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Business Associations and Professions

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Business Associations and Professions

Business Associations and Professions; extension of civil liability for corporate securities law violations

Corporations Code §§25504.1, 25504.2 (new); §§25506, 25507 (amended).
AB 592 (Knox); STATS 1977, Ch 144
Support: State Bar of California

Chapter 144 extends civil liability for specified violations of the Corporate Securities Law of 1968 [CAL. CORP. CODE §§25000-25804] to any person who materially assists in such violations with an intent to deceive or defraud [CAL. CORP. CODE §25504.1]. In addition, Section 25504.2 of the Corporations Code, as added by Chapter 144, extends civil liability to certain professionals, who, with their written consent, have been named as having prepared or certified specified documents distributed in connection with the offer or sale of securities, when such documents contain untrue statements or omissions of material facts and a person acquires the described securities in reliance on these statements [CAL. CORP. CODE §25504.2 (a)(1)-(2)] [Sections 25504.1, 25504.2 and 25506 of the Corporations Code were subsequently amended by Chapter 762 of the Statutes of 1977 without substantial change to the provisions of these sections. Thus, all future reference to Sections 25504.1, 25504.2, and 25506 shall be to the Chapter 762 version of these code sections.].

Prior to the enactment of Chapter 144, civil liability for violations of the Corporate Securities Law of 1968 was imposed only on persons who were in privity with the plaintiff [See, e.g., CAL. CORP. CODE §§25501, 25503; 6 B. WTITKIN, SUMMARY OF CALIFORNIA LAW, Corporations §243 (8th ed. 1974)], or persons who controlled the party who was in privity with the plaintiff [See CAL. CORP. CODE §25504]. A person “in privity with the plaintiff” as used in this context is defined as being a person from whom the plaintiff purchased or to whom the plaintiff sold a security [6 B. WTITKIN, SUMMARY OF CALIFORNIA LAW, Corporations §243 (8th ed. 1974)]. Section 25504.1, as added by Chapter 144, imposes civil liability on any person, regardless of the existence of privity, if the following conditions can be established: (1) the person materially assisted in a violation of one of the several enumerated sections concerning the qualification and sale of securities in California [See generally CAL. CORP. CODE §§25110, 25120, 25401]; (2) there was, in fact, a violation of one of these sections; and (3) the person acted with intent to deceive or defraud. If these three elements are present, a defendant is jointly and severally liable with any person who is

Section 25504.2 provides that "[a]ny accountant, engineer, appraiser, or other person whose profession gives authority to a statement made by such person" may be liable for any material misrepresentation that is contained in any prospectus, offering circular, or any written report or valuation that is distributed with or referred to in such a prospectus or offering circular [CAL. CORP. CODE §25504.2(a)]. Before liability is found to exist under Section 25504.2, however, this section requires that the following elements be established: (1) the professional must have given written consent to be named "as having prepared or certified in such capacity any part of a prospectus or offering circular or any written report or valuation referred to in any such document" [CAL. CORP. CODE §25504.2(a)]; (2) the professional must have been named in such document as having prepared or certified in such professional capacity the document in question [CAL. CORP. CODE §25504.2(a)]; (3) the prospectus, circular or other related document must have included an untrue statement of a material fact or an omission of a material fact that is necessary to keep the document from being misleading [CAL. CORP. CODE §25504.2(a)(1)]; and (4) the plaintiff must have relied on the untrue statement or on the omission in acquiring the security [CAL. CORP. CODE §25504.2(a)(2)]. In addition to describing the elements of this cause of action, Section 25504.2(b) provides the following defenses for the affected professionals: (1) defendants may show that after reasonable investigation they had reasonable grounds to believe and did believe that the statements in a particular prospectus were true and that there were no misleading omissions [CAL. CORP. CODE §25504.2(b)(1)]; (2) defendants may establish that such a document was not a fair representation or not a fair copy of their statement [CAL. CORP. CODE §25504.2(b)(2)]; or (3) defendants may show that prior to a plaintiff's acquiring the security they notified the issuer and the Corporations Commissioner in writing that they would not be responsible for the document in question [CAL. CORP. CODE
§25504.2(b)(3)]. Further, Section 25504.2 provides that persons who participate in the preparation of a prospectus, offering circular, or related document will be held liable only for those portions of the documents that are expressly stated as having been made on their authority and that were attributed to them with their written consent [CAL. CORP. CODE §25504.2(c)]. Thus, Section 25504.2 appears to increase the potential liability of certain professionals who certify or assist in the preparation of various documents that are relied on by the public when buying corporate securities.

Finally, the legislature has amended Sections 25506 and 25507 of the Corporations Code apparently to indicate that the statute of limitations for a violation of Section 25504.1 depends on the context in which a particular violation occurs [See CAL. CORP. CODE §§25506, 25507]. All violations of Section 25504.1 that involve omissions or untrue statements of material facts in an offer to sell or purchase securities have a statute of limitations that will expire four years after the violation or one year after the plaintiff discovers the facts constituting a violation, whichever occurs first [See CAL. CORP. CODE §25506]. Alternatively, civil actions for those violations of Section 25504.1 that involve certain regulations governing the qualification or transfer of corporate securities must be brought within two years of the violation or within one year after the discovery of the facts constituting a violation of these regulations, whichever expires first [See CAL. CORP. CODE §25507. See generally CAL. CORP CODE §§25120, 25130, 25133, 25141, 25503, 25510]. A buyer, however, may not commence an action under Section 25504.1 for the violation of a securities qualification or sales regulation if, prior to commencement of the suit, the seller offers to repurchase, rescind, or pay damages for the defective securities with the approval of the Corporations Commissioner as to the form of such an offer [See CAL. CORP. CODE §25507(b)]. In contrast, all violations of Section 25504.2 must be asserted in a civil action brought within one year after the discovery of the facts constituting the violation, or after such discovery should have been made by the exercise of reasonable diligence [CAL. CORP. CODE §25506.1, as added, CAL. STATS. 1977, c. 762, §6.7, at ——]. Section 25506.1 further provides that in no event shall an action be brought for a violation of Section 25504.2 more than three years after the act or transaction constituting the violation [CAL. CORP. CODE §25506.1, as added, CAL. STATS. 1977, c. 762, §6.7, at ——].

**COMMENT**

Chapter 144 is basically an extension of the Securities and Exchange Commission's Rule 10b-5 [Compare CAL. CORP. CODE §25504.1 with 17 C.F.R. §240.10b-5 (1977)] and Section 11 of the Securities Act of 1933
[Compare Cal. Corp. Code §25504.2 with 15 U.S.C. §77k (1970)] to California corporate securities law. Rule 10b-5 proscribes, inter alia, any material misrepresentation in the sale or purchase of securities that are registered pursuant to federal law [See 17 C.F.R. §240.10b-5 (1977)]. Section 11 of the Securities Act of 1933 provides a similar but more restricted cause of action than the federal rule for any person acquiring a security when the issuer's registration statement contained an untrue statement or omission of a material fact [Compare 15 U.S.C. §77k (1970) with 17 C.F.R. §240.10b-5 (1977)]. In comparing case interpretations of Rule 10b-5, Section 11 of the Securities Act of 1933, and the language of Sections 25504.1 and 25504.2, however, some interesting differences are manifested that may create some confusion in the application of these new sections. This comment will attempt to outline the comparisons that can be drawn from an examination of the language of Chapter 144, Rule 10b-5, and Section 11 to provide an indication of the manner in which the California courts may interpret Sections 25504.1 and 25504.2 of the Corporations Code.

Section 25504.1 applies to "[a]ny person who materially assists in any violation" of certain provisions governing the qualification of securities or the regulation of their sale [See, e.g., Cal. Corp. Code §§25110, 25120, 25130, 25401]. It seems that this provision is primarily aimed at attorneys, accountants, and other expert third parties who indirectly participate in the sale or purchase of securities [See State Bar of California, Committee on Corporations, Legislation to Provide for Civil Liability for Aiding in the Violation of Corporate Securities Law, Interim Report at 2 (Dec. 20, 1976) (hereinafter cited as Corporation Committee Report)]. In order to be liable under Section 25504.1, such defendants must materially assist in the violation at issue [Cal. Corp. Code §25504.1], which is analogous to the "aider and abettor" liability that exists under Rule 10b-5 [See Ruder, Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution, 120 U. Pa. L. Rev. 597, 620-46 (1972)]. Thus, the requirement for material assistance would seem to be satisfied if the defendant could be classified as an "aider and abettor" as that term is applied in the federal courts [See id. at 625 n.124 (listing federal cases on aider and abettor theory)]. There appear to be four factors considered by the federal courts in deciding whether particular assistance is material to a particular violation: (1) the extent of the assistance provided by the defendant; (2) the presence of the defendant at the time the fraud was perpetrated; (3) the defendant's intent; and (4) the defendant's relation to the principal violator [Comment, Rule 10b-5 Liability for Aiding and Abetting After Ernst & Ernst v. Hochfelder, 28 U. Fla. L. Rev. 999, 1011 n.86 (1976)]. Thus, it
would seem that the California courts may logically base their interpretation of "material assistance," as required by Section 25504.1, upon the federal courts' interpretation of "aider and abettor" liability under Rule 10b-5.

The most crucial interpretation problem in Section 25504.1, however, apparently involves the element of "intent to deceive or defraud." One possible interpretation would be for the courts to apply the definition of deceit and defraud contained in Corporate Securities Law of 1968: " '[f]raud,' 'deceit,' and 'defraud' are not limited to common law fraud or deceit" [CAL. CORP. CODE §25006]. This provision of Section 25006 indicates that definitions of fraud and deceit, other than those that existed at common law, are applicable to the Corporate Securities Law of 1968. As the courts have interpreted these definitions, negligent misrepresentation has been held to be a form of fraud and deceit [See, e.g., Gagne v. Bertran, 43 Cal. 2d 481, 487-88, 275 P.2d 15, 20 (1954); Gonsalves v. Hodgson, 38 Cal. 2d 91, 100, 237 P.2d 656, 662 (1952); Wishnick v. Frye, 111 Cal. App. 2d 926, 930, 245 P.2d 532, 534-35 (1952); CAL. CIV. CODE §§1572, 1709, 1710]. While the courts may be hesitant to apply negligent misrepresentation to Section 25504.1 due to the lack of a privity requirement [Cf. Roberts v. Ball, Hunt, Hart, Brown & Baerwitz, 57 Cal. App. 3d 104, 110-11, 128 Cal. Rptr. 901, 1005-06 (1976) (factors for holding attorney liable to a party not in privity for negligent misrepresentation)], case law seems to indicate that reckless conduct might be construed as a form of "intent to deceive or defraud" under Section 25504.1 [Cf. Wishnick v. Frye, 111 Cal. App. 2d 926, 930, 245 P.2d 532, 534-35 (1952) (representations by corporate directors concerning securities; scienter would be satisfied by statements made carelessly or recklessly)]. If California courts apply these tort definitions to the civil remedy provisions of the Corporate Securities Law of 1968, then Section 25504.1 liability apparently would attach to conduct that could be classified as intentional, in reckless disregard of the truth, or, under limited circumstances, negligent misrepresentation. To the extent that Section 25504.1 was intended primarily to regulate those actions performed "with intent to deceive or defraud" (emphasis added), it is arguable that the application of these other tort definitions may be inconsistent with such a purpose [See CORPORATIONS COMMITTEE REPORT at 3-4].

Another possible interpretation of "intent to deceive or defraud" may be derived by analogizing this language to the requirements of Rule 10b-5 of the federal securities regulations. In the recent case of Ernst & Ernst v. Hochfelder [425 U.S. 185 (1976)], the United States Supreme Court held that a private cause of action for damages would not lie under Rule 10b-5 in the absence of any allegations of "scienter," which was defined in footnote 12 as "a mental state embracing intent to deceive, manipulate, or defraud," and the Court further stated that "[w]e need not address here the question
whether, in some circumstances, reckless behavior is sufficient for civil liability under Section 10b and Rule 10b-5" [Id. at 193-94 n.12]. This would seem to indicate that there may be some form of reckless conduct that is sufficient to constitute a violation of Rule 10b-5 [See Pardon Products v. Lybrand Ross Bros. & Montgomery, 72 F.R.D. 556, 559 (1976); Lanza v. Drexel, 479 F.2d 1277, 1306 (2nd Cir. 1973); Cox, Ernst & Ernst v. Hochfelder: A Critique and an Evaluation of Its Impact Upon the Scheme of the Federal Securities Laws, 28 HASTINGS L.J. 569, 628 (1976)]. Moreover, it has been speculated that because of Hochfelder, Rule 10b-5 liability could turn on the defendant’s knowledge of the wrong and whether he or she had materially assisted in its commission, since an intent to deceive, defraud, or manipulate could be inferred from this type of knowledge and action [Comment, Rule 10b-5 Liability for Aiding and Abetting After Ernst & Ernst v. Hochfelder, 28 U. FLA. L. REV. 999, 1002 (1976)]. The Court in Hochfelder, however, apparently relied on the use of the word “manipulate” in Section 10b of the Securities Exchange Act of 1934 to conclude that some form of “intentional wrongdoing” was required to impose 10b-5 liability [See 425 U.S. at 197-99]. Consistent with this interpretation but in somewhat more precise language, Section 25504.1 expressly creates civil liability for any person who, with an intent to deceive or defraud, materially assists in the sale or purchase of securities by means of any communication that contains an untrue statement of a material fact or the omission of a material fact that makes the communication misleading [CAL. CORP. CODE §§25401, 25504.1]. If Hochfelder is premised on the use of the word “manipulate” as a word of art used by Congress to proscribe intentional conduct [See 425 U.S. at 197-99; Santa Fe Industries, Inc. v. Green, 97 S.Ct. 1292, 1300-01 (1977)], then the use of the phrase “with intent to deceive or defraud” in Section 25504.1 would seem to indicate an even stronger intent on the part of the legislature at least to proscribe and to create liability for intentional misconduct in securities transactions [See CORPORATIONS COMMITTEE REPORT at 4]. In addition, this latter construction appears to be the one originally intended by the proponents of this legislation and the most consistent with a literal interpretation of the language of Section 25504.1 [See CORPORATION COMMITTEE REPORT at 1, 4-5]. Thus, it would seem that the California courts will most likely interpret the phrase “with intent to deceive or defraud” as requiring a defendant to act intentionally to deceive a particular plaintiff or a general class of individuals to which the plaintiff belongs.

