1996

Attorney-Client Fee Arrangements. Securities Fraud. Lawsuits.

211

Attorney-Client Fee Arrangements. Securities Fraud. Lawsuits. Initiative Statute.

Official Title and Summary Prepared by the Attorney General

ATTORNEY-CLIENT FEE ARRANGEMENTS. SECURITIES FRAUD. LAWSUITS. INITIATIVE STATUTE.

- Prohibits restrictions on attorney-client fee arrangements, except as allowed by laws existing on January 1, 1995.
- Prohibits deceptive conduct by any person in securities transactions resulting in loss to pension, retirement funds, savings. Imposes civil liability, including punitive damages, for losses.
- Authorizes class actions, derivative suits; adds presumption fraudulent acts affected market value of security.
- Prohibits indemnification of officers found liable for fraudulent acts by business entities, but may purchase insurance to cover liability.
- Declares measure conflicts with other ballot measures that restrict attorney fees or securities fraud actions.

Summary of Legislative Analyst's Estimate of Net State and Local Government Fiscal Impact:

- Potential increase in court-related costs to state and local governments of an unknown, but probably not significant, amount.
- Potential increase in revenue to the state of an unknown, but probably not significant, amount.

Analysis by the Legislative Analyst

PROPOSAL

Many Californians contribute to private and public pension and retirement funds that invest in securities (stocks and bonds). In addition, many Californians individually invest their retirement savings or other assets in such securities. To help protect investors, current law prohibits people from making false or misleading statements or omitting facts which (1) influence the purchase or sale of the security by others or (2) affect the price of the security. These illegal activities are known as securities fraud.

The measure makes various changes regarding fraud with respect particularly to retirement savings (as defined by the measure). It also would make it more difficult to change state laws concerning attorney-client fee agreements in all types of cases.

Prohibited Conduct. Current law regarding securities fraud applies to people *buying or selling* a security (such as a broker). For securities fraud regarding retirement savings, the measure broadens the law by applying it to *any person* involved in the buying or selling of securities (such as accountants or lawyers). (The measure exempts government officials from this provision.)

Liability Resulting From Prohibited Conduct. In many cases, the buying or selling of securities is done by retirement groups and plans that invest retirement savings for individuals. Because these groups or plans buy and sell securities, they are the parties who can sue for securities fraud. The individuals whose retirement savings are invested by these plans must rely on them for such lawsuits.

Under the measure, it would be easier for *individuals* to sue for securities fraud involving their retirement savings rather than having to rely on a retirement plan or group to initiate such lawsuits. This is because the measure makes anyone who commits securities fraud liable to *any person* whose retirement investments suffered a loss because of securities fraud.

Punitive Damages. Punitive damages are damages awarded by the court in addition to actual damages, in order to punish the wrongdoer. Under current law, any punitive damages awarded go to the winning party. Under this measure, any punitive damages awarded (less legal fees and expenses) in a retirement savings-related fraud suit would go to the state General Fund.

Fraud-on-the-Market Doctrine. Under current law, those who sue for securities fraud must prove that they relied on fraudulent information to purchase or sell the security and that the false information directly affected the value of their investment. Thus, under current law the burden of proof is placed on *those who sue* for securities fraud.

In securities fraud cases, this measure shifts the burden of proof to the *person accused* of fraud. It does this by applying a legal doctrine called "fraud on the market." Under this doctrine, it is presumed that the people who are suing relied on the fraudulent information and that this information affected the value of the investment.

Individual Liability for Fraud. Current law allows a business to pay for any legal actions taken against any executive (such as a director or chief executive officer) whose fraudulent actions are found to have caused a loss of money to investors. Under the measure, a business could no longer pay these costs. Instead, any executive of a business who is found liable for the fraudulent actions must pay these amounts. A business, however, could purchase insurance on behalf of these executives to cover such potential liability.

Attorneys' Fees. Under the measure, attorney fees for *any* legal matter (not just those for retirement savings-related cases) would be subject to the laws in effect on January 1, 1995. As a result, any changes to these state laws by the Legislature would require a vote of the electorate.

FISCAL EFFECT

Potential Court Costs. The measure would result in an increase in lawsuits against persons committing securities fraud. This, in turn, would increase court-related costs to state and local governments. These costs probably would not be significant.

Potential General Fund Revenue. The measure also could result in additional revenue to the state from the provision that allows the courts to assess punitive damages in a retirement savings-related fraud suit and deposit the monies in the state General Fund. As these damages would be decided on a case-by-case basis by the courts, it is difficult to estimate the impact of this provision. The annual revenue gain to the state, however, probably would not be significant.

