Legal Backgrounder

WLF Washington Legal Foundation

Advocate for freedom and justice®
2009 Massachusetts Avenue, NW
Washington, DC 20036
202.588.0302

Vol. 21 No. 34 November 17, 2006

RULINGS SLOWLY REVEAL IMPACT OF CALIFORNIA'S PROPOSITION 64

by

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In its November 2, 2004 General Election, California's voters approved a ballot initiative (Proposition 64) altering the standing rights of plaintiffs to sue in California for unfair competition and false advertising. Before its passage, California law authorized private persons to file quasi-class action lawsuits for unfair competition and false advertising under California Business & Professions Code § 17200 (the "UCL") without requiring traditional class certification and without requiring a showing that such person(s) had been injured or damaged. After Proposition 64, a private person has standing to sue only if he or she "has suffered injury in fact and has lost money or property as a result of such unfair competition." (California Business & Professions Code § 17204, as amended.) Proposition 64 became effective on November 3, 2004.

The preamble to Proposition 64 declares that the UCL's relaxed standing rules had encouraged "[f]rivolous unfair competition lawsuits [that] clog our courts[,] cost taxpayers" and "threaten[ ] the survival of small businesses...." (Prop. 64, § 1(c) ["Findings and Declarations of Purpose"].) Change was necessary, according to the voters, because the former version of the UCL had promoted misuse by some private attorneys who had filed undesirable and/or objectionable lawsuits, including "frivolous lawsuits as a means of generating attorneys' fees without creating a corresponding public benefit," "lawsuits where no client ha[d] been injured in fact," "lawsuits for clients who ha[d] not used the defendant's product or service, viewed the defendant's advertising, or had any other business dealing with the defendant," and "lawsuits on behalf of the general public without any accountability to the public and without adequate court supervision." (Prop. 64, § 1(b)(1)-(4).) By enacting Proposition 64, California voters intended to limit the exploitation and expansion of the UCL by "prohibit[ing] private attorneys from filing lawsuits for unfair competition where they have no client who has been injured in fact" (*id.*, § 1(e)) and by providing "that only the California Attorney General and local public officials be authorized to file and prosecute actions on behalf of the general public" (*id.*, § 1(f)).

Although Proposition 64 did not expressly declare whether these new standing provisions would apply to pending cases, shortly after its passage defendants in UCL actions began filing motions to dismiss pending lawsuits based on the new standing limitations. Trial court decisions on these motions were quickly appealed across California's six appellate districts, most of which held that Proposition 64 applied "retroactively" to pending cases, thereby leading to dismissal of cases led by "uninjured" plaintiffs. Given the importance of the issue to thousands of pending lawsuits in California state and federal courts, as well as the absence of consensus among the appellate districts, the California Supreme Court accepted review of two cases which presented questions on the standing issue. The two companion cases – *California for Disability Rights v. Mervyn's, LLC* (2006) 39 Cal.4th 223 ("*Mervyn's*") and *Branick v. Downey Savings and Loan Association* (2006) 39 Cal.4th 235

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("*Branick*") – were decided on July 24, 2006.

Mervyn's was a 2002 lawsuit brought by Californians for Disability Rights ("CDR"), which sued Mervyn's department store chain on injunctive grounds, seeking to widen aisles at 125 outlets around the state to accommodate wheelchairs. When Proposition 64 passed, CDR was appealing an adverse trial court ruling entered in favor of Mervyn's after a bench trial. Mervyn's filed a motion to dismiss the appeal, arguing that Proposition 64 eliminated CDR's standing to prosecute the action. The key question was whether Proposition 64 could only be applied "prospectively," or whether it could be applied "retrospectively." If Proposition 64 could be applied "retrospectively," the next question was whether such an application to pending cases would constitute an impermissible "retroactive" application of a new statute to pre-statute conduct.

Rather than considering whether a procedural or substantive label best applied, the California Supreme Court in *Mervyn's* considered instead the effect of a law on a party's rights and liabilities. In the court's view, function, not form, was the more important focus. Accordingly, the court began its analysis summarizing a recognized retroactivity principle under California law: when new laws or statutes change the legal consequences of past conduct by imposing new or different liabilities based upon such conduct, or substantially affect existing rights and obligations, retroactive application of the new laws or statutes to pre-enactment conduct is forbidden, absent an express legislative intent to permit such retroactive application. The court reasoned that, "[v]iewed functionally, a statute that establishes rules for the conduct of pending litigation without changing the legal consequences of past conduct … is not made retroactive merely because it draws upon facts existing prior to its enactment." *Mervyn's*, 39 Cal.4th at 231 (internal quotations omitted). Simply stated, where the effect of a new statute only changes the "procedure to be followed in the future," it is considered prospective in nature. *Id*. In such cases, the court concluded "it is a misnomer to designate [such statutes] as having retrospective effect." *Id*.

