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FILED
Superior Court of California
County of San Francisco
JUN 15 2009
GORDON PARK-LI, Clerk
BY: 
Deputy Clerk

**SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF SAN FRANCISCO**

THE PEOPLE OF THE STATE OF CALIFORNIA,

Plaintiff,

v.

JTH TAX, INC. (D/B/A LIBERTY TAX SERVICE),

Defendant.

CGC-07-460778

STATEMENT OF DECISION

JTH Tax, Inc. d/b/a Liberty Tax Service (Liberty) provides tax preparation services, and offers (through its association with certain banks) certain loans to customers. The Attorney General has charged Liberty with violations of California's Unfair Competition Law and False Advertising Law. The Attorney General, also referred to as the People here, seeks penalties, restitution, and injunctive relief. For the reasons stated that relief is provided in the accompanying judgment and permanent injunction.

The Attorney General filed this lawsuit on February 26, 2007, and a bench trial was held

1 before me on various dates in October 2008. The trial was followed by extensive post trial
2 briefing including proposed statements of decision and objections to those. The final briefing was
3 concluded May 26, 2009, on which date the matter was deemed submitted.

4 In § I, I discuss the factual background, including Liberty's relationship with its
5 franchisees and with the banks with which it works to provide certain types of loans. I discuss
6 theories of indirect liability and explore Liberty's substantive liability under the theories
7 presented by the Attorney General in § II. Remedies are discussed in § III.
8

9
10 **I. FACTUAL BACKGROUND AND CLAIMS**

11
12 Liberty is a Delaware corporation with headquarters in Virginia Beach, Virginia.
13 Complaint at 1:24-28 (admitted in Answer). Liberty provides tax preparation services, e-filing,
14 refund anticipation loans (RALs), and electronic refund checks (ERCs)¹ to consumers through
15 more than 2,000 franchised and company-owned stores throughout California and the United
16 States, all of which do business under the name Liberty Tax Service. Complaint at 1:26-28 and
17 2:4-6 (admitted in Answer); *see also, e.g.*, Exhibit (Ex.) 15 at 84859. As of April 30, 2007,
18 Liberty had 195 franchised stores in California, up from nine (9) at the end of fiscal 2002, its first
19 year of doing business in the State. Ex.17 at 23784 and Ex.13 at 100901. Liberty had two
20 company-owned stores in California in 2005-2006. Ex.17 at 23785.

21 **A. RALs and ERCs**

22 This case concerns Liberty's practices surrounding the sale of RALs and ERCs. A RAL is
23 a short-term loan secured by a customer's anticipated refund and issued by a third-party bank.
24 The loan amount is based on the anticipated refund minus all fees, including a finance charge, the
25 tax preparation fees, and an "account" or "handling" fee, and is usually disbursed in one to two
26 days. *E.g.*, Ex.275 at 23:1-18 and Ex.34 at 18122. In contrast, the IRS generally takes 8-14 days

27 ¹ ERCs are also called "refund transfers" or RTs, or "refund anticipation checks" or
28 RACs, depending on the bank involved.

1 to process a tax refund by direct deposit into the taxpayer's bank account, or 3-4 weeks by check
2 sent through the mail.

3 The RAL applications used in Liberty stores authorize the bank to set up a temporary,
4 special purpose "account" in the customer's name for the sole purpose of receiving the
5 customer's refund directly from the IRS. When the customer's tax return is sent to the IRS, this
6 special purpose account is designated as the destination to which the refund should be directed.
7 Once the IRS is notified, the destination for the tax refund cannot be changed. Complaint at 4:15-
8 20 (admitted in Answer). When the refund arrives from the IRS in the account, the lender repays
9 itself out of the refund. If for any reason the client's refund is not deposited into the temporary
10 "account" or is less than expected, the consumer is still held liable for the full amount of the loan.
11 Complaint at 5:24-26 (admitted in Answer).

12 With an ERC, as with a RAL, the bank sets up a temporary "account" to receive the
13 customer's refund. After the refund is disbursed by the IRS, *see, e.g.*, Exs.122-24, 132-33, and
14 135 (RAL/ERC applications), the bank deducts the tax return preparation fees, the "account" or
15 "handling" fee, and any other applicable charges, and pays the remainder to the customer
16 (typically) in the form of a personal check that can be picked up at the Liberty office. *E.g.*, Ex.34
17 at 18127 and Ex.43 at 28673.

18 A substantial part of Liberty's business and its growth in recent years has stemmed from the
19 sale of RALs and ERCs to its tax preparation customers. In 2007, Liberty earned more than
20 \$11.6 million in revenue from the sale of RALs and ERCs, accounting for 17.5 percent of its total
21 revenues nationwide. Ex.17 at 23764. In California, RALs and ERCs have become increasingly
22 important to Liberty's revenues, accounting for 22 percent of revenues in 2007, up from 8.28
23 percent in 2005. Trial Transcript (Tr.) at 414:11-416:1. Consistent with this upward trend, in
24 2006 and 2007 roughly 35 percent of Liberty's customers purchased either a RAL or an ERC, up
25 from 15 percent in 2002. Ex.301 (responses to special interrogatories 10, 12-13).

26 Liberty benefits from sales of RALs and ERCs both directly and indirectly. From 2002-
27 2005, it received 65 percent of the revenues on RALs and ERCs issued by First Bank of Delaware
28 (FBOD) to Liberty customers. Ex.2 at 100004. And, from 2006-2008, when Santa Barbara Bank

1 & Trust ("SBBT") was Liberty's exclusive supplier of RALs and ERCs in California, Liberty
2 received a flat amount for each RAL and ERC. Exs.110 and 111; *see also* Tr. at 422:28-423:7;
3 423:26-424:4; 425:1-7; and 426:22-24.

4 Sales of RALs and ERCs also benefit Liberty indirectly because they make its tax
5 preparation services more affordable. Liberty has a high percentage of lower-income customers.
6 Ex.301 (special interrogatory response number 18), and Liberty acknowledges that many of its
7 customers cannot afford to pay for tax preparation out-of-pocket. Ex.25 at 3.² But, as Liberty's
8 sales documents indicate, the key selling points for RALs and ERCs is there are "no up front
9 costs" for the customer. Ex.141 ("Product Information Sheets"); *see also* Ex.45 at 29426. The
10 tax preparation fees are paid out of the loan amount in the case of a RAL and out of the refund in
11 the case of an ERC. This expands the market for Liberty's tax preparation services and, by
12 extension, the franchisees fees and royalties collected by Liberty from its franchisees. Tr. at
13 403:26-407:2 and 526:8-527:16. As Mike Piper, Liberty's chief financial officer testified, "Well,
14 if we didn't offer bank products, customers – a lot of customers wouldn't come in our doors."
15 *Id.* at 525:26-527:15.

16 The advertisements at issue in this case establish that, among other things, Liberty relies on
17 promises of speedy cash to bring in customers. Whether deceptive or not, the loan programs are
18 an important focus of Liberty's marketing efforts. Liberty provides substantial assistance to the
19 banks in marketing and soliciting these products and its receipt of consequent benefits, among
20 other reasons, makes it fair to hold Liberty liable for the violations of law described below.

21 **B. Liberty's Relationship With Its Franchisees**

22 Liberty's relations with its franchisees are governed in large part by a standard franchise
23 agreement and an Operations Manual. Each franchise owner must execute a franchise agreement
24 with Liberty, and must comply with the policies and procedures set out in the Operations Manual.
25 *E.g.*, Ex.13 at 100916 and Ex.17 at 23954.

26 _____
27 ² In 2006, Liberty franchises charged an average of \$147.62 for tax preparation. Ex. 18 at
28 24161. Liberty calculated this average using tax preparation fees charged by 702 out of 1,649
franchised offices in 2006. *Id.*

1 The Operations Manual is a “detailed extension” of the franchise agreement, *id.*, and
2 prescribes in minute detail the manner and means by which the franchisees do business. *See*
3 *generally* Exs.38-45 (Operations Manuals from 2002-2008); *see also* Tr. at 583 (the Operations
4 Manual “tells the franchisees everything, really, they need to know to run their business”).
5 Compliance with Liberty’s Operations Manual is mandatory. Liberty’s Post-Trial Brief at 35; *see*
6 *also, e.g.*, Ex.13 at 100916 and Ex.17 at 23954.

7 Liberty reserves the right to unilaterally modify the Operations Manual at any time to adjust
8 for “competitive changes, technological advancements, legal requirements and attempts to
9 improve in the marketplace.” Ex.13 at 100916 and Ex.17 at 23954. Breaches of the franchise
10 agreement or the Operations Manual, including failing to use the RALs and ERCs supplied by
11 Liberty’s chosen lender(s), could result in termination of the franchise. *E.g.*, Ex.13 at 100917-
12 100918 and Ex.17 at 23955-23956.

13 Liberty’s franchise documents provide, *inter alia*, that:

- 14 • Liberty must approve the site of each franchised office (*e.g.*, Ex.13 at 10887, 100913, and
15 10992; Ex.17 at 23762, 23768, and 23951; Ex.41 at 27590, 27735; and Ex.45 at 29297);
- 16 • Franchisees must attend Liberty training courses (*e.g.*, Ex.13 at 100891-100892, 100913,
17 100915; Ex.17 at 23767-23768, 23951-23952);
- 18 • Franchisees must hold at least one “tax school” every year with a minimum student
19 enrollment as dictated by Liberty for employee recruitment purposes (*e.g.*, Ex.13 at
20 100916; Ex.43 at 28593-28594; and Ex.45 at 29537);
- 21 • Liberty may enter any franchised office during normal business hours to inspect operations
22 or inspect and copy any business records, including customer receipts; alternatively,
23 Liberty may request copies of any records, and the franchisee must mail them to Liberty at
24 her own expense within five days (*e.g.*, Ex.13 at 100917 and Ex.17 at 23955);
- 25 • Franchisees must send Liberty gross receipt reports and profit and loss statements in the
26 manner and form and at the times specified by Liberty (*e.g.* Ex.13 at 100917; Ex.17 at
27 23955);

28

- 1 • Liberty must approve each franchisee's general manager, and the general manager may be
2 required to attend Liberty training courses (*e.g.*, Ex.13 at 100896, 100916; Ex.17 at
3 23778, 23952, 23954);
- 4 • Franchisees must commit to maintaining Liberty's extensive filing system as well as the
5 setup for the tax return processing center (*e.g.*, Ex.42 at 28207-28226; Ex.45 at 29590-
6 29606);
- 7 • Franchisees may not offer any products or services without first obtaining Liberty's written
8 consent (*e.g.*, Ex.13 at 100887; Ex.17 at 23762; Ex.45 at 29290-29291);
- 9 • Liberty has the right to resolve disputes directly with franchise customers and bill the
10 franchisee for any refunds that Liberty issues (*e.g.*, Ex.15 at 84968 and Ex.17 at 23950);
- 11 • Liberty exercises substantial control over franchisee pricing by requiring franchisees to
12 offer a minimum number of free tax returns each season and by controlling the dollar or
13 percentage amounts of discounts that franchisees are allowed to offer depending on the
14 time of the year (*e.g.*, Ex.290 at 64:18-65:8, 68:7-9; and 49:25-51:24; *see also* Ex.252);
15 Liberty also reserves to itself the right to prohibit franchisees from imposing fees
16 attendant to the offering of RALs and ERCs, including the RAL "application fees" at issue
17 in this case;
- 18 • Liberty determines the opening date and minimum operating hours of its franchised stores
19 (*e.g.*, Ex.13 at 100895, 100897, 100915; Ex.17 at 23775, 23778-23779, 23953; Ex.38 at
20 26577; Ex.45 at 29407);
- 21 • Franchisees must purchase their computers from Liberty's approved vendor and use
22 Liberty's approved tax preparation software (*e.g.* Ex.13 100887 and 100914-100915;
23 Ex.17 at 23761, 23763-23764, 23774-23775, 23779, and 23953; Ex.38 at 26577; and
24 Ex.45 at 29407);
- 25 • Liberty may run programs on its franchisees' computers, thus allowing Liberty access to
26 electronically review whatever data is contained in each franchisee's computer system
27 (*e.g.*, Ex.13 at 100917 and Ex.17 at 23955);
- 28

- 1 • Liberty provides its franchisees scripted answers and information to be provided to
2 customers (e.g., Ex.42 at 28074-28075 and Ex.45 at 29426-29427);
- 3 • Day-to-day tasks such as how to open the store, when to clean the bathrooms, whether to
4 pay for employees' lunch breaks, when to answer the phone, and even reservation of the
5 right to specify the make and model of furniture used by franchisees, are covered by the
6 Operations Manual (e.g., Ex.13 at 10887-10888; Ex.16 at 14941; Ex.17 at 23763, 23767,
7 and 23952; Ex.38 at 26638, 26757; Ex.43 at 28490, 28494, and 28510-28511; and Ex.45
8 at 29442-29443, 29464); and
- 9 • Liberty conducts compliance reviews to ensure its operational policies and procedures are
10 being followed.

11 With respect to advertising, Liberty's franchise documents require that any and all
12 franchisee advertising be submitted to Liberty's marketing department for its review and approval
13 prior to being used. Liberty testified that starting with the 2009 tax season it will no longer
14 permit franchisees to create their own advertising for submission to the marketing department.
15 Franchisees are now only supposed to use advertising content made available through Liberty's
16 centralized "Ad Builder" system. (As of the time of trial, RAL ads were not yet part of this
17 system.)

18 Liberty uses its advertising approval rights not just to protect the integrity of its marks, but
19 also to exert control over unrelated matters such as:

- 20 • The discounts franchisees can offer depending on the time of year;³
- 21 • The products and services that franchisees can advertise depending on the time of year, and
22 strategies for soliciting particular demographic groups;⁴

23 ³ Ex. 290 [O'Gorman Depo.] at 49:24-51:24 ["I wouldn't allow a franchisee to run a \$50
24 off coupon in January"; corporate permits deep discount offers only late in the tax season "when
25 the traffic is not as heavy."]; Ex. 289 [Schuster Depo.] at 110:7-111:7 ["We have three different
26 [discounts]. [Franchisees] can choose 30 percent off, 50 percent off last year, or free. And
27 sometimes we let them do something else if they want."]; *id.* at 117:16-24; 120:24-121:10; and
150:1-10; Ex. 215 [dictating change in franchisee's preferred discount, despite complaint by
franchisee that "I have set my pricing up for MY ads; I don't do 30% off I do \$50.off"], Ex. 227
at 30671 [email to franchisee regarding "changes that must be made . . . Change 50% off to \$20
off."].)

