

Calif. AG Sets Sights On Loyalty Programs' Privacy Pitfalls

By Allison Grande

Law360 (February 16, 2022, 9:04 PM EST) -- Retailers, hotels and others that offer customer loyalty programs are facing mounting pressure to comply with a unique requirement in California to be upfront about how they're profiting from the personal data they collect, with the state's attorney general making the issue a priority as a key liability safety net is set to fall.

California Attorney General Rob Bonta attracted attention late last month when he announced that his office had sent notices alleging noncompliance with the state's Consumer Privacy Act to "major corporations" in the retail, home improvement, travel and food services industries that operate programs that offer customers discounts, free items or other rewards in exchange for their personal information.

The regulator claimed that these businesses were failing to provide consumers with a notice that clearly explains the financial incentive program before they've opted in to the arrangement, a requirement that's both unique to the California privacy law and has proven tricky for companies to comply with because of a lack of clarity on the topic.

"One of the most difficult provisions in the CCPA is the requirement to post a notice of financial incentive that includes a data valuation," said Dominique Shelton Leipzig, co-chair of the ad tech privacy and data management practice at Perkins Coie LLP. "Given it is required in California, [the AG's] press release should be an impetus for companies who are offering financial incentives related to the collection of data to comply with the law."

The attorney general's letters give their recipients 30 days to fix any violations before an enforcement action can be initiated, but that cure period will soon be going away. The California Privacy Rights Act, which is set to replace the CCPA on Jan. 1, 2023, scraps that grace period, meaning that companies would be wise to take action before enforcement actions start dropping.

"Companies need to work on compliance now while they still have that safety net," said Kyle Janecek, an attorney at Newmeyer Dillion. "The motivation might not quite be there yet for companies, especially smaller businesses, because they're waiting to see heads on pikes. But enforcement actions are indeed coming."

While the attorney general's office has been able to enforce the CCPA since July 2020, the regulator has yet to publicly exercise its power to bring enforcement actions, which could result in civil penalties of up to \$2,500 for each violation and \$7,500 for each intentional violation.

Instead, the attorney general has focused on issuing batches of noncompliance notices, and companies have been quick to react. In an enforcement update issued in September, the regulator's office said that 75% of the dozens of businesses that had received notices since July 2020 had come into compliance within the 30-day period.

So far, the attorney general has shown a particular interest in ensuring that companies are providing consumers with a clear and easy way to stop the sale of their data and that consumers are able to exercise their rights to access and delete their personal information.

The latest batch of warning letters, which the attorney general issued on Data Privacy Day on Jan. 28, is "a clear indicator that loyalty programs are an enforcement priority and the [attorney general's office] wants businesses to be transparent about their data practices," said Kyle Dull, a senior associate in the data privacy, cybersecurity and digital assets practice at Squire Patton Boggs LLP.

"Companies should take away that almost any loyalty program will be considered a financial incentive if it collects any personal information as part of its operation," Dull said.

Since the California Legislature enacted the CCPA in June 2018, questions have swirled around how to interpret the prohibition on treating consumers differently if they exercise their rights to have their data deleted or not shared with third parties. This provision is unique to California, as lawmakers in Virginia and Colorado declined to include such language in privacy laws that were enacted after the CCPA.

Many businesses voiced concerns that the restriction would deal a blow to loyalty programs that are premised on consumers' exchange of information for benefits and that can't be provided to consumers who don't allow companies to retain their data.

The attorney general's office has made clear in past guidance that companies can still offer a different price or service if it is "reasonably related to the value of the consumer's data" and they meet the statutory obligation to provide a notice that "clearly describes the material terms of the financial incentive program" to consumers before they enter into it.

But the regulator has largely left it up to companies to determine how to calculate the value of consumers' data, creating uncertainty about which programs fall under the requirement to post notices of financial incentive, attorneys say.

