

Date of Hearing: June 25, 2012

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Mike Eng, Chair

SB 1058 (Lieu) – As Amended: May 1, 2012

SENATE VOTE: 31-4

SUBJECT: Victims of Corporate Fraud Compensation Fund.

SUMMARY: Revises and recasts the provisions governing administration of the Victims of Corporate Fraud Compensation Fund (the Fund) by the Secretary of State (SOS), by codifying certain existing regulations promulgated by the SOS to administer the Fund, codifying changes to other existing regulations promulgated by the SOS, and adding new statutory language to facilitate the approval of valid claims from the Fund. Specifically, this bill:

- 1) Reestablishes the Fund and codifies statutory requirements for both the administration of the Fund and for the eligibility of victims to receive compensation from the Fund, under a new Chapter 22.5 (commencing with Section 2280) of Division 1 of Title 1 of the Corporations Code.
- 2) Provides that an aggrieved person who obtains a final judgment in a court of competent jurisdiction, as specified, against a corporation for fraud, misrepresentation, or deceit, made with the intent to defraud, and who diligently attempted to recover the judgment from the corporation, may file an application with the SOS for payment from the Fund for the amount unpaid on the judgment, as specified.
- 3) Increases the maximum amount that any one claimant could recover for any single judgment that otherwise meets the requirements for compensation from the Fund, from \$20,000 to \$50,000.
- 4) Provides various definitions for the purposes of the Fund, including, among other things that:
  - a) Claimant means an aggrieved person who resides in the state at the time of the fraud and who submits an application pursuant to this chapter;
  - b) Corporation means a domestic corporation, as defined, or a foreign corporation that is qualified to transact business in California, as specified;
  - c) Court of competent jurisdiction is a superior court of any state, or a United States district court or U.S. bankruptcy court; and
  - d) “Final judgment” is a judgment, arbitration award, or criminal restitution order for which appeals have been exhausted or for which the period for appeal has expired, enforcement of which is not barred by the order of any court or by any statutory provision, which has not been nullified or rendered void by any court order or statutory provision, or for which the claimant has not otherwise been fully reimbursed.

- 5) Specifies the information and documentation required to be provided in an application, and allows for other relevant documents as appropriate, including, among other things:
  - a) The claimant must provide the SOS with a copy of the final judgment, underlying civil complaint and any amendments thereto, for a finding of fraud, misrepresentation, or deceit, made with the intent to defraud, and may also provide other relevant documentation; and
  - b) The claimant must provide the SOS with a description of searches and inquiries conducted by or on behalf of the claimant with respect to the corporation's assets liable to be sold or applied to satisfaction of the judgment, except that a court's determination or finding of the corporation's insolvency or lack of assets to pay the claimant shall be deemed to satisfy this requirement.
- 6) Requires the claimant to make specific declarations, including among other things, that he/she:
  - a) is not a spouse or an immediate family member of an employee, officer, director, managing agent, or other principal of the corporation nor a personal representative, of the spouse or an immediate family member of an employee, officer, director, managing agent, or other principal of the corporation; however, being a spouse or immediate family member does not alone preclude a claimant from receiving an award;
  - b) has complied with specified requirements; and
  - c) does not have a pending claim and has not collected on the final judgment from any other restitution fund, or if the claimant has a pending claim or has collected from another fund, include a description of the nature of the pending claim and the recovery amounts from any restitution fund.
- 7) Provides certain timelines by which the SOS, claimant, and corporation must provide specified responses, including, among other things:
  - a) the SOS must mail to the claimant an itemized list of deficiencies, if any, of the claimant's application within 21 days if for a single claimant, or 40 days for multiple claimants; and
  - b) the SOS must render a decision on the application within 90 calendar days after receiving a completed application.
- 8) Requires the SOS to provide notice, as prescribed by the SOS, to the corporation and claimant with respect to an application made, for specified purposes, including, among other things:
  - a) if after 30 calendar days the SOS has not received a response to the latest list of deficiencies, the SOS shall notify the claimant that unless the claimant responds to the deficiencies within a specified period of time of not less than 15 calendar days, that the application will be denied; and

- b) upon issuance of a proposed decision to award payment or an offer to compromise, the claimant shall have 60 calendar days from the date of service of the proposed award or offer to compromise to accept the proposed award or offer to compromise, and if the claimant fails to accept the proposed award or offer to compromise within the specified time, the application shall be deemed denied.
- 9) Provides that if, at any time, the money deposited in the Fund is insufficient to satisfy any duly authorized award or offer of settlement, the SOS shall, when sufficient money has been deposited in the Fund, satisfy the unpaid awards or offer of settlement, in the order that the awards or offers of settlement were originally filed, plus accumulated interest at the rate set by the Federal Reserve Bank of San Francisco on advances made to member banks, not to exceed 2% per year.
- 10) Permits a claimant whose application for compensation from the Fund is denied by the SOS to petition a court, as specified, for de novo review of the merits of the application based on the administrative record. This bill provides that the burden is on the claimant to prove that the cause of action against the corporation was for fraud, misrepresentation, or deceit, if final judgment in the underlying action in favor of the petitioner was by default, stipulation, consent or pursuant to Section 594 of the Civil Procedure Code, or if the action against the corporation was defended by a trustee in bankruptcy.
- 11) Makes it unlawful for any person or the agent of any person to file with the SOS any notice, statement, or other document required under the provisions of this chapter that is false or untrue or contains any willful, material misstatement of fact, and specifies that such conduct shall constitute a public offense punishable by imprisonment and fine, as specified.
- 12) Permits the SOS to attempt to recover the amount paid to a successful claimant from the corporation and suspend that corporation, as specified, and requires that any sums received by the SOS pursuant to these provisions be deposited in the State Treasury and credited to the Fund.
- 13) Requires that the SOS adopt regulations in furtherance of the administration of the Fund.

