

2009 HOUSE JUDICIARY

HB 1280

2009 HOUSE STANDING COMMITTEE MINUTES

Bill/Resolution No. HB 1280

House Judiciary Committee

☐ Check here for Conference Committee

Hearing Date: 1/21/09

Recorder Job Number: 7461

Committee Clerk Signature



Minutes:

Chairman DeKrey: We will open the hearing on HB 1280.

Rep. Larry Klemin: Sponsor, support (attached).

Rep. Koppelman: There are some agencies that are exempt from the Administrative Practices Act, so I assume you are talking about non-exempt agencies. Are those that are non-exempted are you talking about making rules, not just standards that act as rules and should have, or are we talking about agencies who are exempted under the statute.

Rep. Klemin: We are talking only about those agencies that are specifically not exempted, they are subject to the rule-making requirements of the act, and the standards we are talking about are those that have been put together by some national organization.

Rep. Koppelman: I assume then that these are getting enforced and not within the correct framework. If we pass this legislation, I assume the effective date is the same for all bills which would be this summer, since I didn't see an emergency clause. Did you envision that they would be making all these rules before summer, because there is a window of time required, or envision putting a date in the bill that would give them a period of time to comply.

Rep. Klemin: I hadn't thought about that, but I know that there is a section, which I didn't include with this handout, which is an exception that does allow up to nine months for agency

rules to be adopted when they are being written. I'm not sure, but that may apply to this situation.

Rep. Delmore: Is there a problem out there, or is this a solution seeking a problem. Are there a lot of violations that are going on right now?

Rep. Klemin: The next speaker will tell you about one that led to the Securities Commissioner who has standards, but no rules. We will hear from some agencies who don't want to write rules. I don't know exactly which agencies, which is part of the problem, since they have standards, nothing is written into the Rules. We don't know what the standards are, where are they, who have them, what are they, what is the origin of them. When we find rules in the administrative rule section, then we have gone through the rule-making process and we know what is going on, the public knows what is going on. That meant that they had the opportunity to comment on the rules, they would have been reviewed and objections made if necessary. None of that happens when the group only has standards, not rules. The question you are asking is hard to answer because unless you are intimately involved with working on something with a particular agency, you may never come across that standard; they aren't published.

Chairman DeKrey: Thank you. Further testimony in support.

Garry Pierce, Garry Pierce Financial Services, LLP: Support (attachment).

Rep. Koppelman: You indicated you were regulated by what.

Garry Pierce: FINRA.

Rep. Koppelman: Are those federal regulations, does that translate down to your state licensure then.

Garry Pierce: Yes, requirements before licensing.

Rep. Koppelman: So you need to have a state's security license in order to comply with federal standards, is that referenced anywhere in law.

Garry Pierce: Yes, to be state licensed, you have to meet federal guidelines; we have to have a Series 7 and a Series 24 in that particular case from the federal.

Rep. Koppelman: So those rules that the federal government sets the standards.

Garry Pierce: Yes, the creation of the SEC.

Rep. Koppelman: So there is probably a federal preemptive kind of thing. Your position on this particular issue then is that the NASAA regulations are not referenced anywhere in public and they should be made into rules.

Garry Pierce: Yes.

Rep. Koppelman: The Insurance Department does operate under several standards that are set forth by the National Association of Insurance Commissioners; but I think we require them to adopt them by rule; or perhaps they are referencing a code that was mentioned earlier. Do you know if the Insurance Dept.'s, whether those are in rule.

Garry Pierce: I don't, generally the states regulate the Insurance Dept.

Rep. Koppelman: Does the NAIC, which is a very large organization and the state Insurance Commissioners around the country rely heavily upon what they formulate. I think in ND, we've told the Insurance Commissioner in order to rely on those; you need to put them into Rules.

Garry Pierce: I'm not sure.

Chairman DeKrey: Thank you. Further testimony in support. Testimony in opposition.

Michael Daley, Dep. Securities Commissioner & Enforcement Attorney for the Securities Dept.: Opposition (attached).

Rep. Zaiser: How can someone find the guidelines or information, regulations, policies, standards; Mr. Pierce said it was difficult to find these documents. Where can they be located?

Michael Daley: The statements of policy are published by CCH, and can be found in our office, available to the public through us, and online, at NASAA.org.

Rep. Zaiser: What policy do you make in addition to or beyond NASAA.

Michael Daley: We also have some administrative rules dealing with broker-dealer conduct and they are part of the administrative code.

Rep. Zaiser: Are any of your policies or regulations different from NASAA.

Michael Daley: As to the registration of securities, if they need to be registered and fall within the category that a statement of policy exists, that will be published and what Mr. Kocher and the Commission will use in accepting or denying.

Rep. Zaiser: What is the issue, where don't you publish the information that Mr. Pierce is looking for.

Mr. Pierce: (He was not at the microphone and could not be heard).

Rep. Koppelman: How is this handled in other states, if NASAA is a national entity and so the assumption is that most all the states are applying these standards to regulators in their state, is there some administrative rule, or some policy that they apply.

Michael Daley: There are some states that by statute, are required to adopt them as rules and other states fall under the course of ND. Probably a majority of them are like ND. I want you to understand that we don't just pick and choose which of the policies are applicable.

When we use them, we use them uniformly. But it does give some flexibility to the Department, if an issue or a problem arose, it can be worked around, and it might not be

exactly consistent with the guidelines as if it were an administrative rule. We could lose some flexibility.

Rep. Koppelman: So you do have some leeway in terms of defining the regulations and model policy.

Michael Daley: There are some things which are pretty much standard, based on the type of investment. There are some, for instance, a standard on the solvency of an issuer. There are standards that describe what would be the insolvency, which would be grounds for denial of an application of the issuer if the auditor reports have had a continuous of business comment by the auditor. That wouldn't necessarily ban the issuer from making that location, because there are different definitions that could be applied.

Rep. Koppelman: I do understand that there is a difference between rules and policies and standards. I do understand the administrative rules process and what they are fairly well. I don't claim to understand where insurance policies are from agency to agency and how they are applied. The premise is that if you want to make something; the legislature makes law, that's our branches prevue, and that rules are made through a rule-making authority and we have some oversight over that authority. That system works fairly well. We can usually reach a compromise if needed. In the meantime, we recognize that things change day to day in the agency and in your policies adopt as agencies; procedures and standards. Rules are typically designed to govern the regulated community and the general public. On the other hand, policies are to govern how the department operates on day to day matters. This sounds like more of the former rather than the latter. Because only administrative rules carry the force and effect of the law, do you have a concern that if your standards that you apply based on the commissioner's particular issue were to be challenged, their efficacy under law, might not hold up.

Michael Daley: Obviously that could be a concern if the policies applied by the department were challenged. I guess it would fall back the statutory power and to implement restrictions to make an offer. In the absence of something, I suppose if an issue could return to the wild west, and say well anything goes, that's a concern I have with this bill. It seems broad enough in scope and the statutory definition of standards would encompass what we consider to be policies to be used and interpreted in a fashion. But that we would not have any power or regulation to the registration of those securities. If we had to go through the administrative rule making process, it would require addition of staff.

Rep. Dahl: You said that it would create a fiscal impact for your agency. Wouldn't it be a substantial initial impact, but then you would be able to handle it in the long term, or do you think it would require more restrictive rules in the future, if we passed this the way it is.

Michael Daley: Certainly there would be a substantial impact on a catch up basis, to the extent it would be on-going rule-making necessitated by the changes in the securities laws over time, there could be a continuing impact but probably lesser so.

Rep. Klemin: The publication that you have from the CCH, is a private company as I understand is in the business of publishing a number of things, including what you have there. But out of that volume of things, are some of those things, the statement of policy would have to do with the internal operating policy of the agency, would that be correct, of your agency as to how you regulate or review investment vehicles.

Michael Daley: I don't think that internal policies that are reviewed would be contained in this publication. We do have application forms that require certain information, so to that extent the issuer or the applicant is on notice what information is required. Frankly most issuers are pretty sophisticated and they pretty much know going in what is going to be required. The

statute also lists a number of items that the Commissioner can request additionally if the applicant is being reviewed. That's very often a follow up request for additional information.

Rep. Klemin: I'm trying to get at, that the entire manual that you have there that's published by CCH, probably not everything in there is a proper subject for rule-making. Some of it is probably forms, some of it is probably recommendations for policies that an agency, such as yours, might follow in doing the job, and other things. Certainly some of it may be a proper subject for rule making, I'm wondering if you agree that not the entire CCH volume of materials need to be published; like in other states where they are required to publish these rules, have they published those rules.

Michael Daley: I'm not aware of what the Code section would look like. Certainly there are forms and checklists, as far as the publications that are not part of the statement policy. The statement of policy is probably not in format just to say, here let's put Rules on the top and publish it. I think this would take extensive drafting to make the provisions that NASAA and membership rules have approved as necessary for registration on a nationwide basis on this particular type of investment vehicle.

Rep. Klemin: Aren't some of these statements of policy by NASAA intended to be used as model laws.

Michael Daley: Yes, but as a format matter, as you indicated for rule-making, it needs to go before the Attorney General for review as to substance with the legal, for the administrative rules committee as to format. Just the way some of the statements of policy are set forth, as the definitional sections, minimum requirements; I think there would have to be some modification to say that no offering in this category will be approved unless it contains the minimum requirements.

Rep. Klemin: I guess to follow up on the model law question, aren't some of those statements of policy intended to be implemented as regulations.

Michael Daley: They could be a guide for preparation of a regulation.

