among other things—stated the Assembly's request that the State Treasurer consider withdrawing all deposits from Bank of America and investing them in other banks within California.

LITIGATION

On August 18, Judge Thomas Mellon, Jr. dismissed plaintiffs' claims in ***Badie v. Bank of America***, No. 944916 (San Francisco Superior Court). The test case challenges BofA's policy which requires that customer disputes over deposit and credit card accounts be sent to binding arbitration. *[14:2&3 CRLR 123; 13:2&3 CRLR 124]* Among other things, plaintiffs' attorney Patricia Sturdevant argued that BofA failed to clearly inform customers of the policy change and therefore failed to establish a binding contract. Judge Mellon disagreed, stating that "the notice was adequate even though there is no evidence that in general the bank's customers did, in fact, read or understand or appreciate the significance of the [alternative dispute resolution] clause or that they didn't." BofA hailed the ruling, stating that the decision will ensure that customers have access to a speedy, inexpensive, and fair process for resolving complaints. Consumer groups disagree with the opinion, arguing that the bank's true motivation is to eliminate the possibility of class action litigation to enforce consumer protection laws, such as the recent *Wells Fargo* case which disgorged $5 million in unlawful late and overlimit fees. *[12:1 CRLR 111]* Consumers also argue that BofA's policy forces them to use an unfamiliar forum that may deprive them of a fair hearing; typical complaints regarding arbitration concern the limited discovery options and the fact that no written opinion is issued. Although plaintiffs are expected to appeal, they have not announced that decision at this writing.

On June 8, the California Supreme Court denied review in ***California Grocers Association, Inc., v. Bank of America***, 22 Cal. App. 4th 205 (Feb. 4, 1994), leaving intact the First District Court of Appeal's holding that the $3 deposited item return (DIR) fee charged by BofA to the California Grocers Association (CGA) is not unconscionable and does not violate the implied covenant of good faith and fair dealing, and that the injunction issued by the trial court which required BofA to lower its DIR fee to not more than $1.73 for a ten-year period was an improper use of the unconscionability doctrine and an inappropriate exercise of judicial authority. *[14:2&3 CRLR 123; 14:1 CRLR 96]*

DEPARTMENT OF CORPORATIONS

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The Department of Corporations (DOC) is a part of the cabinet-level Business, Transportation and Housing Agency and is empowered under section 25600 of the California Code of Corporations. The Commissioner of Corporations, appointed by the Governor, oversees and administers the duties and responsibilities of the Department. The rules promulgated by the Department are set forth in Division 3, Title 10 of the California Code of Regulations (CCR).

The Department administers several major statutes. The most important is the Corporate Securities Act of 1968, which requires the "qualification" of all securities sold in California. "Securities" are defined quite broadly, and may include business opportunities in addition to the traditional stocks and bonds. Many securities may be "qualified" through compliance with the Federal Securities Acts of 1933, 1934, and 1940. If the securities are not under federal qualification, the commissioner must issue a "permit" for their sale in California.

The commissioner may issue a "stop order" regarding sales or revoke or suspend permits if in the "public interest" or if the plan of business underlying the securities is not "fair, just or equitable."

The commissioner may refuse to grant a permit unless the securities are properly and publicly offered under the federal securities statutes. A suspension or stop order gives rise to Administrative Procedure Act notice and hearing rights. The commissioner may require that records be kept by all securities issuers, may inspect those records, and may require that a prospectus or proxy statement be given to each potential buyer unless the seller is proceeding under federal law.

The commissioner also licenses agents, broker-dealers, and investment advisors. Those brokers and advisors without a place of business in the state and operating under federal law are exempt. Deception, fraud, or violation of any regulation of the commissioner is cause for license suspension of up to one year or revocation.

The commissioner also has the authority to suspend trading in any securities by summary proceeding and to require securities distributors or underwriters to file all advertising for sale of securities with the Department before publication. The commissioner has particularly broad civil investigative discovery powers; he/she can compel the deposition of witnesses and require production of documents. Witnesses so compelled may be granted automatic immunity from criminal prosecution.

The commissioner can also issue "desist and refrain" orders to halt unlicensed activity or the improper sale of securities. A willful violation of the securities law is a felony, as is securities fraud. These criminal violations are referred by the Department to local district attorneys for prosecution.

The commissioner also enforces a group of more specific statutes involving similar kinds of powers: the Personal Property Brokers Law (Financial Code section 22000 *et seq.*), Franchise Investment Law (Corporations Code section 31000 *et seq.*), Security Owners Protection Law (Corporations Code section 27000 *et seq.*), California Commodity Law of 1990 (Corporations Code section 29500 *et seq.*), California Credit Union Law (Financial Code section 14000 *et seq.*), Industrial Loan Law (Financial Code section 18000 *et seq.*), Escrow Law (Financial Code section 17000 *et seq.*), Check Sellers, Bill Payers and Proraters Law (Financial Code section 12000 *et seq.*), Securities Depository Law (Financial Code section 30000 *et seq.*), Consumer Finance Lenders Law (Financial Code section 24000 *et seq.*), Commercial Finance Lenders Law (Financial Code section 26000 *et seq.*), Knox-Keene Health Care Service Plan Act of 1975 (Health and Safety Code section 1340 *et seq.*), and the Workers' Compensation Health Care Provider Organization Act of 1993 (Labor Code section 5150 *et seq.*).

