missioner, the Superintendent of Banks, the Savings and Loan Commissioner, and the Commissioner of Corporations to adopt regulations governing ex parte communications, as defined, with respect to their departments; and would have permitted the issuance of a public notice adopting more stringent regulations governing ex parte communications when it is in the public interest with respect to particular proceedings to do so. This bill died in the Assembly Ways and Means Committee.

AB 4064 (Epple), as amended August 23, requires the Superintendent of Banks, among others, to inform other supervisory officers and appropriate state and federal agencies of any enforcement actions, including but not limited to civil or criminal actions, cease and desist orders, license or authorization suspensions or revocations, or open investigations. This bill was signed by the Governor on September 18 (Chapter 1035, Statutes of 1990).

SB 2496 (Vuich), as amended August 21, requires the sentencing court to order restitution by persons convicted of certain financial institution-related felonies; and prohibits any person convicted of specified felonies from being a director, officer, or manager of a financial institution with federally or state insured deposits. However, the bill will not apply with respect to pre-1991 convictions of directors, officers, or managers whose office or employment commenced before January 1, 1991. This bill was signed by the Governor on September 14 (Chapter 947, Statutes of 1990).

SB 2745 (Boatwright), which provides that "investment and loan" means an industrial loan company, and requires, if applicable, the use of that term as a part of the company name, was signed by the Governor on September 7 (Chapter 623, Statutes of 1990).

SB 2490 (Vuich), which would have amended the California Interstate (National) Banking Act of 1986, died in the Assembly Finance and Insurance Committee.

AB 3813 (Lewis), as amended June 20, makes numerous revisions to the California Interstate (National) Banking Act of 1986, including the revision of various definitions applicable to that act; the exemption of certain forms of ownership from the definition of control of a company; and permitting the acquisition or ownership of more than 5% of the voting shares of a California bank or California bank holding company by a foreign bank holding company, with the approval of the Superintendent of Banking. This bill was signed by the Governor on September 10 (Chapter 748, Statutes of 1990).

SB 476 (Robbins), which specifies that time deposits include a time certificate of deposit, was signed by the Governor on September 29 (Chapter 1442, Statutes of 1990).

AB 244 (Calderon), as amended August 15, enacts provisions with respect to the safe use of automated teller machines, including certain location, installation, and lighting standards. This bill, which also states legislative intent, was signed by the Governor on September 12 (Chapter 825, Statutes of 1990).

LITIGATION:

In *Dodd v. Citizens Bank of Costa Mesa*, No. G008019 (May 30, 1990), the Fourth District Court of Appeal affirmed the trial court's holding that a bank is not liable for the mismanagement of an account to a non-customer plaintiff. Dodd alleged that he ran a trucking business which contracted with Pacific Payroll Systems, Inc., for preparation of his payroll checks and tax returns, and authorized it to transfer funds from his bank directly into Pacific's account at Citizens Bank. The signature card for the Citizens account authorized Judi Kramer and Richard Hunter, employees of Pacific, to write checks on the account. The card also identified the account as belonging to Pacific and labeled it a "payroll trust account." Subsequently, Kramer and Hunter diverted over $90,000 of Dodd's funds to their own use.

Among the various causes of actions in tort, Dodd sued Citizens for negligence. He alleged that he was a customer of Citizens and that the bank should have sent him monthly statements and all cancelled checks issued in his company's name. If Citizens had done so, he argued, he would have been able to detect the unauthorized use of his funds.

In its decision, the Fourth District distinguished *Kendall Yacht Corp. v. United California Bank*, 50 Cal. App. 3d 949 (1975), and *American National Bank v. Stanfill*, 205 Cal. App. 3d 1089 (1988), from the instant case. In those two cases, the banks dealt directly with the plaintiffs, and the courts held them financially responsible for the accounts in question. Here, the court stated, Dodd had no responsibility for Pacific's account and had no direct dealing with Citizens. He was one of Pacific's many clients and had no customer relationship with Citizens. Thus, Citizens had no duty toward Dodd as a customer.

