Mark H. Wagner
WAGNER LEGAL GROUP P.C.

Journal of Consumer Attorneys Associations for Southern California
ADVOCATE
November 2020

The Federal Arbitration Act and its overreach

A LOOK AT THE BACKGROUND AND RECENT HISTORY OF THE FAA'S PREEMPTION OF STATE LAW

The Federal Arbitration Act ("FAA") was passed in 1925 to establish an alternative to the complications of litigation and to expedite and facilitate settlement of disputes. The goal was to eliminate the expense and delay of extended court proceedings. This resulted in the policy that federal courts favor arbitration. Moreover, any laws that were an impediment to arbitration were trumped by the FAA. Still, this did not mean that all arbitration agreements were per se enforceable.

Section 2 of the FAA states that an arbitration agreement is enforceable, "save upon such grounds as exist at law or in equity for the revocation of any contract." This is known as the "savings clause" and was meant to prevent unfair arbitration contracts from being enforceable. In laymen's terms, it means that if some ground exists (in law or equity) that would defeat any contract, it could defeat an arbitration contract. It was a last hope for parties trying to avoid arbitration. As will be discussed herein, the U.S. Supreme Court continues to dash those with hopes of avoiding mandated arbitration.

The FAA preempts state law

In 1984, the situation worsened for those trying to avoid mandated arbitration. The U.S. Supreme Court held that the FAA pre-empted state law. (See *Southland Corp. v. Keating* (1984) 465 U.S. 1.) This drastically expanded the reach of the FAA and meant that the FAA trumped state laws that were an impediment to the policy favoring arbitration. It forever changed the rights of employees and consumers in America. As a result of this ruling, state courts were being forced to start compelling arbitration of all types of disputes, including consumer and employment disputes.

Over time, the U.S. Supreme Court made clear that FAA preemption applied to any transaction, situation, or contract dealing in any manner with "interstate commerce." While this seems like a limitation, it is in reality, extremely broad and only has to have a tenuous connection to interstate activity. It is a rare circumstance, especially in this age of internet and connectivity between all the states, to find a matter that does not somehow touch upon interstate commerce. [As a side note, in 1961, California enacted the California Arbitration Act (Code Civ. Proc., § 1280 et. seq.).

The FAA also states that arbitration agreements are enforceable, save upon such grounds as exist for the revocation of any contract. It then lays out how to enforce an arbitration agreement, how to conduct the arbitration proceedings, and how to enforce an arbitration award in Court. The reality is that it is very rare to have an arbitration that is controlled by the CAA, rather than the FAA. Again, most things touch interstate commerce. But occasionally, parties agree to be bound by the CAA, or at least follow the procedures.]

California's fight against the FAA

Despite the overreaching power of the FAA, California's Legislature and state courts, including the California Supreme Court, have done a lot to try to stop the tide of depriving people of their rights to a jury trial. In a December 2012 Advocate article, this author examined the history of the FAA and how it went from a federal law that only applied in federal courts, to one of the most powerful laws in the country. It detailed how U.S. Supreme Court decisions have expanded the reach of the FAA, and negated states' and individuals' rights, ignoring the true purpose of the FAA. Since then, California's Legislature and state courts have continued to fight against the U.S. Supreme Court, with a little help from other federal courts. But no matter what they do, the U.S. Supreme Court has continued to create obstacles.

When we last discussed this topic in 2012, we were dealing with the Court's landmark ruling in *AT&T v. Concepcion* (2011) 563 U.S. 333, where the U.S. Supreme Court again held that the FAA preempted California law. There, the Court held that California's state law, which deemed class-action waivers in arbitration agreements unenforceable, was preempted by the FAA because it stood as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress. At that time, this author suggested that it was time to pass the Arbitration Fairness Act of 2011 ("AFA"), which was pending before Congress, after an attempt had failed in 2009. Of course, the AFA never went anywhere. Moreover, the situation has worsened for consumers and employees who are constantly forced into arbitrations. As shown herein, California continues to battle, but until Congress acts, it will always be an uphill battle, even more so with a conservative majority on the Supreme Court.

The Supreme Court continues to expand the power of the FAA

In *Am. Exp. Co. v. Italian Colors Rest.* (2013) 570 U.S. 228, the United States Supreme Court dealt a major blow to class action cases and the right to a jury trial. There, certain merchants filed a class-action antitrust suit against American Express. American Express moved to compel arbitration and it was granted. The Second Circuit reversed, finding that the class-action waiver provision contained in a mandatory arbitration clause in the card acceptance agreement was unenforceable. The Supreme Court took the case to decide whether a contractual waiver of class arbitration was enforceable under the FAA when the plaintiff's cost of individually arbitrating a federal statutory claim exceeds the potential recovery.

