# AGENDA
## ASSEMBLY BUDGET SUBCOMMITTE NO. 4 ON STATE ADMINISTRATION

## Assemblymember John Dutra, Chair

**THURSDAY MAY 20, 2004**
**STATE CAPITOL, ROOM 437**

### ITEMS ON CONSENT



### ITEMS TO BE HEARD

# ITEMS ON CONSENT

## ITEM 0520 SECRETARY FOR BUSINESS TRANSPORTATION AND HOUSING

### ISSUE 1: FINANCE LETTER

The Department of Finance has made the following proposals in an April 1, 2004 Finance Letter:

1. **Technology Trade and Commerce.** The Finance Letter requests $575,000 to fund costs associated with the closure of the Technology Trade and Commerce Agency. Due to unresolved issues, the amount requested is an estimate and the Finance Letter includes provisional language that authorizes the DOF to increase the amount of these appropriation

**Staff Recommendation: Approve as budgeted. CONSENT**

## ITEM 1760 DEPARTMENT OF GENERAL SERVICES

### ISSUE 1: CAPITOL SECURITY

**Capitol Security.** The Department of Finance has proposed in the May Revision to provide $3.0 million (Service Revolving Fund) funding for ongoing Capitol Security costs.

The Legislature has identified $4.0 million (General Fund) in additional one-time funding needs to address various Capitol improvements. Some of these improvements include: a panic alarm replacement; visitor pavilion project; capitol park barrier; monitors for dispatch; closed circuit TV cameras; secure Christy boxes; emergency power; driveway barrier; and tunnel card readers.

**Staff Recommendation: Approve May Revision request and a one-time $4.0 million (General Fund) augmentation for capital improvemnts related to Capitol security. CONSENT**

## ITEM 2180 DEPARTMENT OF CORPORATIONS

### ISSUE 1: MAY REVISION – TRANSFER OF SETTLEMENT FUNDS

As a result of increased enforcement efforts, the department is to receive an additional settlement payment of approximately $2.0 million in the budget year. The Governor's Budget had assumed that the General Fund.

**Staff Recommendation: Approve May Revision.**

## ITEM 8940 MILITARY

## ISSUE 1: CAPITAL OUTLAY

The Administration has proposed the following:

**Jan 10 Governors Budget**

**Bakersfield Armory.** Construction ($5,004,000 General Fund) - preliminary plans, working drawings, and construction ($6,411,000 Federal Funds)
**Advanced Plans and Studies -** ($836,000 in Federal Funds)

**April 1 Finance Letter:**

**Roseville Armory** - $411,000 (General Fund) and $202,000 (Federal Trust Fund) to replace heating, plumbing, electrical, and telephone systems and to provide the necessary expansion to accommodate overcrowded conditions.

**Lancaster Armory.** Reappropriation for working drawings, construction and equipment

**Staff Recommendation: Approve April Finance Letter and Governor's Budget capital outlay requests.**

# ITEM 8955 VETERANS HOMES

## ISSUE 1: MAY REVISION

**Contracting out for Food and Services.** The Governor's Budget on Jan 10th proposed a reduction of $569,000 General Fund and 120 positions (105.0 Personnel Years) that provide food services and security functions at the VHC - Yountville. Under the proposal, the state would instead contract with a private entity to provide these services.

This item was inadvertently left off of the previous Veterans' Affairs consent agenda. Staff has no issues with the proposal.

**Staff Recommendation: Approve May Revision.**

# ITEM 9210 LOCAL GOVERNMENT FINANCING

## ISSUE 1: SANTA BARBARA COUNTY FORMATION COMMISSION LOAN

In this April Finance Letter, the administration requests authority to provide a $400,000 loan to Santa Barbara County to fund the county's costs for the County Formation Review Commission that is statutorily required to be appointed by the Governor to study the proposed formation of a new Mission County. The proposal includes Trailer Bill Language to increase the current statutory limit on these loans from $100,000 to $400,000. Repayment will be due one year after the election on county formation.

**Staff Recommendation: Approve as budgeted. CONSENT.**

## ITEM 9840 AUGMENTATION FOR CONTINGENCIES AND EMERGENCIES CONTROL SECTION 27.00

The subcommittee heard Item 9840 on April 27 and held it open pending further discussions regarding the deficiency process embodied in Control Section 27.00.

Control Section 27.00 of the Budget Bill authorizes the Director of Finance to approve deficiency or emergency spending requests, subject to legislative notification. The Budget Act annually provides nominal appropriations for unforeseen contingencies or emergencies. The Budget Bill includes $2 million General Fund (GF) and $3 million from special funds for these items in 2004-05. The Department of Finance allocates amounts as required. Because the amounts provided in the Budget Act are nominal, the Department of Finance annually sponsors a deficiency bill to provide the additional funding needed to backfill deficiency spending. The Budget Bill also includes $2.5 million GF loan authority to meet the needs of programs, which would be curtailed due to delayed receipt of reimbursements, revenues or other financing.

The LAO observes that the deficiency process has not worked well as a true emergency spending mechanism or in limiting spending to purposes that are consistent with legislative intent. LAO suggests substantial changes in the deficiency process. These include deletion of Section 27.00. Instead unforeseen funding needs would need to be funded through new appropriations while the Legislature is in session. Alternatively, while the Legislature is out of session, unanticipated needs would be funded directly from this item (9840), which would need a larger appropriation.

**Staff Comment.** Discussions among LAO, the Department of Finance, and staff are proceeding along the lines suggested by the LAO. The actions that would be consistent with this direction are to place Item 9840 in Conference (by making $1,000 reductions) and deleting Control Section 27.00.

