

STATE OF CALIFORNIA

OFFICE OF ADMINISTRATIVE LAW

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*Will Jones*  
OCT 2 1998

In re:	)	1998 OAL Determination No. 26
Request for Regulatory	)	
Determination filed by ROSE	)	[Docket No. 92-001]
POTHIER concerning the	)	
policy of the DEPARTMENT OF	)	October 2, 1998
CORPORATIONS which	)	
prohibits the use of	)	Determination Pursuant to
irrevocable letters of credit in	)	Government Code Section 11340.5;
lieu of escrow bonds under	)	Title 1, California Code of
Financial Code section 17202 <sup>1</sup>	)	Regulations, Chapter 1, Article 3

**Determination by: EDWARD G. HEIDIG, Director**

HERBERT F. BOLZ, Supervising Attorney  
JULIA CLINE NEWCOMB, Administrative Law Judge  
on special assignment  
Regulatory Determinations Program

**SYNOPSIS**

The issue presented to the Office of Administrative Law ("OAL") is whether the policy issued by the Department of Corporations ("Department") constitutes a "regulation," which is void unless adopted pursuant to the Administrative Procedures Act ("APA.") The policy prohibits the use of irrevocable letters of credit in lieu of surety bonds with applications for business licenses for escrow agents. OAL has concluded that the Department's policy does constitute a "regulation," which must be promulgated in accordance with the APA in order to be valid.

The Legislature amended Financial Code section 17202 to permit applicants for escrow agent licenses to submit irrevocable letters of credit in lieu of surety bonds with applications, which are subject to the approval of the commissioner of the Department of Corporations. The Department concluded letters of credit could not be drafted in a manner which would meet existing statutory requirements. Therefore, the Department issued a policy prohibiting the use of letters of credit in lieu of surety bonds. The issue presented to the Office of Administrative Law is whether this prohibition of the use of irrevocable letters of credit in lieu of surety bonds is a "regulation" and is therefore without legal effect unless adopted in compliance with the APA.

The Office of Administrative Law has concluded that the Department of Corporation's policy prohibiting the substitution of irrevocable letters of credit in lieu of surety bonds, is a "regulation" required to be adopted in compliance with the APA. The prohibition constitutes a policy which is invalid and unenforceable until properly adopted as a regulation. The Department may consider adopting regulations prescribing requirements for irrevocable letters of credit which incorporate statutory mandates, such as the two year statute of limitations of Financial Code section 17205.

### ISSUE

Operative January 1, 1986, amendments to Financial Code section 17202, among other things, substantially increased the amounts of surety bonds required of applicants for escrow agent licenses, and provided in part as follows: "An applicant or licensee may obtain an irrevocable letter of credit approved by the commissioner in lieu of the bond."<sup>2</sup>

In 1990, the Department noticed a proposal to adopt a regulation and a form to be used in applications for licenses which relied upon irrevocable letters of credit. However, the rulemaking effort was abandoned in 1991 when the Department reasoned that:

“[t]he 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.”<sup>3</sup> Further, “[t]he federal banking laws prohibit banks from acting as a surety.”<sup>4</sup>

On December 23, 1991, the Department 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.”<sup>5</sup> The Department concluded the proposed rule conflicted with FDIC provisions of banking law and

“. . . that there is an inherent conflict 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.”<sup>6</sup>

In addition, the Department reasoned that:

“. . . [t]he 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 . . . [t]his automatic extension provision would be violative of federal banking laws.”<sup>7</sup>

On January 14, 1992, following correspondence with the Department on behalf of more than two hundred and fifty independent escrow agent corporations, Ms. Rose Pothier, Esq., submitted a request for Determination to OAL. The subject of the request was the policy announced in the December 23, 1991 letter of the Department of Corporations. A copy of this document was attached to, and made a part of, the request.

## ANALYSIS

### **I. IS THE APA GENERALLY APPLICABLE TO THE QUASI-LEGISLATIVE ENACTMENTS OF THE DEPARTMENT OF CORPORATIONS?**

The Department of Corporations is responsible for protecting the public from

unfair business practices and fraudulent or improper sale of financial products or services. The Department is supported by license fees and regulatory assessments, which are deposited in the State Corporations Fund.