Applying these standards, the court found that application of Proposition 64 to pending cases would not offend established rules associated with retroactive application, holding: "To apply Proposition 64's standing provisions to the case before us is not to apply them 'retroactively,' as we have defined that term, because the measure does not change the legal consequences of past conduct by imposing new or different liabilities based on such conduct. The measure left entirely unchanged the substantive rules governing business and competitive conduct. Nothing a business might lawfully do before Proposition 64 is unlawful now, and nothing earlier forbidden is now permitted. Nor does the measure eliminate any right to recover." *Id*. at 232. Continuing its analysis, the court then acknowledged that, "[f]or a lawsuit properly to be allowed to continue, standing must exist at all times until judgment is entered and not just on the date the complaint is filed." *Id*. at 232-233. Proposition 64, the court said, "prevent[s] *uninjured* private persons from suing for restitution on behalf of others," and thereby effectively "withdraws the standing of persons who have not been harmed to represent those who have." *Id.* at 232 (emphasis in original). Observing that CDR had not claimed entitlement to monetary relief and had only sought injunctive relief that is by nature prospective only, the court declined to dismiss the case as a matter of law and instead ordered the case remanded for further proceedings consistent with the opinion. While the court effectively concluded that CDR lacked standing to proceed, CDR's entitlement to proceed was not completely or expressly foreclosed.

The Supreme Court granted review in *Branick*, the companion case, to "decide whether plaintiffs, whose standing Proposition 64 revoked, may amend their complaint to substitute a new plaintiff who does not enjoy standing and, if so, whether such an amendment relates back for purposes of the statute of limitations to the date on which the original complaint was filed." *Branick*, *supra*, 39 Cal.4th at 239. *Branick* began in 2002 when two plaintiffs accused Downey Savings and Loan ("Downey") of charging excessive mortgage lending fees, including misrepresenting and overcharging customers for fees charged by governmental entities to record official documents used in real estate transactions, such as deeds, reconveyances and powers of attorney, among others. Neither plaintiff had borrowed any money from Downey, nor had they alleged that they had paid any fees, suffered any injury, or lost any money or property based on these alleged practices. Instead, they claimed standing to sue on behalf of "the general public" under the pre-Proposition 64 version of the UCL (California Business and Professions Code §§ 17204 and 17535). As relief, plaintiffs sought restitution, interest, injunctive relief, and costs and attorneys' fees under the private attorney general act (California Code of Civil Procedure § 1021.5).

In the trial court, Downey prevailed on a motion for judgment on the pleadings on the ground that the federal Home Owners' Loan Act (12 U.S.C. § 1461 et seq.) and associated regulations promulgated by the Office of Thrift Supervision (12 C.F.R. § 560.2 (2006)) preempted plaintiffs' claims. After judgment was entered for Downey, plaintiffs appealed. Proposition 64 took effect while the appeal was pending. Although the Court of Appeal held that federal law did not preempt plaintiffs' claims, it concluded that Proposition 64 revoked the standing of plaintiffs, who did not allege that they had "suffered injury in fact and [had] lost money or property as a result of [the alleged] unfair competition." (§ 17204.)

The Supreme Court granted Downey's petition for review. Consistent with its companion opinion in *Mervyn's*, the court observed that "[t]he policy objectives underlying Proposition 64 are fully achieved by applying the measure to pending cases," and that "[a]n additional rule barring amendments *to comply* with Proposition 64 does not rationally further any goal the voters articulated." *Id*. at 241 (emphasis in original). Reasoning that the voters had not expressed the desire to alter the ordinary rules applicable to amending complaints or relation back, the court rejected Downey's contention that courts may never permit a plaintiff to amend a complaint to satisfy Proposition 64's standing requirements and held that plaintiffs who had lost standing as a result of Proposition 64 may amend their complaints to comply with its requirements and substitute in a plaintiff who has suffered damages. The court was reluctant to interpret Proposition 64 in a manner that "would bar a meritorious action prosecuted by a substituted plaintiff 'who *has* suffered injury in fact and *has* lost money or property as a result of' unfair competition or false advertising …'" *Id*. at 241 (emphasis in original).

However, the court was careful to note that the trial court would determine whether the *Branick* plaintiffs would be allowed to amend (applying established amendment rules) and, if so, whether the amendment would relate back to the original filing of the complaint. The court expressly held that "Proposition 64 does not affect the ordinary rules governing the amendment of complaints and their relation back." *Id*. at 239. On these questions, the trial courts will retain discretion to rule on a case-by-case basis and to decide whether an amendment and/or relation back is appropriate. This leaves open the possibility that many of the pending lawsuits could survive Proposition 64 by substituting new plaintiffs who claim harm from the same business practices. But allowing amendment with a new "harmed" plaintiff may not be a panacea, as the brass ring might still be lost if the trial court concludes in a such a case that the relation back doctrine cannot or does not apply under the circumstances, which could in turn lead to dismissal on statute of limitation grounds. Consequently, it remains to be seen whether *Mervyn's* and *Branick* will have the far-reaching impact that was anticipated by practitioners while the cases were on review.