28 ⁴ Ex. 219 at 30472 (email to franchisee rejecting ad because, in part "Wrong offer for
(continued...)

- 1 • The price quotes for tax preparation services that franchisees can give out over the
2 telephone;⁵
- 3 • The number of free tax returns franchisees must offer each season, and when they must be
4 offered;⁶ and
- 5 • A franchisee's right to have its own website, even a Liberty-approved website.⁷

6 With respect to the offering and sale of RALs and ERCs, Liberty's franchise documents
7 provide that franchisees may only use a bank assigned by Liberty, and if Liberty has
8 arrangements with more than one bank Liberty selects which franchisee will use which bank.
9 Ex.13 at 100888 and 100916; Ex.17 at 23762-23763 and 23953; Ex.45 at 29286; and Ex.304
10 (response to request for admission 35). Since 2005, Liberty's standard franchise agreement has
11 required franchise owners to offer RALs and ERCs to customers. *E.g.*, Ex.15 at 84971.

12 In addition, Liberty controls all of the advertising and disclosures its franchisees must or
13 can use with respect to RALs and ERCs. Liberty requires its franchisees to "conduct their
14 business in full compliance with all agreements, guidelines and directives received from
15 [Liberty], including, without limitation: guidelines and directives pertaining to customer data
16 security, advertising, and disclosures; the franchisee's franchise agreement with [Liberty]; and the
17 documents prepared and/or utilized by First Bank of Delaware and [Liberty] in connection with
18 the offering and sale of bank products." Ex.304 (response to request for admissions 34). These
19 governing documents include but are not limited to Liberty's Operations Manuals and the so-
20 called "Bank Books." (Ex.281 at 62:22-63:16; 64:4-20; 70:19-71:5; and 71:19-72:2; *see also*
21 Exs.33-37.

22
23 (...continued)
24 early season . . ."); Ex. 221 at 30525 ("No this isn't approved. Cash in a Flash is used for really
25 early season customers . . . Hispanics should be brought in through the ITIN program.");
26 ⁵ *E.g.*, Ex. 42 at 28075 ("What will the charge be? Answer: During peak season you will
27 give a quote of 80% of your targeted net fee rounded up to the nearest 9 . . ."; Ex. 43 at 29427
28 (during peak season, "you will give a quote of 90% of your targeted net fee rounded up to the
nearest 9."))

⁶ Ex. 290 at 68:7-11; Ex. 513 at 20954; and Ex. 252 ("Do not issue any free return
coupons after 4/8.)

⁷ *See, e.g.*, Ex. 45 at 29448; Ex. 44 at 29008; and Ex. 43 at 28514-15.

1 Liberty also controls whether and how much franchisees may charge customers for
2 RAL/ERC-related services;⁸ controls whether and how much franchisees may be compensated
3 by the banks for offering RALs and ERCs (e.g., Ex.117); and requires that tax preparation fees,
4 rebates, or other monies paid to franchisees by the banks be routed first to accounts controlled by
5 Liberty, so that Liberty may deduct any amounts owed by the franchisee to Liberty. E.g., Ex.17
6 at 23951 and Ex.18 at 24194-95.

7 **C. Liberty's Relationship with the Banks**

8 Liberty is barred by the IRS from making loans directly to consumers. (Complaint at 3:27-
9 4:1 [admitted in Answer].) Consequently, the loans are

10 provided by lenders with which Liberty contracts. It is primarily Liberty, however,
11 not the lenders, that has advertised and promoted the loans. It is also Liberty that in
12 the course of providing its tax preparation service has offered the loans to its clients,
13 provided its clients the multi-page loan applications, filled out the applications, and
14 obtained the signed loan applications. Liberty has also delivered the loan applications
15 to the lender, and subsequently distributed the loan proceeds to most of its taxpayer
16 clients.

17 *Id.* at 4:1-7 (admitted in Answer).

18 As noted, Liberty only allows franchisees to offer RALs and ERCs supplied by banks that
19 have contracts with Liberty. First Bank of Delaware was Liberty's sole supplier of RALs and
20 ERCs in 2002, 2003, and 2005 in California. Ex.300 at 2 (key to lending banks by year). In
21 2004, all but nine of Liberty's California offices were assigned to FBOD. *Id.* From 2006-2008,
22 with the exception of a single store, Santa Barbara Bank & Trust (SBBT) was Liberty's exclusive
23 supplier of RALs and ERCs in California. *Id.*

24 The contracts between Liberty and FBOD and Liberty and SBBT are in evidence as
25 Exhibits 2 and 74, respectively. The contracts, *inter alia*, create a role for Liberty in the
26 collection of RAL-related debts, Ex.2 at 100006 (agreement between Liberty and FBOD to
27 provide "cooperation and assistance to each other" and to other RAL lenders in "collecting
28 delinquent RALs from applicants"); Ex.74 at 19273. See § II.C.2. *infra*.

⁸ Tr. at 436:7-18; 437:20-25 (prior to 2005, Liberty "permitted" its franchisees to charge
"application fees" to RAL customers; after the Attorney General opened his investigation, Liberty
"instructed" its franchisees to stop charging them; see also *id.* at 540:6 (starting in 2005, "We told
the franchisees not to charge that fee."); *id.* at 543:9-13 (same).

1
2 **D. The Claims at Issue**

3 The Complaint states two causes of action, one for violations of the Unfair Competition
4 Law (UCL), Business and Professions Code [B&P] § 17200, and one for violations of the False
5 Advertising Law (FAL), B&P § 17500. See Complaint at ¶¶ 45-48. The People's UCL cause of
6 action is predicated on several theories of liability, including but not limited to violations of state
7 and federal statutes, violations of the FAL, "fraudulent" conduct, and "unfair" conduct.⁹

8 At trial, the People sought relief based on some, but not all, of the liability theories pleaded
9 in the Complaint. The People sought relief based on:

- 10 • False and/or deceptive statements in violation of the FAL and the UCL;¹⁰
11 • Violations of B&P §§ 22253.1(a), which requires that any advertisement for a RAL state
12 "conspicuously" that (1) the product is a loan, (2) the name of the lender, and (3) that fees
13 and interest apply;¹¹
14

15
16 ⁹ The UCL prohibits "unfair competition," which it defines as any "unlawful, unfair or
17 fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising," as
18 well as "any act prohibited by" the FAL. B&P § 17200. The FAL, in turn, makes it unlawful for
19 any person to make or cause to be made any "statement" which the person knows or by the
20 exercise of reasonable care should know to be untrue or misleading in the course of selling or
21 disposing of any goods, services, or property. B&P §17500. The UCL's "unlawful" prong
22 "borrows" violations of other laws and makes those violations "independently actionable" as
23 unfair competition under the UCL. *Cel-Tech Comms., Inc. v. Los Angeles Cellular Tel. Co.*, 20
24 Cal.4th 163, 180 (1998), quoting *State Farm Fire & Casualty Co. v. Sup. Ct.*, 45 Cal.App.4th
25 1093, 1103 (1996). An "unlawful" business act or practice includes "anything that can properly
26 be called a business practice and that at the same time is forbidden by law." *Bank of the West v.*
27 *Sup. Ct.*, 2 Cal.4th 1254, 1266 (1992). A "fraudulent" act or practice is one that is "likely to
28 deceive" members of the public. *Chern v. Bank of America*, 15 Cal.3d 866, 876 (1976). An
"unfair practice" is one that, *inter alia*, "offends an established public policy." *People v. Casa*
Blanca Convalescent Homes, Inc., 159 Cal.App.3d 509, 530 (1984), but see discussion *infra* § II
(H).

¹⁰ Complaint at ¶¶ 32-33, 46, 46.a, 46.c., 48, and 48.a.

¹¹ These violations are not pleaded in the Complaint, but the People put Liberty on notice
well in advance of the trial through pre-trial discovery and its pre-trial brief that it intended to
seek relief based on alleged violations of Section 22253.1(a), the issue was fully and fairly
litigated, and there was no unfair surprise or prejudice to Liberty. *People v. Toomey*, 157
Cal.App.3d 1, 11 (1984); see also *People v. Custom Craft Carpets, Inc.*, 159 Cal.App.3d 676, 684
(1982) (although specific abuses were not expressly alleged in the Complaint, defendant was
"clearly apprised of the Attorney General's concern . . . during pre-trial discovery, and even filed
a brief addressing the issue . . ."). In addition, the Complaint states that the alleged violations of
(continued...)

- 1 • False, deceptive, or otherwise illegal advertising run by Liberty's franchisees, on the
- 2 grounds that Liberty's franchisees are its agents and/or that this advertising resulted from
- 3 Liberty's negligence;¹²
- 4 • Violations of state and federal fair debt collection practices laws and the Consumer Legal
- 5 Remedies Act, C.C. § 1770(a)(14), with respect to the collection of prior RAL debts;¹³
- 6 • Deceptive marketing of ERCs as a "convenience" product when in fact it is a form of
- 7 credit, i.e., a vehicle for financing the cost of tax preparation;¹⁴
- 8 • Violations of B&P § 17530.5, which specifies the form of consent that tax preparers must
- 9 obtain from their clients in order to share their confidential taxpayer information with
- 10 third-party banks for purposes of offering RALs and ERCs;¹⁵
- 11 • Violations of the California Credit Services Act, which requires persons or entities
- 12 providing "credit services," as defined, to register with the State before doing business in
- 13 California, and to comply with certain other requirements;¹⁶ and
- 14 • Violations of IRS Publication 1345's requirement that participants in the federal e-file
- 15 program not take "contingent fees" (fees that vary with the size of the refund or the loan
- 16 amount) from RAL-lending banks.¹⁷
- 17
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- 19

20 (...continued)
 21 the UCL "include, but are not limited to," the specified acts, which is broad enough to encompass
 22 alleged violations of Section 22253.1(a). *Custom Craft*, 159 Cal.App.3d at 684. Thus, these
 alleged violations are appropriately considered. There was no "prejudicially misleading variance
 between pleading and proof." *Toomey*, 157 Cal.App.3d at 11.

23 ¹² The Complaint does not allege liability based on Liberty's failure to supervise its
 franchisees (the illegal franchise ads were discovered by the Attorney General through third-party
 24 discovery conducted *after* the filing of the Complaint), nor was Liberty apprised of this basis
 before the end of the trial. See *infra*, § II (A)(4).

25 ¹³ Complaint at ¶¶ 48.b., 48.c., and 48.d.(2).

26 ¹⁴ Complaint at ¶¶ 46, 48, and 48.h.

27 ¹⁵ Complaint at ¶¶ 48, 48.e., and 48.f.

28 ¹⁶ Complaint at ¶¶ 48 and 48.i.

¹⁷ These violations were not specifically alleged in the Complaint, but Liberty was
 arguably put on notice of this liability theory before trial. In any event I have not found Liberty
 liable on this basis.

1 The People abandoned its other liability theories, including but not limited to alleged
2 breaches of fiduciary duty, Complaint at ¶¶ 48 and 48.g.

3
4 **II. DISCUSSION**

5 **A. Indirect Liability**

6 The issue arises whether Liberty can be held liable for illegal conduct by its franchisees
7 and/or the banks. As discussed below, there is substantial evidence that Liberty's franchisees are
8 its actual agents. Thus I find Liberty liable for certain actions by its franchisees. I have rejected
9 the People's other theories of indirect liability for the acts of franchisees, such as conspiracy,
10 aider and abettor, and ostensible agency. The People have also asked me to hold Liberty directly
11 liable for failing to supervise its agent franchisees, which I reject for reasons stated below.

12 **1. Liberty's franchisees are its agents.**

13 To determine the existence of a principal-agent relationship, the key test is the extent of the
14 principal's *right of control*. *Nichols v. Arthur Murray, Inc.*, 248 Cal.App.2d 610, 613 (1967);
15 *Kuchta v. Allied Builders Corp.*, 21 Cal.App.3d 542, 548 (1971). "It is not essential that the right
16 of control be exercised or that there be actual supervision of the work of the agent; the existence
17 of the right establishes the relationship." *McCollum v. Friendly Hills Travel Center*, 172
18 Cal.App.3d 83, 91 (1985); 3 B. Witkin, SUMMARY OF CALIFORNIA LAW, Agency § 24 (10th ed.
19 2005, 2008) (right of control, rather than exercise of the right, is key issue).

20 A franchisee may be the agent of the franchisor. *Shoopman v. Pacific Greyhound Lines*,
21 169 Cal.App.2d 848, 856 (1959); *see also Nichols, supra; Beck v. Arthur Murray, Inc.*, 245
22 Cal.App.2d 976 (1966). The general rule is that where the franchisor has "the right of complete
23 or substantial control over the franchisee, an agency relationship exists." 2 B. Witkin, SUMMARY
24 OF CALIFORNIA LAW, Agency & Employment § 6 (9th. ed. 1987); *Nichols*, 248 Cal.App.2d at 613
25 (agency existed because franchisor had right of "complete control" over franchisees); *Kuchta*, 21
26 Cal.App.3d at 547; *Holland v. Nelson*, 5 Cal.App.3d 308, 313 (1970). Further, parties cannot
27 defeat a finding of agency by simply declaring themselves to be independent contractors as to
28 each other; "the declarations of the parties in the agreement respecting the nature of the

1 arrangement are not controlling.” *Kuchta*, 21 Cal.App.3d at 548. Rather, the existence of an
2 agency is a question of fact for this Court. *Id.* at 547; *Nichols*, 248 Cal.App.2d at 614. In the
3 field of franchise operations, this inquiry focuses in particular on the extent to which the
4 franchisor “retained controls beyond those necessary to protect its trademark, trade name, and
5 good will” *Nichols*, 248 Cal.App.2d at 613-614; *accord Cislav v. Southland Corp.*, 4
6 Cal.App.4th 1284, 1295 (1992).

