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CLASS ACTION LITIGATION TRENDS

LINDA WOOLF
Goodell DeVries Leech & Dann

DEVELOPMENTS IN CONSUMER FRAUD CLASS ACTIONS: THE THORNY PROBLEM OF RELIANCE REQUIREMENTS AND THE CALIFORNIA EXPERIENCE

Linda S. Woolf
Goodell, DeVries, Leech & Dann, LLP
One South Street
Baltimore, Maryland 21202

Linda Woolf is the Managing Partner at the Baltimore law firm of Goodell, DeVries, Leech & Dann, LLP, and the head of its commercial litigation and insurance coverage departments. She graduated magna cum laude from the University of Baltimore Law School where she was the Managing Editor of the Law Review.

Linda regularly represents corporations in individual law suits, class actions and multi-district litigation involving alleged violations of consumer fraud and deceptive trade practice statutes. She has handled numerous commercial disputes arising from the sale of corporate subsidiaries, shareholder claims, contract and business tort claims. She has represented insurers in disputes under financial lines policies, including D&O, banker and broker E&O policies. Linda is a frequent lecturer and has authored a number of articles in these areas.

Linda is a past Chair of the Network of Trial Law Firms, Inc. (2000). She is a Vice Chair of the Commercial Litigation Section of the Federation of Defense & Corporate Counsel and has served as the Chair of the Nominating Committee and several of its ad hoc committees. She is a member of the Maryland Chapter of the Federal Bar Association Board of Governors and a past member of the Executive Board of the Maryland Association of Defense Counsel.

In 2007-2009, Linda was named as one of the Top 25 Women Super Lawyers in Maryland. In 2007, she was honored with the Leadership in Law Award and as one of the Top 100 Women in Maryland. She has been recognized since 2008 by Best Lawyers in America for commercial litigation and 2009-2010 for Bet-the-Company litigation.

Introduction

When resolving consumer fraud class actions, judges must balance the goals of protecting consumers from corporate fraud and abuses and protecting businesses from predatory litigation. When the relevant consumer protection law requires plaintiffs to show reliance on the alleged misrepresentation, judges struggle to craft intellectually disciplined decisions that are fair to both consumers and businesses. Strict enforcement of reliance requirements for all class members makes certification virtually impossible. But ignoring a statutory reliance requirement may improperly alter a substantive burden of proof and can trigger waves of no-injury class actions that can devastate small and not-so-small businesses while yielding little to no benefit to consumers or the public.

While courts construing reliance requirements in consumer protection acts sometimes lower the barrier to certification by using a rebuttable presumption of reliance, the California Supreme Court crafted a new compromise in a recent 4-3 decision. Relying upon language specific to a ballot initiative that amended California's Unfair Competition Law ("UCL"), the court held that each class representative must prove actual reliance to have standing but that standing requirement does not apply to

every absent class member. While the outcome in the *In re: Tobacco II Cases* turned on the particular language of the California UCL and the later ballot initiative, for purposes of this paper, the majority and dissent vividly capture the struggle that judges go through as they try to strike the proper balance between consumer and business interests.

I. The California Unfair Competition Law and Proposition 64

California's UCL originally authorized any individual to sue a business for UCL violations regardless of whether the violation harmed that individual (or anyone else). *See In re Tobacco II Cases*, No. S147345, 2009 WL 1362556, at *1 (Cal. May 18, 2009). UCL plaintiffs did not have to show they relied on the misrepresentation or that it harmed them. *Official Voter Information Guide*, at 38 (http://vote2004.sos.ca.gov/voterguide/english.pdf) (last visited October 27, 2009) ("Voter Information Guide")). The rationale behind these permissive standards was that California would benefit from vigorous action against unfair business practices regardless of who brought the action. *In re Tobacco II Cases*, 2009 WL 1362556, at *14.

