Superior Court of the State of California
County of San Diego

Mike Hernandez and Amanda Georgino, on behalf of themselves and all others similarly situated,	)	Case No. 37-2008-94395-CU-BT-CTL
Plaintiffs,	)	**Proposed Statement of Decision And Judgment**
v.	)	
Restoration Hardware, Inc., A Delaware corporation,	)	
Defendant.	)	

This action came on regularly for bench trial between January 6 and 17, 2014 before the Honorable William S. Dato, Judge presiding. James R. Patterson and Allison H. Goddard of the Patterson Law Group and Gene J. Stonebarger of Stonebarger Law appeared on behalf of plaintiffs and the

certified class. David F. McDowell, Purvi G. Patel, and Jonder Ho of Morrison & Foerster LLP appeared on behalf of defendant Restoration Hardware, Inc. Oral testimony and documentary evidence were introduced by the parties, and closing briefs were filed. Having considered the pleadings, the evidence, and the arguments of counsel, the court rules as follows:

Introduction and Factual Summary

The Song-Beverly Credit Card Act of 1971, and specifically Civil Code section 1747.08(a)(2), prohibits businesses from requesting and recording "personal identification information" during credit card transactions. In *Pineda v. Williams-Sonoma Stores, Inc.* (2011) 51 Cal.4th 524, the Supreme Court held that "requesting and recording a cardholder's ZIP code, without more, violates [section 1747.08]." (*Id.* at p. 527.) "The statute's overriding purpose," according to the *Pineda* decision, "was to 'protect the personal privacy of consumers who pay for transactions with credit cards.'" (*Id.* at p. 534, quoting the Assem. Com. on Finance & Insurance, Analysis of Assem. Bill No. 2920 (1989–1990 Reg. Sess.) as amended Mar. 19, 1990, p. 2.)

Defendant Restoration Hardware, Inc. (RHI) does not dispute that pursuant to a uniform company policy its store cashiers were instructed to request a ZIP code from every credit card customer during the class period between October 21, 2007 and February 12, 2011. Any ZIP code provided by the customer at the point of sale was recorded and then used in an attempt to determine a mailing address for that customer. Addresses thus obtained were employed for internal marketing purposes – primarily to send merchandise catalogs – and shared with other retailers. RHI admits that it recorded ZIP code information in approximately 1.2 million California credit card purchase transactions during the class period, and that it was able to match more than 450,000 unique customer addresses as a result.

This court previously certified a class consisting of all persons from whom RHI requested and recorded ZIP codes in conjunction with a credit card purchase transaction in its California retail stores since October 21, 2007. Following class notice, the matter proceeded to trial and presents two principal questions: (1) To what extent did RHI violate the Song-Beverly Act? (2) What is the appropriate penalty for any violations?

Discussion

A. Did Restoration Hardware Violate the Song-Beverly Act?

As noted, RHI does not dispute that it violated Civil Code section 1747.08(a)(2) by requesting and recording class member ZIP codes in conjunction with in-store credit card transactions. Rather, it attacks the violation question obliquely by contending that its liability cannot be established on a classwide basis using classwide proof. It urges that the class must be decertified because each violation requires individual proof. In this regard RHI points out that no violation of the statute occurs unless it recorded the customer's *actual* ZIP code. Thus, it argues, each transaction must be examined to determine whether the cashier accurately recorded the customer's actual ZIP code, or instead typed some different 5-digit number.

RHI confuses a "possible" method of proof with a "necessary" means. Plaintiffs introduced classwide proof to show that during the class period, RHI requested and recorded ZIP codes as part of 1,213,745 credit card transactions. (Ex. 68, No. 15.) Customers, presumably, know their own ZIP codes. RHI employees were instructed to accurately record the ZIP code information. (Ex. 5, p. 4.)[1] Absent other evidence, it is a fair inference that

[1] RHI's objections to the admissibility of Exhibit 5 are overruled.

the ZIP codes recorded by RHI at the point of sale were recorded accurately. (Cf. *Vasquez v. Superior Court* (1971) 4 Cal.3d 800, 814 [classwide inference of reliance arises where it is shown that material misrepresentations were made to each class member].) Examination of each individual transaction is unnecessary.

RHI sought to introduce evidence to show that, on occasion, a customer's ZIP code was not accurately recorded. That there were occasional inaccuracies is hardly surprising. Indeed, considering that there were more than 1.2 million transactions during the class period it would be astonishing if there weren't occasional mistakes. Even so, it was unclear from the evidence presented whether the inconsistencies identified by RHI were the result of the inaccurate recording of ZIP codes at the point of sale, or later changes to the database where an address was updated with new information.

