

OCTOBER 3, 2016

New California Law Prohibits Choice of Law and Venue in Employment Contracts

BY M. SCOTT MCDONALD AND JIM HART

On September 25, 2016, Governor Brown signed into law a new California Labor Code provision (Section 925) that is likely to have major repercussions for contracts with employees who live and work primarily in California. The new California Labor Code provision prohibits the use of contract provisions that apply another state's law or require adjudication of disputes in another state as a condition of the employment of an individual who primarily resides and works in California.

The law applies to contracts entered into, modified, or extended on or after January 1, 2017. This gives employers a brief window to address the need for changes in their existing employment agreements. However, determining what changes are needed will require an individualized assessment because the new law raises a whole host of unanswered questions, and employers will have more than one option regarding how to address the concerns created by the new law.

The New Law - Section 925

Section 925 appears relatively simple on its face. It provides as follows:

- a. *An employer shall not require an employee who primarily resides and works in California, as a condition of employment, to agree to a provision that would do either of the following:*
 1. *Require the employee to adjudicate outside of California a claim arising in California.*
 2. *Deprive the employee of the substantive protection of California law with respect to a controversy arising in California.*
- b. *Any provision of a contract that violates subdivision (a) is voidable by the employee, and if a provision is rendered void at the request of the employee, the matter shall be adjudicated in California and California law shall govern the dispute.*

- c. *In addition to injunctive relief and any other remedies available, a court may award an employee who is enforcing his or her rights under this section reasonable attorney's fees.*
- d. *For purposes of this section, adjudication includes litigation and arbitration.*
- e. *This section shall not apply to a contract with an employee who is in fact individually represented by legal counsel in negotiating the terms of an agreement to designate either the venue or forum in which a controversy arising from the employment contract may be adjudicated or the choice of law to be applied.*
- f. *This section shall apply to a contract entered into, modified, or extended on or after January 1, 2017.¹*

The apparent intent of Section 925 is to largely eliminate the normal contractual right that parties have to select the law governing their contractual obligations and the venue (or location) for any legal proceeding adjudicating the rights of the parties under their contract. While other state and federal laws will occasionally prohibit contractual provisions that would avoid their application, Section 925 appears unique and unprecedented in its extremely broad and sweeping prohibition regarding the use of choice-of-law and venue clauses for individuals who primarily reside and work in California.

Choice of law and choice of venue clauses are commonplace elements in contract law. They are already governed in a relatively uniform fashion across the United States through common-law principles largely articulated in the Restatement of Conflict of Laws, and in jurisdictional and procedural rules and doctrines (like forum non conveniens and personal jurisdiction). Why the protections already built into these legal guidelines were deemed inadequate to protect the rights of California employees, and how the special protections created by Section 925 will be reconciled with some of these principles going forward, are only two of many unanswered questions raised by Section 925.

Is choosing another state's law or venue now an illegal act in California? Or is it simply the use of a voidable provision?

Section 925 and the Legislative Counsel's Digest accompanying it paint an unclear picture on this issue. Section 925(a) provides that an employer "shall not" require an employee who primarily resides and works in California, as a condition of employment, to agree to a contract that has a choice of venue or law provision that would offend the statute. This type of language is usually reserved for a direct and complete prohibition of the conduct at issue—it would appear to make asking an employee to sign such an agreement an illegal act. Similarly, the Digest introduction to the law starts out by noting that existing law prohibits an employer from requiring an employee or applicant for employment to agree, in writing, to any term or condition that is known by the employer to be illegal. This is a reference to Labor Code Section 423.5, and sets the stage for the argument that using such an agreement is an illegal act in and of itself.

On the other hand, Section 925, subdivision (b) goes on to say that an offending provision "*is voidable by the employee, and if a provision is rendered void at the request of the employee, the matter shall be adjudicated in California and California law shall govern the dispute.*" This suggests that the employee is the one who controls whether the provision (choice-of-law or venue) is honored or not. The statute is very unusual in that it does not simply declare the provision void but instead makes it voidable. Logically, this means it is not an illegal provision from the outset – otherwise it would simply be void – but is instead potentially illegal depending on what the employee elects to do and whether the employee happened to be represented by counsel when the contract was formed. The law is clearly written so as to give the employee the option to use (and enforce) the questionable provision if it is favorable to him or her or request that it be voided if it is not favorable. Presumably, it is not an illegal clause or illegal act by the employer to use it

¹ The bill initially was intended to apply to both employment and consumer contracts, but the final bill was revised to only apply to employment contracts.

if the employee likes it and chooses to enforce it. Under this scenario, the employer has no way to know in advance what decision the employee will make in this regard, which is significant because the employer's knowledge is an important factor in determining liability. Rather, the inclusion of language permitting an employee to void the agreement appears to be in response to prior bills that were vetoed in past legislative sessions, including AB 267 (Swanson, 2011), AB 335 (Fuentes, 2009), and AB 1043 (Swanson, 2007). In an attempt to distinguish this law from prior unsuccessful bills, the legislative history here indicated that "[i]n contrast to those bills, this bill would make the choice-of-law and choice of forum provisions voidable by the employee, and not automatically void and unenforceable."