Rep. Klemin: In fact, in the handout that you gave us, a statement of policy is, "a statement of general and prospective applicability to implement, interpret or prescribe model laws, regulations, forms, or policies pertaining to investor protection and series regulation". So the way I read this definition of statement of policy, it is the intent of NASAA that these statements of policy could be used as model laws or develop these regulations, or there may be some of them in there that are forms, and some are intended to be used as agency type policies in how you conduct your business. The statement in the procedures that you handed out to us, it seems to evidence intent by NASAA to exactly what this bill calls for.

Michael Daley: The two page handout deals with all of the NASAA statements of policies, not just the statement of policies that relate to securities registration, which is what our concern is. NASAA also issues policies, for instance, when Hurricane Katrina happened, they issued a policy whereby if either investor move to another jurisdiction there brokers, even though they might not be registered or licensed in that jurisdiction, they wouldn't be penalized or have a forced financial statement against them, under a statement of policy that was adopted by NASAA and in the states. When the National Guard called up financial advisors, NASAA issued a statement of policy of the way it worked and it was adopted by various states. That broader statement in the first paragraph of what you read as to a model act, might be a statement policy on the Uniform Act or Model Act, or Model Regulation. But not all the statements of policy would necessarily be in a format to just adopt them as a rule.

Rep. Delmore: Would your people have a problem, do you sit down and talk to them, explain to them how your standards work and why they are in place the way they are.

Michael Daley: Yes, certainly we do. Mr. Kocher or Tom Palmer has people in his office on a daily basis. His job is not just to review the applications, he is a resource to the attorneys and issuers around the state, as to the proper way to get registered or find information on registration. He has been there for a number of years.

Rep. Zaiser: One of the reasons that I asked about the securities information, because of what happened at the federal level. You recall the whole national situation with the downturn, and initially it called for the firing of the SEC commissioner because they blamed him for significant problems in that process. Determinations were made that two problems came out of that process; that there was a lack of oversight on the national legislative body in terms of the SEC, which I think was maybe what was looked at. Or was there a lack of administrative know-how and appropriate administrative guidelines given to the process of the SEC. I think we need more visibility and transparency, education might be helpful. Would that be something that you think might be helpful in terms of the image process.

Michael Daley: It is an interesting conundrum, and I don't know that I am speaking for the Dept. in response. Less than two years ago, the policy that came out for an overhaul of the federal securities regulations, said there was too much regulation. We're dragging capital out of the country and then the market collapsed, and now everybody is saying we need more regulation. What is the answer to that. As to whether or not more legislative oversight is necessary, I think the statutes are in place, at least on a state basis to actively protect the investors in ND. We certainly advocate maintaining state regulations. Our mission has always been that we are the local cops on the beat with our feet on the ground; like a first responder vs. the SEC has a very limited number of actions they take on an annual basis to focus on more major matters. I don't think that we need major modifications in our securities act unless

we need to take steps to codify in administrative rules some of the things that we review on an annual basis and we already do.

Chairman DeKrey: Thank you. Further testimony in opposition.

Jeff Swank, ITD: We stand in opposition to this bill; not because of the intent we have heard this afternoon, but because of what we perceive as the unintended consequences. We've heard discussions and would ask you to consider adding language which clarifies exactly which agencies are involved. The concern that we have, specifically, deals with a process that we use within the technology community, called the enterprise architecture. It is a collaborative effort of various state agencies to adopt standards or guidelines on technology across those state agencies, does not impact the general public. As we interpret the bill, those standards that were adopted would have to go through the administrative rules process and we're not sure that that is the intent, and we certainly would not wish that to be the intent of the legislation.

Rep. Klemin: The Administrative Practices Act specifies what an administrative agency is and which agencies are exempt from following these rulemaking procedures. All agencies that are not exempt are required to follow these procedures. So that is specified in the law already. With regard to what you're talking about, whereby agencies are publishing standards for technology use within their agencies would not affect the regulated community, such as in the case of investor and securities. This is something that is in-house within the government that you are describing, is that right.

Jeff Swank: Correct, this is an in-house government operation and we were just looking for clarification to further that. We do not want to lose that functionality.

Rep. Klemin: What you are doing is not a standard adopted by some association or commission or other organization.

Jeff Swank: That is correct.

Rep. Klemin: So the way I read this, you're not part of the group.

Chairman DeKrey: Thank you. Further testimony on HB 1280. We will close the hearing.

2009 HOUSE STANDING COMMITTEE MINUTES

Bill/Resolution No. HB 1280

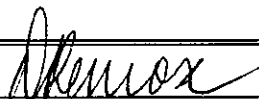
House Judiciary Committee

☐ Check here for Conference Committee

Hearing Date: 1/28/09

Recorder Job Number: 7973

Committee Clerk Signature



Minutes:

Chairman DeKrey: We will take a look at HB 1280.

Rep. Klemin: As you recall this is a bill I brought forward because of the fact that some of the administrative agencies who weren't adopting rules and they were implementing certain standards from national associations without going through the rule-making process. I can see that it is a lot bigger problem than I thought it was. You can see from the fiscal note that they put in that it's going to cost a million dollars for them to adopt these standards as rules, which really they should have been doing all along, but haven't been doing. So now we have to play catch up and it's going to cost a lot of money. Well, I don't know how big the scope of the problem really is and so, instead of the bill I put in, I am proposing an amendment to have a study on this to determine what is the scope of the problem and the committee that studies that problem then to report back to the next Legislature with what they recommend as the solution, if there is one. That's what the hog house amendment is about. With respect to the fiscal note, that the office of OMB had stated it would cost a million dollars for these agencies to do what they should have done already, sort of illustrates the scope of the problem. In particular, with the Securities Commissioner, if you look at the administrative rules that have been adopted by the Security Commissioner, you will find that there is hardly anything. The last

time, there were a couple of pages about some broker ethics in 1998. Before that there was a one or two page on something else in 1988, and that's all the rules they have. If you go online to the North American Association of Security Administrator's website, they have their standards of practice, you will find in there that that organization has a lot of proposed model laws, they have a lot of proposed regulations that can be implemented in the state, they have statements of policy as to what forms might look like, but in ND, what is happening is instead of taking those model regulations and going through the rule-making procedure so people here can look it and comment on it, they are just implementing them, as if they had already done that, which they hadn't. So I think that's a situation that needs to be investigated further and that's the reason for the LC study. I move the amendment.

Rep. Delmore: Second.

Chairman DeKrey: Voice vote. Motion carried. We now have the bill before us as amended.

Rep. Delmore: I move a Do pass as amended.

Rep. Wolf: Second.

11 YES 0 NO 2 ABSENT

DO PASS AS AMENDED

CARRIER: Rep. Klemin

FISCAL NOTE
Requested by Legislative Council
02/04/2009

Amendment to: HB 1280

1A. State fiscal effect: *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2007-2009 Biennium		2009-2011 Biennium		2011-2013 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues	\$0	\$0	\$0	\$0	\$0	\$0
Expenditures	\$0	\$0	\$0	\$0	\$0	\$0
Appropriations	\$0	\$0	\$0	\$0	\$0	\$0

1B. County, city, and school district fiscal effect: *Identify the fiscal effect on the appropriate political subdivision.*

2007-2009 Biennium			2009-2011 Biennium			2011-2013 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

2A. Bill and fiscal impact summary: *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

Engrossed House Bill No. 1280 requires the Legislative Council to study application by administrative agencies of standards from other than state or federal law which have not been adopted as administrative rules.

B. Fiscal impact sections: *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

There is no fiscal impact for this bill.

3. State fiscal effect detail: *For information shown under state fiscal effect in 1A, please:*

A. Revenues: *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

B. Expenditures: *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

C. Appropriations: *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation is also included in the executive budget or relates to a continuing appropriation.*

Name:	Allen H. Knudson	Agency:	Legislative Council
Phone Number:	328-2916	Date Prepared:	02/04/2009

FISCAL NOTE
Requested by Legislative Council
01/27/2009

REVISION

Bill/Resolution No.: HB 1280

1A. State fiscal effect: *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2007-2009 Biennium		2009-2011 Biennium		2011-2013 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures			\$1,000,000		\$1,100,000	
Appropriations			\$1,000,000		\$1,100,000	

1B. County, city, and school district fiscal effect: *Identify the fiscal effect on the appropriate political subdivision.*

2007-2009 Biennium			2009-2011 Biennium			2011-2013 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

2A. Bill and fiscal impact summary: *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

This bill could potentially impact many agencies. Agencies that are impacted would likely need to increase their legal staff to comply with the writing of administrative rules and review current rules.

B. Fiscal impact sections: *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

3. State fiscal effect detail: *For information shown under state fiscal effect in 1A, please:*

A. Revenues: *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

B. Expenditures: *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

C. Appropriations: *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation is also included in the executive budget or relates to a continuing appropriation.*

Fiscal note is based on one FTE for the Securities Department, in addition 2 FTEs may be needed for DHS, 1 FTE for ITD, and 1 FTE for the Attorney General's Office. Operating costs would also be incurred.

Name:	Pam Sharp	Agency:	OMB
Phone Number:	328-4606	Date Prepared:	01/26/2009

FISCAL NOTE
Requested by Legislative Council
01/22/2009

Bill/Resolution No.: HB 1280

1A. State fiscal effect: *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2007-2009 Biennium		2009-2011 Biennium		2011-2013 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures						
Appropriations						

1B. County, city, and school district fiscal effect: *Identify the fiscal effect on the appropriate political subdivision.*

2007-2009 Biennium			2009-2011 Biennium			2011-2013 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

2A. Bill and fiscal impact summary: *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

This bill could potentially impact many agencies. Agencies that are impacted would likely need to increase their legal staff to comply with the writing of administrative rules.

