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Does the California Arbitration Act Disfavor Arbitration?

Christopher Daley · Thursday, December 19th, 2024 · Young California Arbitration (Young CalArb)

Keeton v. Tesla addresses a significant question: whether a section of the California Arbitration Act (CAA) is preempted by the United States Federal Arbitration Act (FAA). The California Court of Appeal concluded that Section 1281.98 of the CAA is *not* preempted by the FAA, although, due to procedural nuances under the California Rules of Court, the precedential value of this case is limited. While some may view *Keeton v. Tesla* as a means of clarifying certain issues, I believe that its primary significance lies in underscoring outstanding questions—that may soon receive definitive answers—and offering a solution.

Factual and Procedural Background

Keeton v. Tesla arises from an employment dispute. At the start of her employment with Tesla, Keeton signed an employment agreement containing an arbitration clause. Keeton subsequently filed a lawsuit in a California trial court of first instance against Tesla. In accordance with the arbitration clause in the employment agreement, the parties stipulated to binding arbitration before JAMS, and the trial court stayed the litigation pending arbitration. JAMS received Keeton's demand for arbitration a few months later.

The initial fees to commence arbitration were paid by both parties.

The arbitration commenced, and the parties were subsequently invoiced for a pre-hearing deposit, with payment due upon receipt. However, Tesla delayed paying the pre-hearing deposit for thirty-three days after receipt of the initial invoice. Approximately one month after Tesla's payment was received by JAMS, Keeton filed a motion asking for the court to vacate the prior order submitting the action to binding arbitration and to lift the stay on litigation, arguing that Tesla failed to timely pay the arbitration fees.

Keeton relied on California Code of Civil Procedure, Section 1281.98, which allows a non-drafting party to "[w]ithdraw the claim from arbitration and proceed in a court of appropriate jurisdiction" upon a failure to "pay certain fees and costs during the pendency of an arbitration proceeding, if the fees or costs required to continue the arbitration proceeding are not paid within 30 days after the due date." Tesla responded that Section 1281.98 was preempted by the FAA and that the arbitration agreement delegated such authority to the arbitrator, including the authority to determine whether Tesla complied with Section 1281.98.

The trial court granted Keeton's motion, finding that it had jurisdiction "because the arbitration agreement did not delegate issues of breach or arbitrability to the arbitrator." The trial court lifted the stay and imposed a monetary sanction on Tesla. Tesla appealed the trial court's order, arguing that (1) the arbitration agreement delegated issues of arbitrability to the arbitrator, (2) the FAA preempts Section 1281.98 of the CAA, and (3) Section 1281.98 violates the contracts clauses of the California and United States Constitutions. The California Court of Appeal addressed each of these arguments in its opinion but published only its reasoning on FAA preemption as binding precedent.

Precedent and Preemption

The Court of Appeal delved into a direct examination of preemption to resolve the appeal brought by Tesla. Relying on federal and California precedents, the court emphasized that preemption applies only when a state law undermines the FAA's policy objectives. Specifically, the United States Supreme Court has clarified that state laws may regulate arbitration as long as they do not "disfavor" arbitration or impose disproportionate burdens.

Tesla argued that Section 1281.98 unfairly targets arbitration agreements because it voids only arbitration contracts for delayed performance in this way. The Court of Appeal rejected this reasoning, however, explaining that Section 1281.98 in fact promotes the goals of the FAA by ensuring procedural fairness and efficiency in arbitration proceedings. Far from disfavoring arbitration, the provision supports its effective implementation by incentivizing timely compliance with fee obligations.

The Court of Appeal examined precedent from both federal appellate and district courts and noted that federal courts are split on the question of whether Section 1281.98 is preempted by the FAA.

It is important to note that the question answered by *Keeton v. Tesla* involves a matter of United States constitutional law, i.e., the Contracts Clause in U.S. Const. Art. VI., § 2, and concerns federal law, i.e., 9 U.S.C. § 1 *et seq*. However, decisions from federal trial and circuit courts, while having persuasive value, are not binding upon California courts. Likewise, an opinion from the California Court of Appeal is not binding on any federal court or the California Supreme Court.

