

# Developments in Class-Action Law

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## ■ Introduction

Last year, the California Supreme Court and the California Courts of Appeal issued many opinions that made significant developments in class action law. The California Supreme Court's decision in *Californians for Disability Rights v. Mervyn's, LLC*<sup>1</sup> (“*Mervyn's*”) and *Branick v. Downey Savings & Loan Ass'n*<sup>2</sup> are probably the most notable. In *Mervyn's*, the Court held that the new standing requirements imposed by Proposition 64 (“Prop. 64”) apply to cases initiated prior to its enactment, and in *Branick*, the Court held that a plaintiff who does not meet the new standing requirements may amend the complaint to add a proper class representative.

But, according to the Second Appellate District in *First American Title Insurance Co. v. Superior Court*,<sup>3</sup> a plaintiff who does not meet Prop. 64's new standing requirements cannot conduct pre-certification discovery to identify a suitable representative for the class. The court distinguished the Fourth Appellate District's decision in *Best Buy Stores, L.P. v. Superior Court*,<sup>4</sup> which held that the plaintiff can conduct pre-certification discovery of potential class members when he or she is not an adequate class representative. The court held that unlike the plaintiff in *Best Buy* who had standing at the time he filed suit, the plaintiff in *First American Title* never had standing to sue.

Two weeks after the Fourth Appellate District decided *Best Buy*, the same court (with a different panel of judges) held that once the court denies the plaintiff's motion for class certification,

the plaintiff is not entitled to communicate with potential class members to inform them that they might have legal claims against the defendant.<sup>5</sup> The court, however, held that even after the plaintiff's motion to certify the class is denied, the plaintiff can communicate with potential class members to determine whether they have evidence relevant to the plaintiff's claims.

In *Pioneer Electronics (USA), Inc. v. Superior Court*,<sup>6</sup> the California Supreme Court also dealt with the issue of whether class members had to affirmatively consent (opt in) before plaintiff could obtain their identifying information as part of pre-certification discovery. The Court held that class members were not required to opt in before their identifying information was disclosed, noting that an opt-out notice sufficiently protected their right to privacy.

Finally, within the last year, the Second Appellate District also issued several opinions affecting class action procedure. Some of the most noteworthy decisions held: (1) class action waivers are unconscionable in some, but not all, circumstances; and (2) the collateral estoppel doctrine can bar the plaintiff from re-litigating class certification issues.

## ■ Prop. 64 Affects Actions Pending at the Time of Its Enactment

Prop. 64, which the electorate passed on November 3, 2004, changed the procedural requirements for bringing claims under California's Unfair Competition Law (“UCL”) and False Advertising Law (“FAL”).<sup>8</sup> Prior to

1. 39 Cal. 4th 223 (2006).

2. 39 Cal. 4th 235 (2006).

3. 146 Cal. App. 4th 1564 (2007). See also *Cryoport Sys. v. CNA Ins. Co.*, No. G037056, 2007 Cal. App. LEXIS 520 (Mar. 13, 2007).

4. 137 Cal. App. 4th 772 (2006).

5. *Experian Info. Solutions, Inc. v. Superior Court*, 138 Cal. App. 4th 122 (2006). The *Experian* case, however, did not involve a situation where the court denied class certification because the class representative did not have standing, but because common issues did not predominate. Thus, whether a court would permit communications when it denies a motion for standing reasons is still questionable.

6. 40 Cal. 4th 360 (2007); accord *Belaire-West Landscape, Inc. v. Superior Court*, No. B194844, 2007 Cal. App. LEXIS 505 (Apr. 9, 2007).

7. Bus. & Prof. Code, §17200 *et seq.*

8. Bus. & Prof. Code, §17500 *et seq.*

Prop. 64's enactment, a private plaintiff could bring claims under the UCL and FAL on behalf of the general public, regardless of whether the plaintiff suffered injury from the challenged conduct. Since Prop. 64 was enacted, a private plaintiff alleging a cause of action under the UCL or FAL must now demonstrate that he or she suffered an "injury in fact" and "lost money or property as a result of" the defendant's unfair business practices, and must also meet the requirements for class certification.