**Staff Recommendation: Place Item 9840 in Conference and delete Control Section 27.00. CONSENT.**

# ITEMS TO BE HEARD

## ITEM 0520 SECRETARY FOR BUSINESS TRANSPORTATION AND HOUSING

### ISSUE 1: SMALL BUSINESS LOAN GUARANTEE PROGRAM

The Governor's Budget proposes $4 million (General Fund) to fund administrative costs for 11 Financial Development Corporations (FDC) which administer the Small Business Loan Guarantee Program (SBLG). In the March 23, 2004 hearing, the subcommittee expressed concerns regarding unnecessarily high costs of the SBLG program.

Agency and subcommittee staff has worked together to develop an alternative solution that would provide BBL to:

- Place a cap the total costs for loans produced through the SBLG program at $6,000.
- Give the Secretary of BTH discretionary oversight over 15 percent of loans produced.
- State the intent that the SBLG program move to a 100 percent pay for performance structure by 2005-06.

**Staff Recommendation: Approve as budgeted with budget bill language.**

### ISSUE 2: APRIL 1 FINANCE LETTER

The Department of Finance has made the following proposals in an April 1, 2004 Finance Letter:

**Office of Military Base Retention and Reuse (OMBRR).** OMBRR historically resided in the Technology Trade and Commerce Agency. Upon closure of the Agency in 2003-04, OMBRR was transferred to the Department of Housing. The Finance Letter proposes to transfer the office to the Business Transportation and Housing Agency.

**Staff Comments:** There has been concern expressed by various members of the legislature that the level of funding provided for this item is insufficient considering that next round of Federal Base Realignment and Closures is scheduled for the 2005.

**Staff Recommendation: Approve as budgeted.**

## ISSUE 3: MAY REVISE – CALIFORNIA FILM COMMISSION

The Agency has requested in the May Revision a $600,000 (General Fund) augmentation to fund the development of an automated film permitting system for the California Film Commission. The web-based permit application entry system would be available to all production companies, departmental permit liaisons, and internal staff. Total first year cost for the system is $600,000, which includes $444,000 for system development and $156,000 for maintenance and support.

**LAO Option:** The LAO has commented that since this would be a direct benefit to the industry, it is recommended that budget bill language be included to make the 2004-05 General Fund augmentation a loan to be repaid over a few years through permit charges. The LAO also recommends budget bill language requiring the Film Commission to submit an April 1, 2005 report to the Legislature on permit fee proposals to cover Film Commission expenses, based on data available from the online permitting system.

**Staff Comments:** The Film Commission should be prepared to comment on the feasibility of integrating a permitting fee charging process into the web-based system. To collect this information, the subcommittee could add provision 1 to item 0520-001-0001:

*The Business, Transportation and Housing Agency shall report to the budget committees of each house of the Legislature and the LAO by April 1, 2005, with a cost-recovery fee plan for film permits issued to for-profit production companies. The plan shall include, but not necessarily be limited to, fee levels for individual permits and projections for total fee revenue.*

**Staff Recommendation: Approve the May Revision request with BBL.**

## ITEM 0890 SECRETARY OF STATE

## ISSUE 1: APRIL 1 FINANCE LETTER

The Department of Finance has made the following proposals in an April 1, 2004 Finance Letter:

**International Business Relations Program.** The Administration proposes to increase the Secretary of State's Business Fees Fund by $284,000 to restore 3 positions in the International Business Relations Program (IBRP).

**Staff Comments.** The Secretary of State has notified staff that the IBRP provides the following functions to the State: 1) Educating and assisting foreign corporations about the various filing processes and procedures required in the California business climate. 2) Provide customer service to foreign investment contacts. 3) Act as a liason for secured transactions for the State's internationally located financial institutions. 4) To perform outreach to international contacts that express interest in doing business in California. 5) Arrange tours and facilitate state governemnt meetings. 6) Serve as a central point of contact for international parties interested in doing business in California.

In the 2003-04 Budget, the Legislature acted to eliminate the International Trade programs operated under the now-eliminated, Technology Trade and Commerce Agency and the IBRP represents one of the only remaining programs developed with the core mission to assist international trade within the State. This program was originally proposed for elimination in the Governor's Budget. Restoring these positions results in a $284,000 General Fund cost, as these funds would otherwise be transferred to the General Fund.

**Staff Recommendation: Adopt Finance Letter Proposal.**

## ISSUE 2: APRIL 1 FINANCE LETTER - HELP AMERICA VOTE ACT

**Help America Vote Act (HAVA) Federal Funding.** The federal Help America Vote Act of 2002 (HAVA) is expected to provide approximately $250 million for changes to election equipment and processes in California. The Secretary of State is responsible for administering the federal HAVA requirements. The SOS has already received approximately $81.2 million in current year HAVA funding through the Control Section 28 budget revision process.

**SOS Proposal.** The Secretary of State has submitted a Finance Letter requesting $264 million in expenditure authority from the Federal Trust Fund to continue HAVA program implementation. The HAVA requirements identified by SOS to date are listed in the following table.

