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## **SECONDARY AGENTS CAN BE HELD LIABLE FOR SECURITIES VIOLATIONS AND RESCISSION**

by  
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In a highly unusual decision, the Second Appellate Court has expressly overruled the recent Fourth Appellate Court decision of *Verterbi v. Wasserman* (2011) 191 Cal. App. 4<sup>th</sup> 927, where that court allowed a secondary agent to escape liability because he/she was not in privity of contract with the investor.

In *Moss v. Robert Kroner et al.*, 2011 DJDAR 10956, decided on July 20, 2011, the Second Appellate Court wrote that the *Verterbi* approach, that an actor who is not in privity of contract with an investor cannot be held liable for securities violations under CC 25504 and 25504.1 is wrong because it reduces the language of those two statutes to surplusage in their entirety whenever a investor still owns the security.

In the *Moss v Kroner* matter, the Appellate Court found that an insurance services company which acted as an agent only in the sale of corporate promissory notes had committed securities violations under Sections 25504 and 25504.1 of the Corporations Code and was liable for \$1,000,000 in a rescission action brought by a defrauded investor. This ruling reflects the Court's expansion of the state securities laws by making secondary actors civilly liable for the repayment and return of invested money. This means that any agent which assists in the sale of securities now stands in the shoes of the actual issuer with respect to civil liability owed to investors and may be made to restore funds to an investor even when there is no contractual relationship between the parties and the secondary agent never received the funds.

The facts of this case are interesting. Plaintiff was prevented by federal Court stay from suing the actual issuer because the SEC has shut it down for running a Ponzi scheme. So, instead, Plaintiff sought alternative recovery of his million dollar investment from the



middle men insurance services agent who recommended the investment to him and acted as “gate-keepers” and marketers on the transaction (the “Kroner” defendants). This led to a lawsuit against the Kroner defendants which was dismissed completely at the trial court level at the demurrer stage due to the fact that the “Kroner” defendants were not the issuer of the securities and could not be considered a “control person” liable under CC 25110. Further, based on a 1982 decision by the 9<sup>th</sup> Circuit, the trial court found that the defendant insurance agent had no liability to the defrauded plaintiff because it was not a direct seller under CC 25401.

The Appellate Court disagreed with the Los Angeles based trial judge and found that Plaintiff, Glenn Moss, had properly pleaded a violation under CC 25110 because the complaint properly pleaded facts claimed that the Kroner defendants knew about the Ponzi scheme, and materially assisted in the sale of unregistered securities with the intent to deceive and defraud were sufficient under CC 25110.

Secondly, the Court analyzed the legislative intent behind CC 25504 and CC 25504.1 and expanded its scope to allow a rescission action to go forward against the Kroner defendants even though no contract for the sale of securities existed between the parties. In making its decision, the Court wrote:

*We agree with the Viterbi court that ordinary principles of rescission require strict privity in order to rescind contracts, we conclude that the Legislature, when it enacted sections 25504 and 25504.1 intended to depart from those principles by placing certain secondary actors in the shoes of the principle violator.....If the relief that would be available from the primary action under section 25501 would be rescission and the return of money owing to the plaintiff, then the person who is secondarily liable is liable for the money required to make the plaintiff whole, even if he or she may not be capable of actual rescission because he or she was not a party to the contract. Any other reading would deprive of meaning the language of sections 25504 and 25504.1 establishing joint and several liability for the underlying violation of section 25501.*



The *Moss v. Kroner* Court found that Section 25504 and 25504.1 demonstrate that the California Legislature chose to expand liability in limited circumstances beyond the strict privity, direct buyer and seller liability established in section 25501 to other, secondarily responsible participants in securities fraud.

The holding in this case should put agents who sell securities on high alert. If fraud is committed by the principle, and the agent knew or should have known about the fraud, or if the agent acted as a gate-keeper to the transaction, or if the agent took part in the marketing of the securities and creation of marketing materials, and/or the disclosure statement, that agent will now be 100% civilly liable to repay any defrauded investor.

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