Memorandum 92-53

Subject: Administrative Matters - New Topics

At the July meeting the Commission decided to request authority to study two new topics suggested by Commissioner Kolkey:

(1) Clarification of the law governing shareholder rights and corporate directors' responsibilities. Specific issues include the demand and excuse aspects of a derivative action, and the scope of the "business judgment rule" for directors' responsibility.

(2) Clarification of the law governing unfair and unlawful business practices. Specific issues include the definition of unfair and unlawful business practices, and res judicata effect on the public of a person purporting to act on behalf of the public.

Both topics are of a type that the Commission is suited to address. However, both have the potential to be politically sensitive. It is quite possible that neither of the Commission's legislative members--Assembly Member Terry Friedman and Senator Bill Lockyer--will be willing to carry a resolution authorizing the Commission to study these matters. Consequently, the staff believes it is critical that the scope of these studies be clearly and narrowly stated, and that the justification for them be apparent. The staff suggests language below for each of them.

In addition, the Uniform Law Commission at its July/August 1992 conference approved the Uniform Unincorporated Nonprofit Association Act. The California statutes governing service of process on, and liability of property of, an unincorporated association are Law Revision Commission products, and it would be appropriate for the Commission to review the new uniform act to determine whether its enactment would be suitable in California. This matter is elaborated below.

Shareholder Rights and Corporate Director Responsibilities

A shareholder has no right to bring or defend an action on behalf of the corporation except where the directors fail to act. In this exceptional case, the shareholder may bring a representative suit to enforce the corporation's rights, called a "derivative action". The derivative action is a common vehicle by which a dissatisfied shareholder may challenge actions of a corporation's board of directors.

The California law governing shareholder derivative actions is codified in Corporations Code Section 800. That section states two prerequisites to maintaining a derivative action--the shareholder must have been a holder of record at the time the damage complained of occurred, and the shareholder must first have made a demand on the corporation or board that the corporation act to remedy the harm. The defendants in the action may require the shareholder to post a security bond for costs. The shareholder must overcome a presumption that the corporate directors acted properly and with sound business judgment by showing fraud, bad faith, or gross overreaching on the part of the board. Additional protections for directors and limitations on liability may be found in the corporation's articles. A good short summary of the derivative action and issues may be found in Counseling California Corporations § 3.52 (Cal. Cont. Ed. Bar 1990), a copy of which is attached as Exhibit pp. 1-4.

Prior demand. The first problem noted by Commissioner Kolkey is that the requirement of prior demand on the board to act is ineffectual, since notice is rarely given and is routinely excused. The statutory requirement of a demand codifies the common law. The reason for the demand is that the directors are charged with the responsibility of governance of the corporation and should be given the opportunity to remedy the problem complained of before a shareholder is authorized to act in their place. However, since the typical derivative action sues the directors for an alleged malfeasance, a demand on the directors to sue themselves would be futile. Harold Marsh observes that, "The great majority of the cases have in fact held that, in the circumstances there present, no demand was necessary upon the board; and it appears that only the Cogswell case and the Bacon

case have actually resulted in a decision for the defendant because of the lack of a demand or an insufficient demand upon the board." 2 Marsh's California Corporation Law § 15.29 (3d ed, 1992 supp.).

Is this a problem in practice? It can be argued that the statutes should accurately reflect the law. Since the common law requirement of demand has been codified, the common law provision for excuse might also be codified. Alternatively, since the demand is routinely excused, the demand requirement could be eliminated. Or, court-developed guidelines for when an excuse will be recognized could be codified. The Delaware case law is much more precise and highly developed than the California law in this respect. See discussion in Yagemann, The Business Judgment Rule and Shareholders' Suits, 6 Cal. Law., #4, p. 25, 26-27 (1986).

Business judgment rule. A more difficult issue is the business judgment defense available to the directors in derivative action litigation. The business judgment rule is stated in Corporations Code Section 309. That section provides that a person is not liable for any failure to discharge the person's obligations as a director if the person performs the duties "in good faith, in a manner such director believes to be in the best interests of the corporation and its shareholders and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances". Corp. Code § 309(a).