**FEDERAL HAVA REQUIREMENTS – May 2004**

| PROGRAM | COST ESTIMATE |
|---|---|
| Voting Systems Standards (local assistance funding) | $42.6 million - $84 million |
| Provisional Voting - for individuals' whose name do not appear on the official list | $1 million - $3 million |
| Voter Information Posting - specified information on election day | $100,000 - $500,000 |
| Statewide Database – A multi-million dollar project to implement a statewide database | $8 million - $40 million |
| Verification of Voter Registration Information | $100,000 - $500,000 |
| Requirements of Certain Voters Who Register By Mail | $100,000 - $500,000 |
| Mail-In Registration Form Requirements | $0 |
| Voter Education – a clearinghouse for voter education processes | $15 million - $45 million |
| Elections Official Education – for local election officials | $15 million - $45 million |
| Poll Worker Education | $15 million - $45 million |
| Complaint Procedure | $100,000 - $500,000 |
| Voting Rights of Military and Overseas Procedures | $100,000 - $400,000 |
| **TOTAL** | **$97,100,000 — $264,400,000** |

(Source: Senate Budget)

**LAO Recommendation**. LAO has raised concerns that the SOS should provide a more detailed spending plan for the anticipated HAVA funds. The LAO has suggested that the legislature adopt budget bill language that would require the Secretary of State to submit a detailed spending plan to the Department of Finance, the Joint Legislative Budget Committee, and the election committees of both houses.

**Staff Recommendation: Approve finance proposal with LAO recommended Budget Bill Language**

## ISSUE 3: EXEMPT POSITIONS

The Secretary of State's Office currently has four exempt entitlements that were originally provided by the Technology Trade and Commerce Agency (TTCA). The entitlements were used to hire the Secretary's Chief Counsel, Director of Communications, Chief of Field Operations and Assistant Secretary of State for Policy and Planning. Due to the elimination of the TTCA in the 2003-004 budget, the four exempt entitlements are scheduled to expire at the end of the year. The Secretary of State has requested that these four exempt entitlements be made permanent. There would be no cost associated with this proposal.

**Staff Recommendation: Approve 4 exempt entitlements for Secretary of State.**

# ITEM 0985 CALIFORNIA SCHOOL FINANCE AUTHORITY

## ISSUE 1: MAY REVISION—PROPOSITION 55 AUGMENTATION

The authority requests $231,000 (bond funds) and 1.0 two-year limited term position to staff the Charter School Facilities Program. Voter approval of Proposition 55 in March 2004 created a workload necessitating staff and contract resources $131,000 of the total expense will be ongoing.

The following budget bill language is included in this request:

*Of the amount appropriated in this item, $100,000 is for the one-time support of external contract consultants who are qualified to provide technical assistance and training in the development of financing programs for charter schools*

**Staff Comment.** The authority points out that all of its positions currently are limited-term. While most of the authority's workload may be temporary, there also will be ongoing tasks. It would be appropriate to allow the authority to designate one of their positions as permanent.
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**Staff Recommendation: Approve the May Revision with authority to select a position to make permanent.**

# ITEM 1730 FRANCHISE TAX BOARD

## ISSUE 1: MAY REVISION—TAX AMNESTY PROGRAM

The Administration requests that the FTB's budget be increased by $10,183,000 and 72 positions (all temporary help with the exception of one limited-term position) to administer a personal income and corporate tax amnesty program. The Franchise Tax Board estimates this program would result in additional General Fund revenues of $185.0 million in 2004-05, a reduction in revenues of $15.0 million in 2005-06, and revenue gains of $10.0 million in 2006-07 and $20.0 million in 2007-08.

The amnesty period would be from February 1, 2005, to March 31, 2005. It would apply to tax years prior to 2003. At the conclusion of the amnesty period, penalties and interest would be increased. This proposal requires legislation and essentially mirrors the provisions of AB 2203 (Chu), which was discussed at the Assembly Budget Oversight Meeting on April 22.

The FTB estimates that total gross amnesty tax receipts will be $595 million in 2004-05. However, FTB also estimates that it would have collected $410 million in payments and penalties from amnesty participants absent the amnesty. Consequently, FTB estimates a net gain of $185 million in 2004-05 (less the administrative costs requested in this proposal).

**Supersedes Prior Action to Extend RAP.** At its April 27 hearing, the subcommittee augmented the FTB budget by $2 million to extend the Revenue Acceleration Program (RAP) for a revenue gain of $23 million. The RAP is a more limited amnesty program that waives penalties *and* interest for a limited group of delinquent taxpayers for which FTB otherwise would expect a low probability of payment. FTB advised the subcommittee at that time that adoption of a broader amnesty program, such as the current May Revision proposal, would supersede the RAP. The subcommittee action included direction to coordinate its action on the RAP with any future amnesty program. Accordingly, the FTB advises that the adoption of the May Revision amnesty proposal should include rescission of the prior action to extend the RAP.

**LAO Comments.** There are two primary goals in any amnesty: (1) raise additional revenues that would otherwise not materialize, and (2) get additional residents into the tax system and retain them as compliant taxpayers. Although it appears that the proposal would result in some increase in penalties, it is not clear that the Finance Letter proposes anything in particular regarding the second goal--such as targeted auditing, an education campaign, tracking of cases or types of cases, etc. In contrast, during the last amnesty, from 1984-85, the Finance Letter notes that FTB significantly increased the visibility of its enforcement program, added additional enforcement tools, used private collection agencies, publicized property seizures and criminal prosecutions, and used other approaches to address the second goal.

- **Staff Comment.** The FTB should respond to the LAO comments and discuss the benefits and costs for a media and marketing campaign.

**Instate Collection Case Referral Process (ISCAR).** At Mr. Canciamilla's request, staff have asked the FTB to explore the option of increasing funding for the ISCAR—a statutorily authorized program under which FTB contracts with private collection services within the state. Accounts referred to ISCAR private collectors have an expected benefit-to-cost ratio of less than 5 to 1 (the normal cutoff for FTB staff efforts). Commissions are paid on collected amounts. For some time, the annual allocation for commissions has been $404,000. The FTB estimates that increasing this amount to $800,000 (an augmentation of $396,000) could yield as much as $2.7 million of additional GF revenue. However, FTB also points out that the proposed amnesty program might put a temporary halt on almost all contract collection activity immediately before and during the amnesty period.

