CALIFORNIA DEPARTMENT OF
Mental Health

1600 9th Street, Sacramento, CA 95814
(916) 654-3551

February 19, 2009

Camille Shelton
Chief Legal Counsel
Commission on State Mandates
980 9th Street
Suite 300
Sacramento, CA 95814

Dear Ms. Shelton:

The Department of Mental Health (DMH) requests clarification on reimbursable activities under the *Handicapped and Disabled Students (HDS)* (04-RL-4282-10), *Handicapped and Disabled Students II (HDS II)* (02-TC-40/02-TC-49), and *Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services* (97-TC-05) consolidated program. Specifically, DMH seeks clarification on the Commission on State Mandate's (Commission) basis for excluding rehabilitation as a mental health service eligible for reimbursement through the *HDS, HDS II, and SED Pupils: Out-of-State Mental Health Services* consolidated program.

In February 2005, Los Angeles County Department of Mental Health (County) submitted a declaration to the Commission after reviewing a January 20, 2005 Commission Staff Analysis regarding a Reconsideration of the *HDS Program* (04-RL-4284-10)[1]. In that declaration, the County asserted that "Rehabilitation", as defined in Section 1810.243 of Title 9 of the California Code of Regulations[2], should be included in the array of mental health services available to children served through the *HDS Program*[3].

On May 26, 2005, the Commission on State Mandates issued a Final Staff Analysis that addressed the County's assertion. In footnote #103, beginning on page SA-39 of the Final Staff Analysis, Commission Staff disagreed with the County's request. In part, footnote #103 reads:

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[1] The HDS Program (04-RL-4284-10) was consolidated with the HDS II Program (02-TC-40/02-TC-49) and the Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services (97-TC-05) commencing in Fiscal Year 2006-07.

[2] Section 1810.243 of Title 9 of the California Code of Regulations defines Rehabilitation as a "service activity which includes assistance in improving, maintaining, or restoring a beneficiary's or group of beneficiaries' functional skills, daily living skills, social and leisure skills, grooming and personal hygiene skills, meal preparation skills, and support resources and/or medication education"

[3] The *HDS, HDS II*, and *SED Pupils: Out-of-State Mental Health Services* consolidated program is also known as the "AB 3632" or "Chapter 26.5" program.

> "...The plain language of test claim regulations (Cal. Code Regs., tit. 2, §§ 60000 et seq.) does not require or mandate counties to perform the activities defined by section 1810.243 of the Department's title 9 regulations. In addition, the test claim regulations do not reference section 1810.243 of the Department's title 9 regulations for any definition relevant to the program at issue in this case."

On October 26, 2006, the Commission on State Mandates adopted Consolidated Parameters and Guidelines for the *HDS*, *HDS II*, and *SED Pupils: Out-of-State Mental Health Services* consolidated program, which identifies reimbursable activities under this program. However, the Parameters and Guidelines do not specifically exclude rehabilitation, as a mental health service, from the list of reimbursable activities. Page 9 of the Parameters and Guidelines states "*When providing psychotherapy or other mental health services, the activities of crisis intervention, vocational services, and socialization services are not reimbursable*" but makes no mention of rehabilitation. Rehabilitation services are also not mentioned in the list of mental health services eligible for reimbursement. However, DMH questions the need to specifically identify rehabilitation as a particular type of mental health service allowable under this program. Pursuant to the Final Statement of Reasons for Section 1810.243 of Title 9 of the California Code of Regulations, rehabilitation is an essential component of many mental health services.

Based on the above information, DMH seeks clarification on the Commission's basis for excluding rehabilitation as a mental health service eligible for reimbursement through the *HDS, HDS II, and SED Pupils: Out-of-State Mental Health Services* consolidated program.

To discuss this issue further, please contact me at (916) 654-3551. We appreciate your cooperation and look forward to your timely response.

Sincerely,

Denise M. Arend

DENISE M. AREND
Deputy Director
Community Services Division

cc: Stan Bajorin, Acting Chief Deputy, Department of Mental Health
Mark Heilman, Policy Advisor, Community Services Division
Sophie Cabrera, Branch Chief, Local Program Support
Barbara Marquez, Branch Chief, State Level Programs

58 Cal.App.3d 340, 129 Cal.Rptr. 824, 22 Wage & Hour Cas. (BNA) 1045
(Cite as: 58 Cal.App.3d 340, 129 Cal.Rptr. 824)

Court of Appeal, First District, Division 4, California.
CALIFORNIA STATE RESTAURANT ASSOCIATION, a non-profit California Corporation, Plaintiff and Respondent,
v.
Evelyn E. WHITLOW, Chief, etc., Defendant and Appellant.

Civ. 38010.
May 17, 1976.
Hearing Denied July 15, 1976.

State Restaurant Association filed petition for writ of mandate to restrain chief of the Division of Industrial Welfare from putting into operation new policy prohibiting employers in restaurant industry from taking a credit for value of meals furnished employees against minimum wage otherwise payable without specific written consent of employee. The Superior Court, City and County of San Francisco, Ira A. Brown, Jr., J., granted peremptory writ of mandate, and defendant appealed. The Court of Appeal, Caldecott, P.J., held that implied power of Welfare Industrial Commission to authorize employers in restaurant industry to take a credit for meals furnished to employees against minimum wage otherwise due employees would be limited to situations in which such manner of payment was authorized by specific and prior voluntary employee consent.

Reversed with directions.

West Headnotes

[1] Administrative Law and Procedure 15A 412.1

15A Administrative Law and Procedure
15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
15AIV(C) Rules and **Regulations**
15Ak412 Construction
15Ak412.1 k. In General. Most Cited Cases
(Formerly 15Ak412)

Generally, same **rules** of **construction** and interpretation which **apply** to **statutes** govern interpretation of rules and **regulations** of administrative agencies.

[2] Labor and Employment 231H 2350(1)

231H Labor and Employment
231HXIII Wages and Hours
231HXIII(B) Minimum Wages and Overtime Pay
231HXIII(B)5 Administrative Powers and Proceedings
231Hk2344 Proceedings
231Hk2350 Orders
231Hk2350(1) k. In General. Most Cited Cases
(Formerly 232Ak1443.1, 232Ak1443 Labor Relations)

The Industrial Welfare Commission acts as quasi-legislative body in promulgating minimum wage orders. West's Ann.Labor Code, § 1182.

[3] Administrative Law and Procedure 15A 412.1

15A Administrative Law and Procedure
15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
15AIV(C) Rules and **Regulations**
15Ak412 Construction
15Ak412.1 k. In General. Most Cited Cases
(Formerly 15Ak412)

Statutes 361 184

361 **Statutes**
361VI Construction and Operation
361VI(A) General **Rules** of **Construction**
361k180 Intention of Legislature
361k184 k. Policy and Purpose of Act. Most Cited Cases

Cardinal **rule** of **construction** is that court should ascertain intent of promulgating body so as to effec-

58 Cal.App.3d 340, 129 Cal.Rptr. 824, 22 Wage & Hour Cas. (BNA) 1045
(Cite as: 58 Cal.App.3d 340, 129 Cal.Rptr. 824)

tuate intended purpose of **statute** or **regulation**; such rule has been extended to construction of administrative **regulations**. West's Ann.Code Civ.Proc. § 1859.

[4] Statutes 361 219(1)

361 **Statutes**
361VI Construction and Operation
361VI(A) General **Rules** of **Construction**
361k213 Extrinsic Aids to Construction
361k219 Executive Construction
361k219(1) k. In General. Most Cited Cases

Reenactment of a provision which has a meaning well established by administrative construction is persuasive evidence that intent of enacting authority was to continue same construction previously applied.

[5] Labor and Employment 231H 2350(3)

231H Labor and Employment
231HXIII Wages and Hours
231HXIII(B) Minimum Wages and Overtime Pay
231HXIII(B)5 Administrative Powers and Proceedings
231Hk2344 Proceedings
231Hk2350 Orders
231Hk2350(3) k. Construction and Operation. Most Cited Cases
(Formerly 232Ak1444 Labor Relations)

Where well-known and documented interpretation and application of Industrial Welfare Commission's minimum wage order authorized employers in restaurant industry to take a credit for meals furnished to employees against minimum wage otherwise due employees without specific written consent of such employees, and Commission reenacted such order in substantially same form, former interpretation of such order remained in effect so as to allow meal credit deductions without employee consent.

[6] Administrative Law and Procedure 15A 303.1

15A Administrative Law and Procedure
15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
15AIV(A) In General
15Ak303 Powers in General
15Ak303.1 k. In General. Most Cited Cases
(Formerly 15Ak303)

Officers and Public Employees 283 103

283 Officers and Public Employees
283III Rights, Powers, Duties, and Liabilities
283k102 Authority and Powers
283k103 k. In General. Most Cited Cases
(Formerly 283k3)

Administrative bodies and officers have only such powers as have expressly or impliedly been conferred upon them by constitution or by statute.

[7] Administrative Law and Procedure 15A 390.1

15A Administrative Law and Procedure
15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
15AIV(C) Rules and Regulations
15Ak390 Validity
15Ak390.1 k. In General. Most Cited Cases
(Formerly 15Ak211)

Constitutional Law 92 2621

92 Constitutional Law
92XX Separation of Powers
92XX(D) Executive Powers and Functions
92k2621 k. Encroachment on Legislature. Most Cited Cases
(Formerly 92k77, 15Ak211)

In absence of valid statutory or constitutional authority, administrative agency may not, under guise of **regulation**, substitute its judgment for that of legislature; administrative **regulations** in conflict with applicable **statutes** are null and void.

[8] Statutes 361 188

361 **Statutes**
361VI Construction and Operation
361VI(A) General **Rules** of **Construction**

58 Cal.App.3d 340, 129 Cal.Rptr. 824, 22 Wage & Hour Cas. (BNA) 1045
(Cite as: 58 Cal.App.3d 340, 129 Cal.Rptr. 824)

361k187 Meaning of Language
361k188 k. In General. Most Cited Cases

In order that legislative intent be given effect, **statute** should be construed with due regard for ordinary meaning of language used and in harmony with whole system of law of which it is a part.

[9] Statutes 361 ⚿236

361 **Statutes**
361VI Construction and Operation
361VI(B) Particular Classes of **Statutes**
361k236 k. Remedial **Statutes**. Most Cited Cases

A remedial **statute** must be liberally construed so as to effectuate its object and purpose, and to suppress mischief at which it is directed.

[10] Statutes 361 ⚿223.1

361 **Statutes**
361VI Construction and Operation
361VI(A) General **Rules** of **Construction**
361k223 Construction with Reference to Other **Statutes**
361k223.1 k. In General. Most Cited Cases

Statutes governing promulgation of minimum wage order and reconsideration of such order must be construed in harmony with **statute** prohibiting employer from coercing employee to patronize employer in purchase of anything of value, so as to carry out fundamental legislative purpose of entire Labor Code. West's Ann.Labor Code, §§ 450, 1182, 1184.

[11] Labor and Employment 231H ⚿2350(3)

231H Labor and Employment
231HXIII Wages and Hours
231HXIII(B) Minimum Wages and Overtime Pay
231HXIII(B)5 Administrative Powers and Proceedings
231Hk2344 Proceedings
231Hk2350 Orders
231Hk2350(3) k. Construction and Operation. Most Cited Cases
(Formerly 232Ak1444 Labor Relations)

In light of statute prohibiting employer from coercing employee to patronize employer in purchase of anything of value, implied power of Industrial Welfare Commission to authorize employers in restaurant industry to take a credit for meals furnished to employees against minimum wage otherwise due employees would be limited to situations in which such manner of payment was authorized by specific and prior voluntary employee consent. West's Ann.Labor Code, §§ 450, 1182, 1184, 1197.

****825 *343** Hawkins, Cooper, Pecherer & Ludvigson, Daryl R. Hawkins, M. Armon Cooper, San Francisco, for plaintiff and respondent.

Evelle J. Younger, Atty. Gen., State of Cal., Gordon Zame, Deputy Atty. Gen., San Francisco, for defendant and appellant.

CALDECOTT, Presiding Justice.

The issue presented on this appeal is whether Labor Code section 450 prohibits an employer in the restaurant industry from requiring a minimum wage employee to take meals as part of his compensation and have the value of the meals deducted from the minimum wage without the written consent of the employee. We conclude that such action is prohibited.

On August 26 1974, appellant Evelyn Whitlow,[FN1] as Chief of the Division of Industrial Welfare, Department of Industrial Relations for the State of California, announced her intention to institute a 'new policy' regarding certain provisions of the then current Minimum Wage Order of the Industrial Welfare Commission.

FN1. The writ of mandate issued by the trial court was directed to Whitlow, who is hereinafter described as 'appellant' although the agency itself is also a named party and appellant.

Section 4 of Minimum Wage Order No. 1-74 allowed employers in the restaurant industry to take a credit for the value of meals furnished employees against the minimum wage otherwise payable. The 'new policy' set forth in a document entitled 'Meal

Policy for Restaurants Only,' inter alia, prohibited a credit against the minimum wage for the dollar value of meals furnished without the Specific written consent of the employee. It further provided that such consent could be revoked at the beginning of each month. This new policy was based on appellant's determination that the current construction of section 4 of Order No. 1-74 was in violation of section 450 of the Labor Code.

Respondent California State Restaurant Association filed a petition for a writ of mandate to, in effect, restrain the appellant from putting the 'new policy' into operation. The trial court entered judgment granting a ***344** peremptory writ of mandate in favor of respondent. The appeal[FN2] is from the judgment.

> FN2. Appellant in her brief has limited her appeal to that portion of the judgment enjoining enforcement of appellant's 'New Policy' of requiring prior revocable employee consent to meal credit deductions from the cash minimum wage.

I

The court below concluded that section 4 of Minimum Wage Order No. 1-74 'authorizes employers in the restaurant industry to take a credit . . . for meals furnished or resonably made available to ****826** employees without the specific written consent of such employees to have the value of such specific meals credited by employers against the minimum wage otherwise due the employees . . ..' Because the appellant's 'new policy' would thus constitute an amendment to the order, the court held that it was beyond the scope of her authority, as only the Industrial Welfare Commission has the power to adopt or change a minimum wage order. (Lab.Code, s 1182.)

Appellant contends that the wage order is silent on the issue of consent to meal credit deductions, and that there has been no administrative interpretation of the regulation to the effect that such deductions are authorized in the absence of employee consent. Thus, appellant argues, the policy statement was within the authority of the Division of Industrial Welfare to take all proceedings necessary to enforce minimum wage **regulations** in accordance with the law, specifically, the prohibitions of Labor Code section 450. (Lab.Code, ss 59, 61, 1195.)

[1][2][3] Generally, the same **rules** of **construction** and interpretation which **apply** to **statutes** govern the interpretation of rules and **regulations** of administrative agencies. (Cal. Drive-In Restaurant Assn. v. Clark, 22 Cal.2d 287, 292, 140 P.2d 657; Intoximeters, Inc. v. Younger, 53 Cal.App.3d 262, 270, 125 Cal.Rptr. 864.) The Industrial Welfare Commission acts as a quasi-legislative body in promulgating minimum wage orders. (Rivera v. Division of Industrial Welfare, 265 Cal.App.2d 576, 586, 71 Cal.Rptr. 739.) Of course, the cardinal **rule** of **construction** is that the court should ascertain the intent of the promulgating body so as to effectuate the intended purpose of the **statute** or **regulation**. (East Bay Garbage Co. v. Washington Township Sanitation Co., 52 Cal.2d 708, 713; California Sch. Employees Assn. v. Jefferson Elementary Sch. Dist., 45 Cal.App.3d 683, 691; Code Civ.Proc., s 1859.) This rule has been extended to ***345** construction of administrative regulations. (Cal. Drive-In Restaurant Assn. v. Clark, supra.)

[4] Thus, the commission's intent is the most significant factor in interpretation of its wage order. In reaching the conclusion that meal credit deductions without employee consent are authorized by section 4 of Order No. 1-74, the trial court properly relied on two additional principles of construction. First 'contemporaneous administrative construction of a statute by an administrative agency charged with its enforcement and interpretation is entitled to great weight unless it is clearly erroneous or unauthorized.' (Rivera v. City of Fresno, 6 Cal.3d 132, 140, 98 Cal.Rptr. 281, 285, 490 P.2d 793, 797.) Second, reenactment of a provision which has a meaning well-established by administrative construction is persuasive evidence that the intent of the enacting authority was to continue the same construction previously applied. (Cooper v. Swoap, 11 Cal.3d 856, 868, 115 Cal.Rptr. 1, 524 P.2d 97; Cal. M. Express. v. St. Bd. of Equalization, 133 Cal.App.2d 237, 239-240, 283 P.2d 1063.)

[5] Appellant urges that there was no administrative construction of the prior wage orders, but only an interpretation by the restaurant industry. The record belies this assertion. Since 1952, every minimum wage order relating to the restaurant industry has specified that 'when meals are furnished by the employer As a part of the minimum wage, they may not be evaluated in excess of the following (cash equivalents) . . ..' (Emphasis added.) Since at least 1944, it

has been the open and recognized practice of the restaurant industry for employers to take a meal credit against the minimum wage without employee consent. Division of Industrial Welfare 'Policy' statements prior to the appellant's 1974 notice make no reference to any requirement of employee consent. Moreover, the commission considered a proposal that Wage Order No. 1-74 expressly requires employee consent to such meal credits, but this was written out of the **827 final version of the order. Just as '(t)he sweep of the statute should not be enlarged by insertion of language which the Legislature had overtly left out' (People v. Brannon, 32 Cal.App.3d 971, 977, 108 Cal.Rptr. 620, 624), so the wage order should not be interpreted as including a limitation declined by the commission. In the face of a well-known and documented interpretation and application of the regulation over many years, the commission ratified that construction by reenacting the regulation in substantially the same form, without substantive change.

*346 This interpretation was thus properly accepted by the trial court as authoritatively intended by the commission in Wage Order No. 1-74. However, this is not dispositive of the matter, for it is clear that the administrative regulation, as interpreted, must not conflict with applicable state laws; to the extent that it does so conflict, the regulation is void.

II

Appellant contends that the meal credit provision of Order No. 1-74, as construed, violates Labor Code section 450, which provides: 'No employer, or agent or officer thereof, or other person, shall compel or coerce any employee, or applicant for employment, to patronize his employer, or any other person, in the purchase of any thing of value.'

Respondent argues that the meal credit provision does not permit an employer to 'compel or coerce' an employee to 'purchase' a meal within the meaning of section 450, but rather merely authorizes the employer to reduce his Cash minimum wage obligation by part payment 'in kind.' Thus, respondent contends, the meal credit against the minimum wage otherwise payable is not a 'purchase' within section 450, but is instead a partial fulfillment of the employer's minimum wage obligation; where a meal is provided an employee is not entitled to the higher cash minimum wage. Respondent urges that under Labor Code sections 1182 and 1184,[FN3] the Industrial Welfare Commission has an implied power to authorize in kind payment of wages without employee consent to such manner of payment, and the wage order as construed is a valid exercise of such authority.

FN3. Section 1182 provides in pertinent part:

'After the wage board conference and public hearing, as provided in this chapter, the commission may, upon its own motion or upon petition, fix:

'(a) A minimum wage to be paid to employees engaged in any occupation, trade, or industry in this state, which shall not be less than a wage adequate to supply the necessary costs of proper living to, and maintain the health and welfare of such employees.'

Section 1184 provides:

'After an order has been promulgated by the commission making wages . . . mandatory in any occupation, trade, or industry, the commission may at any time upon its own motion, or upon petition of employers or employees reconsider such order for the purpose of altering, amending, or rescinding such order of any portion thereof. For this purpose the commission shall proceed in the same manner as prescribed for an original order. Such altered or amended order shall have the same effect as the original order.'

[6][7] Administrative bodies and officers have only such powers as have expressly or impliedly been conferred upon them by the Constitution or *347 by statute. (Ferdig v. State Personnel Bd., 71 Cal.2d 96, 103, 77 Cal.Rptr. 224, 453 P.2d 728.) In the absence of valid statutory or constitutional authority, an administrative agency may not, under the guise of regulation, substitute its judgment for that of the Legislature. Administrative regulations in conflict with applicable statutes are null and void. (Harris v. Alcoholic Bev. Etc. Appeals Bd., 228 Cal.App.2d 1, 6, 39 Cal.Rptr. 192; Hodge v. McCall, 185 Cal. 330, 334, 197 P. 86.)

[8][9] Certain additional principles of construction are helpful to resolution of this controversy. In

order that legislative intent be given effect, a statute should be construed with due regard for the ordinary meaning of the language used and in harmony**828 with the whole system of law of which it is a part. (Anaheim Union Water Co. v. Franchise Tax Bd., 26 Cal.App.3d 95, 106, 102 Cal.Rptr. 692.) A remedial statute must be liberally construed so as to effectuate its object and purpose, and to suppress the mischief at which it is directed. (City of San Jose v. Forsythe, 261 Cal.App.2d 114, 117, 67 Cal.Prtr. 754; Lande v. Jurisich, 59 Cal.App.2d 613, 616-617, 139 P.2d 657.)

Section 450 manifests a legislative intent to protect wage earners against employer coercion to purchase products or services from the employer. In the context of the present case, that section is plainly part of 'the established policy of our Legislature of protecting and promoting the right of a wage earner to all wages lawfully accrued to him.' (City of Ukiah v. Fones, 64 Cal.2d 104, 108, 48 Cal.Rptr. 865, 867, 410 P.2d 369, 371.) The Legislature evidently determined 'that the evil thus to be guarded against was sufficiently prevalent to call for legislative action, and the remedy ought not to be defeated by judicial construction if that result can reasonably be avoided.' (Lande v. Jurisich, supra, 59 Cal.App.2d at p. 617, 139 P.2d at p. 659.)

While it may be argued that 'in kind' payment of wages is not technically or narrowly speaking a 'compelled purchase,' there is no perceptible practical difference between the two. Where an employee is not allowed the choice between cash and in kind payment, but rather is forced to accept goods or services from his employer in lieu of cash as part of the minimum wage, the same mathematical result obtains as if the employer had paid the wages in cash with the condition that the employee spend with the employer an amount equal to the allowable credit (here, on a meal) at the end of each shift. This latter practice unquestionably violates section 450. Employers cannot be permitted to evade the salutary objectives of the statute by indirection.

***348** [10][11] Moreover, sections 1182 and 1184, urged by respondent in support of its contentions, are similarly subject to the rule of liberal construction of remedial legislation. (California Grape Etc. League v. Industrial Welfare Com., 268 Cal.App.2d 692, 698, 74 Cal.Rptr. 313.) Additionally, the statutes must be construed in harmony with section 450, so as to carry out the fundamental legislative purposes of the whole act. (Earl Ranch, Ltd. v. Industrial Acc. Com., 4 Cal.2d 767, 769, 53 P.2d 154; Moyer v. Workmen's Comp. Appeals Bd., 10 Cal.3d 222, 230, 110 Cal.Rptr. 144, 514 P.2d 1224.) In light of the prohibition against compelled purchases in section 450, the implied power of the commission to authorize in kind payments must be limited to situations in which such manner of payment is authorized by specific and prior voluntary employee consent. This limitation is consistent with the strong public policy favoring full payment of minimum wages, which the Legislature has effectuated by making payment of less than the minimum wage unlawful. (Lab.Code, s 1197.)

The judgment is reversed with directions to the trial court to deny the petition for writ of mandate.

RATTIGAN and CHRISTIAN, JJ., concur.

Cal.App. 1976.
California State Restaurant Assn. v. Whitlow
58 Cal.App.3d 340, 129 Cal.Rptr. 824, 22 Wage & Hour Cas. (BNA) 1045

END OF DOCUMENT

526 U.S. 66, 119 S.Ct. 992, 161 A.L.R. Fed. 683, 143 L.Ed.2d 154, 67 USLW 4165, 132 Ed. Law Rep. 40, 99 Cal. Daily Op. Serv. 1582, 1999 Daily Journal D.A.R. 2029, 1999 CJ C.A.R. 1126, 12 Fla. L. Weekly Fed. S 129
(Cite as: 526 U.S. 66, 119 S.Ct. 992)

Supreme Court of the United States
CEDAR RAPIDS COMMUNITY SCHOOL DISTRICT, Petitioner,
v.
GARRET F., a Minor By His Mother and Next Friend, CHARLENE F.

No. 96-1793.
Argued Nov. 4, 1998.
Decided March 3, 1999.

School district brought action challenging administrative determination that district was required to provide continuous nursing services to quadriplegic student under Individuals with Disabilities Education Act (IDEA). The United States District Court for the Northern District of Iowa, Edward J. McManus, J., granted summary judgment for student, and district appealed. The United States Court of Appeals for the Eighth Circuit, 106 F.3d 822, affirmed. Petition for writ of certiorari was granted. The Supreme Court, Justice Stevens, held that continuous nursing service was "related service" that district was required to provide under IDEA, abrogating *Neely*, 68 F.3d 965 and *Detsel*, 820 F.2d 587.

Affirmed.

Justice Thomas filed dissenting opinion in which Justice Kennedy joined.

West Headnotes

[1] Schools 345 148(4)

345 Schools
345II Public Schools
345II(L) Pupils
345k148 Nature of Right to Instruction in General
345k148(2) Handicapped Children and Special Services Therefor
345k148(4) k. Medical Services. Most Cited Cases

Continuous nursing services required by quadriplegic, ventilator-dependent student were "related services" that had to be provided by school district during school hours, under Individuals with Disabilities Education Act (IDEA), because such services were supportive services but did not constitute medical services. Individuals with Disabilities Education Act, § 602(a)(17), as amended, 20 U.S.C.A. § 1401(a)(17); 34 C.F.R. § 300.16(b)(4).

[2] Schools 345 148(2.1)

345 Schools
345II Public Schools
345II(L) Pupils
345k148 Nature of Right to Instruction in General
345k148(2) Handicapped Children and Special Services Therefor
345k148(2.1) k. In General. Most Cited Cases

As a general matter, services that enable a disabled child to remain in school during the day provide the student with the meaningful access to education that Congress envisioned under the Individuals with Disabilities Education Act (IDEA). Individuals with Disabilities Education Act, § 601 et seq., as amended, 20 U.S.C.A. § 1400 et seq.

[3] Schools 345 148(4)

345 Schools
345II Public Schools
345II(L) Pupils
345k148 Nature of Right to Instruction in General
345k148(2) Handicapped Children and Special Services Therefor
345k148(4) k. Medical Services. Most Cited Cases

The phrase "medical services," as excepted from Individuals with Disabilities Education Act (IDEA) definition of related services that must be provided to disabled child by school district, does not embrace all forms of care that might loosely be described as medical in other contexts, such as a claim for an in-

come tax deduction, but refers to those services that must be performed by a physician. Individuals with Disabilities Education Act, § 602(a)(17), as amended, 20 U.S.C.A. § 1401(a)(17); 26 U.S.C.A. § 213(d)(1); 34 C.F.R. § 300.16(b)(4).

[4] Schools 345 148(4)

345 Schools
345II Public Schools
345II(L) Pupils
345k148 Nature of Right to Instruction in General
345k148(2) Handicapped Children and Special Services Therefor
345k148(4) k. Medical Services. Most Cited Cases

Factors such as nature and cost of particular service requested by disabled child are not determinative as to whether that service is "medical service" excluded from statutory definition of "related service" that must be provided under Individuals with Disabilities Education Act (IDEA); abrogating *Neely v. Rutherford County School*, 68 F.3d 965, *Detsel v. Board of Ed. of Auburn Enlarged City School Dist.*, 820 F.2d 587. Individuals with Disabilities Education Act, § 602(a)(17), as amended, 20 U.S.C.A. § 1401(a)(17); 34 C.F.R. § 300.16(b)(4).

[5] Schools 345 148(2.1)

345 Schools
345II Public Schools
345II(L) Pupils
345k148 Nature of Right to Instruction in General
345k148(2) Handicapped Children and Special Services Therefor
345k148(2.1) k. In General. Most Cited Cases

Schools 345 154(2.1)

345 Schools
345II Public Schools
345II(L) Pupils
345k149 Eligibility
345k154 Assignment or Admission to Particular Schools
345k154(2) Handicapped Children
345k154(2.1) k. In General. Most Cited Cases

Although Individuals with Disabilities Education Act (IDEA) may not require public schools to maximize the potential of disabled students commensurate with opportunities provided to other children, and potential financial burdens imposed on participating states may be relevant to arriving at sensible construction of IDEA, Congress intended to open the door of public education to all qualified children and required participating states to educate handicapped children with nonhandicapped children whenever possible. Individuals with Disabilities Education Act, § 612(1), (2)(C), (5)(B), as amended, 20 U.S.C.A. § 1412(1), (2)(C), (5)(B).

*****993 Syllabus*** [FN*]

FN* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

To help "assure that all children with disabilities have available to them ... a free appropriate public education which emphasizes special education and related services designed to meet their unique needs," 20 U.S.C. § 1400(c), the Individuals with Disabilities Education Act (IDEA) authorizes federal financial assistance to States that agree to provide such children with special education and "related services," as defined in § 1401(a)(17). Respondent Garret F., a student in petitioner school district (District), is wheelchair-bound and ventilator dependent; he therefore requires, in part, a responsible individual nearby to attend to certain physical needs during the schoolday. The District declined to accept financial responsibility for the services Garret needs, ****994** believing that it was not legally obligated to provide continuous one-on-one nursing care. At an Iowa Department of Education hearing, an Administrative Law Judge concluded that the IDEA required the District to bear financial responsibility for all of the disputed services, finding that most of them are already provided for some other students; that the District did not contend that only a licensed physician could provide the services; and that applicable federal regulations require

the District to furnish "school health services," which are provided by a "qualified school nurse or other qualified person," but not "medical services," which are limited to services provided by a physician. The Federal District Court agreed and the Court of Appeals affirmed, concluding that *Irving Independent School Dist. v. Tatro,* 468 U.S. 883, 104 S.Ct. 3371, 82 L.Ed.2d 664, provided a two-step analysis of § 1401(a)(17)'s "related services" definition that was satisfied here. First, the requested services were "supportive services" because Garret cannot attend school unless they are provided; and second, the services were not excluded as "medical services" under *Tatro* 's bright-line test: Services provided by a physician (other than for diagnostic and evaluation purposes) are subject to the medical services exclusion, but services that can be provided by a nurse or qualified layperson are not.

Held: The IDEA requires the District to provide Garret with the nursing services he requires during school hours. The IDEA's "related services" definition, *Tatro,* and the overall statutory scheme support the ***67** Court of Appeals' decision. The "related services" definition broadly encompasses those supportive services that "may be required to assist a child with a disability to benefit from special education," § 1401(a)(17), and the District does not challenge the Court of Appeals' conclusion that the services at issue are "supportive services." Furthermore, § 1401(a)(17)'s general "related services" definition is illuminated by a parenthetical phrase listing examples of services that are included within the statute's coverage, including "medical services" if they are "for diagnostic and evaluation purposes." Although the IDEA itself does not define "medical services" more specifically, this Court in *Tatro* concluded that the Secretary of Education had reasonably determined that "medical services" referred to services that must be performed by a physician, and not to school health services. 468 U.S., at 892-894, 104 S.Ct. 3371. The cost-based, multifactor test proposed by the District is supported by neither the statute's text nor the regulations upheld in *Tatro.* Moreover, the District offers no explanation why characteristics such as cost make one service any more "medical" than another. Absent an elaboration of the statutory terms plainly more convincing than that reviewed in *Tatro,* there is no reason to depart from settled law. Although the District may have legitimate concerns about the financial burden of providing the services Garret needs, accepting its cost-based standard as the sole test for determining § 1401(a)(17)'s scope would require the Court to engage in judicial lawmaking without any guidance from Congress. It would also create tension with the IDEA's purposes, since Congress intended to open the doors of public education to all qualified children and required participating States to educate disabled children with nondisabled children whenever possible, *Board of Ed. of Hendrick Hudson Central School Dist., Westchester Cty. v. Rowley,* 458 U.S. 176, 192, 202, 102 S.Ct. 3034, 73 L.Ed.2d 690. Pp. 997-1000.

106 F.3d 822, affirmed.

STEVENS, J., delivered the opinion of the Court, in which REHNQUIST, C.J., and O'CONNOR, SCALIA, SOUTER, GINSBURG, and BREYER, JJ., joined. THOMAS, J., filed a dissenting opinion, in which KENNEDY, J., joined, *post,* p. 1000.
Susan L. Seitz, Des Moines, IA, for petitioner.

Douglas R. Oelschlaeger, Cedar Rapids, IA, for respondent.

Beth S. Brinkmann, Washington, DC, for the U.S. as amicus curiae, by special leave of the Court.

For U.S. Supreme Court briefs, see:1998 WL 375420 (Pet.Brief)****995** 1998 WL 541985 (Resp.Brief)1998 WL 664982 (Reply.Brief)

***68** Justice STEVENS delivered the opinion of the Court.

The Individuals with Disabilities Education Act (IDEA), 84 Stat. 175, as amended, was enacted, in part, "to assure that all children with disabilities have available to them ... a free appropriate public education which emphasizes special education and related services designed to meet their unique needs." 20 U.S.C. § 1400(c). Consistent with this purpose, the IDEA authorizes federal financial assistance to States that agree to provide disabled children with special education and "related services." See §§ 1401(a)(18), 1412(1). The question presented in this case is whether the definition of "related services" in § 1401(a)(17) [FN1] requires a public school ***69** district in a participating State to provide a ventilator-dependent student with certain nursing services during school hours.

FN1. "The term 'related services' means

transportation, and such developmental, corrective, and other supportive services (including speech pathology and audiology, psychological services, physical and occupational therapy, recreation, including therapeutic recreation, social work services, counseling services, including rehabilitation counseling, and medical services, except that such medical services shall be for diagnostic and evaluation purposes only) as may be required to assist a child with a disability to benefit from special education, and includes the early identification and assessment of disabling conditions in children." 20 U.S.C. § 1401(a)(17).

Originally, the statute was enacted without a definition of "related services." See Education of the Handicapped Act, 84 Stat. 175. In 1975, Congress added the definition at issue in this case. Education for All Handicapped Children Act of 1975, § 4(a)(4), 89 Stat. 775. Aside from nonsubstantive changes and added examples of included services, see, *e.g.,* Individuals with Disabilities Education Act Amendments of 1997, § 101, 111 Stat. 45; Individuals with Disabilities Education Act Amendments of 1991, § 25(a)(1)(B), 105 Stat. 605; Education of the Handicapped Act Amendments of 1990, § 101(c), 104 Stat. 1103, the relevant language in § 1401(a)(17) has not been amended since 1975. All references to the IDEA herein are to the 1994 version as codified in Title 20 of the United States Code-the version of the statute in effect when this dispute arose.

I

Respondent Garret F. is a friendly, creative, and intelligent young man. When Garret was four years old, his spinal column was severed in a motorcycle accident. Though paralyzed from the neck down, his mental capacities were unaffected. He is able to speak, to control his motorized wheelchair through use of a puff and suck straw, and to operate a computer with a device that responds to head movements. Garret is currently a student in the Cedar Rapids Community School District (District), he attends regular classes in a typical school program, and his academic performance has been a success. Garret is, however, ventilator dependent,[FN2] and therefore requires a responsible individual nearby to attend to certain physical needs while he is in school. [FN3]

FN2. In his report in this case, the Administrative Law Judge explained: "Being ventilator dependent means that [Garret] breathes only with external aids, usually an electric ventilator, and occasionally by someone else's manual pumping of an air bag attached to his tracheotomy tube when the ventilator is being maintained. This later procedure is called ambu bagging." App. to Pet. for Cert. 19a.

FN3. "He needs assistance with urinary bladder catheterization once a day, the suctioning of his tracheotomy tube as needed, but at least once every six hours, with food and drink at lunchtime, in getting into a reclining position for five minutes of each hour, and ambu bagging occasionally as needed when the ventilator is checked for proper functioning. He also needs assistance from someone familiar with his ventilator in the event there is a malfunction or electrical problem, and someone who can perform emergency procedures in the event he experiences autonomic hyperreflexia. Autonomic hyperreflexia is an uncontrolled visceral reaction to anxiety or a full bladder. Blood pressure increases, heart rate increases, and flushing and sweating may occur. Garret has not experienced autonomic hyperreflexia frequently in recent years, and it has usually been alleviated by catheterization. He has not ever experienced autonomic hyperreflexia at school. Garret is capable of communicating his needs orally or in another fashion so long as he has not been rendered unable to do so by an extended lack of oxygen." *Id.,* at 20a.

70** During Garret's early years at school his family provided for his physical care during the schoolday. When he was in kindergarten, his 18-year-old aunt attended him; in the next four years, his family used settlement proceeds they received after the accident,*996** their insurance, and other resources to employ a licensed practical nurse. In 1993, Garret's mother requested the District to accept

financial responsibility for the health care services that Garret requires during the schoolday. The District denied the request, believing that it was not legally obligated to provide continuous one-on-one nursing services.

Relying on both the IDEA and Iowa law, Garret's mother requested a hearing before the Iowa Department of Education. An Administrative Law Judge (ALJ) received extensive evidence concerning Garret's special needs, the District's treatment of other disabled students, and the assistance provided to other ventilator-dependent children in other parts of the country. In his 47-page report, the ALJ found that the District has about 17,500 students, of whom approximately 2,200 need some form of special education or special services. Although Garret is the only ventilator-dependent student in the District, most of the health care services that he needs are already provided for some other students.[FN4] "The primary difference between Garret's situation and that of other students is his dependency on his ventilator for life support." App. to Pet. for Cert. 28a. The ALJ noted that the parties disagreed over the training or ***71** licensure required for the care and supervision of such students, and that those providing such care in other parts of the country ranged from nonlicensed personnel to registered nurses. However, the District did not contend that only a licensed physician could provide the services in question.

