Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 5 Agenda

Senator Loni Hancock, Chair
Senator Joel Anderson
Senator Jim Beall

Wednesday, May 18, 2016
9:30 a.m. or upon call of the Chair
State Capitol - Room 2040

Consultant: Anita Lee and Farra Bracht

PART B

VOTE-ONLY ISSUES

DISCUSSION / VOTE ISSUES

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Issues Proposed for Vote-Only

7100 Employment Development Department

Issue 1: Benefit Overpayment Collection Automation Resource

Spring Finance Letter: The Governor requests a one-time budget augmentation of $1.6 million in FY 2016-17 and a one-time augmentation of $6.1 million in FY 2017-18. This finance letter also requests an ongoing appropriation of $1.1 million, beginning in FY 2018-19, for the support of the new Benefit Overpayment Collection System (BOCS) application. These requests will be used to fund contracts, hardware, software, ongoing support, and 12.3 new temporary PEs to replace the existing application used to collect unemployment insurance and disability insurance overpayments with an integrated and automated system. This item was heard in committee on April 21, 2016, and was held open.

The proposed solution will significantly reduce the risk of failure of the existing system by integrating the BOCS application into the Accounting and Compliance Enterprise System (ACES), which will also allow for a new revenue collection tool in the form of bank levies, which is estimated to bring in almost $23 million in additional funds annually, once fully implemented.

Staff Recommendation: Approve as proposed.

Issue 2: Unemployment and Insurance Program Administration

The Governor's May Revision includes various technical changes:

Item	
7100-002-0001	**Unemployment Insurance Loan Interest Rate Reduction—**Decrease of $13.06 million to reflect reduced interest due to the federal government for borrowing that has occurred to provide unemployment benefits without interruption.
7100-101-0871 and 7100-111-0890	**Unemployment Insurance Benefit Adjustments—**Decrease of $124.42 million to reflect a projected decrease in UI benefit payments due to historical trends and benefit payment projections. Decrease current year UI Benefit Authority in 2016-16 Fiscal Year by $358.176 million due to improvement in the economy.
7100-101-0588	**Disability Insurance Benefit Adjustment—**Decrease of $315.04 million to reflect a projected decrease in benefit payments due to lower anticipated average weekly benefit payments. Additionally, DI benefit authority in 2015-16 is decreased by 131.51 million based on decrease of current year benefit durations.
7100-101-0908	**School Employees Fund Adjustment—**Increase of $11 million to reflect a projected increase of benefit payments and increase of $12.58 million in current year benefit authority.

Staff Recommendation: Adopt as proposed.
Vote:

Issue 3: Workforce Innovation and Opportunity Act (WIOA) Local Assistance Adjustments

Governor's Proposal. The May Revision proposes to decrease Item 7100-101-0869 and 7100-101-0890 by $3.3 million to align budget authority with current federal allotments for local area activities. The benefit authority in 2015-16 is also being increased by $834,000 to align with the federal youth activities funding.

Staff Recommendation: Approve as proposed.

Issue 4: Workforce Innovation and Opportunity Act (WIOA) Data Sharing

Governor's Proposal. The May Revision proposes trailer bill language that allows various departments to share information to support performance measurement and program evaluation under WIOA. Specifically, the language:

- Provides the California Workforce Development Board and other state agencies, such as the Chancellor of the California Community Colleges, the California Superintendent of Public Instruction, California Department of Rehabilitation, the California Department of Social Services, access to any relevant quarterly wage data for performance evaluation purposes under WIOA, along with other groups such as the Adult Education Grant Consortia and the community college Strong Workforce Taskforce.

- Authorizes the Department of Education to share necessary confidential information for performance tracking purposes with the Employment Development Department (EDD).

These changes will address data sharing gaps and legal barriers that could impede reporting requirements detailed under the WIOA. Without access to this information, under WIOA, the failure to report timely or complete performance data could result in a sanction to the Governor's Discretionary fund. While late quarterly reports (which begin later this year) do not appear to specifically be subject to sanctioning, they are necessary to track performance goals.

Staff Recommendation: Adopt placeholder trailer bill language.

Vote:

Issue 5: Unemployment Insurance Program Funding (May Revision Proposal)

Governor's Proposal: The Governor requests a reduction of $4.5 million and 46.9 PE in Unemployment Administration authority for 2016-17 due to updated workload estimates. In addition, this request also includes a proposal to reduce the Benefit Audit Fund by $23.6 million, and replace it with increases of $19.7 million in General Fund and $3.9 million in Contingent Fund (CF) due to in lower than previously anticipated revenue collections for the Treasury Offset Program.

- Item 7100-001-0001 is increased by $19,651,000 and 154.1 positions
- Item 7100-001-0184 is decreased by $23,611,000 and 185.2 positions
- Item 7100-001-0185 is increased by $3,960,000 and 31.1 positions
- Item 7100-001-0870 is decreased by $4,513,000 and 46.9 positions
- Item 7100-011-0890 is decreased by $4,513,000 (non-add item)

In January, EDD proposed to increase funding for UI administration from the BAF and the CF to backfill a loss in federal funds. A portion of available BAF and CF funds were anticipated to come from the Treasury Offset Program (TOP), which allows the state to collect from UI claimants with overpayment liabilities by deducting the overpayments from claimants' federal income tax refunds. Revenues to BAF and CF from TOP were higher than expected in 2015-16. However, revenues from TOP in 2016-17 are now anticipated to be significantly less than estimated in EDD's January proposal. As a result, EDD estimates that $19.7 million of General Fund support is needed to continue meeting service level targets.