The court is unwilling to accept plaintiffs' suggestion that the statute should be deemed to be violated whenever a ZIP code is requested and a number is recorded, even if it is recorded inaccurately. The explicit focus of Civil Code section 1747.08(b) is to prohibit the recording of the credit customer's "personal identification information." An inaccurate ZIP code does not personally identify the customer.

As an alternative, class counsel proposes that RHI be given the opportunity to challenge an individual class member's claim at an appropriate point in the claims process if it can show that the ZIP code recorded by RHI does not match the personal ZIP code(s) listed by the class member on the claim form. The court finds this to be a satisfactory and pragmatic means of assuring that RHI is only charged with violations that resulted from the accurate recording of ZIP code information. (See *Fireside Bank v. Superior Court* (2007) 40 Cal.4th 1069, 1088 [urging trial courts to be "flexible and innovative" in designing class action procedures that are "'fair to the litigants and expedient in serving the judicial process'"].)

Accordingly, for purposes of calculating an appropriate penalty, this court finds that RHI committed as many as 1,213,745 violations of section 1747.08(a)(2) during the class period by recording the customer's ZIP code at the point of sale during a credit card transaction. This number is subject to reduction to the extent RHI can show following the submission of claims by individual class members that the ZIP code information in a particular transaction was not accurately recorded.

B. What Is the Appropriate Penalty for Each Violation?

Civil Code section 1747.08(e) provides that "[a]ny person who violates this section shall be subject to a civil penalty not to exceed two hundred fifty dollars ($250) for the first violation and one thousand dollars ($1,000) for each subsequent violation, to be assessed and collected in a civil action brought by the person paying with a credit card ...." The penalty is payable "to the person paying with a credit card who brought the action." Because this case is a class action brought on behalf of absent class members, any penalty would be payable to the class members.

Given the mandatory nature of the statutory language, the court has a "duty to impose a penalty for each violation" of the Act. (See *People v. National Association of Realtors* (1984) 155 Cal.App.3d 578, 585.) Of course, there is considerable latitude in assessing an appropriate penalty for each violation, which "'could span between a penny (or even the proverbial peppercorn we all encountered in law school) to the maximum amounts authorized by the statute.'" (*Pineda v. Williams-Sonoma Stores, Inc., supra,* 51 Cal.4th at p. 536, quoting *The TJX Companies, Inc. v. Superior Court* (2008) 163 Cal.App.4th 80, 86.) Having found at this point more than 1.2 million violations, the maximum aggregate penalty would be in excess of $1.2 billion and the burden is on the defendant to introduce evidence of

mitigating factors indicating that the penalty should be less than the statutory maximum. (*State of California v. City and County of San Francisco* (1979) 94 Cal.App.3d 522, 530-531; *People ex rel. State Air Resources Bd. v. Wilmshurst* (1999) 68 Cal.App.4th 1332, 1351.)

Notwithstanding that the burden is on the defendant, in attempting to justify imposition of a substantial penalty plaintiffs have placed primary emphasis on calculating the increased sales – and in turn profits – that resulted or will result from RHI's ZIP code capture policy. By plaintiffs' calculation, this amounts to at least $81 million. They argue that the aggregate penalty imposed should at a minimum recapture the profits that RHI obtained as a result of its unlawful policy.

To be sure, the disgorgement of illegal profits is a factor often referred to in cases that discuss calculating the appropriate amount of a penalty assessment. (See, e.g., *People ex rel. Bill Lockyer v. Fremont Life Ins. Co.* (2002) 104 Cal.App.4th 508, 528 [deceptive marketing of annuities]; *People ex rel. State Air Resources Bd. v. Wilmshurst, supra,* 68 Cal.App.4th at p. 1351 [vehicle air pollution certification].) And while it is clear that illegal profits are not the only way to measure an appropriate penalty – indeed, penalties are often appropriate even where there are no profits that flow from an illegal practice – in some cases the amount of illegal profit is indisputably

an important consideration. There are, however, certain problems with exclusive or even substantial reliance on a disgorgement methodology for calculating the appropriate penalty in this case.

Plaintiffs' business valuation expert Forrest Vickery testified that he was able to determine the additional sales attributable to the 450,000-plus "unique" customer addresses RHI was able to obtain as a result of its ZIP code capture policy for the period between October 2007 and September 2013. These sales – roughly $363 million – included both subsequent purchases made by class members at RHI retail stores ($85 million) as well as so-called direct-to-customer (DTC) transactions through the company's catalogs or website ($278 million). (Ex. 122, sched. 1.)

