

1 BEFORE THE DEPARTMENT OF CORPORATIONS
2 OF THE STATE OF CALIFORNIA

3
4 In the Matter of THE CALIFORNIA
5 CORPORATIONS COMMISSIONER,

Case No. 963-5029

OAH No. N2001060004

6 Complainant,

7 vs.

8 ESCROW CONTROL COMPANY,

9 Respondent.
10

11
12 **DECISION**
13 **(AFTER REJECTION)**

14
15 This matter came on for hearing before Robert Walker, Administrative Law Judge
16 of the Office of Administrative Hearings, Oakland, California on July 19, 2001.

17 William L. Marder, Corporations Counsel, represented complainant.

18 Respondent, Escrow Control Company, was represented by Michael Kay, Attorney at
19 Law.

20 Oral and documentary evidence was received and the matter was submitted.

21 On August 20, 2001, the Administrative Law Judge submitted a Proposed
22 Decision, which was not adopted as the Decision in this matter. Pursuant to Section
23 11517(c) of the Government Code, Respondent was served on November 28, 2001,
24 with notice of the determination not to adopt the Proposed Decision of the
25 Administrative Law Judge along with a copy of said Proposed Decision. Respondent
26 was notified that the case would be decided by the California Corporations
27 Commissioner upon the record including the transcript of proceedings held on July 19,
28 2001, and upon any written argument offered by the parties.

1 On December 20, 2001, Respondent submitted written argument.

2 The record in this case, including the transcript of proceedings of July 19, 2001
3 and Respondent's arguments, have been given careful consideration.

4 The following shall constitute the Decision of the California Corporations
5 Commissioner in the above-entitled matter.

6
7 **SUMMARY AND ISSUES**
8

9 In an Order To Discontinue Violations Pursuant To Financial Code Section 17602
10 (hereafter the "Order") the California Corporations Commissioner ("Commissioner")
11 found that Respondent had failed to reconcile its escrow trust bank account at least
12 once each month. The Commissioner determined that the failure to reconcile amounted
13 to a violation of the Escrow Law and certain regulations adopted pursuant to the Escrow
14 Law, and the Commissioner ordered Respondent to discontinue engaging in certain
15 violations. Respondent appealed the Order.

16
17 The issues are:

18
19 1. Did Respondent, in violation of section 1732.2 of title 10 of the California
20 Code of Regulations,¹ fail to reconcile its escrow trust bank account at least once each
21 month?

22
23 2. Did Respondent, by failing to reconcile its escrow trust bank account monthly,
24 fail to keep records that would enable the Commissioner to determine whether
25 Respondent had complied with the Escrow Law or with the Commissioner's rules?

26
27 3. Did Respondent, by failing to reconcile its escrow trust bank account monthly,
28 fail to maintain its books in accordance with good business practice?

¹ All references to the Regulations are to title 10 of the California Code of Regulations (hereafter the "Regulations") unless otherwise specified.

1 4. Did Respondent, by failing to reconcile its escrow trust bank account monthly,
2 improperly use property deposited in escrow?

3
4 5. Should the Order become final?

5
6 6. If the Order should become final, should it, nevertheless, be modified?
7

8 **FACTUAL FINDINGS**

9 10 **BACKGROUND**

11
12 1. Respondent, Escrow Control Company, is an escrow agent licensed by the
13 Department of Corporations pursuant to the Escrow Law, which begins at section 17000
14 of the Financial Code.²

15
16 2. On April 30, 2001, the Commissioner issued an Order to Discontinue
17 Violations Pursuant to Financial Code Section 17602. The Order stated that the
18 Commissioner found that Respondent had "failed to reconcile its escrow trust bank
19 account on a monthly basis." The Order stated, further, that the failure to reconcile was
20 a violation of section 17404 of the Code and sections 1732, 1732.2, and 1738.2 of the
21 Regulations. The Commissioner ordered Respondent to "discontinue the violations set
22 forth above, to include currently reconciling its escrow trust bank account and correcting
23 any adjustments disclosed in such reconciliation, including any escrow account
24 shortages."
25

26 **ONLY ONE FACT IS NECESSARY TO SUPPORT THE ORDER**

27
28 3. On December 7, 2000, the department's examiner called Respondent's

² All references to the Code are to the Financial Code unless otherwise specified.

1 attention to the fact that Respondent's last reconciliation had been for June.

2 Respondent immediately set about to bring its reconciliations current.

3
4 **OTHER FACTS ILLUSTRATE THE CONSEQUENCES OF FAILING TO RECONCILE**

5
6 4. On December 11, 2000, when Respondent completed the reconciliation for
7 July, the reconciliation was off by fourteen cents. Respondent identified that fourteen-
8 cent discrepancy as an unlocated difference. If Respondent had done reconciliations at
9 least once a month, it would have discovered this error no later than the end of August
10 rather than on December 11.

