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Ninth Circuit Restores California's Ban on Mandatory Employment Arbitration Agreements

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On September 15, a Ninth Circuit panel in a 2-1 decision vacated a preliminary injunction, which has blocked enforcement of California Assembly Bill (AB) 51 since January 2020. The decision also partially struck down the law's civil and criminal penalties, but only as applied to signed arbitration agreements covered by the Federal Arbitration Act (FAA). This ruling will likely be challenged, but in the meantime, it creates risk and uncertainty for any employers that continue to use mandatory arbitration agreements.

Refresher on AB 51 and Its Procedural History

On October 10, 2019, Governor Gavin Newsom signed the controversial AB 51 into law, which was supposed to go into effect on January 1, 2020. Notably, AB 51:

- Prohibits mandatory arbitration agreements for any claims arising under the California Fair Employment and Housing Act (FEHA) or the California Labor Code as a condition of employment or receipt of any employment-related benefit. Cal. Lab. Code § 432.6.
- Imposes criminal and civil penalties for employers that violate its provisions — including "imprisonment in a county jail, not exceeding six months, or … a fine not exceeding one thousand dollars ($1,000), or both," as well as injunctive relief and attorney's fees to a prevailing plaintiff for enforcing his/her rights. Cal. Lab. Code §§ 23, 432.6, 433.
- Protects against retaliation and discrimination for those employees who refuse to consent to a mandatory arbitration agreement or who file a claim to enforce AB 51. Cal. Lab. Code § 432.6.; Cal. Gov. Code § 12953.
- Applies to agreements entered into or modified on or after January 1, 2020. Cal. Lab. Code § 432.6.
- Does not apply to arbitration agreements otherwise enforceable under the FAA. Cal. Lab. Code § 432.6.

The U.S. and California Chambers of Commerce and other national and state organizations filed lawsuits in an attempt to block AB 51, asserting that it is preempted by the FAA. On December 30, 2019 (two days before AB 51 was scheduled to go into effect), the U.S. District Court for the Eastern District of California issued a temporary restraining order that prohibited enforcement of AB 51. Ultimately, the district court issued a preliminary injunction on January 31, 2020 on the basis that AB 51 interferes with the FAA's objectives and is preempted by the FAA because it discriminates against arbitration. For a recap of this procedural history, please refer to previous Troutman Pepper client advisories linked in this section.

The January 2020 preliminary injunction meant that California employers could continue to utilize mandatory employment arbitration agreements without fear of criminal or civil penalties under AB 51 until now.

Ninth Circuit's Ruling

In *Chamber of Commerce of the U.S. v. Bonta*, the Ninth Circuit issued a 2-1 decision, upholding AB 51's prohibition on mandatory employment arbitration agreements as a condition of employment. The court also vacated the district court's preliminary injunction that blocked enforcement of AB 51, and it remanded the case to the district court for further proceedings.

In explaining its decision, the court noted that AB 51 does not run afoul of the FAA because it regulates "pre-agreement employer behavior" that does not undermine validity or enforcement of an arbitration agreement. The decision also emphasized that AB 51's stated intent — "to assure that entry into an arbitration agreement by an employer and employee is mutually consensual" — is consistent with the congressional intent for the FAA to not preempt state laws requiring "voluntary" arbitration agreements.

The court also stated that AB 51 does not create or constitute a contract defense or otherwise "make invalid or unenforceable any agreement to arbitrate, even if such agreement was consummated in violation of the statute." As such, an employee may not seek to invalidate a signed arbitration agreement solely on the basis of a violation of AB 51.

Concerning its penalties, the court invalidated AB 51's civil and criminal penalties as preempted, but only "to the extent that they apply to executed arbitration agreements covered by the FAA." With this caveat, the flip side of this holding is that these penalties are not preempted (and will apply to employers), where an employee does not actually sign a mandatory arbitration agreement. Thus, employers apparently are exposed to criminal and civil penalties for conditioning employment or benefits on execution of an arbitration agreement when employees do not sign the agreement, but they are not exposed to such sanctions if an employee does not sign the agreement even though the employer presented it as a mandatory condition of employment.

I Dissent!

One judge dissented, blasting AB 51 as "the poster child for covertly discriminating against arbitration agreements and enacting a scheme that disproportionately burdens arbitration" and as a "blatant attack on arbitration agreements." The dissent detailed California's lengthy history of legislation as examples of the state's repeated attempts to sidestep the FAA "no matter how many times [it] is smacked down for violating the Federal Arbitration Act (FAA)."

The dissent focused on two key objections to the majority opinion: (1) It conflicts with the United States Supreme Court's guidance in *Kindred Nursing Centers Ltd. Partnership v. Clark*, 137 S.Ct. 1421 (2017) (which held that the FAA invalidates state laws that impede or burden the formation of arbitration agreements), and (2) it unnecessarily creates a circuit split with the First and Fourth circuits (which have held that workarounds and "covert efforts to block the formation of arbitration agreements are preempted by the FAA) without strong reason to do so. Both of these reasons also set the stage for "en banc review or Supreme Court intervention."

The dissent noted that the FAA preempts AB 51 because it is "intentionally designed to burden and penalize an employer's formation, or attempted formation, of an arbitration agreement with employees," and therefore obstructs the purpose and objectives of the FAA. The dissent also pointed out this absurd outcome from the

majority decision: “[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.” In other words, an employer may be penalized for a mere attempt to get an employee to sign an arbitration agreement, but it is not otherwise penalized if the employee signs the agreement, which is then subject to (and therefore preempted by) the FAA.

Does This Mean Employers Should Comply With AB 51 Immediately?

The *Bonta* opinion is not likely the last word about the validity of AB 51. As mentioned in the dissent, there is ample opportunity for the U.S. Chamber of Commerce to petition for rehearing en banc or to file a writ of certiorari in the Supreme Court, or both. In fact, the Chamber of Commerce has already requested an extension of time for a possible rehearing petition, strongly signaling that a rehearing request is forthcoming.

While the Ninth Circuit remanded the case to the district court, its decision (namely, the lift on the district court’s preliminary injunction) does not become effective until the court issues a formal mandate. However, a rehearing petition would automatically stay the court’s mandate for a few months, thereby leaving the district court’s injunction on AB 51 intact. A petition for writ of certiorari in the Supreme Court would not automatically stay the mandate, but could further stay the issuance of the mandate potentially throughout the Supreme Court’s final review if the Ninth Circuit grants such a request.

Given the likely delay in issuing the mandate (and corresponding lift on AB 51’s injunction) based on the U.S. Chamber of Commerce’s anticipated rehearing petition, employers should consult legal counsel about whether, when, and to what extent AB 51 applies to existing and continuing arbitration programs and practices, so they are ready to act once the dust around AB 51 finally settles.

If any part of AB 51 survives further judicial scrutiny, employers using arbitration agreements will need to ensure that agreements are purely voluntary. When revising their arbitration agreements, employers should also note that “opt-out” provisions do not exempt an arbitration agreement from AB 51 and will still be considered a “condition of employment.”

Troutman Pepper’s Labor and Employment attorneys are available to guide you through these novel issues and evaluate the best strategy for your business, despite the ongoing uncertainty surrounding AB 51 and use of employment arbitration agreements.

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