

State of California

Office of Administrative Law

In re:
State Controller's Office

Regulatory Action:

Title 02, California Code of
Regulations

Adopt sections: 1180.11, 1180.12,
1180.13, 1180.14,
1180.15, 1180.16,
1180.17, 1180.18,
1180.19, 1180.20,
1180.21, 1180.22,
1180.23, 1180.24,
1180.25, 1180.26,
1180.27, 1180.28,
1180.29, 1180.30,
1180.31, 1180.32,
1180.33, 1180.34,
1180.35, 1180.36,
1180.37, 1180.38,
1180.39, 1180.40,
1180.41, 1180.42,
1180.43, 1180.44,
1180.45, 1180.46,
1180.47, and 1180.48

DECISION OF DISAPPROVAL OF
REGULATORY ACTION

Government Code Section 11349.3

OAL Matter Number: 2024-0621-06

OAL Matter Type: Regular
Resubmittal (SR)

SUMMARY OF REGULATORY ACTION

In this regulatory action, the State Controller's Office ("SCO") proposes to adopt regulations governing the activities of third-party auditors hired by SCO to examine the records of a person who has failed to report property that should have been reported pursuant to the Unclaimed Property Law.¹

¹ Chapter 7 (commencing with section 1500) in Title 10 in Part 3 of the Code of Civil Procedure is known as the "Unclaimed Property Law." (Code Civ. Proc., sec. 1500.)

On June 21, 2024, SCO submitted the above-referenced regulatory action to the Office of Administrative Law ("OAL") for review. On August 5, 2024, OAL notified SCO of OAL's decision to disapprove the proposed regulations.

DECISION

OAL disapproved the above-referenced action because the proposed regulations failed to comply with the clarity and necessity standards of the Administrative Procedure Act (the "APA"), as well as required APA procedures. This Decision of Disapproval of Regulatory Action explains the reasons for OAL's action.

DISCUSSION

SCO's regulatory action must satisfy requirements established by the part of the APA that governs rulemaking by a state agency. Any regulation adopted, amended, or repealed by a state agency to implement, interpret, or make specific the law enforced or administered by it, or to govern its procedure, is subject to the APA unless a statute expressly exempts the regulation from APA coverage. (Gov. Code, sec. 11346.) No exemption applies to this regulatory action.

Before any regulation subject to the APA may become effective, the regulation is reviewed by OAL for compliance with the procedural requirements of the APA and the standards for administrative regulations in Government Code section 11349.1. Generally, to satisfy the APA standards, a regulation must be legally valid, supported by an adequate record, and easy to understand. In this review, OAL is limited to the rulemaking record and may not substitute its judgment for that of the rulemaking agency regarding the substantive content of the regulation. This review is an independent check on the exercise of rulemaking powers by executive branch agencies intended to improve the quality of regulations that implement, interpret, and make specific statutory law, and to ensure that the public is provided with a meaningful opportunity to comment on the regulations before they become effective.

1. Clarity Standard

In adopting the APA, the Legislature found that the language of many regulations was unclear and confusing to persons who must comply with the regulations. (Gov. Code, sec. 11340, subd. (b).) Government Code section 11349.1, subdivision (a)(3), requires that OAL review all regulations for compliance with the clarity standard. Government Code section 11349, subdivision (c), defines "clarity" to mean "written or displayed so that the meaning of regulations will be easily understood by those persons directly affected by them."

The “clarity” standard is further defined in section 16 of title 1 of the California Code of Regulations (“CCR”), which provides:

In examining a regulation for compliance with the “clarity” requirement of Government Code section 11349.1, OAL shall apply the following standards and presumptions:

(a) A regulation shall be presumed not to comply with the “clarity” standard if any of the following conditions exists:

(1) the regulation can, on its face, be reasonably and logically interpreted to have more than one meaning; or

(2) the language of the regulation conflicts with the agency's description of the effect of the regulation; or

(3) the regulation uses terms which do not have meanings generally familiar to those “directly affected” by the regulation, and those terms are defined neither in the regulation nor in the governing statute; or

(4) the regulation uses language incorrectly. This includes, but is not limited to, incorrect spelling, grammar or punctuation; or

(5) the regulation presents information in a format that is not readily understandable by persons “directly affected[.]”

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(b) Persons shall be presumed to be “directly affected” if they:

(1) are legally required to comply with the regulation; or

(2) are legally required to enforce the regulation; or

(3) derive from the enforcement of the regulation a benefit that is not common to the public in general; or

(4) incur from the enforcement of the regulation a detriment that is not common to the public in general.

The following provisions in SCO's proposed regulatory action do not satisfy the clarity standard.