See Wagner, Next Page

Journal of Consumer Attorneys Associations for Southern California
ADVOCATE
November 2020

The Supreme Court held that the FAA does not permit courts to invalidate a contractual waiver of class arbitration on the ground that the plaintiff's cost of individually arbitrating a federal statutory claim exceeds the potential recovery. It basically upheld arbitration of claims and said there could be a waiver of class claims. It rejected the argument that class arbitration was necessary to prosecute claims "that might otherwise slip through the legal system."

In short, this case helps destroy class actions and scares off plaintiffs who may have small claims that would only be worth pursuing as a class. In other words, if a company cheats everyone for a tiny amount, that makes it not worth it to pursue individual claims, the company can get away with it. As the dissent put it, American Express "has insulated itself from antitrust liability – even if it has in fact violated the law. The monopolist gets to use its monopoly power to insist on a contract effectively depriving its victims of all legal recourse…" and the majority's response is, "Too darn bad." It was a major blow to consumers.

In *Sonic-Calabasas A, Inc. v. Moreno* (2011) 51 Cal.4th 659 (*Sonic* I), the California Supreme Court held that, as a categorical rule, it was contrary to public policy and unconscionable for an employer to require an employee, as a condition of employment, to waive the right to a Berman hearing, a dispute resolution forum established by the Legislature to assist employees in recovering wages owed. The Court held that a rule prohibiting waiver of a Berman hearing did not discriminate against arbitration agreements and was therefore not preempted by the FAA.

The U.S. Supreme Court granted certiorari, vacated the judgment, and remanded the case for consideration in light of *AT&T Mobility LLC v. Concepcion* (2011). Thus, the California Supreme Court was forced to reconsider its decision. It did so in *Sonic-Calabasas A, Inc. v. Moreno* (2013) 57 Cal.4th 1109 (*Sonic* II). Upon reconsideration, the California Supreme Court stated that in light of *Concepcion*, it concluded that "because compelling the parties to undergo a Berman hearing would impose significant delays in the commencement of arbitration, the approach we took in *Sonic I* is inconsistent with the FAA." It thus reversed its prior decision. It held now that the FAA preempted the California law that categorically prohibited the waiver of a Berman hearing in a pre-dispute arbitration agreement imposed on an employee as a condition of employment.

In other words, the U.S. Supreme Court's ruling forced the California Supreme Court to reverse course. The only good news was that the Court held that a trial court could consider the waiver of the Berman protections when considering whether the arbitration agreement was unconscionable due to waiver of affordable and accessible dispute resolution forum. It noted, again, the general rules of unconscionability still applied under the savings clause.

In *Ferguson v. Corinthian Colleges, Inc.* (9th Cir. 2013) 733 F.3d 928, the Ninth Circuit held that the FAA preempted the *Broughton–Cruz* rule, which the California Supreme Court had created to exempt claims for "public injunctive relief" from arbitration. A group of college students brought a class action against the college alleging breach of implied contract, breach of implied covenant of good faith and fair dealing, fraud, and other claims, seeking restitution, punitive damages, and injunctive relief. The district court granted in part, and denied in part, the college's motion to compel individual arbitration. The denial was based on the *Broughton-Cruz* rule regarding injunctive relief. Defendants appealed. The Ninth Circuit held that based on the decisions of the U.S. Supreme Court, California's rule was preempted by the FAA. It reversed and forced all claims into arbitration. In essence, the Supreme Court's ruling forced another court to overrule the California Supreme Court's limitations on imposing arbitration.

In *Iskanian v. CLS Transportation Los Angeles, LLC* (2014) 59 Cal.4th 348, the FAA was again used to preempt a California law. The California Supreme Court had previously ruled that class action waivers as to employees' unwaivable rights to be contrary to public policy. In this case, the California Supreme Court was forced to reexamine that rule after the rulings by the U.S. Supreme Court. Upon reexamination, the California Supreme Court ruled that the class action waiver did not violate the National Labor Relations Act (NLRA) and the FAA did in fact preempt California law. It had to overturn its precedent. It was a huge blow to class actions and to employees. Again, the Court was forced to overrule itself based on rulings from the U.S. Supreme Court. The one exception to the rule related to the waiver of employees' right to bring a representative action under Private Attorney General Act (PAGA). The Court held that this violated public policy and that the FAA did not preempt state law as to unenforceability of waivers of PAGA. While it was only part of the case, this was a major and rare victory in trying to defeat forced arbitration. But as a whole, the ruling hurt employees in a major way.

