scheduled for October 17. If the Appeals Board's decision is appealed to a state court, the resulting decision could establish a new precedent extending or limiting the scope of Unruh Act protection.

The First District Court of Appeal is currently reviewing a case in which a supermarket clerk sold a six-pack of beer to a 19-year-old police decoy; this is the first time a state court has examined the use of minor decoys by ABC and police departments to catch ABC licensees violating the law regarding sales to minors. Licensees who sell to a minor decoy risk fines, license suspension, and even revocation of their licenses. Opponents of the practice claim that it amounts to entrapment, while proponents contend that it is the best way for police to keep alcoholic beverage retailers honest. John Hinman, the attorney representing several retailers caught selling alcohol to minor decoys, contends the following:

–The state constitution prohibits sales of alcohol to any person under the age of 21; therefore, police are acting improperly by having under-age agents buy alcohol and should not be allowed to introduce such evidence in court.

–By using a decoy whose appearance and mannerisms are that of an adult over the age of 21, clerks are entrapped into believing sales are legal or, in the alternative, not given constructive notice that they are selling to a minor.

–ABC has provided no evidence that the use of decoys is an effective deterrent in preventing alcohol use by minors.

The case to be heard in the First District involves the sale of beer to a 19-year-old football player and weightlifter who said he was not nervous when he made the transaction and was not told to act like a "typical minor" making an illegal purchase. When the case came before an administrative law judge (ALJ) during ABC's disciplinary process, the ALJ agreed that the ABC's guidelines for decoys had not been followed. Those guidelines require the decoy to be 18 or 19 years of age and have the general appearance, mannerisms, and dress of a person well under 21 years of age; if a male is used, he should not be large in stature. Nevertheless, the ALJ issued a ten-day suspension or payment of a fine in lieu of the suspension.

BANKING DEPARTMENT

Superintendent:
James E. Gilleran
(415) 557-3232
Toll-Free Complaint Number:
1-800-622-0620

Pursuant to Financial Code section 99 *et seq.*, the State Banking Department (SBD) administers all laws applicable to corporations engaging in the commercial banking or trust business, including the establishment of state banks and trust companies; the establishment, operation, relocation, and discontinuance of various types of offices of these entities; and the establishment, operation, relocation, and discontinuance of various types of offices of foreign banks. The Department is authorized to adopt regulations, which are codified in Chapter 1, Title 10 of the California Code of Regulations (CCR).

The superintendent, the chief officer of the Department, is appointed by and holds office at the pleasure of the Governor. The superintendent approves applications for authority to organize and establish a corporation to engage in the commercial banking or trust business. In acting upon the application, the superintendent must consider:

(1) the character, reputation, and financial standing of the organizers or incorporators and their motives in seeking to organize the proposed bank or trust company;

(2) the need for banking or trust facilities in the proposed community;

(3) the ability of the community to support the proposed bank or trust company, considering the competition offered by existing banks or trust companies; the previous banking history of the community; opportunities for profitable use of bank funds as indicated by the average demand for credit; the number of potential depositors; the volume of bank transactions; and the stability, diversity, and size of the businesses and industries of the community. For trust companies, the opportunities for profitable employment of fiduciary services are also considered;

(4) the character, financial responsibility, banking or trust experience, and business qualifications of the proposed officers; and

(5) the character, financial responsibility, business experience and standing of the proposed stockholders and directors.

The superintendent may not approve any application unless he/she determines that the public convenience and advantage will be promoted by the establishment of the proposed bank or trust company; conditions in the locality of the proposed bank or trust company afford reasonable promise of successful operation; the bank is being formed for legitimate purposes; the capital is adequate; the proposed name does not so closely resemble as to cause confusion with the name of any other bank or trust company transacting or which has previously transacted business in the state; and the applicant has complied with all applicable laws.

If the superintendent finds that the proposed bank or trust company has fulfilled all conditions precedent to commencing business, a certificate of authorization to transact business as a bank or trust company will be issued.

The superintendent must also approve all changes in the location of a head office; the establishment, relocation, or discontinuance of branch offices and ATM facilities; and the establishment, discontinuance, or relocation of other places of business. A foreign corporation must obtain a license from the superintendent to engage in the banking or trust business in this state. No one may receive money for transmission to foreign countries or issue money orders or travelers checks unless licensed.

The superintendent examines the condition of all licensees when necessary, but at least once every two years. The Department is coordinating its examinations with the Federal Deposit Insurance Corporation (FDIC) so that every year each agency examines certain licensees. New and problem banks and trust companies are examined each year by both agencies.

The superintendent licenses Business and Industrial Development Corporations which provide financial and management assistance to business firms in California.

Acting as Administrator of Local Agency Security, the superintendent oversees security pools that cover the deposits of money belonging to a local governmental agency in any state or national bank or savings and loan association. All such deposits must be secured by the depository.

