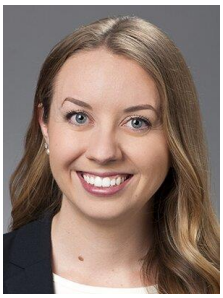
Wave Of Online Marketplace Laws May Confuse Compliance

By **Alyssa Sones, Craig Cardon and Snehal Desai** (March 9, 2023)



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A wave of new laws applying to online marketplaces and the third-party sellers they host will come into effect in 2023.

The new California and federal laws deserve a critical eye, not least because the federal law expressly preempts conflicting state laws. Their intricate requirements will affect online marketplaces and third-party sellers.

Slight differences between the federal and California versions threaten to confuse compliance efforts.

Online marketplace laws emerge as the online stolen goods market flourishes.

The legal concept of online marketplaces is fairly new.

California law first referenced online marketplaces around 2017 and federal law in 2021.[1] Many of those early laws did not directly regulate the platforms.[2]

Other California laws covering taxation of marketplaces and agreements between marketplaces and sellers related to product placement characterized online marketplaces as a subset of all marketplaces where a single operator facilitates sales from third parties to consumers.[3]

In contrast to their previous brief mentions in statutes, online marketplaces are the key player in the new laws proposed in 2021 to protect against the online resale of stolen and counterfeit goods within these marketplaces.

California's Senate Judiciary Committee explained that while "online platforms often host third-party sellers and connect those sellers with consumers, they do not directly conduct oversight into the sellers' businesses."[4]

The lack of transparency means there may be no direct consequences for making illicit sales. Consequently, consumers also suffer.

Hunting for bargains may leave them "unwitting accomplices to these crimes."[5] It may also expose them to health risks and other consequences for improperly stored, expired or damaged products.

The new California law and its federal counterpart aim to keep sellers accountable and protect both consumers and retailers.

While the laws authorize certain government enforcement actions against online marketplaces that violate these laws, they may also serve as an avenue for retailers and brands to pursue compliance from online marketplaces directly.

Many in-scope businesses must confront both the California and federal laws.

The global nature of online marketplaces and the third parties that use them to transact with consumers means that most companies that fall under the scope of the federal laws are likely doing a lot of business in California as well.

Those companies could be within the scope of the California law, even if they are based outside of California. The same basic requirements apply under both laws.

Online marketplaces must collect and validate banking, identification and contact information from high-volume third-party sellers.[6]

The marketplaces should require those sellers to disclose their contact information to consumers who buy their products.[7] If sellers fail to comply with the collection or disclosure requirements, the online marketplaces are expected to suspend those sellers from transacting on the platform.[8]

Finally, the online marketplaces must include links for consumers to report suspicious activity to the marketplace, and, in California, to the attorney general.[9]

Online marketplaces and third-party sellers face imminent compliance deadlines, as the two laws become effective within a few days of each other this summer. Affected companies are likely to see impacts to multiple operational functions and must ensure that highly specific disclosures are made directly to consumers.

While much of the federal language directly parrots the California bill introduced just a month prior to it, there are a number of material differences between the two laws — including a provision in the federal law expressly preempting conflicting state laws.

Potential preemption issues make it all the more important that companies consider whether the California law applies to them, in addition to the federal.

For those that may be affected by both laws, a preemption analysis will likely complicate the setup of compliance programs.

5 key issues complicate dual-track compliance.

Does federal preemption block certain companies that may unexpectedly be in scope for the California law from having to comply with either law?

The definition of an "online marketplace" might be interpreted to broaden the apparent intent of the statutory scheme.

Online marketplaces are defined to include digital platforms that host third-party sellers engaged in the sale, purchase, payment, storage, shipping or delivery of consumer products in California.

This definition calls into question precisely how the new statutory schemes intend to capture companies not typically thought of as the "seller" of consumer products in light of the creative and innovative uses of omnichannel strategies among retailers.

The federal law directly addresses this question with a handful of exclusions from the

definition of third-party sellers. Three exclusions stand out. The federal law does not apply to business sellers that:

- Also operate the marketplace's platform;
- Publish their name, business address and contact information already; or
- Have ongoing contractual relationships with the online marketplace to manufacture, distribute, wholesale or fulfill consumer product shipments.

These federal exclusions are nowhere to be found in the California law. Companies that do not necessarily consider themselves marketplace sellers or that tweak the conventional direct-to-consumer model may therefore be covered by the California law even though they would be excluded from the federal law.

Many e-commerce services rely on individual or corporate third parties to carry out tasks in their supply chain that may require them to comply with the new laws.

Some common models that could merit a closer look include, for example, the use of last-mile delivery services, partnerships with payment plan services and dropship arrangements. In the dropship example, sales on a retailer's website may be fulfilled by a dropship vendor.

The dropship vendors may not be third-party sellers under the federal law because of their contractual relationship with the retailer, which may in turn exempt the retailer from complying with the new federal law.

Retailers engaging dropship vendors in those same circumstances nevertheless may be considered online marketplaces subject to compliance obligations in California.

