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Chair's Column
Holly A. House

Editor's Column
Kathleen J. Tuttle

UCL Post-Prop. 64

“WILL YOU STILL NEED ME; WILL YOU STILL PLEAD ME, AFTER PROP. 64?”

ARTICLES

**PRIVATE “REPRESENTATIVE ACTIONS” UNDER
CALIFORNIA’S UNFAIR COMPETITION LAW
AFTER PROPOSITION 64: A COMPARATIVE ANALYSIS**

Gerald E. Hawxhurst and Kevin Y. Teruya

**PROPOSITION 64 DOES NOT APPLY
TO PENDING CASES**

Bonny E. Sweeney

PROPOSITION 64 APPLIES TO PENDING CASES

Thomas S. Hixson

**IS UCL FRAUD NOW AKIN TO COMMON LAW FRAUD?
RELIANCE, MATERIALITY AND CAUSATION AFTER
PROPOSITION 64**

Andrew B. Serwin and Russell L. Carlberg

PROBLEMS IN PARTNERING WITH PUBLIC PROSECUTORS

Barbara M. Motz

**HAVE UNFAIR COMPETITION CLAIMS BECOME “FEDERALIZED”
AFTER PROPOSITION 64 AND THE CLASS ACTION FAIRNESS ACT?**

Amy Darby and Amy Maclear

**CALIFORNIA ANTITRUST AND UNFAIR
COMPETITION LAW UPDATE**

Thomas Greene and Thomas A. Papageorge

HAVE UNFAIR COMPETITION CLAIMS BECOME “FEDERALIZED” AFTER PROPOSITION 64 AND THE CLASS ACTION FAIRNESS ACT?

By Amy Darby and Amy Maclear*

I. INTRODUCTION

Congress and California voters recently adopted measures to curb alleged lawsuit abuses that many claimed undermined the judicial system. Both reform efforts were years in the making, and succeeded only after numerous attempts. The reform endeavors, although largely unconnected, were passed within months of one another resulting in what could be considered the federalization of California’s Unfair Competition Law (“UCL”).¹

Proposition 64 (“Prop. 64”)² abolished private attorney general standing to sue for alleged unfair competition on behalf of the general public and imposed a requirement of individual injury and loss of money or property.³ This reform permits controversial “representative actions” only if certification requirements of California class action statutes are satisfied.⁴ On the federal level, the Class Action Fairness Act of 2005 (“CAFA”)⁵ granted federal district courts original jurisdiction and removal jurisdiction over class actions where the aggregated amount in controversy exceeds \$5 million and any member of the class is from a different state than any defendant.⁶

Proponents of reform argued that lawyers, whose motive was to file suits as a means of generating attorneys’ fees without creating a corresponding public or class benefit, unduly burdened businesses and imposed increased costs on the economy.⁷ CAFA and Prop. 64 attempt to close loopholes in the law and stem perceived growing abuses of the federal and state systems. However, critics of CAFA and Prop. 64 maintain that these new measures impose changes far broader than necessary to fix the alleged “abuses” and will result in protracted litigation to establish their parameters.

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1 Cal. Bus. & Prof. Code §§ 17200-17208.

2 Limits on Private Enforcement of Unfair Business Competition Laws, Ballot Initiative to Reform California’s Unfair Competition Law. Filed October 22, 2003, for qualification in the November 2, 2004, general election.

3 Cal. Bus. & Prof. Code § 17204.

4 Cal. Bus. & Prof. Code § 17203.

5 S.5, 109th Cong. 1st Sess. (2005) (enacted).

6 28 U.S.C. § 1332(d).

7 The burdens include the loss of jobs and benefits, and increased prices and insurance premiums. See *Yes on 64, Examples of Shakedown Lawsuits*, at <http://www.stopshakedownlawsuits.com/facts_examples.html>; S.5 109th Cong. 1st Sess., *supra* at 5, § 2.