The APA applies to *all* state agencies, except those "in the judicial or legislative departments."<sup>8</sup> Since the Department is in neither the judicial nor the legislative branch of state government, OAL concludes that APA rulemaking requirements generally apply to the Department and the Commissioner.<sup>9</sup>

In any event, Corporations Code section 25614 makes clear that the Department's rulemaking is subject to the APA:

"All rules of the commissioner (other than those relating solely to the internal administration of the Department of Corporations) shall be made, amended or rescinded in accordance with the provisions of the [APA]. . . ."

## **II. DOES THE CHALLENGED RULE CONSTITUTE A "REGULATION" WITHIN THE MEANING OF GOVERNMENT CODE SECTION 11342?**

Government Code section 11342, subdivision (g), defines "regulation" as:

". . . *every* rule, regulation, order, or standard of general application *or* the amendment, supplement, or revision of any such rule, regulation, order, or standard adopted by *any* state agency to implement, interpret, or make specific the law enforced or administered by it, or to govern its procedure . . . . [Emphasis added.]"

Government Code section 11340.5, authorizing OAL to determine whether agency rules are "regulations," and thus subject to APA adoption requirements, provides in part:

"(a) *No* state agency shall issue, utilize, enforce, or attempt to enforce *any* guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule, which is a ["]regulation["] as defined in subdivision (g) of Section 11342, *unless* the guideline, criterion, bulletin,

manual, instruction, order, standard of general application or other rule has been adopted as a regulation and filed with the Secretary of State pursuant to [the APA]. [Emphasis added.]”

In *Grier v. Kizer*,<sup>10</sup> the California Court of Appeal upheld OAL's two-part test<sup>11</sup> as to whether a challenged agency rule is a "regulation" as defined in the key provision of Government Code section 11342, subdivision (g):

First, is the challenged rule either:

- a rule or standard of general application, *or*
- a modification or supplement to such a rule?

Second, has the challenged rule been adopted by the agency to either:

- implement, interpret, or make specific the law enforced or administered by the agency, *or*
- govern the agency's procedure?

If an uncodified rule satisfies the above two parts of the test, OAL must conclude that it is a "regulation" and is subject to the APA. In applying the two-part test, however, OAL is mindful of the admonition of the *Grier* court:

“... because the Legislature adopted the APA to give interested persons the opportunity to provide input on proposed regulatory action (*Armistead, supra*, 22 Cal.3d at p. 204, 149 Cal. Rptr. 1, 583 P.2d 744), we are of the view that *any doubt as to the applicability of the APA's requirements should be resolved in favor of the APA*. [Emphasis added.]”<sup>12</sup>

In the Agency Response to the request for determination, the Department argues that the rule at issue here was not “adopted by the agency” because the challenged rule was adopted by the Legislature. In *Grier v. Kizer*<sup>13</sup> the Court of Appeal rejected a similar argument by the Department of Health Services. In that case the Department submitted “..there was no need to promulgate a regulation because the

only legally tenable interpretation of its statutory auditing authority [was] that statistical sampling and extrapolation procedures must be utilized.” The Court rejected that argument by finding that other auditing procedures, although perhaps not as feasible or cost effective, existed. Thus, that method was not the only “tenable” interpretation of the statute. (Emphasis in original.)

In 1989,<sup>14</sup> OAL rejected a similar argument, while explaining:

“In general, if the agency does not add to, interpret, or modify the statute, it may legally inform interested parties in writing of the statute and “its application.” Such an enactment is simply “administrative” in nature, rather than “quasi-judicial” or “quasi-legislative.” If, however, the agency makes new law, i.e., supplements or “interprets” a statute or other provision of law, such activity is deemed to be an exercise of quasi-legislative power.”

Citing an earlier OAL Determination, OAL went on to explain:

“If a rule simply applies an *existing* constitutional, statutory or regulatory requirement that has only *one* legally tenable ‘interpretation,’ that rule is not quasi-legislative in nature--no new ‘law’ is created.”<sup>15</sup> [Emphasis added.]

Stated another way, if the requirements in statute, relevant to the commissioner’s policy to prohibit reliance on irrevocable letters of credit, can reasonably be read only one way, then those same requirements, if included in the commissioner’s policy, are no more than restatements of the law.