The California codification of the business judgment rule introduces a new and conflicting element, not found in the common law. The common law business judgment rule protects a director from being second-guessed by the courts in making an honest business decision, whether the decision turns out to be a good one or bad one. There is a presumption in favor of the director's decision, so that the director is not liable for a mistake in business judgment which is made in good faith and in what the director believes to be the best interests of the corporation, where no conflict of interest exists.

The 1975 California codification adds the requirement of care of an ordinarily prudent person, including reasonable inquiry. Although courts have enunciated such language in the past, until recently they

have consistently held that mere negligence of a director does not overcome the protection of the business judgment rule--fraud, bad faith, or gross overreaching are required. See discussion in 2 Marsh's California Corporation Law § 11.3 at 788-9 (3d ed, 1992 supp.). However, the California statute has now been construed to apply a standard of ordinary negligence in determining whether directors made an adequate inquiry before exercising their business judgment. Gaillard v. Natomas Co., 208 Cal. App. 3d 1250, 256 Cal. Rptr. 702 (1989).

This substantially weakens the protection of the business judgment rule in California. The staff is informed that the uncertainty in the California law is a factor in the decision of a number of California corporations to reincorporate in Delaware. The Delaware common law business judgment rule is believed to be clear and well developed. The staff notes that the Delaware business judgment rule has also been weakened in recent years. The leading case of Smith v. Van Gorkom, 488 A. 2d 858 (Del. Sup. Ct. 1985) requires an informed decision by a director, the standard applied being one of gross negligence (as opposed to California's ordinary negligence standard).

The focus of inquiry here would be whether in fact Delaware law offers a more clear and useful business judgment rule than California, and if so whether California should codify Delaware principles.

Scope of study. Consistent with the staff's recommendation of a narrow statement of authority in this area, if the Commission wishes to pursue this matter the staff suggests something along the following lines:

> Shareholder Derivative Actions
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> Whether, in a shareholder's derivative action, the requirement of Corporations Code Section 800(b)(2) that the plaintiff must allege the plaintiff's efforts to secure board action or the reasons for not making the effort, and the standard under Corporations Code Section 309 for protection of a director from liability for a good faith business judgment, and related matters, should be revised.
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> Statement of Reasons
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> The California law governing shareholder derivative actions requires the shareholder to allege with particularity the efforts made to secure the board action the shareholder desires or the reasons for not making the effort. Corp. Code

§ 800(b)(2). Notwithstanding the statute, the demand requirement is excused routinely. See, e.g., 2 Marsh's California Corporation Law § 15.29 (3d ed, 1992 supp.). The law should be reviewed to determine whether it should be revised to codify common law excuse provisions or to modify or eliminate the demand requirement.

A principle defense of a director in a shareholder derivative action is the business judgment rule, a common law principle now codified in Corporations Code Section 309. The codification limits the protection given for a good faith business decision. The protection is not available if the decision is not made with the care of an ordinarily prudent person, including reasonable inquiry. Section 309(a); Gaillard v. Natomas Co., 208 Cal. App. 3d 1250, 256 Cal. Rptr. 702 (1989). The importation of ordinary negligence principles into the business judgment rule has confused the law in this area and been a factor in the decision of a number of California corporations to reincorporate in Delaware. Delaware has a well and clearly defined body of law governing the business judgment rule, including a gross negligence limitation with respect to inquiry. See, e.g., 2 Marsh's California Corporation Law § 11.3 at 788-9 (3d ed, 1992 supp.). The business judgment rule of Delaware and other jurisdictions should be examined to determine whether they may offer useful guidance for codification and clarification of the law in California.

Unfair Business Practices

Business and Professions Code Sections 17200-8 provide civil penalties and injunctive relief for a broad spectrum of unfair business practices, including undefined "unlawful, unfair or fraudulent business practice and unfair, deceptive, untrue or misleading advertising". Bus. & Prof. Code § 17200. The remedies are available to a broad spectrum of possible plaintiffs including an action by the Attorney General, district attorney, and other public officials, as well as by "any person acting for the interests of itself, its members, or the general public". Bus. & Prof. Code § 17204. A good brief description of the unfair business practice statute and cases interpreting it is excepted from Competitive Business Practices § 3.6 (2d ed., Cal. Cont. Ed. Bar 1991) as Exhibit pp. 5-8.

