SPECIAL ALERT: CALIFORNIA LAW BARRING MANDATORY ARBITRATION AGREEMENTS IN EMPLOYMENT CONTRACTS REINSTATED BY THE NINTH CIRCUIT (FOR NOW)

A divided panel of the Ninth Circuit Court of Appeals issued a decision on September 15, 2021 that will reinstate a California law prohibiting employers from requiring employees to agree to arbitrate disputes under the California Labor Code or the California Fair Employment and Housing Act ("FEHA") as a condition of employment. Although the court in the case *Chamber of Commerce of the United States v. Bonta* left in place a preliminary injunction forbidding the state from enforcing civil and criminal penalties against employers who enter into arbitration agreements covered by the Federal Arbitration Act ("FAA"), significant risks for employers remain if the decision goes into effect (absent further judicial action). Thus, employers who currently require employees or applicants to agree to arbitrate possible disputes under the FEHA or the Labor Code should immediately begin preparing for a possible change in their employment contracts and onboarding procedures, in consultation with legal counsel.

This case arises from the latest in a long line of California legislative attempts to limit an employer's ability to require its employees to arbitrate employment-related disputes. Many prior attempts have been thwarted by the FAA, a federal law whose purpose is to ensure that private arbitration agreements are enforced according to their terms. In recent years, the FAA has been applied to preempt (and thus invalidate) state laws that make arbitration agreements unenforceable. In 2019, California enacted AB 51, a bill which was expressly designed as an end-run around the FAA. The law created Labor Code Section 432.6, which does several things relevant to the recent case:

- First, it prohibits employers from requiring employees or applicants to enter mandatory arbitration agreements related to resolution of disputes under the FEHA or the Labor Code as a condition of employment, continued employment, or the receipt of any employment-related benefit. (Labor Code § 432.6(a).)
- Second, it prohibits employers from retaliating or discriminating against or terminating any applicant or employee because the applicant or employee declines to enter into an arbitration agreement that applies to claims under the FEHA or the Labor Code. (Labor Code § 432.6(b).)
- The statute makes clear that employers cannot require an employee to "opt out" or take any affirmative action to preserve their rights under the FEHA or the Labor Code. Thus, an employer could not have an employment agreement that says, "You agree to mandatory arbitration unless you check this box." (Labor Code § 432.6(c).)
- However, the statute states it is not intended to invalidate any arbitration agreements that are otherwise enforceable under the Federal Arbitration Act ("FAA").

Labor Code section 433 makes violation of Section 432.6 a misdemeanor, punishable by up to six months' imprisonment and/or a fine up to $1,000. Government Code section 12953 (also enacted by AB 51) makes violation of Section 432.6 an unlawful employment practice. Other provisions of the Government Code create civil sanctions for unlawful employment practices, including investigation by the Department of Fair Housing and Employment ("DFEH") and potential civil litigation brought by the DFEH or by the aggrieved individual. And Section 432.6 itself provides that a prevailing plaintiff enforcing their rights under the section is entitled to attorneys' fees and costs, as well as injunctive relief and any other remedies available. The law

was set to go into effect on January 1, 2020 and was intended to be applicable to all employment contracts entered into, modified, or extended on or after that date.

However, before AB 51 went into effect, a federal district court granted a preliminary injunction prohibiting the state of California from enforcing the law as it applies to entry into an arbitration agreement covered by the FAA, finding that the law's challengers were likely to succeed on the merits of their claim that the FAA preempted the law. A preliminary injunction is not a final decision on the merits of the case, but it preserves that status quo (in this case, stopping the state from enforcing the new law) while the parties are litigating the matter.

On September 15, 2021, a panel of the Ninth Circuit Court of Appeals disagreed and vacated a significant part of the preliminary injunction. The two-judge majority concluded that the challengers were *not* likely to succeed on the merits of their argument that Section 432.6 was preempted by the FAA, because it is not used to invalidate an otherwise enforceable arbitration agreement; instead, it governs the parties' pre-agreement conduct. Thus, the court vacated the preliminary injunction with respect to Section 432.6, subsections (a), (b), and (c).