7 The parties agree that Liberty exercises (or retains the right to exercise) a certain amount of
8 control over its franchisees. Liberty contends it is just enough to properly exercise its rights as
9 franchisor and to protect the associated marks, *Krehl v. Baskin-Robbins Ice Cream Co.*, 664 F.2d
10 1348, 1353 (9th Cir. 1982); the People contend it is more than that: *i.e.*, that the right to control
11 Liberty reserves is enough to show the franchisees, at least in the context of their advertising
12 activities, are Liberty’s agents.

13 It is generally understood that franchisors are often caught between the Scylla of failing to
14 exercise sufficient control to protect their marks, and the Charybdis of exercising so much control
15 they are vicariously liable for the torts of the franchisees or other licensees. *E.g.*, Philip F.
16 Zeidman, “Franchising and Other Methods of Distribution: Regulatory Pattern And Judicial
17 Trend,” CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES, 1714 PLI/Corp. 443, 693
18 (January – February 2009). Courts are sensitive to the problem. “A franchisor must be permitted
19 to retain such control as is necessary to protect and maintain its trademark, trade name and good
20 will, without the risk of creating an agency relationship with its franchisees.” *Cislav*, 4
21 Cal.App.4th at 1295. At the core of the issue is the fact that “control” is part of the definition of a
22 franchise:

23 [A] contract or agreement, either expressed or implied, whether oral or written,
24 between two or more persons which:

25 (1) A franchisee is granted the right to engage in the business of offering, selling or
26 distributing goods or services under a marketing plan or system prescribed in
substantial part by a franchisor; and

27 (2) the operation of the franchisee’s business pursuant to such plan or system is
28 substantially associated with the franchisor’s trademark, service mark, trade name,
logotype, advertising or other commercial symbol designating the franchisor or its

1 affiliate; and (3) the franchisee is required to pay, directly or indirectly, a franchise
2 fee.

3 Corp. Code § 31005.

4 A recent district court opinion noted:

5 Few California courts have defined “marketing plan or system,” but those that have
6 found extensive control and material assistance essential. *See, e.g., People v. Kline*,
7 110 Cal.App.3d 587 . . . (1980) (finding a “marketing plan or system” existed where
8 restaurant franchisor offered a complete operational plan, advertising and promotional
9 support, menu, food, supplies, and distinctive kiosks and labeled the offer “a business
10 opportunity”).

11 *Dress for Success Worldwide v. Dress 4 Success*, 589 F.Supp.2d 351 (S.D.N.Y. 2008).

12 Thus, the inquiry must focus on the extent to which the control reserved to the franchisor
13 plainly exceeds that required to police the mark, which is control so pervasive that it amounts to
14 complete or substantial control over the daily activities of the franchisee’s business. *Singh v. 7-
15 Eleven, Inc.*, 2007 WL 715488, *7 (N.D.Cal. 2007) citing, *Kaplan v. Coldwell Banker Residential
16 Affiliates, Inc.*, 59 Cal.App.4th 741, 746 (1997); 3 MCCARTHY ON TRADEMARKS § 18:75 (2008).

17 To make this distinction, it is important to recall the legitimate reasons for policing a mark:
18 to preserve its ability to identify “the goodwill and quality standards of the enterprise which it
19 identifies” and ensure the public is not misled with respect to those. *Siegel v. Chicken Delight,
20 Inc.*, 448 F.2d 43, 48-49 (9th Cir. 1971), *abrogated on other grounds, Principe v. McDonald’s
21 Corp.*, 631 F.2d 303 (4th Cir. 1980). *See Rick-Mik Enterprises, Inc. v. Equilon Enterprises LLC*,
22 532 F.3d 963, 974 n.3 (9th Cir. 2008); *Schlotzsky’s, Ltd. v. Sterling Purchasing and Nat.
23 Distribution Co., Inc.*, 520 F.3d 393, 405 n.3 (5th Cir. 2008) (“We note that a franchisor has a
24 responsibility imposed by the Lanham Act to protect the integrity and goodwill of its licensed
25 trademark by controlling the quality of products sold under that trademark”). *See generally*, 3
26 MCCARTHY ON TRADEMARKS § 18:42 (2008).

27 The People contend that the control exercised by Liberty, in particular as manifested
28 through the Operations Manuals, shows control far in excess of that needed to police the mark. It
is important to consider whether the Manuals’ prescriptions are mandatory or only suggestions.

1 *Walker v. Pacific Pride Services, Inc.*, 2007 WL 42094445, 4 (N.D.Cal. 2007). Here they are
2 mandatory.

3 Many of Liberty's restrictions appear designed to police its trademarks and the good will
4 associated with those, such as executing the franchise agreement, approving sites, requiring
5 franchisees to attend trainings on filling out tax returns, performing compliance reviews, and
6 perhaps providing scripted answers for interactions with customers.

7 But other restrictions do not have this goal. For example, as noted above,

- 8 • Compliance with Liberty's Operations Manual is mandatory;
- 9 • Liberty mandates the banks to be used by each franchisee, and requires its franchisees to
10 offer RALs and ERCs; more generally, franchisees cannot offer any products and
11 services without first obtaining permission from Liberty;
- 12 • Liberty determines the franchisees' minimum operating hours;
- 13 • Liberty mandates the computers to be used;
- 14 • The Operations Manual governs day-to-day tasks such as how to open the store and when
15 to clean the bathrooms;
- 16 • Liberty reserves the right to intervene in disputes between customers and franchisees, to
17 pay refunds directly to customers, and then bill the franchisees;
- 18 • Franchisees must commit to maintaining Liberty's prescribed filing system as well as the
19 setup for the tax return processing center;
- 20 • Liberty exercises control over franchisee pricing by controlling the discounts that
21 franchisees may offer depending on the time of year.

22 In sum, as in *Nichols* and *Kuchta*, Liberty's right of control extends not only to the products and
23 services franchisees may offer, but also to the manner and means by which its franchisees prepare
24 tax returns, offer RALs and ERCs, and interact with customers, and extends beyond that needed
25 to protect its marks.

26 Liberty's right of control over franchisee advertising is particularly extensive, and is in
27 particular relevant to the issue before me, *viz.*, the extent to which Liberty may be liable for the
28 acts of its franchisee in the advertising context. As noted above, Liberty requires its franchisees

1 to submit all advertising material to the marketing department for review and approval before it
2 may be used. But Liberty uses its control over advertising not just to protect its marks, but also to
3 dictate business strategy for franchisees. Thus, for example, Liberty controls the discounts that
4 franchisees may advertise depending on the time of year, not because offering \$50 off in the early
5 part of the tax season would damage Liberty's trademark or goodwill, but because, in Liberty's
6 estimation, early season customers are not as price sensitive as late season customers. Similarly,
7 Liberty controls the products and services that franchisees may advertise, not because doing so is
8 necessary to protect the integrity of the marks, but because Liberty believes that certain
9 advertising is a waste of time and money. Liberty's control of advertising is pervasive, extending
10 from the provision of sample copy, review procedures, and detailed instructions in the Operations
11 Manuals. Those Manuals, while not always using terms such as 'must' or 'shall,' provide
12 detailed instructions on advertising, such as breaking down the year into various temporal
13 "Tiers;" mandate pre-approval of all Liberty marks (which inevitably requires approval of
14 virtually all advertising since "Liberty Tax Service" is a registered mark¹⁸); set out a host of
15 marketing and advertising methods, provide samples of copy, and so on, literally providing a
16 detailed, step-by-step guide for every aspect of marketing and advertising. The provisions are
17 expressed as imperatives, and include "General Rules" for marketing and advertising (Ex. 38,
18 p.26675). See e.g. Ex. 38 at [Bates stamped] pp. 26654-26689. And Liberty retains an open-
19 ended right to modify the Operations Manual without consent of the franchisees. This right of
20 essentially complete control over franchisee operations, and specifically advertising operations,
21 exceeds what Liberty reasonably needs to protect its trademark and goodwill.

22 Thus substantial evidence shows Liberty's franchisees are its agents. Even if Liberty's
23 franchisees are not its agents for all purposes, they are its agents at a minimum for purposes of
24 advertising.

25
26
27

¹⁸ E.g., Ex 38 at 16, Bates Stamped 26660.
28

1 2. **Toomey's Discussion of Vicarious Liability.**

2 The notion that "vicarious liability" is not available in an action for unfair business
3 practices stems from *People v. Toomey*, 157 Cal.App.3d 1, 14 (1984). *See also, Emery v. Visa*
4 *Internat. Service Ass'n*, 95 Cal.App.4th 952, 960 (2002). And so Liberty argues here. Other
5 decisions do rely on *Toomey* for this proposition, including federal cases seeking to apply
6 California law. *E.g., Amalgamated Transit Union v. First Transit, Inc.*, 2004 WL 2806328 (C.D.
7 Cal. Nov. 30, 2004).

8 This issue has been extensively briefed here. But a close review of *Toomey* shows it does
9 not stand for the proposition that principal-agency liability is unavailable in an unfair business
10 practices case.

11 The issue depends on what *Toomey* means by 'vicarious liability'. Vicarious liability
12 ordinarily has a very broad meaning indeed: it covers any situation in which one is liable for the
13 acts of another. *See e.g.*, 6 B. Witkin, SUMMARY OF CALIFORNIA LAW, Torts § 1220 (10th ed.
14 2005, 2008). These situations include agency, employment, joint enterprises, and a host of other
15 special relationships by which (either under common law or by statute) one is liable for another's
16 actions. *See generally*, J. King, Jr., "Limiting the Vicarious Liability of Franchisors For The
17 Torts of Their Franchisees," 62 WASH. & LEE L. REV. 417, 427 (2005).

18 *Toomey* is a civil enforcement action brought under Business and Professions Code §
19 17200. *Toomey* does not explain why "vicarious liability" is unavailable, but rather relies on two
20 cases, *People v. Regan*, 95 Cal.App.3d Supp. 1, 4 (1979), and *People v. E.W.A.P. Inc.*, 106
21 Cal.App.3d 315, 322 (1980). Neither case supports *Toomey's* supposed conclusion that vicarious
22 liability, broadly speaking, is inappropriate in an unfair business practices case.

23 *Regan*, a § 17500 case decided by the appellate department of the Superior Court, was not a
24 civil case. Its holding was critically based on the fact that criminal scienter was an essential
25 element of the criminal case, and for that, the "control or knowledge appellant had of his
26 employee's activities" had to be established. There are two things to note here. In *Regan*, control
27 or knowledge, it appears, could have been enough even for criminal liability (neither was in fact
28 established). That does not support the notion that vicarious liability is unavailable for, e.g., the

1 acts of an agent over which the principal has control. Second, *Regan* as a criminal case is driven
2 by the usual scienter requirements of such cases, an important contrast to civil cases such as
3 *Toomey* or the present case.

4 Then *Toomey* cites *People v. E.W.A.P., Inc.*, 106 Cal.App.3d 315 (1980), stating that in
5 *E.W.A.P.* “the defendant argued that civil penalties cannot be imposed under section 17206 absent
6 a showing of scienter. The court responded by explaining that the evidence established
7 defendant’s participation in the unlawful acts, thereby impliedly recognizing the need to prove
8 active and knowing involvement in the offending conduct by the defendant. (*Id.*, at p. 322.)”
9 *Toomey*, 157 Cal.App.3d at 14-15.

10 But this is what *E.W.A.P.* really says:

11 On the contrary, the People’s theory in this case is that defendants’ business practices
12 are unlawful because they violate Penal Code section 311.2, and thus to establish that
13 defendants’ conduct comes within section 17200 the People would have to prove that
14 defendants “knowingly” distributed or possessed for distribution obscene matter.
(Pen. Code, Section 311.2.)

15 106 Cal.App.3d at 322. That is, the scienter requirement was a function of the Penal Code
16 section, not the fact that *E.W.A.P.* was a civil UCL case.

17 *Toomey* also mentions four other cases, albeit not in support of the proposition that
18 vicarious liability is unavailable under the UCL. These cases are cited to show that theories of
19 more direct liability, such as for conspiracy or aider and abettor, are available. While the
20 availability of these *direct* theories does not mean that vicarious liability is unavailable in UCL
21 actions, it is instructive to note that none of these cases supports the argument that *Toomey*’s
22 rejection of ‘vicarious liability’ extends to the rejection of general principal-agency liability.

23 *People v. Bestline Products, Inc.*, 61 Cal.App.3d 879, 918 (1976) endorses conspiracy and
24 aider and abettor liability, but does not say that agency liability is not available; the Court only
25 noted that the trial court had not relied on vicarious liability, and so the issue was moot. 61
26 Cal.App.3d at 918.

27 Then there is *People v. Witzerman*, 29 Cal.App.3d 169, 181 (1972). Here too, the court just
28 held that the “knew or should have known” test for scienter is enough. Nothing suggests that
variations of vicarious liability are not applicable. Next, we have *People v. Arthur Murray, Inc.*,

1 238 Cal.App.2d 333, 341-342 (1965), which expressly avoids the agency issue because there was
2 enough evidence of aider and abettor liability.

3 The last case *Toomey* cites is *International Art Co. v. FTC*, 109 F.2d 393, 396 (7th Cir.
4 1940), which actually endorses the agency liability at stake here:

5 Petitioners' argument and authorities are largely concerned with the relation between
6 a manufacturer and a retail merchant. For example, it cites Marshall Field and
7 Company, a store which sells the products of the American Woolen Company, and
8 argues that the latter is not liable for representations made by the former as to the
9 products sold. We assume, however, that Marshall Field and Company acts entirely in
10 an independent capacity, and not as a representative of the Woolen Company. It is
11 also sought to compare the instant situation with the relation existing between the
12 automobile manufacturer and its local agent. This is another instance, however, of the
13 agency conducting its business in its own right and in an independent manner. These
14 illustrations have no analogy to the present situation. Here, the agent was clothed with
15 apparent and, we think, real authority to speak and act for and on behalf of the
16 principal, and the latter is bound thereby.

17 We know of no theory of law by which the company could hold out to the public
18 these salesmen as its representatives, reap the fruits from their acts and doings
19 without incurring such liability as attach thereto.

20 *International Art Co.*, 109 F.2d at 396.

