IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON
IN AND FOR THE COUNTY OF THURSTON

NATIONSCAPITAL MORTGAGE CORP, JAMIE CHISICK, MICHAEL BUFF, KEVIN KRAUS & DARREN WILLIAMS, Petitioners, vs. STATE OF WASHINGTON DEPARTMENT OF FINANCIAL INSTITUTIONS & SCOTT JOHNSON, Respondents.	SUPERIOR COURT NO. 03-2-00353-8

ALR HEARING BEFORE THE HONORABLE RICHARD D. HICKS,
DEPARTMENT 5

June 25, 2004
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Olympia, Washington

COPY

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THE COURT: I've made some preliminary notes which I'll share, and I'll probably have to pause and reflect a little bit. Petitioner is a former mortgage broker in the state of Washington which began business here in May of 1995, and in April, May or June of 1997 DFI initiated an investigation after receiving complaints. Apparently earlier there had been five complaints successfully resolved, but in April 1997 Salic filed a complaint and in May 1997 Prater filed a complaint, and these two complaints triggered a very thorough and comprehensive investigation.

Then on May 13th, 1998 DFI issued a statement of charges and signaled an intention to revoke the petitioner's license, impose fines, make restitution and so on. The petitioner then avers that they voluntarily surrendered their license in May, 1998. The appeal to this court was bifurcated and there are two initial issues.

Petitioners argue that RCW 19.146.235 only allows a compliance examination during the first two years of operation and then only on a sampling basis with no ability to examine all books and records, and subsequent to that initial examination, which must

be commenced within the initial two years of operation, can only make a subsequent investigation in response to a specific complaint, the examination of which must be limited to what is relevant to investigate the specific complaint and not be any broader or enter areas outside the specific complaint.

The petitioners argue the legislature intended only limited investigation of mortgage brokers, unlike those regulated under the Consumer Loan Act, RCW 31.04.145, which allows an investigation for discovering violations at any time, similar to that investigation allowed of escrow agents in RCW 18.44.420 or check cashers which may be investigated at any time under RCW 31.45.100.

They argue that a state agency has only the power it is granted by the legislature and has no inherent powers, citing *All Around Underground versus The Washington State Patrol*, 148 Wn.2d 145 (2002), and that DFI had no power to order restitution to 120 customers who never complained and therefore that order must be reversed.

Second, petitioners argue that acting director Thomson was biased and thus should not have been allowed to select the reviewing officer. In June

2002 Dellwo accepted a temporary appointment as the review officer in this case. Petitioners, however, argue that since Thomson, in their opinion, conceded he was biased in his letter of April 2nd, 2002, that when he confirmed the appointment of Dellwo, which had been earlier made by Bley, the original director, that it was biased. They argue that RCW 34.05.425(7) providing for a substitute when there's been disqualification or bias should be construed to require the replacement to be appointed by someone themselves not subject to disqualification, even though the statute requires such replacement must be made by the appointing authority and that the challenged person, including the appointed replacement, makes the determination whether to step down or not.

Petitioners argue that *Jackstadt v. Washington*, 96 Wn.App. 501 (1999), which they argue allowed a police chief -- but I think it was the Washington State Patrol -- to remove herself for bias to appoint her successor, should be limited to its unique facts. There the bias was in favor of the one under investigation who did not want the chief to disqualify herself.

Petitioners argue that the appearance of fairness

doctrine, like the appearance standard for Caesar's wife, should override the specific statutory direction and upon only a showing that bias might be an influence, not that it actually was.

Finally, even if the admitted bias of Thomson could appoint his own successor Dellwo, they argue it was error not to allow the petitioners to discover on what basis the appointment was made. They argue that this refusal to allow discovery amounts eventually to a denial of due process.

Now, the respondents point out that the petitioners bear the burden of demonstrating DFI's action was invalid under RCW 34.05.570(1) and that they were also substantially prejudiced. DFI argues that the act (Chapter 19.146 RCW) should be construed broadly to promote honesty and fair dealing with the citizenry. They argue that DFI may visit the petitioners' office at any time to investigate a complaint under RCW 19.146.235 and that it is reasonable for DFI to have broad authority to determine the scope of inquiry in this regard. They argue this statute does not limit the scope of inquiry, as argued by the petitioners, but provides for a thorough, in-depth investigation of any complaint.

