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False Alarm? The Practical Impact of AB 51, California's New Anti-Arbitration Statute

Article By:

Christopher C. Murray

Danielle Ochs

California recently enacted Assembly Bill (AB) 51, a law that attempts to ban certain mandatory employment arbitration agreements in the state. But what is the practical impact of AB 51 in light of its possible preemption by the Federal Arbitration Act (FAA) and other potential challenges to its limits on arbitration?

Background

On October 10, 2019, California Governor Gavin Newsom signed into law a state statute purporting to prohibit employers from requiring employees to enter into certain types of arbitration agreements. This new law is creating significant uncertainty and anxiety among employers.

California's new statute prohibits and criminalizes the use of certain employment arbitration agreements.

AB 51 purports to ban employers from requiring applicants or employees, "as a condition of employment, continued employment, or the receipt of any employment-related benefit," to "waive any right, forum, or procedure for a violation of any provision of the California Fair Employment and Housing Act" (FEHA) or California Labor Code, "including the right to file and pursue a civil action or complaint with . . . any court." In short, AB 51 prohibits the use of mandatory employment arbitration agreements for claims under these state laws.

AB 51 also prohibits employers from retaliating against applicants or employees who refuse to enter into banned mandatory arbitration agreements, including by terminating their employment. Further, the statute provides that using an opt-out procedure will not prevent an agreement from being considered mandatory for purposes of the law.

AB 51 authorizes a plaintiff enforcing his or her rights under the statute to obtain "injunctive relief and any other remedies available" (presumably, lost wages and other damages), as well as attorneys' fees.

But that's not all. AB 51 amends the Labor Code by adding Section 432.6. Under Section 433 of the Labor Code, a violation of AB 51 is thus deemed a misdemeanor. An employer that violates this new law could be subject to criminal sanctions, including "imprisonment in a county jail, not exceeding six months, or . . . a fine not exceeding one thousand dollars ($1,000), or both" under Section 23 of the Labor Code.

AB 51 does not appear to cover mandatory employment arbitration agreements for claims under statutes other than the FEHA and the Labor Code. AB 51 also does not cover Financial Industry Regulatory Authority arbitration agreements, which are expressly excluded.

AB 51 attempts to circumvent the Federal Arbitration Act.

Last year, the California Legislature passed AB 3080, a bill virtually identical to AB 51, but then-governor Jerry Brown vetoed it. Referring to the preemptive effect of the FAA, the governor explained, "Since this bill plainly violates federal law, I cannot sign this measure."

Now AB 51 declares that it is not "intended to invalidate a written arbitration agreement that is otherwise enforceable under the [FAA]." Section 2 of the FAA generally makes most arbitration agreements "valid, irrevocable, and enforceable" as a matter of federal law. At first glance, AB 51, by carving out arbitration agreements covered by the FAA, would seem to dramatically narrow its potential coverage.

But AB 51's FAA carve-out may not be as straightforward as it first appears. Regardless of whether this law is "intended" to void arbitration agreements, plaintiffs will undoubtedly rely on it to argue that covered arbitration agreements are unconscionable and unenforceable on public policy grounds because this statute makes them unlawful.

Moreover, the legislative history of AB 51 suggests that AB 51 may be intended not to invalidate arbitration agreements so much as to scare employers out of using them.

Specifically, an analysis by the California Senate Judiciary Committee states that AB 51's author and sponsors believe they "crafted a statute that does not conflict with the FAA and thereby avoids preemption." The legislative history emphasizes that "AB 51 would not invalidate any contract once formed." The analysis points out that "once a mandatory arbitration agreement has been signed, this bill has nothing more to say about the situation." Rather, "[a]ll the bill does is say that an employee cannot be forced to sign an arbitration agreement, and if the employee elects not to, the employee cannot be retaliated against."

AB 51's sponsors thus argue that the law does not conflict with the FAA because it does not void arbitration agreements. So if AB 51 prohibits employers from requiring mandatory arbitration agreements but does not invalidate those agreements, what does AB 51 do as a practical matter?

First, AB 51 allows applicants or employees who are not hired or who are fired because they refuse to enter mandatory agreements to sue for damages and attorneys' fees.

Second, AB 51 allows applicants and employees who do enter into mandatory arbitration agreements (and those who do not) to report employers for potential criminal sanctions. As noted above, an employer that violates AB 51 could be subject to up to six months' imprisonment, a $1,000 fine, or both.

While AB 51 does not invalidate mandatory employment arbitration agreements, it does threaten to impose a hefty price on employers that use them. The new law is obviously intended to intimidate employers out of using such agreements altogether. And, by the way, the sponsors of AB 51 happen to be the Consumer Attorneys of California, an organization focused on eliminating any impediments to the expansion of jury trials in employment litigation.

The FAA will likely preempt much of AB 51.

AB 51 is likely preempted by federal law, at least in part. The Supreme Court of the United States has repeatedly made clear that the FAA preempts state laws that ban or burden arbitration.

