider whether the issue should go first to a state administrative agency—ignores *Buckeye*’s holding that its rules trump conflicting state procedures.

The majority of the Court of Appeal did not dispute the applicability of the Federal Arbitration Act, but dis-

tinguished *Buckeye* on the grounds that the Talent Agencies Act vests initial jurisdiction in an administrative agency, whereas *Buckeye* involved an attempt to avoid arbitration by filing a lawsuit in a court.

The California Supreme Court denied review on February 14, 2007. Preston’s request for review by the U.S. Supreme Court was granted on September 25, 2007. 128 S.Ct. 31 (2007).

CASE ANALYSIS

Arbitration is a method of dispute resolution in which the parties submit a dispute to an impartial person selected by the parties. The arbitration procedure is generally less formal than a judicial trial. The arbitrator’s decision is final and binding on the parties.

Traditionally, courts refused to enforce agreements to arbitrate. The Federal Arbitration Act of 1925 (FAA) changed that common-law rule and made a written agreement to arbitrate specifically enforceable in the federal courts—if the agreement is connected with a maritime transaction or evidences a transaction involving foreign or interstate commerce. According to the Supreme Court, in enacting the FAA, Congress intended to create a new body of federal substantive law affecting the validity and interpretation of arbitration agreements and to exercise as much of its constitutional power under the Commerce Clause as it could in order to make the FAA as widely effective as possible. See *Southland Corp. v. Keating*, 465 U.S. 1 (1984). The FAA applies in state courts as well as in federal courts.

The Supreme Court has determined that in enacting the FAA, Congress declared a national policy favoring arbitration and withdrawing the

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power of the states to require a judicial forum for the resolution of claims that the contracting parties have agreed to resolve by arbitration. *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 687 (1996). According to the Supreme Court, there is a strong federal policy favoring arbitration of statutory claims. *Green Tree Financial Corp.-Alabama v. Randolph*, 531 U.S. 79, 89-90 (2000).

The Supreme Court has held that a court's duty to enforce an arbitration agreement is not diminished when a party bound by an agreement raises a claim based on statutory rights. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991). By agreeing to arbitrate a statutory claim, the Supreme Court reasoned, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.

Preston asserts that, under the FAA, the arbitrator decides issues concerning the legality of the entire contract. He argues that, because only attacks on the arbitration agreement itself are decided by the judiciary, allegations that the entire contract is void or illegal are decided by the arbitrator. According to Preston, state law abrogation of the right to arbitrate is subject to FAA preemption. Preston reasons that, on its face, Ferrer's petition to the labor commissioner is nothing more than a private, civil pleading that seeks an adjudication that the entire contract is invalid.

Ferrer responds that the FAA does not preempt state procedural laws that the parties expressly incorporate into their contracts. It is Ferrer's position that the principal purpose of the FAA is to enforce the parties' contract in accordance with its terms. Ferrer argues that, if the

arbitration clause is valid and applicable, the parties may proceed to arbitration if either is dissatisfied with the commissioner's determination. If so, Ferrer says an arbitrator, rather than a court, will resolve the controversy.

It is Preston's position that the fact that Ferrer was the petitioner in the labor commissioner proceeding and a plaintiff in the Superior Court action distinguishes this case from *Equal Employment Opportunity Commission v. Waffle House, Inc.*, 534 U.S. 279 (2002), in which the court held that an agreement between an employer and an employee to arbitrate employment-related disputes does not bar the EEOC from pursuing victim-specific judicial relief, such as back pay, reinstatement, and damages, in an Americans with Disabilities Act enforcement action.

In *Waffle House*, Preston notes, the EEOC filed an enforcement action in its own name. According to Preston, the decision in *Waffle House* clearly turned on the identity of the EEOC as the named plaintiff and its status as a nonsignatory to the arbitration agreement. Preston submits that *Waffle House* ultimately hinges on the exercise of discretion by the administrative enforcement agency. Preston asserts that in his case, by contrast, the labor commissioner did not file an action in her own name. Based on Ferrer's pleading, the hearing officer merely found there was a "colorable" case based on Ferrer's pleadings. There was never any evaluation of evidence, much less any decision by the labor commissioner to file a lawsuit in her own name.

Ferrer disagrees, asserting that the FAA does not preempt the California procedural rules that merely postpone arbitration. Ferrer suggests that, because the labor

commissioner's review is informal, expeditious, and subject to complete *de novo* review, Ferrer says it does not tie the hands of the arbitrator, who is left, as between the parties, to fashion the ultimate remedy. At the same time, as between the parties and the state of California, Ferrer contends the Talent Agencies Act procedure permits the commissioner to exercise her administrative, regulatory authority to conduct an investigation, make an initial determination whether the act has been violated, and take appropriate administrative action—an authority that private parties are powerless to negate by contract.

