Consumer Class Actions in the Wake of *Daugherty v. American Honda Motor Company*

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The Origins of Consumer Class Actions In California

The consumer class action definitively emerged in California with the publication of *Vazquez v. Superior Court*, taking its place as a vital tool in the "[p]rotection of unwary consumers from being duped by unscrupulous sellers." (*Vazquez v. Superior Court* (1971) 4 Cal. 3d 800, 808.) The California Supreme Court recognized in *Vazquez* that consumers are in much the same position as stockholders, whose rights to band together and seek redress for common injuries had been recognized decades before. (*Id.* at p. 807.) Whereas a seller stands to gain handsomely if it can leverage consumers' limited knowledge about its products into undeserved sales or a slightly higher price, a single victimized consumer lacks the resources, the knowledge, or the financial incentive to combat exploitive business practices through the legal process. Allowing consumers to proceed collectively through a class action levels not only the playing field in the courtroom but in the marketplace as well. As the *Vasquez* court noted, consumer class actions have the direct effect of facilitating legal claims that otherwise could not be pursued, but also generate several salutary by-products that may be even more important. (*Id.* at p. 808.) The potential for consumer retribution in the courtroom serves as a disincentive to those sellers who would indulge in unscrupulous practices, gives aid to legitimate business enterprises by curtailing illegitimate competition, and generally facilitates trust in the marketplace. (*Id.*) For an economic system, like ours, that depends so heavily on transparency and accountability, an effective check against abuses in the consumer marketplace is invaluable. It is small wonder that the right to seek class action relief in consumer cases has been extolled by California courts for the more than thirty years. (*Am. Online v. Superior Court* (2001) 90 Cal.App.4th 1, 17.)

The Importance of Consumer Expectations

Consumer class actions depend heavily for their effectiveness on the collective power offered by the class action procedure, but just as heavily on the substantive law to which the class action procedure is applied. Most consumer class actions in California proceed under the Consumers Legal Remedies Act (CLRA) and/or the Unfair Competition Law (UCL). (Civ. Code § 1750, et seq.; Bus. & Prof. Code § 17200, et seq.) While different in important respects that will not be examined in detail here, both consumer protection statutes owe their strength to their flexibility. The CLRA prohibits a wide variety of "unfair methods of competition and unfair or deceptive acts or practices," which are themselves defined broadly and intended to be liberally construed. (See Civ. Code §§ 1770(a)(1)-(23), 1760.[1]) The UCL takes a different approach, foregoing a list of prohibited practices for a general ban of *any* "unlawful, unfair or fraudulent business act or practice." (Bus. & Prof. Code § 17200.) As the California Supreme Court explained in speaking of the UCL, but it could just as easily have been speaking of the CLRA, the statute is "intentionally framed in its broad, sweeping language, precisely to enable judicial tribunals to deal with the innumerable new schemes which the fertility of man's invention would contrive." (*Cel-Tech Communications v. L.A. Cellular Tel. Co.* (1999) 20 Cal.4th 163, 181.)

California courts have endeavored to achieve in practice the flexibility the Legislature desired for the UCL and CLRA in theory, and one of their primary tools has been the "reasonable consumer" test. Under the reasonable consumer test, the finder of fact does not evaluate the defendants' behavior from the vantage point of a specific person, but instead asks whether a reasonable consumer is likely to be deceived or misled. (See *Williams v. Gerber Prods. Co.* (2008) 523 F.3d 934, 938; *Lavie v. Procter & Gamble Co.* (2003) 105 Cal.App.4th 496, 506-507 (unless conduct targets a particular disadvantaged group, it is judged by the effect it would have on a reasonable consumer).) Behavior that has the "capacity, likelihood or tendency to deceive or confuse the public" will therefore run afoul of the UCL and/or CLRA; the behavior may be enjoined and victimized consumers compensated. (*Williams, supra*, 523 F.3d at p. 938.)

