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NINTH CIRCUIT UPHOLDS CALIFORNIA'S BAN ON MANDATORY ARBITRATION OF EMPLOYMENT DISPUTES

Sep 24, 2021

On October 10, 2019, Governor Gavin Newsom signed into law California Assembly Bill 51 ("AB 51"), with an effective date of January 1, 2020. AB 51 prohibits an employer, as a condition of employment, from requiring an employee to sign an arbitration agreement. The prohibition applies even if the employer provides the employee with the opportunity to opt-out of the agreement to arbitrate. However, AB 51 also provides that it does not invalidate a written arbitration agreement that is otherwise enforceable under the Federal Arbitration Act ("FAA"). Any person who violates AB 51 is guilty of a misdemeanor, punishable by imprisonment in a county jail, not exceeding six months, or by a fine not exceeding one thousand dollars ($1,000), or both. Violation of AB 51 also exposes an employer to investigation by the Department of Fair Employment and Housing ("DFEH") and potential civil litigation brought either by the DFEH on behalf of an aggrieved individual or, if the DFEH declines to initiate litigation, by the individual in a private suit.

On December 9, 2019, the Chamber of Commerce of the United States and other business groups filed a complaint for declaratory and injunctive relief in the United States District Court for the Eastern District of California. The complaint sought a declaration that AB 51 was preempted by the FAA, and asked the court to preliminarily and permanently enjoin California from enforcing the statute. The district court preliminarily enjoined California from enforcing AB 51. California appealed the ruling to the Ninth Circuit.

On September 15, 2021, in a 2-1 decision, the Ninth Circuit reversed the preliminary injunction, in part. The Ninth Circuit held that AB 51 is not preempted by the FAA because its effects are aimed entirely at conduct that takes place prior to the existence of any such agreement, requiring that arbitration agreements be consensual. According to the majority, AB 51 is not preempted by 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."

The Ninth Circuit partially affirmed the district court's holding that the civil and criminal penalties associated with AB 51 stand as an obstacle to the purposes of the FAA, and are therefore preempted. However, it limited its holding in that regard to executed arbitration agreements,

apparently permitted imposition of civil and criminal penalties when the employee refuses to sign the agreement.

In a spirited dissent, Judge Sandra S. Ikuta compared the California Legislature to a clown bop bag, stating that, "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." She also accused the majority of "abet[ting] California's attempt to evade the FAA and the Supreme Court's caselaw by upholding this anti-arbitration law on the pretext that it bars only nonconsensual agreements."

Judge Ikuta argued that the FAA preempts AB 51 because it has a disproportionate impact on, and burdens the formation of, arbitration agreements. Judge Ikuta cited to Supreme Court authority holding that state law may not impede the parties' abilities to enter into arbitration agreements. And she opined that AB 51 is intentionally designed to burden and penalize an employer's formation, or attempted formation, of an arbitration agreement with employees. She referred to AB 51 as the "poster child for covertly discriminating against arbitration agreements and enacting a scheme that disproportionately burdens arbitration."

Judge Ikuta also asserted that the majority's ruling with respect to the civil and criminal penalties will lead to absurd results. If an employee signs the mandatory arbitration agreement, the agreement is enforceable and the employer may not be held civilly or criminally liable. However, if the employee refuses to sign, the FAA does not preempt the civil and criminal liability. An employer's failed attempt to enter into a prohibited arbitration agreement is unlawful, but a successful attempt is lawful. Because such a "bizarre approach" does not apply to any other contracts in California, she opined that AB 51 is preempted by the FAA because it disfavors arbitration agreements and obstructs the purposes and objectives of the FAA.

The Chamber of Commerce will likely seek further appellate review of the decision by the Ninth Circuit or the United States Supreme Court. This is important because the Ninth Circuit's decision does not immediately lift the district court's preliminary injunction. The decision takes effect only when the Ninth Circuit issues its mandate. The Chamber of Commerce has 14 days to file a petition for rehearing or rehearing *en banc*. If a petition is filed and accepted by the Ninth Circuit, issuance of the mandate is automatically stayed until the petition is decided. If a petition for review is filed with the Supreme Court, the Chamber of Commerce may move to stay issuance of the Ninth Circuit's mandate pending review by the Supreme Court. Therefore, the preliminary injunction may not be lifted for months or years, or it may never be lifted.

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