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Kearney v. Salomon Smith Barney, Inc.

On July 13, 2006, in *Kearney* v. *Salomon Smith Barney, Inc.*,[1] the Supreme Court of California held that "California law should apply in determining whether the alleged secret recording of telephone conversations [between an out-of-state party and a California party] . . . constitutes an unlawful invasion of privacy."[2] As a result, phone calls between clients in California and a brokerage firm office based in Georgia could not be recorded without the consent of both parties, regardless of the origin of the call. Although the decision analyzes choice-of-law issues, its holding has practical implications for when companies need to disclose the recording of phone calls to California and, potentially, other jurisdictions. This decision is of significance for any business that routinely records or monitors telephone calls

I. BACKGROUND

In considering whether a telephone conversation may be recorded, the majority of states (the "one-party consent" states), and federal law, have a one-party consent scheme similar to the Georgia privacy statute at issue in *Kearney*, which permits "a person [to] intercept[] a wire, oral, or electronic communication where such person is a party to the communication or one of the parties to the communication has given prior consent to such inception."[3] In one-party consent states, either party to a telephone call may record that call without obtaining the consent of (or informing) the other party to the call.

In contrast, eleven states (the "two-party consent" states) — including California — prohibit recording telephone conversations "without the consent of all parties to the conversation."[4] California's law dates back to the 1967 enactment of "a broad, protective invasion-of-privacy statute in response to what [the California Legislature] viewed as a serious and increasing threat to the confidentiality of private

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1 *Kearney* v. *Salomon Smith Barney, Inc*., S124739, 2006 WL 1913135 (Cal. July 13, 2006).

2 *Kearney, supra* note 1, at 43.

3 *Id.* at 6, 34. Ga. Code Ann. § 16-11-66.

4 *Kearney, supra* note 1, 34 at n. 14 (emphasis added).

communications resulting from then recent advances in science and technology." Section 632 of California Penal Code ("Section 632") provides that "'[e]very person who, intentionally and without the consent of *all* parties to a confidential communication, by means of any electronic amplifying or recording device, . . . records the confidential communication, whether the communication is carried on among the parties in the presence of one another or by means of a telegraph, telephone, or other device' . . . violates the statute and is punishable." In addition to providing for possible criminal penalties, Section 632 creates a private right of action and authorizes monetary damages in the amount of the greater of $5,000 or three times actual damages.[5] The *Kearney* case addresses the issue of what consent is needed to record a conversation when a telephone call originates in a one-party consent state, but is made to a party in a two-party consent state.

II. FACTS AND PROCEDURAL HISTORY OF *KEARNEY*

The named plaintiffs in *Kearney* were California residents employed by WorldCom in California. They were granted WorldCom stock options that could be exercised only through Salomon Smith Barney ("SSB"). Plaintiffs opened accounts with SSB's Atlanta office, which handled financial matters, including matters related to stock options, for WorldCom employees. Over time, the plaintiffs made and received a number of telephone calls from individual SSB brokers in Atlanta.[6]

During the course of unrelated litigation, plaintiffs discovered that their telephone calls with SSB's Atlanta office had been tape-recorded without their knowledge, and filed a class action lawsuit in California on behalf of SSB clients who resided in California and whose accounts were serviced by SSB's Atlanta branch. Plaintiffs alleged that class members "took part in numerous telephone conversations concerning their personal financial affairs, had an expectation of privacy in those communications, were unaware that their conversations were being recorded, and did not give consent to the recording of such conversations . . . [, and] SSB intentionally recorded such conversations without disclosing that it was doing so."[7] Plaintiffs "sought (1) injunctive relief to restrain SSB in the future 'from using its practice/policy of illegally recording telephone conversations with its clients,' and (2) damages and restitution based upon SSB's past conduct."[8]

The trial court dismissed the complaint, holding that "under both Georgia and federal law recordings may lawfully be made in Georgia with one party's consent. . . . Further, any attempt to apply Penal Code § 632 to recordings made in Georgia would be preempted by federal law and violate the

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5 *Id.* at 24-27.

6 *Id.* at 4-5.

7 *Id*. at 5.

8 *Id.* at 6.

Commerce Clause."[9] The Court of Appeals affirmed the judgment, but identified the legal issue as one of choice-of-law and held that "Georgia has the greater interest in having its law applied."[10] The plaintiffs appealed to the Supreme Court of California, which accepted the case for "the novel choice-of-law-issue presented."[11]

III. RATIONALE OF THE COURT

Constitutional Limitations

Although the Supreme Court of California viewed "the only substantial issue presented by the case [as] the choice-of-law issues," it also considered several additional challenges to the application of California law to the case.[12]

First, the Court stated that the California privacy scheme did not exceed the constitutional limitations imposed on a state's legislative jurisdiction because it involved "a traditional setting in which a state may act to protect the interest of its own residents while in their home state."[13] "California clearly has an interest — in protecting the privacy of telephone conversation of California residents while they are in California — sufficient to permit this state, as a constitutional matter, to exercise legislative jurisdiction over such activity."[14] The court distinguished the case from one "in which California would be applying its law in order to alter a defendant's conduct in another state *vis-à-vis another state's residents*," finding that "the federal system contemplates that individual states may adopt distinct policies to protect their own residents and generally may apply those policies to businesses that choose to conduct business within that state."[15]

Second, the Court found that "there is no basis for concluding that application of California law is preempted by federal law," relying on its earlier decision in *People v. Conklin*, 12 Cal. 3d 259 (1974). In *Conklin*, the Court analyzed the legislative history of, *inter alia*, 18 U.S.C. § 2511, and determined that "Congress intended that the states be allowed to enact more restrictive laws designed to protect the right

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9 *Id.* at 6.

10 *Id.* at 6-7

11 *Id*. at 7.