Immediately after Prop. 64's enactment, there was much debate about whether its requirements applied to pending cases and, if so, whether the plaintiff who did not meet such requirements could amend the complaint and cure such deficiencies. Last year, the California Supreme Court answered both questions. The Court held that Prop. 64's new standing and class certification requirements do apply to pending cases,<sup>9</sup> and the plaintiff who does not meet the new standing requirements can amend the complaint to add a suitable class representative.<sup>10</sup>

In making its decision in *Mervyn's*, the Court employed ordinary presumptions and rules of statutory construction. First, the Court acknowledged that "[w]hen a statute's application to a given case is challenged as impermissibly retroactive, we typically begin our analysis by reiterating the presumption that statutes operate prospectively absent a clear indication the voters or the Legislature intended otherwise."<sup>11</sup> According to the Court, application of a law is retroactive when the law changes the legal consequences of past conduct or substantially affects existing rights and obligations.<sup>12</sup> Based on this definition, the Court held applying Prop. 64's standing requirements to pending

cases was not applying them "retroactively" because Prop. 64 merely withdraws the standing of uninjured persons. The court explained 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. '[C]ontentions based on a lack of standing involve jurisdictional challenges and may be raised at any time in the proceeding.'"<sup>13</sup> Consequently, the Court concluded that Prop. 64 applies to cases pending at the time of its enactment because Prop. 64 "does not change the legal consequences of past conduct by imposing new or different liabilities based on such conduct."<sup>14</sup> Instead, Prop. 64 "left entirely unchanged the substantive rules governing business and competitive conduct. Nothing a business might lawfully do before [Prop.] 64 is unlawful now, and nothing earlier forbidden is now permitted."<sup>15</sup>

The same day the Court decided *Mervyn's*, it also issued its opinion in *Branick*. In *Branick*, after plaintiffs lost standing as a result of Prop. 64, the defendant argued that Prop. 64 prohibited the plaintiffs from amending the complaint and substituting a new plaintiff with the requisite standing. The Court rejected defendant's argument and held "[Prop.] 64 does not affect the ordinary rules governing the amendment of complaints and their relation back."<sup>16</sup> Thus, a plaintiff who does not have standing under Prop. 64 may substitute in a new plaintiff who meets the standing requirements by amending the complaint, and a complaint amended in such a manner relates back to the filing of the original complaint, to avoid statute of limitations problems.<sup>17</sup>

The California Supreme Court, however, did not decide whether Prop. 64 changed the UCL's and FAL's substantive requirements. We

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9. *Mervyn's*, 39 Cal. 4th at 232.

10. *Branick*, 39 Cal. 4th at 239.

11. *Mervyn's*, 39 Cal. 4th at 230.

12. *Id.* at 231.

13. *Id.* at 232-33 (citation omitted).

14. *Id.* at 232.

15. *Id.*

16. 39 Cal. 4th at 239.

17. *Id.*

expect the Court to decide that issue late this year when it issues its opinion in *Pfizer, Inc. v. Superior Court*.<sup>18</sup>

The Second Appellate District issued a decision in *Pfizer, Inc. v. Superior Court*<sup>19</sup> shortly before the California Supreme Court issued its opinions in *Mervyn's* and *Branick*. In *Pfizer*, plaintiff filed a class action complaint under the UCL and FAL on the grounds that Pfizer misleadingly marketed Listerine mouthwash by indicating that Listerine could replace the use of dental floss in reducing plaque and gingivitis.<sup>20</sup> The trial court certified a class of “all persons who purchased Listerine, in California, from June 2004 through January 7, 2005.”<sup>21</sup> Pfizer sought a writ of mandate overturning the trial court’s order on the grounds that under Prop. 64, the plaintiff and all class members must have suffered injury in fact and must have lost money or property as a result of unfair competition.<sup>22</sup>

The appellate court agreed with *Pfizer*, concluding that if not all class members suffered an injury in fact and lost money or property, then by definition the plaintiff’s claims would not be typical of the class. Therefore, according to the appellate court, in order for the plaintiff to satisfy the requirements for class certification, the plaintiff must prove all class members suffered an injury in fact and lost money or property as a result of the defendant’s misrepresentations.<sup>23</sup>

The appellate court in *Pfizer* also held that Prop. 64’s “as a result” language requires the plaintiff and the class to prove actual reliance on the misrepresentation. Historically, the plaintiff only needed to prove that “members of the public were likely to be deceived” in order to state a cause of action under the UCL or FAL.