In reviewing the legislative history, the last paragraph of RCW 19.146.235, in part seized upon by the petitioners here, was added in 1994, and the final bill report instructs that its intent is to allow an examination even without a complaint within the first two years, but it is not a limit on the scope of DFI's investigatory powers. If during a thorough investigation of one complaint other unlawful conduct is discovered or a pattern of unlawful conduct is revealed, even if it's not complained about, particularly because this is an area which the average consumer may not have expertise, that DFI has a duty to call for compliance or sanction for non-compliance.

Insofar as the appointment of Dennis Dellwo, they argue it was lawful and did not violate due process rights or the appearance of fairness. They point out that in our state the Office of Administrative Hearings was created to be an independent hearing agency under RCW 34.12.010, and when a hearing is conducted by another agency, such as it is here, it is with one of OAH's hearing officers. They then say that an agency head may appoint a person to review the initial order of the administrative law judge and enter the final agency order. Here the

ALJ issued the initial order, but Thomson was acting director.

Petitioners even call Thomson as a witness. The previous director, John Bley, had appointed Dellwo as review officer, and so DFI argues that when Thomson became the acting director, he merely reaffirmed the appointment. They argue the *Jackstadt* case is on point here and that the court based its opinion on the APA and particularly at page 509 indicated the substitute must be appointed by the appropriate appointing authority, which is a reference to RCW 34.05.425(7).

DFI also argues that there isn't any evidence that Dellwo is biased in any way. They say that none of the factors in *Ritter versus Board of Commissioners*, 96 Wn.2d 503 (1981) are present here, such as (A) prejudice about the facts or parties, (B) personal bias or (C) an interest where the hearing officer can gain or lose something. Merely speculating that Dellwo may be biased because Thomson confirmed him as Bley's appointment is not sufficient to even test the allegation of bias under DFI's theory. There is a presumption, they point out, that public officers will perform their duties properly, citing *State v. Post*, 118 Wn.2d 596 (1992).

DFI argues that discovery was properly disallowed under the principle of *US v. Morgan*, 313 US 409 (1941) disallowing an inquiry into the thought processes of the quasi-judicial hearing officer. The petitioners come back to reply that a specific complaint cannot trigger an investigation of every single file and record of the company. They again point out that the investigatory statutes for mortgage brokers are different than those for some other consumer lenders or financial entities. Petitioners argue that the legislature only intended a company be subject to a broad review, and then by sample only, during its first two years, and after that period it is immune from any general regulatory investigation and only specific complaints may then be investigated, and then in the most limited manner.

The petitioners submit that DFI's June 24th, 1997 demand -- I take that to mean at the location -- for virtually all records on the day they are said to begin the investigation, that while such demand doesn't explain how this demand will be relevant to any specific investigation, yet is a bold, general compliance inquiry without regard to any specific complaint. The follow-up letter to petitioners'

entire client base on January 16th, 1998, they say, shows the breadth of the investigation before any specific nexus was shown.

Finally, the petitioners again reply that Bley is just as tainted as Thomson and that neither should be able to appoint a hearing officer and for that reason they were at least entitled to discovery on the issue of bias for Dellwo.

That was my understanding of the case prior to the oral arguments being made, and I had further notes, but I don't think I can use my notes any further at this point and have to discard what I was prepared to say earlier.

First, on what I think is the least controversial issue, though perhaps the most emotionally charged, is the issue regarding whether Mr. Dellwo can be appointed by Mr. Thomson or Mr. Bley, and I think the petitioners carry a heavy burden here because of the language in the APA that says quite clearly under RCW 34.05.425(7), "If a substitute is required for an individual who becomes unavailable as a result of disqualification or any other reason, the substitute must" -- and I'll emphasize the word "must" -- "be appointed by the appropriate appointing authority."

There is no provision to apply to the courts or to the governor or someone else to make the appointment. Although I didn't understand the petitioners' written material to clearly ask the court to require that part of the statute unconstitutional, that would be the only way to avoid the effect of that statute it seems to me. It couldn't be more clear.

And there is a case which is directly on point, though I agree with Mr. Roberts that it can be distinguished on its facts, and that's the *Jackstadt* case in which the chief of the State Patrol disqualified herself because she previously represented a trooper who was now going to be the subject of a hearing, and even though the trooper wanted her to stay on and be the hearing officer, she stepped aside, but she also appointed the replacement, and Mr. Roberts says that can be distinguished from the case where the person for whom the hearing is going to be under the scrutiny of the fact-finder doesn't want the disqualified person from making the appointment.

