Commentary

A Fine Line: The California Supreme Court Bars Statutory Trebling Of Restitutionary Awards In Private Party UCL Actions For Predatory Conduct Against Elders

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[Editor's Note: Lisa Perrochet is a partner at Horvitz & Levy LLP. Copyright 2010 by Lisa Perrochet. Replies to this commentary are welcome.]

The California Supreme Court has, for now, stymied one effort to extend the application of a treble recovery statute beyond its apparent purpose — to increase fines or penalties for predatory practices targeting senior citizens and disabled persons. In *Clark v. Superior Court (Nat'l Western Life Ins.)* (2010) 112 Cal. Rptr.3d 876 (*Clark*), the court last month held that the plaintiffs in a private action seeking *restitution* of money lost through such predatory practices were not seeking a form of penalty, and thus were not entitled to invoke Civil Code section 3345 to increase their monetary recovery. As explained below, however, the final chapter on creative use of section 3345 by the plaintiffs' bar probably has not yet been written.

Civil Code Section 3345 And The Clark Decision

California public policy recognizes, in a variety of ways, that older and disabled members of our society are particularly vulnerable and need enhanced legal protections. For example, in the introductory language to Penal Code section 368, "[t]he Legislature finds and declares that crimes against elders and dependent adults are deserving of special consideration and protection, not unlike the special protections provided for minor children, because elders and dependent adults may be confused, on various medications, mentally or physically impaired, or incompetent, and therefore less able to protect themselves, to understand or report criminal conduct, or to testify in court proceedings on their own behalf." Consistent with that sentiment, a patchwork of laws not only imposes extra criminal punishment for crimes against elders, but also offers special civil remedies. Some laws provide for statutory attorney fees or abrogation of otherwise applicable limits on certain types of damages. And, in the case of Civil Code section 3345, trebling of "a fine, or a civil penalty, or any other remedy the purpose or effect of which is to punish or deter" in actions brought by senior citizens or disabled persons to redress unfair or deceptive acts or unfair methods of competition.

Last month, in *Clark v. Superior Court,* the California Supreme Court analyzed the interplay between section 3345's treble penalty provision and the consumer protection remedies available under the Unfair Competition Law (UCL) found in Business & Professions Code sections 17200 et seq. The UCL offers a few different remedies, depending on who is suing. If an authorized government agent is suing in a representative capacity on behalf of the general public, a court may order a civil penalty of up to $2,500 per statutory violation. But if a private plaintiff is suing, the only monetary remedy available is a restitutionary award that will "restore to a person in interest money . . . acquired by means of an unfair business practice." (Bus. & Prof. Code § 17203.)

In a straightforward application of the plain language of section 3345, the Supreme Court held trebling of such restitution in a private action is *not* to be trebled. In so holding, the court disagreed with the analysis in the Court of Appeal opinion under review, in which the lower court had expressed the understanding that any remedy with a deterrent purpose qualifies for trebling in actions otherwise encompassed under section 3345. The Court of Appeal had concluded that an award of restitution — the only monetary remedy available in a private action under the UCL — has a deterrent purpose and effect and therefore falls within the statutory language as a "remedy the purpose or effect of which is to . . . deter" within the meaning of section 3345. (See *Clark, supra,* 112 Cal. Rptr.3d at p. 879.) The Court of Appeal relied on Supreme Court decisions that noted the deterrent effect a restitution award may have. (*Ibid.*)

The Supreme Court agreed with the defendant, however, that "the Court of Appeal read in isolation, rather than in context, the statutory phrase 'the purpose or effect of which is to . . . deter,' which appears in subdivision (b) of section 3345. This led the court to conclude that any remedy with a deterrent effect falls within subdivision (b)'s trebled recovery provision. Defendant points out that immediately preceding the just-quoted statutory language is phrasing restricting trebled recovery to a statutorily authorized 'fine, or a civil penalty or other penalty.' Thus . . . subdivision (b)'s 'deter' language must be read as pertaining to a remedy that is designed to punish." (*Clark, supra,* 112 Cal.Rptr.3d at pp. 881-882.)