According to the Second Appellate District, however, the likelihood of harm standard is no longer sufficient; the standard of proof is now akin to common law fraud.<sup>24</sup> The Second District held that Prop. 64’s “injury in fact . . . as a result of” language now requires the plaintiff to actually rely on the misrepresentation.<sup>25</sup> Thus, “[a] consumer who was unaware of, or who did not rely upon, [the defendant’s misrepresentations does] not suffer any injury in fact as a result of the alleged fraudulent business practice or false advertising.”<sup>26</sup> But, in light of the California Supreme Court’s language in *Mervyn’s* to the effect that Prop. 64 did not change the UCL’s and FAL’s substantive rules, it is not clear that the California Supreme Court will agree with the appellate court’s analysis.

### ■ Plaintiff May Obtain Pre-Certification Discovery to Identify a Suitable Class Representative if Plaintiff Is or Was a Member of the Class

Another significant development in class action law relates to pre-certification discovery of potential class members in order to find a suitable class representative. Last year, the appellate court in *Best Buy* held that when the plaintiff is an inadequate class representative, the plaintiff can conduct pre-certification discovery to identify a suitable class representative.<sup>27</sup> According to the appellate court in *First American Title*, however, plaintiff cannot obtain such discovery if plaintiff is not and never was a member of the class.<sup>28</sup>

In *Best Buy*, plaintiff, who was also counsel for the class, brought a class action against Best Buy for violations of the Consumer Legal Remedies Act (“CLRA”) and for unfair competition

18. No. S145775, 2006 Cal. LEXIS 13327 (Cal. S. Ct. Nov. 1, 2006) (“*Pfizer I*”).

19. 141 Cal App. 4th 290 (2006), review granted and depublished by *Pfizer II* (“*Pfizer*”).

20. *Id.* at 294.

21. *Id.* (internal quotations omitted).

22. *Id.* at 298.

23. *Id.* at 303.

24. *Id.* at 304.

25. *Id.* at 305.

26. *Id.* at 305-06.

27. 137 Cal. App. 4th at 774.

28. 146 Cal. App. 4th 1564.

and unjust enrichment on the grounds that Best Buy charged an illegal restocking fee for returned merchandise.<sup>29</sup> While the case was pending, the appellate court issued its opinion in *Apple Computer, Inc. v. Superior Court*,<sup>30</sup> which held lawyers could not simultaneously serve as class representatives and class counsel. As such, the plaintiff moved for pre-certification discovery in order to find a new class representative. The trial court granted the plaintiff's motion and ordered Best Buy to provide a third-party with the names and addresses of 200 Best Buy customers, ordered the third-party to mail notice within 10 days of receipt of the information, and gave the customers 35 days to respond to the third-party or to the plaintiff directly. The notice informed Best Buy's customers of the following: (1) plaintiff had commenced a class action; (2) the general nature of the claims; (3) why plaintiff was not a suitable class representative; and that plaintiff was seeking to identify a potential substitute; (4) if they had interest in assisting in the prosecution of the case they could contact the third-party who would then share that information with the plaintiff; and (5) if no one stepped forward, the court would dismiss the class action claims.<sup>31</sup>

Best Buy immediately petitioned for a writ of mandate seeking to reverse the trial court's order.<sup>32</sup> Best Buy argued: (1) the contemplated contact between plaintiff and the potential substitute class representatives constituted prohibited solicitation under the California Rules of Professional Conduct, rule 1-400(B)(1), (B)(2)(a), and (c); (2) the plaintiff would continue to control the litigation even if another class representative was found; (3) the trial judge violated the canons of judicial ethics; and

(4) the order and proposed letter violated Best Buy customers' privacy rights.<sup>33</sup>