Commissioner Kolkey and others have pointed to three problem areas in this law:

(1) The lack of definition of what acts may be held to constitute unfair competition for the purposes of this statute.

(2) Procedural problems where a person purports to act on behalf of the public under this statute without class action mechanisms and protections.

(3) Procedural problems where parallel actions are commenced under this statute for the same activity by both a public official and a private individual.

The courts have construed the concept of unfair competition in quite a broad and open-ended manner for the purposes of this statute. Cases indicate that the statute establishes only a wide standard to guide courts of equity, and that the determination of whether a particular practice is unfair involves an examination of its impact on its alleged victim, balanced against the reasons, justifications, and motives of the alleged wrongdoer. "In brief, the court must weigh the utility of the defendant's conduct against the gravity of the harm to the plaintiff." Motors v. Times-Mirror Co., 102 Cal. App. 3d 735, 543 (1980); see also Barquis v. Merchants Collection Assn., 7 Cal. 3d 94 (1972). The statutes have been applied to such matters as false advertising, unfair collection practice, simulating official forms, record piracy, commercial sale of academic materials, unauthorized use of union's trade name and trademark, chain referral marketing program, commercial distribution of obscene matter, unfair packaging or labeling, crediting tips against minimum wage, improper impounding and towing of parked cars, retaliatory eviction, improper downgrading of purchased commodity, resale of drugs acquired at preferentially low prices, sales of telephones and other communications equipment, and violation of Cartwright Act. See 11 B. Witkin, Summary of California Law, Equity §§ 96-99 (9th ed., 1990).

In class action litigation, rules have evolved to ensure that the plaintiff representing the class acts in the best interest of the class rather than in the plaintiff's self interest. The fiduciary obligation present in class action litigation does not apply to citizen suits on behalf of the public under Business and Professions Code Section 17200. Settlements may be made without court approval or class notice. Whether a settlement will bind the members of the public on whose behalf the suit was brought is not clear. There is no res judicata effect on persons harmed by the unfair business practice if

the plaintiff suffered no harm, since the interests of absent parties must be adequately represented. If the plaintiff did suffer harm, a settlement might have res judicata effect, but the law is not clear on this issue. In either case, the defendant would be bound on collateral estoppel principles. See generally discussion in Chilton & Stern, California's Unfair Business Practices Statutes: Settling the "Nonclass Class" Action and Fighting the "Two-Front War", 12 CEB Civ. Litigation Rep. 95, 96-99 (1990).

Since unfair business practice litigation under Business and Professions Code Section 17200 may be maintained by both private citizens and public officials, procedural issues are complex. Settlement of a claim with a private litigant will not prevent a public prosecutor from pursuing the same claim. Moreover, settlement of an action brought by a district attorney does not preclude the Attorney General and other district attorneys from commencing action on the same matter. It is not clear whether settlement with the Attorney General will bind district attorneys. And in either case, a settlement with a public prosecutor will not bar contemporaneous or future actions by private persons on the same claim. See generally discussion in Chilton & Stern, California's Unfair Business Practices Statutes: Settling the "Nonclass Class" Action and Fighting the "Two-Front War", 12 CEB Civ. Litigation Rep. 95, 96-99 (1990).

These are a few of the problems pointed out in the extensive literature on Business and Professions Code Section 17200. The broadside for the Rutter Group's advanced level program on unfair business practice notes:

> If you litigate consumer or business cases, you need to know about Business & Professions Code § 17200 and the fast-developing case law in this area.
>
> The statute has an extraordinary reach: It applies to *any business practice* forbidden by law, as well as those that are simply "unfair" . . . from antitrust to slumlords!
>
> Moreover, it provides tremendous *procedural advantages* for plaintiffs, including standing to sue on behalf of the general public for injunctive relief, without the hassle of a class action!

Again, the staff believes that due to the politically sensitive nature of this subject, a narrow statement of authority is necessary if the Commission wishes to pursue it (and even then it may provoke a

negative reaction from the Commission's legislative members). The staff suggests the following:

Unfair Competition Litigation

Whether the law governing unfair competition litigation under Business and Professions Code Sections 17200-8 should be revised to clarify the scope of the statute and to resolve procedural problems in litigation under the statute, including the res judicata and collateral estoppel effect of a judgment between the parties to the litigation, and related matters.

