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SB 707 and AB 51 – an update

AN UPDATE ON THESE NEW CONSUMER-FRIENDLY LAWS, CURRENTLY HELD UP IN LITIGATION. BE READY TO BRIEF THE COURT NOW

Last year, Governor Gavin Newsom signed into law two arbitration-related bills, SB 707 and AB 51. SB 707 has been in effect since January 1, 2020. While AB 51 was supposed to take effect the same day, a coalition of business organizations was able to convince the United States District Court of the Eastern District of California to prevent California from enforcing AB 51 while the case in the Eastern District is being litigated.

SB 707's amendments to the Code of Civil Procedure

SB 707 amends sections 1280 and 1281.96 of the Code of Civil Procedure, and adds sections 1281.97, 1281.98, and 1281.99 to, the Code of Civil Procedure.

Summary of SB 707

This new law applies to employment or consumer arbitration agreements and imposes stiff penalties on businesses that default on arbitration payments beyond 30 days of their due date. If a company or business fails to timely pay arbitration fees and costs, SB 707 states that it is in default of the arbitration and has waived its right to compel arbitration. In this scenario, SB 707 outlines *four* procedural remedies available to employees and consumers:

1. they may elect to withdraw the claim from arbitration and proceed in court;
2. they may pay the employer's unpaid fees in order to continue the arbitration, and recover the amount paid at the end of the proceeding regardless of whether or not they prevail;
3. they may petition the court for an order compelling the defendant to pay the fees; or
4. they may choose to continue in arbitration, provided that the arbitrator agrees to continue as well.

SB 707 also requires arbitrators to now disclose arbitrators' demographic data (namely gender, race/ethnicity, sexual orientation, gender identity, and veteran and disability status). The Legislature's intention here is to address the issue of diversity in the arbitration industry by requiring arbitrators to report the same kind of demographic information that the Judicial Council has been required to report about state court justices and judges for years.

Why it is important to already have an understanding of SB 707 arguments

In practice, defendants in employment and consumer cases have failed to timely pay their arbitration fees since January 1, 2020. Thus, it is important to understand the arguments at play now (as opposed to rushing to understand the issues when you have to quickly brief the issues for your judge).

Defaulting defendants' strategies when they default and how to overcome them

In practice, defense lawyers have been emailing plaintiff's lawyers for extensions after their client(s) default on arbitration fees, citing the strains of coronavirus. The California Chamber of Commerce also tried to get a "financial hardship" exemption to SB 707. If your opposing counsel is mentioning coronavirus or claiming "financial hardship," you can cite to Page 10 of the California Judiciary Committee's analysis on SB 707. In a nutshell, the Judiciary Committee, in its analysis, showed no sympathy for such defendants. The Judiciary Committee pointed out that arbitration is a choice and the defaulting company could have simply avoided its liberal use of an arbitration provision in its employment agreements in the first place.

Even if the arbitrator unilaterally agrees to re-open the arbitration before you can file a lawsuit in court or the arbitrator agrees to re-open the arbitration down the line (after you file), the court should still deem the defendant(s)' failure to pay a material breach of the arbitration agreement. Under SB 707 (California Code of Civil Procedures Section 1281.97(b)(1)), you can proceed to court and the court must also impose sanctions. It does not matter if the arbitrator re-opens the file, as the defendant(s) already breached the arbitration agreement.

Should you use SB 707 to get back into civil court?

If your case is a low-value one, and you have a decent arbitrator, you might want to give the defendant(s) a chance to pay and suggest early mediation. Even if mediation is not successful in such a low-value case, you can leverage the arbitration fees into a settlement. However, if you have a good case, take advantage of SB 707 to get out of arbitration.

Should you stay in arbitration despite a default in payment?

In the event a defendant does not pay for the arbitration, SB 707 allows recovery of attorneys' fees and costs. If the defendant(s) cannot pay, you may want to force the defendant(s) to stay in arbitration and then get an order pursuant to SB 707 to at least get your fees and costs.

Challenges to SB 707 this year

On April 8, 2020, the restaurant delivery service Postmates filed an ex parte application for a temporary restraining order ("TRO") in the U.S. District Court for the Central District of California. Postmates asked the court to declare that SB 707 is unconstitutional and preempted by the Federal Arbitration Act (FAA). Thankfully, Postmates was unsuccessful. The court denied the ex parte application, concluding that none

See Gupta, Next Page

Journal of Consumer Attorneys Associations for Southern California
ADVOCATE
November 2020

of Postmates' arguments justified any need for immediate injunctive relief. Postmates could simply pay the arbitration filing fees and continue litigating, instead of preemptively exaggerating that it faces irreparable harm if a TRO is not granted. (*Postmates, Inc. v. 10,356 Individuals*, No. 2:20-cv-02783 (C.D. Cal.).)

The following is a great template on how to brief SB 707 issues for your Judge: https://static.reuters.com/resources/media/editorial/20200721/postmates--greenwoodmotion.pdf. The template is from a recent filing by the lawyers representing the Postmates employees.

AB 51 did not become effective Jan. 1 as intended

As discussed in the introduction above, the court in *Chamber of Commerce of the United States et al. v. Becerra et al.*, No. 2:19-cv-02456 (E.D. Cal.) has kept an injunction in place blocking AB 51's enforcement while the case is being litigated.

Where AB 51 would be codified

AB 51 would add Section 432.6 to the Labor Code and Section 12953 to the Government Code.

