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Legal Sidebar

Ninth Circuit Rules That Federal Arbitration Act Preempts California's Ban on Employer-Mandated Arbitration Agreements

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On February 15, 2023, a divided three-judge panel of the U.S. Court of Appeals for the Ninth Circuit issued its opinion in *Chamber of Commerce of the United States v. Bonta*. The court held that the Federal Arbitration Act (FAA) preempts a California law (AB 51) that prohibits employers from requiring employees or job applicants to agree to resolve certain disputes in binding arbitration instead of in court.

California enacted AB 51 in 2019 against a backdrop of Supreme Court precedent holding that the FAA prohibits states from enforcing laws that treat arbitration agreements less favorably than other contracts. AB 51's legislative history suggests that the California legislature aimed to design the law to restrict employer-mandated arbitration while avoiding conflict with the FAA. Whereas Supreme Court cases addressing preemption under the FAA have focused on state laws that impede the enforcement of executed arbitration agreements, AB 51 prohibits only activity occurring before the formation of an arbitration agreement. As the *Bonta* court observed, AB 51 thus "resulted in the oddity that an employer subject to criminal prosecution for requiring an employee to enter into an arbitration agreement could nevertheless enforce that agreement once it was executed."

This Legal Sidebar discusses the use of arbitration agreements in employment contexts, provides an overview of the FAA and AB 51, and examines the Ninth Circuit's *Bonta* decision.

Arbitration Agreements in Employment Contexts

Employment contracts often contain predispute arbitration agreements in which the parties waive their right to litigate future disputes in court and instead agree to resolve disputes in binding arbitration before a neutral third party. These arbitration agreements may also limit other procedural rights, such as by precluding class action proceedings and requiring parties to arbitrate disputes on an individual basis. A 2018 study found that over half of private-sector non-union workers in the United States are subject to mandatory arbitration agreements with their employers.

The widespread use of arbitration agreements in employment contexts has been the subject of ongoing policy debates. Some commentators argue that arbitration can provide a faster resolution and a more cost-

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effective and accessible forum for employees than traditional court litigation. Others argue that employers may unfairly impose arbitration agreements on workers with less bargaining power and use the agreements to shield themselves from liability, such as by precluding class litigation of claims that might be too small to justify the expense of an individual lawsuit.

The Federal Arbitration Act and Preemption

The FAA generally requires courts to treat written arbitration agreements as "valid, irrevocable, and enforceable," as well as requires courts "rigorously" to enforce the agreements according to their terms. The Supreme Court has explained that Congress enacted the FAA "to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate . . . and [to] place such agreements upon the same footing as other contracts." The Court has characterized the FAA as establishing a "national policy favoring arbitration." The Court has thus held arbitration agreements to be enforceable in a wide range of contexts, including employment contracts.

The Supremacy Clause of the U.S. Constitution (Article VI, clause 2) provides the basis for the doctrine of federal preemption, under which "state laws that interfere with, or are contrary to, federal law" are invalidated. Federal law can preempt state law in several ways. Congress may enact legislation with language explicitly preempting state law, but federal law also may impliedly preempt state law under principles of field preemption or conflict preemption. State laws are field preempted when "federal law occupies a field of regulation so comprehensively that it has left no room for supplementary state legislation." State laws are conflict preempted when it is "impossible for a private party to comply with both state and federal requirements," or when state law poses an obstacle to the "accomplishment and execution of the full purposes and objectives" of federal law.

The FAA contains no express preemption provision, and the Supreme Court has held that it does not occupy the field of arbitration. The FAA does, however, impliedly preempt state laws that conflict with it, such as laws that "disfavor" or "interfere with fundamental attributes" of arbitration. For example, the Supreme Court has held that the FAA preempts state laws invalidating class-action waivers in arbitration agreements.

AB 51

California's AB 51 prohibits employers from requiring an employee or job applicant as a condition of employment to waive the right to litigate claims for violations of California's Fair Employment and Housing Act or Labor Code. It provides in part:

> A person shall not, as a condition of employment, continued employment, or the receipt of any employment-related benefit, require any applicant for employment or any employee to waive any right, forum, or procedure for a violation of any provision of the California Fair Employment and Housing Act (Part 2.8 (commencing with Section 12900) of Division 3 of Title 2 of the Government Code) or this code, including the right to file and pursue a civil action or a complaint with, or otherwise notify, any state agency, other public prosecutor, law enforcement agency, or any court or other governmental entity of any alleged violation.

Examples of claims under California's Fair Employment and Housing Act and Labor Code include claims for unpaid wages or discrimination. Employers who violate AB 51 are subject to civil and criminal penalties.

While AB 51 prohibits employers from mandating arbitration agreements, it does not prohibit employers from enforcing such agreements once made—a provision in AB 51 states that "[n]othing in this [law] is intended to invalidate a written arbitration agreement that is otherwise enforceable under the Federal Arbitration Act."

