Arbitration Agreements Live to See Another Day in California

Labor & Employment Law Update

By Suzannah Wilson Overholt on February 16, 2023

On February 15, 2023, in *Chamber of Commerce of the United States of America et al. v. Bonta et al.,* a panel of the U.S. Court of Appeals for the Ninth Circuit held that the Federal Arbitration Act ("FAA") preempts a state rule that discriminates against the formation of an arbitration agreement, even if that agreement is ultimately enforceable. The law at issue, California Assembly Bill 51 ("AB 51"), made it a criminal offense for an employer to require an existing employee or an applicant for employment to consent to arbitrate specified claims as a condition of employment. The court concluded that because the FAA preempts AB 51, AB 51 cannot be enforced.

By way of background, the U.S. Supreme Court had already struck down a number of California laws relating to arbitration because they were preempted by the FAA. Enacted in 2019, AB 51 sought to prevent all agreements to arbitrate employment matters under the Fair Employment and Housing Act or the California Labor Code and to impose civil penalties on employers who use them. Legislative reports specifically recognized that AB 51 was another effort to avoid the preemption issue by criminalizing only contract *formation*, so an arbitration agreement that was actually *executed* was enforceable.

The Ninth Circuit concluded that the approach previously adopted by the Supreme Court for determining whether the FAA preempts a state rule limiting the ability of parties to *form* arbitration agreements also applies to state rules that prevent parties from *entering into* arbitration agreements in the first place. The court agreed with decisions from the First and Fourth Circuits that found that the FAA preempts a state rule that discriminates against arbitration by discouraging or prohibiting the formation of an arbitration agreement.

The court also agreed with prior decisions finding that a state rule discriminates against arbitration even if it does not expressly refer to arbitration, but instead targets its defining characteristics. The court noted, "Because the FAA's purpose is to further Congress's policy of encouraging arbitration, a state law that also applies to other provisions (such as forum-selection clauses) unrelated to arbitration may be preempted if its focus is on arbitration."

Recognizing that the FAA's purpose is to encourage arbitration, the Ninth Circuit held that "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."

Based on the Ninth Circuit decision, California employers may lawfully require employees to agree to arbitrate employment disputes (except for sexual assault and harassment claims). However, any arbitration agreement will be unenforceable if it is deemed unconscionable under California's unconscionability law , which California courts have generally interpreted to mean that the agreement must give employees adequate notice and be generally fair (e.g. not shortening statutes of limitations or limiting discovery). Employers are encouraged to seek the assistance of counsel in preparing new or revising existing arbitration agreements.

This decision follows the July 15, 2022, United States Supreme Court decision in *Viking River Cruises v. Moriana*, which addressed employees' right to sue employers for violations of the California Labor Code under the California Private Attorney General Act ("PAGA"). You can read about the *Viking* decision in our June 21, 2022 blog post.