Staff Recommendation: Approve as proposed.

Vote:

7320 PUBLIC EMPLOYMENT RELATIONS BOARD (PERB)

Issue 1: Augmentation to Reduce Backlog and Los Angeles Regional Office Relocation

Governor's Budget: The Governor proposes two augmentations for PERB: (1) $885,000 General Fund to fund five new positions—bringing the board's total position authority to 62 positions—and (2) $217,000 General Fund to pay for costs associated with relocating the Glendale office.

The Administration indicates that its proposal for five new positions and $885,000 in 2016-17 ($873,000 ongoing) is intended to address increased workload, reduce backlogs, and contribute towards meeting statutory requirements. The requested funding would support four of the five positions. The fifth position would be funded with existing departmental resources freed up by canceling a contract with the Department of General Services (DGS) to provide administrative services. The new positions would be distributed across PERB's four divisions, with two new supervising attorney positions under the Office of the General Counsel (one based in Oakland and one in Glendale).

The Los Angeles regional office is located in Glendale. This regional office is PERB's busiest regional office and processes more than 50 percent of cases. The board has occupied its current building since March 2009, with an annual rent of $259,000. DGS determined that the existing office space does not fully comply with federal and state laws that establish standards to ensure buildings are accessible to people with disabilities. DGS directed PERB to move to a building that complies with these laws before February 2017, when the "soft term" of the existing lease expires. The Administration's proposal provides $100,000 one-time funding for moving to the new building, and $117,000 on an ongoing basis, to pay for increased rental costs.

Staff Recommendation:

1. Approve $885,000 to fund three of the proposed five positions, specifically one supervising attorney, one conciliator, and one staff services manager, and the balance to address operating expenses, and approve proposed funding for office relocation

2. Adopt the following budget bill language requiring PERB to report to the Joint Legislative Budget Committee, other fiscal committees of the Legislature, and the Legislative Analyst's Office on its workload and resources:

   The amount of time it takes the Public Employment Relations Board (board) to resolve labor disputes brought before it has an effect on labor relations and state and local governments' ability to provide services to the public. Accordingly, it is the intent of the Legislature to provide the board sufficient resources to effectively and efficiently resolve cases in a timely manner. On or before January 10, 2017, and May 14, 2017, the board shall report to the Chairperson of the Joint Legislative Budget Committee, the chairpersons of the other fiscal committees of the Legislature, and the Legislative Analyst's Office on its workload and resources. Specifically, for each of the three divisions of the board that resolve labor disputes—Office of General Counsel, Administrative Law Judges, and State Mediation and Conciliation, the board shall report for each quarter between July 1, 2015 and the reporting deadline (1) the number of open cases, (2) case aging and average processing time, (3) the number of authorized positions in the Division, and (4) the number of filled positions in the division.

Vote:

7350 DEPARTMENT OF INDUSTRIAL RELATIONS

Issue 1: Revenue and Expenditure Alignment for Various Special Funds

Summary: The Governor's budget proposes to align expenditure authority and special fund revenue from various fees and permits to the appropriate program; increase resources for labor law enforcement in the car wash program to help bring its special funds into balance; delete decades-old statutory caps on certain fees to allow for proper cost recovery; and clean up and standardize language for various fees and permits. This proposal includes statutory changes to various sections of the Labor Code for the Division of Occupational Safety & Health (DOSH) and the Division of Labor Standards Enforcement (DLSE).

Approximately $1.6 million in regulatory licenses and permits are deposited into the General Fund each year as a result of the DIR's regulatory activities, even though the General Fund no longer provides any support to the department.

Subcommittee action on April 21, 2016. The subcommittee held the Car Wash Worker Fund component of this issue open, and the balance of the BCP was approved.

May Revise. The Administration proposed the following amendments for the Car Wash Worker Fund to clarify that the registration fee would not be increased unless the fund balance is projected to fall below 25 percent of annual expenditures:

> **2059.** (a) The commissioner shall establish and collect from employers a registration fee ~~of two hundred fifty dollars ($250)~~ for each branch location. The commissioner may periodically adjust the registration fee ~~fee for inflation~~ to ensure that it is sufficient to fund all direct and indirect costs to administer and enforce the provisions of this part.
>
> (b) In addition to the fee specified in subdivision (a), each employer shall be assessed an annual fee equal to twenty percent of the registration fee established pursuant to subdivision (a) ~~of fifty dollars ($50)~~ for each branch location, which shall be deposited in the Car Wash Worker Restitution Fund.
> ***(c) The fee established pursuant to subdivision (a) shall not be increased unless the published fund balance is projected to fall below 25% of annual expenditures.***

Staff Recommendation: Adopt placeholder TBL as proposed.

Vote:

Issue 2: Concrete Delivery and Public Works

Governor's Proposal: The May Revision proposes trailer bill language makes technical changes regrading concrete delivery and public works contracts to provide greater clarity for its implementation. Specifically, the language:

- Clarifies that nothing in the section shall cause an entity to be treated as a contractor or subcontractor for any purpose other than this section.
- Extends the time an entity hauling ready-mixed concrete can submit certified payroll records from three to five days.
- Clarifies that the section does not apply to public works contracts that are advertised for bid or awarded prior to July 1, 2016. .

