Also at its August 20 meeting, OSB tabled Petition No. 387, submitted by George J. McCafferty of Foothill Industrial and Mechanical Incorporated, which asked OSB to amend section 3583(d), Title 8 of the CCR, regarding guards for wire wheels, sanding discs, and cut-off abrasive wheels. Petitioner requested that the petition be tabled until he has another opportunity to speak with OSB staff.

At its October meeting, OSB considered Petition No. 388, submitted by Craig Goodall, which asked the Board to amend section 4313, Title 8 of the CCR, to reduce the required clearance between the wheel and the work rest of disc grinding equipment to 1/16-1/4 inch. DOSH noted that section 4313 relates to woodworking, whereas Petitioner sought a regulation pertaining to metal grinding equipment. Both DOSH and OSB staff agreed that section 3577, Title 8 of the CCR, pertains more adequately to metal grinding operations; section 3577 states in part: “The work rest shall be adjusted such that the gap between the work rest and the grinding face of the abrasive wheel shall not exceed 1/8 inch.” OSB denied the petition.

Also in October, OSB considered Petition No. 389, submitted by Greg Walker of the Otis Elevator Company, which recommends amendments to sections 3041 and 3071, Title 8 of the CCR, part of the Board’s elevator safety orders, concerning the operations of elevators under fire and other emergency conditions, commonly known as the “firefighter’s service.” Section 3071(j) requires a load test of all hydraulic elevators to be performed at intervals not to exceed five years. Petitioner seeks the relocation of the requirement to test firefighter’s service from the hydraulic system testing requirement in section 3071 to section 3041. Both DOSH and OSB staff concurred that the petition has merit, and OSB granted it to the extent that an advisory committee will be formed to investigate the matter.

Future Meetings

- January 14, 1999 in Los Angeles.
- February 18, 1999 in Oakland.
- March 18, 1999 in San Diego.
- April 15, 1999 in Sacramento.
- May 20, 1999 in Los Angeles.
- June 17, 1999 in Oakland.
- July 15, 1999 in San Diego.
- August 19, 1999 in Sacramento.
- September 17, 1999 in Sacramento.
- October 21, 1999 in Oakland.
- November 18, 1999 in San Diego.
- December 16, 1999 in Sacramento.

Department of Corporations

Commissioner: Dale E. Bonner ♦ (916) 445-7205 ♦ (213) 576-7500 ♦ Internet: www.corp.ca.gov/

The Department of Corporations (DOC) is 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.

The Department administers several major statutes, including the Corporate Securities Law 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 more 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 may issue a permit for their sale in California.

Through DOC’s Securities Regulation Division, the Commissioner licenses securities agents, broker-dealers, and investment advisers, and may issue “desist and refrain” orders to halt unlicensed activity or the improper sale of securities. Deception, fraud, or violation of any DOC regulation is cause for license revocation or suspension of up to one year. Also, any willful violation of the securities law is a felony, and DOC refers these criminal violations to local district attorneys for prosecution.


The Corporations Commissioner also administers the Knox-Keene Health Care Service Plan Act of 1975, Health and Safety Code section 1340 et seq., which is intended to promote the delivery of health and medical care to Californians who enroll in or subscribe to services provided by a health care service plan or specialized health care service plan; coverage of these DOC activities is found above, under “Health Care Regulatory Agencies.”
Major Projects

**DOC Rulemaking Under the Corporate Securities Law**

The following is a brief summary of the rulemaking proceedings recently initiated by DOC under the Corporate Securities Law of 1968.

- **Transfer of Stock Options.** On December 29, the Office of Administrative Law (OAL) approved DOC’s amendment to section 260.140.41, Title 10 of the CCR, which provides that stock options granted to employees, directors, or consultants of the issuing corporation or any of its affiliates must be made pursuant to a stock option plan that meets specified conditions. Prior to the amendment, section 260.140.41(d) provides that the options may not be transferred except by will or the laws of descent or distribution; DOC amended subsection (d) to additionally allow the transfer of stock options by instrument to an inter vivos or testamentary trust, for estate planning purposes of the option holder. This amendment becomes effective on January 29, 1999.

