Four views of consumer fraud

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A more conservative political and judicial landscape has changed the cases we bring, who we represent and in what forum our cases are brought. Concentrating on different areas of the law that all relate to fraud – consumer, financial, or government – this article focuses on how to successfully attract, prosecute, and win fraud cases and also identifies some potential traps for the unwary.

Consumer Fraud

California has some of the strongest consumer protection laws in the nation. That said, application of these laws is often inconsistent and highly dependent on the facts, making early case evaluation critical. Three causes of action to consider when evaluating any potential consumer fraud case are: 1) violations of the Unfair Competition Law ("UCL");[1] 2) violations of the Consumers Legal Remedies Act ("CLRA");[2] and 3) fraudulent concealment, which applies where the defendants concealed a material fact they were otherwise under a duty to disclose.[3]

As a practical matter, consumer fraud cases are usually pursued as class actions, given the relatively small amounts of money at stake per consumer. Thus, it is also important to review the elements of each cause of action and determine early on whether they can be shown on a classwide basis or whether certain elements require an individual inquiry that would predominate over common issues and, therefore, defeat class certification.[4]

Of all of the available claims, the UCL provides the most flexibility, both in terms of prevailing on the merits and certifying a class. The UCL prohibits any "unlawful," "unfair" or "fraudulent" business practice.[5] To prove a cause of action under the "fraudulent" prong of the UCL, the plaintiff need only show that members of the public are "likely to be 'deceived'" by the conduct.[6] Unlike common law fraud or the CLRA, the UCL does not require individualized proof of reliance, causation or injury.[7] The statute does impose special standing requirements on the named plaintiff – i.e., the named plaintiff must demonstrate they actually relied, suffered an injury in fact and lost money or property – but these requirements do not apply to absent class members.[8] To prevail at the class certification stage, however, the plaintiff must also establish that the misrepresentation or fraudulent practice was the same for, or is common to, all absent class members.[9] While the UCL's application is broad, its remedies are limited to injunctive relief and restitution; damages and attorneys' fees are not available.[10] Thus, augmenting the UCL with other claims to broaden the available remedies is often desirable.

The CLRA prohibits certain unfair conduct in the sale or lease of goods or services, and provides for damages and attorneys' fees.[11] As with common law fraud, the CLRA requires a showing of causation or reliance.[12] Reliance is often a barrier to class certification, but, fortunately for consumers, reliance can be presumed in California if the misrepresentation or omission is shown to be material.[13] Because materiality is judged by the "reasonable person" standard – an objective standard, amenable to common proof as opposed to a subjective, individual standard – a presumption of reliance is essential at class certification.[14] While many courts have correctly found that materiality challenges go to the merits of the case and do not defeat class certification,[15] others have refused to certify classes where materiality of the misrepresentation is questionable.[16] Thus, the best factual scenarios to support a

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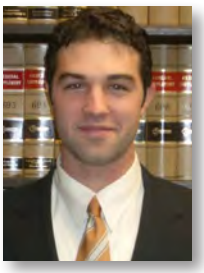

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presumption of reliance are those where the misrepresentations or omissions go to the core of the very purpose or function of the product such that materiality cannot be denied.

Cases involving fraudulent concealment are among the most difficult to pursue because, in addition to the hurdles described above, plaintiffs must also establish that the defendants had a duty to disclose. Under California law, a duty to disclose arises in four circumstances: (1) when the defendant is in a fiduciary relationship with the plaintiff; (2) when the defendant has exclusive knowledge of material facts not known to the plaintiff; (3) when the defendant actively conceals a material fact from the plaintiff; and (4) when the defendant makes partial representations but also suppresses some material fact.[17] While not technically required under the UCL, courts frequently conflate the UCL, CLRA and fraud analyses and require plaintiffs to establish a duty to disclose for concealment claims to be actionable under *any* theory.[18] In products cases, some courts have also held that that a safety defect must be alleged to advance a claim based on a fraudulent concealment theory.[19] Thus, in cases where the defect poses no risk to human safety, it is critical to distinguish these cases on the facts and advise the court that a safety defect is not an *additional* requirement, but instead goes to the level of materiality.[20] To the degree an affirmative misrepresentation or a safety defect can be alleged, however, such allegations will strengthen these cases.