- **Staff Comment.** The FTB should inform the committee as to the potential revenue gains from augmenting ISCAR funding in 2004-05 in light of the amnesty proposal.

**Staff Recommendation:**
- **Adopt May Revision.**
- **Consider augmentations for a media and marketing campaign and for an augmentation to ISCAR based on the testimony presented.**

## ISSUE 2: MAY REVISION AND APRIL REQUESTS — TASKFORCE ON ABUSIVE TAX SHELTERS (ATS)

**May Revision Request.** The Administration requests that the FTB's General Fund appropriation be increased by $4,310,000 to provide funding for contracts with tax shelter experts ($1.8 million) and to backfill 42 audit positions that are being redirected by the FTB to work on abusive tax shelter cases. This augmentation would result in an estimated $28.0 million General Fund revenue increase in 2004-05, $71 million in 2005-06, and $97 million annually through 2008-09. Costs will increase to $9.2 million in 2005-06.when all staff have been hired and trained. This request is in addition to the April request described below. This proposal was developed by the FTB in response to an initiative by the State Controller and was presented to the Assembly Budget Oversight Meeting on April 22. The administration has incorporated this proposal into its May Revision budget plan.

**April Request.** In an April 1 Finance Letter, the FTB requested $400,000 for additional consulting services to obtain expert assistance to identify uses of abusive tax shelters and to develop audit and enforcement actions to recover tax payments that are due. The FTB estimates that these additional consultant resources will result in increased GF revenues of $11 million in 2004-05, $91 million in 2005-06, $64 million in 2006-07, and smaller amounts through 2008-09.

**Redirected Staff.** In the current year, the FTB has redirected existing audit staff to combat abusive tax shelters. This redirection will be ongoing. The FTB estimates that the revenue gain from this redirection will be $28 million in 2004-05, $57 million in 2005-06, $79 million in 2006-07, and $63 million annually in 2007-08 and 2008-09.

**$900 million Gain Over Next 5 Years**. Overall, the Abusive Tax Shelter Task Force activities listed above will generate a total estimated GF revenue gain of $67 million in 2004-05, $219 million in 2005-06, and similar amounts thereafter—a total of $903 million through 2008-09. These efforts will follow-up on leads identified through the Voluntary Compliance Initiative (VCI)—a limited amnesty for users of abusive tax shelters-- and they will take advantage of new enforcement tools. Both the VCI and the new enforcement tools were established by AB 1601 (Frommer) and SB 614 (Cedillo and Burton).

**FTB Identifies Potential for Doing More.** The FTB has indicated that it could use an additional $1.7 million in consultant services to assist in ATS cases, bringing the total to $3.5 million for consultants in each fiscal year. In addition, FTB could backfill an additional 25 auditors who were initially redirected to work ATS cases. The staffing backfill would cost $1.1 million on a half-year basis in 2004-05. Total cost of this proposal in 2004-05 would be $2.8 million. Estimated revenue from these resources is $13million annually, discounted by 50 percent to $6.5m in 2004-05.

- **Staff Comment.** The FTB only recently identified this additional revenue generation opportunity. The LAO has not yet had an opportunity to review the proposal. It would seem advisable to approve the additional augmentation (and revenue) in order to place the issue in Conference and allow the LAO to evaluate the proposal.

**Additional VCI Revenue.** As of May 3, 2004, payments VCI California's latest tax amnesty program, called the Voluntary Compliance Initiative (VCI), generated over $1.325 billion in revenues from collecting past unpaid tax debts. In the Governor's May Revision $1.225 billion of VCI payments were included as prior-year adjustments to GF revenues. Due to the timing of the May Revision revenue estimates, $100 million has not yet been recognized.

- **Staff Comment.** The FTB and the Department of Finance should comment on whether it would be appropriate to increase the GF revenue from VCI payments by the $100 million in additional receipts (as a prior-year adjustment).

**Staff Recommendation:**

1) **Approve the April Finance Letter and the May Revision requests.**
2) **Augment by $2.8 million and increase revenue by $6.5 million for additional abusive tax shelter task force resources and to backfill redirected audit positions.**
3) **Recognize additional $100 million VCI revenue as a prior-year adjustment.**

## ISSUE 3: MAY REVISION— CHILD SUPPORT AUTOMATION SYSTEM

The Administration requests that FTB funding be increased by $17,473,000 ($5,991,000 General Fund and $11,482,000 Reimbursements) to provide for nine additional positions and for vendor payments in order to continue the CCSAS project Child Support Enforcement component development phase. The vendor payment schedule has been revised to reflect the current anticipated payment dates. Project deliverables have been coming in sooner and better than expected, so the State is incurring these costs earlier than expected. This augmentation does not reflect an increase in total contract cost over the life of the project.

**LAO Recommendation.** FTB and the Department of Child Support Services (DCSS) jointly manage the CCSAS project. Between the two departments, the Legislature has approved 184 state staff (113 for FTB and 71 for DCSS) to support the project. LAO believes that both departments are performing similar, if not duplicative, tasks on the project. For this reason, the LAO recommends that the Legislature reduce the request by nine positions and the associated dollars of $740,000. The remaining funding increase reflects $16.2 million in contract costs and $490,000 in wide area network costs.