II. PRIOR REFORM EFFORTS: A LONG TIME COMING

Class action and UCL reform efforts date back over a decade. Prop. 64 follows years of unsuccessful legislative reform efforts.⁸ On the federal level, class action reform attempts began in 1997.⁹ Not surprisingly, the asserted need underlying the two reform efforts was similar. Both reforms sought to eliminate the economic incentive for lawyers to bring actions of debatable utility as a means of generating attorneys' fees without creating a corresponding direct class¹⁰ or public benefit in the case of representative UCL claims.¹¹

Last summer, the Republican leadership in the U. S. Senate brought to the floor a class action bill carefully crafted to attract the support needed to overcome a filibuster that blocked Senate passage in October 2003.¹² The bill fell one vote short of killing the filibuster.¹³ On January 25, 2005, Senator Grassley (R-Ill.) introduced CAFA in a form virtually identical to the bill that failed the previous July, and the one blocked by filibuster in October 2003.¹⁴ The bill passed shortly thereafter with the support of 18 Democrats.¹⁵ Passage in the House of Representatives was considered a foregone conclusion since it consistently passed similar versions in previous years.¹⁶ President Bush promptly signed the bill on February 18, 2005.

III. INTERSECTION OF CAFA AND PROP. 64: INCREASED REMOVAL OF UCL ACTIONS TO FEDERAL COURT

Now that Prop. 64 requires UCL representative actions to satisfy California class action requirements, CAFA will prompt the removal of many UCL class actions to federal court. This unforeseen intersection of the two reforms may result in federal courts developing a new body of law on representative UCL claims.

8 Assemblyman Lou Correa (D-Santa Ana) introduced Assem. Bill No. 69 in 2002, Assem. Bill No. 60 in 2003, and Assem. Bill No. 2369 in 2004; Assemblymen Robert Pacheco and Tom Harman introduced Assem. Bill No. 102 in 2003; Assemblywoman Ellen Corbett introduced Assem. Bill No. 95 in 2003 (co-authored with Senator Escutia); and Senator Martha Escutia introduced Sen. Bill No. 122 in 2003 (co-authored with Assemblywoman Corbett), at <<http://www.leginfo.ca.gov>>.

9 See Sen. Rep. No. 104-366, 2d. Sess. (1996) (105th Congress Senate Judiciary Subcommittee on Administrative Oversight and the Courts convened a hearing to study the need for reform).

10 Proponents of CAFA often cite the following class action settlements as favorable to class counsel that produced minimal benefit to class members: (1) a class action involving Blockbuster Video in which plaintiffs' counsel walked away with \$9.25 million in fees while the customers got a \$1-off coupon for future video rentals; (2) a suit against Cheerios over a food additive, where the trial lawyers were paid nearly \$2 million in fees, while customers received coupons for a free box of cereal; and (3) a settlement involving Bank of Boston where the lawyers took home fees of \$8.5 million while the actual victims were later required to pay \$90 toward lawyer fees. See Sen. Rep. No. 109- 014, 1st Sess. (2005), § IV.

11 Abusive representative UCL claims often involved uninjured plaintiffs suing smaller, unsophisticated businesses over technical violations of law with the intent to force a settlement. See Yes on 64, Examples of Shakedown Lawsuits, at <http://www.stopshakedownlawsuits.com/facts_examples.html>.

12 Public Citizens' Litigation Group, *A Section-by-Section Analysis of the Class Action Fairness Act of 2005*, pp. 1-2, at <<http://www.citizen.org/documents/TheClass%20ActionFairnessAct.pdf>>; see also U.S. Senate Republican Policy Committee, Legislative Notice No. 1 (Feb. 4, 2005).