Statement of Reasons

Business and Professions Code Sections 17200-8 provide injunctive relief and civil penalties for a broad spectrum of unfair business practices, enforceable by both public and private plaintiffs. These remedies have been used widely in the past two decades, generating extensive case law and commentary exposing ambiguities and procedural problems in the statutes. See, e.g., 11 B. Witkin, Summary of California Law, Equity §§ 96-99 (9th ed., 1990); Competitive Business Practices § 3.6 (2d ed., Cal. Cont. Ed. Bar 1991); Chilton & Stern, California's Unfair Business Practices Statutes: Settling the "Nonclass Class" Action and Fighting the "Two-Front War", 12 CEB Civ. Litigation Rep. 95, 96-99 (1990). Specific unresolved issues and problems include the scope of the statute (definition of "unfair competition"), whether litigation between a private person acting on behalf of the public and a defendant can have res judicata and collateral estoppel effect, and whether litigation between a public prosecutor and a defendant can bind other public prosecutors or a private person. A study should be made to determine whether these issues may be clarified by statute.

Uniform Unincorporated Nonprofit Association Act

The newly-adopted uniform act on unincorporated nonprofit associations is limited in scope. It does not purport to be a comprehensive treatment of the law governing unincorporated nonprofit associations. Rather, it deals with discrete legal issues involving nonprofit associations, such as ability of the association to acquire and transfer real property, treatment of the association as an entity for purposes of contract and tort, liability of person acting on behalf of association, liability of individual members of association, capacity of association to sue, and venue and service of process issues.

The Law Revision Commission has a long history of involvement in this area of law. A number of the California statutes governing unincorporated associations were enacted on Commission recommendation.

The Commission made recommendations to the Legislature which were enacted in 1967 (suit by or against unincorporated association), 1968 (service of process on unincorporated association), and 1976 (revision of designation of agent statute).

Review of the new uniform act on this subject would be an appropriate task for the Commission. The staff does not believe this would involve a substantial amount of Commission or staff time, since the uniform act is well developed and articulated, and draws from existing state statutes, including California's. The staff recommends that the Commission request the following authority.

Uniform Unincorporated Nonprofit Association Act

Whether the Uniform Unincorporated Nonprofit Association Act, or parts of the uniform act, should be adopted in California, and related matters.

Statement of Reasons

The National Conference of Commissioners on Uniform State Laws has recommended for adoption in all the states a new Uniform Unincorporated Nonprofit Association Act (1992). The new uniform act deals with issues such as suits by and against unincorporated associations and appointment of agents for service of process. Some of these issues are governed by statutes in California, many enacted on recommendation of the California Law Revision Commission. See, e.g., Corp. Code §§ 24000-24007; see also Suit By or Against an Unincorporated Association, 8 Cal. L. Revision Comm'n Reports 901 (1967); Service of Process on Unincorporated Association, 8 Cal. L. Revision Comm'n Reports 1403 (1967); Service of Process on Unincorporated Associations, 13 Cal. L. Revision Comm'n Reports 1657 (1976). The uniform act builds on the law of California and other jurisdictions, and offers the possibility of uniformity among the states on issues with which it deals. It would be appropriate for the Law Revision Commission to review the uniform act to determine whether the act, or parts of it, should be adopted in California.

Respectfully submitted,

Nathaniel Sterling
Executive Secretary

81 CR 592, 598. (See discussion of class actions at §3.53; see also discussion of minority rights against the majority at §3.59.)