The appellate court rejected all of Best Buy's arguments except the last.<sup>34</sup> The court concluded that in order to protect consumers' privacy rights, something more than simply using a third-party to communicate with Best Buy's customers was required. Specifically, the court held that the notice needed to inform Best Buy's customers that they were free to ignore the notice and that if they so chose, their identities would not be disclosed to plaintiff, and, the notice could not contain any information that would facilitate direct contact with the plaintiff. The court concluded that the third-party could only disclose to plaintiff the identities of those customers who affirmatively requested in writing that the third-party make such disclosures.<sup>35</sup> In the end, the court ordered the trial court to modify the notice and send it out to Best Buy's customers.<sup>36</sup>

Earlier this year, however, the appellate court in *First American Title*, limited which plaintiffs could obtain pre-certification discovery of potential class members. In *First American Title*, the trial court issued an order for pre-certification discovery despite the fact that the plaintiff was not a member of the class he sought to represent and had no other interest in the litigation. The Second Appellate District reversed the lower court's order and held that the plaintiff could not engage in pre-certification discovery to identify potential class representatives because he was not, and never was, a member of the class he sought to represent.<sup>37</sup>

Weighing the danger of possible abuses of class action procedure against the rights of the parties, the appellate court determined that the

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29. 137 Cal. App. 4th at 774.

30. 126 Cal. App. 4th 1253 (2005).

31. *Best Buy*, 137 Cal. App. 4th at 775.

32. *Id.* at 774.

33. *Id.* at 776.

34. *Id.*

35. *Id.* at 778.

36. *Id.* at 780.

37. 146 Cal. App. 4th at 1566.

plaintiff was not entitled to pre-certification discovery because the potential for abuse outweighed the parties' rights. The court held that the plaintiff did not have standing to bring such claims, and that voters had enacted Prop. 64 to prevent attorneys from abusing the class action system by prohibiting them from filing UCL and FAL claims without an injured client. The court refused to "permit attorneys to make an 'end-run' around [Prop.] 64 by filing class actions in the name of private individuals who are not members of the classes they seek to represent and then using precertification discovery to obtain more appropriate plaintiffs."<sup>38</sup>

### ■ The Plaintiff is Not Entitled to Communicate With Potential Class Members After the Court Denies the Motion for Class Certification

Two weeks after the court decided *Best Buy*, the same court (with a different panel of judges) held that the plaintiff is not entitled to communicate with potential class members regarding their claims after the trial court denies the motion for class certification.<sup>39</sup> In *Experian*, after the court denied the motion for class certification on the grounds that common issues did not predominate, the plaintiff moved for an order allowing him to send notice to potential class members informing them that they might have claims subject to a running statute of limitations. By the notice, plaintiff also sought their consent to be contacted by his counsel to determine whether they had evidence relevant to plaintiff's damages.<sup>40</sup>

The appellate court held that after a trial court denies a motion for class certification, the court may not order notifications be sent to former or potential class members indicating that they might have legal claims against the defendants.<sup>41</sup>

"[I]n non-class-action litigation, it is not the court's role to order notification to third parties of their possible legal claims. In our view, such a role is inconsistent with *Woosley v. State of California*, [3 Cal. 4th 758, 793 (1992)], and draws the trial court's impartiality into question."<sup>42</sup> The appellate court, however, held that the plaintiff could send potential class members a letter to determine whether they had evidence relevant to plaintiff's damages, so long as the letter provided the recipient with a means of establishing his or her consent through a written, signed authorization, and did not state that it was approved by the Superior Court.<sup>43</sup>

### ■ Pre-Certification Discovery Does Not Violate Consumers' Privacy Rights as Long as Consumers Receive Notice and Have an Opportunity to Object

Earlier this year, the California Supreme Court in *Pioneer Electronics*, held that disclosing consumers' identifying information for purposes of consumer class action litigation did not violate their right to privacy. The Supreme Court held that consumers' privacy rights are not violated by such disclosure, as long as they are provided notice of their right to object.<sup>44</sup>

In *Pioneer*, the plaintiff brought a class action lawsuit against Pioneer for selling defective DVD players. In response to discovery requests, Pioneer produced approximately 700-800 complaints from consumers regarding the DVD player, but Pioneer redacted the consumers' identifying information. In response to the plaintiff's motion to compel it to provide the consumers' identifying information (*e.g.*, names, addresses and telephone numbers), Pioneer argued that consumers possess a constitutional right to privacy, prohibiting disclosure of such information.<sup>45</sup> The appellate court agreed and

38. *Id.* at 1577.

