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NINTH CIRCUIT HOLDS THAT THE FEDERAL ARBITRATION ACT PREEMPTS CALIFORNIA'S ATTEMPT TO CRIMINALIZE EMPLOYMENT ARBITRATION AGREEMENTS

To Our Clients and Friends:

In a significant ruling for California employers, the Ninth Circuit on February 15, 2023 in *Chamber of Commerce v. Bonta* held that California's Assembly Bill 51—a statute that attempted to criminalize the use of arbitration agreements by employers—is preempted by the Federal Arbitration Act. The Ninth Circuit's decision affirms a preliminary injunction prohibiting California from enforcing AB 51. As a result, California employers remain able to require employees to sign arbitration agreements in connection with their employment without the risk of potential criminal liability.

The Ninth Circuit's opinion reaches the opposite result of a prior opinion issued in September 2021 by the same panel of judges. In the new opinion, Ninth Circuit Judge William A. Fletcher changed his vote and joined Judge Sandra S. Ikuta's opinion affirming the district court's order.

California's Assembly Bill 51, enacted with an effective date of January 1, 2020, makes it a criminal misdemeanor for an employer to require an existing employee or a job applicant to sign an arbitration agreement as a condition of employment. Specifically, under AB 51 employers are prohibited from requiring employees to waive "any right, forum, or procedure for violation of any provision of the California Fair Employment and Housing Act" or the California Labor Code. AB 51 criminalizes only the formation of the contract, meaning an employer could be subject to criminal prosecution for requiring an employee to enter into an arbitration agreement, even if the resulting agreement could be enforced.

On December 9, 2019, the United States Chamber of Commerce filed a complaint against the State of California challenging AB 51 as preempted by the Federal Arbitration Act. A judge in the Eastern District of California granted the Chamber's motion for a preliminary injunction, finding that the Chamber was likely to succeed on the merits of its claim that the FAA preempted AB 51. California appealed, challenging only the district court's holding that AB 51 was likely to be preempted by the FAA.

A divided panel of the Ninth Circuit initially reversed the district court in a September 2021 opinion, but after a rehearing petition was filed, the Ninth Circuit withdrew its opinion and it has now issued a new opinion, affirming the district court's preliminary injunction order and holding that AB 51 is preempted by the FAA.

The Ninth Circuit began its opinion by explaining that the United States Supreme Court "has made clear that the FAA's preemptive scope is not limited" to a state rule that affects the enforceability of arbitration

agreements, but also extends to a state rule that "discriminate[s] against the formation of arbitration agreements." Applying this to AB 51, the Ninth Circuit held that the law's imposition of civil and criminal penalties for forming an arbitration agreement in violation of the law "stands as an unacceptable obstacle to the accomplishment and execution of the full purpose and objectives of Congress in enacting the FAA."

The Ninth Circuit explained that this was true despite the fact that AB 51 does not explicitly bar arbitration agreements. Even though some arbitration agreements (specifically those subject to the FAA) are permissible under AB 51, the Ninth Circuit concluded that the law has the effect of imposing severe burdens on arbitration agreements which do not apply to contracts generally. Accordingly, the Ninth Circuit held that 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.'"

Finally, the Ninth Circuit concluded that AB 51's severability provision could not save the law from preemption. The Court reasoned that the provisions of the law that impose criminal and civil penalties were not severable because the Court could not presume that the State would want to keep a statute with no enforcement mechanism.

The Ninth Circuit's decision is a victory for California employers, who can continue to use arbitration agreements with employees in California. Absent further review by the en banc Ninth Circuit or the Supreme Court, the Ninth Circuit's conclusion that the FAA preempts AB 51 likely will lead to the law being permanently enjoined on remand. The Court's opinion puts the Ninth Circuit in line with the Fourth and First Circuits in holding that the FAA preempts a state rule that discriminates against arbitration by discouraging or prohibiting the formation of an arbitration agreement.

The following Gibson Dunn attorneys assisted in preparing this client update: Jason C. Schwartz, Katherine V.A. Smith, Bradley J. Hamburger, Megan Cooney, Jessica Brostek-Maciel, and Jordan Johnson.

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