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## California Supreme Court Survey - A Review of Decisions: April 1994-August 1995

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# California Supreme Court Survey

April 1994 - August 1995

*The California Supreme Court Survey provides a brief synopsis of recent decisions by the supreme court. The purpose of the survey is to inform the reader of issues that the supreme court has addressed, as well as to serve as a starting point for researching any of the topical areas. Attorney discipline, judicial misconduct, and death penalty appeal cases have been omitted from the survey.*

*Beginning with this issue, the survey will review California Supreme Court cases in either an article or summary format. Articles provide an in-depth analysis of selected California Supreme Court cases including the potential impact a case may have on California law. Additionally, articles guide the reader to secondary sources that focus on specific points of law.*

*Summaries provide a brief outline of the areas of law addressed in selected California Supreme Court cases. Summaries are designed to provide the reader with a basic understanding of the legal implications of cases in a concise format.*

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- C. California’s “hate crime” criminal enhancement statute, Penal Code section 422.75, does not necessitate a showing of specific intent, but requires that bias motivation be the cause in fact of the crime, and when there are multiple concurrent causes of the hate crime, bias motivation must be a substantial factor in the commission of the crime.

*People v. Aishman, Supreme Court of California, Decided July 3, 1995, 10 Cal. 4th 735, 896 P.2d 1387, 42 Cal. Rptr. 2d 377. . . . .* 782

- D. A criminal defendant who appeals a conviction arising from a plea of guilty or nolo contendere, contesting either the validity of a search or seizure or the validity of a post plea proceeding may proceed without a certificate of probable cause for appeal, and may raise other noncertificate issues on appeal.

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## I. ATTORNEYS AT LAW

- A. *When an attorney must withdraw from representing a new client because of a conflict of interest with another, first-engaged client, the attorney has no duty, in the course of terminating the attorney-client relationship, to advise the second client of legal matters that are adverse to the first client's interest, such as the statute of limitations and the need to obtain new counsel, and therefore an action for legal malpractice must fail: Flatt v. Superior Court.*

### I. INTRODUCTION

An action for legal malpractice may not survive summary judgment after *Flatt v. Superior Court*.<sup>1</sup> In this case, the California Supreme Court attempted to reconcile the Rules of Professional Conduct, the realities of legal practice, and the consumer's right to bring an action for legal malpractice.<sup>2</sup> The majority determined that when a new or prospective client

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1. 9 Cal. 4th 275, 885 P.2d 950, 36 Cal. Rptr. 2d 537 (4-3 decision) (1994). Justice Arabian authored the majority opinion, in which Chief Justice Lucas and Justices Baxter and George concurred. *Id.* at 278, 885 P.2d at 950, 36 Cal. Rptr. 2d at 537. Justice Kennard authored a dissenting opinion, in which Justices Mosk and Werdegar concurred. *Id.* at 291, 885 P.2d at 960, 36 Cal. Rptr. 2d at 547 (Kennard, J., dissenting).

William Daniel, the plaintiff, sought defendant Flatt's advice about bringing a legal malpractice action against Hinkle, an attorney who allegedly failed to protect Daniel's business assets from being classified as community property in a divorce proceeding. *Flatt*, 9 Cal. 4th at 279, 885 P.2d at 952, 36 Cal. Rptr. 2d at 539. Flatt met with Daniel and told him that he had a valid claim against Hinkle. *Id.* at 280, 885 P.2d at 952, 36 Cal. Rptr. 2d at 539. A week later, Flatt informed Daniel by letter that her firm represented Hinkle in another matter and that the conflict of interest precluded her from taking his case. *Id.* Flatt returned Daniel's papers, and Daniel admitted to the trial court that he understood that he needed to hire another attorney. *Id.* Nonetheless, Daniel did not hire another attorney until a year and a half after the meeting with Flatt. *Id.* Nearly two years after that meeting, Daniel sued both Hinkle and Flatt in separate actions for legal malpractice. *Id.* Daniel sued Flatt for breach of duty for not advising him about either the time-constraints of his claim or the need to hire another attorney to avoid having the claim time-barred. *Id.* Flatt sought summary judgment on the theory that she could have no duty to preserve the interests of a client whom she could not legally represent and whose interests directly conflict with those of an already existing client. *Id.*

2. *See id.* at 278-91, 885 P.2d at 951-60, 36 Cal. Rptr. 2d at 538-47; 7 CAL. JUR. 3D *Attorneys at Law* §§ 339-346 (1989 & Supp. 1995) (examining legal malpractice, including clients' contributory negligence); *see also* 7 AM. JUR. 2D *Attorneys at Law* § 198 (1980 & Supp. 1995) (discussing malpractice for simultaneously representing adverse parties), §§ 197-203 (1980 & Supp. 1995) (discussing legal malpractice, including negligence for failure to file a claim within the statute of limitations); 7A C.J.S.

engages a lawyer to bring suit against an existing client, the lawyer must withdraw promptly when he learns of the conflict, but has no duty to advise the new client in any way that would operate to the detriment of the existing client.<sup>3</sup>

According to the supreme court, both the trial court and the court of appeal incorrectly denied the motion for summary judgment in this case by focusing on the factual issue of whether an attorney-client relationship existed.<sup>4</sup> The supreme court agreed that this was in dispute, but went beyond this issue and considered whether the attorney, upon disengaging himself from representing a new client, has a duty to provide this client with information that could harm a previously engaged client.<sup>5</sup> As the supreme court decided *Flatt* owed no duty to the new client even if an attorney-client relationship existed between them, it reversed the court of appeal's decision and remanded the case, ordering the trial court to grant the defendant's motion for summary judgment.<sup>6</sup> The court explained that its holding was a reasonable response to the dilemma that lawyers face when an attorney must end a relationship with a client in order to conform with the Professional Rules of Conduct.<sup>7</sup> For example, when a new client seeks counsel to bring an action against a lawyer's existing client, the lawyer must sever the relationship.<sup>8</sup> Even if the attorney breaks off the relationship promptly, he runs the risk of breaching a duty to one client or the other.<sup>9</sup> After *Flatt*, an attorney is protected

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*Attorney & Client* § 255 (1980 & Supp. 1995) (discussing legal malpractice); W.R. Habeeb, Annotation, *Malpractice: Liability of Attorney Representing Conflicting Interests*, 28 A.L.R.3d 389, 393 (1969 & Supp. 1995) (reviewing the elements of legal malpractice, including proximate cause as it pertains to client negligence and duty that is predicated on an attorney-client relationship).

3. *Flatt*, 9 Cal. 4th at 278-79, 885 P.2d at 951, 36 Cal. Rptr. 2d at 538.

4. *Id.* at 281, 885 P.2d at 953, 36 Cal. Rptr. 2d at 540.

5. *Id.* (agreeing with the reasoning of the dissenting justice in the court of appeal's decision).

6. *Id.* at 290-91, 885 P.2d at 959-60, 36 Cal. Rptr. 2d at 546-47.

7. *Id.*

8. *See id.* at 290, 885 P.2d at 959, 36 Cal. Rptr. 2d at 546.

9. *See id.* at 289, 885 P.2d at 958, 36 Cal. Rptr. 2d at 545 (noting that, because of the conflict of interests in such situations, a lawyer cannot avoid breaching a duty to one client); *id.* at 292, 885 P.2d at 960, 36 Cal. Rptr. 2d at 547 (Kennard, J., dissenting) ("A lawyer who has conflicting responsibilities to two different clients is caught in a dilemma, because steps taken to protect the rights of one client may cause injury to another."); *see also Developments in the Law - Conflicts of Interests in the Legal Profession*, 94 HARV. L. REV. 1244, 1295-96 (1981) (stating that, with conflicts arising from simultaneous representation, a lawyer cannot "avoid a breach of his duty to promote the interests of each with loyal vigor") [hereinafter *Developments*

from liability to a new client in those instances where the Rules mandate that the lawyer terminate the attorney-client relationship with that client because of a concurrent conflict.<sup>10</sup>

## II. TREATMENT

### A. *The Majority Opinion*

Justice Arabian examined how conflicts of interests that occur between clients and lawyers impact the duty that lawyers owe clients under the California Rules of Professional Conduct.<sup>11</sup> Although possible conflicts between successive clients of an attorney threaten counsel's duty of confidentiality, an attorney may use the "substantial relationship"<sup>12</sup> test to determine whether taking a case will breach the duty of confidentiality to a previously engaged client.<sup>13</sup> Thus, in that instance an attorney is not automatically precluded from taking the case.<sup>14</sup>

Conversely, a simultaneous conflict of interest occurs when an attorney represents both parties to a lawsuit, which is a concern when a prospective client seeks representation to bring an action against an

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*in the Law*].

10. *Flatt*, 9 Cal. 4th at 278-79, 885 P.2d at 951, 36 Cal. Rptr. 2d at 538; see CALIFORNIA RULES OF PROFESSIONAL CONDUCT Rule 3-310(C)(2) (1994) (prohibiting an attorney from "accept[ing] or continu[ing] representation of more than one client in a matter in which the interests of the clients actually conflict"); 7 CAL. JUR. 3D *Attorneys at Law* §§ 89, 93, 94 (1989 & Supp. 1995) (discussing lawyers' duty of undivided loyalty and conflicts of interest); 1 B.E. WITKIN, CALIFORNIA PROCEDURE, *Attorneys* § 109 (3d ed. 1985 & Supp. 1995) (stating that dual representation, without the knowledge and consent of both parties, violates Rule 5-102); see also 7 AM. JUR. 2D *Attorneys at Law* § 184 (1980 & Supp. 1995) (examining dual representation and conflict of interest); 7A C.J.S. *Attorney & Client* §§ 150, 151 (1969) (same); Habeeb, *supra* note 2, at 391-95 (reviewing conflicts of interests as they relate to the Canons of Professional Ethics).

11. *Flatt*, 9 Cal. 4th at 282-91, 885 P.2d at 953-60, 36 Cal. Rptr. 2d at 540-47.

12. Under the substantial relationship analysis, an ex-client challenging an attorney's right to represent his adversary in a matter must show "a 'substantial relationship' between the subjects of the antecedent and current representations." *Id.* at 283, 885 P.2d at 954, 36 Cal. Rptr. 2d at 541; see CALIFORNIA RULES OF PROFESSIONAL CONDUCT Rule 3-310(E) (1994) (stating that, without consent, an attorney shall not "accept employment adverse to the client or former client, where, by reason of the representation of the client or former client, the [lawyer] has obtained confidential information material to the employment"). If a substantial relationship exists, the attorney is presumed to hold confidential information, and both he and his firm are disqualified from representing the former client's adversary. *Flatt*, 9 Cal. 4th at 283-84, 885 P.2d at 954-55, 36 Cal. Rptr. 2d at 541-42; see GEOFFREY C. HAZARD, JR., ET AL., *THE LAW AND ETHICS OF LAWYERING* 692-96 (2d ed. 1994) (discussing successive representation and the substantial relationship test); 7A C.J.S. *Attorney & Client* § 160 (1980 & Supp. 1995) (examining the substantial relationship test).

13. *Flatt*, 9 Cal. 4th at 282-85, 885 P.2d at 954-56, 36 Cal. Rptr. 2d at 540-43.

14. *Id.* at 283, 885 P.2d at 954, 36 Cal. Rptr. 2d at 541.

existing client.<sup>15</sup> Professional ethics codes prohibit this dual representation because the lawyer's duty of loyalty is paramount and a breach of this duty destroys the trust that is essential to the attorney-client relationship.<sup>16</sup> Further, the duty of loyalty arises from a client's reasonable expectations, not a lawyer's intent.<sup>17</sup> Thus, severing a relationship with an existing client neither cures a dual representation conflict nor abrogates the lawyer's duty of loyalty to that client.<sup>18</sup>

Having noted that the duty of loyalty forbids a lawyer from representing a party who seeks to sue an existing client, the court reasoned that a lawyer could have no legal duty to one party that violated his duty to another.<sup>19</sup> Therefore, when an attorney properly declines to further represent a new client, the attorney breaches no duty to him if the attorney does not advise the client about the statute of limitations or about the need to obtain a new lawyer.<sup>20</sup> The court's ruling recognizes that having conflicting duties to two clients is an untenable position for lawyers.<sup>21</sup> In modern law practice, an attorney may not know the targets of a prospective or new client's lawsuit until after the initial consultation.<sup>22</sup> Further, without doing research, an attorney may not be aware of all the clients that his firm currently represents.<sup>23</sup> Therefore, without the *Flatt* ruling, a lawyer would not know about conflicts until she already has an established duty of due care to another client.<sup>24</sup> According to Justice

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15. *Id.* at 284-85, 885 P.2d at 955-56, 36 Cal. Rptr. 2d at 542-43.

16. *Id.*; see RONALD E. MALLIN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 2.11, at 114-15 (3d ed. 1989) (providing introductory information concerning the prevention of malpractice claims); CHARLES W. WOLFRAM, MODERN LEGAL ETHICS § 7.3, at 349-58 (1986) (discussing the duty of loyalty and conflicts of interest arising from simultaneous representation); *Developments in the Law*, *supra* note 9, at 1292-1303 (discussing the hazards of simultaneous representation). See generally Charles Fried, *The Lawyer as Friend: The Moral Foundations of the Lawyer-Client Relation*, 85 YALE L.J. 1060 (1976) (positing that the duty of loyalty implies a moral duty that exceeds duties required by law or ethics codes); Marc I. Steinberg & Timothy U. Sharpe, *Attorney Conflicts of Interest: The Need for a Coherent Framework*, 66 NOTRE DAME L. REV. 1 (1990) (advocating measures in successive representation to cure conflicts of interest, but noting that such measures cannot cure conflicts of interest arising from simultaneous representation).

17. *Flatt*, 9 Cal. 4th at 284-85, 885 P.2d at 955-56, 36 Cal. Rptr. 2d at 542-43.

18. *Id.* at 288, 885 P.2d at 957-58, 36 Cal. Rptr. 2d at 544-45.

19. *Id.* at 289, 885 P.2d at 958, 36 Cal. Rptr. 2d at 545.

20. *Id.* at 290-91, 885 P.2d at 959-60, 36 Cal. Rptr. 2d at 546-47.

21. *Id.*

22. See *id.* at 279-80, 885 P.2d at 952, 36 Cal. Rptr. 2d at 539.

23. See *id.*

24. See *id.* at 290-91, 885 P.2d at 959-60, 36 Cal. Rptr. 2d at 546-47.

Arabian, *Flatt* logically allows a lawyer to extricate himself from improper representation without being exposed to liability for malpractice on the basis of a brief attorney-client relationship.<sup>25</sup>

### B. Justice Kennard's Dissenting Opinion

In her spirited dissent, Justice Kennard insisted that the threshold issue of whether an attorney-client relationship exists must be addressed before the consequences of any attendant duties.<sup>26</sup> Justice Kennard noted that the attorney in this case sought summary judgment based upon the absence of an attorney-client relationship, not upon the absence of a duty if such a relationship did exist.<sup>27</sup> Therefore, since the trial court must resolve a factual issue, summary judgment was inappropriate.<sup>28</sup>

Criticizing the majority for relegating "second-engaged" clients to a lower status than "first-engaged" clients, Justice Kennard maintained that lawyers owe a duty of due care to all clients, even those clients whose interests directly conflict.<sup>29</sup> A duty to one client cannot abrogate the duty to another.<sup>30</sup> Further, attorneys who unknowingly consult with a new client before discovering a conflict and severing the attorney-client relationship should not be immunized from liability to that client's detriment.<sup>31</sup> Citing the California Professional Rules of Conduct, Justice Kennard noted that a lawyer who must terminate an attorney-client relationship due to a conflict retains a duty to protect, within reason, the interests of the client who has been released.<sup>32</sup> Finally, Justice Kennard recognized that a plaintiff must overcome many barriers to succeed in an action for legal malpractice; however, the action should not fail because a client "belongs to a new species . . . to whom lawyers owe no duty."<sup>33</sup>

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25. *See id.*

26. *Id.* at 293-94, 885 P.2d at 961, 36 Cal. Rptr. 2d at 548 (Kennard, J., dissenting).

27. *Id.* at 297, 885 P.2d at 964, 36 Cal. Rptr. 2d at 551 (Kennard, J., dissenting).

28. *Id.* at 297-98, 885 P.2d at 964, 36 Cal. Rptr. 2d at 551 (Kennard, J., dissenting).

29. *Id.* at 292, 298, 885 P.2d at 960, 964, 36 Cal. Rptr. 2d at 547, 551 (Kennard, J., dissenting).

30. *Id.* (Kennard, J., dissenting).

31. *Id.* (Kennard, J., dissenting).

32. *Id.* at 298, 885 P.2d at 964, 36 Cal. Rptr. 2d at 551 (Kennard, J., dissenting) (citing CALIFORNIA RULES OF PROFESSIONAL CONDUCT Rule 3-700 (1994)). The California Rules of Professional Conduct state that a lawyer "shall not withdraw from employment until [he] has taken reasonable steps to avoid reasonably foreseeable prejudice to the rights of the client, including giving due notice to the client [and] allowing time for employment of other counsel." CALIFORNIA RULES OF PROFESSIONAL CONDUCT Rule 3-700 (1994).

33. *Flatt*, 9 Cal. 4th at 298-99, 885 P.2d at 964-65, 36 Cal. Rptr. 2d at 551-52 (Kennard, J., dissenting).

## III. IMPACT AND CONCLUSION

*Flatt* is the latest pro-attorney case in which the supreme court effectively mitigates the Professional Rules of Conduct.<sup>34</sup> The majority warned attorneys, however, that *Flatt's* holding applies only when an attorney is faced with a conflict of interest stemming from dual representation, requiring the attorney to terminate the attorney-client relationship with the second-engaged client.<sup>35</sup> Very likely, attorneys may rely upon *Flatt* when a conflict is discovered early, the attorney terminates the prohibited attorney-client relationship promptly, and the client has reason to know that he must obtain new counsel. Although the court held that an attorney has no duty to advise the second client about either the statute of limitations or the need to seek another lawyer,<sup>36</sup> some questions remain about the extent of this holding. It is possible that the second aspect of this holding may be inseparable from the first.<sup>37</sup> The facts of this case support an argument that, where a lawyer must terminate a relationship because of a concurrent conflict, he may have no duty to advise the second-engaged client about the need to obtain new counsel *in a timely manner, to prevent the statute of limitations from invalidating the claim*, but the lawyer must at least have some indication that the client knows he has to acquire new counsel.<sup>38</sup> Thus, in light

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34. See *Howard v. Babcock*, 6 Cal. 4th 409, 863 P.2d 150, 25 Cal. Rptr. 2d 80 (1993) (holding that reasonable noncompetition agreements between lawyers are consonant with the California Rules of Professional Conduct); Joshua M. Fried, *California Supreme Court Survey*, 21 PEPP. L. REV. 988-94 (1994) (analyzing the case); see also CALIFORNIA RULES OF PROFESSIONAL CONDUCT 1-500 (1994) (proscribing agreements that restrict the practice of law); cf. *General Dynamics Corp. v. Superior Court*, 7 Cal. 4th 1164, 876 P.2d 487, 32 Cal. Rptr. 2d 1 (1994) (holding that a corporate client may not unilaterally discharge in-house counsel); 1 B.E. WITKIN, CALIFORNIA PROCEDURE, *Attorneys* §§ 82-83 (3d ed. 1985 & Supp. 1995) (examining clients' rights to dismiss an attorney at any time); Christopher Dallas, *California Supreme Court Survey*, 22 PEPP. L. REV. 1180-84 (1995) (analyzing the holding).

35. *Flatt*, 9 Cal. 4th at 279, 290 n.6, 885 P.2d at 951, 959 n.6, 36 Cal. Rptr. 2d at 538, 546 n.6.

36. *Id.* at 290-91, 885 P.2d at 959-60, 36 Cal. Rptr. 2d at 546-47.

37. See *id.* at 279, 885 P.2d at 951, 36 Cal. Rptr. 2d at 538 (stating that the holding is limited to particular situations).

38. See *id.*; cf. *id.* at 290, 885 P.2d at 959, 36 Cal. Rptr. 2d at 546 ("We acknowledge . . . the possibility that in a different factual situation—one involving, perhaps, the lapse of considerable time and expenditure of substantial resources before discovery of the conflicting dual representation—an attorney's mere withdrawal from the second representation may not be sufficient in itself to resolve all ethical responsibilities."). In *Flatt*, the second client admitted that he knew he needed to obtain another lawyer. *Id.* at 280, 885 P.2d at 952, 36 Cal. Rptr. 2d at 539. Yet, the client, evidently

of the court's warning that it intends to apply its holding narrowly,<sup>39</sup> a client's subjective understanding of the need to obtain new representation could impact future applications of this decision.<sup>40</sup> If the court's words are applied literally and without reference to the facts of this case, however, lawyers will not face liability for neglecting to advise a second-engaged client to seek representation elsewhere.

LORRAINE WRIGHT FEUERSTEIN

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a sophisticated businessman, waited a year and a half to seek new representation. *Id.* at 279-80, 885 P.2d at 952, 36 Cal. Rptr. 2d at 539. The client's own negligence in this regard may have influenced the *Flatt* decision.

39. *Id.* at 279, 885 P.2d at 951, 36 Cal. Rptr. 2d at 538 ("Our holding is narrow, confined to the circumstances of this case . . .").

40. *See id.* at 280, 885 P.2d at 952, 36 Cal. Rptr. 2d at 539 (noting that "Daniel . . . understood Flatt's firm had declined to represent him and that he would need to continue his search for counsel"). *But cf. generally* Debra B. Perschbacher & Rex R. Perschbacher, *Enter at Your Own Risk: The Initial Consultation and Conflicts of Interest*, 3 GEO. J. LEGAL ETHICS 689 (1990) (recommending revision of the Model Rules of Professional Conduct to provide an objective standard for disqualifying a lawyer due to a concurrent conflict).

- B. *Under California Code of Civil Procedure section 340.6, a cause of action for transactional legal malpractice accrues on entry of adverse judgment, settlement, or dismissal of the underlying action when adequacy of the documentation is the subject of the dispute: ITT Small Business Finance Corp. v. Niles.*

## I. INTRODUCTION

In *ITT Small Business Finance Corp. v. Niles*,<sup>1</sup> the California Supreme Court determined the time of "actual injury" for the purpose of tolling the statute of limitations under California Code of Civil Procedure section 340.6(a)(1).<sup>2</sup> ITT Small Business Finance Corporation (ITT) brought a professional malpractice action against its attorney, Niles, for his alleged failure to adequately prepare certain loan documents.<sup>3</sup> The

1. 9 Cal. 4th 245, 885 P.2d 965, 36 Cal. Rptr. 2d 552 (1994). Chief Justice Lucas delivered the majority opinion in which Justices Arabian, Baxter, George, and Werdegar concurred. *Id.* at 248-58, 885 P.2d at 966-73, 36 Cal. Rptr. 2d at 553-60. Justice Mosk wrote a separate concurring opinion. *Id.* at 258, 885 P.2d at 973, 36 Cal. Rptr. 2d at 560 (Mosk, J., concurring). Justice Kennard filed a separate dissenting opinion. *Id.* at 258-62, 885 P.2d at 973-76, 36 Cal. Rptr. 2d at 560-63 (Kennard, J., dissenting).

2. California Code of Civil Procedure § 340.6(a) provides in relevant part:

An action against an attorney for a wrongful act or omission, other than for actual fraud, arising in the performance of professional services shall be commenced within one year after the plaintiff discovers . . . the wrongful act or omission . . . . In no event shall the time for commencement of legal action exceed four years except that the period shall be tolled during the time that any of the following exist: (1) the plaintiff has not sustained actual injury.

CAL. CIV. PROC. CODE § 340.6(a)(1) (West 1982 & Supp. 1995); *see also* 7 CAL. JUR. 3D *Attorneys at Law* § 340 (1989 & Supp. 1995) (discussing statute of limitations as a defense). *See generally* 7A C.J.S. *Attorney & Client* § 267 (1980) (analyzing legal malpractice actions); 54 C.J.S. *Limitations of Actions* § 172 (1980) (discussing the commencement of the statute of limitations for legal malpractice actions).

3. *Niles*, 9 Cal. 4th at 248, 885 P.2d at 966, 36 Cal. Rptr. 2d at 553. In December 1984, the defendant prepared a promissory note and certain loan documents purportedly granting ITT a "first security interest in machinery, equipment, [and] furniture . . . in exchange for a \$200,000 loan to debtor. In addition, the agreement granted ITT second liens on three pieces of real property and a pledge of certain stock as collateral securing the guaranty." *Id.* Defendant filed for bankruptcy and, in February 1990, "filed an adversary proceeding (in effect to avoid ITT's lien on its property) against ITT in United States Bankruptcy Court to contest inadequacies in the loan documents prepared by Niles on ITT's behalf." *Id.* ITT employed independent counsel to defend it in the adversary proceedings and put Niles on notice that he



trial court granted summary judgment in Niles favor, holding that the statute of limitations barred the action.<sup>4</sup> The court of appeal reversed, reasoning that “the statute of limitations in ‘transactional malpractice’ cases” commences on settlement or adverse judgment in the underlying action.<sup>5</sup> On review, the supreme court affirmed the court of appeal’s decision and held that the time of “actual injury” in a transactional legal malpractice action occurs at the entry of adverse final judgment in the underlying transaction.<sup>6</sup>

## II. TREATMENT

### A. *Majority Opinion*

In deciding what constitutes “actual injury” in transactional malpractice cases, the *Niles* court analogized the present case to its recent decision in *Laird v. Blacker*.<sup>7</sup> *Laird* addressed the issue of what constitutes “actual injury” under section 340.6(a)(1) when the malpractice action results from an attorney’s mismanagement of the client’s litigation.<sup>8</sup> The court determined that discovery of both the malpractice and actual harm

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may be subject to malpractice liability. *Id.* at 248-49, 885 P.2d at 966, 36 Cal. Rptr. 2d at 553. ITT later settled for less than the security’s full value. *Id.* Two months after the settlement ITT filed its malpractice claim against Niles. *Id.* at 249, 885 P.2d at 966-67, 36 Cal. Rptr. 2d at 553-54. ITT filed this claim more than two years after the commencement of the underlying litigation in the United States Bankruptcy Court. *Id.*

4. *Id.* at 249, 885 P.2d at 967, 36 Cal. Rptr. 2d at 554.

5. *Id.*

6. *Id.* at 258, 885 P.2d at 972, 36 Cal. Rptr. 2d at 559.

7. 2 Cal. 4th 606, 620, 828 P.2d 691, 699-700, 7 Cal. Rptr. 2d 550, 558-59 (holding that the statute of limitations should begin running on entry of adverse judgment or final order of dismissal), *cert. denied*, 113 S. Ct. 658 (1992).

8. *Id.* at 612, 828 P.2d at 694, 7 Cal. Rptr. 2d at 553. In *Laird*, the court reviewed the legislative history and other cases construing “actual injury” and interpreted § 340.6(a)(1) as requiring both discovery of the negligence and actual harm. *Id.* at 610-14, 828 P.2d at 693-96, 7 Cal. Rptr. 2d at 552-55. “The court emphasized that the focus of the statute of limitations for legal malpractice should be on discovery of the fact of damage, not the amount.” *Id.* at 612, 828 P.2d at 694, 7 Cal. Rptr. 2d at 553 (citing *Budd v. Nixen*, 6 Cal. 3d 195, 200-01, 491 P.2d 433, 436, 98 Cal. Rptr. 849, 852 (1971)). The court reasoned that although an appeal may reduce the amount of damages, it does not necessarily eliminate the client’s action for malpractice, and thus the client suffers actual harm upon entry of adverse judgment in the underlying action. *Id.* at 614-15, 828 P.2d at 696, 7 Cal. Rptr. 2d at 555. *See generally* 7 CAL. JUR. 3D *Attorneys at Law* § 340 (1989 & Supp. 1994) (discussing statute of limitations as a defense); 3 B.E. WITKIN, CALIFORNIA PROCEDURE, *Actions* §§ 444, 446, 446(a) (3d ed. 1985 & Supp. 1994) (discussing the nature and scope of the statute and its tolling provisions); Francis M. McDougherty, Annotation, *When Statute of Limitations Begins to Run Upon Action Against Attorney for Malpractice*, 32 A.L.R. 4th 260 (1984) (discussing the different views concerning when a cause of action for attorney malpractice accrues and when the statute begins to run).

are necessary before a cause of action accrues.<sup>9</sup> Applying *Laird*, the court reasoned that had ITT prevailed in the attack on the loan documentation, it would not have suffered an "actual injury."<sup>10</sup> Under this analysis, it was ITT's settlement of its claim for less than the full amount of the security, rather than Niles' inadequate preparation of the documents, that caused ITT harm.<sup>11</sup> The supreme court further reasoned that fixing "actual injury" at the point of judgment in transactional litigation will eliminate the problem of simultaneous litigation and will also greatly reduce the number of future malpractice actions filed.<sup>12</sup> The court noted that the interests of judicial economy and the goals of the statute of limitations are best served by tolling the malpractice statute until entry of adverse judgment or settlement of the transactional litigation.<sup>13</sup> Fur-

9. *Niles*, 9 Cal. 4th at 251, 885 P.2d at 968, 36 Cal. Rptr. 2d at 555.

10. *Id.* See generally Ronald E. Mallen, *Limitations And The Need For "Damages" In Legal Malpractice Actions*, 60 DEF. COUNS. J. 234 (1993) (discussing when an injury "occurs" to commence the statute of limitations for a legal malpractice action); Tyler T. Ochoa & Andrew J. Wistrich, *Limitation of Legal Malpractice Actions: Defining Actual Injury and the Problem of Simultaneous Litigation*, 24 SW. U. L. REV. 1 (1994) (discussing when "actual injury" occurs).

11. *Niles*, 9 Cal. 4th at 253, 885 P.2d at 969, 36 Cal. Rptr. 2d at 556.

12. *Id.* at 257, 885 P.2d at 972, 36 Cal. Rptr. 2d at 559. "Finally, it would be a waste of judicial resources to require both the adversary proceeding and the attorney malpractice action to be litigated simultaneously. Had ITT prevailed in the adversary proceeding, the malpractice action would have been unnecessary." *Id.*

13. *Id.* The court also rejected Niles's argument that actual harm occurred when the former client was forced to defend the adequacy of the loan documentation and incurred attorney's fees. *Id.* at 251, 885 P.2d at 968, 36 Cal. Rptr. 2d at 555. Niles relied on several court of appeal decisions to support his argument. *Id.*; see *Sirott v. Latts*, 6 Cal. App. 4th 923, 929-30, 8 Cal. Rptr. 2d 206, 210 (1992) (holding that actual harm occurred upon entry of arbitration judgment); *Johnson v. Simonelli*, 231 Cal. App. 3d 105, 110, 282 Cal. Rptr. 205, 208 (1991) (holding that the buyer's default on a promissory note constituted "actual injury"); *Kovacevich v. McKinney & Wainwright*, 16 Cal. App. 4th 337, 19 Cal. Rptr. 2d 692 (1993) (holding that actual harm was suffered when legal fees were incurred to mitigate the harm caused by malpractice); *Hensley v. Caietti*, 13 Cal. App. 4th 1165, 16 Cal. Rptr. 2d 837 (1993) (holding that "actual injury" was suffered when the settlement agreement was reached). The court, however, rejected the argument, concluding that the cases relied upon by Niles were either distinguishable, consistent with its present reasoning, or disapproved of based upon its reasoning in the present case. *Niles*, 9 Cal. 4th at 251, 885 P.2d at 968, 36 Cal. Rptr. 2d at 555.