These plaintiff-friendly standards, however, produced a host of unintended consequences. *See Voter Information Guide.* Businesses of all sizes complained that the UCL incentivized frivolous lawsuits by fee-seeking attorneys and their uninjured clients. *Id.* Attorneys pounced upon technical and harmless violations of the UCL (such as using "A.P.R." instead of the term "Annual Percentage Rates" in advertisements) to extort shakedown settlements from businesses unwilling or unable to fund extensive litigation. *Id.*

Californians grew particularly sympathetic to small businesses – often owned by first-generation Americans – who faced crippling class action litigation costs over harmless statutory violations. *In re Tobacco II Cases*, 2009 WL 1362556, at *9. In November 2004, 58% of California voters passed the ballot initiative Proposition 64 ("Prop 64") to curb these UCL abuses. California General Election, http://vote2004.sos.ca.gov/Returns/prop/00.htm Prop 64 replaces section 17204's original provision allowing UCL suits by any person "acting for the interests of itself, its members or the general public," with new language limiting the UCL to suits by an individual "who has suffered injury in fact and has lost money or property as a result." *Californians for Disability Rights v. Mervyn's, LLC*, 39 Cal.4th 223, 228, 138 P.3d 207, 210 (2006) (cited in *In re Tobacco II Cases*, 2009 WL 1362556 (Cal. 2009)). Prop 64 also requires any person pursuing representative claims to meet section 17204's standing requirements and comply with the class action requirements of the California Civil Procedure Code. *Id.* (discussing Cal. Bus. & Prof. Code § 17204) (West 2006). Litigants quickly disputed the extent to which Prop 64 changed the requirements for a UCL class action.

II. In re Tobacco

Through *In re Tobacco II Cases*, the California Supreme Court recently tried to resolve this question. 2009 WL 1362556, at *2. Plaintiff Willard Brown, individually and on behalf of California's General Public, sued numerous tobacco companies in 1997. *Id.* He alleged that the tobacco companies manufactured and distributed tobacco products while knowingly denying and concealing the fact that the products contained the highly addictive drug nicotine. *Id.* He moved for class certification on two claims: (1) violation of California's UCL and (2) false advertising.

The trial court certified the class before Prop 64 passed, under UCL standards that allowed any individual to bring an action on behalf of the citizens of the entire state without showing actual injury. *Id.* at *3. After Prop 64 amended the UCL, the defendants moved to decertify the class arguing that under the new standing requirements individual issues now predominated over those common to the entire class. *Id.* at *4. They argued that each class member now had to prove that with his cigarette purchase he suffered injury in fact and lost money or property "as a result of" defendants' misrepresentations. *Id.* The trial court granted defendants' motion to decertify, and the California Court of Appeal affirmed. *In re Tobacco II Cases,* 2009 WL 1362556, at *4 (Cal. May 18, 2009).

A. The Majority Holds the Reliance Requirement Applies Only to Class Representatives for Purposes of Standing

The Supreme Court of California reversed the lower courts. In a 4-3 decision, it held that, although Prop 64 required plaintiffs to show actual reliance on the misrepresentations, only the class representatives had to make this showing to have standing. *Id.* at *12. It reached its conclusion by examining the California law authorizing class actions. *See id.* at *8 (citing Cal. Bus. & Prof. Code § 17203). This statute stated that for a "person" to pursue a representative claim on behalf of others, the "claimant" must meet the standing requirements of section 17204 (suffering injury "as a result of unfair competition"). *Id.* Because California's class action statute uses the singular when stating that a "person" may bring a representative claim on behalf of others if the "claimant" meets the standing requirements, the court construed the language as limited to the class representative. It held these requirements did not apply to all members of the class, just those representing the class. *Id.*

The majority also found Prop 64's non-mandatory language created a relaxed standing requirement for absent class members. *In re Tobacco II Cases,* 2009 WL 1362556, at *12 (Cal. May 18, 2009). The UCL's remedies provision allows "any person in interest" to recover "any money or property, real or personal, which *may have been acquired*" by unfair business practices. *Id.* at *12. Therefore, the strict standing requirement, which requires a showing of injury *as a result of* or upon reliance of unfair competition, only applies to the class representative. All class members, however, have standing under the UCL regardless of whether every one of them actually relied on any misrepresentations. *Id.* (stating if Prop 64's drafters intended to require all class members to show actual reliance, "they would have amended section 17203 to reflect this intention").

