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Ninth Circuit Revives California Ban on Mandatory Arbitration Agreements

Ninth Circuit Permits California to Restrict Mandatory Arbitration Agreements Between Employers and Employees, but Enjoins California From Enforcing Such Restrictions Through Civil or Criminal Sanctions

SUMMARY

California Assembly Bill 51 ("AB 51") prohibits employers from requiring mandatory arbitration agreements as a condition of employment, continued employment, or receipt of employment-related benefits for claims arising under California's Labor Code or California's Fair Employment Housing Act, and provides for civil and criminal sanctions for violation of AB 51. The Ninth Circuit partially vacated a lower court's injunction against enforcement of the bill, holding that the ban on mandatory employment arbitration agreements is not preempted by the Federal Arbitration Act ("FAA") because the ban only implicates pre-agreement employer conduct. The Ninth Circuit upheld the injunction imposed by the lower court to the extent that it enjoined California from enforcing violations of AB 51 with criminal or civil sanctions with respect to executed arbitration agreements, reasoning that the FAA does preempt state laws intended to regulate post-agreement employer behavior. Plaintiffs are likely to seek en banc review of the opinion in the Ninth Circuit, as well as review in the U.S. Supreme Court, in light of the fact that the opinion conflicts with two sister circuit courts and takes a narrow view of recent Supreme Court precedent favoring arbitration.

BACKGROUND

In October 2019, California enacted Assembly Bill 51 ("AB 51"), which prohibits employers from requiring mandatory arbitration agreements as a condition of employment, continued employment, or receipt of employment-related benefits for claims arising under California's Labor Code or California's Fair Employment Housing Act ("FEHA"). AB 51's prohibition on mandatory arbitration agreements includes

agreements that permit an employee to opt out of a waiver of rights, or to require an employee to take any affirmative action to preserve his or her rights. It also prohibits employers from taking adverse action against an employee or prospective employee for refusing to consent to arbitration. As enacted, a violation of AB 51's restrictions is a misdemeanor and employers face both civil and criminal sanctions for violating its restrictions.[1]

On December 9, 2019, a coalition of business groups sued the California Attorney General, the California Labor Commissioner, the Secretary of the California Labor and Workforce Development Agency, and the Director of the California Department of Fair Employment and Housing. In February 2020, Judge Mueller of the Eastern District of California issued a preliminary injunction barring AB 51 from taking effect. Plaintiffs argued they are likely to succeed on the merits of their challenge to AB 51 because Supreme Court precedent makes clear that the FAA preempts laws like AB 51. Plaintiffs further asserted that they will suffer irreparable harm if AB 51 is permitted to take effect because refusal to comply exposes Plaintiffs to criminal and civil penalties and lawsuits. Plaintiffs also argued that AB 51 could impact many California employment agreements because compliance with the bill would require employers to alter their relationships with their workers and incur significant costs, because the only practical approach for employers to ensure compliance with AB 51 is to cease entering into pre-dispute arbitration agreements. The District Court adopted Plaintiffs' position in almost every respect. Specifically, the District Court agreed that Plaintiffs were likely to succeed on the merits that the FAA preempted AB 51 because it (1) treats arbitration agreements differently from other contracts; and (2) conflicts with the purposes and objectives of the FAA, which as the has Supreme Court declared, "was designed to promote arbitration."[2] The District Court rejected the State-Defendants' attempts to distinguish AB 51 from prior failed legislation meant to restrict the use of mandatory arbitration agreements as a condition of employment, and highlighted that "AB 51's legislative history acknowledges" that "the primary target of the bill is agreements to arbitrate."[3]

Following the District Court's order, the State appealed to the Ninth Circuit Court of Appeals.

THE NINTH CIRCUIT'S OPINION

The issue before the Ninth Circuit was whether Section 2 of the FAA, which provides that a written agreement to arbitrate "shall be valid, irrevocable, and enforceable," preempts (1) the portions of AB 51 that restrict the formation of arbitration agreements between employers and prospective employees; and (2) the civil and criminal sanctions it imposed on employers for violating its restrictions.[4] To determine whether the FAA preempts any of AB 51's provisions, the Ninth Circuit considered whether AB 51 directly conflicts with the FAA, making it impossible for both to coexist, and whether AB 51 stood as "an obstacle to the accomplishments and execution of the full purposes and objectives" of Congress when it enacted the FAA.[5]

The Ninth Circuit concluded that because AB 51's restrictions prohibiting mandatory arbitration agreements with respect to employment-related claims limit the *formation* of arbitration agreements rather than

invalidating *existing* arbitration agreements, AB 51 does not directly conflict with the FAA.[6] In pertinent part, the Ninth Circuit reasoned that because AB 51 is "aimed entirely at conduct that takes place prior to the existence of any arbitration agreement," it does not "undermine the validity or enforceability of an arbitration agreement" and therefore it is not impossible for both the FAA and AB 51 to coexist.[7]

The Ninth Circuit applied the same logic when assessing whether AB 51's restrictions stood as an obstacle to the purpose and objectives of the FAA, and concluded it did not since AB 51 restricts how employees and employers enter into arbitration agreements rather than how they are enforced. It explained that because "Congress' clear purpose [was] to ensure the validity and enforcement of consensual arbitration agreements according to their terms" it did not intend to preempt "state laws requiring that agreements to arbitrate be voluntary."[8]