B. Fiscal impact sections: *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

3. State fiscal effect detail: *For information shown under state fiscal effect in 1A, please:*

A. Revenues: *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

B. Expenditures: *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

C. Appropriations: *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation is also included in the executive budget or relates to a continuing appropriation.*

Fiscal note is based on one FTE for the Securities Department, 2 FTEs for DHS, 1 FTE for ITD, and 1 FTE for the Attorney General's Office. All FTEs would be attorneys and would work on administrative rules.

Name:	Pam Sharp	Agency:	OMB
Phone Number:	328-4606	Date Prepared:	01/26/2009

VR
1/28/09

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1280

Page 1, line 1, after "A BILL" replace the remainder of the bill with "for an Act to require a legislative council study of application by administrative agencies of standards from other than state or federal law which have not been adopted as administrative rules.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:

SECTION 1. LEGISLATIVE COUNCIL STUDY. The legislative council shall study application by administrative agencies of standards from other than state or federal law which have not been adopted as administrative rules. The legislative council shall obtain information from each agency with administrative rulemaking authority regarding any standards applied by the agency to the regulated community which have not been adopted as administrative rules and the reason why the agency has not used its rulemaking authority to adopt the standards as administrative rules and the reason why the agency has not used its agency bill introduction privilege for legislative consideration of the standards. For purposes of this study, "standards" means a body of regulatory provisions developed by an association, commission, or other organization which do not have the force and effect of law in this state or in federal law or regulations. The legislative council shall report its findings and recommendations, together with any legislation necessary to implement the recommendations, to the sixty-second legislative assembly."

Renumber accordingly

Date: 1/28/09
Roll Call Vote #: 1

2009 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 1280

HOUSE JUDICIARY COMMITTEE

☐ Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken ☐ DP ☐ DNP ☒ DP AS AMEND ☐ DNP AS AMEND

Motion Made By Rep. Delmore Seconded By Rep. Wolf

Representatives	Yes	No	Representatives	Yes	No
Ch. DeKrey	✓		Rep. Delmore	✓	
Rep. Klemin	✓		Rep. Griffin	✓	
Rep. Boehning	✓		Rep. Vig	✓	
Rep. Dahl	✓		Rep. Wolf	✓	
Rep. Hatlestad	✓		Rep. Zaiser		
Rep. Kingsbury	✓				
Rep. Koppelman					
Rep. Kretschmar	✓				

Total (Yes) 11 No 0

Absent 2

Floor Carrier: Rep. Klemin

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1280: Judiciary Committee (Rep. DeKrey, Chairman) recommends AMENDMENTS AS FOLLOWS and when so amended, recommends **DO PASS** (11 YEAS, 0 NAYS, 2 ABSENT AND NOT VOTING). HB 1280 was placed on the Sixth order on the calendar.

Page 1, line 1, after "A BILL" replace the remainder of the bill with "for an Act to require a legislative council study of application by administrative agencies of standards from other than state or federal law which have not been adopted as administrative rules.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF NORTH DAKOTA:

SECTION 1. LEGISLATIVE COUNCIL STUDY. The legislative council shall study application by administrative agencies of standards from other than state or federal law which have not been adopted as administrative rules. The legislative council shall obtain information from each agency with administrative rulemaking authority regarding any standards applied by the agency to the regulated community which have not been adopted as administrative rules and the reason why the agency has not used its rulemaking authority to adopt the standards as administrative rules and the reason why the agency has not used its agency bill introduction privilege for legislative consideration of the standards. For purposes of this study, "standards" means a body of regulatory provisions developed by an association, commission, or other organization which do not have the force and effect of law in this state or in federal law or regulations. The legislative council shall report its findings and recommendations, together with any legislation necessary to implement the recommendations, to the sixty-second legislative assembly."

Renumber accordingly

2009 SENATE GOVERNMENT AND VETERANS AFFAIRS

HB 1280

2009 SENATE STANDING COMMITTEE MINUTES

Bill/Resolution No.1280

Senate Government and Veterans Affairs Committee

☐ Check here for Conference Committee

Hearing Date: 03/13/09

Recorder Job Number: 10948

Committee Clerk Signature

Kates Oliver

Minutes:

Chairman Dever called the committee order; Lawrence Klemin was there to introduce the bill.

Lawrence R. Klemin: Representative from District 47 in Bismarck. See attached testimony #1.

Senator Horne: Can you help us understand what standards are?

Larry Klemin: National organization determines that this is a standard that states could take back and apply to their state. It has a wide variety of standards that could be adopted. That is the essence of what we are getting at: if an outside agency has standards and another agency applies those standards here. The problem is not the rules here, but if they are OK standards to have enforced.

Senator Dever: We had a meeting with lignite energy council before the session started. The comment was made that the rules would be brought about by EPA or congress; they said they would rather see it come from congress. Before they apply those they would have to go through the rule making process.

Larry Klemin: That is not what I am saying. The lignite industry is extensively regulated and that is a good example, in 1977 the federal government enacted the surface mining control and reclamation act and in that act it applied that the states could have their own state program if they wanted to regulate it. What happened in North Dakota is that the Public Service

Commission had a project to develop a statute in North Dakota based on the federal law that established a state program for service mining control and reclamation. And North Dakota enacted a law that adopted that and at the same time the government developed rules to implement that law, so what happened in North Dakota is the Public Service Commission made rules based on the federal rules to implement it. They have gone through the rule making process. What this bill does is take the standards developed by non government entities without going through admin rules process. What we want to do is study the issue and find out the scope of the issue.

Senator Horne: The standards are defined on 12-15.

Gary Pierce: Owner, Gary Pierce Financial Services. See attached testimony #2.

Chairman Dever closed the public hearing on HB1280. Senator Oehlke made a motion for a do pass with a second by Senator Cook. There was no discussion and the motion passed 5-0 with Senator Dever carrying the bill to the floor.

Date: 3-13-09
Roll Call Vote #: 1

2009 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. 1286

Carries
Dever

Senate Government and Veteran's Affairs

Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken Do Pass

Motion Made By Oehlke

Seconded By Cook

Representatives	Yes	No	Representatives	Yes	No
Dick Dever	X		Dwight Cook	X	
Dave Oehlke	X		Carolyn Nelson	X	
Robert M. Horne	X				

Total Yes 5

No 0

Absent _____

Floor Assignment _____

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE (410)
March 13, 2009 1:04 p.m.

Module No: SR-46-4825
Carrier: Dever
Insert LC: . Title: .

REPORT OF STANDING COMMITTEE

HB 1280, as engrossed: Government and Veterans Affairs Committee (Sen. Dever, Chairman) recommends DO PASS (5 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). Engrossed HB 1280 was placed on the Fourteenth order on the calendar.

2009 TESTIMONY

HB 1280

⁸⁰
House Bill 1208
House Judiciary Committee
Rep. Lawrence R. Klemin
January 21, 2009

HB 1208 provides that an administrative agency may not apply standards to the regulated community unless the agency has adopted those standards as rules in compliance with Chapter 28-32 of the North Dakota Century Code. "Standards" include regulatory provisions developed by an association, commission, or other organization, which do not have the force and effect of law.

HB 1208 does not preclude an administrative agency from adopting those standards as rules, but merely provides that they are not valid unless the rulemaking procedures of the law are followed.

No administrative agency should be able to adopt and enforce such "standards" by administrative fiat. An administrative agency is an entity created by the Legislature and is subject to the requirements enacted by the Legislature for the adoption of rules.

"Standards" imposed by an agency on the regulated community by administrative fiat are not rules adopted in accordance with the laws of this State; are not subjected to public review, comment and hearing before they are implemented; do not have a regulatory or economic analysis to determine the effect on regulated entities; are not reviewed by the Attorney General to determine legality and conformity with the law; are not subject to review and objection by the Administrative Rules Committee because they are not "rules"; and are not published in the North Dakota Administrative Code so that the regulated community and the public know what they are.

"Standards" are subject to change at the whim of administrative agency and are forced upon the regulated community without the approval of the Legislature. A requirement of an agency which is enforced like a rule, is required to be followed by the regulated community as a condition for a permit, license, or other approval, is a rule and must be adopted in accordance with the North Dakota Administrative Agencies Practice Act. Due process of law requires no less. An administrative agency cannot exempt itself from these requirements on its own volition. It is not a defense that it would cost the agency time and funds to follow the procedures laid down by the Legislature. These procedures were enacted by the Legislature after hearing and review, with input and comment by all affected parties, including the public and the administrative agencies. We live by the rule of law with the consent of those we govern for the well-being of society. Administrative agencies are not above the law.

Compliance with the rulemaking procedure has been reviewed and upheld by the North Dakota Supreme Court.

Huber v. Jahner, 460 N.W.2d 717 (N.D. 1990):

The Department of Human Services is an administrative agency and is subject to the provisions of Chapter 28-32, N.D.C.C. **Pursuant to that chapter, an administrative rule is invalid unless it is adopted in substantial compliance with Section 28-32-02, N.D.C.C.** *Mullins v. Department of Human Services*, 454 N.W.2d 732 (N.D. 1990); *Little v. Spaeth*, 394 N.W.2d 700 (N.D. 1986). [case dealing with child support guidelines that had been enforced by the agency but had not been adopted as rules.]

