A Closer Look At Calif. Privacy Law Bar On 2 Contract Clauses

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In September of 2018, California passed a significant new consumer privacy law, the California Consumer Privacy Act, which is the first U.S. law to regulate how businesses with a presence in California collect, share, and use consumer data. The CCPA not only imposes significant compliance obligations on companies conducting business with California residents but also incentivizes class action litigation through both the CCPA's private right of action and California's Unfair Competition law.

Specifically, the CCPA permits consumers to bring lawsuits when their "nonencrypted or nonredacted personal information ... is subject to an unauthorized access and exfiltration, theft, or disclosure as a result of the business' violation of the duty to implement and maintain reasonable security procedures and practices appropriate to the nature of the information." The CCPA provides consumers with the ability to seek either actual damages or statutory damages up to $750 per incident, which may be filed as class actions.

Under the private right of action, a California resident may initiate a lawsuit after giving businesses notice and a 30-day opportunity to cure. If the business cures the violation and provides the consumer with an "express written statement that the violations have been cured and that no further violations shall occur," the consumer cannot initiate an action. Businesses can expect to contend with the question of whether a cure was adequately provided in a CCPA class action litigation.

Further, the UCL may serve as a predicate for consumer class action litigation, as plaintiffs use this framework to try to enable lawsuits for CCPA violations beyond the data breach provisions. The UCL permits any person, acting for the interests of itself, its members, or the general public, to initiate an action for restitution or injunctive relief against a person or business entity who has engaged in "any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising." Consequently, plaintiffs may try to use the UCL to pursue consumer class actions under the CCPA.

In addition, the CCPA as drafted includes a prohibition on contract terms that appear targeted at arbitration clauses and class action waivers. Arbitration agreements that include class action waivers have typically been powerful tools to manage consumer class action exposure. Businesses can reduce litigation exposure by including an arbitration provision that limits the arbitration to the particular parties in the transaction, which can avoid the risk that a single class action verdict will result in substantial damages.

U.S. Supreme Court precedent confirms that class action waivers in arbitration provisions are enforceable. Even though California was initially hostile to class action waivers, following recent decisions from the Supreme Court, class action waivers in arbitration agreements are increasingly enforced, even in California. Given the strong federal policy favoring arbitration and the evolving landscape in California jurisprudence, it seems likely that practitioners will have a strong argument that the CCPA's prohibition on arbitration and class action waivers should be preempted by the Federal Arbitration Act.

The Federal Arbitration Act

When a party includes a class action waiver in their arbitration agreement, the Federal Arbitration Act is invoked. The FAA governs any written agreement to arbitrate in a maritime transaction or contract evidencing a transaction involving interstate commerce.[1] Congress enacted the FAA in 1925 to ensure that arbitration agreements were recognized and enforced in the United States after years of "widespread judicial hostility" towards arbitration.[2]

The Supreme Court explained that it is "beyond dispute that the FAA was designed to promote arbitration"[3] and that the FAA "embodies the national policy favoring arbitration and places arbitration agreements on equal footing with all other contracts."[4] Indeed, the Supreme Court has explained that any "ambiguities as to the scope of [an] arbitration clause itself" are to be "resolved in favor of arbitration."[5] Lower courts have upheld class action waivers found within arbitration clauses by relying heavily on the Supreme Court's guidance that any doubts about whether an arbitration clause will be upheld should be resolved in favor of requiring arbitration.

A critical determination in applying the FAA is whether the parties' relationship "involves" interstate commerce. Courts have interpreted this phrase incredibly broadly. In fact, the FAA applies if any part of an underlying transaction involves interstate commerce. In other words, the dispute itself need not arise from the particular part of the transaction involving interstate commerce, and the parties to the contract need "not contemplate an interstate commerce connection."

Thus, for example, if a contract involved a company merely using materials manufactured or produced out of state, the transaction would "involve interstate commerce." This was the situation in Allied-Bruce Terminix Companies Inc. v. Dobson. In that case, the parties did not even dispute that the transaction "involved" interstate commerce where "the termite-treating and house-repairing material used" in the transaction came from outside the state.

Provided the parties' relationship "involves" interstate commerce, the FAA controls in both federal and state court. Moreover, if a statute interferes with the purpose of the FAA — namely, to promote arbitration — a court, whether it be state or federal, must consider whether the statute is preempted by the FAA.

Preemption of State Laws That Are Inconsistent With the FAA

In general terms, federal preemption occurs when a validly enacted federal law supersedes an inconsistent state law. Preemption comes from the supremacy clause in Article VI of the U.S. Constitution, which states that that the Constitution and "the laws of the United States ... shall be the supreme law of the land."

While the FAA does not contain an express preemption clause, the Supreme Court has held that the FAA supersedes state laws that undermine the goals of the act pursuant to implied preemption. Nevertheless, state legislatures and state courts continue to try to restrict enforcement of mandatory arbitration clauses, particularly in situations where there may be unequal bargaining power between the contracting parties.

In 2017, in Kindred Nursing Centers LP v. Clark,[6] the Supreme Court reaffirmed that the FAA preempts state laws that treat arbitration agreements differently than other types of contracts. The Supreme Court found that the state court rule at issue attempted to target and disfavor arbitration agreements and, on that basis, held that the arbitration agreement at issue should be enforced despite the state court rule to the contrary.

