

Litigation Alert: California Bans Non-Disparagement Clauses in Consumer Contracts

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On September 9, 2014, Governor Jerry Brown signed into law AB 2365, popularly referred to as the “Yelp” bill. The new law, codified at California Civil Code section 1670.8, will prohibit the use of “non-disparagement” clauses in consumer contracts beginning January 1, 2015. This article provides a brief summary of the law, its potential impact and ambiguities, and practical tips for businesses to avoid its penalties and ensure compliance in the coming year.

Summary of Cal. Civ. Code § 1670.8

The new law provides that a “contract or proposed contract for the sale or lease of consumer goods or services may not include a provision waiving the consumer’s right to make any statement regarding the seller or lessor or its employees or agents, or concerning the goods or services.” Cal. Civ. Code § 1670.8(a)(1). It will also be “unlawful to threaten or to seek to enforce” such a provision, or to “otherwise penalize” a consumer for making any such statement. Cal. Civ. Code § 1670.8(a)(2).

The law carries maximum statutory penalties of \$2500 for the first violation, and \$5,000 for each subsequent violation. Cal. Civ. Code § 1670.8(c). Willful, intentional, or reckless violations carry a maximum penalty of \$10,000. Cal. Civ. Code § 1670.8(d). The law expressly does not prohibit or limit a person or business that hosts online consumer reviews or comments from removing a statement that is otherwise lawful to remove. Cal. Civ. Code § 1670.8(e).

The bill was introduced earlier this year due to concerns from the increasing use of non-disparagement clauses in online clickwrap agreements. The bill sought not only to protect consumers from unknowingly giving up their freedom to speak freely about their online retail experiences, but to also prevent them from being intimidated or penalized for doing so. The bill analysis cites to the experience of two Utah residents where a company had demanded \$3,500 for their alleged violation of a non-disparagement clause in its online terms and

conditions four years after they had criticized the business online. When the couple did not pay, the company reported the “debt” to at least one credit-reporting agency, and for almost two years thereafter the couple had credit problems and difficulty securing loans.

While at least one federal court has upheld a non-disparagement clause in a clickwrap agreement under Arizona law, *see FreeLife Int’l Inc. v. Am. Educ. Music Publ’ns Inc.*, 2009 U.S. Dist. LEXIS 97680 (D. Ariz. Oct. 1, 2009), there has been no known decision in California. This law was intended to resolve this open question of whether such non-disparagement clauses in consumer contracts are unenforceable under California law.

Section 1670.8’s Impact and Ambiguities

Section 1670.8 has no geographic limitations and would apply to any consumer-facing entity or person doing business in California. Thus even out-of-state businesses with prospective and current customers in California should ensure compliance. And although the bill was introduced to ban non-disparagement clauses in online contracts of adhesions, the statutory language itself is broader than that, effectively applying to non-disparagement clauses in any contract or proposed contract with consumers in California.

Moreover, because the law carries statutory penalties, plaintiffs’ class action attorneys will likely seek to test its scope and ambiguities. For example, a business that unwittingly keeps a non-disparagement clause in its online terms (*i.e.*, a “proposed contract”) would likely be in violation of Section 1670.8. Plaintiffs’ attorneys could assert this is not a single violation of Section 1670.8, but multiple violations vis-à-vis each member of a putative class of prospective and existing customers to whom the terms were uniformly presented. Given the potential size of aggregated penalties, we can expect class actions to be filed next year against such businesses in violation of Section 1670.8. Whether these are test cases or cases simply to extract settlements, businesses should not have

to defend against them if they can take steps now to ensure compliance.

Additionally, the law makes it unlawful to “otherwise penalize” a consumer for making a statement protected by the statute. The statute, however, provides no guidance as to what it means to “otherwise penalize” a consumer. Does refusing to conduct business with a consumer who has posted a negative review “penalize” a consumer, or is something more required? This will be a fact-specific issue for each case and one left for the California courts to decide.