In its Agency Response, the Department submits that the blanket prohibition of irrevocable letters of credit is the only legally tenable interpretation of the statutory scheme created by Financial Code sections 17202 and 17205. The Department posits that the 1986 amendment to section 17202 “. . . includes a misleading standard as adopted by the Legislature, . . .”<sup>16</sup> Thus, the Department’s prohibition of all letters of credit for this purpose, constitutes “. . . the only legally tenable interpretation of the underlying law.”<sup>17</sup>

Specifically, the Department points to Financial Code section 17205, which provides: “No action may be brought on an agent’s bond by any person after the

expiration of two years from the time when the act or default complained of occurs.” The Department states that:

“[a]n irrevocable letter of credit cannot satisfy the requirements of Section 17205 and therefore cannot act in lieu of a surety bond for the protection of the public’s trust funds held by licensees . . . [,because] . . . a letter of credit provides that not only must the act of discovery take place before the expiration of the letter of credit, but the demand for payment by the beneficiary of the letter of credit must also take place prior to the expiration of the letter of credit.”<sup>18</sup>

The Department misconstrues the statutory scheme upon which it relies. The Department’s reliance on Title 12, Code of Federal Regulations, (“C.F.R.”), section 7.7016 (now Title 12, C.F.R. section 7.1016) was misplaced. The regulation was then, and remains today, advisory only. Nothing in this regulation prohibits inclusion of a statute of limitations in a letter of credit.

The language of Title 12, C.F.R. section 7.7016, as it existed in 1991, was advisory only. The section was cast repeatedly in the language of “should.” It is clear the draftsmen intended the effect of subdivision (b) to be advisory, when that subdivision is compared with the mandatory language utilized in subdivision (d) of the same section.

In 1991, the language of the section 7.7016, subdivision (b) provided in part:

“As a matter of sound banking practice, letters of credit *should* be issued in conformity with the following: . . .(b) the bank’s undertaking should contain a specified expiration date or be for a definite term; . . .” [Emphasis added.]

The United States Court of Appeals, Eighth Circuit refers to Title 12 C.F.R. section 7.7016 as “guidelines” only.<sup>19</sup> Nothing in that section prohibited the use of a specified statute of limitations where agreed upon by the parties.

Further, Title 12 C.F.R. section 7.7016 had been construed frequently by the Office of Comptroller of the Currency (“OCC”) in its published Interpretive Letters to the effect that automatic extension clauses, or “evergreen clauses,” were

authorized within the meaning of Title 12, C.F.R. section 7.7016, subdivision (b). Again, that subdivision advised that: “. . . the bank’s undertaking should contain a specified expiration date or be for a definite term; . . .” The parties to letters of credit were authorized to include within the instrument an “evergreen clause,” or automatic renewal clause, despite the language of subdivision (b), pursuant to published Interpretive Letters by the OCC as early as 1982.<sup>20</sup>

As revised by amendment, Title 12, C.F.R. section 7.1016 now provides, in part, that a national bank may issue letters of credit within the scope of applicable laws or rules of practice recognized by law. Specifically, Title 12, C.F.R. section 7.1016 advises national banks that they may refer to Article 5 of the Uniform Commercial Code, “UCC,” (1962, or as amended in 1990, or as amended in 1995) among a non-exclusive list of other specified sources, to be used as guidance in the drafting of letters of credit.<sup>21</sup>

Title 12 C.F.R. section 7.1016, subdivisions (b)(iii)(A), (B) and (C) provide, in part, as follows:

“(iii) The undertaking should: (A) Be limited in duration; or (B) Permit the bank to terminate the undertaking either on a periodic basis (consistent with the bank’s ability to make any necessary credit assessments) or at will upon either notice or payment to the beneficiary; or (C) Entitle the bank to cash collateral from the account party on demand (with a right to accelerate the customer’s obligations, as appropriate); . . .”

Moreover, the 1995 amendments to Article 5 of the Uniform Commercial Code, specifically provide for a one year statute of limitations. The Uniform Commercial Code, Article 5, is a model statute drafted from “. . . a sufficient consensus and balance among the interests of the various participants so that universal and uniform enactment by the various states may be achieved.”<sup>22</sup> Final approval of the draft rests with the American Law Institute “ALI” and the National Conference of Commissioners on Uniform State Laws “NCCUSL.” It is axiomatic that the UCC provides a “model” for use by practitioners and others with financial interests. By its 1995 revision, the UCC specifically suggests the parties include a one year statute of limitations in a letter of credit.<sup>23</sup> Where the circumstances warrant a longer statute of limitations, such as two years, as in the

case of applicants for licenses of escrow businesses, the UCC “model” would appear to recommend it, and not discourage it.

