The Arbitration Newsletter

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The Arbitration Newsletter is published periodically by Whitaker Chalk Swindle & Schwartz PLLC, Fort Worth, Texas, to explore the rapidly developing law and practice of commercial arbitration both in the U.S. and other countries.[1]
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FAA PREEMPTION – A REFRESHER

Chamber of Commerce of the United States v. Bonta
13 F.4th 766 (9th Cir. 2021)

California Assembly Bill 51 ("AB51"), signed into law on October 10, 2019, added Section 432.6 to the California Labor Code to protect a person from being required "as a condition of employment, continued employment, or the receipt of any employment-related benefit" either as an "applicant for employment or [as] any employee" to waive "any right, forum, or procedure for a violation of any provision of the *California Fair Employment and Housing Act* … or this [Labor] code." AB51 also prohibited employers from threatening, retaliating, or discriminating against "any applicant for employment or any employee because of the refusal to consent to the waiver of any right, forum, or procedure for a violation of the *California Fair Employment and Housing Act or this* [Labor] *code*." Section 432.6(f) also provided: "Nothing in this section is intended to invalidate a written arbitration agreement that is otherwise enforceable under the Federal Arbitration Act (*9 U.S.C. Sec. 1 et seq.*)."[2]

The federal district court entered a preliminary injunction against the enforcement of Section 432.6 two days before its effective date and found that Section 432.6 was preempted by the Federal Arbitration Act (9 U.S.C. § 2) because "AB51 placed agreements to arbitrate on unequal footing with other contracts and also that it stood as an obstacle to the purposes and objectives of the FAA."[3] The Ninth Circuit vacated the temporary injunction, reversed the FAA preemption of Section 432.6,[4] but affirmed the FAA preemption of the civil and criminal penalties in AB51.[5]

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[1] Nothing in The Arbitration Newsletter is presented as or should be relied on as legal advice to clients or prospective clients. The sole purpose of *The Arbitration Newsletter* is to inform generally. The application of the comments in *The Arbitration Newsletter* to specific questions and cases should be discussed with the reader's independent legal counsel. My thanks to Madeline Bergstrom, a third-year law student at Texas A&M University School of Law, for her research and drafting assistance.
[2] *Chamber of Commerce of the United States v. Bonta*, 13 F.4th 766, 770-774 (9th Cir. 2021).
[3] *Id.* at 772-773.
[4] *Id.* at 775 ("The FAA and *§432.6* do not conflict because, by its terms*, §2 of the FAA* simply does not apply to *§432.6*.").
[5] *Id.* at 781.

The Ninth Circuit provided a brief history of how and why the U.S. Congress enacted the FAA.[6] The Court also gave detailed attention to FAA preemption[7] and explained why Section 432.6 was not preempted by the FAA.[8] The decision provides a helpful refresher on FAA preemption.

Preemption is founded in the Supremacy Clause of the U.S. Constitution.[9] Courts typically follow the rule that "if Congress 'enacts a law that imposes restrictions or confers rights on private actors' and 'a state law confers rights or imposes restrictions that conflict with the federal law,' then 'the federal law takes precedence and the state law is preempted.'"[10]

The court recognizes three different types of preemption in Supremacy Clause jurisprudence: "conflict, express, and field."[11] Express preemption "occurs when Congress passes a statute that explicitly preempts state law."[12] Field preemption "occurs when 'Congress has legislated so comprehensively that it has left no room for supplementary state legislation.'"[13] Both express and field preemption are inapplicable in FAA preemption.[14] Conflict preemption is divided into two separate categories: impossibility preemption and obstacle preemption.[15] Impossibility preemption "occurs when 'it is impossible . . . to comply with both state and federal requirements.'"[16] Obstacle preemption "occurs when a 'state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'"[17]

In this present case, the issue is the preemptive scope of 9 U.S.C. § 2. This section provides for the validity, irrevocability, and enforcement of agreements to arbitrate: "an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract*."[18]

The saving clause provides an exception to strict application of the FAA to arbitration agreements by "permit[ting] agreements to arbitrate to be invalidated by generally applicable contract defenses, such as fraud, duress, or unconscionability."[19] This ensures that courts treat arbitration clauses the same as any other contract. Under the FAA impossibility preemption occurs "if a state-law contract defense treats arbitration agreements less favorably than any other contract—that is, if the defense allows for an agreement to arbitrate to be invalidated or not enforced in circumstances where another contract would be enforced or deemed valid—that contract defense does not fall within the saving clause."[20] Therefore, the standard for enforcing arbitration agreements rises to the same level as enforcing contracts as a whole.

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[6] *Id.* at 770-771.
[7] *Id.* at 774 (referring to "the sheer volume of FAA preemption jurisprudence has created an FAA-specific gloss to the doctrines of impossibility and obstacle preemption.").
[8] *Id.* at 775-781.
[9] *Id.* at 773; citing U.S. Const. art. VI. cl. 2.
[10] *Bonta*, 13 F.4th at 773.
[11] *Id.*
[12] *Id.*, e*.g. Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190 (1983).
[13] *Id.*. e*.g. R.J. Reynolds Tobacco Co. v. Durham County*, 479 U.S. 130 (1986).
[14] *Bonta*, 13 F.4th at 774.
[15] *Id.*
[16] *Id.*, (citation omitted).
[17] *Id.*, (citation omitted).
[18] *Id.*, 9 U.S.C. § 2.
[19] *Bonta*, 13 F.4th at 774.
[20] *Id.* at 774-75.

The Court of Appeals found that the California law "does not create a contract defense that allows for the invalidation or nonenforcement of an agreement to arbitrate, nor does it discriminate on its face against the enforcement of arbitration agreements," and therefore, "the FAA and § 432.6 do not conflict."[21] The court removed § 432.6 from saving clause inclusion based on the fact that the statute "cannot be used to invalidate, revoke, or fail to enforce an arbitration agreement."[22]

But even if a state contract defense can meet the FAA saving clause conditions, it may still be preempted by creating obstacle preemption if it "stands as an obstacle to the accomplishment and execution of the full purposes and objections of Congress [in the FAA]."[23] Any rule that interferes with the enforcement of "private arbitration agreements" or the "fundamental attributes of arbitration," even with "subtle methods," is subject to obstacle preemption.[24] This includes the civil and criminal sanctions related to § 432.6 in both the California Government Code and Labor Code.

The Court of Appeals ultimately held that § 432.6 is not preempted by the FAA for signed, consensual pre-dispute arbitration agreements, but the provisions related to § 432.6 that impose civil or criminal penalties are preempted by the FAA.

OBSERVATIONS

1. FAA preemption is conflict preemption but neither "express" nor "field" preemption.[25]

2. FAA conflict preemption occurs in two forms – "impossibility" and "obstacle" preemption.[26]

3. FAA preemption protects signed, consensual arbitration agreements from state law contract defenses that make it impossible for the contract defense that falls outside the FAA saving clause and the FAA to co-exist.

4. A state law contract defense that does not put signed, consensual arbitration agreements on an "equal plane" or on "equal footing" with all other state law contract defenses falls outside the 9 U.S.C. § 2 saving clause.

5. FAA preemption protects signed, consensual arbitration agreements from any form of state law contract defense that by its operation creates an obstacle to "the accomplishment and execution of the full purposes and objectives of Congress [in the enactment of the FAA]" or interferes "with the enforcement of arbitration agreements."[27]

[21] *Id.* at 775.
[22] *Id.*
[23] *Id.* at 775 (citation omitted).
[24] *Id.*
[25] *Bonta*, at 774 (citation omitted).
[26] *Id.* at 774.
[27] *Id.* at 774-775.