As previously discussed, the language of Section 25504.2 seems to be taken from the Securities Act of 1933, specifically Section 11(a)(4) and Section 11(b)(3), which provide that certain professionals will be liable for untrue statements of material facts or omissions of material facts in the

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security registration statements, absent a showing by these professionals that they acted with due diligence [15 U.S.C. §77k(a)(4), (b)(3) (1970)]. Apparently, the purpose of Section 11 is "not so much to compensate the defrauded purchaser as to promote enforcement of the Act and to deter negligence by providing a penalty for those who fail in their duties" [Globus v. Law Research Service, Inc., 418 F.2d 1276, 1288 (2nd Cir. 1969) cert. denied, 397 U.S. 913 (1970) (emphasis added)]. It appears that the underlying rationale behind this statement of the purpose of Section 11 is the assumption that purchasers are not directly defrauded by registration statements in the usual security transaction [See generally Globus v. Law Research Service, Inc., 418 F.2d 1276 (2nd Cir. 1969)]. Thus, it would seem that by borrowing Section 11 language and applying it to misrepresentations in prospectuses, offering circulars, and related documents, which are directly relied on by purchasers, as opposed to merely registration statements, the California Legislature appears to have created a section designed primarily to compensate defrauded purchasers [See CAL. CORP. CODE §25504.2].

Section 25504.2 applies to "[a]ny accountant, engineer, appraiser, or other person whose profession gives authority to a statement made by such person" [CAL. CORP. CODE §25504.2(a)]. This seems to indicate that attorneys will be liable under this section for statements made in a professional capacity [Cf. Small, An Attorney's Responsibilities Under Federal and State Securities Laws: Private Counselor or Public Servant, 61 CALIF. L. REV. 1189, 1192-94 (1972) (attorneys are "other persons whose profession gives authority to a statement made by him" under Section 11 of the Securities Act of 1933)]. Initially, then, accountants, engineers, appraisers, and lawyers are now jointly and severally liable with other parties making untrue statements or misleading omissions if they cannot show that after a reasonable investigation they had reasonable grounds to believe that statements they made were true and contained no material omissions [CAL. CORP. CODE §25504.2(b)(1)]. In essence this provision makes accountants and other specified professionals liable for negligent misrepresentation in the preparation or certification of a prospectus, offering circular, or related document to plaintiffs not in privity with them [See CAL. CORP. CODE §25504.2]. Noting again that Section 11 of the Securities Act of 1933 only creates liability for negligent misrepresentation in preparation of the registration statement, it would appear that the legislature has provided liability on the state level that does not exist on the federal level under either Section 11 or Rule 10b-5 [Compare Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) and 15 U.S.C. §77k (1970) and 17 C.F.R. 240.10b-5 (1977) with CAL. CORP. CODE §25504.2]. Section 25504.2 is self-limiting in its application, however, since negligent misrepresentation alone is not enough without written consent to have the statements attributed to the professional
[CAL. CORP. CODE §25504.2(a)] and proof that the plaintiff relied on the untrue statement or the misleading omission [CAL. CORP. CODE §25504.2(a)(2)].

Section 25504.2 also provides that these professionals may avoid liability for misrepresentations if they can prove that "after reasonable investigation [they] had reasonable ground[s] to believe . . . that the statements . . . were true and that there was no omission to state a material fact" necessary to prevent the document from being misleading [CAL. CORP. CODE §25504.2(b)(1)]. This defense is the same as the one provided in Section 11 of the Securities Act of 1933 [Compare CAL. CORP. CODE §25504.2(b)(1) with 15 U.S.C. §77k(b)(3) (1970)] and similar to the defense established by Section 25501 of the Corporations Code, which requires the defendant to show that he or she exercised reasonable care and did not know (or if he or she had exercised reasonable care, would not have known) of the untruth or omission [Compare CAL. CORP. CODE §25504.2(b)(1) with CAL. CORP. CODE §25501]. The California courts have not interpreted the defense in Section 25501, but it seems reasonable to assume that this defense will be construed consistently with its counterpart, Section 11 of the 1933 Securities Exchange Act, which contains a statutory definition of reasonableness that applies directly to Section 11(b)(3): "[t]he standard of reasonableness shall be that required of a prudent man in the management of his own property" [15 U.S.C. §77k(c) (1970)]. One federal court has further elaborated upon this defense by stating that "[w]hat constitutes ‘reasonable investigation’ and a ‘reasonable ground to believe’ will vary with the degree of involvement of the individual, his expertise, and his access to the pertinent information and data" [Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544, 577 (E.D.N.Y. 1971)]. Application of these reasonableness tests leads to the conclusion that a professional will apparently be held to the standards of his or her profession and that these standards may vary with the particular defendant's involvement and access to information [See Ruder, Disclosure of Financial Projections-Developments, Problems and Techniques, in PRACTICING LAW INSTITUTE SERIES No. 5, FIFTH ANNUAL INSTITUTE ON SECURITIES REGULATION 37 (1974)]. Accordingly, professionals governed by Section 25504.2 would appear to have a sound defense to liability under this section, but the degree of difficulty to be experienced by these professionals in establishing this defense under Section 25504.2 will apparently depend on their position in a particular organization.

The misrepresentation violations under Sections 25504.1 and 25504.2 must be of a material fact that makes the specified document or report misleading [CAL. CORP. CODE §25504.2(a)(1); See CAL. CORP. CODE §§25401, 25504.1]. This requirement is the same as for a violation of Section 25401 and the resultant liability under Section 25501 [CAL. CORP.}

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The United States Supreme Court has recently redefined materiality in the securities context, holding that "an omitted fact is material if there is substantial likelihood that a reasonable stockholder would consider it important" [TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) (emphasis added)]. By the use of the word "would" the Supreme Court seemed to be approving the test articulated in List v. Fashion Park [340 F.2d 457 (2nd Cir. 1965)], which provided that "the basic test of materiality is whether a reasonable man would attach importance [to the fact misrepresented] in determining his choice of action in the transaction in question" [Id. at 462]. Since both the federal and state securities laws refer to a "material" fact or omission, it seems reasonable to assume that the California courts would define materiality for the purpose of Chapter 144 in the same manner.

In conclusion, it would appear that by adding Sections 25504.1 and 25504.2 to the Corporations Code, the legislature has extended liability for securities fraud to certain professionals who, while not in privity with the defrauded purchasers, or transferees, have made material misrepresentations on which such defrauded individuals have relied to their detriment, and has apparently provided a remedy in securities fraud cases similar to that which exists under the federal law.

See Generally:

2) A. BROMBERG, SECURITIES LAW: FRAUD (1975).

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Business and Professions Code §§16759, 16760 (new); §§16750, 16750.1, 16753, 16754, 16754.5, 16755 (amended).
AB 1158 (Chel); STATS 1977, Ch 540
Support: California Attorney General; Golden State Mobile Home Owners Association
Opposition: California Manufacturers Association
AB 1159 (Chel); STATS 1977, Ch 541
Support: California Attorney General; Golden State Mobile Home Owners Association
Opposition: California Manufacturers Association
AB 1161 (Chel); STATS 1977, Ch 542
Support: California Attorney General, California Peace Officers Association, Golden State Mobile Home Owners Association

Opposition: California Manufacturers Association
AB 1162 (Chel); STATS 1977, Ch 543
Support: California Attorney General, Golden State Mobile Home Owners Association

Chapters 540, 541, 542, and 543 amend and add various sections to the Business and Professions Code to provide the Attorney General and the 58 county district attorneys with new enforcement mechanisms that are designed to facilitate the prosecution of antitrust and price-fixing cases in California [See, e.g., CAL. BUS. & PROF. CODE §§16750, 16759, 16760; L.A. Daily J., Apr. 12, 1977, at 1, col. 5]. The Business and Professions Code authorizes the Attorney General to bring a cause of action on behalf of the state or any of its public subdivisions or public agencies for restraint of trade, and any individual “injured in his or her business or property” by such unlawful conduct could sue and recover treble damages [See CAL. BUS. & PROF. CODE §§16750(a), (c)]. Prior to the enactment of these new laws, county district attorneys apparently were precluded from prosecuting any antitrust or price-fixing violations on their own initiative on behalf of the county or any of its political subdivisions or public agencies, and thus, in the absence of an Attorney General order to the contrary, required all such actions to be initiated by the state Attorney General [See CAL. STATS. 1961, c. 757, §1, at 2013]. Even when ordered to initiate an action for a restraint of trade violation, the power of county district attorneys to conduct thorough investigations was severely limited in that the law did not authorize these officials to issue subpoenas in connection with antitrust cases. Also, since the average consumer’s damages from antitrust or price-fixing violations are usually slight and the bonding and notice requirements for filing class actions are often prohibitive, these prior laws left consumers with few remedies for the damages incurred by such unlawful business practices [See, e.g., Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 173-79 (1973); L.A. Daily J., Apr. 12, 1977, at 1, col. 5]. Finally, prior to the enactment of Chapter 541, only actions brought pursuant to Section 16750 of the Business and Professions Code were restricted by a four year statute of limitations, while the time limit on prosecuting other antitrust violations was apparently unclear [See CAL. STATS. 1963, c. 792, §1, at 1828].

behalf of state residents by bringing a civil action as parens patriae for violations of the federal antitrust laws [Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. No. 94-435, §301, 90 Stat. 1394-95 (1976); see H.R. REP. No. 94-499, 94th Cong., 2d Sess. 3, reprinted in [1976] U.S. CODE CONG. & AD. NEWS 2572, 2572-73 (hereinafter cited as HOUSE REPORT)]. An action in parens patriae permits an official to sue in the name of the government on behalf of injured individuals [See HOUSE REPORT at 8-9]. This federal legislation was enacted to provide an accessible remedy to consumers because "it is the consuming public that ultimately benefits from the enforcement of the antitrust laws" [HOUSE REPORT at 4] and because there was no practical remedy for consumers that were damaged by violations of the antitrust laws when the damage was to many consumers in nominal amounts [HOUSE REPORT at 6-8; see Tunney, A View From the Senate, 8 Sw. U.L. REV. 510, 512 (1976); Note, Parens Patriae: An Effective Consumer Remedy in Antitrust, 16 WASHBURN L.J. 135 (1976)]. The provisions of Section 16760 of the Business and Professions Code, as added by Chapter 543, closely parallel those of the federal law and would appear to provide California consumers with a more effective remedy for injuries resulting from violations of state law governing restraints on trade [See L.A. Daily J., Apr. 12, 1977, at 1, col. 5].

Section 16760 specifically provides that the Attorney General, or a district attorney if the activities giving rise to the action or the effects of such activities occur primarily within the district attorney's county, may now bring a civil action as parens patriae for monetary relief for any injury to the property of natural persons residing in California that is caused by a violation of the provisions of the Business and Professions Code (commencing with Section 16700) relating to restraints on trade [CAL. BUS. & PROF. CODE §§16760(a)(1), (g)]. The injury must be to the property of a "natural person" for the provisions of Section 16760 to apply and this element is also necessary under the parens patriae provision of the federal law [Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. No. 94-435, §301, 90 Stat. 1394 (1976)]. Under the federal law, the term "natural person . . . is intended to exclude business entities such as corporations, partnerships, and sole proprietorships" [HOUSE REPORT at 9] and it seems reasonable to assume that the state law will be similarly interpreted. Chapter 543 further provides that the Attorney General or a district attorney must give notice, as directed by the court, of any action brought on behalf of the people of the state or county for violation of the law relating to restraints on trade [CAL. BUS. & PROF. CODE §16760(b)(1), (g)]. This notice may be by publication or by such other means as required by the court to avoid denial of due process to any person or persons [CAL. BUS. & PROF. CODE §16760(b)(1), (g)]. This notice provision is also apparently adopted from the federal law.
that requires notice by publication and the use of the best possible notice practicable under the circumstances [Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. No. 94-435, §301, 90 Stat. 1394 (1976)]. Since Section 16760(b)(1) of the Business and Professions Code provides that notice must meet due process requirements, if publication is not the best notice practicable under the circumstances, the courts may be constitutionally compelled to direct a further notice that does meet such requirements [See Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 314-15 (1950); HOUSE REPORT at 12]. This notice requirement apparently will serve the purpose of informing any person that may have a claim, as an individual against the defendant, that the Attorney General is initiating a civil action as parens patriae [Cf. HOUSE REPORT at 12 (purpose of federal law notice provision is to inform individuals with claims of the parens patriae action)].

Section 16760 allows an individual to elect to exclude his or her portion of the claim from the parens patriae adjudication by filing notice to that effect with the court [CAL. BUS. & PROF. CODE §16760(b)(2)]. Any final judgment in a parens patriae action will operate as res judicata as to any individual claim that has not been excluded in accordance with this section [CAL. BUS. & PROF. CODE §16760(b)(3)]. Under the federal law the notice, election, and res judicata provisions are designed to serve the constitutional due process interests of both potential claimants and defendants [See HOUSE REPORT at 11]. Thus, it would appear that the same interests are served by the similar provisions in the California law.