The defendant has the burden to prove preemption

While FAA preemption is extremely broad, and nearly everything touches interstate commerce, the California courts have made clear that it is not an automatic issue. In *Lane v. Francis Capital Mgmt. LLC* (2014) 224 Cal.App.4th 676, the court noted a small exception to the trend of forced arbitration when examining a case dealing with California Labor Code section 229. In essence, section 229 states that claims for unpaid wages may be litigated in court despite any arbitration agreement.

This was one of the laws passed in California to help employees avoid forced arbitration. The court ruled that some of the claims in the lawsuit fit within section 229's protections. Defendant argued that even assuming some of the claims did fall into it, that section 229 was preempted by the FAA, as stated in *Perry v. Thomas*

See Wagner, Next Page

Journal of Consumer Attorneys Associations for Southern California
ADVOCATE
November 2020

(1987) 482 U.S. 483, 492, another U.S. Supreme Court ruling that obstructed California's effort to protect employees.

The *Lane* court noted that while that was true, a party seeking to enforce an arbitration agreement has the burden of proving FAA preemption, e.g., showing the subject matter involves interstate commerce. The court noted that the petitioner failed to offer any evidence of preemption. It offered no evidence as to how the employment relationship involved interstate commerce. As a result, the burden of showing preemption had not been met. As a result, section 229 still applied and arbitration was not proper. While the rules of FAA preemption still applied, and generally force California courts into forcing arbitration on employees, there is a sliver of hope that a defendant may fail to meet the basic requirements; it is not simply an automatic preemption. Any non-lazy defendant, however, will likely satisfy this burden.

The California Supreme Court (with a little help from the 9th Circuit) fights back when it can

As noted above, in 2014, the California Supreme Court held in *Iskanian* that forcing PAGA claims into arbitration was not proper. In 2015, a different set of defendants tried to have a federal court overturn the California Supreme Court and hold that the decision was preempted by the FAA. In *Sakkab v. Luxottica Retail N. Am., Inc.* (9th Cir. 2015) 803 F.3d 425, defendants argued to the Ninth Circuit that the FAA did, in fact, preempt California's rule barring waiver of representative claims under PAGA, and that the California Supreme Court was wrong in *Iskanian*. The Ninth Circuit rejected that argument. It said that rule was not an obstacle to arbitration and the goals of the FAA. It held that the savings clause applied, as the *Iskanian* rule was a ground for the revocation of any contract. It was a key victory on stopping forced arbitrations with respect to PAGA claims.

In 2017, the California Supreme Court looked at FAA preemption in the consumer context. In *McGill v. Citibank, N.A.*, 2 Cal.5th 945 (2017), the Court addressed the issue of the validity of a provision in a pre-dispute arbitration agreement that waives the right to seek public injunctive relief, even in arbitration. The California Supreme Court held that such a provision is contrary to California public policy and is thus unenforceable under California law. Moreover, the Court then held that the FAA did not preempt this rule of California law or require enforcement of the waiver provision. It was another victory for consumers in state Court. Of course, as detailed below, this was soon challenged in federal court.

In *Blair v. Rent-A-Ctr., Inc.* (9th Cir. 2019) 928 F.3d 819, the defendants argued to the Ninth Circuit that the California Supreme Court ruling in *McGill*, was preempted by the FAA. It was another attempt to overrule the California Supreme Court. The Ninth Circuit ruled that the FAA did not preempt the California Supreme Court's holding in *McGill* and thus, it was allowed to stand. The court stated that it was guided by the Supreme Court's decision in *Concepcion* and its prior decision in *Sakkab*. The court held that the *McGill* rule is a generally applicable contract defense derived from long-established California public policy and applied to any contract and falls under the FAA's saving clause. Moreover, it held that the *McGill* rule did not "mandate procedures that interfere with arbitration." In short, it was not preempted. This was a victory against forced arbitration and the Ninth Circuit again protected the California Supreme Court, something the U.S. Supreme Court has not been willing to do.

The U.S. Supreme Court strikes another blow

In *Epic Sys. Corp. v. Lewis* (2018) 138 S.Ct. 1612, the Supreme Court dealt another major blow to employees' rights when it held the FAA preempted the National Labor Relations Act ("NLRA"). The Supreme Court addressed the issue whether employees and employers should be allowed to agree that any disputes between them will be resolved through one-on-one arbitration or should employees always be permitted to bring their claims in class or collective actions, no matter what they agreed with their employers.