On April 21, 2016, the subcommittee approved an augmentation of $133,000 and one deputy labor commissioner I in FY 2016-17 and $125,000 ongoing to implement AB 219 (Daly), Chapter 739, Statutes of 2015, which expands the definition of "public works" under the California Prevailing Wage Law to include "the hauling and delivery of ready-mixed concrete to carry out a public works contract, with respect to contracts involving any state agency, including the California State University and the University of California, or any political subdivision of the state."

Staff Recommendation: Approve as proposed.

Vote:

7501 DEPARTMENT OF HUMAN RESOURCES

Issue 1: Civil Service Improvement

Governor's Budget: The subcommittee heard this item at its April 21, 2016 hearing, and held the item open. The Governor's budget requests the following resources over the next three years to implement civil service improvement reforms:

- 16 positions and $1.92 million ($606,000 General Fund, $848,000 Reimbursement, $462,000 Central Service Cost Recovery Fund) in fiscal year 2016-17;

- 17 positions and $1.85 million ($558,000 General Fund, $864,000 Reimbursement, $426,000 Central Service Cost Recovery Fund) in fiscal year 2017-18, and

- $1.84 million ($558,000 General Fund, $855,000 Reimbursement, $426,000 Central Service Cost Recovery Fund) in fiscal year 2018-19 to implement Civil Service Improvement reforms and identify new areas for improvement.

Staff Recommendation: Approve the proposed positions.

Vote:

7920 CALIFORNIA TEACHERS' RETIREMENT SYSTEM (STRS)

Issue 1: Revised Creditable Compensation (May Revision)

Governor's Proposal: The Administration requests an increase of $4.6 million General Fund due to an increase in creditable compensation reported by STRS for fiscal year 2014-15. The defined benefit payment will be increased by $1 million, the pre-1990 defined benefit level payment will be increased by $2.2 million, and the supplemental benefit maintenance account contribution will be increased by $1.3 million. These adjustments represent existing statutory funding requirements.

Staff Comment: Staff has no concerns with this proposal.

Staff Recommendation: Approve as proposed.

Vote:

CONTROL SECTION 3.60

Issue 1: Rate Adjustments (May Revision)

Governor's Proposal: The Administration requests that Control Section 3.60 be amended to capture reductions in state retirement contribution rates adopted by the CalPERS Board on April 18, 2015.

Background and Detail: The reduction is a result of new hires entering the system under lower benefit formulas pursuant to the Public Employees' Pension Reform Act of 2013, stronger than expected investment performance, higher mortality rates, and greater than expected contributions to the system.

The newly adopted state employer contribution rates result in total state costs of $452.8 million and a decrease of $89.8 million from the $542.6 million included in the Governor's 2016-17 budget. Of the $89.8 million, the General Fund amount is $42.9 million, special funds are $32.8 million and other nongovernmental cost funds are $14.1 million. Additionally, it is requested that CalPERS' fourth quarter deferral be reduced by $7.0 million General Fund from the Governor's budget to reflect the changes in retirement rates. The net effect of these changes is a decrease of $35.9 million General Fund in 2016-17 as compared to the Governor's budget.

Staff Comment and Recommendation: Staff has no concerns. Approve as proposed.

Vote:

Issues Proposed for Discussion/Vote

7100 Employment Development Department (EDD)

Issue 1: Paid Family Leave and State Disability Insurance Rate Increase (May Revision Proposal)

Governor's Proposal: The May Revision proposes a one-time augmentation of $5,028,000 from the Unemployment Commensation Disability Insurance Fund in Fiscal Year (FY) 2016-17, along with a one-time augmentation of $629,000 in FY 2017-18, to support the costs incurred as a result of AB 908 (Gomez), Chapter 5, Statutes of 2016. These resources will be used to fund vendor contracts and 16.4 Pes to performmodifications to the State Disability Insurance (SDI) program applications and processes as required to comply with AB 908.

AB 908 modifies the SDI program by increasing the wage replacement rate to 60 percent for middle and high-income workers, and to 70 percent for low-income workers. In order to comply with AB 908, extensive programming of the Employment Development Department's automated systems is required along with updates to SDI forms, publications, procedures, and training.

Background. The EDD will need to make programming changes to two major IT systems - the Single Client Database (SCDB) and the SDI Online system. The SCDB is EDD's main database and contains the wage and benefit data for the Unemployment Insurance and SDI programs. The SDI Online system allows customers to file SDI claims online. These systems would need to be programmed to capture the state average weekly wage for benefit calculation, and provide editing capabilities to accommodate future increases to the average weekly wage. EDD IT staff will be utilized to make changes to the SCDB, while vendor staff will be leveraged to make changes to the SDI Online system.