21 Finally, I note that a type of vicarious liability, that flowing from the employer/employee
22 relationship, is patently available under *Toomey*. 157 Cal.App.3d at 14 (holding that a
23 corporation "can, of course, be held liable for violations of sections 17200 and 17500 by its
24 employees"; see also *id.* at 15 (holding that a "managing officer of a corporation with control
25 over the operation of the business is personally responsible for the acts of subordinates done in
26 the normal course of business"). *Toomey* does not explain why this type of vicarious liability in
27 the employment context is acceptable, but not other types of vicarious liability. See generally, 3
28 B. Witkin, SUMMARY OF CALIFORNIA LAW, Agency (10th ed. 2005, 2008) (agent and employee
vicarious liability are generally indistinguishable).

29 Thus *Toomey*'s use of the term 'vicarious liability' must be far more limited than the usual
30 expansive notion reflected in the Witkin treaties cited above and commonly used to encompass all
31 types of liability for the acts of another.¹⁹ *Toomey*'s emphasis on the personal participation or

32 ¹⁹ It is clear that there is no universally accepted scope of the term. The most recent
33 RESTATEMENT seems to limit it to liability for the torts of one's (i) employees and (ii)
34 (continued...)

1 knowledge of corporations' managing agents as a requirement for liability indicates that the Court
2 had in mind fact patterns—and the 'vicarious liability'—of cases such as *Frances T. v. Village*
3 *Green Owners Assn.*, 42 Cal.3d 490 (1986):

4
5 It is well settled that corporate directors cannot be held *vicariously* liable for the
6 corporation's torts in which they do not participate. Their liability, if any, stems from their
7 own tortious conduct, not from their status as directors or officers of the enterprise.

8 *Frances T.*, 42 Cal.3d at 503 (emphasis in original).

9 In short, *Toomey* disallows what I may call a *reverse* vicarious liability: corporations may
10 be (vicariously) liable for the acts of their managing agents such as corporate directors and
11 officers, but the reverse is not true: The multitude of officers and directors are not automatically
12 (vicariously) liable for the acts of the company that employs them.²⁰

13 Reverse vicarious liability is not at issue here. Nor, therefore, is *Toomey* a bar to traditional
14 agency liability or to Liberty's vicarious liability for the acts of its franchisees.

15 3. Aider and abettor liability.

16 Liberty is liable for aiding and abetting the banks in violating state and federal fair debt
17 collection practices laws and the Consumer Legal Remedies Act in connection with the collection
18 of past RAL debts.

19 In this regard, I note that Liberty is wrong when it argues that any prohibition of vicarious
20 liability extends to aider and abettor liability. Liberty cites *Amalgamated Transit Union*, 2004
21 WL 2806328, but the case obviously does not say what Liberty argues. *See id.* at 2004 WL

22 _____
23 (...continued)

24 ostensible—but not actual—agents; otherwise theories of what the RESTATEMENT calls 'direct'
25 liability may be available. RESTATEMENT (THIRD) OF AGENCY, § 7.03 (2006).
26 ²⁰ *See e.g., Sea Horse Ranch, Inc. v. Superior Court*, 24 Cal.App.4th 446, 457 (1994) ("It
27 is well settled that [a]n officer of a corporation is not criminally answerable for any act of a
28 corporation in which he [or she] is not personally a participant . . ." *Toomey* and *Regan* are then
cited as examples of this principle). *Emery v. Visa Int'l. Serv. Assn.*, 95 Cal.App.4th 952, 960
(2002) cites *Toomey* for the apparently broad proposition that vicarious liability is unavailable,
but then proceeds to discuss various strands of classic agency liability. *Emery* disposes of its
case finding that there was insufficient control over the supposed agents, *not* on the notion that
vicarious liability (broadly construed) is inapposite.

1 2806328 at *1. Aider and abettor liability is plainly acceptable in actions for unfair business
2 practices. *See, e.g., Ray v. BlueHippo Funding, LLC*, 2008 WL 1995113, 4 (N.D.Cal. 2008),
3 *citing, Emery v. Visa Internat. Service Ass'n, supra; Toomey*, 157 Cal.App.3d at 15 (*citing*
4 *Bestline Products, supra*, for the proposition that aider and abettor liability is available under the
5 UCL); *People v. Arthur Murray, Inc.*, 238 Cal.App.2d 333, 341-342 (1965).

6 **4. Failure to supervise franchisee advertising.**

7 The People urge me to find Liberty liable for failing to adequately supervise its franchisees,
8 many of whom ran deceptive or otherwise illegal advertisements for RALs in the *Pennysaver*²¹ in
9 California in 2007 and 2008. A principal's negligent failure to supervise an agent, resulting in the
10 breach of a legal duty, gives rise to direct, and not vicarious, liability. RESTATEMENT (THIRD) OF
11 AGENCY, §§ 7.03(1)(b) & 7.05; *see also Phillips v. TLC Plumbing*, 2009 WL 884938 (Apr. 3,
12 2009) (following § 7.05). Liberty protests that this theory of liability was neither suggested nor
13 briefed until after the trial was concluded, precluding the opportunity to present evidence of the
14 care with which Liberty regulated its franchisees. I agree, and thus have determined not to pursue
15 this theory here.

16 **5. Ostensible Agency And Conspiracy.**

17 The People seek to hold Liberty liable for various acts of its franchisees on a theory of
18 "ostensible agency," ratification, and conspiracy. Complaint, ¶ 9, 11.

19 As for ostensible agency, *Kuchta v. Allied Builders Corp.*, 21 Cal.App.3d 541, 547 (1971)
20 holds that "[a]n agency is ostensible when the principal intentionally, or by want of ordinary care,
21 causes a third person to believe another to be his agent who is really not employed by him." *See*
22 *also, Kaplan v. Coldwell Banker Residential Affiliates, Inc.*, 59 Cal.App.4th 741, 747 (1997) (to
23 establish ostensible agency plaintiff must prove: (i) "representations made by the principal"; (ii)
24 "justifiable reliance by a third party"; and (iii) "a change of position from such reliance resulting
25 in injury."). *See generally*, 3 B. Witkin, SUMMARY OF CALIFORNIA LAW, Agency § 96 (10th ed.
26 2008).

27 ²¹ *Pennysaver* is a free weekly print newspaper consisting primarily of advertisements
28 including classified ads.

1 Here, the People offered no evidence that any third party held the belief that franchisees
2 were agents, nor was there evidence of Liberty's intent or negligence in the matter.

3 Ratification is not pled. The Attorney General's theory, as set forth in his briefs, is that
4 Liberty ratified franchisees' acts by accepting royalty payments from franchisees, failing to return
5 moneys paid by customers during times when unapproved advertisements ran, and failing to
6 discharge disobedient franchisees after it learned of the unapproved advertisements. "A principal
7 ratifies an agent's acts when he knows of the acts, and accepts the benefits which flow from them
8" *Spahn v. Guild Indus. Corp.*, 94 Cal.App.3d 143, 157 (1979). Here there is no evidence
9 that Liberty knew of or deliberately ignored its franchisees' actions in placing illegal
10 advertisements.

11 The Attorney General also accuses Liberty of conspiracy. A conspiracy requires two or
12 more actors to agree to perform a wrongful act. *Wyatt v. Union Mortgage Co.*, 24 Cal.3d 773,
13 784 (1979). Liberty did not "agree" that its franchisees could run the unapproved
14 advertisements. In fact, Liberty advised Area Developers and franchisees not to run such
15 advertisements. *See, e.g.*, Ex. 42, Bates 28098 (Operations Manual states, "Terms such as
16 'Instant Refund' or 'Refund in 24 Hours' will never be approved and must not be used."). There
17 is no evidence of conspiracy.

18 **B. False, Misleading, or Otherwise Illegal Advertising**

19 Both the UCL and FAL ban overtly false advertisements as well as "advertising which[,]
20 although true, is either actually misleading or which has a capacity, likelihood, or tendency to
21 deceive or confuse the public." *Kasky v. Nike, Inc.*, 27 Cal.4th 939, 951 (2002). Unlike actions
22 for fraud or misrepresentation, proof of actual deception, reasonable reliance, and damage are
23 unnecessary here. *E.g.*, *Chern v. Bank of America*, 15 Cal.3d 866, 876 (1976).

24 So too a "fraudulent" business act or practice can be shown even if no one was actually
25 deceived, relied upon the fraudulent practice, or sustained any damage. It is only necessary to
26 show that members of the public are likely to be deceived. *Podolsky v. First Healthcare Corp.* 50
27 Cal.App.4th 632, 647-48 (1996).

1 Generally, courts judge deceptive advertising claims from the standpoint of a "reasonable"
2 consumer. *South Bay Chevrolet v. General Motors Acceptance Corp.*, 72 Cal.App.4th 861, 878
3 (1999). The question is "[w]hat a person of ordinary intelligence would imply [sic: infer]" from
4 an advertisement. *Lavie v. Procter & Gamble Co.*, 105 Cal.App.4th 496, 505 (2003), quoting
5 *State Bd. of Funeral Directors v. Mortuary in Westminster Memorial Park*, 271 Cal.App.2d 638,
6 642 (1969). A "reasonable consumer may be unwary or trusting," 105 Cal.App.4th at 506, and is
7 not required "to investigate the merits of advertising claims." *Id.* at 504. "[A] reasonable
8 consumer need not be exceptionally acute and sophisticated." *Id.* at 509.

9 "[T]he primary evidence in a false advertising case is the advertising itself." *Brockey v.*
10 *Moore*, 107 Cal.App.4th 86, 100 (2003). Thus, if an advertisement is deceptive on its face, it
11 violates the UCL and the FAL, and extrinsic evidence of deception is unnecessary to prove
12 liability.

13 **1. Liberty ads that falsely promised refunds in one day.**

14 Only a RAL, and not a refund, can be obtained in a day. Complaint at ¶ 19:25-28 (admitted
15 in Answer). Further, RALs carry costs, fees, and other restrictions, including provisions
16 authorizing collection of past RAL debts, whereas the IRS provides refunds to taxpayers for free.
17 Thus, advertisements which falsely portray RALs as refunds violate the UCL/FAL. The People
18 adduced substantial evidence that Liberty created and/or approved several such ads for RALs that
19 violate the UCL and the FAL.

20 **a. The Spanish-language television ad (most "reembolsos" in only**
21 **24 hours).**

22 Substantial evidence demonstrates that in 2007 Liberty approved a Spanish-language
23 television ad for use in California that promised "[e]n Liberty Tax Services, le entregamos la
24 mayoria de los reembolsos en tan solo 24 horas," which translates to: "At Liberty Tax Service,
25 we deliver most refunds in only 24 hours." Ex.20 (file names "Image 2007-S.mov" and
26 "10096202.wmv"); see also Ex.89 (certified transcriptions and translations appended thereto as
27 Exhibits 2A/2B and 4A/4B).

28

1 Loubna Rachid, Liberty's then-director of Hispanic marketing, had authority to approve
2 Spanish-language advertising on Liberty's behalf, Ex.286 at 25:11-13; 26:19-22; and 27:10-14,
3 and she actively encouraged the ad's use in California. Ex.75 at 22150, 22147, and 22176. Two
4 franchise owners (one of them also an area developer) ran the ad on Spanish-language stations in
5 Central California. See Exs.66 and Ex.67 at AG-LIB00465-470. The script for the ad changed
6 slightly over time. The original version, approved by Ms. Rachid and Ms. O'Gorman, Liberty's
7 chief marketing officer, falsely promised consumers that they could obtain their refunds "de
8 inmediato" and "al instante!" – i.e., "immediately" and "to the moment!" – at Liberty Tax
9 Service. Ex.75 at 22138. The wording changed later to promise "most refunds in only 24 hours."
10 Ms. Rachid approved the final version for use in California. (*Id.* at 22147-22149.)

11 Ms. O'Gorman testified that she approved the initial version of the ad by mistake.
12 Regardless, the ad that ran in California was approved by Ms. Rachid on Liberty's behalf and was
13 deceptive on its face.

14 **b. Pennysaver ads promising "most refunds in one day."**

15 In addition to the Spanish-language television ad, there were other ads that California
16 franchisees ran in the *Pennysaver* in 2007 and 2008. Ex.76; Tr. at 272:2-25, 274:3-6. Liberty
17 approved four of these *Pennysaver* ads promising "Most Refunds in One Day." Ex.289 at 9:7-20;
18 85:11-25; and 86:7-88:1 (Ms. Schuster, Liberty's director of communications, testifying that
19 Liberty approved the ads labeled AG-LIB 4073, 4030, 4012, and 4244). These ads (Exs.76 and
20 206) are deceptive on their face.

21 **c. The "Origami" ad.**

22 The so-called "Origami" ad, see Exhibit A to Exhibit 104, was prepared for and made
23 available by Liberty to its California franchisees. Tr. at 924:26-925:9. This television ad starts
24 by asking "Hey, you want to turn a boring old tax form into something really cool? Like money?
25 Refund money . . . in just 24 hours." Meanwhile, the screen shows a \$100 bill, and a flashing
26 arrow pointing to it from the word "refund." After promising "refund money" in 24 hours the ad
27 mentions that Liberty has the "fastest refund loans in the country." The ad then closes with:
28 "Hey, it's your money and Liberty gets it to you fast."

1 This ad, which aired in the Southern California area, is deceptive on its face. The voiceover
2 and the flashing “refund” arrow plainly promise a “refund” and/or “refund money” in just 24
3 hours. After reciting those promises, the phrase “(Based on Refund Anticipation Loan)” appears
4 briefly at the bottom of the screen, and the voiceover mentions quickly that Liberty offers the
5 “fastest refund loans in the country.” Those disclaimers fail to dispel the deception engendered
6 by the unambiguous promise of “refund money” in 24 hours that precedes them. Even if the
7 disclaimers made it sufficiently clear that the product being offered was actually a refund *loan*,
8 and not a 24-hour refund – and they do not -- the ad then reinforces its deceptive message at the
9 end by promising “Hey, it’s your money, and Liberty gets it to you fast.” The reference to “your
10 money,” is reasonably understood to refer to a “refund” and/or “refund money” in just 24 hours.
11 But of course no one obtains a refund, “your money,” in 24 hours; rather, only a RAL may be
12 available in that time. Ms. O’Gorman, the company’s chief marketing officer, testified that she
13 would still approve the Origami ad today for use in California, Tr. at 979:3-5. This and other
14 evidence demonstrates the need for injunctive relief and specifically ¶ D 4 of the Injunction.

15 16 2. “Stumbling Blocks” & “Look for the Lady.”