Parallel Appeals, Distinct Reasoning

Keeton v. Tesla is not the first case to address whether the FAA preempts Section 1281.98. Another California appellate court considered the same preemption issue in *Hohenshelt v. Superior Court*, specifically examining whether Section 1281.98 and its analogue, Section 1281.97, are preempted by the FAA.

As *Hohenshelt* is moving forward through the appeals process, it is important to briefly review that case to understand how *Keeton v. Tesla* differs and what contribution it can provide. To arrive at its ruling, the majority in *Hohenshelt* relies entirely on *Gallo v. Wood Ranch USA, Inc.*, 81 Cal. App. 5th 621 (Cal. Ct. App. 2022), confirming rather than expanding upon that precedent. A dissenting opinion was also issued in *Hohenshelt*.

The *Hohenshelt* dissent engages in a cursory review of precedent, binding and otherwise, making broad statements, and concluding that sections 1281.97 and 1281.98 of the CAA impose unfavorable treatment on arbitration. The dissent in *Hohenshelt* criticizes the majority for overlooking a "devastating" critique from a non-binding federal precedent, *Belyea v. GreenSky, Inc.*, 637 F. Supp. 3d 745 (N.D. Cal. 2022). The *Hohenshelt* dissent explains that "[n]o other contracts are voided on a hair-trigger basis due to tardy performance. Only arbitration contracts face this firing squad."

The California Supreme Court has granted review in *Hohenshelt*. And the California Supreme Court's eventual decision in *Hohenshelt* may not be the end of it: because *Hohenshelt* addresses a federal question, there remains the possibility of an additional appeal to the United States Supreme Court even after the California Supreme Court renders its decision. In fact, since federal courts are split on the preemption issue, some federal court rulings are likely to conflict with the forthcoming *Hohenshelt* decision from the California Supreme Court. Accordingly, it is likely this question will eventually reach the United States Supreme Court. If the dispute reaches the United States Supreme Court, the Court could resolve the disagreement between federal and California state courts and provide binding precedent on whether FAA preempts sections 1281.97 and 1281.98 of the CAA.

Therefore, if the court in *Keeton v. Tesla* knew that the California Supreme Court's review in *Hohenshelt* could ultimately result in a United States Supreme Court decision—which would provide a definitive answer for all lower courts—then what was the purpose of the *Keeton v. Tesla* opinion?

As *Keeton v. Tesla* addresses in its reasoning, the *Hohenshelt* dissent seems to argue that Section 1281.98 disfavors arbitration simply because it specifically targets arbitration. However, an applicable ruling from the United States Supreme Court clarifies that statutes can target arbitration insofar as they "give effect to the contractual rights and expectations of the parties, without doing violence to the policies behind the FAA." The United States Supreme Court, and all other courts addressing this issue, agree that the pertinent question is whether the statute "disfavors" arbitration. For this term to be meaningful, state law providing neutral or even favored treatment of arbitration agreements should not be preempted.

Unlike the majority opinion in *Hohenshelt*, *Keeton v. Tesla* directly engages with and responds to the referenced precedents in the *Hohenshelt* dissent, reasoning that Section 1281.98 aligns with the policy goals of the FAA. Further, whereas the majority in *Hohenshelt* relied solely on existing precedent to arrive at its decision, *Keeton v. Tesla* actively expands on that precedent by distinguishing itself from otherwise conflicting cases and expanding on supporting precedent to justify its outcome.

With the *Hohenshelt* appeal presently before the California Supreme Court, and the possibility of an appeal to the United States Supreme Court thereafter, *Keeton v. Tesla* offers an opinion that Section 1281.98 of the CAA is not preempted by the FAA because it advances rather than disfavors arbitration and the objectives of the FAA. Whether this view will ultimately prevail remains uncertain. But the appellate stage is set, and *Keeton v. Tesla* provides a solution that could provide a lasting answer to this ongoing saga.

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