The key component of the Supreme Court's analysis was a bit of common sense: "All remedies have some incidental deterrent effect. Here, the trebled recovery provision comes into play when the governing statutory remedy has '*the* purpose or effect' of punishing or deterring. (Civ. Code, § 3345, subd. (b), italics added.) Had the Legislature intended *any* statutory remedy to be subject to section 3345's trebling provision, it would have used simply the word "remedy" without any qualifying language."

In contrast, the purpose of restitution is, primarily, to return the plaintiff to the position he or she would have enjoyed but for the defendant's statutory violation: "Restitution is not a punitive remedy. The word 'restitution' means the return of money or other property obtained through an improper means to the person from whom the property was taken." (*Clark, supra,* 112 Cal.Rptr.3d at p. 882.) "'The object of restitution is to restore the status quo by *returning to the plaintiff* funds in which he or she has an ownership interest.'" (*Ibid.*) In contrast, a penalty is a recovery without reference to the actual damage sustained. "Penalties provide for "'recovery of damages additional to actual losses incurred, such as double or treble damages . . . .'"" (*Ibid.*) Accordingly, the Supreme Court concluded that the UCL's restitution remedy, measured by what was taken from the plaintiff, "is not a penalty and hence does not fall within the trebled recovery provision of Civil Code section 3345, subdivision (b)." (*Id.* at p. 883.)

Measured against most California Supreme Court opinions these days, the opinion in *Clark* — a unanimous decision — is refreshingly short. The court did not embark on a survey of other states' treatment of similar subject, nor did the court hypothesize about how its analysis might differ and what ramifications might result in other contexts (such as where statutory civil penalties are sought in a UCL action brought by a *government official* rather than a private plaintiff), or about how its analysis might trigger a refinement of related legal principles (such as the principle that at least some types of penalties imposed by state actors are subject to constitutional due process review). Some musings on those subjects are offered below.

Does The Clark Opinion Set The Stage For More Aggressive Prosecution Of Public UCL Actions — Initiated By Private Contingency Fee Counsel?

In addition to *Clark,* the California Supreme Court handed down another interesting opinion this summer, in a seemingly unrelated case involving public nuisance claims arising out of the use of lead paint in construction during the 1970s and before. Putting the two cases together, however, one can envision a groundswell of new UCL litigation fueled by the prospect of treble damages under section 3345.

In *Santa Clara v. Superior Court (Atlantic Richfield Co.)* (2010) 50 Cal.4th 35 [112 Cal.Rptr.3d at 697.] (*Santa Clara*), plaintiffs — local government entities — sued former manufacturers of lead paint products alleging that the defendants had created a public

nuisance. Such an action is of a uniquely sovereign character. The public interest in allowing such claims is a core reason why defenses normally applicable to what is at bottom a decades-overdue product liability action are unavailable to the defendants facing a public nuisance claim. And yet, to prosecute this action, the plaintiffs delegated their prosecutorial discretion to outside private contingent fee counsel. The trial court invalidated the agreement on the ground that such an arrangement was inconsistent with the precept that sovereign actions will be prosecuted by entirely neutral representatives who would be guided entirely by the best interests of the public. The court relied on the California Supreme Court's 1985 decision in *People ex rel. Clancy v. Superior Court* (1985) 39 Cal.3d 740, which held the financial interest of contingent fee counsel in the outcome of the litigation compromises the impartiality and neutrality required of the government when prosecuting public law enforcement actions.