"We've seen some companies making the wrong call, thinking something isn't a financial incentive program where it may have been deemed so by the AG, and unfortunately the regulations that have been issued so far don't give too much more clarity on that front and embrace more of an 'I'll know it when I see it' approach, which isn't always helpful," said Janecek, the Newmeyer Dillion attorney.

The attorney general's latest enforcement notices, which cover both online and brick-and-mortar operations, provide some "clarity" on how the regulator is viewing the issue and are likely to push more companies to err on "the conservative side" and post financial incentive notices, noted Aaron Charfoos, a partner in the privacy and cybersecurity practice at Paul Hastings LLP.

"It's interesting because this is the first statement from the AG's office that it's focusing in on a particular aspect of an industry, instead of focusing on something like privacy policies that the AG claims aren't good across the spectrum," Charfoos said. "It's helpful that the AG has signaled that this is going

to be a focus and has given companies the better part of a year to fix this so that when Jan. 1 comes along, those loyalty programs can be compliant with these requirements."

Besides removing the 30-day grace period, the CPRA will also establish a new administrative agency, the California Privacy Protection Agency, which will be dedicated to data privacy. Aside from enforcing the law, the agency will also be charged with writing regulations to guide companies in fulfilling their obligations, including the mandate to alert consumers about the details of financial incentive programs and to refrain from asking those who decline to join the program again for at least 12 months.

Attorneys say it would be useful for the new California agency to tackle financial incentive issues as part of its rulemaking, particularly with respect to the trade secrets concerns that have emerged as the law has matured.

Under the CCPA, businesses must disclose "a good-faith estimate of the value of the consumer's data that forms the basis for offering the financial incentive or price or service difference" and a "description of the method the business used to calculate the value of the consumer's data," along with details about the value of the financial incentive itself.

Companies have voiced concerns that furnishing this information could reveal too much about its inner workings, which could give rivals a competitive advantage, including by opening the door for them to reverse engineer a loyalty program based on the disclosures made in the financial incentive notice.

"The data and benefit valuation methods and balancing requirement require strategic thought, including regarding trade secrets," said Dull, the Squire Patton Boggs attorney. "Businesses need to be careful about their disclosures because they do not want to reveal any trade secrets developed when designing their loyalty programs, but at the same time being transparent about their data practices to satisfy the AG and CPPA."

More guidance on how to calculate the value of consumers' data and how that's related to the benefits that customers are receiving would also be helpful, attorneys say.

"One of the more problematic provisions of the CCPA's notice of financial incentive is the requirement that the notice include an explanation of how the financial incentive or price or service difference is reasonably related to the value of the consumer's data, including a good faith estimate of the value of the consumer's data and a description of the method the business used to calculate that value," said Reece Hirsch, co-head of the privacy and cybersecurity practice at Morgan Lewis & Bockius LLP. "While there is a section in the CCPA regulations devoted to calculating the value of consumer data, this remains a very challenging standard for businesses to apply in practice."

Given the difficulty of valuing customer data in relation to the benefits they're receiving, especially when it comes to programs that offer free hotel rooms or flights whose prices can fluctuate, many companies have "just punted it to say we're not going to address it right now because we don't know how to address it, or we don't want to address it because that could disclose trade secrets that give our competitors an advantage," noted Daniel Goldberg, chair of the privacy and data security group at Frankfurt Kurnit Klein & Selz PC.

But with the attorney general making it clear that his office is focused on the issue, and a new dedicated privacy enforcer poised to soon take over, loyalty programs won't be able to fly under the radar for much longer, attorneys say.

"What's interesting is that the notices didn't talk about deficiencies in the notice but rather a lack of notice completely, and that's low-hanging fruit that's easy for the regulator to walk into a store or go onto a website and check out," Goldberg said. "So the practical takeaway from these notices has to be for companies to understand that this is something the AG's office is looking at very closely, and it's no longer an issue that companies can avoid addressing."

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