MAJOR PROJECTS

Public Interest Coalition Requests Rulemaking to Guide DOC Valuations in Nonprofit Conversions. On September 12, Consumers Union (CU) filed an administrative petition with DOC; the petition—filed on behalf of CU, the Children's Advocacy Institute, the Congress of California Seniors, Heath Access, Latino Issues Forum, the California Black Health Network, and nineteen other concerned nonprofit organizations—requests that DOC adopt and implement regulations governing the conversion or restructuring of a nonprofit entity to a for-profit entity, and challenges the actions taken by DOC regarding the recent conversion of Blue Cross of California, a nonprofit health maintenance organization (HMO), into a for-profit organization.

In an August report entitled *Blue Cross' $2.5 Billion Dollar Grab*, CU explained that, in order to encourage positive charitable services, California law provides that nonprofit organizations whose activities provide a benefit to the public may be exempt from requirements to pay certain state taxes; the activities of these organizations are expected to be for tax-exempt purposes which promote the social welfare. In exchange for this public financial support, tax-exempt organizations must promise to give back their wealth—which may be significantly enhanced due to the tax breaks—if they choose to become for-profit corporations. To accomplish this, nonprofits are required to include in their articles of incorporation a promise that, if and when they choose to convert to for-profit status, they will transfer an amount equal to the total value of their assets to the sort of charitable purposes for which they were formed.

Under the Knox-Keene Health Care Service Plan Act of 1975, DOC is responsible for adopting procedures which nonprofit entities must follow when they convert to for-profit entities. When a nonprofit decides to convert, it files an application with DOC; the Department reviews the proposed conversion and makes a valuation of the company's assets—this value is used as the basis for the company's charitable obligation. The organization is then required by law and by its articles of incorporation to turn this amount over to an independent entity which is required to apply those resources to purposes that are consistent with the purposes for which the original nonprofit was incorporated. According to CU, however, DOC has used faulty methodologies to determine the value of converting HMOs, resulting in charitable contributions that were "grossly inadequate."

The administrative petition alleges that DOC has overseen a number of these conversions but has refused to adopt regulations necessary to ensure consistency in the review and approval process. In some cases, objections from CU have prompted DOC to reevaluate the fair market price of the converting HMO; in other cases, however, DOC accepted valuations which later proved to be "grossly understated." The market value of these HMOs, according to the petition, soon proved to be dramatically higher than DOC had estimated at the time of conversion; according to the petition, these underevaluations resulted in the loss of hundreds of millions of dollars that should have been directed to charitable purposes.

The most recent controversy involves Blue Cross of California. In 1991, Blue Cross presented DOC with a plan to "restructure," rather than convert, and to place 90% of its assets into a for-profit entity. Under this plan, Blue Cross would remain in existence as a nonprofit entity, but its for-profit subsidiary called Wellpoint Health Networks would conduct its HMO business. After more than a year of negotiations and some modifications to the proposed plan, then-DOC Commissioner Tom Sayles approved Blue Cross' new status.

The coalition's petition contends that under this agreement, Blue Cross retained 10% of its assets in its nonprofit shell, while Wellpoint received 90% of the assets, making it the largest for-profit HMO in California. Under the plan and as part of the deal, nonprofit Blue Cross retained remainder of the stock in Wellpoint, and in January 1993 sold nearly 20% in a public offering, netting $517 million; the remainder of the Wellpoint stock still held by Blue Cross was recently valued by DOC at $2.5 billion.

According to CU's August report, Blue Cross claimed immunity from the California law requiring a nonprofit HMO converting to a for-profit HMO to transfer an amount equal to its full value to charitable purposes, by referring to its action as a "restructuring" rather than a conversion. Although prior DOC management accepted this interpretation, current DOC Commissioner Gary Mendoza has called for the transfer of some of the assets generated by the Wellpoint transaction to an independent foundation.

CU and the other petitioners believe that 100% of Blue Cross' $2.5 billion in assets is owed to the public of California and should be dedicated toward the same charitable purposes for which Blue Cross of California was originally incorporated. Through the petition filed with DOC, petitioners asked the Department to order Blue Cross to immediately divest itself of assets in this amount; transfer the funds to an independent nonprofit foundation dedicated to the health care needs of Californians; and ensure that the governing board of the foundation is completely independent of Blue Cross and all corporate interests, and is comprised of and reflective of the diversity of the state with regard to race, gender, and other relevant factors. The petition also requested DOC to formally adopt regulations, in full compliance with the Administrative Procedure Act, which govern the conversion or restructuring process and establish a mechanism for public scrutiny of the valuation and conversion process, including public notice, disinterested evaluators, public records, meaningful public hearings and input into the process, objection rights by the service beneficiaries, procedures for creating new or funding existing foundations, and criteria for board composition including conflict of interest rules, diversity, and a majority of consumer representatives.

