

## Memorandum 92-64

Subject: Administrative Matters - New Topics

At the September meeting the Commission decided to request authority to study two new topics--(1) clarification of the law governing shareholder rights and corporate directors' responsibilities; and (2) clarification of the law governing unfair and unlawful business practices. The statement of these two topics, as revised at the September meeting, is attached as Exhibit 1.

Also at that meeting the staff suggested a study of the newly adopted Uniform Unincorporated Nonprofit Associations Act (1992). The study would be to determine whether the uniform act, or parts of it, are appropriate for adoption in California. Many of the key California statutes in this area are the result of previous Commission recommendations. The Commission requested that the staff research how well the existing California statutes are operating and whether there are any problems in the cases or otherwise.

A California Continuing Education of the Bar publication, Advising California Nonprofit Corporations (1984), devotes a few pages to discussion of the advantages and disadvantages of unincorporated associations. The major advantages are the relative ease of organization, the informality with which it can act, and the absence of statutorily mandated formalities and standards of conduct applicable to directors. The major disadvantages are the uncertainty as to the law applicable and the difficulty of drafting comprehensive documents for the association that would relieve some of the uncertainty.

Several uncoordinated statutory provisions define some but not all of the attributes of nonprofit unincorporated associations. The most troublesome uncertainty is the potential personal liability of members for the association's obligations. In addition, there are no statutory provisions giving officers, directors, or members implied or apparent authority to act for a nonprofit association (by statute this uncertainty has been relieved somewhat as to real property

transactions). The drafting of a comprehensive constitution or governing document can be a formidable task, given the numerous rights, obligations, and procedures to be defined and the absence of any statutory norms. "The inadequacy of the statutory scheme and the resulting uncertainties make the unincorporated association less than desirable for most nonprofit enterprises." Advising California Nonprofit Corporations § 1.4 at p.9 (Cal. Cont. Ed. Bar 1984).

The Uniform Unincorporated Nonprofit Association Act (1992), while not purporting to provide comprehensive treatment of all issues, does address some of the most troublesome legal problems. Particularly, it provides guidance lacking in current California law concerning liability of members for the association's obligations. Other provisions of the uniform act are worth examining for improvements since they build on existing California statutes and those of other jurisdictions. Uniformity of the law on these matters could prove useful where interstate transactions are involved or where association members reside in more than one jurisdiction.

The staff believes that review of the uniform act would be a worthwhile Commission project that would require relatively little staff or Commission resources. It could be done on a low priority basis, as time and resources permit. The staff suggests that the Commission request authority for the following study:

Uniform Unincorporated Nonprofit Association Act

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 uniform act deals with issues such as suits by and against unincorporated associations, appointment of agents for service of process, and liability of members. 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 California law governing other issues is less clear. See, e.g., Advising California Nonprofit Corporations § 1.4 (Cal. Cont. Ed. Bar 1984). The uniform act builds on the law of California and other jurisdictions, clarifies the law concerning some of the more troublesome issues, 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.

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A study should be made to determine:

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

Respectfully submitted,

Nathaniel Sterling  
Executive Secretary

EXHIBIT 1

Shareholder Rights and Corporate Director Responsibilities

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 with the view toward clarification and codification of standards for excuse under the statute.

A principal defense of a director in a shareholder derivative action and in other litigation 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 clear and well-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.

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A study should be made to determine:

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.

#### Unfair Business Practices

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.

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A study should be made to determine:

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 on the public of a judgment between the parties to the litigation, and related matters.