

Date of Hearing: April 12, 2011

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE
ECONOMY

V. Manuel Pérez, Chair

AB 541 (Morrell) – As Introduced: February 16, 2011

SUBJECT: California Small Business Board recommendations on regulatory reforms

SUMMARY: Directs the California Small Business Board (Board) to focus for the next two years on, among other items, the impact of licensing and permitting regulations on small business startups. The Board is required to report its findings and recommendations to the Governor, the Small Business Advocate, and the Legislature in July 2012, July 2013 and December 2013.

EXISTING LAW:

- 1) Finds and declares that it is in the public interest to aid, counsel, assist, and protect the interests of small business concerns in order to maintain a healthy state economy.
- 2) Finds and declares that there has been an unprecedented growth in the number of administrative regulations, in recent years and that correcting the problems requires the direct involvement of the Legislature, as well as that of the executive branch of state government. Further, statute finds and declares that the complexity and lack of clarity in many regulations put small businesses, which do not have the resources to hire experts to assist them, at a distinct disadvantage.
- 3) Establishes basic minimum procedural requirements for the adoption, amendment, or repeal of administrative regulations, including assessing the potential adverse impact of an action on California businesses and individuals with the purpose of avoiding the imposition of unreasonable and unnecessary regulations, reporting, recordkeeping, or compliance requirements. Among other requirements, a rulemaking agency is required to:
 - a) Base decisions on adequate information;
 - b) Consider its impact on an industry's ability to compete with businesses in other states; and
 - c) Assess its potential impact on the creation or elimination of California jobs, as well as its potential impact on the creation, expansion and/or elimination of California businesses.

Further, no regulation adopted after January 1, 1993 that requires a report can be applied to a business unless the state agency makes a finding that it is necessary for the health, safety or welfare of the people of the state.

- 4) Establishes the Office of Administrative Law (OAL) as the entity with purview of the state's regulatory process, however, OAL is not authorized to substitute its opinion relative to specific content over that of the state adopting agency. In submitting a regulation for OAL's procedural review, the rule making agency is required to provide, among other things, a description of reasonable alternatives to the regulation that would lessen any adverse impact on small business and the reason for rejecting those alternatives.

- 5) Establishes the Office of the Small Business Advocate (OSBA), within the Governor's Office of Planning and Research, for the purpose of advocating for small businesses including responding to complaints from small businesses concerning the actions of state agencies and the operative effects of state laws and regulations.
- 6) Requires the OSBA to report to the Legislature, every two years, on the efforts of the state in assisting minority and other small business enterprises, and make recommendations on how to strengthen minority and other small business enterprises.
- 7) Establishes the Board, which is comprised of the Secretary of the Business, Transportation and Housing Agency (BTH), six Governor appointees and two Members of the Legislature. The purpose of the Board, among other responsibilities, is to hold public hearings that facilitate the role of BTH as an advocate and ombudsman for the small business community. The Board is also responsible for advising the Governor and the OSBA regarding issues affecting the small business community.

FISCAL EFFECT: Unknown

COMMENTS:

- 1) Purpose: According to the author, over the past 20 years, regulations have been created in California, often in a vacuum, without a proper perspective on how they impact and affect the business environment. This sometimes haphazard nature of regulation has led to unintended consequences and California being regularly rated as one of the worst states to create and do business. Last year, according to the California Association of Independent Businesses (CAIB), "California's small businesses, which average 5.8 employees, comprise 98% of all businesses in the state, provide 82% of the private sector jobs, and 75% of the gross state product.

With small business being such a driving factor in our economy, we must identify what is standing in the way of small businesses if we hope to turn our economy around. AB 541 is crucial in identifying the rules and regulations that are preventing small businesses from opening their doors and keeping their doors open. This bill will help identify what hurdles small businesses face. In identifying the problems, we will be able to take action to keep businesses in California.

- 2) Small business studies: Due to their importance in the state economy, small business issues have been a particular focus of the Assembly Committee on Jobs, Economic Development and the Economy (JEDE) for the past two legislative sessions. In March 2009, JEDE produced a state economic recovery strategy that included several key recommendations on the challenges facing small business, including how the state can help small businesses access short-term capital, the importance of regulatory reforms, and workforce development programs that can more directly link to the needs of businesses.