17 The Attorney General contends that the “Stumbling Blocks” and “Look for the Lady”
18 television ads (Ex. 20, Ex. A) constitute false advertising in violation of Sections 17500 and
19 17200. The People offered no extrinsic evidence of deception. They ask the Court to find these
20 advertisements deceptive *per se*. They are not. There is no suggestion of a tax refund within 24
21 hours. The People argue that when a customer wants the “fast” money advertised he will, instead,
22 be met with a loan application (Post-Trial Brief at 30). This may be so, but that does not suggest
23 the advertisement is deceptive on its face.

24 25 3. Ads that lack statutorily-mandated RAL disclosures.

26 The Legislature enacted certain restrictions that apply specifically to RAL-related
27 advertising. B&P § 22253.1(a), effective January 1, 2006. Section 22253.1(a) requires specific
28

1 disclosures in any advertisement that mentions RALs, and mandates that those disclosures be
2 “conspicuous”:

3 Any tax preparer who advertises the availability of a refund anticipation loan shall not
4 directly or indirectly represent the loan as a client's actual refund. Any advertisement
5 that mentions a refund anticipation loan shall state conspicuously that it is a loan and
6 that a fee or interest will be charged by the lending institution. The advertisement
7 shall also disclose the name of the lending institution.

8 Liberty violated § 22253.1(a) and, by extension the UCL and the FAL, by creating or approving
9 ads that lack mandatory disclosures that the Legislature determined are necessary to prevent
10 confusion about RALs.

11 **a. Yellow Pages ads with missing disclosures.**

12 In order to place an ad in the Yellow Pages, Liberty requires its franchisees to use templates
13 created by the corporate marketing department. Ex.290 at 27:8-15. Liberty admitted that it
14 supplied its California franchisees with Yellow Pages ads that violate § 22253.1(a); these ads
15 promote refund loans, but fail to state (i) that fees and interest apply and (ii) the name of the bank.
16 *E.g.*, Tr. at 861:12-862:14; Ex.289 at 61:19-62:13. The problem is not that the information is not
17 stated “conspicuously”; the problem is that it does not appear at all. The record contains 36
18 illegal Yellow Pages ads that ran in California in 2006, 2007, and 2008. *See* Exs.24; 240; 305;
19 and 323-325; *see also* First Set of Stipulations For Trial at ¶ 17.

20 Liberty testified that this problem arose because Ms. Schuster, the Liberty executive
21 charged with designing and approving these ads, did not herself understand the requirements of
22 the statute. Tr. at 862:10-17 and 893:20-894:9. But these ads ran in three successive years after
23 Section 22253.1(a) took effect (2006-2008), and Liberty did not correct the problem until shortly
24 before the 2009 tax season.

25 **b. Pennysaver ad with missing disclosures**

26 Liberty approved one *Pennysaver* ad run by a franchisee which mentions RALs but does
27 not include the lender name and bank fee disclosures required by § 22253.1(a). Ex.289 at 87:17
28 (Ms. Schuster testifying that Liberty approved the ad); for the ad itself, *see* Ex.76 at AG-
LIB4234. Liberty is liable for this ad.

1 4. **Ads with “inconspicuous” RAL disclosures**

2 a. **“We Wave You Save”**

3 The People contend that Liberty’s “We Wave You Save” Yellow Page ads (Ex. 162, last
4 page) violated the disclaimer requirement of § 22253.1(a), specifically that the 6-point font used
5 for the disclaimer is too small. *Conservatorship of Link*, 158 Cal.App.3d 138 (1984). Merely
6 “readable” font, the People contend, is insufficient to satisfy a standard of “conspicuousness.”

7 The disclaimer is both legible and readable. Section 22253.1(a) does not mandate
8 minimum font sizes. Although the *Link* court refers to code sections that require at least 8- to 10-
9 point font, that case does not require 8-point font as a matter of law. In *Link*, the critical language
10 was contained in the third paragraph of the document, in a complicated 193-word sentence. *Id.* at
11 143. See also *Bennett v. United States Cycling Federation*, 193 Cal.App.3d 1485, 1489 (1987)
12 (“Print size is an important factor, but not necessarily the only one to be considered in assessing
13 the adequacy of a document as a release”). The core problem in *Link* was that the 5.5 point font
14 message was embedded in “lengthy fine print.” By contrast, here there is very little surrounding
15 text to obscure the message intended by the disclaimer. Liberty has no liability for this ad.

16 b. **“Stomp and Catch”**

17 Liberty produced television ads titled “Stomp” and “Catch” for its franchisees which
18 contain the mandatory language required by § 22253.1(a), but these violate the law’s conspicuity
19 requirement. Tr. at 38:27-40:7; for the ads themselves, see Ex.20.²²

20 The mandatory bank name and fee disclosures appear at the end of the ad but are not
21 readable, as Ms. O’Gorman confirmed at trial. Tr. at 976:16-22. The mandatory disclosures are
22 in a very small font, appear within a mass of other text, and are on screen for just one second, *id.*
23 Further, there is insufficient contrast between the background and the text to allow it to be easily
24 read, as Ms. Schuster acknowledged. *Id.* at 849:3-6. The mandatory disclosures were plainly
25 designed to be overlooked. These ads violate § 22253.1(a) and, accordingly, the UCL and FAL.

26
27 ²² File names 10123522.wmv, 10123525.wmv, 10123528.wmv, 10123529.wmv,
28 10123532.wmv, and 10123535.wmv.

1 **5. Liberty's Indirect Liability for Franchisee Advertising.**

2 The People proved that in 2007 and 2008 a large number of illegal ads for Liberty Tax
3 Service ran in *Pennysavers* throughout California. Liberty blames its area developers and
4 franchisees for running them, but Liberty is liable as a principal for its agents' acts.

5 The record contains over 200 *Pennysaver* ads with a combined direct mail circulation of
6 5,201,500 that ran in 2007 and 2008. *See Ex.76; see also* Plaintiff's Post-Trial Brief at Table I.
7 Many of these ads consist of the "We Wave You Save" ad approved by Liberty; as discussed
8 above, I find that these ads do not violate Section 22253.1(a)'s conspicuity requirement. But
9 more than 100 of the other *Pennysaver* ads in evidence are illegal for other reasons.

10 In all, Exhibit 76 contains 43 ads falsely promising "most refunds in one day" or a variation
11 on that theme, not including the four that Liberty specifically approved. These ads can be found
12 in Exhibit 76 and include:

- 13 • "Get \$1200 in Minutes . . . And the Rest of Your Refund In 24 Hours" (Ex.76 at AGLIB
14 4258-4260, 4264, 4267, 4269, 4273, 4291-92, 4299, and 4362);
- 15 • "Most Tax Refunds In 24 Hours" (*id.* at AG-LIB 4333, 4335, 4336-38);
- 16 • "Saint Patrick's Day Special Most Refunds in 24 Hours" (*id.* at AG-LIB 4430 and 4446);
- 17 • "Most Refunds In One Day" (*id.* at AG-LIB 4004,4018, 4020, 4021, 4022, 4031, 4047,
18 4067, 4068, 4069, 4070, 4074, 4100, and 4254);
- 19 • "Got W-2? 24 Hour Refunds" (*id.* at AG-LIB 4131); and
- 20 • "Got W-2? Most Refunds in 24 Hours" (*id.* at AG-LIB 4025-26, 4051-52, 4062-64, 4080,
21 4110, 4113).²³

22 In addition, Exhibit 76 contains 67 ads that violate B&P § 22253.1(a) by omitting the
23 mandatory bank name and lender fee disclosures, not including the one that Liberty approved.
24 These include: AG-LIB 4048-49, 4065-66, 4072, 4075-78, 4084, 4096, 4099, 4103-04, 4129,
25 4138-39, 4181-83, 4233, 4235-36, 4243, 4253, 4255-57, 4265-66, 4268, 4280-82, 4284, 4288,

26 _____
27 ²³ In addition, franchisee Majeed Ghadialy admitted to running a false and misleading ad
28 that promised "Le Tendremos Su Dinero en 24 a 48 Horas" (i.e., "your money in 24 to 48
hours"). Tr. at 816:26, 817:18-23, and 821:17-19; Ex. 314; Ex. 317.

1 4294-98, 4300-01, 4304, 4312-13, 4321-23, 4329-31, 4353-54, 4358, 4380-81, 4387, 4405-06,
2 4424, 4459, 4462, 4465-66, 4570, and 4592.

3 C. Fair Debt Collection

4 The People contend that Liberty violated state and federal fair debt collection laws, either in
5 its own right or as an aider and abettor of the banks. The People contend that the so-called
6 "cross-collection" scheme is at once unlawful, fraudulent, and unfair under the UCL, and it
7 therefore violates the UCL regardless of whether Liberty or the banks meet the statutory
8 definition of a "debt collector." As discussed below, I conclude that both Liberty and the banks
9 acted as "debt collectors," and that Liberty is also liable for aiding and abetting the banks in
10 violating both the federal Fair Debt Collection Practices Act (FDCPA), 15 U.S.C. § 1692 et seq.,
11 and California's Rosenthal FDCPA, C.C. § 1788.17 et seq.

12 1. Liberty is a "debt collector."

13 First, I conclude that Liberty is a "debt collector" because it "regularly" engages in debt
14 collection. 15 U.S.C. § 1692(a)(6); C.C. § 1788.2(c). Its activities in connection with the
15 collection of debts are routine, performed in the regular course of its business, and integral to the
16 banks' efforts, which are concededly debt collection, Ex. 297. *See also, e.g.*, Ex.2 at 100006
17 (Liberty's contract with FBOD stating that each will help the other, as well as other banks, to
18 collect debts) and Ex.74 at 19273 (Liberty's contract with SBBT stating that it will help SBBT
19 collect debts). The Rosenthal FDCPA defines "debt collection" as "any act or practice in
20 connection with the collection of consumer debts." C.C. § 1788.2(b). Substantial evidence
21 shows that Liberty performed numerous actions "in connection with the collection of consumer
22 debts."

23 Liberty cites *Schroyer v. Frankel*, 197 F.3d 1170, 1174 (6th Cir. 1999) for the proposition
24 that Liberty must have more than an "occasional involvement" with debt collection in order to
25 trigger the state or federal FDCPA. *Schroyer* is only moderately helpful because it dealt with the
26 distinct question of whether attorneys are covered by the FDCPA, and turned on interpreting the
27 effect of the 1986 repeal of a former exemption for attorneys from the FDCPA's coverage. *Id.*

1 More fundamentally, even if a relatively small number of customers owe a past RAL debt,²⁴ the
2 question is one of *regularity*. An activity can be regular and routine without it being “frequent”
3 (whatever that may mean), just as a tax preparer may “regularly” help people with tax returns –
4 even though the work only takes place once a year. So too for example cicadas “regularly”
5 swarm--but only once every seven years. If regular, a practice is predictable, and hence it is fair
6 to impose the strictures of rules which regulate the activity such as state and federal fair debt
7 collection laws.

8 Put another way, the question is simply whether the activity occurs in the “regular course of
9 business.” *Romine v. Diversified Collection Services, Inc.*, 155 F.3d 1142, 1146 (9th Cir. 1998).
10 Thus, in *Romine*, without inquiring into the proportion of its business that consisted of debt
11 collection activities, the Ninth Circuit found that Western Union “regularly” engaged in debt
12 collection because it did so in the usual course of its business. *Romine*, 155 F.3d at 1146.²⁵

13 The Second Circuit recently reversed a district court that had found no coverage under the
14 FDCPA based on arguments similar to Liberty’s. *Goldstein v. Hutton, Ingram, Yuzek, Gainen,*
15 *Carroll & Bertolotti*, 374 F.3d 56, 62 (2d Cir. 2004)(holding that a law firm was “regularly”
16 engaged in debt collection by assessing facts “closely relating to ordinary concepts of regularity,”
17 regardless of whether the entity derives significant portion of its business from debt collection).
18 See also *Oppong v. First Union Morg. Corp.*, 215 Fed.Appx. 114, 119 (3d Cir. 2007).

19 **2. Liberty is liable for aiding and abetting violations by the banks.**

20 In addition, I find that Liberty is liable for aiding and abetting the banks in their violation of
21 the state and federal FDCPAs. As noted, the banks themselves are concededly engaged in debt
22 collection, and Liberty admitted that the banks are debt collectors. See Ex.297 (admitting that the
23 banks provide information “required by” the federal FDCPA, and referencing the bank’s
24

25 _____
26 ²⁴ Liberty argues that .11 percent of its customers were subject to cross-collection. See
27 Ex. 751.

28 ²⁵ Liberty inappropriately cites *Anderson v. Credit Collection Serv., Inc.*, 322 F.Supp.2d
1094 (S.D. Cal. 2004) for the proposition that *Romine* constitutes a “narrow” holding and so not
applicable here. *Anderson* said that, but not related to the issues in the present case.

1 validation notices, which expressly state that they are debt collectors acting under obligation of
2 the federal FDCPA).

3 Further, Liberty provided substantial assistance to the banks in collecting debts and knew
4 precisely what the banks were doing. Thus, the key scienter requirement for aiding and abetting
5 liability is met here. *See, e.g., People v. Costa*, 1 Cal.App.4th 1201, 1211 (1991); *see also, e.g.,*
6 *People v. McLaughlin*, 111 Cal.App.2d 781 (1952).

7 Liberty contracted with the banks to assist them in collecting debts, in a variety of ways.

8 **a. First Bank of Delaware (FBOD).**

9 With FBOD, Liberty's first job was "bringing the consumer [to] the bank." Ex.281 at 28:4-
10 7. Liberty set up the RAL/ERC program with FBOD and used its bank-assignment rights to
11 make FBOD by far Liberty's largest supplier of RALs and ERCs in California from 2002-2005.
12 Ex.300 at p. 2. The FBOD "bank books" described the workings of the cross-collection process
13 in detail, and Liberty required its franchisees to comply with the rules and procedures set out in
14 those manuals.

15 The RAL/ERC applications authorizing collection of prior RAL debts, as well as any other
16 written disclosures or documents provided to customers, were subject to Liberty's "review and
17 approval." Ex.2 at 100002; *see also id.* at 100010 (application to be supplied by FBOD and
18 "approved by JTH"); Ex.275 at 67:13-68:17 (Piper testifying that all forms prepared by FBOD
19 were "reviewed by Liberty's legal department and operations department").