DEPARTMENT OF CORPORATIONS

Commissioner: Christine W. Bender
(916) 445-7205
(213) 736-2741

The Department of Corporations is a part of the cabinet-level Business and Transportation 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 Chapter 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: Franchise Investment Statute, Credit Union Statute, Industrial Loan Law, Personal Property Brokers Law, Health Care Service Plan Law, Escrow Law, Check Sellers and Cashiers Law, Securities Depositor Law, California Finance Lenders Law, and Security Owners Protection Law.

A Consumer Lenders Advising Committee advises the commissioner on policy matters affecting regulation of consumer lending companies licensed by the Department of Corporations. The committee is composed of leading executives, attorneys, and accountants in consumer finance.

MAJOR PROJECTS:

Enforcement Action Against Charles Keating. As a result of the estimated $250 million in investor losses in the Lincoln Savings and Loan collapse, the Department of Corporations has filed a civil action charging Charles Keating, American Continental Corporation (ACC) and two of its top officers and directors, Judy Wischer and Andrew Ligget, with securities fraud, fraud in application for qualification and offer/sale of unauthorized securities, and unauthorized advertising. *(See infra* LITIGATION; *see also* CRLR Vol. 10, Nos. 2 & 3 (Spring/Summer 1990) pp. 135-38; Vol. 10, No. 1 (Winter 1990) pp. 103 and 113-14; and Vol. 9, No. 4 (Fall 1989) p. 100 for detailed background information on the Lincoln scandal.)

Although this action was brought in Los Angeles County Superior Court, the defendants removed the case to federal court. The Department then transferred the case to Arizona (where ACC's bankruptcy petition and other cases related to the collapse of Lincoln Savings are pending), and filed a motion for relief from the automatic bankruptcy stay and for remand back to California state court. On July 12, these motions were denied by the Arizona district court. The state is currently preparing a motion for summary judgment and will seek, in the alternative, a partial adjudication of issues.

Subsequent to this action, the Los Angeles County grand jury issued a multicount criminal indictment alleging fraud, embezzlement, and securities violations against Keating and several others associated with ACC. The defendants have been arraigned and are now awaiting criminal trial.

Regulatory Action Under the Health Care Service Plan Act. The Department has proposed numerous amendments and additions to its regulations implementing the Knox-Keene Health Care Service Plan Act (HCSPA) regarding the Medicare program. (See CRLR Vol. 10, Nos. 2 & 3 (Spring/Summer 1990) p. 136 and Vol. 10, No. 1 (Winter 1990) pp. 104-05 for detailed background information on these changes.) The proposed changes are still being reviewed by the federal government to ensure consistency with federal Medicare laws.

The Department is currently reviewing public comments it received regarding proposed amendments to section 1300.70, which would establish mandatory requirements governing the structure, elements, and implementation of internal quality of care review systems for health care service plans. (See CRLR Vol. 10, Nos. 2 & 3 (Spring/Summer 1990) p. 136 and Vol. 10, No. 1 (Winter 1990) p. 105 for detailed background information on these amendments.) The Department anticipated amending its proposed changes and releasing the new version for additional comments at the end of September.

The Commissioner has also proposed to amend the Department's regulations under the HCSPA relating to tangible net equity (TNE), including changes to sections 1300.84, 1300.84.06, and 1300.84.3. (See CRLR Vol. 10, Nos. 2 & 3 (Spring/Summer 1990) p. 136 for background information.) The Department received public comments regarding these proposed amendments at a June 19 public hearing; it is currently amending its proposed changes and anticipated releasing the revised version for additional comments at the end of September.

Regulatory Action Under the Escrow Law. The Department recently adopted new section 1718 to its regulations, relating to the deposit of a cash bond with the Commissioner in lieu of a surety bond. (See CRLR Vol. 10, Nos. 2 & 3 (Spring/Summer 1990) p. 136 for background information.) The Office of Administrative Law (OAL) approved this proposed addition on August 24.