Later in the year, JEDE held a number of hearings specifically to receive testimony from small businesses and manufacturers about their economic recovery needs. During these hearings small business prioritized two areas: increasing access to capital and reducing the

costs associated with doing business in California, including costs related to business permits, licenses and other areas of regulatory compliance.

There are two major sources of data on the cost of regulatory compliance on businesses, the federal Small Business Administration and the state OSBA. For the last 10 years, the federal Small Business Administration has conducted a peer reviewed study that analyzes the cost of federal government regulations on different sizes of businesses. This research shows that small businesses continue to bear a disproportionate share of the federal regulatory burden. On a per employee basis for firms with less than 20 employees, it costs about \$10,585, or 36%, more for small firms to comply with federal regulations than their larger counterparts.

In the federal peer reviewed study, the most costly regulations for small businesses were found to be environmental compliance where small business costs were 364% higher than in large-size firms. The regulatory category with the least disproportionate cost impact between large and small businesses related to occupational safety and health and homeland security.

The impact of California regulations on small businesses was unknown until 2009, when the study required by AB 2330 (Arambula), Chapter 232, Statutes of 2006, was published by the OSBA. Although state agencies have been required to consider the costs of adopted regulations on the California economy, in general, and on small business specifically, state agencies have historically failed to meaningfully undertake such an analysis, and instead, have indicated that the need for the regulation was an overriding state concern. This first state study found that total cost of regulations to the State of California was \$493 billion. Since small businesses constitute 99.2 % of all employer businesses in California and all of non-employer business, the regulatory cost, according to the report, is shouldered substantially by small business (averaging \$134,123.00 per small business in 2007).

AB 2330 also required that state agencies examine the cumulative impact of regulations. Due, in part, to the difficult economic times, state agencies have done a poor job in meeting this new requirement when developing and amending regulations.

- 3) Adoption of regulations in California: Existing law sets forth an extensive process for the development and adoption of regulations, including requiring the identification of potential adverse impacts of regulations on California businesses and individuals. Statute states that the purpose of the rulemaking process is to avoid the imposition of unreasonable and unnecessary regulations, reporting, recordkeeping, or compliance requirements. Businesses, however, have repeatedly testified before this policy committee that they believe that California's regulatory process is expensive, overly burdensome, and that compliance has not necessarily provided a better quality of life for people in the state.

One of the criticisms of the process has been that OAL has no real authority to ensure that the intent of the law is enforced because its oversight is limited to a procedural review. Other criticisms have included that the regulations are developed without adequate regard to their cumulative impact or challenges faced by small versus large companies.

This means that while the rulemaking entity is required to consider the impact of a regulation on businesses and consider alternatives, the OAL may only check to be sure that an assessment has been done. Rulemaking agencies may even decline to consider alternatives and may limit their assessment of a regulation's impact to only information supplied by

interested parties. AB 541 would call on an existing small business board to review the existing regulatory framework and make recommendations on how to reduce the impact of licensing and permitting regulations on small business startups.

- 4) Starting a Business: Entrepreneurs who want to start a business in California are required to obtain one or more licenses and/or permits issued by different federal, state, and local government agencies. Due to the complexity of the state license and permitting rules, entities such as the Permit Assistance Unit within the Governor's Office of Economic Development and the regional network of Small Business Development Centers are available to help small business identify and understand how to apply for required licenses and permits. Even with this assistance, small businesses often find the process confusing, expensive and time consuming. The list below provides a number of examples of permits and licenses that may be required by businesses getting started in California.
- Federal employer identification number from the IRS and a state employer account number from the Employment Development Department.
 - A seller's permit and other arrangements for collecting and transferring state sales and use taxes with the State Board of Equalization.
 - Business operation license from the city or county where the business locates.
 - Special state business licenses and permits relating to the sale and/or distribution of such products such as liquor, lottery tickets, gasoline and firearms.
 - Fictitious business name permit also called "dba" or "doing business as" permit.
 - Various state and local land use permits including permits for conditional use of land, still photography on public lands, filming on public land, construction and rehabilitation, air and water quality permits.
 - Commercial driver's license and other various Department of Motor Vehicle Occupational licenses including those for a dealer, dismantler, distributor, driving school, manufacturer, registration service, and traffic school.
 - State licenses for consumer services and product safety from the State Fire Marshal including building materials, portable fire extinguishers, and flame retardant and automatic extinguishing systems.
 - Special state-issued occupational/professional licenses, for business that employ people who will be offering a number of state-regulated services, including medical care, auto repair, real estate sales, tax or insurance services, cosmetology, and legal representation (attorneys).

