The Arbitration Whipsaw Continues – Court Reinstates Portions of California Prohibition of Mandatory Arbitration Agreements

Insights
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- **The Ninth Circuit rules that portions of Assembly Bill 51 are not preempted by the Federal Arbitration Act ("FAA") and lifts a lower court's injunction that barred the law from taking effect.**
- **The court did rule that certain criminal and civil sanctions are preempted, reducing some of the risks for noncompliance.**
- **Further appeals are likely, which could include a further stay of enforcement.**

A split Ninth Circuit panel just voted 2-1 to partially uphold California's Assembly Bill 51 (AB 51) that prohibits employers from conditioning employment on an employee's execution of an arbitration agreement for nearly all types of employment claims.

The September 16 ruling is a mixed bag for California employers. The court held that the Federal Arbitration Act does not preempt the portion of the law that precludes employers mandating arbitration agreements as a condition of employment or from retaliating against employees or applicants who refuse to sign an arbitration agreement. However, the court emphasized as part of its ruling that the law *does not* invalidate arbitration agreements that are otherwise enforceable under the FAA, including agreements that violate the new law. The Ninth Circuit also upheld the lower court ruling that invalidated the enforcement mechanisms included in AB 51 that would have imposed civil and criminal penalties against employers who violate the new law.

Thus, while the ruling partially validates the California legislature's ongoing efforts to sidestep the FAA and prevent employment arbitration agreements, the ruling does not impact enforceability of current agreements and largely removes the most concerning aspects of the law that would create new civil or criminal penalties against employers that maintain mandatory arbitration programs.

Brief Background of AB 51 and the Lower Court's Injunction Blocking Enforcement

California Assembly Bill 51, signed into effect in October 2019, would make it unlawful for California employers to require applicants and employees to sign arbitration agreements as a condition of employment. Violations of the law could not only lead to civil and criminal penalties but would also be considered an "unlawful employment practice." This means employers would have been subject

to the private right of action under the Fair Employment and Housing Act ("FEHA," set forth in Government Code Section 12960). The law was set to become enforceable beginning January 1, 2020.

As we reported, a coalition of business groups led by the U.S. Chamber of Commerce filed a lawsuit seeking to block AB 51 from ever taking effect. The plaintiffs asked the Eastern District of California federal court to grant a preliminary injunction and filed a request for a Temporary Restraining Order (TRO), which would halt the law from being enforced while the litigation over the preliminary injunction request was taking place.

On December 30, 2019, the court granted the TRO, effectively preventing the state from enforcing AB 51 until the request for a preliminary injunction was decided. And on January 31, 2020 the court granted the full preliminary injunction and blocked the state from enforcing the law while the litigation was ongoing. The district court found that AB 51 is preempted by the FAA both because it placed arbitration agreements on "unequal footing" with other contracts, and because AB 51's deterrent effect on the use of arbitration agreements interfered with the FAA's main objective to promote arbitration. The state filed an appeal, the ruling from which we discuss in depth in this update.

The Ninth Circuit Holds That the FAA Only Partially Preempts AB 51

AB 51 is a multifaceted piece of legislation that added new sections to California's Labor Code and Government Code that, combined together, would have imposed strict penalties against employers that require employees to sign arbitration agreements. The court's analysis looked at each statutory addition individually to determine whether it was preempted by the FAA.

The FAA Does Not Preempt AB 51's General Ban on Mandatory Arbitration Agreements

AB 51 adds section 432.6 to the Labor Code which precludes employers from making arbitration agreements a condition of employment, and from retaliating or discriminating against any employees or applicants who refuse to sign an arbitration agreement. This code section also specifically takes aim at "opt out" agreements that require employees to opt out or take other action to avoid being bound by the agreement, deeming such agreements to be a violation of the statute.

The court held that the FAA does not preempt this aspect of AB 51 and vacated the preliminary injunction with respect to enforcement of section 432.6. Specifically, the court found that section 432.6 does not conflict with the FAA because it "does not make invalid or unenforceable any agreement to arbitrate, even if such agreement is consummated in violation of the statute."

Thus, according to the Ninth Circuit, section 432.6 only regulates pre-agreement behavior and cannot run afoul of the FAA, which takes effect after an agreement is consummated. In doing so, the court distinguished US Supreme Court precedent striking down similar recent attempts at restricting arbitration as conflicting with a strong federal policy favoring it.

Moreover, the Court also found that section 432.6 did not interfere with the FAA since, according to the Ninth Circuit, the intent of the FAA is to promote enforcement of *consensual* arbitration agreements. Thus, section 432.6 does not interfere with this intent by banning only *non-voluntary* arbitration agreements.

AB 51 Does Not Impact Enforceability of Arbitration Agreements

Crucial to the court's ruling that section 432.6 was not preempted by the FAA was that it does *not* impact enforceability of arbitration agreements.

The court noted that section 432.6(f) specifically provides for the validity and enforceability of arbitration agreements - "[n]othing in this section is intended to invalidate a written arbitration agreement that is otherwise enforceable under the Federal Arbitration Act." Cal. Lab. Code § 432.6(f). Thus, the Ninth Circuit held that section 432.6 exclusively regulates pre-agreement employer behavior, which is beyond the scope of FAA preemption. While section 432.6 makes it unlawful for employers to mandate arbitration agreements as a condition of employment, it does not impact the enforceability of any such agreements.