For FY 2016-17, EDD requires 11.1 PEs of state IT staff and one program position for the following activities in addition to the vendor:

- Project management including scheduling, identifying and managing project risk.
- Requirements elicitation and refinement.
- Developing test scripts, test plans for system, interface, user, penetration, end to end and stress testing (these are done by non-prime vendor staff to ensure the solution truly meets the department's needs).
- Analysis, design, coding, and testing of mainframe (SCDB) changes to both the SDI and PFL calculations.
- Setting up performance environments, databases, and providing support during project phases.
- Updating of SDI/PFL forms and publications, updating of information on the EDD website, and updating manuals and procedures for staff along with providing staff training on the new program changes.

Additionally, a significant portion ($3.3 million) of the estimated one-time IT costs would be for a vendor to make changes to the SDI Online system, and for testing of those changes by vendor staff (along with EDD staff). Changes would also be required to the PFL application and the claims scanning/data capture system that EDD uses.

For SFY 2017-18, EDD requires 4.3 PEs of state IT staff for continued testing of the changes to the SCDB and SDI Online applications and to ensure that they will be able to revert to the previous calculation methodologies (effective January 1, 2022, pursuant to the provisions of AB 908). The required legislative reports will also be developed during this time period.

The EDD project management framework will ensure accountability for the requested funds. All vendor contracts related to this project will be deliverables-based to ensure delivery of appropriate hardware, software, documentation, etc., prior to payment. The vendor contracts will include language that states EDD shall be the sole judge of the acceptance of all work performed and all work products produced by the contractor to ensure quality standard are met.

The EDD uses the Cost and Resources Management Group within the Information Technology Branch to account for all dollars spent on staffing, hardware, software, and vendor contracts. EDD management will review staffing reports to ensure all project team members are fully engaged on the project.

The table below provides a schedule of milestones and targeted completion dates for this project:

Major Milestones	**Estimated completion dates**
Project Initiation	May 31, 2016
Requirements Phase	June 30, 2016
Design Phase	September 30, 2016
Development Phase	June 30, 2017
Testing Phase	September 30, 2017
Implementation	October 24, 2017
Project Closeout	February 1, 2018

Staff Recommendation: Approve as proposed.

Vote:

Issue 2: Workforce Innovation Opportunity Act (WIOA) Discretionary Workforce Funds

The Governor's Proposal: The May Revision proposes to use an increase of $22 million discretionary workforce funds for a mix of purposes, including $10 million and 58 positions for staff resources and training, $8.6 million for grant expansion, and $1.6 million for technological upgrades.

Background. Federal law provides that a certain portion of federal Workforce Innovation and Opportunity Act (WIOA) funding, up to 15 percent, may be held by the state for "statewide workforce investment activities," while the remainder of WIOA funds are passed on to Local Workforce development boards to provide services to unemployed or underemployed adults and youth. The statewide funds are sometimes referred to as "discretionary funds." The actual amount of discretionary funds that may be reserved at the state level, subject to the 15 percent cap, depends on congressional appropriations. In 2015-16, the state was able to reserve 10 percent of WIOA funds as discretionary funds. In 2016-17, the state may reserve 15 percent of WIOA funds as discretionary workforce funds. This results in an increase in total discretionary funds in 2016-17 of $23.1 million from the prior year.

The Administration has proposed a mix of new programs and augmentations to previously existing programs, as shown in the table below. As in recent years, the administration's proposal prioritizes the use of discretionary funds to develop the capacity of the state's local workforce development system in areas that are emphasized by the federal WIOA legislation, including regional coordination and planning, program alignment, data sharing, and sector strategies. A portion of the discretionary funds are also provided to support programs that directly provide services to certain target populations. For example, the May Revision proposal includes additional funding for the Governor's Award for Veteran's Services and the Regional Workforce Accelerator program, focusing on ex-offender and immigrant populations, which are described in more detail below.

Proposed Allocation of Increased WIOA Discretionary Funds in 2016-17 (Dollars in millions)	
Funding for New Programs/Activities	
Technical assistance and training for state and local staff to implement State Strategic Workforce Plan.	$5.0
Funding to place unemployment insurance staff in AJCC's: 48 positions for Employment Development Department to fund at least one UI trained individual in a designated comprehensive America's Job Centers of California to train existing workforce service staff and provide UI assistance.	3.5
Awards for development of model multiple-employer industry sector programs: This is a competitive Industry Sector grant for local workforce areas of coalitions to develop multi-employer workforce initiatives to develop career pathways for sectors with projected job growth.	2.0
Awards for "high performing boards," pursuant to SB 985 (Lieu), Chapter 497, Statutes of 2011: This will provide grant awards to 33 local workforce investment boards that have received High-Performing Board status to engage businesses and workforce partners.	1.7