Under the federal parens patriae provisions the defendant is subject to treble damages once liability has been established [Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. No. 94-435, §301, 90 Stat. 1394 (1976)]. Chapter 543 authorizes the court to award only “the total damage sustained” and the costs of the suit, including reasonable attorney’s fees, and thereby apparently is designed to provide a remedy to injured consumers rather than to impose a penalty to deter unlawful restraints of trade [See CAL. BUS. & PROF. CODE §16760(a)(2)]. Specifically, the court must exclude from such damages any amount that duplicates an award already given for the same injury [CAL. BUS. & PROF. CODE §16760(a)(1)(A)], any amount that is allocable to an individual who has excluded his or her claim from the parens patriae action [CAL. BUS. & PROF. CODE §16760(a)(1)(B)(i)], and any amount allocable to a business entity [CAL. BUS. & PROF. CODE §16760(a)(1)(B)(ii)]. Further, when there has been a determination that a defendant agreed to fix prices, the damages may be measured in an aggregate amount “by statistical or sampling methods, by the pro rata allocation of illegal overcharges or of excess profits,” or by any means the court determines is reasonable to estimate aggregate damages without requiring proof as to individual claims and damages [CAL. BUS. & PROF. CODE §16760(a)(1)(B)(ii)].
The parallel federal provision for measurement of damages is designed to ease the burden of proving damages and consequently guarantees a remedy when liability is established [See Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. No. 94-435, §301, 90 Stat. 1394 (1976); House Report at 14]. By adopting this flexible rule on proof of damages, the California Legislature apparently has provided injured consumers, who are being represented by the Attorney General or a district attorney as parens patriae in price-fixing cases, with a more certain remedy than might be expected in a private lawsuit [Cf. House Report at 14-15 (federal law is designed to provide consumers with a more certain remedy)]. In addition, Chapter 543 provides specific guidelines for the distribution of the damage award: (1) the court is to insure to the extent possible that each individual represented is afforded a reasonable opportunity to receive his or her proportionate share [Cal. Bus. & Prof. Code §16760(e)(1)]; (2) the Attorney General or district attorney is to retain the costs of the suit and a reasonable attorney's fee for deposit in either the Attorney General Antitrust Account or in an appropriate account provided by law [Cal. Bus. & Prof. Code §§16760(e)(2), (g)]; and (3) if the damage award is not exhausted, the remaining funds are to be considered unclaimed property and dealt with under specified provisions of the Code of Civil Procedure [Cal. Bus. & Prof. Code §16760(e)(3). See generally Cal. Civ. Proc. Code §§1540-1542]. In addition, should a defendant prevail, the court may award reasonable attorney's fees to such defendant upon a finding that the Attorney General or district attorney has acted in bad faith, vexatiously, wantonly, or for oppressive reasons [Cal. Bus. & Prof. Code §16760(a)(3)].

Chapter 543 specifically provides that a restraint of trade action brought as parens patriae "shall not be dismissed or compromised without the approval of the court" and notice of any such dismissal or compromise must be given to the court [Cal. Bus. & Prof. Code §16760(c)]. This provision is apparently designed to guarantee that all parens patriae actions are pursued diligently and any compromises or settlements are fair and just to the consumers represented [Cf. Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. No. 94-435, §301, 90 Stat. 1394 (1976); House Report at 13 (federal law's similar provision designed to promote public confidence in parens patriae settlements)].

All county district attorneys are authorized by Chapter 543 to bring any action as parens patriae that the Attorney General may bring pursuant to Section 16760(a), and are further authorized by Chapter 540 to bring any action on behalf of their county or its political subdivisions that the Attorney General is authorized to bring for damages under Section 16750 for violations of the law relating to restraints on trade or any comparable federal law [Cal. Bus. & Prof. Code §§16750(g), 16760(g)]. Such actions, however,
may be brought by a district attorney only when the activities giving rise to such prosecution occur primarily within his or her county [CAL. BUS. & PROF. CODE §§16750(g), 16760(g)]. Furthermore, the district attorney must, before bringing an action as parens patriae or an action on behalf of his or her county, file with the Attorney General a copy of the proposed complaint together with a confidential memorandum and report setting forth the facts and reasons that give rise to the proposed complaint at least 30 days prior to the filing of such complaint [CAL. BUS. & PROF. CODE §§16750(g), 16760(g)]. In an action brought by a district attorney on behalf of the state or any of its agencies, the Attorney General is authorized to take full charge of the action if the Attorney General deems it necessary and in the public interest [CAL. BUS. & PROF. CODE §16750(g)]. Further, a district attorney must also give notice to the Attorney General at least 30 days before any settlement or stipulated judgment of such actions and this notice must include a copy of the proposed settlement and an explanation of the action [CAL. BUS. & PROF. CODE §§16750(g), 16760(g)].

Chapters 541 and 542 further strengthen California's antitrust laws by clarifying the applicable statute of limitations in such actions and providing district attorneys with enlarged investigatory powers [See CAL. BUS. & PROF. CODE §§16750.1, 16759]. Section 16750.1 has been amended by Chapter 541 to clearly state that any civil action brought to enforce any cause of action under the antitrust laws of California must be commenced within four years after the cause of action has accrued. Chapter 542 adds Section 16759 to the Business and Professions Code and provides that a district attorney who reasonably believes that there may have been a violation of the statutory prohibitions against restraints on competition, conspiracy against trade, or unfair trade practice or competition is now authorized to exercise all those investigatory powers granted to the Attorney General as the head of a department. Thus, a district attorney may now subpoena witnesses, records, papers, books, and other documents as well as exercise all the other powers that the Attorney General may exercise under Article 2 (commencing with Section 11180) of the Government Code when investigating an antitrust violation [See CAL. BUS. & PROF. CODE §16759; CAL. GOV'T CODE §§11180-11191]. Thus, it appears that by authorizing both the state Attorney General and local district attorneys to initiate civil actions for the benefit of injured consumers for violations of these state laws and by granting county district attorneys the same investigatory and prosecutorial powers as the state Attorney General when taking action against local antitrust violations, Chapters 540, 541, 542, and 543 are designed to strengthen the civil enforcement of California antitrust law.

Selected 1977 California Legislation

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Business Associations and Professions; General Corporation Law amendments


AB 256 (Knox); STATS 1977, Ch 235

Support: State Bar of California; California Department of Corporations

Chapter 235 makes several technical amendments in the General Corporation Law [CAL. CORP. CODE §§100-8999] that became effective January 1, 1977 [See, e.g., CAL. CORP. CODE §§114, 171, 204]. While most of the provisions of Chapter 235 are apparently designed to clarify the law and to provide uniformity to certain aspects of the General Corporation Law, this review of Chapter 235 will focus on the substantive changes of this enactment.

Articles of Incorporation

Prior to the enactment of Chapter 235, Section 204(a)(5) of the Corporations Code provided that the articles of incorporation could contain a provision increasing the proportion of the vote of the directors necessary for corporate action beyond that otherwise prescribed by the Code [CAL. STATS. 1976, c. 641, §6.2, at —]. Section 204(a)(5), as amended by Chapter 235, now provides that such a provision of the articles of incorporation may also prescribe a larger proportion of directors necessary for a quorum for taking action than is otherwise required by the Code [CAL. CORP. CODE §204(a)(5)].

Section 904 of the Corporations Code now provides that if an amendment to the articles of incorporation would make shares assessable or would subject fully paid shares to an action for collection of an assessment then it need only be approved by the outstanding shares affected [CAL. CORP. CODE §904] instead of by all the outstanding shares [CAL. STATS. 1975, c. 682, §7, at 1573].

Shareholder Voting

Prior to the enactment of Chapter 235, the Corporations Code indicated that the clause “[a]pproved by (or approval of) the shareholders” required
an affirmative vote of a majority of the shares represented at a shareholder meeting [CAL. STATS. 1976, c. 641, §2.4, at —]. This definition apparently required a majority of all the shares represented at a meeting, including those abstaining, and thus, a greater number of affirmative votes would be necessary to constitute a majority [See CAL. STATS. 1976, c. 641, §2.4, at —]. Section 153 of the Corporations Code now defines approval of the shareholders as an affirmative vote of the majority of shares represented and voting at the meeting. Thus, it would appear that an approval of the shareholders would no longer take abstentions into account when determining whether an affirmative vote constituted a majority [See CAL. CORP. CODE §153].

A further definitional amendment made by Chapter 235 is in the area of shareholder replacement of directors. Under the prior law, Section 305 of the Corporations Code was ambiguous as to the vote required to fill a vacancy in a board of directors created by the removal of a director [See CAL. STATS. 1976, c. 641, §7.5, at —]. Chapter 235 appears to resolve this ambiguity by clearly indicating that shareholders may fill a vacancy created by removal of a director only by approval of a majority of the shares represented and voting [Compare CAL. CORP. CODE §305(a), (b) with CAL. CORP. CODE §153].

Further, with regard to shareholder voting, Section 604 of the Corporations Code provides that all proxies distributed to ten or more shareholders of a corporation with 100 or more shareholders must contain the specific matters to be acted upon and provide space for shareholders to approve, disapprove, or abstain [CAL. CORP. CODE §604]. Prior to the enactment of Chapter 235, however, Section 604 expressly denied the application of these requirements to general proxies, which were proxies in which the proposals or candidates on which shareholders were to vote were not set forth, and stated further that such requirements should not preclude the use of general proxies [CAL. STATS. 1976, c. 1392, §1, at —]. Chapter 235 deletes this exception to the rules governing the form of proxies, and thus, would appear to preclude the use of general proxies as defined [See CAL. CORP. CODE §604]. Further, with regard to irrevocable proxies, Chapter 235 provides that such proxies may now be revoked by any transferee, instead of any purchaser, who takes shares without knowledge of the proxy provisions unless the irrevocability clause appeared on the share certificates [CAL. CORP. CODE §705(f)]. Thus, Chapter 235 would seem to be extending protection against unknown irrevocable proxies beyond a purchaser of shares subject to such a proxy to any person who is a transferee without notice of the irrevocability [See CAL. CORP. CODE §705(f)].

Selected 1977 California Legislation
Board of Directors

Section 311 of the Corporations Code provides that the board of directors of a corporation may designate committees of two or more members to serve the board by a resolution adopted by a majority of the authorized number of directors. This section further provides that the board may designate alternative members for said committees [CAL. CORP. CODE §311]. Chapter 235 amends Section 311 to require that the appointment of members or alternate members must also be by the vote of a majority of the authorized number of directors [CAL. CORP. CODE §311].

Corporate Transactions

Chapter 235 amends Section 500 of the Corporations Code to eliminate the prohibition against using "appreciation in value not yet realized" in determining corporate assets for shareholder distribution purposes [See CAL. CORP. CODE §500(b)(2); CAL. STATS. 1976, c. 641, §14, at —]. It would appear that by allowing California corporations to use "appreciation in value not yet realized" as an asset for the purpose of shareholder distributions, Chapter 235 will place this state among the minority of states that allow such a procedure [Compare CAL. CORP. CODE §500 with Randall v. Bailey, 288 N.Y. 280, 43 N.E.2d 43 (1942) and Finn, Price-Level Accounting for Corporate Dividends, 12 SANTA CLARA LAW. 59, 70 (1972)]. While taking into account that unrealized appreciation may give a corporation more flexibility in determining assets available to meet the statutory requirement for distribution of earnings [See CAL. CORP. CODE §500], this flexibility may be limited if the California courts follow the other minority jurisdictions allowing the inclusion of unrealized appreciation and require "that this fund should be based upon 'actual values' . . . and not the mere book value" of the assets [See Finn, Price-Level Accounting for Corporate Dividends, 12 SANTA CLARA LAW. 59, 70 (1972)].

Chapter 235 adds Section 503.1 to provide that the restrictions of the General Corporation Law on corporate distributions will not apply "to a purchase or redemption of shares of a deceased shareholder from the proceeds of insurance on the life of such shareholder" [CAL. CORP. CODE §503.1. See generally CAL. CORP. CODE §§500, 501, 502, 503]. The proceeds used to make such a purchase or redemption, however, must be "in excess of the total amount of all premiums paid by the corporation for such insurance" [CAL. CORP. CODE §503.1 (emphasis added)]. Thus, it appears that a corporation is now expressly authorized to utilize certain insurance policy proceeds to repurchase or redeem shares issued to the person who is the subject of the policy.

Prior to the enactment of Chapter 235 a sale of assets that constitutes
reorganization as defined in Section 181 of the Corporations Code was not subject to the approval provisions of Section 1001, but had to be approved by each corporation participating in the reorganization [See CAL. CORP. CODE §1200] and by a majority of the outstanding shares [See CAL. CORP. CODE §§152, 1201(d)]. Chapter 235 provides that a sale of assets that constitutes a reorganization must now be approved by at least 90 percent of the voting power if the buyer is in control of or under the common control with the seller [CAL. CORP. CODE §1001(d)]. This requirement does not apply, however, if the sale is in consideration of the nonredeemable common shares of the purchasing corporation or its parent [CAL. CORP. CODE §1001(d)]. Section 1001 has been amended to further provide that even if buyers, who are selling all or substantially all of their assets, are in control, or under common control with the seller, the terms of the sale need not be approved by the shareholders if they have been previously approved by the Commissioner of Corporations, the Insurance Commissioner, or the Public Utilities Commission [CAL. CORP. CODE §1001(e). See generally, CAL. CORP. CODE §25142; CAL. INS. CODE §838.5; CAL. PUB. UTIL. CODE §822].

Section 1101 of the Corporations Code provides that the board of each corporation desiring a merger must approve a merger agreement that sets forth the details and procedures of the merger [CAL. CORP. CODE §1101]. Prior to the enactment of Chapter 235 it appears that the law was unclear as to what corporations or other persons were required to be parties to such an agreement [CAL. STATS. 1976, c. 641, §19, at —]. Chapter 235 amends Section 1101 to provide that constituent corporations must be parties to the agreement and that a parent party corporation and other persons may be parties to such an agreement [CAL. CORP. CODE §1101]. The last two sentences of Section 1101 of the Corporations Code additionally provide that a merger agreement must treat each share of the same class or series of any constituent corporation equally with respect to any distribution of cash, property, rights, or securities [CAL. CORP. CODE §1101] and that the nonredeemable common shares of a constituent corporation may be converted only into nonredeemable common shares of the surviving corporation or a parent party when the constituent corporation or its parent owns shares of another constituent corporation representing more than 50 percent of its voting power prior to the merger [CAL. CORP. CODE §1101]. Both requirements are subject to exceptions provided by the provisions of Section 407 of the Corporations Code dealing with fractional shares and provided by consent of the shareholders of the class [CAL. CORP. CODE §1101]. In addition, Chapter 235 adds Sections 1101.1 to provide that the above requirements of Section 1101 do not apply to any transaction if the Commissioner of Corporations, the Commissioner of Insurance or the Pub-
lic Utilities Commission has approved the terms and conditions of the transaction and fairness of such terms and conditions” [CAL. CORP. CODE §1101.1]. Since it would appear that the purpose of Section 1101 requirements is to protect the interest of the shareholders in a merger transaction [See CAL. CORP. CODE §1101], Section 1101.1 would seem to continue this purpose by subjecting the terms and conditions of a merger to the approval of the Insurance and Corporation Commissioners or the Public Utilities Commission before the exception to Section 1101 comes into operation.

