August 7, 2018

California State Senate
State Capitol
Sacramento, CA 95814

SUBJECT: AB 3080 (GONZALEZ FLETCHER) EMPLOYMENT DISCRIMINATION: ENFORCEMENT

Dear Members of the Senate:

Our law firms represent a number of California businesses and employers who will be impacted by **AB 3080's** prohibition of employment arbitration agreements for the vast majority of employment-related disputes. We have reviewed the pending bill and know it to be unconstitutional. For this reason, we urge the California Legislature not to pass it.

While others capably have explained **AB 3080's** adverse impacts on jobs, as well as the expediency and cost-effectiveness of arbitration compared to litigation (especially since the law already requires employers to pay all fees and costs unique to arbitration), this letter focuses only on how **AB 3080's** prohibition of employment and independent contractor arbitration agreements offends the Supremacy Clause of the U.S. Constitution, because it is preempted by the Federal Arbitration Act.

AB 3080 Prohibits Most Employment Arbitration Agreements.

AB 3080 would prohibit mandatory employment or independent contractor arbitration agreements entered into on or after January 1, 2019, as a condition of employment, continued employment, employment-related benefits, or contractual agreements. It also would prohibit voluntary employment arbitration agreements, whereby an applicant, employee, or independent contractor has a right to opt out of an arbitration agreement. By its terms, **AB 3080** inexplicably deems even this type of opt-out a mandatory agreement to arbitrate as a condition of employment.

AB 3080, if passed, would enact Section 12953 of the California Government Code that would become part of the California Fair Employment and Housing Act ("FEHA") making mandatory arbitration agreements as a condition of employment an "unlawful employment practice" under FEHA, as well as a separate violation of the California Labor Code. Under **AB 3080**, Section 12953 of FEHA would provide that *"[i]t is an unlawful employment practice for an employer to violate Section 432.4 and 432.6 of the Labor Code."* Section 432.6 of the Labor Code, in relevant part, would prohibit mandatory employment or independent contractor arbitration agreements entered into on or after January 1, 2019, as a condition of employment, continued employment, employment-related benefits, or contractual agreements. Labor Code § 432.6(a) and (b). It also prohibits arbitration agreements with opt outs or agreements that require affirmative action in order to preserve court rights by deeming such agreements to be "a condition of employment." Labor Code § 432.6(c).

AB 3080 Is Unconstitutional Because It Is Preempted By The FAA.

As written, **AB 3080** violates Article VI, Clause 2 of the U. S. Constitution ("Supremacy Clause") under, and is preempted by, the Federal Arbitration Act, 9 U.S.C. §§ 1 et seq. ("FAA"). The FAA provides that arbitration

agreements included in contracts evidencing a transaction involving interstate commerce "***shall be valid, irrevocable, and enforceable, save upon grounds as exist at law or in equity for the revocation of any contract."*** 9 U.S.C. § 2 (emphasis added). In deciding whether the FAA applies, courts "must broadly construe the phrase, 'evidencing a transaction involving commerce,' because ***the FAA 'embodies Congress' intent to provide for the enforcement of arbitration agreements within the full reach of the Commerce Clause.***'" *Giuliano v. Inland Empire Pers., Inc.*, 149 Cal.App.4th 1276, 1286 (2007) (referencing 9 U.S.C. §2).

All or virtually all employment or independent contractor arbitration agreements evidence a transaction involving interstate commerce. "'[E]videncing a transaction involving commerce' (9 U.S.C. § 2) simply means that 'the "transaction" in fact "involv[ed]" interstate commerce, even if the parties did not contemplate an interstate commerce connection.'" *Giuliano,* 149 Cal.App.4th at 1286, citing *Allied-Bruce Terminix Cos. v. Dobson,* 513 U.S. 265, 281 (1995) (FAA applies to a contract for local services because the materials used came from outside the state); *Citizens Bank v. Alafabco, Inc*., 539 U.S. 52, 56-57 (2003) ("'involving commerce' in the FAA" is interpreted "as the functional equivalent of the more familiar term 'affecting commerce'" and applies to an individual transaction even if the transaction does not have a substantial effect on interstate commerce so long as "in the aggregate the economic activity in question would represent 'a general practice . . . subject to federal control.'"). The only remaining preemption issue, then, is whether the sole statutory exception in the FAA itself regarding substantive contract revocation law applies. It clearly does not apply here. Thus, the FAA applies.