As it turned out, however, it was no easy task to translate these sales numbers into some reasonable approximation of the profits obtained by RHI as a result of the ZIP code capture policy. In attempting to do so, Vickery made several crucial assumptions. He first assumed that each of the "unique" address obtained by RHI was a new address, that is, an address that did not previously appear in its marketing database. The evidence indicated,

however, that as many as 60 percent of the addresses matched by virtue of the ZIP codes provided by customers were already in the database.[2]

And even if we assume that 40 or more percent *were* new addresses, Vickery conceded that not all later purchases by class members could be attributed to the ZIP code obtained by RHI and the subsequent catalogs that were mailed to the matched address. He made calculations using various percentages and suggested that 50 percent of the sales be attributed to the catalogs the customer received, but he offered no real rationale for that assumption other than a reference to a ComScore study conducted on behalf of the U.S. Postal Service purporting to show that the distribution of catalogs leads to increased sales. The Court finds Vickery's reliance on this study to be less-than-persuasive support for his assumption.

These various assumptions turn out to be very significant. If the 450,000 "unique" addresses were all new, and if 50 percent of the subsequent sales to these households resulted from the ZIP code/address capture policy, Vickery calculated the added profits to RHI at something between $47 and $60 million. On the other hand, if we assume only 40

[2] Plaintiffs point out that addresses already in the database may have been originally obtained by RHI as a result of Song-Beverly violations that occurred before the class period. Even if true, it cannot be said that the profits derived from these customers were the result of the violations in this case.

percent new addresses and further assume, unlike Vickery, that only 25 percent of the sales to these "new" households were a result of the catalog mailings, the additional profit to RHI would be less than $2 million.

The wide-ranging uncertainties associated with these various assumptions suggest that the specific resulting numbers border on the speculative. But this is not to say we can assume there was little or no economic benefit to RHI from its ZIP code capture policy. The circumstantial evidence strongly suggests otherwise. After all, RHI continues to collect ZIP code information in states without statutes similar to the Song-Beverly Act. RHI paid money to Experian to match the ZIP codes to mailing addresses. It incurred the additional expense of printing and mailing catalogs to the addresses thus obtained. The cost of printing and mailing catalogs to additional addresses ($1 to $5 depending on the size of the catalog) is a marginal cost that presumably would not have been incurred had RHI not believed it would receive *some* return on its investment.

Even putting aside the actual amount of profit attributable to ZIP code capture, there is an additional conceptual problem associated with focusing on profit disgorgement to measure the appropriate penalty. This is because these profits are derived from customers who *chose* to make additional purchases from RHI. One can debate principles of consumer psychology

and the ability to "create" consumer demand, but people who bought additional items presumably received some benefit in exchange for the money they spent. An unsolicited catalog that led to a subsequent purchase may have invaded the customer's privacy in a theoretical sense, but it also provided information that the consumer ultimately decided to utilize.

A focus on subsequent sales fails to account for the damage suffered by class members whose personal information RHI shared with other retailers. More importantly, perhaps, it completely ignores class members who are arguably the people Song-Beverly was most concerned with protecting, i.e., individuals who did *not* want to buy anything else from RHI.[3] For these consumers, a single in-store purchase subjected them to receiving a variety of unwanted marketing materials without any reciprocal benefit. And their addresses remain a part of RHI's database to this day. Whether the harm to these consumers is characterized as a minor annoyance or a fundamental interference with the right to be left alone, it must be accounted for in assessing the appropriate penalty.

Of course, the profits obtained and/or harm inflicted as a result of the illegal practice are not the only factors to be considered. (Cf. Bus. & Prof.

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[3] The parties agree that this represents nearly half of the persons for whom RHI obtained address information as a result of its ZIP code capture policy. (RHI Closing Brief at p. 11; Pltfs.' Rebuttal Brief at p. 8, fn. 4.)

Code, § 17206 [in assessing penalty, court should consider "the nature and seriousness of the misconduct, the number of violations, the persistence of the misconduct, the length of time over which the misconduct occurred, the willfulness of the defendant's misconduct, and the defendant's assets, liabilities, and net worth"].) In suggesting that any penalty should be minimal, RHI argues it acted in good faith because the illegality of its ZIP code capture policy was far from clear before the *Pineda* decision, as evidenced by the fact that two published Court of Appeal opinions had concluded ZIP codes were *not* "personal identification information" within the meaning of the statute. (See *Party City Corp. v. Superior Court,* decided Dec. 19, 2008, formerly at 169 Cal.App.4th 497; *Pineda v. Williams-Sonoma, Inc.,* decided Oct. 8, 2009, formerly at 178 Cal.App.4th 714.) It points out that it stopped requesting customer ZIP codes as soon as the Supreme Court's *Pineda* decision was announced.