On August 22, the Department submitted nonsubstantive revisions to section 1726 of its regulations to OAL. Section 1726 contains a form to be used by escrow agents for reporting to the Commissioner information concerning their employees and other specified persons who have access to funds held in trust. OAL approved proposed nonsubstantive amendments which revise the format in which filing fees are enumerated and the listing of the Department's telephone number, and which add a provision for the use of an applicant identification number. However, an additional proposed change—requiring applicants to list their prior names and addresses—was disapproved by OAL, on grounds that disclosure of this information is not presently required by any law identified by the Department. Because the proposed changes would affect the rights and responsibilities of applicants by creating new requirements for the disclosure of information, the Department must comply with the procedures and standards of the Administrative Procedure Act in order to properly adopt this requirement.

Regulatory Action Under the Corporate Securities Act. The Department has proposed regulatory changes repealing section 260.104 of its regulations, which currently defines "written bid for a security or a written solicitation of an offer to sell a security" for purposes of section 25014(b) of the Corporate Securities Law of 1968. The Department proposes to repeal this language and adopt a new section 260.104, to be titled "Unsolicited Orders." This regulation would provide that an order to offer to buy a security is presumed not to be "unsolicited," if the broker-dealer (a) would be required to deliver a prospectus or offering circular to a customer, or (b) has engaged in one or more of the following activities within the previous 60 days: (1) publicly quoted a bid or asked a price for the security; (2) made a direct solicitation that customers purchase the security; (3) recommended the purchase of a security to customers; (4) volunteered information about the issuer of the security either to a particular customer who then purchased the security or to customers generally; and (5) executed a transaction for a discretionary account to purchase or sell the security. Also, new section 260.104 would provide that a statement that the security is ineligible for trading in California or not recommended for California investors included in a recommendation or information circulated regarding a security or an issuer does not negate the presumption created by the section.

However, the section would not create a presumption that an order or offer is "unsolicited" if the broker-dealer is not engaged in the listed activities within the previous 60 days. Finally, new section 260.104 would provide that the term "customer," for purposes of the regulation, does not include persons to whom offers or sales may be made pursuant to the exemption in section 25104(c) of the Corporate Securities Law.

The public comment period regarding these proposed amendments was scheduled to end on November 9.

Regulatory Action Under the Franchise Investment Law. On July 13, OAL approved the Department's proposed amendments to section 310.101 of its regulations, regarding the proper format of a Notice of Exemption under sections 31101 or 31104 of the Corporations Code, required to be filed in certain circumstances under the Franchise Investment Law.

Regulatory Action Under the Security Owners Protection Law. On August 17, OAL approved the Department's proposed amendments to section 1592 of its regulations, regarding general instructions for preparing and filing an application for a certificate under the Security Owners Protection Law. The amendment clarifies that such an application may be filed at either the Los Angeles or San Francisco office of the Department.

Regulatory Action Under the Industrial Loan Law. On August 13, OAL approved the Department's revisions to sections 1133, 1135, 1150, 1159, 1168, 1169, 1187, 1188, 1190, 1191, 1197, 1201, 1203, 1204, 1207, 1210, 1212, 1214, 1215, 1217, 1223, 1226, 1227, 1230, 1236, 1247, 1264, 1285, and 1286-88, and the proposed repeal of sections 1136, 1153, 1160, 1161, 1163, 1164, 1173, 1177, 1180-85, 1190.4, 1196, 1200, 1220, 1222, 1233, 1234, 1234.1, 1235, 1237-39, 1245, 1246, 1248, 1249-50, 1268, 1269, 1289, 1290, 1290.1, and 1290.2 of its regulations implementing the Industrial Loan Law. While many of these revisions are nonsubstantive, several changes are significant, such as the repeal of the section describing the form and content of investment certificates; the repeal of the section providing for the contents, filing, and posting of the schedule of charges required by section 18230 of the Financial Code; and the revision of requirements for the approval of qualified real property appraisers.

