

September 18, 2007

Hon. Edmund G. Brown Jr.  
Attorney General  
1300 I Street, 17<sup>th</sup> Floor  
Sacramento, California 95814

Attention: Ms. Toni Melton  
Initiative Secretary

Dear Attorney General Brown:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative, entitled the "California Class Action Reform and Corporate Accountability Act" (A.G. File No. 07-0044).

## **Background**

***Class Action Lawsuits.*** Many lawsuits in California's courts involve the filing of cases by attorneys on behalf of individuals against other parties. Other types of cases, known as class action lawsuits, are generally filed by attorneys on behalf of a group of plaintiffs to represent their common legal claims against one or more other parties. For example, in one California case, a class action lawsuit was filed on behalf of more than one million California residents (the "class" of parties filing suit) against a chain of gas stations alleging that customers who paid with a credit card were illegally overcharged for gasoline. A class of defendants—for example, all companies selling gasoline in the state—can also be represented in class action cases. Class action cases frequently involve legal issues relating to consumer protection, environmental protection, civil rights, violations of contracts, and the enforcement of minimum wage and overtime labor laws.

The standards and procedures for the conduct of such cases are set forth in federal and state statutes, rules adopted by the courts, and legal opinions issued by judges. Notably, two different state statutes authorize class action lawsuits. One statute, known as the Consumer Legal Remedies Act, applies only to cases brought to protect consumers against unfair and deceptive business practices. The other state statute authorizing class action lawsuits, Civil Code Section 382, is more general and applies to a wider range of legal cases. The legal standards used by judges for determining whether a case can proceed as a class action can differ depending upon the provision of state statute that is the basis for the lawsuit.

***Punitive Damages.*** Under state law, individuals who have been harmed or injured can file suit to obtain damages from parties that have injured them. If a plaintiff can show “clear and convincing evidence” that he or she suffered from “oppression, fraud, or malice,” as defined by state law, the defendant can be required to pay additional damages in excess of the actual damage caused. These so-called “punitive damages” are meant to be a form of additional punishment. Punitive damage awards, which are generally shared by plaintiffs and their attorneys, are generally subject to state (as well as federal) income taxes.

***Unfair Competition Law.*** California’s unfair competition law prohibits any person from engaging in any unlawful or fraudulent business act. This law may be enforced through lawsuits by the Attorney General or local public prosecutors. Examples of this type of lawsuit include cases involving deceptive or misleading advertising or violations of state law intended to protect the public well-being, such as health and safety requirements.

Proposition 64, a statewide ballot initiative that was approved by voters in November 2004, imposed new restrictions on private parties bringing unfair competition lawsuits. Among other changes, Proposition 64 provides that private parties cannot bring such cases unless they have suffered injury and lost money or property.

## **Proposal**

This measure changes state law relating to class action lawsuits, punitive damage awards, and unfair competition lawsuits. The measure states that its provisions apply only to cases filed on or after its enactment.

Some of the most significant provisions of this measure are summarized below.

***Policy Favoring Class Action Cases Placed in Statute.*** Current state law has been interpreted by the courts as generally favoring class action lawsuits. This general state policy in favor of such cases has sometimes been cited by the courts in rulings on specific legal issues about whether such lawsuits should be allowed to proceed. This initiative declares in statute that state law favors having lawsuits proceed as class actions to resolve legal disputes. This means that this policy could not change in the future unless it was submitted to and approved by the voters in a statewide election. Also, the measure allows judges to order multiple defendants to be joined in a single class action case when there are common legal issues.

***Easier Standards to Qualify Some Class Action Cases.*** This measure could make it easier for some lawsuits to qualify as class action cases. As noted earlier, class action lawsuits are currently authorized under two separate statutes—the Consumer Legal Remedies Act (for consumer cases only) and Civil Code Section 382 (for various types of

legal cases in general). This measure places into statute legal standards for cases brought under Section 382 that are generally similar to those now in statute for consumer cases. The initiative states that lawsuits filed under Section 382 may proceed as a class action if the legal standards established in this measure are met. For example, the measure specifies that, similar to consumer cases, a lawsuit filed under Section 382 may proceed as a class action if it would be impractical to bring all members of a class before the court. These statutory changes mean that some lawsuits that currently do not qualify as a class action might now do so.

The measure enacts various other additional statutory changes that could make it easier to qualify certain types of cases as class actions. This includes, for example, lawsuits that are filed primarily to obtain court orders requiring certain actions to be taken, rather than money (for example, a lawsuit to prohibit discrimination against certain people). This measure also authorizes in statute class action lawsuits for the purpose of requiring ongoing monitoring of the medical condition of individuals who face a risk of damage to their health in the future (for example, from taking a prescription drug that was subsequently found to be defective).