Following months of pressure by the consumer groups, Commissioner Mendoza, and interested legislators, Blue Cross finally promised to turn over $2.1 billion in assets to an independent charitable foundation on September 15. The same day, CU released a press release stating that it remains skeptical of the plan, and cautioning the public and state regulators to scrutinize the plan to ensure that the foundation receives the entire value of Blue Cross' assets that have been transferred to Wellpoint and to ensure the foundation's independence from Blue Cross and Wellpoint. Among other things, CU expressed concern that the percentage of Blue Cross' assets given to Wellpoint has never been adequately verified, and is not mentioned in Blue Cross' proposal. CU also notes that under Blue Cross' proposal, the board members of the new foundation would be the same members that made up Blue Cross; according to CU, the same board should not be carried over to run the independent foundation, noting that "[t]hey are the same board members who tried to stonewall the state for years." CU also contends that Blue Cross has determined what activities this "independent foundation" will begin working on; according to CU, Blue Cross should not determine how this money should be distributed, as this is the public's money, not Blue Cross' money. Commissioner Mendoza stated he would closely scrutinize Blue Cross' proposal, and expressed concern over the make-up of the foundation's board.

At this writing, Assemblymember Phil Isenberg of the Judiciary Committee's Subcommittee on Public Trust and Corporate Charitable Activity has scheduled a September 26 hearing on Blue Cross' September 15 proposal. Representatives of Blue Cross, DOC, CU, and other interested parties are expected to participate.

Regulatory Action Under the Corporate Securities Act. On July 20, DOC released modified language of proposed new section 260.140.80.5, Title 10 of the CCR, which would allow the offer and sale of contractual plans in California under certain conditions *[14:2&3 CRLR 124; 14:1 CRLR 97]*; the comment period closed on August 8, whereupon the Commissioner adopted the proposed rule.

A contractual plan is a type of long-term mutual fund investment where the investor makes monthly installment payments for a ten- to fifteen-year period; one-half of the sales commissions over the term of the contract are typically paid from the first year's installments. Among other things, section 260.140.80.5 requires a broker-dealer to determine whether a contractual plan is suitable for the purchasing investor and retain the documentation used in determining investor suitability for five years; allows an investor to withdraw from the plan within 28 months of his/her initial payment; sets forth the disclosure form which must be executed by a broker-dealer and an investor; requires issuers to file quarterly and annual persistency reports; and provides that three years after the rule becomes effective, the DOC Commissioner may periodically review the history of sales practices and persistency rates of plans to determine whether sales should be continued in this state. At this writing, proposed section 260.140.80.5. is being reviewed by the Office of Administrative Law (OAL).

In December 1993, the Commissioner published for public comment proposed amendments to section 260.141.11, Title 10 of the CCR, to allow the transfer of one-class voting common stock issued pursuant to Corporations Code section 25102(h) without the consent of the Commissioner, if the stock could have been originally issued pursuant to the exemption from qualification afforded by section 25102(f); as amended, section 260.141.11 would require that a notice, statement of transferee, and opinion of counsel be filed with the Commissioner. *[14:2&3 CRLR 124; 14:1 CRLR 98]* Public comment on the proposed amendment ended on February 11; at this writing, the amendments still await adoption by the Commissioner and approval by OAL.

On July 22, the Commissioner published notice of his intent to amend section 260.105.6, Title 10 of the CCR, in response to legislation enacted in 1993. Currently, section 260.105.6 provides an exemption for professional corporations organized under the Professional Corporation Act from the qualification requirements of section 25110 and 25120 of the Corporations Code. SB 687 (Boatwright) (Chapter 910, Statutes of 1993) amended the Professional Corporation Act to allow a "foreign professional corporation," as defined in Corporations Code section 13401(c), to qualify as a foreign corporation in order to render professional services in California. *[13:4 CRLR 108]* Essentially, the same limitations and safeguards imposed upon professional corporations—such as requiring that professional services be rendered through persons who are licensed in the profession, restricting ownership of shares to those licensed to practice that profession, and subjecting the professional corporation to the supervision and regulation of state agencies governing the profession—are equally applicable to foreign professional corporations.

According to DOC, the proposed amendments to section 260.105.6 are necessary to conform the section with the statutory changes made by SB 687, so as to explicitly include foreign professional corporations within the provisions of the exemption provided for professional organizations. Following a public comment period which ended on September 9, the DOC Commissioner adopted the proposed changes; at this writing, the amendments await review and approval by OAL.

Regulatory Action Under the California Credit Union Law. On May 27, the Commissioner published notice of his intent to adopt new section 933, Title 10 of the CCR. The DOC Commissioner regulates state-chartered credit unions under the California Credit Union Law, Financial Code section 14000 *et seq.* Effective January 1, 1994, Financial Code section 14410(b) provides that a director or committee member may be reimbursed for actual expenses incurred in the performance of his/her duties if reimbursement is made pursuant to the requirements of the Commissioner's regulations controlling expense reimbursements by the credit union. Reimbursements for actual expenses under section 14410(b) may include, among other things, travel, business, and any other matters, categories, or items of expense that the Commissioner may establish by regulation. Proposed new section 933 would clarify the term "expense" for purposes of section 14410(b); the proposed definition is similar to a federal rule adopted by the National Credit Union Administration in 12 C.F.R. Part 701.33. DOC received public comment on the proposed rule until July 15, and subsequently adopted the new section; on August 24, OAL approved section 933.