13 *Id.*

14 *Id.*

15 *Id.*

16 *Id.*

A. Removal of UCL Claims Before Prop. 64 and CAFA.

Before CAFA, UCL claims were subject to removal to federal court under the same standards as any other, based on a federal question¹⁷ or diversity of citizenship.¹⁸ In the case of diversity jurisdiction, if the plaintiff in a UCL action claimed to have been harmed by the alleged conduct, it had standing under article III, section 2 of the United States Constitution and removal, if otherwise appropriate, was possible. Courts required complete diversity of citizenship between all plaintiffs and defendants, and the \$75,000 amount in controversy required could not be aggregated.¹⁹ Supporters of class action reform often complained that class counsel deliberately avoided removal by drafting the complaint to specifically allege that no individual's claim exceeded \$75,000.²⁰

The former UCL complicated removal on grounds of diversity jurisdiction because it permitted plaintiffs to sue on behalf of the general public, even if they did not suffer harm.²¹ In those instances, removal to federal court was improper because no "case or controversy" existed sufficient to confer article III standing.²² As a result, the federal court lacked subject matter jurisdiction, and was required to remand the case back to state court where the uninjured plaintiff was permitted to pursue the UCL claim.²³

Another complication prior to Prop. 64 and CAFA occurred when the defendant removed a representative UCL case involving an uninjured plaintiff on grounds of federal question jurisdiction.²⁴ Following removal, the defendant could immediately move to dismiss the case based on the plaintiff's lack of standing under article III of the United States Constitution.²⁵ Any attempts to plead around federal jurisdiction risked defeat by the "artful pleading" doctrine, under which the court can look past the complaint and recast plaintiff's claim as one within the purview of the federal court.²⁶

17 28 U.S.C. § 1331.

18 Former 28 U.S.C. § 1332(a).

19 See, e.g., *Surber v. Reliance Nat'l Indem. Co.* (N.D. Cal. 2000) 110 F Supp. 2d 1227, 1233.

20 Christa and Whatley, *Defending Against California Business and Professions Code Section 17200 Claims: A Discussion of Defenses and Procedural Challenges*, PLI Unfair Competition Claims 2004 (Aug. 2004) p. 77.

21 Former Cal. Bus. & Prof. Code § 17204.

22 U.S. Const., art. III, § 2; see also *Mortera v. North Am. Mort. Co.* (N.D. Cal. 2001) 172 F Supp. 2d 1240, 1243-44 (plaintiff's state created statutory right to act as a private attorney general does not confer injury on plaintiff sufficient to satisfy federal standing requirements); see also *Mangini v. R.J. Reynolds Tobacco Co.* (N.D. Cal. 1992) 793 F Supp. 925, 929 (state cannot by way of a state created right confer injury in the art. III sense where otherwise none would exist).

23 *Id.*; 28 U.S.C. § 1447(c) ("If at any time before final judgment it appears that the district court lacks subject matter jurisdiction over a case that has been removed to federal court, the case shall be remanded.").

24 For example, if the "borrowed" law supporting the UCL claim arose under a federal statute or regulation, a defendant could remove the case to federal court based on the federal question. See 28 U.S.C. § 1331.

25 See, e.g., *Herman v. Salomon Smith Barney, Inc.* (S.D. Cal. 2003) 266 F Supp. 2d 1208.

26 See, e.g., *Patenaude v. The Equitable Life Assurance Society of the United States* (9th Cir. 2002) 290 F3d 1020.

B. Without Prop. 64, CAFA Would Not Affect Representative UCL Claims.

Ironically, if Prop. 64 had failed, CAFA would have had no effect on representative UCL claims. Indeed, UCL claims expressly were excluded from the definition of “class action” under CAFA due to the efforts of Senator Dianne Feinstein (D-Cal.).²⁷ When a previous version was presented in 2003, Senator Feinstein introduced an amendment to preserve the right of individuals and concerned groups to bring “private attorney general actions.”²⁸ Originally, the bill classified these suits as class actions which would have made them subject to removal. Senator Feinstein described the classification “[as] an attack on state laws such as California’s [UCL] that allow such lawsuits in state court.”²⁹ The issue became moot after California voters overwhelmingly passed Prop. 64, effectively closing the door on private attorney general UCL actions. All UCL representative actions must now be pleaded as class actions and will be vulnerable to removal under CAFA.