Congress enacted the FAA in 1925 in response to "widespread judicial hostility" at the time toward arbitration agreements. *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, ___ (2011) (emphasis added). "The overreaching purpose of the FAA . . . is to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings." *Id.* at 1748. Indeed, the U.S. Supreme Court has described the FAA as ***"'embodying a national policy favoring arbitration' and 'a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary.'"*** *Id.* at 1749 (citations omitted) (emphasis added).

Consistent with the strong federal policy favoring arbitration, U.S. Supreme Court cases "place it beyond dispute that ***the FAA was designed to promote arbitration***." *Concepcion*, 131 S. Ct. at 1749 (emphasis added). ***This federal policy favoring arbitration also specifically includes employment arbitration agreements.*** *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 113-14, 119 (2001) (the FAA applies to arbitration provisions in employment contracts, except those involving transportation workers); *Gilmer v. Interstate-Johnson Lane Corp*., 500 U.S. 20, 31 (1991) (employment discrimination claim was subject to compulsory arbitration under the FAA). California courts are in accord. *See, e.g., Ruiz v. Sysco Food Servs.*, 122 Cal. App. 4th 520, 534-39 (2004) (compelling arbitration of employee's tort claims against employer). And the U.S. Supreme Court recently upheld class action waivers specifically in employment arbitration agreements, again citing the FAA's policy favoring arbitration and enforcement of arbitration agreements according to the terms agreed upon by the parties. *Epic Sys. Corp. v. Lewis,* ___ U.S. ___, 138 S. Ct. 1612, 1621, 1632 (2018).

Courts consistently have rejected legislative and judicial efforts to discriminate against arbitration agreements and/or arbitration as a dispute resolution forum. This issue already has arisen repeatedly in California. For example, in 2014, the California Legislature passed AB 2617, which was later signed into law, prohibiting mandatory, pre-dispute arbitration agreements that waive the right to pursue a civil action under certain California civil rights statutes. After enactment, AB 2617's validity was challenged on FAA preemption grounds, and the court held that AB 2617 was invalid because it was preempted by the FAA. *Saheli v. White Mem'l Med. Ctr.*, 21 Cal. App. 5th 308, 326 (2018), *review denied* (June 27, 2018). The *Salehi* court held that "the motivating force behind the enactment of AB 2617 was a belief that arbitration is inherently inferior to the courts. . . . In accordance with this dim view of arbitration, the Legislature placed special restrictions on waivers of judicial forums and procedures in connection with such claims. In practice, such restrictions discourage arbitration by invalidating otherwise valid arbitration agreements. ***It is precisely this sort of hostility to arbitration that the FAA prohibits."***) (emphasis added).

The same fate invariably awaits **AB 3080** based on the text of the FAA itself, the authorities cited above, as well as nearly four decades of U.S. Supreme Court authority striking down contrary state laws. *See, e.g., Kindred Nursing Centers Ltd. Partnership v. Clark,* ___ U.S. ___, 137 S. Ct. 1421 (2017) (***FAA preempts*** state law based on "contract formation" since law applied only to arbitration provisions); *DIRECTV, Inc. v. Imburgia,* 136 S. Ct. 463 (2015) (***FAA preempts*** invalid state law applied only to arbitration agreements); *Preston v. Ferrer,* 552 U.S. 346 (2008) (***FAA preempts*** contention that state law grants state commissioner exclusive jurisdiction to decide issue the parties agreed to arbitrate); *Doctor's Associates, Inc. v. Casarotto,* 517 U.S. 681 (1996) (***FAA preempts*** state statute that required special notice requirements for arbitration agreements, as such notice requirements were not required for all other contracts); *Mastrobuono v. Shearson Lehman Hutton, Inc.,* 514 U.S. 52 (1995) (***FAA preempts*** state law requiring judicial resolution of claims involving punitive damages); *Perry v. Thomas,* 482 U.S. 483 (1987) (***FAA preempts*** state-law requirement codified by California Labor Code section 229 that litigants be provided a judicial forum for wage disputes); *Southland Corp. v. Keating,* 465 U.S. 1 (1984) (***FAA preempts*** state financial investment statute's prohibition of arbitration of such statutory claims).

California courts are in accord. *See, e.g., Sanchez v. Valencia Holding Co., LLC,* 61 Cal. 4th 899 (2015) (***FAA preempts*** any state statute, including the California Consumer Legal Remedies Act, that interferes with arbitration, such that a class action waiver in a mandatory consumer arbitration agreement is enforceable); *see also Iskanian v. CLS Transportation Los Angeles, LLC,* 59 Cal. 4th 348 (2014) (class action waiver in employment arbitration agreement is enforceable based on *Concepcion*; federal law preempts any other rule.