DOC Offers Guidance Under the Franchise Investment Law. On June 22, DOC issued Release No. 3-F (Revised), which provides guidance in determining whether an agreement constitutes a "franchise," an "area franchise," or a "subfranchise" under sections 31005(a), 31008, 31008.5, and 31010 of the Franchise Investment Law (Corporations Code section 31000 *et seq.*), the offer of which may be subject to the registration requirements of Corporations Code section 31100–31104 (or by a rule of the DOC Commissioner), unless exempted from the definition of a franchise under section 31005(c). An offer of a franchise subject to registration under the Franchise Investment Law, or exempted from such registration by section 31100 or 31101 of the law, is excluded from the definition of the term "security" in section 25019 of the Corporate Securities Law of 1968 (Corporations Code section 25000 *et seq.*).

DOC outlined the following four elements essential for an agreement to constitute a "franchise" within the definition of section 31005(a): (1) a right must be granted to the franchisee to engage in the business of offering, selling, or distributing goods or services; (2) the right must be granted to engage in the business under a marketing plan or system prescribed in substantial part by the franchisor; (3) the operation of the franchisee's business must be substantially associated with an advertising or other commercial symbol designating the franchisor or an affiliate of the franchisor, such as a trademark, service mark, trade name, or logotype; and (4) the franchisee must be required to pay, directly or indirectly, a fee or charge, known as a "franchise fee," for the right to enter into the business. However, DOC notes that the percentage of gross revenues of a business that is attributable to the "franchise" agreement may not be a factor in determining whether the agreement in question is a "franchise."

According to Corporations Code section 31010, the term "franchise," unless otherwise stated, includes a "subfranchise." A "subfranchise" is defined in section 31008.5 to mean an agreement by which a franchisor, for consideration, grants to a subfranchisor the right to sell or negotiate the sale of franchises in the name or on behalf of the franchisor; section 31009 defines a "subfranchisor" as a person to whom a subfranchise is granted. According to DOC, the same agreement may constitute both a franchise and a subfranchise, meaning that a person may be both a franchisee and a subfranchisor under the same agreement. However, the definition of the term subfranchise does not require the subfranchisor to also be a franchisee, and the agreement constituting a subfranchise may be a totally separate and independent agreement. Also, "consideration" for purposes of a subfranchise is not limited to the payment of a fee, as it is under the definition of the term "franchise" in section 31005(a); instead, "consideration" is construed to mean any payment or other legal consideration.

According to Corporations Code section 31010, the term "franchise," unless otherwise stated, also includes an "area franchise," which is defined by section 31008 to mean any franchise between a franchisor and a franchisee whereby the franchisee is granted the right to operate more than one unit within a specified geographical area.

DOC's guidance provides insight into the complexity one faces when attempting to determine whether an agreement involves an offer or sale of a franchise. According to DOC, the practitioner should review the Department's opinions and, when an issue is still unclear, either request an interpretive opinion under Corporations Code section 31510 (and pursuant to the requirements of Commissioner's Release No. 61-C *[14:2&3 CRLR 125]*) or file an application for registration of an offer of a franchise pursuant to section 31110.

DOC Issues Advisory Warnings to Credit Union Licensees. On June 30, DOC informed its credit union licensees that it had recently learned of an individual passing fraudulent cashier's checks presented as items of Pacific Inland Bank; the fraudulent cashier's checks indicate that Pacific Inland Bank is located in La Palma, and that the check is payable through the Federal Home Loan Bank in Los Angeles. However, Pacific Inland Bank is actually located in Anaheim, and clears its checks through its own bank with its own ABA number. According to DOC, one individual passing the fraudulent checks has apparently been apprehended; however, it is unknown whether that person acted alone and whether the problem is indeed solved.

On July 15, DOC informed its credit union licensees about a current credit card scam involving Visa and MasterCard accounts issued by credit unions. According to DOC, the perpetrators make a counterfeit duplicate credit card imprinted with a name and account number which may also be counterfeit. However, the microstrip on the back of the card will contain the credit union member's accurate account number; in some cases, the information has been obtained from a credit union employee. Once it is determined that the card works, the perpetrators then obtain cash advances or purchases expensive items. The perpetrators have also made counterfeit identification, including drivers' licenses, travelers checks, cashier's checks, and social security cards.

DOC Enforcement Activity. On June 2, Commissioner Mendoza reported on the progress and expansion of DOC's ongoing investigation into wireless cable investment scams, following up on the April law enforcement sweep of ten southern California telemarketing boiler rooms offering investments in wireless cable communications systems to investors across the country. *[14:2&3 CRLR 126]* DOC investigators and attorneys continue to review materials seized in the April raid for evidence of securities fraud. From the information and the flood of investor tips received by investigators since that raid, DOC has opened investigations into over 50 California businesses believed to be selling unregistered wireless cable investments through telemarketing boiler rooms and infomercials, promising returns of up to 600% on investments in wireless cable systems.

The Commissioner cautions investors to carefully review proposals before they invest; for wireless cable systems in particular, the Commissioner warned that "investors need to ask how much of their money is really going into building these systems, and how much is going into sales commissions and slick advertising materials." The Department believes that many of these unregistered wireless cable offerings are raising millions more than they really need to develop the systems, and that up to 50% of each investment is going directly to sales commissions. The Commissioner encourages investors to contact DOC to find out if an investment opportunity or investment professional is properly registered or qualified with the state.