- 5) Federal model for regulatory reforms: In 1976, the federal government established the Office of Advocacy (FAO) within the federal Small Business Administration. The purpose of the FAO is to "protect, strengthen and effectively represent the nation's small businesses within the federal government's legislative and rule-making processes."

Among its duties, the FAO reviews federal regulations and makes recommendations on how to reduce the burden on small firms and maximize the benefits small businesses can receive from the federal government. In 2010, the FAO issued 46 letters (up from 39 in 2009) to federal agencies, each posted on the FAO website and accompanied by a fact sheet summarizing key points in the FAO letter. The letters covered a range of rulemaking including, but not limited to:

- The Truth in Lending Proposed Rule, the U.S. Treasury;
- National emission standards for hazardous air pollutants for major and area sources: industrial, commercial and institutional boilers, Environmental Protection Agency; and
- Proposed changes to the consultation procedures rules at the Department of Labor, Occupational Safety and Health Administration.

Another activity of the FAO is the convening of issue specific Small Business Advocacy Review Panels. Having a specific government entity responsible for the review and comment on federal regulations is particularly useful because the FAO can provide more detailed comments and make specific and technical recommendations to assist the rulemaking entity modify a rule to lessen its impact on small businesses, without necessarily reducing its policy objective.

While California has an OSBA, the state advocate does not currently have the staff, or the directed statutory mission, to formally comment on pending state regulations. AB 541 would direct the existing California Small Business Board to review regulations relating to small business start-ups, but is silent as to whether the Board would engage during the rulemaking process or after.

- 6) New Federal Flexibility Act: In January 2011, President Obama signed Executive Order 13563 for the purpose of improving regulation and regulatory review. Among other factors, the EO stated that the federal "regulatory system must protect public health, welfare, safety and our environment while promoting economic growth, innovation, competitiveness, and job creation."

In furtherance of these objectives, the EO outlines the steps federal agencies are required to take in adopting regulations including tailoring rules to impose the least burden on society, while achieving policy objectives; developing rules through an open exchange of perspectives from affected stakeholders in the private sector (among others), and promoting the use of retrospective analysis on impacts of previously adopted regulations.

The EO also states that federal regulators should recognize that some industries face significant regulatory requirements, some of which are redundant, inconsistent and

overlapping. Federal agencies are then directed to increase coordination, simplification and harmonization of regulations applied to the same industry when rulemaking.

- 7) California Small Business: California's dominance in many economic areas is based, in part, on the significant role small businesses play in the state's \$1.9 trillion economy. Businesses with less than 100 employees comprise nearly 98% of all businesses, and are responsible for employing more than 37% of all workers in the state.

Small- and medium-sized businesses are crucial to the state's international competitiveness and are an important means for dispersing the positive economic impacts of trade within the California economy. Of the over 57,461 companies that exported goods from California in 2008, 96% were small- and medium-sized enterprises (SME) with fewer than 500 employees. These SMEs generated nearly half (44%) of California's exports in 2008. Nationally, SMEs represented only 31% of total exports. Again, these numbers include the export of only goods and not services.

Small businesses function as economic engines, especially in challenging economic times. During the nation's economic downturn from 1999 to 2003, microenterprises (businesses with less than five employees) created 318,183 new jobs or 77% of all employment growth, while larger businesses with more than 50 employees lost over 444,000 jobs. From 2000 to 2001, microenterprises created 62,731 jobs in the state, accounting for nearly 64% of all new employment growth.

Unfortunately during the current recession, small businesses have not been able to play their traditional economic recovery role due to, among other reasons, the double impact of losing their access to capital resulting from the financial crisis and a drop in consumption. Equifax reports that small business bankruptcies were up 81% for the 12 months ending September 2009, as compared to the same period in the previous year. Nationally, bankruptcy filings were up 44% during the same term.

