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PRODUCT MISLABELING

CERTIFICATION

Beyond announcing a liberal state-court pleading standard for plaintiffs who sue under California's Unfair Competition Law, the state supreme court's Jan. 27 ruling in *Kwikset* has important implications for class action litigators, say attorneys Scott T. Schutte, J. Gordon Cooney Jr., and Molly Moriarty Lane in this BNA Insight.

The authors analyze the ruling, which they say will embolden the plaintiffs' bar to file false advertising claims, and discuss the unresolved issue of how economic harm can be proved where plaintiffs do not contend the product at issue was substandard or defective.

Kwikset Lowers Pleading Standard on UCL Mislabeling Cases, But Effects on Class Certification in California Remain an Open Question

BY SCOTT T. SCHUTTE, J. GORDON COONEY JR., AND MOLLY MORIARTY LANE

On January 27, the California Supreme Court ruled that a plaintiff who alleges that a product's deceptive labeling caused the plaintiff to purchase the product, and that plaintiff would not have purchased the product but for the allegedly deceptive labeling, has properly alleged ''lost money or property'' within the meaning of Proposition 64, and thus has pleaded standing to sue under the California Unfair Competition Law (UCL). *Kwikset Corp. v. Superior Court of Orange County (Benson)*, ___ Cal. Rptr. 3d ___, No. S171845, 2011 WL 240278 (Jan. 27, 2011).

While announcing a liberal state-court pleading standard for the named plaintiff in a UCL lawsuit, the import of the *Kwikset* on class actions is less clear. Plaintiffs in future cases undoubtedly will argue that *Kwikset* does not alter – and even extends – the analysis in *In re Tobacco II Cases*, 46 Cal. 4th 298, 312–329 (2009) (''*Tobacco II*''), where the California Supreme Court held that Proposition 64's ''standing requirements are applicable only to the class representatives, and not to all absent class members.'' Nonetheless, the *Kwikset* decision's emphasis on the need for consumers to demonstrate both (i) that there is a connection between the labeling and a consumer's individual purchase decision, and (ii) that the consumer actually lost money or prop-

erty as a result, opens the door for summary judgment and for potential arguments against class certification. Indeed, the *Kwikset* court's discussion of why there may be ''economic injury'' when a claim is based on mislabeling alone (without any allegation that the purchased product did not perform as expected) demonstrates that – if *Kwikset's* analysis of how a particular consumer can plead economic injury is coupled with *Tobacco II's* focus only on the named plaintiff – some consumers would be included in the class even though they did not share the named plaintiff's purchasing preferences and did not suffer economic injury.

Finally, regardless of how *Kwikset* and *Tobacco II* play out in California state courts, defendants who find themselves facing UCL claims in federal court may have additional arguments. First, more stringent federal pleading standards may require more than a conclusory allegation about economic injury and causation. In addition, defendants may still have solid arguments against class certification based on the Rules Enabling Act and Article III of the United States Constitution. In federal court, no absent class member may recover damages unless he or she was actually injured by the allegedly false label; *Kwikset and Tobacco II* do not (and cannot) change that requirement. Thus, to the extent that *Kwikset* and *Tobacco II* articulate state court rules of procedure governing pleading and class certification, they do not displace the more stringent relevant Federal Rules. As a result, jurisdictional controversies likely will become more intense as plaintiffs fight to keep cases in state court and defendants seek to remove them.

Proposition 64 and *Tobacco II*

In November 2004, California voters approved Proposition 64, which altered standing rules for plaintiffs seeking to bring claims under the UCL (Cal. Bus. & Prof. Code § 17,200 et seq.). Before Proposition 64 was enacted, any private individual could file a UCL lawsuit on behalf of the general public, even if the person had not suffered any injury. Proposition 64 amended the UCL to require a private plaintiff to have personally incurred ''injury in fact,'' and also ''lost money or property'' as a result of unfair competition or business practices in order to bring suit for violations of the UCL. *See generally*, *Californians for Disability Rights v. Mervyn's LLC*, 39 Cal. 4th 223, 227–228 (2006).