The court reasoned its holding was consistent with Prop 64's purpose because "[t]he specific abuse of the UCL at which Prop 64 was directed was its use by unscrupulous lawyers who exploited the generous standing requirement of the UCL to file 'shakedown' suits to extort money from small business." *Id*. at *9. The court explained that Prop 64 was not intended to radically change UCL class action requirements. Rather, its narrow focus was stopping trial attorneys from suing small businesses, after searching through public records for "often ridiculously minor violations of some regulation or law," and extracting quick settlements from businesses that could not afford the expenses of litigation. *Id.*

The majority construed Prop 64 as limited to eliminating lawyers' ability to bring an action on behalf of the general public where no client has been injured in fact. *Id.* Citing the Voter Information Guide, designed to inform voters as to how the Proposition would affect the law, the court noted that Prop 64's proponents argued that it would have no effect on the ability to bring actions to enforce environmental and consumer protection laws. *Id.* at *10. Additionally, because these ballot materials did not address how the measure would affect class actions, the court concluded that it had no effect.

Thus, the majority believed it reached the just result because it upheld Prop 64's goal of preventing uninjured individuals from acting as class representatives without insulating businesses from liability for its harmful fraudulent actions. Under the amended UCL, fee-seeking trial lawyers could no longer bring suit against small businesses where there was no injury in fact. Under the court's interpretation, the main evil Prop 64 targeted was eliminated, while "[t]he substantive right extended to the public by the UCL . . . , the right to protection from fraud, deceit and unlawful conduct" was protected. *In re Tobacco Cases*, 2009 WL 1362556, at *14 (Cal. May 18, 2009).

B. The Dissent Argues That All Class Members Must Show Reliance to Have Standing

Justice Baxter's dissent argued that the majority's opinion undercut Prop 64. He argued that under Prop 64 unnamed class members in a UCL class action also must meet the actual reliance requirements articulated in Prop 64. The dissent, however, concurred with the majority that Prop 64 requires a showing of actual reliance on any fraudulent misrepresentations. Focusing on the statute's required compliance with Section 382 of the California Code of Civil Procedure, the state's version of Rule 23 of the Federal Rules, the dissent asserted that class treatment under Section 382 required a "well defined community of interest," which requires class representatives to have claims or defenses that are *typical of the class*. *Id.* at *19. (Baxter, J., dissenting). Because this typicality requirement mirrors Federal Rule 23(a)(3), the dissent cited various federal cases holding typicality requires class members to have causes of action against the defendant and that a class cannot be so broad "as to include individuals who are without standing to maintain the action on their own behalf." *Id.* (citing *Clay v. Am. Tobacco Co.*, 188 F.R.D. 483, 490 (S.D. Ill. 1999)).

The majority dismissed this assertion, stating that "such references do not support the proposition that all class members must individually show they have the same standing as the class representative in order to be part of the class. Rather, federal case law is clear that the question of standing in class actions involves the standing of the class representative and not the class." *Id.* at *11. It reasoned that, because the post-Prop 64 amendments require a showing of injury that occurred *as a result* of unfair business practices, all class members must make this showing. *Id.* In its view, the contrary holding not only misinterprets the UCL but also frustrates Prop 64's stated purpose. *Id.*

The dissent argued that the majority's view would only encourage the frivolous lawsuits that Prop 64 was designed to eliminate. *Id.* at *19. By allowing one plaintiff who relied upon deceptive advertising to seek "relief on behalf of *all California smokers who simply saw or heard such ads* during the period at issue, regardless of whether false claims contained in those ads had anything to do with any class member's decision to buy and smoke cigarettes," frivolous lawsuits would continue. *In re Tobacco II Cases*,

2009 WL 1362555, at *19 (Cal. May 18, 2009) (Baxter, J., dissenting). Those who could not bring a claim in their own name under Prop 64 could still join an identical suit brought by someone else. *Id.*

The dissent predicted more destructive, parasitic litigation in California and illustrated its point with a well crafted hypothetical:

