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Balsam V. Trancos Inc.

The Insiders' Perspective on the First Spam Trial in California

By Dan Balsam and Timothy Walton

***Trial Lawyer* asked us to write this article** about *Balsam v. Trancos Inc.*, No. CIV471797 (Super. Ct. Cal. Cty. of San Mateo Mar. 10, 2010), *affirmed in all respects*, 203 Cal. App. 4th 1083 (1st Dist. 2012), *petition for review denied*, 2012 Cal. LEXIS 4979 (May 23, 2012). We believe is the first case (other than small claims) by a consumer recipient to go to trial under California's anti-spam law, Business & Professions Code § 17529.5.

First, some background. California had anti-spam laws – B&P Code §§ 17538.4 and 17538.45 – as far back as 1998. But the laws had a number of weaknesses, not least of which was the omission of damages. After a California Court of Appeal found that California's anti-spam laws did not violate the dormant commerce clause of the U.S. Constitution and ruled that California has jurisdiction over out-of-state advertisers who send spam to California residents, *Ferguson v. Friendfinders, Inc.*, 94 Cal. App. 4th 1255 (1st Dist. 2002), the California Legislature took a look at increasing the laws' teeth. In 2003, California enacted B&P Code § 17529, which would have become the strongest state anti-spam law in the country. The statute made all spam unlawful, and granted recipients standing to sue for $1,000 liquidated damages per spam and/or actual damages. A separate subsection, § 17529.5, specifically made it unlawful to use third parties' domain names without permission; prohibited falsified, misrepresented, or forged information in email headers; and prohibited subject lines likely to mislead a recipient about the contents of the email. B&P Code § 17529.1(d) requires that email advertisers have "direct consent" from recipients to send them commercial email. The statute provides for attorneys' fees for the prevailing *recipient*, not the prevailing party. Unfortunately, B&P Code § 17529 does not grant injunctive relief, so after Proposition 64, there is no means for a court to order compliance with the law.

The Direct Marketing Association panicked and kicked its Congressional lobbying into high gear in late 2003. At that time, there were seven anti-spam bills pending in Congress. The DMA lobbied for the one that would allow for the most spamming. Congress, in response, passed the CAN-SPAM Act, 15 U.S.C. § 7701 et seq. and 18 U.S.C. § 1037... timed not coincidentally to go into effect on January 1, 2004 – the same date as B&P Code § 17529.

Many consider the CAN-SPAM Act to be a failure, at least from the perspective of stopping spam. For one thing, Congress made "truthful spam" legal, subject to certain requirements (e.g., inclusion of a physical mailing address and a means of opting-out). Congress made it illegal to spam after a person opted out, but denied that very person standing to sue. Only the Federal Trade Commission, State Attorneys General, and Internet Service Providers can sue under federal law. Worse, federal law preempts State anti-spam laws – such as California's – that *do* give recipients (individuals or businesses) the right to sue. But, there are some exceptions to preemption: by its own plain language, the CAN-SPAM Act does not preempt state laws that prohibit "falsity or deception" in commercial email, nor does it preempt state laws that are not specific to email. 15 U.S.C. § 7707(b).

The preemption question has been heavily litigated in federal and state courts. In *Omega World Travel, Inc. v. Mummagraphics Inc.*, 469 F.3d 348 (4th Cir. 2006), the Fourth Circuit read "falsity" as if it meant common-law fraud... and the scienter, reliance, and actual damages requirements that go along with it. The Court ignored the disjunctive "or deception," even though the plain language of the statute indicates that deception – even without falsity/fraud – is sufficient to avoid preemption. Spammers frequently glom onto *Omega* as if it categorically stands for preemption except for common law fraud, but what the Court really said was that federal law preempts State law – Oklahoma, in that case – as to the immaterial technical errors that only appeared in the "full headers" of the Omega spams that most recipients don't see.

Numerous cases in the Northern District of California read the preemption exactly as Congress wrote it – "falsity or deception" – not least because the CAN-SPAM Act uses the word "fraud" two lines later, suggesting that Congress meant two different things. In *Gordon v. Virtumundo Inc.*, 575 F.3d 1040 (9th Cir. 2009), the Ninth Circuit similarly ruled that federal law preempts (Washington) State law as to immaterial technical errors. Spammers also like to claim that Gordon stands for preemption except for fraud, but often neglect to mention that several courts in the Northern District found no preemption of California law, even after the Gordon decision. In fact, in direct response to Gordon, the court in Hoang v. Reunion.com even reversed its prior order granting defendant's motion to dismiss. 2010 U.S. Dist. LEXIS 34466 (N.D. Cal. Mar. 31, 2010).