MAJOR PROJECTS

New Federal Rules Hasten Shutdown of Ailing Banks. In late September, the Federal Reserve Board and the Federal Deposit Insurance Corporation (FDIC) adopted tough new rules which will speed the closure of troubled banks. The corrective action scheme, which took effect on December 19, implements new section 38 of the Federal Deposit Insurance Act, and divides financial institutions into five categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Regulatory responses are similarly graded—stronger restrictions are imposed as an institution falls into lower categories. An institution will be deemed to be:

-well-capitalized if it has a total risk-based capital ratio of 6% or greater, and a leverage ratio of 5% or greater, and the institution is not subject to an order, written agreement, capital directive, or prompt corrective action directive to meet and maintain a specific capital level for any capital measure;

-adequately capitalized if it has a total risk-based capital ratio of 8% or greater, a Tier 1 risk-based capital ratio of 4% or greater, and a leverage ratio of 4% or greater (or a leverage ratio of 3% or greater if the institution is rated composite 1 in its most recent report of examination, subject to appropriate federal banking agency guidelines), and the institution does not meet the definition of a well-capitalized institution;

-undercapitalized if it has a total risk-based capital ratio that is less than 8%, a Tier 1 risk-based capital ratio that is less than 4%, or a leverage ratio that is less than 4% (or a leverage ratio that is less than 3% if the institution is rated composite 1 in its most recent report of examination, subject to appropriate federal banking agency guidelines);

-significantly undercapitalized if it has a total risk-based capital ratio that is less than 6%, a Tier 1 risk-based capital ratio that is less than 3%, or a leverage ratio that is less than 3%; or

-critically undercapitalized if it has a ratio of tangible equity to total assets that is equal to or less than 2%.

Section 38's most severe response occurs when an institution is determined by regulators to be critically undercapitalized. Once an institution hits that level, regulators generally will be required to close it within 90 days, unless its condition dramatically improves. According to the latest federal estimate, about 50 banks with a total of $21 billion in assets currently fit this category, and are in danger of being closed within 90 days of the December 19 effective date.

Section 38's specific capital targets and progressive responses provide bankers with adequate knowledge of their capital classification. Formal notification is given through inspection reports by federal regulators; in addition, informal hearings are provided when an institution's capital classification is downgraded. This new regulatory action is intended to alert bankers and regulators to an institution's declining health, encourage weaker institutions to correct their problems quickly, and save insurance fund money by closing weak banks while there is still some capital left in them.

FDIC Raises Premiums for Weak Institutions. Beginning January 1, the FDIC will increase premiums paid by banks to FDIC to an average of 24 cents per $100 of deposits. *[12:2&3 CRLR 162]* However, the healthiest, best-managed institutions will be exempt from the increase; only the country's weaker banks, whose risk of failure is greater, will be subject to the increased premium. Presently, all FDIC-insured institutions pay 23 cents in premiums for every $100 of deposits. Strong institutions, including about 75% of insured banks and 60% of insured S&Ls, will continue to pay this rate. Premiums for weaker institutions will increase by three to eight cents, depending on which of nine categories they fall into; each category reflects a graduated safety rating received by the institutions in their regular federal examinations.

The plan is designed to place the burden of strengthening the deposit insurance fund on the institutions which pose the greatest risk of failure. Although federal regulators contend that such troubled institutions ought to pay more for deposit insurance, they admit that the higher premiums will increase the likelihood of these banks failing or being forced into mergers because it will raise the cost of doing business for banks that already are having difficulties making money. U.S. Senator Donald Riegle, Jr. (D-Michigan), chair of the Senate Banking Committee, is critical of the plan, which he has stated is too lenient; Riegle believes that all federally-insured institutions should bear the costs of rebuilding the bank insurance fund, which is currently running a $5.5 billion deficit. Predictably, the banking industry favors the plan, maintaining that the combination of the scaled premium rate increase and recent industry profitability will solve the insurance fund's deficit problem. The premium increase is expected to raise an additional $600 million from banks and $200 million from savings associations annually.

Bank of America Imposes Binding Arbitration on Customers. In June, Bank of America (BofA) began requiring that all customer disputes regarding deposit or credit card accounts be submitted to binding arbitration. Bank officials claim that the process will be faster and more cost-efficient than traditional litigation, as disputes can be handled in weeks instead of months, and both parties will avoid the high costs of a court battle. Under the arbitration requirement, customer disputes and lawsuits will be submitted to the American Arbitration Association, which then appoints an arbitrator from a list that is acceptable to both parties. After an informal hearing, the arbitrator will render a decision that is binding on both parties.