- **Limited Public Offering Exemption Notice of Transaction.** SB 1951 (Killea) (Chapter 828, Statutes of 1994) added subdivision (n) to Corporations Code section 25102. Subdivision (n) provides that an offer and sale of a security in a limited public offering to certain “qualified purchasers” may be exempted from the Commissioner’s review and approval process provided specific requirements are met. This exemption is unique in that it allows for the publication of a notice announcing the proposed offer of securities. Only those investors who meet the specified qualifications may purchase these securities. [14:4 CRLR 119]

Under existing section 260.102.16, Title 10 of the CCR, the issuer must file a notice of transaction (the “first notice”) with the Commissioner concurrently with the publication of the general announcement of the proposed offering or at the time of the initial offer of securities, whichever occurs first. A second notice (“second notice”) must be filed within ten business days following the close or abandonment of the offering, but in any case no more than 210 days from the date of the filing of the first notice.

On August 5, OAL approved DOC’s amendments to subsections (d) and (e) of section 260.102.16. Section 260.102.16(d), which contains the “first notice” form, was amended to require the issuer to specify its state of incorporation or organization, or whether it is another form of business entity organized under California law; state how purchasers will be provided with applicable disclosure statements; indicate whether the disclosure statement is attached to the notice; indicate whether the general announcement of the offering was made, and (if so) to attach a copy and include information on the date and method of publication; and to sign and date the first notice.

Existing section 260.102.16(e) contains the “second notice” form which must be filed, and instructions for its completion. DOC amended this form to delete an item which is now required to be addressed in the “first notice.” These changes became effective on September 4.

- **Real Estate Loans: Multiple Lender Transactions.** The activities of licensed real estate brokers are generally regulated by the Department of Real Estate (DRE). However, when a broker is the agent for the sale of multiple notes secured by the same piece of property, the transaction is a sale of securities subject to regulation by DOC. Both departments require auditing and reporting with conflicting triggers and timing. AB 754 (Kuykendall) (Chapter 392, Statutes of 1997) removed the regulation of sales of ten or fewer notes secured by a single piece of real property from DOC, placing it instead under DRE. The bill codified DOC’s regulation applicable to this kind of sale in Business and Professions Code section 10229 for application by DRE.

Thus, on August 5, DOC repealed section 260.105.30, Title 10 of the CCR, which previously contained an exemption to Corporations Code section 25110’s qualification requirement for these multi-lender securities transactions; amended sections 260.204.1 and 260.204.1, Title 10 of the CCR, to conform with AB 754; and revised the definition of the term “issuer” in section 260.115, Title 10 of the CCR, to conform with existing law and practice. These changes became effective on September 5.

- **Exemption for Rated Debt Securities.** Corporations Code section 25110 makes it unlawful for any person to offer or sell in California any security or an issuer transaction, unless the security has been qualified with the Commissioner of Corporations or the security is exempt from qualification. On July 28, OAL approved DOC’s amendment to section 260.105.34, Title 10 of the CCR, which exempts from the qualification requirement investment grade debt securities which have been rated by Standard & Poor’s Corporation or Moody’s Investors Service, Inc.; DOC’s amendment to this section adds Fitch IBCA, Inc. to this list. This change became effective on August 27.

**DOC Rulemaking Under the Franchise Investment Law**

DOC regulates the offer and sale of franchises under the Franchise Investment Law (FIL). Under the FIL, it is unlawful to offer or sell any franchise within the state unless the offer has been registered with DOC or is exempt from registration. AB 3061 (Weggeland) (Chapter 477, Statutes of 1996) added Corporations Code section 31106 to exempt transactions involving “experienced franchise purchasers.”