However, the majority left in place the preliminary injunction barring the imposition of civil and criminal sanctions for the act of executing an arbitration agreement that is enforceable under the FAA, finding the challengers were likely to succeed on the merits of their claim that these sanctions conflict with the FAA. Notably, the court arguably left open the possibility that the civil and criminal sanctions could apply in circumstances in which an arbitration agreement is *not* executed. As the dissenting opinion pointed out, an employer *might* still face civil and criminal sanctions if the employer chose to require entry into an arbitration agreement as a condition of employment, and an applicant refused, thus resulting in the employer's decision not to hire the applicant. Furthermore, Section 432.6's provision for entitlement to an injunction and attorneys' fees to a prevailing party may remain in effect because that provision was never expressly enjoined by the district court. Therefore, an employer might face a lawsuit to enjoin its ability to require mandatory arbitration as a condition of employment, and could be forced to pay fees and costs in such a case. The bottom line is that if this decision goes into effect, it will be risky for an employer to require employees or applicants to agree to mandatory arbitration of claims under the California Labor Code or the FEHA, even though the decision leaves in place a part of the preliminary injunction.

What is next for this case?

The dissenting opinion noted that the Ninth Circuit's decision sets up a conflict between the circuits (as the First and Fourth Circuits have reached the opposite conclusion regarding similar laws), and indicated an expectation that the case is not over yet. It is almost certain that the challengers will seek further review of this decision – either by seeking "*en banc*" review by the full Ninth Circuit Court of Appeals or by asking the U.S. Supreme Court to weigh in. If the Ninth Circuit decides to review the case, implementation of the decision will be delayed until after the review is complete. If the challengers ask the U.S. Supreme Court to consider the case, they can also seek interim relief to maintain the status quo (i.e., maintain the effect of the original injunction preventing enforcement of the statute) while review is pending. It is likely that we will know within the next two weeks whether the challengers will seek further review and/or an order maintaining the effect of the preliminary injunction.

What does this mean for California employers?

In the meantime, employers should prepare for the reinstatement of Section 432.6. Thus, employers who currently require employees or applicants to agree to arbitration of claims under the California Labor Code or the FEHA should immediately seek legal advice concerning how to proceed.

Because the state of California was prohibited from enforcing Section 432.6 with respect to arbitration agreements that otherwise were enforceable under the FAA while the preliminary injunction was in effect, employers should not face state penalties related to arbitration agreements entered into while the preliminary injunction was in place. Moreover, because Section 432.6 expressly states that it is not intended to invalidate otherwise enforceable arbitration agreements, even if the statute is in effect, it should not render arbitration agreements entered during the past year and a half *un*enforceable. Of course, such arbitration agreements are still open to the traditional challenges that they are procedurally or substantively unconscionable, or otherwise unenforceable under generally applicable contract rules. And because none of these issues have been addressed head-on by California courts, there is no guarantee about how courts would decide any of these issues.

Moreover, if the decision goes into effect (that is, if there is no further action extending the injunction pending further review by the Ninth Circuit or the Supreme Court), the state of California will be able to begin enforcing the law. Employers should be prepared to quickly change their practices if they currently mandate arbitration agreements and should consult with legal counsel about how to do so.

Notably, even if it is in full effect, Section 432.6 does not prohibit *voluntary* arbitration agreements between employees and employers. Thus, to the extent an employer presents the employee with the *voluntary option* whether to enter into an arbitration agreement and does not require the employee to agree as a condition of employment or the receipt of any "employment-related benefit," the agreement should not run afoul of Section 432.6 (although employees could – and likely will – challenge such agreement as unenforceable under traditional standards of unconscionability). There is no guidance regarding whether an employer could offer anything of value (such as a cash payment) in return for the agreement to arbitrate, but employers may wish to consider such options in consultation with legal counsel. Alternatively, an employer may consider a procedure whereby an employee must affirmatively opt in to arbitration, such as by initialing or checking a box that says something like, "I agree to arbitrate any disputes I may have against XYZ Corp." perhaps followed by a period in which the employee can revoke their consent to arbitration.

Do you have questions about how this update may affect you? For further information contact:

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