In May 2009, the California Supreme Court held in *Tobacco II* that the UCL, as amended by Proposition 64, requires only the named class representative in a putative class action alleging fraudulent misrepresentation to plead actual reliance, causation, and injury; absent class members were not required to affirmatively plead these factors in order to properly state a claim under Proposition 64. *Tobacco II*, at 312–329. Thus, under *Tobacco II,* only the putative class representative must meet Proposition 64's threshold standing requirements of having suffered ''injury in fact,'' and having ''lost money or property as a result'' of the defendant's allegedly unfair competition. Among the questions left unanswered by *Tobacco II* was what ''injury in fact'' must be pleaded and proved in a post-Proposition 64 UCL case.

The *Kwikset* Ruling

In *Kwikset*, the plaintiffs' amended complaint contained four counts – three asserting violations of the UCL and a fourth count under the false advertising law (Cal. Bus. & Prof. Code § 17500 *et seq*.). Plaintiffs alleged the following: (1) Kwikset labeled certain locksets as ''Made in the U.S.A.,'' or with a similar description; (2) Kwikset made these representations despite knowing they were false, in that parts of the lockset were foreign-made or aspects of the products were foreign-manufactured; (3) plaintiffs saw and relied upon the truth of those representations in purchasing the Kwikset locksets; (4) plaintiffs would not have purchased Kwikset's products had the products not contained the ''Made in the U.S.A.'' label; and (5) the plaintiffs spent and lost the amount of money each plaintiff paid for the defendant's locksets.

Notably, the named plaintiffs alleged only ''economic harm''; they did not (and presumably could not) allege the product actually purchased performed less well or was not functionally equivalent to the advertised product. Rather, they contended (or, at least the Supreme Court of California assumed they contended) that the harm they suffered was economic, *i.e.,* they paid more for the locksets because of the ''Made in the U.S.A.'' representation than they would have paid had no such representation been made.

The court granted review to clarify the UCL's standing requirements in light of Proposition 64, and pronounced a ''simple test'' for standing. That ''simple test'' is this: a party must (1) establish an economic injury sufficient to qualify as injury in fact, and (2) show the economic injury was caused by the unfair business practice or false advertising at issue.

With respect to the ''economic harm'' issue, the court found an allegation that the plaintiff relied on the truth and accuracy of a label, and was deceived by a misrepresentation into making a purchase he or she otherwise would not have made, has suffered an economic harm because the consumer paid more for a product than the consumer otherwise would have paid for an accurately labeled product. This economic injury may exist, according to the court, even though the mislabeled product may be viewed objectively as functionally equivalent to the product the consumer intended to purchase. The court rejected the lower' court's analysis, which limited standing to those circumstances where a plaintiff alleges the product received was either defective, overpriced, or of inferior quality, stating that injuries of this sort were ''wholly unrelated'' to the false labeling. The California high court found this analysis to be simultaneously ''underinclusive'' (in that it ignored the ''real economic harm'' a consumer may suffer as a result of purchasing a mislabeled product in reliance on the truth of the label) as well as ''overinclusive'' with respect to the forms of injuries that might be causally related to the false labeling.

Kwikset opens the door for summary judgment and for potential arguments against class certification.

The court concluded a consumer making a false advertising claim who alleges he or she relied on a product label to make a purchase decision satisfies the re-

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quirement for pleading causation by alleging he or she would not have purchased the product but for the misrepresentation. In doing so, the court observed that mislabeling may cause economic injury, even if the product is not defective or substandard, if the plaintiff has purchasing preferences that were affected by the mislabeling. The court thus reversed the appellate court and remanded for further proceedings consistent with its opinion.

Lastly, the court rejected the analysis of the Court of Appeal, which had held that only the individuals who are ''eligible for restitution'' have standing. Under the UCL, restitution is only available for restoration of any interest in money or property ''acquired'' by means of unfair competition. The Court found that this language seemingly precludes economic injuries that involve a loss by the plaintiff, but no corresponding gain by the defendant, such as where the asset possessed by the plaintiff has suffered a diminishment in value. The Court found that these forms of injury satisfy the plain meaning of the ''lost money or property'' requirement of Proposition 64, and thus qualify as injury in fact. As such, the Court held ''ineligibility for restitution is not a basis for denying standing'' under the UCL, and it expressly disapproved prior opinions that had concluded otherwise. *See Silvaco Data Sys. v. Intel Corp.*, 184 Cal. App. 4th 210, 245 (2010); *Citizens of Humanity LLC v. Costco Wholesale Corp.*, 171 Cal. App. 4th 1, 22 (2009); *Buckland v. Threshold Enterprises Ltd.*, 155 Cal. App. 4th 798, 817 (2007).