And I think that's a fair distinction, but I don't think that it makes this statute inapplicable. And I would point out that -- although I don't think

any of the counsel argued it, that in this area of administrative law there are very many investigative agencies who also hold the administrative hearings, and during oral argument I asked Mr. Roberts, who was quite candid, about the example of the sheriff who when making an arrest seizes drugs or property, such as cars and houses and real estate, and then the hearing as to whether or not the person gets the property back because it was wrongfully seized or from some other defect of how the process was carried out, gets a hearing in front of the sheriff, the very person who seized the property and wants to keep it. That's just kind of an extreme example.

But there are other examples. This court's had cases where doctors whose licenses were revoked, suspended or put under some encumbrance felt that the hearing officer was biased because it was the same officer who did the investigation when the complaint was made by the patient. There is some example of this in the Department of Revenue if the taxpayer chooses to go to the Board of Tax Appeals, but not necessarily if they bypass that and merely make an appeal through the department because there's two roads they can choose there.

And there is some avoidance of this, for instance

on an environmental decision where you can go to an independent board like the Pollution Control Hearings Board, but I think that the whole purpose for the Office of Administrative Hearings was to address the very danger that Mr. Roberts brings to our attention here, and that is that when someone is invested in making the investigation and has signed their name on the results, there is a natural human nature to stand by the results that you yourself found or were part of finding.

So I think his case would be strong for Thomson, but here he wants it extended further, and that is can a person who perhaps admits they're biased be permitted to appoint someone else, and if they do, should the assumption be that that person too is biased, which I don't think we can make that assumption. If you're the person or entity under investigation, you certainly can't feel very comfortable if someone who's already publically come out and said your actions "shocked the conscience" then is the person who appoints the hearing examiner who's going to review the fact-finder, and as Mr. Roberts pointed out today, not only reviewed and upheld the fact-finder, but extended the fact-finder's findings and increased the amount of

fines and so on. But the issue is does it violate the constitution or is it contrary to the legislative intent?

Clearly it's exactly what the legislature intended because the APA specifically says that when someone is disqualified, the appointing authority must make the replacement. So there's no doubt about what the legislature intended. So the question is did the legislature draft something that's unconstitutional. And I think that's what gets us back to the *Morgan* case.

Mr. Roberts' client is in a difficult position because although I suppose they can do their own investigation, they were denied any opportunity to do discovery. I think Ms. Blado is right that discovery can't be allowed or is not customarily allowed into fact-finders' or judicials' thought processes and so on. But does this amount to a *prima facie* case of bias for the hearing itself when the biased person isn't the one reviewing but has simply made the appointment?

And that's where the *Jackstadt* case I think answers that question for us, unless the Supreme Court is going to distinguish it on the facts by which it can be distinguished, and as argued by

Mr. Roberts, that when a person is disqualified, but the person who's the subject of the hearing wants that person to be the hearing officer, then the statute applies, but if the person doesn't want that person to be the hearing officer, then the statute's unconstitutional, or is somehow not followed by application maybe of a special writ to the Superior Court or something of that nature.

I don't think that I can with integrity make that finding, although the logic of Mr. Roberts' argument it seems to me is unassailable, and at the same time I can't say beyond a reasonable doubt that this whole hearing should be thrown out because Mr. Dellwo was appointed by Mr. Bley and confirmed by Mr. Thomson. Even if I assume *arguendo* that both Bley and Thomson themselves were prejudiced by their involvement or supervision of the investigation into the petitioners' business, there is no nexus like that shown for Dellwo. The only taint he has is that he accepted the appointment by people who arguably were biased. So I would decline to reverse the DFI on that issue.

This other issue regarding the scope of the investigation is very troubling, and this is the part of my notes that I had to discard. But during

the questioning of the oral argument, the colloquy with all counsel, and because of what I'll call boldness of the statements of Mr. Worthy when the Court pressed him on it, it's made me rethink what the legislature must have intended by RCW 19.146.235.

I don't know whether it's useful to say what I'm going to say next or not, but after the written material I was prepared to rule along the lines Mr. Roberts has invited me because -- maybe because I'm an old trial lawyer, I agreed with his line of argument. And his oral argument was, until I encountered Mr. Worthy's candidness, was with integrity, he gave what he had to give, but he held on to his point, and his thinking was exactly the same as mine about -- or maybe mine was a little broader than his, but until the oral argument today it was my position that the first paragraph of Section 235, to have any meaning at all, if it has limitations, those limitations must have some meaning, and we find that although the director or his designee can look in every cupboard and under every desk without exception, all books and records, interview people under oath and so on, that it has to be relevant to the inquiry that's being made, and

that the word "relevant" has to be given some meaning is how it occurred to me, and that's what I wrote.