In the summer of 2007, Balsam was between his second and third years of law school at U.C. Hastings, working for

the California Attorney General, Consumer Law Section in Los Angeles. Balsam received eight spams from eight different nonsensical domain names, all of which were proxy-registered through Domains By Proxy Inc. (which expressly prohibits use of its services for spamming). The "from names" (part of the email headers) were "Paid Survey," "Your Business," "Christian Dating," "Your Promotion," "Bank Wire Transfer Available," "eHarmony," "Dating Generic," and "Join Elite." All of the spams claimed that Balsam opted in on July 11, 2007 from an Internet Protocol address in Indiana. The body of each spam identified the sender only as "USAProductsOnline.com" – also a proxy-registered domain name – claiming its address to be a box at a branch of The UPS Store in Los Angeles.

Because the proxy registration prevented Balsam from querying the Whois database to identity Trancos, and of course The UPS Store would not identify its customer, Balsam filed a small claims action against "USAProductsOnline.com." As part of that case, Balsam sent a subpoena to The UPS Store for the identify of its boxholder. The UPS Store produced a copy of the application for the box, which identified "USA ProductsOnline.com" – not a company or even a registered fictitious business name – in the "Name of Firm or Corporation" line. However, that form did have a mailing address in Pacific Palisades, and further research on that address finally led to Trancos Inc.

Balsam contacted Trancos' Chief Executive Officer, Brian Nelson, and offered to settle his statutory claims against Trancos and the other entities advertised in the spams for $5,000. Nelson initially agreed, but then backed out on advice from his uncle, Trancos' lawyer.

Because the statutory damages of $8,000 exceeded the jurisdiction of the small claims court (at the time), and because Balsam also sought injunctive relief under the Consumers Legal Remedies Act, we filed an action in the Superior Court of San Mateo County – Trancos is headquartered in Redwood City – in 2008. Balsam was represented by Walton, who has litigated numerous anti-spam cases in superior and small claims court, as well as courts of appeal.

We wrote a highly detailed Verified Complaint that we intended to be "demurrer-proof," and Trancos did not try to demurrer. Trancos did, however, try to strike portions of the Complaint that it claimed were irrelevant and improper. We opposed, arguing that the text was necessary context that supported the factual allegations, and the Court denied the Motion. Trancos then filed the typical Answer one would expect from a defendant... denying almost everything, and setting forth no less than 18 affirmative defenses, none of which stated any facts in support. (For example, how exactly were Balsam's hands unclean...?) We demurred to the Answer – an uncommon but legitimate strategy – and knocked out 16 of the 18 defenses. Trancos was left with only federal preemption and "due care" (i.e., it took steps to prevent advertising in unlawful spam).

Trancos filed a Motion for Judgment on the Pleadings, which the Judge denied in its entirety, rejecting Trancos' arguments for preemption and against Balsam's CLRA standing. We filed a Motion for Summary Judgment/Adjudication, which the Court denied on procedural grounds: We unfortunately cited the Verified Complaint instead of filing a separate declaration to support the MSJ.

The case went to trial in October 2009 before Hon. Marie S. Weiner. We had an expert witness, with years of experience in online and traditional marketing, to discuss the spams' misleading content. Trancos had no experts. We argued that the "from names" misrepresented who was advertising in/sent the spams – an easy argument, since Nelson, Trancos' CEO, could not even identify his own clients based on the "from names." We argued that proxy registration misrepresented who owned the domain names, and that one of the subject lines "Get paid 5 Dollars for 1 survey" was misleading. We argued that in B&P Code § 17500 actions, "fraud" does not mean the common-law tort but rather the likelihood of deception, and we argued strongly for a reading of the plain language of the statutes and the presumption against preemption in areas – such as advertising – traditionally regulated by the States. It was undisputed that Balsam was in Los Angeles on July 11, 2007 – the date Trancos claimed Balsam supposedly opted in from an I.P. address in Indiana.

Trancos finally revealed on the first day of trial an interesting piece of information that it had never disclosed during written discovery – that it acquired Balsam's email address from Hi-Speed Media Inc., a subsidiary of ValueClick Inc. ValueClick, incidentally, was the defendant in

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Timothy Walton was one of the first attorneys in the world to have a web site. He established his law office in 1998, specifically to focus on Internet law. Walton began suing spammers in 1999, and has been counsel of record for numerous anti-spam activists, both in trial court and on appeal.

another published opinion in a spam case: *Hypertouch v. ValueClick Inc.*, 192 Cal. App. 4th 805 (2d Dist. 2011). The *Hypertouch* Court ruled that advertisers are strictly liable for their affiliates, that B&P Code § 17529.5 – which only prohibits false and deceptive spam – fits squarely within the exception-to-preemption set forth by the CAN-SPAM Act, and spam recipients do not have to plead or prove common-law fraud or actual damages. We were prepared to prove at trial that not only had Balsam not opted in to receive commercial email from ValueClick, but he had actually affirmatively and repeatedly taken steps to opt *out* from ValueClick spam, including suing ValueClick. But that was not actually necessary, because even *if* Balsam had opted in to receive ValueClick emails, that would not constitute "direct consent" for Trancos to send him commercial email.