Whether or not the use of the potentially offending provision could create a violation of Labor Code Section 432.5 referred to in the Digest is dependent on the employer's knowledge. By its express terms, Section 432.5 applies only where an employee is required to agree to a term or condition known by the employer to be prohibited by law. Cal. Lab. Code § 432.5. Does the fact that the provision might be deemed void if the employee so chooses make it prohibited by law from the outset, or only prohibited by law if the employee does not like it? That it might be declared void is not the same as illegal. "Void" merely means "of no legal effect; null," whereas "prohibit" means "to forbid by law."² Consequently, several important questions remain unanswered and are ripe for litigation.

Can the employee change position at any time or elect to void provisions in a selective fashion?

The statute is not clear how the employee's right to elect whether to void the offending choice-of-law or venue provision will work. It appears unlikely that the employee can be compelled to choose before the "controversy" at issue is ripe for legal action since the substantive prohibition applies only to the application of a choice of law to a particular controversy.

However, the wording of Section 925, subdivision (b) suggests that once a controversy has arisen and the employee elects to void the selection of another state's law, the entire matter is controlled by California law and adjudicated in California (the "matter shall be adjudicated in California and California law shall govern the dispute"). This would indicate that statute contemplates one, simple election with no change in course thereafter. It does not, however, indicate at what stage of a dispute this election can (or must) be made.

Is the selection of another state's law always going to be problem?

Technically "no," but practically "yes." Section 925, subdivision (b) only prohibits the selection of another state's law if it deprives the employee of the substantive protection of California law with respect to a controversy arising in California.

However, this sets up a difficult and largely unpredictable stage upon which the parties can contract. Are the parties supposed to anticipate every conceivable "controversy" that might ever come up between them and compare the laws of the two states and somehow "know" in advance whether the result would be different under California law or the law chosen? Realistically, that would be an impossible task. And, consequently, the practical effect is that an employer will have little choice but to presume it cannot use another state's law in most instances.

Is Section 925 applicable to all employment contracts with California employees?

Not exactly. By its terms, Section 925 applies only to contracts that are required "as a condition of employment, ...". As a result, if an employee is given a choice and not required to sign the agreement as a condition of employment, the prohibition in the statute would not appear to apply. This suggests, for example, that an agreement that is not a condition of employment but instead a condition of participation

² See Black's Law Dictionary (8th ed. 2004).

in some form optional benefit (like a stock option plan), or one with an opt-out provision, could choose another state's law and venue.

What are the remedies for the employee under Section 925?

Section 925 says that in addition to injunctive relief, the employee can collect attorneys' fees and other remedies available by law. The statute does not identify specifically what these other remedies might be, but the Digest's reference to 423.5 suggests some potential for application of remedies available under the Labor Code.

The remedy that is apparently presumed to be applicable by the statute is injunctive relief, but exactly how this would work is uncertain. Certainly, the pursuit of a declaratory judgment claim where the employee seeks to have the choice of law and venue declared unenforceable is a logical remedy. But the statute's reference to injunctive relief is more puzzling.

The most logical way for Section 925 to come up is a situation wherein the employer has taken steps to enforce the choice of law or venue in a court of law. Normally, courts are very reluctant to enjoin a party from exercising the right to pursue legal relief in a court of law. For example, in the context of attempts to enforce noncompete contract provisions that would be void under Cal. Bus. & Professions Code Section 16600, the California Supreme Court has previously ruled that a California court cannot enjoin an employer's use of another state's court to enforce a noncompete nor can it enjoin a foreign state court from going forward with a legal action to enforce a noncompete.³ And, in federal courts, the concept of using Section 16600 as basis for one court enjoining another court has been rejected under the Anti-Injunction Act.⁴ There is no apparent reason on the face of Section 925 why an employee's attempt to enjoin an employer from using a court to enforce choice-of-law or venue provisions that offend Section 925 would be treated any differently than attempts to enforce noncompete contracts unenforceable under Section 16600. This does not mean that a declaratory judgment declaring the offending choice-of-law or venue provision in the contract at issue void under Section 925 could not be pursued, nor does it mean that the employee could not assert other remedies. It simply means the statute's purported remedy of injunctive relief is suspect.

Can an arbitration agreement be used instead of court action to avoid Section 925?

By its terms, Section 925 applies to both court and arbitration adjudication matters. Consequently, on its face it does not make a difference whether or not the controversy at issue is subject to a mandatory arbitration agreement. And, in fact, if the mandatory arbitration agreement itself is a condition of the individual's employment and it has an offending choice-of-law or venue provision, these provisions in the arbitration agreement might violate Section 925.

Legislative history candidly acknowledges the new law is being enacted to outlaw or limit the freedom to enter into arbitration agreements. In fact, the legislative history behind the bill criticized the entire notion of arbitration at length, citing numerous criticisms of the process with almost no acknowledgement of the benefits frequently cited in favor of the process.⁵ In many respects the legislative history focused on criticisms of arbitration that arise in the consumer advocacy context and not the employment law context. Consequently, it is ironic that the bill ended up as one that applies only to employment contracts.