Perhaps an even more noteworthy case than either *Mervyn's* or *Branick*, and one that has sparked far more interest in the defense bar, is *Pfizer, Inc. v. Superior Court* (2006) 141 Cal.App.4th 290, decided July 11, 2006. Although the California Supreme Court granted review of *Pfizer* on November 1, 2006 (meaning it can no longer be relied upon or cited under applicable appellate citation rules), *Pfizer's* interpretation of Proposition 64 was both more dramatic and more controversial, and if the Supreme Court adopts its reasoning, will have a far greater effect on UCL litigation than either *Mervyn's* or *Branick*. Pfizer, the manufacturer of Listerine mouthwash, was sued by plaintiff Galfano for allegedly misleading advertising associated with Listerine, based on marketing which suggested that the use of Listerine could replace the use of dental floss in reducing plaque and gingivitis. The complaint asserted causes of action for breach of express warranty, false advertising under California Business and Professions Code § 17500 ("FAL"), and unlawful, unfair and fraudulent business practices under the UCL.

Plaintiff sought to certify the action as a class action. Pfizer opposed class certification on numerous grounds, including that the case contained numerous factual issues that required individual inquiries, such as "whether each class member saw or read a label; if so, *which* of the labels was seen or read; whether the consumer was deceived or misled by, or relied on, the label; if so, whether that was part of the bargain and caused the consumer to buy Listerine; if so, whether the consumer suffered injury in fact and lost money or property as a result of the alleged deception or reliance; and if so, the amount of damages or restitution, given that prices vary and most consumers will not have records of the price(s) they paid." *Pfizer, supra*, 141 Cal.App.4th at 297. Notwithstanding Pfizer's vigorous opposition to class certification, and despite the trial

court's reservations about certifying a class, the trial court certified a class on November 22, 2005, consisting of "all persons who purchased Listerine, in California, from June 2004 through January 7, 2005." *Id*.

Pfizer filed a petition for writ of mandate with the Court of Appeal, seeking to overturn the trial court's class certification ruling based on the mandates of Proposition 64. Pfizer claimed that the trial court erroneously certified the class because "under Proposition 64, one who maintains an action under the UCL must have suffered injury in fact and have lost money or property as a result of the unfair competition (§ 17204), and this standing requirement applies equally to the named plaintiff and to all class members."

After summarizing the state of UCL and FAL law before Proposition 64, the changes wrought by the revisions to the statutes, and the requirements for class certification, the court specifically noted that pre-Proposition 64 case law "only required a showing that 'members of the public [were] *likely to be deceived*.'" *Id*. at 303 (emphasis in original). Given the pre-Proposition case authority, the court identified the key issue as "whether the 'likely to be deceived' standard [could] be reconciled with Proposition 64's new standing requirements." *Id*. Since Proposition 64 "prohibits any person, other than the Attorney General or local public prosecutors, from bringing a lawsuit for unfair competition or false advertising unless the person has suffered 'injury in fact' and has lost money or property as a result of such violation," the court of appeal concluded that the "likely to be deceived" standard could *not* survive Proposition 64's statutory changes.

The court held that "the mere likelihood of harm to members of the public [was] no longer sufficient for standing to sue" and that those persons who had "not suffered any injury in fact and who [had] not lost money or property as a result of an alleged fraudulent business practice" could not state a claim "merely based on the 'likelihood' that members of the public [could] be deceived." *Id*. at 304. Additionally, because Proposition 64 requires that a plaintiff plead and prove an "injury in fact ... *as a result of* the fraudulent business practice or false advertising" (§§ 17204, 17535), such a standard necessitates pleading and proving that a plaintiff "actually relied on the false or misleading misrepresentation or advertisement in entering into the transaction in issue." *Id*. at 305 (emphasis in original). Based on these findings, the court held that the certification order was overbroad, erroneous and contrary to law. Accordingly, the Court of Appeal directed the trial court to vacate its order granting class certification and "enter a new and different order denying the motion." *Id*. at 308.

Under the *Pfizer* rule as articulated by the Court of Appeal, a plaintiff in a UCL and/or FAL case must plead and prove that he or she *actually relied* on the alleged misrepresentation and, as a result, was injured. It remains to be seen whether the California Supreme Court will adopt the *Pfizer* court's interpretation of Proposition 64, but given the Supreme Court's long history of proactively protecting consumers by issuing pro-consumer opinions, the odds of *Pfizer* surviving seem long. One may posit that the mere acceptance of review signals that the Supreme Court intends to reverse the Court of Appeal's formulation. *Pfizer's* standards are reminiscent of common-law fraud claims, which are challenging to certify, particularly given the "causation" and "reliance" elements. *Pfizer's* requirement that each class member must have standing to bring an action in his or her own right, if it survives Supreme Court review, would represent a major shift in UCL litigation. Indeed, the *Pfizer* court even recognized that the addition of a reliance requirement might "preclude a consumer who did not read and rely on a label from stating a UCL or FAL", and that these new standing requirements could well dramatically restrict consumer protection lawsuits. *Id*. at 307. Thus, the final chapter on the potentially wide-ranging impact of Proposition 64 has not yet been written, but practitioners and clients alike are closely monitoring future developments that could mean success or failure in otherwise unremarkable cases.

  ISBN 1056 3059