No material distinction exists between **AB 3080's** effort to ban agreements to arbitrate FEHA and Labor Code claims and prior legislation that courts already have ruled are FAA-preempted. Labor Code 229 provided that employees have a right to have wage claims resolved in court regardless of the existence of an agreement to arbitrate such claims, and the U.S. Supreme Court held in *Perry v. Thomas* that this statute was preempted by the FAA. Similarly, AB 2617 sought to preclude arbitration provisions in certain contracts, and this statute too was held to be preempted by the FAA because it was a law that specifically discriminated against arbitration. *Saheli*, 21 Cal. App. 5th at 323. Finally, even the California Supreme Court has upheld the enforceability of mandatory agreements to arbitrate FEHA claims as a condition of employment, citing the FAA's strong policy favoring arbitration as a means for resolving disputes. *See Armendariz v. Found. Health Psychcare Servs., Inc*., 24 Cal. 4th 83 (2000). **AB 3080** cannot escape the same fate as Labor Code 229 and AB 2617 because just like those prior statutes, **AB 3080** specifically discriminates against arbitration agreements and, therefore, is plainly preempted by the FAA.

The Preemption Issue Is Not Close.

The Legislature should understand that the preemption issue is straightforward, not remotely a close call. It is not an issue that depends on the ideology of the judge deciding the question. Justice Thurgood Marshall wrote for the U.S. Supreme Court in *Perry v. Thomas*, 482 U.S. 483 (1987), a 7-2 decision holding that the FAA preempts California Labor Code section 229 (a statute that purported to invalidate arbitration agreements of employees' wage claims). Justice Ruth Bader Ginsburg wrote the 8-1 majority opinion in *Preston v. Ferrer*, 552 U.S. 346 (2008), holding that the FAA preempts any contention that California's Talent Agencies Act restricted predispute arbitration agreements. Justice Stephen Breyer wrote for the Court in *DirecTV v. Imburgia*, 577 U.S. ___, 136 S. Ct. 463 (2015), a 6-3 decision holding preempted California's refusal to enforce DirecTV's arbitration agreement. (Most of the dissenting justices in these cases did so for various jurisdictional reasons unique to the particular case, not on the merits of the preemption issue.) In *Marmet Health Care Centers v. Brown*, 565 U.S. 530 (2012), the Supreme Court *unanimously* held preempted a West Virginia doctrine refusing to enforce arbitration agreements in nursing home contracts.

The preemption of **AB 3080** is plain; the statute, if it were to be enacted, is doomed. This is not a close issue.

Proponents of AB 3080 Rely On Illusory Distinctions.

Proponents of **AB 3080** rely on two distinctions to argue that it will not be preempted by the FAA, but these distinctions are legally unmeritorious.

The first distinction **AB 3080's** proponents advance is that **AB 3080** somehow escapes preemption since it does not prohibit arbitration agreements *voluntarily* entered into, only those *required* as a condition of employment. This "required-voluntary" distinction is legally unsustainable for at least two key reasons:

(1) **AB 3080** prohibits more than just "mandatory" arbitration agreements that are required as a condition of employment. **AB 3080** sweeps voluntary arbitration agreements into its prohibition by providing that an arbitration agreement still is considered a mandatory condition of employment when an applicant or employee has an express right and opportunity to opt out of the agreement.

(2) Most importantly, FAA preemption applies regardless of whether an arbitration agreement is required as a condition of employment. Indeed, the vast majority of cases where courts have upheld the enforceability of an arbitration agreement under the FAA (notwithstanding a contrary state law), involved mandatory arbitration agreements entered into as a condition of employment (or as a condition of a consumer contract). The California Supreme Court very recently — and unanimously — enforced an arbitration agreement where the employee was told "sign it, or no job." *Baltazar v. Forever 21, Inc.*, 62 Cal. 4th 1237 (2016). All kinds of contractual relationships are established at the time of hire. Employees sign mandatory at-will agreements to obtain jobs they like. Employees sign mandatory intellectual property agreements to obtain jobs they like. No one questions the enforceability of these agreements. Outside the employment context, consumers accept nonnegotiable limited warranties when they purchase products that they like. No one questions the enforceability of these warranties, either.