For text of Proposition 211 see page 95

---

211 Attorney-Client Fee Arrangements. Securities Fraud. Lawsuits. Initiative Statute.

Argument in Favor of Proposition 211

Proposition 211:
Legal Rights for Senior Citizens.

30% of all fraud victims are over 65. Proposition 211 gives senior citizens stronger legal rights to take swindlers to court and get their money back.

Proposition 211:
Protection for Young Families.

More young families are trying to save for retirement because there is no guarantee Social Security will take care of them. Proposition 211 reduces the risk that they could lose their life savings.

Proposition 211:
Personal Responsibility for Corporate Executives.

Corporate executives can hide behind their corporate shield when they defraud investors. Proposition 211 holds them personally responsible for fraud they commit.

Proposition 211:
The "Yes" Argument.

According to the Federal Trade Commission, Americans are losing $1,000,000,000 (one billion dollars) a year to investment swindlers.

The Federal Deposit Insurance Corporation says that many banks don't even tell investors that money in mutual funds is *un*insured against fraud.

Congress gutted the law that allowed the victims of Charles Keating's fraud to recover most of their money. California's politicians refuse to even license individual stockbrokers—they don't check their business background before allowing them to do business here.

Proposition 211:
Stops Frivolous Lawsuits.

Big business argues that under Proposition 211 out of state lawyers will come here to file lawsuits.

That's not true! Under Proposition 211 only frauds in *California* cheating people out of their pension or retirement savings are punished. And Proposition 211 punishes frivolous lawsuits. Anyone who files a frivolous suit must pay the other side's legal fees.

Big business is using their typical scare tactic. They just don't want to be held responsible for their actions.

Retired Californians are sponsoring Proposition 211. Pension fund managers and law enforcement support it. And every Californian trying to save or invest for retirement should vote "Yes."

Proposition 211:
Securities Fraud and Retirement Fund Protection.

"In California, the rule for investors looking for a stockbroker is caveat emptor—let the buyer beware."

— Los Angeles Times

"The Securities and Exchange Commission is conducting a record 300 inside-trading investigations . . . In 1995, the SEC brought 45 inside-trading cases."

— USA Today

"A 1994 study by the National Center on Elder Abuse in Washington, D.C. says there were more than 29,000 cases of financial exploitation last year."

— Money Magazine

"Older Americans are the No. 1 target of investment con artists... The retirement nest eggs of Americans are in danger of being scrambled today by an alarming surge in investment schemes . . ."

— Investor Bulletins
North American Securities
Administrators Association
(50 state securities
regulators)

"Some Workers Find Retirement Nest Eggs Full of Strange Assets . . . Losses Can be Serious

"The extent of such dubious 'investing' is only now beginning to surface. But an ominous sign emerges in the Labor Department's records on 401 (k) and profit sharing plans: At plans smaller than $1 million, fully 17% of the employee money has been funneled into (bizarre) categories . . ."

— The Wall Street Journal
June 5, 1996

LOIS WELLINGTON
President, Congress of California Seniors

KENNETH E. WILSON
President, Retired Public Employees Association of California

RAMONA E. JACOBS
Victim, Charles Keating's Lincoln Savings & Loan Fraud

Rebuttal to Argument in Favor of Proposition 211

211 isn't about protecting us from fraud. 211 isn't about being able to recover legitimate losses. *We're already protected.*

211 doesn't stop frivolous lawsuits—*it encourages frivolous lawsuits.* 211 doesn't limit attorney fees—*it prohibits limits on fees.*

Here's what 211 is really about:

211 was written by and for securities lawyers.

211 allows these lawyers to file frivolous lawsuits in California—lawsuits outlawed in federal courts.

211 guarantees that lawyers can charge outrageous fees. 211 prohibits the Legislature from passing laws restricting lawyer fees.

211 is a hoax that benefits a few greedy lawyers, but hurts the rest of us:

DAMAGES PENSIONS, RETIREMENT AND FAMILY SAVINGS

211 allows "frivolous lawsuit" lawyers to "legally extort" hundreds of millions of dollars from companies in which Californians hold investments through pension funds, mutual funds and savings.

Californians lose hundreds of millions of dollars to these lawsuits which often cause drops in stock prices, further reducing savings.

DAMAGES MEDICAL RESEARCH

"211 jeopardizes crucial research into new treatments and cures for many life threatening diseases. It takes millions of dollars from research and sends it to the pocket books of a few wealthy securities lawyers."

