



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

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| Date Amended: | 06/22/10 | Bill No: | SB 356 |
| Tax: | Administration | Author: | Wright, et al |
| Related Bills: | | | |

BILL SUMMARY

This bill would impose additional requirements on state agencies when proposing to adopt, amend, or repeal regulations under the Administrative Procedure Act.

ANALYSIS

CURRENT LAW

Current law establishes detailed procedural requirements in the Administrative Procedure Act (APA) (chapter 3.5 (commencing with Section 11340) of division 3 of title 2 of the Government Code) that must be followed by state agencies when they propose to adopt, amend, or repeal regulations.

The need for regulatory action is identified in a number of ways. Under current law, interested persons may identify the need for regulatory action by filing a petition with a state agency for the adoption, amendment, or repeal of a regulation. When a petition is filed, a state agency must acknowledge its receipt in writing and, within 30 days, either schedule the petition for a public hearing or issue a detailed written decision indicating why the petition was denied on its merits and submit the decision to the Office of Administrative Law (OAL) for publication in the California Regulatory Notice Register. If an interested person disagrees with the reasons why an agency denied its petition, the interested person may also file a petition for reconsideration, which must be acknowledged and responded to in the same manner as the original petition.

Current law also allows state agencies to internally identify the need for regulatory action and gives state agencies that are considering adopting, amending, or repealing a regulation the discretion to informally consult with interested persons before considering whether to initiate the formal APA process for adopting, amending, or repealing a regulation. Current law only requires state agencies to consult with interested persons prior to initiating the formal APA process when a regulation involves complex proposals or numerous proposals.

If a state agency decides to begin the formal APA process to adopt, amend, or repeal a regulation, the APA provides for the public to actively participate in the agency's rulemaking. The APA requires a state agency to notify by mail every person who has filed a request for notice and also a representative number of businesses affected regarding the commencement of each regulatory action. The APA also requires a state agency to publish the same written notice in the California Regulatory Notice Register and to post the notice on its Website.

The written notice must:

- State the time, place, and nature of the regulatory action;

- Identify the state agency's authority for initiating the proposed regulatory action and refer to the specific provision of law being implemented, interpreted, or made specific by the proposed regulatory action;
- Contain an informative digest drafted in plain English describing existing law, the proposed regulatory action, the effect of the proposed regulatory action, and the broad objectives of the regulatory action;
- Contain a determination as to whether the proposed regulatory action imposes a mandate on local agencies or school districts and an estimate of the cost or savings to any state agency, the cost to any local agency or school district, other nondiscretionary cost or savings imposed on local agencies, and the cost or savings in federal funding to the state anticipated to result from the proposed regulatory action;
- Contain a determination and statement regarding whether the proposed regulatory action may have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with out-of-state businesses;
- Contain a description of all the cost impacts, known to the agency, that a representative private person or business would necessarily incur in reasonable compliance with the proposed regulatory action;
- Contain a statement regarding the results of the state agency's assessment of the proposed regulatory action's potential for adverse economic impact on California business enterprises and individuals, and its potential to impose unnecessary or unreasonable regulations or reporting, recordkeeping, or compliance requirements;
- Contain a determination and statement as to whether the proposed regulatory action will have a significant effect on housing costs;
- Include a statement that the state agency may not adopt the proposed regulatory action unless it finds that no reasonable alternative considered by the agency or that was identified and brought to the agency's attention would be more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons than the proposed action;
- Include the contact information for two agency representatives to whom inquiries concerning the proposed regulatory action may be directed;
- State the date by which written comments must be received to present statements, arguments, or contentions in writing relating to the proposed regulatory action in order for them to be considered by the state agency before it adopts the proposed regulatory action;
- State that the state agency has prepared the text of the proposed regulatory action and an initial statement of reasons regarding the proposed regulatory action, which are available to the public;
- State that if a public hearing is not scheduled, a public hearing will be scheduled if requested no later than 15 days prior to the close of the written comment period;
- State that if the state agency makes sufficiently related changes to the proposed regulatory action, the full text of the changes will be available for

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

- public comment for at least 15 days prior to the adoption of the proposed regulatory action; and
- Explain how the public can obtain a copy of the final statement of reasons and provide the address for the state agency's Website.