**Staff Comments**

- Subcommittee 1 has approved the DCSS May Revision proposal. Approval of this FTB May Revision request would conform to that action.

- FTB responds to the LAO recommendation by pointing out that FTB staff focuses on the technical aspects of the project, while DCSS staff focuses on the program aspects of the project. Although their tasks interact, FTB argues that they are distinct and both vital to the ultimate success of the project.

- California currently is subject to federal penalties of $220 million annually for failure comply with federal child support automation system requirements that this project will address.

**Staff Recommendation: Approve the May Revision request.**

## ISSUE 4: MAY REVISION— LITIGATION COSTS FOR HYATT CASE

The Administration requests that the FTB's General Fund support item be increased by $1,334,000 and two limited-term positions to provide funding to continue to defend a lawsuit filed by a taxpayer who currently resides in the State of Nevada. These funds will pay for Nevada counsel, analytical support, and various related expenses. The State's potential liability in this case is approximately $200 million. The Department of Justice (DOJ) notified the FTB that they will no longer be representing the FTB in this case and granted the FTB permission to retain private counsel. The case is scheduled for trial in Nevada in August 2006 and the estimated cost to the State to defend itself over the next three years is estimated to be $3.8 million.

Through 2003-04, the DOJ budget has been augmented by nearly $4.4 million for litigation expenses related to this case.

**Staff Comment.** The FTB should explain the need for the substantial litigation funding that it requests and the anticipated timing of court action.

**Staff Recommendation: Approve the May Revision request.**

## ITEM 1760 DEPARTMENT OF GENERAL SERVICES

## ISSUE 1: CAPITAL OUTLAY

The Department of Finance is proposing trailer bill language that would do the following:

1. Clarify existing State Public Works Board (PWB) authority to augment capital outlay projects by stating that the PWB may augment a project in an amount equal to all capital outlay appropriations for the project, regardless of when each appropriation was made and whether or not it has been reverted.

2. Clarify the PWB's authority to establish a reasonable construction reserve when lease revenue bonds are sold prior to completion of a project, without first augmenting the project.

3. Conform and clarify the terminology and definitions used in the two primary statutes that authorize the use of design-build construction procurement process for capital outlay projects.

**Staff Comments:** The issues proposed in this trailer bill have policy implications that may be more appropriately suited for a policy committee. However, the DOF has stated that the proposed trailer bill language provides technical clarifications that are necessary for the sale of lease-revenue bonds for projects that are currently in progress and/or proposed for the 2004-05 budget.

**Staff Recommendation: Approve trailer bill language**

## ITEM 2150 DEPARTMENT OF FINANCIAL INSTITUTIONS
## ITEM 2180 DEPARTMENT OF CORPORATIONS

### ISSUE 1: IMPLEMENTATION OF SB 1 (SPEIER)

The Governor's budget proposes $1.9 million and 17 positions for the department to implement and enforce Chapter 241 which establishes particular restrictions on the ability of businesses involved in financial-related transactions to share customer information. Chapter 241 affects the sharing of information with both a business' financial affiliates and independent (nonaffiliated) companies.

**Alternative Staffing Options:** This issue was heard in the Subcommittee on April 20, 2004 and was held open in order for staff to develop alternative staffing options. The following staffing alternatives have been provided by the department:

| Options | Description | Positions | Cost |
|---|---|---|---|
| 1 | Investigate and litigate based on complaints, but do not incorporate SB 1 audits into bi-annual examinations. | 6.0 | $679 |
| 2 | Investigate and litigate based on complaints, and also perform nonroutine, "red flag" SB 1 audit checks triggered by a certain level of complaints against individual licensees.* | 6.0 | $679 |
| 3 | Investigate and litigate based on complaints, and also perform SB 1 audit checks on 25 percent of firms each bi-annual cycle. | 8.0 | $907 |
| 4 | Investigate and litigate based on complaints, and also perform SB 1 audit checks on 50 percent of firms each bi-annual cycle. | 12.0 | $1,363 |
| 5 | **BCP Request:** Investigate all firms for SB 1 compliance during bi-annual examinations and follow-up on complaints | 17.0 | $1,881 |

* DFI indicates that for them, Option 2 would be the same as Option 1. (Source: Senate Budget)

**Staff Comment**: Recently, the American Bankers Association (ABA) filed a lawsuit against the Department regarding Federal preemption of state law. This suit appears to only apply to members of the ABA and therefore, will not impact, if successful, non-members such as credit unions and other smaller financial institutions. Most these institutions fall under the jurisdiction of the DFI and therefore the outcome of the lawsuit will have a minimal impact on SB 1 implementation workload levels. Thus, the question before the committee is at what level would be the appropriate level of enforcement for SB 1. The following budget bill language has also been proposed to require DFI to report back to the legislature, the LAO and Finance regarding implementation of SB 1:

*Provisions:*
*The Department of Financial Institutions shall report to the budget committees of each house of the Legislature and the LAO by January 10, 2006, on (a) the level of non-compliance found with Chapter 241, Statutes of 2003, (b) any changes to state or federal law, or court decisions, that affect Chapter 241 workload, and (c) any staffing changes requested based on the level of compliance or changes in law.*

**Staff Recommendation:**
1) **Approve option #2 with proposed BBL–** allow the departments to investigate and litigate based on complaints, and also perform non-routine, "red flag" SB 1 audit checks triggered by a certain level of complaints against individual licensees.