Preston contends the express intent of the parties in the present case was that the arbitrator shall decide the validity of the entire contract. Preston points out that the management agreement expressly states that the "validity or legality" of the contract is subject to arbitration. Even if the "validity or legality" language was not present, Preston argues that the management agreement incorporates the AAA rules. It notes those rules contain an express agreement to arbitrate issues of the "validity" of the contract.

Pointing out that California has long been recognized as "the center of the entertainment industry," Ferrer asserts that the state has a strong interest in regulating relations between artists and those who procure or attempt to procure employment for them. Ferrer claims that employing the expert office of the California labor commissioner to monitor and adjust relations between agents and artists furthers important state interests.

Preston concludes that, if Ferrer had honored his promise to arbitrate, including the specific promise to arbitrate the "validity or legality"

of the contract, this case would have been expeditiously and economically resolved at a two-day hearing on January 26 and 27, 2006. Instead, Preston says the matter has been contested before the arbitrator, the labor commissioner, the Los Angeles Superior Court, the California Court of Appeal, the California Supreme Court, and now before the highest Court in the land.

Noting that the management agreement specifically provides that it is governed by the laws of California, Ferrer contends that Preston agreed to be bound by the Talent Agencies Act procedure. Accordingly, Ferrer says that Preston should be bound by that agreement.

Ferrer also suggests the Supreme Court should consider overruling its decision in *Southland v. Keating*, 45 U.S. 1 (1984), and hold that the FAA does not preempt state statutes exempting certain state law controversies from arbitration.

This proceeding implicates four Supreme Court decisions: (1) *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006); (2) *EEOC v. Waffle House, Inc.*, 534 U.S. 279 (2002); (3) *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991); and (4) *Southland v. Keating*, 45 U.S. 1 (1984).

In *Buckeye Check Cashing, Inc. v. Cardegna*, borrowers brought a class-action lawsuit against Buckeye Check Cashing, alleging Buckeye had made illegal usurious loans disguised as check cashing transactions in violation of various state statutes. For each deferred-payment transaction the borrowers entered into with Buckeye, they signed an agreement containing provisions that required binding arbitration to resolve disputes arising out of the agreement. The borrowers sued in Florida state court, alleging Buckeye charged usurious interest rates and

that the agreement violated various Florida laws, making it criminal on its face.

The trial court denied Buckeye's motion to compel arbitration, holding that a court rather than an arbitrator should resolve a claim that a contract is illegal and void from the beginning. A state appellate court reversed, but was in turn reversed by the Florida Supreme Court, which reasoned that enforcing an arbitration agreement in a contract challenged as unlawful would violate state public policy and contract law.

The U.S. Supreme Court reversed the Florida Supreme Court, holding that, regardless of whether it is brought in federal or state court, a challenge to the validity of a contract as a whole, and not specifically to the arbitration clause within it, must go to the arbitrator, not the court. The Court explained that, as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract. Unless the challenge is to the arbitration clause itself, the Court said the issue of the contract's validity is considered by the arbitrator in the first instance. Finally, the Court held that this arbitration law applies in state as well as in federal courts.

The Court rejected the borrowers' claim that the agreement as a whole (including its arbitration provision) was rendered invalid by the usurious finance charge. Because the borrowers challenged the entire agreement, and not specifically its arbitration provisions, the Court ruled the arbitration provisions were enforceable apart from the remainder of the contract, and that the challenge should be considered by an arbitrator, not a court.

In the *Waffle House* case, Waffle House employees had to sign an agreement requiring employment

disputes to be settled by arbitration. After an employee suffered a seizure and was fired by Waffle House, he filed a timely discrimination charge with the Equal Employment Opportunity Commission alleging his discharge violated Title I of the Americans with Disabilities Act. The EEOC filed an enforcement suit, to which the employee was not a party, alleging the employment practices of Waffle House, including the employee's discharge "because of his disability," violated the ADA, and that the violation was intentional and done with malice or reckless indifference. The complaint requested injunctive relief to eradicate the effects of Waffle House's past and present unlawful employment practices.

Waffle House petitioned under the FAA to stay the EEOC's suit and to compel arbitration, or to dismiss the action. The district court denied relief. The Fourth Circuit concluded that the arbitration agreement between Baker and Waffle House did not foreclose the enforcement action because the EEOC was not a party to the contract, but had independent statutory authority to bring suit in any federal district court where venue was proper. Nevertheless, the court held that the EEOC was limited to injunctive relief and precluded from seeking victim-specific relief because the FAA policy favoring enforcement of private arbitration agreements outweighs the EEOC's right to proceed in federal court when it seeks primarily to vindicate private, rather than public, interests.