1.1. Proposed Section 1180.22

Proposed Section 1180.22 states, in pertinent part, the following:

A third-party auditor is responsible for ensuring that any affiliated companies and any sub-contractors that are used during the examinations possess sufficient training and experience to adequately perform the unclaimed property examination and fully comply with **these and all other policies and procedures governing its conduct.** [(Emphasis added.)]

As written, it is unclear what policies and procedures SCO is referring to that the third-party auditors must comply with. As a result, proposed Section

1180.22 is not written so that the meaning of the regulations will be easily understood by those persons directly affected by them. (Gov. Code, sec. 11349, subd. (c); see also Cal. Code Regs., tit. 1, sec. 16, sub. (a)(5).)

1.2. Proposed Section 1180.44

Subsection (a) of proposed Section 1180.44 states, in pertinent part, the following:

After the holder and the third-party auditor have agreed to the amount deliverable, a third-party auditor shall provide the holder and the SCO with an examination report summarizing the procedures performed and the conclusions reached, including the amount deliverable within 120 days of **request by the holder** following conclusion of the audit. [(Emphasis added.)]

In the Addendum to the Initial Statement of Reasons, SCO states, “This section requires that the auditor **will provide** the audited holder and the SCO with a report that includes the procedures performed during the audit, the conclusions reached, and the amount deliverable.” (Emphasis added.) However, the regulation only requires the report 120 days **after request by the holder**. It is unclear if SCO intends for a report to be provided in all circumstances or just upon request by the holder. Therefore, the regulation can, on its face, be reasonably and logically interpreted to have more than one meaning regarding whether the examination report must always be provided. (Cal. Code Regs., tit. 1, sec. 16, sub. (a)(1).) Additionally, the language of the regulation conflicts with SCO's description of the effect of the regulation. (Cal. Code Regs., tit. 1, sec. 16, sub. (a)(2).)

1.3. Proposed Section 1180.37

SCO references a “lead” working paper in proposed Section 1180.37: “Each lead working paper must be initialed and dated by the preparer and the reviewer, and all pages numbered.” However, it is unclear from the proposed regulations what constitutes a “lead” working paper, and the term is not defined in existing regulations or the governing statute. For these reasons, the regulations use a term which does not have meaning generally familiar to those directly affected by the regulations. (Cal. Code Regs., tit. 1, sec. 16, sub. (a)(3).)

1.4. Proposed Section 1180.12

Code of Civil Procedure section 1571, subdivision (a), states, “The Controller may at reasonable times and upon reasonable notice examine the records of any person if the Controller has reason to believe that the person is a holder who has failed to report property that should have been reported

pursuant to this chapter.” Proposed Section 1180.12 partially restates this statutory provision: “The Controller is authorized to examine the records of any person if the Controller has reason to believe that the person is a holder who has failed to report property that should have been reported pursuant to Code of Civil Procedure Section 1500 et seq.” By omitting the statutory phrase “at reasonable times and upon reasonable notice” from the regulation, persons directly affected by the proposed regulation will not be informed that the examination pursuant to proposed Section 1180.12 involves certain other statutory requirements. As a result, proposed Section 1180.12 is not written so that the meaning of the regulations will be easily understood by those persons directly affected by them. (Gov. Code, sec. 11349, subd. (c); see also Cal. Code Regs., tit. 1, sec. 16, subs. (a)(1) and (5).)

1.5. Additional Clarity Issues

Numerous changes must be made to correct grammar, punctuation, spelling, and syntax. (Cal. Code Regs., tit. 1, sec. 16, sub. (a)(4).) Additionally, SCO must correct inaccurate cross-references throughout the proposed regulations. (Gov. Code, sec. 11349, subd. (c).)

For the reasons discussed above, the proposed regulatory changes failed to comply with the clarity standard of the APA.

2. Necessity

OAL must review regulations for compliance with the necessity standard of Government Code section 11349.1, subdivision (a)(1). Government Code section 11349, subdivision (a), defines “necessity” as follows:

“Necessity” means the record of the rulemaking proceeding **demonstrates by substantial evidence the need for a regulation** to effectuate the purpose of the statute, court decision, or other provision of law that the regulation implements, interprets, or makes specific, taking into account the totality of the record. For purposes of this standard, evidence includes, but is not limited to, facts, studies, and expert opinion. [(Emphasis added.)]

To further explain the meaning of “substantial evidence” in the context of the necessity standard, subsection (b) of section 10 of title 1 of the CCR provides:

(b) In order to meet the “necessity” standard of Government Code section 11349.1, the record of the rulemaking proceeding shall include:

- (1) A statement of the specific purpose of each adoption, amendment, or repeal; and
- (2) information explaining why each provision of the adopted regulation is required to carry out the described purpose of the provision. Such information shall include, but is not limited to, facts, studies, or expert opinion. When the explanation is based upon policies, conclusions, speculation, or conjecture, the rulemaking record must include, in addition, supporting facts, studies, expert opinion, or other information. An "expert" within the meaning of this section is a person who possesses special skill or knowledge by reason of study or experience which is relevant to the regulation in question.