For examples of cases in which individual shareholders were allowed to sue in their individual capacity as shareholders rather than on behalf of the corporation, see *Smith v Tele-Communication, Inc.* (1982) 134 CA3d 338, 184 CR 571 (sole minority shareholder of subsidiary corporation could sue its directors and the parent corporation in his individual capacity where, after sale of all the assets of the subsidiary, parent and subsidiary filed consolidated tax return allocating all tax benefits from the sale to the parent, thereby depriving plaintiff of a portion of his distributive share); *Crain v Electronic Memories & Magnetics Corp.* (1975) 50 CA3d 509, 123 CR 419 (founding minority shareholders could sue as individuals where it was alleged that acts of the majority shareholder and its agent had deprived plaintiffs of their ownership interests without any compensation whatever); *Low v Wheeler* (1962) 207 CA2d 477, 24 CR 538 (minority shareholder was not told of a higher offer for shares made to gain control of the corporation and thus received substantially less for his shares); *Campbell v Clark* (1958) 159 CA2d 439, 324 P2d 55 (plaintiff was fraudulently induced to sell her interest in a corporation, suffering financial injury); *Sutter v General Petroleum Corp.* (1946) 28 C2d 525, 170 P2d 898 (plaintiff was fraudulently induced to abandon his own oil developments and invest in a corporation whose assets became worthless). See also 2 MARSH'S CALIFORNIA CORPORATIONS LAW §14.21 (2d ed); 1A Ballantine & Sterling, CALIFORNIA CORPORATION LAWS §291.04[1] (4th ed); 12B Fletcher, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§5910–5921 (rev ed 1984).

§3.52 2. Derivative Suits

As stated by the California Supreme Court in *Jones v H. F. Ahmanson & Co.* (1969) 1 C3d 93, 107, 81 CR 592, 598:

> A stockholder's derivative suit is brought to enforce a cause of action which the corporation itself possesses against some third party, a suit to recompense the corporation for injuries which it has suffered as a result of the acts of third parties. The management owes to the stockholders a duty to take proper steps to enforce all claims which the corporation may have. When it fails to perform this duty, the stockholders have a right

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> to do so. Thus, although the corporation is made a defendant in a derivative suit, the corporation nevertheless is the real plaintiff and it alone benefits from the decree; the stockholders derive no benefit therefrom except the indirect benefit resulting from a realization upon the corporation's assets. The stockholder's individual suit, on the other hand, is a suit to enforce a right against the corporation which the stockholder possesses as an individual.

A shareholder may bring a derivative suit on a corporation's behalf when the directors fail or refuse to act to enforce the corporation's rights. Corp C §800(b)(2). The shareholder is the nominal plaintiff; the corporation is the real party in interest and an indispensable party. See Corp C §800; *Gagnon Co. v Nevada Desert Inn* (1955) 45 C2d 448, 289 P2d 466. As a practical matter, corporate management, directors, and, in certain cases, majority shareholders are frequently named defendants in derivative suits. A shareholder who brings a derivative suit on behalf of the corporation assumes a fiduciary duty towards those on whose behalf the shareholder is suing, and one who assumes such a fiduciary role may not abandon it for personal aggrandizement (*i.e.*, by settling). *Heckmann v Ahmanson* (1985) 168 CA3d 119, 214 CR 177.

In order to bring a derivative suit, two conditions must be met:

"Contemporaneous ownership" requirement. Subject to several exceptions, the plaintiff must allege standing as a record or beneficial shareholder or as the holder of voting trust certificates at the time of the action or transaction alleged to have damaged the plaintiff. Corp C §800(b)(1).

A shareholder who has met the contemporaneous ownership requirement of Corp C §800(b)(1) for shareholder derivative suits has standing to proceed with the suit despite involuntary loss of shareholder status resulting from a merger of the defendant corporation. *Gaillard v Natomas Co.* (1985) 173 CA3d 410, 219 CR 74.

"Demand" requirement. The plaintiff must allege the efforts made to cause the board to bring the suit that plaintiff is bringing, or the reasons for not making that effort ("excuse"), and must allege further that the corporation or the board has been informed in writing of the facts of each cause of action against each defendant or that the plaintiff has delivered to the corporation or the board a true copy of the complaint that has been filed. These allegations must be made "with particularity." Corp C §800(b)(2).

Security Bond. The defendant(s) may move that a security bond be required of the plaintiff, on either of the following grounds: (1) that there is no reasonable possibility that the continuation of the lawsuit will benefit the corporation or its shareholders (Corp C §800(c)(1)), or (2) that the moving party, if other than the corporation, did not participate in the transaction complained of in any capacity (Corp C §800(c)(2)). The filing of a motion for a bond stays the proceedings until ten days after the motion has been disposed of. Corp C §800(f). Because of this stay in proceedings and the expense of the bond to the plaintiff, it can be expected that in most derivative suits, if not all, attorneys for the defense will file a motion for a bond. For further discussion, see 1A Ballantine & Sterling, CALIFORNIA CORPORATION LAWS §§293.01–293.09 (4th ed); 2 MARSH'S CALIFORNIA CORPORATION LAW §24.33 (2d ed).

