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Ninth Circuit Reverses Prior Ruling on AB 51 and Allows Mandatory Arbitration Agreements in California

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After pending on appeal for nearly three years, the Ninth Circuit in a 2-1 decision[1] finally struck down AB 51, a controversial California law that attempted to impose criminal liability against employers who require arbitration agreements as a condition of employment, finding the statute is preempted by the Federal Arbitration Act ("FAA"). This is welcome news for California employers, as it once again allows the use of mandatory arbitration agreements in California.

As discussed in our prior articles and blog posts (link here), these court decisions addressing enforcement of AB 51 have taken a long and winding road to reach this point. In September 2021, the Ninth Circuit in a 2-1 decision lifted a preliminary injunction prohibiting enforcement by the State and held that AB 51 was not fully preempted by the FAA.[2] That decision was pending review before the full Ninth Circuit when the panel voted 2-1 in August 2022 to withdraw its prior ruling in light of the U.S. Supreme Court's June 2022 decision in *Viking River Cruises v. Moriana*.[3] The current 2-1 decision, issued on February 15, 2023, now holds that AB 51 serves as an obstacle to arbitration by subjecting employers to possible criminal liability for requiring mandatory arbitration and is therefore fully preempted by the FAA.

As a result of this decision, employers may now require employees in California to enter into mandatory arbitration agreements as a condition of employment or continued employment, rather than solely on a voluntary basis, and the arbitration agreements may contain waiver provisions of class and representative actions. This is significant when coupled with the U.S. Supreme Court's recent ruling in *Viking River Cruises*, which held that individual claims seeking civil penalties under the California Private Attorneys General Act ("PAGA") can be arbitrated pursuant to a valid arbitration agreement with a waiver of representative actions, including claims under PAGA.

Viking River Cruises reversed a 2014 decision by the California Supreme Court in *Iskanian v. CLS Transportation* [4] on the grounds that *Iskanian* was preempted by the FAA. *Iskanian* had prohibited arbitration of PAGA claims and required PAGA claims to be litigated in court on behalf of all aggrieved employees. Based on *Iskanian*, many arbitration agreements in California created a "carve-out" for PAGA claims that excluded them from arbitration to comply with *Iskanian*. Employers may now desire to issue mandatory, non-negotiable arbitration agreements to all employees that no longer contain the PAGA carve-out language, and may do so without fear of potential prosecution under AB 51.[5]

AB 51 was first enacted in October 2019 with an effective date of January 1, 2020. The new law added Section 432.6 to the California Labor Code to prohibit any person, as a condition of employment, continued employment, or the receipt of any employment-related benefit, from requiring any applicant or employee "to waive any right, forum, or procedure" for a violation of any provision of the California Fair Employment and Housing Act or the California Labor Code, including the right to file and pursue a civil action or complaint with any state agency or court. AB 51 applied even if the employee had the option to voluntarily "opt-out" of arbitration after initially agreeing to its terms. A violation of Section 432.6 was a criminal misdemeanor that could

[1] *Chamber of Commerce of the United States of America, et al. v. Bonta, et al*., No. 20-15291 (9th Cir. 2023), issued Feb. 15, 2023.
[2] *Chamber of Commerce of the United States of America, et al. v. Bonta, et al*., No. 20-15291 (9th Cir. 2021), issued Sept. 15, 2021 and withdrawn on August 22, 2022.
[3] *Viking River Cruises v. Moriana*, No. 20-15735, 596 U.S. __ (2022), issued June 15, 2022.
[4] *Iskanian v. CLS Transp. Los Angeles, LLC*, 59 Cal. 4th 348 (2014).
[5] Employment counsel should be consulted in connection with making any such changes.

subject a person to harsh penalties, including a fine of up to $1,000 and up to six months' imprisonment, as well as the potential for civil penalties against the employer under PAGA.

The California legislature in enacting AB 51 attempted to avoid FAA preemption by focusing on employer conduct occurring prior to formation of the arbitration agreement, and AB 51 specifically provided that "[n]othing in this section is intended to invalidate a written arbitration agreement that is otherwise enforceable under the [FAA]." This resulted in the anomaly that an employer seeking to require an employee to enter into mandatory arbitration was committing a criminal offense, but if the employee actually entered into the arbitration agreement then the agreement would become enforceable under the FAA and the employer could not be subjected to criminal prosecution.

The U.S. Supreme Court has repeatedly held that the FAA embodies a national policy favoring arbitration and that any state law that treats arbitration agreements less favorably than other contracts is preempted by the FAA. The Supreme Court also has held that state rules which discriminate against the formation of arbitration agreements stand as an obstacle to the FAA and are preempted.[6] Those prior Supreme Court decisions all dealt with cases involving the enforcement of executed arbitration agreements rather than laws relating to the *formation* of arbitration agreements, as regulated by AB 51.

The current 2-1 majority in *Chamber of Commerce, et al. v. Bonta* had no problem extending the established Supreme Court precedent to rule that AB 51 stood as an obstacle to arbitration and was therefore fully preempted by the FAA. The majority also rejected the dissent's argument that arbitration under the FAA must be consensual, noting that contract formation in the employment setting, even where non-negotiable due to the employer's unequal bargaining strength, may still be "consensual" as that term is used in contract law, thus affirming the preliminary injunction issued by the District Court.

The State of California may seek *en banc* review of this decision before the full Ninth Circuit and possible review by the U.S. Supreme Court. In the interim, employers may require California employees to sign non-negotiable arbitration agreements to obtain or maintain employment, provided the agreements are governed by the FAA and not by state law.[7] Arbitration agreements still may be unenforceable however if they are both procedurally and substantively unconscionable, or if the agreement lacks mutual, voluntary consent "upon such grounds as exist at law or in equity for the revocation of any contract," such as fraud, mistake or coercion. Employers should carefully review their current arbitration agreements with employment counsel to ensure compliance with California requirements and to determine if any changes should be made at the present time, such as requiring mandatory arbitration as a condition of employment and including arbitration of PAGA claims solely on an individual basis, with a waiver of class and representative actions contained in the arbitration agreement.

Should you have any questions, please contact **Thomas H. Petrides** at tpetrides@vedderprice.com, **Sheryl Skibbe** at sskibbe@vedderprice.com or the Vedder Price lawyer(s) with whom you normally work.

[6] *See Kindred Nursing Ctrs. Ltd. P'ship v. Clark*, 137 S. Ct. 1421, 1428 (2017); and *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 683 (1996).

[7] The FAA does not apply to contracts of employment for certain employees engaged in interstate commerce, such as seamen, railroad employees, various airline workers and interstate truckers, such that arbitration agreements for those employees are not covered by the FAA and those agreements would be subject to the provisions of AB 51.