In order to further assist the public, the APA requires state agencies to prepare an initial statement of reasons for proposing the adoption, amendment, or repeal of a regulation. The initial statement of reasons is required to: (1) provide the state agency's specific purpose for the proposed regulatory action and the agency's rationale for determining that the proposed regulatory action is reasonably necessary to carryout such purpose; (2) identify each technical, theoretical, and empirical study, report, or similar document, if any, the state agency is relying upon in initiating the proposed regulatory action; and (3) a description of any reasonable alternatives that would lessen any adverse impact on small business and the state agency's reasons for rejecting those reasonable alternatives. However, state agencies are not required, in the initial statement of reasons, to artificially construct alternatives, describe unreasonable alternatives, or justify why the agency has not described alternatives.

If a state agency adopts a proposed regulatory action after considering all of the written comments submitted during the comment period and conducting a public hearing, then the state agency must prepare a final statement of reasons and an updated informative digest. The final statement of reasons must contain: (A) an update of all the information contained in the initial statement of reasons; (B) a determination as to whether the adopted regulatory action imposes a mandate on local agencies or school districts and, if so, whether the mandated costs are reimbursable; (C) a summary of each public comment objecting to or recommending a change to the proposed regulatory action and an explanation of the changes to the proposed regulatory action made in response to such comments or the state agency's reasons for not making any changes; and (D) a determination with supporting information that no alternative considered by the agency would be more effective or would be as effective and less burdensome to affected private persons than the adopted action. The updated informative digest must provide an update to the information set forth in the informative digest included in the original notice. Then, the state agency must submit the entire rulemaking file to the OAL.

The OAL is charged with the orderly review of adopted regulations in order to reduce the number of administrative regulations and improve the quality of those regulations that are adopted. In its review, the OAL determines if the regulations comply with all six of the substantive standards prescribed by law, which are: necessity, authority, clarity, consistency, reference, and nonduplication.

Furthermore, Government Code Section 11148.5 requires each state agency that significantly regulates or impacts small business to designate at least one person to serve as a small business liaison in addition to complying with the APA requirements for the adoption, amendment, or repeal of a regulation. The small business liaison is responsible for all of the following:

1. Receiving and responding to complaints received by the agency from small businesses.
2. Providing technical advice and assisting small businesses in resolving problems and questions regarding compliance with the agency's regulations and relevant statutes.

3. Reporting small business concerns and, where appropriate, reporting recommendations to the agency secretary.
4. Reviewing and updating content on the agency Web site that is accessible through the small business link provided on the State of California Internet portal, as specified.
5. Assisting the agency secretary, department director, or executive officer in ensuring that the procurement and contracting processes of the applicable entity are administered in order to meet or exceed the 25 percent small business participation goal.

Current law also requires the Office of the Small Business Advocate to issue a report every two years evaluating the efforts of state agencies in assisting minority and other small businesses, and requires the advocate to maintain and distribute to interested parties, a list of persons serving as small business liaison for each state agency.

PROPOSED LAW

This bill would delete the state agencies' broad discretion to consult with all interested parties before initiating regulatory action. The bill would also effectively require state agencies to consult with parties who would be subject to a proposed regulatory action before initiating such action or prepare a written justification containing the reasons for not engaging in such consultations.

This bill would delete the provisions of the APA stating that a state agency is not required to artificially construct alternatives or justify why the agency has not described alternatives; and thereby creates the inference that the bill will require state agencies to artificially construct alternatives so that they can be rejected or justify why they have not created such alternatives. Furthermore, the bill amends the APA so that it requires a state agency, when preparing an initial statement of reasons to describe its reasons for rejecting each specific alternative, rather than its reasons for rejecting each "reasonable" alternative, and thereby creates an inference that state agencies must respond to unreasonable alternatives as part of the APA process.