> FN4. "Included are such services as care for students who need urinary catheterization, food and drink, oxygen supplement positioning, and suctioning." *Id.,* at 28a; see also *id.,* at 53a.

The ALJ explained that federal law requires that children with a variety of health impairments be provided with "special education and related services" when their disabilities adversely affect their academic performance, and that such children should be educated to the maximum extent appropriate with children who are not disabled. In addition, the ALJ explained that applicable federal regulations distinguish between "school health services," which are provided by a "qualified school nurse or other qualified person," and "medical services," which are provided by a licensed physician. See 34 C.F.R. §§ 300.16(a), (b)(4), (b)(11) (1998). The District must provide the former, but need not provide the latter (except, of course, those "medical services" that are for diagnostic or evaluation purposes, 20 U.S.C. § 1401(a)(17)). According to the ALJ, the distinction in the regulations does not just depend on "the title of the person providing the service"; instead, the "medical services" exclusion is limited to services that are "in the special training, knowledge, and judgment of a physician to carry out." App. to Pet. for Cert. 51a. The ALJ thus concluded that the IDEA required the District to bear financial responsibility for all of the services in dispute, including continuous nursing services.[FN5]

> FN5. In addition, the ALJ's opinion contains a thorough discussion of "other tests and criteria" pressed by the District, *id.,* at 52a, including the burden on the District and the cost of providing assistance to Garret. Although the ALJ found no legal authority for establishing a cost-based test for determining what related services are required by the statute, he went on to reject the District's arguments on the merits. See *id.,* at 42a-53a. We do not reach the issue here, but the ALJ also found that Garret's in-school needs must be met by the District under an Iowa statute as well as the IDEA. *Id.,* at 54a-55a.

***72** The District challenged the ALJ's decision in Federal District Court, but that court approved the ALJ's IDEA ruling and granted summary judgment against the District. *Id.,* at 9a, 15a. The Court of Appeals affirmed. 106 F.3d 822 (C.A.8 1997). It noted that, as a recipient of federal funds under the IDEA, Iowa has a statutory duty to provide all disabled children a "free appropriate public education," which includes "related services." See *id.,* at 824. The Court of Appeals read our opinion in *Irving Independent School Dist. v. Tatro,* 468 U.S. 883, 104 S.Ct. 3371, 82 L.Ed.2d 664 (1984), to provide a two-step analysis of the "related services" definition in § 1401(a)(17)-asking first, whether the requested services are included within the phrase "supportive services"; and second, whether the services are excluded as "medical services." 106 F.3d, at 824-825. ****997** The Court of Appeals succinctly answered both questions in Garret's favor. The Court found the first step plainly satisfied, since Garret cannot attend school unless the requested services are available during the schoolday. *Id.,* at 825. As to the second step, the court reasoned that *Tatro* "established a bright-line test: the services of a physician (other than for diagnostic and

evaluation purposes) are subject to the medical services exclusion, but services that can be provided in the school setting by a nurse or qualified layperson are not." 106 F.3d, at 825.

In its petition for certiorari, the District challenged only the second step of the Court of Appeals' analysis. The District pointed out that some federal courts have not asked whether the requested health services must be delivered by a physician, but instead have applied a multifactor test that considers, generally speaking, the nature and extent of the services at issue. See, *e.g.*, *Neely v. Rutherford County School*, 68 F.3d 965, 972-973 (C.A.6 1995), cert. denied, 517 U.S. 1134, 116 S.Ct. 1418, 134 L.Ed.2d 543 (1996); *Detsel v. Board of Ed. of Auburn Enlarged City School Dist.*, 820 F.2d 587, 588(CA2) *(per curiam)*, cert. denied, 484 U.S. 981, 108 S.Ct. 495, 98 L.Ed.2d 494 (1987). We granted the District's petition to resolve this conflict. 523 U.S. 1117, 118 S.Ct. 1793, 140 L.Ed.2d 934 (1998).

***73** II

[1] The District contends that § 1401(a)(17) does not require it to provide Garret with "continuous one-on-one nursing services" during the schoolday, even though Garret cannot remain in school without such care. Brief for Petitioner 10. However, the IDEA's definition of "related services," our decision in *Irving Independent School Dist. v. Tatro*, 468 U.S. 883, 104 S.Ct. 3371, 82 L.Ed.2d 664 (1984), and the overall statutory scheme all support the decision of the Court of Appeals.

[2] The text of the "related services" definition, see n. 1, *supra,* broadly encompasses those supportive services that "may be required to assist a child with a disability to benefit from special education." As we have already noted, the District does not challenge the Court of Appeals' conclusion that the in-school services at issue are within the covered category of "supportive services." As a general matter, services that enable a disabled child to remain in school during the day provide the student with "the meaningful access to education that Congress envisioned." *Tatro*, 468 U.S., at 891, 104 S.Ct. 3371 (" 'Congress sought primarily to make public education available to handicapped children' and 'to make such access meaningful' " (quoting *Board of Ed. of Hendrick Hudson Central School Dist., Westchester Cty. v. Rowley*, 458 U.S. 176, 192, 102 S.Ct. 3034, 73 L.Ed.2d 690 (1982))).

This general definition of "related services" is illuminated by a parenthetical phrase listing examples of particular services that are included within the statute's coverage. § 1401(a)(17). "[M]edical services" are enumerated in this list, but such services are limited to those that are "for diagnostic and evaluation purposes." *Ibid.* The statute does not contain a more specific definition of the "medical services" that are excepted from the coverage of § 1401(a)(17).

[3] The scope of the "medical services" exclusion is not a matter of first impression in this Court. In *Tatro* we concluded that the Secretary of Education had reasonably determined that the term "medical services" referred only to services ***74** that must be performed by a physician, and not to school health services. 468 U.S., at 892-894, 104 S.Ct. 3371. Accordingly, we held that a specific form of health care (clean intermittent catheterization) that is often, though not always, performed by a nurse is not an excluded medical service. We referenced the likely cost of the services and the competence of school staff as justifications for drawing a line between physician and other services, *ibid.*, but our endorsement of that line was unmistakable.[FN6] It is thus settled that the ****998** phrase ***75** "medical services" in § 1401(a)(17) does not embrace all forms of care that might loosely be described as "medical" in other contexts, such as a claim for an income tax deduction. See 26 U.S.C. § 213(d)(1) (1994 ed. and Supp. II) (defining "medical care").

FN6. "The regulations define 'related services' for handicapped children to include 'school health services,' 34 C.F.R. § 300.13(a) (1983), which are defined in turn as 'services provided by a qualified school nurse or other qualified person,' § 300.13(b)(10). 'Medical services' are defined as 'services provided by a licensed physician.' § 300.13(b)(4). Thus, the Secretary has [reasonably] determined that the services of a school nurse otherwise qualifying as a 'related service' are not subject to exclusion as a 'medical service,' but that the services of a physician are excludable as such.

. . . . .

> "... *By limiting the 'medical services' exclusion to the services of a physician or hospital,* both far more expensive, the Secretary has given a permissible construction to the provision." 468 U.S., at 892-893, 104 S.Ct. 3371 (emphasis added) (footnote omitted); see also *id.,* at 894, 104 S.Ct. 3371 ("[T]he regulations state that school nursing services must be provided only if they can be performed by a nurse or other qualified person, not if they must be performed by a physician").
>
> Based on certain policy letters issued by the Department of Education, it seems that the Secretary's post- *Tatro* view of the statute has not been entirely clear. *E.g.,* App. to Pet. for Cert. 64a. We may assume that the Secretary has authority under the IDEA to adopt regulations that define the "medical services" exclusion by more explicitly taking into account the nature and extent of the requested services; and the Secretary surely has the authority to enumerate the services that are, and are not, fairly included within the scope of § 1407(a)(17). But the Secretary has done neither; and, in this Court, she advocates affirming the judgment of the Court of Appeals. Brief for United States as *Amicus Curiae* 7-8, 30; see also *Auer v. Robbins,* 519 U.S. 452, 462, 117 S.Ct. 905, 137 L.Ed.2d 79 (1997) (an agency's views as *amicus curiae* may be entitled to deference). We obviously have no authority to rewrite the regulations, and we see no sufficient reason to revise *Tatro,* either.

The District does not ask us to define the term so broadly. Indeed, the District does not argue that any of the items of care that Garret needs, considered individually, could be excluded from the scope of 20 U.S.C. § 1401(a)(17).[FN7] It could not make such an argument, considering that one of the services Garret needs (catheterization) was at issue in *Tatro,* and the others may be provided competently by a school nurse or other trained personnel. See App. to Pet. for Cert. 15a, 52a. As the ALJ concluded, most of the requested services are already provided by the District to other students, and the in-school care necessitated by Garret's ventilator dependency does not demand the training, knowledge, and judgment of a licensed physician. *Id.,* at 51a-52a. While more extensive, the in-school services Garret needs are no more "medical" than was the care sought in *Tatro.*

FN7. See Tr. of Oral Arg. 4-5, 12.

[4] Instead, the District points to the combined and continuous character of the required care, and proposes a test under which the outcome in any particular case would "depend upon a series of factors, such as [1] whether the care is continuous or intermittent, [2] whether existing school health personnel can provide the service, [3] the cost of the service, and [4] the potential consequences if the service is not properly performed." Brief for Petitioner 11; see also *id.,* at 34-35.

The District's multifactor test is not supported by any recognized source of legal authority. The proposed factors can be found in neither the text of the statute nor the regulations that we upheld in *Tatro.* Moreover, the District offers no explanation why these characteristics make one service ***76** any more "medical" than another. The continuous character of certain services associated with Garret's ventilator dependency has no apparent relationship to "medical" services, much less a relationship of equivalence. Continuous services may be more costly and may require additional school personnel, but they are not thereby more "medical." Whatever its imperfections, a rule that limits the medical services exemption to physician services is unquestionably a reasonable and generally workable interpretation of the statute. Absent an elaboration of the statutory terms plainly more convincing than that which we reviewed in *Tatro,* there is no good reason to depart from settled law.[FN8]

FN8. At oral argument, the District suggested that we first consider the nature of the requested service (either "medical" or not); then, if the service is "medical," apply the multifactor test to determine whether the service is an excluded physician service or an included school nursing service under the Secretary of Education's regulations. See Tr. of Oral Arg. 7, 13-14. Not only does this approach provide no additional guidance for identifying "medical" services, it is also disconnected from both the statutory text and the regulations we upheld in *Irving Inde-*

pendent School Dist. v. Tatro, 468 U.S. 883, 104 S.Ct. 3371, 82 L.Ed.2d 664 (1984). "Medical" services are generally *excluded* from the statute, and the regulations elaborate on that statutory term. No authority cited by the District requires an additional inquiry if the requested service is both "related" and non-"medical." Even if § 1401(a)(17) demanded an additional step, the factors proposed by the District are hardly more useful in identifying "nursing" services than they are in identifying "medical" services; and the District cannot limit educational access simply by pointing to the limitations of existing staff. As we noted in *Tatro,* the IDEA requires schools to hire specially trained personnel to meet disabled student needs. *Id.,* at 893, 104 S.Ct. 3371.

****999** Finally, the District raises broader concerns about the financial burden that it must bear to provide the services that Garret needs to stay in school. The problem for the District in providing these services is not that its staff cannot be trained to deliver them; the problem, the District contends, is that the existing school health staff cannot meet all of their ***77** responsibilities and provide for Garret at the same time.[FN9] Through its multifactor test, the District seeks to establish a kind of undue-burden exemption primarily based on the cost of the requested services. The first two factors can be seen as examples of cost-based distinctions: Intermittent care is often less expensive than continuous care, and the use of existing personnel is cheaper than hiring additional employees. The third factor-the cost of the service-would then encompass the first two. The relevance of the fourth factor is likewise related to cost because extra care may be necessary if potential consequences are especially serious.

FN9. See Tr. of Oral Arg. 4-5, 13; Brief for Petitioner 6-7, 9. The District, however, will not necessarily need to hire an additional employee to meet Garret's needs. The District already employs a one-on-one teacher associate (TA) who assists Garret during the schoolday. See App. to Pet. for Cert. 26a-27a. At one time, Garret's TA was a licensed practical nurse (LPN). In light of the state Board of Nursing's recent ruling that the District's registered nurses may decide to delegate Garret's care to an LPN, see Brief for United States as *Amicus Curiae* 9-10 (filed Apr. 22, 1998), the dissent's future-cost estimate is speculative. See App. to Pet. for Cert. 28a, 58a-60a (if the District could assign Garret's care to a TA who is also an LPN, there would be "a minimum of additional expense").

[5] The District may have legitimate financial concerns, but our role in this dispute is to interpret existing law. Defining "related services" in a manner that *accommodates* the cost concerns Congress may have had, cf. *Tatro,* 468 U.S., at 892, 104 S.Ct. 3371, is altogether different from using cost *itself* as the definition. Given that § 1401(a)(17) does not employ cost in its definition of "related services" or excluded "medical services," accepting the District's cost-based standard as the sole test for determining the scope of the provision would require us to engage in judicial lawmaking without any guidance from Congress. It would also create some tension with the purposes of the IDEA. The statute may not require public schools to maximize the potential of disabled students commensurate***78** with the opportunities provided to other children, see *Rowley,* 458 U.S., at 200, 102 S.Ct. 3034; and the potential financial burdens imposed on participating States may be relevant to arriving at a sensible construction of the IDEA, see *Tatro,* 468 U.S., at 892, 104 S.Ct. 3371. But Congress intended "to open the door of public education" to all qualified children and "require[d] participating States to educate handicapped children with nonhandicapped children whenever possible." *Rowley,* 458 U.S., at 192, 202, 102 S.Ct. 3034; see *id.,* at 179-181, 102 S.Ct. 3034; see also *Honig v. Doe,* 484 U.S. 305, 310-311, 324, 108 S.Ct. 592, 98 L.Ed.2d 686 (1988); §§ 1412(1), (2)(C), (5)(B).[FN10]

FN10. The dissent's approach, which seems to be even broader than the District's, is unconvincing. The dissent's rejection of our unanimous decision in *Tatro* comes 15 years too late, see *Patterson v. McLean Credit Union,* 491 U.S. 164, 172-173, 109 S.Ct. 2363, 105 L.Ed.2d 132 (1989) (*stare decisis* has "special force" in statutory interpretation), and it offers nothing constructive in its place. Aside from rejecting a "provider-specific approach," the dissent cites unrelated statutes and offers a circular defini-

tion of "medical services." *Post,* at 1001 (opinion of THOMAS, J.) (" 'services' that are 'medical' in 'nature' "). Moreover, the dissent's approach apparently would exclude most ordinary school nursing services of the kind routinely provided to nondisabled children; that anomalous result is not easily attributable to congressional intent. See *Tatro,* 468 U.S., at 893, 104 S.Ct. 3371.

In a later discussion the dissent does offer a specific proposal: that we now interpret (or rewrite) the Secretary's regulations so that school districts need only provide disabled children with "health-related services that school nurses can perform as part of their normal duties." *Post,* at 1003. The District does not dispute that its nurses "can perform" the requested services, so the dissent's objection is that District nurses would not be performing their "normal duties" if they met Garret's needs. That is, the District would need an "additional employee." *Post,* at 1003. This proposal is functionally similar to a proposed regulation-ultimately withdrawn-that would have replaced the "school health services" provision. See 47 Fed.Reg. 33838, 33854 (1982) (the statute and regulations may not be read to affect legal obligations to make available to handicapped children services, including school health services, made available to nonhandicapped children). The dissent's suggestion is unacceptable for several reasons. Most important, such revisions of the regulations are better left to the Secretary, and an additional staffing need is generally not a sufficient objection to the requirements of § 1401(a)(17). See n. 8, *supra.*

****1000 *79** This case is about whether meaningful access to the public schools will be assured, not the level of education that a school must finance once access is attained. It is undisputed that the services at issue must be provided if Garret is to remain in school. Under the statute, our precedent, and the purposes of the IDEA, the District must fund such "related services" in order to help guarantee that students like Garret are integrated into the public schools.

The judgment of the Court of Appeals is accordingly

Affirmed.

Justice THOMAS, with whom Justice KENNEDY joins, dissenting.

The majority, relying heavily on our decision in *Irving Independent School Dist. v. Tatro,* 468 U.S. 883, 104 S.Ct. 3371, 82 L.Ed.2d 664 (1984), concludes that the Individuals with Disabilities Education Act (IDEA), 20 U.S.C. § 1400 *et seq.,* requires a public school district to fund continuous, one-on-one nursing care for disabled children. Because *Tatro* cannot be squared with the text of IDEA, the Court should not adhere to it in this case. Even assuming that *Tatro* was correct in the first instance, the majority's extension of it is unwarranted and ignores the constitutionally mandated rules of construction applicable to legislation enacted pursuant to Congress' spending power.

I

As the majority recounts, *ante,* at 995, IDEA authorizes the provision of federal financial assistance to States that agree to provide, *inter alia,* "special education and related services" for disabled children. § 1401(a)(18). In *Tatro, supra,* we held that this provision of IDEA required a school district to provide clean intermittent catheterization to a disabled child several times a day. In so holding, we relied on Department of Education regulations, which we concluded had reasonably interpreted IDEA's definition of "related ***80** services" [FN1] to require school districts in participating States to provide "school nursing services" (of which we assumed catheterization was a subcategory) but not "services of a physician." *Id.,* at 892-893, 104 S.Ct. 3371. This holding is contrary to the plain text of IDEA, and its reliance on the Department of Education's regulations was misplaced.

FN1. IDEA currently defines "related services" as "transportation, and such developmental, corrective, and other supportive services (including speech pathology and audiology, psychological services, physical and occupational therapy, recreation, including therapeutic recreation, social work services, counseling services, including rehabilitation counseling, and medical services, *except that such medical services shall be*

> *for diagnostic and evaluation purposes only*) as may be required to assist a child with a disability to benefit from special education ...." 20 U.S.C. § 1401(a)(17) (emphasis added).

A

Before we consider whether deference to an agency regulation is appropriate, "we first ask whether Congress has 'directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.' " *National Credit Union Admin. v. First Nat. Bank & Trust Co.*, 522 U.S. 479, 499-500, 118 S.Ct. 927, 140 L.Ed.2d 1 (1998) (quoting **1001*Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-843, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984)).

Unfortunately, the Court in *Tatro* failed to consider this necessary antecedent question before turning to the Department of Education's regulations implementing IDEA's related services provision. The Court instead began "with the regulations of the Department of Education, which," it said, "are entitled to deference." *Tatro, supra,* at 891-892, 104 S.Ct. 3371. The Court need not have looked beyond the text of IDEA, which expressly indicates that school districts are not required to provide medical services, except for diagnostic and evaluation purposes. 20 U.S.C. § 1401(a)(17). The majority asserts that *Tatro* precludes reading the term "medical services"**81** to include "all forms of care that might loosely be described as 'medical.' " *Ante,* at 998. The majority does not explain, however, why "services" that are "medical" in nature are not "medical services." Not only is the definition that the majority rejects consistent with other uses of the term in federal law, [FN2] it also avoids the anomalous result of holding that the services at issue in *Tatro* (as well as in this case), while not "medical services," would nonetheless qualify as medical care for federal income tax purposes. *Ante,* at 997-998.

> FN2. See, *e.g.*, 38 U.S.C. § 1701(6) ("The term 'medical services' includes, in addition to medical examination, treatment, and rehabilitative services-... surgical services, dental services ..., optometric and podiatric services, ... preventive health services, ... [and] such consultation, professional counseling, training, and mental health services as are necessary in connection with the treatment"); § 101(28) ("The term 'nursing home care' means the accommodation of convalescents ... who require nursing care and related medical services"); 26 U.S.C. § 213(d)(1) ("The term 'medical care' means amounts paid-... for the diagnosis, cure, mitigation, treatment, or prevention of disease").

The primary problem with *Tatro,* and the majority's reliance on it today, is that the Court focused on the provider of the services rather than the services themselves. We do not typically think that automotive services are limited to those provided by a mechanic, for example. Rather, anything done to repair or service a car, no matter who does the work, is thought to fall into that category. Similarly, the term "food service" is not generally thought to be limited to work performed by a chef. The term "medical" similarly does not support *Tatro* 's provider-specific approach, but encompasses services that are "of, *relating to, or concerned with* physicians *or* with the practice of medicine." See Webster's Third New International Dictionary 1402 (1986) (emphasis added); see also *id.,* at 1551 (defining "nurse" as "a person skilled in caring for and waiting on the infirm, the injured, or the sick; *specif:* one esp. trained to carry out such duties under the supervision of a physician").

82 IDEA's structure and purpose reinforce this textual interpretation. Congress enacted IDEA to increase the *educational* opportunities available to disabled children, not to provide medical care for them. See 20 U.S.C. § 1400(c) ("It is the purpose of this chapter to assure that all children with disabilities have ... a free appropriate public education"); see also § 1412 ("In order to qualify for assistance ... a State shall demonstrate ... [that it] has in effect a policy that assures all children with disabilities the right to a free appropriate public education"); *Board of Ed. of Hendrick Hudson Central School Dist., Westchester Cty. v. Rowley,* 458 U.S. 176, 179, 102 S.Ct. 3034, 73 L.Ed.2d 690 (1982) ("The Act represents an ambitious federal effort to promote the education of handicapped children"). As such, where Congress decided to require a supportive service-including speech pathology, occupational therapy, and audiology-that appears "medical" in nature, it took care to do so explicitly.

See § 1401(a)(17). Congress specified these services precisely because it recognized that they would otherwise fall under the broad "medical services" exclusion. Indeed, when it crafted the definition of related services, Congress could have, but chose not to, include "nursing services" in this list.

B

Tatro was wrongly decided even if the phrase "medical services" was subject to multiple constructions, and therefore, deference****1002** to any reasonable Department of Education regulation was appropriate. The Department of Education has never promulgated regulations defining the scope of IDEA's "medical services" exclusion. One year before *Tatro* was decided, the Secretary of Education issued proposed regulations that defined excluded medical services as "services relating to the practice of medicine." 47 Fed.Reg. 33838 (1982). These regulations, which represent the Department's only attempt to define the disputed term, were never adopted. Instead, "[t]he regulations actually define only those 'medical services' that *are* owed to handicapped ***83** children," *Tatro,* 468 U.S., at 892, n. 10, 104 S.Ct. 3371 (emphasis in original), not those that *are not.* Now, as when *Tatro* was decided, the regulations require districts to provide services performed " 'by a licensed physician to determine a child's medically related handicapping condition which results in the child's need for special education and related services.' " *Ibid.* (quoting 34 C.F.R. § 300.13(b)(4) (1983), recodified and amended as 34 C.F.R. § 300.16(b)(4) (1998).

Extrapolating from this regulation, the *Tatro* Court presumed that this meant that " 'medical services' not owed under the statute are those 'services by a licensed physician' that serve other purposes." *Tatro, supra,* at 892, n. 10, 104 S.Ct. 3371 (emphasis deleted). The Court, therefore, did not defer to the regulation itself, but rather relied on an inference drawn from it to speculate about how a regulation might read if the Department of Education promulgated one. Deference in those circumstances is impermissible. We cannot defer to a regulation that does not exist.[FN3]

FN3. Nor do I think that it is appropriate to defer to the Department of Education's litigating position in this case. The agency has had ample opportunity to address this problem but has failed to do so in a formal regulation. Instead, it has maintained conflicting positions about whether the services at issue in this case are required by IDEA. See *ante,* at 997-998, n. 6. Under these circumstances, we should not assume that the litigating position reflects the "agency's fair and considered judgment." *Auer v. Robbins,* 519 U.S. 452, 462, 117 S.Ct. 905, 137 L.Ed.2d 79 (1997).

II

Assuming that *Tatro* was correctly decided in the first instance, it does not control the outcome of this case. Because IDEA was enacted pursuant to Congress' spending power, *Rowley, supra,* at 190, n. 11, 102 S.Ct. 3034, our analysis of the statute in this case is governed by special rules of construction. We have repeatedly emphasized that, when Congress places conditions on the receipt of federal funds, "it must do so unambiguously." ***84***Pennhurst State School and Hospital v. Halderman,* 451 U.S. 1, 17, 101 S.Ct. 1531, 67 L.Ed.2d 694 (1981). See also *Rowley, supra,* at 190, n. 11, 102 S.Ct. 3034; *South Dakota v. Dole,* 483 U.S. 203, 207, 107 S.Ct. 2793, 97 L.Ed.2d 171 (1987); *New York v. United States,* 505 U.S. 144, 158, 112 S.Ct. 2408, 120 L.Ed.2d 120 (1992). This is because a law that "condition[s] an offer of federal funding on a promise by the recipient ... amounts essentially to a contract between the Government and the recipient of funds." *Gebser v. Lago Vista Independent School Dist.,* 524 U.S. 274, 286, 118 S.Ct. 1989, 141 L.Ed.2d 277 (1998). As such, "[t]he legitimacy of Congress' power to legislate under the spending power ... rests on whether the State voluntarily and knowingly accepts the terms of the 'contract.' There can, of course, be no knowing acceptance if a State is unaware of the conditions or is unable to ascertain what is expected of it." *Pennhurst, supra,* at 17, 101 S.Ct. 1531 (citations omitted). It follows that we must interpret Spending Clause legislation narrowly, in order to avoid saddling the States with obligations that they did not anticipate.

The majority's approach in this case turns this Spending Clause presumption on its head. We have held that, in enacting IDEA, Congress wished to require "States to educate handicapped children with nonhandicapped children whenever possible," *Rowley, supra,* at 202, 102 S.Ct. 3034. Congress, however, also took steps to limit the fiscal burdens that States must bear in attempting to achieve this laudable goal.

These steps include requiring States to provide an education that is only "appropriate" rather than **1003 requiring them to maximize the potential of disabled students, see 20 U.S.C. § 1400(c); *Rowley, supra,* at 200, 102 S.Ct. 3034, recognizing that integration into the public school environment is not always possible, see § 1412(5), and clarifying that, with a few exceptions, public schools need not provide "medical services" for disabled students, §§ 1401(a)(17) and (18).

For this reason, we have previously recognized that Congress did not intend to "impos[e] upon the States a burden of unspecified proportions and weight" in enacting IDEA. *Rowley, supra,* at 190, n. 11, 102 S.Ct. 3034. These federalism concerns require us to interpret IDEA's related services provision, consistent*85 with *Tatro,* as follows: Department of Education regulations require districts to provide disabled children with health-related services that school nurses can perform as part of their normal duties. This reading of *Tatro,* although less broad than the majority's, is equally plausible and certainly more consistent with our obligation to interpret Spending Clause legislation narrowly. Before concluding that the district was required to provide clean intermittent catheterization for Amber Tatro, we observed that school nurses in the district were authorized to perform services that were "difficult to distinguish from the provision of [clean intermittent catheterization] to the handicapped." *Tatro,* 468 U.S., at 893, 104 S.Ct. 3371. We concluded that "[i]t would be strange indeed if Congress, in attempting to extend special services to handicapped children, were unwilling to guarantee them services of a kind that are routinely provided to the nonhandicapped." *Id.,* at 893-894, 104 S.Ct. 3371.

Unlike clean intermittent catheterization, however, a school nurse cannot provide the services that respondent requires, see *ante,* at 995, n. 3, and continue to perform her normal duties. To the contrary, because respondent requires continuous, one-on-one care throughout the entire schoolday, all agree that the district must hire an additional employee to attend solely to respondent. This will cost a minimum of $18,000 per year. Although the majority recognizes this fact, it nonetheless concludes that the "more extensive" nature of the services that respondent needs is irrelevant to the question whether those services fall under the medical services exclusion. *Ante,* at 998. This approach disregards the constitutionally mandated principles of construction applicable to Spending Clause legislation and blindsides unwary States with fiscal obligations that they could not have anticipated.

* * *

For the foregoing reasons, I respectfully dissent.

U.S.Iowa,1999.
Cedar Rapids Community School Dist. v. Garret F. ex rel. Charlene F.
526 U.S. 66, 119 S.Ct. 992, 161 A.L.R. Fed. 683, 143 L.Ed.2d 154, 67 USLW 4165, 132 Ed. Law Rep. 40, 99 Cal. Daily Op. Serv. 1582, 1999 Daily Journal D.A.R. 2029, 1999 CJ C.A.R. 1126, 12 Fla. L. Weekly Fed. S 129

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903 F.2d 635, 58 USLW 2682, 60 Ed. Law Rep. 728, 15 Fla. L. Weekly D2682
(Cite as: 903 F.2d 635)

United States Court of Appeals,
Ninth Circuit.
CLOVIS UNIFIED SCHOOL DISTRICT, Plaintiff-Appellant, Cross-Appellee,
v.
CALIFORNIA OFFICE OF ADMINISTRATIVE HEARINGS; and Ronald Diedrich, Hearing Officer, Defendants-Appellees,
William Honig, California State Superintendent of Public Instruction; and California State Department of Education, Defendants-Appellees, Cross-Appellants.
Michelle Shorey, Real Party in Interest-Appellee, Cross-Appellant.

Nos. 86-2747, 86-2825, 86-2842, 87-1537 and 87-1554.
Argued and Submitted Aug. 14, 1987.
Submission Vacated April 7, 1988.
Resubmitted March 12, 1990.
Decided May 3, 1990.

School district was ordered by administrative hearing officer to pay for placement of emotionally disturbed child in acute care psychiatric hospital under the Education for All Handicapped Children Act (EHA) for particular school year, and district appealed. The United States District Court for the Eastern District of California, Edward Dean Price, J., ruled in favor of child and granted her attorney fees. On consolidated appeals and cross appeals, the Court of Appeals held that: (1) district was responsible for maintaining placement of child at hospital through pendency of court review proceedings following administrative decision that hospital was appropriate placement; (2) child was hospitalized primarily for medical, psychiatric reasons, and thus, hospitalization was not educationally related service for the costs of which school district was responsible under the EHA; and (3) state defendants had not violated EHA's requirements of finality and impartiality by aligning themselves with district.

Reversed.

West Headnotes

[1] Schools 345 155.5(2.1)

345 Schools
345II Public Schools
345II(L) Pupils
345k155.5 Handicapped Children, Proceedings to Enforce Rights
345k155.5(2) Judicial Review or Intervention
345k155.5(2.1) k. In General. Most Cited Cases
(Formerly 345k155.5(2))

School district was responsible for maintaining emotionally disturbed child's residential placement in acute care psychiatric hospital throughout pendency of court review proceedings which followed administrative decision that hospital was appropriate educational placement for child under the Education for All Handicapped Children Act (EHA), pursuant to EHA's stay-put provisions, even though parents originally placed child at hospital on their own initiative. Education of the Handicapped Act, § 615(e)(3), as amended, 20 U.S.C.A. § 1415(e)(3).

[2] Federal Courts 170B 13.30

170B Federal Courts
170BI Jurisdiction and Powers in General
170BI(A) In General
170Bk12 Case or Controversy Requirement
170Bk13.30 k. Schools and Colleges. Most Cited Cases

Whether residential placement of emotionally disturbed child in acute care psychiatric hospital was appropriate educational placement under the Education for All Handicapped Children Act (EHA) was not rendered moot by facts that child was no longer placed in hospital and it was determined that school district was responsible for costs of placement at hospital after administrative decision that such placement was appropriate; issue of responsibility for costs of placement prior to administrative decision remained. Education of the Handicapped Act, § 601 et seq., as amended, 20 U.S.C.A. § 1400 et seq.

903 F.2d 635, 58 USLW 2682, 60 Ed. Law Rep. 728, 15 Fla. L. Weekly D2682
(Cite as: 903 F.2d 635)

[3] Federal Courts 170B 776

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(K) Scope, Standards, and Extent
170BVIII(K)1 In General
170Bk776 k. Trial De Novo. Most Cited Cases

Issue of whether school district was obligated under the Education for All Handicapped Children Act (EHA) to pay fees for placement of emotionally disturbed child in acute care psychiatric hospital as educationally related service or whether costs were incurred for excludable medical service presented question of law that Court of Appeals would review de novo. Education of the Handicapped Act, § 601 et seq., as amended, 20 U.S.C.A. § 1400 et seq.

[4] Schools 345 148(4)

345 Schools
345II Public Schools
345II(L) Pupils
345k148 Nature of Right to Instruction in General
345k148(2) Handicapped Children and Special Services Therefor
345k148(4) k. Medical Services. Most Cited Cases

In determining whether government agency was responsible for costs of placement of child under Education for All Handicapped Children Act (EHA), relevant inquiry was not only whether placement was supportive of handicapped child's education; all medical services were arguably supportive of handicapped child's education, but EHA excluded coverage of costs for medical services, and thus, mere supportiveness was too broad a criterion to be test for whether specific service was necessary under EHA to assist child to benefit from special education. Education of the Handicapped Act, § 601 et seq., as amended, 20 U.S.C.A. § 1400 et seq.

[5] Schools 345 148(4)

345 Schools
345II Public Schools
345II(L) Pupils
345k148 Nature of Right to Instruction in General
345k148(2) Handicapped Children and Special Services Therefor
345k148(4) k. Medical Services. Most Cited Cases

In determining whether government agency was responsible for costs of child's placement under the Education for All Handicapped Children Act (EHA), government agency would not be held responsible for entire cost of placement when medical, social, or emotional problems that required hospitalization create or are intertwined with educational problem. Education of the Handicapped Act, § 601 et seq., as amended, 20 U.S.C.A. § 1400 et seq.

[6] Schools 345 148(3)

345 Schools
345II Public Schools
345II(L) Pupils
345k148 Nature of Right to Instruction in General
345k148(2) Handicapped Children and Special Services Therefor
345k148(3) k. Mental or Emotional Handicap; Learning Disabilities. Most Cited Cases

In determining whether government agency was responsible for costs of child's placement under the Education for All Handicapped Children Act (EHA), analysis must focus on whether placement may be considered necessary for educational purposes, or whether placement is response to medical, social, or emotional problems that is necessary apart from learning process. Education of the Handicapped Act, § 601 et seq., as amended, 20 U.S.C.A. § 1400 et seq.

[7] Schools 345 148(4)

345 Schools
345II Public Schools
345II(L) Pupils
345k148 Nature of Right to Instruction in General
345k148(2) Handicapped Children and Special **Services** Therefor
345k148(4) k. Medical **Services**. Most Cited Cases

Medical **services** exclusion from government agency's required coverage for costs of child's placement under the Education for All Handicapped Children Act (EHA) would **not** be construed to apply only to those **services** provided by licensed physician or based on licensed status of **service** provider. Education of the Handicapped Act, § 601 et seq., as amended, 20 U.S.C.A. § 1400 et seq.

[8] Schools 345 ⚿148(4)

345 Schools
345II Public Schools
345II(L) Pupils
345k148 Nature of Right to Instruction in General
345k148(2) Handicapped Children and Special **Services** Therefor
345k148(4) k. Medical **Services**. Most Cited Cases

Obligation of government agency to pay for child's placement costs under the Education for All Handicapped Children Act (EHA) would **not** be construed to require payment for psychiatric hospitalization of children under EHA's mandate to provide educationally **related services** to all children regardless of severity of their handicap, with exception of **services** by licensed physicians, on theory child's educational needs remain unsegregable from needs for treatment unless or until those needs must be addressed by licensed physicians, in view of exclusion from coverage of medical **services**. Education of the Handicapped Act, § 601 et seq., as amended, 20 U.S.C.A. § 1400 et seq.

[9] Schools 345 ⚿148(4)

345 Schools
345II Public Schools
345II(L) Pupils
345k148 Nature of Right to Instruction in General
345k148(2) Handicapped Children and Special **Services** Therefor
345k148(4) k. Medical **Services**. Most Cited Cases

Emotionally disturbed child's placement in acute care psychiatric hospital was primarily for medical, psychiatric reasons, and child's hospitalization thus did **not** constitute educationally **related service** for the costs of which a school district was responsible under the Education for All Handicapped Children Act (EHA), even though psychotherapeutic **services** which child received at hospital might be qualitatively similar to those she would receive at residential placement. Education of the Handicapped Act, § 601 et seq., as amended, 20 U.S.C.A. § 1400 et seq.

[10] Schools 345 ⚿148(4)

345 Schools
345II Public Schools
345II(L) Pupils
345k148 Nature of Right to Instruction in General
345k148(2) Handicapped Children and Special **Services** Therefor
345k148(4) k. Medical **Services**. Most Cited Cases

Under California law, psychiatric hospitals came under jurisdiction of **State** Department of Health **Services** and were **not included** as educational placement options for handicapped pupils for purposes of the Education for All Handicapped Children Act (EHA). Education of the Handicapped Act, § 601 et seq., as amended, 20 U.S.C.A. § 1400 et seq.; West's Ann.Cal.Educ.Code §§ 56167, 56360.

[11] Schools 345 ⚿148(4)

345 Schools
345II Public Schools
345II(L) Pupils
345k148 Nature of Right to Instruction in General
345k148(2) Handicapped Children and Special **Services** Therefor
345k148(4) k. Medical **Services**. Most Cited Cases

Federal district court was **not** free to substitute its own standards for educational programs for those of the **state** and impose responsibility on school district for costs of placing emotionally disturbed child at acute psychiatric care hospital under the Education for All Handicapped Children Act (EHA) when psychia-

tric hospitals such as the one at which child was placed were **not** under **state** law **includable** as educational placement options for handicapped pupils. Education of the Handicapped Act, § 601 et seq., as amended, 20 U.S.C.A. § 1400 et seq.; West's Ann.Cal.Educ.Code §§ 56167, 56360.

[12] Federal Courts 170B 13.30

170B Federal Courts
170BI Jurisdiction and Powers in General
170BI(A) In General
170Bk12 Case or Controversy Requirement
170Bk13.30 k. Schools and Colleges. Most Cited Cases

Issue of whether **federal regulations** governing use of federal grant monies for education that explicitly prohibit use of funds for religious purposes and **state** law prohibiting **state** from contracting with sectarian hospital for instructional **services** would preclude reimbursement of psychiatric hospital allegedly affiliated with church for placement costs for child under the Education for All Handicapped Children Act (EHA) was mooted, where **state** official determined **not** to move child from hospital pending outcome of litigation over whether placement costs were responsibility of government agency. Education of the Handicapped Act, § 601 et seq., as amended, 20 U.S.C.A. § 1400 et seq.; West's Ann.Cal.Educ.Code § 56361.5(a).