Regarding necessity for changes made to the originally proposed regulations, Government Code section 11346.9 states, in pertinent part, the following:

Every agency subject to this chapter shall do the following:

(a) Prepare and submit to the office with the adopted regulation a final statement of reasons ["FSR"]) that shall include all of the following:

(1) An update of the information contained in the initial statement of reasons. If the update identifies any data or any technical, theoretical or empirical study, report, or similar document on which the agency is relying in proposing the adoption, amendment, or repeal of a regulation that was not identified in the initial statement of reasons, or which was otherwise not identified or made available for public review prior to the close of the public comment period, the agency shall comply with Section 11347.1.

In the modified regulation text made available pursuant to Government Code section 11346.8, subdivision (c), and section 44 of title 1 of the CCR, SCO made numerous substantive changes to the originally proposed regulations. The rulemaking record does not contain the necessity for these changes and therefore does not comply with Government Code section 11346.9, subdivision (a), and section 10 of title 1 of the CCR.

3. Incorrect Procedure

The APA and OAL's regulations require agencies to follow specific procedures when conducting a regulatory action. In this action, SCO did not comply with the following procedures.

3.1. Failure to Clearly Illustrate Post-Notice Modifications

Subdivision (c) of Government Code section 11346.8 requires that, when an agency makes a change sufficiently related to the original text, the resulting change must be clearly indicated. (See also Cal. Code Regs., tit. 1, secs. 44 and 46.) Here, SCO made modifications to the regulation text but failed to show the full text of the originally proposed regulations with proposed changes clearly indicated. These inconsistencies must be resolved in any future modified regulation text made available pursuant to Government Code section 11346.8, subdivision (c), and section 44 of title 1 of the CCR.

3.2. Incorporation by Reference

Subsection (a) of section 20 of title 1 of the CCR defines “incorporation by reference” as “the method whereby a regulation printed in the [CCR] makes provisions of another document part of that regulation by reference to the other document.” Proposed Section 1180.32 states, in pertinent part, the following: “A third-party auditor will prepare and submit to SCO unclaimed property **Holder Notice Reports** in accordance with the requirements of CCP section 1530 and unclaimed property **Holder Remit Reports** with property remittance in accordance with the requirements of CCP section 1532.” (Emphasis added.) To the extent requiring use of these reports is regulatory or these reports contain regulatory elements, then they must be incorporated by reference pursuant to section 20 of title 1 of the CCR.

3.3. Updated Informative Digest

Subdivision (b) of Government Code section 11346.9 requires that the Updated Informative Digest (“UID”) contain “a clear and concise summary of the immediately preceding laws and regulations, if any, relating directly to the adopted, amended, or repealed regulation and the effect of the adopted, amended, or repealed regulation.” The UID in the rulemaking record does not include the required summary. Prior to resubmitting this action, SCO must complete a UID in accordance with subdivision (b) of Government Code section 11346.9 and include it in the rulemaking record.

3.4. Final Statement of Reasons

The FSR (1) is missing the statements required by subsection (c) of section 20 of title 1 of the CCR for incorporation by reference and (2) does not contain a summary of and response to all relevant objections and recommendations received during the comment periods. (Gov. Code, sec. 11346.9, subd. (a)(3).) All instances of insufficient summaries and responses to public comments have been identified for SCO.

For the reasons discussed above, SCO failed to comply with all the procedural requirements of the APA.

CONCLUSION

For the foregoing reasons, OAL disapproved the above-referenced regulatory action. Pursuant to Government Code section 11349.4, subdivision (a), SCO may resubmit revised regulations within 120 days of its receipt of this Decision of Disapproval of Regulatory Action. A copy of this Decision will be emailed to SCO on the date indicated below.

Any substantive regulatory text changes necessary to address the deficiencies discussed above, must be sufficiently related to the originally noticed text, and be made available for public comment for at least 15 days pursuant to subdivision (c) of Government Code section 11346.8 and section 44 of title 1 of the CCR. All relevant objections and recommendations received during the 15-day public comment period must be summarized and responded to in the FSR. SCO must resolve all issues raised in this Decision of Disapproval of Regulatory Action prior to the resubmittal of this regulatory action. OAL reserves the right to review SCO's resubmitted regulations and rulemaking record for compliance with all substantive and procedural requirements of the APA.

Date: August 12, 2024



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