20 Liberty advertised the loans, solicited the loans from customers in the office, filled out and
21 obtained signatures on the loan applications that authorized debt collection. Complaint at 4:2-6
22 (admitted in Answer). After submitting the applications authorizing debt collection, Liberty
23 processed the applications through the bank's automated underwriting system, which was housed
24 and maintained by Liberty at its office in Virginia. *See* Ex.2 at 100012 (¶ 3.c.) and 100016 (¶ 9.a.);
25 Ex.281 at 38:7-39:20. The underwriting system contained the "cross-collection file," which
26 Liberty compiled on behalf of the bank, and which listed customers who supposedly owed prior
27 RAL debts to either FBOD and/or other banks. Ex.275 at 246:6-24; Ex.281 at 40:2-24. The loan
28 underwriting criteria were jointly authored by Liberty and FBOD, and were based, in part, on

1 whether or not the customer owed a prior RAL-related debt to either FBOD or another bank.
2 Ex.275 at 43:16-46:7, 46:21-47:2; Ex.281 at 40:2-8, 13-17; and Tr. at 493:2-499:13.

3 Liberty also assisted the bank in mailing debt validation notices to RAL customers after
4 they were solicited for a loan, had signed the application authorizing debt collection, and were
5 denied a loan because they supposedly owed a prior RAL debt. Tr. at 607:17-19.

6 Pursuant to their contract, Liberty received 65 percent of all debts collected from its
7 California customers. Ex.281 at 28:24-29:18, 29:24-30:15, and 30:18-31:2; Ex.275 at 72:17-
8 73:14 and 273:22-274:1; Ex.301 at 20955 (showing "Cross-collections by FBOD – year
9 received").

10 **b. Santa Barbara Bank & Trust (SBBT)**

11 As with FBOD, Liberty contractually bound itself to facilitate and assist SBBT in collecting
12 debts. Under this agreement, Liberty made SBBT its major supplier of RALs and ERCs in
13 California for a three-year period. Ex.300 at 2; Ex.301 at 20955. And Liberty brought customers
14 to the bank by advertising and marketed RALs offered by SBBT in California. Complaint at
15 ¶14:2-3 (admitted in Answer); *see also, e.g.*, Ex.104 ("Stomp" and "Catch" television ads); Ex.76
16 ("We Wave You Save" ads for SBBT loans); Ex.74 at 19275 (committing Liberty to advertise
17 SBBT bank products).

18 Liberty solicited loans to individual consumers and obtained their signatures on RAL/ERC
19 applications that authorized debt collection, Complaint at 4:3-5 (admitted in Answer); transmitted
20 the signed, completed bank product applications to SBBT, Complaint at 4:5-6 (admitted in
21 Answer), which then deducted any past RAL debts owed by Liberty's customers from their
22 refund proceeds.

23 The facts described above amply demonstrate that Liberty was aware of and fully
24 understood the workings of the cross-collection process and its role in that process. *See also* Ex.2
25 at 100006 (Liberty's agreement with FBOD to "participate in industry-standard cross-collection
26 procedures to the extent it is lawful to do so").
27
28

1 **3. The scheme violates the state and federal FDCPAs.**

2 When a Liberty customer receives a RAL as an advance against the refund, and the refund
3 is not funded, or is smaller than expected, the difference between the loan amount and the refund
4 amount becomes a delinquent loan from the issuing bank. *E.g.*, Ex.34 at 18118; Ex.275 at
5 229:16-24. Liberty's and the banks' efforts to collect these debts are deceptive, 15 U.S.C. §§
6 1692e, 1692e(10), 1692e(11), and 1692g, and unfair, 15 U.S.C. § 1692f, within the meaning of
7 the state and federal FDCPAs. (California's Rosenthal FDCPA incorporates 15 U.S.C. §§ 1692e,
8 f, and g. *See* Civ. Code § 1788.17.) The scheme independently is "fraudulent" and "unfair"
9 within the meaning of the UCL.

10 The RAL and ERC applications used by Liberty in California since 2002 have all contained
11 "authorizations" to collect any unpaid refund loan debts from past years out of the customer's
12 refund proceeds. These debts might be owed to the current lender, or to any number of other
13 RAL lenders. This can occur even with "stale" or otherwise uncollectible debts that are several
14 years old. Exs.135 and 146 (SBBT applications). It is unlikely that customers²⁶ can recall the
15 details of such debts, particularly debts incurred far in the past and perhaps in connection with a
16 loan issued by a different lender and/or obtained through a different tax preparer. Yet neither
17 Liberty nor the banks inform customers *before* inducing them to "authorize" cross-collection
18 whether they are believed to owe a past debt or not. Customers are not screened for a past debt
19 until *after* they have already "irrevocably" authorized the collection of any past RAL debts,
20 including stale debts, from their refund and instructed the IRS to send their refund to the account
21 set up by the bank. Thus, before the customer has been given meaningful notice about the
22 existence of a debt, the customer has lost control of the refund and, as a result, his or her right to
23 effectively dispute the debt. This is precisely the type of outcome the state and federal FDCPAs

24 ²⁶ The test is whether the "least sophisticated consumer" would be misled. *E.g.*, *Swanson v.*
25 *Southern Oregon Credit Serv., Inc.*, 869 F.2d 1222, 1227 (9th Cir.1988). The People introduced
26 some evidence on the subject of consumers' level of sophistication, specifically their likely
27 reading level. I found this evidence of little use, because, for example, it does not provide a basis
28 to infer what consumers might know about their past debts, or their understanding about (i) the
difference between various types of loans and IRS refunds, or (ii) other aspects of the transactions
at issue in this case. My own examination of the evidence here persuades me that the practices
described in the text would confuse and mislead any reasonable consumer.

1 were intended to prevent. The FDCPA's were designed among other things to ensure consumers
2 have a meaningful opportunity to dispute purported debts, 15 U.S.C. §§ 1692e, f, & g, and to
3 "eliminate the recurring problem of debt collectors dunning the wrong person or attempting to
4 collect debts which the consumer has already paid. S.Rep.No. 95-382, 9th Cong., 1st Sess. 4
5 (1977)." *Read v. Amana Collection Servs., Inc.*, 1991 WL 5155 (W.D.N.Y. Jan. 15, 1991) *2.
6 By seizing control of taxpayers' refunds before providing them any meaningful notice that they
7 are believed to owe a debt, even a stale and possibly uncollectible debt, the collection scheme at
8 issue is deceptive, unfair, and frustrates the fundamental purpose of the state and federal
9 FDCPA's.

10 The RAL/ERC applications do not clearly and effectively communicate the fact that the
11 bank is acting as a debt collector and that any information obtained may be used for that purpose.
12 *See* 15 U.S.C. § 1692e(11). Customers are not screened for a past debt until *after* they have
13 "authorized" cross-collection. Yet the SBBT RAL/ERC applications state only that the bank
14 "may" be acting as a debt collector. The 2002 FBOD application did not contain the statements
15 required by Section 1692e(11), and the 2003-2005 FBOD applications did not clearly and
16 effectively communicate the required information. It appeared on the second page (in 2005, on
17 the third page) of lengthy and complex contracts that, on their face, have nothing to do with debt
18 collection, making it unlikely consumers would read and understand the significance of the
19 information. (*Read, supra*, 1991 WL 5155 at *2 (holding that section 1692e(11) is violated
20 where the defendant "made the requisite disclosure but . . . in such a manner that the least
21 sophisticated debtor would not be assured of receiving it."); *accord Swanson v. Southern Oregon*
22 *Credit Service, Inc.*, 869 F.2d 1222, 1225 (9th Cir. 1988); *Riviera v. MAB Collections, Inc.*, 682
23 F.Supp. 174, 177 (W.D.N.Y. 1988).

24 Further, I disagree with Liberty's contention that consumers with prior RAL debts are not
25 likely to be deceived. The RAL/ERC applications have stated in some years that if the customer
26 owes a debt and does not want it collected, s/he should not sign up for a RAL or an ERC. But, as
27 explained above, this does not negate the fundamental problem with the scheme, which is that
28 consumers are not told whether they owe a debt before being induced to irrevocably authorize

1 cross-collection, even of stale debts they may not recall, and/or debts that they may not
2 legitimately owe. Contrary to Liberty's claims, there is no reason to assume consumers who owe
3 a prior RAL debt would have a "heightened understanding" of that fact. There is no substantial
4 evidence supporting the argument. *See* People's Post-Trial Reply Brief at 21 & n.16. Indeed, Mr.
5 Piper testified that customers subject to cross-collection become "irate" and usually take their
6 business elsewhere. They would have no reason to become upset if, as Liberty contends, the
7 process were adequately disclosed and those customers with past debts actually knew they owed a
8 debt.

9 The People suggest that Liberty violated the law regardless of whether a debt is actually
10 collected in a given transaction, and indeed regardless of whether the customer has any debts to
11 collect. Each and every time a customer applies for a RAL or an ERC, the People argue, Liberty
12 and the banks are attempting to collect a past RAL debt in a deceptive manner. True, all unfair
13 and deceptive "attempts" to collect debts are barred, 16 U.S.C. §§ 1692e, e(10), & f, not just
14 successful attempts. But there must at least be a debt involved in the attempted transaction. The
15 statute assumes the existence of such a debt as it bars certain representations "in connection with
16 the collection of any debt." 15 U.S.C. § 1692e. The consumers protected by the federal
17 legislation are those with debts. *See generally*, S.Rep. No. 95-382, at 1 (1977), *reprinted in* 1977
18 U.S.C.C.A.N. 1695, 1696, 1698-99, *cited in, e.g., Clark v. Capital Credit & Collection Services,*
19 *Inc.*, 460 F.3d 1162, 1170 (9th Cir. 2006). Thus Liberty violates the FDCPA's in those cases
20 where it attempts to collect an extant debt through cross collection, which here is with regard to
21 118 customers.²⁷

22
23 ²⁷ Without a debt, an attempt to collect it is not possible. *Cf.*, 1 B. Witkin, CALIFORNIA
24 CRIMINAL LAW, Elements (3d ed. 2000) § 61, p. 269 (impossibility as defense to attempt). To be
25 sure, Congress intended to protect consumers who owed nothing but were mistakenly harassed by
26 unscrupulous debt collectors. *Shapiro v. Law Offices of Cohen & Slomowitz, LLP.*, 2007 WL
27 958513, at 4 (S.D.N.Y. 2007), *citing* H.R.Rep. No. 131, 95th Cong. 1st Sess. 8. Nevertheless
28 such harassment concerns an extant debt. "Certainly a person who has a common name and is
being hounded by a debt collector *because of the debts of another* person deserves the protection
this legislation will offer." *Shapiro, op. cit. quoting* H.R. Rep No. 1202, 94th Cong.2d Sess. 5
(emphasis supplied). *See also, Dutton v. Wolhar*, 809 F.Supp. 1130, 135 (D.Del.1992). The
People have not established here that persons not subject to cross-collection were harassed or
otherwise adversely affected.

1
2 **D. Consumer Legal Remedies Act**

3 The RAL and ERC applications used to effectuate the cross-collection state that applying
4 for a RAL or an ERC “may result in you repaying debt, *even if the entity to whom you owe such*
5 *debt is prevented by law from bringing a lawsuit against you to collect the debt.*” Exs.135 and
6 146, italics added. As such, they purportedly authorize the collection of any and all past RAL
7 debts, including “stale” debts that ordinarily could not be recovered as a matter of law due to the
8 passage of time. The People contend this violates the Consumer Legal Remedies Act, which
9 prohibits, *inter alia*, “[r]epresenting that a transaction confers or involves rights, remedies, or
10 obligations which it does not have or involve, or which are prohibited by law.” C.C. §
11 1770(a)(14). I agree. Liberty is liable for aiding and abetting SBBT in violating § 1770(a)(14)
12 and, by extension, the UCL; because this conduct is deceptive, it also violates the FAL.

13 Under California law, in order to collect a “stale” debt, the debt must be revived in writing,
14 in the form of an express promise to pay or an unconditional acknowledgment of the
15 indebtedness, signed by the debtor, and communicated to the creditor or his agent or
16 representative. 3 B. Witkin, CALIFORNIA PROCEDURE, Actions § 680 (4th ed. 1997). There must
17 be evidence of a clear and unqualified acknowledgment of the debt. *Steiner v. Croonquist*, 108
18 Cal.App.2d Supp. 895, 899 (1951). The SBBT application fails on its face to meet these
19 requirements, and neither Liberty nor the banks provide customers any other information that
20 would rectify the problem. Contrary to the representations on the face of the SBBT applications,
21 consumers cannot unequivocally and unconditionally acknowledge a stale debt merely by signing
22 an application for a RAL or an ERC without first even being told that they are believed to owe a
23 debt, or any details about the supposed debt.

24 Liberty argues that the CLRA does not apply because the statute does not cover credit
25 transactions, but covers solely sales of goods and services. C.C. § 1770. *Berry v. American*
26 *Express*, 147 Cal.App.4th 224, 233 (2007)(“credit transactions separate and apart from any sale or
27 lease of goods or services are [not] covered” by the statute). Echoing the “separate and apart”
28 language from *Berry*, some federal courts have found that the statute does apply when the

1 extension of credit is made in *conjunction* with goods and services. *Hernandez v. Hilltop*
2 *Financial Mortg., Inc.*, 2007 WL 3101250, 6 (N.D.Cal. 2007), *citing* *Jefferson v. Chase Home*
3 *Finance LLC*, No. C06-6510, 2007 WL 1302984, at *3 (N.D.Cal. May 3, 2007); *Knox v.*
4 *Ameriquist Mortgage Co.*, No. C05-00240, 2005 WL 1910927, at *4 (N.D.Cal. Aug.10, 2005); *In*
5 *re Ameriquist Mortgage Co.*, No 05-CV-7097, 2007 WL 1202544, at *6 (N.D.Ill. Apr.23, 2007).
6 Liberty's post-trial briefing takes solace from a recent Supreme Court opinion which "cites *Berry*
7 with approval," Liberty's Proposed Statement of Decision at 7. *Fairbanks v. Superior Court*, 46
8 Cal.4th 56, 61-62 (2009) does cite *Berry*, but the approval is just for *Berry's* method of statutory
9 analysis, and neither *Berry* nor *Fairbanks* reflects on the approach taken by the District Court in
10 *Hernandez*.