Financial and Securities Fraud Class Actions

As noted above, a class action brought under Federal Rules of Civil Procedure rule 23 or California Civil Procedure Code section 382 is often the most efficient and leveraged means of asserting claims on behalf of victims of fraud. Cases involving financial fraud are as varied as the deceitful schemes financial institutions can cook up, but often involve misleading consumers about fees associated with investments or the terms of loans or credit card programs. The menu of available claims usually includes breach of fiduciary duty, breach of contract, unconscionability and unjust enrichment. Securities class actions arising from investments in stock or other products are most commonly prosecuted under federal securities legislation that Congress passed in the wake of the stock market crash of 1929 and the Great Depression.

While class actions may typically be filed in either state or federal court, the passage of the Class Action Fairness Act of 2005[21] increases defendants' odds of successfully removing most large cases to federal court. Before the defendants even take their first shot at the complaint, there is often an intra-plaintiff battle for control of the case which is governed by the Private Securities Litigation Reform Act (PSLRA) of 1995 in federal securities cases or Rule 23(g) in non-securities cases.[22] Next come the *Twombly* and *Iqbal*[23] pleading challenges, which pose a serious threat to even the most watertight class action claims. Navigating the pleading requirements is even more daunting when the claims "sound in fraud" and must therefore be pled with sufficient particularity under Rule 9(b).[24]

Delay is another major issue: it routinely takes more than a year to get a ruling on motions to dismiss, and discovery is stayed under the PSLRA while any motion to dismiss is pending. Plaintiffs fortunate enough to get past the motions must then really run the gauntlet, as discovery in class actions (particularly accounting fraud and other highly technical cases) is notoriously complex, hard-fought and expensive. Add to the mix the vagaries of multi-district litigation and coordination among multiple plaintiffs' and defense counsel, and additional delay is a virtual certainty.

Seasoned class action litigators may tell you that defendants often stipulated to class certification in the good old days (especially in securities cases), but those days are long gone. Certification always depends on satisfying the basic elements of Rule 23(a) and, if the class is seeking damages, the even more demanding predominance and superiority requirements of Rule 23(b)(3). Proposed nationwide classes asserting state or common law claims typically have to reckon with a choice-of-law analysis. And any one of many available defenses – based on individualized sales practices, reliance, due diligence or loss causation, to name a few – may win the day at class certification, summary judgment or even trial (on the rare occasion a class action goes all the way).

The Supreme Court's recent decisions in *Dukes v. Wal-Mart*[25] and *AT&T Mobility v. Concepcion*[26] have been touted by the defense bar as class action killers. *Concepcion* has undoubtedly changed the landscape when it comes to class actions arising from contracts that include arbitration provisions, as described below, and may well wipe out certain financial fraud class actions. *Wal-Mart* may also have wide-ranging implications on the commonality analysis in a variety of class actions. But because neither case involved securities fraud claims (and for additional reasons that are beyond the scope or space constraints of this article), most members of the plaintiffs' securities bar remain optimistic that neither *Concepcion* nor *Wal-Mart* will have a devastating impact on securities class actions.

No class action primer would be complete without addressing whether these cases are really as lucrative for the plaintiffs' attorneys as urban legend makes them out to be. The answer is that on

rare occasion they may be, but there are certainly no guarantees. Counsel work on a contingency basis, advance the costs of these expensive cases (including the inevitable battles of the experts) and – assuming a successful resolution of the matter – only recover whatever fees and expenses the court approves. Courts usually apply a "lodestar cross check" these days to ensure the lawyers aren't asking for more than their fair share of the recovery, and may award even less than the lawyers' reported lodestar.