[13] Federal Courts 170B 757

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(K) Scope, Standards, and Extent
170BVIII(K)1 In General
170Bk756 Matters **Not** Necessary to Decision in Review
170Bk757 k. Specific Questions. Most Cited Cases

Court of Appeals was **not** required to decide whether district court erred by failing to extend child's placement in acute care psychiatric hospital for another year under Education for All Handicapped Children Act (EHA), where Court of Appeals reversed court order requiring school district to pay for placement during pendency of review proceedings under stay-put provisions of the EHA. Education of the Handicapped Act, §§ 601 et seq., 615(e)(3), as amended, 20 U.S.C.A. §§ 1400 et seq., 1415(e)(3).

[14] Schools 345 155.5(2.1)

345 Schools
345II Public Schools
345II(L) Pupils
345k155.5 Handicapped Children, Proceedings to Enforce Rights
345k155.5(2) Judicial Review or Intervention
345k155.5(2.1) k. In General. Most Cited Cases
(Formerly 345k155.5(2))

State defendants had not violated the Education for All Handicapped Children Act's (EHA) requirement of finality and impartiality by aligning themselves with school district which appealed from determination that it was required to fund placement of emotionally disturbed child at acute care psychiatric hospital under EHA; hearing officer who made initial determination was not employee of State Department of Education, hearing officer's decision was treated as final and enforceable unless appealed, and neither impartiality of administrative decision nor its finality were threatened by state defendants' alignment with school district. Education of the Handicapped Act, § 615, as amended, 20 U.S.C.A. § 1415.

[15] Schools 345 155.5(1)

345 Schools
345II Public Schools
345II(L) Pupils
345k155.5 Handicapped Children, Proceedings to Enforce Rights
345k155.5(1) k. In General. Most Cited Cases

Impartiality of determination under the Education for All Handicapped Children Act (EHA) is ensured by requirement that hearing on disputes regarding identification, assessment, and placement of handicapped children not be conducted by employee of agency which is directly or indirectly involved in education or care of child. Education of the Handicapped Act, § 615(b)(2), as amended, 20 U.S.C.A. §

1415(b)(2).

*637 Diana K. Smith, Lozano Smith Smith & Woliver, San Francisco, Cal., for Clovis Unified School Dist., plaintiff-appellant and cross-appellee.

Joyce Eckrem and Michael E. Hersher, California State Dept. of Educ., Sacramento, Cal., for William Honig, California State Superintendent of Public Instruction, and the California State Dept. of Educ., defendants-appellees and cross-appellants.

John K. Van de Kamp, Atty. Gen., and Richard M. Frank and Paul Dobson, Supervising Deputy Attys. Gen., Sacramento, Cal., for Michelle Shorey, Real Party in Interest, defendant-appellee and cross-appellant, and for the California Office of Administrative Hearings and Ronald Diedrich, Hearing Officer, defendants-appellees.

Ronald D. Wenkart, Costa Mesa, Cal., for the Anaheim City School Dist., et al., Amicus.

Andrea M. Miller, Kronick, Moskovitz, Tiedemann & Girard, Sacramento, Cal., for the California Ass'n of School Boards, Amicus.

*638 Appeal from the United States District Court for the Eastern District of California.

Before SCHROEDER, POOLE and CANBY,[FN*] Circuit Judges.

FN* Honorable William C. Canby was drawn to replace Russell E. Smith, Senior United States District Judge, now deceased.

PER CURIAM:

INTRODUCTION

Three of the appeals addressed in this opinion are taken from the District Court's decision ordering Clovis Unified School District to pay for the placement of real-party-in-interest Michelle Shorey in King's View Hospital as a residential placement under the Education for All Handicapped Children Act, 20 U.S.C. §§ 1400 *et seq.* (Education of the Handicapped Act, EHA, the Act). Two of the appeals are taken from the District Court's order granting attorneys' fees to Michelle as a prevailing party in an action brought under 20 U.S.C. § 1415(e). The primary issue for decision is whether Michelle's placement was a "related service" or excluded as a "medical service" under the Act. Because we find that Michelle was hospitalized for medical, rather than educational purposes, we reverse the orders of the District Court.

STATUTORY BACKGROUND

The Education for All Handicapped Children Act of 1975, 20 U.S.C. §§ 1400 *et seq.*, provides funds and also regulates **state** assistance to handicapped students. *Department of Education of the **State** of Hawaii v. Katherine D.*, 727 F.2d 809, 813 (9th Cir.1983), *cert. denied* 471 U.S. 1117, 105 S.Ct. 2360, 86 L.Ed.2d 260 (1985). To qualify for federal assistance for special education programs, a **state** must have in effect a policy that assures all handicapped children the right to a "free appropriate public education." 20 U.S.C. § 1412(1). The **state** must adopt policies and procedures which assure that all children receive an appropriate education "regardless of the severity of their handicap." 20 U.S.C. § 1412(2)(C).

The term "free appropriate public education" is defined to **include** "special education" and "**related services**." 20 U.S.C. § 1401(a)(18). "**Related services**" in turn are defined by the statute as

> [T]ransportation and such **developmental**, **corrective**, and other **supportive services** (**including** speech pathology and audiology, psychological **services**, physical and occupational therapy, recreation, and medical and counseling **services**, *except that such medical **services** shall be for diagnostic and evaluation purposes only*) as may be required to assist a handicapped child to benefit from special education (emphasis added)

20 U.S.C. § 1401(a)(17).[FN1] The Act contains no explicit definition of "medical **services**."

FN1. The **comments** accompanying 34 C.F.R. § 300. 13 indicate that "[t]he **list** of **related services** is **not exhaustive** and may **include** other **developmental**, **corrective**, or **supportive services** (such as artistic and cultural programs, and art, music, and dance therapy), if they are required to assist a handicapped child to benefit from special education."

The EHA indirectly requires school districts to

provide residential placements by defining elementary and secondary schools to include "residential schools." 20 U.S.C. § 1401(a)(9) and (10). There is no further explanation in the Act, but the pertinent regulations provide that "[i]f placement in a public or private residential program is necessary to provide special education and related services to a handicapped child, the program, including non-medical care and room and board, must be at no cost to the parents of the child." 34 C.F.R. § 300.302.

Under the Act an Individualized Educational Program (IEP) must be developed for each handicapped child. 20 U.S.C. § 1401(a)(18). The program is developed by representatives of the educational agency, the teacher, the parents or guardians of the child, and when appropriate, the child. 20 U.S.C. § 1401(a)(19).

The primary issue before us is whether Michelle Shorey's hospitalization at King's View Hospital constitutes either a "residential*639 placement" or a "related service" which her local school district is required to pay for under the Act, or constitutes "medical services" excluded from the purview of the Act.

FACTS AND PROCEEDINGS BELOW

Michelle Shorey is a seriously emotionally disturbed child who is entitled to special education and related services under the Education of the Handicapped Act, 20 U.S.C. §§ 1400 *et seq.* At the time of this appeal she was ten years old. There is no dispute that Michelle requires a residential placement in order to receive an appropriate education. Clovis Unified School District ("Clovis" or "the district") is the local educational agency responsible under the EHA for providing Michelle with an appropriate education, including a residential placement at no cost to her parents. *See* 34 C.F.R. § 300.302.

The Shoreys adopted Michelle at the age of 4 1/2 . Apparently as a result of an extremely unstable and chaotic childhood, including neglect and abuse in eight or nine different placements before her ultimate adoption, Michelle developed serious emotional problems. When they adopted Michelle, the Shoreys lived in Washington state, where Michelle started public schooling.[FN2] When the adoptive parents moved to Riverside, California in 1984, they enrolled the child in a mental health day treatment program. Shortly thereafter, however, because of her destructive behavior, she was placed in a mental health residential treatment program. In January 1985 the Shoreys moved to Fresno, leaving Michelle in Riverside. Although Michelle continued to perform adequately in the classroom, her emotional condition deteriorated considerably.

FN2. Emotional difficulties led to Michelle's hospitalization for two months in October, 1983.

In March 1985, the Mental Health Director of the Riverside facility informed the Shoreys that Michelle's behavior had deteriorated to such an extent that the staff could no longer control her, even with medication. The Riverside staff recommended placement in an acute care facility. The Shoreys applied for Michelle's admission to King's View Hospital, an acute care psychiatric hospital in Reedley, California. In mid-March Michelle was discharged from the Riverside facility and placed at King's View. The costs of her placement there were paid primarily through the Shoreys' private medical insurance until about July, when that coverage was exhausted.

During her first few months at King's View, personnel from Clovis Unified School District, the Shoreys' district of residence, attempted to locate an appropriate residential school for Michelle's educational placement. They considered and suggested a number of options, of which the most appropriate were the State Diagnostic School, a temporary residential placement, and Re-Ed West, a residential school located in Sacramento. The Shoreys rejected these suggestions, believing that neither could provide Michelle with an appropriate education.

Instead the Shoreys requested that Clovis fund Michelle's placement at King's View. When Clovis refused to do so, Michelle's parents sought an administrative hearing pursuant to the "procedural safeguards" provisions of the EHA, 20 U.S.C. § 1415(b), and Cal.Educ.Code § 56501, to determine whether she was entitled to be placed at Clovis' expense at King's View as a residential school placement under the Act. At the administrative hearing, the parents argued for placement at King's View at a cost of $150,000 per year; the school district argued for placement at Re-Ed West or the Diagnostic School, at a cost of approximately $50,000. The administrative hearing officer ruled in favor of Michelle, ordering the District to pay

for her hospitalization from August 16, 1985, through the 1985-86 school year.

Clovis appealed the hearing officer's decision to the United States District Court for the Eastern District of California pursuant to Cal.Educ.Code § 56505(j) and 20 U.S.C. § 1415(e)(2), seeking injunctive and declaratory relief against Superintendent of Public Instruction William Honig and the California State Department of Education***640** ("State Defendants"), the State Office of Administrative Hearings, Ronald Diedrich, the independent hearing officer, and Michelle. Clovis argued that placement at the hospital was for medical, rather than educational reasons, and that therefore the district was not obligated to fund such a placement. The State Defendants answered by admitting that the hearing officer's decision was erroneous. They have consistently supported Clovis' position throughout these proceedings.

Clovis first sought a temporary restraining order and a preliminary injunction under Cal.Educ.Code § 56505(j). The motion for a TRO was denied on September 11, 1985; the District Court set the matter for trial on October 1, at which time it proposed to address both the preliminary injunction and the request for permanent relief.

Trial was delayed until March 18, 1986. In the interim, Clovis discovered that King's View had ties with the Mennonite church. Clovis moved to amend its complaint to add the issue of sectarian status. That motion, and a subsequent motion for reconsideration, were both denied by the District Court.

The District Court heard testimony at trial from those who knew or had occasion to interact with Michelle. The court ultimately ruled in favor of Michelle and ordered Clovis to pay all costs incident to her placement at King's View from August 16, 1985 through the 1985-86 school year. The court entered Findings of Fact and Conclusions of Law on June 17, 1986 and entered judgment on July 23. Following denial of their motion for a new trial and for amendment of the Findings of Fact and Conclusions of Law, Clovis and the State Defendants filed appeals. (No. 86-2747 and No. 86-2825). Michelle, whose counter-motion to amend Findings of Fact and Conclusions of Law was also denied, has cross-appealed. Michelle challenges the authority of the State Department of Education to seek to overturn the decision of the administrative hearing officer, and the failure of the District Court to extend her placement at King's View beyond the 1986 school year to which the administrative decision applied. (No. 86-2842).

On December 8, 1986, the District Court granted attorneys' fees to Michelle Shorey pursuant to 20 U.S.C. § 1415(e)(4). Clovis and the State Defendants jointly appealed that award, challenging Congress's authority to create a retroactive right to attorneys' fees for prevailing parties in suits brought under 20 U.S.C. § 1415. (No. 87-1537). Michelle cross-appealed, challenging the District Court's decision to award less than was requested without specifying the basis for the award. (No. 87-1554). The appeal and cross-appeal concerning attorneys' fees have been consolidated with the three appeals on the merits for disposition. We address all five related appeals in this opinion.

THE "STAY PUT" PROVISIONS AND MOOTNESS

Michelle was at King's View throughout the 1985-1986 academic year pursuant to the August 16, 1985 order of the hearing officer and thereafter pursuant to the judgment of the district court. Under the "stay put" provisions of 20 U.S.C. § 1415(e)(3), a child is to remain in "the then current educational placement of such child" during the pendency of review proceedings. At oral argument, on August 14, 1987, this court was informed that just a few weeks earlier, Michelle had returned from King's View to live with her family. We asked the parties to provide supplemental briefs on the application of the "stay put" provisions to this case, and second as to the issue of mootness in light of Michelle's move from King's View.

[1] The principal issue to which the supplemental briefs were directed was whether the "stay put" provisions required Clovis to maintain the child in King's View throughout the course of the court review proceedings which followed the agency decision that King's View was the appropriate placement. 20 U.S.C. § 1415(e)(3) provides as follows:

During the pendency of any proceedings conducted pursuant to this section, unless the State or local educational ***641** agency and the parents or guardian otherwise agree, the child shall remain in the then current educational placement of such child, or, if applying for initial admission to a public school, shall,

with the consent of the parents or guardians, be placed in the public school program until all such proceedings have been completed.

Clovis argues that under the stay put provisions the Shoreys should bear the King's View cost because the Shoreys originally placed the child at King's View on their own initiative. Clovis maintains it is irrelevant that the Shoreys won administrative and district court decisions holding that the placement was the appropriate one.

The Shoreys, however, argue persuasively that the school district and the state are responsible for the costs of Michelle's placement during the court review proceedings regardless of which party prevails in this appeal. They argue that the purpose and the language of the Act support a holding that Clovis, under the stay put provisions, was responsible for keeping Michelle in the King's View placement after the administrative decision that the placement was appropriate, and until a court directed otherwise.

The Shoreys' position is supported by the decision of the United States Supreme Court in *School Committee of the Town of Burlington v. Massachusetts Department of Education,* 471 U.S. 359, 105 S.Ct. 1996, 85 L.Ed.2d 385 (1985). The Supreme Court there considered a situation, like this one, in which parents had unilaterally changed a placement, but had received a state administrative agency decision in favor of their choice. The Supreme Court there said that the agency's decision in the parents' favor "would seem to constitute an agreement by the State to the change of placement." The Court refused to give the stay put provisions a reading that would force parents to leave a child in what they feel may be an inappropriate educational placement, or act at their peril in keeping a child in their chosen placement, after a successful administrative ruling. *Burlington School Committee* at 372-73, 105 S.Ct. at 2003-04. The Court took the view that once the State educational agency decided that the parents' placement was the appropriate placement, it became the "then current educational placement" within the meaning of section 1415(e)(3). *Burlington* concluded that the school was required to maintain that placement pending the court review proceedings pursuant to section 1415. We reach the same conclusion here. The district was responsible for maintaining the King's View placement through the pendency of court review proceedings.

[2] The second question on which we asked for supplemental briefing was whether, because Michelle is no longer in King's View, the question of appropriate placement under the Act is moot. On this point, the parties agreed that it is not. Even though we have held that the district is responsible for the costs of her placement at King's View after the administrative decision, there remains in issue the responsibility for the costs prior to that decision. If the Shoreys are correct on the merits, then the district must pay for the King's View placement. If the district prevails on the merits of the placement issue, then the Shoreys are responsible for the costs from the time they unilaterally placed Michelle in King's View until the time of the administrative decision favorable to the Shoreys. *See Burlington School Committee* at 373-74, 105 S.Ct. at 2004-05. These appeals are therefore not moot as to the issue of the appropriateness of the placement under the EHA.

RELATED SERVICE VS. MEDICAL EXCLUSION

[3] Clovis agrees that Michelle's needs are such that a residential placement of some kind is necessary. *See Kruelle v. New Castle County School District,* 642 F.2d 687, 693-96 (3d Cir.1981); *North v. District of Columbia Board of Educ.,* 471 F.Supp. 136, 139-41 (D.D.C., 1979). Nor does the district dispute that a highly structured and integrated program, offering regularly scheduled psychological services, including psychotherapy, is needed for Michelle***642** to benefit from any educational program. Clovis also agrees that Michelle is entitled to state-supplied educational services while in the hospital, and those services are in fact provided by a local school district. Clovis asserts, however, that it is not obligated to pay for Michelle's hospitalization at King's View. It contends that the EHA does not require the school district to pay the costs of psychiatric hospitalization because that type of placement is a response to a medical rather than an educational need and is not the type of residential program contemplated by the Act. Clovis also contends that the intensive, extended psychological treatment Michelle receives at King's View is a "medical service" for which the school district is not financially liable under the Act, even if it is related to Michelle's education in the sense that she cannot fully benefit from her education without it. Hence, Clovis denies responsibility for Michelle's hospitalization, contending it is not the kind of "residential placement" or "related service" contemplated by the Act but is an

excluded medical service.

The Shoreys, on the other hand, argue that Clovis is obligated under the EHA to pay King's View's fees because there is no other residential placement which can provide Michelle with the services she requires to benefit from her education. They note that the psychiatric treatment she receives is qualitatively the same as that provided in other residential placement centers or at day schools, and argue that therefore her treatment is not excludable as a "medical service." FN3

FN3. No party has ever raised in this litigation the possibility of separating the costs of the "educational" services from the costs of the "medical" services provided at King's View in order to apportion them among the parties. *See, e.g., Drew P. v. Clarke County School Dist.,* 877 F.2d 927, 929 (11th Cir.1989) (costs of residential placement apportioned between school district and parents); *Doe v. Anrig,* 651 F.Supp. 424, 430-32 (D.Mass.1987) (court apportioned costs between school district and father). We address no such issues.

The question is one of law, which we review *de novo. United States v. McConney,* 728 F.2d 1195 (9th Cir.) (en banc), *cert. denied,* 469 U.S. 824, 105 S.Ct. 101, 83 L.Ed.2d 46 (1984).

The "Tatro" Decision

The leading case on excludable "medical services" is *Irving Independent School District v. Tatro,* 468 U.S. 883, 104 S.Ct. 3371, 82 L.Ed.2d 664 (1984). *Tatro* did not involve a residential placement, but its standards, though not dispositive, are helpful. That case involved an 8-year old girl who suffered from a neurogenic bladder and required insertion of a catheter into the urethra to empty her bladder every three or four hours. The Supreme Court held that the school nurse should perform that procedure as a "related service" under the EHA.

The Court based its decision, in part, on the fact the services did not have to be performed by a licensed physician. But the Court's decision was not based solely on the "licensed physician" distinction. The Court also supported its decision with a discussion of (1) the nature of the requested service and (2) the burden which it would place on the school district. With regard to the nature of the services, the Court explained that it was unable to distinguish between the services sought by the handicapped student and those routinely provided by the school nurse to non-handicapped students. It pointed out that even a trained lay person could have provided the services requested. *Id.* at 893-94, 104 S.Ct. at 3377-78. With regard to the burden, the Court began by recognizing that the genesis of the medical services exclusion was partly based on Congress' intent to "spare schools from an obligation to provide a service that might well prove unduly expensive and beyond the range of their competence." *Id.* at 892, 104 S.Ct. at 3377. It noted that the "services provided by a physician or hospital," which *are* excluded, are "far more expensive" than the services of a school nurse. *Id.* at 893, 104 S.Ct. at 3377.

Both parties argue that they should prevail under the analysis in *Tatro.* The parties agree that Michelle is handicapped. They dispute whether the services provided ***643** to Michelle at King's View are necessary to aid her to benefit from special education or, as Clovis contends, primarily aimed at meeting her medical needs. They also dispute the extent to which the "licensed physician" distinction should control.

[4] The Shoreys suggest that the *only* relevant inquiry under *Tatro* is whether the placement is *supportive* of a handicapped child's education. We think this test is far too inclusive, however, in light of the Act's explicit exclusion of medical services. If a child requires, for example, ear surgery to improve his hearing, he may learn better after a successful operation and therefore in some respects his surgery is "supportive" of his education, but the school district is certainly not responsible for his treatment. Similarly, a child who must be maintained on kidney dialysis certainly cannot physically benefit from education to the extent that such services are necessary to keep him alive, but again, it is not the responsibility of the school district to provide such maintenance care. *See McKenzie v. Jefferson,* 566 F.Supp. 404, 413 (D.D.C.1983) ("If [a schizophrenic child] had not been medically treated, she would have been unable to take advantage of and receive any benefit from her education, but the same would apply to any illness"). All medical services are arguably "supportive" of a handicapped child's education; therefore, mere "supportiveness" is too broad a criterion to be the test for whether a specific service is necessary under the Act

to assist a child to benefit from special education.

[5][6] Similarly, we reject the line of reasoning proferred in *Vander Malle v. Ambach,* 667 F.Supp. 1015, 1039 (S.D.N.Y.1987), that where "medical, social or emotional problems that require hospitalization create or are intertwined with the educational problem, the states remain responsible" for the entire cost of the placement. Rather, our analysis must focus on whether Michelle's placement may be considered necessary for educational purposes, or whether the placement is a response to medical, social, or emotional problems that is necessary quite apart from the learning process. *See Kruelle v. New Castle County School District,* 642 F.2d at 693; *Corbett v. Regional Center for the Easy Bay, Inc.,* 676 F.Supp. 964, 968-69 (N.D.Cal.1988); *McKenzie v. Jefferson,* 566 F.Supp. at 408, 412; *North v. District of Columbia Board of Educ.,* 471 F.Supp. at 160.

Medical Services Exclusion And The "Licensed Physician" Distinction

[7] The Shoreys do not deny that Michelle's program is in part therapeutic, but argue for a narrow definition of medical services, contending that, under *Tatro,* medical services are *only* those services that *must* be provided by a licensed physician. They believe that the services which Michelle is provided at King's View are necessarily not excluded because, while some treatment is on that scale, not all of the services are provided by physicians.

We cannot agree. A number of District Courts have faced this issue and have concluded that the "licensed physician" distinction is inadequate as the sole criterion for determining when services fall under the medical exclusion from liability. In *Max M. v. Thompson,* 592 F.Supp. 1437 (N.D.Ill.1984), the District Court held that psychotherapy, a recognized related service under the Act, does not become excluded as a medical service *merely* because it is provided by a psychiatrist-a licensed physician-rather than by a psychologist. We agree with the reasoning of this opinion, and with its rejection of an arbitrary classification of services based solely on the licensed status of the service provider. If a licensed physician may provide related services without their becoming instantly "medical," we believe that by the same token a program clearly aimed at curing an illness-whether mental or physical-does not become instantly "related" when it can be implemented by persons other than licensed physicians.

The post-*Tatro* case of *Detsel v. Board of Education of Auburn,* 637 F.Supp. 1022 (N.D.N.Y.1986), *aff'd* 820 F.2d 587 (2d Cir.), *cert. denied,* 484 U.S. 981, 108 S.Ct. 495, 98 L.Ed.2d 494 (1987), is even more on point. There a district court found that intensive *644 life **support services** necessary to maintain a child in school fell outside the "**related services**" mandated by the Act and "more closely resemble[d] the medical **services** specifically excluded by § 1401(17) of the [EHA]," despite the fact that the **services** could be provided by a practical nurse rather than by a physician. *Id.* at 1027. Applying the principles of *Tatro,* the court found that holding the school district responsible for the provision of such "extensive, therapeutic health **services**" would be contrary to the rationale of the medical **services** exclusion in the Act, based as it is upon relieving schools of the obligation to provide **services** calculated to be unduly expensive. *Id.*

We agree with the *Detsel* court, that under the analysis in *Tatro,* the Shorey's argument for limiting medically excluded **services** to those requiring a physician's intervention must fail. The Court in *Tatro* did **not** hold that all health **services** are to be provided as **related services** so long as they may be performed by other than a licensed physician. 468 U.S. at 891-95, 104 S.Ct. at 3376-78; *see also Detsel,* 637 F.Supp. at 1027. Rather, the Court held only that **services** which *must* be provided by a licensed physician, other than those which are diagnostic or evaluative, *are* excluded and that school nursing **services** of a simple nature are **not** excluded. In reaching this decision the Court considered the extent and nature of the **services** performed, **not** solely the status of the person performing the **services**. We must do the same.

[8] Despite the Shoreys' arguments, we see no reason why the "licensed physician" distinction should take on special significance in cases, such as this, which involve intensive psychological rather than physiological disability. A child hospitalized for ear surgery or kidney dialysis who, the Shoreys concede, is not entitled to subsidy of the costs of hospitalization, frequently must receive care by other than licensed physicians. The services of hospital nurses, dieticians, physical therapists, orderlies and other aids constitute integrated medical services in the treatment of a physical illness requiring the "medical" interven-

tion of licensed professionals. Clearly all such services, including the strictly medical or surgical services themselves, "support" a child's education. But it would do havoc to the structure of the Act to exclude only the services of licensed physicians in such circumstances, and to require the school district to pay for all other services. At oral argument, the Shoreys conceded that the services of the aforementioned hospital personnel are excluded as medical, not because they are provided by doctors (because they are not), but rather because their institutional efforts are involved in the curing of a physical illness.

However, the Shoreys assert that when a child is psychologically or psychiatrically handicapped, as distinguished from a child who suffers a physical handicap, there is no single point at which the needs of the child become medical. They argue that a continuum of educational needs dictates that school districts must pay for the psychiatric hospitalization of such children under the Act's mandate to provide related services to all children "regardless of the severity of their handicap." 20 U.S.C. § 1412(2)(C). According to the Shoreys, this continuum of needs exists, and a child's educational needs remain unsegregable from her needs for treatment (and thus by hypothesis "related") unless or until those needs must be addressed by licensed physicians.

We cannot accept as reasonable a definition of "medical" which ultimately turns on the distinction between physiological illness and mental illness. Such a definition would mandate huge expenditures by local school boards aimed at "curing" psychiatric illness but not require similar expenditures for treating children with physical problems who require the more traditional "medical" services. The clear intention of the Act is to provide access to education for *all* handicapped students on an equal basis. Section 1412(2)(B) precludes such an unfair result. 20 U.S.C. § 1412(2)(B).

APPLICATION OF THE ACT TO THIS CASE

[9] With these considerations in mind, we turn now to an examination of the case ***645** before us. We find that the psychiatric hospitalization of Michelle Shorey, although perhaps necessary for her continued mental health, was not the financial responsibility of the Clovis Unified School District under the Act.

A. *Services Provided at King's View*

Michelle was hospitalized at King's View because of an "acute" psychiatric crisis. Her wild and destructive rages rendered her not only unable to benefit from education, but, indeed, generally uncontrollable.

At King's View, Michelle's program consisted of a residential/therapeutic program coordinated with an on-grounds classroom program. She spent her day in a variety of therapy programs including individual therapy, pottery, and animal care. These therapies were provided by various persons who met the state licensing or training requirements for hospital medical staff. Psychiatric nurses supervised the "residential" component of Michelle's program and were trained to complement her total treatment program. By law, a licensed physician, though not necessarily the primary treating physician, was required to supervise Michelle's overall treatment program. On the other hand, none of Michelle's therapy was actually provided by psychiatrists, nor did she require the prescription of psychotropic medication.

Because school districts are required by state law to provide education to school-aged patients confined to hospitals, *see* Cal.Educ.Code § 56167, King's Canyon Unified School District provides classroom instructors, both regular and special education teachers, to meet the educational needs of children in King's View. Michelle received approximately one to two hours per day of classroom instruction during her time at King's View. Michelle's program at the hospital was implemented not by the Individualized Education Program (IEP) designed by the school system, but was instead determined by a medical team, supervised by a licensed physician. The amount of time spent in the classroom was determined by the hospital staff, and dependent upon her other treatment needs.

B. *The Services Are Not Primarily To Aid Michelle To Benefit From Special Education But Rather Are Excludable Medical Services*

Michelle was hospitalized primarily for medical, i.e. psychiatric, reasons, and therefore the District Court erred when it determined hospitalization to be a "related service" for which Clovis was responsible under the Act.

The psychotherapeutic services Michelle received at King's View may be qualitatively similar to those she would receive at a residential placement, and it is clear that some psychological services are explicitly

included within the definition of related services under the Act when pupils need such services to benefit from their special instruction. However, the intensity of Michelle's program indicates that the services she received were focused upon treating an underlying medical crisis. Where, as here, a child requires six hours per day of intensive psychotherapy, such services would appear "medical" in that they address a medical crisis.

Further, although Michelle could be helped by treatment by psychologists rather than psychiatrists, it stands to reason that the high cost of her placement is due to the status of King's View as a medical facility, requiring a staff of licensed physicians, a high staff to patient ratio, and other services which would not be available or required at a placement in an educational institution. While the cost of medical and hospital services is not dispositive, the Court in *Tatro* noted that the Secretary of Education, in promulgating the regulations, excluded "the services of a physician or hospital" partly because such services are "far more expensive" than the services, for example, of a school nurse. *Tatro,* 468 U.S. at 893, 104 S.Ct. at 3377. Clearly hospital care is, and was understood by Congress and Secretary of Education to be, a far more expensive proposition than an educational residential placement and a greater burden than the states could ordinarily***646** be expected to shoulder in their budgets for education.

This conclusion is also supported by the failure of Congress to include hospitalization explicitly as a related service or placement under the Act. As the Supreme Court wrote in *Pennhurst State School v. Halderman,* 451 U.S. 1, 17, 101 S.Ct. 1531, 1539, 67 L.Ed.2d 694 (1982) "[i]f Congress intends to impose a condition on the grant of federal moneys, it must do so unambiguously." Similarly, in *Board of Education v. Rowley* the Court found that the EHA does not require states to maximize the potential of each handicapped child, noting that any other view would be "contrary to the fundamental proposition that Congress, when exercising its spending power, can impose no burden upon the states unless it does so unambiguously." 458 U.S. 176, 190 n. 11, 102 S.Ct. 3034, 3042 n. 11, 73 L.Ed.2d 690 (1981). We, too, recognize the unfairness of requiring school districts to pay for hospitalization on the basis of broad interpretations of ambiguous language in funding statutes such as the EHA.

[10][11] Our decision is further supported by the state's characterization of hospitals such as King's View. Under section 1412(6) of the Act, the state educational agency is responsible for assuring that "all educational programs for handicapped children ... shall meet education standards of the State educational agency." Thus the underlying policies which direct the establishment of individualized educational programs and their implementation are left to the discretion of educators and parents within the state. *See Board of Education v. Rowley,* 458 U.S. at 208-09 nn. 30, 31, 102 S.Ct. at 3051-52 nn. 30, 31. In California, hospitals such as King's View come under the jurisdiction of the State Department of Health Services. [FN4] They are not included as educational placement options for handicapped pupils in that state. *See* Cal.Educ.Code §§ 56360, 56167. The District Court was not free to substitute its own standards for educational programs for those of the state. *See Doe v. Anrig,* 651 F.Supp. at 430 (school district not financially responsible for placement at a psychiatric hospital as institution was not a state approved special education facility); *Darlene L. v. Illinois State Board of Education,* 568 F.Supp. 1340, 1345-46 (N.D.Ill.1983) (upholding a state regulation excluding psychiatric hospitals as placement options for handicapped pupils under the Act.)

FN4. We note that there is nothing magical about the appellation "hospital" in our analysis. There are many public institutions around the nation which are called "state hospitals" that are in fact primary residential treatment facilities where the educational, social, and developmental training needs of severely handicapped individuals are met. For example, in California the legislature has established eight "State Hospitals for the Developmentally Disabled." *See* Cal. Wel. & Inst.Code § 7500. These institutions are not primarily medical hospitals, but are more like residential treatment centers where an individual's multiple and intertwined needs can be met. The object of these "hospitals" is the "care, treatment, habilitation, training, and education" of the persons committed thereto, Cal. Wel. & Inst.Code § 7503, and may well qualify, under state law, as residential placements with which school districts may contract under the Act. That question is not before us, and we express no opinion on it. We simply emphasize that King's View is

> quite distinguishable from such state institutions. Psychiatric hospitals, under California law, are not responsible for the "training" or "education" of their patients, but for their medical care. *See* Cal. Health and Safety Code § 1250(b) and 1250.2(a); Chapter 2, Article 3, Title 22 Cal.Admin.Code. §§ 71201 *et seq.*

Furthermore, King's View hardly provided Michelle with any educational services. Rather, the local school district sent both regular and special education teachers to King's View to meet the educational needs of Michelle and other children who were patients there. Because King's View does not provide its patients with educational services, it differs substantially from facilities found by other circuits to be residential placements within the ambit of 34 C.F.R. § 300.302 for which school districts are financially responsible. In *Jefferson County Board of Education v. Breen*, 853 F.2d 853, 857 (11th Cir.1988), the Eleventh Circuit required a school district to pay for a child's placement at The Ranch, a Brown school, as the school had the facilities to provide the child with an integrated program***647** of educational and other supporting services. The *Breen* court expressly refused to place the child in a psychiatric hospital, finding that such a placement was inappropriate under the Act as the hospital lacked the facilities to provide the child with an appropriate education. *Id.* Similarly, the Sixth Circuit in *Clevenger v. Oak Ridge School Board*, 744 F.2d 514 (6th Cir.1984), required the school district to pay for the placement of a seriously emotionally disturbed youth at San Marcos School, a Brown school, on the grounds that the school could meet the child's educational and **related** needs. *Id.* at 516. The absence of educational **services** provided by King's View indicates that the room and board were medically as opposed to educationally **related**. They were thus outside the purview of 34 C.F.R. § 300.302 which provides that where "placement in a public or private residential program is necessary to provide special education and **related services** to a handicapped child, the program **including** *non-medical* care and room and board, must be at no cost to the parents." (Emphasis added).

In fact, the educational **services** which the school district provided Michelle at King's View are those encompassed by the Act itself which **states** that "special education" **includes** specially designed instruction at home, at hospitals and at institutions. 20 U.S.C. § 1401(16). In enacting this provision, Congress sought to ensure that children confined to hospitals or homes for either physical or mental illnesses would **not** be denied an education. School districts, therefore, are required to send tutors and other trained specialists to both homes and hospitals to meet the educational needs of handicapped children. However, **section** 1401(16) does **not** require school districts to pay the costs of a child's room and board at home and similarly does **not** require them to pay the room and board costs at a hospital.

Michelle may well be entitled to funds from other social agencies to cover the costs of her hospitalization, but the school district is **not** the proper agency for such relief.

OTHER ISSUES

Some brief mention must be made of the other issues presented in the appeals on the merits.

Sectarian Status Of King's View

[12] The **federal regulations** governing the use of federal grant monies for education explicitly prohibit the use of such funds for religious purposes. 34 C.F.R. § 76.532. Similarly, California prohibits the **state** from contracting with a sectarian hospital for instructional **services**. Cal.Educ.Code § 56361.5(a).

At trial Clovis moved to amend its pleading and offer testimony on the issue of King's View's affiliation with the Mennonite church. At that time, the District Court denied the motion and excluded Clovis' proffered testimony relating to the decertification, considering the matter one for decision by the state courts. In its letter decertifying King's View, the State Department of Education wrote that Michelle "may remain [at King's View] pending the outcome of the litigation" because "[t]he Department does not believe it is wise to administratively decide an issue that is properly before the court" and "federal law appears to disallow any interference with a Hearing Officer's decision by the state agency, except by appeal to a court of competent jurisdiction." In its final judgment, the District Court effectively determined the issue to have been mooted by the Superintendent's decision not to move Michelle. We agree.

The Shorey Cross-Appeal

[13] At trial, the District Court indicated that,

because its decision constituted an appeal from the administrative hearing in this case, it could not order placement beyond the end of the 1985-86 school year to which the administrative hearing officer's decision applied. In their cross-appeal, the Shoreys contend that the District Court erred in failing to grant their motion to amend the judgment to extend Michelle's placement. Because we reverse the order of the District Court ordering Clovis to pay ***648** for Michelle's placement while at the same time we require the school district to pay for such placement during the pendency of the review proceedings under the stay-put provisions of 20 U.S.C. § 1415(e)(3), we need not decide whether there was any error in the failure of the District Court to extend that placement for another year.

[14][15] The Shoreys also contend that the state defendants, in aligning themselves with appellant Clovis in this action, have violated EHA's requirements of finality and impartiality, 20 U.S.C. § 1415(b)(2) and (e)(1), by "renouncing and seeking to overturn [their] own decision." This argument is meritless. Under the EHA, parents must be accorded the right to take disputes as to the identification, assessment, and placement of handicapped children to an impartial due process hearing. 20 U.S.C. § 1415. States are accorded the option of providing either for hearings by a local or intermediate educational agency with review by a state agency, or for a single hearing by a state level agency. Impartiality is ensured by the requirement that the hearing may not be conducted by an employee of an agency which is either directly or indirectly involved in the education or care of the child. 20 U.S.C. § 1415(b)(2); *Robert M. v. Benton*, 634 F.2d 1139, 1141-42 (8th Cir.1980). California has implemented a system of single, state level hearings. Although the State Department of Education in this case is in the seemingly unique position of challenging an administrative determination rendered in its name by an independent hearing officer, the Office of Administrative Hearings in this case is not an employee of the State Department of Education and there is no indication that his decision in this case was not "impartial."

Under the EHA, the decision of the hearing officer is final and enforceable unless appealed. 20 U.S.C. § 1415(e)(1) and (3). It has been treated as such in this case. The state defendants have simply aligned themselves with Clovis, which properly brought this appeal. In short, neither the impartiality of the administrative decision nor its finality are threatened by the state defendants' posture in this case.

Attorneys' Fees Award

In view of our disposition on the merits of the case, it is apparent that Michelle Shorey was not a prevailing party and therefore was not entitled to attorneys' fees under 20 U.S.C. § 1415(e)(4).