Business Judgment Rule. In a derivative suit, the plaintiff must at the outset overcome the presumption that a decision of the board of directors (or a duly appointed committee acting on its behalf) to dismiss the suit was made on an informed basis, in good faith, and in the belief that the decision was in the corporation's best interest. See Corp C §§309, 311. The business judgment rule creates a presumption that the directors' decisions are based on sound business judgment, and the plaintiff in a derivative suit must rebut this presumption by showing fraud, bad faith, or gross overreaching on the part of the board. *Eldridge v Tymshare* (1986) 186 CA3d 767, 230 CR 815. Although the California Supreme Court has not ruled directly on this issue, the Ninth Circuit, seeking to apply California law, has followed the "business judgment" approach. See *Gaines v Haughton* (9th Cir 1981) 645 F2d 761; *Greenspun v Del E. Webb Corp.* (9th Cir 1980) 634 F2d 1204; *Lewis v Anderson* (9th Cir 1979) 615 F2d 778; *In re Bankamerica Securities Litigation* (1986) 636 F Supp 419. For an alternative approach (the "structural bias" approach), see *Zapata Corp. v Maldonado* (Del 1981) 430 A2d 779, in which the Delaware Supreme Court held that if disinterested directors decide that a derivate suit is contrary to a corporation's best interests and move to dismiss it, the court will apply its own "independent business judgment," evaluating the director's good faith and examining the result in light of the shareholders' interests and public policy. For discussion, see Yagemann, *The Business Judgment Rule and Shareholders' Suits,*

6 Cal Lawyer No. 4 p 25 (April 1986); 1A Ballantine & Sterling §292.05; 2 Marsh §14.34.

Exculpation of Directors; Indemnification of Agents. Derivative suits for breach of a director's duties to the corporation and its shareholders may be limited by provisions in the corporation's articles. See Corp C §§204(a)(10), 204.5. In addition, a corporation has power to indemnify its "agents," as that term is defined in Corp C §317(a), against liability (Corp C §317), and in certain instances the articles may authorize indemnification in excess of that specified in Corp C §317. Corp C §204(a)(11). See discussion at §3.50. These provisions are complex, and the attorney will need to review the law, the corporation's articles and bylaws, and any indemnity agreements entered into by the corporation and its agents to determine their effect, if any, on the plaintiff's cause of action.

Further References. Derivative suits have many other special aspects and also share many of the problems common to corporate litigation generally. For more detailed discussion, see 1A Ballantine & Sterling §§290–294; 2 Marsh §§14.20–14.37; 9 Witkin, SUMMARY OF CALIFORNIA LAW, *Corporations* §§179–188 (9th ed 1989). See also CALIFORNIA ATTORNEY'S DAMAGES GUIDE chap 5 (Cal CEB 1974).

§3.53 3. Class Actions

Plaintiff's cause of action in a class action derives from the defendant's violation of a duty owed directly to the plaintiff class members, *i.e.*, the shareholders, rather than a duty owed to the corporation as in a derivative suit (see §3.52). Although developed mainly in the federal courts under Rule 23 of the Federal Rules of Civil Procedure, class actions are authorized in California by CCP §382, which provides that "when the question is one of a common or general interest, of many persons, or when the parties are numerous, and it is impracticable to bring them all before the court, one or more may sue or defend for the benefit of all."

A class action on behalf of injured shareholders is not an alternative to a derivative action; ordinarily the two are mutually exclusive. However, if the defendant has also breached a duty to the corporation, a derivative cause of action on the corporation's behalf may be available as well.

A detailed treatment of class actions, either generally or in the

toward covenants not to compete. In *Campbell v Board of Trustees* (9th Cir 1987) 817 F2d 499, the court, in construing California's statutory prohibition on covenants not to compete, reiterated the rule that all covenants not to compete, regardless of whether they arise in an employer-employee relationship, are invalid unless they come within one of the statutory exceptions. It was argued in *Campbell* that, in relationships other than those of employer-employee, covenants not to compete should not be found invalid unless they are unreasonable.