All that said, there is no doubt that prosecuting class actions is rewarding work. Victims of financial and securities fraud are more appreciative than ever to find counsel willing to take on the risk of prosecuting claims – especially against increasingly unpopular financial institutions – that are otherwise simply too small for consumers to bring on an individual basis. This truly complex litigation is as intellectually stimulating as it is financially risky. It's great work if you can get it, sustain it, weather the storms, and ultimately succeed at it.

Arbitration: Our New Reality

A year ago, the U.S. Supreme Court held that when class action waivers appear in arbitration agreements, they must be enforced as written.[27] A few month later, the state Supreme Court accepted review of *Sanchez v. Valencia Holding Co. LLC* (2011) 135 Cal.Rptr.3d 19, where the 2nd District Court of Appeal did not address the specific question of the enforceability of the class action waiver provision because the entire arbitration agreement was struck as unconscionable. Regardless of how our Supreme Court rules in *Sanchez*, CAOC members are undoubtedly going to find themselves in arbitration more and more. As trial lawyers, CAOC members are uniquely positioned to take advantage of the unfortunate reality of the disappearing jury.

Prehearing Discovery

Arbitrators are "guided by the principle that discovery should provide sufficient information to allow all parties to prepare for and present a full and fair hearing."[28] However, arbitrators rarely permit interrogatory or depositions.[29] If you cannot obtain the discovery you require, you can request discovery through a motion to the arbitrator(s) or the court. In certain circumstances, California courts have statutory power to grant discovery if arbitrators will not; however courts exercise that right sparingly.[30]

All three venues generally provide for an initial exchange of relevant, non-privileged documents.[31] If you require more discovery, identify this early in the action so that you can alert the arbitrators. The AAA Commercial Rules make no provision for discovery requests except in large, complex matters (claims over $1,000,000), where the arbitrator may exercise discretion "upon good cause shown consistent with the expedited nature of arbitration."[32] Standard interrogatories are generally not permitted, but a Request For Information and Documents – an abbreviated hybrid of an Interrogatory Request and Request for Documents – is allowed under FINRA's discovery guidelines.

Depositions are difficult to obtain.[33] In general, a motion must be made and such motions are granted upon very limited circumstances, such as: (1) perpetuation of testimony for ill or dying witnesses; (2) accommodating essential witnesses who are unable or unwilling to travel long distances for a hearing; (3) expediting large or complex cases; and (4) the existence of extraordinary circumstances. FINRA Rule 12510. Once a deposition is ordered by the arbitrator(s) or agreed to by the parties, the deposition may be offered into evidence by any party.

Arbitration Hearing

Is anything inadmissible? Generally, exclusionary rules of evidence do not apply and arbitrators are accorded great discretion as to what is "pertinent and material."[34] While arbitrators may be guided by the Federal or California Rules of Evidence, just about everything, with particular exceptions for work product, attorney-client privileges, and settlement negotiations, can come into evidence as long as they are relevant.[35] For example, an arbitrator may consult with a disinterested attorney for advice regarding conclusions of law, provided the arbitrator discloses that in the award.[36] That said, I am just finishing a FINRA arbitration where my arbitration panel held that my expert could not base any opinions on hearsay despite clear California and Federal rules to the contrary.

Opening Statements

Arbitrators, like jurors, "feel most deeply and retain most vigorously" information they hear and believe first.[37] In arbitrations, the line dividing a proper statement of "what the evidence will show" and "improper" argument is virtually nonexistent. Be creative. Push the boundaries of demonstrative evidence and consider providing summary materials to the panelists in a digestible and persuasive form that might not be admissible in a bench or jury trial. Depending on the complexity of your case, a glossary of terms may be useful. Propose one to your opposing counsel.