Prior to the enactment of Chapter 235 a corporation that did not own all of the outstanding shares of a subsidiary corporation that was party to a merger was required to give at least ten days notice to each shareholder of such subsidiary corporation prior to the effective date of the merger [CAL. STATS. 1976, c. 641, §20, at —]. Section 1110, as amended by Chapter 235, now provides that such notice must be given at least 20 days prior to the effective date of the merger [CAL. CORP. CODE §1101(i)].

General Provisions

Section 1501 of the Corporations Code sets forth specific circumstances and time periods by which a corporation must send its shareholders an annual financial report [CAL. CORP. CODE §1501]. Prior to the enactment of Chapter 235 all such financial statements were required to be prepared in conformity with generally accepted accounting principles [CAL. CORP. CODE §114]. Chapter 235 provides that such financial statements for corporations with fewer than 100 holders of record of its shares no longer need be prepared in conformity with generally accepted accounting principles if the report reasonably sets forth assets and liabilities, income and expenses, and discloses the accounting basis used [CAL. CORP. CODE §1501(a)].

In addition, Chapter 235 makes two amendments in the California Uniform Commercial Code concerning the validity of liens upon securities and restrictions on the transfer of securities [See CAL. COM. CODE §§8103, 8204]. Prior to the enactment of Chapter 235 a lien upon a security was valid against a purchaser only if noted conspicuously on the security [CAL. STATS. 1963, c. 819, §8103, at 1955]. Chapter 235 extends this provision to all transferees of the security, unless the transferee took with actual knowledge of the lien [CAL. COM. CODE §8103]. In addition, though arguably the law prior to the enactment of Chapter 235 [See CAL. STATS. 1963, c. 819, §8103, at 1955], Section 8103 now makes it clear that a transferee who receives securities with actual knowledge of a lien would be subject to this, regardless of whether the lien was conspicuously noted on the security certificate [CAL. COM. CODE §8103]. Similarly, under the prior law, restrictions on transfer of securities imposed by the issuer were effective only if noted conspicuously on the security or were against a person with actual
knowledge of the restrictions [CAL. STATS. 1963, c. 819, §8204, at 1957].
Section 8204, as amended by Chapter 235, now provides that such restric-
tions are effective if noted conspicuously or are against a *transferee*,
including a purchaser from the issuer, who has actual knowledge of the
restrictions [CAL. COM. CODE §8204].

Finally, Chapter 235 provides that the General Corporation Law will not
become applicable to banks, as that term is defined in Section 102 of the
Financial Code, until January 1, 1979 [CAL. STATS. 1977, c. 235, §30.5, at
—], which extends for one year the period during which banks will continue
to be governed by the applicable provisions of the Financial Code [See CAL.
FIN. CODE §§100-3706]. In conclusion, it would appear that by enactment
of Chapter 235 the legislature is providing uniformity and clarity to certain
aspects of the General Corporation Law as well as providing several sub-
stantive changes in the law that governs corporations in California.

See Generally:
1) 7 PAC. L.J., REVIEW OF SELECTED 1975 CALIFORNIA LEGISLATION 258 (Review of General

**Business Associations and Professions; liquidated damages**

Civil Code §§1670, 1676 (repealed); §1669, Chapter 2 (commencing with §1675) (new); §§1671, 1951.5, 3358 (amended); Education Code
§92050 (new); §90226 (amended); Government Code §§14376, 53069.85
(amended); Streets and Highways Code §5254.5 (amended).
AB 570 (McAlister); STATS 1977, Ch 198
(Effective July 1, 1978)
Support: California Association of Realtors; California Law Revision
Commission

*Generally authorizes the use of liquidated damages provisions in
specific types of contracts; provides specific guidelines for measur-
ing the reasonableness of liquidated damages provisions in real
property contracts for the sale of residential and nonresidential
property, certain public contracts, and for contracts not covered
by another statute; continues the prior law restrictions on liq-
uidated damages provisions in specified consumer contracts.*

Chapter 198 generally authorizes the use of liquidated damages in con-
tracts entered into after July 1, 1978 [CAL. STATS. 1977, c. 198, §16, at —].
Prior to the enactment of Chapter 198, parties to a contract could, under
some circumstances, agree on the amount or manner of computation of
damages recoverable for breach of contract. Sections 1670 and 1671 of the
Civil Code permitted the enforcement of a liquidated damages provision

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only when the actual damages "would be impracticable or extremely difficult to fix" [CAL. CIV. CODE §§1670, 1671 as enacted 1872]. In addition, the courts had developed a second requirement that a liquidated damages provision must reflect a "reasonable endeavor" to estimate actual damages [E.g., McCarthy v. Tally, 46 Cal. 2d 577, 584, 297 P.2d 981, 986 (1956); Better Food Mkts., Inc. v. American Dist. Tel. Co., 40 Cal. 2d 179, 187, 253 P.2d 10, 15 (1953)]. It has been argued that judicial decisions interpreting and applying these requirements provide an inadequate guide to contracting parties and has severely limited the use of liquidated damages provisions [Recommendation Relating to Liquidated Damages, 13 CAL. LAW REVISION COMM’N REPORTS, RECOMMENDATIONS AND STUDIES 1739 (1976) (hereinafter cited as RECOMMENDATIONS)]. Chapter 198 repeals Section 1670 of the Civil Code, which made void all liquidated damages provisions that were not governed by other statutes or did not meet the criteria of impracticability as set forth in the former version of Section 1671 of the Civil Code [See CAL. CIV. CODE §1670 as enacted 1872].

Chapter 198 provides different standards for the validity of liquidated damages provisions in the following types of contracts: (1) specified consumer purchases and rentals [CAL. CIV. CODE §1671(c), (d)]; (2) the sale or purchase of residential property [CAL. CIV. CODE §1675]; (3) all contracts not expressly governed by another statute, including the sale or purchase of nonresidential property [CAL. CIV. CODE §§1671(b), 1676]; and (4) all contracts expressly governed by another statute, including certain public construction contracts [CAL. CIV. CODE §1671(a); see, e.g., CAL. COM. CODE §2718; CAL. EDUC. CODE §§90226, 92050; RECOMMENDATIONS at 1750].

The prior law restrictions on the validity of liquidated damages are retained in cases against a consumer for a purchase or rental of personal property or services primarily for domestic use [CAL. CIV. CODE §1671(c) (1), (d)] and in cases against a lessee of real property used as a dwelling by the lessee or his or her dependents [CAL. CIV. CODE §1671(c)(2), (d)]. Thus, for these two types of consumer contracts, a liquidated damages provision will be upheld only if it would have been "impracticable or extremely difficult to fix the actual damage" [CAL. CIV. CODE §1671(d)] and the provision constitutes a "reasonable endeavor" to estimate the actual damages [McCarthy v. Tally, 46 Cal. 2d 577, 584, 297 P.2d 981, 986 (1956); RECOMMENDATIONS at 1752].

A different standard for upholding the validity of a liquidated damages provision is established by Chapter 198 in cases in which the buyer defaults on a contract for the purchase of residential real property [CAL. CIV. CODE §§1675, 1678]. Residential property is defined as a dwelling containing not more than four residential units, at least one of which the buyer intends, at
the time of making the purchase contract, to occupy as his or her residence [CAL. CIV. CODE §1675(a)(1)-(2)]. Section 1675(b) provides that if the parties to a contract agree that all or any part of a payment made by the buyer will constitute liquidated damages in the case of the buyer's default, it is valid as liquidated damages to the extent that the buyer has actually made such payment in the form of cash or check, including post-dated check [CAL. CIV. CODE §1675(b)]. Thus, if the liquidated damages provision asserts damages for more than was actually paid in "earnest money" deposited by the buyer, the provision is now valid only to the extent of the amount actually paid by the buyer [RECOMMENDATIONS at 1754]. Similarly, if the amount paid is greater than the amount specified in the liquidated damages provision, only the specified amount may be recovered as liquidated damages [Id.]. In addition, Section 1675 now establishes three percent of the purchase price as a threshold standard by which to measure the reasonableness of liquidated damages provisions in contracts for the sale or purchase of residential property [CAL. CIV. CODE §§1675(c), (d)]. If the amount paid as liquidated damages pursuant to Section 1675(b) does not exceed three percent of the purchase price, the buyer has the burden of establishing that the liquidated damages provision was unreasonable [CAL. CIV. CODE §1675(c)]. On the other hand, if the amount paid exceeds three percent, then the party seeking to enforce the provision has the burden of establishing that the additional amount was reasonable [CAL. CIV. CODE §1675(d)]. In determining whether the amount paid was reasonable, the court must consider both the circumstances at the time the contract was made [CAL. CIV. CODE §1675(e)(1)] and the price, terms, and circumstances of any subsequent sale or contract to sell the property made within six months of the buyer's default [CAL. CIV. CODE §1675(e)(2)]. The provision for considering any subsequent sale would appear to have been in response to the Governor's veto of similar legislation in 1976 [See JOURNAL OF THE CALIFORNIA ASSEMBLY 21614-15 (1976 Reg. Sess.); AB 3169, 1976 Regular Session].

Chapter 198 also provides that a liquidated damages provision for a buyer's default in a contract to purchase and sell real property is now valid only if it is separately signed or initialed by the parties to the contract [CAL. CIV. CODE §1677(a)]. In addition, if a liquidated damages provision is contained on a printed contract, it must be printed in either a ten-point bold type or contrasting red print in at least eight-point bold type [CAL. CIV. CODE §1677(b)]. Further, Section 1678 of the Civil Code requires a separately signed or initialed agreement whenever any subsequent payment is intended to constitute liquidated damages for the buyer's failure to purchase real property [CAL. CIV. CODE §1678]. Importantly, Sections 1675 through 1681 extend only to provisions concerning liquidated damages for a buyer's
failure to purchase property, and the liquidated damages provisions for a seller's default are to be governed by Section 1671 [CAL. CIV. CODE §1679]. These sections, however, do not affect the right of a party to a contract to obtain specific performance of the contract [CAL. CIV. CODE §1680]. Moreover, none of the provisions of Section 1675 through 1681 apply to "contracts for the purchase of real property" as defined in Section 2985 of the Civil Code, which are contracts in which the parties agree to convey real property upon satisfaction of specified conditions that do not require conveyance of title within one year of the date of the contract [CAL. CIV. CODE §§1681, 2985]. Finally, if a liquidated damages provision is upheld under the provisions of Sections 1675 or 1676, the limitations of Section 3307 of the Civil Code relating to damages for breach of an agreement to purchase real property will not apply [RECOMMENDATIONS at 1755-56].

Chapter 198 establishes a third standard to test the validity of liquidated damages provisions in contracts for the purchase or sale of nonresidential real property and for all contracts not expressly governed by another statute [CAL. CIV. CODE §§1671(b), 1676]. Section 1671(b) provides that liquidated damages provisions contained in either of these types of contracts are valid unless the party seeking to avoid such a provision sustains the burden of proof that the provision was "unreasonable under the circumstances existing at the time the contract was made" [CAL. CIV. CODE §1671(b)]. In determining whether the amount of liquidated damages is unreasonable, the court may consider all the circumstances existing at the time of contracting, including: (1) the relationship between foreseeable harm and the amount of liquidated damages; (2) the relative equality of the bargaining power of the parties; (3) whether the parties were represented by counsel at the time of contracting; (4) the anticipation of the parties that proof of actual damages would be costly or inconvenient; (5) the difficulty in proving causation and foreseeability; and (6) whether the liquidated damages provision is included in a form contract [RECOMMENDATIONS at 1751-52]. Thus, the court apparently may not judge the reasonableness of a liquidated damages provision in retrospect or consider the amount of actual damages suffered as having any bearing upon the validity of such a damage provision [See CAL. CIV. CODE §1671(b); RECOMMENDATIONS at 1751]. Similarly, in determining the validity of liquidated damages against a buyer who defaults in a contract for the purchase or sale of nonresidential property, Section 1676 provides that the same standard of "unreasonableness under the circumstances at the time the contract was made" must be shown to invalidate any liquidated damages provision in such a contract. Furthermore, liquidated damages provisions in contracts for the sale or purchase of nonresidential property are subject to the same requirements of separate
signing or initialing and minimum type-size printing as those governing such provisions in contracts involving residential property [See CAL. CIV. CODE §§1676-1678]. In addition, Section 1676, like the sections relating to contracts for the sale or purchase of residential property, is limited to situations involving defaulting buyers and is inapplicable to Section 2985 contracts and makes inapplicable the damages provisions of Section 3307 [See CAL. CIV. CODE §§1679, 1681; RECOMMENDATIONS at 1755, 1756].

The provisions of Section 1671, which generally allow for liquidated damages, do not extend to contracts governed expressly by another statute [CAL. CIV. CODE §1671(a)]. Chapter 198, however, amends certain code sections to specifically allow for liquidated damages in some public contracts. Section 90226 of the Education Code is amended to provide that construction delay payments in state university and college contracts are now expressly valid as liquidated damages unless such damages were manifestly unreasonable at the time the contract was made [CAL. EDUC. CODE §90226]. Further, Chapter 198 adds Section 92050 to the Education Code to provide that the Regents of the University of California may include a liquidated damages provision in construction contracts for the University of California that allows a specified sum of money to be deducted from payments due, or to become due, to a contractor for each day of delay after the completion date specified in the contract. Such a sum is valid as liquidated damages unless it was manifestly unreasonable at the time the contract was made [CAL. EDUC. CODE §92050]. This section also permits the Regents to include a bonus for contractors who complete projects prior to the specified date in their contract [CAL. EDUC. CODE §92050]. Section 92050 does not prevent the Regents from including other provisions concerning liquidated damages in any contract for construction, but does specify that the validity of such provisions is to be governed by Civil Code Section 1671 [RECOMMENDATIONS at 1761].