No citizen should be required undergo the legal expense needed to challenge a "standard" in court in order to invalidate the "standard". This is the reason for HB 1208

Ask the agencies present at this hearing today if they have any "standards" which have not been adopted in the manner required by law. Administrative agencies should be required to justify why the "standards" that they are enforcing upon the persons they regulate are not subject to the rulemaking procedures and review by the Legislature.

Let us not forget that we are a government of the people, by the people, and for the people. This is the basic foundation of our society. No person in charge of or employed by an administrative agency is empowered to act in a manner contrary to this guiding principle. I encourage your support for HB 1208

A short course in rulemaking procedure:

CHAPTER 28-32
Administrative Agencies Practice Act

28-32-01. Definitions.

*Same
information
given to
Senate.*

11. "Rule" means the whole or a part of an agency statement of general applicability which implements or prescribes law or policy or the organization, procedure, or practice requirements of the agency. The term includes the adoption of new rules and the amendment, repeal, or suspension of an existing rule. The term does not include:

a. A rule concerning only the internal management of an agency which does not directly or substantially affect the substantive or procedural rights or duties of any segment of the public.

b. A rule that sets forth criteria or guidelines to be used by the staff of an agency in the performance of audits, investigations, inspections, and settling commercial disputes or negotiating commercial arrangements, or in the defense, prosecution, or settlement of cases, if the disclosure of the statement would:

- (1) Enable law violators to avoid detection;
- (2) Facilitate disregard of requirements imposed by law; or
- (3) Give a clearly improper advantage to persons who are in an adverse

position to the state.

c. A rule establishing specific prices to be charged for particular goods or services sold by an agency.

d. A rule concerning only the physical servicing, maintenance, or care of agency-owned or agency-operated facilities or property.

e. A rule relating only to the use of a particular facility or property owned, operated, or maintained by the state or any of its subdivisions, if the substance of the rule is adequately indicated by means of signs or signals to persons who use the facility or property.

f. A rule concerning only inmates of a correctional or detention facility, students enrolled in an educational institution, or patients admitted to a hospital, if adopted by that facility, institution, or hospital.

g. A form whose contents or substantive requirements are prescribed by rule or statute or are instructions for the execution or use of the form.

h. An agency budget.

i. An opinion of the attorney general.

j. A rule adopted by an agency selection committee under section 54-44.7-03. [procurement procedures]

k. Any material, including a guideline, interpretive statement, statement of general policy, manual, brochure, or pamphlet, which is explanatory and not intended to have the force and effect of law.

28-32-02. Rulemaking power of agency — Organizational rule.

1. The authority of an administrative agency to adopt administrative rules is authority delegated by the legislative assembly. As part of that delegation, the legislative assembly reserves to itself the authority to determine when and if rules of administrative agencies are effective. Every administrative agency may adopt, amend, or repeal reasonable rules in conformity with this chapter and any statute administered or enforced by the agency.

2. In addition to other rulemaking requirements imposed by law, each agency shall include in its rules a description of that portion of its organization and functions subject to this chapter, stating the general course and method of its operations and how the public may obtain information or make submissions or requests.

28-32-06. Force and effect of rules.

Upon becoming effective, rules have the force and effect of law until amended or repealed by the agency, declared invalid by a final court decision, suspended or found to be void by the administrative rules committee, or determined repealed by the office of the legislative council because the authority for adoption of the rules is repealed or transferred to another agency.

28-32-08. Regulatory analysis.

1. An agency shall issue a regulatory analysis of a proposed rule if:
 - a. Within twenty days after the last published notice date of a proposed rule hearing, a written request for the analysis is filed by the governor or a member of the legislative assembly; or
 - b. The proposed rule is expected to have an impact on the regulated community in excess of fifty thousand dollars. The analysis under this subdivision must be available on or before the first date of public notice as provided for in section 28-32-10.
2. The regulatory analysis must contain:
 - a. A description of the classes of persons who probably will be affected by the proposed rule, including classes that will bear the costs of the proposed rule and classes that will benefit from the proposed rule;
 - b. A description of the probable impact, including economic impact, of the proposed rule;
 - c. The probable costs to the agency of the implementation and enforcement of the proposed rule and any anticipated effect on state revenues; and
 - d. A description of any alternative methods for achieving the purpose of the proposed rule that were seriously considered by the agency and the reasons why the methods were rejected in favor of the proposed rule.
3. Each regulatory analysis must include quantification of the data to the extent practicable.
4. The agency shall mail or deliver a copy of the regulatory analysis to any person who requests a copy of the regulatory analysis. The agency may charge a fee for a copy of the regulatory analysis as allowed under section 44-04-18.
5. If required under subsection 1, the preparation and issuance of a regulatory analysis is a mandatory duty of the agency proposing a rule. Errors in a regulatory analysis, including erroneous determinations concerning the impact of the proposed rule on the regulated community, are not a ground upon which the invalidity of a rule may be asserted or declared.

28-32-08.1. Rules affecting small entities — Analysis — Economic impact statements — Judicial review.

1. As used in this section:
 - a. "Small business" means a business entity, including its affiliates, which:
 - (1) Is independently owned and operated; and
 - (2) Employs fewer than twenty-five full-time employees or has gross annual sales of less than two million five hundred thousand dollars;
 - b. "Small entity" includes small business, small organization, and small political subdivision;
 - c. "Small organization" means any not-for-profit enterprise that is independently owned and operated and is not dominant in its field; and
 - d. "Small political subdivision" means a political subdivision with a population of

less than five thousand.

2. Before adoption of any proposed rule, the adopting agency shall prepare a regulatory analysis in which, consistent with public health, safety, and welfare, the agency considers utilizing regulatory methods that will accomplish the objectives of applicable statutes while minimizing adverse impact on small entities. The agency shall consider each of the following methods of reducing impact of the proposed rule on small entities:

- a. Establishment of less stringent compliance or reporting requirements for small entities;
- b. Establishment of less stringent schedules or deadlines for compliance or reporting requirements for small entities;
- c. Consolidation or simplification of compliance or reporting requirements for small entities;
- d. Establishment of performance standards for small entities to replace design or operational standards required in the proposed rule; and
- e. Exemption of small entities from all or any part of the requirements contained in the proposed rule.

3. Before adoption of any proposed rule that may have an adverse impact on small entities, the adopting agency shall prepare an economic impact statement that includes consideration of:

- a. The small entities subject to the proposed rule;
- b. The administrative and other costs required for compliance with the proposed rule;
- c. The probable cost and benefit to private persons and consumers who are affected by the proposed rule;
- d. The probable effect of the proposed rule on state revenues; and
- e. Any less intrusive or less costly alternative methods of achieving the purpose of the proposed rule.

4. For any rule subject to this section, a small entity that is adversely affected or aggrieved by final agency action is entitled to judicial review of agency compliance with the requirements of this section. A small entity seeking judicial review under this section must file a petition for judicial review within one year from the date of final agency action.

5. This section does not apply to any agency that is an occupational or professional licensing authority, nor does this section apply to the following agencies or divisions of agencies:

- a. Council on the arts.
- b. Beef commission.
- c. Dairy promotion commission.
- d. Dry bean council.
- e. Highway patrolmen's retirement board.
- f. Indian affairs commission.
- g. Board for Indian scholarships.
- h. State personnel board.
- i. Potato council.

- j. Board of public school education.
- k. Real estate trust account committee.
- l. Seed commission.
- m. Soil conservation committee.
- n. Oilseed council.
- o. Wheat commission.
- p. State seed arbitration board.
- q. North Dakota lottery.
- 6. This section does not apply to rules mandated by federal law.
- 7. The adopting agency shall provide the administrative rules committee copies of any regulatory analysis or economic impact statement, or both, prepared under this section when the committee is considering the associated rules.

28-32-10. Notice of rulemaking — Hearing date.

1. An agency shall prepare a full notice and an abbreviated notice of rulemaking.

a. The agency's full notice of the proposed adoption, amendment, or repeal of a rule must include a short, specific explanation of the proposed rule and the purpose of the proposed rule, a determination of whether the proposed rulemaking is expected to have an impact on the regulated community in excess of fifty thousand dollars, identify at least one location where interested persons may review the text of the proposed rule, provide the address to which written comments concerning the proposed rule may be sent, provide the deadline for submission of written comments, provide a telephone number at which a copy of the rules and regulatory analysis may be requested, and, in the case of a substantive rule, provide the time and place set for each oral hearing. The agency's full notice must be filed with the office of the legislative council, and the agency shall request publication of an abbreviated newspaper publication notice at least once in each official county newspaper published in this state. The notice filed with the office of the legislative council must be accompanied by a copy of the proposed rules.

b. The abbreviated newspaper publication of notice must be in a display-type format with a minimum width of one column of approximately two inches [5.08 centimeters] and a depth of from three inches [7.62 centimeters] to four inches [10.16 centimeters] with a headline describing the general topic of the proposed rules. The notice must also include the telephone number or address to use to obtain a copy of the proposed rules, the address to use and the deadline to submit written comments, and the location, date, and time of the public hearing on the rules.

2. The agency shall mail or deliver a copy of the agency's full notice to each member of the legislative assembly whose name appeared as a sponsor or cosponsor of legislation enacted during the most recent session of the legislative assembly which is being implemented by the proposed rule and to each person who has made a timely request to the agency for a copy of the notice. The agency may mail or otherwise provide a copy of the agency's full notice to any person who is likely to be an interested person. The agency shall mail or deliver a copy of the rules to each member of the

legislative assembly whose name appeared as a sponsor or cosponsor of legislation enacted during the most recent session of the legislative assembly which is being implemented by the proposed rule and to any person requesting a copy. The agency may charge persons who are not members of the legislative assembly fees for copies of the proposed rule as allowed under section 44-04-18.