Closing Argument: Written Briefs or Oral Closing

Submitting briefs has become the default method of closing argument. This is unfortunate and I recommend oral closing argument immediately after the close of evidence rather than post-hearing briefing. An oral closing means the arbitrator starts work sooner. Depending on the panel and the issues involved, closing briefs may not be submitted until a month or more after the close of evidence. The review of additional briefs will drive the costs up for you and your client.

False Claims Act Litigation

Another category of fraud cases that consumer attorneys often overlook – despite being well suited to handle them – is false claims act litigation. Fraud against federal, state, and local governments is rampant. Whistleblowers, and the attorneys who represent them, have several tools – some new, and some old – to help the government stop this fraud, and recoup taxpayer dollars.

The oldest of those tools – the federal False Claims Act ("FCA")[38] – allows a "private person" to bring a civil action to recover damages to the government resulting from false or fraudulent claims. Under the federal FCA, such an individual is referred to as the "relator." If the relator succeeds in recovering damages on behalf of the government, the relator is entitled to a reward for those efforts of up to 15 to 30% of the total amount recovered by the government, plus attorneys' fees and costs.[39]

This creative mechanism for protecting the government from fraud also adds a layer of delay to the normal litigation timeline, and several unique procedural pitfalls that must be navigated carefully.

For example, a relator's FCA complaint is always filed with the court under seal, and is not initially served on the defendants. The complaint must, however, be immediately served on the Attorney General, who then investigates the case while it remains under seal – oftentimes for years. In addition, practitioners need to be aware of the first-to-file rule, and the public disclosure bar.

Approximately half of the states, including California, have their own false claims act statutes, most of which are largely modeled after the federal FCA. California's statute is found at Government Code § 12650 et seq., and closely resembles the federal FCA.

Two other avenues for representing whistleblowers have more recently been created: (1) the Dodd-Frank Wall Street Reform Act includes a "Securities Whistleblower Incentive Program," codified at 15 U.S.C. §§ 78u-6 and 78u-7; and (2) federal tax fraud, which is exempt from the False Claims Act, may now be attacked by whistleblowers through the IRS Whistleblower Law, enacted December 20, 2006, and codified at Internal Revenue Code § 7623(b) (applies only to claims exceeding $2 million).

Given the vast amount of fraud against the government, good cases abound. You likely already have clients who would qualify as whistleblowers, especially if you do any work on behalf of mistreated employees. Whistleblower litigation, however, is not for everyone. As described above, the investigatory period – during which the case remains under seal – can add years to the already-lengthy complex litigation timeline. This can be tough on your practice, and on your client. Additionally, the false claims act contains a multitude of procedural traps for the unwary and inexperienced. Your first false claims case – or first several – should only be taken on with the help of experienced false claims co-counsel.

Despite their complexity, false claims cases offer your practice something no other area of consumer law does: bipartisan political support and an ever-strengthening statutory scheme. Republicans and Democrats alike disdain fraud on the government, and virtually every recent amendment to the whistleblower laws has made them stronger. This trend, we hope, will continue. ■

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1 Cal. Bus & Prof. Code § 17200, et seq.

2 Cal. Civ. Code § 1750, et seq.

3 See *LiMandri v. Judkins* (1997) 52 Cal. App.4th 326, 336.

4 See Fed. R. Civ. P. 23 (b); Cal. Code Civ. Proc. §382.

5 Cal. Bus. & Prof. Code § 17200.

6 See *In re Tobacco II Cases* (2009) 46 Cal.4th 298, 312; *Stearns v. TicketMaster Corp*. (9th Cir. 2011) 655 F.3d 1013, 1020.

7 See *In re Tobacco II Cases*, 46 Cal.4th at 327; *Stearns*, 655 F.3d at 1020.

8 See *In re Tobacco II Cases*, 46 Cal.4th at 315-316; *Stearns*, 655 F.3d at 1020-1021.

9 See, e.g., *Stearns*, 655 F.3d at 1020; *Yokoyama v. Midland Nat'l Life Ins. Co.* (9th Cir. 2009) 594 F.3d 1087, 1093-94.

