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California's Proposed Ban on Mandatory Arbitration Agreements as a Condition of Employment

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CALIFORNIA'S PROPOSED BAN ON MANDATORY ARBITRATION AGREEMENTS AS A CONDITION OF EMPLOYMENT

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California is casting uncertainty on the employer's ability to implement mandatory arbitration agreements on employees.[1] In October 2019, Governor Newson signed Assembly Bill No. 51,[2] which would apply to employment contracts entered, modified, or extended on or after January 1, 2020.[3] This bill created Labor Code Section 432.6, banning mandatory arbitration agreements as a condition of employment in California.[4] This would work around the Federal Arbitration Act, which requires courts to enforce arbitration agreements, preempting the state laws that stood in its way.[5] Critics argue that the process favors employers and discourages prospective employees from bringing legal claims.[6] On the other hand, proponents of the FAA have said it provides an efficient and cheaper alternative, benefiting both workers and employers.[7] The Eastern District Court issued a restraining order,[8] and preliminary injunction, finding it violated the FAA.[9]

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[1] Beth Graham, *California Bans Mandatory Arbitration Agreements as a Condition of Employment*, ADR TOOLBOX (Nov. 19, 2019) http://www.adrtoolbox.com/2019/11/california-bans-mandatory-arbitration-agreements-as-a-condition-of-employment/ [https://perma.cc/M5ZM-JLRQ].

[2] Cal. Ass. Bill No. 51.

[3] Spencer C. Skeen ET AL., *Ninth Circuit Blocks California's Ban on Mandatory Arbitration in Employment*, OGLETREE DEAKINS (Feb. 16, 2023) https://ogletree.com/insights/ninth-circuit-blocks-californias-ban-on-mandatory-arbitration-in-employment/ [https://perma.cc/6GWK-UMLP].

[4] Cal. Lab. Code § 432.6.; *Id.*

[5] *See, e.g.,* Concepcion, 563 U.S. at 352 (holding the FAA preempted a California rule finding contract provisions disallowing classwide arbitration are unconscionable); Preston v. Ferrer, 552 U.S. 346, 349–50 (2008) (holding the FAA preempted a California law giving a state agency primary jurisdiction over a dispute involving the California Talent Agency Act despite the parties' agreement to arbitrate such disputes); Perry v. Thomas, 482 U.S. 483, 484, 491 (1987) (holding the FAA preempted a statute permitting collection actions, despite a valid arbitration agreement).

[6] Brendan Pierson, *Appeals court blocks California ban on mandatory arbitration for workers*, REUTERS (Feb. 15, 2023, 5:05 PM EST) https://www.reuters.com/legal/appeals-court-blocks-california-bar-mandatory-arbitration-workers-2023-02-15/ [https://perma.cc/R89F-NVWR].

[7] *Id.*

[8] Jack S. Sholkoff, et al., *Ninth Circuit Upholds Portions of California Law Prohibiting Use of Mandatory Arbitration Agreements*, OGLETREE DEAKINS (Sep. 16, 2021) https://ogletree.com/insights/ninth-circuit-upholds-portions-of-california-law-prohibiting-use-of-mandatory-arbitration-agreements/ [https://perma.cc/NH64-JSMC].

[9] *Id.*; 9 U.S.C.A. § 2.

The court upheld the bill.[10] The court reasoned that the FAA protects enforcement of arbitration agreements but not involuntary and mandatory arbitrate agreements.[11] Previously signed agreements may not be invalidated by the bill.[12] Instead, Section 432.6 focuses on "pre-agreement" conduct, which is not subject to FAA law.[13] Additionally, the bill regulates "employer conduct," not agreement formations, and therefore does not conflict with the FAA.[14] The outcome is that mandatory arbitration agreements are banned yet enforceable.[15]

