Study N-110 September 18, 1995

Memorandum 95-54

Administrative Adjudication: Follow-Up Issues

This memorandum presents several issues for possible follow-up legislation on administrative adjudication, assuming enactment of Senate Bill 523. The staff contemplates development of a tentative recommendation that addresses any of these matters that appear appropriate, before submission of a report to the Legislature. On a bill of this size, other issues may come to our attention after enactment; we would add these to the followup legislation as we discover them.

State Board of Equalization

The State Board of Equalization was removed from the administrative adjudication bill on a 7-6 partisan vote in the Assembly Committee on Consumer Protection, Governmental Efficiency & Economic Development. The basis of the opposition was a negative analysis by the Republican Caucus consultant, drawn from information provided by the Board of Equalization and by the California Taxpayers Association, that the bill would have the effect of unduly formalizing taxation proceedings and cause added time, expense, and lawyers' bills.

The staff believes the bill should be allowed to become operative and favorable experience developed under it before we consider another effort to bring the Board of Equalization under the new law. At that time we would also review the other exemptions from the new law, e.g., Public Utilities Commission, to determine whether they remain appropriate.

Insurance Commissioner

Proposition 103 provides that:

> **Ins. Code § 1861.08. Conduct of hearings**
>
> Hearings shall be conducted pursuant to Sections 11500 through 11528 of the Government Code, except that: (a) hearings shall be conducted by administrative law judges for purposes of Sections 11512 and 11517, chosen under Section 11502 or appointed by the commissioner; (b) hearings are commenced by a filing of a Notice in lieu of Sections 11503 and 11504; (c) the commissioner shall adopt, amend or reject a decision only under Section 11517 (c) and

(e) and solely on the basis of the record; (d) Section 11513.5 shall apply to the commissioner; (e) discovery shall be liberally construed and disputes determined by the administrative law judge.

This section may only be amended by a two-thirds vote of the Legislature, by reason of language in Proposition 103.

Because to make a conforming revision of this section would have imposed a two-thirds vote requirement on our bill, we decided to hold off and do separate legislation on it. This could go into the followup bill, thus:

Ins. Code § 1861.08. Conduct of hearings

1861.08. Hearings shall be conducted pursuant to ~~Sections 11500 through 11528~~ Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code, except that: ~~(a) hearings~~

(a) Hearings shall be conducted by administrative law judges for purposes of Sections 11512 and 11517, chosen under Section 11502 or appointed by the commissioner~~; (b) hearings~~ .

(b) Hearings are commenced by a filing of a Notice in lieu of Sections 11503 and 11504~~; (c) the~~ .

(c) The commissioner shall adopt, amend or reject a decision only under Section 11517 (c) and (e) and ~~solely on the basis of the record; (d) Section 11513.5 shall apply to the commissioner; (e) discovery~~ Section 11518.5.

(d) Discovery shall be liberally construed ~~and disputes determined by the administrative law judge~~.

Comment. Section 1861.08 is amended to reflect revision of the Administrative Procedure Act by 1995 Cal. Stat. ch ***.

The introductory portion of the section is amended to refer to the entire formal hearing chapter. That chapter is supplemented by Chapter 4.5 (commencing with Section 11400) of the same part, containing general provisions on administrative adjudication applicable to all state agency hearings. See Gov't Code § 11410.10 (application of chapter).

The reference to a decision "solely on the basis of the record" in subdivision (c) is deleted as surplus. All decisions under the Administrative Procedure Act must be based exclusively on the record. Gov't Code § 11425.50 (decision).

The reference to former Government Code Section 11513.5 is deleted as obsolete. It is superseded by Government Code Sections 11430.10-11430.80 (ex parte communications), which apply to all hearings under the Administrative Procedure Act.

The reference in subdivision (d) to determination of discovery disputes by the administrative law judge is deleted as surplus. All

discovery disputes under the formal hearing procedure are now determined by the administrative law judge. Gov't Code § 11507.7.

Staff Note. *The reference in subdivision (c) to Government Code Section 11517 (c) and (e) is in error. We are attempting to ascertain what the correct reference should be.*

Quasi-public entities

During the development of the administrative adjudication proposals, the Commission received a letter from Rose Pothier of Santa Ana suggesting that the provisions be extended to hearings by private entities acting on behalf of the state. The Commission deferred consideration of this suggestion until after enactment of the administrative adjudication reforms.

Ms. Pothier was specifically concerned with hearings of the Escrow Agents' Fidelity Corporation under the Escrow Law to deny, suspend, or revoke escrow license certificates. The Escrow Agents' Fidelity Corporation is a statutory mutual benefit nonprofit corporation operating under the control of the Commissioner of Corporations.

Whether the Administrative Procedure Act applies or should apply to quasi-public entities such as this is not a completely new issue. For example, under the Lanterman Developmental Disabilities Services Act, private nonprofit community agencies operate regional centers under contract with the Department of Social Services. The Office of Administrative Law has issued a determination that rules issued by regional centers are not "regulations" within the meaning of the rulemaking statute because the regional centers are not "state agencies", and therefore the regional centers need not comply with Administrative Procedure Act rulemaking requirements. 1991 OAL Determination No. 2 (March 28, 1991).