Specifically, the court found the holding in *Sirott* to be consistent with its reasoning in the present case. *Id.* at 252-53, 885 P.2d at 969, 36 Cal. Rptr. 2d at 556. The court disapproved of the holdings in *Johnson* and *Kovacevich*, finding their reasoning inconsistent with the court's current analysis of "actual injury." *Id.* at 253-54, 885 P.2d at 969-70, 36 Cal. Rptr. 2d at 556-57. Additionally, the court distinguished

thermore, the dangers of tolling the statute, such as loss of evidence, notice to defendant, and stale actions, were not present in this case.<sup>14</sup> After considering all of these factors, the court held that an action for transactional malpractice accrues upon "entry of adverse judgment, settlement, or dismissal of the underlying action."<sup>15</sup> The court, however, cautioned that its holding was narrow and limited to the facts of this case.<sup>16</sup>

### B. Justice Mosk's Concurring Opinion

Although Justice Mosk concurred with the majority's opinion, he emphasized his adherence to his dissenting opinion in *Laird v. Blacker*, wherein he discussed the problems involved in determining the commencement of the statute of limitations.<sup>17</sup>

### C. Justice Kennard's Dissenting Opinion

Justice Kennard vigorously dissented from the majority's opinion, contending that the majority misconstrued California Code of Civil Procedure section 340.6.<sup>18</sup> Justice Kennard relied heavily on the court's decisions in *Budd v. Nixen*<sup>19</sup> and *Neel v. Magana, Olney, Levy, Cathcart & Gelfand*,<sup>20</sup> emphasizing that section 340.6 codified these supreme court decisions.<sup>21</sup> Moreover, based upon her review of these cases, Justice Kennard opined that the majority's decision in the present case was inconsistent with the plain meaning of the statute.<sup>22</sup>

Finally, Justice Kennard asserted that the majority's decision in *Niles* would result in substantial hardship for clients forced to defend a

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*Hensley* on its facts. *Id.* at 255, 885 P.2d at 971, 36 Cal. Rptr. 2d at 558.

14. *Niles*, 9 Cal. 4th at 257, 885 P.2d at 972, 36 Cal. Rptr. 2d at 559. "ITT notified Niles that he should contact his malpractice insurer as soon as ITT realized it would have to defend the documentation prepared by Niles in the adversary proceeding." *Id.*

15. *Id.* at 258, 885 P.2d at 972, 36 Cal. Rptr. 2d at 559.

16. *Id.*

17. *Id.* (Mosk, J., concurring); see *Laird v. Blacker*, 2 Cal. 4th 606, 621-28, 828 P.2d 691, 700-05, 7 Cal. Rptr. 2d 550, 559-64 (Mosk, J., dissenting) (arguing that the statute should be tolled pending the client's appeal as of right from the underlying judgment), *cert. denied*, 113 S. Ct. 658 (1992).

18. *Niles*, 9 Cal. 4th at 258-59, 885 P.2d at 973, 36 Cal. Rptr. 2d at 560 (Kennard, J., dissenting).

19. 6 Cal. 3d 195, 491 P.2d 433, 98 Cal. Rptr. 849 (1971).

20. 6 Cal. 3d 176, 491 P.2d 421, 98 Cal. Rptr. 837 (1971). See generally 3 B.E. WITKIN, CALIFORNIA PROCEDURE, *Actions* §§ 443, 444 (3d ed. 1985 & Supp. 1994) (discussing when a legal malpractice cause of action accrued before the passage of the statute and the incorporation of the decisions in *Neel* and *Budd* into the statute).

21. *Niles*, 9 Cal. 4th at 259, 885 P.2d at 973, 36 Cal. Rptr. 2d at 560 (Kennard, J., dissenting).

22. *Id.* at 262, 885 P.2d at 975, 36 Cal. Rptr. 2d at 562 (Kennard, J., dissenting).

lawyer's negligence in preparing documents, because a client who prevails is left without legal recourse to recover legal fees incurred in defending such action.<sup>23</sup>

### III. CONCLUSION

In *Niles*, the California Supreme Court established a bright line rule for determining "actual injury" in transactional malpractice cases under California Code of Civil Procedure section 340.6(a)(1). By defining "actual injury" as the point at which an adverse final judgment is entered in the underlying litigation, the court greatly reduced the number of potential transactional malpractice actions that may be filed. Such actions are now precluded if the client prevails in the underlying adversary proceeding.<sup>24</sup>

Additionally, the court's decision alleviated the problem of simultaneous litigation. A client can await judgment in the underlying action before being forced to institute malpractice proceedings against the attorney, relieving the client of the necessity of making inconsistent arguments in each of the proceedings, and quite possibly, of filing a malpractice suit at all.<sup>25</sup> Although the court's decision in *Niles* may reduce the number of malpractice actions filed, it may also extend the period of liability for the underlying transaction well beyond the four year limit set forth in the statute.<sup>26</sup> This result is justified by the court's reasoning, the

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23. *Id.* (Kennard, J., dissenting). Justice Kennard noted that in *Budd*, the court held that the statute of limitations commenced when the client suffered actual harm and "that the client's payment of attorney's fees may constitute such harm." *Id.* at 259, 885 P.2d at 973, 36 Cal. Rptr. 2d at 560 (Kennard, J., dissenting); see *Budd*, 6 Cal. 3d at 201, 491 P.2d at 436, 98 Cal. Rptr. at 852. *Budd* was remanded to the trial court to determine when "actual injury" occurs, thereby rejecting, in Justice Kennard's opinion, the client's argument that injury was sustained, upon entry of final judgment at the trial level. *Niles*, 9 Cal. 4th at 261, 885 P.2d at 975, 36 Cal. Rptr. 2d at 562 (Kennard, J., dissenting); see *Budd*, 6 Cal. 3d at 203-04, 491 P.2d at 433, 98 Cal. Rptr. at 849. The court in *Budd*, however, left it to the trial court to determine if actual harm was sustained, theorizing that the facts could show that the plaintiff suffered damage either when he incurred attorney's fees or upon entry of judgment in the adversary proceedings. *Id.* at 201-02, 491 P.2d at 437, 98 Cal. Rptr. at 853; see Carlos Solis, *Statute of Limitations in Legal Malpractice Cases: The California Supreme Court Establishes New Guidelines*, 7 U.S.F. L. REV. 85, 87-91 (1972) (analyzing the decisions in *Neel* and *Budd*).

24. *Niles*, 9 Cal. 4th at 257, 885 P.2d at 972, 36 Cal. Rptr. 2d at 559.

25. *Id.*

26. In *Niles*, the attorney prepared the loan documents in 1984, but because a settlement was not reached until January 1992, ITT's professional negligence claim

tolling provision provided in the statute, and the fact that ITT put Niles on notice of his potential liability when defending the bankruptcy proceeding.<sup>27</sup> Furthermore, although the court cautioned that its holding was limited to the type of situation presented in *Niles*,<sup>28</sup> it is likely that its definition of "actual injury" will be extended to encompass other situations.

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was timely filed in March of 1992, two years after the adversary proceedings had commenced and eight years after the initial transaction. *Id.* at 249, 885 P.2d at 966, 36 Cal. Rptr. 2d at 553; see Ochoa & Wistrich, *supra* note 10, at 22-24 (discussing the policy reasons behind the view that "actual injury" is sustained upon termination of the underlying action).

27. *Niles*, 9 Cal. 4th at 257, 885 P.2d at 972, 36 Cal. Rptr. 2d at 559.

28. *Id.* at 258, 885 P.2d at 972-73, 36 Cal. Rptr. 2d at 559-60.

## II. CIVIL PROCEDURE

*Section 425.13(a) of the California Code of Civil Procedure bars inclusion of punitive damage claims in actions against health care providers unless the plaintiff states and substantiates a legally sufficient claim; the court must deny a Section 425.13(a) motion to amend the complaint to include punitive damages when the facts asserted in the proposed amended complaint are legally insufficient to support a claim for punitive damages under section 3294 of the Civil Code, or when the evidence provided in affidavits either negates or fails to reveal the actual existence of a triable claim:*

**College Hospital Inc. v. Superior Court.**

### I. INTRODUCTION

In *College Hospital Inc. v. Superior Court*,<sup>1</sup> the California Supreme Court delineated the pleading standard that a party must meet in attempting to amend a complaint, pursuant to section 425.13(a) of the Code of Civil Procedure, when seeking punitive damages against a health care provider.<sup>2</sup> In conjunction, the court examined the requirements for

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1. 8 Cal. 4th 704, 882 P.2d 894, 34 Cal. Rptr. 2d 898 (1994). Justice Baxter wrote the majority opinion, with Chief Justice Lucas and Justices Mosk, Kennard, Arabian, George, and Werdegar concurring. *Id.* at 709-27, 882 P.2d at 896-908, 34 Cal. Rptr. 2d at 900-12.

2. *Id.* at 709, 882 P.2d at 896, 34 Cal. Rptr. 2d at 900. The California Code of Civil Procedure § 425.13(a) provides in relevant part:

In any action for damages arising out of the professional negligence of a health care provider, no claim for punitive damages shall be included in a complaint or other pleading unless the court enters an order allowing an amended pleading that includes a claim for punitive damages to be filed. The court may allow the filing of an amended pleading claiming punitive damages on a motion by the party seeking the amended pleading and on the basis of the supporting and opposing affidavits presented that the plaintiff has established that there is a substantial probability that the plaintiff will prevail on the claim pursuant to Section 3294 of the Civil Code.

CAL. CIV. PROC. CODE § 425.13(a) (West Supp. 1995). See generally 6 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Torts* §§ 777, 1368, 1368A (9th ed. 1988 & Supp. 1994) (discussing the § 425.13(a) requirement of a showing of merit when seeking punitive damages against a health care provider).

recovering punitive damages under section 3294 of the Civil Code, with particular emphasis upon vicarious liability for acts of employees.<sup>3</sup>

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The court had previously determined the applicability of § 425.13(a) in *Central Pathology Serv. Medical Clinic, Inc. v. Superior Court*, 3 Cal. 4th 181, 191, 832 P.2d 924, 930, 10 Cal. Rptr. 2d 208, 214 (1992) (stating that § 425.13(a) applies to any action alleging misconduct "directly related to the professional services provided by the health care provider," including both intentional and non-intentional torts). See generally Paul F. Arentz, *Defining "Professional Negligence" After Central Pathology Service Medical Clinic v. Superior Court: Should California's Medical Injury Compensation Reform Act Cover Intentional Torts?*, 30 CAL. W. L. REV. 221 (1994) (considering whether the other provisions of MICRA should be extended to intentional torts or be limited to professional negligence); Russell A. Gold, Note, *Central Pathology Service Medical Clinic, Inc. v. Superior Court: Statute Limiting Punitive Damages for the Professional Negligence of Health Care Providers Includes Intentional Torts*, 30 SAN DIEGO L. REV. 621 (1993) (discussing the broad applicability of § 425.13(a) as a result of the decision in *Central Pathology*).

3. *College Hosp.*, 8 Cal. 4th at 721, 882 P.2d at 904, 34 Cal. Rptr. 2d at 908. Civil Code § 3294 outlines the required elements for a punitive damage claim:

(a) In an action for the breach of an obligation not arising from contract, where it is proven by clear and convincing evidence that the defendant has been guilty of oppression, fraud, or malice, the plaintiff, in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant.

(b) An employer shall not be liable for damages pursuant to subdivision (a), based upon acts of an employee of the employer, unless the employer had advance knowledge of the unfitness of the employee and employed him or her with a conscious disregard of the rights or safety of others or authorized or ratified the wrongful conduct for which the damages are awarded or was personally guilty of oppression, fraud, or malice. With respect to a corporate employer, the advance knowledge and conscious disregard, authorization, ratification or act of oppression, fraud, or malice must be on the part of an officer, director, or managing agent of the corporation.

(c) As used in this section, the following definitions shall apply:

(1) "Malice" means conduct which is intended by the defendant to cause injury to the plaintiff or despicable conduct which is carried on by the defendant with a willful and conscious disregard of the rights or safety of others.

(2) "Oppression" means despicable conduct that subjects a person to cruel and unjust hardship in conscious disregard of that person's rights.

(3) "Fraud" means an intentional misrepresentation, deceit, or concealment of a material fact known to the defendant with the intention on the part of the defendant of thereby depriving a person of property or legal rights or otherwise causing injury.

CAL. CIV. CODE § 3294 (West Supp. 1995).

In 1990, the plaintiff in *College Hospital* sought treatment from the hospital for agoraphobia and other disorders. *College Hosp.*, 8 Cal. 4th at 710, 882 P.2d at 897, 34 Cal. Rptr. 2d at 901. Robert Berry worked in the cardiopulmonary department of College Hospital and had no professional contact with the plaintiff. *Id.* The plaintiff and Berry met and started an extramarital affair. *Id.* When the defendant Berry ended the relationship, the plaintiff alleged that she suffered a breakdown. *Id.*

The plaintiff and her husband sued in 1991 for professional negligence, and intentional and negligent infliction of emotional distress. *Id.* at 709-10, 882 P.2d at 896-97,

The trial court granted the plaintiffs' section 425.13(a) motion and allowed them to amend their complaint in order to include a punitive damages claim against Robert Berry and College Hospital, his employer.<sup>4</sup> The court of appeal denied the defendants' appeal and upheld the decision of the trial court.<sup>5</sup> The California Supreme Court granted the defendants' petition for relief.<sup>6</sup>

## II. TREATMENT

### A. *Section 425.13(a) of the California Code of Civil Procedure Bars Inclusion of Punitive Damages in Actions Against Health Care Providers Unless the Plaintiff Both States and Substantiates a Legally Sufficient Claim*

The California Supreme Court relied heavily upon the legislative history and purpose of section 425.13(a) in deciding the legal standard to apply in determining whether a plaintiff may include a claim for punitive damages in an action against a health care provider.<sup>7</sup> The court noted that, "[a]lthough the language of section 425.13(a) is uncertain, its prophylactic purpose is clear—to protect health care providers from the

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34 Cal. Rptr. 2d at 900-01. They alleged that the hospital breached its "duty to provide competent therapeutic care" by allowing its employee to carry on an affair with a patient. *Id.* at 710, 882 P.2d at 897, 34 Cal. Rptr. 2d at 901. The complaint also sought punitive damages against the hospital and the Berry. *Id.* Both defendants moved to strike the punitive damages claim based on the plaintiff's failure to comply with the requirements of § 425.13(a). The court granted the motion to strike. *Id.* at 710-11, 882 P.2d at 897, 34 Cal. Rptr. 2d at 901.

The plaintiffs moved to amend their complaint under § 425.13(a) to allow them to seek punitive damages, based primarily on a declaration executed by the plaintiff. *Id.* at 711, 882 P.2d at 897, 34 Cal. Rptr. 2d at 901. The defendants opposed this motion, and the plaintiffs argued that the punitive damages claim was proper against Berry since the relationship with the plaintiff was "malicious and harmful." *Id.* The plaintiffs argued that the hospital should pay punitive damages because: "(1) Berry was a management-level employee who committed malicious acts against Laura, (2) Westbrook, the highest ranking manager at the hospital, investigated and otherwise handled the Laura-Berry relationship in a malicious way, and (3) Westbrook ratified Berry's malicious conduct towards Laura." *Id.* at 711, 882 P.2d at 897-98, 34 Cal. Rptr. 2d at 901-02.

4. *Id.* at 711, 882 P.2d at 898, 34 Cal. Rptr. 2d at 902.

5. *Id.* The hospital petitioned for a writ of mandate to set aside the ruling of the trial court, but the appellate court denied relief. *Id.*

6. *Id.* Since only the hospital pursued this appeal, the court did not decide whether the plaintiffs may bring a punitive damage claim against Berry. *See id.*

7. *Id.* at 712-20, 882 P.2d at 898-904, 34 Cal. Rptr. 2d at 902-08.



onerous burden of defending against meritless punitive damage claims.<sup>8</sup> Chronicling the legislative scheme relating to punitive damages in California,<sup>9</sup> the court stated that, while “[t]he civil law is normally concerned with compensating victims for actual injuries sustained at the hands of a tortfeasor,”<sup>10</sup> punitive damages are designed to punish.<sup>11</sup> Punitive damages are allowed in cases involving “tortious events that involve an additional egregious component—‘oppression, fraud, or malice.’”<sup>12</sup> The court observed that the Legislature has been refining statutes to make it more difficult for plaintiffs to plead and prove” punitive damage claims.<sup>13</sup> The court noted that section 425.13 was implemented as part of the Brown-Lockyer Civil Liability Reform Act of 1987,<sup>14</sup> and that it “imposes certain pretrial procedural requirements on plaintiffs attempting to plead a punitive damages claim against a health care provider.”<sup>15</sup>

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8. *Id.* at 709, 882 P.2d at 896, 34 Cal. Rptr. 2d at 900.

9. *Id.* at 712-20, 882 P.2d at 898-904, 34 Cal. Rptr. 2d at 902-08.

10. *Id.* at 712, 882 P.2d at 898, 34 Cal. Rptr. 2d at 902.

11. *Id.*

12. *Id.* (quoting CAL. CIV. CODE § 3294(a) (West Supp. 1995)). The court emphasized that, since compensatory damages already make a plaintiff whole, punitive damages can be deemed a “windfall” to the plaintiff. *Id.* (citing *Adams v. Murakami*, 54 Cal. 3d 105, 120, 813 P.2d 1348, 1357, 284 Cal. Rptr. 318, 327 (1991)). See generally 6 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Torts* §§ 1327-1381 (9th ed. 1988 & Supp. 1994) (outlining the nature, purpose, and availability of punitive damages); 23 CAL. JUR. 3D *Damages* §§ 116-134 (1975 & Supp. 1994) (explaining the special requirements, which plaintiffs must meet in order to seek punitive damages).

13. *College Hosp.*, 8 Cal. 4th at 712, 882 P.2d at 898, 34 Cal. Rptr. 2d at 902. In 1979, the Legislature enacted a series of procedural restrictions in an attempt to limit the use of punitive damage claims as a “tactical ploy.” *Id.* These provisions “limited the circumstances under which evidence of the defendant’s financial condition could be discovered and admitted, authorized bifurcation of the punitive damages phase of trial, and barred disclosure of the amount of punitive damages sought in the complaint.” *Id.* (citing CAL. CIV. CODE § 3295(a)-(e) (West Supp. 1995)). The court noted that “[t]he pretrial discovery limits ensure that defendants are not coerced into settling suits solely to avoid unwarranted intrusions into their private financial affairs, while the evidentiary restrictions minimize the potential prejudice to the defense in front of a jury.” *Id.*

The court further noted that, in an effort to limit employer’s liability for an employee’s acts, the California Legislature has changed the elements necessary to sustain a punitive damage award and has clarified crucial terms, such as “oppression,” “fraud” and “malice.” *Id.* at 712-13, 882 P.2d at 898-99, 34 Cal. Rptr. at 902-03 (citing CAL. CIV. CODE § 3294(b), (c) (West Supp. 1995)). See generally 6 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Torts* §§ 1344-1348 (9th ed. 1988 & Supp. 1994) (stating that the general rule of respondeat superior does not apply to punitive damages unless the requirements of § 3294(b) are fulfilled).

14. 1987 Cal. Stat. 5777, ch. 1498, §§ 1-7 (S.B. 241); see CAL. CIV. CODE § 3294.

15. *College Hosp.*, 8 Cal. 4th at 713, 882 P.2d at 899, 34 Cal. Rptr. 2d at 903. The court noted that “[i]t is not the only statute of its kind. Between 1988 and 1992, several similar provisions, covering both compensatory and punitive damage claims, were added to the Code of Civil Procedure.” *Id.* These additional statutes are helpful in

The court found it necessary to define "substantial probability" as used in section 425.13(a) in order to determine the pleading burden that plaintiffs must meet when seeking recovery for punitive damages in actions against a health care providers.<sup>16</sup> The court rejected the defendants' argument that the court must consider the merits of a complaint and deny a punitive damages claim that is not "highly likely to succeed at trial."<sup>17</sup> The court reasoned that such an interpretation would "prevent trial of all but the most compelling punitive damage claims" and that if this were the intent of the legislature, it would have made this purpose clear in the text of the statute.<sup>18</sup> Concluding that section 425.13(a) is unclear in providing a standard of "substantial probability" of prevailing on a punitive damage claim against a health care provider,<sup>19</sup> the court asserted that it must define the language in a manner consistent with the purpose of the statutory scheme and legislative history of section 425.13.<sup>20</sup>

The court noted:

By its own terms, section 425.13(a) requires the plaintiff to specially move to amend the complaint at a fairly early stage in the lawsuit. Discovery may not be complete at that time. Indeed, until a punitive damages claim is stated, discovery on some issues may not have begun. In apparent recognition of this fact, section 425.13(a) does not contemplate a mini-trial in which witness testimony is introduced . . . [A] section 425.13(a) motion, like a motion for summary judgment, is decided entirely on an 'affidavit' showing.<sup>21</sup>

The court found that the legislative intent behind section 425.13 was to prevent the pleading of frivolous punitive damage claims that substantive proof did not support.<sup>22</sup> The court rejected the defendant's proposed

interpreting the application of § 425.13.

16. *Id.* at 714, 882 P.2d at 900, 34 Cal. Rptr. 2d at 904.

17. *Id.* The court observed that such an inquiry might raise a constitutional issue because the weighing could infringe upon the role of the jury as the trier of fact. *Id.* at 720, 882 P.2d at 904, 34 Cal. Rptr. 2d at 908. The court declined to address this issue, however, since it rejected the "weighing" test that the defendants put forward. *Id.* at 720-21, 882 P.2d at 904, 34 Cal. Rptr. 2d at 908.

18. *Id.* at 716, 882 P.2d at 901, 34 Cal. Rptr. 2d at 905.

19. *Id.*

20. *Id.* at 716-17, 882 P.2d at 901, 34 Cal. Rptr. 2d at 905.

21. *Id.* at 717, 882 P.2d at 901, 34 Cal. Rptr. 2d at 905 (citation omitted). The court emphasized that § 425.13 is a pretrial, not a "mini-trial," mechanism by pointing out that the legislature placed it in the Code of Civil Procedure "near other [pretrial] statutes long used by courts to screen the legal sufficiency and triability of claims before trial." *Id.* (emphasis added).

22. *Id.* at 717-18, 882 P.2d at 902, 34 Cal. Rptr. 2d at 906 (quoting ASSEMBLY JUDICIARY COMMITTEE, COMMITTEE ANALYSIS OF S.B. 1, at 1 (Jan. 26, 1988)).

“weighing” of the evidence threshold because nothing authorized such an approach.<sup>23</sup> The court pointed out that such an interpretation would infringe upon the traditional role of the jury as the finder of fact and that the Legislature would have been quite explicit had they intended to drastically alter the fact-finding process.<sup>24</sup> The court held that “section 425.13(a) required a plaintiff to state and substantiate a punitive damage claim before the plaintiff pleads such relief. A court must deny a section 425.13(a) motion when the asserted facts insufficiently support the claim, or when there is no triable punitive damage claim.”<sup>25</sup>

The court then applied this standard in determining whether the plaintiffs could include a claim for punitive damages in their action against the hospital.<sup>26</sup> Noting that section 425.13 requires that proof of oppression, fraud, or malice,<sup>27</sup> the court pointed out that California Civil Code section 3294(b) establishes additional requirements for claims of punitive damages under a theory of respondeat superior.<sup>28</sup> Specifically, section 3294(b) requires plaintiffs to show that the employee acted within the scope of employment.<sup>29</sup> The court found that the plaintiff in the instant case did not meet this requirement.<sup>30</sup>

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23. *Id.* Instead, the court found:

[T]he tone and substance of the debate strongly suggest that the motion required by such statutes operates like a demurrer or motion for summary judgment in “reverse.” Rather than requiring the defendant to defeat the plaintiff’s pleading by showing it is legally or factually meritless, the motion requires the plaintiff to demonstrate that he possesses a legally sufficient claim which is “substantiated,” that is, supported by competent, admissible evidence.

*Id.* at 719, 882 P.2d at 902-03, 34 Cal. Rptr. 2d at 906-07.

24. *Id.* at 719, 882 P.2d at 903, 34 Cal. Rptr. 2d at 907.

25. *Id.* The court further held that “substantiation of a proposed punitive damages claim occurs only where the factual recitals are made under penalty of perjury and set forth competent admissible evidence within the personal knowledge of the declarant.” *Id.* at 719-20, 882 P.2d at 903, 34 Cal. Rptr. 2d at 907.

26. *Id.* at 721-27, 882 P.2d at 904-05, 34 Cal. Rptr. 2d at 908-12.

27. *Id.* at 721, 882 P.2d at 904, 34 Cal. Rptr. 2d at 908.

28. *Id.* (quoting CAL. CIV. CODE § 3294(b)); *see supra* note 3 and accompanying text for requirements of § 3294(b).

29. *Id.* at 723-24, 882 P.2d at 906, 34 Cal. Rptr. 2d at 910.

30. *Id.* at 724, 882 P.2d at 906, 34 Cal. Rptr. 2d at 910. The court observed that the evidence submitted indicates that Berry acted on his own and not in the scope of his employment with the hospital when the alleged wrongs took place. *Id.* The court also rejected plaintiff’s argument that Westbrook, a hospital administrator, “ratified” defendant Berry’s conduct within the meaning of Civil Code § 3294(b), for which the hospital would be liable. *Id.* at 724-25, 882 P.2d at 906-907, 34 Cal. Rptr. 2d at 911. The court stated that “[c]orporate ratification in the punitive damages context requires actual knowledge of the conduct and its outrageous nature.” *Id.* at 726, 882 P.2d at 908, 34 Cal. Rptr. 2d at 912.

The California Supreme Court reversed the court of appeal's denial of College Hospital's petition for a writ of mandate to set aside the trial court's order, which allowed the plaintiffs to state a claim for punitive damages.<sup>31</sup> The court held that the "plaintiffs failed to satisfy the requirements of section 425.13(a) when they sought to plead a punitive damages claim against the Hospital."<sup>32</sup>

### III. IMPACT

The California Supreme Court articulated a "substantial probability" of success standard for assessing the pleadability of punitive damage claims against health care providers under section 425.13(a).<sup>33</sup> In so doing, the court struck a delicate balance between the legislative intent of requiring substantiation and the traditional role of the jury as the finder of fact.<sup>34</sup> The supreme court went to great lengths to reject the defendants' claim that section 425.13(a) requires the court to weigh the evidence.<sup>35</sup> Nevertheless, any heightened pleading requirement, such as substantiation, necessarily involves some judicial inquiry into the merits of the case. This requires courts to apply such a test carefully in order to both obviate the need for a "mini-trial" when the courts consider section 425.13(a) motions and protect health care providers against frivolous punitive damage claims.

CHRIS DALLAS

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31. *Id.* at 727, 882 P.2d 908, 34 Cal. Rptr. 2d at 912.

32. *Id.* at 727, 882 P.2d at 908, 34 Cal. Rptr. 2d at 912.

33. *Id.* at 714-17, 882 P.2d at 899-901, 34 Cal. Rptr. 2d at 903-05; *see supra* note 18 and accompanying text.

34. *College Hosp.*, 8 Cal. 4th at 719-20, 882 P.2d at 902-03, 34 Cal. Rptr. 2d 906-07.

35. *Id.*; *see supra* note 16 and accompanying text.

### III. CONSTITUTIONAL LAW

*An ordinance that bans camping and storage of personal property in public areas is constitutional on its face because the ordinance does not impermissibly restrict the right to travel, does not permit cruel and unusual punishment based on status, and is neither vague nor overbroad.*

**Tobe v. City of Santa Ana.**

#### I. INTRODUCTION

In *Tobe v. City of Santa Ana*,<sup>1</sup> the California Supreme Court consolidated two separate actions<sup>2</sup> and considered the constitutional validity of a Santa Ana ordinance<sup>3</sup> that prohibits camping or storing of personal property in public areas.<sup>4</sup> After differentiating between “facial”<sup>5</sup> and “as

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1. 9 Cal. 4th 1069, 892 P.2d 1145, 40 Cal. Rptr. 2d 402 (1995). Justice Baxter wrote the majority opinion, in which Chief Justice Lucas, and Justices Kennard, Arabian and George concurred. *Id.* at 1069-1110, 892 P.2d at 1145-69, 40 Cal. Rptr. 2d at 402-26. Justice Kennard wrote a separate concurring opinion. *Id.* at 1110, 892 P.2d at 1169-70, 40 Cal. Rptr. 2d at 426-27. (Kennard, J., concurring). Justice Werdegar also wrote a separate concurring opinion. *Id.* at 1110-11, 892 P.2d at 1170, 40 Cal. Rptr. 2d at 427. (Werdegar, J., concurring). Justice Mosk wrote a dissenting opinion. *Id.* at 1111-32, 892 P.2d at 1170-84, 40 Cal. Rptr. 2d at 427-41. (Mosk, J., dissenting).

2. In the first action (Tobe), homeless residents petitioned for a writ of mandate challenging the constitutionality of the ordinance. *Tobe*, 9 Cal. 4th at 1086, 892 P.2d at 1154, 40 Cal. Rptr. 2d at 411. The residents alleged that they had previously been convicted for violating the city ordinance, and that police would likely arrest them again in the future for the same violation. *Id.* In the second action (Zuckernick), the plaintiffs, who were charged with violating the ordinance, petitioned for a writ of mandate to compel the municipal court to sustain their demurrers. *Id.* at 1089, 892 P.2d at 1156, 40 Cal. Rptr. 2d at 413.

3. Section 10-402 of the Santa Ana ordinance provides in relevant part that “[i]t shall be unlawful for any person to camp, occupy camp facilities or use camp paraphernalia in . . . any . . . public area.” *Id.* at 1081, 892 P.2d at 1150, 40 Cal. Rptr. 2d at 407 (quoting SANTA ANA, CAL., ORDINANCE § 10-402 (1992)). Section 10-403 provides in pertinent part that “[i]t shall be unlawful for any person to store personal property . . . in . . . any . . . public area.” *Id.* at 1081, 892 P.2d at 1150-51, 40 Cal. Rptr. 2d at 407-08 (quoting SANTA ANA, CAL., ORDINANCE § 10-403 (1992)).