3. In addition to the other notice requirements of this subsection, the superintendent of public instruction shall provide notice of any proposed rulemaking by the superintendent of public instruction to each association with statewide membership whose primary focus is elementary and secondary education issues which has requested to receive notice from the superintendent under this subsection and to the superintendent of each public school district in this state, or the president of the school board for school districts that have no superintendent, at least twenty days before the date of the hearing described in the notice. Notice provided by the superintendent of public instruction under this section must be by first-class mail. However, upon request of a group or person entitled to notice under this section, the superintendent of public instruction shall provide the group or person notice by electronic mail.

4. The legislative council shall establish standard procedures for all agencies to follow in complying with the provisions of this section and a procedure to allow any person to request and receive mailed copies of all filings made by agencies pursuant to this section. The legislative council may charge an annual fee as established by the administrative rules committee for providing copies of the filings.

5. At least twenty days must elapse between the date of the publication of the notice and the date of the hearing. Within fifteen business days after receipt of a notice under this section, a copy of the notice must be mailed by the legislative council to any person who has paid the annual fee established under subsection 4.

28-32-11. Conduct of hearings — Notice of administrative rules committee consideration — Consideration and written record of comments.

The agency shall adopt a procedure whereby all interested persons are afforded reasonable opportunity to submit data, views, or arguments, orally or in writing, concerning the proposed rule, including data respecting the impact of the proposed rule. The agency shall adopt a procedure to allow interested parties to request and receive notice from the agency of the date and place the rule will be reviewed by the administrative rules committee. In case of substantive rules, the agency shall conduct an oral hearing. The agency shall consider fully all written and oral submissions respecting a proposed rule prior to the adoption, amendment, or repeal of any rule not of an emergency nature. The agency shall make a written record of its consideration of all written and oral submissions contained in the rulemaking record respecting a proposed rule.

28-32-12. Comment period.

The agency shall allow, after the conclusion of any rulemaking hearing, a comment period of at least ten days during which data, views, or arguments concerning the proposed rulemaking will be received by the agency and made a part of the rulemaking record to be considered by the agency.

28-32-13. Substantial compliance with rulemaking procedure.

A rule is invalid unless adopted in substantial compliance with this chapter. However, inadvertent failure to supply any person with a notice required by section 28-32-10 does not invalidate a rule. Notwithstanding subsection 2 of section 28-32-42, an action to contest the validity of a rule on the grounds of noncompliance with this chapter may not be commenced more than two years after the effective date of the rule.

28-32-14. Attorney general review of rules.

Every rule proposed by any administrative agency must be submitted to the attorney general for an opinion as to its legality before final adoption, and the attorney general promptly shall furnish each such opinion. The attorney general may not approve any rule as to legality when the rule exceeds the statutory authority of the agency or is written in a manner that is not concise or easily understandable or when the procedural requirements for adoption of the rule in this chapter are not substantially met. The attorney general shall advise an agency of any revision or rewording of a rule necessary to correct objections as to legality.

28-32-15. Filing of rules for publication — Effective date of rules.

1. A copy of each rule adopted by an administrative agency, a copy of each written comment and a written summary of each oral comment on the rule, and the attorney general's opinion on the rule must be filed by the adopting agency with the office of the legislative council for publication of the rule in the North Dakota Administrative Code.

2. a. Nonemergency rules approved by the attorney general as to legality, adopted by an administrative agency, and filed with the office of the legislative council and not voided or held for consideration by the administrative rules committee become effective according to the following schedule:

(1) Rules filed with the legislative council from August sixteenth through November fifteenth become effective on the immediately succeeding January first.

(2) Rules filed with the legislative council from November sixteenth through February fifteenth become effective on the immediately succeeding April first.

(3) Rules filed with the legislative council from February sixteenth through May fifteenth become effective on the immediately succeeding July first.

(4) Rules filed with the legislative council from May sixteenth through August fifteenth become effective on the immediately succeeding October first.

b. If publication is delayed for any reason other than action of the administrative rules committee, nonemergency rules, unless otherwise provided, become effective when publication would have occurred but for the delay.

c. A rule held for consideration by the administrative rules committee becomes effective on the first effective date of rules under the schedule in subdivision a following the meeting at which that rule is reconsidered by the committee.

28-32-16. Petition for reconsideration of rule — Hearing by agency.

Any person substantially interested in the effect of a rule adopted by an administrative agency may petition such agency for a reconsideration of any such rule or for an amendment or repeal thereof. Such petition must state clearly and concisely the petitioners' alleged grounds for such reconsideration or for the proposed repeal or amendment of such rule. The agency may grant the petitioner a public hearing upon such terms and conditions as the agency may prescribe.

28-32-17. **Administrative rules committee objection.**

If the legislative council's administrative rules committee objects to all or any portion of a rule because the committee deems it to be unreasonable, arbitrary, capricious, or beyond the authority delegated to the adopting agency, the committee may file that objection in certified form in the office of the legislative council. The filed objection must contain a concise statement of the committee's reasons for its action.

1. The office of the legislative council shall attach to each objection a certification of the time and date of its filing and, as soon as possible, shall transmit a copy of the objection and the certification to the agency adopting the rule in question. The office of the legislative council shall also maintain a permanent register of all committee objections.

2. The office of the legislative council shall publish an objection filed pursuant to this section in the next issue of the code supplement. In case of a filed committee objection to a rule subject to the exceptions of the definition of rule in section 28-32-01, the agency shall indicate the existence of that objection adjacent to the rule in any compilation containing that rule.

3. Within fourteen days after the filing of a committee objection to a rule, the adopting agency shall respond in writing to the committee. After receipt of the response, the committee may withdraw or modify its objection.

4. After the filing of a committee objection, the burden of persuasion is upon the agency in any action for judicial review or for enforcement of the rule to establish that the whole or portion thereof objected to is within the procedural and substantive authority delegated to the agency. If the agency fails to meet its burden of persuasion, the court shall declare the whole or portion of the rule objected to invalid and judgment must be rendered against the agency for court costs. These court costs must include a

reasonable attorney's fee and must be payable from the appropriation of the agency which adopted the rule in question.

28-32-18. Administrative rules committee may void rule — Grounds — Amendment by agreement of agency and committee.

1. The legislative council's administrative rules committee may find that all or any portion of a rule is void if that rule is initially considered by the committee not later than the fifteenth day of the month before the date of the administrative code supplement in which the rule change is scheduled to appear. The administrative rules committee may find a rule or portion of a rule void if the committee makes the specific finding that, with regard to that rule or portion of a rule, there is:

- a. An absence of statutory authority.
- b. An emergency relating to public health, safety, or welfare.
- c. A failure to comply with express legislative intent or to substantially meet the procedural requirements of this chapter for adoption of the rule.
- d. A conflict with state law.
- e. Arbitrariness and capriciousness.
- f. A failure to make a written record of its consideration of written and oral submissions respecting the rule under section 28-32-11.

2. The administrative rules committee may find a rule void at the meeting at which the rule is initially considered by the committee or may hold consideration of that rule for one subsequent meeting. Within three business days after the administrative rules committee finds that a rule is void, the office of the legislative council shall provide written notice of that finding and the committee's specific finding under subdivisions a through f of subsection 1 to the adopting agency and to the chairman of the legislative council. Within fourteen days after receipt of the notice, the adopting agency may file a petition with the chairman of the legislative council for review by the legislative council of the decision of the administrative rules committee. If the adopting agency does not file a petition for review, the rule becomes void on the fifteenth day after the notice from the office of the legislative council to the adopting agency. If within sixty days after receipt of the petition from the adopting agency the legislative council has not disapproved by motion the finding of the administrative rules committee, the rule is void.

3. An agency may amend or repeal a rule or create a related rule if, after consideration of rules by the administrative rules committee, the agency and committee agree that the rule amendment, repeal, or creation is necessary to address any of the considerations under subsection 1. A rule amended, repealed, or created under this subsection is not subject to the other requirements of this chapter relating to adoption of administrative rules and may be published by the legislative council as amended, repealed, or created. If requested by the agency or any interested party, a rule amended, repealed, or created under this subsection must be reconsidered by the administrative rules committee at a subsequent meeting at which public comment on the agreed rule change must be allowed.

28-32-18.1. Administrative rules committee review of existing administrative rules.

1. Upon request by the administrative rules committee, an administrative agency shall brief the committee on its existing administrative rules and point out any provisions that appear to be obsolete and any areas in which statutory authority has changed or been repealed since the rules were adopted or amended.

2. An agency may amend or repeal a rule without complying with the other requirements of this chapter relating to adoption of administrative rules and may resubmit the change to the legislative council for publication provided:

a. The agency initiates the request to the administrative rules committee for consideration of the amendment or repeal;

b. The agency provides notice to the regulated community, in a manner reasonably calculated to provide notice to those persons interested in the rule, of the time and place the administrative rules committee will consider the request for amendment or repeal of the rule; and

c. The agency and the administrative rules committee agree the rule amendment or repeal eliminates a provision that is obsolete or no longer in compliance with law and that no detriment would result to the substantive rights of the regulated community from the amendment or repeal.

28-32-19. Publication of administrative code and code supplement.

1. The office of the legislative council shall compile, index, and publish all rules filed pursuant to this chapter in a publication which must be known as the North Dakota Administrative Code, in this chapter referred to as the code. The code must also contain all objections filed with the office of the legislative council by the administrative rules committee pursuant to section 28-32-17. The code must be printed or otherwise duplicated in looseleaf form. The office of the legislative council shall revise all or part of the code as often as the legislative council deems necessary.