The Supreme Court held an agreement between an employer and an employee to arbitrate employment-related disputes does not bar the EEOC from pursuing victim-specific judicial relief, such as back pay, reinstatement, and damages, in an ADA enforcement action. The Court reasoned that neither statutes nor

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the Court's decisions suggest that the existence of an arbitration agreement between private parties materially changes the EEOC's statutory function or the remedies otherwise available. Despite the FAA policy favoring arbitration agreements, the Court said nothing in the FAA authorizes a court to compel arbitration of any issues, or by any parties, that are not already covered in the agreement. The Court said the FAA does not mention enforcement by public agencies; it ensures the enforceability of private agreements to arbitrate, but otherwise does not purport to place any restriction on a nonparty's choice of a judicial forum.

Because the EEOC was not a party to the contract and had not agreed to arbitrate its claims, Court ruled the FAA's pro-arbitration policy goals do not require the EEOC to relinquish its statutory authority to pursue victim-specific relief, regardless of the forum that the employer and employee have chosen to resolve their disputes. Although an employee's conduct may effectively limit the relief the EEOC can obtain in court if, for example, the employee fails to mitigate damages or accepts a monetary settlement, the Court noted that the Waffle House employee had not sought arbitration, and there was no indication he had entered into settlement negotiations with Waffle House.

In *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991), Gilmer was required by Interstate/Johnson, his employer, to register as a securities representative with, among others, the New York Stock Exchange. His registration application contained an agreement to arbitrate when required to by NYSE rules. NYSE Rule 347 provides for arbitration of any controversy arising out of a registered representative's employment or termination of employment.

Interstate/Johnson terminated Gilmer's employment at age 62. Gilmer filed a charge with the EEOC and brought suit in the district court, alleging that he had been discharged in violation of the Age Discrimination in Employment Act. Interstate/Johnson moved to compel arbitration, relying on the agreement in Gilmer's registration application and the FAA. The court denied the motion, based on *Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974), which held that an employee's suit under Title VII of the Civil Rights Act of 1964 is not foreclosed by the prior submission of his claim to arbitration under the terms of a collective-bargaining agreement. The court of appeals reversed.

The Supreme Court held that an ADEA claim can be subjected to compulsory arbitration. Since neither the text nor the legislative history of the ADEA explicitly precludes arbitration, Gilmer was bound by his agreement to arbitrate unless he could show an inherent conflict between arbitration and the ADEA's underlying purposes. The Court determined there was no inconsistency between the important social policies furthered by the ADEA and the policy of enforcing agreements to arbitrate age discrimination claims.

The Court held that arbitration would not undermine the EEOC's role in ADEA enforcement. It noted that an ADEA claimant is free to file an EEOC charge even if he is precluded from instituting suit; the EEOC has independent authority to investigate age discrimination; the ADEA does not indicate that Congress intended that the EEOC be involved in all disputes; and an administrative agency's mere involvement in a statute's enforcement is insufficient to preclude arbitration. Moreover, the Court said compulsory arbitration does not

improperly deprive claimants of the judicial forum provided by the ADEA.

In *Southland*, the Supreme Court held that, in enacting § 2 of the FAA, Congress declared a national policy favoring arbitration and withdrew the power of a state to require a judicial forum for the resolution of claims that the contracting parties agreed to resolve by arbitration. The Supreme Court declared that the FAA, resting on Congress's authority under the Commerce Clause, creates a body of federal substantive law that is applicable in both state and federal courts. If Congress, in enacting FAA, had intended to create a procedural rule applicable only in federal courts, the Supreme Court said it would not have limited the act to contracts "involving commerce."

SIGNIFICANCE

The Supreme Court now has the opportunity to clarify whether in light of these cases the FAA preempts a state law mandating that a matter be submitted to an administrative agency before a complainant who has agreed to arbitration may seek judicial resolution or have the matter submitted to arbitration.

This is an important case with respect to defining the nature of disputes that can be submitted to arbitration. A decision in favor of the petitioner will demonstrate the Supreme Court's continued policy of encouraging arbitration of all disputes. It would limit the ability of states to require that disputes be submitted to state administrative agencies for resolution.

A decision in favor of the respondent would limit the applicability of the FAA to state courts. It would permit states, in some situations, to require that certain matters be submitted to state administrative agen-

cies before they can be submitted to the courts or to arbitration. Moreover, the respondent has also invited the Supreme Court to consider overruling its decision in *Southland*, holding that the FAA is a substantive statute.

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