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A judicial approach based on a reasonable consumer's expectations squares well with the market-leveling function of consumer class actions. Surprises disrupt the functioning of efficient markets, as the recent financial market meltdown has painfully demonstrated. By incentivizing sellers to comport their business with consumer expectations, the UCL and CLRA avoid surprises in the consumer marketplace that, if unchecked, would result in inefficient allocation of consumer resources and undermine consumer trust – i.e., consumers buying products they would not have otherwise bought had they known the truth. By asking whether a reasonable consumer would be deceived in the context of a consumer class action, courts thus are taking a pragmatic approach to the more theoretical question of whether the challenged behavior is unfair to consumers and to competition for consumer dollars.

The *Daugherty* Approach

Daugherty v. Honda Motor Company (2006) 144 Cal.App.4th 824, has changed the way many courts have been assessing consumer expectations under the UCL and CLRA, bringing warranty contracts into the equation for the first time.

The plaintiffs in *Daugherty* were owners of Honda Accords and Preludes manufactured between 1990-1997. Plaintiffs alleged that an oil seal in their vehicles' engines was not properly secured, which over time causes oil leaks, contamination of nearby engine parts, and, in severe cases, total engine failure. (*Id*. at p. 827.) Plaintiffs further alleged that Honda knew of the oil seal defect in its vehicles when it was selling them to class members. (*Id*. at 828.) Finally, plaintiffs alleged that although Honda designed a retainer bracket to maintain the oil seal in its proper position, and, with respect to certain vehicles, offered to install the retainer bracket free of charge, to repair any engine damage caused by the defect, and to provide reimbursement for previous repair costs, Honda failed to provide the same assistance to plaintiffs and the consumer class they sought to represent. (*Id*.) Plaintiffs brought claims against Honda under warranty law for failing to repair the defective oil seal in their engines, and under the UCL and CLRA for failing to disclose known material facts at the time of sale.

The express warranty that came with plaintiffs' vehicles included Honda's promise to "repair or replace any part that is defective in material or workmanship under normal use" for a term of three years or 36,000 miles, whichever came first. (*Id.* at p. 830.) The *Daugherty* court was thus faced with an issue of contract interpretation: by contracting to repair or replace a defective part within three years or 36,000 miles, did Honda contract to only repair or replace defective parts that actually *failed* within that time period.[2] Plaintiffs argued that "because the language of the warranty did not state that the defect must be 'found,' 'discovered' or 'manifest' during the warranty period, the warranty covers any defect that 'exists' during the warranty period." (*Id.* at pp. 831-832.) Finding no California law on point, the *Daugherty* court agreed with the concerns of other jurisdictions that such an interpretation could be stretched to create a lifetime warranty, as almost all product failures might be attributed to some latent defect that existed within the warranty period. (*Id.* at pp. 830-831.) *Daugherty* thus held that, as a matter of law, an express warranty only applies to failures that manifest themselves within the warranty period, and affirmed the trial court's dismissal of plaintiffs' warranty claims on demurrer. (*Id*. at pp. 830, 832-833.)

While the wisdom of *Daugherty*'s general rule of warranty contract interpretation is itself fodder for debate,[3] what is of greater interest – at least for the purpose of this article – is what the *Daugherty* court did next. In considering plaintiffs' claims under the CLRA and UCL on demurrer, the court held, also as a matter of law, that in light of Honda's warranty, "the only expectation buyers could have had about [Honda's] engine was that it would function properly for the length of Honda's express warranty." (*Id*. at p. 838.) Accordingly, a reasonable consumer could not be mislead or deceived by Honda's alleged conduct – essentially, selling vehicles that it knew were defective – if the vehicle performed for three years or 36,000 miles.