The judgment of the District Court is REVERSED. The order granting attorneys' fees to Michelle is also REVERSED. Each party will bear its own costs on appeal.

C.A.9 (Cal.),1990.
Clovis Unified School Dist. v. California Office of Administrative Hearings
903 F.2d 635, 58 USLW 2682, 60 Ed. Law Rep. 728, 15 Fla. L. Weekly D2682

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Supreme Court of California,
In Bank.
Harvey MORRIS, Plaintiff and Respondent,
v.
Spencer W. WILLIAMS et al., Defendants and Appellants.

Sac. 7817.
Nov. 20, 1967.

Plaintiff, a recipient of welfare assistance and eligible for so-called Medi-Cal benefits, brought class action for permanent injunction and declaratory judgment that amended regulations concerning medical assistance program were invalid. The Superior Court, Sacramento County, Irving H. Perluss, J., entered judgment declaring regulations invalid and permanently enjoining their implementation, and defendants appealed. The Supreme Court, Sullivan, J., held, inter alia, that regulations pursuant to medical assistance program, popularly known as Medi-Cal, by reducing minimum coverage for recipients of public assistance by restricting physicians' services, without eliminating the medically indigent, were invalid. It was also held that regulations, by eliminating certain services entirely, violated statutory provisions requiring proportionate reductions to the extent feasible, in the absence of a sufficient showing that proportionate reductions were not feasible to some extent.

Judgment affirmed.

McComb and Burke, JJ., dissented.

West Headnotes

[1] Constitutional Law 92 ⚿2552

92 Constitutional Law
92XX Separation of Powers
92XX(C) Judicial Powers and Functions
92XX(C)3 Encroachment on Executive
92k2542 Particular Issues and Applications
92k2552 k. Health. Most Cited Cases
(Formerly 92k73)

Supreme Court's function was to inquire into legality of regulations of health and welfare agency reducing benefits provided under medical assistance program, and not their wisdom, and court would not superimpose upon agency any policy judgments of its own.

[2] Administrative Law and Procedure 15A ⚿390.1

15A Administrative Law and Procedure
15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
15AIV(C) Rules and Regulations
15Ak390 Validity
15Ak390.1 k. In General. Most Cited Cases
(Formerly 15Ak390)

Administrative regulations that violate acts of Legislature are void, and no protestations that they are merely an exercise of administrative discretion can sanctify them.

[3] Statutes 361 ⚿219(10)

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k213 Extrinsic Aids to Construction
361k219 Executive Construction
361k219(9) Particular State Statutes
361k219(10) k. Licenses and Taxes. Most Cited Cases
(Formerly 361k219)

Construction of statute by officials charged with its administration, including their interpretation of authority vested in them to implement and carry out its provisions, is entitled to great weight, but whatever the force of administrative construction final responsibility for interpretation of law rests with courts. West's Ann.Gov.Code, §§ 11000, 11373, 11374.

[4] Administrative Law and Procedure 15A ⚿390.1

15A Administrative Law and Procedure
15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
15AIV(C) Rules and Regulations
15Ak390 Validity
15Ak390.1 k. In General. Most Cited Cases
(Formerly 15Ak390)

Administrative regulations that alter or amend statute or enlarge or impair its scope are void, and courts not only may, but it is their obligation to strike down such regulations. West's Ann.Gov.Code, §§ 11000, 11373, 11374.

[5] Administrative Law and Procedure 15A ⚿754.1

15A Administrative Law and Procedure
15AV Judicial Review of Administrative Decisions
15AV(D) Scope of Review in General
15Ak754 Discretion of Administrative Agency
15Ak754.1 k. In General. Most Cited Cases
(Formerly 15Ak754)

It is unnecessary for Supreme Court to review administrative action for abuse of discretion, where court finds no discretion was in fact conferred. West's Ann.Gov.Code, §§ 11000, 11373, 11374.

[6] Statutes 361 ⚿149

361 Statutes
361V Repeal, Suspension, Expiration, and Revival
361k149 k. Power to Repeal in General. Most Cited Cases

Legislature could not bind its successors.

[7] Health 198H ⚿487(1)

198H Health
198HIII Government Assistance
198HIII(B) Medical Assistance in General; Medicaid
198Hk484 Providers
198Hk487 Reimbursement
198Hk487(1) k. In General. Most Cited Cases
(Formerly 356Ak241.60, 356Ak241)

Fact that medical assistance statute left open possibility that additional funds might yet be authorized in no way altered responsibility of administrator to spend appropriated amount only. Stats.1967, c. 1421; West's Ann.Welfare & Inst.Code, § 14000.1.

[8] Health 198H ⚿467

198H Health
198HIII Government Assistance
198HIII(B) Medical Assistance in General; Medicaid
198Hk466 Eligibility for Benefits
198Hk467 k. In General. Most Cited Cases
(Formerly 356Ak241.60, 356Ak241)

Section of medical assistance statute concerning mandatory order of priorities for reducing services and the permissive language of section relating to the medically indigent were not in conflict. West's Ann.Welfare & Inst.Code, §§ 14006.5, 14105.

[9] Health 198H ⚿467

198H Health
198HIII Government Assistance
198HIII(B) Medical Assistance in General; Medicaid
198Hk466 Eligibility for Benefits
198Hk467 k. In General. Most Cited Cases
(Formerly 356Ak241.60, 356Ak241)

Permissive language of welfare assistance statute section relating to the medically indigent means that the administrator may adopt one or more methods of reducing services and mandatory language of section establishing a mandatory order of priorities for reducing services to the two groups of persons covered by the act means that administrator must adopt some of such methods. West's Ann.Welfare & Inst.Code, §§ 14006.5, 14105.

[10] Health 198H ⚿473

198H Health
198HIII Government Assistance
198HIII(B) Medical Assistance in General; Medicaid
198Hk472 Benefits and Services Covered
198Hk473 k. In General. Most Cited Cases
(Formerly 356Ak241.91, 356Ak241.90, 356Ak241)

Regulations pursuant to medical assistance program, popularly known as Medi-Cal, by reducing minimum coverage for recipients of public assistance by restricting physicians' services, without eliminating the medically indigent, were invalid. West's Ann.Welfare & Inst.Code, §§ 14005, 14005.1, 14005.2, 14006, 14152; Social Security Act, § 1902(a)(10)(B), 42 U.S.C.A. § 1396a(a)(10)(B).

[11] Health 198H 473

198H Health
198HIII Government Assistance
198HIII(B) Medical Assistance in General; Medicaid
198Hk472 Benefits and Services Covered
198Hk473 k. In General. Most Cited Cases
(Formerly 356Ak241.91, 356Ak241.90, 356Ak241)

Specific requirement of medical assistance statute that in establishing scope of services to be provided director shall provide for recipients at least for a minimum coverage qualifies general authority to prescribe scope of services to be provided and constitutes a duty with which implementing regulations may not be inconsistent. West's Ann.Welfare & Inst.Code, § 14105.

[12] Health 198H 473

198H Health
198HIII Government Assistance
198HIII(B) Medical Assistance in General; Medicaid
198Hk472 Benefits and Services Covered
198Hk473 k. In General. Most Cited Cases
(Formerly 356Ak241.91, 356Ak241.90, 356Ak241, 356Ak1)

Section of medical assistance statute specifying manner in which administrator may act in following priorities for reducing services was not in conflict with section concerning proportionate reductions but containing no independent authorization to reduce services, and former statute was not impliedly repealed by the latter. West's Ann.Welfare & Inst.Code, §§ 14103.7, 14105.

[13] Administrative Law and Procedure 15A 754.1

15A Administrative Law and Procedure
15AV Judicial Review of Administrative Decisions
15AV(D) Scope of Review in General
15Ak754 Discretion of Administrative Agency
15Ak754.1 k. In General. Most Cited Cases
(Formerly 15Ak754)

It is duty and responsibility of courts to examine statutes with care to ascertain that Legislature indeed intended to subject administrative action to narrow scope of review that discretion occasions, and to identify with particularity the areas, if any, truly within administrative discretion.

[14] Health 198H 473

198H Health
198HIII Government Assistance
198HIII(B) Medical Assistance in General; Medicaid
198Hk472 Benefits and Services Covered
198Hk473 k. In General. Most Cited Cases
(Formerly 356Ak241.91, 356Ak241.90, 356Ak241, 356Ak24)

Section of medical assistance statute requiring proportionate reductions to the extent feasible confers no discretion upon administrator to decline to follow its mandate if proportionate reductions are feasible to some extent, and hence administrator must use every feasible means of curtailing expenditures in an effort

to reduce deficit so that no service need be eliminated, although he has discretion to select the means to be utilized if not all are necessary to produce the necessary savings. West's Ann.Welfare & Inst.Code, § 14103.7.

[15] Health 198H 467

198H Health
198HIII Government Assistance
198HIII(B) Medical Assistance in General; Medicaid
198Hk466 Eligibility for Benefits
198Hk467 k. In General. Most Cited Cases
(Formerly 356Ak241.60, 356Ak241)

Under medical assistance statute requiring proportionate reductions to the extent feasible, whether a particular measure is feasible is initially for administrator to determine, but his determination must be based on factors that the statute, as interpreted by courts, permits him to weigh, and he has no discretion to decline to adopt an economy measure, not specifically proscribed by law, on grounds unrelated to curtailment of expenditures. West's Ann.Welfare & Inst.Code, § 14103.7.

[16] Health 198H 467

198H Health
198HIII Government Assistance
198HIII(B) Medical Assistance in General; Medicaid
198Hk466 Eligibility for Benefits
198Hk467 k. In General. Most Cited Cases
(Formerly 356Ak241.60, 356Ak241)

Under medical assistance statute requiring proportionate reductions to the extent feasible, "feasible" means capable of being done and capable of producing a saving in a manner not otherwise barred by the statute. West's Ann.Welfare & Inst.Code, § 14103.7.

[17] Health 198H 473

198H Health
198HIII Government Assistance
198HIII(B) Medical Assistance in General; Medicaid
198Hk472 Benefits and Services Covered
198Hk473 k. In General. Most Cited Cases
(Formerly 356Ak241.91, 356Ak241.90, 356Ak241)

Medical assistance statute would justify fixing physicians' fees as a method of preventing the elimination of services. West's Ann.Welfare & Inst.Code, §§ 14103.7, 14104, subd. (c), par. 6; Stats.1967, c. 1421.

[18] Health 198H 467

198H Health
198HIII Government Assistance
198HIII(B) Medical Assistance in General; Medicaid
198Hk466 Eligibility for Benefits
198Hk467 k. In General. Most Cited Cases
(Formerly 356Ak241.60, 356Ak241)

Under medical assistance statute requiring proportionate reductions to the extent feasible, utilization of countyhospitals is a "feasible" measure. West's Ann.Welfare & Inst.Code, § 14103.7.

[19] Health 198H 473

198H Health
198HIII Government Assistance
198HIII(B) Medical Assistance in General; Medicaid
198Hk472 Benefits and Services Covered
198Hk473 k. In General. Most Cited Cases
(Formerly 356Ak241.91, 356Ak241.90, 356Ak241)

Regulations of administrator pursuant to medical assistance program, popularly known as Medi-Cal, by eliminating certain services entirely, violated statutory provision requiring proportionate reductions to the extent feasible, in the absence of a sufficient showing that proportionate reductions were not feasible to some extent. West's Ann.Welfare & Inst.Code, § 14103.7.

[20] Health 198H 503(2)

198H Health
198HIII Government Assistance
198HIII(B) Medical Assistance in General; Medicaid
198Hk499 Administrative Proceedings
198Hk503 Evidence
198Hk503(2) k. Presumptions and Burden of Proof. Most Cited Cases
(Formerly 356Ak241.115, 356Ak241)

Burden of going forward with evidence on issue of nonfeasibility of proportionate reductions under medical assistance statute was on defendants asserting validity of regulations eliminating certain services entirely. West's Ann.Welfare & Inst.Code, § 14103.7.

[21] Evidence 157 95

157 Evidence
157III Burden of Proof
157k95 k. Elements of Cause of Action or Claim. Most Cited Cases

Evidence 157 96(1)

157 Evidence
157III Burden of Proof
157k96 Matters of Defense and Rebuttal
157k96(1) k. In General. Most Cited Cases

A plaintiff ordinarily has burden of proving every allegation of complaint and a defendant approving any affirmative defense but fairness and policy may sometimes require a different allocation. West's Ann.Evid.Code, § 500.

[22] Evidence 157 93

157 Evidence
157III Burden of Proof
157k93 k. Facts Within Knowledge of Adverse Party. Most Cited Cases

Where evidence necessary to establish a fact essential to a claim lies peculiarly within knowledge and competence of one of parties, that party has burden of going forward with evidence on issue although it is not party asserting the claim. West's Ann.Evid.Code, § 500.

[23] Appeal and Error 30 237(2)

30 Appeal and Error
30V Presentation and Reservation in Lower Court of Grounds of Review
30V(B) Objections and Motions, and Rulings Thereon
30k234 Necessity of Motion Presenting Objection
30k237 At Trial or Hearing
30k237(2) k. Objections to Evidence and Witnesses in General. Most Cited Cases

Trial 388 66

388 Trial
388IV Reception of Evidence
388IV(B) Order of Proof, Rebuttal, and Reopening Case
388k65 Reopening Case for Further Evidence
388k66 k. In General. Most Cited Cases

Defendants' proper remedy for raising point of having been misled on issue of burden of proof was by motion to reopen following submission of cause, supported by affidavit showing good grounds, and, having failed to assert error properly in trial court, defendants were precluded from raising matter in Supreme Court.

[24] Appeal and Error 30 1061.3

30 Appeal and Error
30XVI Review
30XVI(J) Harmless Error
30XVI(J)15 Nonsuit
30k1061.3 k. In General. Most Cited Cases
(Formerly 30k1061(3))

Even if contention that defendants were misled on issue of burden of going forward on issue of non-feasibility of proportionate reduction under medical assistance were properly before Supreme Court, despite trial court's unfortunate language, defendants, under circumstances, should have known that burden rested on them, where court indicated that

plaintiffs had established a prima facie case and that a motion for nonsuit would fail and defendants in fact had examined Director of Health Care, the only witness, and had opportunity to elicit information allegedly such witness could have produced. West's Ann.Welfare & Inst.Code, § 14103.7.

[25] Health 198H 467

198H Health
198HIII Government Assistance
198HIII(B) Medical Assistance in General; Medicaid
198Hk466 Eligibility for Benefits
198Hk467 k. In General. Most Cited Cases
(Formerly 356Ak241.60, 356Ak241)

Neither section of medical assistance statute, expressing legislative intent that scope and duration of health services shall be at least equivalent to level provided in 1964-65 under public assistance programs, nor the urgency clause of 1967 amendment, prohibited reductions in services which accorded with directives of relevant statutory provisions. West's Ann.Welfare & Inst.Code, § 14000.1; Stats.1967, c. 1421.

***691 **699 *736** Thomas C. Lynch, Atty. Gen., Walter J. Wiesner and Richard L. Mayers, Deputy Attys. Gen., for defendants and appellants.

***737** Peart, Hassard, Smith & Bonnington, Howard Hassard, San Francisco, Musick, Peeler & Garrett and James E. Ludlam, Los Angeles, as amici curiae on behalf of defendants and appellants.

Sheldon L. Greene, Clark F. Ide, Modesto, George Bodle, Bodle & Fogel, Los Angeles, and James Ahern, North Hollywood, for plaintiff and respondent.

Wilke, Fleury, Sapunor & Hoffelt, Richard H. Hoffelt, Sacramento, Charles P. Scully, San Francisco, David B. Finkel, Bodle, Fogel, Julber & Reinhardt, George E. Bodle, Daniel Fogel, Stephen Reinhardt and Loren R. Rothschild, Los Angeles, as amici curiae on behalf of plaintiff and respondent.

***692 **700** SULLIVAN, Justice.

[1][2] We are called upon to inquire into the validity of certain amended regulations of the Health and Welfare Agency reducing benefits provided under the California Medical Assistance Program, popularly known as Medi-Cal. Accordingly, as required by long established and unassailable California precedents, we here discharge our responsibility to determine whether the Agency has acted in obedience to the mandate of the Legislature or has ignored or violated it. Our function is to inquire into the legality of the regulations, not their wisdom. Nor do we superimpose upon the Agency any policy judgments of our own. Administrative regulations that violate acts of the Legislature are void and no protestations that they are merely an exercise of administrative discretion can sanctify them. They must conform to the legislative will if we are to preserve an orderly system of government.

As we shall explain, we have concluded that the regulations under review are violative of the pertinent law in two major respects: (1) by restricting physicians' services for recipients of public assistance without eliminating the medically indigent from the Medi-Cal program; and (2) by eliminating certain services entirely in the absence of a showing that proportionate reductions were not feasible to some extent. We hold that the trial court properly enjoined their implementation. We therefore affirm the judgment.

Plaintiff, a recipient of welfare assistance eligible for Medi-Cal benefits, commenced the instant class action on behalf of himself and all other persons eligible for assistance under the Medi-Cal program[FN1] for the purpose of challenging the ***738** validity of the regulations. Defendants[FN2] appeal[FN3] from the ensuing judgment declaring the regulations invalid and permanently enjoining their implementation.[FN4]

FN1. Plaintiff alleges that the members of such class are readily ascertainable from the records of the Department of Social Welfare and the respective county welfare departments, but are so numerous as to make joinder impracticable; and that the issues of law and fact are common to all members of the represented class.

FN2. Defendants are: Spencer W. Williams, Administrator of the Health and Welfare Agency (hereafter Administrator and Agen-

cy); Carel Mulder, Director of the California Office of Health Care (hereafter Director of Health Care); and John Montgomery, Director of the State Department of Social Welfare (hereafter Director of Social Welfare).

FN3. Defendants appealed to the Court of Appeal for the Third Appellate District. Upon the request of the parties and in view of the importance and urgency of the matter involved we ordered the cause transferred to this court. (Cal.Rules of Court, rule 20.)

FN4. The judgment recites that such amended regulations are declared invalid pursuant to section 11440 of Government Code. That section, which is found in the Administrative Procedure Act (ch. 4, art. 5 of pt. 1 of div. 3 of tit. 2; and see s 11370), provides as follows:

'Any interested person may obtain a judicial declaration as to the validity of any regulation by bringing an action for declaratory relief in the superior court in accordance with the provisions of the Code of Civil Procedure and in addition to any other ground which may exist, such regulation may be declared to be invalid for a substantial failure to comply with the provisions of this chapter or, in the case of an emergency regulation or order of repeal, upon the ground that the facts recited in the statement do not constitute an emergency within the provisions of Section 11421(b).'

The Medi-Cal program is found in chapters 7 and 8 of part 3 of division 9 of the Welfare and Institutions Code (s 14000 et seq.).[FN5] These statutes were enacted by the Legislature at the 1965 Second Extraordinary Session in order to establish a program of basic and extended health care services for recipients of public assistance and for medically indigent persons (ss 14000 et seq., 14500 et seq.) and, by meeting the requirements of federal law, to qualify California for the recipt of federal funds ***693 **701 made available under title XIX of the Social Security Act. An outline of the pertinent provisions of these statutes is essential to a grasp of the issues now presented to us.

FN5. Hereafter, unless otherwise indicated, all section references are to the Welfare and Institutions Code.

The Federal Statute

Title XIX, enacted by Congress in 1965 as Public Law 89-97, authorizes the Secretary of Health, Education and Welfare to make payments to states whose medical assistance programs meet the requirements of the statute. (42 U.S.C.A. s 1396.)[FN6] A state plan must cover individuals receiving aid or *739 assistance under federally aided state programs for the aged, blind, disabled, and needy families with children; these groups must be treated equally. Persons who do not meet the income requirements for such aid or assistance may also be covered, but in 'amount, duration, or scope' no greater than extended to cash recipients. (42 U.S.C.A. s 1396a(a)(10).)[FN7] A state must provide at least five categories of medical assistance: inpatient hospital services; outpatient hospital services; other laboratory and X-ray services; skilled nursing home services; and physicians' services, wherever furnished. (*740***694**70242 U.S.C.A. ss 1396a(a)(13),[FN8] 1396d(a)(1-5).[FN9]) The plan may not require any contribution by the individual towards payment for inpatient hospital services. (42 U.S.C.A. s 1396a(a)(14)(A).)

FN6. 42 U.S.C.A. section 1396 provides: 'For the purpose of enabling each State, as far as practicable under the conditions in such State, to furnish (1) medical assistance on behalf of families with dependent children and of aged, blind, or permanently and totally disabled individuals, whose income and resources are insufficient to meet the costs of necessary medical services, and (2) rehabilitation and other services to help such families and individuals attain or retain capability for independence or self-care, there is hereby authorized to be appropriated for each fiscal year a sum sufficient to carry out the purposes of this subchapter. The sums made available under this section shall be used for making payments to States which have submitted, and had approved by the Secretary of Health, Education, and Welfare, State plans for medical assistance.'

FN7. 42 U.S.C.A. section 1396a provides in

pertinent part: '(a) A State plan for medical assistance must-* * * (10) provide for making medical assistance available to all individuals receiving aid or assistance under State plans approved under subchapters I, IV, X, XIV, and XVI of this chapter, and-

'(A) provide that the medical assistance made available to individuals receiving aid or assistance under any such State plan-(i) shall not be less in amount, duration, or scope than the medical assistance made available to individuals receiving aid or assistance under any other such State plan, and (ii) shall not be less in amount, duration, or scope than the medical or remedial care and services made available to individuals not receiving aid or assistance under any such plan; and

'(B) if medical or remedial care and services are included for any group of individuals who are not receiving aid or assistance under any such State plan and who do not meet the income and resources requirements of the one of such State plans which is appropriate, as determined in accordance with standards prescribed by the Secretary, provide-(i) for making medical or remedial care and services available to all individuals who would, if needy, be eligible for aid or assistance under any such State plan and who have insufficient (as determined in accordance with comparable standards) income and resources to meet the costs of necessary medical or remedial care and services, and (ii) that the medical or remedial care and services made available to all individuals not receiving aid or assistance under any such State plan shall be equal in amount, duration, and scope; * * *.'

The five subchapters mentioned in subparagraph (10) above are entitled respectively as follows: I (s 301, et seq.)-Grants to States For Old-Age Assistance and Medical Assistance For The Aged; IV (s 601 et seq.)-Grants To States For Aid And Services To Needy Families With Children; X (s 1201 et seq.)-Grants To States For Aid To The Blind; XIV (s 1351 et seq.)-Grants to States for Aid To The Permanently and Totally Disabled; and XVI (s 1381 et seq.)-Grants To States For Aid To The Aged, Blind, Or Disabled, Or For Such Aid And Medical Assistance For The Aged.

FN8. 42 U.S.C.A. section 1396a provides in pertinent part: '(a) A State plan for medical assistance must-* * * (13) provide for inclusion of some institutional and some non-institutional care and services, and, effective July 1, 1967, provide (A) for inclusion of at least the care and services listed in clauses (1) through (5) of section 1396d(a) of this title, and (B) for payment of the reasonable cost (as determined in accordance with standards approved by the Secretary and included in the plan) of inpatient hospital services provided under the plan; * * *.'

FN9. 42 U.S.C.A. section 1396d(a) lists such care and services as follows: '(1) inpatient hospital services (other than services in an institution for tuberculosis or mental diseases); (2) outpatient hospital services; (3) other laboratory and X-ray services; (4) skilled nursing home services (other than services in an institution for tuberculosis or mental diseases) for individuals 21 years of age or older; (5) physicians' services, whether furnished in the office, the patient's home, a hospital, or a skilled nursing home, or elsewhere; * * *.'

In addition to these and other specific requirements, the federal statute provides that the Secretary 'shall not make payments * * * unless the State makes a satisfactory showing that it is making efforts' to broaden 'the scope of the care and services made available under the plan' and to liberalize 'the eligibility requirements for medical assistance, with a view toward furnishing by July 1, 1975, comprehensive care and services to substantially all individuals who meet the plan's eligibility standards * * *.' (42 U.S.C.A. s 1396b(e).)

The California Statute

As previously stated, the Medi-Cal program provides for basic health care (ch. 7) and extended health services (ch. 8). It is the purpose of chapter 7 'to afford basic health care and related remedial or preventive services to recipients of public assistance and to

medically indigent aged and other persons, including related social services which are necessary for those receiving health care under this chapter and Chapter 8 (commencing with Section 14500).' (s 14000, 1st par.) The Legislature expressed its intent to provide through chapter 7 'for basic health care for those aged and other persons, including family persons who lack sufficient annual income to meet the costs of health care, and whose other assets are so limited that their application toward the cost of such care would jeopardize the person or family's future minimum self-maintenance and security.' (s 14000, 2nd par.) It also expressed its intent 'that the scope and duration of health services under this chapter and Chapter 8 (commencing with Section 14500) ***741** shall be at least equivalent to the level provided in 1964-65 under public assistance programs.' (s 14000.1) 'Basic health care * * * may include diagnostic, preventive, corrective, and curative services and supplies essential thereto * * * for conditions that cause suffering, endanger life, result in illness or infirmity, interfere with capacity for normal activity including employment, or for conditions which may develop into some significant handicap.' (s 14059.) The specific categories of basic health care are those listed in the federal statute. (s 14053, following 42 U.S.C.A. s 1396d.)

The Legislature authorized the Administrator of the Health and Welfare Agency to administer the program. Section 14105,[FN10] *****695 **703** reenacted by chapter 104 of the 1967 statutes, contains the legislative mandate: 'The director (the Administrator of the Health and Welfare Agency, as defined in section 14060) shall prescribe the policies to be followed in the administration * * * (of the program) and the scope of the services to be provided, and may limit the rates of ***742** payment for such services, and shall adopt such rules and regulations as are necessary for carrying out, not inconsistent with, the provisions (of the statute). * * * Insofar as practical, consistent with the efficient and economical administration of this part, the department (the Health and Welfare Agency, as defined in section 14062) shall afford recipients of public assistance free choice of arrangements under which they shall receive basic health care. * * *'

FN10. For convenience or reference, we set forth In toto the provisions of section 14105 as reenacted in 1967: 'The director shall prescribe the policies to be followed in the administration of this chapter and Chapter 8 (commencing with Section 14500) and the scope of the services to be provided, And may limit the rates of payment for such services, and shall adopt such rules and regulations as are necessary for carrying out, * * * not inconsistent with, the provisions thereof.

'Such policies and regulations shall include rates for payment for services not rendered under a contract pursuant to Section 14104. Standards for costs shall be based on payments of the reasonable cost for such services.

'Insofar as practical, consistent with the efficient and economical administration of this part, the department shall afford recipients of public assistance free choice of arrangements under which they shall receive basic health care.

'In establishing the scope of services to be provided, the director shall provide for recipients at least for a minimum coverage as defined in Section 14056, and insofar as possible shall include other health care and related remedial or preventive services giving priority to those services which are considered to have the greatest value in preventing or reducing the likelihood of future high cost medical services.

'Notwithstanding the provisions of the preceding paragraph, and in accordance with the intent of this chapter and Chapter 8 (commencing with Section 14500), the director, with respect to medically indigent persons, may limit, by appropriate classifications, the number of medically indigent persons eligible, and may limit the scope and kinds of basic health care and extended health services to which such persons are entitled, to the extent necessary to operate programs under this part within the limits of appropriated funds. When and if necessary, such action shall be taken by the director with the advice of the Health Review and Program Council and in ways consistent with the requirements of the Federal Social Security Act.'

(The italicized portion was added by chapter 104 of the 1967 statutes as the only change in the original version of the section.)

Section 14105 further requires that 'In establishing the scope of services to be provided, the director shall provide for recipients (of public assistance) at least for a minimum coverage'-defined by section 14056 as the five basic services required by 42 U.S.C.A. s 1396a(a)(13) (see fns. 8 and 9, ante)-'and insofar as possible shall include other health care and related remedial or preventive services giving priority to those services which are considered to have the greatest value in preventing or reducing the likelihood of future high cost medical services.' Section 14152 expresses 'the intention of the Legislature, whenever feasible, that the needs of recipients of public assistance for health care and related remedial or preventive services be met under the provisions of this chapter.' Explicit priorities favoring recipients of public assistance over those whose 'income and resources are comparable' are set forth in section 14006.5,[FN11] which provides***696 **704** that the 'director shall reduce services in accordance with the priorities.'

FN11. Section 14006.5 provides: 'Health care shall be provided, as soon as practicable under this chapter and Chapter 8 of this part, to persons and families who would, had they chosen to apply, have been considered as medically indigent and eligible for medical or other assistance under the state programs in effect in December 1965.

'Health care shall, within the limits of available funds and in accordance with federal law, be extended to other persons and families in accordance with the following priorities:

'(a) Public assistance recipients and persons and families who would be eligible for public assistance but for the fact that they do not meet the durational residence requirements prescribed for public assistance.

'(b) Persons and families whose income and resources are comparable to those in receipt of public assistance.

'(c) Persons and families whose income and resources are comparable to the standard for the medical assistance for the aged program in effect in December 1965.

'(d) Persons and families whose income and resources are comparable to the standard for the aid to the blind program in effect in December 1965.

'If sufficient funds are not available to provide health care for all of the persons enumerated in this section, the director shall reduce services in accordance with the priorities set forth in this section and in accordance with the provisions of Section 1902(a)(14) of the Federal Social Security Act.'

*743 Section 14105 provides also that the Administrator 'may limit, by appropriate classifications, the number of medically indigent persons eligible, and may limit the scope and kinds of basic health care and extended health services to which such persons are entitled, to the extent necessary to operate programs under this part within the limits of appropriated funds. When and if necessary, such action shall be taken by the director with the advice of the Health Review and Program Council * * *.'

Additional standards for the Administrator's guidance are contained in chapter 1421 of the 1967 statutes, approved by the Governor and filed with the Secretary of State, August 25, 1967. The act is 'an urgency statute' which took effect immediately 'In order that the California Medical Assistance Program be permitted to operate at its present level, as contemplated by the Legislature.' (Ch. 1421, s 3.) Medi-Cal expenditures from state sources for the fiscal year 1967-68 may not exceed $305 million, 'except that with the approval of the Director of Finance additional amounts may be expended if they are obtained by transfer from other sources as authorized by the Legislature.' (Ch. 1421, s 4.)

The new act adds section 14120 to the Welfare and Institutions Code, requiring the Administrator, with the approval of the Director of Finance, to 'set up a monthly schedule of anticipated total payments and payments for physicians' services * * * for the fiscal year. (s 14120, subd. (a).) 'At any time the total

amounts paid for physicians' services since the beginning of the fiscal year exceed by 10 percent the amounts scheduled to have been paid by that time, the administrator shall so inform the Director of Finance and at that time the administrator shall modify the method of payment of usual and customary fees to physicians to assure that the total amount paid for physicians' services in the fiscal year shall not exceed the total amount scheduled.' (s 14120, subd. (c).) Similarly, when Total payments exceed by 10 percent the amount scheduled, the Administrator 'within 30 days * * * shall institute program reductions which shall in his judgment assure that total payments in the fiscal year shall not exceed' available revenues. (s 14120, subd. (d).)

Section 14103.7, also added by the new statute, provides that the Administrator, 'when reducing services under this chapter (chapter 7) and Chapter 8 of this part in order to maintain the program within the fiscal limits fixed by the ***744** Legislature, shall, to the extent feasible, make proportionate reductions in all services, rather than eliminating any service or services entirely.'

The Administrator must present a comprehensive report to the Legislature not later than January 31, 1968, including details of payment rates, program reductions, and 'expenditure reductions caused by program reductions' for each type of service. (Ch. 1421, s 5(7).)

The Regulations

Defendants adopted the challenged regulations as an emergency measure to take effect September 1, 1967. The emergency, as recited in the order of the Health and Welfare Agency, arose from the budget limitation of Medi-Cal expenditures in the 1967-68 fiscal year to $305 million. With the federal contribution added, and over-obligations from the previous fiscal year subtracted, approximately $600 million are available for program benefits in 1967-68. At existing rates of program expenditures, however, the total expenditures for the year would approximate $811 million. The emergency measure was designed to *****697 **705** prevent the potential over-expenditure of $211 million by curtailing program benefits available under regulations in effect August 31, 1967.

Several of the changes restrict the scope of 'minimum coverage' as defined in section 14056. Regulation 51305 of title 22, California Administrative Code, providing for physicians' services for recipients of public assistance is amended to Exclude coverage for non-emergency surgery; routine care of nails, corns, and callouses; outpatient psychiatric care; eye refractions except after operations; pleoptics and orthoptics; hearing examinations for the purpose of hearing aid utilization; drugs administered by physicians except those listed in the state formulary; and services rendered beyond eight days in a private hospital or rehabilitation center except when approved by a Medi-Cal consultant. The same limitations on physicians' services are imposed upon the medically indigent under amended regulation 51403(a).

Inpatient hospital services are another category of 'minimum coverage' modified by defendants' order. Amended regulation 51327(a), which applies to recipients of public assistance, limits these services to a maximum of eight consecutive days in a noncounty hospital, unless extended by a Medi-Cal consultant. Regulation 51405 applies the same limitation to the medically indigent.

Amended regulation 51307 limits dental services to 'the ***745** relief of pain or the elimination of acute infection,' and eliminates diagnostic and restorative dental services.

The services of chiropractors, spiritual healers, occupational therapists, psychologists, and audiologists are eliminated. Physical and speech therapy is covered 'only when provided to an inpatient * * * under an arrangement whereby the cost of services are included in the payment formula of the institution.' (Amended reg. 51309(c).)

Discharge medications are limited to a maximum of 14 days' supply. (Amended reg. 51313.) Eliminated are prosthetic and orthotic appliances (reg. 51315), hearing aids (reg. 51319), and assistive devices (reg. 51321). Eyeglasses are covered 'only for the initial restoration of adequate vision following extraction of the lens of the eye.' (Amended reg. 51317.)

Home health care services are limited to 14 days and may be extended by the Medi-Cal consultant to a maximum of 30 days. (Amended reg. 51337.) Special duty nursing (reg. 51339) is eliminated.

Findings of Fact and Conclusions of Law[FN12]

FN12. The cause was advanced for hearing on the merits by stipulation of the parties.

The trial court found so far as is here material that insufficient funds are available for expenditure during the 1967-68 fiscal year to finance the Medi-Cal program at the level provided for in the regulations prior to their amendment and at the level of health services provided in 1964-65 under public assistance programs; that the amended regulations delete as physicians' services, Inter alia, psychiatric service (other than inpatient care) and eye refractions (except as necessary following extraction of the lens of the eye) for recipients of public assistance; that the amended regulations eliminated some health services entirely and did not make proportionate reductions in all such services; that the amended regulations do not exclude the medically indigent as defined in section 14005, subdivisions (b) and (c) and in portions of section 14006.5; that the Administrator did not provide explanations convincing to the court of the lack of feasibility of proportionate reductions in services;[FN13] and that curtailment of expenditure reasonably may be possible to permit proportionate reduction in service particularly in the ***746** utilization of public hospital facilities and in the establishment of *****698 **706** fee schedules for providers where not now established.

FN13. This finding contained the following: 'The Court did indicate to the parties at the hearing that the burden of proof in this regard rested on the plaintiff.'

The trial court concluded that the Administrator 'properly cannot maintain' the Medi-Cal program at the expenditure level of the preceding fiscal year or at the 1964-65 level; that section 14000.1 has been modified by chapter 1421, particularly section 4 of the measure and section 14103.7; that section 14006.5 has been modified by chapter 104, statutes of 1967 and particularly section 14105; that chapter 1421, statutes of 1967 did not modify section 14006.5 or section 14105 (as reenacted in 1967); and that 'the amended regulations by providing for the elimination of some services entirely and not proportionately, in the absence of explanation by the Administrator convincing to the Court of lack of feasibility, as heretofore found, are violative of section 14103.7 * * * and the amended regulations are invalid in this regard.'

The court further concluded that 'amended regulations by eliminating as physicians' services, certain psychiatric service and eye refractions do not provide for the minimum coverage for public assistance recipients as required by sections 14105, 14056 and 14053 * * * and the amended regulations are invalid in this regard'; and that the 'amended regulations do not provide for the limitation of care for the medically indigent to the extent necessary to operate the program within the limits of appropriated funds as directed by section 14105 * * * as reenacted * * * and the amended regulations insofar as they reduce minimum coverage to public assistance recipients are invalid.'

Judgment was entered accordingly. This appeal followed.

The parties' positions may be conveniently summarized as follows. Defendants' position may be analyzed as two principal assertions:

(1) That the amended regulations are valid under section 14103.7. Upon this issue, defendants urge that although the Administrator eliminated some services entirely instead of reducing all services proportionately, he acted within the discretion conferred by the statute to determine whether across-the-board reductions were 'feasible.' The record, they argue, supports as reasonable the Administrator's considered decision not to curtail expenditures by utilizing public hospitals or by establishing fee schedules for physicians. The trial court, however, improperly reviewed the Administrator's judgment not for abuse of discretion, but for correctness or wisdom. Moreover, defendants contend, the court's admittedly***747** misleading indication to the parties that the burden of proof on the 'feasibility' issue rested on Plaintiffs, taints the finding that Defendants did not convincingly explain why proportionate reductions were unfeasible.

(2) That the amended regulations are valid under section 14105. The argument runs as follows: Although the Administrator reduced the 'minimum coverage' for recipients of public assistance, he acted within the discretion conferred by the statute to define the scope of that coverage. Moreover, the statute permits him to meet budgetary limitations by restricting the basic five services without eliminating the medically indigent from the program. The record, defendants contend, supports as reasonable the Administrator's considered decision to limit coverage for

physicians' services and not to curtail expenditures by striking the medically indigent. The trial court, however, erroneously construed the statute to preclude such a determination. If section 14105 does require elimination of persons before reduction of services, defendants urge that it should be deemed modified in that regard by section 14103.7, more recently enacted.