BofA's move has drawn considerable criticism from consumer groups and bank customers, who allege that the plan is unfair and denies consumers important rights. For example, Los Angeles Trial Lawyers Association vice-president Charles Mazursky notes that there is no right of appeal from binding arbitration, even in the case of judicial error or abuse of authority by the arbitrator; also, arbitrators may favor the party most likely to use (and pay for) their services on a regular basis. Further, consumers would lose the right to a jury trial, as well as access to internal bank documents and other evidence available in normal litigation through the discovery process.

In addition to requiring binding arbitration for individual lawsuits, BofA is also requiring that all class action claims be handled through "judicial reference," an alternative dispute resolution procedure under which a trial judge refers the matter to a referee, whose decision is binding. Unlike the arbitration procedure, however, decisions resulting from the judicial reference procedure are appealable.

Critics also note that the arbitration process is not inexpensive—there are fees for filing, processing, and hearing the case, as well as for postponing hearings and renting hearing rooms; these fees are in addition to the arbitrator's compensation. Contrary to BofA's claims, some critics contend that the arbitration procedure could prove as costly as traditional litigation.

In August, four BofA customers, the California Trial Lawyers Association, and Consumer Action filed a lawsuit challenging BofA's mandatory binding arbitration requirement in San Francisco County Superior Court; plaintiffs contend that BofA's unilateral imposition of arbitration and reference requirements violates the California Constitution, the Consumer Legal Remedies Act, and the Unfair Business Practices Act (*see infra* LITIGATION).

OAL Approves SBD's Amendments to Conflict of Interest Code. On June 15, the Office of Administrative Law approved SBD's amendments to its conflict of interest code. The code, which is set forth at section 5.2000, Article 3, Subchapter 5, Chapter 1, Title 10 of the CCR, now conforms to the model code established by the Fair Political Practices Commission at section 18730, Title 2 of the CCR. *[11:3 CRLR 117]*

LEGISLATION

The following is a status update on bills reported in detail in CRLR Vol. 12, Nos. 2 & 3 (Spring/Summer 1992) at pages 163–64:

AB 3683 (Peace) would have required every banking organization located in a census tract with a median family income that is less than 80% of the median family income for the Metropolitan Statistical Area or county to mail written notice with customer statements of any planned closing to its customers, or to post notice of the planned closing at the branch office. This bill was vetoed by the Governor on September 26.

AB 2389 (Moore) requires the operator of any automated teller machine (ATM) in this state to disclose any transaction surcharge with respect to customers utilizing an access device not issued by that operator prior to completion of any transaction. This bill was signed by the Governor on July 24 (Chapter 348, Statutes of 1992).

SB 506 (McCorquodale) would have transferred the licensing and regulatory functions of SBD, the Superintendent of Banks, the Department of Savings and Loan (DSL), and the Savings and Loan Commissioner to the Department of State Banking and Savings and Loan, which the bill would have created. This bill was vetoed by the Governor on September 30. (*See infra* agency report on DSL for related discussion.)

AB 3469 (T. Friedman) was amended to pertain only to savings and loan institutions (*see infra* agency report on DSL for related discussion).

The following bills died in committee: **ABX 45 (Peace)**, which would have prohibited state, city, and county governments from contracting for services with financial institutions with $100 million or more in assets unless those companies file reports annually with the state Controller; **SB 1396 (Marks)**, which would have required banks and other financial institutions that assemble, evaluate, or disseminate information on the checking account experiences of consumer customers to give specified notices to new customers; **AB 3025 (Lancaster)**, which would have provided that when a bank's tangible shareholders' equity is less than certain sums, the Superintendent is authorized to take possession of the bank; **SB 1463 (Calderon)**, which would have provided that the robbery of any person who is using an ATM or immediately after the person has used an ATM while the person is in the vicinity of the ATM shall be punished by an additional term of one year in state prison; and **AB 696 (Lancaster)**, which would have increased from $100 to $250 the fee a bank must pay in order to change a place of business from one location to another in the same vicinity upon application.

LITIGATION

Badie v. Bank of America, No. 944916, which was filed in San Francisco County Superior Court on August 4, challenges BofA's new policy which requires that customer disputes over deposit and credit card accounts be sent to binding arbitration. The plaintiffs in the suit—four BofA customers, Consumer Action, and the California Trial Lawyers Association—seek an injunction blocking enforcement of the policy, which they claim violates the California Constitution, the Consumer Legal Remedies Act, and the Unfair Business Practice Act. Among other things, plaintiffs claim that the policy denies customers the right to trial by jury; severely curtails or eliminates customers' ability to obtain discoverable documents from the bank; was unilaterally and deceptively imposed; involves exorbitant fees; and results in a procedure that is biased toward the bank. A status conference in the proceeding is scheduled for February 26. (*See supra* MAJOR PROJECTS).

DEPARTMENT OF CORPORATIONS

Commissioner: Thomas Sayles
(916) 445-7205
(213) 736-2741

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 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 Cashers Law, Securities Depositor Law, California Finance Lenders Law, and