Implications and Open Issues

Kwikset Lowers Pleading Standard for Plaintiffs

In a nutshell, *Kwikset* teaches that ''plaintiffs who can truthfully allege they were deceived by a product's label into spending money to purchase the product, and would not have purchased it otherwise, have 'lost money or property' within the meaning of Proposition 64 and have standing to sue.'' This portion of the ruling almost certainly will embolden the plaintiffs' bar to file false advertising claims even where (as was the case in *Kwikset*) the product actually delivered to the consumer was functionally equivalent to the advertised product.

Applicability to Certification in California Uncertain

An open issue – and sure to be a focus of both plaintiffs and defendants in future cases – is how a plaintiff will prove economic harm where plaintiffs do not contend the product at issue is substandard or defective. In addition, the decision introduces uncertainty concerning how its ''lost money or property'' analysis affects class certification in such cases. In this latter regard, courts will have to grapple with whether the *Tobacco II* analysis applies and only the named plaintiff must prove that he or she ''lost money or property,'' or whether in seeking class certification the named plaintiff must demonstrate that the ''lost money or property'' issue can be litigated on a class-wide basis.

Plaintiffs assuredly will take the position that *Kwikset* – read together with *Tobacco II* – means that only the named plaintiff needs to prove deception and causation in a mislabeling case where the purchased product is functionally equivalent to the advertised product. That being said, the *Kwikset* court's analysis provides some good arguments in opposing class certification where the allegations only involve ''disappointed expectations,'' even in California state court in the post-*Tobacco II* world.

In order to demonstrate how ''economic harm'' may occur when (as was the case in *Kwikset*) the named plaintiff could not allege that the purchased product was functionally inferior to the advertised product, the court gave several examples of how, ''[t]o some consumers, [statements about] processes and places of origin matter.'' For example, the court pointed out:

> A counterfeit Rolex might be proven to tell the time as accurately as a genuine Rolex and in other ways be functionally equivalent, but we do not doubt the consumer (as well as the company that was deprived of a sale) has been economically harmed by the substitution in a manner sufficient to create standing to sue. Two wines might to almost any palate taste indistinguishable – but to serious oenophiles, the difference between one year and the next, between grapes from one valley and another nearby, might be sufficient to carry with it real economic differences in how much they would pay. Nonkosher meat might taste and in every respect be nutritionally identical to kosher meat, but to an observant Jew who keeps kosher, the former would be worthless.

The court also referred to how a statement that a diamond is conflict-free ''may matter to the fiancee who wishes not to think of supporting bloodshed and human rights violations each time she looks at the ring on her finger''; and how ''whether food was harvested or a product manufactured by union workers may matter to still others.''

This analysis makes clear that the named plaintiff must come forward with proof of how the product was less valuable to him or her because, according to the court, some plaintiffs may have particularized purchasing preferences that confer standing. And the plaintiff must convert that disappointed expectation into some form of quantifiable injury. But implicit in the court's analysis is the unassailable notion that there also are absent class members who *do not* share in these particularized purchasing preferences. That is, just as there are persons who can allege that they cared about whether the product at issue was made by union workers or ''Made in the U.S.A.,'' the court's analysis acknowledges that there are other purchasers for whom these representations were of no import in their purchasing decisions.

Kwikset introduces uncertainty concerning how its 'lost money or property' analysis affects class certification in economic harm cases where plaintiffs do not contend the product at issue is substandard or defective.

By substantiating the notion of ''economic harm'' this way, the court opened potential summary judgment issues as to the named plaintiff's claims as well as thorny issues concerning class certification. In this latter re-

gard, determining whether an absent class member suffered economic harm at all can only be determined by looking at the purchasing preferences of each absent class member. For example, was a wine purchaser and member of a putative false advertising class a oenophile who actually cared which valley the grapes came from or what year the grapes were grown, or a person who was satisfied with the taste of the wine (irrespective of any false advertising), and therefore suffered no economic harm? Was the fiancee with the beautiful diamond engagement ring a person who cared that the ring was not actually conflict-free (as advertised), or a person who was thrilled with the ring irrespective of its origins and therefore suffered no economic harm? Again, these questions can only be answered on a class-member by class-member basis.