Plaintiffs' position consists essentially of four contentions:

(1) That the amended regulations violate section 14000.1 by reducing the 'scope and duration of health services' below the level provided in 1964-65 under public assistance programs. Plaintiffs urge that the trial court erroneously concluded ***699 **707 that section 14000.1 was modified by chapter 1421, statutes of 1967; whereas section 3 of chapter 1421 recites the Legislature's intention, consistent with section 14000.1, that the program 'be permitted to operate at its present level.'

(2) That the amended regulations violate sections 14105, 14053 subdivision (5) and 14056, by reducing 'physicians' services' for recipients of public assistance. Plaintiffs argue that the statute's general language mandates unqualified physicians' services; the Administrator may control their utilization by requiring prior authorizations, but may not reduce their scope.

(3) That the amended regulations violate section 14120 subdivision (c), added by chapter 1421, by failing to establish monthly schedules of payments for physicians' services. The Administrator thus illegally avoided his duty to 'modify the method of payment of usual and customary fees' should payments exceed the scheduled amounts by 10 percent.

(4) That the amended regulations violate section 14103.7 by eliminating some services entirely. Upon this issue, the *748 argument runs as follows: The evidence presented at the hearing fails to show that the Administrator discharged his duty to determine whether proportionate reductions were 'feasible.' Material prepared After the hearing contains a superficial analysis of the problem. The record as a whole supports the finding that proportionate reductions 'reasonably may be possible. Thus, plaintiffs contend, defendants failed to meet their burden of proving the contrary proposition.

[3][4] Before proceeding to consider the parties' contentions, we deem it proper to delineate the scope of judicial review of the administrative actions plaintiffs attack. Under Government Code section 11373, 'Each regulation adopted (by a state agency),[FN14] to be effective, must be within the scope of authority conferred * * *.' Whenever a state agency is authorized by statute 'to adopt regulations to implement, interpret, make specific or otherwise carry out the provisions of the statute, No regulation adopted is valid or effective unless consistent and not in conflict with the statute. * * *' (Italics added.) (Gov.Code, s 11374.) Our first duty, therefore, is to determine whether the Administrator exercised quasi-legislative authority within the bounds of the statutory mandate. While the construction of a statute by officials charged with its administration, including their interpretation of the authority invested in them to implement and carry out its provisions, is entitled to great weight, nevertheless 'Whatever the force of administrative construction * * * final responsibility for the interpretation of the law rests with the courts.' (Whitcomb Hotel v. Cal. Emp. Com. (1944) 24 Cal.2d 753, 756-757, 151 P.2d 233, 155 A.L.R. 405, and authorities there collected.) Administrative regulations that alter or amend the statute or enlarge or impair its scope are void and courts not only may, but it is their obligation to strike down such regulations. (Whitcomb Hotel v. Cal. Emp. Com., supra; Hodge v. McCall (1921) 185 Cal. 330, 334, 197 P. 86; Boone v. Kingsbury (1928) 206 Cal. 148, 161-162, 273 P. 797; First Industrial Loan Co. of California v. Daugherty (1945) 26 Cal.2d 545, 550, 159 P.2d 921; see Brock v. Superior Court (1938) 11 Cal.2d 682, 688, 81 P.2d 931.)

> FN14. Government Code section 11000 in pertinent part provides: As used in this title (title 2 'Government of the State of California') 'state agency' includes every state office, officer, department, division, bureau, board, and commission.'

[5] If we conclude that the Administrator was empowered *749 to adopt the regulations, we must also determine whether the regulations are 'reasonably necessary to effectuate the purpose of the statute.' (Gov.Code, s 11374.) In making such a determination, the court will not 'superimpose its own policy judgment upon the agency in the absence of its arbitrary and capricious decision.' (***700**708Pitts v. Per-

luss (1962) 58 Cal.2d 824, 832, 27 Cal.Rptr. 19, 25, 377 P.2d 83, 89; Ray v. Parker (1940) 15 Cal.2d 275, 311, 101 P.2d 665.) But we need not make such a determination if the regulations transgress statutory power. (Whitcomb Hotel v. Cal. Emp. Com., supra, 24 Cal.2d 753, 759, 151 P.2d 233, 155 A.L.R. 405.) To put it another way, it is unnecessary for us to review administrative action for abuse of discretion, where we find no discretion was in fact conferred. With the foregoing principles in mind, we proceed to a consideration of the issues before us.

The trial court found, and defendants stipulated, that the amended regulations reduce Medi-Cal below the level of medical assistance provided under 1964-65 programs. (s 14000.1.) The regulations thus contravene the legislative intent expressed in section 14000.1.

Chapter 1421 of the 1967 statutes provides for a maximum of $305 million in state funds for Medi-Cal in 1967-68. It is undisputed that the 1964-65 level of health care 'scope and duration' cannot be maintained under that appropriation.

[6] The Administrator is empowered to spend no more than the appropriated amount. His authority must therefore be measured by the annual budgetary provisions. Section 14000.1, by contrast, contains no mandate directed to the Administrator that defines his spending power. Rather, that section is directed to future Legislatures informing them of a principal long-term goal of Medi-Cal founders. The 1965 Legislature, of course, could not bind its successors and did not intend to do so. Nothing in section 14000.1 prevents the 1967 Legislature from establishing different goals or modifying old ones to accord with fiscal realities.

Plaintiffs urge, however, that chapter 1421 in its urgency clause reaffirms the objective of section 14000.1 by expressing the Legislature's 'contemplation' that Medi-Cal 'be permitted to operate at its present (1966-67) level.' The Legislature, however, clearly contemplated that program reductions may be necessary to meet fiscal limitations. For that reason chapter 1421 contains numerous provisions for reduction and possible elimination of services, and requires the Administrator to report such actions by January 31, 1968. To focus on ***750** the precatory language of the urgency clause is to miss the central impact of the act: that the limited appropriation may compel program cuts that would necessarily reduce the 1966-67 level.

[7] The fact that the statute leaves open the possibility that additional funds may yet be authorized, in no way alters the responsibility of the Administrator to spend the appropriated amount only. The possibility of legislative relief is, in theory, always available. We agree with the trial court that the Administrator was entitled to proceed on the practical assumption that no further financial succor was forthcoming.

The first issue presented as to the propriety of the reductions is whether the Medi-Cal statute authorizes the Administrator to reduce the minimum coverage for recipients of public assistance (hereafter sometimes 'recipients') without eliminating the medically indigent from the program.

The record reveals that the elimination of the medically indigent would produce a reduction of expenditures estimated at $145 million. The Director of Health Care testified that the regulations eschewed this method of reducing the estimated $210 million deficit on the ground that the counties would be forced to care for the medically indigent without the benefit of federal matching funds and with an injurious effect on local tax rates. Defendants contend that these reasons suffice to uphold their decision as a reasonable exercise of administrative discretion.

Federal law enables states to include medically indigent persons in medical assistance programs that qualify for federal grants. The inclusion of that group, however, is not required by federal law; a plan providing only for recipients of public assistance fully meets the qualifications of 42 U.S.C.A. section 1396a(a)(10). (See fn. 7, ante.)

*****701 **709** Accordingly, California's Medi-Cal legislation includes coverage of persons not receiving public assistance whose income and resources and not sufficient to meet the cost of health care (ss 14000; 14005; [FN15] 14006.5; 14051[FN16]), but ***751** clearly expresses priorities favoring public assistance recipients. (ss 14006.5-see fn. 11, ante, 14105-see fn. 10, ante.) Section 14006.5 foresees the possibility that 'sufficient funds' may not be available to provide 'health care' for all persons initially covered. In that event, the Administrator 'shall reduce

services in accordance with the priorities set forth in this section. * * *' (Italics added.) Upon analysis, the designated priorities indicate general categories: First, persons receiving public assistance; and second, persons 'whose income and resources are comparable' to those in receipt of public assistance or to the standards prescribed for other specified aid and assistance.

> FN15. Section 14005 in pertinent part provides that basic health care shall be provided 'to any person who is a resident of the state and is: (a) A recipient of public assistance; or (b) A medically indigent adult person (of specified income) * * *; or (c) A medically indigent family person in a family (of specified income) * * *.'
>
> FN16. Section 14051 provides: "Medically indigent person' means an aged or other person who is not currently receiving public assistance, but whose income and resources as defined by regulations are not sufficient to meet the cost of maintenance and health care or coverage.'

The clear preference for recipients of public assistance appears also in section 14105 (see fn. 10, ante), reenacted in 1967 with one change not relevant here. That section requires the Administrator to 'provide for Recipients at least for a minimum coverage'-the basic five services as defined in sections 14056 and 14053-and, 'insofar as possible,' other services, 'giving priority to' preventive care. By contrast, the same section provides that the Administrator 'may limit, by appropriate classifications, the number of Medically indigent persons eligible, and May limit the scope and kinds' of health care to which they are entitled, 'to the extent necessary to operate programs under this part within the limits of appropriated funds.' (Italics added.)

The trial court determined that a conflict existed between the mandatory order of priorities established in section 14006.5, and the permissive language relating to the medically indigent in section 14105.[FN17] The court concluded ***752** that section 14105 modifies section 14006.5 by virtue of recent reenactment. Nevertheless, the court held that by reducing minimum coverage for recipients without eliminating the medically indigent, the Administrator violated section 14105. We reach the same holding through a somewhat different analysis.

> FN17. The trial court's conclusion on this point is subject to another interpretation as well. It may be that the conflict found is between the first sentence of section 14006.5 (see fn. 11, ante), requiring that 'Health care Shall be provided' to a certain category of 'medically indigent,' and the last paragraph of section 14105, under which the Administrator 'may limit' services provided to the medically indigent. (Italics added.) An examination of the record reveals, however, that the first sentence of section 14006.5 was never discussed by the parties or the court. Only that part of the section which sets forth priorities among eligible groups was argued below. In its memorandum opinion, the trial court phrased the question as 'whether section 14006.5 and its system of priorities has been modified.' The court's conclusion that the section has been modified, therefore, reasonably pertains to the system of priorities. The first sentence of section 14006.5 is in fact irrelevant to the issues in this case. It merely describes a category of eligible persons to be included in the program from its inception, continuing the eligibility criteria dealt with in the immediately preceding sections 14005 (see fn. 15, ante), 14005.1, 14005.2 and 14006. The eligibility of any group was not an issue before the trial court; the system of priorities among eligible groups was.

[8] We find no conflict between sections 14006.5 and 14105. Both are part of the original Medi-Cal legislation, and the *****702 **710** reenactment of the latter section in 1967 left unchanged its language relating to recipients of public assistance and to the medically indigent. Our examination of the two sections fails to convince us that they are 'irreconcilable, clearly repugnant, and so inconsistent as to prevent their concurrent operation' (Warne v. Harkness (1963) 60 Cal.2d 579, 588, 35 Cal.Rptr. 601, 606, 387 P.2d 377, 382; California Drive-In Restaurant Assn. v. Clark (1943) 22 Cal.2d 287, 292, 140 P.2d 657, 147 A.L.R. 1028; see People v. Harmon (1960) 54 Cal.2d 9, 26, 4 Cal.Rptr. 161, 351 P.2d 329) and that the settled presumption against repeal or modification by implication has been overcome.

[9] Section 14006.5 indeed establishes a mandatory order of priorities for reducing services to the two groups of persons covered by the act. [FN18] Section 14105 specifies the manner in which the Administrator may act in following the priorities of section 14006.5. He 'may limit' the number of the medically indigent eligible for any coverage; he 'may limit' the coverage provided to those medically indigent who are eligible; and he 'shall' seek the 'advice' of the Health Review and Program Council when acting in either way. The 'permissive' language of section 14105 means that the Administrator*753 may adopt one or more of these methods; the mandatory language of section 14006.5 means that he must adopt some. In short, section 14105 tells the Administrator what he may do about the medically indigent when section 14006.5 tells him to do something.

> FN18. Although the language of section 14006.5 is hardly a model of clarity, we are satisfied that the section establishes the priority of recipients of public assistance over the medically indigent. The low-priority group is described by the section as 'Persons and families whose income and resources are comparable' to those in receipt of public assistance or to standards for other specified aid and assistance. A reference to 'comparable standards' is found also in 42 U.S.C.A. section 1396a(a)(10)(B) (see fn. 7, ante) dealing with the group whose coverage is optional with the states. Since this group is Not in receipt of public assistance, it can only be covered by the program at all if it consists of medically indigent (see ss 14005 (fn. 15, ante), 14051 (fn. 16, ante)). The administrative regulations also refer to persons covered as two groups: Group I consists of recipients of public assistance, and Group II of medically indigent. Moreover, one of the trial court's findings refers to the 'medically indigent as defined' in 'portions of section 14006.5.' This was also the parties' understanding. In fact, both counsel stated at oral argument that the section establishes the priorities as we have construed them.

The event that triggers this duty under section 14006.5 is the insufficiency of funds to provide 'health care' for all. Section 14105 requires that the basic five services be provided to recipients of public assistance. When the Administrator seeks to meet budgetary limitations by reducing the hard core of the program, the clearest case of insufficient funds under section 14006.5 appears.

The requirement of minimum coverage for recipients, moreover, constitutes an independent duty imposed on the Administrator. To discharge that duty faithfully, the Administrator must utilize every weapon the legislation makes available. Those weapons are the methods outlined in section 14105 for implementing the priorities of section 14006.5.

[10] Since the Administrator reduced minimum coverage for recipients as well as for the medically indigent, it is obvious that his method of limiting care for the latter group did not enable him to provide full minimum coverage for recipients as required by section 14105. In these circumstances, the Administrator was bound to resort to the alternative method of eliminating some or all of the medically indigent. His failure to do so invalidates the amended regulations insofar as they reduce minimum coverage for recipients of public assistance.

Our holding upon this issue fully effectuates the legislative intent in accordance ***703 **711 with a fundamental rule of statutory construction. (Select Base Materials v. Board of Equal. (1959) 51 Cal.2d 640, 645, 335 P.2d 672; East Bay Garbage Co. v. Washington Township Sanitation Co. (1959) 52 Cal.2d 708, 713, 344 P.2d 289; Kusior v. Silver (1960) 54 Cal.2d 603, 620, 7 Cal.Rptr. 129, 354 P.2d 657.) The Medi-Cal program combines previously disparate plans of medical assistance for recipients of public assistance. These persons, first and foremost, are the beneficiaries of the statutory scheme, and the Legislature intended that, whenever feasible, their needs be met. (s 14152.) While a truly comprehensive program would provide fully for the medically indigent as well, they are given secondary status in both federal and state legislation. Their number is considerably smaller than that of *754 public assistance recipients; [FN19] and they have recourse at the county level if excluded from statewide coverage. There is no more justifiable occasion for invoking the power to exclude them than when fiscal difficulties threaten to undermine the right of public assistance recipients to receive the minimum coverage guaranteed by both state and federal laws.

FN19. The number of medically indigent is estimated at 160,000 (Memorandum of Charles W. Stewart, Exhibit on Appeal), as compared with an estimated 1,358,200 recipients of public assistance (Medi-Cal Fiscal and Expenditure Program Summary, Exhibit on Appeal).

Defendants contend, however, that they have discretion to define the content of 'minimum coverage,' and that as long as a 'reasonable' version of the basic five services is provided, the duty to provide 'minimum coverage' is discharged. Thus, they argue, the Administrator may reduce physicians' services-the only one of the basic five at issue here-[FN20] when funds are in short supply without doing violence to the priorities established by the Legislature.

FN20. The trial court indicated that the eight-day limit on private hospital services (followed by transfer to county hospital) was a 'control measure * * * not before me' rather than a reduction of service. Since the regulations did not of their own force reduce the coverage under the drug formulary, the trial court did not pass on the validity of that restriction.

[11] Section 14105 generally authorizes the Administrator to 'prescribe * * * the scope of the services to be provided' and to adopt regulations 'not inconsistent' with the provisions of the act. The same section, however, contains a specific mandate that 'In establishing the scope of services to be provided, the director shall provide for recipients at least for a minimum coverage * * *.' (Italics added.) This specific requirement clearly qualifies the general authority conferred by the section. Moreover, it constitutes a duty with which implementing regulations may not be 'inconsistent.'

We have no occasion upon this appeal to decide the meaning of 'physicians' services' in some theoretical sense. We deal rather with the statutory mandate the Administrator must follow in the present circumstances of limited funds. The statute does not tell the Administrator that he may redefine physicians' services to meet financial needs. As we have indicated, the statute requires that he must curtail expenditures for the medically indigent before he reduces the minimum coverage afforded prior to the incipiency of a fiscal crisis. Such a reduction is plainly 'inconsistent' with the priority provisions of the statute and therefore outside the authority conferred by section 14105.

***755** [12] It may be that minimum coverage must be reduced when even the elimination of the medically indigent fails to free sufficient funds. In that event, the reduction must accord with the provisions of section 14103.7 on 'proportionate' reductions, which we discuss in detail below. Section 14103.7 contains no independent authorization to reduce services. Rather, it provides the method to be used 'when reducing services under this chapter * * *.' (Italics added.) There is thus no conflict between sections 14105 and 14103.7, and no implied ***704 **712** repeal of the former as urged by defendants.

We now turn to examine the validity of the amended regulations under section 14103.7, which provides: 'The Administrator * * *, when reducing services under this chapter * * * in order to maintain the program within the fiscal limits fixed by the Legislature, shall, to the extent feasible, make proportionate reductions in all services, rather than eliminating any service or services entirely.'

Defendants stipulated at the hearing that some services were eliminated entirely and hence all services were not reduced proportionately, and the trial court so found. The sole issue for our determination, therefore, is whether the Administrator met the 'feasibility' criterion of the statute.

As we have already pointed out, the trial court found that the Administrator failed to explain to the court's satisfaction why proportionate reductions were not feasible and also found that the utilization of public hospitals and the establishment of fee schedules for providers of medical assistance may possibly curtail expenditures 'to permit' proportionate reductions. From these facts the court concluded that the amended regulations violate section 14103.7.

The Director of Health Care testified at the hearing that, on a statewide basis, there are sufficient facilities in county hospitals (7,000 beds) to accommodate the 5,000 recipients of assistance who require inpatient services at any given time, and that per diem charges of county hospitals are typically lower than those of private hospitals. He agreed that the use of

county hospital facilities would result in a saving, and that these facilities were used to care for recipients prior to the Medi-Cal program.

In response to a question by the court, the witness explained that utilization of county hospitals was rejected on two grounds: reluctance to consign recipients to treatment in facilities 'traditionally reserved for the poor,' and fear of ***756** interruption in continuity of care by physicians having no staff privileges at county hospitals.

With respect to establishing fee schedules for physicians, the witness testified that the possibility was rejected in order to give effect to 'an expressed preference' in the law for payment of 'usual and customary' fees.

Section 14103.7 was added by chapter 1421 of the 1967 statutes to guide the Administrator in tailoring the program to meet appropriated funds. The 1967 Legislature, while foreseeing that reductions in services may be inevitable, hoped that the program could be permitted to operate at its 1966-67 level, to wit, without reductions in services (ch. 1421, s 3). If reductions could not be avoided, the Legislature mandated that, 'to the extent feasible,' they be made proportionately in all services. The record is woefully deficient in evidence on the meaning of proportionality of reductions in services that cannot be qualitatively compared. It is not clear whether proportionality of reductions means a strictly uniform percentage cut in the expenditures for all services, or merely partial reductions in varying degrees. It is clear, however, that the challenged regulations accord with no possible meaning of the term insofar as they eliminate some services entirely.

The record establishes that the elimination of certain services was undertaken because proportionate reductions in all services were not expected to produce the savings needed to meet budgetary limitations. If the deficit could be narrowed by economy measures unrelated to cuts in services, however, proportionate reductions in services may then result in enough savings to avoid the elimination of any service. It is in this context that the trial court suggested the possibility of cutting costs through the utilization of public hospitals and the establishment of fixed fees for physicians. Defendants obviously agreed that such factors were relevant in determining the possibility of compliance ***705 **713** with the mandate of section 14103.7, for they considered (and rejected) the very measures the trial court suggested. They contend that their decision in this respect was made in reasonable exercise of discretion under the statute.

[13] However, it is the duty and responsibility of the courts to examine statutes with care to ascertain that the Legislature indeed intended to subject administrative action to the narrow scope of review that discretion occasions (see Pitts v. Perluss, supra, 58 Cal.2d 824, 832, 27 Cal.Rptr. 19, 377 P.2d 83), and to identify with particularity***757** the areas, if any, truly within administrative discretion.

[14][15][16] Section 14103.7, by requiring proportionate reductions 'to the extent feasible' (italics added), confers no discretion upon the Administrator to decline to follow its mandate if proportionate reductions are 'feasible' To some extent. The Administrator must therefore use every 'feasible' means of curtailing expenditures in an effort to reduce the deficit so that no service need be eliminated. He has discretion to select the means to be utilized if not all are necessary to produce the necessary savings. Moreover, whether a particular measure is 'feasible' is initially for the Administrator to determine. But his determination must be based on factors that the statute, as interpreted by the courts, permits him to weigh. He has no discretion to decline to adopt an economy measure, not specifically proscribed by law, on grounds unrelated to curtailment of expenditures. 'Feasible,' in short, means capable of being done and capable of producing a saving in a manner not otherwise barred by the statute.

We articulate the foregoing definition in the light of the full substance of the statute. (Wallace v. Payne (1925) 197 Cal. 539, 544, 241 P. 879; City of San Diego v. Granniss (1888) 77 Cal. 511, 517, 19 P. 875.) Any other construction of 'feasibility' would fail to take cognizance of the overriding purpose of the 1967 legislation to provide the most comprehensive care possible under emergency fiscal conditions. The Legislature was aware that the limited appropriation may necessitate curtailment of expenditures that served useful purposes. The 1965 Legislature preferred, for example, that 'In determining the reasonable charge for a physician's services, there shall be taken into consideration the customary charge for similar services generally made by the physician, as

well as the prevailing charges in the locality for similar services' (s 14104, subd. c(6)). But the 1967 Legislature in reenacting section 14105, as the only change in the provision, added authority for the director to 'limit the rates of payments' for services. (See fn. 10, ante.) By chapter 1421, moreover, the same Legislature added section 14120 Requiring the Administrator to 'modify the method of payment of usual and customary fees to physicians' when the amount paid exceeds by 10 percent the amount scheduled to be paid.

[17][18] These recent enactments indicate to us that the Legislature intended to compromise the customary fee principle if necessary.*758 Section 14103.7 indicates that the Legislature intended to avoid elimination of services 'to the extent feasible.' In combination, these provisions justify fixing physicians' fees as a method of preventing the elimination of services. The same principle supports the conclusion that utilization of county hospitals is a 'feasible' measure within the meaning of section 14103.7. Although there is a legislative preference for free choice of facilities (ss 14000, 14000.2), this policy is required only 'Insofar as practical, consistent with the efficient and economical administration' of the program (s 14105). The Administrator in fact compromised the policy by promulgating the eight-day limit for private hospital services. The evidence supports the trial court's conclusion that more drastic measures along similar lines may result in a saving and thus qualify as 'feasible' under section 14103.7.

***706 **714** We do not decide that the Administrator must utilize either or both of these measures. He may institute others that would meet the requirements of section 14103.7. In particular, we reject plaintiffs' contention that the Administrator has violated section 14120 by failing to establish schedules for physicians' fees and thus avoiding the duty to reduce fees when payments exceed the scheduled amount. The Director of Health Care testified that the pendency of the action made it impossible to prepare monthly schedules, because until the court determined which services must be provided, there was no sound basis upon which to base monthly schedules of anticipated payments for services. In view of the fact that the legislation was enacted only two weeks prior to the hearing, the Director's explanation provides a plausible ground for suspending implementation of the mandate of section 14120.

[19] We conclude that the evidence supports the trial court's finding that the Administrator failed to explain why proportionate reductions were not feasible. The amended regulations therefore violate section 14103.7 insofar as they eliminate certain services entirely.

Defendants contend that the trial court misled them by indicating that the burden of proof on the issue of nonfeasibility rested on plaintiffs. As we have pointed out, the hearing below, by stipulation of the parties in open court, was a trial on the merits. Plaintiffs, proceeding upon their amended complaint in two counts,[FN21] sought a permanent injunction and a *759 declaratory judgment that the amended regulations were invalid. (Gov.Code, s 11440.) The sole witness was defendant Carel Mulder, Director of the Office of Health Care. Plaintiffs called Mr. Mulder as an adverse witness (Evid.Code, s 776). At the conclusion of such cross-examination of Mr. Mulder, defendants' counsel stated that before proceeding he would 'like to address an inquiry as to the Court as to the Sharing of the burden of going forward here. * * * I wonder if at this point it would be appropriate for the Defendant to move for a nonsuit or whether you desire me at this time to inquire of Mr. Mulder on these areas which would be similar, to clarify these issues for the Court?' (Italics added.) The court replied: 'Well, I don't think there's any basis for nonsuit in this matter. It primarily is a matter of law.'

FN21. By leave of court, plaintiffs filed such amended complaint at the commencement of the hearing and by stipulation of the parties its material allegations were deemed denied by defendants.

A colloquy ensued among counsel and the court on the subject of the feasibility language in section 14103.7. The court remarked that if such section was applicable 'it seems to me we should either By affidavit or Through testimony have something with respect to the meaning of the feasibility language in Section 14103.7 as added by Senate Bill 1065. * * * Now, I think Mr. Meyers, on this that this is the Plaintiffs' burden and unless something is produced, why, it isn't produced, period. I see no reason why you have to go into that.' (Italics added.) The court then stated, apparently in response to an interruption by plaintiffs' counsel, 'let me hasten to assure you that I

regard that as really short of a relatively minor point, because I think basically we are talking about law.'[FN22] Apparently because of these remarks of the court plaintiffs' counsel further questioned Mr. Mulder. Defendants' counsel then took the witness on redirect examination[FN23] after which plaintiffs' counsel***707 **715 took the witness on recross-examination. This completed the testimony. Counsel for both parties then proceeded to introduce various affidavits subject to a reserved motion to strike.

FN22. In further explanation, the court stated that 'the question is a very simple one. Why, Mr. Mulder, was it not feasible to make proportionate reductions in all services rather than eliminating certain services entirely?'

FN23. The remarks of defense counsel at this point are significant. 'Well, I've been waiting for the last half hour for the question that your Honor suggested he ask, although I don't think it's the obligation of the Defendant to do this, I think in the purpose of clarity and to get on with it-THE COURT: If you don't ask it at this point, I'm going to ask it.'

It would therefore appear that all testimony in the case was *760 introduced during the plaintiffs' case in chief. The record fails to disclose that either of the parties formally rested at any point. Nor does it disclose that defendants made a motion for nonsuit at any point. Instead, after affidavits had been offered by both parties, counsel for each of them stated that there was 'nothing further at this time.' After statements by each of the counsel on the legal issues, both counsel indicated their agreement that the court 'close the hearing.' The court then took the matter under submission. Fairly read the record discloses that counsel did not pursue, nor did the court insist upon, all of the usual trial procedures; rather both counsel appeared to have been desirous of presenting, and the court of receiving, all competent and material evidence which might assist the court in resolving the problem before it.

Subsequently the court in its memorandum opinion indicated that defendants failed to met the burden on the issue of non-feasibility under section 14103.7. Defendants then protested that they had been misled, and proffered material in part prepared subsequent to the hearing purporting to explain the reasons for the adoption of the regulations.

[20][21][22] We have no doubt that the burden of going forward with the evidence on the issue of non-feasibility properly belonged to defendants. Although a plaintiff ordinarily has the burden of proving every allegation of the complaint and a defendant of proving any affirmative defense, fairness and policy may sometimes require a different allocation. (See Evid.Code, s 500.) Where the evidence necessary to establish a fact essential to a claim lies peculiarly within the knowledge and competence of one of the parties, that party has the burden of going forward with the evidence on the issue although it is not the party asserting the claim. (Garcia v. Industrial Accident Com. (1953) 41 Cal.2d 689, 694, 263 P.2d 8; 9 Wigmore, Evidence (3d ed. 1940) s 2486; Witkin, Cal.Evidence (1958) s 56(b).) Clearly only defendants could explain why they deemed proportionate reductions not feasible, and the burden on this issue was theirs.

[23] Defendants' proper remedy for raising the point now made was by motion to reopen following submission of the cause, supported by affidavit showing good grounds. (Shimpones v. Stickney (1934) 219 Cal. 637, 28 P.2d 673; Eatwell v. Beck (1953) 41 Cal.2d 128, 257 P.2d 643; Foster v. Keating (1953) 120 Cal.App.2d 435, 451, 261 P.2d 529.) *761 Having failed to assert error properly below, defendants are precluded from raising the matter at this stage of the proceeding. (Damiani v. Albert (1957) 48 Cal.2d 15, 18, 306 P.2d 780; Horn v. Atchison T. & S.F. Ry. Co. (1964) 61 Cal.2d 602, 610, 39 Cal.Rptr. 721, 394 P.2d 561.)

[24] Assuming Arguendo that the contention is properly before us, we are convinced that despite the trial court's unfortunate language, defendants should have known that the burden rested on them. As part of their case, plaintiffs showed that the regulations eliminated certain services entirely, and that arguably 'feasible' methods for achieving proportionate reductions were available. As we have pointed out, the court indicated that plaintiffs had established a prima facie case and that a motion for nonsuit would fail. Defendants did not make that motion. Defendants' counsel in fact examined the Director of Health Care and had the opportunity to elicit the information defendants now claim that witness could have produced. As we have explained, we think counsel for both parties strove

conscientiously to provide the court with all available evidence either through oral testimony or by affidavit and at the conclusion of their efforts both clearly indicated to the court that it could 'close the hearing.'

***708 **716** Defendants subsequently submitted material containing additional information and, although not properly in evidence, these exhibits are filed with the record on appeal. We have examined them and we find that the information they contain would in all likelihood have been deemed irrelevant under the test of feasibility set out in this opinion.

In sum, we cannot say that defendants were prejudiced in the presentation of their case.

[25] We reach these conclusions: (1) Neither section 14000.1 nor the urgency clause found in section 3 of chapter 1421, statutes of 1967, prohibits reductions in services that accord with the directives of the relevant statutory provisions. (2) The amended regulations violate the mandatory requirements of sections 14006.5 and 14105 by restricting physicians' services for recipients of public assistance without eliminating the medically indigent from the Medi-Cal program. (3) The amended regulations violate section 14103.7 by eliminating certain services entirely in the absence of a showing that proportionate reductions were not 'feasible' to some extent.

The judgment is affirmed.

*762 TRAYNOR, C.J., and PETERS, TOBRINER and MOSK, JJ., concur.

DISSENTING OPINION

McCOMB, Justice.

I dissent. I would reverse the judgment of the trial court. Our government is divided into three branches: Legislative, Executive and Judicial, and this court should not invade the powers of the legislative or executive branches of the government, which in my opinion has been done by the majority opinion in the instant case. It is not the business of this court to pronounce policy. Self-restraint is of the essence of the judiciary. Our Constitution does not authorize the court to sit in judgment on the wisdom of the actions of the legislative or executive branches of the government.

The superior court entered judgment enjoining defendants from implementing certain emergency regulations, the net effect of which was to reduce the level of services provided under the Medi-Cal Program, effective September 1, 1967. The emergency regulations represented the Administrator's decision as to how outgo under the Medi-Cal Program should be brought into balance with the monies which had been appropriated by the 1967 Legislature.

The superior court agreed that outgo had to be balanced with the available funds but held nevertheless that the Administrator had gone beyond the authority granted to him by the Legislature when he carried out the quasi-legislative duty of adopting the challenged regulations.

The issue presented is whether defendants' emergency regulations are valid. An examination of the legislative and administrative background may prove helpful in evaluating the issue and considering the applicable law.

Legislative and Administrative Background

A. The Decision to Provide Mainstream Medical Care for the Poor-The Medi-Cal Program.

In 1965 the United States Congress enacted Public Law 89-97, the Social Security Amendments of 1965. This law added Title XIX to the Social Security Act and contained the provisions of what is now referred to as the Federal Medicaid Program. Title XIX broadened the provisions of the Kerr-Mills Program for the aged, extended its provisions to additional needy persons, and allowed the states to combine within a single uniform program various medical services for the needy previously authorized by five separate titles of the Social Security Act. Title XIX extended the advantages of an ***763** expanded medical assistance program to the aged who are indigent, and to needy individuals in programs for dependent children, to the blind, ***709 **717** and to the permanently and totally disabled. In addition, Title XIX contained provisions allowing coverage of persons who would qualify under the named programs if in sufficient financial need. These latter provisions have been described as the most far-reaching provisions of the new legislation insofar as they are designed to bring the benefits of modern medical care to all needy people, a group referred to herein as the medically indigent or medically needy as defined in subdivisions (b) and (c) of section 14005 of the Welfare and Insti-

tutions Code. [FN1]

FN1. All section references herein are to the Welfare and Institutions Code except as hereinafter noted.

California's Medi-Cal Program, as contained in chapters 7 and 8 of division 9 of the Welfare and Institutions Code, section 14000 et seq., was adopted by the 1965 Second Extraordinary Session of the Legislature and constitutes California's effort to take advantage of the provisions of Title XIX. This was an emergency measure effective November 15, 1965, which became operative on March 1, 1966. The measure repealed the prior provisions relating to medical care for public assistance recipients and medical care for the aged. It established in their place a program of basic and extended health benefits for public assistance recipients and medically indigent persons.

At the time this legislation was adopted, the Legislature did not have sufficient information with which to gauge the extent or scope of the program it was approving in principle, nor did it have adequate data upon which to make a sound estimate of the probable costs of the program. The Legislature's general intent, however, was clear. It wished to establish a broad program of medical services that would capture as much of the federal matching funds available as possible, without exceeding the state and county funds that had been made available for this purpose in the immediately preceding year. (s 14010.)

The Legislature also indicated its purpose and intentions when it adopted the program. Thus, section 14000 provides: 'The purpose of this chapter is to afford basic health care and related remedial or preventive services to recipients of public assistance and to medically indigent aged and other persons, including related social services which are necessary ***764** for those receiving health care under this chapter and Chapter 8 (commencing with Section 14500).

'The intent of the Legislature is to provide, to the extent practicable, through the provisions of this chapter, for basic health care for those aged and other persons, including family persons who lack sufficient annual income to meet the costs of health care, and whose other assets are so limited that their application toward the costs of such care would jeopardize the person or family's future minimum self-maintenance and security. It is intended that whenever possible and feasible:

'(a) After December 31, 1966, such care shall, to the extent feasible, be provided through a system of prepaid health care or contracts with carriers;

'(b) The means employed shall be such as to allow eligible persons to secure basic health care in the same manner employed by the public generally, and without discrimination or segregation based purely on their economic disability.

'(c) The benefits available under this chapter shall not duplicate those provided under other federal or state laws or under other contractual or legal entitlements of the person or persons receiving them.

'(d) In the administration of this part and in establishing the means to be used, the department shall give due consideration to the appropriate organization and to the ready accessibility and availability of the facilities and resources for basic health care and extended health services to persons eligible under this chapter and Chapter 8.

'It is also the intent of the Legislature that, except in accordance with the provisions*****710 **718** of Section 14010, and as necessary to secure federal approval of a plan under Title 19 of the Federal Social Security Act, until January 1, 1967, care shall, to the extent feasible, be limited to persons and families who would, had they chosen to apply, have been considered as medically indigent and eligible for medical or other assistance under the state programs in effect in December 1965.'

The concept set forth in section 14000, subdivision (b), expresses the legislative intent to provide 'mainstream' medical care to the poor. In other words, the program is intended to provide medical care comparable to that made available to those economically able to pay for average, competent medical care. The Legislature also indicated its intent that the scope and duration of health services provided under the Medi-Cal Program should at least be equivalent to the level provided in 1964-1965 under the then existing public ***765** assistance programs. (s 14000.1). It indicated an intent that county hospitals integrate their services 'with those of other hospitals into a system of

community service which offers free choice of hospitals to those requiring hospital care' in order to 'eliminate discrimination or segregation based on economic disability.' (s 14000.2; see, also ss 14006.5, 14104, 14105.)

B. Fiscal Implications of the Above Decision and the 1967 Fiscal Crisis.

By the spring of 1967, if not earlier, it was fully apparent that the cost of the Medi-Cal Program was far exceeding the state funds appropriated for the program. Committees of the 1967 Legislature held hearings on this financial problem. These hearings resulted in legislation (specifically chapter 1421) designed to furnish guidelines for reductions in the program.

Chapter 1421, Statutes of 1967, was an urgency measure that became effective on August 25, 1967. The measure did many things-all in an obvious response to the fiscal crisis faced by the Medi-Cal Program:

1. It added section 14103.7, which provides: 'The Administrator of the Health and Welfare Agency, when reducing services under this chapter and Chapter 8 of this part in order to maintain the program within the fiscal limits fixed by the Legislature, shall, to the extent feasible, make proportionate reductions in all services, rather than eliminating any service or services entirely.'

2. It added section 14120, which requires the establishment of a monthly schedule of anticipated billings, and, within the framework of that schedule, requires the Health and Welfare Agency Administrator to institute program reductions whenever the total exceeded by 10 percent the amount scheduled to have been paid by that time, and to modify the usual and customary physicians' fees whenever such fees exceed by 10 percent the amount scheduled for that segment of the program.

3. By amending the next to last sentence of section 14157, the Legislature closed the appropriations for the current fiscal year at $305 million. This limitation is made explicit by the provisions of section 4 of the bill, which provides: 'Expenditures from state sources under the medical assistance program for the fiscal year 1967-1968 shall not exceed three hundred five million dollars ($305,000,000), except that with the approval of the Director of Finance additional amounts may ***766** be expended if they are obtained by transfer from other sources as authorized by the Legislature.'