11
12 5. On December 11, 2000, when Respondent completed the reconciliation for
13 August, the reconciliation was off by \$67,378.86. Respondent determined that its bank
14 had mistakenly duplicated a wire transfer. Respondent had instructed its bank to wire
15 transfer \$67,378.86 from its account. The bank, however, mistakenly acted on the
16 instruction twice. If Respondent had done reconciliations at least once a month, it
17 would have discovered this error no later than the end of September rather than on
18 December 11. When Respondent learned of the bank's mistake it immediately used its
19 own funds to replace the missing \$67,378.86.

20
21 6. As established by the department's examiner's undisputed testimony, doing
22 monthly reconciliations results in the preparation of a "bank reconciliation report" on a
23 monthly basis which is kept by the licensee and is used by the department to determine
24 if the licensee is in compliance with the law. If Respondent had done reconciliations at
25 least once a month, the bank reconciliation reports for July, August, September and
26 October of 2000 would have been available for review when the department's examiner
27 first visited Respondent in order to enable the department to determine whether the
28 escrow functions performed by Respondent comply with the Escrow Law and the

1 Commissioner's rules. Further, had these reconciliation records been prepared on a
2 monthly basis, Respondent would have discovered the above mentioned errors several
3 months earlier, rather than on December 11.

4
5 **GOOD BUSINESS PRACTICE**
6

7 7. The department's examiner testified that a failure to reconcile an escrow trust
8 bank account at least once each month constitutes a lack of "sound escrow practice"
9 but that monthly reconciliation is not required by generally accepted accounting
10 principles.

11
12 **GENERAL FINDINGS**
13

14 8. The Commissioner does not suggest that Respondent did anything dishonest.
15 Respondent has been in business since 1973. There have been no known orders
16 against it in the past. It has a net worth substantially in excess of the net worth that is
17 required of an escrow agent. There is no question that Respondent acted responsibly
18 in replacing the missing \$67,378.86 when it discovered the bank's error. It is disturbing,
19 however, that Respondent did not discover that its bank had made a mistake until more
20 than two months after it should have if it had complied with section 1732.2 of the
21 Regulations. The fact that there was a fourteen-cent mistake is neither surprising nor
22 disturbing. Small mistakes do occur. It is disturbing, again, that Respondent did not
23 discover that mistake until more than three months after it should have if it had complied
24 with section 1732.2 of the Regulations.

25
26 **LEGAL CONCLUSIONS**
27

28 1. If the Commissioner determines that a licensed escrow agent has violated the

1 Escrow Law, the Commissioner is required to order the escrow agent to discontinue the
2 violation.³ If the escrow agent requests a hearing, the Commissioner's order does not
3 become final unless it is determined, after a hearing, that it should become final.⁴
4

5 2. By reason of the matters set forth in Finding 3, it is determined that
6 Respondent, in violation of section 1732.2 of the Regulations, failed to reconcile its
7 escrow trust bank account at least once each month. Thus, pursuant to section 17602
8 of the Code, there are grounds to order Respondent to discontinue that violation.
9

10 3. By reason of the matters set forth in Finding 6, it is determined that
11 Respondent, in violation of section 17404 of the Code, failed to keep and use in its
12 business, records which will enable the Commissioner to determine whether the escrow
13 functions performed by the escrow agent comply with the provisions of the Escrow Law
14 and the Commissioner's rules. Although section 17404 of the Code does not
15 specifically require monthly reconciliations, it does require the keeping and use of
16 "records" which will enable the Commissioner to determine whether the escrow agent
17 complies with the Escrow Law and the Commissioner's rules. Since section 1732.2 of
18 the regulations requires an escrow agent to reconcile at least once each month the
19 escrow trust bank account which, as the department's examiner testified, results in the
20 preparation of a "bank reconciliation report" on a monthly basis, there is in fact a record
21 that is generated to show that the reconciliation has been done. Therefore, this bank
22 reconciliation report is a "record" and, as the department's examiner testified, these
23 monthly bank reconciliations are used to help the department to determine if an escrow
24 agent is in compliance with the law. Thus, pursuant to section 17602 of the Code, there
25 are grounds to order Respondent to discontinue that violation.
26

27 4. The Order determined that a failure to reconcile an escrow trust bank account
28 at least once each month is a violation of section 1732 of the Regulations. That section

³ Fin. Code, § 17602.

⁴ Fin. Code, § 17604.