Numerous courts have followed *Daugherty*'s approach in dealing with consumer class actions over the past year. In *Long v. Hewlett-Packard* (N.D. Cal. 2007) U.S. Dist. LEXIS 79262, for example, HP allegedly sold the consumer class Pavilion notebook computers with a display inverter that it knew to be problematic, as shown by its internal reports, troubleshooting, and risk assessments. (*Id.* at p. *3.) The named plaintiff's Pavilion screen went dark within the warranty period because of a failed inverter and was replaced by HP with yet another defective inverter; when that inverter failed four months later, HP refused to replace it again because the computer was no longer under warranty. (*Id.* at p. *4.) The court cited *Daugherty* in granting defendants' motion to dismiss the UCL and CLRA claims, holding that "a consumer's only reasonable expectation was that the Pavilions would function properly for the duration of HP's limited one-year warranty." (*Id.* at p. *24.)

Similarly, in *Oestreicher v. Alienware* (N. D. Cal. 2008) 544 F. Supp. 2d 964, the plaintiff alleged that Alienware knew that its computers had an inadequate heat management system that was causing its computers to overheat and fail prematurely, but sold them anyway and without telling consumers. (*Id*. at p. 967) Citing *Daugherty*, the court dismissed the putative consumer class action on a motion to dismiss, finding that the plaintiff had failed to allege his computer had failed within Alienware's three-month warranty: "*Daugherty* expressly rejected the notion that a manufacturer can be liable under the CLRA for failure to disclose a defect that manifests itself after expiration of the warranty period." (*Id.* at p. 969.)

The Drawbacks of *Daugherty*

While it may make some intuitive sense to evaluate consumer expectations with the limits of the warranty in mind, if taken too far, that approach could undermine the efficacy of California's consumer protection laws, which depend on actual, empirical consumer expectations.

In particular, *Daugherty*'s holding that "the only expectation buyers could have had about [Honda's] engine was that it would function properly for the length of Honda's express warranty," should not be mechanically applied without regard to the facts of a particular case. Consumers purchasing a given product rely on a wide variety of expectations. (See, e.g., *Baggett*

v. Hewlett-Packard Co. (C.D. Cal. 2007) 2007 U.S. Dist. LEXIS 97642, at *9 [consumers had a reasonable expectation they would be able to use all the ink in their HP printer cartridges]; *Williams, supra,* 523 F.3d at p. 939 [consumers could expect that a product's ingredients were all natural].) Included among these assumptions is that when the seller is offering a warranty with its product, it is merely offering to repair *unexpected* design or manufacturing flaws, and is not aware of any inherent problems with the product, otherwise it would tell consumers or would not sell the product. (See *Chamberlan v. Ford Motor Co.* (N.D. Cal. 2005) 369 F. Supp. 2d 1138, 1145 [consumers implicitly assume that a vehicle's manifolds will last the life of the engine]; *Mass. Mut. Life Ins. Co. v. Superior Court* (2002) 97 Cal.App.4th 1282, 1291 [a seller's own conclusions about its product can be important to a reasonable consumer and its failure to disclose that information misleading].)

A rigid, judicially-mandated rule that consumers cannot expect anything other than that the product will last for the term of the warranty would run contrary to market realities and ultimately harm the consumer markets. Sellers would have less incentive to comport their business practices with actual consumer expectations, and the wary consumer would have little reason to buy with confidence. Any deceit arising at or around the point of sale that is discovered after the warranty period – which could conceivably be as short or as long as the seller desired – would be subject to the rule of *caveat emptor*, restoring all the iniquities of knowledge and accountability that *Vasquez* long ago recognized was detrimental to efficient competition and a fair marketplace.

The Future Impact of *Daugherty*

The future impact of *Daugherty*, and in many ways the future impact of consumer class actions in California, depends on how future courts address at least two principal avenues by which *Daugherty* can be distinguished.