Alternatively, the Department relied upon Title 12 C.F.R. section 332.1, since repealed, in its decision to prohibit letters of credit. The Department’s reliance was misplaced. In 1991, it provided as follows:

“A state nonmember insured bank (except a district bank) which does not have any of the powers hereinafter enumerated, or which, although it has any such power, does not exercise the same, shall not hereafter exercise, take or assume the power : (a) to do a surety business; (b) to insure the fidelity of others; (c) to engage in insuring, guaranteeing or certifying titles to real estate; or (d) to guarantee or become surety upon the obligations of others, except as provided in [Title 12 C.F.R.] section 347.3(c)(1).”<sup>24</sup>

By its own terms this regulation applied to the limited class of “state nonmember insured banks.” Financial Code section 17202 does not restrict its application to the limited class of national bank lending institutions.

Moreover, as the Department acknowledges, Title 12 C.F.R. section 332.1 “. . . was repealed by the FDIC in 1993 because [Title] 12 C.F.R. section 1831 allows FDIC-insured banks to conduct activities permissible for a national bank.”<sup>25</sup>

As contrasted with the federal statutory scheme, the Department points out that the California statutory scheme, as modified, now precludes the use of letters of credit in lieu of security bonds. Specifically, the Department argues: “. . . Civil Code section 2787, was amended in 1994 to expressly provide that a letter of credit is not a form of suretyship..[t]herefore, a letter of credit can never function in lieu of a surety bond.”<sup>26</sup>

The Department posits that the 1986 amendment to Financial Code section 17202 was repealed by implication in 1994 when the Legislature amended Civil Code section 2787. As enacted in 1872, Civil Code section 2787 provided in part that “[t]he distinction between sureties and guarantors is hereby abolished.”<sup>27</sup> The

1994 amendment to Civil Code section 2787 provides, in part, as follows: "A letter of credit is not a form of suretyship obligation."<sup>28</sup>

The question of repeal by implication was addressed in *Sacramento Newspaper Guild v. Sacramento County Board of Supervisors*.<sup>29</sup> The following analysis in *Sacramento Newspaper Guild*, which applied the doctrine of repeal by implication, is pertinent here to discern the true legislative intent. The *Sacramento Newspaper Guild* court stated:

"When a later statute supersedes or substantially modifies an earlier law but without expressly referring to it, [courts have often said that] the earlier law is repealed or partially repealed by implication. The courts [at the same time] assume that in enacting a statute the legislature was aware of existing, related laws and intended to maintain a consistent body of statutes. [Citations.] Thus [reconciling these two principles, courts have concluded that] *there is a presumption against repeals by implication; they will occur only where the two acts are so inconsistent that there is no possibility of concurrent operation, or where the later provision gives undebatable evidence of an intent to supersede the earlier*; the courts are bound to maintain the integrity of both statutes if they may stand together. [Citations.]" (Emphasis and brackets added.)

The *Sacramento Newspaper Guild* Court reasoned it could not find the Legislature repealed a statute by implication unless the Legislature had "indulged in a knowing choice between two competing public interests; that it adopted the [new act] with *unmistakable intent* to abolish the [provisions of existing law]." (Emphasis added.)<sup>30</sup> The Court determined that the language of the new legislation was insufficient to evidence unmistakable legislative intent to override the existing statute. Also, the legislative history of the new act "gave no clue" that the Legislature had even considered its interplay with the existing statutory provisions. Finally, the Court noted, the two enactments were capable of concurrent operation, it was possible to carry out both statutes.