The FAA requires that the same rule apply to arbitration agreements, mandatory or otherwise. Under California law, standard form contracts are enforceable, and the law is no different (indeed, can be no different under the FAA) for arbitration agreements. The U.S. Court of Appeals for the Seventh Circuit applied California law (by reason of a contractual choice-of-law provision) in reversing a decision that had refused to enforce an arbitration agreement, partly on grounds that the agreement was an adhesion contract. The court of appeals pointed out:

> Standard-form agreements are a fact of life, and given § 2 of the Federal Arbitration Act, 9 U.S.C. § 2, arbitration provisions in these contracts must be enforced unless states would refuse to enforce all off-the-shelf package deals. . . . California routinely enforces limited warranties and other terms found in form contracts. If a state treats arbitration differently, and imposes on form arbitration clauses more or different requirements from those imposed on other clauses, then its approach is preempted by § 2 of the Federal Arbitration Act.

Oblix, Inc. v. Winiecki, 374 F.3d 488, 491-92 (7th Cir. 2004) (emphasis added; citations omitted); *accord id.* at 492 ("[N]o state can apply to arbitration (when governed by the [FAA]) any novel rule. Under normal rules of contract, the promises [the employee] made in order to be hired and paid are enforceable. Thus she must arbitrate.").

The second distinction proponents of **AB 3080** erroneously advance is that **AB 3080** does not explicitly declare that mandatory employment or independent contractor arbitration agreements are void and unenforceable as against public policy. They advance this argument in an attempt to distinguish **AB 3080**

from AB 2617, which was previously found unconstitutional in *Saheli, supra*. This argument is yet another illusory "legal" distinction without an actual constitutional difference. The Supreme Court has held that any state law is preempted if it "stands as an obstacle" to enforcing an agreement "according to its terms." *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011). **AB 3080** absolutely "stands as [such an] obstacle." It plainly is preempted.

Proponents Of AB 3080 Mistakenly Would Kick The Preemption Can Down The Road For Judicial Resolution.

We have heard it argued — but the argument is deeply flawed — that there is no cost, injury, or detriment to enacting a law that courts later will hold preempted. The flaws in the argument are as follows.

First, **AB 3080** would add provisions to Chapter 3, Article 3 of the Labor Code. Labor Code section 433 *criminalizes* violations of any provision of Chapter 3, Article 3. Time will elapse between the enactment date of **AB 3080** and even a trial-court decision on the preemption issue. Even more time will elapse before an appellate court will rule, and still more time will elapse before the California Supreme Court or U.S. Supreme Court decide the issue authoritatively. The passage of time means that law-abiding businesses will be in a quandary: Do they risk *committing a crime* because they are confident that a statute is preempted? It is unconscionable to put law-abiding citizens to this choice. The Legislature should not attempt to criminalize the formation of a contract that federal law not only protects but favors.

Second, even laying aside the criminalization issue, protracted litigation of preemption helps no one. The preemption issue will be litigated in every case — hundreds, perhaps thousands of them statewide — where an arbitration agreement covered by **AB 3080** is at issue. Countless dollars will be spent in such litigation, and countless hours of busy judges' time will be consumed — and in the end wasted.

Third, because **AB 3080** is subject to a direct constitutional attack with recoverable fees to prevailing parties (with lodestar), California taxpayers needlessly — but invariably — will be forced to foot the bill. This ultimate reality is not a question of *if*, but rather, *when* and *why*?

Fourth (and here again even laying aside the criminalization issue), the Legislature should strive to promote certainty in the law, so that law-abiding workers and businesses can knowledgeably order their affairs. The Legislature should not spawn years of litigation before an authoritative resolution of the issue can be had.

For all these reasons, the Legislature should not kick the preemption can down the road for courts to deal with. The Legislature should acknowledge, now, the preemption flaw in this bill, and refuse to enact it for that reason.

Conclusion

Based upon the above legal concerns, we urge you not to pass **AB 3080.**

Sincerely,

David G. Hagopian
Carothers, DiSante & Freudenberger, LLP

cc: Camille Wagner, Office of the Governor
The Honorable Lorena Gonzalez Fletcher
Mark McKenzie, Senate Committee on Appropriations
Jessica Billingsley, Senate Republican Caucus

ADDENDUM OF SUPPORT

The signatures below are partners in substantive California law firms knowledgeable in the field of Federal Arbitration Act preemption. We have reviewed the letter above and fully agree with its reasoning. The preemption issue is not close, and material damage will result if the Legislature enacts the statute and leaves it to the courts to declare it preempted. The Legislature should recognize the preemption flaw in the bill and refuse to enact it.

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