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California's Attack on Arbitration Will Survive in Part, According to the Ninth Circuit

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On September 15, 2021, the Ninth Circuit issued its long-awaited decision in *Chamber of Commerce v. Bonta*, which revives, in part, controversial legislation that sought to prohibit pre-dispute employment arbitration agreements in California.

AB 51, signed into law by Governor Newsom on October 10, 2019, imposed several restrictions on the formation of employer/employee arbitration agreements, including the possibility of civil or criminal penalties for employers. The Eastern District of California previously issued a preliminary injunction[1] prohibiting the enforcement of AB 51 against arbitration agreements covered by the Federal Arbitration Act (the "FAA"), [2] finding that AB 51 likely "is preempted by the FAA because it discriminates against arbitration and interferes with the FAA's objectives." [3]

The State appealed that ruling to the Ninth Circuit, which has now reversed in part the District Court's injunction. The 2-to-1 decision revives some of AB 51's restraints on pre-dispute employment arbitration agreements. But the panel's decision probably is not the final word; the Chamber of Commerce is likely to seek review by the full Ninth Circuit, and if unsuccessful, by the U.S. Supreme Court.

Anti-Arbitration Provisions of AB 51 Are Not Preempted by the FAA

AB 51 added a new section 432.6 to the Labor Code, [4] which, among other things, precludes employers from requiring any applicant or employee, as a condition of employment, to agree to arbitration of any claim under the California Fair Employment and Housing Act (the "FEHA") or Labor Code.[5]

In concluding that section 432.6 does not conflict with the FAA, the Ninth Circuit majority reasoned that, in enacting the FAA, Congress did not intend to preempt state laws requiring that agreements to arbitrate be voluntary. The court found that Section 432.6 does *not* invalidate or make unenforceable any agreement to arbitrate, but rather mandates that employee arbitration agreements be consensual.

The majority, in an opinion written by visiting Judge Carlos Lucero, viewed the legislation as proscribing conduct *before* the formation of an arbitration contract, and leaving unaffected the enforceability of the contract itself. According to the majority, nothing in AB 51 invalidates any arbitration agreement once formed. According to the majority, this analysis differentiated the statute from the litany of Supreme Court FAA cases enforcing arbitration agreements according to their terms. The majority found, however, that the FAA does not preempt the portions of AB 51 that led up to the formation of the

arbitration contract: requiring employees to consent to arbitration agreements, or retaliating against workers who decline to accept arbitration as a condition of employment. [6]

Civil and Criminal Penalties Associated With AB 51 Are Unlawful, To the Extent They Apply To Executed Contracts

Controversially, AB 51 also had created both civil and criminal penalties for employers in violation of the statute, [7] in addition to allowing for other remedies such as injunctive relief and attorney's fees to a prevailing plaintiff who enforces his or her rights under the statute.

In a partial win for employers, the Ninth Circuit majority agreed with the District Court that the civil and criminal penalties imposed on arbitration contracts once formed stood as an obstacle to the purposes of the FAA, and therefore are preempted. But the penalties are not preempted to the extent they are imposed on pre-agreement behavior – asking for the arbitration agreement – if the agreement never is formed.

Judge Ikuta's Dissent

In a compelling dissent, Judge Sandra Ikuta described AB 51 as another of California's efforts to flout the FAA. Referencing earlier cases where the Supreme Court rejected similar efforts by California, Judge Ikuta wrote: "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." Judge Ikuta stated that the majority's ruling conflicted with the Supreme Court's teaching in *Kindred Nursing Centers Ltd. Partnership v. Clark*, [8] which held that the FAA invalidates state laws that impede the formation of arbitration agreements. Judge Ikuta viewed AB 51 as a "blatant attack on arbitration agreements," noting that the law "exemplifies the exact sort of 'hostility to arbitration that led Congress to enact the FAA.'"

Judge Ikuta rejected the majority's attempt to "rescue its opinion" by finding the civil and criminal penalties preempted in part. Because the majority did so only "to the extent that [the penalties] apply to executed agreements covered by the FAA," Judge Ikuta explained the effect of the majority's holding as follows: "[I]f the employer offers an arbitration agreement to the prospective employee as a condition of employment, and the prospective employee executes the agreement, the employer may not be held civilly or criminally liable. But if the prospective employee refuses to sign, then the FAA does not preempt civil and criminal liability for the employer under AB 51's provisions." Judge Ikuta ridiculed this result as akin to absolving a drug dealer from criminal liability if the drug sale was made, but holding the drug dealer criminally liable if a prospective purchaser declined in the end to make the purchase.