The statute also covers “any” statement protected by the statute and does not expressly require such statement be truthful. Thus, hypothetically, if sued for defamation, a consumer could cross-claim for violation of Section 1670.8 because the suit “penalizes” the customer. While it is very unlikely any court would find such an argument persuasive, until there is judicial precedent to the contrary, such claims under the plain language of the statute do not appear frivolous and could be nevertheless brought. However, keep in mind that because such defamation claims and cross-claims are likely subject to anti-SLAPP motions, they should be brought only if one can establish a reasonable probability of prevailing thereon.

Finally, while the statute has no retroactive application, it also provides no exception or safe harbor for any consumer contracts with non-disparagement clauses entered before January 1, 2015. Thus, if such contracts remain effective after January 1, 2015, they are likely still subject to Section 1670.8 and should be amended to ensure compliance.

What Can Businesses Do to Avoid Getting Sued?

If you are doing business in California and have used, are using, or are considering using non-disparagement clauses in any of your customer contracts, you should take the following steps this year to ensure compliance with Section 1670.8:

- ***Review all contracts, including online terms and conditions.*** You should review all of your consumer contracts or proposed contracts for any non-disparagement clauses. As mentioned, because the law includes “proposed contracts,” it would cover online terms and conditions (*i.e.*, clickwraps) presented to a prospective customer irrespective of whether or not a consumer has actually consented thereto. Therefore be sure to include a review of

all online terms and conditions to ensure no non-disparagement clauses exist therein.

- ***If your consumer contracts have non-disparagement clauses, remove them and notify your customers.*** If you discover that you have existing consumer contracts with non-disparagement clauses (including any accepted terms and conditions), you should revise and amend them to remove these clauses. You should also provide notice to your customers of the updated terms. The method of notice (for example, by email or posting online) will depend on, *inter alia*, the contract’s terms and what is practicable for your business.
- ***Avoid any non-disparagement clauses beginning in 2015.*** In addition to removing any non-disparagement clauses in your consumer contracts, it goes without saying that you should not suggest, propose, or otherwise include any non-disparagement clauses in your consumer contracts beginning January 1, 2015.
- ***Do not attempt to contract around Section 1670.8.*** You should not try to include language in your agreements to contract around the prohibition of Section 1670.8. Section 1670.8(b) provides any waiver of Section 1670.8’s provisions is “contrary to public policy,” and “void and unenforceable.” In fact, the bill’s legislative history reflects that proposed statutory language allowing for a knowing, voluntary and intelligent waiver had been stricken. Moreover, trying to apply another state’s law through a choice of law clause will be very likely unenforceable given California’s clear public policy to render such non-disparagement clauses unlawful.
- ***Be cognizant and careful in how you respond to consumer statements.*** Before taking any adverse action in response to a customer statement, whether in writing or otherwise, be cautious and cognizant that any such actions could be viewed as “penalizing” the customer and potentially subject you to liability under Section 1670.8.

The law did not intend to leave a company completely without recourse. The bill analysis notes that a business may still bring claims against consumers for defamatory statements. And businesses may still seek removal from third party websites hosting unlawful customer statements in accordance with such websites’ policies and procedures. Moreover, a business can always respond with its own statements in response to customers’ reviews. It is also good

business sense not to use non-disparagement clauses, which are ill-received and could generate negative publicity for your business. Indeed, customer reviews can often be good sources of information for a company to identify within the business the things they are doing right or issues that should be addressed and improved.

Even if you are not doing business in California, note that similar federal legislation may soon follow. Earlier this week, Reps. Eric Swalwell and Brad Sherman (D-CA) introduced the Consumer Review Freedom Act of 2014 to make non-disparagement clauses in form contracts void and unlawful under federal law. The current text of the proposed bill can be found [here](#). As currently proposed, it does not specify any statutory penalties or create a private cause of action for use of non-disparagement clauses, and provides for enforcement by the Federal Trade Commission and States' attorney generals.

For more information please contact:

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