## ITEM 8770 ELECTRICITY OVERSIGHT BOARD

The Electricity Oversight Board (EOB) is part of the regulatory oversight structure that was established by the legislation restructuring California's electricity industry in 1996. The board is charged with ensuring the reliability of the electricity transmission system and in the power market. The Budget proposes total expenditures of $3.6 million (from special funds that support the Public Utilities Commission and the Energy Commission) and 21.9 personnel-years of staff.

**Report Has Been Submitted.** The subcommittee heard the board's budget on April 20 and held it open pending submission of a report on the state's activities before the Federal Energy Regulatory Commission (FERC) that was required by the 2003 Budget Act. That report has now been submitted.

**Staff Recommendation: Approve as budgeted.**

## ITEM 9100 TAX RELIEF

### ISSUE 1: GOVERNOR'S LOCAL GOVERNMENT REVENUE SWAP

The May Revision substantially revises the Governor's January proposal for a $1.3 billion local government contribution to the state's budget solutions. The January Budget proposed an ongoing annual increase in the property tax shift from local governments to schools and community colleges. This shift took place via the Educational Revenue Augmentation Fund (ERAF) in each county and reduced on a dollar-for-dollar basis the state's General Fund obligation to K-14 education under Proposition 98. About $900 million of this additional ERAF shift would have been from counties, with the remainder from cities, special districts, and redevelopment agencies.

- The May Revision proposal includes the following elements.
  - $1.3 billion savings in 2004-05 and 2005-06 only.
  - Makes the Vehicle License Fee (VLF) reduction permanent and eliminates the state General Fund backfill payments with a "reverse" ERAF shift of property taxes back to cities and counties. However, in 2004-05 and 2005-06, the state will provide a reverse shift will have a shortfall of $700 million—resulting in equivalent state savings. Schools will be made whole by the state for their net loss of property tax revenue.
  - For 204-05 and 2005-06, redevelopment agencies and special districts will shift $250 million and $350 million, respectively to the schools, resulting in an equivalent state savings
- The May Revision proposes a constitutional amendment to protect local property, sales, and VLF revenues in the future.
- The May Revision proposes to reform the mandate process by automatically repealing unfunded mandates.

- The May Revision states intent for another state-local program realignment in 2006-07.

**Budget Actions.** In terms of providing the technical budgeting adjustments needed to achieve the $1.3 billion GF savings for 2004-05, the subcommittee would need to take the following actions:

1) Eliminate the 2004-05 General Fund backfill for the VLF offsets (reduce GF backfill costs by $4.1 billion).

2) Shift a net $2.8 billion of property tax revenue from K-14 education to local government. This amount is calculated as $4.1 billion for VLF backfill less the $700 backfill shortfall and less the $600 million property tax shift from local governments (special districts and redevelopment agencies in the Governor's proposal) to schools.

These actions would enable the subcommittee to recognize the $1.3 billion state savings in the Governor's proposal, but without designating the allocation of the local government impact among the various types of local entities and without acting on the proposal's constitutional and other policy changes. These issues would remain open for further discussion as the budget process continues.

**Staff Recommendation: Adopt the budget actions described above to recognize $1.3 billion of state savings.**

## ITEM 9210 LOCAL GOVERNMENT FINANCING—BOOKING FEE SUBVENTIONS

The subcommittee heard this issue at its April 20 hearing and held it open at that time with direction to representatives of county sheriffs and city police chiefs to explore restructuring the program in a way that provided more uniformity in booking fees and ensured that any state funds would be directed to law enforcement.

**Background.** Chapter 466, Statutes of 1990 (SB 2557, Maddy) gave counties the ability to charge cities and special districts a booking fee each time an individual was booked into the county jail. While giving counties a new revenue source, the payment of booking fees also, some contend, provides a fiscal incentive for police departments to avoid unnecessary bookings. Beginning with the 1999-00 budget, local governments have been annually reimbursed for the booking fees they paid in 1997-98.

**Governor's Proposal.** The Governor's Budget proposes Trailer Bill Language to (1) eliminate reimbursements to 373 cities and special districts that are based on jail booking fees they paid to counties in 1997-98 for an annual GF savings of $38.2 million and (2) repeal counties' authority to charge booking fees. Eliminating the booking fee reimbursements, therefore, would affect those cities and special districts that paid booking fees in 1997-98. However, the loss to those cities and special districts would be offset (more or less) by being relieved of any requirement to pay booking fees. For that reason, the primary impact of this proposal would be a loss of booking fee revenue to counties.

**LAO Recommends Retaining Booking Fees But Eliminating Subventions.** The LAO contends that booking fees encourage local agencies to use county booking and detention services efficiently and that it is appropriate for cities and special districts to pay for the costs that they impose on counties.

**Impact on Counties Could be Larger.** The California State Association of Counties (CSAC) surveyed its members and found that they receive about $37 million in booking fees annually. However, the impact on counties from the elimination of booking fee authority could be larger than this amount. This is because cities and districts probably would increase their booking activity in the absence of these charges.

**Frozen in Time.** The subvention amounts and recipients are frozen based on the situation in 1997-98. The subventions do not necessarily relate to any current booking fee costs. Instead, they are general revenue to the recipient cities and the amounts may or may not relate to their current costs for booking fees. LAO points out that cities in Orange County (Garden Grove and Santa Ana, for example) continue to receive booking fee subventions even though Orange County no longer charges booking fees. SB 1808 (Torlakson) would revise the program to pay the subventions based on the amount of booking fees actually paid in the prior year.

**Two Approaches Under Discussion**

Since the subcommittee's initial hearing two potential approaches have been under discussion to reform the booking fee subvention program and counties' ability to charge booking fees. Staff's current understanding of these approaches is outlined below.

