BARNES & THORNBURG LLP

Rare Victory For California Employers: Ninth Circuit Says State Arbitration Law Preempted By Federal Law

February 16, 2023 | Labor Agreements,State Labor Laws,Labor And Employment

Mark Wallin
Partner

Michael Witczak
Associate

California employers that utilize arbitration agreements can breathe a sigh of relief, for now, because the U.S. Court of Appeals for the Ninth Circuit has finally ruled that a California arbitration law is preempted by the Federal Arbitration Act (FAA). The law, AB 51, prohibits California employers from requiring employees to agree to arbitrate their claims as a condition of employment and imposes criminal penalties for violation of the act. This, according to the Ninth Circuit's ruling in *Chamber of Commerce of the United States of America et al. v. Rob Bonta et al*, creates too great an obstacle to arbitration, and the California law is thus preempted by the FAA.

AB 51, which was enacted in 2019 and effective Jan. 1, 2020, prohibits California employers from requiring employees to "waive any right, forum, or procedure" for a violation of certain state laws, as a condition of employment, continued employment, or employment related benefit. AB 51 further states that any person violating the act is guilty of a misdemeanor. Yet, to avoid preemption by the FAA, the legislature included a provision that ensured if an arbitration agreement was entered into – even illegally under AB 51 – it would still be enforceable. By maintaining the enforceability of arbitration agreements, according to legislative history, the legislature hoped to avoid preemption and end "forced arbitration" as a condition of employment.

Shortly before AB 51 became effective, business groups challenged the law and a federal District Court entered a preliminary injunction on preemption

RELATED PRACTICE AREAS

Employment Litigation
Labor Relations

RELATED TOPICS

Arbitration
California Employers
California Law

grounds. The state appealed, and, in 2021, a divided panel of the Ninth Circuit reversed the District Court, in part, finding that while the criminal penalties were preempted, the remainder of the law was not.

Nearly a year later, in September 2022, the Ninth Circuit panel, sua sponte, issued an order stating it would reexamine its 2021 decision. Now, in February 2023, another divided panel of the Ninth Circuit has ruled that AB 51 is preempted by the FAA in its entirety.

The majority held that AB 51 "discriminates" against arbitration because it inhibits a party's willingness to enter into an arbitration agreement – even though it does not directly refer to arbitration. Despite the lack of express reference, AB 51 still disfavors the formation of agreements that have the essential terms of arbitration agreements. The majority relied largely on the aspects of AB 51 that imposed criminal penalties on employers, which the court found would inhibit an employer from entering into arbitration agreements.

According to the court, "AB 51's deterrence of an employer's willingness to enter into an arbitration agreement is antithetical to the FAA's liberal federal policy favoring arbitration agreements."

The lengthy dissenting opinion relied largely on the notion that AB 51 merely prohibited contracts of adhesion, where the employee, as a practical matter, is not voluntarily consenting to the agreement. The dissent notes in closing that at the end of the 20th century, approximately 2 percent of nonunion employers utilized arbitration agreements; by 2018, the number had reached 56 percent. In the face of these statistics, the dissent cautions against the diminished role of courts in adjudicating employment disputes, stating that such role will "freeze" the evolution of precedent.

The Ninth Circuit's belated determination to uphold the preliminary injunction and find the FAA preempts AB 51 will undoubtedly be accepted as good news by most California employers. However, whether this is the end of the AB 51 saga remains to be seen. The state may well seek en banc review by the Ninth Circuit, or petition the U.S. Supreme Court for certiorari. Until then, however, employers in the Golden State may continue to utilize and implement arbitration agreements as a condition of employment or continued employment.