To the extent that Section 925 was intended to force employers in California to stop using arbitration agreements or to make all arbitration agreements with California employees subject to California law, it is not likely to achieve this result. The United States Supreme Court has repeatedly made it clear that mandatory

³ *Advanced Bionics Corp. v. Medtronics, Inc.*, 29 Cal. 4th 697, 707-708 (Cal. 2002).

⁴ *Bennett v. Medtronic, Inc.*, 285 F.3d 801, 807 (9th Cir. 2002).

⁵ Assembly Committee on Judiciary, SB1241 (Wieckowski), p. 3 (June 21, 2016).

arbitration agreements governed by the Federal Arbitration Act (FAA) are enforceable under standards set forth in the FAA and that the FAA preempts state laws that contradict it or that stand as an obstacle to the accomplishment of the Federal law.⁶ To the extent that an employer selects the FAA as governing law over the agreement, it seems unlikely that California could, through force of state law, prohibit a U.S. citizen from selecting and relying on a favorable federal law even if California believed the federal law somehow deprived the individual of some of the protections of California law. Simply put, a state cannot legislate its way out of the preemptive effective of a federal law.

From the perspective of the contract law underlying the formation of a binding contract, state laws do apply to arbitration agreements even when they are covered by the FAA. To this extent, the selection of another state's law for the law governing contract formation might be covered and controlled by Section 925. Conflicts-of-law principles frequently result in the choice of another state's law in an arbitration agreement with a California employee not being honored by a court in California anyway.⁷ So, there is certainly good reason to question why such a sweeping new law was necessary to address a choice-of-law issue in this context.

If the contract selects an out-of-state venue for the adjudication of disputes under the arbitration agreement, this could also trigger application of Section 925. However, it is worth noting that for purposes of arbitration agreements with most employees, it would be very difficult to enforce the selection of a highly inconvenient and distant venue for the arbitration both under American Arbitration Association rules and under generally applicable law prior to the passage of Section 925.⁸ Consequently, if preventing this kind of oppressive venue selection activity was the motivation behind the statute, what the California legislature did was arguably unnecessary and a lot like using a shotgun to kill a fly.

Does the retention of legal counsel exception apply if the agreement is not negotiable?

Section 925 does not apply if legal counsel for the employee is involved in negotiating the contract. This is a potentially useful exception for employers at the executive level where individually negotiated agreements may be more feasible, but it will have little application to the vast majority of agreements where for reasons of practicality, consistency, and fairness among employees who hold the same or substantially similar positions, an employer will want to use a uniform set of contract terms.

This new law applies to 2017 agreements, but what happens with existing agreements entered into before January 1, 2017?

Agreements entered into before January 1, 2017, simply are not covered by Section 925. However, it is important to note that the statute does not limit itself to contracts entered into on or after January 1. It also covers contracts modified or extended on or after January 1, 2017. The modification or extension of a contract can sometimes occur in ways that are easy for an employer or employee to overlook. By way of example, a contract that expires by its terms at the end of the year but automatically rolls into a new year if no notice is given might be viewed as extended; a contract that initially contained a specific initial salary (subject to an increase through mutual agreement) might be deemed modified when the employee gets a raise.

⁶ See *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 356 (2011).

⁷ See, e.g., *Pinela v. Neiman Marcus Group, Inc.*, 238 Cal. App. 4th 227, 256-258 (2015).

⁸ See *Milliner v. Bock Evans Fin. Counsel, Ltd.*, 114 F. Supp. 3d 871, 880 (N.D. Cal. 2015) (holding unconscionable arbitral forum selection clause, selecting Denver, Colorado, as the arbitral forum, where both parties were located in California).

Practical Takeaways

Employers that have contracts in place with employees who primarily reside and work in California will want to consider taking the following steps due to the passage of Section 925:

- Review contracts that will be used in 2017 to determine if they have provisions that either (a) require the adjudication of controversies in another state other than California, or (b) choose the law of another state other than California.
- Consider removing potentially offending choice-of-law and/or venue provisions and replace them with California selections or remain silent on choice of law and venue.
- Where appropriate, consider adding an opt-out provision that does not make the contract a condition of employment and allows the employee a window of time during which he or she may opt out of the agreement before it becomes binding.
- If the selection of another state's law is going to be retained, then consider using a carve-out or savings clause in employment agreements with California employees that recognizes the employee's option to void the choice of law and that disclaims any intent to deprive the employee of the substantive protection of California law with respect to a controversy arising in California.
- Audit existing contracts to flag those that might offend Section 925 and might be likely to come up as a modified or extended contract due to the presence of a fixed-term provision or other provisions (like a set salary, position designation, or defined territory of responsibility) that are likely to be modified over time.
- Before going either (i) forward with litigation against a California employee in an out-of-state forum based on a forum selection clause, or (ii) seeking to enforce a choice-of-law clause that applies another state's law, evaluate whether Section 925 applies and whether or not the employee has engaged in any conduct that might be viewed as an election to void or not void the potentially offensive selection provisions.