#### EXISTING LAW

- 1) Establishes the Fund within the State Treasury, authorizes the SOS to administer the Fund, and directs the SOS to adopt regulations regarding administration of the Fund and the eligibility of victims to receive compensation from the Fund. Provides that the Fund exists for the sole purpose of providing restitution to the victims of a corporate fraud (Corporations Code (CORP) Section 1502.5). Regulations promulgated by the SOS to administer the Fund are contained in Title 2, Division 7, Chapter 12, Sections 22500 et seq.
- 2) Raises money for Fund by directing one-half of the \$5 disclosure fee required to be paid by corporations when they file their annual Statements of Information with the SOS (CORP Sections 1502 and 2117).
- 3) Provides for the Real Estate Recovery Program (also known as the Consumer Recovery Program within the Real Estate Fund; Business and Professions Code Section 10470 et seq.), administered by the Department of Real Estate for the purpose of providing a fund of last

resort to compensate persons who are defrauded by real estate licensees. The SOS's Office used the Real Estate Recovery Program rules as a guide, when developing regulations to administer the Fund.

**FISCAL EFFECT:** According to Senate Appropriations Committee analysis, first year costs of \$122,990 and ongoing of \$97,990 (Special). The Secretary of State's office anticipates the need for one PY analyst to process claims, and will incur expenses associated with revising the forms, updating the Internet web site and revising regulations. Costs will be incurred from the Business Fees Fund.

**COMMENTS:**

This bill is based on an article authored by Sacramento Bee columnist Dan Morain on October 9, 2011, *Fund Victims Fund is a Tragedy*, profiling the challenges faced by the approximately 500 victims of a corporate fraud perpetrated by James Walker and his now-defunct Senior Care Advocates, Inc. In his article, Morain detailed the nearly 18-month struggle of victims scammed by James Walker and Senior Care Advocates to obtain compensation from the SOS's Office through the Fund.

Subsequent to the Dan Morain article and the correspondence between Mr. Redmond and the SOS, several legislative offices contacted the SOS's office in an attempt to determine whether the case summarized in the Bee article and detailed in the lengthy correspondence between Mr. Redmond and the SOS's office was an aberration, or was, instead, representative of a pattern of over-protectiveness toward the Fund within the SOS's Office. Findings from those inquiries are summarized immediately below.

**How Many Claimants Are Receiving Compensation From the Fund?**

1. When first contacted, the SOS's Office indicated that, from the Fund's inception through August 1, 2011, the SOS had received 701 claims for restitution from the Fund.

Of these 701 claims, five claims were awarded, one claim was settled during litigation, and one court appeal by a victim resulted in a judgment confirming the SOS's settlement offer. When summed, all seven of these claims resulted in a payout from the Fund of \$92,497.

Of the remaining claims, 102 did not qualify for payment, because they did not meet the eligibility criteria established by the SOS, 28 claims were withdrawn, three claims were denied, and 561 claims (most related to Senior Care Advocates) were pending resolution.

2. On October 14, 2011, the SOS's office responded to legislative requests for a breakdown of the 102 claims which did not qualify for payment, because they did not meet the eligibility criteria established by the SOS's office in its regulations (a number which grew to 103 by the date of the SOS's response). The 103 claims were rejected for the following reasons:

Reason for Denial	Number of Applications Denied
The victims applied for compensation based on judgments that were not based on corporate fraud	52

A judgment was lacking, or the judgment was not issued by a court in California	23
Applications were based upon judgments against entities that were not corporations	14
Applications were based on judgments that were not final	5
Applicants demonstrated insufficient proof regarding their attempts to collect from the corporation and its corporate officers prior to filing a claim with the Fund	4
Applications were submitted more than 18 months following final judgment	3
Applicant was not a party to the court judgment	1
Application was based on a judgment issued prior to January 1, 2003	1

3. By March 28, 2012, the SOS's office had resolved a considerable number of its outstanding applications.

From the Fund's inception through March 28, 2012, a total of 225 claims have been approved or resulted in victims being offered settlements (up from less than ten through August 1, 2011), and 25 claims are pending resolution (down from over 550 through August 1, 2011). An additional 27 claims have been deemed complete and are pending a decision. 118 claims have been rejected, because the SOS's office found the victims did not qualify for payment from the Fund (see reasons cited immediately above). 294 claims have been denied, because the applicants could not prove damages. 30 claims have been withdrawn.

How Much Money Is In The Fund? The Fund collects approximately \$1.5 million per year, through the \$2.50 annual disclosure fee paid by corporations pursuant to the Fund's enabling legislation. At present, the Fund holds approximately \$5 million. Because the Fund went several years without making any significant payments to victims, and thus built up a significant reserve, it was raided in the 2010-11 fiscal year, to help address General Fund shortfalls. The Fund currently has an outstanding \$10 million loan to the General Fund, which is required to be repaid, with interest, when it is needed to pay claims out of the Fund. From the Fund's inception to date, the SOS's office has approved the payout of approximately \$2.1 million in compensation to victims (most, as cited above, in the last eight months).

Prior Legislation: AB 55 (Shelley, Ch. 1015, Stats. 2002), established the Fund to provide restitution to victims of corporate crime by requiring corporations to pay a \$2.50 fee when filing their annual disclosures.

REGISTERED SUPPORT / OPPOSITION:

Support

Secretary of State, Debra Bowen  
Los Angeles District Attorney's Office  
American Federation of State, County and Municipal Employees (AFSCME)  
Congress of California Seniors (CCS)

Opposition

None on file.

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