4. *Id.* at 1080, 892 P.2d at 1150, 40 Cal. Rptr. 2d at 407.

5. “A facial challenge to the constitutional validity of . . . [an] ordinance considers only the text of the measure itself, not its application to the particular circumstances of an individual.” *Id.* at 1084, 892 P.2d at 1152, 40 Cal. Rptr. 2d at 409; see also Pacific Legal Found. v. Brown, 29 Cal. 3d 168, 180-81, 624 P.2d 1215, 1221, 172 Cal. Rptr. 487, 493 (1981) (holding that a facial challenge requires petitioners to show a present conflict with the unconstitutional statute, and not a “future hypothetical situation”). See generally 13 CAL. JUR. 3D *Constitutional Law* § 68 (1989) (examining the facial validity and constitutionality of statutes).

applied<sup>6</sup> constitutional challenges,<sup>7</sup> the court determined that based on the procedural history of both cases, the plaintiffs could only facially challenge the constitutionality of the ordinance.<sup>8</sup> Accordingly, the court examined whether the ordinance violated, on its face, plaintiffs' constitutional rights to travel, freedom from cruel and unusual punishment, and substantive due process.<sup>9</sup> The supreme court reversed the court of appeal's decision<sup>10</sup> on all three constitutional issues, and held that Santa Ana's ordinance was constitutionally valid.<sup>11</sup>

## II. TREATMENT

### A. Majority Opinion

#### 1. Challenge to Constitutionality as "Facial" or "As Applied"

The court initially considered whether the plaintiffs in each case had mounted both "facial" and "as applied" challenges to the constitutionality of the ordinance.<sup>12</sup> The court found that while the *Tobe* plaintiffs may

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An as applied challenge may seek . . . relief from a specific application of a facially valid . . . ordinance to an individual or class of individuals who are under allegedly impermissible present restraint or disability as a result of the manner or circumstances in which the statute or ordinance has been applied, or . . . an injunction against future application of the statute or ordinance . . . .

*Tobe*, 9 Cal. 4th at 1083, 892 P.2d at 1152, 40 Cal. Rptr. 2d at 409; see also *Hale v. Morgan*, 22 Cal. 3d 388, 404, 584 P.2d 512, 522, 149 Cal. Rptr. 375, 385 (1978) (holding that the court makes a case by case determination for "as applied" challenges to facially valid statutes); *Mandel v. Hodges*, 54 Cal. App. 3d 596, 127 Cal. Rptr. 244 (1976) (holding that a court will find unconstitutional a facially valid statute that is unconstitutionally applied).

7. *Tobe*, 9 Cal. 4th at 1084-86, 892 P.2d at 1152-54, 40 Cal. Rptr. 2d at 409-11.

8. *Id.* at 1086-93, 892 P.2d at 1154-58, 40 Cal. Rptr. 2d at 411-15. The Zuckernick plaintiffs were unable to bring such an action on demurrer, and the *Tobe* plaintiffs did not clearly identify how the ordinance impermissibly applied to them or others in the past. *Id.* at 1083, 892 P.2d at 1152, 40 Cal. Rptr. 2d at 409. Hence, neither party could challenge the constitutionality of the ordinance "as applied." *Id.*

9. *Id.* at 1096-1109, 892 P.2d at 1161-69, 40 Cal. Rptr. 2d at 418-26.

10. According to the supreme court, the court of appeal mistakenly allowed the plaintiffs' challenge to the ordinance "as applied" because their petitions entitled them only to a facial challenge. *Id.* at 1080, 892 P.2d at 1150, 40 Cal. Rptr. 2d at 407; see also Stephanie B. Goldberg, *Homeless Victory*, 80 A.B.A. J. 102 (1994) (discussing the court of appeal's decision as a victory for the homeless).

11. *Tobe*, 9 Cal. 4th at 1080, 892 P.2d at 1150, 40 Cal. Rptr. 2d at 407.

12. *Id.* at 1083, 892 P.2d at 1152, 40 Cal. Rptr. 2d at 409.

have intended to mount both types of challenges, they only perfected a facial challenge in the trial court.<sup>13</sup> The court reasoned that at trial the *Tobe* plaintiffs inadvertently failed to provide one of the two general requirements for an “as applied”<sup>14</sup> challenge.<sup>15</sup> The court stated that the *Tobe* plaintiffs “sought to enjoin any application of the ordinance to any person in any circumstance,” rather than identifying the particular applications of the law that the court should enjoin, and describing the circumstances of their past arrests.<sup>16</sup> The court held that such general relief is sought only in a facial attack.<sup>17</sup>

Similarly, the court ruled that the Zuckernick plaintiffs had not perfected an “as applied” attack on the ordinance when they petitioned for a writ of mandate to compel the municipal court to sustain their demurrer.<sup>18</sup> The court held that a demurrer to a criminal complaint only raises issues of law,<sup>19</sup> and thus the plaintiffs could not claim that the ordi-

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13. *Id.*

14. “As applied” challenges assume that the ordinance being challenged is facially valid, and assert that the manner in which the ordinance is being enforced is invalid. *Id.* at 1089, 892 P.2d at 1156, 40 Cal. Rptr. 2d at 413. See generally 7 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Constitutional Law* § 58 (9th ed. 1988 & Supp. 1995) (describing the policy that legislative acts are presumed constitutional); 16 AM. JUR. 2D *Constitutional Law* § 212 (1979 & Supp. 1995) (stating that the constitutionality of legislation is the basis for all legal concepts).

15. A plaintiff challenging a statute or ordinance “as applied” must show: (1) a sufficient beneficial interest to have standing, and; (2) an “impermissible application of the challenged statute or ordinance which the court can remedy.” *Tobe*, 9 Cal. 4th at 1085, 892 P.2d at 1153, 40 Cal. Rptr. 2d at 410. The court held that the *Tobe* plaintiffs had standing as taxpayers who wanted to prevent the city from spending funds to enforce an unconstitutional ordinance in the future. *Id.* at 1086, 892 P.2d at 1154, 40 Cal. Rptr. 2d at 411; see also CAL. CIV. PROC. CODE § 1086 (West 1991 & Supp. 1995) (describing the statutory requirements to have standing for mandate). See generally 16 C.J.S. *Constitutional Law* § 64 (1984) (discussing persons entitled to raise constitutional questions); 7 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Constitutional Law* §§ 59-63 (9th ed. 1988 & Supp. 1995) (describing the policy that a person must be affected by an ordinance to have standing to challenge the constitutionality of that ordinance).

16. *Tobe*, 9 Cal. 4th at 1086-87, 892 P.2d at 1154, 40 Cal. Rptr. 2d at 411.

17. *Id.*; see also *U.S. v. Salerno*, 481 U.S. 739 (1987) (holding that a plaintiff facially challenging a statute must establish that the act would be invalid under any set of circumstances). See generally Michael C. Dorf, *Facial Challenges to State and Federal Statutes*, 46 STAN. L. REV. 235 (1994) (discussing how the facial challenge doctrine is generally restricted to cases where the government cannot apply the statute constitutionally to any set of circumstances).

18. *Tobe*, 9 Cal. 4th at 1092, 892 P.2d at 1157-58, 40 Cal. Rptr. 2d at 414-15.

19. *Id.* at 1090, 892 P.2d at 1156, 40 Cal. Rptr. 2d at 413 (citing CAL. PENAL CODE § 1004 (West 1985 & Supp. 1995)) (“expressly limit[ing] demurrers to defects appearing on the face of the accusatory pleading”); *Ratner v. Municipal Court*, 256 Cal. App. 2d 925, 929, 64 Cal. Rptr. 500, 503 (1967) (holding that a demurrer to a criminal proceeding can only raise issues of law); 4 B.E. WITKIN & NORMAN L. EPSTEIN, CALI-

nance was invalid as applied to their individual circumstances.<sup>20</sup> Rather, the plaintiffs were limited to demur to defects appearing on the face of the accusatory pleading.<sup>21</sup> After determining that both the Tobe and Zuckernick plaintiffs could only challenge the constitutionality of the ordinance on its face, the supreme court next focused upon the constitutional issues of the right to travel, cruel and unusual punishment, and vagueness and overbreadth.

## 2. Fundamental Right to Travel

The Zuckernick plaintiffs claimed that the Santa Ana ordinance violated the fundamental right to travel<sup>22</sup> because it prohibited camping on public property.<sup>23</sup> To address this claim, the court examined the principles surrounding the right to travel.<sup>24</sup> The court stated that California

FORNIA CRIMINAL LAW, *Proceedings Before Trial* § 2127 (2d ed. 1989 & Supp. 1995) (explaining scope and general applications of demurrers).

20. *Tobe*, 9 Cal. 4th at 1091-92, 892 P.2d at 1157, 40 Cal. Rptr. 2d at 414; *see also* *Dillon v. Municipal Court*, 4 Cal. 3d 860, 865, 484 P.2d 945, 948, 94 Cal. Rptr. 777, 780 (1971) (holding that a demurrer to an accusatory pleading constitutes only a facial attack on the ordinance, and therefore, does not allow the admission of evidence pertaining to the plaintiff's individual circumstances).

21. *Tobe*, 9 Cal. 4th at 1089-90, 892 P.2d at 1156, 40 Cal. Rptr. 2d at 413.

22. *Tobe*, 9 Cal. 4th at 1090-91, 892 P.2d at 1156-57, 40 Cal. Rptr. 2d at 413-14; *see* CAL. CONST. art. I, § 7 (describing the fundamental right to travel). *See generally* 13 CAL. JUR. 3D *Constitutional Law* § 238 (1989 & Supp. 1995) (explaining the benefits and restrictions of the right to travel); 7 B.E. WITKIN, *SUMMARY OF CALIFORNIA LAW, Constitutional Law* § 287 (9th ed. 1988 & Supp. 1995) (discussing the right to travel as a fundamental right); 16A C.J.S. *Constitutional Law* § 478 (1984) (stating that the right to travel is a basic right guaranteed by the Constitution).

23. *See generally* Paul Ades, *The Unconstitutionality of "Antihomeless" Law: Ordinances Prohibiting Sleeping in Outdoor Public Areas as a Violation of the Right to Travel*, 77 CAL. L. REV. 595 (1989) (discussing the constitutional issues raised by ordinances banning homeless in public areas); Christine L. Bella & David L. Lopez, *Quality of Life—at What Price?: Constitutional Challenges to Laws Adversely Impacting the Homeless*, 10 ST. JOHN'S J. LEGAL COMMENT 89 (1994) (discussing the constitutional challenges to a law disadvantaging the homeless); William M. Berg, Note, *Roulette v. City of Seattle: A City Lives With Its Homeless*, 18 SEATTLE U. L. REV. 147 (1994) (discussing the impact of homeless laws in a particular case); Harry Simon, *Towns without Pity: A Constitutional and Historical Analysis of Official Efforts to Drive Homeless Persons from American Cities*, 66 TUL. L. REV. 631 (1992) (discussing efforts by cities to punish homeless indigents).

24. *Tobe*, 9 Cal. 4th at 1096-1101, 892 P.2d at 1161-64, 40 Cal. Rptr. 2d at 418-21; *see also In re White*, 97 Cal. App. 3d 141, 148, 158 Cal. Rptr. 562, 567 (1979) (holding that both the United States and California Constitutions protect the right to intrastate travel).



broadly views the right to intrastate travel: violations of the right are only found when there has been a "direct restriction."<sup>25</sup> The court ultimately declared that the ordinance was nondiscriminatory, even though it may have an incidental impact on the right of some persons to intrastate travel.<sup>26</sup> The court further concluded that the facial challenges in both cases failed because there was simply no evidence that the ordinance's provisions would conflict with applicable constitutional provisions.<sup>27</sup> Not surprisingly, the court held that the ordinance did not violate the fundamental right to travel.<sup>28</sup>

### 3. Cruel and Unusual Punishment for Status

The court next turned to the issue of cruel and unusual punishment.<sup>29</sup> The plaintiffs in each case claimed that the ordinance was invalid because it punished the "involuntary status of being homeless."<sup>30</sup> The supreme court, however, reasoned that while the ordinance punishes conduct, it neither punishes status, nor convicts solely on the basis that a person has no fixed home.<sup>31</sup> Indeed, the supreme court went so far as to

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25. *Tobe*, 9 Cal. 4th at 1101, 892 P.2d at 1163, 40 Cal. Rptr. 2d at 420-21; *see also* *Joyce v. City and County of San Francisco*, 846 F. Supp. 843, 860-61 (N.D. 1994) (holding that a San Francisco law banning camping or lodging in public parks did not violate the right to travel, nor did it require the city to show a compelling state interest); *Adams v. Superior Court*, 12 Cal. 3d 55, 61-62, 524 P.2d 375, 379-80, 115 Cal. Rptr. 247, 251-52 (1974) (holding that the courts will not strictly scrutinize government action that burdens the right to travel).

26. *Tobe*, 9 Cal. 4th at 1101, 892 P.2d at 1164, 40 Cal. Rptr. 2d at 421; *see also* *People v. Scott*, 20 Cal. App. 4th 5, 13, 26 Cal. Rptr. 2d 179, 183 (1993) (holding that an ordinance does not directly impede on the right to travel when it bans camping and storing of personal possessions on public property).

27. *Tobe*, 9 Cal. 4th at 1102, 892 P.2d at 1164, 40 Cal. Rptr. 2d at 421; *see also* *Arcadia Unified School Dist. v. State Dep't of Educ.*, 2 Cal. 4th 251, 267, 825 P.2d 438, 449, 5 Cal. Rptr. 2d 545, 556 (1992) (discussing the conflict between provisions of an ordinance and the constitution).

28. *Tobe*, 9 Cal. 4th at 1102, 892 P.2d at 1164, 40 Cal. Rptr. 2d at 421.

29. *Id.* at 1104-06, 892 P.2d at 1166-67, 40 Cal. Rptr. 2d at 423-24; *see* CAL. CONST. art I, § 17 (West 1983 & Supp. 1995) (describing cruel and unusual punishment). *See generally* Sheldon R. Shapiro, Annotation, *Federal Constitutional Guaranty Against Cruel and Unusual Punishment—Supreme Court Cases*, 33 L.R.A. 2d 932 (1975) (explaining the federal constitutional guaranty against cruel and unusual punishment); 16 C.J.S. *Constitutional Law* § 24 (1984) (explaining how ambiguous words are construed in a constitution).

30. *Tobe*, 9 Cal. 4th at 1104, 892 P.2d at 1166, 40 Cal. Rptr. 2d at 423. The supreme court criticized the court of appeal because it "did not distinguish between involuntarily being homeless, and involuntarily engaging in conduct that violated the ordinance." *Id.* at 1104 n.19, 892 P.2d at 1166 n.19, 40 Cal. Rptr. 2d at 423 n.19.

31. *Id.* at 1104, 892 P.2d at 1166, 40 Cal. Rptr. 2d at 423 (citing *Joyce v. City and County of San Francisco*, 846 F. Supp. 857 (N.D. Cal. 1994) (noting that the United States Supreme Court has not prohibited as unconstitutional the punishment of "acts

question whether homelessness even qualifies as a "status."<sup>32</sup> Accordingly, the supreme court held that the ordinance was constitutionally valid because it did not punish persons for their indigent or homeless status.<sup>33</sup>

#### 4. Vagueness and Overbreadth

The final issue the supreme court addressed was whether the Santa Ana ordinance was vague or overbroad.<sup>34</sup> The court of appeal found the ordinance vague based on the "nonexclusive list of examples of camping paraphernalia and facilities" found in the ordinance.<sup>35</sup> The supreme court reversed, stating that rather than isolate the particular terms, courts should consider the terms in the context of the rest of the ordinance.<sup>36</sup> The court reasoned that the statute satisfied the two basic requirements of constitutionality,<sup>37</sup> and that when properly analyzed, the

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derivative of a person's status").

32. *Id.* at 1105, 892 P.2d at 1166, 40 Cal. Rptr. 2d at 423 (citing *Joyce v. City and County of San Francisco*, 846 F. Supp. 843, 857 (N.D. Cal. 1994)). While the court did not decide whether homelessness is a "status," it did provide factors to assist in the determination of "status." *Id.* These factors included the involuntariness of the acquisition of that quality, and the amount of control that the individual has over that characteristic. *Id.*

33. *Id.* at 1106, 892 P.2d at 1167, 40 Cal. Rptr. 2d at 424.

34. *Id.* at 1106-09, 892 P.2d at 1167-69, 40 Cal. Rptr. 2d at 424-26. See generally Romualdo P. Eclavea, *Supreme Court Application of Vagueness Doctrine to Noncriminal Statutes or Ordinances*, 40 L.R.A. 823 (1975); 13 CAL. JUR. 3D *Constitutional Law* § 64 (1989 & Supp. 1995) (explaining how courts deal with vague or overbroad statutes); 7 B.E. WITKIN, *SUMMARY OF CALIFORNIA LAW, Constitutional Law* § 292 (9th ed. 1988 & Supp. 1995) (analyzing the constitutional problems of vagueness and overbreadth); 16A AM. JUR. 2D *Constitutional Law* §§ 460-463 (1979 and Supp. 1995) (discussing the overbreadth doctrine).

35. *Tobe*, 9 Cal. 4th at 1106, 892 P.2d at 1167, 40 Cal. Rptr. 2d at 424. The ordinance states that "[i]t shall be unlawful for any person to store personal property, including camp facilities and camp paraphernalia . . . in . . . any . . . public area." SANTA ANA, CAL., ORDINANCE § 10-402 (1992).

36. *Tobe*, 9 Cal. 4th at 1107-08, 892 P.2d at 1167-68, 40 Cal. Rptr. 2d at 424-25. The supreme court further stated that the ordinance is clear "when the purpose clause of the ordinance is considered and the terms are read in that context as they should." *Id.* at 1107, 892 P.2d at 1167-68, 40 Cal. Rptr. 2d at 424-25. The court also suggested that the reasoning of the court of appeal was flawed because "no reasonable person would believe that a picnic in an area designated for picnics would constitute camping in violation of the ordinance." *Id.* at 1107, 892 P.2d at 1168, 40 Cal. Rptr. 2d at 425.

37. The two requirements for a statute to pass the vagueness doctrine are: "(1) [t]he statute must be sufficiently definite to provide adequate notice of the conduct proscribed; and (2) the statute must provide sufficiently definite guidelines for the

stated purpose of the ordinance was clear.<sup>38</sup> These facts, coupled with the theory that a legislative ordinance is presumptively valid,<sup>39</sup> led the court to hold that the Santa Ana ordinance was not vague.<sup>40</sup>

The court of appeal also found that the ordinance was overbroad<sup>41</sup> because it “could be applied to constitutionally protected conduct.”<sup>42</sup> The supreme court disagreed, however, reasoning that the ordinance neither violated the equal protection clause, nor impaired a fundamental constitutional right.<sup>43</sup> Relying upon precedent,<sup>44</sup> statutes, and constitutional provisions,<sup>45</sup> the court determined that the plaintiffs’ facial challenge failed because the plaintiffs did not identify a single right that would be restricted by the application of the ordinance.<sup>46</sup> Therefore, the court held that the ordinance was facially valid and not overbroad.<sup>47</sup>

### B. Justice Kennard’s Concurring Opinion

In a separate concurring opinion, Justice Kennard pointed out that by not considering the merits of an “as applied” challenge, the majority did not differentiate between involuntary homelessness and involuntary conduct that is illegal under the ordinance.<sup>48</sup> Justice Kennard suggested that this unresolved issue is likely to create confusion in future cases.<sup>49</sup> She

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police in order to prevent arbitrary and discriminatory enforcement.” *Id.* at 1106-07, 892 P.2d at 1167, 40 Cal. Rptr. 2d at 424 (citing *Williams v. Garcetti*, 5 Cal. 4th 561, 567, 853 P.2d 507, 509, 20 Cal. Rptr. 2d 341, 343 (1993)).

38. *Id.* at 1107, 892 P.2d at 1168, 40 Cal. Rptr. 2d at 425.

39. See generally 7 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Constitutional Law* § 58 (9th ed. 1988 & Supp. 1995) (discussing how legislative acts are presumed constitutional unless proven otherwise).

40. *Tobe*, 9 Cal. 4th at 1108, 892 P.2d at 1168, 40 Cal. Rptr. 2d at 425.

41. See generally Richard H. Fallon, Jr., *Making Sense of Overbreadth*, 100 YALE L. J. 853 (1991) (discussing the use and effect of the overbreadth doctrine).

42. *Tobe*, 9 Cal. 4th at 1106, 892 P.2d at 1167, 40 Cal. Rptr. 2d at 424. Agreeing with the plaintiffs, the court of appeal stated that the ordinance was “broader than necessary since it banned camping on all public property.” *Id.* at 1108, 892 P.2d at 1168, 40 Cal. Rptr. 2d at 425.

43. *Id.* at 1108-09, 892 P.2d at 1168-69, 40 Cal. Rptr. 2d at 425-26.

44. *Id.* at 1109, 892 P.2d at 1169, 40 Cal. Rptr. 2d at 426 (citing *San Francisco Street Artists Guild v. Scott*, 37 Cal. App. 3d 667, 674, 112 Cal. Rptr. 502, 507 (1974) (holding that a city has the duty and the power to keep its public areas open and available for the purposes to which they are dedicated)).

45. *Id.* (citing CAL. CONST. art. XI, § 7 (stating that a city has the power to adopt and enforce an ordinance that does not conflict with general laws)).

46. *Id.*

47. *Id.*

48. *Id.* at 1110, 892 P.2d at 1169, 40 Cal. Rptr. 2d at 426 (Kennard, J., concurring).

49. *Id.* at 1110, 892 P.2d at 1169-70, 40 Cal. Rptr. 2d at 426-27 (Kennard, J., concurring). Justice Kennard noted that the majority did not resolve “whether a person who by reason of necessity falls asleep in a public park may constitutionally be suc-

further hypothesized that two more issues would lead to confusion from the majority's failure to decide them now: whether homelessness is a "status" or a condition,<sup>50</sup> and whether there can be unlimited "punishing [of] conduct regardless of the circumstances."<sup>51</sup>

### C. Justice Werdegar's Concurring Opinion

In a separate concurring opinion, Justice Werdegar agreed that the court should treat the plaintiffs' constitutional challenges as purely facial challenges.<sup>52</sup> However, Justice Werdegar also argued that the majority should not have addressed the merits of an "as applied" attack.<sup>53</sup> In doing so, Justice Werdegar thought that the majority treated a very important matter cursorily, and did not adequately consider the plaintiffs' legal arguments or the authorities cited.<sup>54</sup>

### D. Justice Mosk's Dissenting Opinion

In a separate dissenting opinion, Justice Mosk stated that by only examining the ordinance on its face, the majority essentially "sidestep[ped] the pressing and difficult issues" encountered in an "as applied" challenge.<sup>55</sup> Justice Mosk began his dissent by attacking several primary points of the majority's argument. First, he asserted that the court should have treated the plaintiffs' cause of action as both an "as applied" challenge and a "facial" challenge.<sup>56</sup> Next, he suggested that contrary to the majority opinion, the plaintiffs in *Tobe* did have standing to challenge the ordinance.<sup>57</sup> Justice Mosk further argued that the ordinance violated the

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cessfully prosecuted." *Id.* at 1110, 892 P.2d at 1170, 40 Cal. Rptr. 2d at 427 (Kennard, J., concurring).

50. *Id.* (Kennard, J., concurring).

51. *Id.* (Kennard, J., concurring).

52. *Id.* at 1110-11, 892 P.2d at 1170, 40 Cal. Rptr. 2d at 427 (Werdegar, J., concurring).

53. *Id.* at 1111, 892 P.2d at 1170, 40 Cal. Rptr. 2d at 427 (Werdegar, J., concurring).

54. *Id.* (Werdegar, J., concurring).

55. *Id.* at 1111, 892 P.2d at 1170, 40 Cal. Rptr. 2d at 427 (Mosk, J., dissenting).

56. *Id.* at 1113-15, 892 P.2d at 1171-73, 40 Cal. Rptr. 2d at 428-30 (Mosk, J., dissenting).

57. *Id.* at 1116-19, 892 P.2d at 1173-76, 40 Cal. Rptr. 2d at 430-33 (Mosk, J., dissenting). "Plaintiffs include persons who have been cited under the ordinance and who, because they are homeless, are likely to be cited again. Thus they have a direct personal stake in the outcome of this action." *Id.* (Mosk, J., dissenting). *Id.* at 1116,

Equal Protection Clause<sup>58</sup> and the fundamental right to travel.<sup>59</sup> He maintained that the ordinance did not serve a legitimate governmental interest,<sup>60</sup> and concluded that the Santa Ana ordinance banning camping and storage of personal property in public areas was clearly unconstitutional.<sup>61</sup>

### III. IMPACT

Prior to *Tobe*, the supreme court had not extensively addressed the constitutionality of homeless ordinances. Yet the court's decision in *Tobe* may not offer much guidance, because it is limited to a strictly "facial" challenge due to its procedural history. Hence, while *Tobe* clarifies some aspects of existing law, it similarly leaves several questions unanswered; perhaps the most important is the distinction between involuntary homelessness and involuntary conduct that violates the ordinance.<sup>62</sup>

*Tobe* will likely provide an incentive for other cities in California to enact homeless ordinances because it is unlikely that the courts will hold them constitutionally invalid. Indeed, many of the communities surrounding Santa Ana have already enacted similar measures to protect themselves from an influx of Santa Ana's homeless.<sup>63</sup>

### IV. CONCLUSION

Certainly, the city of Santa Ana has a right to pass and enforce laws necessary for the protection and well being of the community. However, many argue that such ordinances serve more harm than good because they favor a temporary solution for what is in reality an increasingly serious, long term societal ill. Perhaps there is wisdom to be gained from Supreme Court Justice Cardozo, who propounded:

the Constitution was framed . . . upon the theory that the peoples of the several states must sink or swim together, and that in the long run prosperity and salvation are in union and not division . . . [I]n not inconsiderable measure the relief of

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892 P.2d at 1173, 40 Cal. Rptr. 2d at 430.

58. *Id.* at 1119-25, 892 P.2d at 1176-80, 40 Cal. Rptr. 2d at 433-37 (Mosk, J., dissenting).

59. *Id.* at 1125-32, 892 P.2d at 1180-84, 40 Cal. Rptr. 2d at 437-41 (Mosk, J., dissenting).

60. *Id.* at 1129-32, 892 P.2d at 1182-84, 40 Cal. Rptr. 2d at 439-41 (Mosk, J., dissenting).

61. *Id.* at 1132, 892 P.2d at 1184, 40 Cal. Rptr. 2d at 441 (Mosk, J., dissenting).

62. *Id.* at 1110, 892 P.2d at 1169-70, 40 Cal. Rptr. 2d at 426-27 (Kennard, J., concurring).

63. *Id.* at 1128, 892 P.2d at 1182, 40 Cal. Rptr. 2d at 439 (Mosk, J., dissenting).

the needy has become the common responsibility and concern of the whole nation.<sup>64</sup>

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64. *Id.* at 1128-29, 892 P.2d at 1182, 40 Cal. Rptr. at 439 (Mosk, J., dissenting) (quoting *Edwards v. State of California*, 314 U.S. 160, 173-74 (1941)).

## IV. CRIMINAL LAW

- A. *The attorney-client privilege does not bar an attorney from revealing disclosures made subsequent to the attorney's refusal to represent an individual when the disclosures were not made to the attorney in his professional capacity; and, the prosecutor's closing argument remarks about attorneys and the legal profession did not amount to prosecutorial misconduct: People v. Gionis.*

### I. INTRODUCTION

In *People v. Gionis*,<sup>1</sup> the California Supreme Court considered whether statements made to an attorney after the attorney unequivocally refused to act as counsel for the defendant<sup>2</sup> were protected by the attorney-client privilege.<sup>3</sup> The *Gionis* court reversed the court of appeal and af-

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1. 9 Cal. 4th 1196, 892 P.2d 1199, 40 Cal. Rptr. 2d 456 (1995). Justice Baxter delivered the majority opinion, in which Chief Justice Lucas and Justices Arabian, George, and Werdegar concurred. *Id.* at 1196-1221, 892 P.2d at 1199-1214, 40 Cal. Rptr. 2d 456-71. Justice Kennard wrote a concurring and a dissenting opinion. *Id.* at 1221-29, 892 P.2d at 1214-19, 40 Cal. Rptr. 2d 471-76 (Kennard J., concurring and dissenting). Justice Mosk authored a separate dissenting opinion. *Id.* at 1229-35, 892 P.2d at 1219-24, 40 Cal. Rptr. 2d 476-81 (Mosk J., dissenting).

2. *Id.* at 1206, 892 P.2d at 1204, 40 Cal. Rptr. 2d at 461. In May or June of 1987, the defendant called Lueck, an attorney, and asked him to come to his home because he had just been served with divorce papers and was upset. *Id.* at 1203, 892 P.2d at 1202, 40 Cal. Rptr. 2d at 459. Lueck informed the defendant that he did not want to become involved in the dispute since he knew both the defendant and his wife, Wayne. *Id.* Although the defendant persuaded Lueck to come to his home, Lueck made it clear that he did not want to be involved as a lawyer in the dissolution dispute. *Id.* Defendant showed Lueck the divorce papers and asked if a change of venue would be appropriate. *Id.* Lueck indicated that it might be and informed defendant to consult counsel. *Id.* The defendant, upset and angered, commented to Lueck that he was capable of hurting Wayne. *Id.* at 1203-04, 892 P.2d at 1202, 40 Cal. Rptr. 2d at 459. The following year, Wayne and her boyfriend were beaten and defendant was arrested. *Id.* at 1204-05, 892 P.2d at 1203, 40 Cal. Rptr. 2d at 460. During defendant's trial, Lueck testified that defendant made the following statements to him during the May or June conversation: "the altercation which resulted in the holes in the wall were nothing relative to what he [defendant] was capable of doing"; that defendant could "pay somebody to really take care of her"; that "defendant was too smart to do something like that [to Wayne] at a time when it would be obvious that it was his responsibility"; and "if he [defendant] were to do something [to Wayne], he would wait until an opportune time . . . so that suspicion wouldn't be directed towards him." *Id.* at 1206, 892 P.2d at 1204, 40 Cal. Rptr. 2d at 461 (internal quotation marks omitted).