Chapter 198 also amends Government Code Sections 14376 and 53069.85 concerning forfeiture provisions for delays in completion of construction contracts entered into by the state pursuant to the State Contract Act [CAL. GOV'T CODE §§14250-14424] and local public works contracts entered into by local agencies [CAL. GOV'T CODE §53069.85]. These amendments provide that any sum that must be forfeited pursuant to Sections 14376 and 53069.85 is valid as liquidated damages "unless manifestly unreasonable under the circumstances existing at the time the contract was made" [CAL. GOV'T CODE §§14376, 53069.85]. Section 5254.5 of the Streets and Highways Code is similarly amended with regard to contracts entered into pursuant to the Improvement Act of 1911 [CAL. STS. & HY. CODE §§5000-6794].
COMMENT

Chapter 198 appears to expand the potential use of liquidated damages provisions in California. The California Law Revision Commission has indicated several useful functions that may be served by such provisions, including the avoidance of the cost, difficulty, and delay of proving damages in litigation; the avoidance of possible inequities of the normal rules of damages; and the potential conservation of judicial resources due to the fact that liquidated damage provisions may lead to fewer contract breaches and fewer lawsuits [RECOMMENDATIONS at 1740-41]. There exists, however, a great potential for the abuse of liquidated damage clauses in cases of unequal bargaining strength of the parties [See RECOMMENDATIONS at 1741] and consequently, Chapter 198 retains the prior restrictions on enforceability of liquidated damages provisions in cases of consumer purchases for domestic needs and residential leases [CAL. CIV. CODE §1671(c), (d)].

Chapter 198 is nearly identical to Assembly Bill 3169 that was introduced in the 1975-76 regular session of the legislature. Assembly Bill 3169 was vetoed by the Governor because, as he stated, “[i]n cases where the value of the real property is expected to increase and the seller will suffer no actual damages, automatic retention by the seller of any amount deposited by the buyer is unreasonable” [JOURNAL OF THE CALIFORNIA ASSEMBLY 21614-15 (1976 Reg. Sess.)]. It would appear, therefore, that Section 1675(e) (2) was added to meet the Governor’s objection. This section requires consideration of “the price, terms, and other circumstances” of a subsequent sale or contract to sell that is made within six months of the buyer’s default on the contract [CAL. CIV. CODE §1675(e) (2)]. It appears that the court is to consider whether or not the seller suffers actual damages by looking to the price, terms, and other circumstances of a subsequent transaction. Following the rationale of the veto message and Section 1675(e)(2), it appears that a court would find a liquidated damages clause in the sale of residential property invalid if the seller is able to sell the property within six months of a default and suffers no actual damage [See CAL. CIV. CODE §1675(e)(2)]. This particular test of reasonableness appears inconsistent with the “unreasonable at the time of contracting” test that is applied to all contracts covered by section 1671(b) and to all contracts for the sale of residential property [CAL. CIV. CODE §§1671(b), 1675(e)(1), 1676] and may operate to partially frustrate the purpose for liquidated damages; that purpose being to provide both the buyer and the seller with some assurance that a reasonable deposit will operate as a guarantee of the buyer’s performance or serve as “damages” to the seller if the buyer defaults [See Sweet, Liquidated Damages in California, 60 CALIF. L. REV. 84, 100 (1972)]. If Section 1675(e)(2) requires consideration of actual damages in the determination of reasonableness, it would appear that, at least in regard to buyer...
defaults in contracts for the purchase or sale of residential property, Chapter 198 may not "relieve the already overburdened courts of the frustrating and difficult process of determining the amount of damages for contract breach" [Id., at 145].

The overall impact of Chapter 198 would appear to be an increased use of liquidated damages provisions in California contract law, which should result in both more certain remedies and more clearly defined liabilities for parties to a contract that is breached, as well as a saving of judicial resources.

See Generally:
1) Sweet, Liquidated Damages in California, 60 CALIF. L. REV. 84 (1972).

Business Associations and Professions; business discrimination in interstate or foreign commerce

Business and Professions Code § 16721.6 (new).
SB 927 (Carpenter); STATS 1977, Ch 859
(Effective September 17, 1977)
Support: Bank of America

In 1977 California became one of a few states to enact legislation that was apparently aimed at prohibiting individuals and businesses from complying with the boycott provisions imposed against Israel by the Arab League [See CAL. BUS. & PROF. CODE §§16721, 16721.5; H.R. REP. NO. 95-190, 95th Cong., 1st Sess. 24, reprinted in [1977] U.S. CODE CONG. & AD. NEWS 1138, 1161 (hereinafter cited as HOUSE REPORT); Sacramento Bee, Apr. 28, 1976, §A, at 6, col. 5; Senator David Roberti, Press Release, No. 87, Aug. 11, 1976]. On June 22, 1977, the Export Administration Amendments of 1977 came into effect on the federal level [Export Administration Amendments of 1977, Pub. L. No. 95-52, 91 Stat. 235 (1977)] and provide for regulations to prohibit any United States person with certain exceptions, from complying with the provisions of a foreign boycott [Export Administration Amendments of 1977, Pub. L. No. 95-52, 91 Stat. 235 (1977)]. In an apparent response to this federal legislation, Chapter 859 has been enacted to provide that to the extent that Sections 16721 and 16721.5 are to be applied to transactions in interstate or foreign commerce they are to be interpreted and applied so as not to conflict with federal law [CAL. BUS. & PROF. CODE §16721.6].

Prior to the enactment of Chapter 859, Section 16721 of the Business and Professions Code expressly prohibited the exclusion of any person from a business transaction on the basis of an express discrimination policy imposed by a third party [CAL. BUS. & PROF. CODE §16721(a)]. Further, Section 16721.5 specifically made it an unlawful trust and an unlawful

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restraint of trade for any person: (1) to grant or accept any letter of credit or enter into any contract for goods or services when such document contains a provision requiring any person to discriminate or to certify that such person has not dealt with any other person on a discriminatory basis [CAL. BUS. & PROF. CODE §16721.5(a)]; or (2) to refuse to grant or accept any letter of credit or enter into any contract for goods or services because it does not contain a discrimination provision [CAL. BUS. & PROF. CODE §16721.5(b)].

Chapter 859 adds Section 16721.6 to the Business and Professions Code to provide that it is the intent of the legislature that the above sections "be interpreted and applied so as not to conflict with federal law with respect to transactions in the interstate or foreign commerce of the United States" [CAL. BUS. & PROF. CODE §16721.6]. Thus, it would now appear that to the extent that Sections 16721 and 16721.5 are to be applied to restrictive trade practices or boycotts in interstate or foreign commerce, that application is to be consistent with the federal law [See CAL. BUS. & PROF. CODE §16721.6].

The federal law governing restrictive trade practices and foreign boycotts referred to in Section 16721.6 would appear to be the 1977 amendments to the Export Administration Act [Compare CAL. STATS. 1977, c. 859, §2, at — with Export Administration Amendments of 1977, Pub. L. No. 95-52, §§201-205, 91 Stat. 244-48 (1977)]. The Export Administration Act in general "would prohibit U.S. persons, including U.S. controlled subsidiaries and affiliates abroad, from discriminating against or refusing to do business with other persons in response to a foreign boycott request, requirement, or agreement" [HOUSE REPORT at 5]. The Export Administration Act also contains, however, "[s]everal significant exceptions" to the above prohibition "to permit normal commercial practices to be followed, to avoid disruptions of business resulting from any intractable conflict of this . . . law with specific laws of foreign countries, and to interfere as little as possible with the right of any sovereign nation to conduct a direct, primary boycott of another nation" [HOUSE REPORT at 5; see Export Administration Amendments of 1977, Pub. L. No. 95-52, §201, 91 Stat. 245 (1977)]. Thus, Sections 16721 and 16721.5 of the Business and Professions Code would now apparently be interpreted to provide the same exceptions as the federal law when applied to interstate or foreign commerce transactions.

Since Chapter 859 only provides for federal law conformity in terms of interstate and foreign commerce transactions [See CAL. BUS. & PROF. CODE §16721.6], it is arguable that Sections 16721 and 16721.5 may still have an independent application and interpretation when applied to intrastate transactions. Thus, it is possible that Sections 16721 and 16721.5 will still prohibit the situation in which A enters into a contract with B, which requires that B refuse to deal with C because C is dealing with D without
any exceptions when the entire transaction concerns California persons and commerce exclusively [See CAL. BUS. & PROF. CODE §16721, 16721.5].

Chapter 859 also provides that Sections 16721 and 16721.5 shall be applied in the previously discussed manner only "to the extent, if any, not preempted by the Export Administration Act of 1969 as amended" [CAL. BUS. & PROF. CODE §16721.6]. The Export Administration Amendments of 1977 provide, however, that "[t]he amendments made by this title and the rules and regulations issued pursuant thereto shall preempt any law, rule, or regulation of any of the several States . . . which pertains to participation in, compliance with, implementation of, or the furnishing of information regarding restrictive trade practices or boycotts fostered or imposed by foreign countries against other countries" [Export Administration Amendments of 1977, Pub. L. No. 95-52, §205, 91 Stat. 248 (1977)]. Such an express preemption clause should effectively preclude the enforcement of Sections 16721 and 16721.5 of the California Business and Professions Code to the extent that they are sought to be applied to foreign boycotts, since "[w]here Congress has unequivocally and expressly declared that the authority conferred by it shall be exclusive, then there is no doubt but that states cannot exert concomitant or supplementary regulatory authority over the identical activity" [Northern States Power Co. v. Minnesota, 447 F.2d 1143, 1146 (8th Cir. 1971), aff'd mem., 405 U.S. 1035 (1971)] [See Comment, The Preemption Doctrine: Shifting Perspectives on Federalism and the Burger Court, 75 COLUM. L. REV. 623, 625 (1975)]. It is apparently the intent of Congress in this instance to preempt "all State laws which have the same purpose and goal" as the federal legislation [HOUSE REPORT at 24]. Thus, since the apparent purpose of Sections 16721 and 16721.5 is to make illegal business discrimination caused by the Arab League's boycott of Israel in California [See Sacramento Bee, Apr. 28, 1976, §A, at 6, col. 5; Senator David Roberti, Press Release, No. 87, Aug. 11, 1976. Contra, Op. CAL. LEGIS. COUNSEL No. 9055 (May 6, 1976)] and Chapter 859 now expressly provides for an interpretation of these sections that is not in conflict with the federal law [CAL. BUS. & PROF. CODE §16721.6], it would appear that the Export Administration Amendments of 1977 may be interpreted so as to completely preempt Sections 16721 and 16721.5 of the Business and Professions Code. It is also possible, however, to conclude that to the extent Sections 16721 and 16721.5 are applied to nonforeign boycott types of business discrimination in exclusive intrastate transactions, the federal law may not preempt such application [See CAL. BUS. & PROF. CODE §16721.6; HOUSE REPORT at 24].

In summary, by stipulating the possibility of preemption, Chapter 859 may provide the courts with an expression of legislative intent as to the continuing vitality of Section 16721 and 16721.5 of the Business and Professions Code.
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Professions Code in light of the federal government’s express intent to maintain exclusive control of the issues concerning foreign boycotts and their effect on business practices in the United States.

See Generally:

Business Associations and Professions; warranty service and repair contracts

Business and Professions Code §17048.5 (new)
§17026 (amended).
SB 625 (Roberti); STATS 1977, Ch 787

The Song-Beverly Consumer Warranty Act [CAL. CIV. CODE §§1790-1795.7] requires every manufacturer of consumer goods to designate authorized service and repair facilities reasonably close to retail outlets in order to carry out the terms of express warranties [CAL. CIV. CODE §1793.2(a)(1)]. Apparently as a result of this requirement “‘[a] handful of large manufacturers dictate the terms of warranty service contracts with thousands of independent repair shops, and the repairman is often forced to perform warranty service below his actual costs’” [Senator David Roberti, Press Release, No. 49, May 12, 1976]. As a result of these subcost contracts, repair shops are apparently forced to cut corners, oftentimes causing them to “turn out shoddy work” [Id.]. Chapter 787 amends the Unfair Trade Practices Act [CAL. BUS. & PROF. CODE §§17000-17101] to provide that this type of warranty service and repair contract is now unlawful as an unfair trade practice [CAL. BUS. & PROF. CODE §17048.5].

Chapter 787 specifically provides that “[i]t is unlawful for any manufacturer, wholesaler, distributor, jobber, contractor, broker, retailer, or other vendor, or any agent of any such person,” to contract for the performance of warranty service or repair of such person’s products with any service or repair agency if the service or repair will be provided “below the cost to such service or repair agency of performing the warranty service or repair” [CAL. BUS. & PROF. CODE §17048.5]. Cost is defined by Chapter 787 so as to include “the cost of parts, transporting the parts, and all overhead expenses of the service agency” [CAL. BUS. & PROF. CODE §17026]. Any independent service or repair agency will be able to enjoin violations of Chapter 787 [See CAL. BUS. & PROF. CODE §17070] as well as seek treble damages and attorney’s fees for any injury resulting from such violation [See CAL. BUS. & PROF. CODE §17082].