First, the conclusions *Daugherty* reached about consumer expectations in that case were made in the absence of specific allegations to the contrary. (See *Falk v. General Motors Corp.* (N.D. Cal. 2007) 496 F.Supp.2d 1088, 1096.) *Daugherty* may thus prove to be an example of the "rare situation" in which consumer protection claims could be resolved at the pleading stage. (*Williams, supra*, 523 F.3d at p. 939.) Ordinarily, whether the alleged conduct is likely to deceive a reasonable consumer is a question of fact that requires "consideration and weighing of evidence from both sides" and should not be resolved on the pleadings. (*Linear Technology Corp. v. Applied Materials, Inc.* (2007) 152 Cal.App.4th 115, 134-35.) In the wake of *Daugherty*, however, a number of recent cases have relied on *Daugherty*'s reasoning to dismiss consumer class actions at the pleadings stage, and it remains to be seen if that trend will continue. (See *Long, supra,* U.S. Dist. LEXIS 79262; *Oestreicher, supra,* 544 F.Supp.2d 964; *Hoey v. Sony Electronics, Inc.* (N.D. Cal. 2007) 515 F.Supp.2d 1099.)

To fulfill the consumer protection laws' purpose of preserving fair competition and efficient behavior in the consumer marketplace, resolution of UCL and CLRA claims should be based on evidence of actual consumer expectations. Thus, only when the plaintiff cannot plead or adduce any evidence should it be concluded that consumers had no expectation beyond that stated in the seller's warranty. A good example is *Clemens v. DaimlerChrysler* (9th Cir. 2008) 534 F.3d 1017, where the court only reached the holding of *Daugherty* after finding that while "[t]he UCL would permit Clemens to offer additional evidence of consumer expectations," he had not, and so "had not produced sufficient evidence that [Daimler-Chrysler's] failure to disclose [a propensity for oil leaks] was likely to deceive a reasonable consumer." (*Id.* at p. 1026.)

Second, *Daugherty* recognizes an exception to its holding where a seller omits facts it was obligated to disclose. (*Daugherty, supra,* 144 Cal.App.4th at p. 835.) *Daugherty* itself construed this duty rather narrowly, and there remains disagreement on how broadly the duty to disclose should be construed. (See *Oestreicher, supra,* 544 F.Supp.2d at p. 972 [noting split among courts].) The cases agree that a seller must disclose facts that are contrary to statements it actually made, although so far they tend to require those statements be directly contradictory and reject more general statements (which might nonetheless be perceived by a reasonable consumer as misleading in light of the withheld information). (See *id.* at p. 973; *Long, supra,* U.S. Dist. LEXIS 79262, at pp. *21-22.) The cases also agree that even where no representation has been made, a seller may not withhold facts relating to product safety. (See *Oestreicher, supra,* 544 F.Supp.2d at p. 969.) Some cases recognize that the safety exception to *Daugherty*'s holding should extend to *any* material facts within the seller's exclusive knowledge, and that materiality should be judged using the expectations of a reasonable consumer and his behavior. (*Id.* at p. 971, citing *Falk, supra,* 496 F.Supp.2d at p. 1095.) That sort of an inquiry, if consistently undertaken by courts, would alleviate many of the drawbacks of *Daugherty* discussed above. *Daugherty* memorably opined, in language that has since been frequently quoted to support dismissals of consumer class actions at the pleadings stage, "We cannot agree that a failure to disclose a fact one has no affirmative duty to disclose is 'likely to deceive' anyone." An approach that instead asks whether a reasonable consumer is likely to be deceived in the absence of certain information, and then decides whether a seller should have a duty to disclose, will go farther toward preserving the flexibility of California's consumer protection statutes and realizing the vision of *Vasquez*. ■

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[1] Civil Code section 1760 specifies that the CLRA "shall be liberally construed and applied to promote its underlying purposes, which are to protect consumers against unfair and deceptive business practices and to provide efficient and economical procedures to secure such protection."

[2] In contrast, Honda's warranty promise pertaining to its muffler specified that Honda would only replace the muffler during the applicable warranty period if it "*fails* due to a defect." (emphasis added).

[3] Another California Court of Appeal has recently suggested that warranty contracts can be construed to cover not only defects that result in malfunctions during the stated warranty period, but also defects that are substantially certain to result in malfunctions during the product's useful life. (See *Hewlett-Packard Co. v. Superior Court* (2008) 167 Cal.App.4th 87, 96.)