3. The attorney-client privilege is a statutory privilege, created by California Evidence Code § 954. CAL. EVID. CODE § 954 (West 1995).

firmed the trial court's determination, holding that the attorney-client privilege was not applicable because the attorney's refusal to represent the defendant terminated any type of attorney-client relationship.<sup>4</sup>

The *Gionis* court also considered whether the prosecutor's comments during his closing argument rebuttal<sup>5</sup> constituted prosecutorial misconduct.<sup>6</sup> In reversing the court of appeal, the supreme court held that the defense counsel's failure to object to the statements resulted in a waiver of the right to appeal.<sup>7</sup> The court further held that, even on the merits, the prosecution's comments did not reach the level of "deceptive or reprehensible" methods of persuasion.<sup>8</sup>

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4. *Gionis*, 9 Cal. 4th at 1212-13, 892 P.2d at 1208-09, 40 Cal. Rptr. 2d at 465-66. The court noted that the crime-fraud exception was inapplicable. *Id.* at 1208 n.4, 892 P.2d at 1205 n.4, 40 Cal. Rptr. 2d at 462 n.4. For a discussion of this exception, see Ross G. Greenberg et al., *Attorney-Client Privilege*, 30 AM. CRIM. L. REV. 1011, 1019-21 (1993).

5. During the closing arguments, the prosecuting attorney stated that defense counsel "was arguing out of both sides of his mouth." *Gionis*, 9 Cal. 4th at 1216, 892 P.2d at 1210, 40 Cal. Rptr. 2d at 467. He also recited five quotes about lawyers: (1) "Lawyers and painters can soon change white to black." (2) "If there were no bad people there would be no good lawyers." (3) "There is no better way of exercising the imagination than the study of law. No poet ever interpreted nature as freely as a lawyer interprets truth." (4) "You're an attorney. It's your duty to lie, conceal and distort everything and slander everybody." (5) "In law, what plea so tainted and corrupt but being seasoned with a gracious voice, obscures the show of evil." *Id.* at 1216, 892 P.2d at 1210-11, 40 Cal. Rptr. 2d at 467-68 (internal quotation marks omitted). The defense counsel failed to object to all but the fourth quote. *Id.* at 1216, 892 P.2d at 1211, 40 Cal. Rptr. 2d at 468.

6. *Id.* at 1214-20, 892 P.2d at 1210-14, 40 Cal. Rptr. 2d 467-71. See generally 5 B.E. WITKIN & NORMAN L. EPSTEIN, CALIFORNIA CRIMINAL LAW, *Trial* § 2914 (2d ed. 1989) (describing prejudicial remarks about counsel as misconduct); Michael T. Fisher, *Harmless Error, Prosecutorial Misconduct, and Due Process: There's More to Due Process than the Bottom Line*, 88 COLUM. L. REV. 1298 (1988) (discussing misconduct as due process violations); Alexander K. Sudnik, Project, *Prosecutorial Misconduct Twenty-Fourth Annual Review of Criminal Procedure: United States Supreme Court and Courts of Appeals: 1993-1994*, 83 GEO. L.J. 1162 (1995) (updating a continuing look at prosecutorial misconduct).

7. *Gionis*, 9 Cal. 4th at 1215, 892 P.2d at 1210, 40 Cal. Rptr. 2d at 467.

8. *Id.* at 1218-19, 892 P.2d at 1212, 40 Cal. Rptr. 2d at 469.



## II. TREATMENT

### A. *Majority Opinion*

#### 1. Attorney Client Privilege

The court began its analysis of the attorney-client privilege by delineating the scope of the statutorily created privilege.<sup>9</sup> The court noted that "client," for purposes of the attorney-client privilege under California Evidence Code sections 951 and 954,<sup>10</sup> included an individual who consulted an attorney in order to make communications with the attorney in his or her "professional capacity."<sup>11</sup> Confronting the scarcity of California case law directly on point, the court acknowledged that other jurisdictions are uniform in holding that communications made subsequent to an attorney's explicit refusal of representation are not protected by the attorney-client privilege.<sup>12</sup> Although the court refused to adopt such a bright-line rule, the court did state that an explicit refusal to undertake representation by an attorney "may give rise to a reasonable inference" that subsequent communications with the attorney are not made to the attorney in his or her capacity as a professional.<sup>13</sup> In applying the facts from the record, the court reasoned that Lueck's repeated refusals to act as counsel for defendant during defendant's divorce dispute gave "rise to the reasonable inference that defendant sought to speak with Lueck in his capacity as a friend, not as an attorney."<sup>14</sup> Thus, the court concluded

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9. *Id.* at 1206-08, 892 P.2d at 1204-05, 40 Cal. Rptr. 2d at 461-62.

10. CAL. EVID. CODE §§ 951, 954 (West 1995).

11. *Gionis*, 9 Cal. 4th at 1207, 892 P.2d at 1204, 40 Cal. Rptr. 2d at 461. The court further noted that communications do not have to result in the retention of the attorney for the privilege to be applicable. *Id.* at 1208, 892 P.2d at 1205, 40 Cal. Rptr. 2d at 462; *see also* *People v. Canfield*, 12 Cal. 3d 699, 705, 527 P.2d 633, 636-37, 117 Cal. Rptr. 81, 84-85 (1974) (stating that the privilege exists even prior to the retention of the attorney). *See generally* 31 CAL. JUR. 3D *Evidence* § 435 (1976 & Supp. 1995) (explaining when a relationship exists and thus making the privilege applicable); 2 B.E. WITKIN, CALIFORNIA EVIDENCE § 803 (3d ed. 1986 & Supp. 1995) (detailing the privilege as it applies to consultations); 97 C.J.S. *Witnesses* §§ 277-278 (1957 & Supp. 1995) (illustrating how privilege might apply to communications made to unretained attorney). For a discussion of the problems attorneys face when they assume more than one professional role, *see* Scott R. Flucke, *The Attorney-Client Privilege in the Corporate Setting: Counsel's Dual Role as Attorney and Executive*, 62 UMKC L. REV. 549 (1994).

12. *Gionis*, 9 Cal. 4th at 1211, 892 P.2d at 1207, 40 Cal. Rptr. 2d at 464.

13. *Id.* at 1211, 892 P.2d at 1207-08, 40 Cal. Rptr. 2d at 464-65. *See generally* 97 C.J.S. *Witnesses* § 277 (1957 & Supp. 1995) (indicating that to be privileged, communications must be made to an attorney as such).

14. *Gionis*, 9 Cal. 4th at 1212, 892 P.2d at 1208, 40 Cal. Rptr. 2d at 465.

that, absent the attorney-client relationship, no privilege existed to protect defendant's subsequent statements to Lueck.<sup>15</sup>

## 2. Prosecutorial Misconduct

The court resolved the prosecutorial misconduct claim by concluding that the issue was not properly preserved for appeal.<sup>16</sup> The court noted that in order to be reviewable, the claim of impropriety must be made during the trial.<sup>17</sup> Since the defendant failed to object to the prosecutor's statements during the course of the trial, the court held that the defendant waived his right to appeal.<sup>18</sup>

Nevertheless, the court went on to state that the claim of impropriety, absent the waiver, would still be rejected on its merits.<sup>19</sup> In reviewing the merits of the prosecutorial misconduct claim, the court began its analysis by stating that misconduct involves the "use of deceptive or reprehensible methods" of persuasion.<sup>20</sup> The court examined the comments in question<sup>21</sup> and concluded that they did not amount to "deceptive or reprehensible" methods of persuasion and thus, did not constitute prosecutorial misconduct.<sup>22</sup>

### B. Justice Kennard's Concurring and Dissenting Opinion

In Justice Kennard's separate opinion, she concurred in the judgment but disagreed with the majority's analysis.<sup>23</sup> Justice Kennard first took

15. *Id.*

16. *Id.* at 1215, 892 P.2d at 1210, 40 Cal. Rptr. 2d at 467. The court noted that the one objection was made against the fourth quotation: "You're an attorney. It's your duty to lie." The court found that the objection was properly sustained; however, the court found that the admonition to the jury was sufficient to eliminate any prejudice to the defendant. *Id.* at 1216, 892 P.2d at 1211, 40 Cal. Rptr. 2d at 468.

17. *Id.* at 1215, 892 P.2d at 1210, 40 Cal. Rptr. 2d at 467.

18. *Id.*

19. *Id.*

20. *Id.* The court also noted that the questioning of "the integrity of opposing counsel" constituted misconduct. *Id.* (citing *People v. Espinoza*, 3 Cal. 4th 806, 820, 838 P.2d 204, 211, 12 Cal. Rptr. 2d 682, 689 (1992), *cert. denied*, 114 S. Ct. 2780 (1994)); *see also* *People v. Perry*, 7 Cal. 3d 756, 789-91, 499 P.2d 129, 150-51, 103 Cal. Rptr. 161, 182-83 (1972) (expanding prosecutorial misconduct to include attacks on opposing counsel).

21. *Gionis*, 9 Cal. 4th at 1215-21, 892 P.2d at 1210-14, 40 Cal. Rptr. 2d at 467-71.

22. *Id.*

23. *Id.* at 1221-29, 892 P.2d at 1214-19, 40 Cal. Rptr. 2d at 471-76 (Kennard, J., concurring and dissenting).

issue with whether, under the attorney-client privilege, certain portions of the defendant's conversation were made to Lueck in his capacity as an attorney.<sup>24</sup> Justice Kennard questioned the majority's treatment of the scope of the phrase "professional capacity."<sup>25</sup> Arguing that Lueck was acting in his "professional capacity" as an attorney when he informed the defendant that a change in venue may be appropriate, Justice Kennard reasoned that the privilege should have been applicable to the venue conversation.<sup>26</sup> She noted that, although privileged, the disclosure of the change of venue conversation was harmless error.<sup>27</sup>

In stating that "[a] trial should not be a duel between attorneys, but a search for truth," Justice Kennard expressed her disagreement with the majority's finding that the prosecutor did not engage in misconduct.<sup>28</sup> Although Justice Kennard agreed the defendant waived his right to appeal by not objecting to the prosecutor's comments during the trial,<sup>29</sup> she rejected the notion that the prosecutor's comments did not put the integrity of defense counsel into question.<sup>30</sup> In disagreeing with the majority about the comments' implications, Justice Kennard concluded that the comments did reach the level of impropriety and, therefore, constituted misconduct.<sup>31</sup>

### C. Justice Mosk's Dissenting Opinion

In his dissenting opinion, Justice Mosk disagreed with the majority as well as Justice Kennard and argued that the attorney-client privilege should have protected the defendant's statements from being disclosed by Lueck.<sup>32</sup> Justice Mosk focused his attention on the second prong of

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24. *Id.* at 1221-23, 892 P.2d at 1214-15, 40 Cal. Rptr. 2d at 471-72 (Kennard, J., concurring and dissenting).

25. *Id.* at 1223-24, 892 P.2d at 1216, 40 Cal. Rptr. 2d at 473 (Kennard, J., concurring and dissenting). *See generally* 31 CAL JUR 3D *Evidence* §§ 435-436 (1976 & Supp. 1995) (explaining that to be privileged, the communication must be made to attorney in his or her capacity as an attorney).

26. *Gionis*, 9 Cal. 4th at 1224, 892 P.2d at 1216, 40 Cal. Rptr. 2d at 473 (Kennard, J., concurring and dissenting).

27. *Id.* at 1225, 892 P.2d at 1217, 40 Cal. Rptr. 2d at 474 (Kennard, J., concurring and dissenting).

28. *Id.* at 1227-28, 892 P.2d at 1219, 40 Cal. Rptr. 2d at 476 (Kennard, J., concurring and dissenting). *See generally* Sudnik, *supra* note 6 (reviewing claims of prosecutorial misconduct).

29. *Gionis*, 9 Cal. 4th at 1226, 892 P.2d at 1217, 40 Cal. Rptr. 2d at 474 (Kennard, J., concurring and dissenting).

30. *Id.* at 1226-27, 892 P.2d at 1218, 40 Cal. Rptr. 2d at 475 (Kennard, J., concurring and dissenting).

31. *Id.* at 1228, 892 P.2d at 1219, 40 Cal. Rptr. 2d at 476 (Kennard, J., concurring and dissenting).

32. *Id.* at 1229-35, 892 P.2d at 1219-24, 40 Cal. Rptr. 2d at 476-81 (Mosk, J., dis-

the Evidence Code's definition of client:<sup>33</sup> "one who consults a lawyer . . . for the purpose of securing legal service and advice in the lawyer's professional capacity."<sup>34</sup> Justice Mosk stressed that an individual can still seek legal advice from an attorney in his capacity as a professional even though the attorney refuses to represent the individual.<sup>35</sup> Justice Mosk explained that the defendant, in showing and discussing the divorce papers with Lueck, sought legal advice even though Lueck refused to be retained as defendant's counsel.<sup>36</sup> Thus, since the defendant sought legal advice from Lueck in his capacity as a lawyer, regardless of Lueck's refusal to represent the defendant, Justice Mosk concluded that an attorney-client relationship existed and should have made the defendant's communications inadmissible privileged information.<sup>37</sup>

On the issue of misconduct, Justice Mosk agreed with Justice Kennard that the prosecutor's comments disparaging defense counsel and the legal profession constituted misconduct.<sup>38</sup> He also agreed with Justice Kennard and the majority that the defendant's failure to object during the trial led to a waiver of his claim on appeal.<sup>39</sup>

### III. IMPACT AND CONCLUSION

In *Gionis*, the California Supreme Court held that the defendant's communications made to his attorney were not the product of an attorney-client relationship because the evidence tended to show that the communications were made subsequent to the attorney's refusal to act as counsel.<sup>40</sup> Although the court declined to adopt a bright-line rule making the attorney-client privilege inapplicable to all such situations,<sup>41</sup> the court did state that an unequivocal refusal by an attorney may "give rise

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33. See CAL. EVID. CODE § 951 (West 1995).

34. *Gionis*, 9 Cal. 4th at 1229-30, 892 P.2d at 1220, 40 Cal. Rptr. 2d at 477 (Mosk, J., dissenting).

35. *Id.* at 1230, 892 P.2d at 1220, 40 Cal. Rptr. 2d at 477 (Mosk, J., dissenting). See generally 2 B.E. WITKIN, CALIFORNIA EVIDENCE § 1117 (3d ed. 1986 & Supp. 1995) (asserting that privilege applies to advice given by an attorney).

36. *Gionis*, 9 Cal. 4th at 1230-31, 892 P.2d at 1220-21, 40 Cal. Rptr. 2d at 477-78 (Mosk, J., dissenting).

37. *Id.* at 1234, 892 P.2d at 1224, 40 Cal. Rptr. 2d at 481 (Mosk, J., dissenting).

38. *Id.* at 1229, 892 P.2d at 1219, 40 Cal. Rptr. 2d at 476 (Mosk, J., dissenting).

39. *Id.* at 1229, 892 P.2d at 1219-20, 40 Cal. Rptr. 2d at 476-77 (Mosk, J., dissenting); see also *supra* note 28 and accompanying text.

40. *Gionis*, 9 Cal. 4th at 1212, 892 P.2d at 1208, 40 Cal. Rptr. 2d at 465.

41. *Id.* at 1211, 892 P.2d at 1207-08, 40 Cal. Rptr. 2d at 464-65.

to a reasonable inference" that no relationship exists.<sup>42</sup> In no prior case has a California court ever addressed the applicability of the privilege subsequent to an attorney's unequivocal refusal to represent a potential client.<sup>43</sup> The California Supreme Court has, however, afforded attorney-client privilege protection to communications made to an attorney prior to the attorney assuming the role of counsel.<sup>44</sup> In following the lead of other states,<sup>45</sup> California may well be on its way to limiting the privilege to cases where an attorney has been retained or to cases where an attorney engages in preliminary consultations with a prospective client. Instead of directly analyzing whether the communication involved the lawyer in his or her capacity as an attorney, which the court has done in the past, the *Gionis* court suggests that an analysis of the attorney-client relationship should be the initial deciding factor.<sup>46</sup>

On the issue of prosecutorial misconduct, the court merely followed precedent in the application of the facts to the present law, finding that no impropriety existed.<sup>47</sup> Although setting no new ground on this issue, the court clarified, through example, what types of remarks made about opposing counsel and the legal profession would be tolerated in California courtrooms.<sup>48</sup> Although the court expressed its disfavor about certain disparaging remarks,<sup>49</sup> the court seemed to give the quick-tongued sufficient room to keep the opposition on their toes.

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42. *Id.* at 1211, 892 P.2d at 1208, 40 Cal. Rptr. 2d at 465.

43. *Id.* at 1211, 892 P.2d at 1207, 40 Cal. Rptr. 2d at 464.

44. *People v. Canfield*, 12 Cal. 3d 699, 705, 527 P.2d 633, 636-37, 117 Cal. Rptr. 81, 84-85 (1974).

45. *Gionis*, 9 Cal. 4th at 1211, 892 P.2d at 1207, 40 Cal. Rptr. 2d at 464.

46. *Id.* at 1212, 892 P.2d at 1208, 40 Cal. Rptr. 2d at 465.

47. *Id.* at 1220-21, 892 P.2d at 1214, 40 Cal. Rptr. 2d at 471.

48. *Id.* at 1214-21, 892 P.2d at 1210-14, 40 Cal. Rptr. 2d at 467-71. The court listed the questionable comments made by the prosecutor, analyzed each one, and determined that they did not equate to misconduct. *Id.*

49. *Id.* at 1218, 892 P.2d at 1212, 40 Cal. Rptr. 2d at 469.

- B. *The Leon exception to the exclusionary rule does not apply to seizures made under a warrant issued on the basis of illegally obtained evidence during an antecedent warrantless entry: People v. Machupa.*

## I. INTRODUCTION

In *People v. Machupa*,<sup>1</sup> the California Supreme Court considered whether the good faith exception to the exclusionary rule, set forth in *United States v. Leon*,<sup>2</sup> allows the subsequent issuance of a warrant to cure the taint of evidence seized during warrantless and nonconsensual searches.<sup>3</sup> Applying the reasoning of *Leon*, the court found that an exception could not exist in the instant case.<sup>4</sup> The court concluded that *Leon's* good faith exception does not apply to cases in which the police use the fruit of an otherwise illegal search to obtain a subsequent search warrant.<sup>5</sup>

## II. STATEMENT OF THE CASE

On October 22, 1990, Deputy Frank Battles and Sergeant Dale Morrison of the Contra Costa County Sheriff's Office investigated a reported shooting.<sup>6</sup> In the course of the investigation, the officers recovered two .32-caliber shell casings.<sup>7</sup> When asked by the officers whether he owned any weapons, the defendant replied that he did, but that they were not .32-

1. 7 Cal. 4th 614, 872 P.2d 114, 29 Cal. Rptr. 2d 775 (1994). Justice Arabian drafted the opinion in which Chief Justice Lucas and Justices Baxter, George, Kennard, Mosk, and Turner concurred. *Id.* Justice Turner, presiding justice of the Court of Appeal, Second District, Division Five, sat on assignment by the Acting Chairperson of the Judicial Council. *Id.* at 633 n.\*, 872 P.2d at 125 n.\*, 29 Cal. Rptr. 2d at 786 n.\*.

2. 468 U.S. 897 (1984). For a further discussion of *Leon* and the ramifications of the good faith exception it announced, see Donald Dripps, *Living with Leon*, 95 YALE L.J. 906 (1986).

3. *Machupa*, 7 Cal. 4th at 616-17, 872 P.2d at 114, 29 Cal. Rptr. 2d at 775. The right to be free from unreasonable search and seizure is secured by the Fifth Amendment. U.S. CONST. amend. IV. See generally 4 B.E. WITKIN & NORMAN L. EPSTEIN, CALIFORNIA CRIMINAL LAW, *Exclusion of Illegally Obtained Evidence* §§ 2230-2474 (2d ed 1989 & Supp. 1995); 21 CAL. JUR. 3D *Criminal Law* § 3180 (3d ed. 1985 & Supp. 1995).

4. *Machupa*, 7 Cal. 4th at 627-28, 872 P.2d at 122, 29 Cal. Rptr. 2d at 783.

5. *Id.* at 632, 872 P.2d at 124-25, 29 Cal. Rptr. 2d at 785-86.

6. *Id.* at 617, 872 P.2d at 115, 29 Cal. Rptr. 2d at 776.

7. *Id.* at 617-18, 872 P.2d at 115, 29 Cal. Rptr. 2d at 776.

caliber.<sup>8</sup> According to Sergeant Morrison, the officers asked to see the guns and “explained to the defendant that’ [they] wished to accompany him into the residence while he picked up the gun for [their] own safety.”<sup>9</sup> Deputy Battles asserted that the defendant responded, “I guess,” and allowed the officers to follow him into the house.<sup>10</sup>

Upon entering the house, the deputies noticed a plastic bag of marijuana.<sup>11</sup> A further search of the house revealed a considerable quantity of drugs.<sup>12</sup> They arrested the defendant, and acquired a warrant on the basis of the evidence recovered in the initial search.<sup>13</sup> A later search recovered more drugs, and the defendant was charged with possession of marijuana for sale and possession of cocaine while armed with a firearm.<sup>14</sup>

The defendant was convicted, but the court of appeal reversed the conviction.<sup>15</sup> The California Supreme Court granted review.<sup>16</sup>

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8. *Id.* at 618, 872 P.2d at 115, 29 Cal. Rptr. 2d at 776.

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.* at 618-19, 872 P.2d at 115-16, 29 Cal. Rptr. 2d at 776-77. The court included a summary of the officer's affidavit.

Morrison said he was *invited* into [defendant's] residence along with Battles as [defendant] agreed to retrieve his two guns. After describing seeing the baggie of marijuana in plain view in defendant's bedroom and a greater quantity in the study, Hansen's affidavit provided a more detailed account of the circumstances leading up to the entry into the house, including the following: "In the course of questioning [defendant,] Battles asked 'Do you have any weapons.[]' When [defendant] replied 'Yes, two,' Battles asked, 'May we see them.' [Defendant] replied, 'I'll get them.' Battles then said to [defendant] that he and Morrison *would have to go with him*. Battles said he and Morrison followed [defendant] into the house without any protest from [defendant].

*Id.* (alterations in original). However, the defendant's testimony at the preliminary hearing contradicted the officer's statement. The defendant stated, "I did not invite the deputies into my home. Neither deputy asked if they could come in my home. I never gave the deputies permission to enter my home." *Id.* at 619, 872 P.2d at 116, 29 Cal. Rptr. 2d at 777.

14. *Id.*

15. *Id.* at 620-21, 872 P.2d at 116-17, 29 Cal. Rptr. 2d at 777-78. In arriving at its decision, the court of appeal focused on whether the investigating officers could have had a good faith belief that the warrant was valid despite the absence of consent or exigent circumstances. *Id.* However, the supreme court chose to evaluate the validity of the court of appeal's underlying assumption "that the exception to the exclusionary rule formulated in *Leon* applies to seizures . . . made under a warrant issued on the basis of the observation of contraband in the course of an antecedent *warrantless entry*." *Id.* at 621, 872 P.2d at 117, 29 Cal. Rptr. 2d at 778.

16. *Id.* at 621, 872 P.2d at 117, 29 Cal. Rptr. 2d at 778.

## III. TREATMENT

Justice Arabian began by noting the court of appeal's reliance on the California Supreme Court's opinion in *People v. Camarella*.<sup>17</sup> Justice Arabian observed that *Camarella* involved "the circumstances under which one of the . . . exceptions to the *Leon* exception itself . . . applied to a search conducted *pursuant to a warrant* that was regular on its face."<sup>18</sup> Thus, the court declined to apply the reasoning of *Camarella* to *Machupa*, because *Machupa* concerned a search *antecedent* to a warrant.<sup>19</sup>

The court then focused on the rationale behind the Supreme Court's decision in *Leon*.<sup>20</sup> The court reasoned that the *Leon* good faith exception was dependent on the understanding that "the 'exclusionary rule [was] designed to deter *police* misconduct rather than to punish the errors of judges and magistrates."<sup>21</sup> The court further commented that it was highly unlikely that the Supreme Court intended the *Leon* exception to swallow the rule prohibiting the use of illegally acquired evidence.<sup>22</sup>

The court acknowledged that in numerous instances the courts of appeal had "rejected claims that the good faith exception validates searches and seizures under a warrant on the basis of an antecedent warrantless search."<sup>23</sup> Justice Arabian further noted that the decisions of

17. 54 Cal. 3d 592, 818 P.2d 63, 286 Cal. Rptr. 780 (1991) (cited in *Machupa*, 7 Cal. 4th at 621, 872 P.2d at 117, 29 Cal. Rptr. 2d at 778).

18. *Machupa*, 7 Cal. 4th at 621, 872 P.2d at 117, 29 Cal. Rptr. 2d at 778.

19. *Id.* at 621-22, 872 P.2d at 117, 29 Cal. Rptr. 2d at 778.

20. *Id.* at 622-23, 872 P.2d at 117-18, 29 Cal. Rptr. 2d at 778-79.

21. *Id.* at 623, 872 P.2d at 117-18, 29 Cal. Rptr. 2d at 779 (quoting *United States v. Leon*, 468 U.S. 897, 916 (1984) (emphasis in original)). "[W]hen an officer acting with objective good faith has obtained a search warrant from a judge or magistrate and acted within its scope . . . there is no police illegality and thus nothing to deter." *Id.* at 623, 872 P.2d at 118, 29 Cal. Rptr. 2d at 779 (quoting *Leon*, 468 U.S. at 920-21).

22. *Id.* at 622, 872 P.2d at 118, 29 Cal. Rptr. 2d at 779; *see also* *Wong Sun v. United States*, 371 U.S. 471, 488 (1963) (explaining the "fruit of the poisonous tree" doctrine); *Mapp v. Ohio*, 367 U.S. 643 (1961) (imposing the exclusionary rule on states).

23. *Machupa*, 7 Cal. 4th at 623-25, 872 P.2d at 119-20, 29 Cal. Rptr. 2d at 780-81; *see* *People v. Ingham*, 6 Cal. Rptr. 2d 756 (Cal. Ct. App. 1992) (declining to apply good faith exception where search warrant was based on illegally seized evidence); *People v. Ivey*, 279 Cal. Rptr. 554 (Cal. Ct. App. 1991) (declining to apply good faith exception where evidence was seized during arrest on the basis of a warrant recalled because police department erred in transmission of information); *People v. Brown*, 260 Cal. Rptr. 293 (Cal. Ct. App. 1989) (declining to apply good faith exception where evidence forming basis of warrant was obtained during illegal search); *People*



the courts of appeal “parallel[ed], and in several instances explicitly rel[ie]d on,”<sup>24</sup> the reasoning expressed by the Ninth Circuit Court of Appeals in *United States v. Vasey*.<sup>25</sup>

In *Vasey*, the Ninth Circuit found that it was the officer, and not the presiding magistrate, who had committed a constitutional error by exceeding the scope of a vehicle search.<sup>26</sup> The *Vasey* court ultimately held that a “magistrate’s consideration does not protect from exclusion evidence seized during a search under a warrant if that warrant was based on evidence seized in an unconstitutional search.”<sup>27</sup>

Ultimately, the California Supreme Court adopted the reasoning of the courts of appeal and the *Vasey* court and “declin[ed] to validate warrantless searches on the basis of the post hoc issuance of a warrant.”<sup>28</sup>

#### IV. CONCLUSION

The California Supreme Court declined to extend the good faith exception to the exclusionary rule in situations where illegally acquired evidence forms the basis for the subsequent warrant.<sup>29</sup> By adopting this more restrictive view, California is now in accord with the United States Ninth Circuit Court Appeals and other state supreme courts.

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v. Leichty, 252 Cal. Rptr. 669 (Cal. Ct. App. 1988) (declining to apply good faith exception as application of the exclusionary rule would deter illegal police behavior), *cert denied*, 490 U.S. 1095 (1989). For a discussion of the application of the *Leon* exception in other state courts, see Leigh A. Morrissey, *State Courts Reject Leon on State Constitutional Grounds: A Defense of Reactive Rulings*, 47 VAND. L. REV. 917 (1994).

24. *Machupa*, 7 Cal. 4th at 625, 872 P.2d at 120, 29 Cal. Rptr. 2d at 781.

25. 834 F.2d 782 (9th Cir. 1987). In *Vasey*, officers conducted a warrantless search of a car, followed by a warranted search. *Id.* at 784. However, the officers lied to obtain the warrant. *Id.* The latter search found three kilos of cocaine. *Id.* at 785.

26. *Id.* at 789.

27. *Id.* In *Machupa*, Justice Arabian observed that the Ninth Circuit is in accord with the First, Sixth, and Tenth Circuits. *Machupa*, 7 Cal. 4th at 627, 872 P.2d at 121, 29 Cal. Rptr. 2d at 782; see *United States v. Scales*, 903 F.2d 765, 768 (10th Cir. 1990) (finding *Leon* rationale does not apply when constitutional error is not a function of the police officer's good faith reliance on warrant); *United States v. Curzi*, 867 F.2d 36, 44 (1st Cir. 1989) (refusing to recognize a good faith exception where searches are conducted without a warrant); *United States v. Morgan*, 743 F.2d 1158, 1165 (6th Cir. 1984) (holding that *Leon* is applicable where officers conduct a warrantless search), *cert. denied*, 471 U.S. 1061 (1985).

28. *Machupa*, 7 Cal. 4th at 625-28, 872 P.2d at 119-22, 29 Cal. Rptr. 2d at 780-83.

29. *Id.* at 632, 872 P.2d at 124-25, 29 Cal. Rptr. 2d at 785-86.

## V. FAMILY LAW

*Benefits from a term disability insurance policy received after separation are classified as separate property when the policy is renewed after separation with no intent to provide community retirement income: In re Marriage of Elfmont.*

## I. INTRODUCTION

In *In re Marriage of Elfmont*,<sup>1</sup> the California Supreme Court considered whether property received in the form of disability benefits after separation constitutes separate or community property when the policy is initiated with community funds during marriage, then renewed with individual funds post-separation.<sup>2</sup> The court contemplated both the time frame and the intent of the parties in determining the status of the dis-

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1. 9 Cal. 4th 1026, 891 P.2d 136, 39 Cal. Rptr. 2d 590 (1995). Justice Werdegar delivered the majority opinion in which Chief Justice Lucas and Justices Mosk, Arabian, and Baxter concurred. *Id.* at 1028-35, 891 P.2d at 138-43, 39 Cal. Rptr. 2d at 592-97. Justice Baxter wrote a separate concurring opinion in which Justice Arabian joined. *Id.* at 1036-38, 891 P.2d at 143-44, 39 Cal. Rptr. 2d at 597-98 (Baxter, J., concurring). Justice George filed a separate concurring opinion. *Id.* at 1038-43, 891 P.2d at 145-48, 39 Cal. Rptr. 2d at 599-602 (George, J., concurring). Justice Kennard wrote a dissenting opinion. *Id.* at 1043-51, 891 P.2d at 148-53, 39 Cal. Rptr. 2d at 602-07 (Kennard, J., dissenting).