After a brief stop at the Court of Appeal (which granted the plaintiffs' writ petition challenging the trial court's order), the case found its way to the California Supreme Court. And, in the same month that it handed down the *Clark* decision, a divided court held that public entities may hire private attorneys on a contingent fee basis to prosecute public nuisance actions. The majority concluded that, given the nature of the lead paint public nuisance action at issue, the rule in *Clancy* could be narrowed. Specifically, "because — in contrast to the situation in Clancy — neither a liberty interest nor the right of an existing business to continued operation is threatened by the present prosecution, this case is closer on the spectrum to an ordinary civil case than it is to a criminal prosecution. The role played in the current setting both by the government attorneys and by the private attorneys differs significantly from that played by the private attorney in *Clancy*. Accordingly, the absolute prohibition on contingent-fee arrangements imported in *Clancy* from the context of criminal proceedings is unwarranted in the circumstances of the present civil public-nuisance action." Thus, the court held an exception to *Clancy* exists where the government plaintiff maintains "control" over the litigation, including formal retention of final settlement authority and an agreement that defendants may contact the government in-house counsel directly, without gatekeeping by the contingency fee counsel.

To distinguish between those cases in which the general rule against private contingency fee counsel were barred, and those sovereign actions in which such counsel could be used, the court focused on "the types of remedies sought and the types of interests implicated." (*Santa Clara, supra,* 50 Cal.4th ___ [112 Cal.Rptr.3d at p. 709].) Thus, the court distinguished the case before it from *Clancy,* in which contingency fee counsel attempting to enjoin the operation of a book store was improper "because the public-nuisance abatement action at issue implicated important constitutional concerns, threatened ongoing business activity, and carried the threat of criminal liability." (*Id.* at 711.) In contrast, in *Santa Clara,* the Supreme Court said, "This case will result, at most, in defendants' having to expend resources to abate the lead-paint nuisance they allegedly created, either by paying into a fund dedicated to that abatement purpose or by undertaking the abatement themselves. The expenditure of resources to abate a hazardous substance affecting the environment is the type of remedy one might find in an ordinary civil case and does not threaten the continued operation of an existing business." (*Id.* at 712.)

In light of this analysis, an open question now is whether the *Santa Clara* decision applies broadly beyond the context of the facts before the court — involving a public nuisance claim against companies that had long since ceased the conduct that gave rise to the action. Specifically, does *Santa Clara* authorize the government officials charged with prosecuting public UCL actions (that is, the Attorney General or any California district attorney, county counsel, city attorney, or city prosecutor) to hire out their standing to seek civil penalties in UCL cases, bringing in private contingency fee counsel to take on that task?

Arguably, *Santa Clara* stops short of authorizing private contingency fee counsel to pursue civil penalties under the UCL in the name of government plaintiffs. In a UCL case seeking statutory penalties against a business operating in California, a court confronted with the issue might well find that the "type of remedy sought" (a penalty that is not tied to an amount needed to cure or abate harm actually caused by the defendant) and the "type of interest implicated" (the interest of a business operating in California, potentially without any understanding that it was violating the broad statutory prohibitions found in the UCL)

dictate that the case falls outside the realm of those subject to the *Santa Clara* control exception.

Where does *Clark* fit with all of this? By raising the profile of section 3345, the decision provides strong impetus to plaintiffs' lawyers to seek out opportunities to join with public prosecutors to file new claims of UCL violations involving senior citizens and disabled persons — including those who have not been harmed in any way. Combined with the notoriously low evidentiary threshold needed to prove a violation under the UCL, section 3345 raises the prospects for counsel to collect a hefty percentage of significant civil penalties. And cash-strapped cities and counties will likely feel a strong pull to push the envelope of the *Santa Clara* decision, and join with private counsel in a fundraising enterprise to collect UCL penalties.