Improvements to the CalJOBS system: This will develop a mobile job search application, enhance document management and scanning capabilities, automate tracking of services using scan card technology, and develop a customer relationship management system.	1.6
WIOA program evaluation: This will provides research and evaluation of program practices from all discretionary and other CWDB and EDD investments.	1.5
Increased staff capacity for regional planning: This will support regional staff capacity to provide assistance and consulting grantee communities, Slingshot work, and the development of WIOA regional plans.	1.2
Performance and Participant Data Alignment: This will fund the development and implementation of state-level and local data sharing to improve services for job seekers as required under WIOA.	1.0
Support for Local Workforce Area consolidation planning: This will support and assist multiple local workforce areas to within a planning region to facilitate the re-designation into a single workforce area.	0.6
Labor market information support for local boards [a]	0.5
Subtotal	($18.6)
Augmentations to Existing Programs/Activities	
Governor's Award for Veteran's Grants: This will fund competitive grants with a focus on transitioning veterans into high-wage, high-demand occupations.	$2.3
Regional Workforce Accelerator Program (focusing on formerly incarcerated and immigrant populations): This program grants award to local programs to develop strategies and services to remove barriers and create improvements in training and job placement.	2.0
Disability Employment Initiative: This will expand funding for the Disability Employment Accelerator to support people with disabilities gain the necessary skills for employment.	0.6
Local program oversight and technical assistance. [a]	0.5
CWDB administration, policy development, and program partner coordination: This will provide nine positions for the California Workforce Development Board to handle the increased workload and responsibilities associated with WIOA implementation.	0.5
Financial management and information technology. [a]	0.3
EDD administration. [a]	0.1
Subtotal	($6.3)
Total	**$24.9**[b]

a. The May Revision proposal includes a request for 10 additional positions associated with the combined increased funding for these items.
b. Reflects a $23.1 million year-over-year increase discretionary funds plus $2.8 million in funds freed up by year-over-year reductions in funding for certain items, partially offset by a $1 million year-over-year reduction in WIOA discretionary funds available to be carried in from the prior year.

AJCC = America's Job Center of California (formerly known as OneStops), WIOA = Workforce Innovation and Opportunity Act, CWDB = California Workforce Development Board, and EDD = Employment Development Department.

Legislative Analyst's Office. The May Revision proposal is consistent with federal law and with the recently completed State Strategic Workforce Plan, and the LAO has raised no issues. However, the LAO would also note that discretionary funds may be used to support a variety of programs and activities and that the Legislature may have priorities that differ from those in the May Revision.

Staff Recommendation: Approve as proposed.

Vote:

7350 Department of Industrial Relations (DIR)

Issue 1: Private Attorney General Act (PAGA)

Governor's Proposal: The Governor proposes trailer bill language to amend the Private Attorney General Act. Specifically, the proposal:

1. Requires new case notices and any employer response to such a notice to be accompanied by a $75 filing fee. Provides for waiver of fees for parties entitled to "in forma pauperis" status, using same standards applicable to court filing fees. The new notice filing fees will be recoverable costs in a PAGA action.
2. Requires plaintiff to provide Labor Workforce Development Agency (LWDA) with a file-stamped copy of the court complaint within 10 days following commencement of a civil action. This requirement is limited to cases filed on or after July 1, 2016.
3. Changes current superior court review and approval of PAGA penalties sought in proposed settlement to court review and approval of all settlements in PAGA actions.
4. Requires copy of proposed settlement to be submitted to LWDA at same that it is submitted to the court.
5. Requires parties to provide LWDA with a copy of the court's judgment and any other order that denies or awards PAGA penalties within 10 days after entry.
6. Requires online filing/transmission of all items that must be submitted to LWDA.
7. Extends various time lines, including:
    a. The time LWDA review new cases from 30 to 60 days.
    b. The time after which a plaintiff may file suit if not notified of LWDA's decision to accept a case for investigation from 33 to 65 days.
    c. The time for LWDA to notify parties of intent to investigate violation from 33 to 65 days.
    a. Provides LWDA with option to send notice to extend the 120 day time limit for investigating and citing the employer by an additional 60 days. (This provision will sunset in 2021, pursuant Section 4 of the bill.)

Background. When an employer does not pay wages as required by law (such as overtime), statute allows employees to recover these wages, either through an administrative proceeding with the state's Labor and Workforce Development Agency (LWDA) or through private legal action in superior court. In addition to wages that may be recovered, statute also specifies civil penalties may be imposed on employers who violate Labor Code provisions. These civil penalties are intended to act as a deterrent against violations. The LWDA and the related state agencies that it oversees, including DIR, the Division of Labor Standards Enforcement (DLSE) and Division of Occupational Safety and Health (DOSH) within DIR, are responsible for enforcing the Labor Code and are authorized to impose civil penalties.

Employees may seek to recover wages improperly withheld through private legal action against the employer, and for those who do so, the PAGA—enacted by SB 796 (Dunn) Chapter 906, Statutes of 2003 and SB 1809 (Dunn), Chapter 221, Statutes of 2004—grants employees the right to additionally seek civil penalties from employers. Prior to PAGA, penalties could only be pursued by LWDA and related state agencies. The general intent of PAGA is to allow employees to pursue civil penalties through the legal system when LWDA and related state agencies do not have the resources to do so. While civil penalties collected by LWDA are generally deposited in the state General Fund, any penalties collected under PAGA are split between the employee, who receives 25 percent, and LWDA, which receives the remaining 75 percent. The LWDA's portion of PAGA penalties is deposited into the Labor and Workforce Development Fund (LWDF), which is used for enforcement of labor laws and to educate employers and employees about their rights and responsibilities under the Labor Code.

PAGA Process. An individual who wishes to pursue civil penalties against an employer must provide a written notice to both the employer and LWDA of the alleged violations and his or her intent to pursue civil penalties under PAGA. This notice is the first step in a PAGA claim. This notification requirement is intended to allow LWDA to step in and investigate claims that it views as preferable to handle administratively rather than through the PAGA process, such as when the claim overlaps with other matters already under investigation by LWDA. LWDA notes that since 2014, only one position performs a high-level review of PAGA notices and determines which claims to investigate. As a result, less than half of PAGA notices were reviewed, and less than one percent of PAGA notices have been reviewed or investigated since PAGA was implemented.