- 8) Related legislation: Below is a list of related bills. The first group of bills represents four examples of the more than one dozen regulatory reform bills introduced in the Assembly during the current session. The eight similar-in-concept regulatory reform bills introduced by Senate authors have been omitted due to space limitations. The second group of bills reflects legislation from the prior session.

a) Group one:

- i) *AB 273 (Valadao) Regulations: economic impacts review*: This bill requires the Department of Finance to adopt and update instructions for inclusion in the State Administrative Manual that prescribe the methods that any agency shall use in making certain determinations, estimates, statements, and findings relating to the economic and cost impacts of a regulation on businesses and private individuals. Status: Pending in Assembly Accountability and Administrative Review.
- ii) *AB 535 (Morrell) Regulations: five-year review and report*: This bill requires a state agency to review and report on regulations that it adopts or amends on and after January 1, 2012, five years after adoption, as specified. The bill would require that the review and report include 10 specified factors, including a summary of the written

- criticisms of the regulation received by the agency within the immediately preceding 5 years and the estimated economic, small business, and consumer impact of the regulation. The bill would require the OAL to make the review and report available on the office's Internet Web site. Status: Pending in Business, Professions and Consumer Protection.
- iii) *AB 586 (Garrick) Administrative regulations: legislative review:* This bill requires a standing committee of the Legislature with jurisdiction over a state agency proposing to adopt a regulation with a gross cost in excess of \$10,000,000 to hold an informational hearing regarding the proposed regulation. Status: Pending in Business, Professions and Consumer Protection.
- iv) *AB 1037 (V. Manuel Pérez) Regulations: small business impact:* This bill removes statutory barriers that inhibit the full consideration of the impacts of state rules and regulations on the economy, including the small business sector, and requires a review of all regulations on small businesses after five years to identify opportunities to mitigate negative impacts. Status: Pending in Assembly Committee on Business, Professions and Consumer Protection.
- v) *AB 1213 (Nielsen) Regulations: philosophy and principles of regulation:* This bill adopts the regulatory philosophy and the principles of regulation, as outlined in Presidential Executive Order 12866 and Presidential Executive Order 13563, by directing state agencies to improve, among other things, public participation in the rulemaking process, to reduce redundant, inconsistent, or overlapping regulations through increased agency coordination, to improve flexibility, and to develop and submit to the office a preliminary plan under which the agency will periodically review its existing significant regulations to determine whether any regulation should be modified, streamlined, expanded, or repealed. Status: Pending in Business, Professions and Consumer Protection.
- b) Group two: During the 2009-10 legislative session, more than a dozen bills relating to reforming the process whereby regulations are developed and approved were introduced. Although several bills relating to the reforming the California Environmental Quality Act passed and were signed by the Governor, no regulation adoption process bill passed. Below are examples of three failed passage bills, including AB 2692 (Tran and V. Manuel Pérez), which is identical to AB 541.
- i) *AB 1949 (Logue) Regulations: Five-year Review:* This bill requires specified state agencies to review and report to the OAL on regulations that it adopts five years after adoption. The bill would require the review and report include 10 specified factors, including a summary of the written criticisms of the regulation received by the agency within the immediately preceding five years and the estimated economic, small business, and consumer impact of the regulation. Status: The bill remained with the Assembly Committee on Business, Professions and Consumer Protection until the close of the 2009-10 legislative session.
- ii) *AB 2529 (Fuentes) State Auditor Cost Benefit Analysis:* This bill requires the State Auditor to conduct a specified cost benefit analysis of regulations. If a proposed regulation is approved that has an annual statewide economic cost of more than \$10

million or the benefits of the regulation do not equal or exceed the costs of the regulation, the State Auditor is required to notify the Legislature, and specified legislative committees are then required to conduct a public hearing to review the regulation. Status: The bill remained with the Senate Committee on Business Professions and Consumer Protection until the close of the 2009-10 legislative session.

iii) *AB 2692 (Tran and V. Manuel Pérez) Small Business Reforms*: Directs the California Small Business Board (Board) to focus for the next two years on, among other items, the impact of licensing and permitting regulations on small business startups. Status: The bill was held on the Suspense File by the Assembly Appropriation Committee in May 2010.

iv) *SB 356 (Wright) Impact of Regulations on Small Businesses*: This bill requires an agency considering the adoption of a regulation to consult with those persons and businesses potentially affected and would delete the condition that the agency only involve those parties if the proposal is large or complex. Status: The bill passed its policy committee hearing, but was referred to the Assembly Committee on Rules where it remained until the close of the 2009-10 legislative session.

REGISTERED SUPPORT / OPPOSITION:

Support

None received

Opposition

None received

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