The analysis utilized by the court in the *Sacramento Newspaper Guild* case applies equally to the Department's argument in its response. There is no evidence of legislative intent to legislate "...that a letter of credit can never function in lieu of a

surety bond.”<sup>31</sup> The California Supreme Court clearly construed the Legislature’s intent underlying its 1994 amendment to Civil Code section 2787 (Senate Bill No. 1612 (1993-1994 Reg. Sess.) (“SB 1612,”) in *Western Security Bank, N.A. v. Superior Court*.<sup>32</sup> That case concerned California’s statutory scheme pertaining to foreclosure and antideficiency laws that circumscribe enforcement of obligations secured by interests in real property, and the letter of credit law’s “independence principle.” The antideficiency statute specifically at issue was Code of Civil Procedure section 580d, which precludes a judgment for any loan balance left unpaid after the lender’s nonjudicial foreclosure under the power of sale in a deed of trust or mortgage on real property. The “independence principle” essentially “..makes the letter of credit issuer’s obligation to pay a draw conforming to the letter’s terms completely separate from, and not contingent on any underlying contract between the issuer’s customer and the letter’s deficiency.”<sup>33</sup>

In that case, after nonjudicial foreclosure of the real property security for its loan left a deficiency, the lender tried to collect the remaining amount owed on the loan by drawing on the standby letters of credit of which it was a beneficiary. In resolving ensuing litigation, the Court of Appeal found the draw on the letters of credit to constitute a prohibited deficiency judgment. Following the decision of the Court of Appeal, the Legislature amended Civil Code section 2787 to express a clear contrary legislative intent.

SB 1612 was passed as an urgency measure specifically meant to abrogate the decision of the Court of Appeal.<sup>34</sup> Following extensive appellate litigation, the California Supreme Court resolved the Legislature’s intent in passage of the 1994 amendment to Civil Code section 2787. The Court cited the Legislature’s statement of intent located in section 5 of SB 1612.<sup>35</sup>

“It is the intent of the Legislature in enacting Sections 2 and 4 of this act to confirm the independent nature of the letter of credit engagement and to abrogate the holding in [the Court of Appeal’s earlier opinion in this case], . . . The Legislature also intends to confirm the expectation of the parties to a contract that underlies a letter of credit, that the beneficiary will have available the value of the real estate collateral and the benefit of the letter of

credit without regard to the order in which the beneficiary may resort to either.”<sup>36</sup>

The Legislature also clarified its intent in its statement of facts justifying the urgency nature of the 1994 amendment to Civil Code section 2787.

“In order to confirm and clarify the law applicable to obligations which are secured by real property or an estate for years therein and which also are supported by a letter of credit, it is necessary that this act take effect immediately.”<sup>37</sup>

Thus, nothing in the subsequent amendment to Civil Code section supports a conclusion that the Legislature intended to repeal the use of letters of credit in lieu of surety bonds by its 1994 amendment to Civil Code section 2787.

Moreover, in *Western Security Bank*, the Supreme Court first decided that SB 1612 would apply to the parties in the litigation despite the fact that the legislation was passed after the decision of the Court of Appeal. In doing so, the Court found that:

“... Senate Bill No. 1612 did not effect a change in the law, [but] instead represented a clarification of the state of the law before the Court of Appeal’s decision.”<sup>38</sup>

In its Agency Response, the Department cites nothing to refute this settled construction of the Legislature’s intent. Thus, no authority was proffered to support the Department’s position that Civil Code section 2787 now means something different than it did in 1986 when Finance Code section 17202 was amended to permit letters of credit to be used in lieu of surety bonds.

The fact that letters of credit are distinguishable from surety bonds does not support the Department’s position that they cannot be used in place of surety bonds, or that the Legislature did not intend to permit the use of letters of credit in place of surety bonds for applicants for escrow licenses.<sup>39</sup>

The Supreme Court reiterated the distinction between a suretyship and a letter of credit.

“Generally a surety’s liability for an obligation is secondary to, and derivative of, the liability of the principal for that obligation. (See, e.g., Civ. Code, section 2806 et seq.) . . . By contrast, the liability of the issuer of credit to the letter’s beneficiary is direct and independent of the underlying transaction between the beneficiary and the issuer’s customer. (Citations omitted.) Thus, as the amendment to Civil Code section 2787 made clear, existing law viewed a letter of credit as an independent obligation of the issuing bank rather than as a form of guaranty or a surety obligation. (Citations omitted.) The issuer of a letter of credit cannot refuse to pay based on extraneous defenses that might have been available to its customer. (Citations omitted.)”<sup>40</sup>

By its 1994 amendment to Civil Code section 2787, the Legislature did not intend to repeal Finance Code section 17202 by implication. The Legislature’s intent, as construed by the California Supreme Court, was to address antideficiency protections attendant to nonjudicial foreclosures of real property. In so doing, the Legislature restated the law as it existed prior to the amendment. Thus, the amendment did not have a retrospective effect, and Finance Code section 17202 and its 1986 amendment were not repealed by implication. No implication was intended to affect Finance Code section 17202.