11 If *Berry's* "separate and apart" language has substance, extensions of credit made in
12 conjunction with what are otherwise goods or services are covered by the CLRA. Here, the
13 RALs and ERCs are in effect marketing tools: as virtually all the advertng discussed above
14 reveals, they are primarily designed to bring in customers for Liberty's tax preparations services
15 (Tr. 525:26-527:15), and they are offered *only* in conjunction with those services. For these
16 reasons I conclude that *Berry* does not bar the application of the CLRA here.

17 E. Deceptive Marketing of ERCs/TILA

18 The People contend that ERCs are deceptively marketed as a convenience product, when in
19 fact they are form of credit, i.e., a vehicle for deferring the cost of tax preparation. *See, e.g.*,
20 Exs.137 at 11058, 140 at 11022, and 141. The People further contend that the ERC "handling
21 fee" is a finance charge within the meaning of the Truth-In-Lending Act, 15 U.S.C. § 1601 *et*
22 *seq.*, and that the failure to disclose it as such is deceptive under the UCL and the FAL. Liberty
23 contends that ERCs are not credit and that, in any event, this liability theory is preempted by the
24 National Bank Act.

25 Liberty's National Bank Act preemption defense fails because Liberty has not established
26 that any bank it did business with in California was a national bank during the relevant time
27 period. Liberty has the burden of proving the factual predicates for the preemption defense and it
28 has not met its burden.

1 Liberty is also incorrect that this liability theory targets conduct by the banks. It cites
2 *Pacific Capital Bank, N.A. v. Connecticut*, 542 F.3d 341 (2d Cir. 2008), but that case involved a
3 perceived attempt by a state to regulate the *rate of interest* that national banks could charge on
4 RALs. Here, in contrast, the “handling fee” is shared between Liberty and the bank. Moreover,
5 the fact that this fee is charged indirectly (i.e., through the bank) does not affect its status as a
6 finance charge. See *Yazzie v. Ray Vicker’s Special Cars, Inc.*, 12 F.Supp.2d 1230, 1232 (D.N.M.
7 1998) (“the important question is whether the seller refuses to extend credit until the consumer
8 agrees to pay the charge and details of the manner in which the charge is imposed are irrelevant”).
9 Liberty requires payment for tax preparation at the time the return is prepared and filed, unless the
10 customer purchases an ERC (or a RAL). Ex.156 at 11581; Ex.275 at 311:12-312:5; 313:5-314:6;
11 Ex.42 at 28071 (for paper returns filed by mail, “accept payment before giving the completed
12 return to the customer”; for e-filed returns, “[p]ayment must be made by the client before the
13 return is processed.”). Stated differently, in order to defer payment of tax preparation fees, a
14 customer must obtain an ERC and pay the “handling fee.” This makes the handling fee a finance
15 charge. *Berryhill v. Rich Plan of Pensacola*, 578 F.2d 1092, 1099 (5th Cir. 1978); see also, e.g.,
16 *White v. Diamond Motors, Inc.*, 962 F.Supp. 867, 871 (M.D. La. 1997), quoting, *First Acadiana*
17 *Bank v. FDIC*, 833 F.2d 548, 550 (5th Cir.1987) (test for a finance charge is whether the seller
18 “would not extend credit otherwise”).
19
20
21

22 Liberty argues the handling fee is not a finance charge because it is also charged in
23 “comparable cash transactions,” which Liberty defines as customers who paid for tax preparation
24 in cash and at the same time purchased an ERC. About 60,000 California customers purchased
25 ERCs between 2002-2007, Ex.301 at 20955, but Liberty could only verify that four of them paid
26 cash for tax preparation. These are “insignificant exceptions” to what is, for all practical
27 purposes, a credit sale business. *Carney v. Worthmore Furniture, Inc.*, 561 F.2d 1100, 1102-03
28

1 (4th Cir. 1977). Liberty has not established a “substantial cash business,” obviating Liberty’s
2 “comparable cash transaction” defense. *Id.*

3 Liberty cited the testimony of a single franchisee to make an argument that it accepts “post-
4 dated checks” for tax preparation. But Liberty’s franchise documents require payment in
5 advance, and the fact that a single franchisee takes post-dated checks does not change the result.
6 Liberty also argues that franchisees accept credit cards, but there is no deferral of payment in
7 those circumstances.
8

9 Finally, based on *Davis v. Pacific Capital Bank, N.A.*, 550 F.3d 915 (9th Cir. 2008), Liberty
10 argues that because the handling fee is a flat charge, it is not “interest.” Whether or not a
11 ‘handling fee’ is ‘interest,’ the fact remains that it is a finance charge.²⁸ *Davis* itself distinguishes
12 “finance charges,” which comprise a broader category of payments for credit, from “interest,”
13 which is one form of a finance charge.
14

15 In sum, I find that the ERC handling fee is a finance charge for deferring the cost of tax
16 preparation and that the failure to disclose it as such is deceptive under the UCL and the FAL.
17

18 **F. Violation of Taxpayer Privacy Laws**

19 The Attorney General contends that Liberty violated the UCL by disclosing client tax
20 information to lenders without first obtaining a “separate written disclosure” for each disclosure
21 or use. Complaint, ¶ 48(e). Since 2005, Liberty has been using a separate form to obtain
22 customers’ consent to use their tax return information for obtaining a bank product.

23 B.& P. § 17530.5(a)(2) allows use of consents if the consent to use taxpayer information is
24 “[e]xpressly authorized by . . . federal law.” Federal law does not require a separate document,
25 only separate consent: “A *separate written consent*, signed by the taxpayer or his duly authorized
26 agent or fiduciary, must be obtained for each separate use or disclosure” 26 C.F.R.

27 ²⁸ ERCs allow customers to “defer” tax preparation fees (Tr. 404:1-2, 403:26-27). See Ex.
28 45 at 29426 (fees taken from the check); Ex. 275 at 311-314.

1 § 301.7216-3(b) (emphasis added).²⁹ Here, the consents were indeed separate from consents
2 obtained for other purposes. The People believe that even under federal law consent must be
3 made through a separate *document*. There is no authority for this. Liberty did not violate federal
4 or state law in the manner in which it obtained customers' consents to release their privacy
5 information.

6 **G. Violations of the Credit Services Act**

7 The People charge Liberty with violations of the Credit Services Act of 1984, C.C.
8 § 1789.10 *et seq.* "Liberty has sold, provided, or performed for its clients the services of
9 obtaining RALs funded by Liberty's partner lenders, and/or providing advice or assistance to its
10 clients with respect to obtaining RALs funded by Liberty's partner lenders. Therefore, Liberty
11 meets the definition of a 'credit service organization' under state law." Complaint, ¶ 48(g). The
12 People must establish three elements: (i) A person must receive compensation, (ii) for
13 performing services, (iii) in connection with assisting a buyer obtain an "extension of credit by
14 others." C.C. § 1789.12. The People contend this is what California franchisees did, at least
15 prior to 2005, when they received an "application fee."

16 The statute requires registration by those who collect the fee. The fee, however, was
17 collected by the franchisees, not Liberty. Liberty was not required to register. The People
18 provide no coherent theory as to why Liberty is liable for any failure of the franchisees to register.
19 Hence, Liberty is not liable on this claim.

20 **H. Violations of IRS's Ban on Contingent Fees**

21 The People have argued that "Liberty took banned 'contingent fees' from [First Bank of
22 Delaware] during tax season 2002-2005." Post-Trial Brief, 80:6-12. This follows, it is said,
23 because of Liberty's fee-sharing arrangement with FBD by which Liberty earned 65% of so-
24 called Bank Product revenue. The People argue this is a contingent fee prohibited by IRS
25 Publication 1345, *id.* at 82:5-11, and thus "unfair" within the meaning of § 17200.

26
27 ²⁹ These regulations were re-written effective January 1, 2009. 73 Fed. Reg. 1058 (Jan. 7,
28 2008).

1 The People suggest that because this practice (i) breaches an “established public policy”
2 and harms the income tax system and the public, it violates the UCL. People’s Objections to
3 Proposed Statement of Decision at 11. That memorandum goes on to argue that ‘harm’ to
4 consumers (which I assume is the ‘public’) need not be shown (although if shown, it would be
5 enough). Indeed I was presented with no evidence of such harm.

6 Thus I must turn to the notion that any violation of an established ‘public policy’ is a
7 violation of the UCL. The People refer me to *Progressive West Ins. Co. v. Yolo County Superior*
8 *Court*, 135 Cal.App.4th 263, 286 (2005) which states the bases for UCL liability: viz., an act
9 which “offends an established public policy or when the practice is immoral, unethical,
10 oppressive, unscrupulous or substantially injurious to consumers,” 135 Ca.App.4th at 286, *citing*
11 *Smith v. State Farm Mutual Automobile Ins. Co.*, 93 Cal.App.4th 700, 719 (2001).

12 This broad scope is “too amorphous” in private action UCL contexts. *Cel-Tech*
13 *Comm., Inc. v. Los Angeles Cellular Tel. Co.*, 20 Cal.4th 163 (1998), and the Supreme Court
14 likely has signaled a contraction of eligible acts more generally. *Puentes v. Wells Fargo Home*
15 *Mortg., Inc.*, 160 Cal.App.4th 638, 647 (2008), *citing Scripps Clinic v. Superior Court*, 108
16 Cal.App.4th 917, 940 (2003) and *Gregory v. Albertson's, Inc.*, 104 Cal.App.4th 845, 854 (2002).
17 *Compare Bardin v. Daimlerchrysler Corp.*, 136 Cal.App.4th 1255, 1268 (2006)(court conducts
18 “an examination of [practices’] impact on its alleged victim, balanced against the reasons,
19 justifications and motives of the alleged wrongdoer”).

20 The Supreme Court’s warnings in *Cel-Tech* that the “public policy” branch of UCL
21 liability is notoriously susceptible of abuse is well taken, regardless of whether a private action
22 such as *Cel-Tech*, or a public one such as this, is in play. A “public policy which is a predicate to
23 the action must be ‘tethered’ to specific constitutional, statutory or regulatory provisions.”
24 *Puentes*, 160 Cal.App.4th at 647. Any such regulatory provision should demonstrably carry out
25 statutory policy. *Cel-Tech*, 20 Cal.4th at 185. The People point me to no such statutory policy,
26 and with *Cel-Tech’s* admonitions in mind, it is too much to conclude that a breach of any IRS
27 regulation necessarily triggers liability under California’s UCL. Accordingly I reject liability
28 premised on a contravention of IRS Publication 1345.

1 **III. REMEDIES**

2 Civil penalties, a permanent injunction, and restitution should be ordered for the violations
3 of the UCL and the FAL discussed above.

4 **A. Penalties**

5 The parties dispute the means by which I should count a “violation” for purposes of
6 assessing penalties.

7
8 The Attorney General, district attorneys, and certain other designated public legal
9 officers are empowered to seek and obtain injunctive relief against violations of section
10 17500 (§ 17535) and section 17200 (§ 17203) and to recover civil penalties on behalf of
11 the government in an amount not to exceed \$2,500 for each violation of the false
12 advertising statute (§ 17536) and for each violation of the unfair competition statute (§
13 17206). A violation of the false advertising statute is also made a misdemeanor. (§ 17500.)

14 *People v. Superior Court (Olson)*, 96 Cal.App.3d 181, 190-191 (1979).

15 The proper measure of advertising violations is neither the circulation of a newspaper, 96
16 Cal.App.3d at 197 (not every subscriber reads the ads), nor to count as one violation each edition
17 of the paper. *Id.* “Rather, a reasonable interpretation of the statute in the context of a newspaper
18 advertisement would be that a single publication constitutes a *minimum* of one violation with as
19 many additional violations as there are persons who read the advertisement.” 96 Cal.App.3d at
20 198 (emphasis in original).

21 The submissions from the parties on the specific sums to be assessed are of limited
22 assistance. Despite my request, Liberty did not describe the calculations by which it arrived at its
23 modest suggestions. The People generally but not always did so, and did not explain why they
24 used e.g. \$10 as a base penalty per violation the Origami ad and e.g., \$1 for the Spanish language
25 ad, and how other base penalties were generated.

26 These sort of calculations concededly are not a science. In mine, I have been guided
27 primarily by the seriousness of the violation, which I believe to be a function of Liberty’s role and
28 the nature of the violation. The penalties should be highest when ads are for example created by

1 Liberty, somewhat less when Liberty approved them, and markedly less when Liberty is
2 indirectly liable. Disclosure violations should be punished most severely when they appear
3 willful (Stomp & Catch) and less so when, at least initially, a mistake may have been involved
4 (Spanish language ad). These considerations are augmented or countered when the violation lasts
5 for years or when, as with Origami, Liberty would approve the ad today despite its illegality. I
6 also have considered the relative harm to consumers. Thus, for example, cross-collections which
7 deceptively obtained authorization to go after debts without informing consumers I treat as more
8 serious than ERC/TILA violations, where the consumers willing paid the fees for the services
9 (including the extension of credit) they received, albeit without full disclosure of exactly what the
10 fees were for. *See generally, People v. Beaumont Inv., Ltd.*, 111 Cal.App.4th 102, 129-130
11 (2003).
12

13
14 There are no figures on the number of people who read the *PennySaver* or Yellow pages
15 ads, and so I must estimate this. To do so, I use a fraction of circulation as a proxy for
16 readership. Instead of using e.g. \$1 per violation multiplied by the circulation, I use a far lower
17 dollar figure to be multiplied by the circulation to approximate actual readership.

18 In connection with what is referred to below as the "Single Liberty-approved PennySaver
19 ad" a deconstruction of the People's recommendation suggests 0.0028 per violation (assuming for
20 sake of illustration a violation occurs for each person the item is circulated to). The same process
21 suggests \$0.0088 for the Liberty-approved *PennySaver* ads (promising "most refunds in one
22 day"); \$20 for each Franchisee *PennySaver* ad, and \$7 per Yellow pages violation. The large
23 number of ads in these publications suggests a relatively low dollar figure should be used (if
24 circulation is used as the initial touchstone, which I do to estimate actual readership). But the
25 discrepancies among the base figures used by the People are not explained. I will generally use
26 0.0088 for *PennySaver* violations on a circulation basis. I use \$400 for the Yellow Pages to
27
28

1 account for its persistence and continued availability through the year, the fact that more than one
2 person may consult a given volume, as well as the seriousness of the offense.