In most cases, LWDA has 30 days to determine whether to investigate and, if it does investigate, 120 additional days to complete the investigation and determine whether to issue a citation. If LWDA does not investigate, or does investigate but does not issue a citation, or when an investigation is not completed, or not completed on time, the PAGA claim is automatically authorized to proceed. For certain violations that are considered less serious (for example, failing to correctly display the legal name and address of the employer on an itemized wage statement), employers are provided 33 days to prevent a PAGA claim from proceeding by correcting the alleged violations. When a PAGA notice is investigated, LWDA reports that it has difficulty completing the investigation within the timeframes outlined in PAGA.

Once the PAGA claim proceeds, LWDA typically receives no further information beyond payment of the portion of any civil penalties that is due to the LWDF. Civil penalties can be assessed through the PAGA process in two ways. When the court finds that the allegations in the PAGA claim have merit, they have the authority to impose civil penalties. Alternatively, the parties to the claim may settle out of court and include civil penalties as part of such a settlement. However, not all settlements include civil penalties. When cases that involve a PAGA claim settle out of court and civil penalties are included as part of the settlement, PAGA requires court review and approval of the settlement.

Staff Comment: The subcommittee rejected the Governor's January trailer bill proposal regarding PAGA without prejudice, as much of the proposal warranted a larger policy discussion, and directed the Administration to return with a compromise proposal. This new trailer bill proposal removes several items that raised significant policy questions, including the ability to allow DIR to comment and object to proposed settlement in PAGA cases, requiring PAGA notices involving multiple employees to be verified, and allowing DIR to create an ad hoc employer amnesty program.

Staff Recommendation: Approve placeholder TBL.

Vote:

7900 California Public Employees' Retirement System (CalPERS)

Issue 1: CalPERS Board-Approved Budget

Governor's Proposal: The Governor proposes various budget bill amendments to incorporate the CalPERS board-approved budget into the budget act. These changes are as follows and are display items for informational purposes to reflect a change in CalPERS' continuous appropriation authority.

- Item 7900-003-0830 is decreased by $26.4 million.
- Item 7900-015-0815 is increased by $515,000.
- Item 7900-015-0820 is increased by $117,000.
- Item 7900-015-0830 is increased by $510,000.
- Item 7900-015-0833 is increased by $1.5 million.
- Item 7900-015-0849 is increased by $7,000.
- Item 7900-015-0884 is increased by $615,000.
- An increase of 39 positions.

The budget adopted by the CalPERS board reflects a total budget of $1.788 billion, which represents a decrease of $16.3 million percent from the 2015-16 budget of $1.807 billion. These changes reflect the 2016-17 budget approved during the April 18, 2016 CalPERS board meeting. The budget's reduction is primarily driven by higher than anticipated position vacancies and lower than anticipated outside counsel and third party investment management fees.

It is also requested that Item 7900-001-0822 be added in the amount of $40.5 million to replace Item 7900-015-0822 which is being eliminated. This includes an increase of $6.9 million to reflect the budget approved by the CalPERS board.

Staff Recommendation: Approve the Governor's incorporation of the board-approved CalPERS budget into the state budget.

Vote:

Issue 2: CalPERS Health Benefit Administration

Governor's Proposal: The Governor's budget proposes changes in budget bill language and trailer bill language that effect the administration of the CalPERS health benefit.

Budget Bill Changes. The budget bill changes are summarized below:

- ***Contingency Reserve Fund (CRF) Appropriation.*** Authorizes the Department of Finance (DOF) to reduce the current year appropriation to reflect reductions in the CRF surcharge (Control Section 4.20) as a result of premium changes.

- ***Remove Medicare Report Requirement Language.*** CalPERS has met what was envisioned as a one-time reporting requirement.

- ***Zero-Based Budgeting.*** Directs CalPERS to work with DOF on a zero-based budgeting exercise for health care administration expenses, to prepare for the 2017-18 budget.

- ***Removes 100-Day Report.*** Deletes the 100-day reporting requirement.

- ***Risk Adjustment.*** Requires CalPERS to submit a one-time report on or before October 2016 covering the administration of its health care premium risk adjustment procedures for the premium years of 2014 through 2017.

- ***Clarify Authority for Current Year Executive Order.*** Adds revised dental rates to DOF authority to adjust for actual rates that have been negotiated.

Trailer Bill Language. The Administration has proposed trailer bill language that does the following.

- ***Legislative Oversight of the Contingency Reserve Fund (CRF).*** Clarifies existing statute that health care administrative expenses in the CRF must be approved by the Legislature.

- ***Legislative Oversight of the Public Employees Health Care Fund (HCF).*** Establishes that health care administrative expenses in the HCF must be approved by the Legislature.

- ***Risk Adjustment.*** Requires CalPERS to disclose both adjusted and unadjusted risk single party premiums for each health plan.