Thus, no statutory or regulatory scheme prevented the Department from drafting regulations to effectuate the Legislature’s mandate to consider letters of credit in lieu of surety bonds with applications for escrow agents’ licenses. Accordingly, the Department’s position that it was the Legislature acting through its statutory scheme, and not the Department, who was responsible for the blanket prohibition of irrevocable letters of credit in lieu of surety bonds, is not persuasive.

The Department, and not the Legislature, adopted the challenged blanket prohibition in response to legislative direction to consider applications accompanied by irrevocable letters of credit. This provision of law is to be administered by the Department, a state agency. Accordingly, the challenged rule

constitutes a "regulation" within the meaning of Government Code section 11342, subdivision (g).

**A. IS THE CHALLENGED RULE A "STANDARD OF GENERAL APPLICATION?"**

The challenged letter clearly modifies or supplements Finance Code section 17202. Further, the Commissioner of Corporations recognized that: "... eliminating the use of letters of credit will have somewhat (sic) an impact on the escrow industry, ..." but believed the prohibition was essential "... from a public protection standpoint. . ."<sup>41</sup>

For an agency policy to be of "general application," it need not apply to all citizens of the state. It is sufficient if the rule applies to members of a class, kind or order.<sup>42</sup> Just as in *Tidewater Marine Western, Inc. v. Bradshaw*<sup>43</sup> (1996), where the California Supreme Court found a policy to be a rule of general application, the prohibition in the matter at hand is expressly applicable to all persons who apply using "...irrevocable letters of credit in lieu of the surety bond required by Financial Code section 17202."<sup>44</sup>

Therefore, the challenged prohibition is a standard of general application, a rule that applies statewide to all applicants for an escrow agent business license.

**B. DOES THE CHALLENGED RULE INTERPRET, IMPLEMENT, OR MAKE SPECIFIC THE LAW ENFORCED OR ADMINISTERED BY THE AGENCY OR GOVERN THE AGENCY'S PROCEDURE?**

Financial Code section 17202, subdivision (a), specifically authorizes the use of irrevocable letters of credit in lieu of surety bonds, subject to the approval of the commissioner. The statute provides, in part, as follows: "An applicant or licensee may obtain an irrevocable letter of credit approved by the commissioner in lieu of the [surety] bond." The clear mandate of the statute requires the commissioner to consider individual applications and letters of credit, in light of the need to protect the public.

By 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, subdivision (g), because it is applicable generally, and because it interprets and modifies the statute to be enforced by the Department.

**C. DOES THE CHALLENGED RULE FOUND TO BE A "REGULATION" FALL WITHIN ANY ESTABLISHED SPECIAL EXCEPTION TO APA REQUIREMENTS?**

Generally, all 'regulations issued by state agencies are required to be adopted pursuant to the APA, unless *expressly* exempted by statute.<sup>45</sup> Although not argued by the Department, OAL notes that Corporations Code section 25614 provides:

"All rules of the commissioner (*other than those relating solely to the internal administration of the Department of Corporations*) shall be made, amended or rescinded in accordance with the provisions of the [APA]. . . ." (Emphasis added.)

The exception noted above is specific to the Department of Corporations. However, it utilizes the general exception language of Government Code section 11342, subdivision (g) and does not exceed the scope of that general exception.

**D. DOES THE CHALLENGED RULE FOUND TO BE A "REGULATION" FALL WITHIN ANY ESTABLISHED GENERAL EXCEPTION TO APA REQUIREMENTS?**

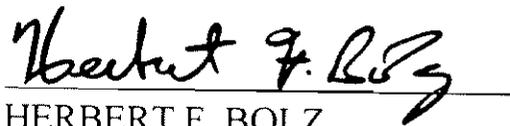
The APA provides a limited number of general exceptions to its rulemaking requirements.<sup>46</sup> The APA excepts policies which pertain solely to the internal management of a state agency from the notice and hearing requirements of the act.<sup>47</sup> However, as the *Grier* Court found: ". . . the definition of regulation is broad, as contrasted with the scope of the internal management exception, which is narrow."<sup>48</sup>

Internal management policies are those designed to govern the internal operations of the department. The exception does not apply to “. . . the rules necessary to properly consider the interests of all who will seek consideration under the provisions of the statutes dealing with review and allocations.”<sup>49</sup> The policy at issue in this determination clearly deals with “. . . the interests of all who will seek consideration under the provisions of [Financial Code section 17202]. . .”<sup>50</sup> Accordingly, the Department’s policy is not covered by the internal management exception to the APA.

