IDEAS ON LIBERTY
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# How California's Consumer Laws Legalize Extortion

*by Steven Greenhut*

Barry Zanck, owner of a small mortgage company in Newport Beach, California, says he had never had a complaint lodged against his business. So he was shocked when he was named, along with a dozen other mortgage-related companies, in lawsuits filed last year by a prominent southern California law firm.

"The unlawful, unfair and fraudulent business practices and false and misleading advertising of defendants . . . present a continuing threat to members of the public," the lawsuit stated. "Plaintiff and other members of the general public have no other adequate remedy of law. As a direct and proximate result of the aforementioned acts, defendants received and continue to hold ill-gotten gains belonging to members of the public."

What had Zanck done?

His company had run a series of advertisements in a real-estate advertising magazine that showed properties for sale along with approximate monthly payments, including principal and interest. At the bottom he explained the basic terms of the loan: 10 percent down at 7 percent with 7.388 percent APR. But Zanck didn't print the length of the loan—30 years—and didn't include his mortgage-license number, as required under federal lending regulations. Other companies named in the lawsuit had left out similar information in classified advertisements.

Soon after the lawsuit was filed, Zanck's attorney received a settlement offer from the law firm that filed the suit. The information it included was frightening: "Conceivably, your client could be required to return all profits earned over the past four years resulting from a violative advertisement." The law firm was willing to make the whole problem go away for a mere $13,000.

Zanck is a feisty guy and a successful businessman. Unlike many who fear the legal system and lack the resources to fight back, he decided to defend himself. When his attorney began playing hardball, the price of a settlement started dropping. But Zanck wasn't eager to settle. The matter ended up in court—something that rarely happens in cases like this. (He believes the plaintiff attorneys wanted to teach him a lesson after the *Orange County Register* wrote an editorial about the case.)

The judge ruled in Zanck's favor, saying, "I'm looking at those ads. I see them all the time. I'm a reasonable consumer. And if I picked up the phone and called and asked about those things . . . he would tell us what the price would be. . . . So judgment for the defense. There will be no injunction because there's nothing to enjoin."

Zanck's "victory" cost more than $10,000.

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## Judging Regulations

It's an old saying, but it's generally true: If you want to gauge the true effect of any proposed law or government regulation, ignore the promises and expect the exact opposite to come true. The War on Poverty? Figure it will cause government dependency and exacerbate poverty. The War on Terror? Figure it will create new grievances that lead to more terrorist attacks.

This basic principle is playing out today in California, as the state's consumer laws, designed to protect the "little guy" from unfair business practices, are providing unethical predators the tools to unfairly take advantage of those least able to protect themselves. The biggest losers are the consumers, who must pay more for products they wish to buy, and the small mom-and-pop businesses that are viewed as easy marks by entrepreneurial trial lawyers who exploit the state's unfair-business-practices law for private gain.

"They've sued bowling alleys, alleging that 'ladies night' discounts are unfair to men," reported the *Los Angeles Times*. "They've sued software manufacturers on the ground that their bulky packaging tricks consumers into thinking they're getting more than a small computer disk. . . . A small band of litigators has struck gold in the fine print of laws intended to protect Californians from hazardous chemicals, discrimination and business scams. They blanket the business world with hundreds of lawsuits at a time, often making claims that appear fanciful, even absurd."

Most Americans are familiar with the well-publicized abuses of the legal system. In January, a judge ruled that McDonald's could not be held liable for the obesity of children who—stop me before I eat again—couldn't help but stuff their faces with Big Macs. Despite the sanity of the ruling, this insane lawsuit was of a type that has become increasingly common. Companies are sued these days for the misuse, or overuse, of their products by consumers even though there is nothing wrong with the products themselves.

The basic goal: Score big monetary awards from gullible juries, who are moved by sob stories rather than by traditional legal theories. What's less commonly known is a form of legal abuse—legal extortion, really—in which the smallest businesses are targeted by trial attorneys for small sums of money. It's the low-rent version of the process described above by the *Times*.

Instead of seeking multimillion-dollar settlements, trial attorneys typically seek a few thousand dollars from scores of businesses at a time. Their goal isn't to get before a jury, but to exact settlements from small companies that know it is too costly to fight. It's cheaper to pay $5,000 in extortion than it is to hire an attorney and spend $20,000 to $30,000 to "win" in court.

One tool used to hammer businessmen is Section 17200 of California's Business and Professions Code, which deals with so-called unfair business practices. "Any person who engages, has engaged, or proposes to engage in unfair competition may be enjoined in any court of competent jurisdiction. The court may make such orders or judgments, including the appointment of a receiver, as may be necessary to prevent the use or employment by any person of any practice which constitutes unfair competition."

The section is vague about what unfair competition is, but it includes being in violation of any law. So Zanck—being technically in violation of federal advertising standards—could be said to have been engaged in unfair competition. But one needn't be in violation of any law to be accused of an unfair business practice.

At least 200 immigrant-owned nail salons in the Los Angeles area have been accused of unfair business practices by enterprising lawyers because the salons reuse nail polish on different customers. Never mind that there's no evidence showing harm from this perfectly legal practice and that the state's Bureau of Barbering and Cosmetology says there's nothing wrong with it.

In January, Los Angeles-area restaurant owners were sued for unfair business practices after their county health-department ratings on cleanliness and other health standards were downgraded from "A" to "B."