On June 23, in an effort to crack down on the illegal sale of gold, silver, and foreign currency futures contracts to Californians, DOC and U.S. Commodity Futures Trading Commission (CFTC) announced a series of civil actions against three California businesses, as well as businesses in New York and Texas and their Hong Kong-based parent company; the businesses were apparently soliciting salespeople via print advertisements and investors through extensive cold-calling. According to DOC, the businesses were making promises of high returns to investors and of impressive sales commissions, and were operating illegally.

The two agencies filed charges against Frankwell Bullion Ltd., a Hong Kong corporation, and its U.S. affiliates Frankwell Investment Services, Inc. of San Francisco, Maywell Investment Services, Inc. of San Diego, Frankwell Investment Services, Inc. of Houston, and Frankwell Management Services, Inc. of New York. The charges were filed in the U.S. District Court in San Francisco for alleged violations of the Federal Commodity Exchange Act and the California Commodity Law of 1990. Under federal law, contracts for the purchase or sale of a commodity for future delivery can only be offered and executed through a board of trade designated by the CFTC as a contract market, and by members of a contract market. None of the six companies were trading on exchanges registered with the CFTC, and their commodities brokers were not registered with that agency. Under California law, contracts purchased or sold on an exchange not recognized by the CFTC, or by unregistered brokers, are illegal for sale in California.

As a result of the filing, the agencies obtained a temporary restraining order, a receiver over, and orders against all of the businesses—thus freezing their assets and preventing the destruction or alteration of books and records. At present, investigators are reviewing customer and financial records from all of the locations; based upon a preliminary review, they estimate that over 1,000 investors were doing business with the U.S. companies, and that the combined businesses were taking in approximately $1 million each month.

On June 29, DOC served a search warrant against Marada Corporation, Marada Capital, Inc., Marada Aviation, Inc., and Marada Casino Resorts Hotel, Inc., at the sales offices of Marada Capital in Palm Springs; the search warrant was based upon allegations that the companies were offering and selling unregistered and potentially fraudulent investments in a Caribbean airline and resort. According to their preliminary review of information found at the Palm Springs location, investigators believe that office was also selling general partnerships in ostrich ranching investments from Trans-American Ostrich Traders, Inc., and doing business as J.B.C. Capital. Neither the airline/resort investments nor the ostrich ranching investment are registered with DOC as securities for public offering in the state of California.

On June 30, in connection with a nationwide effort by state securities regulators to raise public awareness of the dangers involved in investing through online computer networks, Commissioner Mendoza issued an investor alert urging Californians who subscribe to major commercial online services and the Internet to exercise great caution when investing in products promoted on computer bulletin boards and through e-mail. According to Mendoza, the networks allow their subscribers to use specialized bulletin boards, including a growing number of bulletin boards and discussion groups devoted to investment tips, advice, and solicitation. The Commissioner cautioned online users that although DOC and other securities regulators are aware that these bulletin boards and other computer services are increasingly being used to promote investment scams, the agencies' limited resources simply do not allow them to effectively investigate and end "cyber-fraud."

Instead, Mendoza urged online users to exercise caution when investing through their computer services, and provided tips to potential investors. Among other things, Mendoza stated that if an offer sounds too good to be true, it probably is; one should not assume that the online computer service researches or polices its investment bulletin boards or messages, as most do not; a potential investor should always take the time to do his/her own research into an investment; DOC should be contacted to ensure that an investment opportunity and the person or people promoting it are registered with the proper authorities; and investors should not act on the advice of a person who hides his/her identity online. The Commissioner also urged investors to be particularly careful when dealing with thinly-traded, little-known stocks as, due to their low volume, these stocks are most susceptible to manipulation.

LEGISLATION

SB 1951 (Killea), as amended August 23, creates a new exemption to the Corporate Securities Act's requirement that the Commissioner review and approve securities before they are offered or sold. Under the new exemption, the issuer must be a California corporation or a foreign corporation subject to California law, so long as the entity is not organized for the purpose of raising capital to invest in future unknown businesses or an investment company subject to the Investment Company Act of 1940. Sales of the exempt securities may be made only to "qualified purchasers" who are "sophisticated persons" as defined in DOC's regulations, institutional investors (such as banks, insurance companies, and corporations), corporations or other entities with total assets in excess of $5 million, and natural persons who have a net worth of at least $250,000 and, during the immediately preceding tax year, had a gross income in excess of $100,000 and reasonable expect gross income in excess of $100,000 for the current tax year, or who have a minimum net worth of $500,000. The issuer must publish a written announcement of the proposed offering containing specified information, and notice of the transaction must be filed with the DOC Commissioner concurrent with the publication of the announcement of the proposed offering; the filing fee is $600. According to Senator Killea, the purpose of the bill is to facilitate the ability of small businesses to raise the capital necessary to finance their operations or growth through the sale of securities by reducing the cost of these transactions. SB 1951 was signed by the Governor on September 25 (Chapter 828, Statutes of 1994).

AB 389 (Peace). Existing law provides that any person subject to the Escrow Law who knows of a person's involvement in an abstraction or misappropriation of money, funds, trust obligations, or property deposited with a licensed escrow agent shall immediately report the abstraction or misappropriation in writing to the Commissioner of Corporations. As amended June 20, this bill instead provides that any person subject to the Escrow Law who knows of a person's involvement in an abstraction or misappropriation of money, funds, trust obligations, or property deposited with a licensed escrow agent shall immediately report the abstraction or misappropriation in writing to the Commissioner and to Fidelity Corporation.