***Rules for Class Action Lawsuit Notices Modified.*** In some class action cases, notices are sent to members of the class informing them of a lawsuit affecting them, such as through mailings or newspaper advertising. This measure, among other statutory changes, directs state courts to consider requiring the use of “the most effective and least costly” form of notice, including use of the Internet, email, and putting up posters in publicly visible locations.

***Restrictions Imposed on Class Action Coupon Settlements.*** Some class action cases are settled by awarding individuals represented in a class action a coupon, certificate, or other form of scrip that can be redeemed for a discount on a product or service. In some instances, use of these various types of coupons may require individuals to incur an out-of-pocket cost in order to use the coupon. This measure imposes new restrictions in state statutes on coupon settlements, including a requirement that state courts approve such settlements only when it has been proven that such an approach is reasonable under the circumstances and provides valuable benefits to individuals receiving the coupons.

***Punitive Damages.*** This measure requires that 25 percent of punitive damage awards resulting from lawsuits brought under these new class action statutes be paid directly to the state. Any funds received by the state under this measure must be used to enforce laws promoting consumer protection, shareholder and pension protection, fire and police protection, and protection from insurance companies and discrimination.

***Lawsuits by Certain Nonprofit Agencies Permitted.*** This measure permits certain nonprofit groups to pursue class action lawsuits to enforce the state's consumer protection, environmental, civil rights, and other laws. Specifically, this measure allows charitable nonprofit organizations who are exempt from federal income taxation to bring such lawsuits under the state's unfair competition laws on behalf of other persons even if the organization itself, or other persons, did not suffer injury or a loss of money or property. In effect, this measure provides such nonprofit organizations an exception from the provisions of Proposition 64, which otherwise prohibits private parties from bringing lawsuits under the unfair competition laws unless they had suffered injury or a loss of money or property.

### **Fiscal Effects**

***Direct Fiscal Effects on State Court Operations.*** The combined effect of the various changes made by this measure could increase the number of class action and unfair competition lawsuits in state courts. However, other changes made by this measure could reduce court workload and costs. For example, some of the cases that would have otherwise been pursued as individual court cases may instead, under this measure, be litigated as class actions. The net effect of these and other possible responses on state revenues from court filing fees and court operating costs is unknown.

***Effects of Punitive Damage Award Provisions on Revenues and Spending.*** The provisions of this measure providing the state a 25 percent share of punitive damage awards from class action cases may not be significant initially. That is because this provision, like the rest of the initiative, only affects cases filed in the courts after its enactment that may take some years to resolve. After these future cases have been resolved by the courts, the revenues received by the state under this measure could become significant. The actual amount of revenues could fluctuate from year to year depending upon the claims made in the cases before the courts and judicial decision-making in those cases. Eventually, in some years, the state might receive up to the low tens of millions of dollars as its share of punitive damages in class action cases.

These new state revenues would be partly offset by a reduction in state income tax revenues. That is because, under this measure, the share of punitive damage awards paid to attorneys and plaintiffs would be reduced by the amount paid directly to the state, thus reducing the amounts that might otherwise be subject to state income taxes.

This measure could eventually result in an increase in state and local expenditures of the new revenues from punitive damage awards for the various public purposes, such as consumer protection or fire and police protection, that are specified in the measure. However, the measure does not prohibit the use of these new funds to replace existing state or local government funding now being provided for these programs.

Therefore, the net fiscal effect of this measure on state and local government expenditures is unknown.

***Indirect Fiscal Effects.*** This measure may have various indirect fiscal effects. For example, to the extent that this measure increases business costs associated with class action and unfair competition lawsuits, it could reduce firms' profitability, the level of economic activity, and thus, state and local revenues. On the other hand, state revenues could increase to the extent that this measure increases payments to individuals represented in class action lawsuits that are subject to taxation. Also, state and local government costs for health care could be reduced in the future to the extent that class action lawsuits and unfair competition lawsuits that could now be brought by nonprofit organizations were effective in correcting violations of health and safety requirements. The net indirect fiscal effects of these and other possible responses to this measure are unknown.

### **Summary of Fiscal Effects**

- Unknown fiscal impact on state revenues from court filing fees and the cost of court operations.
- Unknown net increase in state revenues, potentially up to the low tens of millions of dollars in some years, from providing a 25 percent share of punitive damage awards from class action cases to the state.

Sincerely,

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Elizabeth G. Hill  
Legislative Analyst

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Michael C. Genest  
Director of Finance