Prior to the enactment of Chapter 787 it would appear that independent service and repair agencies were entitled to “actual and reasonable cost of
repair, including any cost for parts and any reasonable cost of transporting
the goods or parts, plus a reasonable profit” in any contract entered into
with a manufacturer for the performance of warranty service or repair [CAL.
CIV. CODE §§1793.2(a)(1), 1793.3(c); Senator David Roberti, Press Re-
lease, 73, June 23, 1976]. For a violation of this provision of the Song-
Beverly Consumer Warranty Act, an independent service or repair agency
can apparently recover treble damages and reasonable attorney’s fees [See
CAL. CIV. CODE §1794.3]. Section 1793.2(a)(1) of the Civil Code, howev-
er, provides that although the rates under such a warranty service contract
must be in conformance with Section 1793.3(c), this does not preclude the
use of a discount in such contracts that is “reasonably related to reduce
credit and general overhead cost factors arising from the manufacturer’s
payment of warranty charges direct to the independent” [CAL. CIV. CODE
§1793.2(a)(1)]. Section 17026 of the Business and Professions Code, on the
other hand, defines cost for the purpose of warranty service agreements so
as to include “labor and all overhead expenses” [CAL. BUS. & PROF. CODE
§17026] and thus, Section 17048.5 does not seem to permit a discount to
reduce such costs to the manufacturer that enters into such a contract with an
independent service or repair agency [CAL. BUS. & PROF. CODE §17048.5].
Thus, a contract rate that may have been permitted under the Song-Beverly
Consumer Warranty Act due to its provision for a discount may be in
violation of Section 17048.5 as an unfair trade practice if such discount
brings the rate below the cost to the independent service or repair agency
making the repair. In conclusion, it would appear that by prohibiting these
below cost contracts, Chapter 787 attempts to assure California consumers
high-quality service and provide warranty service and repair shops with an
adequate remedy to redress any violation of this prohibition.

See Generally:
1) 8 PAC. L.J., REVIEW OF SELECTED 1976 CALIFORNIA LEGISLATION 267 (1976 amendments
to Song-Beverly Consumer Warranty Act) (19M7).

Business Associations and Professions; privacy of business
records

Civil Code §§1799, 1799.1, 1799.2 (new).
AB 679 (Chimbole); STATS 1977, Ch 221
Support: California Franchisee Council, California Service Station
Council

Prior to the enactment of Chapter 221 there was apparently no specific
prohibition of the disclosure of records prepared or maintained by business
entities performing bookkeeping services for individuals or other business
entities. Although it would appear that an argument may be made that such

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disclosure by a bookkeeping service could violate Article I, Section 1 of the California Constitution as an infringement upon privacy [Cf. White v. Davis, 13 Cal. 3d 757, 774, 533 P.2d 222, 233-34, 120 Cal. Rptr. 94, 105-06 (1975) ("The right of privacy . . . prevents . . . business interests from . . . misusing information gathered for one purpose in order to serve other purposes . . ."); Porten v. University of San Francisco, 64 Cal. App. 3d 825, 829, 134 Cal. Rptr. 839, 842 (1976) ("Privacy is protected not merely against state action; it is considered an inalienable right which may not be violated by anyone")], no such interpretation of the amendment has been applied specifically to the "bookkeeping services" context. By enactment of Chapter 221, however, the legislature has now specifically proscribed disclosure of records by business entities performing bookkeeping services [CAL. CIV. CODE §1799.1].

Chapter 221 provides that any business entity, as defined in Section 1799 of the Civil Code, which performs bookkeeping services and discloses in whole or in part the contents of any of its records to any person other than the individual or business entity that is the subject of the record, will be liable to such person for actual damages sustained, but in no case less than $500, plus the attendant court costs and reasonable attorney's fees [CAL. CIV. CODE §§1799.1, .2]. The cause of action established by Chapter 221 must be brought within two years from the date on which it arose [CAL. CIV. CODE §1799.2].

Section 1799.1 excepts certain disclosures from its provisions, and thus, a disclosure does not give rise to a cause of action for damages if such disclosure: (1) is made pursuant to a subpoena or court order; (2) is discoverable; (3) is made to a person acting pursuant to a lawful search warrant; (4) is made to a law enforcement agency for the purpose of "investigations of criminal activity," unless the disclosure is prohibited by law; or (5) is made to a taxing agency for the purpose of tax administration [CAL. CIV. CODE §1799.1].

The effective operation of Chapter 221 appears to be somewhat limited by the definitions of "bookkeeping services" and "business entity" as set forth in Section 1799 of the Civil Code. This section defines "bookkeeping services" as "keeping books, making trial balances, preparing statements . . . as part of bookkeeping operations" but excludes those services in which the trial balances, statements or reports are issued "as having been prepared by or examined by a certified public accountant or public accountant" [CAL. CIV. CODE §1799(a); see CAL. BUS. & PROF. CODE §§5051, 5052. See generally 16 CAL. ADM. CODE §54 (breach of confidential relationship if certified public accountant or public accountant discloses information obtained from a client)]. In addition, the definition of "business entity" specifically excludes any "financial institution organized, chartered

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or holding a license or authorization certificate under a law of this state or the United States ... [or] the parent of any such financial institution, [or] any subsidiary of any such financial institution or parent” [CAL. CIV. CODE §1799(b)]. Thus, the civil remedy created by Chapter 221 for disclosure of business records would appear to be applicable to only those businesses that are not regulated as financial institutions and that perform limited bookkeeping services for other businesses that do not include preparation or review by certified public accountants or public accountants. In this manner, Chapter 221 is apparently intended to protect small businesses and franchises that contract for bookkeeping services with certain business entities from having the financial records of their operations involuntarily disclosed to others.

Business Associations and Professions; savings and loan associations—conformity to General Corporation Law.

Financial Code §§5500.1, 9201.1 (new); 5503, 5512.5, 5653, 6456.5, 7616, 8400, 9200, 9201, 9206, 9207, 9209, 9214, 9215, 9216 (amended).
AB 637 (Robinson); STATS 1977, Ch 626
Support: California Savings and Loan League; California Department of Savings and Loan

Chapter 626 amends the existing Savings and Loan Association Law to bring its provisions into line with the General Corporation Law, which became effective on January 1, 1977 [See, e.g., CAL. FIN. CODE §§5503, 5653, 9200, 9201, 9207]. Section 5500.1 of the Financial Code specifies, however, that in applying the statutory provisions regulating transition to this new General Corporation Law [See CAL. CORP. CODE §§2300-2319], “effective date” as used in Section 2300 of the Corporation Code now means January 1, 1978, which is also the effective date of Chapter 626. Chapter 626 also provides that savings and loan associations may now merge with their subsidiaries when the parent association owns 90 percent or more of the outstanding stock of the subsidiary [CAL. FIN. CODE §§9215, 9216(b)].

Section 5503 of the Financial Code now requires the articles of incorporation of a savings and loan association to include in the statement of purpose that the association is formed primarily to engage in the business of a savings and loan and any other lawful activities not prohibited to such associations [CAL. FIN. CODE §5503(a)]. This amendment conforms the statement of purpose in the articles of incorporation of a savings and loan association to those of other corporations [See CAL. CORP. CODE §202(b) (1)].

Prior law voided any amendment to the articles of incorporation that made “any change in the rights, preferences, or privileges of any outstanding
stock or shares . . . adverse to the holders' unless such change was approved by the holders of two-thirds of the outstanding stock adversely affected” [CAL. STATS. 1963, c. 619, §1, at 1497]. Further, a two-thirds majority was required if a domestic association sought to transfer all or a substantial part of its assets to a domestic or federal association, or to effect a merger [CAL. STATS. 1968, c. 1143, §2, at 2164-65]. Chapter 626 now provides that any amendments to the articles of incorporation or bylaws of an association that make any change in the rights, preferences or privileges of any outstanding stock or share need only be approved by a majority of the outstanding stock adversely affected [CAL. FIN. CODE §5653] and that agreements to transfer a major portion of an association’s assets or of merger agreements similarly only require approval of a majority of the outstanding shares [CAL. FIN. CODE §§9200, 9201, 9207]. These amendments further conform the law governing savings and loan associations to that governing other corporations under the General Corporation Law [See CAL. CORP. CODE §§204(a)(5), 903]. Chapter 626 also provides that when a merger or consolidation agreement has been approved, unless approved unanimously, the parent association must mail a notice to the stockholders or shareholders ten days before submitting the certificate required by Section 9210 to the Savings and Loan Commissioner [CAL. FIN. CODE §9209].

Prior to the enactment of Chapter 626, a savings and loan association could not effect a merger with one of its subsidiaries unless it owned all of the subsidiary’s outstanding stock [CAL. STATS. 1968, c. 1143, §2, at 2168-69]. Sections 9215 and 9216 of the Financial Code now provide that such mergers may be effective if the parent association owns at least 90 percent of the subsidiary’s outstanding stock [CAL. FIN. CODE §9216(b)]. The procedures for a 90 percent merger, however, are more complicated than those established under prior law for a merger in which the parent was required to own all of the subsidiary’s stock. The parent and the subsidiary must each adopt resolutions agreeing to the merger and the parent association’s resolution must state that the parent assumes all the liabilities of the subsidiary and must indicate the amount of consideration that the parent is providing for the stock it does not already own [CAL. FIN. CODE §9216(b)]. The subsidiary’s resolution must approve the fairness of the consideration that the parent is offering for the outstanding stock [CAL. FIN. CODE §9216(b)]. In addition, the parent association may now adopt the name of any disappearing subsidiary despite any other provision of law [CAL. FIN. CODE §9216(c)]. After adoption of the merger resolutions, Chapter 626 further requires the parent association to submit a certificate of ownership to the Savings and Loan Commissioner, which must contain: (1) a statement that the parent owns at least 90 percent of the subsidiary’s stock; (2) a copy of the parent association’s resolution; (3) a copy of the subsidiary’s resolu-
tion; and (4) notice of the time and place at which these mergers were adopted and the vote by which they were approved [CAL. FIN. CODE §9216(d)]. If, however, the merger is one in which the parent association does not own all of the outstanding stock, then the parent must notify each stockholder of the subsidiary association by mail at least 20 days before the effective date of the merger [CAL. FIN. CODE §9216(e)]. The notice must contain: (1) the effective date of the merger; (2) a copy of the merger resolutions; and (3) pursuant to Section 1301(a) of the Corporations Code: (a) a copy of Sections 1300-1304 of the Corporations Code, (b) a statement of the fair market value of the outstanding stock of the subsidiary, and (c) the procedure by which a stockholder may enforce his or her rights [CAL. FIN. CODE §9216(e)]. Finally, Chapter 626 provides that stockholders of a subsidiary savings and loan association involved in a merger now have the right to demand that the parent association pay cash for their shares pursuant to Chapter 13 of the General Corporation Law [CAL. FIN. CODE §9216(e)]. Thus, Chapter 626 conforms the Savings and Loan Association Law to the new General Corporation Law and provides that savings and loans may now merge with their subsidiaries if the parent association owns at least 90 percent of the subsidiary’s outstanding stock. These provisions would appear to provide greater uniformity to the regulation of corporate business in California and to establish more realistic merger procedures for savings and loan associations in this state.

See Generally:
2) 10 CAL. ADM. CODE §§200-209(a).

Business Associations and Professions; savings and loan associations—farm loans

Financial Code §7154.5 (new); Government Code §§16522, 16612, 53630, 53651, 53657 (amended).
AB 44 (Robinson); STATS 1977, Ch 60
(Effective May 18, 1977)
Support: California Savings and Loan League

Chapter 60 gives express statutory authority for state chartered savings and loan associations to make loans secured by real property when the principal improvement on the property consists of a combination of a farm residence and property used for a commercial farming enterprise [CAL. FIN. CODE §7154.5]. Prior to the enactment of Chapter 60, the Financial Code authorized savings and loan associations to make loans secured by various
kinds of real property, but there was no express authority for long-term loans secured by farm property [See CAL. FIN. CODE §§7153-7154].

In April of 1975, the Federal Home Loan Bank Board, the authority that issues rules and regulations for the federally chartered savings and loan associations, expressly authorized the federal associations to make long-term farm loans within specified criteria [12 C.F.R. §541.12(c) (1977)]. Pursuant to Section 5500.5 of the Financial Code, the State Savings and Loan Commissioner was able to authorize state chartered savings and loan associations to make similar farm loans on the same terms as those authorized by federal regulations [10 CAL. ADM. CODE §235.13]. Thus, prior to January 1, 1977, state regulations provided that these state associations could make loans secured upon real property if the following criteria were met: (1) the principal improvement on the property was either a farm residence or a commercial farming enterprise or a combination thereof; (2) the loan was payable in 25 years; (3) the loan was not in excess of 80 percent of the appraised value of the property; (4) the commercial farming enterprise did not include hobby and vacation property and was operational within a reasonable time; and (5) the farm residence was used for residential purposes for not more than four families [10 CAL. ADM. CODE §235.13]. Thus, until its expiration in January of 1977, Section 235.13 of the Administrative Code provided California savings and loan associations with the same general loan authority as the federal institutions.

Chapter 60, which has apparently been enacted in response to the expiration of Administrative Code Section 235.13, requires that the principal improvement on the property that is to be used as loan security consist of a farm residence and a commercial farming enterprise [CAL. FIN. CODE §7154.5]. This provision is more restrictive than existing federal law, which requires that the principal improvement be only a commercial farming enterprise [12 C.F.R. §545.6-1 (1977)]. Thus, a state chartered savings and loan association may not be able to make loans in certain situations in which the federally chartered institutions would be able to do so. Furthermore, for a state chartered savings and loan association to make a loan secured by real property under Chapter 60, the portion of the principal improvement that consists of a farm residence must be the owner's principal residence [CAL. FIN. CODE §7154.5(d)] and the commercial farming enterprise segment of the principal improvement must be a farm that is operational within a reasonable time and one that does not include hobby or vacation property [CAL. FIN. CODE §7154.5(c)]. Finally, the law now requires that these loans must be repayable within 25 years and may only be made in an amount that does not exceed 80 percent of the appraised value [CAL. FIN. CODE §§7154.5(a), (b)]. The lending requirement on state chartered savings and loans that the principal improvement on property that is to be used as loan
security be a *combination* farm residence and commercial farming enterprise may indicate an intent by the legislature to limit these loans to the so-called “family farm” operations. This legislative intent is further evidenced by the requirement that the residence be the principal residence of the owner of the farm [CAL. FIN. CODE §7154.5(d)]. Thus, the language and apparent intent of Chapter 60 would seem to allay fears that this legislation would result in a diversion of home loan funds for strictly commercial farms.