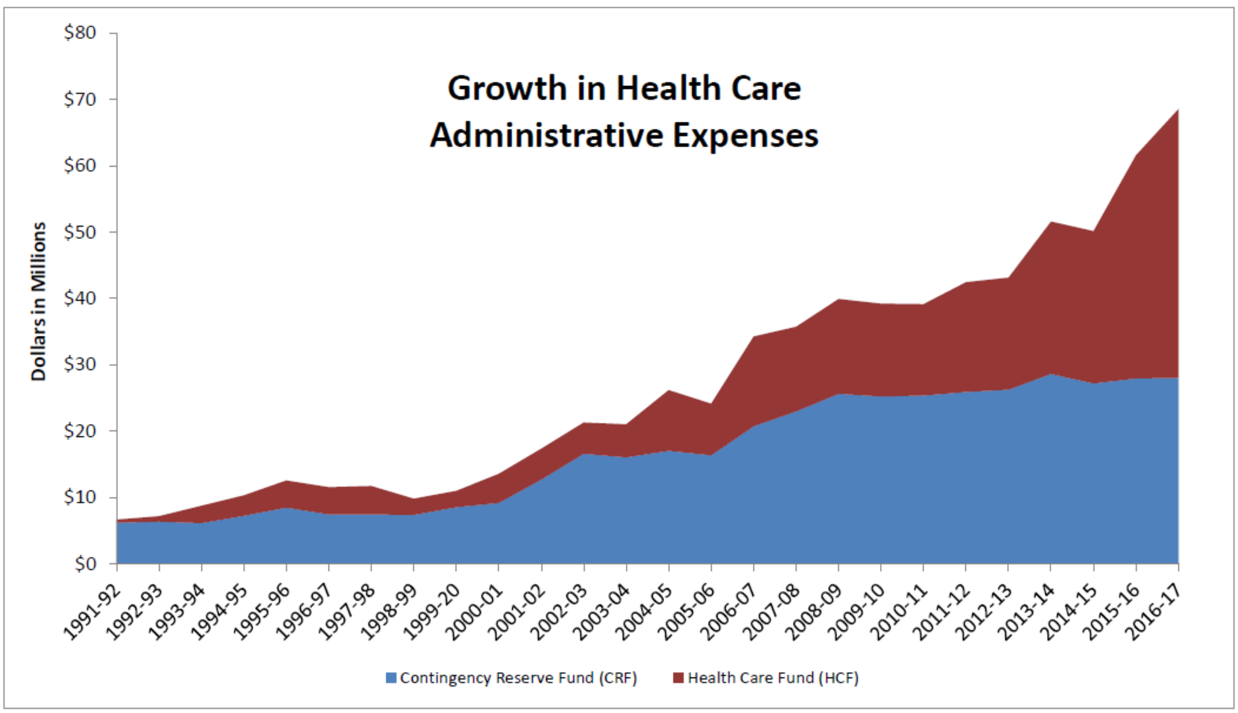
- ***Administrative Expenses.*** Establishes that the state CRF surcharge is to be used for administrative expenses incurred on behalf of state employees and retirees.

- ***Administrative Expenses.*** Authorizes CalPERS to customize the CRF surcharge for contracting agencies (local agencies) based on service levels provided.

Background: CalPERS uses two funds to pay for its health care program administrative expenses. The first is the Contingency Reserve Fund (CRF). The CRF was established in 1962 to fund program-wide administrative activities for the CalPERS health care program. An employer-paid surcharge is levied on all health plays to pay for state personnel and operating expenses, and maintain a reserve. All funding changes to the CRF require approval through the annual legislative budget process.

The second fund is the Health Care Fund (HCF). The HCF was established in 1988 to fund the self-funded health benefit plans administered by CalPERS (PERSChoice, PERSCare, PERSSelect) that rely upon cash flows from premiums and investment income to fund health benefit payments. In addition, certain administrative costs can be run through this fund. These costs are not subject to the annual budget process.

As shown in the figure below, costs in the CRF have remained relatively flat in the last five years, while costs in the HCF have increased significantly. As a result, the Department of Finance has become concerned about the costs for this fund not being subject to the annual budget process and is recommending that the HCF go through the same budgetary processes as the CRF.



Risk Adjustment. Risk adjustment is used for a variety of purposes in the health care industry. One of the principal uses of risk adjustment is to set payments for health plans to reflect expected treatment costs of their members. Because of differences in health status and treatment needs, the cost of health care will vary from person to person. Without risk adjustment, plans have an incentive to enroll healthier patients and avoid sick patients, especially in cases where plans cannot use health status to set premiums. With risk-adjustment plans, receive a higher payment for members with multiple chronic illnesses than for members with no or limited health problems. If risk adjustment is done well, it should reduce the incentives for plans to avoid patients they expect to be costly. Risk adjustment was adopted as one of the major health reforms envisioned under the federal Affordable Care Act (ACA) to ensure that a health care plan will not benefit from enrolling a disproportionate share of healthy patients.

AB 2141 (Furutani), Chapter 445, Statutes of 2012, authorizes CalPERS to implement risk adjustment procedures that adjust and redistribute premium payments across its health plans based on rules and regulations established by the CalPERS Board of Administration. The bill also establishes that any risk adjustment program or procedure would be at the sole discretion of the board. The bill analysis states that this proposed risk-adjustment model could potentially save money to the extent that it encourages members to select the most cost-efficient health plans. Any savings will depend on several factors including: the adjustment methodology; the speed at which member behavior changes as a result; and the contribution formulas for the various participating employers and their employees/retirees.