2. The office of the legislative council may prescribe a format, style, and arrangement for rules which are to be published in the code and may refuse to accept the filing of any rule that is not in substantial compliance therewith. In arranging rules for publication, the office of the legislative council may make such corrections in spelling, grammatical construction, format, and punctuation of the rules as deemed proper. The office of the legislative council shall keep and maintain a permanent code of all rules filed, including superseded and repealed rules, which must be open to public inspection during office hours.

3. The office of the legislative council shall compile and publish the North Dakota Administrative Code supplement according to the schedule of effective dates of rules in section 28-32-15.

a. The code supplement must contain all rules that have been filed with the office of the legislative council or which have become effective since the compilation and publication of the preceding issue of the code supplement.

b. The code supplement must contain all objections filed with the office of the legislative council by the administrative rules committee pursuant to section 28-32-17.

c. The code supplement must be printed or duplicated in the same style as the code so as to permit changes to be inserted as pages in the code in lieu of the pages containing superseded material and to permit additions to the code.

4. The office of the legislative council, with the consent of the adopting agency, may omit from the code or code supplement any rule the publication of which would be unduly cumbersome, expensive, or otherwise inexpedient, if the rule in printed or duplicated form is made available on application to the agency, and if the code or code supplement contains a notice stating the general subject matter of the omitted rule and stating how a copy may be obtained.

5. The code must be arranged, indexed, and printed or duplicated in a manner to permit separate publication of portions thereof relating to individual agencies. An agency may print as many copies of such separate portions of the code as it may require. If the office of the legislative council does not publish the code supplement due to technological problems or lack of funds, the agency whose rules would have been published in the code supplement shall provide a copy of the rules to any person upon request. The agency may charge a fee for a copy of the rules as allowed under section 44-04-18.

HB 1280 Testimony

My name is Garry Pierce. I own Garry Pierce Financial Services, LLP an independent member firm of FINRA or the Financial Regulatory Authority (formerly the National Association of Securities Dealers). My firm sells real estate investment trusts (REITS) which are similar to mutual funds but invest in income properties, mainly in North Dakota. North Dakota is unique in the six state region in having three REITS, two of which are non-publicly traded. These investments are sold by prospectus which must be examined and cleared for sale by the North Dakota Securities Department. In recent years, the Department has required suitability standards which investors must meet before they are allowed to invest. These include income and net worth (and are attached). They were issued by the North American Securities Administrators Association, Inc. or NASAA which is not a branch of government but an association of state regulators, each of whom is responsible to their respective state legislatures. Since these standards are required by the Department before a prospectus can be used, the Department, in effect, puts the burden on the brokers to enforce these requirements on the public.

This no different than the Transportation Department requiring all North Dakota car dealers to obtain proof of a certain income or net worth from a customer before they could purchase a vehicle. Or the Real Estate Commissioner requiring all licensed agents to require proof of a certain income or net worth before someone could purchase a home. In each case, that is the buyer's business – not the State's. Securities are property. These requirements are denying American citizens the right to own property. I don't think NASAA considered the political implications of what they were doing. Brokers are already extensively regulated by FINRA. Our first duty is to ensure that an investment is suitable for the investor. We are directly responsible for any investment sale and yet do not have the authority to decide what is best for the customer.

The Securities Department informed me that these standards were guidelines, but mandatory. The United States Supreme Court addressed this very issue recently in the Blakely decision. The Justice Department had issued guidelines to District Court judges requiring them to sentence crack cocaine offenders more severely than other drug offenders. The District Court judges disagreed and the matter went to the Supreme Court. The Supreme Court decided in favor of the District Court judges and against the Justice Department, stating that a guideline was just that. Although the District Court judges were bound to consider the guidelines in their deliberations, they had a better understanding of the facts in each particular case than did the Justice Department back in Washington, D.C. Likewise, brokers can make a better decision for their customers than a one-size-fits-all guideline from the Securities Department. I

would urge the Committee to require the Securities Department to hold a hearing on these standards. They should be made voluntary rather than mandatory and could be included with other caveats in the prospectus.

The North Dakota Insurance Department holds forums throughout North Dakota each year for agents like myself who are insurance and variable annuity licensed. Besides giving us continuing education credits for attending, the insurance officials bring us up to date on current issues and tell us about any legislation they intend to propose which might affect us and why they are proposing it. They invite our comments. The Securities Department offers no such programs.

North Dakotans who might otherwise have qualified to buy these investments probably invested elsewhere and may have lost money in the financial bear market. Now I learn that the NASAA standards were "informally adopted" with no input from the public. Had there been some public input, these concerns could have been addressed.

In reply to Representative Klemin's request for an explanation for the adoption of the suitability standards, the Department cited, from the Century Code, the Commissioner's authority to "...place such conditions, limitations and restrictions of the approval of registration as may be necessary to carry out the purposes of the chapter". A reading of the entire chapter will show that it defines the Commissioner's authority over sellers of securities, not purchasers. Only Section 10-04-17, Remedies, defines the rights of a defrauded investor. And yet this citation is used to justify standards which regulate purchasers' investing.

Garry Pierce

WHO MAY INVEST

*Same
handover given
to sender*

The Subscriber will become a Shareholder when the following representations are made to the Trust:

1. The Subscriber is not a minor under the laws of the State of North Dakota and warrants and represents to be a bona fide resident of the State of North Dakota.
2. The undersigned acknowledges receiving, prior to executing this Subscription Agreement, the Prospectus of the INREIT, to include its exhibits and attachments.
3. The Subscriber has either (i) a minimum annual gross income of at least \$45,000 and a net worth (exclusive of home, home furnishings, and automobiles) of \$45,000; or (ii) a net worth (determined with the foregoing exclusions) of at least \$150,000. Assets included in the computation of net worth may be valued at fair market value. Gross annual income is based upon actual income an investor had during the last tax year, or is estimated to have during the current tax year.
4. The Subscriber, if acting in a representative or fiduciary capacity, the above representations and warranties shall be deemed to have been made by the person(s) or entity, any of whom are bona fide residents of the State of North Dakota.
5. The Subscriber, if acting in a representative or fiduciary capacity for a corporation, limited liability company, partnership, pension plan or trust, or as custodian or agent for any person or entity, has full authority to enter into this agreement in such capacity and on behalf of such entity.
6. Upon the Subscription Agreement being executed and accepted by the Trust, the sale occurs effective as of that date. When the entire consideration is paid and received by the Trust as required herein, an acknowledgment certificate representing the Shares/Units purchased will thereafter be issued.
7. The Subscriber hereby acknowledges and agrees that Subscriber is not entitled to cancel, terminate or revoke this subscription or any agreements of the Subscriber hereunder and that such subscription and agreements shall survive the death or disability of the Subscriber.
8. Upon the execution of the Subscription Agreement and the delivery thereof, the Subscriber covenants and has agreed to be bound by and governed by each and all of the provisions of the Declaration of the Trust, (attached here to as Exhibit A), to the Prospectus, and also to any valid and enforceable amendments thereto which may be subsequently adopted, and that the requested information as disclosed on page 2 of the Subscription Agreement is true and correct and the Trust is entitled to rely upon its accuracy and completeness.
9. Subscriber will provide the necessary and required information to the Trust so as to qualify the investment as a REIT under Internal Revenue Service laws, rules and regulations.

SUMMARY OF THE OFFERING

The following summary is qualified in its entirety by the detailed information appearing elsewhere in this Prospectus. Certain capitalized terms used in this Summary and throughout this Prospectus are defined under "Glossary."

The Trust. INREIT Real Estate Investment Trust ("INREIT") is a registered but unincorporated business trust and has been formed under North Dakota law. The trust intends to qualify as a REIT. The Trust has a term of existence which qualifies under North Dakota law. The Trust will initially invest in properties primarily in North Dakota that the Board of Trustees considers suitable investments. Properties can and may include commercial properties and multi-family dwellings, such as apartment buildings and senior assisted or independent living centers. The Trust's principal office is located at 216 South Broadway, Suite 202, Minot, North Dakota 58701, phone 701-837-1031.

WHO MAY INVEST

This offering is available to residents of the state of North Dakota who have either (i) a minimum annual gross income of at least \$45,000 and a minimum net worth (exclusive of home, home furnishings and automobiles) of \$45,000; or (ii) a net worth (determined with the foregoing exclusions) of at least \$150,000. Assets included in the computation of net worth may be valued at fair market value. Gross annual income is based upon actual income an investor had during the last tax year, or is estimated to have during the current tax year.

This suitability standard will not apply to purchases of less than \$25,000 of Shares in cases where such subscription does not exceed ten percent (10%) of the Subscriber's net worth, which in all cases will be calculated exclusive of home, furnishings, and personal automobiles.

HB 1280

Testimony of Deputy Securities Commissioner Michael Daley

Before the House Judiciary Committee

January 21, 2009

Mr. Chairman and members of the Committee, good afternoon. I am Michael Daley, Deputy Securities Commissioner and Enforcement Attorney for the Securities Department. Also with me today is our Chief Securities Examiner, Harold Kocher, who has been with the Department for over 40 years. I am here today to testify in opposition to House Bill 1280 on behalf of Securities Commissioner Karen Tyler.

Many of you are familiar with the operation of the Securities Department but I want to briefly outline what we do. Our primary mission is to protect North Dakota investors who purchase securities and investment advice in this state. We support this mission through our efforts in four functional areas:

- 1) Regulation of the Capital Formation Process
- 2) Registration of Securities Industry Firms and Professionals
- 3) Examinations, Investigations and Enforcement Actions
- 4) Investor Education and Financial Literacy Initiatives

I want to focus my remarks on how this proposed legislation would adversely affect the ability of the Department to fairly protect investors while remaining business- friendly to issuers seeking to raise capital in this state.