There are numerous cases holding that private entities performing a function in the public interest are subject to fairness requirements in their hearing procedures. For example, in Gaenslen v. Board of Directors, 185 Cal. App. 3d 563, 232 Cal. Rptr. 239 (1985), the court held that although the actions of a private institution such as a private hospital are not state actions, fair procedures must be observed with respect to termination of a physician's staff membership. This is a common law rather than constitutional doctrine and has been applied typically to private hospitals in the admission or exclusion of physicians to staff privileges,

and professional societies in the exclusion and expulsion of members. See discussion in CEB, California Administrative Hearing Practice §§ 1.35-1.36 (1984).

A recent case requires a private country club to comply with fair hearing procedures in expulsion of a member pursuant to the Nonprofit Corporation Law. Aluisi v. Fort Washington Golf and Country Club, 42 Cal. Rptr. 2d 761 (1995).

The staff agrees with Ms. Pothier that a private entity conducting a hearing on behalf of a state agency should be subject to the same fairness protections the state agency would be subject to if it were administering the law itself. The problem is to describe the circumstances sufficiently precisely that a private entity can know with some assurance whether or not its hearing is subject to the Administrative Procedure Act. Ms. Pothier suggests that entities "supervised" by state agencies should be subject to the APA. The staff believes this is too nebulous.

A better test might be something like:

> This chapter applies to a private entity that performs a function of an agency of the state pursuant to a statute that delegates or authorizes delegation of the function of the agency to the private entity by contract or otherwise, whether or not an action of the private entity is subject to the direction, control, supervision, or review of the agency.

Confidentiality of Settlement Communications

The administrative adjudication reforms encourage settlement and alternative dispute resolution by protecting the confidentiality of communications made during those processes. A problem that has arisen is that a party entering into negotiations in bad faith may disclose damaging information with the intent that it may not thereafter be used against the party in litigation. To cure this problem in civil proceedings, the Evidence Code has been amended to make clear that the "poisoned fruit" defense does not work for evidence that is otherwise admissible. We added parallel language to the ADR provision in the administrative adjudication bill:

> Evidence otherwise admissible outside of alternative dispute resolution under this article is not inadmissible or protected from disclosure solely by reason of its introduction or use in alternative dispute resolution under this article.
> Gov't Code § 11420.30(d)

The Department of Corporations has written us with a similar concern on settlement negotiations. See Exhibit pp. 1-3. Section 11415.60 provides:

> Notwithstanding any other provision of law, no evidence of an offer of compromise or settlement made in settlement negotiations is admissible in an adjudicative proceeding or civil action, whether as affirmative evidence, by way of impeachment, or for any other purpose.

The Department proposes that this provision be amended to limit its application:

> Notwithstanding any other provision of law, no evidence of an offer of compromise or settlement made in settlement negotiations is admissible to prove liability in an adjudicative proceeding or civil action~~, whether as affirmative evidence, by way of impeachment, or for any other purpose~~.

This would parallel the protection given offers of compromise generally by Evidence Code Section 1152.

The staff disagrees with this proposal. The Evidence Code provision only applies to offers "to furnish money or any other thing, act, or service to another who has sustained or claims that he or she has sustained or will sustain loss or damage". Evid. Code § 1152(a). In that situation it may be appropriate that an offer of compromise be inadmissible to prove liability. But the kinds of issues that arise in an adjudicative proceeding are much more diverse, and a broader protection is necessary. It should be noted that the settlement provision, unlike the alternative dispute resolution provision, does not protect communications — it only protects evidence of the fact that an offer of compromise was made.

Code of Ethics for Administrative Law Judges

The Commission has previously decided to develop the concept of a code of ethics for administrative law judges in conjunction with the Office of Administrative Hearings, the Association of California State Attorneys and Administrative Law Judges, and affected agencies. It is likely that this item will not be ready for legislation in 1996, since the Supreme Court's rules of ethics for judges are still being developed. If we complete work on the Code of Ethics during the legislative session, we could add the material to the bill by amendment.

Electronic Reporting of Hearings

Under existing law, in hearings under Administrative Procedure Act, a stenographic reporter is required unless the parties agree to electronic reporting (tape recording). The Commission's recommendation would have allowed the administrative law judge to select stenographic or electronic reporting, as appropriate. If the administrative law judge selected stenographic reporting, a party could nonetheless demand stenographic reporting, at the party's own expense.

The reason for this proposal is that electronic reporting is less expensive than stenographic reporting. Advances in technology (multi-track recorders) have made electronic reporting accurate and reliable. The person responsible for the record (administrative law judge) should select the best means of reporting based on cost, quality, etc.

The hearing reporters associations opposed this provision. They argued that stenographic reporting gives the best quality report of proceedings. Moreover, with computer technology, stenographic reporting yields a quick and inexpensive transcript.