Existing law requires the Escrow Agents' Fidelity Corporation to deny an application for a certificate or revoke the certificate of any person upon specified grounds. This bill additionally specifies, as grounds, that a person has committed or caused to be committed an act of dishonesty, fraud, deceit, embezzlement, fraudulent conversion, or misappropriation of property, to the material damage of a member or for which the member has been held liable to any third party, by final judgment.

Existing law provides that any director, officer, stockholder, trustee, employee, or agent of an escrow agent, who abstracts or willfully misappropriates money, funds, trust obligations, or property deposited with an escrow agent, is guilty of a felony. Upon conviction, the court shall, in addition to any other punishment imposed, order the person to make full restitution, first to the escrow agent and then to Fidelity Corporation, to the extent it has indemnified the escrow agent. This bill also specifies additional violations relating to forgery and counterfeiting, larceny, and embezzlement for those restitution purposes, as specified. The bill also provides that the license of an escrow agent shall be deemed revoked upon the completion or closure of a court approved liquidation, as specified. This bill was signed by the Governor on September 6 (Chapter 423, Statutes of 1994).

The following is a status update on bills reported in detail in CRLR Vol. 14, Nos. 2 & 3 (Spring/Summer 1994) at pages 268–28:

AB 2885 (Committee on Banking and Finance), as amended August 18, consolidates the Personal Property Brokers Law, the Consumer Finance Lenders Law, and the Commercial Finance Lenders Law by repealing the latter two, and regulating consumer and commercial loans under the Personal Property Brokers Law, to be renamed the California Finance Lenders Law. This bill, which will become operative on July 1, 1995, was signed by the Governor on September 28 (Chapter 1115, Statutes of 1994).

AB 3260 (Bornstein), as amended August 24, requires a health care service plan (HCSP), disability insurance policy, and a nonprofit hospital service plan that includes terms that require binding arbitration to settle disputes and that restrict, or provide for a waiver of, the right to a jury trial to include a specified disclosure; requires any HCSP, disability insurance policy, or nonprofit health care service plan that includes a term that requires binding arbitration in case of a medical malpractice claim or dispute to provide for the selection of a neutral arbitrator by the parties in those cases or disputes for which the total amount of damages claimed is $50,000 or less; provides that the single neutral arbitrator shall have no jurisdiction to award more than $50,000; provides that certain procedures for court appointment of an arbitrator shall be followed if the parties are unable to agree on the selection of an arbitrator; and expressly prohibits waiver of these requirements.

Existing law requires certain judgments against specified licensed health care professionals by a court to be reported by the clerk of the court to the relevant occupational licensing agency. This bill requires an arbitration under a HCSP contract for any death or personal injury resulting in an award for an amount in excess of $30,000 to be a judgment for purposes of the above-described provision of law. This bill was signed by the Governor on September 19 (Chapter 653, Statutes of 1994).

SB 1832 (Bergeson), as amended August 29, requires HCSPs to reimburse providers for emergency services and care without prior authorization in specified circumstances; provides procedures for obtaining authorization and resolving disagreements in circumstances where, in the opinion of the emergency or attending physician or other provider, a patient who has received emergency care may not be safely discharged; provides an exception to certain of these provisions for a provider who has a contract with a HCSP for providing emergency and necessary medical care, and for a HCSP that has 3,500,000 enrollees and maintains a prior authorization system that meets certain criteria; and requires DOC to adopt emergency regulations governing instances when an enrollee requires medical care following stabilization of an emergency condition.

Existing law requires every HCSP to establish procedures in accordance with DOC regulations for continuously reviewing the quality of care, performance of medical personnel, utilization of services and facilities, and costs. This bill requires a HCSP to disclose to the Commissioner and providers under contract with the plan the processes the plan uses to authorize health care services by a provider pursuant to the benefits provided by the plan, with certain exceptions. It also requires that those processes be disclosed to enrollees upon request. This bill prohibits certain disability insurers, a HCSP, or a nonprofit hospital service plan that authorizes a specific type of treatment by a provider from rescinding or modifying this authorization after the provider renders the health care service in good faith and pursuant to the authorization.

Existing law requires a HCSP to establish and maintain a grievance system approved by DOC under which enrollees may submit grievances, and imposes procedures for this system. This bill requires the Commissioner to annually file, as a public record, an aggregate summary of complaints filed against HCSPs. The bill also provides that upon appeal to the plan of a contested claim, the claim would be referred by the plan to the medical director or other appropriately licensed health care provider, and sets forth procedures for this appeal.

Existing law requires a HCSP to reimburse claims or any portion thereof as soon as practical, but no later than 30 working days for a health care service plan and 45 working days for a health maintenance organization after receipt of the claim unless the claim or portion thereof is contested; it deems a claim or portion thereof to be reasonably contested where the plan has not received the completed claim and all information necessary to determine payor liability for the claim. This bill requires a HCSP to complete reconsideration of the claim within 30 working days and requires a health maintenance organization to complete reconsideration of the claim within 45 working days after receipt of this additional information.