On July 28, OAL approved DOC’s adoption of section 310.106, Title 10 of the CCR, which sets forth the form and instructions for filing the notice of exemption required by Corporations Code section 31106. The regulation specifies that the following are exempt under section 31106: any offer, sale, or transfer of a franchise or any interest in a franchise if one or more owners of the prospective franchisee owning at least a 50% interest in the prospective franchisee (1) has had, within the last seven years, at least two years’ experience being responsible for the financial and operational aspects of a business offering products or services substantially similar to the franchised business, and (2) is not controlled by the franchisor; any offer, sale, or transfer of a franchise or any interest in a franchise if one or
more owners of the prospective franchisee owning at least a 50% interest in the prospective franchisee (1) is, or has been within 60 days prior to the sale, an officer, director, managing agent, or an owner of at least a 25% interest in the franchisor for at least two years, and (2) is not controlled by the franchisor; and any offer, sale, or transfer of an additional franchise to an existing franchisee, or to an entity, one or more of the officers, directors, managing agents, or owners of at least a 25% interest of which is an existing franchisee of the franchisor, provided that, in either case, for 24 months or more the franchisee, or the qualifying person, has been engaged in a business offering products or services substantially similar to those to be offered by the franchisee being sold or otherwise transferred.

In order for a transaction to qualify for any of the above exemptions, the franchisor must file a notice of exemption with DOC and pay the fee prescribed in Corporations Code section 31500(f) no later than 15 calendar days after the sale of a franchise in this state.

New section 310.106 became effective on August 27.

**DOC Rulemaking Under the California Finance Lenders Law**

On August 4, OAL approved DOC's amendments to sections 1404, 1427, 1431, 1433, 1434, 1435, 1451, 1455, 1457, 1460, 1485, 1489, 1498, 1510, 1511, 1517, 1537, 1539, and 1570, and its repeal of section 1477, Title 10 of the CCR, its regulations under the California Finance Lenders Law. Most of the changes replaced archaic language with "plain English" in order to make the rules easier to understand. In order to maintain consistency of terms, the phrase "finance company" has been substituted for "licensee" throughout the regulations. These changes became effective on September 3.

**DOC Legal Residency Verification Regulations**

As approved by OAL on July 6, DOC has adopted sections 250.60 and 250.61, Title 10 of the CCR, in accordance with the federal Personal Responsibility and Work Opportunity Reconciliation Act of 1996; the new regulation requires applicants for licensure to show proof of legal residency or U.S. citizenship at the time of application. Section 250.60 notes that it applies to applicants for broker-dealer and investment adviser certificates, finance lender or broker licenses, residential mortgage lender and/or servicer licenses, and health care service plan licensees. Section 250.61 includes a statement of citizenship which all applicants must complete, and a list of acceptable documents which must be submitted along with the application. These regulations became effective on August 5.

**OAL Rules Against DOC in Regulatory Determination**

On October 2, OAL issued Regulatory Determination No. 26 (1998), in which it found that a DOC policy which prohibits the use of irrevocable letters of credit in lieu of a surety bond by an applicant for an escrow agent license is a regulation which must be adopted pursuant to the rulemaking requirements in the Administrative Procedure Act, Government Code section 11340 et seq.

Effective January 1, 1986, Financial Code section 17202 was amended to substantially increase the amount of the surety bond required of an applicant for an escrow agent license, and to permit an applicant or licensee to "obtain an irrevocable letter of credit approved by the commissioner in lieu of the bond." In 1991, DOC published notice of its intent to adopt section 1727, Title 10 of the CCR, a regulation implementing the new statute. [11:2 CRLR 117] However, DOC abandoned the rulemaking in 1992 [12:1 CRLR 114], finding that "the language currently contained in the letter of credit format does not comply with the statute of limitations provided by [Financial Code] section 17205, and that a bank would not be able to provide a letter of credit with acceptable provisions because federal banking laws would prohibit such language." Further, "the federal banking laws prohibit banks from acting as a surety."