The FAA Does Preempt AB 51's Civil and Criminal Penalties Imposed on Employers That Violate the New Law

AB 51 sought to impose criminal penalties for violating section 432.6 of the Labor Code pursuant to Labor Code sections 433 and 23, and to impose civil liability against employers by adding violations of Labor Code section 432.6 as an "unlawful employment practice" under the FEHA. Unlike regulating pre-agreement conduct, the court found that these enforcement mechanisms are preempted by the FAA since they necessarily punish employers for the act of executing an arbitration agreement. Thus, taken together, the court revived section 432.6 as a standalone statute but upheld preemption of the enforcement mechanisms included in AB 51 and confirmed that section 432.6 may not be used to invalidate any agreement to arbitrate.

Potential for Further Appeal and Stay

Based on the potential far-reaching ramifications of AB 51, this is a case with high stakes that is being closely observed by many. Therefore, it is likely that the panel's decision will be appealed to the full Ninth Circuit to review *en banc* and/or ultimately to the United States Supreme Court.

In her dissent calling AB 51 a "blatant attack" on arbitration agreements, Judge Sandra Ikuta colorfully foreshadowed future grounds for appeal by stating:

> Like a classic clown bop bag, no matter how many times California is smacked down for violating the Federal Arbitration Act (FAA), the state bounces back with even more creative methods to sidestep the FAA.

Even though the lower court's preliminary injunction was lifted, it is possible that such a further appeal could result in a stay of AB 51's remaining provisions. But until/unless that happens, employers should operate as if the remaining provisions of AB 51 are in effect.

Next Steps for Employers

If the remaining provisions of AB 51 are not stayed pending further appeal, employers will need to evaluate how to proceed with respect to the use of arbitration agreements in California.

These are fact-specific and nuanced considerations, so there is no "one size fits all" piece of advice here. And the best advice is always to consult with counsel before making a decision.

But overall, there are three general options that employers should begin evaluating with counsel:

1. **Consider Stopping Use of Mandatory Arbitration Agreements**

   Some employers may wish to avoid further uncertainty and simply discontinue the use of mandatory arbitration agreements in employment altogether.

   While this may have some appeal for some, there are some drawbacks or considerations on the other side that should be evaluated with counsel. Not having an executed arbitration agreement from an employee could dramatically raise the stakes in any future class action litigation. Moreover, the court's decision emphasized that AB 51 "does not make invalid or unenforceable any agreement to arbitrate, even if such an agreement is consummated in violation of the statute."

   The fact that such an agreement will not be unenforceable, coupled with the court's finding that the criminal penalties and FEHA civil sanctions would be preempted by federal law, are factors that employers should weigh with counsel before deciding to eliminate the use of arbitration agreements altogether.

2. **Do Nothing and Proceed with Mandatory Arbitration Agreements**

   Others may be tempted to maintain the status quo until further appeals and litigation play out – in the hopes that the United States Supreme Court ultimately rules that the entire statute is preempted by the FAA.

   Some may be tempted to take this course of action, especially because the court stated that such clauses are not invalid even if in violation of AB 51, and reduced the potential risk for employers by negating the criminal violation and FEHA sanctions.

   However, employers should keep in mind that there still could be other potential statutory claims arising from the use of mandatory arbitration agreements (and potentially PAGA claims) even though the court appeared to significantly reduce ramifications of noncompliance. Employers

should also be aware that under AB 51, an employee who successfully challenges an alleged violation of the new law may be entitled to their attorney's fees.

These are all considerations that should be weighed in a cost/benefit analysis in consultation with counsel before deciding to maintain the status quo.

3. **Ensure That the Use of Such Agreements is "Voluntary"**

   Perhaps a middle ground approach is to take steps to ensure that the use of arbitration agreements is voluntary and not imposed as a condition of employment. One potential consideration is to consider making such agreements "stand-alone" documents that are not imbedded in other documents or policies – strengthening the argument that an employee is free to sign or not sign such an agreement. Onboarding platforms would also need to be programmed to allow for an employee to bypass executing the agreement before moving onto the next policy document.

   The consideration of whether such agreements are "voluntary" will likely hinge on more than just use of the term "voluntary" in such agreements. It's likely that other pre-agreement conditions and factors will be relevant to this overall determination. Therefore, employers should consult with counsel on approaches to ensuring the "voluntariness" of such agreements – with an eye towards considerations beyond the mere terms of the agreement itself.

   With proper planning and some strategic advice, it may be possible to simultaneously ensure that arbitration agreements are voluntary while also increasing the likelihood that they will be signed by employees.

Again, these are nuanced considerations that may vary by employer and industry. So it's always best to have this conversation with competent employment counsel.

We'll keep you posted on any legal developments in the further fight over this law, and you can stay updated on the latest news by making sure you are subscribed to Fisher Phillips' Insight system. For more information, contact your Fisher Phillips attorney or one of the attorneys in any of our California offices.

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