This bill requires HCSPs to notify enrollees of the termination of a contract with a medical group, individual practice association, or individual providers within such a group or association selected by those enrollees, and authorizes the plan to request the medical group or individual practice association to notify the enrollees who are patients of that provider when the individual provider is within that group or association. This bill also requires plans to disclose the reasons for termination of a contract in certain circumstances.

This bill prohibits, with certain exceptions, the release of any information by certain disability insurers, a HCSP, or a nonprofit hospital service plan to an employer that would directly or indirectly indicate to the employer that an employee is receiving or has received services from a health care provider that is covered by the plan, unless authorized to do so by the employee. This bill was signed by the Governor on September 15 (Chapter 614, Statutes of 1994).

SB 469 (Beverly), as amended August 25, enacts the California Limited Liability Company Act, authorizing a limited liability company (LLC) to engage in any lawful business activity. LLCs are hybrid entities which enjoy the favorable provisions of tax law associated with partnerships and the favorable provisions of liability law associated with corporations. SB 469 sets forth the duties and obligations of the managers of a LLC; and establishes requirements and procedures for membership interests in LLCs, including voting, meeting, and inspection rights. This bill was signed by the Governor on September 30 (Chapter 1200, Statutes of 1994).

AB 1031 (Aguiar). Existing law requires licensed escrow agents to annually submit to the Commissioner of Corporations an audit report containing audited financial statements covering the calendar year. As amended June 21, this bill provides that upon completion of those reports and financial statements, the independent accountant shall submit to the Commissioner complete copies of the reports and statements at the same time that copies are submitted to the licensed escrow agent. It also requires the licensee to submit to the Commissioner a specified written notice when the accountant reporting upon or certifying these reports and statements is other than the accountant reporting upon or certifying the licensee's most recent reports on financial statements, as specified. This bill was signed by the Governor on September 11 (Chapter 496, Statutes of 1994).

The following bills died in committee: **AB 2940 (Aguiar)**, which would have authorized, pursuant to regulations adopted by the Commissioner, a credit union to offer an incentive or inducement to individuals who wish to become members of the credit union, or to its employees or members who assist in adding new members to the credit union; **AB 3244 (Epple)**, which would have required HCSPs, nonprofit hospital service plans, and certain disability insurers that deny coverage for an experimental medical procedure or plan of treatment for an enrollee or claimant with a terminal illness to notify the enrollee or claimant of specified information and rights; **AB 3572 (Martinez)**, which would have—among other things—required HCSP contracts, disability insurance policies providing coverage for hospital, medical, and surgical benefits, and nonprofit hospital service plan contracts issued, amended, delivered, or renewed in this state on or after January 1, 1995, to provide coverage for the participation of an enrollee, insured, or subscriber in a clinical trial that meets certain criteria; **AB 3571 (Margolin)**, which would have required DOC and the Department of Insurance to jointly establish a health benefits panel to consider whether particular procedures, services, drugs, or devices may be excluded from coverage by health care service plan contracts or disability insurance policies because they are considered experimental or investigational; **AB 3681 (Margolin)**, which would have—among other things—prohibited HCSPs and disability insurers from awarding bonus compensation to any employee on the basis of that employee's performance in denying authorization or payment for costly services; **AB 2649 (Woodruff)**, which would have authorized a licensed plan to give written notice to the Commissioner annually, as provided, of specified changes; **AB 3749 (Margolin)**, which would have required all HCSPs and policies of disability insurance that cover hospital, medical, or surgical expenses, to provide coverage for screening, diagnosis, treatment of, or surgery for, cervical cancer and cervical dysplasia, as well as screening, diagnosis, and treatment of sexually transmitted infections, and federally approved contraceptive devices; **SB 930 (Killea)**, which would have enacted the California Limited Liability Company Act; **AB 1057 (Conroy)**, which would have permitted an escrow agent applicant or licensee to obtain an irrevocable letter of credit in a form which shall be approved by the Commissioner in lieu of a specified bond; **AB 1125 (Johnson)**, which would have required the Commissioner to conduct an inspection and examination of a new escrow agent licensee within six months of licensure; and **AB 2306 (Margolin)**, which would have added to the acts that constitute grounds for HCSP disciplinary action the failure of a plan to correct prescribed deficiencies identified by the Commissioner.

LITIGATION

At this writing, the California Supreme Court is still reviewing the Second District Court of Appeal's decision in ***People v. Charles Keating***, 16 Cal. App. 4th 280 (1993). *[14:2&3 CRLR 128]* In its ruling, the Second District affirmed a jury verdict in which the former savings and loan boss was found guilty of defrauding 25,000 investors out of $268 million by persuading them to buy worthless junk bonds instead of government-insured certificates. *[12:2&3 CRLR 169]* In his appeal (No. S033855), Keating primarily challenges the trial court's jury instructions stating that he could be convicted under theories that he was either the direct seller of false securities in violation of Corporations Code sections 25401 and 25540, or a principal who aided and abetted the violations. The issue is whether aiding and abetting of a section 25401 crime statutorily exists; Keating claims that criminal liability is restricted to direct offerors and sellers, and that the evidence failed to prove he personally interacted with any of the investors.