Finally, Chapter 60 adds the bonds, debentures and other obligations of two federal agencies, the Government National Mortgage Association and the Federal Home Loan Mortgage Corporation, to the list of securities that may be posted by a depository of state or local agency funds [CAL. GOV’T CODE §§16522(e), 53651(f)]. A further amendment extends the availability of these new securities to savings and loan associations [CAL. GOV’T CODE §16612(e)], which may now accept such instruments as security for demand and time deposits of public funds [See CAL. GOV’T CODE §§16600-16609]. Thus, Chapter 60, in addition to some technical amendments concerning public fund depositories, appears to reinstate the authority of state chartered savings and loan associations to make long term residential farm loans and thus ensure the near-parity of these associations with their federal counterparts.

**Business Associations and Professions; savings and loan associations—loan authority**


AB 913 (McAlister); STATS 1977, Ch 97

Support: California Savings and Loan League, Department of Savings and Loan

Regulations adopted by the Federal Home Loan Bank Board permit federally chartered savings and loan associations to issue investment certificates or withdrawable shares that are evidenced by marketable certificates of deposit [12 C.F.R. §545.1-5 (1977)]; to make loans, advances of credit, or invest in interests therein on the security of residential real property when not otherwise authorized by law for specified reasons [12 C.F.R. §545.6-26 (1977)]; and to make, purchase, or invest in loans for constructing or improving residential real property based on the borrower’s general credit standing [12 C.F.R. §545.8(c) (1977)]. Pursuant to Section 5500.5 of the California Financial Code, which authorizes the Savings and Loan Commissioner to issue regulations giving state chartered savings and loan associations comparable authority to their federal counterparts, the Commissioner promulgated regulations giving the state chartered savings and loan associations authority to accept savings deposits evidenced by marketable certifi-
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cates of deposit and to make these same residential real property loans that
the federal savings and loan associations are authorized to make under the
federal regulations [See 10 CAL. ADM. CODE §§218, 235.15, 235.16,
235.17]. Chapter 97 generally codifies these regulations so that state char-
tered savings and loan associations may continue to conduct business under
the same guidelines as their federal counterparts [See CAL. FIN. CODE
§§6420, 7155.3, 7184.1].

Section 6420 of the Financial Code authorizes a savings and loan associa-
tion to issue investment certificates or withdrawable shares, which are
evidenced by marketable certificates of deposit [CAL. FIN. CODE §6420].
Such certificates or shares must be for fixed terms and bear fixed returns
[CAL. FIN. CODE §6420]. Further, a savings and loan association may
authorize a commercial bank that is insured by the Federal Deposit Insur-
ance Corporation “to prepare, sign and deliver such certificates and to
collect and transmit funds in connection therewith” [CAL. FIN. CODE
§6420]. Section 6420, however, makes clear that commercial banks au-
thorized to act in this capacity are not “collectors” or “salesmen.” Prior to
the enactment of Chapter 97, state chartered savings and loan associations
were authorized by the Administrative Code to use marketable certificates of
deposit in the above manner until the regulation expired on January 1, 1978
[See 10 CAL. ADM. CODE §235.17]. Since both Section 235.17 of the
Administrative Code and Section 6420 of the Financial Code provide that
the authority therein is subject to the regulations of the commissioner, it
appears that Section 218 of the Administrative Code, which sets out certain
limitations on marketable certificates of deposit, will continue to apply to
such certificates [Compare 10 CAL. ADM. CODE §§218 and 235.17 with
CAL. FIN. CODE §6420]. Section 218 was adopted “to implement, interpret
and carry out the provisions of Section 235.17” and provides regulations on
the return, terms, limitations, required provisions, form, transfer or with-
drawal, and filing for marketable certificates of deposit [10 CAL. ADM.
CODE §218]. Thus, it would appear that savings and loan associations’ use
of marketable certificates of deposit under Chapter 97 should remain consist-
tent with the use of such certificates under the prior parity regulations.

Section 7155.3 of the Financial Code generally authorizes savings and
loan associations to “make loans or advances of credit or invest in interests
therein, on the security of residential real property” in cases in which such
practices are not authorized under the prior law in five specific instances
[CAL. FIN. CODE §7155.3]. Thus, a savings and loan association may now
make loans or advances of credit, or invest in interests therein upon resident-
ial real property security even if: (1) the security interest is not a first lien;
(2) the loan-to-value ratio, stated maturity, or loan amount is in excess of the
maximum allowable limits; (3) there is a lack of any required borrower
certification or required private mortgage insurance; (4) the loan would cause an applicable percentage-of-assets category to be excluded; or (5) the combination of any of the above factors [CAL. FIN. CODE §7155.3]. Prior to the enactment of Chapter 97 such loan authority was given to state chartered savings and loan associations by Section 235.15 of the Administration Code which expired January 1, 1978 [See CAL. ADM. CODE §235.15]. Although Section 7155.3 of the Financial Code closely parallels former Section 235.15 of the Administrative Code, this new section of the Financial Code appears to be less restrictive in its application than the prior regulations [Compare CAL. FIN. CODE §7155.3 with 10 CAL. ADM. CODE §235.15]. Specifically, state savings and loan associations apparently may now have scheduled items in excess of two and one-half percent of risk assets and need no longer have a statutory worth in excess of four percent of total assets in order to make investments in specified loans, advances of credit or interest therein secured by residential real property [Compare CAL. FIN. CODE §7155.3 with 10 CAL. ADM. CODE §235.15]. This prior regulation also provided that a savings and loan association that had a statutory net worth in excess of four percent of total assets could obtain an exception to the scheduled items not in excess of two and one-half percent of risk assets requirement from the Savings and Loan Commissioner [10 CAL. ADM. CODE §235.15]. Such exception is not contained in Section 7155.3 of the Financial Code, and thus, it would appear that state savings and loan associations may now make the authorized investments pursuant to Section 7155.3 without regard to the former scheduled items and net worth limitations unless reimposed by the Savings and Loan Commissioner [See CAL. FIN. CODE §7155.3]. As in the past, however, such investments under Section 7155.3 are subject to the limitation that no association shall have at any one time more than an amount equal to the lesser of: (1) two percent of its total assets plus one-half percent of total assets for each percentage point of statutory net worth in excess of four percent of assets; or (2) five percent of its total assets [CAL. FIN. CODE §7155.3(a); see 10 CAL. ADM. CODE §235.15]. Finally, Section 7155.3 continues to provide that a secured investment is deemed unsecured to the extent that it exceeds the appraised value or purchase price of the security and that certain authorized investments shall be considered as not having been made pursuant to this Section [See CAL. FIN. CODE §7155.3(c)].

Prior to the enactment of Chapter 97 Section 235.16 of the California Administrative Code provided that certain savings and loan associations could make loans "directly for constructing, adding to, improving, altering, repairing, equipping, or furnishing what is or is not expected to become residential real property, where the association relies substantially for repayment on the borrower's general credit standing and forecast of income, with

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or without other security, or the association relies on other assurances for repayment" [10 CAL. ADM. CODE §235.16]. Section 235.16 expired on January 1, 1978, but has been substantially codified by Chapter 97 in Section 7184.1 of the Financial Code [Compare CAL. FIN. CODE §7184.1 with 10 CAL. ADM. CODE §235.16]. Under the prior law an association could not have scheduled items in excess of two and one-half percent of risk assets and was required to have a statutory net worth in excess of four percent of total assets in order to qualify for such loan authority [10 CAL. ADM. CODE §235.16]. Section 7184.1 of the Financial Code does not contain the above requirements but does subject loans to regulations of the Savings and Loan Commissioner [See CAL. FIN. CODE §7184.1]. Thus, it would appear that now any association may make such loans regardless of scheduled items/risk assets ratio and statutory net worth unless the Commissioner promulgates regulations similar to those contained in former Section 235.16 of Title 10 of the Administrative Code. In all other respects it would appear that Section 7184.1 of the Financial Code is parallel in its requirements with former Section 235.16 of the Administrative Code, including requiring that all such loans be fully documented to establish the reliability, source, purpose, and overall soundness of the loan [Compare CAL. FIN. CODE §7184.1(a)(1)-(8) with 10 CAL. ADM. CODE §235.16(b)(1)-(8)] and that the investment in such loans by any association shall not at any one time exceed an amount equal to the lessor of: (1) two percent of its total assets plus one-half percent of total assets for each percentage point of statutory net worth in excess of four percent of assets; or (2) five percent of its total assets [Compare CAL. FIN. CODE §7184.1(b) with 10 CAL. ADM. CODE §235.16(a)].

By enactment of Chapter 97 the legislature would appear to be providing state chartered savings and loan associations with investment loan authority substantially similar to that of federally chartered associations and thus insuring that the state associations will remain substantially on par with their federal counterparts in their ability to make certain loans and investments.

Business Associations and Professions: insurers—sale of securities

Insurance Code §827.5 (new).
SB 290 (Briggs); STATS 1977, Ch 1020

The issuance of any security that is authorized by the Insurance Commissioner is generally exempt from the qualification requirements of the California Corporate Securities Law [CAL. CORP. CODE §25100(e)]. Prior to the enactment of Chapter 1020, however, the sale or transfer of any security by an insurer required authorization from the Insurance Commissioner [CAL. INS. CODE §827]. Chapter 1020 generally provides that certain insur-
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ers will now be exempt from obtaining this prior authorization from the Commissioner for specified securities transactions [See CAL. INS. CODE §827.5]. Chapter 1020 specifically applies to admitted insurers, nonadmitted foreign insurers, nonadmitted alien insurers, and an attorney in fact of a reciprocal or interinsurance exchange [CAL. INS. CODE §§826, 827.5] and expressly excludes any insurer organized under the laws of this state [See CAL. INS. CODE §827.5. See generally CAL. INS. CODE §26]. Thus, it appears that unlike domestic insurers, foreign insurers who conduct business in this state will no longer be required to obtain the approval of the Insurance Commissioner for specified security transactions [See CAL. INS. CODE §827.5].

The security transactions that are exempted from the requirement of prior approval of the Commissioner by Chapter 1020, parallel exemptions that have existed for some time under the Corporate Securities Act [CAL. CORP. CODE §§25000-25804] [Compare CAL. INS. CODE §827.5 with CAL. CORP. CODE §25103]. Specifically this exemption applies to the following transactions: (1) negotiations or agreements that take place prior to a general solicitation for shareholder approval of specified transactions [CAL. INS. CODE §827.5(a)]; (2) "[a]ny change in the rights, preferences, privileges, or restrictions of or on outstanding securities of such insurer" unless the holders of at least 25 percent of the substantially and adversely affected outstanding shares have addresses in this state [CAL. INS. CODE §827.5(b). See generally CAL. INS. CODE §827.5(d)]; (3) "[a]ny exchange incident to a merger, a consolidation, an acquisition of outstanding stock, or a sale of corporate assets in consideration of the issuance of securities of another insurer or corporation" unless at least 25 percent of the holders of the outstanding shares of any class have California addresses and are to receive securities in the exchange of the surviving, consolidated, or purchasing corporation or insurer [CAL. INS. CODE §827.5(c). See generally CAL. INS. CODE §§827.5(d)]; (4) changes in the rights, preferences, privileges, or restrictions of or on outstanding shares, excepting transactions of a specified nature that would materially and adversely affect any class of shareholders [CAL. INS. CODE §827.5(e)]; (5) stock splits or reverse stock splits except transactions that generally would substantially affect the shareholders [See CAL. INS. CODE §827.5(f)]; and (6) changes in the rights of outstanding debt securities except in certain specified transactions that substantially and adversely affect any class of securities [CAL. INS. CODE §827.5(g)].

Thus, a nondomestic insurer may apparently now issue securities in this state without obtaining approval of the Insurance Commissioner when such issuance will not affect 25 percent or more of the issuer's California shareholders or is in conformance with one of the above exemptions [See CAL. INS. CODE §827.5(a)-(f)]. Since it appears that the exempted transac-
tions in Section 827.5 of the Insurance Code are nearly identical to those in Section 25103 of the Corporations Code [Compare CAL. INS. CODE §827.5 with CAL. CORP. CODE §25103], the purpose of Chapter 1020 would seem to be to realize greater conformity and consistency in the operation of California corporate securities law.

**Business Associations and Professions; formulation of state bar rules of professional conduct by initiative**

Business and Professions Code §6076.5 (new).
AB 1001 (Brown); STATS 1977, Ch 478
Support: State Bar of California

The State Bar of California is governed by a board of governors that is charged by Section 6030 of the Business and Professions Code with the executive function of the state bar and the enforcement of the provisions of the State Bar Act [CAL. BUS. & PROF. CODE §§6000-6190.6]. The board of governors has authority pursuant to Sections 6076 and 6077 of the Business and Professions Code to formulate rules of professional conduct that, when approved by the California Supreme Court, become binding upon all members of the state bar. Since the rules thus formulated become the rules of the supreme court upon the court's approval [Barton v. State Bar, 209 Cal. 677, 680, 289 P. 818, 819 (1930)], and since the power of the court to make such reasonable rules and regulations is not open to serious challenge, it seems that the court could, on its own or any other person's initiative, propose and approve new rules of professional conduct. It appears, however, that to date all amendments to the rules of professional conduct have been the result of proposed changes formulated by the board of governors.

Chapter 478 provides a means by which lawyers as a community may submit proposed rules to the state supreme court for its approval. Section 6076.5 is added to the Business and Professions Code to permit active members of the state bar to formulate rules of professional conduct by an initiative procedure. These rules are to have the same force and effect, when approved by the supreme court, as those that have been formulated by the board of governors and approved by the supreme court [CAL. BUS. & PROF. CODE §6076.5(p)].