Recent events show this is not just supposition. Even before the *Santa Clara* decision came down, Orange County's District Attorney hired a private lawyer to pursue a public action against Toyota in a "sudden acceleration" case. (See *People v. Toyota Motor Sales, U.S.A. Inc.*, No. 30-2010-00352900-CU-BT-CXC (Super. Ct. filed March 12, 2010).) The County is represented by the former president of the Consumer Attorneys of California, on a contingency basis, to bring these claims. The District Attorney reportedly hired private counsel without a competitive bidding process, and has refused to disclose the details of the agreement, saying it would expose litigation strategy. To the extent that section 3345 enhances the potential reward, it will be easier for in-house government counsel in such situations to justify allowing outside contingency fee counsel to handle the heavy lifting in government-initiated UCL actions.

Does The Potential For Trebling Of UCL Penalties Set Up A Constitutional Problem?

In *BMW of North America, Inc. v. Gore* (1996) 517 U.S. 559, 572, 574-575 [116 S.Ct. 1589, 134 L.Ed.2d 809] (BMW) and *Cooper Industries, Inc. v. Leatherman Tool Group* (2001) 532 U.S. 424, 433-434 [121 S.Ct. 1678, 149 L.Ed.2d 674] (Cooper), the United States Supreme Court held the Due Process Clause of the Fourteenth Amendment imposes a substantive limit on the size of punitive damage awards, and that, as a result, a punitive damage award is subject to de novo appellate review to ensure it is not constitutionally excessive.

Based on *BMW, Cooper* and subsequent cases, one could argue that a UCL penalty is subject to independent review by an appellate court to ensure that the defendant's due process rights are not violated. The assessment of civil penalties under the UCL requires particularly close scrutiny because the statutory scheme creates a substantial risk that unconstitutionally excessive penalties may be imposed. This is so for three reasons.

First, while the Supreme Court in *BMW* stated the amount of a penalty must reflect the reprehensibility of the defendant's conduct and the extent of actual harm caused thereby (*BMW, supra*, 517 U.S. at p. 575), a distinguishing feature of the UCL is that it is a "strict liability" statute: to establish a statutory violation, it is not necessary to show that the defendant had any understanding (much less intent) that harm would because cause, nor is it necessary that harm was in fact caused by the defendant's practice. (E.g., *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal.4th 163, 180-181; *Bank of the West v. Superior Court* (1992) 2 Cal.4th 1254, 1266-1267; *Committee on Children's Television, Inc. v. General Foods Corp.* (1983) 35 Cal.3d 197, 209.) And yet the UCL *requires* the trial court to impose a penalty — even where the defendant's conduct was not harmful, intentional, or reprehensible. The notion is counterintuitive. (See *Lane v. Hughes Aircraft Co.* (2000) 22 Cal.4th 405, 424 (conc. opn. of Brown, J.) ["fundamental notions of justice require some correlation between punishment and harm"].)

Second, the central due process concern expressed by the Supreme Court in *BMW*, that a defendant must have "fair notice" of the conduct that will subject him to punishment and the severity of the penalty the State might impose (*BMW, supra*, 517 U.S. at p. 574), is significantly threatened by the broad authority granted courts under the UCL. The UCL does not define the conduct prohibited by the statute, but grants the trial court sweeping authority to find an undefined and unlimited range of conduct unfair or unlawful. The statute also gives the trial court wide discretion in setting the amount of the mandatory penalty, which can reach many millions of dollars. As a result, the UCL authorizes imposition of a substantial UCL penalty even when a defendant did not, and could not have, anticipated such punishment.

The federal statute corresponding to the UCL — section 5 of the Federal Trade Commission Act (15 U.S.C.A. § 45(a)) — avoids this problem even though it describes prohibited conduct in broad, generic terms similar to the UCL. To ensure that penalties imposed for an FTC violation would not impinge on constitutional fair notice requirements, Congress enacted a restrictive remedial scheme, as to which no private right of action exists. (*Holloway v. Bristol-Myers Corporation* (D.C. Cir. 1973) 485 F.2d 986, 990.) Thus, where the Federal Trade Commission finds a violation of section 5, a cease and desist order is issued notifying the defendant of the exact nature of the prohibited conduct. (Id. at pp. 991, 1000.) Civil penalties, injunctions, and other equitable relief are authorized only for violations of the very specific cease and desist order, or where a defendant has violated a rule of the FTC with knowledge its conduct was unfair, deceptive and prohibited by that rule. (15 U.S.C.A. § 45(l), (m); *Holloway, supra*, 485 F.2d at p. 1000 ["balance struck by Congress" is reflected in its reliance on cease and desist procedures and rejection of penalties imposed on a "per se basis" for all violations].) The UCL contains no similar procedure to ensure that a defendant has notice that its conduct violates the UCL and might subject it to severe punishment.