> "A local chain of family-owned supermarkets receives a large shipment of ground beef and puts it out for sale. The stores' meat departments label and display the meat as "ground round," the leanest grade. The stores' regular price for ground round is $5.99 per pound, but the display labels offer the meat from this shipment at a "reduced price" of $4.99 per pound. The company has not intentionally misrepresented the product. However, in the exercise of due care, it should have known the meat is *ground sirloin,* a wholesome but slightly fattier grade. The chain is actually selling other quantities of ground sirloin, correctly labeled, at its regular $4.99 per pound price.
>
> Customer A visits one of the stores, seeking to buy ground beef. Concerned about his fat intake, he does not intend to purchase any grade other than ground round and would not knowingly do so. Relying upon the incorrect "ground round" label, he buys a pound of the meat, so labeled, at the $4.99 price, and consumes it. A substantial number of other customers also see the incorrect "ground round" labels. However, many do not care about the grade of ground beef they eat, do not realize the significance of the label, and are not influenced by it. Nonetheless, they also buy substantial quantities of the mislabeled meat and happily consume it.
>
> Customer A later discovers the labeling mistake. He obtains counsel and brings a UCL action alleging false advertising that caused him actual injury or loss in the amount of $4.99. He claims restitution to himself in that amount. In the suit, he further seeks to certify a class of all other customers who saw the incorrect labels and purchased the mistakenly mislabeled meat. Regardless of whether these persons relied on the incorrect description when purchasing the mislabeled product, he prays for restitution, on their behalf, of all profits the stores received from such purchases.
>
> Under the majority's concept of no-injury class actions, the plaintiff, Customer A, may well succeed in this endeavor if the case proceeds in court. Realizing this, the company quickly settles. That cannot be what the voters intended when they adopted the substantial reforms set forth in Proposition 64." *Id.* at *21-22.

The dissent attacked the supposed balance sought by the majority, whereby consumers' rights are protected and frivolous lawsuits stopped, on the grounds that the UCL's enhanced standing requirements do not apply to the attorney general and other specific public officials. *Id.* at *20. Even where all class members must show reliance in private lawsuits, California's citizens remain protected and businesses remain motivated

to deal honestly because the state's enforcement power has no reliance requirement. *Id.*

III. The Thorny Issue of Reliance in Consumer Fraud Class Action Certification Decisions

While *In re Tobacco*'s holding is limited to the unique language of the amended California UCL, the policy considerations raised by the high court's debate provide valuable lessons on the tensions between strict and permissive application of reliance standards in consumer fraud class actions. Nationwide, courts struggle with these tensions case by case. Class action practitioners must be sensitive not only to the particular requirements of the relevant states but also the competing forces pulling at a judge who is asked to certify a consumer fraud class action.

While virtually all states have statutory consumer fraud laws, reliance requirements are not uniform. *Latman v. Costa Cruise Lines, N.V.*, 758 So.2d 699 (Fla. Dist. Ct. App. 3d. Dist. 2000). Some states, like pre-Prop 64 California, do not have actual reliance requirements. *See, e.g., Celex Group, Inc. v. Executive Gallery, Inc*., 877 F. Supp. 1114, 1127-28 (N.D. Ill. 1995) (applying Illinois law); *Prishwalko v. Bob Thomas Ford, Inc*., 33 Conn. App. 575, 583, 636 A.2d 1383, 1388 (1994). And among the reliance states, many afford plaintiffs a presumption of reliance at the class certification stage, which defendants may be able to rebut to prevent certification. A commonly recognized presumption of reliance occurs in securities fraud cases where plaintiffs allege 'fraud on the market.' This theory allows courts to dispense with individual inquiries into reliance where plaintiffs have purchased stock in a market whose prices have been corrupted by defendant's fraud. The theory is that the plaintiffs all rely on the market price as uncorrupted when purchasing the stock and all suffer damage by purchasing artificially inflated stock. *See*, *e.g.*, *Peil v. Spiser*, 806 F.2d 1154, 1161 (3d Cir. 1986).

While judicial application of these standards is relatively straightforward in individual consumer fraud cases, the analysis grows much more complicated when plaintiffs seek class treatment of such fraud claims. *See*, *e.g.*, *Varcallo v. Mass. Mutual Life Ins. Co.*, 332 N.J. Super. 31, 44, 752 A.2d 807, 814 (2000) ("[D]ifferent courts, even when presented with substantially similar, if not identical, claims have reached divergent conclusions in deciding whether to certify a class action."). In reliance states, strictly requiring each class member to show reliance before certifying a class virtually eliminates the chances of certifying a consumer fraud class action. Thus, reliance jurisdictions tend to either allow a rebuttable presumption of reliance or on a case-by-case basis look to other policy considerations that they may consider more important. Conversely, 'no reliance' states risk encouraging "shake-down" no-injury lawsuits, like those that drove California voters to pass Prop 64, unless other elements of the claim require individual proof.