Judge Ikuta further cautioned that the ruling created a circuit split with sister circuits, which have held that similar state workarounds to block the formation of arbitration agreements are preempted by the FAA. Although not mentioned by the dissent, the Seventh Circuit in *Oblix, Inc. v. Winiecki*[9] held that a take-it-or-leave-it arbitration clause was enforceable under California law. That case likened a non-negotiable arbitration provision to a non-negotiable salary provision. A person who accepts a non-negotiable salary offer "would be laughed out of court if she filed suit . . . contending that the employer's refusal to negotiate made the deal 'unconscionable' and entitled her to better terms." That case further explained that California law enforces all manner of non-negotiable provisions, like limited warranties. Because California enforces, and does not penalize attempts to obtain, non-negotiable provisions in other contracts, the FAA requires that California apply the same rules to arbitration contracts.

In sum, Judge Ikuta scorned the "majority's bifurcated, half-hearted, and circuit-splitting approach," saying that the majority's opinion "makes little sense, except to the extent it aims at abetting California in disfavoring arbitration."

Next Steps

We expect the Chamber of Commerce to seek further review of this decision, either by petitioning the full Ninth Circuit for an en banc review, or by petitioning for a writ of certiorari to the United States Supreme Court. Any such petition(s) would have strong support in the Supreme Court's cases. The District Court's injunction will remain in effect until the Ninth Circuit issues its formal mandate, which will not issue until the en banc petition is ruled upon. That certainly will take weeks, could take months, and might not happen at all if the court on motion issues a stay pending U.S. Supreme Court review.

What Should Employers Do Now?

California employers with ongoing arbitration programs (or those interested in enacting arbitration programs) must decide appropriate next steps. Because the District Court's injunction remains in effect for now, time is not of the essence, unless, and until, the Ninth Circuit's mandate issues. When that happens, some employers – confident that FAA preemption will be found in the end, and mindful that enforceable arbitration agreements still can be created even under the Ninth Circuit majority's decision – may decide to continue to seek arbitration agreements from new hires or existing employees. Other employers, daunted by the specter of possible penalties for seeking (without obtaining) an arbitration agreement, may choose to err on the side of caution. Some employers may choose to make arbitration totally voluntary. Others may choose to suspend implementation of new arbitration agreements until the meaning and enforceability of AB 51 is definitively resolved. If the Ninth Circuit's decision is reversed, such employers could reinstate their arbitration program at that time and evaluate ways to recapture new hires and employees who have slipped through the cracks in the meantime.

The particular path chosen by an employer will depend on each employer's specific circumstances, assessment of the risks and benefits, and the guidance of employment counsel.

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[1] See *Chamber of Commerce v. Becerra*, No. 2:19-cv-02456-KJM-DB (E.D. Cal., filed Dec. 9, 2019).

[2] 9 U.S.C. § 1 et seq.

[3] For a detailed discussion of the district court's ruling, see Paul Hastings' February 03, 2020 Client Alert, *Nipped In The Bud: Federal Court Enjoins California's New Arbitration Statute*, https://www.paulhastings.com/insights/client-alerts/nipped-in-the-bud-federal-court-enjoins-californias-new-arbitration-statute

[4] AB 51 also added a new section 12953 to the Government Code (within the Fair Employment and Housing Act) making it an unfair labor practice for an employer to violate section 432.6 of the Labor Code.

[5] For a detailed discussion of section 432.6's specific provisions, *see* Paul Hastings' October 21, 2019 Client Alert, *AB 51: Attacking Arbitration, Again*, https://www.paulhastings.com/insights/client-alerts/ab-51-attacking-arbitration-again.

[6] AB 51 defines as "mandatory" – and hence declared improper – arbitration agreements, even where employees have free choice to opt out of them. [ADD CITE.]

[7] Because AB 51 added its prohibitions to the Labor Code at section 432.6, a violation would be a misdemeanor under Labor Code section 433. *See* CAL. LAB. CODE § 433 ("Any person violating this article is guilty of a misdemeanor.").

[8] 137 S. Ct. 1421, 1425 (2017).

[9] 374 F.3d 488, 491 (7th Cir. 2004).