39. *Experian*, 138 Cal. App. 4th at 125.

40. *Id.* at 125.

41. *Id.* at 132.

42. *Id.* at 131-32.

43. *Id.* at 134-35.

44. *Pioneer*, 40 Cal. 4th at 363.

45. *Id.* at 364.

held that in order to protect a consumer's privacy rights, consumers must provide affirmative consent (opt in) before the plaintiff may obtain their identifying information.<sup>46</sup>

Citing *Hill v. National Collegiate Athletic Ass'n*,<sup>47</sup> the California Supreme Court reversed the appellate court's order. The Court explained that the "right of privacy protects the individual's reasonable expectation of privacy against a *serious* invasion."<sup>48</sup> Accordingly, in order to bring a claim for invasion of privacy, the claimant must (1) possess a legally protected privacy interest; (2) have a reasonable expectation of privacy under the particular circumstances; and (3) the invasion about which the claimant complains must be serious in nature.<sup>49</sup> After a claimant meets these requirements, the court must then weigh that individual's interest against other competing interests in a "balancing test."<sup>50</sup>

Based on these standards, the Court held the appellate court's opt-in requirement was too strict.<sup>51</sup> Instead, the California Supreme Court held that even though consumers are entitled to some privacy protection in their identifying information, consumers do not have a reasonable expectation that their information will be kept confidential unless they affirmatively consent. The Court focused on the fact that the consumers voluntarily disclosed their information, hoping to obtain some form of relief.<sup>52</sup> Thus, the Court held that the disclosure of consumers' identifying information did not constitute a serious invasion of privacy, so long as the information was only released to the named plaintiff in a class action filed against Pioneer, and only after written notice provided consum-

ers with an opportunity to object.<sup>53</sup> The Court noted that even if consumers had a reasonable expectation of privacy, the balancing test tips in favor of disclosure because the plaintiff's interest in obtaining the information (complaining consumers are percipient witnesses) outweighed any potential harm that could result from the possibility that some people might not receive the notice and have the opportunity to object.<sup>54</sup>

### ■ Some, but Not All, Class Action Waivers Are Unconscionable

Just as they did in 2005, the appellate courts continued to interpret the California Supreme Court's decision in *Discover Bank v. Superior Court*,<sup>55</sup> and continued to further define the circumstances under which class action waivers are unconscionable.

As discussed in the last issue, the Supreme Court in *Discover Bank* presented a set of circumstances in which class actions waivers are unconscionable and therefore unenforceable. Specifically, a waiver is unconscionable and therefore unenforceable if it (1) is presented to the consumer as a bill "stuffer" that the consumer is deemed to accept unless he or she closes the account; (2) exempts the defendant from being responsible for its own fraud; and/or (3) is in a setting in which disputes between the contracting parties involve small amounts of damages.<sup>56</sup>

Applying *Discover Bank*, the appellate court in *Cohen v. DIRECTV, Inc.*,<sup>57</sup> found a clause prohibiting class-wide arbitration of claims unconscionable. In *Cohen*, plaintiff filed a class

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46. *Id.* at 365.

47. 7 Cal. 4th 1, 36-37 (1994).

48. *Pioneer*, 40 Cal. 4th at 370 (emphasis in original).

49. *Id.* at 370-71.

50. *Id.* at 371.

51. *Id.* at 370.

52. *Id.* at 372-73.

53. *Id.* at 373.

54. *Id.* at 373-74.

55. 36 Cal. 4th 148 (2005).

56. *Id.* at 152-53.

57. 142 Cal. App. 4th 1442 (2006).

action complaint against DIRECTV for violating the CLRA and the UCL on the grounds that DIRECTV covertly degraded some of its high definition television transmissions.<sup>58</sup> Although plaintiff's original agreement with DIRECTV did not contain an arbitration clause, two months after entering into the original agreement the plaintiff received an amended customer agreement containing such a clause. Then, approximately seven years later DIRECTV sent plaintiff another revision to the customer agreement – one that prohibited class-wide arbitration.<sup>59</sup> In *Cohen*, DIRECTV moved to compel arbitration based on the revised agreement.