Section 6076 of the Business and Professions Code, which is the statutory source of the board of governor's power to propose rules of professional conduct, uses the language "may formulate" to accomplish its grant of power. Under this authority, the board has periodically revised and augmented the rules [See, e.g., RULES OF PROF. CONDUCT OF STATE BAR 2-107 (added in 1975 to prohibit collection of illegal or unconscionable fees) and 1-100 (1975 amendment of prior rule proscribing wilful breach of a rule of
conduct) and in 1974 adopted the first complete revision of the rules since they were originally adopted in 1928 [See Proposed New Rules of Professional Conduct, 49 CAL. S.B.J. 542 (1974)]. Section 6076.5 of the Business and Professions Code uses the same language—"may formulate"—to create the power to propose rules of professional conduct in the members of the bar. Although the bill, as introduced, defined initiative as "the power . . . to propose . . . additions or amendments to, or the repeal of, rules . . . ." [AB 1001, 1977-78 Regular Session, as introduced, March 17, 1977], the language as finally adopted is consistent with that used in granting authority to the board of governors [CAL. BUS. & PROF. CODE §6076.5(a)]. Thus, even though the term "initiative" may be a misnomer since the voters, who in this case are active members of the bar, do not have the ultimate authority to approve or disapprove the measure, it appears that the same expansive powers that have always been vested in the board of governors to revise and augment the rules of professional conduct have now been extended to the members of the state bar.

Chapter 478 requires the proponents of an initiative petition to file the text of the proposed measure both with the secretary of the state bar and with the clerk of the state supreme court [CAL. BUS. & PROF. CODE §6076.5(c)]. The secretary must then prepare a "true and impartial" summary of the chief purposes and points of the proposed initiative measure, which the proponents are required to place across the top of each page of the petition on which signatures are to appear [CAL. BUS. & PROF. CODE §6076.5(d),(e)].

Chapter 478 allows 180 days for the petition to be circulated and filed with the secretary and provides that to qualify for submission to the members for a vote, an initiative measure must be signed by at least 20 percent of the active members from each state bar district [CAL. BUS. & PROF. CODE §6076.5(k), (l)]. While any member of the state bar, or an employee or agent thereof, may circulate an initiative petition [CAL. BUS. & PROF. CODE §6076.5(i)], only active members [See CAL. BUS. & PROF. CODE §§6003-6007 (defines classes of membership)] are entitled to propose a measure or to sign a petition [CAL. BUS. & PROF. CODE §6076.5(b), (h)(4)].

Section 6076.5(m) of the Business and Professions Code provides that if the requisite number of verified signatures appears on a petition, the secretary must submit the measure within 90 days to all active members of the bar for a mail vote. If a majority of the active members approve the initiative measure, it is then submitted to the state supreme court for its consideration [CAL. BUS. & PROF. CODE §6076.5(o)].

COMMENT

It is clear that statutory grounds for discipline are not exclusive since the supreme court retains inherent power to require standards with respect to

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admission to, and practice in, the bar [E.g., Stratmore v. State Bar, 14 Cal. 3d 887, 889, 538 P.2d 229, 230, 123 Cal. Rptr. 101, 102 (1975); Emslie v. State Bar, 11 Cal. 3d 210, 224-25, 520 P.2d 991, 999, 113 Cal. Rptr. 175, 183 (1974)]. Furthermore, the Rules of Professional Conduct supplement rather than limit or supersede other provisions of law relating to the duties and obligations of attorneys [Hutchins v. Municipal Court, 61 Cal. App. 3d 77, 89, 132 Cal. Rptr. 158, 166 (1976); RULES OF PROF. CONDUCT OF STATE BAR 1-100]. Nevertheless, since the court as a matter of policy will not exercise its inherent powers until the disciplinary powers of the state bar have been exhausted [In re Walker, 32 Cal. 2d 488, 490, 196 P.2d 882, 883 (1948)], the rules of professional conduct appear to be of primary importance to the California Bar.

The state bar serves as an arm of the court and assists in matters of attorney admission and discipline [Chronicle Publishing Co. v. Superior Court, 54 Cal. 2d 548, 566, 354 P.2d 637, 645, 7 Cal. Rptr. 109, 117 (1960)]. This status has enabled the state bar to withstand constitutional attacks on its authority that were based upon claims of legislative infringement on the powers of the court [See Brotsky v. State Bar, 57 Cal. 2d 287, 300, 368 P.2d 697, 703, 19 Cal. Rptr. 153, 159 (1962)] and improper delegation of judicial power [See Barton v. State Bar, 209 Cal. 677, 680, 289 P. 818, 819 (1930); In re Shattuck, 208 Cal. 6, 12, 279 P. 998, 1000 (1929)]. The court has noted that the state bar is sui generis; that since it proceeds as an arm of the court, the legislature had not usurped the judicial power, in violation of the doctrine of separation of powers, when it adopted the statutory scheme [See Brotsky v. State Bar, 57 Cal. 2d 287, 300, 368 P.2d 697, 703, 19 Cal. Rptr. 153, 159 (1962)]. The court has also stated that since the board of governors is not given powers that possess the finality and effect of judicial orders [In re Shattuck, 208 Cal. 6, 12, 279 P. 998, 1000 (1929)], but rather has only the power to propose rules of conduct that do not become effective until approved by the supreme court, the formulation of such rules by the board of governors is not an improper delegation of judicial power [See Barton v. State Bar, 209 Cal. 677, 680, 289 P. 818, 819 (1930)].

Since the formulation of rules of professional conduct by active members of the bar, as provided in Chapter 478, appears to have the same characteristics as the formulation of such rules by the board of governors, i.e., the members of the bar would be proceeding as an arm of the court and the rules proposed by them would not become final until approved by the supreme court, it would seem that the provisions of Chapter 478 that permit the proposal of rules of professional conduct by initiative petition should withstand a constitutional challenge by employing the same reasoning that has previously been used to uphold similar activities by the Board of Governors.

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of the State Bar of California. Thus, Chapter 478 would appear to provide a viable alternative by which active members of the bar can expeditiously make known their thoughts on the present rules of conduct and propose constructive additions, amendments, or deletions to these governing laws.

See Generally:

Business Associations and Professions; discrimination by licensees

Business and Professions Code §125.6 (amended).
AB 779 (Chappie); Stats 1977, Ch 293
Support: California Association of the Physically Handicapped
Opposition: California Association of Realtors

In 1974 the California Legislature subjected all persons licensed under the provisions of the Business and Professions Code to disciplinary action for any discrimination based on race, color, sex, religion, ancestry, or national origin in the performance of the licensed activity [See Cal. Stats. 1974, c. 1350, §1, at 2930]. Section 125.6 of the Business and Professions Code, as amended by Chapter 293, now provides that specified licensees under this code may now be subject to disciplinary action for discriminating against a person in the performance of a licensed service because of his or her physical handicap [Cal. Bus. & Prof. Code §125.6]. It appears that such disciplinary action may include the suspension or revocation of a licensee's license [See Cal. Bus. & Prof. Code §§475-492]. For the purposes of Section 125.6, a "physical handicap" includes "impairment of sight, hearing, or speech, or impairment of physical ability because of amputation or loss of function or coordination, or any other health impairment that requires special education or related services" [Cal. Bus. & Prof. Code §125.6. See also Cal. Lab. Code §1413(h)].

Specifically, Chapter 293 now raises the possibility of disciplinary action if a specified licensee refuses to perform or aids or incites the refusal to perform a licensed activity, or if he or she discriminates or restricts the performance of a licensed activity because of an applicant's physical handicap [Cal. Bus. & Prof. Code §125.6]. Discrimination by licensees under Section 125.6, however, does not include: (1) employer hiring practices; (2) discrimination by private clubs holding alcoholic beverage licenses; and (3) as added by Chapter 293, architectural barriers that conform to state or local building codes and regulations [Cal. Bus. & Prof. Code §125.6]. Additionally, refusal to perform a licensed activity by a person licensed under the healing arts division of the Business and Professions Code [Cal. Bus. & Prof. Code Division 2 (commencing with §500)] will not constitute dis-
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crimination against a handicapped person if the licensee determines that the licensed service being requested is beyond his or her skill or "could better be performed by another licensee" [See CAL. BUS. & PROF. CODE §125.6]. Thus, it would appear that a physician or other healing arts professional could refuse to extend services to a physically handicapped person without being subject to disciplinary action pursuant to Section 125.6, if the physician or other professional demonstrates that the service sought was beyond his or her skill or could better be performed by another professional.

Prior to the enactment of Chapter 293, Section 125.6 provided for disciplinary action if the licensee made any discrimination, distinction, or restriction based on race, color, sex, etc. [CAL. STATS. 1974, c. 1350, §1, at 2930]. Chapter 293 amends Section 125.6 to eliminate the word "distinction" as a proscribed element for which a licensee can be subject to disciplinary action [CAL. BUS. & PROF. CODE §125.6]. It would appear that the elimination of this word will not affect the operation of Section 125.6 since the definition of the terms "distinction" and "discrimination" would appear to be essentially synonymous in proscribing activity that would constitute a difference of treatment of a certain class of persons [See MERIAM-WEBSTER NEW INTERNATIONAL DICTIONARY 648, 659 (unabridged 3rd ed. 1976)].

Discrimination against the physically handicapped is statutorily discouraged in the area of employment opportunities [See CAL. LAB. CODE §1412] and in the area of access to public places and housing accommodations [See CAL. CIV. CODE §§54-55.1]. Thus, through the enactment of Chapter 293, the California Legislature would appear to be continuing a policy of extending statutory protection to certain rights and privileges of the physically handicapped.

See Generally:
2) 6 PAC. L.J., REVIEW OF SELECTED 1974 CALIFORNIA LEGISLATION 377 (right of access to public places and housing accommodations for handicapped persons) (1975).

Business Associations and Professions; healing arts—excessive treatment as unprofessional conduct

Business and Professions Code §§2361.5, 3108 (repealed); §700 (new); §§1680, 2660, 2690 (amended).
AB 722 (Duffy); STATS 1977, Ch 509
Support: Board of Medical Quality Assurance; California Attorney General

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Prior to the enactment of Chapter 509, the excessive prescribing or administering of drugs or treatment, use of diagnostic procedures, or use of diagnostic or treatment facilities constituted unprofessional conduct by physicians, surgeons, osteopaths, dentists, podiatrists, physical therapists, psychologists, and optometrists if such treatment was shown to be "clearly excessive," as determined by the customary practice and standards of the local community of the licensee and was detrimental to the patient [See, e.g., CAL. STATS. 1974, c. 546, §4, at 1354; CAL. STATS. 1970, c. 1318, §§2, 4, at 2455-56]. Not specifically regulated under the prior law, however, was the professional conduct of chiropractors in matters concerning excessive treatment [See CAL. BUS. & PROF. CODE §1000-1010]. In addition, the law previously prescribed specific sanctions for excessive or unnecessary treatment that constituted unprofessional conduct, which included suspension or revocation of the professional license or the imposition of probationary conditions [See, e.g., CAL. STATS. 1973, c. 757, §9, at 1366; CAL. STATS. 1970, c. 1318, §1, at 2454-55].

Chapter 509 adds Section 700 to the Business and Professions Code, which now defines as unprofessional conduct "repeated acts of clearly excessive" prescribing, or administering drugs or treatment, use of diagnostic procedures, or use of diagnostic or treatment facilities "as determined by the standard of the local community of licensees." Although Chapter 509 repeals the former prohibitions and specific sanctions against such conduct [See CAL. BUS. & PROF. CODE §§1680, 2660, 2690, as amended, CAL. STATS. 1977, c. 509, §§3, 6, 7, at —]. Section 700 specifically provides that the conduct described in that section is unprofessional for physicians, surgeons, dentists, podiatrists, psychologists, physical therapists, optometrists, and chiropractors. Besides consolidating the provisions proscribing excessive treatment by professionals in the healing arts, Chapter 509 also makes two substantive changes in the description of this type of unprofessional conduct. First, as a precondition to any disciplinary action the new law now requires the complainant to show that the conduct of the particular professional consisted of "repeated acts of clearly excessive" treatment rather than simply to show that such conduct was "clearly excessive," as was the case under the old law [Compare CAL. BUS. & PROF. CODE §700 with CAL. STATS. 1974, c. 546, §4, at 1353 and CAL. STATS. 1970, c. 1318, §§2, 4, at 2455-56]. Furthermore, Chapter 509 eliminates the requirement established under the prior law that the results of such excessive treatment must be detrimental to the patient before the conduct may be declared unprofessional [Compare CAL. BUS. & PROF. CODE §700 with CAL. STATS. 1974, c. 546, §4, at 1353 and CAL. STATS. 1970, c. 1318, §§2, 4, 5, at 2455-57]. Section 700 of the Business and Professions Code, however, does not specify the sanctions that may be imposed against

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professionals in the healing arts for this type of unprofessional conduct. It would appear, therefore, that disciplinary action against such individuals must be governed by the general prohibitions against unprofessional conduct [See, e.g., CAL. BUS. & PROF. CODE §§1670, 2360, 2660] or by the governing boards of the individual professions [See, e.g., CAL. BUS. & PROF. CODE §§1000-1010, 2960(h)].

Finally, by eliminating the requirement that excessive treatment be detrimental to the patient before it may constitute unprofessional conduct, the effect of Chapter 509 appears to be a strengthening of 1970 legislation enacted to discourage excessive and unnecessary treatment by members of the healing arts [Compare CAL. BUS. & PROF. CODE §700 with CAL. STATS. 1970, c. 1318, §§2, 4, at 2455-56]. This original legislation, on the other hand, may have been weakened by Chapter 509 in the sense that a complainant must now show repeated acts of excessive treatment before conduct may be declared unprofessional, while before a practitioner could be accused on the basis of a single instance of excessive treatment if it was detrimental to the patient [Compare CAL. BUS. & PROF. CODE §700 with CAL. STATS. 1970, c. 1318, §§2, 4, at 2455-56]. Nevertheless, it would appear that Chapter 509 may strengthen the laws deterring excessive or unnecessary treatment by members of specified professions by enabling injured patients and the governing boards of these professions to more easily establish the fact of such unprofessional conduct.