On December 23, 1991, DOC announced by letter to all interested parties that "effective February 1, 1992, the Department will no longer approve or accept letters of credit in lieu of a surety bond." DOC concluded the proposed rule conflicted with FDIC provisions of banking law and "that there is an inherent conflict of interest between the intent of the statute that the letter of credit function like a surety bond and the law prohibiting FDIC insured banks from writing surety bonds." Additionally, DOC found that "the proposed rule also conflicts with banking law by requiring that the letter of credit be automatically extended for at least two years from any expiration date to satisfy any claims which may be made against the escrow company for violations of the Escrow Law occurring prior to the date of expiration....this automatic extension provision would be violative of federal banking laws." On January 14, 1992, following correspondence with DOC on behalf of 250 independent escrow agent corporations, Rose Pothier submitted a request for determination to OAL.

Preliminarily, OAL found that DOC is fully subject to the rulemaking requirements of the APA. OAL also found that the policy asserted in DOC's December 23, 1991 letter is a "regulation" as that term is defined in Government Code section 11342, because it implements the legislature's mandate to consider letters of credit in lieu of surety bonds with applications for escrow agents' licenses. OAL rejected DOC's argument that its blanket prohibition of irrevocable letters of credit is the only legally tenable interpretation of the statutory scheme created in Financial Code sections 17202 and 17205, finding that the federal regulations relied upon by DOC are merely advisory in nature; OAL further rejected the Department's argument that the legislature impliedly repealed Financial Code section 17202 in 1994 when it enacted Civil Code section 2787. Through its policy precluding the use of irrevocable letters of credit, "the Department has modified the intent of the statute and abrogated the duty delegated to it by the Legislature. Accordingly, the challenged rule was adopted to interpret the specific law enforced by the agency. The prohibition is a 'regulation' within the meaning of Government Code section 11342...."

**Legislation**

Governor's Reorganization Plan No. 1 of 1998, as forwarded to the legislature on June 1, 1998, would have dissolved
DOC and transferred DOC’s health care-related regulatory programs to a new Department of Managed Care. DOC’s investment and lender-fiduciary programs would have been transferred to the existing Department of Financial Institutions, which would be renamed “Department of Financial Services.” Both of these agencies would have remained within the Business, Transportation and Housing Agency, each administered by a single gubernatorial appointee subject to Senate confirmation.

As required by Government Code section 8523, Governor Wilson forwarded a copy of the Reorganization Plan to the Little Hoover Commission on April 30, 1998. LHC held a public hearing on the plan on May 28, and voted to recommend rejection of the plan by a 5-4 vote on June 25 (see MAJOR PROJECTS).

SR 34 (Rosenthal), as adopted July 2, 1998, rejects the Governor’s Reorganization Plan No. 1 (see above).

SB 2189 (Vasconcellos), as amended August 6, implements the federal National Securities Markets Improvement Act of 1996 by enacting the Capital Access Company Law, which—effective July 1, 1999—provides for the licensure and regulation by the Corporations Commissioner of capital access companies, to enable those entities to provide risk capital and management assistance to small businesses in California, exempt from the requirements of the federal Investment Company Act of 1940.

Among other things, the bill requires the approval of an application for licensure if the Commissioner finds that the applicant has a tangible net worth of at least $250,000 and funds of at least $5 million to invest; has additional financial resources to pay expenses for at least three years; has directors, officers, and controlling persons who are of good character and sound financial standing and are collectively competent; has reasonable promise of successful operation; and will comply with all the provisions of this act. The bill establishes application and other fees; sets forth requirements relating to a capital access company’s organization and name, directors, officers, business transactions, records, reports, examinations, acquisition of control, merger and purchase or sale of business, and voluntary surrender of license. SB 2189 also enacts conflict of interest provisions, prescribes enforcement procedures, and establishes civil and criminal penalties for violation of the act. SB 2189 was signed by the Governor on September 20 (Chapter 668, Statutes of 1998).

