



Judge Explains Her Decision to Block California's Ban on Mandatory Arbitration

Insights

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California employers breathed a bit easier once a federal judge pressed the indefinite pause button on the newly enacted law aimed at preventing employers from utilizing mandatory arbitration agreements. Now, a few weeks later, U.S. District Court Judge Kimberly J. Mueller issued an order fully explaining her reasons for granting the preliminary injunction that blocked AB 51. The 36-page order, issued on February 7, said that the law not only would have placed arbitration agreements on unequal footing with other contracts, but it would have interfered with the stated objectives of the Federal Arbitration Act (FAA).

Brief Background of AB 51

California Assembly Bill 51, signed into effect in October, would make it unlawful for California employers to require applicants and employees to sign arbitration agreements as a condition of employment beginning January 1, 2020. Violations of the law could not only lead to civil and criminal penalties but would also be considered an “unlawful employment practice.” This means they would have been subject to the private right of action under FEHA set forth in Government Code Section 12960.

At the time the law passed, we predicted that “the law could very well be blocked by a court before it ever takes effect” because “similar recent attempts at restricting arbitration have been struck down as conflicting with a strong federal law favoring it.” As we reported, a coalition of business groups led by the U.S. Chamber of Commerce filed a lawsuit in December seeking to block AB 51 from ever taking effect. The plaintiffs asked the Eastern District of California court to grant a preliminary injunction blocking the enforcement of AB 51 pending proceedings in the lawsuit. They also 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, the court granted the TRO, effectively preventing the state from enforcing AB 51 until the request for a preliminary injunction is decided. And on January 31, the court issued a brief minute order granting the full preliminary injunction and blocking the state from enforcing the law while the litigation is ongoing. “In the coming days,” Judge Mueller wrote, “the court will explain its reasoning in a detailed, written order.” It’s that order we will dive into in this blog entry.

A Double Set Back for AB 51

To begin, the court addressed jurisdictional arguments made by the state defendants seeking to uphold the law and found that federal courts have subject matter jurisdiction to enjoin state officers “from implementing law allegedly preempted by the Supremacy Clause.” In so doing, the judge rejected the argument that the court lacked subject matter jurisdiction.

As to the merits of the decision, the court found that AB51 is preempted by the FAA both under the “unequal footing” theory and the “interference” theory.

Unequal Footing Theory

Specifically, the court found that although the plaintiffs had overreached “in arguing that AB 51 prevents employers from offering arbitration agreements to employees,” the legislative history of AB 51 is clear in acknowledging that the primary target of the bill is agreements to arbitrate. The court concluded that because AB 51 penalizes employers who include mandatory arbitration agreements as a condition of employment by calling for both civil and criminal penalties for violations of the statute, AB 51 “singles out the requirement of entering into arbitration agreements and thus subjects these kinds of agreements to unequal footing.” In so deciding, the court rejected defendants’ argument that AB 51 merely codifies a central tenant of the FAA that arbitration is strictly a matter of consent. Instead, the court noted that AB 51’s prohibition on California employers’ use of mandatory arbitration agreements “disfavors contracts with the defining features of arbitration.” Therefore, the court noted that even if AB 51 was artfully crafted to support the argument that it only regulates the behavior of employers, “it cannot avoid being construed as a law that in effect discriminates against arbitration agreements.”

The court also rejected defendants’ argument that AB 51 does not expressly render invalid any arbitration agreement that would otherwise be enforceable under the FAA. The court noted that mandatory arbitration agreements are enforceable under the FAA, and, given the sanctions associated with AB 51, the law would have a deterrent effect on California employers’ decision to implement enforceable mandatory arbitration agreements. Thus, the court concluded that AB 51’s “design does not comport with the equal footing principle and its effort to avoid FAA preemption fails.”

Interference Theory

Judge Mueller further found that AB 51 was preempted under the interference theory. As with the unequal footing theory, the court found that AB 51’s deterrent effect on the use of arbitration agreements interfered with the FAA’s main objective to promote arbitration. To that end, the court rejected defendants’ argument that AB 51 only regulates employer’s behavior, as it allows for voluntary agreements. In so doing, the court noted that the risk of criminal and civil liability was too high to rely on the voluntariness of the process, as what the court will view as “voluntary is especially uncertain in the context of where an employer presents an agreement to its employees.”

Irreparable Harm

The court concluded that, without the injunction, California employers would suffer irreparable harm as the enforcement of AB 51 would cause an immediate disruption of the California

harm as the enforcement of AB 51 would cause an immediate disruption of the California employment market. This is because California employers who choose not to comply with AB 51 would risk criminal prosecution or a civil enforcement action or both. And those who choose to comply with AB 51 may forego their federally protected right to enter into arbitration agreements due to the deterrent effect of AB 51. This would lead them to be deprived of the fiscal benefit associated with arbitration (thereby incurring hefty litigation costs and administrative fees to change their employment policies) without the ability to recoup costs from the State of California — which happens to be an immune entity.

Scope of Injunction

Finally, the court held that the preliminary injunctive relief was applicable not only to provision (a) of section 432.6 of the Labor Code but also to provisions (b) and (c) of this section. The court found that while section (a) targets conditional use of arbitration agreements, section (b) focuses on what actions an employer may take when an applicant or employee refused to sign a mandatory arbitration provision. The court noted that the practical effect of section (b) is that “an employer would be prohibited from refusing to hire a prospective employee, or terminate, an existing employee, if the employee refused to sign the mandatory arbitration agreement” and as such “employers [would] lose the ability to act on an employee’s refusal to abide by the requirement of entering into an agreement.”

Next Steps

The status quo remains in effect for California employers – at least through the duration of the court proceedings. Accordingly, it is still lawful to continue requiring employees to sign arbitration agreements as a condition for employment if the agreement is encompassed by the FAA. But the litigation surrounding AB 51 could move quickly, so California employers will need to monitor developments closely over the coming weeks and months. Make sure you stay updated on the latest news on our [California Employers Blog](#) and through [our legal alert system](#).

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