C. Removal of UCL Claims After Proposition 64 and CAFA

CAFA’s central reform is a reworking of the complete diversity and aggregation rules for removing class actions.³⁰ Formerly, diversity jurisdiction was established if the plaintiff and defendant were citizens of different states and the amount in controversy exceeded \$75,000.³¹ Citizenship of class members for diversity jurisdiction purposes was determined only by class representatives.³² If the class representatives were from a different state than the defendants, removal was proper provided the amount in controversy was sufficient.³³ CAFA significantly modified the previous complete diversity rule by finding diversity if *any member* of a class is from a different state than any defendant, and the *aggregated* amount in controversy is at least \$5 million.³⁴ Under CAFA, the term “class action” includes any civil action filed under Federal Rule of Civil Procedure 23 *and any similar state statute or rule of judicial procedure*.³⁵

Case law prior to Prop. 64 established the long reach of the UCL. Plaintiffs could sue in California superior court, even if they were not California residents,³⁶ and out of state defendants could be sued under the UCL so long as their conduct infiltrated California.³⁷

27 28 U.S.C. § 1332(d)(11)(B)(ii)(III).

28 See 28 U.S.C. § 1332(d)(11)(B)(ii)(III) (expressly excludes claims asserted on behalf of the general public and not on behalf of individual claimants or members of a purported class pursuant to state statute specifically authorizing such action).

29 *Senate Judiciary Committee Approves Class Action Reform Legislation including Feinstein Compromise Amendments, April 11, 2003*, at <<http://feinstein.senate.gov/03Releases/r-classaction2.htm>>.

30 28 U.S.C. § 1332(d).

31 Former 28 U.S.C. § 1332(a).

32 See Schwarzer, Tashima and Wagstaffe, *Federal Civil Procedure Before Trial*, § 2:290.41 (2005).

33 *Id.*

34 28 U.S.C. § 1332(d)(1).

35 28 U.S.C. § 1332(d)(1)(B) (emphasis added).

36 *Norwest Mortgage, Inc. v. Superior Court* (1999) 72 Cal.App.4th 214, 220-22.

37 *Id.*; see also *Mosk v. National Research Co. of California* (1962) 201 Cal.App.2d 765, 777 (defendant’s out of state conduct in violation of the UCL could be enjoined).

Moreover, plaintiffs can use violations of foreign law to form the basis of their UCL claims.³⁸ This extraterritorial jurisdiction combined with the former broad standing requirements encouraged use of the UCL as the foundation for large representative actions in California courts. Now, however, the class standing requirements of Prop. 64, combined with the removal provisions of CAFA, increase the likelihood that federal judges will hear California UCL cases.

Nevertheless, CAFA provides federal district courts grounds to decline jurisdiction. Discretionary remand requires evaluation of several factors, including: (1) whether the number of class members who reside in the forum state significantly outnumber class members and defendants of other states and (2) “whether the action was brought in a forum with a distinct nexus with the class members, the alleged harm or the defendants.”³⁹

Only two situations require the district court to decline jurisdiction. The first is when two-thirds or more of the proposed class members and primary defendants are citizens of the state where the action is filed.⁴⁰ The second is when more than two-thirds of the plaintiff class is composed of citizens of the forum state;⁴¹ at least one defendant “resides” there and is alleged to have caused significant harm to plaintiffs, and has engaged in conduct that forms a significant basis for the claims asserted;⁴² and the principal injuries resulting from that defendant’s alleged conduct incurred there.⁴³ If these conditions are satisfied, the district court is required to decline jurisdiction.⁴⁴

CAFA’s critics point out that this rather complex new partial diversity rule, with its multipart tests for discretionary or mandatory remand, will result in significant satellite litigation over jurisdiction. Supporters do not entirely disagree, but believe the ends justify the means. It appears that both sides agree on one thing: in the coming years plaintiffs, defendants, and the federal courts will grapple with CAFA’s expanded diversity jurisdiction.