N.D.C.C. § 10-04-08.1 provides that the right to sell securities in this state shall not be granted in any case when it appears that the sale of such securities would work a

fraud or deception on purchasers or the public, or that the sale would be on unfair terms, or if the proposed plan of business of the applicant appears to be unfair, unjust, or inequitable. Many people, when they think about securities, think of stocks, bonds and mutual funds; stocks traded on recognized exchanges that they see in the paper or on the news each night. But there are many other investment vehicles being offered that require registration in the various states that must meet the general requirements of full and fair disclosure and suitability of investment, given the investor's income, net worth, investment experience, tolerance for risk and diversification. To promote uniformity in registration filings in North Dakota with those in other states, for the benefit of both investors and issuers, the Commissioner and her staff utilize "Statements of Policy" adopted by the North American Securities Administrators Association (NASAA) as guidelines in determining whether a particular securities offering contains the "reasonable conditions, limitations, and restrictions" necessary for approval of registration.

North American Securities Administrators Association (NASAA)

Organized in 1919, the North American Securities Administrators Association (NASAA) is the oldest international organization devoted to investor protection. NASAA is a voluntary association whose membership consists of 67 state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico.

In the United States, NASAA is the voice of state securities regulators responsible for efficient capital formation and grass-roots investor protection. The fundamental mission of these state regulators is protecting consumers who purchase securities or

investment advice, and their jurisdiction extends to a wide variety of issuers and intermediaries who offer and sell securities to the public.

Through the association, NASAA members also participate in multi-state enforcement actions and information sharing. As an example, Commissioner Tyler, in her role as President of NASAA, recently collaborated with the New York Attorney General and the Securities and Exchange Commission in negotiating a national settlement with 11 investment banking firms, resulting in the return to investors of over fifty billion dollars. This settlement benefited hundreds of North Dakota investors. One firm alone had over 300 North Dakota investors with approximately thirty million dollars at risk.

NASAA also coordinates and implements training and education seminars annually for state/district/provincial and territorial securities agency staff. All of our staff have taken advantage of these valuable training programs.

NASAA Statements of Policy

NASAA Statements of Policy as they pertain to securities registration are standards adopted by NASAA in response to an identified need for regulation as the securities industry evolves and offers new investment vehicles. The Statements of Policy pertain to the various types of securities, such as common stock, preferred stock, options and warrants, and debt; issues such as unsound financial condition; or particular types of industries, such as equipment leasing, cattle-feeding programs, commodity pools, asset backed securities, oil and gas drilling ventures, and real estate investment trusts or REITs.

No Statements of Policy are considered without an internal review by the membership; publication and an opportunity for public comment by other regulators, industry groups, securities professionals or any interested party; possible amendment

based on that public input; and finally, a vote by a majority of the NASAA membership. A copy of the written procedures for adoption of a Statement of Policy is attached as Exhibit 1.

The Statements of Policy are continuously being reviewed by NASAA due to changes in the marketplace and at the request of representatives involved with securities offerings pertaining to the various industries for which there is a specific policy. These reviews involve NASAA committees on capital formation consisting of representatives from five to eight state securities departments, representatives of industry such as legal counsel for the issuers and persons associated with the broker-dealer community. These reviews often result in amendments to the Statements of Policy which are then used by the state regulators in their examination of securities registration applications.

There are approximately 25 NASAA Statements of Policy related to various types of securities registration and seven Statements of Policy or Guidelines related to franchise registration, which is also administered by the department. North Dakota has used the Statements of Policy as a guide for decades, and found them to provide an efficient, effective and flexible approach to the administration of matters of corporate finance and franchise registration.

Absence of Fiscal Note


House Bill 1280 would prohibit the Securities Department from applying NASAA adopted "Statements of Policy" or in the words of the proposed statute, "standards" to securities registration applications of issuers and franchise applications after its effective date. In the absence of similar rules being proposed, heard and adopted under N.D.C.C. Chapter 28-32, in the interim, a regulatory gap would occur with arguably no meaningful

ability of the Commissioner to meet her statutory mandates of investor protection and securities registration. The Securities Department is a small agency. I am the only attorney and have a full-time enforcement schedule. A rule-making project of this magnitude would require more resources from the Legislature for additional legal staff, retention of outside counsel or the assistance of the Attorney General's office. Amendments to the rules would be an ongoing expense to maintain uniformity with offerings being made across the country. With the short time the department has had to analyze this proposal, we would estimate a negative fiscal impact of \$200,000 for the coming biennium. The Securities Department does not currently have sufficient time, staff or funding to meet an effective date of August 1, 2009, if rule-making were mandated in these areas.

It is also not entirely clear if the proposed bill applies to all state agencies or only "regulatory" agencies, such as securities, banking and insurance. No study has been made as to the effect this bill might have on other agencies that might use policies or standards such as medical disability guidelines in determining eligibility for government benefits.

Absence of complaints

It should be noted that in the decades that the Securities Department has been implementing the NASAA Statements of Policy in fulfilling its statutory mandates, the regulated industry has not made complaint either of a lack of notice or inconsistency of application. To the contrary, issuers, their legal counsel and securities salespeople know what to expect and appreciate the consistency these policies give to the registration process. The current combination of law, rule and policies which the Commissioner can



apply in approving offerings with “reasonable conditions, limitations, and restrictions” has served the people of this state and the business community well. The Securities Commissioner would respectfully recommend a “do-not-pass” for House Bill 1280.

Mr. Chairman and members of the Committee, thank you for your time and consideration. I would be happy to answer any questions you may have.

**PROCEDURE FOR THE ADOPTION OF STATEMENTS OF POLICY
BY THE NORTH AMERICAN SECURITIES ADMINISTRATORS
ASSOCIATION, INC.**

Adopted by the Board of Directors, June 25, 1994

[¶ 351]

1. Definitions.

In this policy the following terms shall have the following meanings:

- (a) ASSOCIATION is the North American Securities Administrators Association, Inc.
- (b) RESOLUTION is a formal statement expressing the will or opinion of the board of directors or members of the ASSOCIATION on a specific matter of topical interest.
- (c) STATEMENT OF POLICY is a statement of general and *prospective* applicability to implement, interpret or prescribe model laws, regulations, forms or policies pertaining to investor protection and securities regulation, including statements regarding the registration of securities, registration and business practices of securities industry and investment advisory licensees and enforcement of anti-fraud laws, for implementation among the jurisdictions of the North American Securities Administrators Association, Inc.

STATEMENT OF POLICY also includes an amendment or revision to, or the repeal of, an existing STATEMENT OF POLICY. STATEMENT OF POLICY does not include (i) RESOLUTIONS, (ii) internal operating procedures or fiscal policies of the ASSOCIATION or (iii) the ASSOCIATION's Articles of Incorporation or By-Laws.

[¶ 352]

2. General Rules.

- (a) It is the policy of the ASSOCIATION to adopt STATEMENTS OF POLICY to effect the ongoing administration of securities laws only after publication and opportunity for public comment. STATEMENTS OF POLICY must be adopted by a majority vote of the members of the ASSOCIATION under the procedure set forth in this policy.
- (b) RESOLUTIONS are expressions of the will of the members or board of directors, other than a STATEMENT OF POLICY, which because of their subject matter do not require the prior public exposure and consideration that the public comment process is designed to elicit. RESOLUTIONS may be adopted without advance notice to the public or opportunity for public comment.
- (c) In addition to STATEMENTS OF POLICY and RESOLUTIONS, the executive officers, committees and members of the ASSOCIATION may make other statements in the nature of comment letters, reports, testimony and public releases, which express the beliefs and opinions of their authors on behalf of the ASSOCIATION under the authority and terms expressed in those documents.
- (d) The board of directors of the ASSOCIATION may waive in whole or in part the provisions of subsections (a) through (c) of Section 3 of this section.

[¶ 353]

3. Procedure for Adoption of STATEMENTS OF POLICY.

- (a) STATEMENTS OF POLICY are recommended to the board of directors and the ASSOCIATION membership by its sections and committees. No ASSOCIATION section or committee is authorized to release for public comment on behalf of the ASSOCIATION any proposed STATEMENT OF POLICY without first obtaining approval from the board of directors, upon review of a recommendation of the section chair, to solicit public comment.

Cross Reference

NASAA Reports

¶353

Exhibit 1

By-Law 6.1, §116, requires that the board of directors authorize the public distribution of any proposed guidelines or policies upon review of a recommendation of the appropriate section chair.

(b) Prior to release of a proposed STATEMENT OF POLICY for public comment, the proposal and a brief summary describing the need and background prompting the proposal shall be circulated to the members of the ASSOCIATION for a thirty (30) day internal comment period. Authorization of the board of directors is not required to distribute a proposal internally for comment by the membership. Any comments received by the membership in a timely manner shall be considered by the committee and the STATEMENT OF POLICY amended, if appropriate, prior to requesting board action for the release of the STATEMENT OF POLICY to the public. If significant substantive changes are made to the proposed STATEMENT OF POLICY, the committee should consider re-circulation of the revised STATEMENT OF POLICY to the membership prior to circulation for public comment.