In March 2010, the trial court issued the Judgment and Final Statement of Decision, ruling that B&P Code § 17529.5 is not preempted, and a spam recipient does not have to prove actual damages. The court awarded Balsam $7,000 in liquidated damages, finding that all of the "from names" except "eHarmony" misrepresented who was sending/advertising in the spams. The court found that proxy registration misrepresented who owned the domain names. The court was not impressed with Trancos' claim, unsupported by any facts, that it tried to avoid advertising in deceptive spam. In fact, the court found that Trancos intentionally established practices and procedures to avoid all attempts to identifying it, such as proxy-registering its domain names, claiming a box at The UPS Store as its address, falsifying its box application at The UPS Store, and properly registering FBNs for every division of the company except the spamming division. The court also ruled that Balsam did not have standing under the CLRA because Balsam was not a "consumer" and did not sustain any monetary loss. Finally, the court ruled that Nelson was not jointly and severally liable because he was acting at all relevant times as an officer and employee of Trancos. Balsam requested $148K in attorneys' fees (including a Lodestar multiplier for Walton), and the trial court awarded $82K.

Trancos appealed on the B&P Code § 17529.5 cause of action based only on federal preemption. Trancos incorrectly claimed that the trial court's ruling was based on spamming from multiple domain names, as opposed to proxy-registered domain names. Trancos also appealed the award of attorneys' fees. Trancos never showed the slightest bit of remorse, and admitted that it had stopped spamming only because it wasn't profitable; Trancos never acknowledged that anything it did was wrong.

Balsam cross-appealed on the CLRA cause of action, arguing that the language of Civil Code § 1770 ("transaction *intended to result* in the sale or lease of goods or services") means that the Legislature did not intend to impose an actual purchase requirement, and that the California Supreme Court's ruling in *Meyer v. Sprint Spectrum*, 45 Cal. 4th 634 (2009) held that the CLRA requires any damages, which are broader than pecuniary damages. Balsam also cross-appealed as to Nelson's personal liability, arguing that the fact that Nelson was acting in his capacity as a Trancos officer does not relieve him of liability for his own wrongful actions, and that his testimony indicated awareness and ratification of Trancos' unlawful actions.

In February 2012, the Court of Appeal affirmed the trial court's ruling in all respects, and went into far more detail as to the proxy domain name registration argument than the misrepresented "from names" argument. As to the B&P Code cause of action, the Court agreed with *Hypertouch* that § 17529.5 is not preempted, that the generic "from names" misrepresented the source, and that consent to A does not mean that B has "direct consent" to send commercial email. The Court sharply criticized the steps Trancos took to hide its identity as the spammer, and even endorsed the common belief that opting out of spam is futile because it costs more for a spammer to honor the opt-out request than to keep spamming. As to the CLRA cause of action, the Court ruled that Balsam did not have standing, but for a different reason than the trial court – any harm caused by the spams (see B&P Code § 17529(d), (e), (g), and (h)) arose from receiving the spams, not by any misleading content. The Court acknowledged that corporate officers are liable

for their own tortious acts, but found that Nelson's involvement was not significant enough to impose personal liability. The Court also affirmed the award of attorneys' fees, noting that the amount was quite reasonable and would have been significantly greater but for the fact that Balsam cannot claim attorneys' fees for the substantial time he spent on his own case.

Trancos filed a Petition for Rehearing in the Court of Appeal, which the Court denied in March 2012, but modified the Opinion slightly without making any substantive changes.

Refusing to accept defeat, Trancos petitioned the California Supreme Court for review. Trancos claimed that it did not know what "readily traceable" meant as to domain name registration information, despite the Supreme Court's previous adoption of the simple dictionary definition for "trace." Trancos claimed the instant facts were identical to those in *Kleffman v. Vonage Inc.*, 49 Cal.4th 334 (2010), but in that case, the Supreme Court ruled that sending spam from multiple domain names does not violate B&P Code § 17529.5 and did not address the proxy-registration question, because the domain names were traceable to Vonage's affiliates. Trancos also claimed that the CAN-SPAM Act does not prohibit proxy registration for spamvertised domain names, which is facially false – 18 U.S.C. § 1037(a)(3), (a)(4), and (d)(2) do exactly that – although Balsam never alleged standing under the CAN-SPAM Act. Moreover, Trancos claimed that the Supreme Court had to resolve a conflict between the Appellate Districts, even though the Court of Appeals' ruling in the First District below was entirely consistent with the previous *Hypertouch* ruling in the Second District. In May 2012, the California Supreme Court denied Trancos' Petition.

As we write this article, Trancos has indicated that it intends to petition for review to the U.S. Supreme Court. Stay tuned. TL