— John Gorman, Treasurer
Alzheimer Aid Society of
Northern California

EXEMPTS POLITICIANS

Instead of protecting us from "Orange County" abuses, 211 actually prohibits politicians from being held liable for their fraud and abuse (like Robert Citron, the Treasurer responsible for much of Orange County's $1.7 billion loss).

Seniors, families, taxpayers, small business and employees say "NO" on 211.

GORDON JONES
Director of Legislative Affairs, The Seniors Coalition

MARY GEORGE
Vice President, Hispanic Women's Council

STEVEN J. TEDESCO
President, San Jose Metropolitan Chamber of Commerce

Argument Against Proposition 211

PROP. 211: A SPECIAL INTEREST MEASURE WE DON'T NEED

Californians currently have the same strong protections against investment and securities fraud as citizens in the other 49 states. We don't need 211.

Prop. 211 is *not* about protecting consumers or seniors. *It's about protecting the huge incomes that a handful of lawyers make* filing frivolous lawsuits against some of California's best businesses.

A "FRIVOLOUS LAWSUIT" LOOPHOLE

The only thing 211 protects is the ability of a few securities lawyers to evade federal law and file frivolous lawsuits in California—lawsuits that are outlawed under U.S. law.

Here's what others say about 211:

"This measure is not about protecting seniors, it's about protecting the ability of opportunistic lawyers to continue to make millions by filing frivolous lawsuits."

Oran McNeil, Member
The 60 Plus Association

"This initiative would curtail California's economic recovery. It's a job killer that will send California's best high-tech and bio-tech companies to other states."

Dan Lungren, California Attorney General
Republican

"Frivolous securities lawsuits are a serious problem for the high-tech and bio-tech industries. Creating good jobs and researching new cures for diseases are more important uses of these companies' time and money than responding to frivolous litigation. That's why we oppose Proposition 211."

The Democratic Leadership Council of California

TAXPAYERS, SENIORS AND EMPLOYEES OPPOSE 211

Californians from every walk of life, including Democrats, Republicans, seniors, consumers, taxpayers and employees say "NO" to Proposition 211. Here's why:

A JOB KILLER FOR CALIFORNIA

According to the Law and Economics Consulting Group (Emeryville, California), *159,000 JOBS COULD BE LOST OVER THE NEXT DECADE* under 211. Let's not send more jobs to other states!

The measure could *COST CALIFORNIA BUSINESSES OVER $1.3 BILLION A YEAR*—money that should go to investors and pensions or to create new jobs—not to a handful of lawyers.

HIGHER TAXES

California taxpayers will pay for all the judges, courtrooms and clerks to process these new frivolous lawsuits. According to the same study, these lawsuits could *COST TAXPAYERS UPWARDS OF $100 MILLION* in higher court costs over ten years.

Even worse, California could face up to *$5.1 billion in reduced state revenue* over the next decade because of 211. To make up the difference, taxpayers could expect *ENORMOUS TAX INCREASES* or severe reductions in funding to education, law enforcement and other vital programs.

SECURITIES LAWYERS BANKROLL CAMPAIGN

A few securities lawyers contributed millions of dollars to their special interest committee to put 211 on the ballot.

They are promoting 211 so they can file more frivolous lawsuits in California—*lawsuits where lawyers make millions— sometimes tens of thousands of dollars an hour.*

STOP FRIVOLOUS LAWSUITS

Legal reforms should stop these frivolous lawsuits which severely damage our best businesses and kill jobs. *INSTEAD, PROPOSITION 211 PROMISES MORE FRIVOLOUS LAWSUITS AND FEWER JOBS.*

Check the facts. Find out who's really pouring millions into 211. Then join with consumers, seniors, taxpayers and employees in voting *"NO"* on Proposition 211.

LARRY McCARTHY
President, California Taxpayers Association

MARTYN B. HOPPER
State Director, National Federation of Independent Business/California

KIRK WEST
President, California Chamber of Commerce

Rebuttal to the Argument Against Proposition 211

Fraud must be punished.

Not every crook wears a ski mask and carries a gun.

Today, too many white collar crooks get away. And the few that get caught usually serve "country club" jail time.

Worse, California law allows corporate executives who commit civil fraud to hide behind their "corporate shield". California doesn't even license individual stockbrokers.

Laws against white collar fraud should be as tough as the laws against any other kind of stealing.

Proposition 211 punishes white collar cheaters who "willfully, knowingly, or recklessly" defraud people out of their pension or retirement savings.

It takes away their "corporate shield" and holds them personally responsible for the frauds they've committed.

And Proposition 211 helps the victims get their money back—something very difficult for prosecutors to do!

The only corporate executives this law will hurt are the ones who break it!

