

## **RESOLUTION 7-03-03**

### **DIGEST**

#### Securities Fraud Actions: Discretionary Award of Attorney Fees

Amends Corporations Code section 25501 to allow a discretionary award of attorney fees and costs to the party granted relief in securities fraud actions.

### **RESOLUTIONS COMMITTEE RECOMMENDATION**

APPROVE IN PRINCIPLE

#### History:

None known.

#### Reasons:

This resolution amends Corporations Code section 25501 to allow a discretionary award of attorney fees and costs to the party granted relief in securities fraud actions. This resolution should be approved in principle because the remedies provided by present law are insufficient to adequately serve the public policies embodied in our securities laws.

Corporations Code section 25401 makes it unlawful to buy or sell (or offer to buy or sell) securities by means of any communication that contains a misstatement or omission of a material fact. However, section 25401 does not itself create a cause of action.

Section 25501 creates the cause of action for violations of section 25401. Under section 25501, rescission or damages are available for violations of section 25401, subject to affirmative defenses. If the defendant can show either that the plaintiff actually knew the truth regarding the misstatement or omission, or that the defendant's misstatement or omission was unknowing (and the defendant's ignorance was not negligent) then no liability attaches.

Section 25501 thus differs from common law fraud in two important respects: there is no requirement of a specific intent to deceive and induce on the part of the defendant, and there is no requirement to prove reliance by the plaintiff. These differences are unlikely to result in a judgment against a truly innocent defendant. Thus there is little risk of such a judgment resulting in the award of attorney fees where there was a merely technical or questionable violation of section 25401. What risk remains is adequately dealt with by the provision for judicial discretion in making such awards.

### **TEXT OF RESOLUTION**

RESOLVED, that the Conference of Delegates of California Bar Associations recommends that legislation be sponsored to amend Corporations Code section 25501 to read as follows:

- 1     §25501
- 2             Any person who violates Section 25401 shall be liable to the person who purchases a
- 3     security from him or sells a security to him, who may sue either for rescission or for damages (if the
- 4     plaintiff or the defendant, as the case may be, no longer owns the security), unless the defendant
- 5     proves that the plaintiff knew the facts concerning the untruth or omission or that the defendant
- 6     exercised reasonable care and did not know (or if he had exercised reasonable care would not have
- 7     known) of the untruth or omission. Upon rescission, a purchaser may recover the consideration paid
- 8     for the security, plus interest at the legal rate, less the amount of any income received on the security,
- 9     upon tender of the security. Upon rescission, a seller may recover the security, upon tender of the
- 10    consideration paid for the security plus interest at the legal rate, less the amount of any income

11 received by the defendant on the security. Damages recoverable under this section by a purchaser  
12 shall be an amount equal to the difference between (a) the price at which the security was bought  
13 plus interest at the legal rate from the date of purchase and (b) the value of the security at the time it  
14 was disposed of by the plaintiff plus the amount of any income received on the security by the  
15 plaintiff. Damages recoverable under this section by a seller shall be an amount equal to the  
16 difference between (1) the value of the security at the time of the filing of the complaint plus the  
17 amount of any income received by the defendant on the security and (2) the price at which the  
18 security was sold plus interest at the legal rate from the date of sale. Any tender specified in this  
19 section may be made at any time before entry of judgment. The court, in its discretion, may award a  
20 person obtaining relief under this section the reasonable attorney fees and costs of suit incurred in  
21 obtaining such relief.

(Proposed new language underlined; language to be deleted stricken.)

PROPONENT: Bar Association of San Francisco

#### STATEMENT OF REASONS

Existing Law: Denies defrauded investors the ability to secure an award of attorney fees in an action to rescind the transaction or recover damages.

This Resolution: Permits the court, in its discretion, to order that a defrauded party who obtains relief shall recover his or her reasonable attorney fees and costs.

The Problem: Under Section 25501, a defrauded investor can either rescind a fraudulent securities transaction or recover damages. Although such an action allows the investor to recoup the amount paid for the security or the losses sustained as a result (in cases where the security has already been disposed of), that “recovery” is always reduced by the fact that the investor has to pay attorney fees and costs. This means that the investor is never made whole, which is the overall aim of such actions. This, in turn, diminishes the effectiveness of the remedies and discourages attorneys from accepting the representation of defrauded investors.

Recent instances of corporate misconduct and investment fraud have resulted in staggering losses to numerous investors, most of whom face extreme difficulties in recovering their losses without skilled representation. Even if these persons are able to retain counsel, any recovery they obtain is made less effective because of the costs of prosecuting the claim. Giving the courts the discretion to make an award of statutory attorney fees and costs in securities fraud cases would permit defrauded investors to have a full recovery, and would encourage attorneys to prosecute these important and timely cases that otherwise might go without representation.

#### IMPACT STATEMENT

This resolution does not affect any other law, statute, or rule.

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