SB 2189 (Vasconcellos), as amended August 6, implements the federal National Securities Markets Improvement Act of 1996 by enacting the Capital Access Company Law, which—effective July 1, 1999—provides for the licensure and regulation by the Corporations Commissioner of capital access companies, to enable those entities to provide risk capital and management assistance to small businesses in California, exempt from the requirements of the federal Investment Company Act of 1940.

Among other things, the bill requires the approval of an application for licensure if the Commissioner finds that the applicant has a tangible net worth of at least $250,000 and funds of at least $5 million to invest; has additional financial resources to pay expenses for at least three years; has directors, officers, and controlling persons who are of good character and sound financial standing and are collectively competent; has reasonable promise of successful operation; and will comply with all the provisions of this act. The bill establishes application and other fees; sets forth requirements relating to a capital access company’s organization and name, directors, officers, business transactions, records, reports, examinations, acquisition of control, merger and purchase or sale of business, and voluntary surrender of license. SB 2189 also enacts conflict of interest provisions, prescribes enforcement procedures, and establishes civil and criminal penalties for violation of the act. SB 2189 was signed by the Governor on September 20 (Chapter 668, Statutes of 1998).

SB 1200 (Thompson) modifies certain requirements of the Corporate Securities Law of 1968, and is intended to address issues related to “roll-up” transactions arising from recent court cases.

Corporations Code section 25202 defines an “investment adviser” as “a person registered, licensed, or qualified (or exempt from registration, licensure, or qualification) as an investment adviser by another state, who has not previously had any certificate denied or revoked under this law or any predecessor statute,” and exempts such a person from the provisions of section 25230 if (1) the investment adviser does not have a place of business in this state and (2) during the preceding 12-month period has had fewer than six clients who are residents of this state. SB 1200 modifies section 25202 to revise the definition of “investment adviser” to exclude therefrom persons not having a business place in California and having fewer than six California resident clients in the preceding twelve months.

The bill also provides for the regulation of “roll-up transactions,” which involve the combining of privately held limited partnerships into one master partnership that may be publicly traded on a national exchange; limited partners are given shares of the new entity in return for their prior ownership interests. In practice, however, limited partners are often encouraged to vote against their best interests and exchange their shares for ownership interests in the new entity by securities brokers who have a conflict of interest. Specifically, the bill incorporates by reference Corporations Code provisions that create a presumption that the rights of limited partners will be protected if the roll-up transaction provides dissenting limited partners with the rights enumerated in the Code; provides that nothing in the Corporate Securities Law precludes a court from applying its protections relative to roll-ups when approving transactions wherein securities are issued and exchanged for other securities, claims, or property interests; and makes legislative findings that the Thompson-Killea Limited Partnership Act of 1992 added specified protections for limited partners in connection with roll-up transactions [12:4 CRLR 142], and that the courts may be reviewing roll-up transactions without recognizing the availability of the important protections afforded to investors under the Corporate Securities Law, and therefore encouraging courts to apply the protections described in the Corporations Code and any regulations adopted thereunder. SB 1200 was signed by the Governor on May 28 (Chapter 48, Statutes of 1998).

SB 2060 (Kopp), as amended June 17, makes several changes to the Corporate Securities Law’s sections providing for the regulation of securities broker-dealers and investment advisers. These changes are deemed necessary due to the passage of the federal National Securities Markets Improvement Act of 1996 and the Investment Advisers Supervision Coordination Act, under which the states are now the exclusive regulators of investment advisers that have assets under $25 million. DOC foresees a significant increase in the number of investment adviser licensees as a consequence of the transfer of this regulatory responsibility.