4. By adding section 14158, the measure requires the institution of normal budgetary procedures for 1968-1969 and following years instead of prior continuing appropriations.

5. By section 5, the measure requires the Health and Welfare Administrator to report to the Legislature not later than January 31, 1968, showing total program costs, total program reductions and other data.

6. The measure also implements a modified accrual accounting system in which expenditures in a given fiscal year are *****711 **719** evidenced by billings received rather than obligations incurred. Such a system will permit bills incurred but not yet received by June 30, 1968 (estimated to amount to $53 million in this fiscal year) to be charged against the revenue of the succeeding rather than the current fiscal year.

Thus, it seems apparent that the purpose of the 1967 legislation, as contained in chapter 1421, differed significantly in both its tone and objectives, from the initial legislation adopted in 1965 establishing the program. The original legislation had as its objective the rapid establishment, development and expansion of a program designed to provide main stream medical care to the poor. The 1967 legislation was designed to solve a fiscal crisis by providing guides for program cuts.

The 1967 emergency regulations that were adopted eliminated some types of physicians' services that had previously been provided to public assistance recipients; for example, psychiatric services (other than in-patient care) and eye refractions (except as necessary following extraction of the lens of the eye). The regulations also eliminated certain services in those cases where defendants determined that a proportionate reduction in such services had been demonstrated to be totally impracticable (and therefore not feasible) or else so at variance with a logical offering of medical care as to render such reductions untenable.

As indicated above, the ultimate issue herein is the validity of the emergency regulations. The Legislature intended that the Administrator rely upon his

intimate knowledge of the program and adopt regulations designed to balance expenditures with available funds. In my opinion, the law does not require the Administrator to eliminate entire groups of persons (i.e., the medically needy) from the Medi-Cal Program *767 before it permits reducing the level of services available to all.

The emergency regulations involved herein were adopted by the Administrator in accord with the provisions of the California Administrative Procedure Act. (Gov.Code, s 11370 et seq.) There is no procedural question presented; rather, the question is the substantive one of the propriety of the Administrator's quasi-legislative action in adopting the emergency regulations which he did adopt.

When courts review quasi-legislative administrative action, they are limited to determining whether the quasi-legislator has taken action which was 'arbitrary, capricious, or entirely lacking in evidentiary support, or whether he has failed to follow the procedure and give the notices required by law.' (Brock v. Superior Court, 109 Cal.App.2d 594, 605(8), 241 P.2d 283, 290.)

This problem of the scope of review when an administrative regulation is challenged has been presented to the California appellate courts in a number of different cases. (See, e.g., Pitts v. Perluss, 58 Cal.2d 824, 27 Cal.Rptr. 19; 377 P.2d 83; Ray v. Parker, 15 Cal.2d 275, 101 P.2d 665; Brock v. Superior Court, supra, 109 Cal.App.2d 594, 294 P.2d 283; Vita-Pharmacals, Inc., v. Bd. of Pharmacy, 110 Cal.App.2d 826, 243 P.2d 890.)

In Ray v. Parker, supra, this court discussed generally the problem of judicial review of quasi-legislative acts and, after reviewing numerous federal cases, concluded that due process requirements were satisfied and that the order was valid. The rule as to the scope of review was stated as follows: '* * * In an action of this character challenging proceedings and hearings of the type here involved, it is not for the courts to Weigh the evidence and data adduced before and considered by the director preliminary to his issuance of the several orders here challenged. Under the circumstances here present, judicial interference should occur only when it can be said that administrative action has been arbitrary and capricious. (Citations.)' (15 Cal.2d at 310-311(23), 101 P.2d at 684.)

In Pitts v. Perluss, supra, this court discussed the reasons for the rule and succinctly summarized it by stating: 'We confront***712 **720 a situation here which graphically illustrates the wisdom of the general rule that the court should not substitute its judgment for that of an administrative agency which acts in a quasi-legislative capacity. All of the parties to this litigation recognize the intricate and technical nature of the *768 subject matter as well as the expertise and full technical knowledge which its administration requires. It would be presumptuous of a court to claim such skill; it will not, therefore, superimpose its own policy judgment upon the agency in the absence of an arbitrary and capricious decision.

'The decisions do not sustain the insurers' contention that in determining the validity of the regulation this court should exercise its independent judgment and reweigh the proffered evidence. While such a test may apply to the review of the adjudicatory or quasi-judicial rulings of certain agencies (Code Civ.Proc., s 1094.5) it does not pertain to the review of regulations rendered by an agency in its quasi-legislative capacity. As to the quasi-legislative acts of administrative agencies, 'judicial review is limited to an examination of the proceedings before the officer to determine whether his action has been arbitrary, capricious, or entirely lacking in evidentiary support, or whether he has failed to follow the procedure and give the notices required by law.' (Citations.)' (58 Cal.2d at 832-833, 27 Cal.Rptr. at 24, 377 P.2d at 88.)

The same reasoning and rule are equally applicable here. The regulations are a reasonable attempt to carry out the legislative mandate to balance expenditures with available funds. In order to arrive at a combination of actions which would best carry out the legislative direction to balance program benefits will available funds, a wide variety of alternatives was examined. Furthermore, the Administrator had to consider not only the fiscal crisis but also the following points:

1. Time was of the essence, as each day added to the severity of the necessary cuts; reductions had to produce savings during 1967-1968;

2. Presently available staff at state, county, and fiscal intermediary levels had to suffice for carrying out actions;

3. Attempts to effect 'proportionate' percentage reductions had to be considered in the light of the legislatively expressed purpose to achieve a program that was medically and remedially reasonable; and

4. The 'Basic Five'[FN2] costs had to be limited since by themselves they exceeded available funds.

> FN2. The 'Basic Five' are the first five items listed in section 14053. They are physicians' services, hospital in-patient services, hospital out-patient services, nursing home care, and laboratory and X-ray services. They are also sometimes referred to as the 'minimum coverage' because of the provisions of section 14056.

In his testimony Mr. Mulder outlined some of the relevant ***769** factors that were considered in arriving at decisions concerning the form and scope of the program reductions finally decided upon. Also helpful is the affidavit of Mr. Stewart (the Deputy Director of the Office of Health Care Services) which has attached to it an exhibit and a document entitled 'Medi-Cal Fiscal and Expenditure Program Summary 1967-68 Fiscal Year.' This latter document constituted the agenda submitted to the Health Review and Program Council at its August 4 and 11 special meetings. Although Mr. Stewart's affidavit, as well as Exhibit A attached to that affidavit, was prepared subsequent to the hearing in the superior court, the materials are not after-the-fact rationalizations. Rather, Exhibit A is a summary of the various factors that were previously considered by the Administrator and were in the Medi-Cal Program Summary considered by the Health Review and Program Council a month prior to the court hearing in this matter.

Exhibit A and the agenda submitted to the Health Review and Program Council contain materials which discuss the possible *****713 **721** alternative program cuts that were considered and indicate the many possible ways in which reductions could have been achieved. The affidavit and the exhibits thereto plainly indicate that there were sound reasons for reducing the program in the manner reflected by the emergency regulations rather than in some other manner. In Mr. Stewart's affidavit he discussed the feasibility of proportional cuts and outlined various reasons for the conclusion that such cuts were not feasible. For example, a uniform percentage cut would need to be so deep that it would effectively eliminate some services; a reduction in nursing home care or hospital care by 26 percent (which would have been approximately the percentage reduction required on an across-the-board basis) would in effect deny such services; and an across-the-board reduction in physicians' fees was 'not considered compatible with continued participation of an adequate number of physicians.' It was concluded that 'to effect proportionate cuts, deeper inroads would have to be made in physicians' and out-patient clinic services than just the elimination of non-emergent (sic) surgery and psychiatric care. Without question preventive medical services would have to be disallowed. To reduce hospital and nursing home care proportionately, i.e., 25 to 30 percent, arbitrary, absolute, and unreasonable limits would have to be set on length of stay, either generally or by diagnosis, but in ***770** either case without flexibility to meet the needs of the individual patient. * * * Obviously, there is no way of arranging to allow for 25 percent of necessary laboratory and x-ray services other than through a deductible (plan) or (by requiring) co-payment which welfare recipients could not afford.'

Mr. Stewart refers to the fact that a proportionate reduction in some services could only result in ridiculous situations. 'There can be nothing 'feasible' in any eye examination without the needed eyeglasses, and 75 percent of a pair of eyeglasses is difficult to provide. The same applies to hearing examinations and hearing aids, to tooth extractions and dentures, and to therapy evaluation and therapy services.'

Thus, the Administrator concluded that '(w)here only a partial cut could be made-such as, home health care, dental care, podiatry, transportation, and drugs-it was done in order to provide as medically feasible a program as was possible.'

It is apparent from the above and from the statistical presentation that no combination of actions affecting services was found to be adequate to reduce costs without also reducing the Basic Five services. Moreover, actions affecting caseload or the number of persons covered, including the elimination of the medically needy group, were examined and discarded as being contrary to the best interests of the state as a whole.

All the above-mentioned alternatives were presented to the Health Review and Program Council at special meetings held on August 4 and 11, 1967. Testimony was also received from many organizations and individuals. After reviewing and weighing all these considerations the Health Review and Program Council and the Office of Health Care Services staff recommended that the September 1, 1967, emergency regulations be adopted as the most reasonable and humanitarian method of balancing expenditures with the available funds.

The challengers did suggest alternative means of cutting expenditures by restrictions on physicians' fees and by imposing a requirement of hospitalization in county hospitals. As indicated above, one of the alternatives considered by the Administrator and his staff was a fixed fee schedule for physicians' services. However, it was concluded that this would be disadvantageous in that it would reduce participation of physicians and impair present medical society controls of utilization and quality. Similarly, insofar as the county hospital alternative was concerned, the record reflects consideration of this point and some of the problems involved such as (a) the ***771** inadequate number of county hospital beds, (b) the problem of providing hospitalization in *****714 **722** locations where county hospitals did not exist, and (c) the fact that a requirement of county hospitalization would represent a major change from the mainstream medical concept embodied in section 14000. The suggestions made by plaintiffs constitute alternatives that were considered and rejected by defendants as infeasible.

In the light of the record the Administrator was amply justified in exercising his discretion and accepting the judgment of his professional staff. Accordingly, his actions and the regulations cannot reasonably be characterized as arbitrary, capricious, or without support in the record. The trial court itself refused to make such a finding when it rejected defendants' proposed Conclusion of Law.

In the absence of such a finding, such regulation is valid and proper. This does not mean the regulations should be held to be perfect or that their substance need be approved by this court. In Pitts v. Perluss, supra, 58 Cal.2d at page 846, 27 Cal.Rptr. at page 32, 377 P.2d at page 96, we stated: 'Against the backdrop of the legislation and the director's execution of its policies, the regulation was neither arbitrary nor capricious. We are not called upon to decide whether the provision was perfect; neither do we hold that a better one could not have been fashioned. We do not deal in absolutes or in alternatives; we merely hold the regulation before us does not transgress the pertinent legal limitation.'

The requirement that services be reduced proportionately, if feasible, does not change the scope of judicial review as discussed above. Moreover, proportionate reductions were not shown to be feasible.

The first of the grounds used to hold the regulations invalid turns on section 14103.7 (added by ch. 1421, Stats. 1967, supra) which reads:

'The Administrator of the Health and Welfare Agency, when reducing services under this chapter and Chapter 8 of this part in order to maintain the program within the fiscal limits fixed by the Legislature, shall, to the extent feasible, make proportionate reductions in all services, rather than eliminating any service or services entirely.'

Since it is conceded that the Administrator did not make proportionate reductions in all services, the question presented is whether the above section indicates a legislative intent to restrict the Administrator and, if it does, to what extent the section restricts his discretion. The answer to the question turns on the meaning of the phrase 'to the extent feasible.' ***772** The trial court, in its memorandum opinion, stated '(i)n this context 'feasible' would seem to mean 'capable of being done' and 'suitable.' (Random House Dictionary (1966) 520).' The Legislature used the phrase 'to the extent feasible' to embody the concept of being practicable; workable; and viable rather than remotely possible.

The term 'feasibility' has acquired a generally understood meaning in legislative and governmental administrative areas. It connotes a weighing of all relevant facts with a view towards determining whether a particular objective can be successfully accomplished by alternative methods. It implies rejection of methods which are unworkable, excessively costly, or which would not result in a viable program.

The question is whether the particular alternative method of cost reduction is reasonably likely to carry

out the legislative intent and purpose. The Legislature used the phrase 'to the extent feasible' to channel the Administrator's efforts but not to restrict his expertise and discretion and certainly not to eliminate them completely. Thus, the phrase was simply designed to indicate a preference for partial reductions in all services rather than the arbitrary elimination of many services. To read the phrase as putting a more onerous burden on the Administrator is an attempt to change the generally recognized standard or scope of review in cases such as this. The authorities cited above set forth the proper scope of review, and the test on review is not changed simply because the Legislature has ***715 **723 used the phrase 'to the extent feasible' rather than a phrase such as 'to the extent he determines practicable after the exercise of his expertise and discretion.'

The real vice inherent in this question of 'feasibility' is the opportunity it presents for changing the scope of review by rephrasing the issue. Instead of determining whether the Administrator resolved an extremely difficult problem in a not unreasonable manner after exercising the discretion vested in him by law and the expertise that his staff acquired through years of experience, the trial court converted the issue from the review of a quasi-legislative action to an exercise in determining what words mean, thus allowing the court to second-guess the Administrator.

As previously discussed, the possibility of making proportionate cuts was considered by the Administrator, and such reductions were rejected only after careful deliberation. This exercise of discretion should not be rejected through an erroneous interpretation of the meaning of the term 'feasible' *773 any more than it should be found to be arbitrary or capricious. It has already been demonstrated that the Administrator's action was not arbitrary or capricious.

Compounding the error in interpreting the term 'feasible' was the court's error in placing on the Administrator the burden of proof as to the question of the feasibility of proportionate cuts. This second error facilitated the process whereby the court substituted its judgment for that of the Administrator.

In its memorandum opinion the court stated 'an adequate basis has not been given to it (by the Administrator) for it (the court) to be able to hold that the proportionate reductions in services directed by the Legislature are not feasible.' Counsel for defendants repeatedly asked the court to clearly indicate the burden of proof with respect to the question of demonstrating the nonfeasibility of proportionate reductions in services. The trial court opened the hearing with extensive references to Pitts v. Perluss, supra, 58 Cal.2d 824, 27 Cal.Rptr. 19, 377 P.2d 83, and closed the hearing with references to the views of Justice Frankfurter, all to the effect that courts should not interfere with the discretion given to trained administrators and should not act as 'a super-administrator in trying to determine the wisdom of a particular policy.' The court continually indicated that it would not substitute its judgment of feasibility for that of the Administrator and gave continued assurance of its knowledge of these statutes (Evid.Code, s 644) that provide that regulations are presumed valid and that official conduct is presumed to have been properly performed. Yet in its memorandum opinion the court plainly treated the case as one in which the burden of proof was on the Administrator. When this was made evident at the hearing on the settlement of findings of fact and conclusions of law, the trial court recognized that it had misled the parties and candidly admitted its error in its findings.

After a careful review of the transcript of the September 6 hearing, the court stated 'the court did not indicate that the Administrator had the burden of explanation and in fact indicated that the plaintiffs had such a burden.' The court thereupon proposed and eventually signed the following finding of fact:

'The Administrator did not provide explanations convincing to the court of the lack of feasibility of proportionate reductions in service. The court did indicate to the parties at *774 the hearing that the burden of proof in this regard rested on the plaintiffs.' (Italics added.)

The effect of shifting the burden of proof to defendants permitted the court to substitute its judgment for that of the Administrator on the question of the feasibility of proportionate reductions in services. In doing this, the trial court abused its discretion and committed reversible error.

Irrespective of the error of improperly placing the burden of proof on defendants, plaintiffs did have the burden of proof and failed to meet or sustain that burden. The burden of proof was not on the Admini-

stra tor **724 ***716 to show the nonfeasibility of proportionate reductions. The burden was on the plaintiffs to show the feasibility of proportionate reductions. (This is so even though defendants may have had superior knowledge of the workings of the program.) By law this burden was assumed by plaintiffs and by law remained with them. Plaintiffs sought to evade and avoid this burden of proof by simply presenting the regulations and pointing out that certain services were eliminated rather than proportionately reduced.

Plaintiffs did not demonstrate that the Administrator's determination that it was not feasible to proportionately reduce services (and that the elimination of some services was then necessary) constituted an arbitrary and capricious abuse of the discretion vested in him by the Legislature.

The trial court recognized that plaintiffs had not met this burden of proof and plainly and pointedly refused to find that 'defendants' determination that proportionate reductions were not feasible was arbitrary, capricious and constituted an abuse of discretion.' It rejected a proposed conclusion of law to that effect.

The next problem is whether the law requires the elimination of the medically needy from the program before any reductions are permitted in the minimum coverage provided to recipients of public assistance. The trial court held that the medically needy had to be eliminated before services were cut. It relied on section 14105, the last paragraph of which provides:

'Notwithstanding the provisions of the preceding paragraph, and in accordance with the intent of this chapter and Chapter 8 (commencing with Section 14500), the director, with respect to medically indigent persons, may limit, by appropriate classifications, the number of medically indigent persons eligible, and may limit the scope and kinds of basic health care and extended health services to which such persons*775 are entitled, to the extent necessary to operate programs under this part within the limits of appropriated funds. When and if necessary, such action shall be taken by the director with the advice of the Health Review and Program Council and in ways consistent with the requirements of the Federal Social Security Act.' In other words, the section provides that if there are insufficient funds, certain groups of People may be removed from the program.

The 1967 statute (chapter 1421, supra) unquestionably provided insufficient funds to maintain the Medi-Cal Program at previous levels. Cuts in the program were obviously required. Chapter 1421 constituted a conscious legislative attempt to give direction to the Administrator on how to make the necessary program cuts. The important part of chapter 1421 is the Legislature's adoption of section 14103.7, which provides for reducing Services (proportionately, if feasible), rather than persons.

Thus, the conflict. The earlier statute, section 14105, says eliminate People. The latter enactment, section 14103.7, says reduce or eliminate Services. The Administrator had to resolve this conflict and develop regulations which would meet the fiscal problem. He did so by examining the expressions of legislative intent and he interpreted the more recent provisions of section 14103.7 as having been intended by the Legislature to modify the earlier provisions of section 14105. Accordingly, he reduced services rather than totally removing the medically indigent from the Medi-Cal Program. Logic, as well as consistency, supports the Administrator's interpretation and the applicability of section 14103.7.

Even if there is no conflict between sections 14105 and 14103.7, the problem of whether persons should be eliminated rests on an interpretation of the last paragraph of section 14105, which says the elimination of persons is discretionary rather than mandatory. That is, it provides that if fiscal limitations require, the director May limit the scope and kinds of health care services to be made available to the medically indigent. The paragraph does not Require the director to take such action. Thus, the first sentence of the paragraph repeatedly uses the ***717 **725 word 'may,' indicating a legislative intent to confer discretion upon the director. Other more expressive words could have been found had the Legislature intended to direct that he remove the medically indigent, regardless of other considerations, at the first sign of fiscal difficulties. Moreover, in this connection the first sentence of the last paragraph*776 should be compared with the last sentence of the last paragraph. Thus, in the last sentence the word 'shall' is used when the Legislature directs that the director must secure the advice of the Health Review and Program Council if the exercises the discretion granted to him by the first

sentence of the paragraph. This usage of the terms 'may' and 'shall' within the same paragraph evidences a carefully expressed legislative intent to grant discretion to the Administrator insofar as the elimination of medically indigent persons is concerned, but to not give the Administrator any discretion insofar as securing the advice of the Council.

Finally, as previously noted, the record demonstrates that the Administrator did consider eliminating the medically needy and rejected that alternative only after a careful weighing of all the available facts and after a full consideration of the fiscal problem and its legislative history. The effects of eliminating the medically needy were set forth in great detail in the Medi-Cal Fiscal and Expenditure Program Summary which was attached to Exhibit A as a part of Mr. Stewart's affidavit. It was recognized that 'the elimination of that group (over 160,000 persons) would have resulted in an annual cost reduction to the Medi-Cal Program of about $145 million.'

Mr. Mulder in his testimony continued: '(B)ut, at the same time, to the extent that this group of individuals would be in need of basic services such as hospitalization and physicians' services, and x-ray and laboratory services and nursing home services, they would still have a continued need for these services; still they would have a continuing inability to completely pay for the services, and therefore would rely for the services upon county government, under the provisions of the indigent statutes, which, therefore, would have the effect of losing all federal money that is now being obtained by providing these services through the Medi-Cal program and placing the burden upon the local tax rates without relief from the Medi-Cal program, because the Legislature has closed the relief to counties for the hospital system at the amount of $44,000,000 for the current fiscal term.'

With the adoption of the Medi-Cal Program in 1966, the counties feared an enormous expansion of county costs. As a precondition to their providing legislative support to the enactment of this program, their representatives insisted on inclusion within the program of guarantees that would limit their health care costs. The administration and the Legislature*777 agreed. That understanding was embodied in section 14150.1. In addition, the State agreed to provide $44 million in general fund revenues to assist the counties in providing health care to non-Medi-Cal beneficiaries. This latter provision, referred to by Mr. Mulder, is found in section 14150.2 (added by ch. 104, Stats.1967).

The Administrator, in his deliberations, was well aware that with the advent of both the Medi-Care and Medi-Cal Programs, counties had expanded their health care services, had instituted new, substantial and on-going programs involving large expenditures and had taken important steps to transform county hospitals into general hospitals. The Administrator knew of these factors and desired to forestall and prevent, if possible, any violation of what he deemed to be assurances that had been made to the counties of the legislative intent to stabilize county and state costs (as contained in sections 14150.1 and 14150.2) and did not wish to reverse the trend towards the establishment of county hospitals as general hospitals as a part of the realization of the 'mainstream concept' embodied in sections 14000, subdivision (b), and 14000.2.

***718 **726** The Administrator not only believed that the elimination of the medically needy would violate these principles but would also cause an increase in state costs in mental institutions, thus violating that portion of section 14150.2 which provides that 'In no case shall the administrator approve any plan which increases costs to the state above the limit on expenditures specified in subdivision (c) of this section.'

In addition, the Administrator of course recognized the cruel irony that would result in depriving the very group which has managed to maintain itself on meager resources without the aid of public assistance of the free choice of physicians offered in the mainstream of medical care while affording this wide range of services to recipients of public assistance.

The provisions of the Medi-Cal Program taken as a whole plainly require the Administrator to be concerned with the impact of health care costs upon the entire California population, not merely upon the Health Care Deposit Fund. After considering all of these factors he concluded that the loss of federal sharing funds plus the shift of fiscal liability to the counties' tax resources, together with a marked retreat from the mainstream medical care concept, would result in a situation not consistent with the overall legislative objectives and purposes. Accordingly, he

concluded that in resolving the *778 contradictory guidelines contained in sections 14103.7 and 14105, namely, the conflict between eliminating services and eliminating persons, greater weight and attention should properly be placed on the more recent expression of legislative intent, not only because it was more recent but also because it was part of a legislative measure specifically tailored and designed to guide the Administrator in making reductions in the program.

Furthermore, even if there was no implied modification or repeal of section 14105, still that section confers discretion upon the Administrator, which he exercised in a sound and logical manner.

The Legislature did not direct that certain services, i.e., the 'Basic Five' or 'Minimum Coverage,' be provided regardless of the fiscal situation. Services may be reduced before eliminating the medically indigent from the program, and the Administrator's decisions concerning the cuts and services were neither arbitrary nor capricious. The further issue of whether the terms 'minimum coverage' or 'basic five' services encompasses the full gamut of all services that are available in physicians' offices, hospitals and nursing homes depends upon the interpretation of sections 14105, 14053 and 14056 plus chapter 1421, supra. The fourth paragraph of section 14105 provides that:

'In establishing the scope of services to be provided, the director shall provide for recipients (of public assistance) at least for a minimum coverage as defined in Section 14056, and insofar as possible shall include other health care and related remedial or preventive services giving priority to those services which are considered to have the greatest value in preventing or reducing the likelihood of future high cost medical services.'

Section 14056 reads: "Minimum coverage' means care or coverage specified in paragraphs (1), (2), (3), (4), and (5) of Section 14053.'

The minimum coverage referred to in section 14056 thus constitutes the first five items in section 14053, which reads:

"Health care and related remedial or preventive service' means:

'1. Inpatient hospital services (other than services in a medical institution for tuberculosis or mental diseases) in and by a medical institution or facility operated by, or licensed by, the United States, one of the several states, a political subdivision of a state, the State Department of Public Health, *779 or exempt from such licensure pursuant to subdivision (c) of Section 1415 of the Health and Safety Code.

'2. Outpatient hospital services.

'3. Laboratory and X-ray services.

***719 **727 '4. Skilled nursing home services (other than services in a medical institution for tuberculosis or mental diseases), as defined for the purpose of securing federal approval of a plan under Title XIX of the Federal Social Security Act, to persons 21 years of age or older.

'5. Physicians' services, whether furnished in the office, the patient's home, a hospital, or a skilled nursing home, or elsewhere.

'6. Medical care, or any other type of remedial care recognized under the laws of this state, furnished by licensed practitioners within the scope of their practice as defined by the laws of this state. Other remedial care shall include, without being limited to, treatment by prayer or healing by spiritual means in the practice of any church or religious denomination insofar as these can be encompassed by federal participation under an approved plan.

'7. Home health care services.

'8. Private duty nursing services.

'9. Outpatient clinic services.

'10. Dental services.

'11. Physical therapy and related services.

'12. Prescribed drugs, dentures, and prosthetic devices; and eyeglasses prescribed by a physician skilled in the diseases of the eye or by an optometrist, whichever the individual may select.

'13. Other diagnostic, screening, preventive, or rehabilitative services.

'14. Inpatient hospital services and skilled nursing home services for individuals 65 years of age or over in an institution for tuberculosis or mental diseases except that basic health care shall not include any of the care and services specified in paragraphs 1 through 14 for any person who is an inmate of a public custodial or correctional institution or any person who has not attained 65 years of age and is a patient in a medical institution for tuberculosis or mental diseases.

'15. Except that such terms shall not include

'a. Any care or services for any individual who is an inmate of a public institution (except as a patient in a medical institution); or

'b. Any care or services for any individual who has not ***780** attained 65 years of age and who is a patient in an institution for tuberculosis or mental diseases.'

Section 14053 is a part of a group of statutory definitions. It sets forth a listing of a practically unlimited range of health care services that might conceivably be provided if facilities and funds were unlimited. This listing of categories of health care and related services lacks any clear cut definition of the various categories of service. It simply consists of a grouping of very broad categories of medical care. Although unquestionably some services in each of the first five categories should be available, neither section 14053 nor any other statute prescribes the specific quantities or types of such services that are required. Certainly the scope of services within the categories constituting the minimum coverage to public assistance recipients can be and has in fact been expanded when funds were available. Conversely, when funds are in short supply the scope of services should be able to contract. Neither the expansion nor the contraction requires any change in the statutory language.

Although the Basic Five services are recognized as constituting the foundation of a sound medical program, the Administrator has long recognized that such services have never been unrestricted and that the minimum adequate standard of care (which is essentially what the Basic Five services are designed to provide) must be interpreted with reference to available funds. Recognizing that all previous services could not be financed in toto with available funds, the Administrator determined that it was necessary to further restrict some of the services falling within the first five categories that had previously been provided to recipients of public *****720 **728** assistance, such as, the providing of inpatient psychiatric care and eye refractions except following eye surgery.

The emergency regulations represent additional limitations on what is covered within certain of the Basic Five services but they do not constitute a denial or illegal reduction of the Basic Five services.

It would seem that if the Administrator's original regulations concerning what is covered by the Basic Five could not be changed regardless of the fiscal situation, then in effect the Legislature has created a conflict by virtue of appropriating insufficient money to pay for the Basic Five services. The Legislature intended to allow such reasonable definitional adjustments in the Basic Five as were necessary to meet the fiscal problem and did not intend to forever freeze into the ***781** law either the definitions of the Basic Five services which were adopted by the Administrator immediately subsequent to the adoption of the law setting forth the Basic Five services nor the definitions of the Basic Five services which were in effect on August 31, 1967, immediately prior to the adoption of the regulations in question.

However, the trial court held that the law (and particularly sections 14105, 14056 and 14053) does not permit any reduction in the so-called 'minimum coverage' provided to recipients of public assistance. The problem with this position is that it rests on the unarticulated assumption that the term 'minimum coverage' constitutes a sort of inviolate package from which nothing can be removed without violating the law and on the assumption that there is a fixed and immutable definition of each of the services included in the term. No such definition has been found.

It could be contended that when the Legislature adopted section 14053 it also adopted the subsequent administrative rulings which set forth the specific services that would be provided as a part of the 'minimum coverage' and that any subsequent change or diminution in coverage would somehow violate the

definitions so incorporated. This, however, is plainly contrary to the general tenor and purpose not only of the 1967 amendments to the law but to the entire health care law. It is apparent that several of the Basic Five services and especially physicians' services could be defined in any number of ways. No one apparently has ever contended that physicians' services must necessarily, and by legislative mandate, be considered to include every possible service which can be rendered by a physician at any time or place. For example, if, on August 31, 1967, cosmetic surgery was previously authorized under the regulations, would this mean that thereafter the Administrator could not, without violating the law, deny cosmetic surgery to recipients of public assistance regardless of the availability of funds? Certainly cosmetic surgery would involve either 'in-patient hospital services' or 'out-patient hospital services' and 'physicians' services,' all of which are included in the Basic Five. Yet cosmetic surgery has never been provided to Medi-Cal beneficiaries. (See 22 Cal.Admin.Code, s 41305(a)(2) as it read prior to its amendment effective September 1, 1967.)

Lacking a clear statement of the scope of the term 'minimum coverage,' a holding that the regulations illegally reduced minimum coverage is obviously lacking in logic.

***782** In Ehrenreich v. Shelton, 213 Cal.App.2d 376, 379, 28 Cal.Rptr. 855, 856, the court said: 'In a number of cases, however, it has been held that where the record reflects that in arriving at the result of which appellant complains, the trial court relied upon erroneous reasoning and except for that reliance would probably not have reached such result, then a judgment may properly be reversed.'

In the absence of a clear legislative definition, which does not exist, or a commonly accepted professional definition, the Administrator was by necessary implication given the authority to adopt definitions in light of the program objectives, medical practice, the utilization of mainstream medical care generally, and the legislatively *****721** ****729** imposed fiscal limitations. The Administrator did, by his regulations, determine what services could be allowed as the Basic Five. The discussion above shows that his definitions and limitations were reasonable; certainly they were not arbitrary or capricious or entirely lacking in evidentiary support. Therefore the restrictions on the Basic Five should be upheld.

The scope of judicial review is whether the quasi-legislative action of the Administrator has been proved to be arbitrary or capricious. This has not been done in the instant case. On the contrary, the record demonstrates that the emergency regulations were reasonable, valid and proper. Mr. Spencer Williams, Administrator of the Health and Welfare Agency, has exercised in a careful and excellent manner the powers conferred upon him by the legislative branch of the government.

I would reverse the judgment of the superior court and direct it to hold defendants' regulations valid.

DISSENTING OPINION

BURKE, Justice.

I dissent. In 1967 the Legislature, with full knowledge that the funds appropriated for Medi-Cal were insufficient to continue all the services to all the beneficiaries to which the program had been extended, adopted certain all-important amendments. In the last of these amendments adopted by chapter 1421 of the Statutes of 1967 (regular session) the Legislature added a new section (s 14103.7)[FN1] directing that the Administrator, when reducing services in order to maintain the program within the fiscal limits, shall 'to the extent feasible, make proportionate reductions in all services, rather than eliminating any service or services entirely.'

FN1. All section references are to the Welfare and Institutions Code.

***783** The trial court and the majority of this court construe this section in context with the entire maze of statutory provisions to which it was added and arrive at one conclusion. The Administrator, however, viewed the new section, 14103.7, as controlling, and to the extent that it presented any conflict with any of the other relevant sections (14105, 14056, 14053, and 14006.5) as superseding those earlier enactments.

The proper test as to which interpretation is correct depends upon the construction to be accorded the phrase in section 14103.7, 'to the extent feasible.' Does this vest certain discretion in the Administrator? Is it His determination as to what is feasible which controls, or are his functions merely ministerial?

In administering a program as new, perplexing and complex as this one, I believe the Legislature intended to vest broad powers in the Administrator and that this crucial phrase should be interpreted as vesting him with discretion; furthermore, that his determinations as to what is feasible should be sustained unless shown to be 'arbitrary, capricious, or entirely lacking in evidentiary support * * *.' (Brock v. Superior Court, 109 Cal.App.2d 594, 605(8), 241 P.2d 283, 290.)

The construction of a statute by an agency charged with its administration is entitled to great weight and, although final responsibility for its interpretation rests with the courts, in making such determination the court may not 'superimpose its own policy judgment upon the agency in the absence of an arbitrary and capricious decision.' (Pitts v. Perluss (1962) 58 Cal.2d 824, 832, 27 Cal.Rptr. 19, 24, 377 P.2d 83, 88.)

Here the trial court found that the showing of the Administrator with respect to feasibility was not 'convincing to the court,' and consequently the amended regulations adopted by him were invalid in that respect. This, I submit, was an erroneous application of the power of review of the acts of the Administrator. The test is not whether the showing as to feasibility is 'convincing to the court,' but whether the feasibility decisions of the Administrator:

1. Were arbitrary? Clearly, they were not.

***722 **730** 2. Were capricious? No one so contends. On the contrary, the decisions made were painstakingly analyzed by both the experts on the staff and by the Administrator himself.

3. Were Entirely lacking in evidentiary support? Although in the light of the evidence submitted reasonable minds could and obviously did differ on whether certain actions were feasible, it cannot be said upon a review of the record that the ***784** actions taken by the Administrator were Entirely lacking in evidentiary support.

Under these circumstances the trial court erred in holding the amended regulations invalid.

The trial court also concluded that the amended regulations by eliminating as physicians' services certain psychiatric service and eye refractions do not provide for the minimum coverage for public assistance recipients as required by sections 14105, 14056 and 14053, and to that extent they are invalid. It further concluded that since the amended regulations, in effect, do not eliminate the medically indigent from the program to the extent necessary to continue minimum services to the welfare recipients the regulations were also invalid in that respect.

But these conclusions are dependent upon the effect and weight to be given to the new section added by the Legislature as its last pronouncement and referred to above, section 14103.7. Although the various sections are certainly not a model of clarity, the construction placed upon section 14103.7 by the Administrator in relation to the other sections mentioned above is not unreasonable. Had the Legislature intended to prohibit Any service to be rendered to those in the medically indigent classes mentioned in section 14006.5, subdivisions (b), (c) and (d), it could have so stated. But it did not. What it did say, in section 14103.7, was directly to the contrary. It mandated the Administrator when reducing services 'under this chapter and Chapter 8' (which includes All classes, the welfare recipients And the medically indigent) to make proportionate reductions 'in all services, rather than eliminating Any service or services entirely.' (Italics added.) Strictly construed, this language clearly admonishes the Administrator to Continue services to the extent feasible to All beneficiaries of the program, including All categories ((a), (b), (c) and (d)). Thus, the section does not mandate him to eliminate rendering services to specific classes but to make reductions in All services (proportionately to the extent feasible).

In fact, neither does section 14006.5, the so-called priorities section, which the majority deem controlling, mandate the Administrator to eliminate All services to the three classes of medically indigent, should the funds prove insufficient to continue minimum standards of medical aid to public assistance recipients. The admonition in the latter section is not to eliminate Categories of Persons from All services but to reduce ***785** Services in accordance with the priorities. Had the Legislature intended to eliminate entire categories of persons from participation rather than reduce Services, it would have been simple to have so

stated.

Section 14103.7 directed the Administrator, in curtailing services, to do so by proportionate reduction in all services rather than by eliminating any service or services entirely. But it expressly qualified this admonition by the phrase 'to the extent feasible.' In the exercise of his discretion the Administrator found that certain services did not lend themselves to proportionate reductions, such as certain outpatient psychiatric services and eye refractions, and others mentioned in the majority opinion. These determinations appear to be entirely sensible and reasonable and certainly do not fall within the category of being arbitrary or capricious. They therefore should be sustained by the courts. If these regulations do not comport with what the Legislature intended then the remedy may be supplied by appropriate legislative amendment.

Cal. 1967.
Morris v. Williams
67 Cal.2d 733, 433 P.2d 697, 63 Cal.Rptr. 689

END OF DOCUMENT

Supreme Court of California,
In Bank.

The PEOPLE, Plaintiff and Respondent,
v.
John Martin SIMON, Defendant and Appellant.

No. S036981.
Jan. 23, 1995.
Rehearing Denied March 16, 1995.

Defendant was convicted of seven counts of selling unqualified securities, and five counts of selling securities by means of false statements or omissions, in the Superior Court, Los Angeles County, No. BA001087,George Trammell III, J., and he appealed. Appeal was transferred before decision by Court of Appeal. The Supreme Court, Baxter, J., held that: (1) trial court should have instructed jury that defendant could satisfy burden of establishing exemption from registration requirement by raising reasonable doubt that he had sold nonexempt security, and (2) knowledge of falsity or misleading nature of statement, or materiality of an omission, or criminal negligence in failing to investigate or discover them are elements of statute criminalizing sale or purchase of securities by means of communications containing false or misleading statements or material omissions.

Reversed.

Mosk, J., dissented and filed opinion.

West Headnotes

[1] Securities Regulation 349B 249.1

349B Securities Regulation
349BII State Regulation
349BII(A) In General
349Bk249 Particular Securities
349Bk249.1 k. In general. Most Cited Cases

Limited partnership may be "security," under Corporate Securities Law, if investor provides capital that will be risked in enterprise that is not involved in management. West's Ann.Cal.Corp.Code §§ 25000 et seq., 25019.