DEPARTMENT OF INSURANCE

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Insurance is the only interstate business wholly regulated by the several states, rather than by the federal government. In California, this responsibility rests with the Department of Insurance (DOI), organized in 1868 and headed by the Insurance Commissioner. Insurance Code sections 12919 through 12931 set forth the Commissioner's powers and duties. Authorization for DOI is found in section 12906 of the 800-page Insurance Code; the Department's regulations are codified in Chapter 5, Title 10 of the California Code of Regulations (CCR).

The Department's designated purpose is to regulate the insurance industry in order to protect policyholders. Such regulation includes the licensing of agents and brokers, and the admission of insurers to sell in the state.

In California, the Insurance Commissioner licenses approximately 1,300 insurance companies which carry premiums of approximately $63 billion annually. Of these, 600 specialize in writing life and/or accident and health policies.

In addition to its licensing function, DOI is the principal agency involved in the collection of annual taxes paid by the insurance industry. The Department also collects more than 170 different fees levied against insurance producers and companies.

The Department also performs the following functions:

(1) regulates insurance companies for solvency by tri-annually auditing all domestic insurance companies and by selectively participating in the auditing of other companies licensed in California but organized in another state or foreign country;

(2) grants or denies security permits and other types of formal authorizations to applying insurance and title companies;

(3) reviews formally and approves or disapproves tens of thousands of insurance policies and related forms annually as required by statute, principally related to accident and health, workers' compensation, and group life insurance;

(4) establishes rates and rules for workers' compensation insurance;

(5) preapproves rates in certain lines of insurance under Proposition 103, and regulates compliance with the general rating law in others; and

(6) becomes the receiver of an insurance company in financial or other significant difficulties.

The Insurance Code empowers the Commissioner to hold hearings to determine whether brokers or carriers are complying with state law, and to order an insurer to stop doing business within the state. However, the Commissioner may not force an insurer to pay a claim—that power is reserved to the courts.

DOI has over 800 employees and is headquartered in San Francisco. Branch offices are located in San Diego, Sacramento, and Los Angeles. The Commissioner directs 21 functional divisions and bureaus.

The Underwriting Services Bureau (USB) is part of the Consumer Services Division, and handles daily consumer inquiries through the Department's toll-free complaint number. It receives more than 2,000 telephone calls each day. Almost 50% of the calls result in the mailing of a complaint form to the consumer. Depending on the nature of the returned complaint, it is then referred to Claims Services, Rating Services, Investigations, or other sections of the Division.

Since 1979, the Department has maintained the Bureau of Fraudulent Claims, charged with investigation of suspected fraud by claimants. The California insurance industry asserts that it loses more than $100 million annually to such claims. Licensees currently pay an annual assessment of $1,000 to fund the Bureau's activities.

■ MAJOR PROJECTS

The Race for Insurance Commissioner Narrows. On June 7, California voters limited their choice for Insurance Commissioner to Democrat Art Torres and Republican Charles Quackenbush, two candidates with very different backgrounds and views on insurance regulation. Commissioner John Garamendi, who chose to seek the Democratic nomination for Governor rather than pursue another term as Insurance Commissioner, lost the nomination to state Treasurer Kathleen Brown. *[14:2&3 CRLR 129]*

Torres, a Latino with twenty years' experience in the legislature, has chaired the Senate Insurance Committee since 1992. He supports Proposition 103 and favors aggressive regulation of the insurance industry, expansive coverage for consumers, and sweeping powers for the Commissioner. Should Torres win in November, he would be the first Latino to hold statewide office in this century.

Quackenbush, a former Army captain and entrepreneur from Silicon Valley, has been an assemblyman for eight years. He characterizes himself as a political moderate who believes the unfettered marketplace can force premium rates down and increase availability because more insurers will be attracted to California. He has historically questioned Proposition 103, but has pledged to enforce it if elected. Quackenbush, whose campaign is being handled by Governor Wilson's former deputy chief of staff, is strongly supported by the insurance industry, and has accepted hundreds of thousands of dollars in campaign contributions from the industry.

Garamendi's Rollback Rules Affirmed by California Supreme Court. On August 17, the California Supreme Court unanimously upheld the constitutionality of Commissioner Garamendi's regulations implementing the rollback provisions of Proposition 103 (*see* LITIGATION). The high court's decision in *20th Century Insurance Company v. Garamendi* was a tremendous and long-awaited victory for Garamendi and the Department, Proposition 103 author Harvey Rosenfield, and the team of Fred Woocher and Mike Strumwasser—private attorneys from Santa Monica who have defended Proposition 103 in the relentless onslaught of industry-financed litigation since it was passed by the voters on November 8, 1988. *[12:4 CRLR 151–52]* The ruling affirming the validity of Commissioner Garamendi's regulations implementing Proposition 103's rollback provision and his application of those regulations to 20th Century comes over five years after the same court unanimously upheld the facial constitutionality of the initiative in *Calfarm v. Deukmejian*, 48 Cal.3d 805 (1989). *[9:3 CRLR 86–87]*

Unfortunately for Commissioner Garamendi's political aspirations, the decision came too late to help him in his bid for the Democratic nomination for Governor. Although the *20th Century* matter was fully briefed by August 25, 1993, the Supreme Court did not schedule oral argument in the matter until June 7, 1994—the day of the primary election.