### CONCLUSION

For the reasons set forth above, OAL concludes that the challenged policy is a “regulation” within the meaning of Government Code section 11342 which is required to be adopted pursuant to the rulemaking requirements of the APA. No exceptions to the APA requirements apply to the Department concerning the policy found to be a “regulation.”

DATE: October 2, 1998



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## ENDNOTES

1. This request for determination was brought by Rose Pothier, Esq., "requester," of Pothier and Hinrichs, 856 North Ross Street, Ste. 100, Santa Ana, CA 92701, telephone (714) 953-8580. The State Department of Corporations was represented by Timothy L. Le Bas, Senior Corporations Counsel, Office of Policy, 980 Ninth Street, Ste. 500, Sacramento, CA 95814

On July 17, 1998, OAL published a summary of this Request for Determination in the California Regulatory Notice Register ("CRNR") 98, No. 29-Z, p. 1363, along with a notice inviting public comment. No public comments were received. The Department of Corporations filed a response to the request for determination. The requester did not file a rebuttal to the Department's response.

2. Financial Code section 17202, subdivision (a).
3. Commissioner's letter to Rose Pothier, dated December 18, 1991.
4. Commissioner's letter to Rose Pothier, dated December 18, 1991.
5. Commissioner's letter to Rose Pothier, dated December 18, 1991.
6. Commissioner's letter to Rose Pothier, dated December 18, 1991.
7. Commissioner's letter, dated December 23, 1991
8. Government Code section 11342, subdivision (a). See Government Code sections 11346; 11343.
9. See, *Poschman v. Dumke* (1973) 31 Cal.App.3d 932, 943, 107 Cal.Rptr. 596, 609.
10. (1990) 219 Cal.App.3d 422, 440; 268 Cal.Rptr. 244.
11. The *Grier* Court stated:

“The OAL’s analysis set forth a two-part test: ‘First, is the informal rule either a rule or standard of general application or a modification or supplement to such a rule? [Para.] Second, does the informal rule either implement, interpret, or make specific the law enforced by the agency or govern the agency’s procedure?’ (1987 OAL Determination No.10, *supra*, slip op., at p. 8.)”

OAL’s wording of the two-part test, drawn from Government Code section 11342, has been modified slightly over the years. The cited OAL opinion--1987 OAL Determination No. 10--was belatedly published in California Regulatory Notice Register 96, No. 8-Z, February 23, 1996, p. 292.

12. (1990) 219 Cal.App.3d 422, 438; 268 Cal.Rptr. 244, 253.
13. *Id.*, at 436; 268 Cal.Rptr., at 254.
14. OAL Determination No. 15 [Docket No. 89-002] Oct. 10, 1989.
15. 1986 OAL Determination No. 4 (State Board of Equalization, June 25, 1986, Docket No. 85-005) California Administrative Notice Register 86, No. 28-Z, July 11, 1986, p. B-15, typewritten version, p. 12.
16. Agency Response, footnote 6.
17. Agency Response, footnote 6, referring specifically to 1988 OAL Determination No. 10.
18. Agency Response, dated August 31, 1998, at page 5.
19. *Fidelity and Deposit Company, of Maryland v. Federal Deposit Insurance Corporation* (8th Cir. 1995) 54 F.3d 507, 514.
20. See, e.g., Office of the Comptroller of the Currency, Interpretive Letter No. 239, March 10, 1982. (*Federal Banking Law Reporter*, CCH paragraph 85,403.)
21. It is important to note that the Federal Deposit Insurance Corporation Improvement Act (“FDICIA”) of 1991, at section 303 generally applies the criteria of Title 12 C.F.R. section 7.1016 to state chartered banks unless specific exception is requested and granted. (12 USC 1831a.)
22. Uniform Commercial Code, Revised, Article 5 Letters of Credit, Prefatory Note, Reason for Revision.