[2] Securities Regulation 349B 269

349B Securities Regulation
349BII State Regulation
349BII(A) In General
349Bk262 Transactions Covered
349Bk269 k. Private offerings; close corporations. Most Cited Cases

Security alleged to be exempt because it was sold only to persons with whom issuer had prior business or personal relationship is not exempt if an interest in that security is sold to any person who does not meet that qualification. West's Ann.Cal.Corp.Code §§ 25102(f), 25110.

[3] Securities Regulation 349B 328

349B Securities Regulation
349BII State Regulation
349BII(C) Offenses and Prosecutions
349Bk325 Criminal Prosecutions
349Bk328 k. Weight and sufficiency of evidence. Most Cited Cases

Because an exemption defense is not collateral to defendant's guilt on the charge of selling unqualified securities, defendant's burden of proving exemption is only to raise reasonable doubt that defendant sold nonexempt securities. West's Ann.Cal.Corp.Code § 25163; West's Ann.Cal.Evid.Code § 501; West's Ann.Cal.Penal Code § 1096.

[4] Securities Regulation 349B 329

349B Securities Regulation
349BII State Regulation
349BII(C) Offenses and Prosecutions
349Bk325 Criminal Prosecutions
349Bk329 k. Trial, judgment, and review. Most Cited Cases

Requirement that court instruct on nature of burden of proof applies to an exemption defense in a corporate securities prosecution. West's Ann.Cal.Corp.Code § 25163; West's Ann.Cal.Evid.Code § 502.

[5] Securities Regulation 349B 269

349B Securities Regulation
349BII State Regulation
349BII(A) In General
349Bk262 Transactions Covered
349Bk269 k. Private offerings; close corporations. Most Cited Cases

"Preexisting personal or business relationship," between issuer and purchasers of security, sufficient to satisfy requirements for exemption from securities registration requirements, is relationship consisting of personal or business contacts of nature and duration such as would enable reasonably prudent purchaser to be aware of character, business acumen and general business and financial circumstances of persons with whom relationship exists. West's Ann.Cal.Corp.Code § 25102(f); Cal.Code Regs. tit. 10, r. 260.102.12(d)(1).

[6] Criminal Law 110 1173.2(2)

110 Criminal Law
110XXIV Review
110XXIV(Q) Harmless and Reversible Error
110k1173 Failure or Refusal to Give Instructions
110k1173.2 Instructions on Particular Points
110k1173.2(2) k. Elements and incidents of offense. Most Cited Cases

Securities Regulation 349B 329

349B Securities Regulation
349BII State Regulation
349BII(C) Offenses and Prosecutions
349Bk325 Criminal Prosecutions
349Bk329 k. Trial, judgment, and review. Most Cited Cases

Trial court committed prejudicial error by not instructing jury that defendant charged with selling registered securities could satisfy burden of establishing applicability of exemption by producing evidence sufficient to raise reasonable doubt that he had sold nonexempt security; expert had testified that persons who had been referred to organizer of investment opportunity by persons preparing tax returns for them, as was true in present case, could be considered to have a sufficiently close personal and business relationship to offeror for exemption covering sales to such persons to be applicable, and if instruction had been given it was reasonably probable that outcome more favorable to defendant would have been reached. West's Ann.Cal.Corp.Code §§ 25102(f), 25110; Cal.Code **Regs**. tit. 10, r. 260.102.12(d)(1).

[7] Securities Regulation 349B 323

349B Securities **Regulation**
349BII State **Regulation**
349BII(C) Offenses and Prosecutions
349Bk323 k. Fraud or misrepresentation. Most Cited Cases

In determining whether legislature intended that defendant violating securities fraud statute have "scienter," i.e., guilty knowledge at time that representation or omission was fraudulent, **entire regulatory scheme** of Corporate Securities Law and place in **regulatory** hierarchy into which criminal violation fell, would be required. West's Ann.Cal.Corp.Code §§ 25401, 25540.

[8] Statutes 361 184

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k180 Intention of Legislature
361k184 k. Policy and purpose of act. Most Cited Cases

Statutes 361 207

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k204 Statute as a Whole, and Intrinsic Aids to Construction
361k207 k. Conflicting provisions. Most

Cited Cases

Statutes 361 ⚿223.2(.5)

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k223 Construction with Reference to Other Statutes
361k223.2 Statutes Relating to the Same Subject Matter in General
361k223.2(.5) k. In general. Most Cited Cases

In construing language of statute court must keep in mind statutory purpose, and statutes or statutory sections relating to same subject must be harmonized, both internally and with each other, to extent possible.

[9] Statutes 361 ⚿241(1)

361 Statutes
361VI Construction and Operation
361VI(B) Particular Classes of Statutes
361k241 Penal Statutes
361k241(1) k. In general. Most Cited Cases

In interpreting a criminal statute, susceptible to constructions, court must ordinarily adopt construction most favorable to offender.

[10] Criminal Law 110 ⚿20

110 Criminal Law
110I Nature and Elements of Crime
110k19 Criminal Intent and Malice
110k20 k. In general. Most Cited Cases

Existence of mens rea is rule rather than exception to principles of criminal jurisprudence.

[11] Securities Regulation 349B ⚿323

349B Securities Regulation
349BII State Regulation
349BII(C) Offenses and Prosecutions
349Bk323 k. Fraud or misrepresentation. Most Cited Cases

Knowledge of falsity or misleading nature of statement or of materiality of omission, or criminal negligence in failing to investigate and discover them, are elements of criminal offense involving offer to sell or buy securities by means of communication including untrue statement of material facts or omitting to state material fact. West's Ann.Cal.Corp.Code § 25401.

[12] Criminal Law 110 ⚿1173.2(2)

110 Criminal Law
110XXIV Review
110XXIV(Q) Harmless and Reversible Error
110k1173 Failure or Refusal to Give Instructions
110k1173.2 Instructions on Particular Points
110k1173.2(2) k. Elements and incidents of offense. Most Cited Cases

Securities Regulation 349B ⚿329

349B Securities Regulation
349BII State Regulation
349BII(C) Offenses and Prosecutions
349Bk325 Criminal Prosecutions
349Bk329 k. Trial, judgment, and review. Most Cited Cases

Trial court error, in not instructing jury that defendant making fraudulent statement or misrepresentation must have awareness of falsity or misleading nature at time statement or omission is made, was prejudicial; it was reasonable probability that more favorable result would have been reached had jury been limited to review of intent at time of allegedly wrongful conduct. West's Ann.Cal.Corp.Code § 25401.

*****279 *496 **1273** Thomas F. Coleman, Los Angeles, under appointment by the Supreme Court, for defendant and appellant.

Daniel E. Lungren, Atty. Gen., George Williamson, Chief Asst. Atty. Gen., Carol Wendelin Pollack, Asst. Atty. Gen., John R. Gorey and Sanjay T. Kumar, Deputy Attys. Gen., for plaintiff and respondent.

BAXTER, Justice.

This case arises under the Corporate Securities Law of 1968. (Corp.Code, § 25000, et seq.) [FN1] The principal issue is whether sections 25401 and 25540, which criminalize the sale or purchase of securities by means of oral or written communications which either contain false or misleading statements or omit material facts, create a "strict liability" offense. We also consider appellant's claims that he was prejudiced by the trial court's error in failing to instruct on the magnitude of a defendant's burden of proof when offering an "exemption" defense to a charge of violating section 25110 which prohibits the sale of unqualified securities.[FN2]

FN1. All statutory references are to the Corporations Code unless otherwise noted.

Section 25401 provides: "It is unlawful for any person to offer or sell a security in this state or buy or offer to buy a security in this state by means of any written or oral communication which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."

FN2. The appeal was transferred to this court pursuant to Rule 27.5 of the California Rules of Court before decision by the Court of Appeal.

***280** We conclude that failure to instruct on defendant's burden of proof of an exemption from the requirements of section 25110 was prejudicial. We *497 also conclude that the trial court erred prejudicially in instructing that sections 25401 and 25540 create an offense that does not require either (1) knowledge of the false or misleading nature of a representation or of the materiality of an omission, or (2) criminal negligence in failing to acquire such knowledge. The judgment must, therefore, be reversed.

I
BACKGROUND

Appellant was convicted by a jury of seven counts of selling unqualified securities in violation of section 25110 [FN3] and five counts of selling securities by means of false statements or omissions in violation of section 25401. The charges were based on transactions in which appellant or his employee agents sold interests in promissory notes [FN4] and limited partnerships which appellant created and in which he or Vesper Corporation was the general partner. The actual offeror of the partnership interests was Vesper Corporation, doing business as Clergy Tax and Financial Services. Appellant was the president and primary shareholder of Vesper Corporation and was the manager of its operations. Appellant stipulated that "John Simon is Clergy Tax. He owns Clergy Tax and all of these limited partnerships he was responsible for to manage and direct."

FN3. Section 25110 provides: "It is unlawful for any person to offer or sell in this state any security in an issuer transaction (other than in a transaction subject to Section 25120), whether or not by or through underwriters, unless such sale has been qualified under Section 25111, 25112 or 25113 (and no order under Section 25140 or subdivision (a) of Section 25143 is in effect with respect to such qualification) or unless such security or transaction is exempted under Chapter 1 (commencing with Section 25100) of this part...."

FN4. Unsecured promissory notes are securities if the investor relies on the skill, services, solvency, success, and services of the issuer to ensure payment.

Through Vesper Corporation appellant formed 47 partnerships for the purpose of purchasing, managing, and reselling real property. Nineteen were formed for the purpose of loaning funds to other partnerships. In all, there were 66 limited partnerships in which 870 people had invested a total of $11,449,883. The sales in the counts on **1274 which appellant was convicted [FN5] were made between 1980 and 1985 to eight persons for whom appellant and his employees in Clergy Tax and Financial Services had prepared income tax returns. None of the limited partnerships was qualified pursuant to sections *498 25111, 25112, or 25113. Appellant believed that his preexisting relationship with the investors as their tax preparer exempted the securities from the qualification requirement.

FN5. At the close of the People's case the

judge granted a motion for acquittal (Pen.Code, § 1118.1) on six counts. Appellant was acquitted by the jury on 20 counts. The jury deadlocked on five counts which were subsequently dismissed on motion of the prosecutor. Appellant was not convicted on any of several counts alleging grand theft (Pen.Code, § 487, former subd. 1) from the same victims or on the one count alleging fraudulent practices (§ 25541).

Appellant was involved in all aspects of establishing and managing the limited partnerships, but made only two of the direct sales of interests in them to the investors in the counts of which he was convicted. The others were sold by his employees. The employees did not tell the investors of the risks, and only after making the investment did some receive a prospectus which did disclose that the investment was in a speculative security with a high degree of risk. Appellant minimized the risks, telling one investor that the prospects for a partnership project were more positive than disclosed in the prospectus and that a risk disclaimer in the prospectus was present only because it was required in all limited partnership prospectuses.

Evidence at trial showed that money was usually obtained from investors before property was purchased for a limited partnership and was held in a money market account. Appellant authorized the opening of escrow accounts and was aware of all purchases of property by the limited partnerships. He negotiated the purchase price and down payment,***281 and he authorized the transfer of money from a partnership to make the purchase.

While appellant's employees were instructed to advise investors regarding some risks, they were not told to advise the investors that money from the partnership in which they invested might be loaned to other partnerships or used to finance the operation of Clergy Tax and Financial Services. Appellant testified that he believed that, as general partner in each of the partnerships, he had the authority to make the loans and did so when a partnership had excess cash or a cash flow problem because a lending partnership could earn higher interest and a borrowing partnership would pay lower interest than either would if it dealt with an outside lender. Substantially all of the omissions to disclose material facts were related to loans made between the real estate partnerships after the buyers had invested money. The jury necessarily concluded that this information was material and should have been disclosed to each investor.

The court did not instruct the jury that knowledge of the falsity of statements or misleading nature of omissions in communications with a prospective investor is a necessary element of the section 25401 offense. It ruled instead that section 25401 created a strict liability offense in which scienter or knowledge is not an element and instructed the jury: (1) that the actor's intent or knowledge at the time a material representation is made is irrelevant; (2) that only a general intent to commit the proscribed act was *499 required; and (3) that if later events make a representation untrue that section is violated. The complete instruction was:

"Where the defendant makes a material representation about conduct in the future, he must act in accordance with the representation irrespective of what his intent or knowledge was at the time the representation was made.

"If his later act makes the statement as promised untrue, he may be found in violation of Section 25401.

"In the crime of willfully offering or selling a security by means of a material misrepresentation or omitting to state a material fact (Corporations Code Section 25401), a general **1275 criminal intent need only be shown. 'When a person intentionally does that which the law declares to be a crime, he is acting with general criminal intent-even though he may not know that his act or conduct is unlawful.' "

In the instructions on section 25110, the jury was told that a defendant has the burden of proof that securities are exempt from the qualification requirement of section 25110. However, the court did not advise the jury that this burden was met if the defendant offered enough evidence that an exemption applied to raise a reasonable doubt that registration of the limited partnership interests was required by the Corporate Securities Law of 1968.

Appellant contends that these instructions were erroneous.

II

SECTION 25110: BURDEN OF PROOF

[1] A limited partnership interest may be a security as defined by section 25019 of the Corporate Securities Law of 1968 (§ 25000 et seq.) because the investor provides capital that will be risked in the enterprise and is not involved in management. (*Silver Hills Country Club v. Sobieski* (1961) 55 Cal.2d 811, 13 Cal.Rptr. 186, 361 P.2d 906; *People v. Graham* (1985) 163 Cal.App.3d 1159, 1168, 210 Cal.Rptr. 318; see also Comment, *Limited Partnerships and the California Securities Law: Restricting the Public Sale of Limited Partnership Interests* (1980) 13 U.C.Davis L.Rev. 618; Comment, *Is a Limited Partnership Interest a 'Security'?: The Current State of the California and Federal Definitions Add a Legal Dimension To Economic Speculation* (1976) 16 Santa Clara L.Rev. 311.)

[2] Section 25110 makes it illegal to sell an unqualified security unless the *security* itself, not the individual sale, is exempt. Therefore, a security ***500** alleged to be exempt under subdivision (f) of section 25102 because it was sold only to persons with whom the issuer had a prior business or personal relationship is not exempt if an interest in that *****282** security is sold to any person who does not meet that qualification. Appellant does not contest the characterization of the limited partnership interests he and his employees sold as unqualified securities. He claimed at trial, however, that the sales were exempt from qualification because all were made to persons with whom he and/or Clergy Tax and Financial Service had a preexisting personal or business relationship.[FN6]

> FN6. Respondent does not claim that the limited partnerships or notes sold to the persons named in the counts of which appellant was convicted were nonexempt because interests in them had been sold to other persons who did not have the requisite prior relationship with the offeror.

Section 25102, subdivision (f), presently creates the exemption on which appellant relied. It applies if the sales of securities are to no more than 35 persons each of whom represents that he or she is purchasing for his or her own account and not for sale, the sale is not made through publication of an advertisement, and if the "purchasers either have a preexisting personal or business relationship with the offeror or any of its partners, officers, directors or controlling persons, or by reason of their business or financial experience or the business or financial experience of their professional advisors who are unaffiliated with and who are not compensated by the issuer or any affiliate or selling agent of the issuer, directly or indirectly, could be reasonably assumed to have the capacity to protect their own interests in connection with the transaction."

Some of the sales involved in this prosecution were made prior to November 1, 1981. Prior to that date, subdivision (f) of section 25102 created an exemption for "[a]ny offer or sale, in a transaction not involving any public offering, of any bona fide general partnership, joint venture or limited partnership interest...." (Stats.1979, ch. 665, § 1.7, p. 2042.) Under the statute as it then read and the implementing regulation (former rule 260.102.2, Rules of Comr. of Corp.; see now 10 Cal.Code Reg. § 260.102.12; all references****1276** to rules are to these rules), a defendant could claim an exemption if the offer was to no more than 25 persons with sales to no more than 10 of those persons by showing only that the offering or sale was not a "public offering" because it was to persons with whom the issuer of the security had a preexisting personal or business relationship. (*People v. Feno* (1984) 154 Cal.App.3d 719, 732, 201 Cal.Rptr. 513.)[FN7]

> FN7. Even though some of the sales of unqualified securities of which appellant was convicted allegedly were made prior to November 1, 1981, the date on which the amendment of subdivision (f) of section 25102 became effective, the court instructed only in the language of the amended statute.
>
> This error had the effect of making the appellant's burden greater than it had been under the pre-November 1, 1981, version of the statute inasmuch as he was required to show also that the investor had represented that he or she was purchasing the security for the investor's own account and not with a view to sale in connection with any distribution of the security, and that the offer and sale was not accomplished by publication of any advertisement.
>
> On retrial, the court should distinguish the counts alleging pre- and post-November 1,

> 1981, sales and instruct accordingly to avoid a possibly prejudicial ex post facto application of the amended version of the statute. (See *Miller v. Florida* (1987) 482 U.S. 423, 429-430, 107 S.Ct. 2446, 2450-2451, 96 L.Ed.2d 351). Because we conclude that the error in failing to instruct on the nature of the defendant's burden of proof was prejudicial with respect to all of the section 25110 convictions, we need not consider the impact on the verdicts, if any, of the trial court's failure to instruct under the pre-November 1, 1981, version of the exemption.

[3] The Corporate Securities Law of 1968 assigns the burden of proving an exemption to defendants. Section 25163 provides: "In any proceeding under ***501** this law, the burden of proving an exemption or an exception from a definition is upon the person claiming it." Because an exemption defense is not collateral to the defendant's guilt of a charge of selling unqualified securities, however, a defendant's burden is only to raise a reasonable doubt that the defendant sold nonexempt securities. (Evid.Code, § 501; Pen.Code, § 1096; *People v. Figueroa* (1986) 41 Cal.3d 714, 722, 224 Cal.Rptr. 719, 715 P.2d 680.)

[4] The trial court is required to instruct the jury on which party has the burden of proof *and* on the nature of that burden. "The court on all proper occasions shall instruct the jury as to which party bears the burden of proof on each issue *and as to* *****283** *whether that burden requires that a party raise a reasonable doubt concerning the existence or nonexistence of a fact or that he establish the existence or nonexistence of a fact by a preponderance of the evidence, by clear and convincing proof, or by proof beyond a reasonable doubt.*" (Evid.Code, § 502, italics added.) The requirement that the court instruct on the nature of the burden of proof applies to an exemption defense in a corporate securities prosecution. (*People v. Figueroa, supra,* 41 Cal.3d 714, 722, 224 Cal.Rptr. 719, 715 P.2d 680.)

The court instructed the jury that section 25110 makes it unlawful to offer or sell an unqualified security unless the security is exempt. The only instruction regarding the burden of proof was: "The burden of proving an exemption is upon the defendant."

Appellant contends that the trial court committed reversible error in failing to instruct the jury that his burden was only to raise a reasonable doubt that the securities were not exempt. He notes that the state of the evidence on the question of whether the limited partnership interests he sold were exempt from qualification was such that he was acquitted on four of the counts charging violation of section 25110, and the jury deadlocked on a fifth count. Inasmuch as each count involved the relationship and circumstances of a different investor, however, the acquittal and deadlock on some ***502** counts does not itself establish that the case was close with respect to the counts on which appellant was convicted.

The People concede that the court erred, but argue that those counts were not close and the error does not require reversal. We disagree. When the evidence is considered in light of the instructions actually given by ****1277** the court, it is probable that a result more favorable to appellant would have ensued had the jury been instructed that appellant's burden was only to raise a reasonable doubt in the minds of the jurors that he sold unqualified securities, i.e., a reasonable doubt that the limited partnership interests he sold were not exempt.

[5][6] The trial court instructed in the statutory language on exemption from the qualification requirement. Appellant relied on the exemption for sales made to persons with whom the offeror or an officer, director, or controlling person of the offeror had a preexisting business relationship. No instruction was given on the nature of the relationship necessary to satisfy the statute.[FN8] *****284** Therefore appellant had only to show that the investors had a prior business ***503** relationship with him or with Clergy Tax and Financial Services. In this case, because Vesper Corporation was the issuer of the securities and defendant was a director, officer, and controlling person of Vesper Corporation, the required relationship could be with either appellant or Vesper Corporation, which did business as Clergy Tax and Financial Services. All of the persons to whom appellant sold limited partnership interests were clients of Clergy Tax and Financial Services. The evidence regarding the prior relationships between appellant or Clergy Tax and Financial Services and the purchasers named in the counts in which he was convicted of violating section 25110 is as follows:

FN8. Section 25102, subdivision (f), does not further define the "personal" or "business" relationship between the issuer and the purchasers of a security which is necessary to claim this exemption from the qualification requirement. Rule 260.102.12(d)(1) provides, however, that " 'preexisting personal or business relationship' includes any relationship consisting of personal or business contacts of a nature and duration such as would enable a reasonably prudent purchaser to be aware of the character, business acumen and general business and financial circumstances of the person with whom such relationship exists." The rule also provides that its description of the nature of the required relationship does not create a presumption that other relationships are not within the statutory definition and any determination of whether the statutorily defined relationship exists is to be made without reference to the subsection.

Notwithstanding the rule's disclaimer, rule 260.102.12(d)(1) describes the nature of the relationship contemplated by section 25102. The relationship described in the rule contemplates more than mere acquaintance. If the qualification requirement is to serve the purpose of the corporate securities law, which is to protect unsophisticated investors (*Southern Cal. First Nat. Bank v. Quincy Cass Associates* (1970) 3 Cal.3d 667, 675, 91 Cal.Rptr. 605, 478 P.2d 37), the relationship must be one of sufficient duration and nature that the offeror of a security has reason to believe the investor is able to assess the issuer's honesty and competence. (See 1 Marsh & Volk, Practice under the Cal. Securities Laws (rev. ed. 1994) § 402A[2][c], p. 4-28.8(1) (hereafter Marsh & Volk).) The guidelines suggested by the rule are consistent with that purpose. We do not rule out the possibility that other types of relationships may form a basis on which an investor would be warranted in relying on a person who offers or sells unqualified securities to the investor.

Whether a prior relationship warranting reliance on the seller of an unregistered security exists is an objective test and looks to what a reasonably prudent investor would be aware of about the offeror from the prior personal or business relationship. This test is intended to protect investors by placing on the offeror the burden of establishing that the nature and duration of the relationship is one that would enable a reasonably prudent investor to assess the general business and financial circumstances of the issuer. (See 1 Marsh & Volk, *op. cit. supra,* § 402A [2][c][ii], p. 4-28.9.)

Because the jury was not instructed that this test should be applied, it does not enter into our assessment of whether appellant was prejudiced by the error in the instructions actually given.

The investor in count I, Norma Nordstrom, met appellant in October 1986. Her tax return was prepared by his employee Keith Gunther in 1980 and subsequent years. In February 1985 she asked Gunther about making investments. Ms. Nordstrom invested $10,000 in the "Hesperia 19" limited partnership. At that point she had not met appellant, had never heard of Vesper Corporation, and was unaware that appellant had any connection to Clergy Tax and Financial Services or Vesper Corporation. Appellant had no personal contact with her. There was evidence of a prior business relationship of five years' duration with Clergy Tax and Financial Services at the time she made her investment, however.

****1278** Janet Taylor (count VII) was referred to Clergy Tax and Financial Services for tax return preparation in 1983 by her minister, a friend of defendant. In April 1983, she met appellant, who introduced her to an employee assigned to prepare her tax return. She spoke with appellant for an hour at the most. They discussed Ms. Taylor's friend and what appellant had done with the friend's finances. In June 1983, that employee spoke with Ms. Taylor about investing in limited partnerships. He came to her home and she invested $5,000 in the "University Center Investors" limited partnership. She knew that appellant was to be the general partner who managed the partnership. She had heard of Vesper Corporation and in her mind appellant, Clergy Tax and Financial Ser-

vices and Vesper Corporation were "synonymous." She also invested $5,000 in the "Adelanto III" limited partnership in June 1983. Appellant did not recall meeting personally with Ms. Taylor, and as of June 1983 she had been to the Clergy Tax and Financial Services office only once, in April 1983 for tax return preparation. Again there was evidence of a business relationship with Clergy Tax and Financial services and with appellant.

Neal Shaver (count X) employed Clergy Tax and Financial Services to prepare his tax returns in 1983 and again in 1984. He met with an employee ***504** who prepared the tax returns for Shaver and his wife. In 1984 the employee told Shaver about one of the limited partnerships. In July 1984 Shaver invested $7,000 in the "Commercial Investors II" partnership. In August 1984 he invested another $5,000. In September 1984 he invested $30,000 in the "Commercial Income Investors IV" partnership. He knew that appellant would be the general partner in these partnerships, but he first met appellant in 1985. He dealt only with the employee. Appellant did not recall meeting personally with Shaver. There was evidence therefore that Shaver had a prior business relationship of more than a year's duration with Clergy Tax and Financial Services when he made his first purchase and that relationship extended to the time he made his subsequent purchases.

Verlyne Evers (count XIII) first met appellant in 1980 and after that time employees of Clergy Tax and Financial Services prepared her taxes. An employee discussed investing with her and her first investment was a $37,000 interest in the "Reeves Street" partnership in November 1980. She also invested in the "El Cajon" partnership during that month. In March 1981 she invested in "Victorville Investors." In February 1983 she invested in "Adelanto 20." In May 1984, she and her husband invested $81,130 of his retirement check in "Commercial Income Investors II." Ms. Evers knew that appellant owned and was in charge of Clergy Tax and Financial Services and would manage the *****285** limited partnerships, but she did not discuss investments with appellant. All of the investments were handled by an employee. The evidence was such that the jury could believe that she, too, had an existing business relationship with Clergy Tax and Financial Services at the time of the first purchase and that the relationship continued through the time she made her last purchase.

Duane Tellinghuisen (count XXV) met appellant in 1969 when he went to Clergy Tax and Financial Services to have his tax returns prepared. He continued to have his tax returns prepared by Clergy Tax and Financial Services until 1986, but appellant did not personally prepare them each year. Four other employees did them during that time. Tellinghuisen built a relationship of confidence and trust in appellant's preparation of tax returns, but had no other business dealings with appellant. In 1980 one of appellant's employees mentioned investment opportunities to Tellinghuisen. He had had no business dealings other than tax preparation with Clergy Tax and Financial Services prior to 1980. In February 1980 he invested $5,000 in what he believed was the "Olive Street" limited partnership. He was told that appellant would manage the limited partnership. He had heard of Vesper Corporation and believed that appellant was managing it as a separate corporation. In June 1983, he invested $12,250 in the "Adelanto 20" limited partnership. The jury could have ****1279** believed that this investor had a prior business relationship with Clergy Tax and Financial Services of more than 10 years' duration when he made his first purchase.

***505** Cecil Gates (count XVI) met a Clergy Tax and Financial Services employee at a 1979 seminar and regularly had his tax returns prepared by that employee. He was contacted by the employee in 1981 about investing in one of the limited partnerships. In October and December 1981, he invested $10,000 in the "Lakewood Ltd." limited partnership. In early 1982, he invested $6,000 in the "Victorville Investors" limited partnership. Additional sums were invested in subsequent years when "assessments" were made. Gates had no personal contact with appellant until August or September 1986, but the evidence was of a business relationship with Clergy Tax and Financial Services.

Caroline French was the victim in count IV. She and her husband met appellant in 1974 to have their tax returns prepared. He personally prepared tax returns for Mrs. French until the business expanded and another person was assigned to prepare them. Mr. and Mrs. French also met with various employees of Clergy Tax and Financial Services. When doing financial planning, they invested in annuities with an outside company recommended by defendant. In 1980, when Ms. French received an inheritance, she

and her husband sought help with investments from appellant. In October 1980, she invested $10,000 in a promissory note which appellant said would be a loan to him as he entered the "Elizabeth Gardens" partnership. She also invested $12,000 in the "Aloha Gardens" partnership at that time. Ms. French testified that she and her husband had "ongoing" contacts with appellant, who was their financial advisor from the time he first prepared their tax returns until they made their investments in 1980. Appellant testified that he had many business contacts with Mrs. French. On this count there was evidence of a prior business relationship with both appellant and Clergy Tax and Financial Services.

Some of these investors did not deal with appellant personally. They had done business with Clergy Tax and Financial Services, however. Although some were not aware that their business relationship was with Vesper Corporation, since the corporation did business only under the name of Clergy Tax and Financial Services, the relationship with the issuer of the securities existed. The evidence was such that a properly instructed jury could believe that the prior business relationship between those investors and Clergy Tax and Financial Services might qualify the sales to these investors for the exemption. The jury could also believe that Mrs. French had a prior business relationship with appellant personally, so as to qualify the sale to her for the exemption. If so, the jury might well have had a reasonable doubt that the securities were not exempt.

***286 The possibility that the jury, if properly instructed, might have had a reasonable doubt that the securities sold to these investors were nonexempt *506 is strong because, in addition to above the evidence regarding the purchasers' business relationships with appellant and/or Clergy Tax and Financial Services, defendant offered the testimony of an attorney expert who handled matters subject to subdivision (f) of section 25102 on a regular basis. She testified that in her opinion a person who is referred to a tax preparer with an indication that the tax preparer has a good reputation for doing tax returns, submits relevant personal information to the preparer, is given good tax planning advice with special knowledge of the individual's circumstances, and comes back year after year, during which period the individual sees the tax preparation business growing and seemingly successful, is a person who satisfies the "preexisting relationship" test of the statute. [FN9]

FN9. Our consideration of this evidence in assessing prejudice does not signal approval of admission of expert testimony on legal questions-here the nature of the relationship required by statute to claim an exemption.

In assessing the prejudicial impact of the court's failure to instruct that appellant's **1280 burden was only to offer evidence of a prior business relationship with appellant and/or Vesper Corporation sufficient to raise a reasonable doubt in the jurors' minds as to whether he sold securities that were not exempt, we consider the instructions that were given and the evidence of prior relationships. There was evidence of contacts between the investors and appellant and/or Vesper Corporation doing business as Clergy Tax and Financial Services which could establish an exemption in each case. That evidence was unrebutted. We conclude therefore that it is reasonably probable that an outcome more favorable to appellant might have been reached had the jury been properly instructed that appellant's burden was only to raise a reasonable doubt that the securities he sold were not exempt.[FN10] (*People v. Watson* (1956) 46 Cal.2d 818, 836-837, 299 P.2d 243.)[FN11] The error was prejudicial and necessitates reversal of the judgment entered on each of the counts of violating section 25110.

FN10. We have reviewed the arguments of counsel in an effort to determine if the nature of the burden might have been conveyed to the jury during closing argument. It was not. If anything, the argument would have led the jury to believe that appellant had to do more than raise a reasonable doubt as to whether the securities appellant sold were exempt.

The prosecutor repeated the judge's advice that the defendant "has to prove that he was exempt from the provisions of 25110. If he does not prove that he was exempt and you believe that I have proven all these elements beyond a reasonable doubt, you must find the defendant guilty even though he never intended to violate the law." Later he again told the jury that the "defendant has to prove that the person he's dealing with when he's selling them the security is one, a sophisticated investor or they have a

business relationship to the offeror." Defense counsel did not address the burden during closing argument.

FN11. Because we conclude that reversal is required under *People v. Watson, supra,* 46 Cal.2d 818, 836-837, 299 P.2d 243, we need not decide here whether the error in omitting the instruction of the defendant's burden is one of federal constitutional dimension that necessitates application of the *Chapman* test for reversible error. (*Chapman v. California* (1967) 386 U.S. 18, 87 S.Ct. 824, 17 L.Ed.2d 705.)

***507 III**
SECTIONS 25401 AND 25540: MENS REA OR SCIENTER

Do sections 25401 and 25540 create a "strict liability" offense? Section 25401 itself does not expressly require knowledge of the false or misleading nature of a statement or omission to disclose, made in the sale of a security, as an element of the unlawful act it defines. The criminal penalty for violation of section 25401 is found in section 25540 which, at the time of the offenses with which defendant is charged, included a requirement that the conduct be "willful." At the time of the offenses it provided: "Any person who willfully violates any provision of this law [including section 25401], or who willfully violates any rule or order under this law, shall upon conviction be fined not more than ten thousand dollars ($10,000) or imprisoned in the state prison, or in a county jail for not more than one year, or be punished by both *****287** such fine and imprisonment; but no person may be imprisoned for the violation of any rule or order if he proves that he had no knowledge of the rule or order." (§ 25540, as amended by Stats.1977, ch. 165, § 1, p. 639.)

In *People v. Johnson* (1989) 213 Cal.App.3d 1369, 262 Cal.Rptr. 366 (*Johnson*), the Court of Appeal considered these provisions and the federal securities laws after which the Corporate Securities Law of 1968 was patterned, and concluded that, notwithstanding the "willful" requirement in section 25540, the California Legislature did not intend to make knowledge of the falsity of a statement an element of the offense of selling securities by means of false or misleading statements.

In *Johnson,* as here, interests in limited partnerships which were formed for the purpose of constructing and managing property were sold as unqualified securities. When unanticipated increases in the costs of construction were experienced, and partnership ****1281** funds were inadequate to cover the increased expenses, funds were "temporarily" transferred among the partnerships to meet cash flow needs. The defendant, who was the issuer and general partner, had not advised investors that such transfers would be made and had told those who inquired that the funds would not be commingled. The trial court did not instruct that a violation of section 25401 requires "scienter," i.e., guilty knowledge at the time the representation or omission occurs. The Court of Appeal affirmed the conviction, holding that although California's securities law is patterned after the Securities Act of 1933 (1933 Act) (15 U.S.C. § 77a et seq.), which had been construed in *United States v. Koenig* (S.D.N.Y.1974) 388 F.Supp. 670, 712, as requiring proof that the defendant knew of the falsity of his representations or acted with reckless ***508** disregard for the truth, the California Legislature intended section 25401 to apply to any willful conduct and did not make knowledge of the falsity of a statement an element of the offense.

The *Johnson* court explained: "It is settled that the omission of 'knowingly' from a penal statute indicates that guilty knowledge is not an element of the offense. (*People v. Kuhn* (1963) 216 Cal.App.2d 695, 699, 31 Cal.Rptr. 253.) Had the Legislature intended to require proof of guilty knowledge or scienter under section 25540, it could have so stated by using the word 'knowingly.' Willfulness does not require proof of evil motive or intent to violate the law or knowledge of illegality. (*People v. Clem* (1974) 39 Cal.App.3d 539, 542-543, 114 Cal.Rptr. 359-according to legislative history of § 25540, evidence of good faith or advice of counsel is not a defense; *People v. Gonda* (1982) 138 Cal.App.3d 774, 779, 188 Cal.Rptr. 295-lack of knowledge of illegality is not a defense to violation of law regulating sale of franchise.)" (*People v. Johnson, supra,* 213 Cal.App.3d 1369, 1375, 262 Cal.Rptr. 366.) Johnson has been followed in *People v. Baumgart* (1990) 218 Cal.App.3d 1207, 1219, 267 Cal.Rptr. 534.)

Appellant's defense to the section 25401 charges was that he had instructed all of his employees to go over the prospectus for the partnership in which an

investor was interested line by line and to explain the risk factors to them. He did this himself. The problems with the partnerships arose after the sales were made and they were unanticipated at the time of the sales. Although some of the limited partnership agreements did not give the general partner express authority to lend partnership property, that power was included in others in the mid-1980's. The loans of money between partnerships were made when problems that were unforeseen at the time the investors acquired their interests developed, leaving some partnerships "asset rich," but "cash poor."

Appellant contends that a criminal violation of section 25401, by making an untrue statement of a material fact or omitting a material fact regarding a security being offered for sale or sold, occurs only if the defendant knew or should have known that the statement was untrue or misleading or the omission material, and that this must be determined in light of the circumstances existing at the time of the offer or sale of the security. On that basis he argues that the court erred in instructing the jury that if a ***288** defendant makes a material representation about future conduct, he must act in accordance with the representation regardless of his intent or knowledge at the time the representation was made, and that if a later act makes the representation untrue, a violation has occurred. He concedes that the trial court was bound by **509***Auto Equity Sales, Inc. v. Superior Court* (1962) 57 Cal.2d 450, 455-456, 20 Cal.Rptr. 321, 369 P.2d 937, to follow *People v. Johnson, supra,* 213 Cal.App.3d 1369, 262 Cal.Rptr. 366, but argues that *Johnson* was wrongly decided. We agree.

Appellant's argument that *Johnson* failed to properly construe section 25401 is based on the history of sections 25401 and 25540, and on construction of the federal securities law after which these sections were patterned. Our conclusion rests on those factors and on the Legislature's requirement of guilty knowledge before civil liability may ****1282** attach under section 25501.[FN12]

> FN12. Section 25501 permits an action for rescission or damages by a person who purchases a security sold in violation of section 25401. The plaintiff who establishes a violation may rescind and recover the consideration paid plus interest, or damages if he or she no longer owns the security, "unless the defendant proves that the plaintiff knew the facts concerning the untruth or omission or that the defendant exercised reasonable care and did not know (or if he had exercised reasonable care would not have known) of the untruth or omission." (§ 25501.) Sections 25401 and 25501 were enacted as part of the same legislation. (Stats.1968, ch. 88, § 2, pp. 279-280.)

[7] Neither the language and history of section 25540 nor reference to the federal law after which section 25401 was patterned resolves this question since violations of section 25401 may be the basis for administrative or civil, as well as penal, sanctions. In ascertaining legislative intent in this case we must look to the entire regulatory scheme of the Corporate Securities Law of 1968 and to the place in the regulatory hierarchy into which a criminal violation of section 25401 falls. The *Johnson* court relied principally on the language of section 25540. It did not consider the full regulatory scheme. We do so after also considering other indicia of legislative intent.