The bill would delete the second paragraph in Government Code section 11346.3, which provides that "It is not the intent of this section to impose additional criteria on agencies, above that which exists in current law, in assessing adverse economic impact on California business enterprises, but only to assure that the assessment is made early in the process of initiation and development of a proposed adoption, amendment, or repeal of a regulation." This would change the purpose of section 11346.3 and require state agencies to perform economic impact assessments as part of the requirements for the valid adoption of a regulatory action. Furthermore, the bill would require economic impact assessments to include the preparation of a "new" small business economic impact statement. The small business economic impact statement shall include all of the following:

- An identification and estimate of the number of small businesses subject to the proposed regulation.
- The estimated annual average cost of compliance by a small business subject to the proposed regulation.
- The estimated statewide annual average cost of compliance by small businesses subject to the proposed regulation.

The bill would require a state agency to include a statement describing how a small business could comply with a new regulation without incurring any costs if the agency declares that it is not aware of any cost impact that a representative private person or business would incur in complying with the new regulation.

The bill would require the OAL to reject any proposed regulatory action if: (1) the accompanying rulemaking file does not contain the “new” small business economic impact statement or the statement does not contain all of the required statutory elements; or (2) the accompanying rulemaking file does not contain a description of the cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed regulatory action or a statement describing how a private person or business could comply with the proposed regulatory action without incurring a cost.

This bill makes minor changes to the APA to expressly add a trade association “that represents small businesses and whose members are affected by the regulation,” to the nonexclusive list of “interested persons” who may obtain a judicial declaration as to the validity of a regulation or order of repeal or the OAL’s disapproval of a regulation or order of repeal, by bringing an action for declaratory relief in the superior court.

The bill also expands the Department of Finance’s authority to prescribe the methods a state agency must use to make the determinations required to be included in a notice of action to include the methods for: (A) estimating the cost or savings to any state agency, the cost to any local agency or school district that is required to be reimbursed, other nondiscretionary cost or savings imposed on local agencies, and the cost or savings in federal funding to the state; (B) making an initial determination as to whether an action may have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states; (C) identifying and describing the cost impacts a representative private person or business would necessarily incur in reasonable compliance with the proposed regulatory action; and (D) preparing the “new” small business economic impact statement.

This bill would become operative on January 1, 2011.

BACKGROUND

Informal Rulemaking Process. The BOE is always looking for ways to improve its current regulations and trying to identify areas that may need more or less regulation. Therefore, the BOE values the public’s opinion of its regulations and the BOE’s Website has a dedicated page that the public can use to [submit informal suggestions](#) for regulatory and other changes, in addition to accepting formal rulemaking petitions authorized under the APA. Furthermore, the BOE posts the name of the BOE’s [Regulations Coordinator](#) on its website, and invites the public to contact the BOE Regulations Coordinator with questions about any of the Board’s existing regulations, pending regulatory actions, or the rulemaking process. The Board also encourages its staff to suggest ways to improve the BOE’s current regulations and to identify areas that may need more or less regulation; and the BOE has established a Business Taxes Committee, a Property Tax Committee, a Customer Service and Administrative Efficiency Committee, and a Legislative Committee to formally identify and address the need for potential regulations or the need to repeal existing regulations and work with interested parties, when necessary.

Once BOE staff identifies a regulatory issue, staff prepares an issue paper for the BOE Members, which describes the regulatory issue and makes recommendations for addressing the issue through the adoption, amendment, or repeal of a regulation, or other alternative actions. Then, staff submits the issue paper to the Board Members for discussion during a public Board meeting or committee meeting.