23. Uniform Commercial Code, Revised, Article 5 (1995), section 5-115 provides as follows: "An action to enforce a right or obligation arising under this article must be commenced within one year after the expiration date of the relevant letter of credit or one year after the [claim for relief] [cause of action] accrues, whichever occurs later. A [claim for relief] [cause of action] accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach." Cf: Financial Code section 17205: "No action may be brought on an escrow agent's bond by any person after the expiration of two years from the time when the act or default complained of occurs."
24. 39 Federal Register 29178 Aug.14 1974, as amended at 44 Federal Register 25194, Apr. 30 1979.
25. Agency Response, page 10, footnote 7.
26. Agency Response, page 5.
27. "A surety is one who undertakes to pay money or to do any other act in the event that his principal fails to do so. (*Black's Law Dictionary* (5th ed., 1979).) In general, everyone who incurs a liability for the benefit of another, without sharing in the consideration received by the principal, stands in the position of a surety, whatever may be the form of his obligation. (*Howell v. War Finance Corporation* (1934) 71 F.2d 237, 243.)" Miller and Starr, *California Real Estate*, (2d edition, 1980.) By statute, a surety ". . . is one who promises to answer for the debt, default, or miscarriage of another, or hypothecates property as a surety therefor." (Civil Code section 2787.)
28. No specific form is set for common-law bonds, although they must be in writing and signed by the surety under oath. The writing need not express a consideration. (Civil Code sections 2792 and 2793.) Parties in a common law bond are limited only in that the bond must not violate public policy or statutory provisions. They may establish the extent of the surety's liability themselves and insert such conditions as they desire. (*W.P. Fuller and Co. v. Alturas School District* (1915) 28 Cal.App. 609, 612; *Cavanaugh v. Casselman* (1891) 88 Cal. 543, 547.)
29. (1968) 263 Cal.App.2d 41; 69 Cal.Rptr. 480.
30. 263 Cal.App.2d at 56.
31. Agency Response, page 5.
32. *Western Sec. Bank, N.A. v. Superior Court* (1997) 15 Cal.4th 232, 237.
33. *Id.*

34. Stats.1994, ch. 611, Sections 5 and 6.
35. *Western Sec. Bank, N.A. v. Superior Court*, supra, 15 Cal.4th, at 246.
36. Stats.1994, ch.611, section 5.
37. Stats.1994, ch. Section 6.
38. *Western Sec. Bank, N.A. v. Superior Court*, supra, 15 Cal.4th, at 246.
39. "A [letter of] credit is an original undertaking by one party (the issuer) to substitute its financial strength for that of another (the applicant), [citation omitted], with the undertaking to be conditioned on the presentation of a draft or a demand for payment and usually other documents. [citation omitted.] The credit arises in a number of situations, but generally the applicant seeks the strength of the issuer's financial integrity or reputation so that a third party (the beneficiary of the credit) will give value to the applicant. The beneficiary extends that value by selling goods or services to the applicant on credit, by taking the applicant's negotiable paper, or by extending credit to the applicant. In letter of credit jurisprudence, it is axiomatic that the undertaking of the credit issuer be original and not derivative and that the credit undertaking run directly from the issuer to the beneficiary. Surety contracts and the like are not credits, [citation omitted], and generally neither are promises of the issuer that run to the applicant." (John F. Dolan, *The Law of Letters of Credit*, Rev. Ed. (1996, section 2.02.)
40. *Western Sec. Bank, N.A. v. Superior Court*, supra, 15 Cal.4th, at 246.
41. Commissioner Sayles' letter to the requester, dated December 18, 1991.
42. *Roth v. Department of Veteran Affairs* (1980) 110 Cal.App.3d 622; 167 Cal.Rptr.552. See *Faulkner v. California Toll Bridge Authority* (1953) 40 Cal.2d 317, 323-324 (standard of general application applies to all members of any open class.)
43. 14 Cal.4th 557, 572; 59 Cal.Rptr.2d 186, 195.
44. Letter of the Commissioner, dated December 18, 1991.
45. Government Code section 11346.
46. Government Code section 11371, subdivision (b).
47. Government Code section 11371, subdivision (b).
48. *Grier v. Kizer*, supra, 219 Cal.App.3d, at 438; 268 Cal.Rptr., at 251.

49. *City of San Marcos v. California Highway Commission, Department of Transportation* (1976) 60 Cal.App.3d 383, 408; 131 Cal.Rptr. 804, 820.
50. *Id.*