A. Reliance jurisdictions

Most courts that require a showing of reliance in the class action context stress that class actions do not relieve a party of its burden of proving each element of its cause of action or strip defendants of their due process rights:

> The class action is a procedural device intended to advance judicial economy by trying claims together that lend themselves to collective treatment. It is not meant to alter the parties' burdens of proof, right to a jury trial, or the substantive prerequisites to recovery under a given tort. Procedural devices may "not be construed to enlarge or diminish any substantive rights or obligations of any parties to any civil action." *Henry Schein, Inc. v. Stromboe*, 102 S.W.3d 675, 693 (Tex. 2003).

Whenever courts focus on these points, plaintiffs' claims are in serious jeopardy. Strict construction of these principles rarely results in certification of a consumer fraud class and essentially challenges the viability of the class action mechanism for such claims. *See id*.

California's Supreme Court avoided this by holding that the strict reliance requirement only applied to class representatives. In other reliance states, consumer fraud class actions remain viable because many judges allow a class-wide rebuttable presumption of reliance on misrepresentations at certification. *See, e.g., Amato v. Gen. Motors Corp.*, 11 Ohio App. 3d 124, 127, 463 N.E.2d 625, 629 (1982). Whether courts apply this presumption can be dispositive of certification. *Compare Liberty Lending Servs. v. Canada*, 293 Ga. App. 731, 741, 668 S.E.2d 3, 12 (2008) ("the simple fact that reliance is an element in a cause of action is not an absolute bar to class certification") *with Rollins, Inc. v. Butland*, 951 So.2d 860, 879 (Fla. Dist. Ct. App. 2007) ("reliance is an element of the claims, and [Florida case law] appl[ies] to preclude class certification). *See Liberty Lending Servs.*, 293 Ga. App. at 741, 618 S.E.2d at 12.

Equitable principles purportedly drive the policy of allowing an element of a claim to be presumed instead of rigorously proven. *See Varcallo*, 332 N.J. Super. at 45, 752 A.2d at 815. Most prominent is the idea that large-scale corporate wrongdoing would go unpunished without the presumption because "individual actions [are] uneconomical to pursue." *Id.* Courts reason that requiring individual proof of reliance on broadly disseminated misrepresentations "would result in the utter negation of the fundamental objectives of class-action procedure." *See Amato*, 11 Ohio App.3d at 126-127, 463 N.E.2d at 628.

Courts that allow a reliance presumption are more inclined to do so when the alleged misrepresentations are uniform. These courts feel that when the same misrepresentations were given to all members of the class, then circumstantial evidence showing class-wide reliance is proper. *See Liberty Lending Servs.*, 293 Ga. App. at 742, 668 S.E.2d at 12. *Liberty Lending* held that reliance could be presumed when the alleged misrepresentations were *written* and contained within the contracts between Liberty and the various consumers. *Id.* Because these misrepresentations were written, as opposed to oral, the court could be assured that the same language was used in each contract. *Id.*

B. Non-Reliance jurisdictions

Jurisdictions that do not require reliance as an element of a consumer fraud claim must have some element of the claim to act as a bulwark against a flood of fee-driven lawsuits, such as the one that California faced under the original UCL. New Jersey, for example does not require reliance to recover on a consumer fraud claim but does require class members to show an "ascertainable loss" caused by the

misrepresentation. *Int'l Union of Operating Engineers Local No. 68 Welfare Fund v. Merck & Co.*, 192 N.J. 372, 389, 929 A.2d 1976 (2007) ("Our statute essentially replaces reliance, an element of proof traditional to any fraud claim, with the requirement that plaintiff prove ascertainable loss."). Jurisdictions that have no reliance requirement often have some form of a causation requirement that links the aggrieved plaintiffs to the alleged damages. *Id.* (holding consumer fraud plaintiff must show "a causal relationship between the defendants' unlawful conduct and the plaintiff's ascertainable loss.").