The BOE Members may respond to the issue paper by agreeing that regulatory action is necessary and authorizing BOE staff to either begin the formal rulemaking process or work with industry representatives, taxpayer groups, public officials, and other interested parties to draft regulatory language to be brought back to the BOE Members at a later date. The BOE Members may also direct staff to begin drafting specific regulatory language or assign work on a potential regulation to a specific BOE committee or the BOE's Legal Department depending upon its nature. Or, the BOE Members may simply disagree with the issue paper's conclusion that regulatory action is needed and direct staff to cease work. However, in most cases, the BOE Members assign a regulatory project to the BOE's Business Taxes Committee or Property Tax Committee and the assigned committee conducts one or more interested parties meeting with the public. When the committee is satisfied that all the issues have been addressed and the draft regulation is ready for BOE Member consideration, the committee recommends that the BOE Members authorize staff to publish the notice of action for a public hearing on the proposed regulatory action. The publication of the notice of action begins the formal rulemaking process set forth in the APA.

Formal Rulemaking Process. Approximately 60 days before the public hearing date, BOE sends to the OAL a copy of the *Notice of Action for the proposed regulatory action*. The notice includes the date, time, and place of the hearing (and all of the other information listed above), and explains how to contact the BOE's Regulations Coordinator to obtain the text of the proposed regulatory action.

At least 45 days before the public hearing, OAL publishes the notice in the *California Regulation Notice Register*, and invites the public to review and comment on the proposed regulatory action (comments may be made in writing before the BOE hearing date or in person at the hearing). At the same time, BOE sends the Notice of Action to interested taxpayers, public officials, industry groups, and other interested parties who have requested notice and invites them to review and comment on the proposed regulatory action. The Notice of Action is also posted on the BOE's Website and made available by e-mail.

Comments received from interested parties are circulated to the BOE Members and BOE staff.

Then, the BOE Members hold the scheduled public hearing in accordance with both the APA and the Bagley-Keene Open Meeting Act. (The BOE always schedules and conducts a public hearing.) At the hearing, responsible BOE staff members respond to oral and written comments, and recommend whether or not the BOE Members should adopt the proposed regulatory action as originally proposed or whether the Board Members should approve potential changes to the original proposed text of the regulatory action to address public comments.

If the BOE Members are satisfied with the text of the proposed regulatory action with or without nonsubstantial or solely grammatical changes, the BOE Members may formally vote to adopt the text with or without the changes, and direct staff to complete the rulemaking file and submit it to OAL for review and approval. If the BOE Members are

not satisfied with the text of the proposed regulatory action, they may direct staff to make further sufficiently related changes to the text, and make the changed text available for public comment for another 15 days. Then, the BOE Members may adopt the text of the proposed regulatory action with the sufficiently related changes after considering any comments received during the additional 15-day comment period and direct staff to complete the rulemaking file and submit it to OAL for review and approval. If the BOE Members are not satisfied with the text of the proposed regulatory action they may also direct staff to terminate the rulemaking project and/or start a new and different project.

Generally, the BOE submits its rulemaking files to the OAL within three weeks of BOE adoption; however, the OAL has 30 business days to review the rulemaking file.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the National Federation of Independent Business and the California Small Business Association. According to the fact sheet from the author's office:

“State regulations continue to be a costly and burdensome obstacle to the growth of small businesses in California. State agencies are required to analyze the economic impact of potential regulations by specifically preparing a small business economic impact statement. Unfortunately the law permits agencies to comply by simply stating there is no impact on small business nor any reasonable alternatives to the proposed regulation without providing any information or explanation.

California agencies are encouraged to consult with interested parties in the regulatory development process, but are not required to speak with small businesses. The results, however, are inadequate or unequal at best. If agencies develop regulations in closer coordination with small business owners and more thoroughly consider the economic impact of regulations, California can mitigate the disparate burden of regulations on small businesses.”