Prosecutors throughout California are swamped. Budget cuts have reduced the resources prosecutors have to keep up with all the fraud cases.

Thousands of Californians are victimized every year. Proposition 211 gives fraud victims a powerful new legal weapon to make the guilty pay!

California should be heaven for retirees and hell for those who cheat them.

Vote "YES" on Proposition 211. Stop corporate fraud.

JOHN R. (JACK) QUATMAN
Senior Prosecutor, Fraud Division

JAMES KENNETH HAHN
Los Angeles City Attorney

minimum wage and to help minimum wage workers lift themselves out of poverty;

To achieve that purpose, the Living Wage Act of 1996 will increase the minimum wage to $5.00 per hour in 1997 and $5.75 per hour in 1998.

Section 2. Section 1182.11 is added to the Labor Code to read:

1182.11. Notwithstanding any other provision of this part, on and after March 1, 1997, minimum wage for all industries shall not be less than five dollars ($5.00) per hour; on and after March 1, 1998, the minimum wage for all industries shall not be less than five dollars and seventy-five cents ($5.75) per hour. The Industrial Welfare Commission shall, at a public meeting, adopt minimum wage orders consistent with this section without convening wage boards, which wage orders shall be final and conclusive for all purposes.

Section 3. Name of Act.

This statute shall be known as the Living Wage Act of 1996.

Section 4. Severability.

It is the intent of the People that the provisions of this act are severable and that if any provision of this act, or the application thereof to any person or circumstance, is held invalid, such invalidity shall not affect any other provision or application of this act which can be given effect without the invalid provision or application.

Proposition 211: Text of Proposed Law

This initiative measure is submitted to the people in accordance with the provisions of Article II, Section 8 of the Constitution.

This initiative measure adds sections to various codes; therefore, new provisions proposed to be added are printed in *italic type* to indicate that they are new.

PROPOSED LAW

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. TITLE

This initiative statute shall be known and may be cited as the "Retirement Savings and Consumer Protection Act."

SECTION 2. FINDINGS AND DECLARATIONS

The people of the State of California find and declare as follows:

(a) Millions of Californians work hard, pay their taxes, and save their money in order to provide for their economic security upon retirement. In doing so, they help support their state and local governments as taxpayers and insure that they do not become responsibilities of the state once they leave the workforce.

(b) Many Californians are members of or have contributed to private and public pension and retirement funds that invest in securities of corporations that are publicly traded or sold and other for-profit business entities. Many others invest their retirement savings themselves in such securities.

(c) Financial disasters like the collapse of many savings and loan institutions or the bankruptcy of Orange County result in devastating harm to the pensions and retirement savings of working people.

(d) Full and complete disclosure of material information affecting the value of securities is necessary to protect the millions of Californians who invest in them for their retirement. Existing laws inadequately protect pension and retirement investments in these securities from losses resulting from deceptive activities, including the misrepresentation or concealment of material information affecting the true value of these securities.

(e) An individual's retirement savings can also be threatened by an unexpected accident or ıry. Unless victims of such accidents or injuries are able to obtain full compensation for r losses, they are often forced to use up their retirement savings to pay for medical bills or ıiving expenses after their injury.

(f) Consumers, pension investors, and victims of injuries need access to the civil justice system to insure that they are fully compensated for their losses and damages. Ordinary working people are often denied such access because they cannot afford to hire an attorney to represent them. Proposals are being put forward daily that would limit people's right to contract with the attorney of their choice and make it more difficult for all but the very wealthy to obtain legal representation. These proposals include, but are not limited to, efforts to make it harder for people to find representation to protect their retirement savings and investments.

(g) In order to protect the retirement savings of all Californians, it is necessary to require full disclosure of material information that affects the value of securities or individual savings and to insure that the right to contract with an attorney to obtain compensation for injury or loss shall not be impaired, or subject to interference by the government.

SECTION 3. PROHIBITED CONDUCT

Section 25400.1 is added to the Corporations Code, to read:

25400.1. It shall be unlawful, in connection with the purchase or sale of securities, for any person, for-profit corporation, or other for-profit business entity, directly or indirectly, to willfully, knowingly, or recklessly do any of the following that results in loss to any pension fund, retirement fund, or retirement savings:

(a) Make or cause to be made untrue statements of material facts.

(b) Omit to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

(c) Participate or assist in any deceptive practice, statement, course of conduct, or scheme.

This section shall not apply to any government entity or to any government official acting in his or her official capacity.