The Court noted that public policy is a different issue, but under the law, the answer was clear, the FAA instructed courts to enforce arbitration agreements. The Court noted that the NLRA secures employees' rights to organize unions and bargain collectively, but it says nothing about how judges and arbitrators must try legal disputes that leave the workplace and enter the courtroom or arbitral forum. It noted that there has never been a class action right in the NLRA. The Supreme Court, explained, however, that in 2012, the National Relations Labor Board ("NLRB"), asserted that the NLRA effectively nullifies the FAA in certain cases. (See *D.R. Horton, Inc.*, 357 N.L.R.B. 2277.) At the time, it was considered a major victory for employees. The decision, however, resulted in varying decisions in circuit courts. The Supreme Court took up the case to clarify the confusion. The Court noted that while policy people could debate this issue, and Congress could change the law, it found no evidence to suggest the NLRA had any intention, let alone a clear intention, to displace the FAA. The FAA controlled. It trumped another federal law. The dissent found this to be "egregiously wrong."

California's Legislature again joins the fight against forced arbitration

As has been made clear over the last eight years since the prior article, California state courts and the legislature have been trying to protect rights of employees and consumers who have little to no bargaining power, and who are

See Wagner, Next Page

Journal of Consumer Attorneys Associations for Southern California
ADVOCATE
November 2020

forced into adhesion contracts buried in paperwork. But the U.S. Supreme Court has repeatedly protected corporate America and stomped on the right to a jury trial for the average person. The high court rulings force California courts to vacate rules and laws they believe protect Californians. Frustrated by this, in late 2019, California passed AB 51, which essentially restricted mandatory arbitration as a condition of employment.

This bill had been rejected by the prior administration due to the argument it could violate the FAA, not on policy grounds. Shortly after the enactment, the U.S. Chamber of Commerce challenged AB 51. (*Chamber of Commerce of the United States v. Becerra*, Case No. 2:19-cv-2456 KJM DB.) While the statute was written to try to avoid FAA preemption, the Chamber of Commerce argued it was improper. The district court issued a preliminary injunction that effectively permits employers to continue to enter into arbitration agreements covered by the FAA, concluding that the FAA likely preempts newly enacted law. This will be a long battle, but it was California's attempt to come up with a solution as the U.S. Congress has not passed a law. While this case is in preliminary phases, another article in this magazine will detail this law and all that comes with it. It seems to be a Hail Mary.

The Forced Arbitration Injustice Repeal Act

Assuming for the moment that AB 51 fails, it all comes back to the same point. The United States Congress must act. In 2019, the House of Representatives passed the Forced Arbitration Injustice Repeal Act, which would have protected consumers and employees, similar to the AFA, which never passed. However, the Senate has done nothing and will likely never pass it, at least while there is Republican control and/or a Republican in the White House. That said, in the past, the Democrats failed to do anything when they had control of all three branches. Congress continues to leave the FAA and permit forced arbitrations and waivers of rights. With congress failing to protect employees and consumers, and the U.S. Supreme Court firmly on the side of corporate America, the only other hope is for public pressure to result in changes for each company, which has occurred in limited circumstances. It is likely not a universal solution.

Will public pressure rule the day?

In the past couple of years, as the "me too" movement has gained steam, large companies have started to change some arbitration policies. Microsoft, Google, Facebook, Uber, Lyft and others have bowed to public pressure and will no longer force sexual harassment or assault claims into arbitration. Of course, this is only limited to that one type of claim, and again, only applies to a few companies. Millions of other workers, at other large and small companies are still forced into arbitration, where they simply will not get a fair shake. But for now, this has been the only hope. Is it possible that the recent BLM movement may force companies to abandon arbitration when it comes to race claims? Is it possible that the mood of the country will force companies to stop silencing employees and forcing them into more secretive arbitrations all together? Only time will tell, but as of now, it seems this may be the best hope, as the U.S. Congress has done nothing in the last 10 years, or better said, in the last 95 years.

Mark H. Wagner is the founder of the Wagner Legal Group P.C., *located in Santa Monica, CA. His practice focuses on plaintiff's employment law. He holds degrees in finance, management, and history from Washington University in St. Louis. He graduated with honors from the University of San Diego School of Law, where he was on the law review and a member of the Order of the Coif. He is licensed in California and Arizona. He can be reached at mark@wagnerlegalgroup.com.*