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What Forced Arbitration Ruling Means For Calif. Employers

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On Wednesday, in a surprising turn, the U.S. Court of Appeals for the Ninth Circuit reversed in part a 2020 preliminary injunction issued by a district court and resurrected California Labor Code Section 432.6, the Golden State's latest attempt to outlaw arbitration in the employment context.[1]

As a result, employers in California once again face the very real prospect of incurring criminal and civil penalties for simply requesting that employees and applicants agree to arbitrate future disputes.

In a 2-1 ruling, the Ninth Circuit held in Chamber of Commerce of the U.S. v. Bonta that at least part of Section 432.6 is not preempted by the Federal Arbitration Act insofar as it prohibits "pre-agreement employer behavior" requiring an applicant or employee to enter into an arbitration agreement — but only in those instances in which the employee fails or refuses to execute the agreement.

If, however, the employee does sign the arbitration agreement, then the statute does not apply per Section 432.6(f),[2] and the employer is not in violation of the statute or subject to its criminal and civil penalties, which the Ninth Circuit struck down in that limited context.

The full implications of this new ruling are yet to be determined, but there are definitely some immediate takeaways:

Timing

The statute only applies to arbitration agreements that were entered into, modified or extended on or after Jan. 1, 2020.[3]

Therefore, if an employer secured executed and enforceable arbitration agreements before Jan. 1, 2020, those agreements presumably remain fully enforceable.

Execution

The opinion greenlights arbitration agreements that were entered into, modified or extended at any time (including on or after Jan. 1, 2020) if the agreement was actually executed by the employee or applicant.

So, even if the employer required an applicant or employee to waive his or her right to file an action in court and to agree to arbitrate disputes, the employer is not subject to the statute's criminal or civil penalties if the applicant or employee actually signed the agreement.

Liability

The greatest risk and uncertainty created by the Ninth Circuit's opinion arises for those employers that henceforth seek to have employees or applicants sign arbitration agreements.

If the employee or applicant fails or refuses to sign the arbitration agreement, then the employer could be liable for the criminal and civil penalties. On the other hand, if the agreement is signed, then the employer is not subject to liability.

This will clearly be the most insidious result of the Ninth Circuit's opinion because it will no doubt chill — actually, put in deep freeze — all current and future efforts of California employers to present arbitration agreements to their applicants and employees, which presumably was the intent of the law all along.

Assembly Bill 51

California Gov. Gavin Newsom signed into law A.B. 51, of which Section 432.6 is a part, on Oct. 10, 2019.

The statute was scheduled to take effect on Jan. 1, 2020. On Dec. 30, 2019, Chief U.S. District Judge Kimberly J. Mueller of the U.S. District Court for the Eastern District of California granted a temporary restraining order barring the statute from going into effect, and then granted a preliminary injunction on Jan. 31, 2020.

A.B. 51 is the latest in a long line of California statutes that has sought to limit or prohibit arbitration agreements in various contexts, especially employment.

However, the prior attempts to outlaw arbitration in California were either struck down by the U.S. Supreme Court or vetoed by Newsom's predecessor, former Gov. Jerry Brown, on the ground that those statutes were plainly preempted by the FAA.[4]

In an effort to avoid the inevitable FAA preemption challenge, A.B. 51 uses a different approach — really a "legislative gimmick," according to U.S. Circuit Judge Sandra Ikuta's dissent.

Instead of barring arbitration agreements outright, which would surely fall before the FAA, it prohibits an employer from forming or attempting to form such agreements and, therefore, technically only regulates the formation of arbitration agreements, while expressly permitting their enforcement once formed.

The Ninth Circuit Ruling

The majority of the Ninth Circuit panel adopted a bifurcated approach in reviewing the statute.

The court first noted that the statute expressly does not invalidate an arbitration agreement that is otherwise enforceable under the FAA.[5] Because of that carveout, the court concluded the statute cannot be used as a basis to "invalidate, revoke, or fail to enforce an arbitration agreement."