Even if reliance can be presumed, certification is unlikely to be appropriate where a significant number of class representatives have suffered no damages at all. The Third Circuit ordered decertification of a securities class action, where the lower court improperly presumed reliance, because it was "clear that at least some of the plaintiffs have not suffered economic injury." *Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 189 (3d Cir. 2001) ("While obstacles to calculating damages may not preclude class certification, the putative class must first demonstrate economic loss on a common basis."). Practitioners in non-reliance jurisdictions should be able to effectively oppose certification where part of the proposed class has suffered no damages at all.

Ironically, the inclusion of 'no reliance' states in a purported multi-state consumer fraud class action may weigh against certification of multi-state class actions. A proposed class covering jurisdictions with substantively different standards of liability for consumer fraud will struggle to show that common issues predominate over individual ones. It is the plaintiffs' burden to show by "extensive analysis" that variations in applicable state laws can be accommodated through class treatment. *Lyon v. Caterpillar, Inc.*, 194 F.R.D. 206, 218-221 (E.D. Pa. 2000) (rejecting proposed 41-state consumer fraud class action where plaintiff separated state consumer fraud acts into four groups based on differences in reliance requirements but failed to provide detailed analysis of each state's act and how the court would address differences among them). Accordingly, when asked to defend multi-state class actions, practitioners must be cognizant of inter-jurisdictional differences in reliance requirements.

CONCLUSION

Practitioners outside of California looking for bright line rules in consumer fraud class action law will be disappointed. While most states' consumer fraud acts require reliance, some courts have developed various mechanisms to avoid strictly enforcing the requirement. Thus, practitioners need to be acutely aware of the competing pressures judges are under as they try to equitably resolve cases without creating a judgment or rule that provides shelter for corporate wrongdoing or an avenue for predatory lawsuits.

GOODELL, DEVRIES
LEECH & DANN, LLP
One South Street, 20th Floor, Baltimore, MD 21202
Phone: 410-783-4000 Fax: 410-783-4040

Managing Partner
Linda S. Woolf
lsw@gdldlaw.com
(410) 783-4011

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Linda S. Woolf is the Managing Partner of the firm and one of its founding members. Ms. Woolf's practice is devoted to the representation of clients in complex commercial, insurance coverage, construction, government liability, and employment litigation.

Ms. Woolf is the Vice Chair of the Commercial Litigation Section of the Federation of Defense and Corporate Counsel and serves on several of its ad hoc committees. She is a past Chair of the Network of Trial Law Firms, Inc. (1999-2000), a non-profit corporation comprised of 26 independent law firms nationally recognized for their trial and litigation experience. Ms. Woolf is a past member of the Executive Board of the Maryland Association of Defense Counsel, and past Co-Chair of its Appellate Committee.

In 2007, Ms. Woolf was named to the Top 25 Women Super Lawyers in Maryland, and was honored with the Daily Record's Leadership in Law Award and as one of the Top 100 Women in Maryland.

PROFESSIONAL EXPERIENCE

COMMERCIAL AND BUSINESS TORT LITIGATION

Represents international pharmaceutical company in litigation arising from the divestiture of a wholly-owned medical device subsidiary. Represents an international manufacturer in litigation arising from the divestiture of a worldwide battery business. Has represented national and local corporations at the trial and appellate levels in state and federal courts in matters involving the sale of corporate subsidiaries and businesses, alleged predatory lending practices and consumer fraud, federal and state antitrust violations, claims arising from non-competition agreements and the misappropriation of technology and other contractual disputes. Represented a surety in protracted litigation with the Resolution Trust Corporation arising from the failure of a savings and loan institution. Represented the majority shareholders of two thoroughbred racing corporations in derivative lawsuits filed by minority shareholders, successfully retaining control of nationally known racetracks

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Has represented insurers and policyholders in various complex insurance coverage disputes, including:

Mayor & City Council of Baltimore v. Utica Mutual Ins. Co., et al. Represented primary and umbrella insurers in coverage litigation brought by municipality to recover damages allegedly incurred as a result of asbestos-containing building materials in public buildings. Obtained summary judgment in favor of insurers on basis of products risk exclusion which was affirmed on appeal in a case of first impression in Maryland.