Proposed Regulatory Action. In August, the Department proposed two regulatory changes pursuant to the Personal Property Brokers Law, the Consumer Finance Lenders Law, and the Commercial Finance Lenders Law. Financial Code sections 22476, 24476, and 26476 authorize a personal property broker, consumer finance lender, and commercial finance lender to sell promissory notes evidencing an obligation to repay loans "made by a licensee." Proposed section 1460 would clarify and make specific the manner in which a loan is "made by a licensee," and would require a licensee to process, approve, and fund a loan, with specified exceptions. Under proposed section 1460, the licensee must be the beneficiary on the promissory note and the loan must comply with applicable statutes and regulations.

The Department also proposed amendments to section 1556 of its regulations, which would, among other things, prohibit finance companies from making guaranteed loan offers (rather than firm offers) unless specified conditions are met. As proposed, section 1556 clarifies the loan instruments reviewed by the Commissioner and authorizes individuals to be obligated on the loan. Section 1556 also requires a finance company to make a loan in accordance with stated amounts and rates not to exceed the stated annual percentage rate, as specified. Additionally, section 1556 prohibits a finance company from requiring or considering security for a loan, as specified. Furthermore, section 1556 authorizes a finance company to honor a guaranteed loan offer if there is a lack of current loan balance or a supersession of prior and existing loan offers. Lastly, section 1556 provides various conforming language revisions.

The public comment period on these proposed amendments was scheduled to end on September 21.

LEGISLATION:

AB 2773 (Peace). Existing law provides that a foreign corporation that does not hold a valid certificate to transact intrastate business is subject to a specified penalty. As amended August 20, this bill specifies that the amount of penalty assessed shall be determined by a court. Existing law also provides for specified notification of the suspension or forfeiture, for the voidability of contracts for specified violations, for relief from suspension or forfeiture, and for a specified certificate of revivor. This bill provides that, except for specified relief from voidability, every contract made during the time that corporate powers, rights, and privileges are suspended or forfeited is declared to be voidable at the instance of any party other than the taxpayer. This bill was signed by the Governor on September 14 (Chapter 926, Statutes of 1990).

The following is a status update on bills reported in detail in CRLR Vol. 10, Nos. 2 & 3 (Spring/Summer 1990) at pages 137-38:

SB 2494 (Vuich), as amended August 28, prohibits any financial institution, as defined, or other person from offering to the public, at any retail branch at which deposits are accepted, any security that is not investment grade. The bill also requires a financial institution that sells to the public, at any retail branch office, any security which is not insured by a federal agency or instrumentality or by a private share insurance or guaranty arrangement, to provide a specified disclosure statement. This bill was signed by the Governor on September 30 (Chapter 1545, Statutes of 1990).

SB 2163 (Hart), as amended July 6, would have required the Insurance Commissioner, the Superintendent of Banks, the Savings and Loan Commissioner, and the Commissioner of Corporations to adopt regulations governing *ex parte* communications, as defined, with respect to their departments; and would have permitted the issuance of a public notice adopting more stringent regulations governing *ex parte* communications when it is in the public interest with respect to particular proceedings to do so. This bill died in the Assembly Ways and Means Committee.

AB 4064 (Epple), as amended August 23, requires the Commissioner of Corporations, among others, to inform other supervisory officers and appropriate state and federal agencies of any enforcement actions, including, but not limited to, civil or criminal actions, cease and desist orders, license or authorization suspensions or revocations, or open investigations. This bill was signed by the Governor on September 18 (Chapter 1035, Statutes of 1990).

AB 4157 (Waters, N.), which requires the Department of Housing and Community Development to notify any concerned governmental agency whenever it is determined by investigation that an escrow agent has done any of certain specified acts, was signed by the Governor on September 12 (Chapter 865, Statutes of 1990).

SB 2574 (Robbins), which requires a share exchange tender offer to be approved by the board of the acquiring corporation, was signed by the Governor on September 7 (Chapter 616, Statutes of 1990).

AB 2774 (Eastin), as amended August 22, removes the ceiling on increases in the annual assessment on

licensed escrow agents, to enable the Department of Corporations to fully fund its escrow agent regulatory program. The bill also strengthens and enhances the Commissioner's regulatory power, specifically authorizing the Commissioner to seek injunctions against an escrow agent's license for failure to comply with any order. This bill was signed by the Governor on September 21 (Chapter 1186, Statutes of 1990).