Among other things, SB 2060 authorizes the Commissioner to suspend or revoke the certificate of a broker-dealer or investment adviser, in instances where the broker-dealer or investment adviser fails to maintain certain capital requirements or fails to maintain any record as required by the Commissioner. The bill streamlines DOC’s adjudication process once a deficient broker-dealer or investment adviser has been identified. The bill clarifies that affiliates of investment advisers are subject to the same hearing procedures as investment advisers. Under current law, a violation of certain securities laws may result in a fine, or imprisonment in county jail or state prison, or both. This bill expands the scope of specified securities law by adding a new category of persons to whom these sections apply: those who aid, abet and/or control third parties who violate securities law. SB 2060 also authorizes the Commission to use additional administrative remedies when...
dealing with a violator, such as the appointment of a conservator to take possession of the property, business, and assets of a broker-dealer or investment adviser; orders to discontinue business operations; orders to discontinue unsafe or injurious practices; administrative penalties; and restitution damages on behalf of the victim. SB 2060 was signed by the Governor on August 24 (Chapter 391, Statutes of 1998).

AB 2428 (Knox), as amended July 2, exempts from the provisions of the California Finance Lenders Law any public corporation public entity, other than the state, or any agency of those entities, when making a loan in compliance with federal and state laws and regulations. AB 2428 also extends indefinitely existing law authorizing finance lenders to sell to institutional lenders or investors promissory notes evidencing an obligation to repay certain federally related mortgage loans (consumer loans) or the obligation to repay real estate secured business purpose loans (commercial loans). The Governor signed this bill on September 11 (Chapter 428, Statutes of 1998).

AB 2039 (Baugh), as amended July 27, exempts a “non-profit church extension fund” from the provisions of the California Finance Lenders Law, defined in the bill to mean “a non-profit organization affiliated with a church, that is formed for the purpose of making loans to that church’s congregational organization or organizations for site acquisitions, new facilities, or improvements to existing facilities, purchased for the benefit of the church congregational organization.” The Governor signed AB 2039 on September 13 (Chapter 469, Statutes of 1998).

SB 1512 (Maddy) allows a licensee under the California Finance Lenders Law to contract for and receive a delinquency fee for defaults in loans payments, with respect to loans under $5,000 (and except for precomputed loans), subject to certain limitations on the amount of the fee and the period of default. This bill was signed by the Governor on July 3 (Chapter 104, Statutes of 1998).

AB 2694 (Pacheco). Under the California Residential Mortgage Lending Act, the Corporations Commissioner is authorized to order a licensee that opens a branch office in California or changes its business location or its locations from which activities are conducted, without first obtaining approval from the Commissioner, to forfeit a specified amount. As amended July 2, AB 2694 makes that provision applicable where the licensee has not first notified the Commissioner of its action. This bill was signed by the Governor on July 18 (Chapter 178, Statutes of 1998).

AB 1860 (McCInnott) prohibits the acquisition of any escrow agent license directly or indirectly, through stock purchase, foreclosure pursuant to a pledge or hypothecation, or other device, without the consent of the Corporations Commissioner, and requires that the escrow agent file a new application for licensure prior to the transfer of 10% or more of the shares of the escrow agent unless the transfer will be made by an existing shareholder to another existing shareholder who also owns 10% or more of the shares of the escrow agent before the transfer. AB 1860 was signed by the Governor on July 18 (Chapter 174, Statutes of 1998).

Department of Insurance

Commissioner: Charles Quackenbush ♦ (415) 538-4376 ♦ (916) 492-3500 ♦ Toll-Free Complaint Number: 1-800-927-4357 ♦ Internet: www.insurance.ca.gov

Insurance is the only interstate business wholly regulated by the several states rather than 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 12937 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 companies to sell insurance products in the state. In California, the Insurance Commissioner licenses approximately 1,500 insurance companies that carry premiums of approximately $65 billion annually. Of these, 607 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 175 different fees levied against insurance producers and companies.

The Department also performs the following functions:

1. It 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. It grants or denies security permits and other types of formal authorizations to applying insurance and title companies;

3. It 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. It establishes rates and rules for workers’ compensation insurance;

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

6. It 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.

California Regulatory Law Reporter ♦ Volume 16, No. 1 (Winter 1999) 147