2. *Id.* at 1028, 891 P.2d at 138, 39 Cal. Rptr. 2d at 592. John and Edie Elfmont were married in 1975. *Id.* at 1029, 891 P.2d at 139, 39 Cal. Rptr. 2d at 593. In 1977, Dr. Elfmont established his own medical practice and took out a disability insurance policy. *Id.* He purchased additional policies in 1982 and 1984. *Id.* The premiums for all three policies were paid out of community funds until 1987. *Id.* at 1029-30, 891 P.2d at 139, 39 Cal. Rptr. 2d at 593. In 1987 after the couple separated, Dr. Elfmont renewed the term policies with his own separate property funds. *Id.* at 1030, 891 P.2d at 139, 39 Cal. Rptr. 2d at 593. In 1989, Dr. Elfmont could no longer work due to neck and lower back problems, which started while he was still married. *Id.* at 1030-31, 891 P.2d at 139-40, 39 Cal. Rptr. 2d at 593-94. However, there was conflicting testimony as to whether the problems started before or after Dr. Elfmont purchased the additional policies. *Id.* In 1990, Dr. Elfmont started receiving payments from the disability insurance policies in the amount of \$9,000 per month, of which the trial court classified \$5,000 as community property. *Id.* at 1030-31, 891 P.2d at 139-40, 39 Cal. Rptr. 2d at 593-94. The trial court reasoned that once Dr. Elfmont knew he had a back problem, the additional insurance he acquired was for the purpose of retirement income, and was therefore community property. *Id.* The court of appeal reversed and determined that all of the disability benefits were Dr. Elfmont's separate property. *Id.*

ability insurance benefits.<sup>3</sup> The supreme court affirmed the court of appeal's decision and ruled that the disability insurance benefits received after separation were separate property since the term policy was renewed after separation with no intent to provide retirement income for the community.<sup>4</sup>

## II. TREATMENT

### A. *Majority Opinion*

The court first determined the intent of the parties to provide retirement income for the community.<sup>5</sup> The court stressed both the importance of the parties' intent at the time the policies were purchased as well as their intent at the time the policies were renewed.<sup>6</sup> The court concluded that when Dr. Elfmont renewed the policies with his separate property after the parties separated, he had no intent to provide community retirement income.<sup>7</sup>

The majority then considered the significance of premiums paid with community funds.<sup>8</sup> The court compared term disability insurance with term life insurance and emphasized that after separation the insured has the option to renew the policies or let it lapse.<sup>9</sup> Noting that Dr. Elfmont renewed the policy by continuing to make payments out of his separate property,<sup>10</sup> the majority found that "the right to renew the insured spouse's term disability insurance after separation does not give rise to any community property interest in the insured's disability benefits."<sup>11</sup>

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3. *Id.* at 1028-29, 891 P.2d at 138, 39 Cal. Rptr. 2d at 592.

4. *Id.* at 1035, 891 P.2d at 143, 39 Cal. Rptr. 2d at 597.

5. *Id.* at 1032, 891 P.2d at 141, 39 Cal. Rptr. 2d at 595.

6. *Id.* at 1033, 891 P.2d at 141, 39 Cal. Rptr. 2d at 595; see *In re Marriage of Saslow*, 40 Cal. 3d 848, 861, 710 P.2d 346, 352, 221 Cal. Rptr. 546, 552 (1985) (urging the consideration of the spouses' intent "at the time the disability insurance was originally purchased" as well as the intent "at the times that decisions were made to continue the insurance in force rather than let it lapse").

7. *Elfmont*, 9 Cal. 4th at 1033, 891 P.2d at 141, 39 Cal. Rptr. 2d at 595.

8. *Id.* at 1033-35, 891 P.2d at 141-42, 39 Cal. Rptr. 2d at 595-96.

9. *Id.* at 1033-34, 891 P.2d at 141-42, 39 Cal. Rptr. 2d at 595-96; see *In re Marriage of Lorenz*, 146 Cal. App. 3d 464, 194 Cal. Rptr. 237 (1983) (finding life insurance policy separate property since there is no present cash value when the insured is still living); Daniel J. Jaffe & Suzanne Childs, *A Marital Asset that Varies from State to State*, 12 FAM. ADVOC. 44, 48 (1990) (holding term insurance does not have cash value). See generally 11 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Community Property* § 28 (9th ed. 1990 & Supp. 1995) (discussing the value of term life insurance policies); 65 CAL. JUR. 3D *Work Injury Compensation* §§ 393-395 (1981 & Supp. 1995) (explaining disability insurance).

10. *Elfmont*, 9 Cal. 4th at 1033, 891 P.2d at 141, 39 Cal. Rptr. 2d at 595.

11. *Id.* at 1033-35, 891 P.2d at 141-42, 39 Cal. Rptr. 2d at 595-96.

The court then differentiated term life insurance from disability insurance by stating that the proceeds from term life insurance go to survivors, while the proceeds from disability insurance go to the insured to replace lost wages.<sup>12</sup> The majority reasoned that if the insured of a disability policy becomes disabled during marriage, the benefits received during marriage will be community property since the benefits will replace earnings.<sup>13</sup> However, if the parties subsequently separate, the benefits become the separate property of the insured unless there was an intent during the marriage for the policy to provide retirement income.<sup>14</sup> The court reiterated that upon payment of the renewal premium after the separation, neither party had the intent to provide the community with retirement income; thus, the benefits were separate property.<sup>15</sup> Therefore, the supreme court upheld the decision of the court of appeal by finding that Dr. Elfmont's disability insurance benefits received after separation were his separate property.<sup>16</sup>

### B. Justice Baxter's Concurring Opinion

Justice Baxter wrote separately asserting that *In re Marriage of Saslow*<sup>17</sup> should be overruled.<sup>18</sup> Justice Baxter criticized the reasoning of *Saslow* claiming that the court erroneously relied on *In re Marriage of Stenquist*,<sup>19</sup> a distinguishable case.<sup>20</sup> Justice Baxter further emphasized

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12. *Id.* at 1034, 891 P.2d at 142, 39 Cal. Rptr. 2d at 596; see 11 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Community Property* § 22 (9th ed. 1990 & Supp. 1995) (explaining that the main purpose of workers' compensation is to replace future earnings).

13. *Elfmont*, 9 Cal. 4th at 1034, 891 P.2d at 142, 39 Cal. Rptr. 2d at 596; see *In re Marriage of Saslow*, 40 Cal. 3d 848, 861, 710 P.2d 346, 352, 221 Cal. Rptr. 546, 552 (1985) (determining that disability benefits will be community property when intended for retirement income).

14. *Elfmont*, 9 Cal. 4th at 1034, 891 P.2d at 142, 39 Cal. Rptr. 2d at 596.

15. *Id.* at 1035, 891 P.2d at 142-43, 39 Cal. Rptr. 2d at 596-97.

16. *Id.* at 1035, 891 P.2d at 143, 39 Cal. Rptr. 2d at 597; cf. 11 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Community Property* § 21 (9th ed. Supp. 1995) ("A worker's compensation permanent disability award received after separation is the injured party's separate property.") (quoting *In re Marriage of Fisk*, 2 Cal. App. 4th 1698, 1703, 4 Cal. Rptr. 2d 95, 98 (1992)).

17. 40 Cal. 3d 848, 710 P.2d 346, 221 Cal. Rptr. 546 (1985).

18. *Elfmont*, 9 Cal. 4th at 1036, 891 P.2d at 143, 39 Cal. Rptr. 2d at 597 (Baxter, J., concurring).

19. 21 Cal. 3d 779, 582 P.2d 96, 148 Cal. Rptr. 9 (1978).

20. *Elfmont*, 9 Cal. 4th at 1036, 891 P.2d at 143, 39 Cal. Rptr. 2d at 597 (Baxter, J., concurring). Justice Baxter pointed out that in *Stenquist*, "the husband was enti-

that *Saslow* “does not comport with commercial insurance reality,” since one cannot take out disability insurance in order to retire.<sup>21</sup> Finally, Justice Baxter criticized *Saslow* for implying that courts should second guess insurance providers by determining whether the insured is truly disabled or just using disability insurance to retire.<sup>22</sup>

### C. Justice George’s Concurring Opinion

Justice George wrote separately, stating that the husband should be required to reimburse the community for premiums paid during marriage.<sup>23</sup> Applying principles of the community property system, Justice George concluded that the disability policies at the time of separation were community property since they were obtained during marriage with community funds.<sup>24</sup>

Justice George further explained that the right to renew the disability insurance policy was a valuable asset since the husband was older and may not have been able to get another policy at the same premium had he let the policies lapse.<sup>25</sup> Justice George, however, maintained that the wife was entitled to reimbursement since the valuable contractual right to renew was derived from community funds and the husband “retained and utilized, for his . . . own benefit, a community asset.”<sup>26</sup>

### D. Justice Kennard’s Dissenting Opinion

In a separate dissenting opinion, Justice Kennard denounced the majority opinion and found that the disability insurance benefits should be classified as community property.<sup>27</sup> Justice Kennard criticized the ma-

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ted to choose between military disability and retirement pay.” *Id.* (Baxter, J., concurring). Unlike *Stenquist*, the husband in *Saslow* was not a government worker and his disability policy was through a private insurance company. *Id.* at 1036, 891 P.2d at 143-44, 39 Cal. Rptr. 2d at 597-98 (Baxter, J., concurring).

21. *Id.* at 1037, 891 P.2d at 144, 39 Cal. Rptr. 2d at 598 (Baxter, J., concurring).

22. *Id.* at 1038, 891 P.2d at 144, 39 Cal. Rptr. 2d at 598 (Baxter, J., concurring).

23. *Id.* at 1038-39, 891 P.2d at 145, 39 Cal. Rptr. 2d at 599 (George, J., concurring and dissenting).

24. *Id.* (George, J., concurring and dissenting).

25. *Id.* at 1041, 891 P.2d at 146, 39 Cal. Rptr. 2d at 600 (George, J., concurring and dissenting); see *Estate of Logan*, 191 Cal. App. 3d 319, 325, 236 Cal. Rptr. 368, 371 (1987) (“If the insured remains insurable, the right to renew the policy has no value since the insured could obtain comparable term insurance for a comparable price in the open market.”).

26. *Elfmont*, 9 Cal. 4th at 1042, 891 P.2d at 147, 39 Cal. Rptr. 2d at 601 (George, J., concurring and dissenting). Justice George contended that expert testimony could establish the value of the right to renew the policy. *Id.* at 1042-43, 891 P.2d at 148, 39 Cal. Rptr. 2d at 602 (George, J., concurring and dissenting).

27. *Id.* at 1044, 891 P.2d at 148-49, 39 Cal. Rptr. 2d at 602-03 (Kennard, J., dissent-)

majority for ignoring the fact that community money purchased the policy.<sup>28</sup>

Justice Kennard further disagreed with the majority's application of the *Saslow* rule.<sup>29</sup> She reasoned that since there was no increase in premiums and the husband may not have been able to purchase a different policy due to his current condition, it was only the policies acquired during marriage with community funds that enabled him to receive any current benefits.<sup>30</sup> Justice Kennard concluded that the disability benefits are community property since the insurance was intended as retirement income.<sup>31</sup>

### III. IMPACT AND CONCLUSION

The California Supreme Court first considered the relationship between the community property system and disability pay received after separation in *In re Marriage of Jones*.<sup>32</sup> The court held that a veteran's

ing). See generally 32 CAL. JUR. 3D *Family Law* § 425 (1994 & Supp. 1995) (announcing a strong presumption in favor of community property when acquired during marriage).

28. *Elfmont*, 9 Cal. 4th at 1044, 891 P.2d at 149, 39 Cal. Rptr. 2d at 603 (Kennard, J., dissenting).

29. *Id.* at 1044, 891 P.2d at 148, 39 Cal. Rptr. 2d at 602 (Kennard, J., dissenting). Justice Kennard found the only difference in *Saslow* and the instant case was that in *Saslow* some of the benefits were received before separation. *Id.* at 1048, 891 P.2d at 151, 39 Cal. Rptr. 2d at 605 (Kennard, J., dissenting). Justice Kennard found this difference insignificant. *Id.* (Kennard, J., dissenting).

30. *Id.* at 1049, 891 P.2d at 152, 39 Cal. Rptr. 2d at 606 (Kennard, J., dissenting). See generally 11 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Community Property* § 28 (9th ed. 1990 & Supp. 1995) ("[T]he right to renewal upon payment of the premium for the next term is significant because the insured possesses the right even if he or she has become uninsurable in the meantime.").

31. *Elfmont*, 9 Cal. 4th at 1044, 891 P.2d at 148-49, 39 Cal. Rptr. 2d at 602-03 (Kennard, J., dissenting). Justice Kennard argued that someone with a deteriorating condition may purchase and rely on disability insurance when they believe that their condition will result in retirement. *Id.* at 1047 n.4, 891 P.2d at 151 n.4, 39 Cal. Rptr. 2d at 605 n.4 (Kennard, J., dissenting). Justice Kennard felt this occurred in the present case, relying on the wife's testimony that her husband "had suffered intermittent back pain following his back injury in 1980 or 1981; that he hated the practice of medicine; that he had repeatedly told her and others that he intended to retire, 'come hell or high water,' when he reached 50; and that he had told her about another physician who had deliberately permitted a slipped disc to degenerate so he could claim disability benefits." *Id.* at 1045, 891 P.2d at 149, 39 Cal. Rptr. 2d at 603 (Kennard, J., dissenting).

32. 13 Cal. 3d 457, 531 P.2d 420, 119 Cal. Rptr. 108 (1975).

disability pay received after separation was his separate property.<sup>33</sup> The court distinguished disability pay from retirement benefits by stating that disability pay "does not serve primarily as a form of deferred compensation for past services."<sup>34</sup>

The court reaffirmed the holding of *Jones* in *In re Marriage of Saslow*.<sup>35</sup> In *Saslow*, the court contemplated whether disability benefits received after separation should be classified as community or separate property when the disability insurance policy was purchased during marriage with community funds.<sup>36</sup> The court held that disability benefits intended as retirement income should be classified as community property whereas disability benefits intended to replace the insured's earnings should be classified as the separate property of the insured.<sup>37</sup>

*In re Marriage of Elfmont* challenged the court with a new situation in determining the application of term disability insurance to the community property system. The court embraced prior court decisions and enacted new law: when term disability insurance is renewed after separation and the insurance benefits are subsequently received after separation, the benefits are the separate property of the insured.<sup>38</sup>

Considering that four out of ten marriages in the United States fail,<sup>39</sup> many couples will find themselves consumed in the intricacies of divorce that may include disability insurance.<sup>40</sup> The California Supreme Court

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33. *Id.* at 464, 531 P.2d at 425, 119 Cal. Rptr. at 113.

34. *Id.* at 462, 531 P.2d at 423, 119 Cal. Rptr. at 111; *see also In re Marriage of Stenquist*, 21 Cal. 3d 779, 582 P.2d 96, 148 Cal. Rptr. 9 (1978) (finding husband's military disability benefits were community property since the main purpose of the benefits was to provide retirement income when he chose to receive disability over retirement benefits); *see Grace Ganz Blumberg, Marital Property Treatment of Pensions, Disability Pay, Workers' Compensation, and other Wage Substitutes: An Insurance, or Replacement Analysis*, 33 UCLA L. REV. 1250, 1279 (1986) (questioning California courts for finding pension benefits community property yet classifying disability benefits as separate property).

35. 40 Cal. 3d 848, 710 P.2d 346, 221 Cal. Rptr. 546 (1985).

36. *Id.* at 854, 710 P.2d at 347, 221 Cal. Rptr. at 547.

37. *Id.* at 869, 710 P.2d at 357, 221 Cal. Rptr. at 557. The court assumed that since the husband had no retirement plan, he intended the disability benefits to provide retirement income. *Id.* at 861, 710 P.2d at 352, 221 Cal. Rptr. at 552. Thus, the court concluded that the property was community property. *Id.* at 869, 710 P.2d at 346, 221 Cal. Rptr. at 557.

38. *In re Marriage of Elfmont*, 9 Cal. 4th 1026, 1035, 891 P.2d 136, 143, 39 Cal. Rptr. 2d 590, 597 (1995); *see Blumberg, supra* note 34, at 1292 (explaining term insurance and contrasting term insurance with retirement contributions).

39. Eric W. Maclure, *Freeman v. Freeman: Adopting the Analytical Approach to Equitable Distribution of Workers' Compensation Awards*, 71 N.C. L. REV. 2065, 2065 (1993) (citing Barbara Vobejda, *Baby-Boom Women Setting Divorce Record: Census Data Underscore Dramatic Social Change in Last Two Decades*, WASH. POST, Dec. 9, 1992, at A1).

40. *See, e.g., Jaffe & Childs, supra* note 9, at 48 (advising divorce attorneys in

clearly defined when term disability insurance will be community property and when it will be considered separate property, thereby giving attorneys direction in advising their clients and giving the lower courts guidelines in determining the status of property.<sup>41</sup>

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handling life and disability insurance policies); Lee Hargrove, *Matrimonial Regimes*, 52 LA. L. REV. 655, 669-670 (1992) (discussing Louisiana's community property system in relation to disability benefits); Maclure, *supra* note 39, at 2065 (analyzing North Carolina's approach to disability insurance); Timothy B. Walker & Linda D. Elrod, *Family Law in the Fifty States: An Overview*, 26 FAM. L.Q. 319 (1993) (comparing and contrasting the various divorce laws throughout the United States).

41. *Elmont*, 9 Cal. 4th at 1033, 891 P.2d at 141, 39 Cal. Rptr. 2d at 595.



## VI. INCOME TAXES

*Taxpayers need not treat capital gains on the sale of "small business stock," qualifying under former California Revenue & Tax Code section 18162.5, as preference income, regardless of the date the taxpayer obtained the stock: Lennane v. Franchise Tax Bd.*

### I. INTRODUCTION

*Lennane v. Franchise Tax Bd.*<sup>1</sup> involved the statutory interpretation of California's preference income tax exclusion for "small business stock." While the California legislature repealed the preference income tax in 1987,<sup>2</sup> this supreme court decision still affects taxpayers who acquired "small business stock" prior to September 16, 1981, and who sold such stock prior to January 1, 1987.<sup>3</sup> The court held that since the California Revenue & Taxation Code *unambiguously* defined small business stock without regard to acquisition date, the definition was not subject to interpretation and included no acquisition date limitation.<sup>4</sup>

### II. STATEMENT OF THE CASE

From 1971 to 1987, the California Franchise Tax Board (FTB) separated capital gain from the sale of assets held more than one year into two categories: gain subject to personal income tax and items of tax preference.<sup>5</sup> Although taxed differently, the portion categorized as items

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1. 9 Cal. 4th 263, 885 P.2d 976, 36 Cal. Rptr. 2d 563 (1994). Justice Kennard authored the unanimous decision of the court, with Chief Justice Lucas and Justices Mosk, Arabian, Baxter, George, and Werdegar concurring. *Id.* at 274, 885 P.2d at 982, 36 Cal. Rptr. 2d at 569.

2. Act of Sept. 25, 1987, ch. 1138, § 40, 1987 Cal. Stat. 3879, 3911.

3. Resolution of this issue effects approximately 800 taxpayers and involves more than \$300 million in revenue. *Lennane*, 9 Cal. 4th at 265 n.1, 885 P.2d at 977 n.1, 36 Cal. Rptr. 2d at 563-64 n.1.

4. *Id.* at 268-69, 885 P.2d at 978-79, 36 Cal. Rptr. 2d at 565-66.

5. *Id.* at 265-66, 885 P.2d at 977, 36 Cal. Rptr. 2d at 564. Until 1986, items subject to tax preference included "(f) An amount equal to one-half of the amount by which net long-term capital gain exceeds the net short-term capital loss for the taxable year." *Lennane v. Franchise Tax Bd.*, 27 Cal. App. 4th 355, 360, 21 Cal. Rptr. 2d 25, 27-28 (Ct. App. 1993) (quoting former § 17063 of the CAL. REV. & TAX CODE). For the tax year 1986, however, items of tax preference included:

(e) The amount of the tax preference income with respect to capital gains shall be an amount (but not below zero) equal to the difference between (1) the taxpayer's total net capital gains and losses (determined without regard to any capital loss carryover) for the taxable year, and (2) the taxpayer's net capital gains and losses recognized by virtue of Section 18162.5 for the same

of tax preference did not escape taxation.<sup>6</sup> However, in an effort to increase investment in small businesses,<sup>7</sup> former section 17063.11 of the California Revenue and Taxation Code<sup>8</sup> allowed preference income from "qualified" assets to escape taxation by exempting such income from preference status.<sup>9</sup>

To be qualified, the asset had to meet the specific requirements listed in former section 18162.5.<sup>10</sup> Subdivisions (e) and (f) of section 18162.5 explicitly and comprehensively defined "small business stock" without reference to any date restrictions.<sup>11</sup> While neither subdivision (e) nor (f) of section 18162.5 contained any date restriction on when the taxpayer must have acquired the stock, subdivisions (b) and (d), when read to-

taxable year.

Law of Apr. 15, 1986, ch. 54, § 1.5, 1986 Cal. Stat. 138, 140-41. The California legislature repealed the preference income tax in 1987. Law of Sept. 25, 1987, ch. 1138, § 40, 1987 Cal. Stat. 3879, 3911.

6. *Lennane*, 9 Cal. 4th at 266, 885 P.2d at 977, 36 Cal. Rptr. 2d at 564. Specifically, former § 17062 of the Cal. Rev. & Tax Code imposed a 2.5% tax on all capital gains characterized as items of tax preference. *Lennane v. Franchise Tax Bd.*, 27 Cal. App. 4th at 360, 21 Cal. Rptr. 2d at 27-28.

7. In enacting the exemption for "small business stock," the legislature specifically stated:

[T]he willingness of private entrepreneurs to take risks in starting and expanding small companies . . . has been a critical element in the ability of new and small companies to transform ideas into jobs and income for California. The Legislature finds, however, that state and national tax laws, in an inflationary era, provide insufficient incentive for many investors to risk their savings in new businesses, and excessive incentive to place their savings into nonproductive assets which add nothing to the strength of the economy.

Act of Sept. 16, 1981, ch. 534, § 1, 1981 Cal. Stat. 1903, 1903 (repealed 1987).

8. All future citations to §§ 17063.11 and 18162.5 refer to the CAL. REV. & TAX. CODE §§ repealed in 1987 by Act of Sept. 25, 1987, ch. 1138, §§ 40, 131, 1987 Cal. Stat. 3879, 3911, 3934. All future citations to § 18161.5 refer to the CAL. REV. & TAX. CODE § repealed in 1983 by Act of July 28, 1983, ch. 488, § 64, 1983 Cal. Stat. 1863, 1929.

9. *Lennane*, 9 Cal. 4th at 266, 885 P.2d at 977, 36 Cal. Rptr. 2d at 564; see Act of Sept. 16, 1981, ch. 534, § 1, 1981 Cal. Stat. 1903, 1903 (repealed 1987).

10. *Lennane*, 9 Cal. 4th at 266, 885 P.2d at 977, 36 Cal. Rptr. 2d at 564 (citing Act of Sept. 7, 1984, ch. 938, § 8, 1984 Cal. Stat. 3177, 3199-3200). While § 17063.11 originally referenced § 18161.5, not § 18162.5, most of the substance of § 18161.5 was incorporated into the 1984 amended version of § 18162.5. *Id.* The former § 18161.5, however, contained no reference to any date limitation. *Lennane*, 9 Cal. 4th at 272, 885 P.2d at 981, 36 Cal. Rptr. 2d at 568.

11. *Lennane*, 9 Cal. 4th at 266, 885 P.2d at 977, 36 Cal. Rptr. 2d at 564. For a description of the text of former § 18162.5, see *infra* note 12.

gether, excluded from taxation only capital gain on the sale of small business stock acquired after September 16, 1981.<sup>12</sup>

Section 18162.5 made no mention, explicit or implicit, about whether capital gains from small business stock should be treated as an item of preference. However, the FTB, by interpreting subdivisions (a), (b), and (d) of section 18162.5 as impliedly modifying the definition of small business stock provided in subdivisions (e) and (f), insisted section 18162.5 prevented such stock acquired after September 16, 1981, from being treated as small business stock exempt from preference income.<sup>13</sup> Based on this interpretation, the FTB rejected the Lennane's claim that the portion of capital gain not taxed as ordinary income was exempt from tax as preference income under section 17063.11.<sup>14</sup>

### III. ANALYSIS

Because the dispute centered on the proper interpretation of section 18162.5's definition of small business stock, the court began its analysis by setting forth the general rules of statutory construction.<sup>15</sup> The court

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12. Section 18162.5 provided the percentages of capital gains or losses recognizable as taxable income, according to the length of time the asset was held. Act of June 26, 1985, ch. 106, § 133, 1985 Cal. Stat. 252, 322-24. Specifically, § 18162.5 provided:

(a) In the case of any taxpayer, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset, except gains from small business stock or nonproductive assets, shall be taken into account in computing taxable income: . . . (3) Fifty percent if the capital asset has been held more than five years . . . .

(b) In the case of any taxpayer, only the following percentages of the gain recognized upon the sale or exchange of small business stock shall be taken into account in computing taxable income: . . . (3) Zero percent if the small business stock has been held for more than three years . . . .

(d) Subdivision (b) applies with respect to small business stock acquired after September 16, 1981.

*Id.*

13. *Lennane*, 9 Cal. 4th at 270, 885 P.2d at 979, 36 Cal. Rptr. 2d at 566.

14. *Id.* at 267, 885 P.2d at 977-78, 36 Cal. Rptr. 2d at 564. In March 1991, the FTB assessed a deficiency against the Lennanes for \$386,911.65 plus interest. *Id.* at 267, 885 P.2d at 978, 36 Cal. Rptr. at 565. In October of 1991, plaintiffs brought suit for refund and moved for summary judgment. *Id.* While the trial court granted plaintiffs' motion for summary judgment, the court of appeal reversed the decision in June of 1993, finding § 17063.11 ambiguous. *Lennane v. Franchise Tax Bd.*, 27 Cal. App. 4th at 358, 21 Cal. Rptr. 2d at 26-27 (Ct. App. 1993). The California Supreme Court granted review in September of 1993. *Lennane v. Franchise Tax Bd.*, 885 P.2d 597, 23 Cal. Rptr. 2d 130 (1993).

15. *Lennane*, 9 Cal. 4th at 268, 885 P.2d at 978, 36 Cal. Rptr. 2d at 565. See generally 7 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Constitutional Law* § 94 (9th ed. 1988 & Supp. 1995) (discussing the general rules of interpretation in construing statutes); 58 CAL. JUR. 3D *Statutes* §§ 82-181 (1980 & Supp. 1995) (providing a detailed

first explained that the purpose of all statutory construction is to ascertain and effectuate the intent of the legislature.<sup>16</sup> However, the court noted that the rules of construction are only applicable when the language of the statute is ambiguous.<sup>17</sup> Only if the language is susceptible to multiple interpretations may a court look to extrinsic aids, such as legislative history,<sup>18</sup> the purpose of the statute, or public policy, to ascertain the meaning of the statute.<sup>19</sup> Therefore, a court must not deviate from the plain meaning of the statute's language unless it first finds it ambiguous.<sup>20</sup>

In determining whether the language is ambiguous, a court must look beyond the mere words of the statute and consider all provisions relating to the same subject matter.<sup>21</sup> The court insisted, however, that a court must not be ingenious in finding ambiguity by "interpreting away clear language in favor of an ambiguity that does not exist."<sup>22</sup> The court further noted that the search for ambiguity is tempered especially when

examination on the application of the rules of statutory construction).

16. *Lennane*, 9 Cal. 4th at 268, 885 P.2d at 978, 36 Cal. Rptr. 2d at 565 (quoting *Woods v. Young*, 53 Cal. 3d 315, 323, 807 P.2d 455, 459, 279 Cal. Rptr. 613, 617 (1991)); see 58 CAL. JUR. 3D *Statutes* § 83 (1980 & Supp. 1995) (discussing rule of statutory construction).

17. *Lennane*, 9 Cal. 4th at 268, 885 P.2d at 978, 36 Cal. Rptr. 2d at 565 (quoting *Kizer v. Hanna*, 48 Cal. 3d 1, 8, 767 P.2d 679, 683, 255 Cal. Rptr. 412, 416 (1989)); see 58 CAL. JUR. 3D *Statutes* §§ 84-85 (1980 & Supp. 1995) (examining requirement of ambiguity for applying rules of construction).

18. See generally 7 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Constitutional Law* § 97 (9th ed. 1988 & Supp. 1995) (discussing the use of legislative history to ascertain legislative intent).

19. *Lennane v. Franchise Tax Bd.*, 27 Cal. App. 4th at 362, 21 Cal. Rptr. 2d at 29 (quoting *People v. Woodhead*, 43 Cal. 3d 1002, 1007-08, 741 P.2d 154, 239 Cal. Rptr. 656, 658-69 (1987)); see 58 CAL. JUR. 3D *Statutes* § 103 (1980 & Supp. 1995) (noting that a court may examine the historical background of a statute when the statutory language fails to disclose the legislature's intent). See generally 7 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Constitutional Law* § 96 (9th ed. 1980 & Supp. 1995) (providing several possible sources for legislative intent, including California Law Revision Commission Reports, Legislative counsel's digests, prior judicial construction, legislative history, and contemporaneous administrative construction).

20. *Lennane*, 9 Cal. 4th at 268, 885 P.2d at 978, 36 Cal. Rptr. 2d at 565.

21. *Lennane v. Franchise Tax Bd.*, 27 Cal. App. 4th at 363, 21 Cal. Rptr. 2d at 29 (Ct. App. 1991) (quoting *Title Ins. & Trust Co. v. County of Riverside*, 48 Cal. 3d 84, 91, 767 P.2d 1148, 1152, 255 Cal. Rptr. 670, 674 (1989)); see 58 CAL. JUR. 3D *Statutes* § 85 (1980 & Supp. 1995) (discussing the nature of ambiguity).

22. *Lennane*, 9 Cal. 4th at 268, 885 P.2d at 978, 36 Cal. Rptr. 2d at 565 (quoting *Hartford Fire Ins. Co. v. Macri*, 4 Cal. 4th 318, 326, 842 P.2d 112, 116, 14 Cal. Rptr. 2d 813, 817 (1992)); see 58 CAL. JUR. 3D *Statutes* § 85 (1980 & Supp. 1995).

interpreting tax provisions since the entire tax system is based on self-assessment and the need for understandable tax laws.<sup>23</sup> Based upon these principles, the court analyzed the statutory text of sections 18162.5 and 17063.11 to ascertain the proper definition of “small business stock.”<sup>24</sup>

Analyzing the language of section 18162.5, the court recognized that subdivision (e) explicitly defines the requirements for “small business stock,” while subdivision (f) explicitly lists the characteristics that prevent stock from being considered “small business stock.”<sup>25</sup> To the contrary, the court found that subdivisions (a), (b), (c), (d) or (g) did not explicitly nor implicitly define “small business stock.”<sup>26</sup> Because “[n]either subdivision [(e) nor (f) made] any reference to the date on which the taxpayer acquired the stock,”<sup>27</sup> the court found the language unambiguous and accepted the plain meaning of the statute.<sup>28</sup> The court thus concluded that stock could qualify for “small business stock” status under section 18162.5(e) regardless of the date the taxpayer obtained the stock.