1 requires an escrow agent to "maintain its books ... in accordance with ... good business
2 practice." The department, however, failed to prove that respondent did not "maintain
3 its books ... in accordance with ... good business practice." The department's examiner
4 testified that failing to do monthly reconciliations constitutes a lack of "sound
5 escrow practice" but that monthly reconciliation is not required by generally accepted
6 accounting principles. There was no evidence that "good business practice" requires
7 monthly reconciliation. Further, there was no evidence that the standards are the same
8 for "sound escrow practice" and "good business practice." Thus, the Order should be
9 modified to eliminate the determination that a failure to reconcile at least once each
10 month is a violation of section 1732 of the Regulations.

11
12 5. The Order determined that a failure to reconcile an escrow trust bank account
13 at least once each month is a violation of section 1738.2 of the Regulations. That
14 section provides that an escrow agent shall use "property deposited in escrow only in
15 accordance with the written instructions of the principals..., in accordance with sound
16 escrow practices, or pursuant to ... a court [order]...." The Order, however, found that
17 Respondent failed to do monthly reconciliations. The Order did not find that
18 Respondent misused funds. A failure to do monthly reconciliations can result in a
19 failure to make a timely discovery of a misuse of funds. The failure to reconcile
20 monthly, however, is not itself a misuse of funds. Thus, the Order should be modified to
21 eliminate the determination that a failure to reconcile at least once each month is a
22 violation of section 1738.2 of the Regulations.

23
24 6. Section 1732.2 of the Regulations requires monthly reconciliations of bank
25 accounts in order to reduce the risk that mistakes or fraud can be compounded or
26 repeated and to facilitate the discovery of mistakes or fraud. Thus, while Respondent
27 did nothing dishonest, it frustrated the regulatory scheme by failing to reconcile its
28 accounts monthly. Respondent's violation of section 1732.2 of the Regulations

1 establishes cause for the order under section 17602 of the Code.

2
3 7. The Commissioner is responsible for ensuring consumer protection in its
4 administration of the Escrow Law. In this effort, section 17405 of the Code authorizes
5 the Commissioner to inspect and examine the business, accounts and records of
6 escrow agents at any time and section 17404 of the Code requires escrow agents to
7 keep and use books, accounts and records which would properly enable the
8 Commissioner to determine whether escrow agents are complying with the Escrow Law
9 and the Commissioner's rules. The monthly bank reconciliations required by section
10 1732.2 of the Regulations results in the production of a record of having done a
11 reconciliation for that month, and such records are reviewed by the department's
12 examiners when conducting regulatory examinations on escrow agents. These monthly
13 reconciliation records could reveal errors or mistakes in the escrow trust account or,
14 worse yet, embezzlement or misappropriation of escrow trust funds. If monthly
15 reconciliations are not done, then there would be no reconciliation records available for
16 the department's examiner to review and examine. Thus, failure to prepare and
17 maintain such records frustrates the regulatory scheme for ensuring consumer
18 protection. Respondent's violation of section 17404 of the Code establishes cause for
19 the order under section 17602 of the Code.

20
21 8. The Order directs Respondent to discontinue violations set forth in the Order.
22 There is no finding or determination in the Order that Respondent violated any section
23 of the Code or Regulations requiring an escrow agent to correct adjustments.
24 Nevertheless, the Order directs Respondent to correct adjustments, including escrow
25 account shortages disclosed in reconciliations. Because there is no finding or
26 determination that Respondent violated any section of the Code or Regulations
27 requiring an escrow agent to correct adjustments, the Order should be modified to
28 eliminate the reference to correcting adjustments.

1 **ORDER**

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3 1. The Order is modified to read as follows:

4

5 TO: ESCROW CONTROL COMPANY
6 830 Kiely Blvd., #103
7 Santa Clara, CA 95051

8 THE CALIFORNIA CORPORATIONS COMMISSIONER FINDS THAT:

9

10 ESCROW CONTROL COMPANY, in violation of section 17404 of the
11 Financial Code and section 1732.2 of title 10 of the California Code of
12 Regulations, has failed to reconcile its escrow trust bank account at least
13 once each month.

14

15 NOW, BASED ON THE FOREGOING, AND GOOD CAUSE APPEARING,
16 it is hereby ORDERED, under the provisions of sections 17602 and 17604
17 of the Financial Code, that ESCROW CONTROL COMPANY immediately
18 discontinue the violations set forth above.

19

20 2. As modified, the Order shall become final.

21

22 This Decision shall become effective on Jan 22, 2002.

23 IT IS SO ORDERED.

24 Dated: 1/22/02

25

26 DEMETRIOS A. BOUTRIS
27 California Corporations Commissioner