August 2022 brought Judge Fletcher to withdraw his majority decision and join Judge Ikuta in voting to withdraw the opinion and rehear the case.[16] Ikuta argued that the FAA prohibits states from enacting laws that burden the formation and enforcement of arbitration agreements.[17] Therefore, they reasoned that Section 432.6 violates the FAA.[18]

February 15, 2023, brought an the end of this saga. Ikuta, joined by Fletcher, upheld the FAA preemption over Section 432.6 because the law discourages the formation of arbitration agreements.[19] The argument that the FAA only required enforcement of arbitration agreements and not the pre-agreement conduct fell flat when it was ruled that policies impeding a party's ability to form arbitration agreements hinder the broad national policy favoring arbitration.[20] The Ninth Circuit found that the FAA preempts state law if it interferes with the fundamental attributes

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[10] Chamber of Commerce of the United States v. Bonta, 2023 U.S. App. LEXIS 3586.
[11] *Id.*
[12] *Id.*
[13] *Id.*; *Supra* note 4.; Sholkoff, *supra* note 8.; *Supra* note 9.
[14] Laura Devane ET AL., *Ninth Circuit Eliminates Obstacles to Enforcement of Employment Arbitration Agreements in California*, LITTLER (Feb. 17, 2023) https://www.littler.com/publication-press/publication/ninth-circuit-eliminates-obstacles-enforcement-employment-arbitration [https://perma.cc/3BY4-UHJV].; *Supra* note 4.
[15] Spencer C. Skeen & Zachary V. Zagger, *Ninth Circuit Panel to Reconsider Decision Upholding California Mandatory Arbitration Ban*, OGLETREE DEAKINS (Aug. 26, 2022) https://ogletree.com/insights/ninth-circuit-panel-to-reconsider-decision-upholding-california-mandatory-arbitration-ban/ [https://perma.cc/9SMJ-K5C3].
[16] Skeen, *supra* note 3.
[17] *Id.*
[18] *Id.*
[19] Chamber of Commerce v. Bonta, *supra* note 10.
[20] Skeen, *supra* note 3.

of arbitration" or has a "disproportionate impact on arbitration.[21] If a state law interferes with arbitration on its face or covertly, such a rule cannot stand in harmony with the purposes of the FAA.[22] Because the FAA's purpose is to encourage arbitration, and Section 432.6 is an obstacle to that purpose, (AB)-51 is preempted.[23] The 9th Circuit joined the 1st Circuit and the 4th Circuit in finding that "the FAA preempts a state rule that discriminates against arbitration by discouraging or prohibiting the formation of an arbitration agreement."[24]

Additionally, the appeals court declined to sever certain parts and upheld others[25] because all of (AB)-51's provisions work together, and it, therefore, still impedes the ability of employers to enter into arbitration agreements.[26] Although the reimposed preliminary injunction only temporarily blocks the law, this ruling signals that the final outcome does not appear hopeful for (AB)-51.[27]

The main takeaway is that the Federal Courts still favor arbitration and will strike down state laws that discriminate against arbitration.[28] Courts will protect arbitration at all costs.[29]

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[21] Devane, *supra* note 14.
[22] *Id.*
[23] Michael W. McTigue Jr. ET AL, *Ninth Circuit Blocks California's Ban on Mandatory Arbitration Agreements*, SKADDEN (Feb. 16, 2023), https://www.skadden.com/insights/publications/2023/02/ninth-circuit-blocks-californias-ban-on-mandatory-arbitration-agreements [https://perma.cc/DXW2-CT8Z].
[24] Anet Drapalski ET AL, *Federal Appeals Court Blocks California's Ban on Mandatory Arbitration Agreements: 7 Key Takeaways for Employers*, FISHER PHILIPS (Feb. 16, 2023) https://www.fisherphillips.com/news-insights/federal-appeals-court-blocks-californias-ban-mandatory-arbitration-agreements.html [https://perma.cc/4XGF-8KJS].
[25] *Id.*
[26] Devane, *supra* note 14.
[27] Drapalski, *supra* note 24.
[28] *Id.*
[29] *Id.*