Unlike the appellate court, the supreme court rejected the FTB’s contention that section 18162.5 was ambiguous.<sup>29</sup> Based on an ingenious reading of section 18162.5, the FTB claimed that the acquisition date limitation in subdivision (d) limited the definition of small business stock

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23. *Lennane*, 9 Cal. 4th at 271 n.8, 885 P.2d at 980 n.8, 36 Cal. Rptr. 2d at 567 n.8. While not proposing a definite rule regarding construing ambiguity in a tax provision, the court found that the general language of the California legislature in enacting the Katz-Harris Taxpayers’ Bill of Rights Act suggests a legislative intent to construe tax provisions in the most basic and understandable manner possible. *Id.*; see Katz-Harris Taxpayers’ Bill of Rights Act, ch. 1573, § 2, 1988 Cal. Stat. 2100, 2101 (codified as REV. & TAX. CODE § 21001 et seq. (1994)) (noting “the California tax system is based largely on self-assessment, and the development of understandable tax laws and taxpayers informed of those laws will both improve self-assessment and the relationship between taxpayers and government”).

24. *Lennane*, 9 Cal. 4th at 268-69, 885 P.2d at 978, 36 Cal. Rptr. 2d at 565-66. While the court also analyzed the enactment history of §§ 17063.11 and 18162.5, this was mere dicta since the court found the language of the statutes unambiguous, thus making the legislative history irrelevant to the court’s holding.

25. *Id.* at 268-69, 885 P.2d at 978-79, 36 Cal. Rptr. 2d at 565-66 (quoting Act of June 26, 1985, ch. 106, § 133, 1984 Cal. Stat. 252, 322-324 (repealed 1987)) (noting that subdivision (e) begins “‘small business stock’ is an equity security issued by a corporation which has the following characteristics . . . ” and subdivision (f) begins “‘small business stock’ does not include an equity security issued by a corporation which has either of the following characteristics . . . ”).

26. *Id.* at 269, 885 P.2d at 979, 36 Cal. Rptr. 2d at 566; see *supra* note 12 (providing the text of subdivisions (a), (b) and (d)).

27. *Lennane*, 9 Cal. 4th at 269, 885 P.2d at 979, 36 Cal. Rptr. 2d at 566.

28. *Id.* at 271, 885 P.2d at 980, 36 Cal. Rptr. 2d at 567.

29. *Lennane v. Franchise Tax Bd.*, 27 Cal. App. 4th at 363, 21 Cal. Rptr. 2d at 29-30.

given in subdivisions (e) and (f).<sup>30</sup> The FTB first noted that in providing general rules for recognition of ordinary income on the sale of a capital asset, subdivision (a) of section 18162.5 "expressly exclude[d] 'small business stock' from these rules."<sup>31</sup> The FTB further noted that in providing general rules for recognition of ordinary income on the sale of "small business stock," subdivision (b) and (d) of 18162.5 expressly excluded stock acquired on or before September 16, 1981 from these general rules.<sup>32</sup> Lastly, the FTB noted that stock acquired on or before September 16, 1981 must be counted under subdivisions (a) or (b).<sup>33</sup>

Because subdivision (d) expressly excluded stock acquired prior to September 16, 1981, from subdivision (b), the FTB reasoned that the stock must be counted under subdivision (a).<sup>34</sup> However, since subdivision (a) states that it does not apply to "small business stock," the FTB maintained that such stock must then be considered as something other than "small income stock."<sup>35</sup> Based on this interpretation, the FTB concluded that "section 17063.11's reference for purposes of preference income to 'small business stock, as defined in Section 18162.5' includes only small business stock acquired after September 16, 1981."<sup>36</sup>

While the court found this interpretation not without merit, it dismissed these contentions for three reasons. First, the court reiterated that the character of the language in subdivisions (a), (b), and (d) was not definitional.<sup>37</sup> Instead of construing section (a) as redefining "small business stock," the court interpreted it as a catch-all for all gains not included in subdivisions (b) and (c).<sup>38</sup> Second, the court held that "[b]y using the term 'small business stock' within the statement of the acquisition date limitation, the subdivision assumes that the term has a meaning

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30. *Lennane*, 9 Cal. 4th at 269-70, 885 P.2d at 979, 36 Cal. Rptr. 2d at 566.

31. *Id.* at 270, 885 P.2d at 979, 36 Cal. Rptr. 2d at 566; *see also supra* note 12 (providing the specific language of former § 18162.5(a)).

32. *Lennane*, 9 Cal. 4th at 270, 885 P.2d at 979, 36 Cal. Rptr. 2d at 566; *see also supra* note 12 (providing the specific language of subdivisions (b) and (d) of § 18162.5).

33. *Lennane*, 9 Cal. 4th at 270, 885 P.2d at 979, 36 Cal. Rptr. 2d at 566.

34. *Id.*

35. *Id.*

36. *Id.*

37. *Id.* at 270-71, 885 P.2d at 980, 36 Cal. Rptr. 2d at 567.

38. *Id.* at 271, 885 P.2d at 980, 36 Cal. Rptr. 2d at 567 (finding that "[t]his construction more directly and understandably achieves the result of including in subdivision (a) capital gains from the sale of small business stock acquired on or before September 16, 1981").

apart from that limitation."<sup>39</sup> Lastly, the court was reluctant to deviate from the plain meaning of the language due to a underlying desire to keep tax statutes understandable.<sup>40</sup> For these reasons, the court held sections 17063.11 and 18162.5 were not ambiguous and rejected the FTB's interpretation.<sup>41</sup>

While the court could have concluded its analysis after finding the statute unambiguous and applying the plain meaning of the statute,<sup>42</sup> it reinforced its decision with supporting legislative history.<sup>43</sup> The court first noted that when originally enacted in 1981, section 17063.11 explicitly referenced section 18161.5, not section 18162.5, as the defining statute for small business stock.<sup>44</sup> While the amended version of section 18162.5 incorporated most of the substance of section 18161.5, the provisions in section 18161.5 included no reference to any date limitation.<sup>45</sup> Thus, the date of acquisition had no bearing on the definition of small business stock referenced by former section 17063.11, as originally enacted.<sup>46</sup>

The court recognized that the appellate court erred in finding that legislative history favored the FTB's interpretation of the statute.<sup>47</sup> The court maintained that the committee reports and legislative findings relied upon by the appellate court were not relevant since they were not based on the original statute.<sup>48</sup> Therefore, the court dispelled all doubt

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39. *Id.* at 270, 885 P.2d at 980, 36 Cal. Rptr. 2d at 567.

40. *Id.* at 271 n.8, 885 P.2d at 980 n.8, 36 Cal. Rptr. 2d at 567 n.8; *see* note 23 (describing the court's motivation behind simplifying tax statutes).

41. *Lennane*, 9 Cal. 4th at 271, 885 P.2d at 980, 36 Cal. Rptr. 2d at 567.

42. *See* 58 CAL. JUR. 3D *Statutes* §§ 84-85 (1980 & Supp. 1995) (explaining that the rules of construction are inapplicable and the plain meaning should be used when the language of a statute is unambiguous).

43. *Lennane*, 9 Cal. 4th at 272, 885 P.2d at 981, 36 Cal. Rptr. 2d at 568.

44. *Lennane v. Franchise Tax Bd.*, 27 Cal. App. 4th at 361, 21 Cal. Rptr. 2d at 28 (quoting Act of Sept. 16, 1981, ch. 534, § 2, 1981 Cal. Stat. 1903, 1903).

45. *Lennane*, 9 Cal. 4th at 272, 885 P.2d at 981, 36 Cal. Rptr. 2d at 568.

46. *Id.* at 272, 885 P.2d at 981, 36 Cal. Rptr. 2d at 568. The court specifically noted that "[t]he acquisition date restriction and statutory structure on which the FTB now relies were originally part of a different statute (section 18162.5) that related only to ordinary income tax, did not purport to contain any definition of small business stock, and was not incorporated by reference into section 17063.11." *Id.* at 273, 885 P.2d at 981, 36 Cal. Rptr. 2d at 568.

47. *Id.* at 273, 885 P.2d at 981, 36 Cal. Rptr. 2d at 568. The appellate court, after finding ambiguity in § 18162.5, used analysis by the Legislative Analyst, statements by the Assembly Revenue and Taxation Committee, and prefatory language of the actual bill in concluding that the legislature intended the exemption for small business stock to only apply to stock acquired after September 16, 1981. *Lennane v. Franchise Tax Bd.*, 27 Cal. App. 4th at 363-65, 21 Cal. Rptr. 2d at 29-31.

48. *Lennane*, 9 Cal. 4th at 273, 885 P.2d at 981, 36 Cal. Rptr. 2d at 568.

that its decision was adverse to the legislature's intent in enacting the exemption for small business stock.

### III. IMPACT AND CONCLUSION

By the court's own admission, this decision affects only a few hundred California taxpayers.<sup>49</sup> However, the court's analysis in interpreting the California Revenue and Taxation Code may provide some insight into the current California Supreme Court's view of statutory construction. While the court accepted the traditional rules of construction,<sup>50</sup> it placed a strong emphasis on construing tax statutes in an understandable manner.<sup>51</sup> Therefore, in future interpretations of tax statutes, the court is likely to consider a straight forward construction as more consistent with legislative intent.<sup>52</sup>

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49. *Id.* at 265 n.1, 885 P.2d at 976-77 n.1, 36 Cal. Rptr. 2d at 563-64 n.1 (noting that approximately 800 taxpayers and only \$300 million are involved since the legislature repealed the preference income tax in 1987).

50. *See supra* notes 17-23 and accompanying text.

51. *Lenmane*, 9 Cal. 4th at 271 n.8, 885 P.2d at 980 n.8, 36 Cal. Rptr. 2d at 567 n.8.

52. *Id.* (briefly noting that "construing unambiguous language in tax statutes according to the ordinary meaning of the words use is consistent with the legislative goal of 'understandable tax laws'").



## VII. LANDLORD AND TENANT

*When a landlord fails to meet the requirements of California Civil Code section 1950.5(f), but has acted in good faith, he is entitled to set off the amount of costs or repairs of the property against any money owed from security deposits to a former tenant. In addition, the trial court must choose a method of distributing wrongfully withheld security deposits to include tenants that do not individually bring claims: Granberry v. Islay Investments.*

### I. INTRODUCTION

In *Granberry v. Islay Investments*,<sup>1</sup> the California Supreme Court considered whether a landlord who violated California Civil Code section 1950.5,<sup>2</sup> but had acted in good faith, was entitled to set off damages.<sup>3</sup> The court also considered whether the trial court abused its discretion in requiring the defendants to pay only for individual claims that were brought forward instead of placing the total amount of the damages into a recovery fund.<sup>4</sup> Finally, the supreme court addressed whether the trial

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1. 9 Cal. 4th 738, 889 P.2d 970, 38 Cal. Rptr. 2d 650 (1995), *cert. denied*, 1995 WL 454920 (Oct. 2, 1995) (No. 95-122). Justice Mosk authored the majority opinion, with Chief Justice Lucas, and Justices George and Werdegar concurring. *Id.* at 741-52, 889 P.2d at 971-78, 38 Cal. Rptr. 2d at 651-58. Justice Baxter wrote a separate concurring opinion with Justice Arabian concurring. *Id.* at 752-53, 889 P.2d at 978-79, 38 Cal. Rptr. 2d at 658-59 (Baxter, J., concurring). Justice Kennard wrote a dissenting opinion. *Id.* at 753-62, 889 P.2d at 979-85, 38 Cal. Rptr. 2d at 659-65 (Kennard, J., dissenting).

2. *Id.* at 741, 889 P.2d at 971, 38 Cal. Rptr. 2d at 651.

California Civil Code § 1950.5(f) states:

Within three weeks after the tenant has vacated the premises, the landlord shall furnish the tenant, by personal delivery or by first-class mail, postage prepaid, a copy of an itemized statement indicating the basis for, and the amount of, any security received and the disposition of the security and shall return any remaining portion of the security to the tenant.

CAL. CIV. CODE § 1950.5(f) (West 1985 & Supp. 1995).

3. *Granberry*, 9 Cal. 4th at 741, 889 P.2d at 971, 38 Cal. Rptr. 2d at 651. The defendant landlords own or operate between 1200 and 1500 residential rentals in Santa Barbara. *Id.* at 742, 889 P.2d at 971, 38 Cal. Rptr. 2d at 651. The landlords charged tenants a fee for the first month that was never returned to the tenants. *Id.* The total amount of these fees was about one million dollars. *Id.* During the three-year period these fees were collected, the tenants received neither an accounting nor a return of the security deposits. *Id.* at 743, 889 P.2d at 972, 38 Cal. Rptr. 2d at 652.

4. *Id.* at 741, 889 P.2d at 971, 38 Cal. Rptr. 2d at 651.

court abused its discretion in limiting the amount of attorney fees and costs.<sup>5</sup>

The trial court originally entered summary judgment for Islay Investments, stating that the fees paid during the first month were rent, not security deposits.<sup>6</sup> The plaintiffs appealed, and the court of appeal found that the status of the fees as security deposits was a triable issue of fact.<sup>7</sup> The defendant landlords then filed an amended answer to claim a defense of setoff for amounts owed by the plaintiffs if the fees were found to be security deposits.<sup>8</sup> The trial court then decided that the defendants were not entitled to set off amounts owed to them since they had failed to comply with California Civil Code section 1950.5, subdivision (f).<sup>9</sup> The jury found that the fees were security deposits, but that the defendants had not acted in bad faith by keeping them.<sup>10</sup> Further, the trial court held that the excess fees must be refunded, but only to members of the class who made individual claims.<sup>11</sup> The trial court also limited the amount of the attorney fees to twenty-five percent of the total amount collected by members of the class.<sup>12</sup> In a second appeal, the court of appeal reversed the trial court and found that the defendants were entitled to a setoff, but affirmed the rest of the trial court's opinion.<sup>13</sup>

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5. *Id.*

6. *Id.* at 742, 889 P.2d at 971-72, 38 Cal. Rptr. 2d at 651-52. Under California Civil Code § 1950.5(b) a security deposit is defined as:

[A]ny payment, fee, deposit or charge, including, but not limited to, an advance payment of rent, used or to be used for any purpose, including, but not limited to, any of the following: (1) The compensation of a landlord for a tenant's default in the payment of rent. (2) The repair of damages to the premises, exclusive of ordinary wear and tear, caused by the tenant or by a guest or licensee of the tenant. (3) The cleaning of the premises upon termination of the tenancy. (4) To remedy future defaults by the tenant in any obligation under the rental agreement to restore, replace, or return personal property or appurtenances, exclusive of ordinary wear and tear, if the security deposit is authorized to be applied thereto by the rental agreement.

CAL. CIV. CODE § 1950.5(b) (West 1985 & Supp. 1995).

7. *Granberry*, 9 Cal. 4th at 742, 889 P.2d at 971-72, 38 Cal. Rptr. 2d at 652.

8. *Id.*

9. *Id.* at 742-43, 889 P.2d at 972, 38 Cal. Rptr. 2d at 652.

10. *Id.* at 743, 889 P.2d at 972, 38 Cal. Rptr. 2d at 652.

11. *Id.*

12. *Id.*

13. *Id.*

## II. TREATMENT

### A. *Majority Opinion*

#### 1. Right of Defendants to Setoff Defense

The supreme court began by examining whether a landlord who acted in good faith, but violated California Civil Code section 1950.5, subdivision (f), is entitled to set off the refund of a security deposit to a tenant by costs allegedly owed to the landlord for unpaid rent, repairs, and cleaning.<sup>14</sup> The court decided that a landlord acting in good faith may set off his costs.<sup>15</sup>

The court recognized that setoff has been a valid defense since the seventeenth century.<sup>16</sup> Today, setoff is codified in California Civil Procedure Code section 431.70.<sup>17</sup> In determining whether a landlord who violates California Civil Code section 1950.5 can claim setoff as a defense, the court initially looked to the legislative intent behind its enactment.<sup>18</sup>

The first step in determining legislative intent is to examine the text of the statute.<sup>19</sup> The statute at issue obligates a landlord to perform the three following actions: (1) return the security deposit to the tenant within the statutory period; (2) retain part of the security deposit for the cost of repairs; and (3) provide a written accounting of any money retained

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14. *Id.*

15. *Id.*; see 1 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Contracts* §§ 743, 744 (9th ed. 1990 & Supp. 1995) (defining good faith and fair dealing).

16. *Granberry*, 9 Cal. 4th at 743, 889 P.2d at 972, 38 Cal. Rptr. 2d at 652. At common law, "setoff" meant that where two parties were indebted to each other, they would be liable only for the difference between the amount of the debts. See *Kruger v. Wells Fargo Bank*, 11 Cal. 3d 352, 362, 521 P.2d 441, 447, 113 Cal. Rptr. 449, 455 (1974); see also Tigar, *Automatic Extinction of Cross-Demands: Compensation from Rome to California*, 53 CAL. L. REV. 224 (1965) (setting out the history of the setoff defense from Roman times to present day).

17. *Granberry*, 9 Cal. 4th at 744, 889 P.2d at 973, 38 Cal. Rptr. 2d at 653. The code states:

Where cross-demands for money have existed between persons at any point in time when neither demand was barred by the statute of limitations, and an action is thereafter commenced by one such person, the other person may assert in the answer the defense of payment in that the two demands are compensated for so far as they equal each other . . . .

CAL. CIV. PROC. CODE § 431.70 (West 1973 & Supp. 1995). See 6 B.E. WITKIN, CALIFORNIA PROCEDURE, *Provisional Remedies* §§ 83, 86 (3d ed. 1985 & Supp. 1995) (regarding amounts to be secured and contents of notice); 16 CAL. JUR. 3D *Counterclaim and Setoff* §§ 1, 4, 10 (1983 & Supp. 1995).

18. *Granberry*, 9 Cal. 4th at 744, 889 P.2d at 973, 38 Cal. Rptr. 2d at 653.

19. *Id.* California Civil Code § 1950.5(e) provides that the landlord may retain as much of the security deposit as is necessary to pay for normal costs. *Id.*; CAL. CIV. CODE § 1950.5(e) (West 1985).

from the security deposit.<sup>20</sup> If these elements are not satisfied the landlord must return the entire security deposit to the tenant.<sup>21</sup> The court asserted, however, that while the landlord clearly loses the right to an automatic "deduct-and-retain" procedure, the statute is ambiguous as to whether the landlord loses all right to claim costs from the tenant.<sup>22</sup> Thus, the court next turned to the legislative history of the statute.<sup>23</sup>

The court noted that section 1950.5, subdivision (f) was apparently enacted to "ensure the speedy return of security deposits . . . and to prevent the improper retention of such deposits."<sup>24</sup> The court found that the statute's purpose is ambiguous with regard to whether the defense of setoff is available for a landlord who has violated California Civil Code section 1950.5.<sup>25</sup> The court also discounted the usefulness of unpassed bills as being unpersuasive in showing legislative intent.<sup>26</sup>

The supreme court next looked at the rule of construction that a statute should be interpreted so as to give effect to each part of the statute.<sup>27</sup> The defendants pointed to two parts of the statute that would be without meaning if setoff is not allowed as a defense: (1) a bad-faith violation of the statute will result in the possibility of actual damages, and (2) the landlord bears the burden of proof to show that claimed

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20. *Id.* at 744-45, 889 P.2d at 973, 38 Cal. Rptr. 2d at 653.

21. *Id.* at 745, 889 P.2d at 973, 38 Cal. Rptr. 2d at 653.

22. *Id.*

23. *Id.*

24. *Id.* at 745, 889 P.2d at 974, 38 Cal. Rptr. 2d at 654. The security deposit was meant to be used only when the tenant breached an obligation, but now the landlord keeps the security deposit regardless of damages actually sustained by the landlord. *Id.* (citing Jay Victor Jory, *The Residential Lease: Some Innovations for Improving the Landlord-Tenant Relationship*, 3 U.C. DAVIS L. REV. 31, 38-39 (1971)). Landlords will keep the security deposit because they know that the tenants are restrained from claiming their money by several factors: (1) problems of proof, (2) a small amount of money involved, (3) time issues, and (4) distance between tenant and former landlord after the tenant moves. *Id.* (citing Jory, *supra* at 38-39). Even when the security deposit is eventually returned, the tenant usually does not protest the delay, lack of accounting, or the use of his money. *Id.* at 745-46, 889 P.2d at 974, 38 Cal. Rptr. 2d at 654 (quoting Jory, *supra* at 38-39).

25. *Granberry*, 9 Cal. 4th at 746, 889 P.2d at 974, 38 Cal. Rptr. 2d at 654.

26. *Id.* (citing *Dyna-Med, Inc. v. Fair Employment & Hous. Comm'n*, 43 Cal. 3d 1379, 743 P.2d 1323, 241 Cal. Rptr. 67 (1987); *accord Grupe Dev. Co. v. Superior Court*, 4 Cal. 4th 911, 844 P.2d 545, 16 Cal. Rptr. 2d 226 (1993)). The defendants had pointed to the statute's 1985 enactment, claiming that deletion of language denying a setoff defense indicated the legislative's intention to allow offsets. *Id.* The plaintiffs countered by noting the later failure of two bills supported by the defendants. *Id.*

27. *Id.*

costs are reasonable.<sup>28</sup> The court rejected the defendants' argument that proof of reasonable costs is necessary only for purposes of setoff,<sup>29</sup> finding that a landlord would also have to prove that the costs retained were reasonable when a tenant contests the accounting.<sup>30</sup> The supreme court accepted the defendant's argument, however, since the statute expressly provided a remedy only for bad-faith retention of security deposits, the legislature did not intend to provide a remedy for good-faith retention.<sup>31</sup> The court found that because the statute does not specifically state that landlords are barred from using the setoff defense, the court "will not imply such a penalty" in the statute.<sup>32</sup>

The plaintiff tenants argued that allowing the landlords to set off costs contradicts principles of equity and public policy.<sup>33</sup> The plaintiffs first argued that since an individual should not profit from his own wrong, landlords should not profit from violating the statute.<sup>34</sup> While agreeing that this principle may prevent setoff in individual cases, the court refused to place an absolute bar on the right to setoff.<sup>35</sup> The court recognized that retaining flexibility in the law is especially important when applying equitable doctrines.<sup>36</sup>

The court further reasoned that because the landlord cannot recover any costs that would originally have been barred by the statute, he is not profiting from his violation of the statute; he is merely retaining those costs to which he is entitled.<sup>37</sup>

The plaintiffs also argued that the setoff defense should be barred by principles of estoppel because the plaintiffs did not receive adequate

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28. *Id.* at 746-47, 889 P.2d at 974, 38 Cal. Rptr. 2d at 654.

29. *Id.* at 747, 889 P.2d at 974, 38 Cal. Rptr. 2d at 655.

30. *Id.* at 747, 889 P.2d at 975, 38 Cal. Rptr. 2d at 655.

31. *Id.*

32. *Id.* The right of a landlord to set off costs against the security deposit has been recognized under federal law for several years. *See, e.g., Oldden v. Tonto Realty Corp.*, 143 F.2d 916 (2d Cir. 1944).

33. *Granberry*, 9 Cal. 4th at 747, 889 P.2d at 975, 38 Cal. Rptr. 2d at 655; *see* 11 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Equity* §§ 1, 2 (9th ed. 1990 & Supp. 1995) (stating general principles of equity).

34. *Granberry*, 9 Cal. 4th at 747, 889 P.2d at 975, 38 Cal. Rptr. 2d at 655; *see* 11 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Equity* § 7 (9th ed. 1990 & Supp. 1995) (taking advantage of one's own wrong).

35. *Granberry*, 9 Cal. 4th at 747, 889 P.2d at 975, 38 Cal. Rptr. 2d at 655.

36. *Id.* at 748, 889 P.2d at 975, 38 Cal. Rptr. 2d at 655.

37. *Id.* at 748, 889 P.2d at 976, 38 Cal. Rptr. 2d at 656. The court considered the landlord to be at a disadvantage because he is unable to use the summary nonjudicial procedure to retain costs and he may lose necessary evidence he needs to prove that those costs are reasonable. *Id.*

notice.<sup>38</sup> The court disagreed, finding that the original class notice gave adequate notice that the issue of setoff would arise.<sup>39</sup>

Finally, the court rejected the argument that setoff is inappropriate in class actions due to the practical difficulties.<sup>40</sup> The court pointed out that on remand the trial court could avoid these problems when fashioning the remedy.<sup>41</sup> Further, the court refused to deprive the landlords of a valid defense simply because it may prove inconvenient for the plaintiffs.<sup>42</sup>

The supreme court concluded that a defendant landlord who has violated the requirements of civil code section 1950.5, but has acted in good faith, is entitled to raise a claim for setoff against unreturned security deposits.<sup>43</sup> The landlord has the burden of proving, however, that the amount of the setoff is reasonable.<sup>44</sup> Because setoff is an equitable claim, the trial court must determine whether it is barred by an equitable affirmative defense.<sup>45</sup>

## 2. Shaping of Remedy for Class Action

The supreme court next addressed the issue of whether the trial court abused its discretion in denying the proposed remedy of placing the total amount of the security deposits retained into a fund where any amounts not individually claimed would be forfeited to the state.<sup>46</sup> The trial court decided that only those members of the class who actually filed individu-

38. *Id.* at 748-49, 889 P.2d at 976, 38 Cal. Rptr. 2d at 656; see 30 CAL. JUR. 3D *Equity* §§ 1-21 (1985 & Supp. 1995) (defining estoppel generally); 11 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Equity* §§ 176-187 (9th ed. 1990 & Supp. 1995) (same); see also 30 CAL. JUR. 3D *Equity* §§ 37-54 (1985 & Supp. 1995) (defining laches and delay); 11 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Equity* §§ 14-16 (9th ed. 1990 & Supp. 1995) (same).

39. *Granberry*, 9 Cal. 4th at 749, 889 P.2d at 976, 38 Cal. Rptr. 2d at 656.

40. *Id.* The class is composed of about 10,000 people and there could be as many as 8000 claims for setoff. *Id.* In addition, the amount in each claim is small and defendants will win by default if class members do not appear. *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

45. *Id.* at 750, 889 P.2d at 977, 38 Cal. Rptr. 2d at 657. These defenses include laches, unclean hands, and estoppel. *Id.*; see 30 CAL. JUR. 3D *Equity* §§ 26-30 (1985 & Supp. 1995) (defining clean hands doctrine); 11 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Equity* §§ 8-13 (9th ed. 1990 & Supp. 1995) (same).

46. *Granberry*, 9 Cal. 4th at 750, 889 P.2d at 977, 38 Cal. Rptr. 2d at 657.

al claims would be entitled to recover from the defendants.<sup>47</sup> The trial court determined that “fluid recovery” was not the appropriate remedy in this case.<sup>48</sup> The class action was an equitable claim that has been codified in California Civil Procedure Code section 382.<sup>49</sup> Section 384 of the California Civil Procedure Code provides guidelines for shaping remedies in class actions.<sup>50</sup> The intent of the statute was to ensure that the unpaid residuals in class actions were used either to further the cause of the class action or to benefit all Californians.<sup>51</sup> However, all equitable *cy pres* remedies are still available.<sup>52</sup> In *Granberry*, the trial court opted

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47. *Id.*

48. *Id.* The court defined the concept of “fluid recovery” as follows:

The term “fluid recovery” refers to the application of the equitable doctrine *cy pres* in the context of modern class actions. “The implementation” of fluid recovery involves three steps. First, the defendant’s total damage liability is paid over to a class fund. Second, individual class members are afforded an opportunity to collect their individual shares by proving their particular damages, usually according to a lowered standard of proof. Third, any residue remaining after individual claims have been paid is distributed by one of several practical procedures that have been developed by the courts.

*Id.* at 750 n.7, 889 P.2d at 977 n.7, 38 Cal. Rptr. 2d at 657 n.7 (citations omitted) (quoting *California v. Levi Strauss & Co.*, 41 Cal. 3d 460, 472-73, 715 P.2d 564, 571, 224 Cal. Rptr. 605, 612 (1986)); see also *Daar v. Yellow Cab Co.*, 67 Cal. 2d 695, 433 P.2d 732, 63 Cal. Rptr. 724 (1967) (using fluid recovery to fashion the plaintiff’s remedy); Kerry Barnett, *Equitable Trusts: An Effective Remedy in Consumer Class Actions*, 96 YALE L.J. 1591 (1987) (discussing fluid recovery); James R. McCall et al., *Greater Representation for California Consumers—Fluid Recovery, Consumer Trust Funds, and Representative Actions*, 46 HASTINGS L.J. 797 (1995) (same); Leon E. Trakman, *David Meets Goliath: Consumers Unite Against Big Business*, 25 SETON HALL L. REV. 617 (1994) (same); see generally 12 CAL. JUR. 3D *Charities* § 30 (1974 & Supp. 1995) (describing generally the doctrine of *cy pres*); 11 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Trusts* §§ 288-290 (9th ed. 1990 & Supp. 1995) (same).

49. *Granberry*, 9 Cal. 4th at 750, 889 P.2d at 977, 38 Cal. Rptr. 2d at 657.

50. *Granberry*, 9 Cal. 4th at 750, 889 P.2d at 977, 38 Cal. Rptr. 2d at 657. The California Civil Procedure Code provides that as long as the defendant is not a public entity or public employee,

[P]rior to the entry of any judgment in a class action . . . the court[s] shall determine the total amount that will be payable to all class members, if all class members are paid the amount to which they are entitled pursuant to the judgment. The court[s] shall also set a date when the parties shall report to the court the total amount that was actually paid to the class members. After the report is received, the court shall amend the judgment to direct the defendant to pay the sum of the unpaid residue, plus interest on that sum at the legal rate of interest from the date of entry of the initial judgment, in any manner the court determines is consistent with the objectives and purposes of the underlying cause of action . . . .

CAL. CIV. PROC. CODE § 384(b) (West 1973 & Supp. 1995).

51. *Granberry*, 9 Cal. 4th at 751, 889 P.2d at 977, 38 Cal. Rptr. 2d at 657.

52. *Id.*

not to use fluid recovery when the landlords were not able to use setoff to limit their liability. Now that the supreme court has changed that ruling, the equitable positions have also changed, therefore, the remedy must be reconsidered in light of these changes.<sup>53</sup>

### 3. Limit on Attorney Fees

Finally, the supreme court addressed whether the trial court abused its discretion when it limited costs and attorney fees to twenty-five percent of the total amount recovered by the class.<sup>54</sup> The supreme court found the issue of attorney fees premature for two reasons: (1) the total amount recovered has not yet been determined; and (2) since the case is not over, there is no total of hours that class counsel can submit.<sup>55</sup> The court decided, therefore, that the trial court should determine the question of attorneys fees when the final hearings are over.<sup>56</sup>

#### B. Justice Baxter's Concurring Opinion

Justice Baxter concurred with the judgment of the majority, that a landlord may use setoff as a defense when his failure to comply with civil code section 1950.5, subdivision (f) was in good faith.<sup>57</sup> Justice Baxter argued, however, that because the language of the statute is clear and unambiguous, the court need not construe its meaning.<sup>58</sup> He concluded simply that the statute is devoid of language that could be interpreted as depriving a landlord of the right to setoff.<sup>59</sup>

#### C. Justice Kennard's Dissenting Opinion

Justice Kennard began her opinion by attacking the "equitable" decision of the majority, which allows a landlord who illegally withheld more than one million dollars for fourteen to seventeen years to "assert claims against the tenants' security [deposits] for unpaid rent, cleaning expens-

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53. *Id.* at 751, 889 P.2d at 977-78, 38 Cal. Rptr. 2d at 657-58.