Just two years ago, the Supreme Court overturned an anti-arbitration decision from the Supreme Court of Kentucky in *Kindred Nursing Centers Limited Partnership v. Clark*, No. 16-32 (May 15, 2017). There, the state court had tried to invalidate arbitration agreements based on the Kentucky state constitution. And in 2012, the high court quickly smacked down an anti-arbitration decision by the Supreme Court of Appeals of West Virginia in a short, unsigned decision without even holding oral argument (*Marmet Health Care Center, Inc. v. Brown*, Nos. 11-391 and 11-394 (February 21, 2012)). In that case, the state court had tried to invalidate certain arbitration agreements based on state public policy.

More recently, in the wake of the #MeToo movement, a number of states have enacted laws attempting to prohibit the arbitration of sexual harassment claims and similar claims. These states include Maryland, New York, Vermont, and Washington. Lower federal courts, applying Supreme Court precedent, are finding these statutes preempted by the FAA. We've previously reported on decisions relating to the New York and the Washington statutes.

Contrary to the reasoning advanced by AB 51's sponsors, it is unlikely AB 51 will escape FAA preemption simply because the statute does not directly invalidate arbitration agreements. The Supreme Court has also held that the FAA preempts "state-law rules that stand as an obstacle to the accomplishment of the FAA's objectives" even if those rules do not directly void arbitration agreements (*AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011)).

AB 51 would obviously stand as an obstacle to the use of employment arbitration agreements by exposing employers to possible damages claims and criminal sanctions. AB 51 also obviously disfavors mandatory arbitration agreements compared to other agreements that employers can require as a condition of employment under California law, such as mandatory agreements that employees protect their employer's confidential and trade secret information.

Indeed, the California Senate Judiciary Committee's analysis expressly acknowledged that "[t]he proponents of this bill hope that these provisions will reduce the number of California workers who are forced into arbitration against their will." Thus, the law is intended to reduce the use of employment arbitration agreements. And that intent surely runs headlong into the FAA.

The FAA does not cover all employment arbitration agreements.

Although AB 51 will likely be preempted by the FAA, at least in part, there's a caveat. The FAA does not cover all employment arbitration agreements. Section 1 of the FAA excludes arbitration agreements with any "class of workers engaged in foreign or interstate commerce." This means the FAA does not cover arbitration agreements with "transportation workers" (*Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001)).

The FAA's preemption of AB 51 may thus not be complete. Employers with transportation workers may have to assume that AB 51 will apply to those workers even if the FAA otherwise preempts the statute.

The scope of the term "transportation worker" is not settled for purposes of the FAA. In January 2019, in *New Prime Inc. v. Oliveira*, the Supreme Court again observed that the FAA does not cover arbitration agreements with "transportation workers" but still left unanswered exactly which employees fall under that heading.

Opponents of employment arbitration are working feverishly to try to stretch this FAA exclusion as broadly as possible. (See, for example, the argument that local drivers are not covered by the FAA because they transport passengers or deliver goods in the stream of interstate commerce.) Courts may ultimately reject these arguments.

In conclusion, employers with employees who might be considered "transportation workers" may want to monitor developments in this area closely.

AB 51 could also be unconstitutional on other grounds.

In addition to preemption by the FAA, AB 51 may be unconstitutional on other grounds. The due process clauses of the Fifth and Fourteenth Amendments to the United States Constitution allow a court to deem a criminal statute void for vagueness. The "void-for-vagueness doctrine requires that a penal statute define [a] criminal offense with sufficient definiteness that ordinary people can understand what conduct is prohibited and in a manner that does not encourage arbitrary and discriminatory enforcement" (*Kolender v. Lawson*, 461 U.S. 352, 358 (1983)).

Here, an employer or trade association challenging AB 51 may be able to show that the statute fails to provide notice to employers with "sufficient definiteness" of what conduct the law prohibits. AB 51 appears to state that it will not affect arbitration agreements protected by the FAA, but the legislative history indicates that AB 51's sponsors argued that employers that entered FAA-protected arbitration agreements would still violate this law, exposing themselves to its criminal sanctions. That is hardly sufficient notice.

Practical Impact

First, employers need not panic if they currently have mandatory employment arbitration agreements with California employees. By its own terms, AB 51 applies only to arbitration agreements "entered into, modified, or extended on or after January 1, 2020."

Again, there is a caveat: AB 51 does not explain what it means for an agreement to be "extended" after January 1, 2020. That means a plaintiff's attorney might argue any attempt after January 1, 2020, by an employer to enforce an arbitration agreement that was entered into before that date is prohibited by the law. Employers have the next couple of months to assess this issue.

Second, it is possible that the new law will be challenged prior to January 1, 2020. Employers may want to keep an eye on the legal news (including here) for updates.

Third, employers may wish to determine whether their arbitration agreements should be revised prior to January 1, 2020. Arbitration agreements can be crafted to exclude any claims deemed non-arbitrable by non-preempted law.

Finally, irrespective of AB 51, employers may need to address how to handle potential “transportation workers” under their arbitration agreements. Businesses using arbitration agreements with employees and/or independent contractors who could be classified as transportation workers may want to evaluate whether they can invoke a state’s arbitration statute in place of the FAA or as a backup.

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