The court also addressed the question of what constitutes a "profession, trade or business" so as to bring into play the Bus & P C §16600 prohibition against agreements that would prevent one from "engaging in a lawful profession, trade or business of any kind." Section 16600 has been held not to apply "where one is barred from pursuing only a small or limited part of the business, trade or profession." *Boughton v Socony Mobil Oil Co.* (1964) 231 CA2d 188, 192, 41 CR 714, 716. Under this "small or limited part" test, an agreement barring a person from the orchard heater business was invalidated (*Summerhays v Scheu* (1936) 10 CA2d 574, 52 P2d 512), while an agreement not to produce a particular trailer model was held valid (*King v Gerold* (1952) 109 CA2d 316, 240 P2d 710). In *Campbell v Board of Trustees, supra,* the agreement in question barred a psychologist who had supervised revision and development of psychological aptitude tests for Stanford University from preparing or publishing similar tests for anyone else. Stanford argued that this was not a prohibition on the pursuit of an "entire profession," because Dr. Campbell could still practice his profession of psychology while he was barred from the field of vocational interest exams. The court held, however, that Dr. Campbell should be allowed to prove that the preparation of these tests had become his life's work, and that he had become prominent in the field of test preparation. In effect, Dr. Campbell should be allowed to prove that his entire "profession, trade or business" within the meaning of §16600 is the preparation of vocational interest exams.

§3.6 B. Unfair Competition Law

Business and Professions Code §§17200–17208, known as the unfair competition law, provide remedies for a wide range of unfair business practices, enforceable by a similarly wide range of potential

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plaintiffs. The statutory remedies consist of injunctive relief (Bus & P C §§17203–17204), civil penalties (Bus & P C §17206), and civil penalties for violating an injunction (Bus & P C §17207).

These statutes apply to "unfair competition," defined for this purpose as "unlawful, unfair or fraudulent business practice and unfair, deceptive, untrue or misleading advertising," as well as to specific advertising practices enumerated in Bus & P C §§17500–17577.6. Bus & P C §17200. The courts have characterized unfair competition expansively for this purpose; *e.g.*, the legislature "intended . . . to permit tribunals to enjoin on-going wrongful business conduct in whatever context such activity might occur" (*Barquis v Merchants' Collection Ass'n* (1972) 7 C3d 94, 111, 101 CR 745, 757 (quoted in *People v McKale* (1979) 25 C3d 626, 632, 159 CR 811, 813); *Committee on Children's Television, Inc. v General Foods Corp.* (1983) 35 C3d 197, 210, 197 CR 783, 790); "an 'unfair' business practice occurs when it offends an established public policy or when the practice is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers" (*People v Casa Blanca Convalescent Homes, Inc.* (1984) 159 CA3d 509, 530, 206 CR 164, 177). For an injunction against misleading advertising, "it is necessary only to show that 'members of the public are likely to be deceived.' Allegations of actual deception, reasonable reliance, and damage are unnecessary." *Committee on Children's Television, Inc. v General Foods Corp., supra.* See also *People v Toomey* (1984) 157 CA3d 1, 16, 203 CR 642, 652. Nor is the statute confined to anticompetitive practices. *Committee on Children's Television, Inc. v General Foods Corp.* (1983) 35 C3d 197, 209, 197 CR 783, 790. These sections did not, however, give an author a cause of action against a newspaper that failed to include the author's novel on its bestseller list, due to first amendment restraints. *Blatty v New York Times Co.* (1986) 42 C3d 1033, 232 CR 542.

An action for an injunction may be brought by the Attorney General, by other specified public officers, "or by any person acting for the interests of itself, its members, or the general public." Bus & P C §17204. See *Committee on Children's Television, Inc. v General Foods Corp., supra* (five organizations, individual adults, and individual children had standing to sue for allegedly deceptive advertising); *Consumers Union of U.S., Inc. v Fisher Dev.* (1989) 208 CA3d 1433, 257 CR 151 (consumer group had standing under these statutes to sue to enforce Unruh Act age-discrimination provisions against

residential housing developer, even though group was not personally affected by restrictions in question). For discussion of procedural problems in actions brought on behalf of the public, see Chilton & Stern, *California's Unfair Business Practices Statutes: Settling the "Nonclass Class" Action and Fighting the "Two-Front War"* 12 CEB Civ Litigation Rep 95 (Feb. 1990).