2. **The BOE is currently very pro-active in seeking the input from small business and other interested parties.** BOE staff notes that the fact sheet sets forth state regulations as burdensome obstacles to the growth of small businesses in California. However, the fact sheet does not provide specific examples of regulations that constitute “burdensome obstacles” or explain how any such regulations will be improved or avoided if state agencies work more closely with small business owners than they already do. Further, the BOE does not believe that it has any regulations that are “burdensome obstacles” to the growth of small businesses in California, the BOE already works closely with all interested parties, including small business owners who wish to participate in its rulemaking activities, to ensure that it does not inadvertently adopt burdensome regulations, and the BOE cannot see how the bill will further improve the quality of the BOE's regulations or its responsiveness to the public.

The BOE actively seeks public input regarding its rulemaking activities and invites the public, not just taxpayers or small business owners, to recommend proposed changes to BOE regulations in real-time via the BOE's Website. The BOE also accepts formal rulemaking petitions and works with interested parties (industry representatives, taxpayer groups, public officials, and so forth) during the BOE's informal and formal rulemaking processes to draft effective regulations that address specific regulatory needs and are not broader than necessary. Therefore, the BOE

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does not believe that the author has demonstrated any reason why the APA should be amended to change the way that the BOE consults with interest parties or to require the BOE to justify decisions not to consult with specific interested parties.

3. **This bill will make it more difficult and costly to adopt, amend, or repeal a regulation.** This bill will add to the APAs rulemaking requirements and thereby delay necessary rulemaking, create additional grounds for challenging the validity of state regulations, and force state agencies to incur additional costs. First, the bill will add a new requirement that state agencies consult with specified parties or justify their decisions not to meet with the specified parties; and this will impose additional work and related costs on state agencies in every case where it would not be appropriate or necessary to meet with the specified parties. Second, the bill would likely require state agencies to begin to construct artificial alternatives to proposed regulations, just so that the state agencies can subsequently reject the artificial alternatives; and this will impose additional work and related costs on state agencies. Third, the bill will convert the economic impact provisions in Government Code section 11346.3 into mandatory requirements and add the requirement that state agencies prepare small business economic impact statements to those provisions, and thereby impose additional work and related costs on state agencies and render regulations invalid whenever state agencies do not comply with section 11346.3 in adopting, amending, or repealing a regulation. Fourth, the bill gives the Department of Finance broader authority to prescribe the methods a state agency must use to make the determinations required to be included in a notice of action and, as a result, the Department of Finance may well prescribe methods that impose additional work and related costs on state agencies.

In addition, the bill would require information currently submitted to the OAL to also be submitted to the Office of the Small Business Advocate and Department of Finance. This would create redundant procedures for which there is no apparent purpose and may invariably lead to delays in the adoption of regulations as those other agencies try to evaluate the BOE's activities and decide whether to intercede in such activities on behalf of other parties late in the formal rulemaking process, if their intervention is in fact contemplated by the additional notice provisions.

4. **This bill may increase litigation.** It is not entirely clear that the bill's proposed amendments to Government Code sections 11350 and 11350.3 actually make any substantive changes to the law since both sections already allow "any interested person" to bring an action in superior court for a judicial declaration regarding the validity of a regulation or order or repeal or the OAL's disapproval of a regulation or order of repeal. However, it does appear that the amendments are intended to specifically encourage trade associations that represent small businesses and whose members are affected by regulations to bring such suits and, to the extent it succeeds in encouraging additional litigation, the bill will also cause the state to incur additional litigation costs.

COST ESTIMATE

The BOE would incur additional costs in staff time to address all the additional requirements for specific interactions with small business – including the requirements to prepare a small business economic impact statement prior to submitting a proposal, seek out the specific input of small business owners, and address each of their concerns, offer alternative solutions, and justify why it has not described a specific alternative.

In addition, this bill would allow an organization or trade association that represents small businesses to obtain a judicial declaration protesting the validity of a BOE regulation. This provision would potentially expand the number of “interested persons” who may seek declaratory judgment against the BOE, which would result in the BOE incurring additional costs for litigation.

A detailed estimate of these costs is pending; however, these costs are anticipated to be substantial (over \$250,000 and under \$1 million).

REVENUE ESTIMATE

This bill would have no direct impact on the taxes administered by the BOE.

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