The legislative intent underlying section 25540 does not itself answer the question we face here because the penalties that section prescribes apply to criminal violations of *any* provision of the Corporate Securities Law of 1968, including violations of rules or orders promulgated under that law or of which the violator had knowledge. We hesitate to assume that the Legislature intended that scienter be an element of every regulatory aspect of the Corporate Securities Law of 1968.[FN13]

> FN13. This reluctance is tempered somewhat by recognition that the Legislature has now attached extremely heavy penalties to criminal violations of some provisions of the Corporate Securities Law of 1968. In a 1993 amendment of section 25540 the Legislature increased the maximum fine for most violations to $1 million, and for violations of sections 25400, 25401, 25402, and 25403, to $10 million. (Stats.1993, ch. 723, § 2; Stats.1993, ch. 762, § 2.5.) In 1988, the term of imprisonment was increased to a term of two, three, or five years, with no county jail option. (Stats.1988, ch. 1339, § 5, p. 4431.)

We generally presume that the Legislature

would not attach a substantial penalty to a strict liability offense. "Harsh penalties" are a " 'significant consideration in determining whether the statute should be construed as dispensing with mens rea.' " (*United States v. X-Citement Video, Inc.* (1994) --- U.S. ----, ----, 115 S.Ct. 464, 468, 130 L.Ed.2d 372; *Staples v. United States* (1994) 511 U.S. 600, ----, 114 S.Ct. 1793, 1802, 128 L.Ed.2d 608.) Even the initial penalty, a term of up to 10 years' imprisonment and/or a $15,000 fine (Stats.1968, ch. 88, § 2, p. 285), was significant. Although, for the reasons stated, we do not rely on the penalty authorized by section 25540 as dispositive, the 1993 amendment strongly implies a current legislative understanding that neither section 25401 nor those other regulatory provisions of the Corporate Securities Law of 1968 create a strict liability offense.

We encourage the Legislature to clarify which of the criminal violations of the Corporate Securities Law of 1968 that are punishable under either subdivision (a) or (b) of section 25540 are strict liability offenses and what mental states are elements of those which require scienter.

Section 25540 is modeled after section 32(a) of the Securities Exchange Act of 1934 (1934 Act) (15 U.S.C. § 78a et seq.). (1 Marsh & Volk, *op. cit.* ***510** *supra,* p. 14-79.) [FN14] ***289** Sections 25401 and 25501, which authorizes private civil actions for violation of section 25401, are modeled after provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. (1 Marsh & Volk, *op. cit. supra,* p. 14-4.) Section 12(2) of the 1933 Act (15 U.S.C. § 77*l*) creates civil liability for sellers who make false and misleading statements in the sale of securities. Unlike section 25401, however, section 12(2) of the federal act includes an express scienter provision, placing the burden on the defendant **1283 to prove lack of knowledge of an untruth or omission of a material fact. It provides: "Any person who-[¶] ... [¶] (2) offers or sells a security (whether or not exempted ...) by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security...." (15 U.S.C. § 77*l*.)

FN14. Section 32(a), as codified at 15 U.S.C. § 78ff, now reads in relevant part: "Any person who willfully violates any provision of this title ... or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this title ... shall upon conviction be fined ... or imprisoned ... or both ...; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation."

Notwithstanding the provision of an express affirmative defense of lack of knowledge, section 12(2) of the 1933 Act has been construed as creating strict liability and permitting recovery for negligent misrepresentations. (*Drexel Burnham Lambert Group, Inc. v. MicroGeneSys, Inc.* (S.D.N.Y.1991) 775 F.Supp. 660; *Basile v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (S.D.Ohio 1982) 551 F.Supp. 580; *Banton v. Hackney* (Ala.1989) 557 So.2d 807.) The decisions which have read the scienter defense out of the statute postdate the 1968 adoption of the California Corporate Securities Law of 1968, of which section 25401 is a part, however, and would not support an inference the ***511** California Legislature intended that section 25401 state a strict liability offense at the time our law was enacted.

Since those decisions were handed down, moreover, the United States Court of Appeals of the Ninth Circuit has held, consistent with the language of section 12(2) of the 1933 Act, that liability exists only if the seller knew or should have known the representations were false. (*Casella v. Webb* (9th Cir.1989) 883 F.2d 805; see also *Odette v. Shearson, Hammill & Co., Inc.* (S.D.N.Y.1975) 394 F.Supp. 946.)

Section 10(b) of the 1934 Act makes it unlawful

"for any person, directly or indirectly, ... [¶] ... [¶] (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange Commission] may prescribe...." (15 U.S.C. § 78j.) Rule 10b-5, adopted under this statute, provides in section (b) that it is unlawful "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, ... in connection with the purchase or sale of any security." (17 C.F.R. § 240.10b-5 (1994).)

Appellant seeks to invoke the rule that when a state statute is modeled on a federal statute we presume that the Legislature intended to adopt the construction employed by the federal courts. (*Los Angeles Met. Transit Authority v. Brotherhood of Railroad Trainmen* (1960) 54 Cal.2d 684, 688-689, 8 Cal.Rptr. 1, 355 P.2d 905.) He misstates the rule, however, and it cannot be reliably applied here. The rule applies to statutes enacted *subsequent* to judicial construction of the federal act. (*Id.*, at p. 688, 8 Cal.Rptr. 1, 355 P.2d 905.) Not only is the language of section 25401 materially different from that of Section 10(b) of the 1934 Act, but there was no settled construction of the federal statute or rule 10b-5, which was ***290** adopted under it, at the time section 25401 was enacted.

At that time, in what was then a leading case construing rule 10b-5, the United States Court of Appeals for the Second Circuit had held that scienter was unnecessary to obtain *injunctive* relief against misleading statements by a corporation and left open the possibility that damages could be recovered for misstatements made negligently. (*Securities and Exchange Com'n v. Texas Gulf Sulphur Co.* (1968) 401 F.2d 833.) Judge Friendly, concurring, criticized the majority for suggesting that possibility. (*Id.*, at p. 866; see also Note, *Securities Acts,* 82 Harv.L.Rev. (1969) ***512** 938; Comment, *Negligent Misrepresentations**1284 under Rule 10b-5,* 32 U.Chi.L.Rev. 824 ["There is, however, no agreement on what the substantive elements of a 10b-5(2) private action, particularly with respect to the elements of scienter and reliance, should be."].) This holding throws little light on what the California Legislature intended with regard to criminal violations of section 25401. As we shall discuss below, injunctive relief against future violations of a regulatory statute may be had even where the absence of mens rea precludes imposition of criminal sanctions for past violations.

The United States Supreme Court has now construed section 10(b) of the 1934 Act (15 U.S.C. § 78j) and rule 10b-5, promulgated by the Securities and Exchange Commission under that section, as including a scienter element. In *Ernst & Ernst v. Hochfelder* (1976) 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668, the court held that negligent acts were not a basis for liability under section 10(b) of the 1934 Act. The court reasoned that Congress's use of the terms "manipulative or deceptive" in the statute suggested that the intent was "to proscribe knowing or intentional misconduct." (425 U.S. at p. 197, 96 S.Ct. at p. 1383.) It followed that the scope of the conduct proscribed by rule 10b-5 could be no broader than that covered by section 10(b) of the 1934 Act. The court reaffirmed that conclusion in *Central Bank v. First Interstate Bank* (1994) 511 U.S. 164, 114 S.Ct. 1439, 128 L.Ed.2d 119.) Since section 25401 does not use the term "manipulative or deceptive," however, that construction of section 10(b) of the 1934 Act and of the language of rule 10b-5 does not necessarily reflect the legislative intent underlying section 25401, even though the wording of section 25401 otherwise follows that of rule 10b-5. And, since *Ernst & Ernst v. Hochfelder, supra,* 425 U.S. 185, 96 S.Ct. 1375, was decided after the Corporate Securities Law of 1968 was adopted, the Legislature cannot be presumed to have been aware that the language taken from Rule 10b-5 had been authoritatively construed as requiring knowing or intentional misconduct.

If *Ernst & Ernst v. Hochfelder, supra,* 425 U.S. 185, 96 S.Ct. 1375, teaches anything, it is that as of 1968 when the lawsuit leading to that decision was filed, some courts had construed section 10(b) of the 1934 Act as permitting recovery for negligent misrepresentation. And, when the case was argued before the high court in 1975, the Securities and Exchange Commission, as amicus curiae, argued that Congress intended to bar all false and deceptive practices regardless of whether the conduct was negligent or intentional. (425 U.S. at p. 198, 96 S.Ct. at p. 1383.) The most that can be said with regard to the 1968 understanding of the rule 10b-5 language is that said by the high court: "Courts and commentators long have differed with regard to whether scienter is a

necessary element of such a cause of action, or whether ***513** negligent conduct alone is sufficient." (425 U.S. at p. 197, 96 S.Ct. at p. 1382-1383, fn. omitted.)

Section 32(a) of the 1934 Act, which, like section 25540, establishes penalties for "willful" violations of securities laws and regulations, has been construed by some federal courts as requiring scienter. One decision holds that a plaintiff must show both that the defendant intended to do the proscribed act and that he or she was aware that it was wrongful, even though he or she did not know that it was unlawful, in order to establish the defendant acted "willfully." (*United States v. Chiarella* (2d Cir.1978) 588 F.2d 1358, revd. on other grounds (1980) 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348.) The proscribed act of making false or misleading statements or omitting material facts also has been held to include lack of good faith or *****291** knowledge of the falsity or misleading nature of a statement, or materiality of an omission. (*United States v. Simon* (2d Cir.1969) 425 F.2d 796; *Bank of America Nat. Trust & Savings Ass'n v. Douglas* (D.C.App.1939) 105 F.2d 100.)

Other decisions hold that intent to do the proscribed act is enough (see, e.g., *United States v. Schwartz* (2d Cir.1972) 464 F.2d 499; *United States v. Dixon* (2d Cir.1976) 536 F.2d 1388) and again, with few exceptions, the decision construing Section 32(a) of the 1934 Act postdate the enactment of the Corporate Securities Law of 1968.

****1285** Appellant's argument that the *Johnson* court erred in holding that the failure of the Legislature to use the word "knowingly" in section 25540 reflects an intent to create a strict liability offense does find support in the comments of former Commissioner of Corporations Robert H. Volk and Professor Harold Marsh, Jr. who had major responsibility for drafting the Corporate Securities Law of 1968. (1 Marsh & Volk, *op. cit. supra,* pp. 1-38-1-45.) They describe the *Johnson* holding as "a totally unwarranted and erroneous interpretation of Corp.Code Section 25540...." (*Id.,* at p. 14-78.) They believe that section 25540 was intended to impose criminal liability only for an *intentional* misstatement.

"Corp.Code Section 25540 was copied as a shortened version of Section 32(a) of the Securities Exchange Act of 1934. The [*Johnson*] court dismisse[d] the federal cases requiring an intentional misstatement for a violation of that section, on the basis that the legislature, because it did not use the word 'knowingly' as defined in a Penal Code section, intended to punish conduct as criminal even though the defendant did not know that the statement made was false. As the persons primarily responsible for the drafting of these sections, we can state flatly that this is a purely fictional ***514** account of the legislative intent." (1 Marsh & Volk, *op. cit. supra,* pp. 14-79 to 14-80, fns. omitted.)

While the views of former Commissioner Volk and Professor Marsh no doubt reflect their intent as draftsmen, in construing these statutes we must ascertain the intent of the Legislature when the Corporate Securities Law of 1968 was adopted. Their views are persuasive, however, because, by focusing on the application of section 25540 to a criminal violation of section 25401, they confirm that legislative intent with respect to criminal violations of section 25401, not section 25540 alone, is crucial.

The parties have not supplied any legislative history of Assembly Bill No. 1 (1968 Reg.Sess.), the bill which established the Corporate Securities Law of 1968, in the form of committee reports, legislative counsel analysis, or other materials shown to have been considered by either house of the Legislature, and we have found none. The Legislature was presumably aware, however, that the 1968 law was based on the federal model. It may also have been aware of the legislative history of those acts, therefore, and in that history "there is no indication that any type of criminal or civil liability is to attach in the absence of scienter." (*Ernst & Ernst v. Hochfelder, supra,* 425 U.S. 185, 205, 96 S.Ct. 1375, 1387.)

[8] In considering the language and **effect** of section 25401, we must **construe** that section " 'in **context**, keeping in mind the **statutory** purpose, and statutes or **statutory** sections relating to the same subject must be **harmonized**, both internally and with each other, to the extent possible.' " (*Walnut Creek Manor v. Fair Employment & Housing Com.* (1991) 54 Cal.3d 245, 268, 284 Cal.Rptr. 718, 814 P.2d 704.) The section must be **construed** with reference to the **entire** system of **regulation** of which it is a **part**. (*People v. Comingore* (1977) 20 Cal.3d 142, 147, 141 Cal.Rptr. 542, 570 P.2d 723.) This mandates that we consider the **regulatory scheme** of the Corporate

Securities Law of 1968.

The statutes with which we are concerned are found in two **parts** of the Corporate Securities Law of 1968: **part** 5 (§ 25400 et seq.) and **part** 6 (§ 25500 et seq.). **Part** 5 identifies "Fraudulent and Prohibited Practices." It identifies those "unlawful acts" that may be committed by offerors of securities or corporate insiders. Section 25401 is one of the **provisions** in the "Fraudulent and Prohibited Practices" **part**. **Part** 6 of the *** Corporate Securities Law of 1968 governs "Enforcement." It creates three methods of enforcement of the **provisions** of **part** 5 in chapters establishing the administrative enforcement powers of the Commissioner of Corporations (§ 25530), the civil liability of violators (§ 25501), and the criminal sanctions for violations ***515** of the Corporate Securities Law of 1968 (§ 25540). Civil liability for ****1286** violation of section 25401 is included in this **part**, as are the criminal penalties for any violation (§ 25540).

Thus, the conduct proscribed by section 25401 is subject to a three tiered system of **regulation**. The prohibition on sale of securities by means of false or misleading statements or omission of material facts, like all **regulatory provisions** of the Corporate Securities Law of 1968, is first subject to administrative enforcement. Section 25530 gives the Commissioner of Corporations the power to enjoin the proscribed conduct and, where he deems it to be in the public interest, to seek ancillary relief on behalf of injured persons. That section now provides [FN15] in pertinent part:

> FN15. The several amendments of this section since the date of the offenses charged in this case are not relevant here.

> "(a) Whenever it appears to the commissioner that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this division or any rule or order hereunder, the commissioner may in the commissioner's discretion bring an action in the name of the people of the State of California in the superior court to enjoin the acts or practice or to enforce compliance with this law or any rule or order hereunder. Upon a proper showing a permanent or preliminary injunction, restraining order, or writ of mandate shall be granted and a receiver, monitor, conservator, or other designated fiduciary or officer of the court may be appointed for the defendant or the defendant's assets, or any other ancillary relief may be granted as appropriate.
>
> ".
>
> "(b) If the commissioner determines it is in the public interest, the commissioner may include in any action authorized by subdivision (a) a claim for ancillary relief, including but not limited to, a claim for restitution or disgorgement or damages on behalf of the persons injured by the act or practice constituting the subject matter of the action, and the court shall have jurisdiction to award additional relief."

In addition, since 1981, the commissioner may seek a civil penalty of up to $2,500 for each violation of any provision of the Corporate Securities Law of 1968 or of any rule or order under the law. (§ 25535.)

An enforcement action by the commissioner to enjoin future sales by means of false or misleading statements is designed to protect the public ***516**(*People v. Pacific Land Research Co.* (1977) 20 Cal.3d 10, 17, 141 Cal.Rptr. 20, 569 P.2d 125; *People v. Martinson* (1986) 188 Cal.App.3d 894, 899, 233 Cal.Rptr. 617.) For that reason, it is irrelevant that the defendant knows that the statements or omissions are false or misleading. In light of the language of section 25401, it is reasonable to conclude that the Legislature did not intend to permit members of the public to be harmed by such sales simply because the offeror was unaware that his or her sales pitch was misleading. The relatively small civil penalty authorized implies that administrative enforcement of section 25401 was permissible regardless of whether a violation or threatened violation of that section was a knowing violation.

However, at the next level of enforcement, a civil action by an injured investor, the Legislature did expressly provide that recovery of damages was permissible only if the offeror was aware, or with reasonable care would have been aware, that statements by which the sale was made were false or misleading. Section 25501 provides: "Any person who violates Section 25401 shall be liable to the person who purchases a security from him or a sells a security to him, who may sue either for rescission or for damages (if the plaintiff or the defendant, as the case may be, no

longer owns the security), *unless the defendant proves that the plaintiff knew the facts concerning the untruth or omission or* ***293** *that the defendant exercised reasonable care and did not know (or if he had exercised reasonable care would not have known)* of the untruth or omission...." (Italics added.)

1287 In this provision, one intended to supplement administrative regulation and enforcement (See *Musick, Peeler & Garrett v. Employers Insurance of Wausau* (1993) 508 U.S. 286, 113 S.Ct. 2085, 124 L.Ed.2d 194; *Randall v. Loftsgaarden* (1986) 478 U.S. 647, 664, 106 S.Ct. 3143, 3153, 92 L.Ed.2d 525 [one purpose for creating a private cause of action for violation of a **regulatory statute is to supplement administrative **regulation** of the industry by deterring fraud and encouraging full disclosure of material information in securities transactions]), the Legislature has provided a limited remedy reflecting the actual loss of the purchaser, but permits that recovery *only* if the seller was aware or was negligent in failing to be aware that his representations were misleading. It would be unreasonable therefore to conclude that when the Legislature created the third tier of enforcement, criminal prosecution with sentence to state prison and/or a fine upon conviction, it intended to dispense with any element of knowledge or scienter while permitting a much greater sanction.

The question we face here is similar to that considered by the Court of Appeal in *People v. Calban* (1976) 65 Cal.App.3d 578, 135 Cal.Rptr. 441. There the question was whether knowledge of the falsity of an affidavit was an element of the offense defined in former *517section 29218 of the Elections Code (see now Elections Code section 29780) which provided for imprisonment and/or a fine for making a false affidavit concerning an initiative, referendum or recall petition. The court noted that other provisions of the Elections Code which prohibited the same conduct when committed by public officials and employees applied only to a person "who knowingly makes any false return, certificate or affidavit," and concluded that the Legislature could not have intended to dispense with the knowledge requirement for private persons. "We see no reason in logic or public policy why the Legislature would intend to apply a higher standard of criminal culpability-i.e., absolute liability for filing a false affidavit regardless of knowledge of the falsity-to private persons as contrasted with public officials and employees. Thus, we conclude that the omission of a knowledge requirement from [Elections Code] section 29218 was due simply to legislative oversight, and such a requirement must be implied as part of the statute." (65 Cal.App.3d at p. 585, 135 Cal.Rptr. 441, fn. omitted.)

Similar reasoning suggests that the Legislature could not have intended to require knowledge of the falsity of a statement or materiality of an omission before recovery in a civil action was available, while permitting imposition of substantial criminal penalties on the offeror regardless of the knowledge of the offeror that statements by which a security was sold were false or misleading, or at least of the offeror's criminal negligence in failing to obtain and relate accurate information. The provision in section 25501 permitting a defendant to avoid civil liability on a showing that he or she "exercised reasonable care and did not know (or if he had exercised reasonable care would not have known)" of the false or misleading nature of a statement or omission in order to avoid civil liability, leads to a conclusion that either criminal negligence or actual knowledge also must be an element of a criminal violation of section 25401.

[9] This construction is consistent with the rule that, in construing a statute, the court must attempt to avoid a construction that will lead to unreasonable or arbitrary results. "If two constructions are possible, that which leads to the more reasonable result should be adopted." (*People* ex rel. *Riles v. Windsor University, Inc.* (1977) 71 Cal.App.3d 326, 332, 139 Cal.Rptr. 378.) In this context, application of that rule of construction suggests that conduct that is more, not less, culpable is required for imposition of criminal penalties. (See *Williams v. Garcetti* (1993) 5 Cal.4th 561, 573-574, 20 Cal.Rptr.2d 341, 853 P.2d 507.) Moreover, since we are considering a penal application of section 25401, a statute whose language is susceptible of two constructions, the court must ordinarily adopt the construction more favorable to the offender. "The defendant is entitled to the benefit of every reasonable doubt, ***294 **1288** whether it arise out of a question of fact, or as to the true interpretation of *518 words or the construction of language used in a statute." (*In re Tartar* (1959) 52 Cal.2d 250, 257, 339 P.2d 553; see also *People v. Piper* (1986) 42 Cal.3d 471, 477, 229 Cal.Rptr. 125, 722 P.2d 899; *People v. Craft* (1986) 41 Cal.3d 554, 560, 224 Cal.Rptr. 626, 715 P.2d 585.)

The trial court, believing that a criminal violation of section 25401 was a strict liability offense, also assumed that, since section 25401 did not require knowledge or at least criminal negligence, a seller of a security may also become subject to criminal prosecution and punishment if statements which are true or reasonably believed to be true when made later prove to be inaccurate through no fault or lack of care of the seller. The result was that when, as here, a prosecution is based on the omission to state a material fact, the seller might be found guilty even if, at the time of the offer or sale, the seller had no reason to know that the unstated fact was or might become "material." The significance of the scienter requirement is readily apparent in a case such as this where the falsity or misleading nature of the statements by appellant and/or his employees and the materiality of the omissions were determined on the basis of events which occurred some time after appellant sold the limited partnership interests,[FN16] and the acquittal of defendant on related fraud and embezzlement charges reflects the jury's conclusion that he did not intend at the time he sold the securities to obtain the investors' funds by his fraudulent representations or his omissions to reveal material information.

> FN16. In his closing argument, the prosecutor emphasized the following statements and omissions as warranting conviction under section 25401:
>
> Neither appellant nor the prospectus advised Ms. Nordstrom that funds from the Hesperia 19 limited partnership would be transferred to Geldtco, of which defendant was half-owner; that Geldtco was to construct the improvements; and that Hesperia 19 was never formed and had purchased no property.
>
> Ms. Evers was not told that the Reeves Street partnership funds would be used to purchase the Victorville property.
>
> Mr. Gates was told his money would go into an individual retirement account, but the money was put into a partnership account concerning which he had not seen the prospectus.
>
> Mr. Tellinghuisen was not told that the money he invested in the Olive Street partnership for property in Rialto would be used in Bell Gardens.
>
> Mr. Adams was never told that the Las Gaviotas partnership in which he invested was not formed, property was not purchased, and funds invested were transferred to other accounts. The failure to tell investors that the only way defendant could pay off investors was by depositing money from other accounts was a material omission.

In considering whether the Legislature intended to impose criminal penalties on a seller of securities for the failure to advise investors of facts which in retrospect might have been material in the decision to invest, but whose materiality would not have been anticipated by a reasonably competent seller, we must recognize again that the Legislature expressly declined to permit recovery in civil actions based on more egregious conduct. And, in ***519** this context, it is noteworthy that shortly after the Corporate Securities Law of 1968 was enacted the United States Court of Appeals for the Second Circuit held that, under rule 10b-5, whether a statement made in conjunction with the sale of a security is misleading and whether issuance of the misleading statement resulted from a lack of due diligence must be based on the facts known, or which could have been known, at the time the security is issued. (*Securities and Exchange Com'n v. Texas Gulf Sulphur Co., supra,* 401 F.2d 833, 862-863.)

We must also recognize that other sanctions and remedies are more commonly utilized for conduct which was not contemplated at the time a party entrusts another person with property. The transfer of funds between limited partnerships which occurred here, since it was not among the purposes of the partnership or the powers of the general partner as described in the prospectus and was not authorized by the limited partners, was a breach of the partnership agreement. Had it been done with the intent to deprive the limited partners of the funds they invested, defendant might have been convicted of theft. A statute, even one which creates a ****1289** regulatory offense, which criminalizes conduct on the basis of events that occur subsequent to the conduct, would be both unusual and of doubtful constitutionality.

***295** [10] Finally, we are mindful that "[t]he existence of a mens rea is the rule of, rather than the exception to, the principles of Anglo-American criminal jurisprudence." (*Dennis v. United States* (1951) 341 U.S. 494, 500, 71 S.Ct. 857, 862, 95 L.Ed. 1137; see also *United States v. United States Gypsum Co.* (1978) 438 U.S. 422, 436, 98 S.Ct. 2864, 2873, 57 L.Ed.2d 854; *United States v. Freed* (1971) 401 U.S. 601, 613, 91 S.Ct. 1112, 1120, 28 L.Ed.2d 356 (conc. opn. of Brennan, J.); *United States v. Balint* (1922) 258 U.S. 250, 252-253, 42 S.Ct. 301, 302-303, 66 L.Ed. 604.) The Supreme Court has indicated that regulatory or "public welfare" offenses which dispense with any mens rea, scienter, or wrongful intent element are constitutionally permissible, but it has done so on the assumption that the conduct poses a threat to public health or safety, the penalty for those offenses is usually small, and the conviction does not do "grave damage to an offender's reputation." (*Morissette v. United States* (1952) 342 U.S. 246, 256, 72 S.Ct. 240, 246, 96 L.Ed. 288.) [FN17] It has also observed that "[w]hile strict-liability offenses are not unknown to the criminal law and do not ***520** invariably offend constitutional requirements [citation], the limited circumstances in which Congress has created and this Court has recognized such offenses, [citations], attest to their generally disfavored status." (*United States v. United States Gypsum Co., supra,* 438 U.S. 422, 437-438, 98 S.Ct. 2864, 2873-2874.)

> FN17. In *United States v. Freed, supra,* 401 U.S. 601, 91 S.Ct. 1112, the court upheld conviction under a regulatory statute which did not require scienter and did carry a substantial term of imprisonment (10 years). The law regulated transfer, registration, and taxation of "firearms" which the law defined to include destructive devices and hand grenades. The defendant possessed the latter in violation of the law. The court reversed a district court order dismissing the indictment for failure to allege scienter, holding that the law was "a regulatory measure in the interest of the public safety, which may well be premised on the theory that one would hardly be surprised to learn that possession of hand grenades is not an innocent act." (401 U.S. at p. 609, 91 S.Ct. at p. 1118, fn. omitted.)
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> In *Staples v. United States, supra,* 511 U.S. 600, ----, 114 S.Ct. 1793, 1802, however, the court refused to extend *Freed,* again emphasizing that felony offenses which bear harsh punishment are not the type of "public welfare" offenses in which the court will readily dispense with a mens rea requirement when construing a statute. (511 U.S. at p. ----, 114 S.Ct. at p. ----.)
>
> Here, again, public safety is not involved and it cannot be assumed that an individual would realize that making a statement he believed to be true or failing to reveal information about acts that were not contemplated at the time a security was sold, and thus did not seem material, was criminal.

Notwithstanding this limited acceptance of such offenses, an acceptance that is qualified by the court's refusal to permit abandonment of a mens rea requirement if the statute involves conduct that would constitute a common law malum in se offense, the court continues to express concern about the due process implications of regulatory or public welfare offenses which impose strict liability regardless of fault or awareness that the conduct is prohibited. This concern is reflected in the court's attempt, whenever possible, to imply such intent or awareness in federal statutes, and its admonition that such statutes are more likely to pass constitutional muster if they regulate dangerous activities. (See, e.g., *United States v. International Min'ls & Chemical Corp.* (1971) 402 U.S. 558, 564-565, 91 S.Ct. 1697, 1701, 29 L.Ed.2d 178. ["Pencils, dental floss, paper clips may also be regulated. But they may be the type of products which might raise substantial due process questions if Congress did not require ... '*mens rea* ' as to each ingredient of the offense."].) The question in *International Min'ls Corp.* was whether due process permitted conviction of a defendant who did not know his act was prohibited by a **regulatory** statute and therefore may not have acted with *mens rea.* The court reasoned that the act was so inherently dangerous that any person dealing with the **regulated** matter (sulphuric acid) would be aware that there ****1290** were laws or **regulations** governing their handling or possession.

In *Lambert v. California* (1957) 355 U.S. 225, 78 S.Ct. 240, 2 L.Ed.2d 228, by contrast, the court set aside a conviction for failure of a person convicted of

a felony to register under a municipal ordinance. The court held that a conviction of a person who had no knowledge of the requirement violated due ***296** process because the conduct was wholly passive. "It is unlike the commission of acts, or the failure to act under circumstances that should *521 alert the doer to the consequences of his deed." (*Id.*, at p. 228, 78 S.Ct. at p. 243.)

More recently the court affirmed the conviction of a corporate president who failed to maintain the integrity of food products distributed by the corporation. (*United States v. Park* (1975) 421 U.S. 658, 95 S.Ct. 1903, 44 L.Ed.2d 489.) It did so, however, on the basis that a federal statute imposed a supervisory duty on the defendant to implement measures to avoid contamination of foodstuffs. In *Park*, therefore, the offense involved public health and safety and, while the statute may not have included a mens rea element, criminal negligence was a prerequisite to conviction.

This court has also assumed that regulatory or malum prohibitum crimes are constitutionally permissible where the purpose is to protect public health and safety and the penalties are relatively light. (*People v. Vogel* (1956) 46 Cal.2d 798, 801, fn. 2, 299 P.2d 850.) Other offenses are subject to the requirements of Penal Code section 20: "In every crime or public offense there must exist a union, or joint operation of act and intent, or criminal negligence." Although this court has not had the occasion to consider the permissible scope of the public welfare or regulatory crime exception to the rule that some type of criminal intent or negligence is a necessary element of a criminal offense, that exception has not been applied in this state to offenses which, like section 25401, do not involve conduct which threatens the public health or safety and are punishable with lengthy prison terms. The exception continues to be restricted to crimes of the type described in *Vogel*. (See, e.g., *People v. Matthews* (1992) 7 Cal.App.4th 1052, 1057, 9 Cal.Rptr.2d 348 [storage of hazardous waste]; *People v. Martin* (1989) 211 Cal.App.3d 699, 714, 259 Cal.Rptr. 770 [transportation and disposal of hazardous waste]; *People v. Chevron Chemical Co.* (1983) 143 Cal.App.3d 50, 53-54, 191 Cal.Rptr. 537 [discharge of wastes into watercourse]; *Aantex Pest Control Co. v. Structural Pest Control Bd.* (1980) 108 Cal.App.3d 696, 166 Cal.Rptr. 763 [unlicensed poison].)

We have recognized, however, a "prevailing trend 'away from the imposition of criminal sanctions in the absence of culpability where the governing statute, by implication or otherwise, expresses no legislative intent or policy to be served by imposing strict liability.' (*People v. Hernandez* (1964) 61 Cal.2d 529, 533 [39 Cal.Rptr. 361, 393 P.2d 673]; ...) Eavesdropping is not one of that class of crimes that affects public health, welfare or safety for which strict liability is most often imposed without any ingredient of intent (see *Morissette v. United States* (1952) 342 U.S. 246, 253-254 [72 S.Ct. 240, 245, 96 L.Ed. 288]; *People v. Vogel* (1956) 46 Cal.2d 798, 801, fn. 2 [299 P.2d 850]), and there is no other indication that *522 the Legislature intended to impose criminal sanctions in the absence of criminal intent." (*People v. Superior Court* (1969) 70 Cal.2d 123, 132, 74 Cal.Rptr. 294, 449 P.2d 230.)

We need not decide here whether it is constitutionally permissible to impose a criminal penalty of three years or a fine of as much as $10 million which is now permitted under section 25540 for omitting to advise a potential investor in a security of facts not known to the issuer to be material, or for making a representation which, unknown to the seller, was not true. It is enough to recognize that the due process implications of imposing a criminal penalty of that magnitude for such conduct are sufficient to raise a substantial question as to the validity of section 25401 if it is construed as creating a strict liability criminal offense.

[11] We conclude therefore that knowledge of the falsity or misleading nature of a **1291 statement or of the materiality of an omission, or criminal negligence in failing to investigate and discover them, are elements of the criminal offense described in section 25401.[FN18] We presume the Legislature did not intend to enact a statute of doubtful validity. If knowledge or criminal negligence ***297** is not an element of the offense, criminal penalties would be imposed for conduct less culpable than that for which recovery in a private civil action is not permitted, an unreasonable application of the statutory scheme. For all of these reasons we conclude that when section 25401 was enacted, the Legislature did not intend to create a strict liability criminal offense. This construction is consistent with the drafters' intent and the construction of the federal law after which section 25401 is patterned.[FN19]

FN18. To the extent that it is inconsistent with this conclusion, *People v. Johnson, supra,* 213 Cal.App.3d 1369, 262 Cal.Rptr. 366, is disapproved.

FN19. This conclusion makes it unnecessary to consider appellant's argument that imposition of felony penalties for publication of commercial speech in the absence of actual or constructive guilty knowledge violates the free speech clauses of the state and federal Constitutions. (See *Smith v. California* (1959) 361 U.S. 147, 80 S.Ct. 215, 4 L.Ed.2d 205 [ordinance banning possession of obscene book could not constitutionally be applied to bookstore owner absent proof that defendant had knowledge of contents of book].)

It is also unnecessary to consider defendant's claim that the court erred in instructing the jury that he could be convicted as an aider and abettor on the section 25401 charge. We note for purposes of retrial, however, that petitioner appears to have been a principal in the sale of the limited partnership interests. The actual salespersons were his agents. If so, it may not be appropriate to instruct on aiding and abetting liability. (Pen.Code, § 31; see 1 Witkin & Epstein, Cal.Criminal Law (2d ed. 1988) Introduction to Crimes, § 92, p. 108 [person liable as principal if he or she "authorizes or otherwise causes a crime to be committed through the instrumentality of an innocent agent"] and *id.* § 93, p. 109 ["doctrine of *respondeat superior* ... has no application to crimes requiring *criminal intent.* ... Criminal liability cannot be imposed for the criminal act of the agent or servant unless the principal is a party to it, i.e., unless he aids and abets or commands the act."].) See also *Central Bank v. First Interstate Bank, supra,* 511 U.S. 164, 114 S.Ct. 1439, 128 L.Ed.2d 119.

[12] The trial court erred, therefore, in instructing that only a general criminal intent need be shown in the crime of willfully offering or selling a security ***523** by means of a material misrepresentation or omitting to state a material fact, and that a person acts with general criminal intent when he intentionally does that which the law declares to be a crime.

The court also erred in instructing that if a defendant makes a material representation about conduct in the future, he must act in accordance with that representation irrespective of what his intent or knowledge was at the time the representation was made. The representations made by defendant at the time the securities were sold to which this instruction was related are unclear. The conduct that was inconsistent with those representations is also unclear as the prosecution appears to have relied not on an affirmative representation, but the failure to advise the buyers that funds would be transferred from one limited partnership to another or that loans would be made between or among them. The instruction may have been directed to the evidence that in one instance the limited partnership in which an investment was made was never fully funded and did not buy the property the investors were led to believe would be purchased.

However, for purposes of criminal liability, unless an issuer is aware or should have been aware at the time of the sale that a material representation is untrue, or knew or should have known that an unstated fact was material, he has not sold the security by means of an untrue statement of a material fact or omission to state a material fact within the meaning of section 25401. The truth or falsity of a representation and the materiality of an omission must be determined on the basis of what the seller knew or should have known at the time of the sale.

The evidence in this case suggests that it is reasonably probable that a result more favorable to appellant might have been reached absent these errors. ****1292**(*People v. Watson, supra,* 46 Cal.2d 818, 836-837, 299 P.2d 243.) The judgment of conviction on all counts charging violation of section 25401 must, therefore, be reversed.

IV
DISPOSITION

The judgment is reversed.

LUCAS, C.J., and KENNARD, ARABIAN, GEORGE and WERDEGAR, JJ., concur.

***524** MOSK, Justice, dissenting.

I dissent.

***298** In 1989 the Court of Appeal in *People v. Johnson*, 213 Cal.App.3d 1369, 1375, 262 Cal.Rptr. 366 (*Johnson*), held, "It is settled that the omission of 'knowingly' from a penal statute indicates that guilty knowledge is not an element of the offense. [Citation.] Had the Legislature intended to require proof of guilty knowledge or scienter under [Corporations Code] section 25540, it could have so stated by using the word 'knowingly'. Willfulness does not require proof of evil motive or intent to violate the law or knowledge of illegality. [Citations.]"

A petition for review of Johnson *was filed with this court, and promptly rejected with no votes of any justice to grant.* Have there been any developments in the ensuing years to justify at this late date overruling the prevailing law? The answer must be negative.

Indeed, with full knowledge of the *Johnson* rule, the Legislature in 1993 reconsidered Corporations Code section 25540 and increased the maximum fine for its violation, but took no action to include an element of criminal intent. As this court reiterated in *Harris v. Capital Growth Investors XIV* (1991) 52 Cal.3d 1142, 1156, 278 Cal.Rptr. 614, 805 P.2d 873, " '[W]hen the Legislature amends a statute without altering portions of the provision that have previously been judicially construed, the Legislature is presumed to have been aware of and to have acquiesced in the previous judicial construction.' "

The majority seem to fail to appreciate that there are malum prohibitum crimes punishable despite the absence of criminal intent. Such crimes are generally based on the violation of statutes that are regulatory in nature and that affect innocent victims. It is clear that the purpose of the securities law is to protect the public against fraudulent-even unknowingly fraudulent-stock and investment schemes.

The legislative enactment may not be as strict in its requirements on stock promoters' liability as the majority might prefer. They find it more palatable to require a specific criminal intent. But the bottom line is that the Legislature has not seen fit to impose that requirement, either originally or in its subsequent reconsideration of the statute.

Rewriting statutes is not the function of this court. We must review those the Legislature has given us. As the *Johnson* case held (213 Cal.App.3d at p. 1375, 262 Cal.Rptr. 366), "It is settled that the omission of 'knowingly' from a penal statute indicates that guilty knowledge is not an element of the offense." We have no right to add that element.

***525** I further conclude that if there were any errors in the trial court's instructions, they are-in the frequent words of my colleagues-mere harmless errors.

I would affirm the judgment.

Cal.,1995.
People v. Simon
9 Cal.4th 493, 886 P.2d 1271, 37 Cal.Rptr.2d 278, Blue Sky L. Rep. P 74,010, 63 USLW 2512

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