In reaching this conclusion, the Ninth Circuit interpreted narrowly the Supreme Court's holding in *Kindred Nursing Centers Limited Partnership* v. *Clark*, 137 S. Ct. 1421 (2017) by finding that the FAA preempts state rules that "selectively" find "arbitration agreements invalid because [they were] improperly formed" rather than state laws that impede the formation of arbitration agreements.[9] In *Kindred Nursing*, the Supreme Court held that the FAA preempt[s] any state rule discriminating on its face against arbitration—for example, a "law prohibiting outright the arbitration of a particular type of claim."[10] The Ninth Circuit recognized that *Kindred Nursing* "emphasized that the FAA preempts rules affecting the initial validity of arbitration agreements," but concluded that was not at issue in this case because AB 51 "applies only in the absence of an agreement to arbitrate."[11] According to the Ninth Circuit, the *Kindred Nursing* holding rested on the fact that the law at issue "rendered an executed agreement to arbitrate invalid or unenforceable" and did not regulate "pre-agreement" behavior.[12]

Given the obvious impact AB 51 will have on future employment agreements in California, this interpretation seemingly deviates from *Lamps Plus, Inc.* v. *Valera*, 139 S. Ct. 1407 (2019), in which the Supreme Court rejected arguments that the FAA does not preempt neutral rules that treat arbitration agreements and contracts similarly, finding that even "a neutral rule that gives equal treatment to arbitration agreements and other contracts alike. . . . cannot save from preemption general rules 'that target arbitration either by name or by more subtle methods, such as by interfer[ing] with fundamental attributes of arbitration.'"[13]

This reasoning led the Ninth Circuit to conclude that the FAA does preempt AB 51 to the extent it seeks to impose civil and criminal sanctions on employers who successfully execute arbitration agreements governed by the FAA because they regulate post-agreement employer behavior as opposed to "pre-agreement employer behavior."[14]

The Ninth Circuit's opinion therefore allows California to restrict mandatory arbitration agreements between employers and employees, but in the circumstances where an employer and employee nevertheless enter into such an agreement, it enjoins California from enforcing a violation of such restrictions through civil or criminal sanctions.

IMPLICATIONS

The Ninth Circuit's holding that AB 51's restrictions are valid but cannot be enforced if an unlawful agreement is entered into has puzzling practical implications, which were the subject of a dissenting opinion by Judge Sandra S. Ikuta. As Judge Ikuta explained: the "holding means that an employer's attempt to enter into an arbitration agreement with employees is unlawful, but a completed attempt is lawful," and is similar to "a statute that can make it unlawful for a dealer to attempt to sell illegal drugs, but if that dealer succeeds in completing the drug transaction, the dealer cannot be prosecuted."[15]

The Ninth Circuit's decision will not, however, immediately take effect. The injunction will remain in place until the Ninth Circuit issues its mandate and the case is remanded back to the District Court to make factual findings and decide the case on the merits. If Plaintiffs file a petition for rehearing or rehearing en banc, the mandate will automatically be stayed pending a decision on the petition. In addition, should Plaintiffs decide to file a petition for certiorari with the U.S. Supreme Court, which appears likely given the circuit split and narrow interpretation of the Supreme Court's holding in *Kindred Nursing*, Plaintiffs will likely move to stay the issuance of the mandate pending the Supreme Court's review. For now, employers should monitor future developments and not consider the issue settled.

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ENDNOTES

1 Cal. Labor Code § 433.

2 *AT&T Mobility LLC* v. *Concepcion*, 563 U.S. 333, 345 (2011).

3 *U.S. Chamber of Commerce.* v. *Becerra*, 438 F.Supp.3d 1078 (E.D. Cal. 2020) (order granting preliminary injunction enjoining AB 51).

4 *U.S. Chamber of Commerce* v. *Bonta*, 2021 WL 4187860, at *6 (9th Cir. Sept. 15, 2021).

5 *Id.* at *4–5 (concluding that conflict preemption is the relevant type of preemption for analysis).

6 *Id.* at *6.

7 *Id.* at *6–7.

8 *Id.* at *8–9.

9 *See id.* at *10 (quoting *Kindred Nursing Ctrs. Ltd. P'ship* v. *Clark*, 137 S. Ct. 1421, 1428 (2017)).

10 *Kindred Nursing*, 137 S. Ct. at 1426 (citing *AT&T Mobility Corp.* v. *Concepcion*, 563 U.S. 333, 341 (2011)).

11 *See U.S. Chamber of Commerce*, 2021 WL 4187860, at *10.

12 *See id.* at *7.

13 *Lamps Plus, Inc.* v. *Valera*, 139 S. Ct. 1407, 1418 (2019) (alteration in original) (quoting *Epic Sys. Corp.* v. *Lewis*, 138 S. Ct. 1612, 1622 (2018)).

14 *See U.S. Chamber of Commerce*, 2021 WL 4187860, at *10.

15 *Id.* at *19 (Ikuta, J., dissenting).

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