3 The parties dispute the manner of counting misleading *PennySaver* and Yellow Pages ads.
4 *PennySaver* is a weekly, and the People count it once for each day of availability (i.e. 7 total)
5 because in *Olson* a daily newspaper was counted once for each day. This is unfair here: one can
6 reasonably expect consumer to read a daily paper every day, but not that they will read a single
7 weekly again and again throughout the week. I count a weekly publication once. For the same
8 reason, I count a Yellow Pages ad once, albeit a serious, highly persistent one.

9
10 Ultimately, I must also to consider "all pertinent factors including the kind of
11 misrepresentations or deceptions, whether they were intentionally made or the result of
12 negligence, the circulation of the newspaper, the nature and extent of the public injury, and the
13 size and wealth of the advertising enterprise." 96 Cal.App.3d at 199. Among other things, I have
14 considered the nature and seriousness of the misconduct, the period of time over which it
15 occurred, willfulness, and representations concerning Liberty's assets. B&P §§ 17206, 17535.
16 Violations of B&P §§ 17500 and 17200 generate doubled penalties. *Toomey, supra*, 157
17 Cal.App.3d at 22. And finally, even after my calculation based on a reasonable estimate for each
18 factor, there are some totals which are unconscionably high, and thus I must and do substantially
19 reduce the penalty.³⁰
20
21

22 Origami

- 23 • unique impressions (i.e., number of individuals who saw the ad) plus the number of times
24 the ad ran = 13,294 + 218 (Exs. 70, 102)
- 25 • Double number of violations (violates both UCL and FAL) = 27,024 violations

26 ³⁰ Setting aside all the Yellow Pages and PennySaver ads, there are 590,996 violations
27 (violations are usually counted twice, one for UCL and one for FAL) each of which could be
28 penalized at \$2500, for a potential exposure of \$1,477,490 000.00 (just under 1.5 billion dollars).

- 1 • willful and serious violation of a clear standard that Liberty was intimately familiar with
2 given its history of litigation against H&R Block; Liberty would approve the same ad
3 today
- \$ 5/violation = \$ 135,120

4 Spanish-language television ad (most "reembolsos" in 24 hours)

- 5 • unique impressions + number of times the ad ran = 85,031 + 151 (Exs. 66, 67 at AG-
LIB00465-470, and 102)
- 6 • Double number violations = 170,364 violations
- 7 • serious violation of a clear standard that Liberty was intimately familiar with given its
8 history of litigation against H&R Block; Liberty testimony that it was mistakenly
9 approved by Ms. O'Gorman; partially offset by fact that ad was again approved for use in
California by Loubna Rachid, who had authority to approve Spanish-language advertising
on Liberty's behalf.
- \$1/violation = \$ 170,364

10
11 Liberty-approved PennySaver ads (promising "most refunds in one day")

- 12 • *PennySaver* is a weekly magazine;
- 13 • 4 ads (x) 2 (violates both UCL and FAL) = 8
- 14 • serious violation of a clear standard that Liberty was intimately familiar with given its
15 history of litigation against H&R Block
- 16 • ads were mailed directly to 85,000 homes; *PennySaver* thought by Liberty and franchisees
to be particularly effective.
- 8 x 85,000 x 0.0088 = \$ 5,984

17 Single Liberty-approved PennySaver ad

- 18 • 1 ad (x) 2 (violates both UCL and FAL) = 2
- 19 • serious violation
- 20 • ad was mailed directly to 174,500 homes; *PennySaver* thought by Liberty and franchisees
to be particularly effective
- 2 x 174,500 x 0.0088 = \$ 3,071

21 Yellow Pages ads

- 22 • YP ads are in circulation for a year;
- 23 • 36 ads (x) 2 (violates both UCL and FAL) = 72
- 24 • serious violation;
- 25 • persistent;
- 26 • Liberty testified that ads ran by mistake; offset by fact that, after ads began to run in 2006,
the same ads continued to run in 2007 and 2008.
- \$400 x 72 = \$28,800

27
28

1 Stomp and Catch

- 2 • 273,240 violations, calculated as unique impressions (i.e., number of individuals who saw
3 the ads) plus the number of times the ads ran = 135,160 + 1,460 (Exs. 67 at AG-
4 LIB00483-520 and 102)
- 5 • Violates both UCL and FAL; number of violations doubled
- 6 • serious violation; mandatory language was plainly designed to be overlooked by consumers
- 7 • \$3/violation to reflect the patently and deliberately illegible warnings
- 8 • 273,240 x 3 = \$ 819,720
- 9 • Nevertheless this figure is disproportionate to the one Liberty episode in creating this ad,
10 and accordingly in fairness I reduce this by ½ to \$409,860

11 Franchisee advertising

- 12 • 110 ads (x) 2 (ads violate both UCL and FAL)
- 13 • serious violation; Liberty did not devote sufficient resources to monitoring franchisee
14 advertising, and Liberty knew it had a problem with unapproved and illegal advertising in
15 the *PennySaver* in particular, but failed to take steps to stop it; Liberty then took little or
16 no corrective action to prevent similar occurrences
- 17 • persistent; illegal advertising ran in 2007 and 2008 and involved a large number of
18 franchisees and area developers
- 19 • ads were mailed to millions of homes (I assume one million for present purposes)
- 20 • *PennySaver* thought by Liberty and franchisees to be particularly effective
- 21 • Reduced base penalty because of indirect liability; People's proposal assuming circulation
22 of 1,000,000 = base rate of \$0.00002. I reduced the base rate from that used above in
23 connection with direct liability (0.0088). I preliminarily use a figure half-way between
24 that and the base rate used above, which = 0.0044
- 25 • 0.0044 x 220 x 1,000,000 = \$ 968,000
- 26 • Nevertheless this figure is grossly disproportionate to Liberty's role, harm done to
27 consumers, and the *in terrorem* goal of penalties. The People have asked for \$30,800.
28 With all factors considered, I will set the penalty at \$50,000.

19 Cross-Collection/fair debt collection laws and CLRA

- 20 • Number of debts actually collected = 118 between 2002 and 2005 (Ex.751)
- 21 • [Liberty did not have data available on number of debts collected for later years. Ex.305
22 (supplemental response to interrogatory 14)]
- 23 • Number of violations doubled (conduct violates both UCL and FAL)
- 24 • serious violations and very serious impact on consumers
- 25 • persistent and long-standing misconduct
- 26 • Base penalty of \$500 per violation
- 27 • Penalty = 118 x 500 x 2 = \$118,000

26 ERCs/TILA

- 27 • each ERCs sold in California = 2 violations (UCL and FAL)
- 28 • 60,125 ERCs (x) 2 = 120,250

- 1 • serious violation;
- 2 • persistent; has occurred over a long period of time; offset by potentially unsettled area of law
- 3 • At \$2 per violation = \$240,500

4
5 Pursuant to B&P §§ 17206 and 17536, Liberty should be ordered to pay civil penalties of
6 \$1,161,699. A civil penalty in this amount is necessary and appropriate both to punish Liberty for
7 its misconduct and to deter both Liberty and others from engaging in similar misconduct in the
8 future. This penalty is fair in light of the evidence and the applicable equitable considerations.

9 **B. Restitution**

10 Liberty is concerned that the People's request for restitution exceeds statutory authority,
11 constituting what has been termed "nonrestitutionary disgorgement of profits," *Korea Supply Co.*
12 *v. Lockheed Martin Corp.*, 29 Cal.4th 1134, 1148 (2003). Liberty notes that it was its franchisees
13 and the banks which actually took in many of the fees the People now seek to recoup in this
14 action. Despite Liberty's reliance on the case, *Korea Supply* is not authority for Liberty's
15 position. The 'restitution' claim there failed not because the sums were demanded from the
16 wrong entity, but because the "plaintiff does not have an ownership interest in the money it seeks
17 to recover from defendants," *Korea Supply*, 29 Cal.4th at 1149.³¹ Indeed, the use of the Court's
18 disjunctive here suggests Liberty is wrong: "Under the UCL, an individual may recover profits
19 unfairly obtained to the extent that these profits represent monies given to the defendant *or*
20 benefits in which the plaintiff has an ownership interest." *Korea Supply Co.*, 29 Cal.4th at 1148
21 (citing cases)(emphasis supplied).

22
23
24 It is not enough for Liberty to argue, as it does, that because certain fees ended up in the
25 hands of the banks and franchisees, Liberty cannot be commanded to make restitution. The

26
27 ³¹ For exactly the same reason Liberty cannot rely on *In re First Alliance Mortg. Co.*, 471 F.3d
28 977, 997-998 (9th Cir. 2006)(citing *Korea Supply*). See generally discussion at *Shersher v.*
Superior Court, 154 Cal.App.4th 1491, 1499 (2007).

1 'controlling' case according to Liberty is *Bradstreet v. Wong*, 161 Cal.App.4th 1440 (2008).

2 Liberty doubtless means this language:

3 In the absence of a finding that intervener performed labor for defendants personally,
4 rather than for the benefit of Wins Corporations, or that defendants appropriated for
5 themselves corporate funds that otherwise would have been used to pay the unpaid wages,
6 we agree with the trial court's conclusion that an order requiring defendants to pay the
unpaid wages would not be 'restitutionary as it would not replace any money or property
that defendants took directly from' intervener.

7 *Bradstreet*, 161 Cal.App.4th at 1460.

8 But the citation is as inapposite here as it was in *Grodensky v. Artichoke Joe's Casino*, 171
9 Cal.App.4th 1399, 1430 (2009) which quotes this language only to point out that *Bradstreet* was
10 concerned solely with the liability of officers and directors of the corporation, not the corporation
11 itself. Indeed there was no question that the moneys at issue in *Bradstreet*, although not
12 ultimately held by the company, *could* be the subject of restitution against the company.
13 *Grodensky, op.cit.* Notably, *Grodensky* approves the disgorgement from the company of moneys
14 that ended up in the hands of the company's agents by virtue of the company's UCL violations.
15 *See also, Matoff v. Brinker Restaurant Corp.*, 439 F.Supp.2d 1035, 1038 (C.D.Cal., 2006).

16 Nor is *Inline, Inc. v. A.V.L. Holding Co.*, 125 Cal.App.4th 895, 904 (2005) of any use to
17 Liberty. There, the contested sum was neither paid to the defendant nor to any of its agents,
18 conspirators, or fellow aiders and abettors. Rather, plaintiff "paid [the money] to a third party"
19 and the sum was not 'acquired by means of such unfair competition.' To the contrary [... plaintiff
20 spent the money] in an arm's-length business transaction." *Id.* Because the sums at issue here
21 went to franchisees under the control of Liberty, and banks with which Liberty was at least an
22 aider and abettor, it is fair to turn to Liberty to recoup the money.

23 As the sole type of restitution sought by the People on the theories of liability I have
24 sustained, Liberty should restore any money received as a result of the collection of past RAL
25 debts from California customers: \$135,886. *See Ex. 301 at 20955. B&P §§ 17203, 17535.*

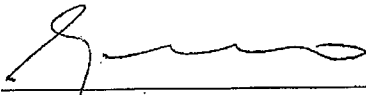
1 C. Injunctive Relief

2 Pursuant to B&P §§ 17203 and 17535, an injunction should issue. I recognize Liberty's
3 suggestion of a three year injunction, but I favor a permanent injunction. I will retain jurisdiction,
4 and Liberty retains the right at some future date to seek modification of the terms. The injunction
5 must address Liberty's failures not only to educate its own internal staff on the legalities of
6 advertising, but its failure in controlling its franchisees. The injunction I have ordered addresses
7 these matters, as well as other obvious issues such as proper disclosures.

8 Several of Liberty's objections to the People's proposed injunction deserve comment. First
9 its objections to terms requiring better supervision of franchisees is rejected for reasons stated
10 above. I also reject the suggestion that I should refrain from requiring enforcement of a current
11 Liberty policy; without an injunction, Liberty could easily and indeed unilaterally change its
12 policies. Next, I agree that the wording of the injunction must be precise, and mandates to
13 'enforce' a policy are too vague. I have provided specificity, although perhaps rather more detail
14 than Liberty sought. I disagree with Liberty that reporting failures to the Attorney General is
15 'punishment'—it is, rather, both an *in terrorem* clause as well as a means of assisting this Court
16 in ensuring the terms of the injunction are carried out and punishing knowing violations of its
17 terms. Finally, I agree that requiring that a copy of the injunction be served on any prospective
18 franchisee is heavy handed. My concern is to ensure actual franchisees are on notice of the
19 injunction's terms, and it is so written.

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Dated: June 15, 2009


Curtis E.A. Karnow
Judge of the Superior Court

SUPERIOR COURT OF CALIFORNIA
County of San Francisco

THE PEOPLE OF THE STATE OF CALIFORNIA

PLAINTIFF

VS.

JTH TAX, INC. (DBA LIBERTY TAX SERVICE) et al

DEFENDANT

Case Number: CGC - 07 - 460778

CERTIFICATE OF MAILING
(CCP 1013a (4))

I, Dennis D. Vegas, a Deputy Clerk of the Superior Court of the County of San Francisco, certify that I am not a party to the within action.

On 6-15-09 I served the attached Statement Of Decision by placing a copy thereof in a sealed envelope, addressed as follows:

PAUL STEIN
DEPARTMENT OF JUSTICE
OFFICE OF THE ATTORNEY GENERAL
455 GOLDEN GATE AVENUE, SUITE 11000
SAN FRANCISCO, CA 94102-7004

SHELDON H. JAFFE
DEPARTMENT OF JUSTICE
OFFICE OF THE ATTORNEY GENERAL
455 GOLDEN GATE AVENUE, SUITE 11000
SAN FRANCISCO, CA 94102-7004

WILLIAM LEWIS STERN
425 MARKET ST
SAN FRANCISCO, CA 94105-2482

BRIAN J. MARTINEZ
425 MARKET ST
SAN FRANCISCO, CA 94105-2482

and, I then placed the sealed envelopes in the outgoing mail at 400 McAllister Street, San Francisco, CA. 94102 on the date indicated above for collection, attachment of required prepaid postage, and mailing on that date following standard court practices.

Dated: 6/15/09

GORDON PARK-LI, Clerk

By:



Dennis D. Vegas, Deputy Clerk