So I was prepared to say that unless this investigation began in April or May, which would be within the two-year compliance time period and thereby supporting a general investigation as is allowed without any complaint being triggered during the initial two-year period, that then any subsequent investigation made pursuant to a specific complaint might bring DFI into all of the books and records, but that they would have to get there by either seeing something in "plain view" while making an investigation of a specific complaint, or by learning things during the specific complaint, that is inducting information that would logically support later deductions for further extensions of the complaint, and that by those two methods they could follow the trail of an investigation no matter where it took them, even if it took them to every portion without exception of the company's business.

So I didn't see any problem with the scope that way, but I guess to give myself away here, I initially agreed with Mr. Roberts that there had to be a trail. And here the department has conceded,

that is DFI has conceded that they didn't follow any trail, that the all-encompassing notice was actually sent and signed at least on June 23rd before they learned some alarming facts, such as the books and records were not being kept in Washington but were all in California. That fact alone it seems to me would have opened up a total investigation of the entire business. But they concede that they didn't know that at the time on June 23rd, that they issued that order and demand for production and they didn't learn that till the following day when they went out to serve it and there was nothing there for them to review.

So the facts couldn't be more clear and precise that they were not following a trail, and Mr. Worthy concedes that. His position, and representing his client, is that if you look at what the legislature intended, not necessarily by what they defined in Section .010, but in the initial section, I think it's .005, that they intended mortgage brokers to be subject to broad regulatory authority for the protection of the citizenry and that this section, even with the 1994 amendment, was not intended to offer them some sort of protection but that it was always the legislature's intent that for good

cause -- and good cause in this case means if a complaint's made that appears not to be frivolous. And the word "frivolous" is my language, but if there's a complaint made that they can from the get-go, if the director deems it relevant, ask for everything.

So it comes down to a very stark issue, and every once in a while I guess I get in this awkward position, but the way I see this now is conflicting because I agree with the argument of Mr. Roberts, but I believe the Supreme Court or the Court of Appeals will agree with Mr. Worthy that the agency has the right with mortgage brokers to -- if there's a complaint that's triggered, to look under every pebble and every nook and cranny of the business. I think that's what's intended here, and I think I'd be reversed if I ruled differently.

But I'll be interested to see how the Court of Appeals or the Supreme Court -- that is I hope they will address this -- how they handle this phrase "deems relevant to the inquiry." Because if it means the meaning I'm now giving it based on Mr. Worthy's argument, that the director from the get-go can request absolutely everything without the showing of any relevance of it to the inquiry, why

is that language in there?

And so before coming out here I was prepared to say they could follow the trail and get to every place, but it has to start with some technique or fact that's relevant to the inquiry. But after re-reading, during the break, the first half of this first paragraph, I'm now convinced that if there is a complaint, then the mortgage brokers' doors are open for as much investigation as the department wants to undertake and that the director has discretion to say I find everything relevant, which in a sense means what does the word "relevant" mean if everything can be relevant?

So it leaves me uncomfortable, but I think this is the answer that's going to be upheld by the higher court because of the overall purpose of this statute, which is to protect the citizens and to make sure that mortgage brokers' actions are clean and transparent insofar as the people they're dealing with, even though they might have a right to keep business secrets from competitors, but that they be regulated insofar as they deal with the general citizenry in a way that makes them vulnerable to this type of very intrusive and all-encompassing investigation, if it's triggered by

a complaint.

I just cannot get it out of my mind that that is what the legislature intended here, even though the logic of Mr. Roberts' argument I think is very persuasive. It's where I first went, but it's not where I end up. So I'm sorry to make it confusing by these remarks, but I guess I have to have the integrity to say I think that's what the legislature intended here, even though I don't know how they're going to deal with Mr. Roberts' argument at the higher court. I would not intentionally make a wrong decision, and maybe I'll be reversed, but I do think this is how this is going to end up. So that's as far as I can go.

I'll sign an appropriate order if one's required for this part of the case.

(A recess was taken.)

CERTIFICATE OF REPORTER

STATE OF WASHINGTON)
) ss.
COUNTY OF THURSTON)

I, RALPH H. BESWICK, CCR, Official Reporter of the Superior Court of the State of Washington in and for the County of Thurston do hereby certify:

That I was authorized to and did stenographically report the foregoing proceedings held in the above-entitled matter as designated by Counsel to be included in the transcript and that the transcript is a true and complete record of my stenographic notes.

Dated this 20th day of August, 2004.

RALPH H. BESWICK, CCR
Official Court Reporter
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