**Sheriffs/Counties Approach**

This approach has the following major features:

1) No change in 2004-05 to booking fee methodology or to the state subventions (General Fund cost of $38.2 million relative to the Governor's Budget).

2) In 2005-06 booking fees charged by counties would have to comply with a three-tier system. This system would divide counties into three classes—urban, suburban, and rural. Within each class of county, those counties with booking above the average would have to reduce them to the average. Those counties with booking fees below the average could not increase their fee.

3) Counties could increase their fees by the California CPI in 2006-07 and thereafter.

4) The Board of Corrections would perform a study of the current cost-based process by which counties set their booking fees.

**Staff Comments.** This approach does not explicitly address the amount of the state subventions after 2004-05. There would be some reduction in booking fee charges to cities starting in 2005-06 because counties with above-average rates (within their class) would have to reduce their charges to the average. However, no estimates of the amount of this reduction have been provided. This approach would continue to allow counties to impose significant fees on all bookings, regardless of the nature of the crime.

**Police/Cities Approach**

Alternate approaches under discussion by some police and city representatives would have the following general characteristics:

1) Require booking fees to be approved by the Board of Corrections.

2) Limit cities' requirement to pay booking fees to crimes for which police generally have some discretion over or alternatives to booking. These would include municipal code violations, and possibly other crimes, such as prostitution, public vagrancy, illegal camping, shoplifting, simple assault and battery, bar fights.

3) Replace all or a portion of the loss to counties from reduced city booking fee payments through either of the following mechanisms:

   a) Authorize counties to collect booking fees from defendants who are convicted or plead no contest and require booking fees to be posted with bail.

   b) Provide state subventions directly to counties and other entities that operate jails.

**Staff Comments.** Imposing booking fees on defendants presumably would eliminate state subventions for a GF savings of $38.2 million, consistent with the Governor's Budget. However, it would burden counties with the responsibility and cost of collecting booking fees from convicted defendants who may be subject to other fines and penalties and may not be able to pay. Providing direct state subventions would eliminate or reduce state savings (depending on the level of the subventions) but would provide counties with a more certain and less costly way to offset their booking costs.

**Key Decisions for the Subcommittee**

From a state budget perspective, the key decision is whether to restore any funding for booking fee subventions (relative to the Governor's Budget) and, if so, how much the subcommittee is willing to spend for this purpose. Either of the approaches could be adapted to a partial restoration of subvention funding.

Another key decision is whether counties should continue to be able to charge booking fees to cities for all bookings (as the in the sheriffs/county approach) or whether booking fees should be limited to lesser crimes--or imposed on defendants rather than cities.

In addition, choosing any approach (other than the status quo) will create fiscal winners and losers. This will occur for two reasons. First, any structural changes to make booking fees more uniform, limit their application, or reallocate subventions will affect individual cities and counties in different ways. Second, any reduction in state subventions will reduce local resources (unless fully replaced by fees imposed on defendants). Consequently, decisions to reduce funding and/or reform the existing booking fee program will involve questions of equity among cities and counties, as well as the state.

**Staff Recommendation: For budgeting purposes, staff recommends that any restoration of subvention funding not exceed $20 million.**

## ITEM 9916 ASSET MANAGEMENT AND SURPLUS PROPERTY REFORM

In the May Revision, the Administration has proposed to reform the process by which the State manages its real property assets and surplus property by enacting the following:

1. **Trailer Bill Language**

- Consolidate the management of the State's real property assets, placing the primary authority for asset management activities vested in a single entity.
- On an interim basis, direct departments to immediately begin operating in a more centralized fashion, including approval from the State Public Works Board (PWB) for a new acquisition, disposal, lease, or major capital alteration of real property assets owned by the State.
- Direct the State and Consumer Services Agency to implement these reforms.

The Administration expects that this proposal will result in $50 million in General Fund revenue in 2004-05 and $200 million in 2005-06 associated with the disposal of surplus property. In order to achieve these savings the administration is requesting that trailer bill language be adopted that would:

- Authorize the Director of General Services to declare property surplus and provide notice to the legislature of this determination prior to disposing of the property.
- Eliminate existing requirements to offer surplus property to local governments prior to public sale.
- Eliminate existing requirements that the state sell surplus property to local government entities for less than market value under certain circumstances.
- Provide state agencies with a limited-term opportunity to earn fiscal incentives for the identification of surplus property that is ultimately sold.

**Staff Comments:** The policy changes proposed in this trailer bill would have a significant effect on the process by which the State manages its real property assets. Thus, it may be more appropriate that the various policy concerns regarding this proposal vetted in a policy committee rather than in the subcommittee.

**Staff Recommendation: Score $50 million savings and deny trailer bill.**

2. **Additional Staffing.**

In addition to Trailer Bill Language, the DOF has requested a one-time $2.8 million (General Fund) augmentation to fund various state agencies for possible costs accrued during the reform process.

**Staff Comments:** The Department of Finance did not provide workload justification for these positions and it is unclear where how these funds will be spent.

**Staff Recommendation: Reject proposal**

## ITEM 9898 PENSION OBLIGATION BOND SAVINGS
## CONTROL SECTION 35.00 DEFICIT RECOVERY FUND

The May Revision continues to propose to sell $929 million of pension obligation bonds to offset state PERS employer contribution costs in 2004-05, contingent on legislative approval of reductions in pension benefits for new employees and increased employee retirement contributions.