The Court of Appeal held that the provision in DIRECTV's customer agreement prohibiting class-wide arbitration was unconscionable and therefore unenforceable.<sup>60</sup> Specifically, the court held that like the circumstances in *Discover Bank*, DIRECTV presented plaintiff with the proposed amendment as a bill “stuffer” and considered the amendment accepted if the plaintiff did not close his account after receiving notice thereof. In addition, the court found that “customer agreements with television programming providers . . . necessarily occur ‘in a setting in which disputes between the contracting parties predictably involve small amounts of damages.’”<sup>61</sup> Although in some instances damages could be more than \$1,000, the court recognized that many consumers “may not view that amount as sufficient to warrant individual litigation, and certainly it is not sufficient to obtain legal assistance in prosecuting the claim.”<sup>62</sup> Finally, similar to the defendant's conduct in *Discover Bank*, DIRECTV engaged in a “scheme to deliberately cheat large numbers

of consumers.”<sup>63</sup> The Court rejected DIRECTV's argument that any such “scheme” was readily detectable because customers would notice the reduction in image quality. Instead, the court found DIRECTV's conduct objectionable because under the scheme “[t]he wrongdoer still profits, albeit perhaps for a shorter time, and the consumer still loses ‘individually small sums of money.’”<sup>64</sup>

In contrast, the appellate court in *Konig v. U-Haul Co. of California*,<sup>65</sup> found the class action waiver contained in an employment agreement was not unconscionable under the standards set forth by *Discover Bank*. In *Konig*, the arbitration agreement prohibiting class-wide arbitration was executed and acknowledged by each employee as a condition of employment.<sup>66</sup> Although the appellate court found the arbitration clause procedurally unconscionable because it was imposed as a condition of employment, the court found it was not substantively unconscionable. According to the court, the plaintiff alleged defendant engaged in a scheme to defraud employees out of overtime compensation, and the plaintiff presented no evidence that the potential damages in such an action would be “predictably . . . small” as required by *Discover Bank*.<sup>67</sup>

### ■ The Collateral Estoppel Doctrine Can Bar Plaintiffs from Relitigating the Class Certification Issue

The Court of Appeal also addressed whether the collateral estoppel doctrine can bar plaintiffs from relitigating class certification issues in *Alvarez v. May Department Stores Co.*<sup>68</sup> In *Alvarez*, the plaintiffs filed a class action suit

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58. *Id.* at 1444-45.

59. *Id.* at 1445.

60. *Id.* at 1446-47.

61. *Id.* at 1452.

62. *Id.* (internal quotations omitted).

63. *Id.*

64. *Id.* at 1453 (citing *Discover Bank*).

65. 145 Cal App. 4th 1243 (2006).

66. *Id.* at 1248.

67. *Id.* at 1246.

68. 143 Cal. App. 4th 1223 (2006).

against the May Department Stores for failure to pay overtime compensation.<sup>69</sup> Defendants demurred to the complaint on the grounds that another court previously issued an order denying certification of the same class and, thus, the plaintiffs should be collaterally estopped from re-litigating the class certification issue in this new case.<sup>70</sup> The trial court sustained the demurrer and an appeal followed.<sup>71</sup>

On appeal, the plaintiffs argued the trial court erred on two grounds. First, the plaintiffs argued that courts cannot resolve class allegation issues by demurrer. The plaintiffs also contended that denial of certification in the previous case was not binding because the named plaintiffs in the earlier case were not *in common* with plaintiffs in this case. The Court of Appeal disagreed with both contentions. The appellate court held that “[i]t may be proper at the pleading stage to strike class allegations if the face of the complaint and other matters subject to judicial notice reveal the invalidity of the class allegations.”<sup>72</sup> The court also held that the plaintiffs were identical to the unnamed class members in the previous action, and therefore the denial of class certification in the prior suit prevented plaintiffs from re-litigating the same issue.<sup>73</sup>

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69. *Id.* at 1227-28.

70. *Id.* at 1229-30.

71. *Id.* at 1230.

72. *Id.* at 1231-32.

73. *Id.* at 1234.