Summary of AB 51

AB 51 would make it unlawful for employers to impose arbitration agreements on employees as a condition of employment, even if employees are permitted to opt out. (Lab. Code, § 432.6, subds. (a), (c).) AB 51 would also prohibit employers from threatening, retaliating against, or discriminating against employees or applicants for refusing to waive their rights, "including the right to file and pursue a civil action or a complaint" for a violation of the California Fair Employment and Housing Act ("FEHA") or the California Labor Code. (Lab. Code, § 432.6, subd. (b).) It would be a *criminal* misdemeanor for an employer to violate AB 51.

AB 51 would apply to arbitration agreements "entered into, modified, or extended on or after January 1, 2020." (Lab. Code, § 432.6, subd. (h).)

AB 51 Litigation Before the Eastern District of California

On January 10, 2020, the court in *Chamber of Commerce of the United States et al. v. Becerra et al.*, No. 2:19-cv-02456 (E.D. Cal.) heard the business coalitions' motion for a preliminary injunction. The court granted the motion by a minute order issued on January 31, 2020. On February 7, 2020, the court issued a 36-page order confirming the minute order, with explanation. As of now, California is temporarily enjoined from enforcing AB 51 throughout the pendency of the litigation.

Summary of court's 36-page order granting the motion for a preliminary injunction

Sole legal issue before the court

The business organizations are trying to convince the court that AB 51 is preempted by the Federal Arbitration Act (FAA). The court reviewed "whether the FAA preempts" AB 51.

Case law considered by court in deciding to grant motion for preliminary injunction

In determining whether to issue a preliminary injunction, federal courts must consider whether the moving party '[1] is likely to succeed on the merits, . . . [2] is likely to suffer irreparable harm in the absence of preliminary relief, . . . [3] the balance of equities tips in [the movant's] favor, and . . . [4] an injunction is in the public interest.

Factor 1: Likelihood of success on the merits

Case law considered by the court: The court found that unequal footing and interference with the fundamental attributes of arbitration are two ways in which a state-law rule can be preempted by the FAA.

Unequal Footing/Equal Treatment: "In practical terms, equal treatment means '[a] court may invalidate an arbitration agreement based on 'generally applicable contract defenses' like fraud or unconscionability, but not on legal rules that 'apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue.'' Therefore, if any state rule 'singles out arbitration,' it is preempted by the FAA.

Interference with the fundamental attributes of arbitration: "[E]ven when a state law puts arbitration agreements on equal footing, the law may nonetheless be subject to FAA preemption if it 'interferes with fundamental attributes of arbitration.'" This kind of interference implicates conflict preemption principles because the state law, in essence, 'stand[s] as an obstacle to the Federal Arbitration Act.'

Reasons why the court found unequal footing here: "As AB 51's legislative history acknowledges, the primary target of the bill is agreements to arbitrate. (S. Floor Analysis at 3-4.) As a result, AB 51 penalizes employers who include, as a take-it-or-leave-it proposition, a mandatory arbitration clause."

"AB 51 singles out the requirement of entering into arbitration agreements and thus subjects these kinds of agreements to unequal treatment…. translates into a state-derived rule affecting arbitration specifically…. runs afoul of the federal law by contravening the equal footing principle."

"California has successfully enacted numerous laws that regulate employer behavior, including with respect to waivers of certain employee rights… These examples, however, are not laws that singled out contracts that bear the defining features, either in name or effect, of arbitration agreements, as prohibited by the FAA."

"Other types of employment provisions may tangentially fall within AB 51's ambit, but the law's clear target is arbitration agreements, given the sponsors' concern regarding an overabundance of arbitration

See Gupta, Next Page

Journal of Consumer Attorneys Associations for Southern California
ADVOCATE
November 2020

agreements in the California employment market."

"It is the employer alone who may face the civil or criminal sanctions available for violating the law. But because the employer may be sanctioned specifically for requiring an arbitration agreement as a condition of employment, with a likely deterrent effect on the use of such agreements…AB 51's design does not comport with the equal footing principle."

Reasons why the court found interference with arbitration:"As noted above, AB 51 will likely have a deterrent effect on employers' use of arbitration agreements given the civil and criminal sanctions associated with violating the law"

Factor 2: Likelihood of harm in absence of preliminary relief

"California businesses that rely on arbitration agreements as a condition of employment will be forced to choose between risking criminal or civil penalties, or both, based on the uncertainties surrounding AB 51's implementation, and foregoing the use of arbitration agreements altogether to avoid penalties…California business that rely on standard form arbitration agreements as a condition of employment will incur immediate costs of redrafting their employment agreements…These costs likely cannot be recouped through traditional legal remedies, such as damages, because the State of California, the moving force behind AB 51's enactment, is immune from suit under sovereign immunity, as are the defendant state actors acting within their lawful capacity."

Factors 3 and 4: Balance of equities and public interest

"The balance of equities and public interest factors merge when the government is the opposing party ….In the unlikely event AB 51 is later found compatible with the FAA and not preempted, defendants will have suffered the minimal harm of delayed enforcement, whereas plaintiffs are likely to have suffered harm that cannot be remedied."

Conclusion

You need to have a general understanding to SB 707 now, not when you are rushing to brief the issue in the unfortunate event that a defendant defaults on arbitration fees. The Chamber of Commerce is trying to sell SB 707 as harmful to small companies who need a "financial hardship" exemption. However, as you can see above, a big company like Postmates has issues with SB 707. SB 707 was enacted partially because big companies like Uber, Lyft, DoorDash and Postmates were strategically refusing to pay arbitration fees. SB 707 was passed to reverse that trend and was much needed because California law was previously *silent* on what employees and consumers could do if companies failed to pay arbitration fees.

As for AB 51, even if the Eastern District of California ultimately disagrees with the business organizations who filed suit, there will likely be some other inevitable challenge to AB 51. Thus, plaintiffs' lawyers should keep track of the case, arguments by the business organizations in the case, and the court's ultimate decision at the end of litigation.

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