(c) Upon the authorization of the board of directors to release a proposed STATEMENT OF POLICY for public comment, the proposal shall be disseminated to the public through *NASAA REPORTS*, a CCH publication, as coordinated by the NASAA corporate office, and by any other method of distribution as the chair of the committee may see fit. The public comment period on the proposed STATEMENT OF POLICY shall remain open for thirty (30) days from the date of publication in *NASAA REPORTS*, or such other time period as set by the board.

A Notice of Request for Comments on a proposed STATEMENT OF POLICY shall accompany the public distribution of the STATEMENT OF POLICY and shall contain: (i) the names and addresses of all committee members and the NASAA corporate office to whom comments should be sent; (ii) the date on which the public comment period began and the date on which it will end; and (iii) a brief summary of the purpose of the STATEMENT OF POLICY or of the proposed revisions of an existing STATEMENT OF POLICY. Comments on STATEMENTS OF POLICY should be addressed to the chair of the committee which has proposed the STATEMENT OF POLICY. A comment period may be extended at the discretion of the proposing committee.

(d) The proposing committee may in the chair's discretion or at the direction of the board of directors hold a public hearing to receive testimony, comments and other oral or visual presentations on a proposed STATEMENT OF POLICY at a time and place to be determined by the chair.

(e) At the end of the public comment period and after any public hearing, the proposing committee shall consider any comments received and determine whether to recommend the proposed STATEMENT OF POLICY for adoption by the membership.

(f) If the committee plans to recommend the STATEMENT OF POLICY for adoption, the following procedures should be followed:

(i) A recommendation of the committee to adopt a STATEMENT OF POLICY shall be in writing and directed to the attention of the section chair. The written recommendation shall include a summary of any substantive revisions made to the proposal and shall distinguish those revisions recommended as a result of public comment and the reasons for such revisions. If comments were received on the proposal that the committee elected not to act upon or adopt, the written recommendation shall summarize those comments and state the reason no action was taken. The committee shall disseminate the summary to all interested parties and the summary shall be published in the *NASAA REPORTS*.

(ii) The summary and the final version of the proposed STATEMENT OF POLICY shall be distributed to the members of the ASSOCIATION at least thirty (30) days in advance of the membership meeting at which it is to be considered for adoption. Clerical revisions to the STATEMENT OF POLICY may be made prior to its publication in final form.

(g) STATEMENTS OF POLICY must be adopted by the affirmative vote of a majority of the members present at a meeting of the membership of the ASSOCIATION.

[The next page is 361.]

Mr. Chairman, Members of the Committee:

My name is Garry Pierce. I own Garry Pierce Financial Services, LLP an independent member firm of FINRA of the Financial Regulatory Authority (formerly the National Association of Securities Dealers). I started in the securities business in 1970. My firm sells mutual funds and real estate investment trusts (REITS) which are similar to mutual funds but invest in income properties, mainly in North Dakota. North Dakota is unique in the six state region in having three REITS two of which are non-publicly traded. No other state in the region has even one. These investments are sold by prospectus which must be examined and cleared for use by the North Dakota Securities Department. In recent years, the Securities Department has required suitability standards in a prospectus which investors must meet before they are allowed to invest. These include income and net worth and are attached. They were issued by the North American Securities Administrators Association, Inc. or NASAA which is not a branch of government but an association of state regulators, each of whom is responsible to their respective state legislatures. Since these standards are required by the Department, the Department, in effect, puts the burden on the brokers to enforce the requirements on the public.

My testimony today is not directed toward the Securities Department. My experience with our Securities Department has been that the people there have been responsive and professional. Many times over the years I have called Mr. Harold Kocher with questions and he has always been knowledgeable and helpful.

Rather, I am concerned about the NASAA standards and the fact that they were adopted without legislative review. Requiring brokers to enforce these standards is no different than the Transportation Department requiring all North Dakota car dealers to obtain proof of a certain income or net worth from a customer before they could purchase a vehicle. Or the Real Estate Commissioner requiring all licensed agents to obtain proof of a certain income or net worth before someone could purchase a home. In each case, that is the buyer's business - not the State's. Securities are property. These standards are denying American citizens the right to own property. I don't think the people of NASAA considered the political implications of what they were doing.

Moreover, we brokers are already extensively regulated in this area by FINRA. Page 4261 of our rule book states that:

"In recommending to a customer the purchase, sale or exchange of any security a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs".

Notice that this rule does not contain dollar amounts but allows the broker flexibility in each situation. It is as relevant today as when it was first crafted decades ago. Before the NASAA standards, we brokers determined suitability. Our first duty is to ensure that an investment is suitable for the investor. We are directly responsible for any investment sale and yet, under these suitability standards, we do not have the authority to decide what is best for the customer.

In reply to Representative Klemin's request for an explanation for the adoption of the suitability standards, the Department cited, from the Century Code, the Commissioner's authority to "...place such conditions, limitations and restrictions of the approval of registration as may be necessary to carry out the purposes of the chapter". A reading of the entire chapter will show that it defines the Commissioner's authority over sellers of securities, not purchasers. Only Section 10-14-17, Remedies, defines the rights of a defrauded investor, And yet this citation is used to justify standards which regulate purchasers' investing. Representative Klemin has argued, and I agree, that a state agency is a creation of the legislature and should not introduce standards which have the force of law upon the public without legislative review.

These NASAA standards are an example of the culture of our national regulators in recent years - it's easier to make new rules rather than enforce the rules that are already there. I can think of no better example than the case of Bernard Madoff. An investment manager named Harry Markopolis attempted to alert the Securities and Exchange Commission six years ago to the fact that Bernard Madoff could not possibly be paying the returns he was paying based upon the investment strategy that Madoff claimed he was using. Markopolis said the calculations to prove this took less than an hour. The SEC investigated Madoff several times but never seemed to ask the right questions. The SEC never did uncover the scandal. Madoff turned himself in.

Warren Buffet, the pre-eminent investor of our time, wrote to the SEC about the dangers of not regulating derivative investments. They ultimately contributed to the Crash of 2008. Warren Buffet wrote his letter in 1982.

House Bill 1280
Senate Government and Veterans Affairs Committee
Rep. Lawrence R. Klemin
March 13, 2009

As originally introduced, HB 1280 provided that an administrative agency could not apply "standards" from other than state or federal law, to the regulated community, unless the agency had adopted those standards as rules in compliance with the Administrative Agencies Practice Act, Chapter 28-32 of the North Dakota Century Code. "Standards" included regulatory provisions developed by an association, commission, or other organization, which do not have the force and effect of law. A copy of the original HB 1280 is attached.

HB 1280 did not preclude an administrative agency from adopting those standards as rules, but merely provided that they would not be valid unless the rulemaking procedures of North Dakota law were followed. In general, those procedures include a notice to the public of proposed rulemaking, a hearing on the proposed rules, an opportunity for the public to comment, a regulatory or economic analysis, a review by the Attorney General, and a review by the Administrative Rules Committee.

"Standards" that are imposed by an agency on the regulated community without going through the proper procedure are not rules adopted in accordance with the laws of this State; are not subjected to public review, comment, and hearing before they are implemented; do not have a regulatory or economic analysis to determine the effect on regulated entities; are not reviewed by the Attorney General to determine legality and conformity with the law; are not subject to review and objection by the Administrative Rules Committee because they are not "rules"; and are not published in the North Dakota Administrative Code so that the regulated community and the public know what they are. These procedures in the Administrative Agencies Practice Act were enacted by the Legislature after public hearings, with input and comment by all affected parties, including the public and the administrative agencies.

Compliance with this rulemaking procedure has been reviewed and upheld by the North Dakota Supreme Court. In *Huber v. Jahner*, 460 N.W.2d 717 (N.D. 1990), a case involving the Department of Human Services, the North Dakota Supreme Court stated:

The Department of Human Services is an administrative agency and is subject to the provisions of Chapter 28-32, N.D.C.C. **Pursuant to that chapter, an administrative rule is invalid unless it is adopted in substantial compliance with Section 28-32-02, N.D.C.C.** *Mullins v. Department of Human Services*, 454 N.W.2d 732 (N.D. 1990); *Little v. Spaeth*, 394 N.W.2d 700 (N.D. 1986). [case dealing with child support guidelines that had been enforced by the agency but had not been adopted as rules.]

After HB 1280 was introduced, OMB prepared a fiscal note indicating that the bill could potentially impact many agencies. OMB stated in the fiscal note that there would be a need for an appropriation of \$1,000,000 in the 2009-2011 biennium and \$1,100,000 in the 2011-2013 biennium. A copy of the fiscal note dated January 26, 2009, is attached.

It then became clear that this could be a much larger problem than I originally thought. Consequently, HB 1280 was amended to provide for an interim study of the use of these outside "standards" by the agencies. An interim legislature committee should determine if there really is a problem and the scope of that problem. The committee can then report back to the next Legislature with a recommendation on what to do about it. Hopefully, it would be the Administrative Rules Committee that studies this issue.

As a result of the amendment of HB 1280 into a study, the fiscal note has been reduced to zero and there is no fiscal impact. The fiscal note dated February 4, 2009, is also attached.

It is not the intent of this bill to preclude the agencies from adopting "standards" as rules or to preclude them from proposing legislation to enact these "standards" into law in North Dakota. However, they should do it in the manner provided by law so that the public has the right to review and comment on them before they are implemented. The Legislature also has an interest in ensuring that administrative rules have the force and effect of law and will be upheld by the courts, if challenged. The agencies could be adopting the "standards" as rules even while the interim study is in progress.

A short course on the administrative rulemaking procedure in N.D.C.C. Chapter 28-32 is attached as an addendum to my testimony.

I encourage you to recommend a "do pass" on HB 1280. Thank you.