The Sixth District Court of Appeal has held that damages are not available to a private litigant under Bus & P C §17203; only injunctive relief may be sought. *Industrial Indem. Co. v Santa Cruz County Superior Court* (1989) 209 CA3d 1093, 257 CR 655. The California Supreme Court had expressly left undecided, in *Committee on Children's Television, Inc. v General Foods Corp.* (1983) 35 C3d 197, 215, 197 CR 783, 794, the question of whether noncompetitors may recover damages.

Civil penalties may be imposed in actions brought by the Attorney General or by a local district attorney. Bus & P C §17206. The maximum penalty under §17206 is $2500 for each violation, and recent cases have held that the courts must impose a separate penalty for each violation of the unfair competition law. *People v Custom Craft Carpets, Inc.* (1984) 159 CA3d 676, 686, 206 CR 12, 18 ("court simply lacks any discretion . . . to not impose a penalty"); *People v National Ass'n of Realtors* (1984) 155 CA3d 578, 585, 202 CR 243, 248 (abuse of discretion to refuse to impose penalties for each violation). But see *People v Casa Blanca Convalescent Homes, Inc.* (1984) 159 CA3d 509, 206 CR 164, decided one week after *Custom Craft Carpets* under the similar provisions of Bus & P C §17536. The court noted that the trial court's "aggregation of certain multiple species of violations into a single 'act' resulted in a more than fair and reasonable interpretation of the legislative intent and resulted in a more than reasonable penalty." 159 CA3d at 535, 206 CR at 180.

These cases authorize or allow the imposition of civil penalties under Bus & P C §§17200 and 17206 without analyzing the language of those sections. However, a flaw in the statutory scheme of Bus & P C §§17200–17208 raises the issue of whether civil penalties may be imposed under §17206 for any act of unfair competition. Business and Professions Code §17206(a) provides: "Any person who *violates any provision of this chapter* shall be liable for a civil penalty not to exceed . . . $2,500." (Emphasis added). The chapter referred to consists of Bus & P C §§17200–17208. Except for Bus

& P C §17203, which specifies that anyone performing or proposing to perform an act of unfair competition may be enjoined, those sections do not forbid acts of unfair competition or state that they are unlawful. Furthermore, nothing is "prohibited" by Bus & P C §17200; that section merely defines "unfair competition," it does not prohibit it. A court faced with this issue would probably fall back on the rule that the legislature will be assumed to have intended its enactments to have some effect (see, *e.g., Moore v City Council* (1966) 244 CA2d 892, 897, 53 CR 603, 606) and give effect to §17206 as the court did in *People v National Ass'n of Realtors, supra.* The courts' construction of the statute also becomes a part of the statute and may cure any vagueness or uncertainty on its face. See *People v Curtis* (1969) 70 C2d 347, 355, 74 CR 713, 718. However, because §17206 is a punitive statute, some courts might be reluctant to give it effect.

§3.7 C. Criminal Sanctions for Theft of Trade Secrets

California has established criminal sanctions for misappropriation of trade secrets. Penal Code §499c(b)(1) prohibits the unauthorized use of a trade secret, thereby broadening the scope of the penal prohibition beyond the theft or taking of the trade secret. The definition of trade secret in Pen C §499c explicitly includes computer programs and data compilations stored in computers. For discussion of the elements that must be shown to establish that certain information is a trade secret under this statute, see *People v Gopal* (1985) 171 CA3d 524, 536, 217 CR 487, 494.

Sanctions are also imposed against those who induce, bribe, or reward an employer's former agents, employees, or servants to procure and turn over a trade secret obtained while working for that employer. Pen C §499c(c).

§3.8 D. Uniform Trade Secrets Act

The Uniform Trade Secrets Act (CC §§3426–3426.10), enacted in 1985, recognizes a statutory cause of action for misappropriation and misuse of trade secrets. The Act generally codifies but also extends previous case law. It defines the elements of that cause of action, provides for injunctive relief and damages (including attorney fees and exemplary damages in certain instances), and sets a