Because under the *Kwikset* economic harm analysis whether a consumer ''lost money or property'' turns on the subjective purchasing preferences of each consumer and then requires a conversion of these disappointed expectations to actual economic loss, the *Kwikset* facts are distinguishable from *Tobacco II*. In *Tobacco II*, one can understand how a court could determine that every class member was harmed by the fact that they were smokers. In *Kwikset*, on the other hand, only those persons who actually cared about the ''Made in the U.S.A.'' label suffered any potential economic harm; purchasers who were just happy to have a lockset that worked irrespective of where the parts came from were not. Moreover, even if economic harm occurred, the degree or amount of any such harm may well turn on individualized facts.

In short, the *Kwikset* court's own reasoning demonstrates that a class in an ''economic harm'' case may necessarily include persons who suffered no economic harm. For this reason, defendants have a viable argument that *Kwikset* does not extend *Tobacco II* to cases where the plaintiff alleges only disappointed expectations.

While the resolution of this issue will turn in large part on a legal analysis, defendants can bolster this argument in advance of class certification by developing a factual record that probes how the named plaintiff made his or her purchasing decision, and that tests how he or she converts the alleged disappointed expectation to actual economic harm. This defense will emphasize the class-member-specific nature of both the expectations themselves and any economic harm. This can be accomplished through depositions of the named plaintiffs and strategic use of expert testimony. Surveys that show differences in consumer purchasing preferences may be particularly useful.

Kwikset Should Not Determine Pleading and Class Certification Analysis in Federal Court

Although *Tobacco II* and *Kwikset* set the governing rules in California state court, they may play much more limited roles in federal court. This distinction may provide for a powerful incentive for defendants to remove cases like these to federal court when possible.

As an initial matter, although *Kwikset* seems to recognize that a plaintiff may be able to prove economic harm even if the product is not defective or substandard, federal courts likely will require more than the conclusory allegation made in *Kwikset*, and likely will insist on a more specific allegation of how and why the product actually was less valuable to the plaintiff. *See Bell Atlantic Corp. v. Twombly*, 127 S. Ct 1955 (2007); *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009).

Moreover, even if *Kwikset* is read by California courts in conjunction with *Tobacco II* such that only the named plaintiff must prove that he or she was ''deceived by a product's label into spending money to purchase the product, and would not have purchased it otherwise,'' that analysis should not apply to cases pending in federal court and applying the UCL.

First, a defendant in federal court still can argue that Article III's case-or-controversy requirement mandates that each class member must demonstrate injury in fact, which is a significant barrier to class certification. *See, e.g.*, *Avritt v. Reliastar Life Ins. Co.*, 615 F.3d 1023, 1034 (8th Cir. 2010) (Article III actual injury requirement must be satisfied by each class member.); *Webb v. Carter's Inc.*, No. CV 08-7367 GAF (C.D. Cal. Feb. 3, 2011) (same). This may be especially true where (as in *Kwikset*) whether or not a class member suffered any economic injury can be determined only by examining the subjective purchasing preferences of that class member.

Second, the Rules Enabling Act precludes a plaintiff from arguing that procedural rules—or a state court decision—can change the substantive and constitutional rights available to a defendant. Thus, defendants only face liability to claimants who can prove elements of their claim. *See* 28 U.S.C. 2072(b).

Finally, as the United States Supreme Court explained in *Shady Grove Orthopedic Assocs. PA v. Allstate Ins. Co.,* 130 S. Ct. 1431 (2010), in federal court, Rule 23 and federal law cannot be displaced by state law. As the Supreme Court put it, ''[a] class action . . . merely enables a federal court to adjudicate claims of multiple parties at once, instead of in separate suits . . . . [I]t leaves the parties' legal rights and duties intact and the rules of decision unchanged.'' *Id.* at 1443. Just as a state cannot prohibit class actions that are cognizable in federal court under Rule 23, state law cannot require certification of classes that would not be certifiable under Rule 23.

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