12 *Id.* at 13, 8-12.

13 *Id.* at 9.

14 *Id*. at 8.

15 *Id.* at 8-9 (citing *BMW of North America, Inc.* v. *Gore*, 517 U.S. 559 (1996)).

of privacy." In *Kearney*, the Court noted that no "developments in the almost four decades since" the *Conklin* decision would lead it to adopt a different position.[16]

Third, the Court found that the California law did not violate the federal commerce clause because "application of the California law . . . would affect only a business's undisclosed recording of telephone conversations with clients or consumers in California and would not compel any action or conduct of the business with regard to conversations with non-California clients or consumers."[17]

Choice of Law

The Court then turned its attention to the choice-of-law issue. Under California law, courts resolve choice-of-law issues using the "governmental interest analysis," a three-step process:

> "First, the court determines whether the relevant law of each of the potentially affected jurisdictions with regard to the particular issue in question is the same or different. Second, if there is a difference, the court examines each jurisdiction's interest in application of its own law under the circumstances of the particular case to determine whether a true conflict exists. Third, if the court finds that there is a true conflict, it carefully evaluates and compares the nature and strength of the interest of each jurisdiction in the application of its own law 'to determine which state's interest would be more impaired if its policy were subordinated to the policy of the other state."[18]

The third step of the governmental interest analysis is the "'comparative impairment' approach," which "proceeds on the principle that true conflicts should be resolved by applying the law of the state whose interest would be more impaired if its law were not applied." The Court endeavored to make clear that this approach was not a weighing or a balancing test "in the sense of determining which conflicting law manifested the 'better' or the 'worthier' social policy on the specific issue . . . [as] states are empowered to mold their policies as they wish." Rather, under the comparative impairment approach, "[e]mphasis is placed on the appropriate scope of conflicting state policies rather than on the "quality" of those policies."[19] After determining that the Georgia and California statutes "differ[ed] with regard to the legality of such conduct," and that because each state had a "legitimate interest in having its law applied," there was a true conflict, the Court considered the comparative impairment analysis.[20] The Court found

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16 *Id*. at 10-11.

17 *Id.* at 12.

18 *Id.* at 13.

19 *Id*. at 19-20.

20 *Id.* at 35-37. The Court rejected SSB's contention that the California Code would not apply in this case because it was an "'extraterritorial' application of the statute." The Court analogized a person recording a telephone call with someone in California to "intentionally shooting a person in California from across the

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that "California decisions repeatedly have invoked and vigorously enforced the provisions of section 632." Additionally, the California Legislature had demonstrated that the law was a priority by "continu[ing] to add provisions to and make modifications of the invasion-of-privacy statutory scheme" in recent years. Hence, "California must be viewed as having a strong and continuing interest in the full and vigorous application of the provisions of section 632 prohibiting the recording of telephone conversations without the knowledge or consent of *all* parties to the conversation." In light of the national character of companies that do business in California and the "recent trend toward outsourcing," not enforcing the law for out-of-state companies would "represent a significant inroad into the privacy interest that the statute was intended to protect."[21]

Moreover, "the application of California law rather than Georgia law in the context presented by the facts of this case would have a relatively less severe effect on Georgia's interest."[22] The Court reached this conclusion by noting first, that California law was more protective than Georgia law, and hence no privacy interest protected by Georgia law would be violated; second, that it "would apply only to those telephone calls that are made to or received from California, not to all telephone calls that are made to and from such Georgia business;" and third, that Georgia's interest "will not [be] severely impair[ed]."[23] The Court stated that because "California law does not totally prohibit a party to a telephone call from recording the call, but rather prohibits only the *secret* or *undisclosed* recording," businesses would simply have to "disclose[] at the outset of a call made to or received from a California customer that the call is being recorded" in order to avoid violation.[24] Such disclosure "would represent only a relatively minor impairment of Georgia's interests."[25]

Damages

Although the Court held that California law applied to the issue of whether an out-of-state party needed to disclose to a California resident that a telephone call was being recorded, it held that Georgia law applied with respect to damages for SSB's *past* conduct, because "Georgia has a legitimate interest in

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California-Nevada border." It was "clear" to the Court that California law covered this fact pattern. *Id.* at 30-31.

21 *Id*. at 39-40.

22 *Id*. at 41.

23 *Id*. at 41-42.

24 *Id*. at 42.

25 *Id*. at 43. The Court left open the possibility that unique factual circumstances of individual telephone calls could cause it to reach a different conclusion with respect to its choice-of-law analysis. *Id*. at 48 at n.18.

ensuring that individuals and businesses who act in Georgia with the reasonable expectation that Georgia law applies to their conduct are not thereafter unexpectedly and unforeseeably subjected to liability for such actions," and not awarding monetary damages would "not seriously impair California's interests." [26] Thus, "out-of-state companies that do business in California are on notice that, with regard to future conduct, they are subject to California law with regard to the recording of telephone conversations made to or received from California, and that the full range of civil sanctions afforded by California law may be imposed for future violations."[27]

IV. SIGNIFICANCE OF DECISION

Kearney v. *Salomon Smith Barney, Inc*. requires all companies that make or receive phone calls to California, and that wish to record such phone calls, to either disclose or cease the recording. Although at least one federal district court has reached a different conclusion with respect to the choice-of-law issue under Massachusetts law, in light of *Kearney* companies need to consider disclosing the recording of any calls that are not clearly within a one-party consent state, or face possibly severe fines and other penalties.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Charles A. Gilman at (212) 701-3403 or cgilman@cahill.com; Jonathan I. Mark at (212) 701-3100 or jmark@cahill.com; or John Schuster at (212) 701-3323 or jschuster@cahill.com.

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26 *Id*. at 46-47.

27 *Id*. at 47-48