10 See Cal. Bus. & Prof. Code § 17203. Attorneys' fees may be available under other statutes, such as Cal. Civ. Proc. §1021.5, however.

11 Cal. Civ. § 1770(a).

12 See e.g., *Stearns,* 655 F.3d at 1022.

13 See, e.g., *Plascencia v. Lending 1st Mortgage* (N.D. Cal. 2009) 259 F.R.D. 437, 447, citing *Vazquez* (1971) 4 Cal.4th 800.

14 See, e.g., *Johns v. Bayer Corp*. (S.D. Cal. Feb. 3, 2012) ---F.R.D.---, 2012 WL 368032, at *4; *Johnson v. Gen. Mills Inc.* (C.D. Cal.2011) 276 F.R.D. 519, 522; *Steroid Hormone Prod. Cases* (2010) 181 Cal. App.4th 145,155–56. See also *Kwikset Corp. v. Superior Court* (Jan. 27, 2011) No. S171845, 2011 WL 240278, at *10.

15 See, e.g., *Johns*, 2012 WL 368032, at *4; *Johnson,* 276 F.R.D. at 522; *Bruno v. Quten Research Institute, LLC*, ---F.R.D.--- 2011 WL 5592880, at *11 (C.D. Cal. Nov. 14, 2011).

16 See e.g., *Stearns,* 655 F.3d at 1024.

17 See *LiMandri*, 52 Cal.App.4th at 336.

18 See, e.g., *Wilson v. Hewlett-Packard Co.* (9th Cir. 2012) 668 F.3d 1136, 1141.

19 *Id*., citing *Daugherty v. Am. Honda Motor Co*. (2006) 144 Cal.App.4th 824.

20 See, e.g., *Collins v. eMachines, Inc.* (2011) 202 Cal.App.4th 249, 256 ("[A] fact is deemed 'material,' and obligates an exclusively knowledgeable defendant to disclose it, if a 'reasonable [consumer]' would deem it important in determining how to act in the transaction at issue.")

21 28 U.S.C. § 1332(d).

22 See 15 U.S.C. § 77z-1(a)(3); 15 U.S.C. § 78u-4(a)(3); Fed. R. Civ. P. 23(g).

23 *Bell Atlantic Corp. v. Twombley* (2007) 127 S.Ct. 1955; *Ashcroft v. Iqbal* (2009) 129 S.Ct. 1937.

24 Fed. R. Civ. P. 9(b) ("In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake"); *Vess v. Ciba-Geigy Corp. USA* (9th Cir. 2003) 317 F.3d 1097, 1103 (non-fraud may "sound in fraud" under certain circumstances and, if they do, they must meet Rule 9(b)'s pleading standards).

25 (2011) 131 S. Ct. 2541.

26 (2011) 131 S. Ct. 174.

27 *AT&T Mobility, LLC v. Concepcion* (2011) 131 S.Ct. 1740.

28 Lawrence R. Mills & Thomas J. Brewer, *Litigation*, Vol. 31 No. 3, 45 (2005).

29 *Id.*

30 *Alexander v. Blue Cross of Cal.* (2001) 88 Cal.App.4th 1082, 1087.

31 See, e.g., JAMS Rule 17(a).

32 Rule L 4.

33 JAMS Rule 17(b); AAA L-4; FINRA Rule 12510.

34 See e.g. AAA Rule 31(A).

35 See e.g. JAMS Rule 22(d) and 22(f).

36 *Canadian Indemnity Co. v. Ohm* (1969) 271 Cal. App. 2d 703, 708-09, citing Cal. Civ. Proc. Code 1282.2(g) (West 1994).

37 See California Trial Handbook, § 19.2 at 69 (3d ed. 2004 Supp.)

38 31 U.S.C. §§ 3729 et seq.

39 § 3730(d).