The *Bonta* Case

In 2019, a group of business organizations and trade associations sued California state officials to block enforcement of AB 51. A U.S. district court determined that the plaintiffs were likely to succeed on their claim that the FAA preempted AB 51, and it preliminarily enjoined California from enforcing the law.

On appeal to the Ninth Circuit, California argued that AB 51 does not conflict with the FAA because (1) "AB 51 regulates the conduct of employers before an arbitration agreement is formed, rather than affecting the validity or enforceability of the executed arbitration agreement itself" and (2) AB 51 merely prevents "forced arbitration." A majority of the three-judge panel rejected those arguments and held that the FAA preempts AB 51.

In rejecting California's first argument, the court relied on the Supreme Court's reasoning in *Kindred Nursing Centers Ltd. P'ship v. Clark* and *Doctor's Assocs., Inc. v. Casarotto*. In those cases, the Court held that the FAA preempted state laws that applied special requirements to the formation of arbitration agreements. In *Kindred Nursing*, the Court determined that the FAA preempted the Kentucky Supreme Court's "clear-statement rule," under which arbitration agreements signed through a general power of attorney were invalid unless the power of attorney explicitly authorized the representative to sign arbitration agreements. Similarly, in *Casarotto* the Court held that the FAA preempted a Montana law that required contracts containing arbitration clauses to provide notice of the arbitration clause on the first page of the contract.

The *Bonta* court explained that, although *Kindred Nursing* and *Casarotto* involved plaintiffs seeking to enforce executed arbitration agreements, "the [Supreme] Court's rationale for invalidating state rules burdening the formation of arbitration agreements is equally applicable to a state rule like AB 51, which discriminates against the formation of an arbitration agreement." According to the *Bonta* court, laws that impair the formation of arbitration agreements impede the FAA's purposes "just as much as those that undermine the enforceability of already-existing arbitration agreements." Thus, while the court acknowledged that the FAA does not "directly apply" to AB 51 insofar as the FAA addresses only the "validity, revocability, and enforceability" of arbitration agreements, the court concluded that AB 51 still created an impermissible obstacle to the FAA's purpose of "encouraging arbitration" and placing arbitration on "equal footing" with other contracts. The court also explained that its reasoning aligned with decisions of the U.S. Courts of Appeals for the First Circuit and Fourth Circuit that similarly concluded that the FAA preempts state laws that discriminate against arbitration by discouraging or prohibiting the formation of an arbitration agreement.

With respect to California's argument that AB 51 merely prohibits "forced arbitration," the Ninth Circuit rejected the notion that requiring arbitration as a condition of employment necessarily forces arbitration onto employees without their "consent." The court explained that it is "a basic principle of contract law that a contract is not enforceable unless there is mutual, voluntary consent," and the Supreme Court has emphasized that arbitration under the FAA is a matter of consent between the parties. The Ninth Circuit further explained that a party may "consent" in the contractual sense "even if one party accepts unfavorable terms due to some degree of unequal bargaining power." The court observed that, while employer-mandated arbitration agreements might be unenforceable in some cases under generally applicable contract law principles, AB 51 criminalized "the formation, or attempted formation, of any basic agreement to arbitrate claims" that an employer requires an employee to sign.

The Ninth Circuit's panel decision drew a dissent from one of the judges, who reasoned that the majority improperly expanded the scope of preemption under the FAA. The dissenting judge emphasized that *Kindred Nursing* and *Casarotto* involved state laws that "directly invalidated" arbitration agreements, and the judge objected to the majority's application of those cases to laws like AB 51 that regulate "conduct preceding arbitration agreements."

Considerations for Congress

Bonta presented a question of the proper interpretation of a statute enacted by Congress. Thus, Congress can act legislatively in response to the Ninth Circuit's interpretation of the FAA if it wishes to do so, even in ways that differ from courts' interpretations of the statute. For example, Congress may revise the FAA to change or otherwise clarify its preemptive effect, such as by expressly permitting or prohibiting the enforcement of state laws that restrict the use of employer-mandated arbitration agreements.

Congress also may consider enacting legislation that directly regulates arbitration agreements. For example, the 117th Congress enacted the Ending Forced Arbitration of Sexual Assault and Sexual Harassment Act of 2021, which amended the FAA to give individuals the right to bring sexual harassment and sexual assault claims in court, including as a joint action, even if they signed a predispute arbitration agreement that would otherwise preclude such litigation. The 117th Congress also considered other legislation that would have limited the enforceability of arbitration agreements in certain contexts. For instance, H.R. 963 would have broadly rendered predispute arbitration agreements and joint-action waivers invalid and unenforceable in the context of employment, consumer, antitrust, and civil rights disputes. Multiple bills introduced so far in the 118th Congress also contain restrictions on predispute arbitration agreements. For instance, H.R. 697 would render such agreements invalid and unenforceable in employment, consumer, and civil rights disputes, and S. 220 would more narrowly render such agreements unenforceable in the context of certain claims related to noncompete agreements.

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