Rather, the court held, quoting the statute, that by

> [p]lacing a pre-agreement condition on the waiver of "any right, forum, or procedure" [it] does not undermine the validity or enforceability of an arbitration agreement — its effects are aimed entirely at conduct that takes place prior to the existence of any such agreement.

California Labor Code Section 433 makes any violation of Section 432.6 a misdemeanor offense punishable by imprisonment in a county jail for a period not exceeding six months, or by a fine not exceeding $1,000, or both.

In addition, A.B. 51 added Section 12953 to the California Government Code, which makes a violation of Section 432.6 an "unlawful employment practice," which in turn subjects an individual or entity that violates it to civil sanctions, including state investigation and private litigation.

The Ninth Circuit affirmed the district court's injunction insofar as it struck down the civil and criminal penalties that attach when an employer succeeds in having applicants or employees sign an arbitration agreement: "An arbitration agreement cannot simultaneously be 'valid' under federal law and grounds for a criminal conviction under state law."

However, in those instances in which the employee or applicant does not sign the arbitration agreement, the employer presumably can be subject to both criminal and civil penalties because, according to the court, the FAA does not regulate such pre-agreement activity.

In a spirited dissenting opinion, Judge Ikuta labeled the California Legislature's naked attempt to duck FAA preemption as a "too-clever-by-half workaround," which criminalizes contract formation if it includes an arbitration provision, while expressly recognizing as legal and enforceable an arbitration agreement once executed.

According to Judge Ikuta, the practical effect of the majority's novel holding is as follows:

> [I]f the employer offers an arbitration agreement to the prospective employee as a condition of employment, and the prospective employee executes the agreement, the employer may not be held civilly or criminally liable. But if the prospective employee refuses to sign, then the FAA does not preempt civil and criminal liability for the employer under AB 51's provisions. In other words, 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.

Judge Ikuta went on to observe that the majority's "tortuous ruling is analogous to holding that a statute can make it unlawful for a dealer to attempt to sell illegal drugs, but if the dealer succeeds in completing the drug transaction, the dealer cannot be prosecuted."

The dissent further noted that the majority opinion conflicts with the Supreme Court's 2017 opinion in Kindred Nursing Centers Limited Partnership v. Clark[6] because the statute has a "disproportionate impact on arbitration" and, in fact, is "the poster child for covertly discriminating against arbitration agreements."

Further, the majority has created an unacknowledged and silent circuit split with the U.S. Courts of Appeals for the First and Fourth Circuits.[7]

Whether A.B. 51 is ultimately upheld or struck down by the Ninth Circuit sitting en banc or the U.S. Supreme Court, it is already having a chilling effect on employers who do business in California, because they run the risk of incurring civil and criminal penalties if they continue to provide arbitration agreements to applicants or employees.

Under the peculiar reasoning of the Ninth Circuit in the Chamber of Commerce case, an employer simply won't know whether it is subject to such penalties until the employee or applicant signs — or doesn't sign — the agreement.

Those employers who succeed in having the employee sign the arbitration agreement can avoid the penalties of the statute; those who fail face a far more uncertain fate, including potentially doing time in the county jail.

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[1] Chamber of Commerce v. Bonta , 2021 WL 4187860 (9th Cir. Sept. 15, 2021).

[2] "Nothing in this section is intended to invalidate a written arbitration agreement that is otherwise enforceable under the Federal Arbitration Act (9 U.S.C. Sec. 1 et seq.)."

[3] Section 432.6(h).

[4] See dissenting opinion of Judge Sandra S. Ikuta at pp. 32-33 & n.1.

[5] (Section 432.6(f)).

[6] Kindred Nursing Ctrs. Ltd. P'ship v. Clark , 137 S. Ct. 1421 (2017).

[7] Securities Ind. Ass'n v. Connolly , 883 F.2d 1114 (1st Cir. 1989) and Saturn Distrib. Corp. v. Williams , 905 F.2d 719 (4th Cir. 1990) (both invalidating state statutes that "attempted to sidestep the FAA while disfavoring arbitration").

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- **Anthony J. Oncidi**
  Partner