However, a transcript is required only in a small fraction of administrative hearings, and agencies with tight budgets shouldn't have to waste public funds to hire a stenographer unnecessarily. The Commission's position is that the person responsible for record (the administrative law judge) is in the best position to make the choice, taking all factors into account, including accuracy and cost.

The opponents were successful in having the electronic reporting reform removed from the bill in the Senate Committee on Governmental Organization. However, we did not have good statistics on the true cost of existing law at the time, and the Office of Administrative Hearings was unable to appear in support of the proposal. The staff believes that if we can obtain good statistics and can get the open support of the Office of Administrative Hearings, we can make a convincing case for this reform, and should try again. We have asked the Office of Administrative Hearings to provide us with numbers.

Transitional Provisions in Bill

Office of Administrative Law has discovered a technical defect in the transitional provisions in the bill. New Government Code Section 11400.20 allows an agency to adopt implementing regulations "before, on, or after July 1,

1997", but this provision is located in a part of the bill that does not become operative until July 1, 1997. In order to clearly enable agencies to adopt regulations before the operative date, general transitional language in the bill should be revised to read:

> SEC. 98. (a) Except as provided in subdivision (b), this act shall be operative on July 1, 1997.
>
> (b) (1) Sections 9, 9.2, 9.4, 9.6, 15, 15.1, 15.3, 15.5, 15.6, 15.7, 15.8, 24, 57, 58, 64, 64.4, 65, 65.4, 71, 72, 72.4, 78, 82, 95.5, 97.1, and 97.2 shall be operative on January 1, 1996.
>
> (2) Section 97 shall be operative on January 1, 1997.
>
> (3) If Section 443.37 of the Health and Safety Code is repealed before July 1, 1997, then Section 59 of this act shall not become operative.
>
> (4) Notwithstanding Section 11400.10 of the Government Code, Section 11400.20 of the Government Code shall be operative immediately.

Making this an urgency measure would require a two-thirds vote for enactment, but the bill will need a two-thirds vote in any case if it is to amend Proposition 103. See discussion above.

Respectfully submitted,

Nathaniel Sterling
Executive Secretary

STATE OF CALIFORNIA – BUSINESS, TRANSPORTATION AND HOUSING AGENCY PETE WILSON, *Governor*

DEPARTMENT OF CORPORATIONS
Sacramento, California

IN REPLY REFER TO:
FILE NO: Alpha

August 24, 1995

Nathaniel Sterling
Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

Re: Senate Bill 523

Dear Mr. Sterling:

This is to memorialize our telephone conversation of this morning, August 24, 1995.

Earlier, the Department of Corporations relayed its concerns regarding SB 523. Namely, we were concerned that the bill would make inadmissible for any purpose, evidence of offers to compromise. We stated that the bill would be unnecessarily more restrictive than Evidence Code Section 1152, which does not allow evidence of offers of compromise for the purpose of showing liability. Courts have found that evidence of compromise is admissible for collateral purposes such as impeachment.

In that letter, the Department proposed an amendment which addressed our concerns regarding offers of compromise when participating in Alternative Dispute Resolution ("ADR") proceedings. However, through an inadvertent oversight, the letter did not include suggested changes to that part of the bill which covers offers of compromise in settlement negotiations.

Subsequently, the bill has been amended to address our concerns relating to the ADR provisions of the bill. Indeed the bill now conforms the ADR provisions of the bill with the Evidence Code section relating to the collateral use of evidence of offers to compromise. However, the bill does not conform that part of the bill dealing with offers of compromise in settlement negotiations with the Evidence Code.

Upon reflection, the Department believes that the section regarding offers to compromise in settlement negotiations should be amended to conform with the changes made in the ADR sections of the bill, and to remain consistent with the Evidence Code. Specifically, the Department of Corporations recommends that Section 11415.60(a) be amended to state that evidence of offers to compromise would be inadmissible to show liability. See, Section 1152 of the Evidence Code.

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The Department of Corporations recognizes that this letter raises issues rather late in the legislative session, as it is our understanding that SB 523 has passed the Assembly Appropriations Committee yesterday. However, in our telephone conversation, you mentioned that there would be clean-up legislation introduced in the next session. In that regard, we would appreciate it if the attached amendment (in Legislative Counsel format) be considered as part of future clean-up legislation.

If you have any questions or comments, please do not hesitate to call me at the number listed below.

Very truly yours,

GAYLE OSHIMA
Corporations Counsel
(916)445-8042

GO:kh

Attachment

cc: The Honorable Quentin Kopp
Member of the Senate
State Capitol, Room 2057
Sacramento, CA 95814

AMENDMENTS TO SENATE BILL 523

AS AMENDED IN THE ASSEMBLY ON JULY 28, 1995

AMENDMENT 1

On page 41 of the printed bill as amended in the Senate on July 28, 1995, strike-out lines 10 through 13, inclusive, and insert:

No evidence of an offer of compromise or settlement made in negotiations is admissible to prove liability in an adjudicative proceeding or civil action.