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Labor & Employment Alert

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Ninth Circuit holds California's attempted ban of mandatory arbitration preempted by the FAA

By Philip Lamborn & Robert H. Pepple

Chamber of Commerce v. Bonta (Bonta II) is welcome news for employers who wish to enter into arbitration agreements with their employees.

What's the Impact?

- California employers can now require their workers to sign arbitration agreements as a condition of employment.
- California could attempt to keep AB 51 alive by requesting the full Ninth Circuit or the U.S. Supreme Court to review the decision.

In 2019 the California Legislature passed Assembly Bill 51 (AB 51), which prohibited employers from requiring employees to sign arbitration agreements as a condition of employment. But last week, a Ninth Circuit panel determined that AB 51 failed to comply with the Federal Arbitration Act (FAA) mandate that arbitration agreements be treated equally with other contracts, opening the door for employers to require employees to sign arbitration agreements. Here's what happened:

Procedural history of AB 51 and first Ninth Circuit opinion (Bonta I)

On December 9, 2019, a collection of trade associations and business groups (collectively, the Chamber of Commerce) sued for declaratory relief and a permanent injunction prohibiting California officials from enforcing AB 51, and a temporary restraining order, due to FAA preemption. The district court granted the motion for a temporary restraining order and granted the motion for a preliminary injunction. California appealed both rulings.

In September 2021, the Ninth Circuit upheld the crux of the law (i.e., prohibition on mandatory arbitration agreements), but struck down the correlative (misdemeanor) criminal penalties for the same conduct.

AB 51 specifically prohibited employers from *the attempt to obtain* a mandatory arbitration because a direct assault on arbitration agreements would have been dead on arrival due to federal preemption by the FAA. The California Legislature was open about their attempt to "successfully navigate[] around" United States Supreme Court FAA preemption precedent by regulating the attempt to enter into arbitration agreements, rather than the arbitration agreements themselves.

The strange consequence was that if an employer successfully obtained such an agreement, it was enforceable under the FAA (see Cal. Lab. Code § 432.6(f)), but if that attempt failed, the employer was in violation of the law. As explained in the vigorous dissent by Judge Ikuta in *Bonta (I)*:

> This 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. Needless to say, such a bizarre approach does not apply to any other contracts in California. As such, it is preempted by the FAA for disfavoring arbitration contracts and obstructing the purpose and objectives of the FAA.

The decision was short-lived, however, as the Ninth Circuit withdrew it in the wake of the United Stated Supreme Court decision in *Viking River Cruises v. Moriana*.

The second Ninth Circuit opinion (Bonta II)

On February 15, 2023, a three-judge panel for the Ninth Circuit Court of Appeals found that AB 51 sufficiently interfered with the objectives of the FAA to be preempted by it. In a straight-forward opinion, the Ninth Circuit reasoned that AB 51's criminal and civil penalties "would seem to have the intended effect of deterring formation of arbitration agreements," which runs afoul of the FAA's mandate that arbitration agreements be placed on "equal footing with all other contracts."

Bonta II is welcome news for California employers who face one of the most litigious climates in the country, especially with respect to wage and hour class actions. Employers may again require employees, as a condition of employment, to enter into arbitration agreements which can include class and representative action waivers. Such provisions can require employees to adjudicate disputes individually in arbitration and not on a class, collective, or representative

basis (though PAGA representative action waivers are under threat in the pendency of the much-anticipated decision of the California Supreme Court decision in *Adolf v. Uber*).

What employers should do

The State of California may request a rehearing in front of the full Ninth Circuit, or it may appeal the ruling to the United States Supreme Court. However, the Supreme Court has a long history of upholding decisions like *Bonta II* (i.e., decisions that underscore the strength of the FAA's preemption doctrine and strike down state laws that interfere with the FAA's objectives. Either way, California employers should not rest easy in the current state of the law, because as Judge Ikuta also wrote in her dissent in *Bonta (I)*:

> Like a classic clown bop bag, no matter how many times California is smacked down for violating the Federal Arbitration Act (FAA), the state bounces back with even more creative methods to sidestep the FAA.

For now, however, the state of the law has returned to a landscape that permits California employers to require arbitration agreements as conditions of employment. Given the utility of such agreements in streamlining dispute resolution, reducing costs, and preserving one-on-one due-process protections, California employers should consider whether mandatory arbitration agreements are a good fit for their workforces.

Nixon Peabody's lawyers have extensive experience in drafting and enforcing mandatory arbitration agreements. If you have questions about your arbitration agreement in the wake of *Bonta II*, or any other employment matter, do not hesitate to contact your Nixon Peabody attorney or the authors of this alert:

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