

BEFORE THE
DEPARTMENT OF BUSINESS OVERSIGHT
STATE OF CALIFORNIA

In the Matter of the Accusation of
THE COMMISSIONER OF BUSINESS
OVERSIGHT,

Complainant,

v.

BUILDERS CONTROL SERVICE CO., and
JOSEPH E. COCHRAN,

Respondents.

File No. 963-0037

OAH No. 2014020568

DECISION

The attached Proposed Decision of the Administrative Law Judge of the Office of Administrative Hearings, dated March 18, 2014, is hereby adopted by the Department of Business Oversight as its Decision in the above-entitled matter.

This Decision shall become effective on May 31, 2014.

IT IS SO ORDERED this 1st day of May, 2014.

COMMISSONER OF BUSINESS OVERSIGHT

/s/
Jan Lynn Owen

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PROPOSED DECISION

Administrative Law Judge Jill Schlichtmann, Office of Administrative Hearings, State of California, heard this matter on March 13, 2014, in Los Angeles, California.

Judy L. Hartley, Senior Corporations Counsel, represented complainant Jan Lynn Owen, Commissioner of Business Oversight.

Joseph E. Cochran represented himself and Builders Control Service Co., and he was present throughout the administrative hearing.

The matter was submitted for decision on March 13, 2014.

FACTUAL FINDINGS

Introduction

1. The Department of Business Oversight¹ (department) is the agency responsible for enforcement of the Escrow Law of California (Financial Code section 17000 et seq.).

¹On July 1, 2013, the Department of Corporations and the Department of Financial Institutions merged to form the Department of Business Oversight in accordance with the

2. Respondent Builders Control Service Co. (Builders) is an escrow agent licensed by the commissioner. Builders has a principal place of business located at 7447 N. Figueroa Street, Suite 305, Los Angeles, California. Builders is a joint fund control company; it holds construction funds in trust and disburses the funds to subcontractors and other parties as a construction project goes forward. Joint control agents such as Builders are regulated under the California Escrow Law pursuant to Financial Code section 17005.6.

3. Respondent Joseph E. Cochran is, and at all times relevant was, the president and a director of Builders, and is the approved manager for Builders.

4. On December 3, 1999, the commissioner commenced a regulatory examination of the books and records of Builders. The regulatory examination disclosed that Builders had taken undisclosed fees from excess funds remaining after construction was completed (dormant escrow funds). Builders was requested to, and did, replace the unauthorized fees found in the 1999 regulatory examination.

5. On January 3, 2002, the commissioner commenced another regulatory examination of the books and records of Builders. The regulatory examination disclosed that between December 1999 and August 22, 2001, Builders had taken as fees dormant escrow funds in at least 12 fund control escrows it handled, totaling \$17,601.77. The unauthorized fees caused a debit balance in the trust account, and violated Financial Code section 17414, subdivision (a)(1). Pursuant to a demand by the commissioner, Builders replaced the unauthorized fees.

6. On September 5, 2002, the commissioner issued an "Order to Discontinue Violations Pursuant to California Financial Code section 17601" against Builders. The order was served on respondents on October 15, 2002, and became final. The order remains in effect.

7. On February 4, 2009, the commissioner commenced a regulatory examination of the books and records of Builders. The examination disclosed that in 2008 Builders had disbursed dormant escrow funds in amount of \$6,219.53 without authorization by canceling five outstanding trust checks, and re-issuing the funds to Builders. The outstanding trust checks that respondents canceled and re-issued to Builders were dated from June 14, 1999, through December 31, 2004.

8. Respondents were instructed on April 24, 2009, to replace \$6,219.53 to the trust account. Respondents complied on May 6, 2009. Respondents were further instructed to escheat the funds to the State Controller as required by the Unclaimed Property Law.²

Governor's reorganization of state departments and agencies to provide services more efficiently and effectively.

² The Unclaimed Property Law can be found at Code of Civil Procedure, section 1500 et seq.

9. On November 2, 2012, the commissioner commenced a regulatory examination of the books and records of Builders. The regulatory examination disclosed that on January 15, 2010, Builders, through Cochran, made four unauthorized disbursements of trust funds to Builders payroll account from three escrows totaling \$6,219.53. The unauthorized disbursements represented dormant escrow funds that should have been escheated to the State Controller pursuant to the Unclaimed Property Law and the commissioner's 2009 instruction. The unauthorized disbursements caused a shortage in the trust account.

10. A review of the payroll account disclosed that the unauthorized disbursement of trust funds were used to make payroll, with Cochran personally receiving \$4,018 of the unauthorized disbursements on January 15, 2010.

11. On March 7, 2013, respondents were instructed to replace the unauthorized disbursements; respondents replaced the funds on March 8, 2013. On March 12, 2013, respondents were again instructed to escheat the dormant trust funds to the State Controller; however, respondents failed to do so.