Finally, the UCL directs the trial court to consider "any one or more of the relevant circumstances presented by . . . the parties," but does not require the court to consider the "reprehensibility" of the defendant's conduct, and the extent of actual harm inflicted, as required by *BMW*. (Bus. & Prof. Code, §§ 17206, subd. (b), 17536, subd. (b), emphasis added; *BMW, supra*, 517 U.S. at p. 575.) Nor must the trial court explain the factual basis for the penalty imposed.

One California appellate court has rejected these arguments, holding that *BMW* and *Cooper* apply only to punitive damages *per se*, not civil penalties. (*People ex rel. Lockyer v. Fremont Life Ins. Co.* (2002) 104 Cal. App.4th 508 [affirming $2.5 million civil penalty against life insurer defendant].) But the reasoning in *Clark* calls that conclusion into question. By highlighting the distinction between restitutionary awards (which have a deterrent value) and civil penalties (which are specifically designed for a punitive purpose), the California Supreme Court in *Clark* comes very close to equating punitive damages under Civil Code section 3294 with civil penalties authorized under other statutes. (Cf. *Sony BMG Music Entertainment v. Tenenbaum* (D. Mass. July 7, 2010) 2010 U.S. Dist. LEXIS 68642 [federal judge relied on *BMW* to reduce an award as constitutionally excessive because the "compensatory" damages award was more in the nature of a penalty insofar as it involved pre-set statutory fines for certain misconduct, and thus was subject to due process review].)

Such an approach is consistent with the views set forth in *BMW*, which imported into punitive damages jurisprudence concepts developed in other contexts, including civil penalties and civil damages awards. Indeed, the United States Supreme Court reasoned that the protection of constitutional due process is not dictated by the form a penalty may take, or whether it is imposed by a judge or a jury, but applies whenever a penalty is imposed as an exercise of a State's authority and power. The court explained: "State power may be exercised as much by a jury's application of a state rule of law in a civil lawsuit as by a statute. . . . 'The test is not the form in which state power has been applied but, whatever the form, whether such power has in fact been exercised.'" (*BMW, supra*, 517 U.S. at p. 572, fn. 17, emphasis added.)

From this premise, the court in *BMW* held the constraints imposed by the Due Process Clause apply broadly: "[T]he economic penalties that a State . . . inflicts on those who transgress its laws, whether [in] the form of legislatively authorized fines or judicially imposed punitive damages, must be supported by the State's interest in protecting its own consumers and its own economy." (Id. at p. 572, emphasis added.) More specifically, the court observed that "the basic protections against 'judgments without notice' afforded by the Due Process Clause," are not limited to imposition of criminal sanctions, but also are "implicated by civil penalties." (Id. at p. 574, fn. 22, first emphasis added, second emphasis in original.)

If, in future cases, section 3345 trebling is added on top of UCL penalties, the foregoing concerns are hugely amplified. Defendants in such a case might well argue that careful de novo review by a reviewing

court is especially essential in those circumstances to ensure that UCL penalties do not exceed constitutional limits. (See *Cooper, supra*, 532 U.S. at p. 436 [independent appellate review of penalties "'does more than simply provide citizens notice of what actions may subject them to punishment; it also helps to assure the uniform general treatment of similarly situated persons that is the essence of law itself'"].) ■