The May Revision reduces by $1 billion the amount of Proposition 57 Economic Recovery Bond funds that are used to help finance the 2004-05 budget. In January, the Governor's Budget proposed using $12.2 billion of the $15 billion bond authorization in Proposition 57 ($9.2 billion to finance the 2002-03 budget deficit, $3 billion to finance the 2004-05 budget deficit). The May Revision reduces the amount of bond proceeds used in 2004-05 to $2 billion. In addition, the January Budget reserved $1 billion of bond authorization for issuance and insurance costs. Because of the strong market reception of the initial Proposition 57 bonds, the May Revision now assumes that issuance costs will be minimal and that all of the remaining $3.8 billion of bond proceeds would remain available for use after 2004-05.

**Staff Comment.** The administration's pension reform proposals will require difficult and complex negotiations with employee groups that are likely to take some time. Accordingly, it would appear more prudent to defer the pension obligation bond savings until 2005-06 and maintain the use of Proposition 57 bond funds at the amount budgeted by the Governor in January.

**Staff Recommendation: Reject May Revision reduction of Proposition 57 bond proceeds and defer pension obligation bonds to 2005-06.**

## CONTROL SECTION 34.50 PUNITIVE DAMAGE AWARDS IN THE PUBLIC BENEFIT TRUST FUND

### BACKGROUND

**Punitive Damages.** Civil lawsuits can result in two types of damages being paid to the plaintiff. Compensatory damages are awarded by the courts to make up for loss or injury sustained by the plaintiffs. Punitive damages are awarded in addition to the award of compensatory damages and are awarded to make an example, to punish a defendant, and to deter future such actions.

The Administration argues that since the plaintiffs are already compensated for their loss the award of punitive damages should more appropriately be awarded to the State where it can be used for the public good consistent with the nature of the award.

The Administration cites that at least eight states have split-award statutes in which a share of the punitive damages award goes to the state instead of the plaintiff. Those are Alaska, Georgia, Illinois, Indiana, Iowa, Missouri, Oregon, and Utah.

**May Revise Proposal.** The May Revision proposes trailer bill language and a new budget control section 34.50 related to split-awards and the number of punitive damages that can be awarded from one defendant. Specifically, this proposal:

- Deposits 75 percent of punitive damages awarded in the state into the "Public Benefit Trust Fund;"
- Allows the remaining 25 percent to plaintiffs and "reasonable attorney fees;"
- Creates the "Public Benefit Trust Fund" administered by the Controller to collect punitive damages and to be appropriated annually in the Budget Act, up to the balance of the fund, consistent with the nature of the damages;
- Prohibits the courts from assessing punitive damages against a defendant more than once in a product liability case;
- Limits punitive damages against small businesses to no more than 2 percent of the average of the last 5 years' state income tax gross receipts;
- Prohibits juries from being informed by either plaintiff or defendant or the court that a portion of the punitive damage award will be deposited in a government fund;
- Restricts the state from intervening in a lawsuit on the basis of its interest in punitive damages and defines the only right of the state is to its share of punitive damages.

**Savings Estimates.** The Administration projects $450 million in General Fund relief. The estimate is based on a McGeorge School of Law study of pre-appellate awards between 1991 and 2000 totaling $6.4 billion. The data came from verdicts voluntarily reported by attorneys to the Westlaw database for the California Jury Verdict Reporter. However, one of the awards was reduced from $4.2 billion to $1.2 billion on appeal, which was not accounted for in the study. A U.S. Justice Department study suggests that it would be unlikely for the state to receive even a quarter of the amount projected by the Administration.

Some of the states with similar provisions have had their statues in place since the mid-1980s. There is little information, however, on how much fiscal relief the laws have generated. Only a few studies of the laws have been published and they simply suggest that there has been no reduction in the number of cases brought to trial as a result of these provisions.

**Constitutional Issues.** There are constitutional concerns regarding where California could place the awards from punitive damages and how the state could spend the funds. For example, some believe it would be illegal to put the funds directly into the General Fund, since the money is supposed to be used for activities related to the offense. Despite the creation of the Public Benefit Trust Fund, the Administration has acknowledged that the punitive damages proposal is a way to help close the deficit. Any money that comes out of the special fund would be used to pay for programs that are already in the budget, and not necessarily designed to fund activities related to the offenses that brought about the punitive damages. The allocation to the special fund rather than the General Fund, acknowledging that the intent is to pay for general state services, is therefore providing a distinction, without a difference.

There are potential constitutional issues involved in splitting punitive damages. A Colorado statute that required one-third of the punitive damage award to the state General Fund was struck down. The court ruled that the state could not take away property rights that were provided in a court judgement. The court reasoned that the state may not transform private property into public property without compensation and that the statute resulted in an illegal "taking."

**Consumer Protection.** There may be an impact on the consumer protection offered to the public if the provision to limit punitive damages to one cause of action is maintained in the trailer bill. The provision would prohibit the courts from assessing punitive damages against a defendant more than once. Hence, only one plaintiff in one suit would be eligible for punitive damages.

An example of the consequences of this restriction is the recent case in which Ford Motor Company knew SUVs had roofs at risk of collapsing but did not recall them, and three people died after one of the vehicles rolled over. The jury delivered a $290 million punitive award, but the U.S. Supreme Court reduced it to $23 million. With this example in mind, companies could do a cost/benefit analysis in which they decide it is cheaper to pay a one-time award of $23 million than to pay for a costly recall.

The Administration does not believe that their provisions would lead to the scenario described above because companies would still be subject to multimillion-dollar judgments to compensate victims for their injuries. The Administration has cited that 11 other states have similar prohibitions against multiple punitive awards.

**Staff Recommendation: Withhold action and refer issue to policy committee.**