54. *Id.* at 751-52, 889 P.2d at 978, 38 Cal. Rptr. 2d at 658. See generally 7 CAL. JUR. 3D *Attorneys at Law* § 129 (1989 & Supp. 1995) (discussing attorney fees).

55. *Granberry*, 9 Cal. 4th at 752, 889 P.2d at 978, 38 Cal. Rptr. 2d at 658.

56. *Id.*

57. *Id.* at 752, 889 P.2d at 978, 38 Cal. Rptr. 2d at 658 (Baxter, J., concurring).

58. *Id.* at 752-53, 889 P.2d at 978, 38 Cal. Rptr. 2d at 658 (Baxter, J., concurring).

59. *Id.* at 753, 889 P.2d at 979, 38 Cal. Rptr. 2d at 659 (Baxter, J., concurring).



es, and repair costs.”<sup>60</sup> Justice Kennard asserted that the “language and the purpose of the statute [civil code section 1950.5(f)] preclude the result [the majority] reaches.”<sup>61</sup> Since the purpose of the statute is to force landlords to return tenants’ security deposits and to assert any claims against the security deposits within the statutory time period, it follows that after that period, landlords lose their right to assert claims against security deposit.<sup>62</sup> Justice Kennard added that she would hold that the trial court abused its discretion in not using fluid recovery as a remedy.<sup>63</sup> Justice Kennard agreed with the majority, however, that the objections to the limit on the attorney fees were premature.<sup>64</sup>

### 1. Right of Defendants to Setoff Defense

Justice Kennard argued that California Civil Code section 1950.5 “limits both the nature of the claims that a landlord may assert against the security and the time within which a landlord may assert those claims” and return any unclaimed portion of the security deposit to the tenant.<sup>65</sup> Justice Kennard noted that the statutory language is clear: the landlord must assert timely claims against the security or lose any right to set off claims.<sup>66</sup>

Even if the landlord loses the right to claim costs against the security, he is not without recourse.<sup>67</sup> The landlord can bring a cause of action against the tenant.<sup>68</sup> Justice Kennard then analyzed the majority’s reasoning that the landlord does not lose the right to a setoff.<sup>69</sup>

Justice Kennard attacked the majority’s holding for two reasons. First, she disagreed with the characterization of the landlord’s loss of right to a setoff as constituting a penalty. Second, she criticized the majority’s conclusion that since a penalty exists for bad faith retention of security deposits, then the legislature did not intend to terminate the landlord’s right to a setoff after the statutory period.<sup>70</sup>

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60. *Id.* at 753, 889 P.2d at 979, 38 Cal. Rptr. 2d at 659 (Kennard, J., dissenting).

61. *Id.* (Kennard, J., dissenting).

62. *Id.* at 753-54, 889 P.2d at 979, 38 Cal. Rptr. 2d at 659 (Kennard, J., dissenting).

63. *Id.* at 754, 889 P.2d at 979, 38 Cal. Rptr. 2d at 659 (Kennard, J., dissenting).

64. *Id.* (Kennard, J., dissenting).

65. *Id.* at 755, 889 P.2d at 980, 38 Cal. Rptr. 2d at 660 (Kennard, J., dissenting).

The landlord has two weeks from the end of the tenancy to refund the balance. *Id.* (Kennard, J., dissenting).

66. *Id.* at 756, 889 P.2d at 981, 38 Cal. Rptr. 2d at 661 (Kennard, J., dissenting).

67. *Id.* (Kennard, J., dissenting).

68. *Id.* (Kennard, J., dissenting). The landlord filed a cross-complaint against the tenants; however, it was dismissed because the landlord failed to properly serve the cross-complaint on the class members. *Id.* (Kennard, J., dissenting).

69. *Id.* (Kennard, J., dissenting).

70. *Id.* at 757, 889 P.2d at 981, 38 Cal. Rptr. 2d at 661 (Kennard, J., dissenting).

To begin with, noted Justice Kennard, a person who loses a claim by not acting within the statutory time period usually has not suffered a penalty.<sup>71</sup> If losing a claim in this manner were a penalty, then "every statute of limitations would be a penalty,"<sup>72</sup> the Justice reasoned. Even if such loss of a claim were a penalty, the loss of a setoff would not be a penalty because the landlord has not lost a claim against the tenant. The landlord has merely lost the right to collect the claim out of the security deposit.<sup>73</sup> Justice Kennard further stated that even if the loss of setoff is a penalty, under the language of the statute the landlord *must* lose the right to claim setoff after the time period has elapsed, or the term "shall" in section 1950.5, subdivision (f) is meaningless.<sup>74</sup>

Justice Kennard next argued that the imposition of a fine for bad-faith retention of security deposits does not mean that there should be no penalty whatsoever for good-faith violations of the statute.<sup>75</sup> Justice Kennard emphasized that the legislature could have intended for loss of setoff to be the consequence of both good-and bad-faith violations of the statute, and for statutory damages to be an additional consequence of bad-faith violations.<sup>76</sup>

Justice Kennard concluded by stating that the majority's holding destroys any impact that section 1950.5 might have had to influence landlords to refund security deposits routinely and without the necessity of court action.<sup>77</sup> Under the majority's holding, the landlord can retain the security deposit and, only if he is sued, will he have to account for the amount of the security deposit that he can reasonably retain.<sup>78</sup>

## 2. Shaping of Remedy for Class Action

Justice Kennard stated that in order to provide guidance to the trial court on remand, she would decide the issue of whether the trial court abused its discretion in fashioning a remedy.<sup>79</sup> The Justice found that

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71. *Id.* (Kennard, J., dissenting).

72. *Id.* (Kennard, J., dissenting).

73. *Id.* at 757, 889 P.2d at 981-82, 38 Cal. Rptr. 2d at 661-62 (Kennard, J., dissenting).

74. *Id.* at 757-58, 889 P.2d at 982, 38 Cal. Rptr. 2d at 662 (Kennard, J., dissenting).

75. *Id.* at 758, 889 P.2d at 982, 38 Cal. Rptr. 2d at 662 (Kennard, J., dissenting).

76. *Id.* (Kennard, J., dissenting).

77. *Id.* at 759, 889 P.2d at 982-83, 38 Cal. Rptr. 2d at 662-63 (Kennard, J., dissenting).

78. *Id.* (Kennard, J., dissenting).

79. *Id.* at 759, 889 P.2d at 983, 38 Cal. Rptr. 2d at 663 (Kennard, J., dissenting).

the trial court abused its discretion in shaping a remedy because it allowed the landlords to keep part of the amount for which they are liable to the class of tenants.<sup>80</sup> Justice Kennard asserted that “the proper measure of the class recovery is the injury caused to the class members, not the amounts that individual class members step forward to claim.”<sup>81</sup> She pointed out that if the measure of the class recovery is based on the effectiveness of the distribution, then there would never be a residual amount for which defendants would be liable.<sup>82</sup> Further, she criticized the trial court by stating that its measure of recovery “in effect narrowed the class without notice after the trial had concluded.”<sup>83</sup> Justice Kennard concluded that the trial court on remand should first determine the total liability and then decide how to distribute the amount to the class.<sup>84</sup> She stated that the trial court should choose some method of distributing the residual of the class recovery to further the purposes of the underlying action or to benefit all Californians.<sup>85</sup>

Justice Kennard concluded by remarking that section 1950.5 was enacted “to protect tenants, not landlords.”<sup>86</sup> Justice Kennard asserted that the majority’s holding “eviscerate[s]” the purpose of the section and creates the possibility that tenants will decide that “it is not worth the effort” to take landlords to court over a security deposit.<sup>87</sup>

### III. IMPACT AND CONCLUSION

The California Supreme Court has held that a landlord who in good faith fails to return the security deposit to a tenant within the statutory period may retain his right to set off the amount owed to the tenant by the costs of repair, cleaning, and unpaid rent.<sup>88</sup> Some people may feel, as Justice Kennard does, that “the majority’s holding ignores the statu-

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80. *Id.* (Kennard, J., dissenting). Justice Kennard noted that restricting a landlord’s liability to only those tenants who file claims, rather than holding the landlord liable for the full amount owed to all tenants, “rarely is one of the options that a court should choose in deciding how to distribute the class recovery . . . .” *Id.* (Kennard, J., dissenting).

81. *Id.* at 760, 889 P.2d at 983, 38 Cal. Rptr. 2d at 663 (Kennard, J., dissenting). Justice Kennard looked to California Civil Procedure Code § 384 (cited by the majority) to determine this measure of recovery. *Id.* at 759-60, 889 P.2d at 983, 38 Cal. Rptr. 2d at 663 (Kennard, J., dissenting).

82. *Id.* at 760, 889 P.2d at 983, 38 Cal. Rptr. 2d at 663 (Kennard, J., dissenting).

83. *Id.* (Kennard, J., dissenting) Justice Kennard noted that the trial court also “extinguished the causes of action of the nonclaiming class members.” *Id.*

84. *Id.* (Kennard, J., dissenting).

85. *Id.* at 760-61, 889 P.2d at 984, 38 Cal. Rptr. 2d at 664 (Kennard, J., dissenting).

86. *Id.* at 761, 889 P.2d at 984, 38 Cal. Rptr. 2d at 664 (Kennard, J., dissenting).

87. *Id.* at 761-62, 889 P.2d at 984-85, 38 Cal. Rptr. 2d at 664-65 (Kennard, J., dissenting).

88. *Id.* at 750, 889 P.2d at 977, 38 Cal. Rptr. 2d at 657.

tory language, disrupts the statutory scheme, and disserves the statute's purpose."<sup>89</sup> Others will feel that the rules of equity have been upheld so that no one will profit at the expense of another. Despite these opinions, the court's decision signals a weakening in the deterrent ability of California Civil Code section 1950.5. A landlord who retains a tenant's security deposit now need fear a penalty only if the landlord acted in bad faith.

JILL ELIZABETH LUSHER

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89. *Id.* at 754, 889 P.2d at 979, 38 Cal. Rptr. 2d at 659 (Kennard, J., dissenting).

## VIII. SALES AND USE TAXES

*The sale of documents containing trade secrets is a transfer of tangible personal property subject to sales tax, as are custom computer programs existing for the exclusive use of the seller:*

**Navistar International Transportation Corporation  
v. State Board of Equalization.**

### I. INTRODUCTION

Exactly what distinguishes tangible from intangible personal property? This question has become the subject of great debate, partly due to the tremendous tax implications such a classification can have on transfers of certain assets.<sup>1</sup> Affirming the court of appeal, the California Supreme Court recently reentered the realm of intellectual property law and held documents containing computer programs which were developed for company's use, to be neither trade secrets, nor intellectual property within the meaning of sales tax exemption.<sup>2</sup>

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1. *Navistar Int'l Transp. Corp. v. State Bd. of Equalization*, 8 Cal. 4th 868, 872, 884 P.2d 108, 109, 35 Cal. Rptr. 2d 651, 652 (1994). Justice Kennard authored the majority opinion of the California Supreme Court in which Chief Justice Lucas and Justices Mosk, Arabian, George, and Werdegar concurred. Justice Baxter concurred in part and dissented in part. *Id.* at 883, 884 P.2d at 116, 35 Cal. Rptr. 2d at 659 (Baxter, J., concurring and dissenting).

2. *Navistar*, 8 Cal. 4th at 872, 884 P.2d at 109, 35 Cal. Rptr. 2d 652. Navistar International Transportation Corporation, then known as International Harvester Company, sold all of the assets in its Solar Division to Solar Turbines, Inc., a wholly owned subsidiary of Caterpillar, Inc., for \$505 million. *Id.* at 872, 884 P.2d at 109, 35 Cal. Rptr. 2d at 652. Navistar and Caterpillar agreed to allocate the purchase price of the sale among certain categories of assets including drawings and designs, manuals and procedures, and computer programs. *Id.* at 873, 884 P.2d at 109, 35 Cal. Rptr. 2d at 652. All three categories were considered trade secrets of Navistar in the manufacture of industrial turbine engines and, as reflecting the leading technological advances, were subject to strict in-house security. *Id.* Navistar filed a sales and use tax return following the sale to Caterpillar in the third quarter of 1981. *Id.* at 874, 884 P.2d at 110, 35 Cal. Rptr. 2d at 653. In 1984, the State Board of Equalization considered the drawings and designs, the manuals and procedures, and the written computer programs to be tangible personal property, and thus taxable. *Id.* The State Board assessed a deficiency against Navistar. *Id.* In November 1986, Navistar paid the amount of the deficiency after having been denied a "Petition for Redetermination." *Id.* In 1987, Navistar requested a refund from the Board which was similarly denied. Navistar, Caterpillar, and Solar Turbines, Inc. brought a refund action against the Board. *Id.* The Superior Court ruled in favor of the Board, which the court of appeal affirmed. *Id.*

## II. TREATMENT OF THE CASE

## A. Justice Kennard's Majority Opinion

## 1. Designs and Drawings; Manuals and Procedures

Defining tangible and intangible property was the starting point for the court's analysis.<sup>3</sup> California law only imposes a tax on the transfer of tangible personal property, which it defines as "that which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses,"<sup>4</sup> thereby excluding the sale of intangible personal property and the performance of services.<sup>5</sup> California case law, the court noted, defines intangible personal property as a right, which may be evidenced by physical objects like a certificate or note.<sup>6</sup> In such instances, the physical object representing the intangible right also falls within the definition of intangible personal property for tax purposes.<sup>7</sup> Where assets transferred involve tangible personal property and the performance of services, the "true object" test governs.<sup>8</sup>

Navistar contended that its sale to Caterpillar involved intangible personal property, citing the "manuscript" example in regulation 1501.<sup>9</sup> The court cited its discussion of the manuscript example in *Simplicity Pattern Co. v. State Bd. of Equalization*,<sup>10</sup> where it held that the transfer of

3. *Id.*

4. CAL. REV. & TAX CODE § 6016 (West 1987). See generally 56 CAL. JUR. 3D *Sales and Use Taxes* §§ 26-41 (1980) (explaining sales and use taxes); 9 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Taxation* § 298 (9th ed. 1987 & Supp. 1994) (explaining which transactions involve sales taxes).

5. *Navistar*, 8 Cal. 4th at 874, 884 P.2d at 110, 35 Cal. Rptr. 2d at 653. See generally 9 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Taxation* § 315 (9th ed. 1987 & Supp. 1994) (custom computer programs exempt from sales taxation).

6. *Navistar*, 8 Cal. 4th at 875, 884 P.2d at 110, 35 Cal. Rptr. 2d at 653.

7. *Id.*

8. *Id.* "The basic distinction . . . [is based on] the true object[] of the contract; that is, [whether] the real object sought by the buyer [is] the service per se or [whether it is] the property produced by the service. If the true object of the contract is the service per se, the transaction is not subject to tax even though some tangible personal property is transferred." CAL. CODE REGS. tit. 18 § 1501 (1995).

9. *Navistar*, 8 Cal. 4th at 875, 884 P.2d at 110, 35 Cal. Rptr. 2d at 653. "[A]n idea may be expressed in the form of tangible personal property and that property may be transferred for a consideration from one person to another; however, the person transferring the property may still be regarded as the consumer of the property. Thus, the transfer to a publisher of an original manuscript by the author thereof for the purpose of publication is not subject to taxation." CAL. CODE REGS. § 1501.

10. 27 Cal. 3d 900, 615 P.2d 555, 167 Cal. Rptr. 366 (1980).

film negatives and master recordings for training medical personnel were not within the exception.<sup>11</sup> In *Simplicity*, the court found that the sale was not incidental to the performance of services.<sup>12</sup> The fact that the sale involved the purchase of the author's idea in tangible form did not automatically exempt it from taxation.<sup>13</sup> Having rejected, in *Simplicity*, the contention that the true object test renders nontaxable any transfer of items with intellectual content, and having observed that regulation 1501 applies only to transfers of personal property incidental to the performance of services, the court rejected Navistar's argument. The court held that the sale of documents should not escape the sales tax.<sup>14</sup>

The court distinguished the transfer of a manuscript by the author to a publisher for the purpose of publication from the purchase of the manuscript for its own sake.<sup>15</sup> The fact that the manuscript is transferred for purposes of publication necessarily implies that the author is also granting the publisher an exclusive copyright.<sup>16</sup> Therefore, the right to reproduce, publish and sell the literary work is separate from the literary work itself.<sup>17</sup> In the case at bar, Caterpillar purchased the documents for the corporation's sake, not for the purposes of publication.<sup>18</sup>

The court also rejected Navistar's reliance on the *Simplicity* holding that the sale of tangible personal property valued in part for its intellectual content is only taxable if "physically useful" in the manufacturing process.<sup>19</sup> Physical usefulness is not a prerequisite for the imposition of sales tax because books purchased for their intellectual content are generally taxable despite the fact that they do not involve utility in manufacturing.<sup>20</sup>

The court found that Navistar's reliance on *Capitol Records, Inc. v. State Bd. of Equalization*,<sup>21</sup> and *A & M Records, Inc. v. State Bd. of Equalization*<sup>22</sup> was also misplaced.<sup>23</sup> In *Capitol Records*, the court of appeal's primary reason for characterizing master tapes as immediately

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11. *Id.* at 909, 615 P.2d at 559-60, 167 Cal. Rptr. at 370-71.

12. *Id.*

13. *Id.*

14. *Navistar*, 8 Cal. 4th at 877, 884 P.2d at 112, 35 Cal. Rptr. 2d at 655. "As we noted in *Simplicity*, it does not follow from the manuscript example that a sale becomes nontaxable whenever its principal purpose is to transfer the intellectual content of a physical object." *Id.* (citations omitted).

15. *Id.*

16. *Id.*

17. *See id.*

18. *Id.* at 877-78, 884 P.2d at 112, 35 Cal. Rptr. 2d at 655.

19. *Id.* at 878, 884 P.2d at 112, 35 Cal. Rptr. 2d at 655.

20. *Id.* at 878, 884 P.2d at 113, 35 Cal. Rptr. 2d at 656.

21. 158 Cal. App. 3d 582, 204 Cal. Rptr. 802 (1984).

22. 204 Cal. App. 3d 358, 250 Cal. Rptr. 915 (1988).

23. *Navistar*, 8 Cal. 4th at 878, 884 P.2d at 113, 35 Cal. Rptr. 2d at 656.

useful in the manufacturing process was to determine whether the classification was arbitrary in typical equal protection analysis fashion.<sup>24</sup> Likewise, the court determined that *Capitol Records* did not stand for the proposition that physical usefulness was a prerequisite for the imposition of sales tax.<sup>25</sup> Instead, the court held that the sale of master tapes was taxable as a transfer of personal property rather than as property accompanying the artist's recording services.<sup>26</sup>

The court quickly dispelled Navistar's reliance on the IRS' acceptance that Caterpillar's documents were intangible. In so doing, the court found the issue of tangible personal property as one of valuation and not of classification, thereby making such considerations inappropriate.<sup>27</sup>

## II. CUSTOM COMPUTER PROGRAMS

After concluding that the documents and designs, manuals and procedures were tangible personal property subject to the sales tax, the court addressed the taxability of Navistar's computer programs.<sup>28</sup> Because the programs were developed for the exclusive use of its Solar Division and not for general or repeated sale, Navistar contended that the programs were custom items exempted by section 6010.9.<sup>29</sup> As noted in *Touche & Ross & Co. v. State Bd. of Equalization*,<sup>30</sup> the subsequent sale of a

24. *Capitol*, 158 Cal. App. 3d at 599-600, 204 Cal. Rptr. at 813.

25. *Navistar*, 8 Cal. 4th at 879, 884 P.2d at 113, 35 Cal. Rptr. 2d at 656.

26. *Id.*

27. *Id.* at 879-80, 884 P.2d at 113-14, 35 Cal. Rptr. 2d at 656-57.

28. *Id.* Section 6010.9 states that custom computer programs are not subject to taxation, and defines them as programs that are:

prepared to the special order of the customer and includes those services represented by separately stated charges for modifications to an existing prewritten program which are prepared to the special order of the customer. The term does not include a "canned" or prewritten computer program which is held or existing for general or repeated sale or lease, even if the prewritten or "canned" program was initially developed on a custom basis or for in-house use. Modification to an existing prewritten program to meet the customer's needs is custom computer programming only to the extent of modification.

CAL. REV. & TAX CODE § 6010.9(d) (West 1987 & Supp. 1995). See generally 9 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Taxation* § 315 (9th ed. 1989 & Supp. 1995) (miscellaneous exemptions from sales tax).

29. *Navistar*, 8 Cal. 4th at 880, 884 P.2d at 114, 35 Cal. Rptr. 2d at 657.

30. 203 Cal. App. 3d 1057, 250 Cal. Rptr. 408 (1988).



custom program can not be characterized as a service and is, therefore, subject to the sales tax.<sup>31</sup>

Notwithstanding Navistar's contention that the Solar Division program fell within the plain language of section 6010.9, the court relied on section 6010.9(d), which clearly states that programs initially developed for in-house use are taxable.<sup>32</sup> The statute defines "custom computer programs" as those prepared to the special order of the customer, excluding all other computer programs.<sup>33</sup> When Caterpillar purchased Solar Division's computer programs, the service transaction had already been completed.<sup>34</sup> Therefore, the court upheld the custom program exclusion only for those programs not canned or prewritten.<sup>35</sup>

The court attacked Justice Baxter's dissent in footnote six of the majority opinion.<sup>36</sup> The majority asserted that Baxter's classification of canned and custom computer programs failed to account for the structure of the statute.<sup>37</sup> The court found defining "custom," as opposed to "canned" computer programs to be the thrust of the statute.<sup>38</sup> This was precisely what Baxter had overlooked.<sup>39</sup> The court noted that the statute defined "custom computer programs" as those prepared to the special order of the customer, using "canned programs" for purposes of contrast thereto.<sup>40</sup> The court concluded that "custom computer programs" did not include those programs prewritten for general or repeated sale but did include those modified for a particular customer, to the extent of the modification.<sup>41</sup> Thus, according to the court's logic, a custom computer program did not embrace those prewritten programs sold to a customer without modification, as found in *Navistar*.<sup>42</sup>

Navistar contended that taxing the subsequent sale of a custom computer program is "inconsistent with the Legislature's treatment of computer media for purpose of property taxation."<sup>43</sup> The court responded by noting that sales taxes were imposed on the storage media for computer programs, and not on the computer programs themselves.<sup>44</sup> Additionally,

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31. *Navistar*, 8 Cal. 4th at 880, 884 P.2d at 114, 35 Cal. Rptr. 2d 657.

32. *Id.* at 881-82, 884 P.2d at 115, 35 Cal. Rptr. 2d at 658.

33. CAL. REV. & TAX CODE § 6010.9(d) (West 1987 & Supp. 1995).

34. *Navistar*, 8 Cal. 4th at 882, 884 P.2d at 115, 35 Cal. Rptr. 2d at 658.

35. *Id.*

36. *Id.* at 882 n.6, 884 P.2d at 115 n.6, 35 Cal. Rptr. 2d at 658 n.6.

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.* at 882-83, 884 P.2d at 116, 35 Cal. Rptr. 2d at 659.

44. *Id.*

the court found that section 6010.9 did not impose a tax on the program while it remained in the owner's possession.<sup>45</sup> The court concluded that Navistar's sale of custom computer programs was a taxable event, as it did not fall within the section 6010.9 exemption.<sup>46</sup>

#### A. Justice Baxter's Concurring and Dissenting Opinion

Justice Baxter began his opinion by agreeing with the majority's holding that Navistar's sale of documents to Caterpillar was a taxable event.<sup>47</sup> However, he disagreed with the majority's holding that the computer programs were taxable.<sup>48</sup> Justice Baxter argued that section 6010.9 created two types of computer programs "canned" and "custom."<sup>49</sup> Justice Baxter asserted that since the Navistar programs were not canned, i.e. not prewritten and held for general and repeated sale, they must be custom.<sup>50</sup> Justice Baxter concluded that to create a third category of taxable custom computer programs was tantamount to "judicial rewriting of the statute."<sup>51</sup>

### III. IMPACT

Before *Navistar* was decided, custom computer programs were held to be exempt from the sales tax.<sup>52</sup> California further defined what constitutes a custom computer program in § 6010.9 of the California Code of Regulations, differentiating those custom programs exempt from taxation and canned programs subject thereto.<sup>53</sup> In *Navistar*, the court strictly

45. *Id.*

46. *Id.*

47. *Id.* (Baxter, J., concurring & dissenting).

48. *Id.* (Baxter, J., concurring & dissenting).

49. *Id.* at 884, 884 P.2d 116, 35 Cal. Rptr. 2d at 659 (Baxter, J., concurring & dissenting).

50. *Id.* at 883-84, 884 P.2d at 116, 35 Cal. Rptr. 2d 659 (Baxter, J., concurring & dissenting).

51. *Id.* at 884, 884 P.2d at 116, 35 Cal. Rptr. 2d 659 (Baxter, J., concurring & dissenting).

52. See generally 9 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Taxation* § 315 (9th ed. 1987 & Supp. 1995) (custom computer programs exempt from sales taxation).

53. CAL. REV. & TAX CODE § 6010.9(d) (West 1978 & Supp. 1995); see also *supra* note 24 and accompanying text. "Custom computer program includes those services represented by separately stated charges for modifications to an existing prewritten program which are prepared to the special order of the customer. The term does not include a 'canned' or prewritten computer program which is held or existing for general or repeated sale or lease, even if the prewritten or 'canned program' was initial-

applied the second sentence of section 6010.9, holding that prewritten computer programs later sold without modification were not within the "custom computer program" exemption.<sup>54</sup>

The taxation of computer programs, such as those found in *Navistar*, has drawn fire in the recent past, as courts accommodate federal and state governmental attempts to get a piece of the software industry's revenue pie.<sup>55</sup> Now, custom computer programs are not generally subject to taxation, but they are potentially taxable if electronically delivered to the buyer.<sup>56</sup> The judiciary has, therefore, created uncertainty in an area known for its benchmarks of equity, certainty, and efficiency.<sup>57</sup> The court's action has not only impeded the normal market operations of the software industry, but has also provided significant barriers to the acquisition of high technology companies.<sup>58</sup>

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ly developed on a custom basis or for in-house use. Modification to an existing prewritten program to meet the customer's needs is custom computer programming only to the extent of modification." CAL. REV. & TAX CODE § 6010.9(d).

54. *Navistar*, 8 Cal. 4th at 883, 884 P.2d at 116, 35 Cal. Rptr. 2d 659.

55. John Wei-Ching Kuo, Comment, *Sales/Use Taxation of Software: An Issue of Tangibility*, 2 HIGH TECH L.J. 1, 1 (1987).

56. *Id.*

57. *Id.*; see also Robert W. McGee, *Software Taxation in Ohio*, 9 AKRON TAX J. 49, 49-52 (1992) (explaining various tests used to determine whether computer programs are taxable).

58. William A. Burnham, *Acquisitions of High Technology Companies*, 4 No. 12 J. PROPRIETARY RTS. 2 (1992); see also Ether Roditti Schachter, *Practical and Legal Considerations In Contracting for the Development and Marketing of Custom Software*, 276 PLI/Pat 409 (1989); cf. *Software Held Intangible Personal Property for Tax Purposes*, 9 No. 5 PH-CLW 37 (1992).

## IX. SECURED TRANSACTIONS

*A secured party who satisfies the statutory notice requirement for a nonjudicial foreclosure may, but does not conclusively, satisfy the publicity requirement under the California Commercial Code; commercial reasonableness requires that a secured party advertise a nonjudicial foreclosure sale using the methods of a responsible dealer:*

**Ford & Vlahos v. ITT Commercial Finance Corp.**

### I. INTRODUCTION

In *Ford & Vlahos v. ITT Commercial Finance Corp.*,<sup>1</sup> the California Supreme Court considered whether a secured party, who satisfies the notice requirement under California Commercial Code section 9504(3)<sup>2</sup> for a nonjudicial foreclosure sale, conclusively satisfies the requirement of adequate publicity.<sup>3</sup> The court noted that section 9504(3) requires a

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1. 8 Cal. 4th 1220, 885 P.2d 877, 36 Cal. Rptr. 2d 464 (1994). Justice Mosk authored the unanimous opinion of the court in which Chief Justice Lucas and Justices Kennard, Arabian, Baxter, George, and Werdegar concurred. *Id.* at 1223-36, 885 P.2d at 879-87, 36 Cal. Rptr. 2d at 466-74.

2. Section 9504(3) provides in pertinent part:

A sale or lease of collateral may be . . . at any time and place and on any terms, provided the secured party acts in good faith and in a commercially reasonable manner. [Ordinarily] the secured party must give to the debtor . . . and to any other person who has a security interest in the collateral . . . a notice in writing of the time and place of any public sale or of the time on or after which any private sale or other intended disposition is to be made . . . . Notice of the time and place of a public sale shall also be given at least five days before the date of sale by publication once in a newspaper of general circulation published in the county in which the sale is to be held . . . . The secured party may buy at any public sale . . . . Any sale of which notice is delivered or mailed and published as herein provided and which is held as herein provided is a public sale.

CAL. COM. CODE § 9504(3) (West 1990 & Supp. 1995). See generally 3 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Secured Transactions in Personal Property* § 71(1) (9th ed. 1987 & Supp. 1995) (discussing the proper notice procedures for the disposition of collateral after a debtor's default); 57 CAL. JUR. 3D *Secured Transactions* §§ 198-204 (1980 & Supp. 1995) (discussing the general requirements of a nonjudicial sale or other disposition of collateral).