12. On January 30, 2014, complainant filed a notice of intention to issue an order revoking Builders's escrow agent license, and to bar Cochran from employment, management or control of any escrow agent. Pursuant to Financial Code section 17423, upon receipt of the notice of intention, Cochran was immediately prohibited from engaging in any escrow processing activities, including disbursing any trust funds in his possession or under his custody or control, or disbursing any trust funds on behalf of Builders. Cochran was served with the notice of intention and a letter advising him that he was prohibited from engaging in the above-described activities as of January 31, 2014, at 9:00 a.m.

13. On February 3, 2014, Cochran transferred trust funds totaling more than \$2 million from 16 Builders trust accounts to non-trust accounts owned by Builders's parent company, Insurance/Surety Services, Inc. These transfers violated the January 31, 2014, notice to respondents.

Respondents' Evidence

14. The Builders business model allows for respondents to be compensated by charging fees on a percentage of construction projects. The amount Builders can charge is limited by the competition in the marketplace. In order to earn additional income, Cochran added a clause to the Builders construction control agreements that states:

[Builders] will charge an equivalent of 1/10th of the total control fee per month on any funds remaining on deposit with [Builders] after the project has been completed or has gone dormant for 5 months or longer.

The contract is signed by a Builders representative, the property owner, the lender and the contractor. After funds are dormant for more than five months, Cochran accepts the dormant funds as fees pursuant to this clause. Neither the payee of the checks that have not been cashed, nor the State of California, is a party to the agreement. Cochran erroneously believes that his obligation to escheat the abandoned funds to the State Controller is abrogated by this clause.

15. Cochran admits he made trust fund transfers after receiving the January 31, 2014 notice in violation of Financial Code section 17423; he asserts that the transfers were necessary in order to protect his clients.

LEGAL CONCLUSIONS

Cause to Revoke Builders' License

1. Financial Code section 17608, subdivision (b), provides that the commissioner may suspend or revoke a license upon finding that the licensee has violated any provision of the division or any rule promulgated thereunder.

2. Financial Code section 17414, subdivision (a)(1), provides
It is a violation for any person subject to this division or any director, stockholder, trustee, officer, agent, or employee of any such person to do any of the following:

(1) Knowingly or recklessly disburse or cause the disbursement of escrow funds otherwise than in accordance with escrow instructions, or knowingly or recklessly to direct, participate in, or aid or abet in a material way, any activity which constitutes theft or fraud in connection with any escrow transaction.

3. California Code of Regulations, title 10, section 1738, provides:

All money deposited in [a] "trust" or "escrow" account shall be withdrawn, paid out or transferred to other accounts only in accordance with the written instructions of the principals to the escrow transaction or pursuant to order of a court of competent jurisdiction.

4. California Code of Regulations, title 10, section 1738.1, provides:

An escrow agent shall not withdraw, pay out, or transfer moneys from any particular escrow account in excess of the amount to

the credit of such account at the time of such withdrawal, payment or transfer.

5. California Code of Regulations, title 10, section 1738.2, provides:

An escrow agent shall use documents or other property deposited in escrow only in accordance with the written instructions of the principals to the escrow transaction, or if not otherwise directed by written instructions, in accordance with sound escrow practice, or pursuant to order of a court of competent jurisdiction.

6. Over the course of a decade, respondents repeatedly defied the commissioner's directives to escheat dormant trust funds to the State Controller rather than to transfer the money to the Builders business accounts as fees. Respondents' control agreement cannot override the Unclaimed Property Law, which provides at Code of Civil Procedure section 1520, that such property must escheat to the state. Respondent's agreement with third parties that unclaimed funds will be an additional source of income to Builders is void as a matter of law as contrary to the public policy expressed in the Unclaimed Property law. (*Blue Cross of Northern California v. Cory* (1981) 120 Cal.App.3d 723.) As set forth in Factual Findings 4 through 15, cause for discipline of Builders's license exists pursuant to Financial Code section 17608.

Cause to Bar Cochran

7. Financial Code section 17423 provides in pertinent part:

(a) The commissioner may, after appropriate notice and opportunity for hearing, by order, . . . bar from any position of employment, management, or control any escrow agent, or any other person, if the commissioner finds either of the following:

- (1) That the . . . bar is in the public interest and that the person has committed or caused a violation of this division or rule or order of the commissioner, which violation was either known or should have been known by the person committing or causing it or has caused material damage to the escrow agent or to the public.

8. Cochran has been told repeatedly that he is violating the law when respondents accept dormant trust funds as fees because pursuant to the Unclaimed Property Law those funds must be remitted to the State Controller. Cochran has refused to abide by this law. In addition, respondent has repeatedly refused to follow the commissioner's orders. As a result of Cochran's refusal to follow the law and the orders of the commissioner, despite numerous

warnings, it is in the public interest to bar Cochran from any position of employment, management or control of any escrow agent. (Factual Findings 4 through 15.)

ORDER

1. The escrow agent license of Builders Control Service Co. is revoked.
2. Joseph E. Cochran is barred from any position of employment, management, or control of any escrow agent.

DATED: March 18, 2014

JILL SCHLICHTMANN
Administrative Law Judge
Office of Administrative Hearings