As it turns out, this "responsible corporate citizen" theme and "good faith reliance" argument sound much better than they really are. It would be significant had RHI implemented its ZIP code capture policy only after thoughtfully considering the implications of Song-Beverly and judicial interpretations of the relevant statutes. But so far as the evidence at trial indicates – and RHI had the burden of providing mitigation evidence – no

one at RHI ever considered the Song-Beverly Act before deciding to adopt a uniform policy of requesting customer ZIP codes in conjunction with every in-store credit card transaction. Even after this lawsuit was filed in October 2008, two months before the *Party City* decision, there is no evidence that anyone at RHI so much as acknowledged there was a potential problem.

And if *Party City* and the initial *Williams-Sonoma* decision could legitimately provide solace for the policymakers at RHI, the Supreme Court's grant of review in *Williams-Sonoma* should have been a warning sign. Again, it is not so much *how* RHI responded to the warning, but rather that it should have responded in some considered fashion. It is difficult, however, to give much credit to a national retailer that appears to have designed, implemented, and continued an illegal business practice for years without at any time giving any thought to its potential illegality.

RHI's conduct after the *Pineda* decision is likewise unworthy of extensive plaudits. To be sure, it immediately discontinued its California ZIP code collection practice. (Ex. 112.) But as plaintiffs point out, RHI did nothing to remedy what was now established as a clear violation of the Song-Beverly Act. Admittedly there was little if anything that could be done even to identify addresses that were shared with other retailers. And RHI protests that it could not even identify which addresses in its own

database were definitively a product of the ZIP code capture policy. But even assuming this is accurate, RHI knew the customers in its database from whom a ZIP code had been requested and recorded. It would have been a relatively simple matter to inform these individuals of the prior practice and inquire whether they wished to remain in the database. In this way, no one who desired to continue receiving catalogs would have been denied that opportunity. That RHI chose not even to offer this option represents, at a minimum, an economic judgment call that needs to be accounted for in assessing the proper penalty.

Given the practical difficulties associated with measuring both the profit obtained and harm inflicted, the court is left to determine a per-violation amount that constitutes a sufficient deterrent to future misconduct. (See *People ex rel. State Air Resources Bd. v. Wilmshurst, supra,* 68 Cal.App.4th at p. 1351 ["In addition to disgorging illicit gains and obtaining recompense, a civil penalty also has the purpose of deterring future misconduct."].) A penalty of $30 per violation admittedly constitutes relatively minimal compensation for the individuals whose privacy was invaded by RHI's practice. Yet the total amount of the penalty – which may approach $36 million – represents (as it should) more than a mere slap on the wrist to a company that reported stockholders' equity in excess of $450

million as of February 2013. (Ex. 33, p. 47; see generally *People ex rel. Van de Kamp v. Cappuccio, Inc.* (1988) 204 Cal.App.3d 750, 765.)

RHI suggests that deterrence is unnecessary here because it has already discontinued the illegal practice. But deterrence is a broader concept in the context of a penalty statute such as Civil Code section 1747.08(e). Rare is the instance when a defendant would flout the State's authority and presume to continue a business practice that has been determined by a court to violate a statute validly passed by the Legislature. Deterrence means more than stopping the particular practice. It refers instead to the governmental interest in dissuading the defendant and others from engaging in future misconduct of a similar – but not necessarily identical – nature. Here, the penalty is properly imposed to deter not the ZIP code capture policy itself, but rather the type of corporate indifference that RHI's policy represents.

Conclusion

Objections to this proposed statement of decision should be filed no later than March 21, 2014. Any responses to those objections are to be filed on or before April 4. A hearing on objections is set for April 25, 2014, at 2:00 p.m. At the hearing the parties should be prepared to address plaintiffs'

motion for sanctions for spoliation of evidence and the extent to which specific sanctions are necessary or appropriate in light of the court's tentative conclusions.

In advance of that hearing, the parties are directed to meet and confer on the scope and particulars of an appropriate claims process, including a means for RHI to challenge the accuracy of any recorded ZIP codes. A joint status conference statement describing identified issues and points of agreement/disagreement should be filed at least one week before the hearing.

Dated: March 7, 2014

WILLIAM S. DATO
Judge of the Superior Court