3. *Ford & Vlahos*, 8 Cal. 4th at 1223, 885 P.2d at 879, 36 Cal. Rptr. 2d at 466. In the present case, the defendant loaned money to the plaintiff to purchase an airplane.

secured creditor "to 'act[] in good faith and in a commercially reasonable manner' when auctioning foreclosed personalty."<sup>4</sup> Applying this standard, the court reasoned that the secured party's actions were commercially unreasonable because of the value of the collateral involved, unless the party advertised the auction in the relevant market.<sup>5</sup> The court noted that in some cases notice by publication may be commercially reasonable.<sup>6</sup> In the present case, however, the court found that publication by newspaper failed to reach the relevant market necessary for an airplane auction.<sup>7</sup> Accordingly, the court held that the publicity was commercially unreasonable.<sup>8</sup>

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*Id.* As a condition of the loan, the defendant acquired a "purchase-money security interest" in plaintiff's airplane. *Id.* See generally 3 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Secured Transactions in Personal Property* § 54 (9th ed. 1987 & Supp. 1995) (discussing the priority of a purchase-money security interest); 57 CAL. JUR. 3D *Secured Transactions* §§ 47-50 (1980 & Supp. 1995) (defining and discussing purchase-money security interests). When the plaintiff defaulted on the loan payments, the defendant notified the plaintiff of its intent to foreclose on the airplane and to hold an auction on September 3, 1987, in Chandler, Arizona. *Ford & Vlahos*, 8 Cal. 4th at 1223, 885 P.2d at 879, 36 Cal. Rptr. 2d at 466.

On August 28, 1987, the defendant advertised the sale in a local newspaper of the county where the sale was to be held. *Id.* at 1224, 885 P.2d at 879, 36 Cal. Rptr. 2d at 466. However, the advertisement lacked information regarding whom to contact for bidder qualifications. *Id.* Knowing that bidder pre-qualification was required, the defendant placed a new advertisement in another local paper on September 2, the day before the auction. *Id.* As the only bidder at the auction, the defendant bought the plane for \$1 million. *Id.* Shortly thereafter, the defendant's agent advertised the airplane in the leading aviation publication and agreed to sell it for a considerable profit. *Id.*

The plaintiff sued upon a claim of improper disposition of the airplane. *Id.* The trial court agreed, finding the sale commercially unreasonable. *Id.* The trial court reasoned that the publicity was inadequate and failed to provide a sufficient number of bidders. *Id.* The trial court also noted that the airplane's value on the auction date was \$3.8 million. *Id.* at 1225, 885 P.2d at 880, 36 Cal. Rptr. 2d at 467. The court of appeal partially reversed the trial court's decision, noting that the legislature established a bright-line rule and provided that satisfying the notice requirement conclusively satisfied the publicity requirement. *Id.* at 1225-26, 885 P.2d at 880, 36 Cal. Rptr. 2d at 467.

4. *Ford & Vlahos*, 8 Cal. 4th at 1228, 885 P.2d at 882, 36 Cal. Rptr. 2d at 469 (quoting CAL. COM. CODE § 9-504(3) (West 1990 & Supp. 1995)). See generally 3 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, *Secured Transactions in Personal Property* § 70 (9th ed. 1987 & Supp. 1994) (suggesting methods for satisfying the requirement of commercial reasonableness in the disposition of collateral); 57 CAL. JUR. 3D *Secured Transactions* § 202 (1980 & Supp. 1995) (discussing the requirement of commercial reasonableness).

5. *Ford & Vlahos*, 8 Cal. 4th at 1229, 885 P.2d at 882, 36 Cal. Rptr. 2d at 469.

6. *Id.* at 1231, 885 P.2d at 884, 36 Cal. Rptr. 2d at 471.

7. *Id.* at 1235, 885 P.2d at 886, 36 Cal. Rptr. 2d at 473.

8. *Id.*

## II. TREATMENT

Justice Mosk, writing for the court, asserted that notice and publicity are "separate but related concepts" under the California Commercial Code.<sup>9</sup> The court examined the language of section 9504(3) and found that it plainly required a "secured party . . . to 'act[] in good faith and in a commercially reasonable manner' when auctioning foreclosed personalty."<sup>10</sup> The court noted that "commercially reasonable" is partially defined in section 9507(2).<sup>11</sup> The court read the two sections together and construed them as implicitly requiring the sale of property "by methods a responsible dealer would utilize" to qualify as commercially reasonable.<sup>12</sup> The court reasoned that given the value of the airplane, a responsible dealer would advertise in the relevant market.<sup>13</sup> The court further reasoned that although section 9507(2) does not explicitly require this method, no other construction of the statute was reasonable given the "valuable type of collateral" involved in the instant case.<sup>14</sup>

Furthermore, the court asserted that "[p]ublicity is . . . too important to a proper sale of foreclosed collateral," and that "advertising is the sine

9. *Id.* at 1227, 885 P.2d at 881, 36 Cal. Rptr. 2d at 468.

10. *Id.* at 1228, 885 P.2d at 882, 36 Cal. Rptr. 2d at 469 (quoting CAL. COM. CODE § 9-504(3) (West 1990 & Supp. 1995)). See generally Maury B. Poscover, *A Commercially Reasonable Sale Under Article 9: Commercial, Reasonable, and Fair to All Involved*, 28 LOY. L.A. L. REV. 235 (1994) (describing how the requirement of commercial reasonableness protects the interests of the parties and ensures a fair price).

11. *Ford & Vlahos*, 8 Cal. 4th at 1228, 885 P.2d at 882, 36 Cal. Rptr. 2d at 469 (quoting CAL. COM. CODE § 9507(2) (West 1990 & Supp. 1995)). Section 9507(2) provides in pertinent part:

The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the secured party either sells the collateral in the usual manner in any recognized market therefor or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner.

CAL. COM. CODE § 9507(2) (West 1990 & Supp. 1995). For a good discussion of the impact of the recent developments under Article 9, see Steven O. Weise, *U.C.C. Article 9—Personal Property Secured Transactions*, 46 BUS. LAW 1711 (1991).

12. *Ford & Vlahos*, 8 Cal. 4th at 1229, 885 P.2d at 882, 36 Cal. Rptr. 2d at 469.

13. *Id.*

14. *Id.* See generally Homer Kripke, *Draftman's Wishes That He Could Do Things Over Again—U.C.C. Article 9*, 26 SAN DIEGO L. REV. 1 (1989) (discussing the interpretation and construction of commercial law).

qua non to attendance at an auction.”<sup>15</sup> The court explained that publicity and advertising yield a “lively concourse of bidders,” which is necessary to achieve “competitive bidding” resulting in the best possible price.<sup>16</sup> Thus, the court concluded that the legislature failed to “merge[] adequate advertising and formal notice into a single requirement for a valid foreclosure sale.”<sup>17</sup> However, the court reasoned that because “publication is a form of advertising,” in some cases notice by publication may also satisfy the publicity requirement.<sup>18</sup>

Additionally, the court compared the purposes of notice and advertising and found them distinguishable.<sup>19</sup> The court explained that the purpose of notice is to “alert [debtors and other secured creditors] . . . that their interests may be extinguished very soon.”<sup>20</sup> On the other hand, the court asserted that the purpose of advertising is “to ensure [that] the auction is well attended by legitimate bidders, so that the highest commercially reasonable price for the collateral will be obtained.”<sup>21</sup> The court further examined the Uniform Commercial Code and found that neither its purpose of fairness nor its purpose of efficiency would benefit from a rule that allowed a party to conclusively satisfy the publicity requirement merely by satisfying the statutory notice requirement.<sup>22</sup>

Applying the California Commercial Code’s requirements to the instant case, the court determined that a responsible dealer auctioning an airplane would advertise in the relevant aviation market.<sup>23</sup> The court found publication of the sale in local newspapers insufficient to reach the relevant market because the newspapers, limited in circulation, failed to

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15. *Ford v. Vlahos*, 8 Cal. 4th at 1230, 885 P.2d at 883, 36 Cal. Rptr. 2d at 470.

16. *Id.* at 1230, 885 P.2d at 883, 36 Cal. Rptr. 2d at 470 (citing *Westgate State Bank v. Clark*, 642 P.2d 961, 970 (Kan. 1982)). The court further explained that “[n]otice of sale should be given to . . . [those] reasonably expected to have an interest in the collateral.” *Id.* (quoting *Villela Enterprises, Inc. v. Young*, 766 P.2d 293, 297 (N.M. 1988) (holding that the creditor’s publication of sale in a newspaper was commercially unreasonable when the creditor was the only bidder in attendance at the sale)).

17. *Id.* at 1231, 885 P.2d at 884, 36 Cal. Rptr. 2d at 471.

18. *Id.*

19. *Id.* at 1232-33, 885 P.2d at 884-85, 36 Cal. Rptr. 2d at 471-72.

20. *Id.* at 1232, 885 P.2d at 884, 36 Cal. Rptr. 2d at 471.

21. *Id.* at 1232-33, 885 P.2d at 885, 36 Cal. Rptr. 2d at 472.

22. *Id.* at 1234-35, 885 P.2d at 885-886, 36 Cal. Rptr. 2d at 472-73. See generally Robert A. Riegert, *Secured Transactions Part III*, 89 COM. L.J. 127 (1984) (discussing the laws and regulations of the Uniform Commercial Code regarding secured transactions, debtors and creditors, and foreclosures).

23. *Ford & Vlahos*, 8 Cal. 4th at 1229, 885 P.2d at 882, 36 Cal. Rptr. 2d at 469; see *Dynallectron Corp. v. Jack Richards Aircraft Co.*, 337 F. Supp. 659, 662-663 (W.D. Okla. 1972) (holding that failure to advertise an aircraft in the customary trade journals or publications was commercially unreasonable).

yield competitive bidders, and consequently, a fair price.<sup>24</sup> Accordingly, the court found that although publication by newspaper satisfied the statutory notice requirement, it failed to satisfy the publicity requirement.<sup>25</sup> Therefore, the court concluded that publication of an airplane auction by newspaper is commercially unreasonable.<sup>26</sup>

### III. IMPACT AND CONCLUSION

In *Ford & Vlahos*, the California Supreme Court clarified the California Commercial Code's nonjudicial foreclosure notice and publicity requirements. The court reasoned that although notice and publicity as set forth in the Code are "related concepts," they are distinct requirements.<sup>27</sup> The court held that the Code requires a secured party to use the methods of a responsible dealer in order for its actions to qualify as commercially reasonable.<sup>28</sup> Because notice by publication is a type of publicity, satisfying the notice requirement in some cases will also satisfy the publicity requirement.<sup>29</sup> Therefore, the question is a factual one that varies depending on the type and value of collateral involved in each case.<sup>30</sup>

The court's decision in this case will help to protect debtors whose property is foreclosed. In an area of law where the debtor is at a great disadvantage, *Ford & Vlahos* ensures that secured creditors act in a commercially reasonable manner regarding the disposition of the foreclosed property. Thus, the court's interpretation of the California Commercial Code's requirement of commercial reasonableness will most likely produce fairer results, including fairer prices.<sup>31</sup>

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24. *Ford & Vlahos*, 8 Cal. 4th at 1235, 885 P.2d at 886, 36 Cal. Rptr. 2d at 473.

25. *Id.*

26. *Id.* The court reversed the court of appeal's judgment and remanded the case for consideration of the defendant's other claims that the court of appeal failed to address. *Id.* at 1235-36, 885 P.2d at 886, 36 Cal. Rptr. 2d at 473.

27. *Id.* at 1227, 885 P.2d at 881, 36 Cal. Rptr. 2d at 468.

28. *Id.* at 1229, 885 P.2d at 882, 36 Cal. Rptr. 2d at 469.

29. *Id.* at 1231, 885 P.2d at 884, 36 Cal. Rptr. 2d at 471.

30. *Id.* at 1235, 885 P.2d at 886, 36 Cal. Rptr. 2d at 473.

31. See Poscover, *supra* note 10.



## I. Attorney Fees

**A trial court does not have discretion to deny attorney's fees pursuant to Civil Code Section 1717 when the court finds for a party on the single contract claim in the action; thus a defendant who prevails on the only contract claim will be the "prevailing party" as a matter of law, and therefore entitled to an award of attorney's fees where the contract permits either party to recover fees.**

*Hsu v. Abbara, California Supreme Court, Decided April 6, 1995, 9 Cal. 4th 863, 891 P.2d 804, 39 Cal. Rptr. 2d 824.*

**Facts.** During negotiations for the sale of real estate, plaintiffs/buyers made a written offer to purchase defendants' home. The offer was made on a standard real estate form which included a provision for reasonable attorney fees to the prevailing party in any action between the parties. Defendants/sellers made a written counteroffer which incorporated the terms and conditions of the offer.

Plaintiffs then made an oral counteroffer, which was refused, but subsequently plaintiffs submitted a written "counteroffer" by signing the defendant's previous counteroffer and delivering it to the sellers' real estate agent. When the defendants refused to acknowledge that a sales contract had been formed, the plaintiffs/prospective buyers sued the owners for specific performance to enforce the contract.

The trial court found that the plaintiffs' alleged acceptance of defendants' counteroffer was actually a new offer, and concluded that no contract had been formed. The court granted defendants' motion for judgment on the complaint, but denied the defendants' motion for attorney's fees, finding that the defendants were not a "prevailing party." Both parties appealed, and the court of appeal affirmed.

**Holding.** The California Supreme Court reversed in favor of the defendants, finding that the sellers were indeed a prevailing party entitled to an award of attorney fees. The court held the defendants were entitled to attorneys fees as a matter of law, and that the trial court did not have the discretionary power to deny the defendants fees under section 1717. The court reasoned that the trial court may have discretion to deny the

award of attorneys fees in a case where there is no clear prevailing party, such as where two parties seek relief, and one party is only partially successful. In the present situation, however, the court found that the defendants had won the judgment on the only contract action to the claim, and therefore were clearly a prevailing party consistent with the intent of the legislature and the language of the statute.

## II. Civil Rights

**A country club that regularly engages in business transactions on club premises with persons who are not club members qualifies as a "business establishment" under the Unruh Civil Rights Act and thus cannot legally discriminate against women or other groups as a "truly private social club" could.**

*Warfield v. Peninsula Golf & Country Club, Decided June 29, 1995, 10 Cal. 4th 594, 896 P.2d 776, 42 Cal. Rptr. 2d 50 (1995).*

**Facts.** The Peninsula Golf & Country Club listed more than 700 members in 1981, approximately half of which were "proprietary members." Proprietary members enjoy virtually no restrictions on club use and are instrumental in member selection. Although Mary Ann Warfield and Richard Warfield purchased a proprietary membership with community funds, the membership was listed in the husband's name pursuant to club by-laws, which precluded the issuance of proprietary memberships in the names of females and minors. In 1981, the Warfields were divorced, and Mrs. Warfield was awarded the proprietary membership at the club. The country club's by-laws allowed the termination of a proprietary interest in the event a female spouse was awarded the membership from a divorce and the husband did not repurchase her interest. Dr. Warfield did not purchase his wife's interest and the club terminated her membership.

Mrs. Warfield brought suit under the Unruh Civil Rights Act, which mandates the "full and equal accommodations, advantages, facilities, privileges, or services in all business establishments of every kind whatsoever." The trial court granted the club's motion for directed verdict, in part because Mrs. Warfield failed to prove that the club qualified as a business establishment. The court of appeal affirmed.

**Holding.** The California Supreme Court reversed and found the club to be a business establishment because it regularly conducted business transactions on the club premises with nonmembers. The court listed three factors important to its conclusion. First, the court likened the club to a commercial caterer because it regularly permitted nonmembers to use club facilities during privately sponsored tournaments, weddings, and other events. Second, the court recognized the commercial nature in accepting marked-up payments from nonmembers for greens fees, tennis court fees, and food and beverage costs. Finally, the court recognized that nonmembers were allowed to purchase items and arrange for professional lessons from golf and tennis pro shops located on the premises. Reasoning that the inclusion of women did not conflict with the nature and purpose of the country club, the court rejected the club's contentions that naming women as proprietary members would violate their constitutional rights of association and privacy. The court also reasoned that the club's large membership and regular business associations with nonmembers were inconsistent with practices of "truly private social clubs."

### **III. Criminal Law**

- A. Hate crime statutes are not unconstitutionally overbroad or vague since they are narrowly tailored, adequately defined, and require proof of specific intent.**

*In re M.S., Supreme Court of California, Decided July 3, 1995, 10 Cal. 4th 698, 896 P.2d 1365, 42 Cal. Rptr. 2d 355.*

**Facts.** One morning, a group of homosexual men were confronted by two men and two minor women. The minors and their companions shouted anti-gay remarks at the men and threatened to beat them up. Eventually, the threats were carried out and two of the gay men were attacked. Both minors were charged with violation of Penal Code sections 422.6 and 422.7, two of California's "hate crime" statutes, along with charges of assault and battery. The juvenile court found all of the charges to be true and declared the juveniles wards of the court. The minors challenged the ruling and argued that the hate crime statutes were vague and overbroad. The court of appeal rejected their constitutional challenge and affirmed the holding of the juvenile court.

**Holding.** The Supreme Court of California affirmed the judgment of the court of appeal. The court held that the hate crime statutes were neither unconstitutionally overbroad nor vague. The supreme court explained that since the statutes were narrowly directed against only those threats that truly pose a danger to society and because both sections require proof of specific intent to interfere with a person's legally protected rights, the statutes were not overbroad. The supreme court additionally noted that the phrases "groups of people" and "apparent ability" were adequately and narrowly defined and did not cause the statutes to be vague.

The court also held that bias need not be the sole motivating force behind the crime, but it must be a substantial factor when multiple concurrent motives exist.

Lastly, the court held that the hate crime statutes are not implicitly exempt from section 654, which prohibits punishment under more than one statute if an act or omission is made punishable in different ways by different provisions of the code.

- B. **A court of appeal cannot summarily reject undisputed factual allegations in a habeas corpus petition for reinstatement of a dismissed appeal solely on a determination that the allegations are not credible without conducting an evidentiary hearing which would allow petitioner an opportunity to prove the facts alleged.**

*In re Serrano, Supreme Court of California, Decided June 19, 1995, 10 Cal. 4th 447, 895 P.2d 936, 41 Cal. Rptr. 2d 695.*

**Facts.** Petitioner was convicted of first degree murder and attempted murder. His appeal was dismissed, pursuant to California Rules of Court, rule 17(a), on the grounds that petitioner failed to file an opening brief. Petitioner filed a writ of habeas corpus seeking reinstatement of his appeal. The court of appeal denied the petition finding no diligence on behalf of the petitioner to protect his right to appeal and concluded that petitioner's explanation for not filing an opening brief was implausible.

**Holding.** The California Supreme Court reversed the court of appeal and granted petitioner's request for relief. The court reasoned that in ascer-

taining the veracity of petitioner's explanation for not filing an opening brief, the court of appeal could not make a credibility determination of the undisputed facts without giving the petitioner an opportunity to prove the allegations in an evidentiary hearing. In appraising the merits of petitioner's writ, the court accepted as true petitioner's undisputed allegations and found there were sufficient reasons to grant petitioner's reinstatement of his appeal. The court also found that the court of appeal showed no bias towards the petitioner and subsequently denied his request that his appeal be transferred to another court.

- C. **California's "hate crime" criminal enhancement statute, Penal Code section 422.75, does not necessitate a showing of specific intent, but requires that bias motivation be the cause in fact of the crime, and when there are multiple concurrent causes of the hate crime, bias motivation must be a substantial factor in the commission of the crime.**

*People v. Aishman, Supreme Court of California, Decided July 3, 1995, 10 Cal. 4th 735, 896 P.2d 1387, 42 Cal. Rptr. 2d 377.*

**Facts.** Defendants were charged with assault with a deadly weapon and battery with serious bodily injury, after attacking three Mexican men who had allegedly raped the wife of one of the defendants. The People argued that because these "hate crimes" were based on bias motivation and violated the victims' protected interests, California enhancement statute section 422.75 should be invoked, adding one to three additional years onto the defendants' prison sentences. At trial, the defendants challenged the constitutionality of the statute, claiming that it violated their rights to free speech and due process. Overruling the trial court, the court of appeal held that the statute was constitutionally valid, and further held that the defendants' prison sentences should be enhanced. While the supreme court agreed with the court of appeal's ultimate findings, it granted review to clarify the more pressing issues of intent and causation as applied to the statute.

**Holding.** Addressing the issue of intent, the supreme court held that section 422.75 of California's Penal Code did not require proof that the defendant had acted with specific intent to deprive the victim of the victim's protected interests. The court reasoned that since the legislature had made no reference in section 422.75 to the specific intent of the perpetrator, and because the statute does nothing more than increase the

punishment for a bias motivated felony with no mention of an intent requirement, specific intent need not be proven.

The supreme court next turned to the issue of causation. The defendants claimed that the statute required a clear showing of "but for" causation to establish guilt, and further argued that no punishment enhancement could be given unless the felony was committed solely because of the victim's race, color or other protected interest. The court disagreed with the defendants' arguments, however, and held that the enhancement statute applies both when the motivation for the crime was the cause in fact of the offense, and also when bias motivation is a substantial factor in crimes having multiple concurrent causes.

- D. **A criminal defendant who appeals a conviction arising from a plea of guilty or nolo contendere, contesting either the validity of a search or seizure or the validity of a post plea proceeding may proceed without a certificate of probable cause for appeal, and may raise other noncertificate issues on appeal.**

*People v. Jones, Supreme Court of California, Decided August 10, 1995, 10 Cal. 4th 1102, 898 P.2d 910, 43 Cal. Rptr. 2d 464.*

**Facts.** After the trial court denied the defendant's motion to suppress evidence, the defendant pleaded guilty to possession of a controlled substance, transportation of a controlled substance, and driving with a suspended license. The defendant was sentenced to probation contingent, inter alia, upon paying certain fees. Defendant appealed without obtaining a court issued certificate of probable cause for appeal. Although the notice of appeal stated as grounds for appeal only the trial court's error in denying the motion to suppress evidence, in defendant's opening brief to the court of appeal he objected additionally to the court's imposition of fees as conditions of probation without having assessed his ability to pay. The court of appeal held that the motion to suppress evidence was properly granted, and refused to decide the probation condition issue because the defendant had omitted that issue in his notice of appeal.

**Holding.** The Supreme Court of California reversed. Criminal appeals based either on post plea proceedings that do not challenge the validity of the plea or based on contested searches and seizures do not need a certificate of probable cause for appeal. Other noncertificate issues, although not cited in the notice of appeal, may also be cognizable on appeal. Rule 31(d) of the California Rules of Court, rather than delineating the scope of the issues to be considered upon appeal, merely determines whether an appeal should proceed. The defendant's notice of appeal was operative because it was based on a noncertificate issue, i.e. a contested search and seizure. Therefore, other noncertificate issues, including the validity of post plea proceedings imposing conditions upon the defendant's probation, are also cognizable upon appeal.

#### **IV. Immunity**

**As a matter of law, the Board of Education's decision to renew a superintendent's contract is a discretionary act entitled to personal immunity for the Board's members under section 820.2 of the California Tort Claims Act, which applies even against the liabilities imposed by the FEHA.**

*Richard Caldwell v. Joseph Montoya, Supreme Court of California, Decided July 27, 1995, 10 Cal. 4th 972, 897 P.2d 1320, 42 Cal. Rptr. 2d 842.*

**Facts.** In August 1991, Richard Caldwell, the sixty-six-year old superintendent of Paramount Unified School District, was serving out his contract with the school district, which was effective through June 30, 1992. On August 13, by a 3 to 2 vote, the Board of Education voted not to renew Mr. Caldwell's contract. Board members Joseph Montoya III, Vivian Hansen, and Janet Miller all voted against renewing Caldwell's contract. Caldwell alleged that all three had improper motives for casting their respective votes against renewal of his contract. He charged that Montoya had cast his vote adversely because Caldwell was not a Hispanic, while Hansen and Miller had cast their votes adversely because of Caldwell's age. Additionally, Caldwell accused Hansen of using her adverse vote as retaliation against him for positions taken by his wife as a member of the city council. Caldwell's claims of improper motive arose from newspaper reports of statements and actions by Montoya, Hansen, and Miller which suggested improper motives behind their votes.

Caldwell's complaint in the trial court stated causes of action against the school district for breach of contract, for violating the California Fair

Employment and Housing Act (FEHA), and for discharge in violation of public policy. Montoya, Miller, and Hansen were included as defendants under the FEHA claims. Hansen was also added in the public policy claim. Montoya, Miller and Hansen demurred, claiming discretionary act immunity under section 820.2 of the California Government Code. The trial court agreed and dismissed Caldwell's claims. Caldwell appealed and the appellate court reversed in Caldwell's favor. Subsequently, the supreme court granted review.

**Holding.** The supreme court reversed the appellate court in favor of the school district. The court held that the Board of Education's decision not to renew the superintendent's contract was a basic discretionary policy decision, and thus immune from civil suits seeking to hold individual board members liable for the motives behind their votes. The court reasoned that there was a vital interest in promoting debate by board members on such issues. Accordingly, not granting members of the board immunity for what was said within meetings would severely hamper free deliberations.

In addition the court stated general statutes like the FEHA would not remove personal governmental immunity from discretionary policy decisions unless there was a clear legislative intent that immunity should be withdrawn in the particular case. The FEHA did not contain such intent, and therefore the Board of Education members were immune from the liabilities imposed by the FEHA.

## V. Judges

**A judge who has engaged in a series of actions constituting willful misconduct in office, conduct prejudicial to the administration of justice which brings the judicial office into disrepute, and improper conduct shall be removed from office.**

*Adams v. Comm'n on Judicial Performance, Supreme Court of California, Decided July 20, 1995, 10 Cal. 4th 866, 42 Cal. Rptr. 2d 606, 897 P.2d 544.*

**Facts.** In 1985, Judge Adams presided over a complex civil case in the Superior Court of San Diego County in which Williams, an automobile



dealer, was a party and Frega, an attorney, represented him. The case was ultimately decided in favor of Williams. From 1989 through 1991, Judge Adams engaged in a series of five transactions with Williams and his automobile dealership. Additionally, four out of the five transactions involved Frega as well. These transactions involved the purchase and repair of automobiles from Williams' dealership, as well as various dinners, loans, and small gifts paid for by Frega and Williams.

In a separate incident, Judge Adams was represented by the law firm of Ault, Midlam & Deuprey, and accepted a legal fee write-off of \$600 from the firm. In another separate incident, he accepted the weekend use of a desert resort condominium from the senior partner of the law firm of Dickor & Spradling.

Judge Adams also failed to disqualify himself when these same law firms and attorneys appeared before him on subsequent matters. In 1991, the Commission on Judicial Performance began investigating these and other events involving Judge Adams. In responding to inquiries from the Commission about some of the events, Judge Adams failed to disclose the fact that attorneys from the firms had appeared before him on subsequent matters. The Commission then filed notice of formal proceedings against Judge Adams.

The Supreme Court of California appointed three special masters who held extensive evidentiary hearings on the issues and reported their findings to the Commission. The masters concluded that while some of the allegations were not established, others justified a finding of prejudicial and improper conduct, but not willful misconduct. The Commission, however, found that some of Judge Adams' actions did amount to willful misconduct. The Commission filed their recommendation of removal from office to the supreme court. Judge Adams argued that the Commission, by acting as investigator, prosecutor, and adjudicator, violated his due process rights. Judge Adams also argued in the alternative, that the facts did not support such a severe punishment.

**Holding.** The supreme court adopted the recommendation of the Commission to remove Judge Adams from office. It held that the record showed no bias on the part of the Commission, so there were no due process concerns. In addition, the supreme court found that, despite the fact that the evidence did not show that Judge Adams definitely knew the committed acts were beyond his power, he either ignored or unjustifiably failed to realize that the acts gave the appearance of serious impropriety. Therefore, his acts amounted to willful misconduct as well as prejudicial and improper conduct, and the importance of public confidence in the integrity and independence of the judicial system justified the removal of Judge Adams from office.

## VI. Property Taxes

**Article XIII A and Article XIII, section 11 of the California Constitution apply concurrently to determine the tax valuation of extraterritorial government lands in all California counties other than Mono and Inyo.**

*City and County of San Francisco v. Counties of San Mateo and Alameda, Decided June 22, 1995, 10 Cal. 4th 554, 896 P.2d 181, 41 Cal. Rptr. 2d 888.*

**Facts.** The city and county of San Francisco owns land (termed extraterritorial) in San Mateo and Alameda counties, subject to property taxation by those counties. Two provisions of the California Constitution, article XIII, section 11 and Article XIII A, prescribe limitations on the taxation and valuation of real property. Article XIII, section 11 was adopted in 1968 and limits the assessed value of extraterritorial lands in all California counties but Mono and Inyo, to the lowest of two determined values. In 1978, Proposition 13 was approved and became article XIII A, limiting the valuation of property to the full cash value of the property with a maximum inflation rate of 2% per year.

In the tax year 1978-79, San Mateo and Alameda counties applied both provisions to determine the taxes assessed to San Francisco's extraterritorial land. The following year, San Mateo applied only section 11, and the year after that, Alameda followed, assessing taxes without application of article XIII A. San Francisco brought suit against both counties for partial refund of property taxes for the tax years 1980-81 through 1988-89. Both the trial and appellate courts found the two provisions in conflict and refused to apply article XIII A to San Francisco's land. San Francisco appealed.

**Holding.** The California Supreme Court reversed the lower courts' rulings and determined that both article XIII A and article XIII, section 11 apply to San Francisco's taxable extraterritorial lands in San Mateo and Alameda counties. Section 11, the court declared, regulates tax valuation at the lower end, providing a floor for value assessment, whereas article XIII A provides a ceiling, restricting taxation by limiting the maximum tax rate that can be levied on real property. Thus, the court found that

neither the applications nor the purposes of the two provisions conflict and both must be applied concurrently to assess the valuation of taxable, extraterritorial government lands in all California counties but Mono and Inyo.

## VII. Restitution

**It is within the trial court's discretion to condition probation on payment of restitution to the owner of the car that was damaged by the defendant who unlawfully fled the scene of the accident.**

*People v. Carbajal, Supreme Court of California, Decided August 14, 1995, 10 Cal. 4th 1114, 899 P.2d 67, 43 Cal. Rptr. 2d 681.*

**Facts.** Jose Carbajal was on probation when he was driving his vehicle and hit a parked car. The car that Carbajal hit was damaged yet he left the scene without leaving his name or other information as required by law.

Carbajal was subsequently charged with violating the hit-and-run statute, section 20002, subdivision (a). Carbajal entered a plea of no contest and admitted violating a condition of his probation. The trial court reinstated the probation terms and conditions of the previous conviction and placed Carbajal on probation for three years and fined him \$250 for the hit-and-run offense.

The trial court denied the People's request that restitution be paid to the owner of the damaged vehicle as a condition of Carbajal's probation. The People appealed the Appellate Department of Ventura County Superior Court. The appellate department held that the trial court has discretion to order restitution. The court of appeal affirmed the ruling. Defendant appealed.

**Holding.** The California Supreme Court affirmed in favor of the People, holding that the sentencing court has discretion to condition probation on the payment of restitution. The court explained that restitution is a valid condition of probation under the statutes and case law as long as it is reasonably related to the crime or the goal of deterring criminal behavior. The court further noted that restitution should comply with the statutory goals of public safety, victim compensation, and offender rehabilitation. The court found that these requirements were met; therefore, it was within the trial court's discretion to condition probation on restitu-

tion to the owner of the car that was damaged by the defendant who unlawfully fled the scene of an accident.

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