A preemption defense is likely to be of great value to sellers or online marketplaces facing this dichotomy. This structure may make it impossible for the seller to comply with both the federal and California requirements.[10]

In these scenarios, the California law would apply stricter rules to businesses that are explicitly excluded from complying with the federal law.

But the preemption defense is just that — a defense to liability. Companies must still battle the risk analysis at the outset when determining how to approach compliance.

Will consumer class actions be preempted by federal limits on enforcement actions?

California is a hotbed for consumer protection class actions. The private right of action under that state's unfair competition law often allows consumers to enforce niche laws that, standing alone, cannot be enforced through consumer class actions.

While the California online marketplace laws can only be enforced by state officials, companies are likely to see the plaintiffs bar trying creative ways to sue online marketplaces and third-party sellers for unfair competition based on these new laws.

Preemption may provide an additional defense for companies to lean on in the event they encounter these lawsuits, such as claims that they failed to disclose information to

consumers or suspend noncompliant third-party sellers.

Both the federal and state laws are silent as to consumer class actions, but the federal law specifically precludes private parties from pursuing certain civil actions.

Preemption principles may support companies seeking to escape these suits if courts interpret the federal law to conflict with the U.S. Congress' purposes and objectives.

Does federal law preempt California's instruction that marketplaces should suspend sellers that make false representations to consumers or take too long to respond to consumer inquiries?

The California law contains two scenarios that do not exist in the federal law where an online marketplace might suspend a seller.

First, if a high-volume third-party seller made a false representation to consumers, an online marketplace must suspend them from engaging in future sales on the marketplace.

Second, if a high-volume third-party seller has not answered consumer inquiries within a reasonable time, an online marketplace may suspend their future sales.

These two suspension provisions create real legal risk for online marketplaces. Suspension obligations apply directly to the online marketplaces.

The broad language of the California-only requirements suggest a new legal requirement for marketplaces to track and validate all claims made on their platforms. Similarly, the law appears to demand that online marketplaces monitor and act on sellers' consumer response times to avoid investigation.

Sellers with sufficient California sales also face weighty business risk as a result of the California suspension obligations. In the case of "false representations to consumers," sellers may see a major uptick in marketplaces questioning their marketing claims.

This could lead to much greater substantiation expense to continue operating on a marketplace or create a risk of unjustified suspensions out of caution.

The absence of these two suspension obligations or opportunities in the federal law greatly increases the likelihood that they will be met with preemption challenges.

However, the federal law does not exclude the possibility that there may be other bases for an online marketplace to suspend a third-party seller — including a suspension required by state law.

E-commerce companies embroiled in the new online marketplace laws may therefore find themselves facing enforcement actions or lawsuits under the California suspension opportunities that would not be considered violations of the federal law.

Is your business is a high-volume third-party seller under the federal law, California law or both?

Some businesses may be covered by the federal law but not the California law by virtue of the size of their sales on a marketplace.

Both the federal and California laws apply collection and verification requirements to high-volume third-party sellers. These are sellers who have at least 200 sales and $5,000 in gross revenues of consumer products on the online marketplace.

Consumer disclosure requirements and additional collection requirements apply only to sellers with at least $20,000 of gross annual revenues.

While the federal law applies to sellers that meet those requirements across all U.S. sales, the California law applies only if the sellers met those requirements for California sales.

Additionally, California requires the minimum revenue for the higher tier of regulations to be met in one of the two prior calendar years.

In contrast, the federal law does not specify which year companies should look at to determine whether the $20,000 threshold has been met.

How should companies complying with both the federal and California laws present consumer disclosures?

Finally, online marketplaces and their sellers complying with both the federal and California laws must decide how to present consumer disclosures. California requires the disclosures in consumer communications after a sale and in the consumer's account history.

The federal law permits this method of disclosure, but also allows disclosures via the product page itself, including by hyperlink.

Again, preemption questions arise because the California law would find product page disclosures insufficient, even though they satisfy the federal law.

Sellers' and online marketplaces' compliance strategies should take into account the dual compliance risk and address which disclosure methods will be used.

Key Takeaways

Companies operating in the e-commerce space would be wise to review the new federal and California collection, verification, disclosure, and reporting requirements for online marketplaces and the sellers that use them.

Read broadly, more companies might be in scope for these laws than legislators intended.

Companies with significant California sales will benefit from addressing conflicts across the two statutory schemes at the outset to minimize risk while streamlining compliance.

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affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] 41 U.S.C. § 1901 (West) (statutory notes); Cal. Civ. Code § 1739.7 effective January 1, 2017.

[2] Id.; Cal. Penal Code § 490.4, effective January 1, 2019.

[3] Cal. Civ. Code § 1749.7, effective January 1, 2020; Cal. Rev. & Tax. Code § 6040 et seq., effective January 1, 2022.

[4] https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=202120220SB301#.

[5] Id.

[6] INFORM Consumers Act, H.R. 5502, 117th Cong. (2021); Cal. Civ. Code § 1749.8 et seq.

[7] Id.

[8] Id.

[9] Id.; Cal. Gov't Code § 7599.110 et seq.

[10] Freightliner Corp. v. Myrick, 514 U.S. 280, 287 (1995).