In one case the cause of the lower grade was a malfunctioning refrigerator, which, according to the owners, was quickly fixed. But that one mistake led to a lawsuit from a Beverly Hills firm that specializes in 17200 actions. A restaurant with a "B" grade is allowed to keep operating, but to attorneys looking for shakedown opportunities, it's enough reason to file suit.

Some official state websites list regulatory violations by businesses, such as expiration of licenses. Attorneys scour those sites for companies to sue. It's another example of how the regulatory state leads to unfair practices against law-abiding citizens. It's one thing to be sued for harming consumers, quite another to be sued because you didn't cross every "t" on reams of state-mandated paperwork.

## Basis of Tort Law

The tort system is flawed, but most people have no problem with the basic idea underlying it. If through negligence an individual harms another person, that individual should be forced to pay whatever damages the negligence caused.

Sell a consumer a toaster that, instead of toasting, blows up in the consumer's face, and the tort system is designed to provide redress. Most trial attorneys and consumer activists seem to believe that were it not for potential lawsuits and consumer statutes, companies wouldn't care if their products maimed or killed customers. They forget that any toaster maker that provided singed hair instead of nicely browned bagels wouldn't be in business very long.

But these days suits are filed against companies even though their products function properly. For example, a gun maker was sued after a man shot up a San Francisco office building; the suit was based on the dubious idea that the company had marketed its guns to criminals. In a similar vein, the parents of obese children didn't sue McDonald's because the burgers were adulterated; they sued because their kids ate too many of them. This clearly was an abuse of the process.

The 17200 lawsuits take the abuse one step further. At least in the cases just mentioned there were actually injured parties (though they weren't injured by the defendants). In the 17200 lawsuits there literally are no victims. No prospective homebuyer complained that Zanck's advertisements lacked all the necessary information required by federal regulation. No customer of the nail salons complained that they caught a disease from the reused polish. No diner claimed to have gotten ill at the restaurants with the "B" rating.

In the late 1970s the plaintiffs' bar managed to insert a provision into the business and professions code that is the heart of the extortion-lawsuit racket today. The original law allowed the attorney general, local district attorneys, and city attorneys in larger cities to use 17200 to file lawsuits against businesses that were deemed to be using abusive or fraudulent tactics. But the amendment allowed any member of the public to serve as a plaintiff in a lawsuit, even if he had not been wronged by the defendant, and it allowed private attorneys to bring cases in the name of the public.

Although many other states have consumer statutes similar to 17200, only California has such glaring incentives for abuse.

In the Zanck case the plaintiff wouldn't say under oath why so many lawsuits had been filed in her name. She couldn't even say how many lawsuits there were. Such a plaintiff is the law firm's stooge. Sometimes a firm creates a small "consumer" organization to serve as a plaintiff; it might be nothing more than the wife of the attorney. Since anyone can be a plaintiff, the only reason to create an organization is for the public-relations value.

Because no one alleges any harm in these suits, the money received in the settlements goes straight to the law firm. Despite a settlement, other law firms can sue a company over the same alleged violation, and the same law firm can sue a company over another similar mistake.

## Repeat Victims

At a January hearing conducted by members of the state assembly in Santa Ana,

many owners of small companies said they had been repeat victims of the practice. The tactics often are crude, resembling the sort of shakedowns perpetrated by mobsters: pay now and the price is $3,000, but wait until Monday and it goes up to $8,000; we know your books aren't right, so if you don't pay up we'll make you open your tax records, and we might contact the IRS in the process.

The California Bar Association is investigating this abusive practice, but few observers believe that the plaintiffs' bar, which gives seminars on how to build a law practice based on 17200 lawsuits, will do anything to put an end to this profit center. A few legislators are angry about the problem, especially because of the harm it's doing to immigrant businessmen, but state legislators rarely say no to the trial-lawyer lobby.

Attorney General Bill Lockyer has criticized the abuses, but consumer "protection" has been his forte, and his representative at the Santa Ana hearing was hooted down by angry businessmen because he spent his entire presentation lauding 17200 for allowing the state to go after miscreants such as—he really said this—Joe Camel.

To supporters of the free market, stories of entrepreneurship do the heart good. Yet in California today, traditional entrepreneurs are leaving the state to escape a crushing tax burden and a regulatory system that treats them like criminals. In their place are legal entrepreneurs who scour statutes to find ways to make profits on the backs of legitimate businesses. Instead of creating jobs and opportunities, these attorneys destroy them.

It's the antithesis of freedom and enterprise. Companies that actually harm people need to be held accountable. But when the legal system strays from its basic mission of sorting through grievances based on traditional legal precepts, the result can be harrowing. Instead of helping an individual to have his day in court, this system makes him vulnerable to the ravages of legal sharks.

It's the opposite of what consumer protection is theoretically about. Then again, given the long history of government regulation, why am I surprised? □

## In Memoriam
## Clarence B. Carson, 1925–2003

As this issue was going to press we received word of the death of historian Clarence Carson, one of our longtime contributing editors.

Clarence wrote more than 225 articles for this magazine and was the author of *A Basic History of the United States* (6 volumes) and many other books. A tribute to his life and work will appear in a future issue.

He is survived by his wife, Myrtice Sears Carson, and two daughters and their husbands, Evelyn and Mike Mallory and Melissa and Mark Bean.