Indeed, recently the California Supreme Court has also recognized the broad scope of FAA preemption. In 2015, for example, the California Supreme Court explained that "a state rule can be preempted not only when it facially discriminates against arbitration but also when it disfavors arbitration as applied."[7] Two years earlier, the California Supreme Court had explained that "[w]hen a state-law rule interferes with fundamental attributes of arbitration, the FAA preempts the state-law rule even if the rule is designed to facilitate" some other proper purpose, such as "prosecution of certain types of claims."[8]

When the California Supreme Court has failed to recognize the broad scope of FAA preemption, the U.S. Supreme Court has stepped in. For instance, in Southland Corporation v. Keating, the court overturned the California Supreme Court's decision regarding another piece of California legislation, the Franchise Investment Law.[9]

Specifically, the U.S. Supreme Court reversed the California Supreme Court's holding that required judicial consideration of claims brought under the CFIL. The Supreme Court viewed the practice as undercutting the enforceability of arbitration agreements and, as such, the Court found that the FAA preempted the CFIL. The Supreme Court explained that "Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum"[10] when it enacted the FAA.

Despite the liberal policy favoring arbitration, California initially refused to enforce arbitration agreements that contained consumer class action waivers based on a number of grounds, mainly unconsionability. However, the Supreme Court recently issued significant decisions that rejected many of the obstacles put in place by California and other state and federal courts.

Thus, in AT&T Mobility LLC v. Concepcion,[11] and DirecTV Inc. v. Imburgia,[12] the Supreme Court confirmed that class actions waivers in arbitration provisions are enforceable. In Concepcion, the Supreme Court held that the FAA preempted California's rule prohibiting class waivers in consumer arbitration agreements. Though the Supreme Court acknowledged that the FAA does not preempt "generally applicable contract defenses such as fraud, duress, or unconscionability," such defenses must be enforced across the board, and not in a manner that disfavors arbitration.

The CCPA'S Inclusion of a Provision Limiting Arbitration and Consumer Class Actions

The CCPA is not the first time the California legislature has passed a law that attempts to undermine the enforceability of arbitration agreements, despite the FAA's policy to the contrary; in fact, it has a history of doing so. California's Consumers Legal Remedies Act is one example. The CLRA is a wide-ranging state law that provides a private right of action for consumers to pursue statutory claims on a class-wide basis.

In Sanchez v. Valencia Holding Co., the California Supreme Court held that the anti-waiver provision of the CLRA was preempted where it prohibited class waivers in arbitration agreements covered by the FAA. The California Supreme Court based much of its reasoning on the U.S. Supreme Court's decision in Concepcion.[13]

Much like the CLRA, the CCPA has a provision that appears to target arbitration clauses and class action waivers. In fact, the provisions in the two laws are quite similar. The CLRA states "[a]ny waiver by a consumer of the provisions of this title is contrary to public policy and shall be unenforceable and void."

Similarly, the CCPA provides, "[a]ny provision of a contract or agreement of any kind that purports to waive or limit in any way a consumer's rights under this title, including, but not

limited to, any right to a remedy or means of enforcement, shall be deemed contrary to public policy and shall be void and unenforceable."[14] Based on the history of courts finding that the FAA preempts such anti-arbitration provisions, including the similar CLRA provision, practitioners will have a strong argument that the FAA preempts the provision in the CCPA as well.

Concluding Thoughts

Given strong federal policy favoring arbitration provisions, companies should consider including an arbitration clause and a class action waiver in their websites' terms and conditions to minimize the potential for significant litigation exposure. Adhering to best practices when drafting class action waivers is paramount.

Business should heed the recent Supreme Court case, Lamps Plus Inc. v. Varela,[15] which found that under the FAA an ambiguous contract could not compel parties to submit to class arbitration and the Ninth Circuit's recent decision in Blair v. Rent-A-Center Inc.,[16] which determined that part of the arbitration agreement was invalid —and not preempted — where the arbitration clause prohibited public injunctive relief.

Practitioners should anticipate class action litigation issues early and be aware of the substantial body of case law favoring enforcement of these provisions and should remain cognizant of the interplay of California state law nuances.

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[1] 9 U.S.C. §§ 1, 2.

[2] AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 339 (2011) (hereinafter "Concepcion").

[3] Id. at 345.

[4] Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 443 (2006).

[5] Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Jr. Univ., 489 U.S. 468, 476 (1989).

[6] Kindred Nursing Ctrs. L.P. v. Clark, — U.S. —, 137 S. Ct. 1421 (2017).

[7] Sanchez v. Valencia Holding Co., LLC, 61 Cal. 4th 899, 924 (2015).

[8] Sonic-Calabasas A, Inc. v. Moreno, 57 Cal. 4th 1109, 1158 (2013).

[9] 465 U.S. 1 (1984).

[10] Id. at 10.

[11] AT&T Mobility LLC v. Concepcion, 563 U.S. 333 (2011)

[12] DirecTV Inc. v. Imburgia , 136 S. Ct. 463 (2015)

[13] AT&T Mobility LLC v. Concepcion, 563 U.S. 333 (2011).

[14] CLRA, Cal. Civ. Code § 1751; CCPA, Cal. Civ. Code § 1798.192.

[15] No. 17-988, 2019 WL 1780275, (U.S. Apr. 24, 2019).

[16] No. 17-17221 (9th Cir. 2019).

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