SB 1762 (Vuich), which authorizes the Commissioner to censure, deny, suspend or revoke a broker-dealer or investment adviser certificate for willful violation of the Commodity Exchange Act, was signed by the Governor on July 16 (Chapter 323, Statutes of 1990).

AB 2259 (Bentley), which, as amended August 15, authorizes a parent corporation to merge into its subsidiary corporation, was signed by the Governor on September 18 (Chapter 1018, Statutes of 1990).

SB 503 (Stirling) would have permitted the director of a corporation to consider and act in the best interests of the public as well as in the best interests of the corporation and its shareholders. This bill was spawned by statements of San Diego Gas & Electric (SDG&E) Company board members that they had to vote for the SDG&E-Southern California Edison merger because of their exclusive duty to their shareholders. This bill died in the Assembly Judiciary Committee.

LITIGATION:

In Re American Continental Corporation/Lincoln Savings and Loan Association, No. 589302 (Orange County Superior Court), the class action lawsuit filed on behalf of 23,000 investors who lost upwards of $200 million in the collapse of Lincoln Savings and its now-bankrupt parent company, American Continental Corporation (ACC), is still pending in superior court. The Department was dismissed as a named defendant in this action last May. (See CRLR Vol. 10, Nos. 2 & 3 (Spring/Summer 1990) p. 138; Vol. 10, No. 1 (Winter 1990) pp. 103 and 113-14; and Vol. 9, No. 4 (Fall 1989) p. 100 for detailed background information.)

Recently, two of the remaining defendants—Karl Samuelian and Franklin Tom—announced a tentative agreement to pay $4.3 million up front to resolve claims by investors, and further agreed to pay an additional $10 million if plaintiffs are unable to collect from other defendants. However, this $10 million guarantee is apparently mooted, since defendant Charles Keating's primary law firm of Kaye, Scholer, Fierman, Hays & Handler has agreed to settle for $20 million. Further, in an unusual move to clear the Lincoln subsidiaries from the bankruptcy proceedings now pending in Arizona, the federal government (named as a defendant in the fourth amended complaint in this action, as holder of Lincoln) has decided to put up $21 million, of which approximately $16 million would go to satisfy bondholders in this class action. Partial settlements after certification of a class action must be approved by the court; however, there is no indication that approval will not be granted.

Three significant events increased the pressure on defendants to settle. First, in a related proceeding in U.S. District Court for the District of Columbia, after a six-month hearing, Judge Stanley Sporkin ruled that there was clear evidence of fraud warranting the government takeover of Lincoln. Judge Sporkin also chastised Lincoln's lawyers and accountants for not stopping the Lincoln violations, or at least disassociating themselves from the defendants. Second, on August 9, Keating was issued a restitution order for $40.9 million, which federal regulators claim was lost in three schemes involving Lincoln ($24.2 million from an illegal loan for the Ponchartrain Hotel in Detroit, $4.4 million from sale of Arizona desert land at inflated prices, and $12.3 million from an employee stock ownership plan that illegally purchased Keating's own stock). Third, as discovery continues in the Orange County Superior Court case, more and more damaging information is being uncovered. Because civil discovery efforts are running ahead of both federal and state agency inquiries, an agreement has been reached that provides federal and state access to plaintiffs' counsel's document depository and some attorney work product in the class action.

Partial settlements are expected to continue. The cut-off date for discovery is March 31, 1991; the trial is scheduled to begin in September 1991. It is still unknown when—if ever—investors will start recouping their losses.

DEPARTMENT OF INSURANCE

Commissioner: Roxani Gillespie
(415) 557-3245
Toll-Free Complaint Number:
1-800-233-9045

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 Codes 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 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 1,450 insurance companies which carry premiums of approximately $53 billion annually. Of these, 650 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) regulates compliance with the general rating law. Rates generally are not set by the Department, but through open competition under the provisions of Insurance Code sections 1850 *et seq.*; 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