SECTION 4. CIVIL LIABILITY

Section 25500.1 is added to the Corporations Code, to read:

25500.1. (a) In addition to any other provision of law, any person, for-profit corporation, or other for-profit business entity that willfully, knowingly, or recklessly engages in conduct prohibited by Section 25400.1 shall be liable for the losses caused by that violation, as determined in an action brought in a court of competent jurisdiction by or on behalf of any person or entity, including any government entity, whose pension funds or retirement funds or savings have suffered a loss as a result of that violation.

(b) To remedy harm to the public and to deter willful, outrageous, or despicable conduct in violation of Section 25400.1 that causes loss to pension funds, retirement funds, or retirement savings, any person who engages in such conduct shall be liable for additional 'l damages in such amount as the finder of fact shall determine is necessary to punish the wrongdoer and deter similar conduct by others, which civil penalty shall be paid, less fees and expenses, to the General Fund of the Treasury of the State of California.

(c) Any action under this section or under Section 1709 or 1710 of the Civil Code, in connection with the purchase or sale of securities may be brought as a class action; the fraud on the market doctrine shall apply; and it shall be presumed that the market value of a security reflected the impact of any prohibited conduct, and reliance upon any material misrepresentation or omission shall be presumed, subject to rebuttal by defendant establishing that the security would have been purchased or sold even if plaintiff had known of the misconduct. Any action under this section may also be brought derivatively, without regard to any limitations or requirements currently imposed on derivative actions.

(d) For purposes of this section and Section 25400.1, "retirement savings" means and includes:

(1) any tax advantaged retirement account or plan, whether group, individual, or joint, or

(2) any other form of retirement savings, however denominated and in whatever form, of a person over 40 years of age, if it had been in existence for over one year or had a value of one thousand dollars ($1,000), or more before suffering any loss sought to be recovered under this title.

(e) Except as otherwise provided by law in effect on January 1, 1995:

(1) In any individual, class, or derivative action brought pursuant to this or any other section of the Corporations Code, including Section 800, or under Section 1709 or 1710 of the Civil Code, each party shall bear his, her, or its own fees and costs, provided, however, that:

(A) the power of the parties to agree to, or a court to award, fees and costs for plaintiffs' counsel in any class or derivative action shall not be restricted or impaired; and

(B) a party shall be entitled to recover his, her, or its reasonable attorneys' fees and costs incurred in the defense or prosecution of the action in the event the court finds that the opposing party's claims or defenses were frivolous.

(2) For purposes of this section, a frivolous claim or defense is one that is either (A) totally and completely without merit, or (B) filed for the sole purpose of harassing an opposing party.

(3) The right of any person, corporation, or other entity to contract with and pay counsel to pursue or defend any action, whether brought under this section or otherwise, shall not be restricted or the validity of such contracts be impaired.

Nothing in this section shall impair the authority of the courts to regulate the practice of law or to prohibit illegal or unconscionable fees.

SECTION 5. ATTORNEY'S FEES

Section 6146.6 is added to the Business and Professions Code, to read:

6146.6. Except as otherwise provided by law in effect on January 1, 1995, the right of any person, corporation, or other entity to contract with and pay counsel to pursue or defend any action shall not be restricted or the validity of such contracts be impaired. Nothing in this section shall impair the authority of the courts to regulate the practice of law or to prohibit illegal or unconscionable fees.

SECTION 6. INDEMNIFICATION

Section 25505.1 is added to the Corporations Code, to read:

25505.1. Notwithstanding any other provision of law, any principal executive officer, director, or controlling person of a corporation or other for-profit business entity who is found individually liable for knowingly or recklessly engaging in deceptive conduct, as prohibited by Section 25400.1, shall not be indemnified by the corporation or other for-profit business entity for any costs of defense or amounts paid in settlement or judgment against that person. Nothing in this section shall prohibit a corporation or other for-profit business entity from purchasing insurance on behalf of its directors, officers, employees, or agents to cover liability under this section.

SECTION 7. RELATIONSHIP TO OTHER INITIATIVES

The people recognize that more than one initiative measure dealing with the general matters set forth in this measure may be on the ballot at the same time. It is the intent of the voters that the provisions in this measure be considered, for purposes of Section 10 of Article II of the California Constitution, to be in conflict with any other measure that would either restrict the right to bring securities fraud or misrepresentation actions or the procedures by which such actions are prosecuted, or which would restrict the right of a client and an attorney to contract freely with each other and to enforce such contracts.

SECTION 8. SEVERABILITY

If any provision of this act or its application to any person or circumstance is held invalid, that invalidity shall not affect other provisions or applications of the act which can be given effect without the invalid provision or application, and to this end the provisions of this act are severable.

SECTION 9. AMENDMENT

The provisions of this act may be amended by a statute that becomes effective upon approval by the electorate.