Buchalter
CLIENT ALERT

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California's AB 51, Which Sought to Ban Mandatory Arbitration Agreements, Is Preempted by the Federal Arbitration Act

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Once again, California employers can require workers to sign arbitration agreements as a condition of employment.

Following the U.S. Supreme Court's decision in *Viking River Cruises v. Moriana* and in a reversal of its own prior decision, a divided three-judge Ninth Circuit panel found that AB 51 is preempted by federal law. *Chamber of Commerce of the U.S., et al. v. Bonta, et al.*, No. 20-15291 (9th Cir. Feb. 15, 2023).

Iskanian v. CLS Transp. Los Angeles, LLC, 59 Cal. 4th 348 (2014)

In 2014, the California Supreme Court ruled that class action waivers were permissible under the Federal Arbitration Act ("FAA"), and that the FAA preempted state laws to the contrary. While this was welcomed news to California employers, the Court also held that arbitration agreements could not require employees to waive their right to bring representative actions under California's Labor Code Private Attorneys General Act of 2004 ("PAGA").

AB 51

In 2019, California enacted AB 51, which prohibited employers from requiring employees to sign arbitration agreements as a condition of their employment, and applied to agreements entered into or modified on or after January 1, 2020. It applies to disputes arising under the California Fair Employment and Housing Act and under the Labor Code. AB 51 imposed civil penalties and also made it a misdemeanor for employers to violate this restriction. (Buchalter's Client Alert about AB 51 can be found here.)

Following its enactment, a California federal district court enjoined the enforcement of AB 51, which the State of California soon appealed to the Ninth Circuit. In 2021, a divided Ninth Circuit panel held that the FAA did not completely preempt AB 51. When the U.S. Chamber of Commerce sought review of this decision, the Ninth Circuit deferred waiting for the U.S. Supreme Court's decision in *Viking River Cruises v. Moriana.*

Viking River v. Moriana

On June 15, 2022, the U.S. Supreme Court held that the FAA preempted the rule of California law found in *Iskanian* that invalidated contractual waivers of the right to assert representative claims under PAGA. However, the Supreme Court upheld the validity of California's prohibition on agreements that waive an employee's right to bring claims on behalf of the state. It further held that the an employee bringing a PAGA suit who had previously signed an arbitration agreement waiving the right to bring representative claims, lacked standing to maintain their non-individual claims in court and that said claims should be dismissed. (Buchalter's Client Alert about the *Viking River* decision can be found here.)

Following *Viking River*, employers could implement arbitration programs requiring employees to arbitrate their individual claims, including their individual PAGA claims, and in turn, preclude the employee from suing on behalf of other aggrieved employees. While this provided a powerful tool to limit an employer's PAGA exposure, employers remained unable to require employees to enter into new or modified arbitration agreements that contained these new provisions. In other words, employers were not able to take full advantage of impact of the *Viking River* decision.

That is, until now…

Chamber of Commerce of the U.S., et al. v. Bonta, et al.

On February 15, 2023, the Ninth Circuit affirmed the preliminary injunction and ruled that AB 51, like *Iskanian*, is preempted by the FAA. In sum, the Ninth Circuit ruled that the FAA preempts a state rule (*i.e.*, AB 51) that discriminates against arbitration by discouraging or prohibiting the formation of an arbitration agreement. *See Chamber of Commerce of the U.S., et. al. v. Bonta, et. al.,* No.-15291, Slip. Op. at 23 (9th Cir. 2023); citing *Saturn Distrib. Corp. v. Williams*, 905 F.2d 719, 723 (4th Cir. 1990); *Sec. Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1123–24 (1st Cir. 1989). The Ninth Circuit reasoned that "AB 51's penalty-based scheme to inhibit arbitration agreements before they are formed violates the equal protection principal inherent in the FAA." *See Chamber of Commerce of the U.S.,* No.-15291, Slip. Op. at 4.

The majority recognized that California enacted AB 51 to protect employees from "forced arbitration," but that the law only criminalizes contract formation. It found that an arbitration agreement executed in violation of AB 51 is still enforceable, the opinion states.

It further recognized that while AB 51 does not expressly prohibit arbitration agreements, it clearly disfavors them by imposing criminal penalties against employers who sought to create arbitration agreements with non-negotiable terms requiring employees to waive certain rights, including the right to sue. For that reason, the majority found that AB 51 was preempted by the FAA:

> 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." [Citations.] Therefore, AB 51's penalty-based scheme to inhibit arbitration agreements before they are formed violates the "equal-treatment principle" inherent in the FAA … and is the

> type of "device[]" or "formula[]" evincing "hostility towards arbitration" that the FAA was enacted to overcome [Citation]. Because the FAA's purpose is to further Congress's policy of encouraging arbitration, and AB 51 stands as an obstacle to that purpose, AB 51 is therefore preempted.

Indeed, as the Ninth Circuit explained, one of Congress's primary purposes in enacting the FAA intended to combat a hostility towards arbitration. *See Chamber of Commerce of the U.S.,* No.-15291, Slip. Op. at 4; citing *AT&T Mobility LLC v. Concepcion,* 563 U.S. 333, 342 (2011). Even the lone dissenting Judge agreed that the imposition of civil and criminal sanctions for the act of executing an arbitration agreement conflicts with the FAA, and that those sections of AB 51 should be severed from AB 51's other provisions.

The full text of the decision in *Chamber of Commerce of the U.S., et al. v. Bonta, et al.* can be found here.

While this decision only temporarily blocks the enforcement of AB 51, and California's Attorney General's office has stated that it is "assessing" next steps in light of the ruling, it is unlikely that AB 51 will be enforced to its full extend in the future. The California Attorney General's Office must now decide whether to pursue an appeal with the U.S. Supreme Court. Buchalter attorneys will monitor the appellate process and continue to provide timely updates.

Presently, while this decision is good news for California employers, there have been many changes to the arbitration agreement landscape in prior years. Therefore, it is always best to consult with an employment attorney to ensure that your agreement is up-to-date. Should you have any questions about how law may impact your company, please reach out to any of the attorneys in Buchalter's Labor & Employment Practice Group.

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