D. Removal Granted, but Class Certification Denied?

If a district court exercises jurisdiction under CAFA, but denies class certification of the UCL claim, the court likely will retain jurisdiction of the removed action. Diversity jurisdiction ordinarily is determined at the time of filing regardless of subsequent events.⁴⁵ Therefore, the district court likely would retain jurisdiction over an action removed to federal court under CAFA even after denial of class certification. This may cause the class representatives’ claim to remain, even though there would be no basis for federal jurisdiction if they had filed an individual action.⁴⁶

38 See, e.g., *Podolsky v. First Healthcare Corp.* (1990) 50 Cal. App. 4th 632, 647 (“Virtually any state, federal or local law can now serve as the predicate for an action under Business and Professions Code Section 17200.”)

39 28 U.S.C. § 1332(d)(3).

40 28 U.S.C. § 1332(d)(4)(B).

41 28 U.S.C. § 1332(d)(4)(A).

42 *Id.*

43 *Id.*

44 *Id.*

45 See *Grupo Dataflux v. Atlas Global, LP* (2004) 541 U.S. 567.

46 Plaintiffs presumably could not amend their pleading to allege individual claims on behalf of putative class members after denial of class certification. See 28 U.S.C. § 1367(b) (plaintiffs cannot be joined and cannot intervene under the court’s supplemental jurisdiction unless they otherwise satisfy diversity requirements).

In such cases, a plaintiff preferring a state court to hear its individual claim potentially could dismiss its case and refile an individual action in state court (assuming the filing would be timely under state statutes of limitations and tolling principles). However, in many cases, it would not be economical to pursue individual claims in federal or state court once class certification was denied.⁴⁷ CAFA's critics contend that this possibility may lead to an abuse of CAFA's removal jurisdiction. Costly removal motions even before class certification is addressed, in a forum perceived to be less friendly to class certification, has many opponents of CAFA concerned.

IV. WILL PROP. 64 AND CAFA ACHIEVE THEIR GOALS?

Prop. 64 and CAFA adherents promised the elimination of frivolous lawsuits, unfair "shake downs," and judicial blackmail allegedly present in representative and class actions.⁴⁸ But these reforms may also cause unintended consequences that will outweigh any benefits the reform legislation provides. Skeptics worry that Prop. 64 and CAFA may not be the solutions they claimed to be.

A. Removal to Federal Court.

Where California courts are well-versed in the law governing UCL claims, federal courts generally are "unfamiliar and uncomfortable" with consumer cases.⁴⁹ As a result, reform proponents anticipate federal courts will be more conservative when ruling on certification of UCL class claims, resulting in fewer UCL classes certified.

However, CAFA presents its own challenges to defendants. It will require defendants to prove at least one member of the class is diverse from one of the defendants to secure removal. If the named representatives are not diverse from any defendants, it will be up to the defendants to prove at the beginning of a case who the class members are.⁵⁰ This burden may require significant investment in investigative reports, surveys, or sampling information, at an early stage of the case.

In response to the specter of removal under CAFA, class counsel may choose to prosecute individual actions in the various affected states instead of litigating one consolidated class action in federal court. This may force defendants to litigate in multiple venues, with a risk of inconsistent rulings.⁵¹

47 See Public Citizen Litigation Group, *A Section-by-Section Analysis of the Class Action Fairness Act of 2005*, *supra* at 12, p. 10.

48 Sen. Rep. No. 109-014, *supra* at 10, § III.

49 Carter, *Class Action Climax*, 4 ABA Journal eReport 7 (Feb. 18, 2004), at <<http://www.abanet.org/journal/ereport/fl8class.html>>.

50 See *Lots of Division-and Myths-About Class Action Bill*, *The Recorder*, v. 129, n. 25, p. 4 (Feb. 7, 2005) ("At the point where the court is deciding jurisdiction, nobody knows where the class members live. It's something you don't learn until the class members start asserting their claims at the very end of the case.").