Staff Comment: DOF has raised legitimate concerns that both of the funds (CRF and HCF) that are used to pay for the administration of CalPERS health benefit programs should be subject to the same level of oversight and that the Legislature should approve both funds through the annual budget process.

In addition, CalPERS was given the authority and directed to use risk adjustment for its health benefit plans. This approach is commonly accepted and used in the health care industry. At this time, DOF has not provided adequate justification for CalPERS to need to report on its risk adjustment procedures. If there are concerns about the efficacy of CalPERS' risk adjustment procedures, it may be more appropriate for this issue to be considered by the health policy committee, not the budget committee. Similarly, the policy issues associated with the administrative expenses for local governments seem more appropriate for consideration by the policy committees, not the budget committee.

Staff Recommendation: Approve as proposed all of the changes to the proposed budget bill language except for the requirement that CalPERS complete a report on its risk adjustment procedures. Adopt placeholder trailer bill language to approve the two changes in the proposed budget trailer bill language that ensure that both the CRF and HCF are approved by the Legislature and reject the remaining proposed changes related to risk adjustment and administrative expenses. Direct the Administration to pursue consideration of all items related to CalPERS' authority to use risk adjustment procedures and the policy issues associated with the administrative expenses for local governments to the policy committees for further discussion.

Vote:

9800 Augmentation for Employee Compensation and Control Section 3.61

Issue 1: Scheduled Employee Compensation Augmentation Increases (May Revision proposal)

Governor's Budget Proposal: Budget Item 9800 allows for adjustments in departmental budgets to account for changes in employee compensation, including salaries, health and retirement benefits. This proposal would increase Item 9800-001-0001 by $314,073,000, would increase Item 9800-001-0494 by $32,345,000, and would increase Item 9800-001-0988 by $15,931,000 to reflect changes discussed below.

Control Section 3.61 is used to prefund retiree health benefits through departmental budgets. The May Revision requests CS 3.61 be amended to reflect additional employer contributions for prefunding other postemployment benefits based on a recent agreement that has been collectively bargained with Bargaining Unit 6 (Correctional Officers.)

Background: Item 9800 includes all augmentations in employee compensation. These reflect increased enrollment in health and dental plans; updated employment information for salary increases previously provided in the Governor's budget; revised pay increases for judges; updated costs related to the salary survey estimates for the California Highway Patrol (Bargaining Unit 5); salary increases and benefit changes for state employees of the Judicial Branch and Commission on Judicial Performance, including justices and trial court judges; increase to salaries and revised benefits recently negotiate with correctional officers (Bargaining Unit 6) and scientists (Bargaining Unit 10); pay increases related to minimum wage changes (SB 3 (Leno), Chapter 4, Statutes of 2016); and retention incentives for the Department of Developmental Services facilities in Fairview, Sonoma, and Porterville.

While these figures include estimated health and dental premium rates, the final rates are not expected to be adopted by the CalPERS board until June 2016. If the actual rates differ from the estimated rates, a technical correction to the budgeted amounts will be made.

Regarding the change to CS 3.61 in fiscal year 2016-17, the state will match correction officer employees' contributions of 1.3 percent, effective July 1, 2016. Additionally the Judicial Council has agreed to adopt the Administration's retiree health prefunding strategies. Therefore, state employees of the Judicial Branch will also begin making contributions towards prefunding other postemployment benefits. In 2016-17, the state will match Judicial Branch state employees' contributions of 1.5 percent effective July 1, 2016.

Staff Comment: Staff has no concerns with these proposals.

Staff Recommendation: Approve as proposed.

Vote:

9804 Augmentation for Contracts Impacted by Minimum Wage

Issue 1: Control Section 3.63 (May Revision Proposal)

Governor's Budget Proposal: The Governor's requests adding Control Section 3.63 to grant the Director of Finance the authority to fund expenditures for personal service contracts, or other personnel costs outside of standard civil service compensation, that are in accordance with Senate Bill 3 (Leno), Chapter 4, Statutes of 2016. This proposal would add Item 9804-001-0001 with the amount of $2 million, and Item 9804-001-0494 with the amount of $500,000, for additional costs related to personal service contracts impacted by the minimum wage.

Background: As part of regular operations, the state may enter into personal service contracts with local governments and other business entities to perform services for California. Some personal service contracts are directly impacted by minimum wage, notably California Department of Forestry and Fire Protection (CAL FIRE), which contracts with cities and counties to protect remote areas of the state. As the minimum wage rises for locally contracted fire fighters, there is an increased pressure on the state to augment contracts with these entities. This control section provides the Administration authority to augment departmental budgets that are directly impacted by minimum wage-related personal service contracts. Absent this control section, each individual department impacted by minimum wage personal service contracts would be required to submit annual budget change proposals. The legislature maintains the authority to augment this item (9804) annually, providing the Administration flexibility to allocate these funds without the need for individual budget change proposals. This proposal provides both the Administration and Legislature the flexibility to fund the impacts of the minimum wage legislation.

Six departments will be impacted by the new control section, CAL FIRE, California Conservation Corps, California Science Center, California Department of Transportation, Board of Equalization, and the Department of Industrial Relations.

Staff Recommendation: Approve as proposed.

Vote: