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Appellate Ruling Clouds California's Ban on Mandatory Arbitration Clauses in Employment

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Employers in California may not condition employment on entering into an arbitration agreement, but at the moment, it appears they may continue to enforce such agreements. The situation is muddled as a result of a federal appellate court ruling blocking a 2019 California law that made it illegal for an employer to condition employment or "any employment-related benefit" on entering into an arbitration agreement. On September 15, 2021, the Ninth Circuit Court of Appeals, which reviews the decisions of federal district courts in the nine westernmost states, including California, vacated a district court injunction blocking the 2019 law, known as Assembly Bill (AB) 51. The U.S. Chamber of Commerce, in concert with six other business groups, filed the suit shortly before it was set to take effect on January 1, 2020 seeking to have the law struck down on the grounds that it is preempted by the Federal Arbitration Act (FAA). The district court entered a temporary restraining order on December 30, 2019, and later a preliminary injunction on February 7, 2020, blocking the law from taking effect. The state then appealed.

The Ninth Circuit's decision partially vacating Judge Mueller's injunction restores the ban on mandatory arbitration agreements in employment, but continues to block the civil and criminal penalties

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against employers who obtain arbitration agreements in violation of the law. This creates an odd paradox. Even though AB 51 makes mandatory employment arbitration agreements illegal again, by its terms, AB 51 does not void existing arbitration agreements, and the court's decision to strike down the civil and criminal penalties appears to defang the law entirely. Unfortunately for employers, the answers for how to proceed with arbitration agreements is clear as mud.

AB 51 Is Not Preempted Because It Does Not *Invalidate* Arbitration Agreements

California has a long history of trying to limit, if not outright ban, employment arbitration that has contributed to much of the recent federal jurisprudence on arbitration. With that collected knowledge, the California Legislature carefully crafted AB 51 to survive an FAA preemption challenge. Accordingly, Labor Code section 432.6(f) provides that "[n]othing in this section is intended to *invalidate* a written arbitration agreement that is otherwise enforceable under the Federal Arbitration Act." This carve-out was an intentional dodge by the legislature; in trying to avoid preemption, the legislature only made *conditioning employment on arbitration* illegal, but it did not invalidate arbitration agreements that already were executed.

So essentially, AB 51 tries to ban arbitration by making it illegal to offer arbitration as a condition of employment. The U.S. Chamber argued in the district court that, in so doing, California placed arbitration agreements on "unequal footing" with other contracts, in violation of the FAA. The district court agreed, explaining that "[i]n its expressed purpose, and its operation, AB 51 singles out the requirement of entering into arbitration agreements and thus subjects these kind of agreements to unequal treatment."

The Ninth Circuit disagreed, finding no conflict between AB 51 and the FAA because AB 51's "effects

are aimed entirely at conduct that takes place prior to the existence of any such agreement." In reaching this conclusion, the court explained its view that "[p]lacing a pre-agreement condition on the waiver of 'any right, forum, or procedure' does not undermine the validity or enforceability of an arbitration agreement."

Where, then, does this "illegal, but enforceable" status leave employers with mandatory arbitration programs? In its final form, AB 51 included criminal penalties of up to six months in jail, a $1,000 fine, or both against any person proffering a mandatory arbitration agreement, and civil enforcement measures through a private right of action for employees presented with mandatory arbitration agreements and enforcement action by the Department of Fair Employment and Housing. The district court enjoined enforcement of those penalties.

The Ninth Circuit affirmed and let stand the injunction of the civil and criminal enforcement measures "to the extent that they apply to executed arbitration agreements covered by the FAA." This outcome leads to a second odd paradox. By limiting the injunction to *executed* arbitration agreements, the court left open the possibility for civil and criminal enforcement provisions where a mandatory arbitration agreement is not executed, presumably because the employee was able to reject it. The dissent noted this counterintuitive result, commenting that "the majority holds that if the employer successfully 'forced' employees 'into arbitration against their will,'... the employer is safe, but if the employer's efforts fail, the employer is a criminal."

The Dissent Predicts A Future Showdown

In dissent, Circuit Judge Sandra Ikuta noted that "the Supreme Court has made it clear that the FAA preempts this type of workaround, which is but the latest of the 'great variety of devices and formulas'

disfavoring arbitration." Discussing recent Supreme Court guidance, Judge Ikuta concluded that "a state cannot single out arbitration agreements by imposing special limiting rules at the formation stage." Further, the dissent observed that the majority's decision creates a split among federal appellate courts. Specifically, the First Circuit previously invalidated a Massachusetts regulation prohibiting securities forms from requiring customers to enter into arbitration agreements, and the Fourth Circuit invalidated a Virginia law that required car manufacturers to include a term effectively barring arbitration clauses. The apparent tension between the court's ruling on AB 51 and these other federal appellate court decisions means that the fight over AB 51 is probably not over. It is possible that the Ninth Circuit will agree to rehear the case before a larger "en banc" panel of the court, or the U.S. Supreme Court may agree to review the decision. It is very likely that the panel's decision will not be the last word on AB 51.

What Does This Mean For Employment Arbitration In California?

The Ninth Circuit's decision adds more confusion than clarity for employers with employment arbitration agreements in California. What is clear, however, is that arbitration agreements subject to the FAA remain enforceable according to their terms, even if entered after January 1, 2020. Employers who are sued by employees with existing arbitration agreements may still enforce those agreements and seek to compel arbitration. Thus, employers should avoid making changes to existing arbitration agreements or taking any actions that could invalidate them.

It is unclear, however, what, if any, consequences employers risk by continuing to present mandatory arbitration agreements to employees. With the civil and criminal penalties at least partially enjoined, it is unclear whether the state or individual employees would have any course of action against an employer

who obtained arbitration agreements in violation of AB 51. But the decision leaves a large degree of uncertainty as to what would happen if employees are not forced into arbitration, but instead *decline* to accept the arbitration agreement, because the Court's decision leaves open the possibility that the civil and criminal sanctions could be imposed if the employer's conduct does not result in an executed arbitration agreement. In the meantime, employers must continue not to threaten, retaliate, or discriminate against any employee who may refuse to enter into an arbitration agreement.

It also leaves open whether an employer can ever enter a *voluntary* arbitration agreement with an employee, and, if so, what the employer would need to show to prove the agreement was voluntary and mutually consensual. The court's decision did not discuss two key aspects of AB 51 that bear on whether an arbitration agreement is truly mandatory. First, Labor Code section 432.6(a) not only prevents and employer from conditioning employment on arbitration, but also prohibits offering "any employment-related benefit" in exchange for an arbitration agreement. Because every contract must be supported by consideration, and every benefit offered by an employer to an employee is by its nature related to employment, it is hard to picture a pre-dispute arbitration agreement that could be voluntary and enforceable and also compliant with AB 51. Second, Labor Code section 432.6(c) provides that "an agreement that requires an employee to opt out of a waiver or take any affirmative action in order to preserve their rights is deemed a condition of employment." This makes an agreement where an employee can choose to opt out of arbitration – the standard form of *voluntary* employment arbitration agreements – into a mandatory agreement as a matter of law. Due to these sections, it appears very unlikely that an employer could ever enter into a pre-dispute arbitration agreement with an employee during employment without substantial risk.

Of course, down the road the viability of employment arbitration in California may well be determined at the U.S. Supreme Court. For now, it is a rocky and uncertain road for employers wishing to enter employment arbitration agreements in California. If you need help navigating these difficult issues, reach out to your Akerman labor and employment lawyer.