51 See *Lots of Division-and Myths-About Class Action Bill*, *supra* at 50. However, purely intrastate claims involving plaintiffs and defendants from the same state will not be affected under CAFA. Claims brought under Prop. 64 that involve California plaintiffs suing a California defendant cannot be removed.

B. Increased Workload of Federal Judges.

CAFA raises concerns about the increased workload of federal judges, already overburdened and required to give priority to criminal cases.⁵² Removal of the cases from the state “fast track” program rules may further reduce the progress of the litigation. However, many class actions filed in California, including UCL claims, often are exempted from “fast-track” rules.⁵³ Consequently, there is no guarantee about the progress of the consumer class action in either state or federal court.

C. Certification

Observers have commented that federal judges are less likely to certify consumer class actions than are their superior court counterparts.⁵⁴ CAFA may not affect certification rates, since most nationwide class actions, including UCL claims, are not certified in state court.⁵⁵ Thus, removal to federal court under CAFA may not affect the likelihood of certification.

D. Less Litigation

Proponents argue that Prop. 64 and CAFA ensure that only “legitimate” claims reach the courtroom.⁵⁶ However, litigation over the operation and scope of these statutes is likely to continue for years. Some believe the sheer brevity of CAFA leaves its language ambiguous, and open to extended litigation that gives courts added reasons to decline jurisdiction.⁵⁷ This already has occurred in the aftermath of Prop. 64 concerning its application to pending cases.⁵⁸

Opponents of reform counter that less litigation may simply mean less ability to curb abusive business practices.⁵⁹ The burdensome and costly class action requirements under Prop. 64 may dissuade attorneys from litigating consumer cases that do not involve large

52 See Coyle, *Reform's Fate Rests in Federal Court: Delays, Larger Classes to Come in Class Action Reform*, National Law Journal, v. 26, no. 72, p. 1 (Feb. 14, 2005) (“federal judges already struggle with crowded dockets” and the bill’s effect of moving class action suits “from 3,141 state jurisdictions to far fewer federal courts is likely to create backlogs in federal court.”).

53 See Cal. Rules of Court 209, 1850-1861.

54 See Smallwood, *Nationwide State Law Class Actions and the Beauty of Federalism*, 53 Duke L.J. 1317, 1147-49 (Dec. 2003).

55 See *Norwest Mortgage, Inc. v. Superior Court* (1999) 72 Cal.App.4th 214, 229; see also Marcia Coyle, *Lots of Division and Myths About Class Action Bill*, The Recorder, *supra* at n.50) (citing a study performed by the Federal Research Center of 728 attorneys involved in class actions in state and federal courts between 1994 and 2001, which found 20% of class actions remanded to state courts were certified for trial and 22 percent of class actions in federal court were certified for trial. Note, the study did not detail how many of the cases reported were consumer fraud cases, which opponents of CAFA claim are less likely to be certified under federal rules.)

56 See Sen. Rep. No. 109-014, *supra* at 10; Yes on 64, Shakedown Examples of Lawsuits, *supra* at 11.

57 See Carter, *Class Action Climax*, 4 ABA Journal Report 7 (Feb. 18, 2004), at <<http://www.abanet.org/journal/ereport/f18class.html>>.

58 See, e.g., *Branick v. Downey Savings & Loan Assn.* (2005) 126 Cal.App.4th 828.

59 See *Thinking Out Loud About the Federal Class-Action Bill*, Notes from the (Legal) Underground, at <http://www.legalunderground.com/2005/02/thinking_out_lo.html>.

potential recovery amounts. Further, the resources saved in joining claims in a nationwide class action may be eliminated after CAFA if plaintiffs elect to file “mini” class actions in multiple states to avoid the \$5 million removal threshold. This will do little to alleviate the purported economic burden caused by class actions.

V. CONCLUSION

It remains to be seen whether Prop. 64 and CAFA will achieve their purported goal of limiting the cases allowed to proceed as representative class actions. In the meantime, defendants likely will vigorously seek removal to federal court, while plaintiffs search for avenues to remain in state court. We now enter an important period in which these new laws will be tested.