

Date of Hearing: April 2, 2019

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Sabrina Cervantes, Chair

AB 1545 (Obernolte) – As Amended March 26, 2019

SUBJECT: Civil penalty reduction policy

POLICY FRAME: Although the state has a vigorous public process designed to allow a rulemaking agency to fully consider the comments, suggestions, and economic impacts of proposed regulations on all business – especially small businesses – these same agencies are often unable to assess the cost and complexity of the proposed implementation method on varying sized businesses. An intrinsic challenge to California’s rule making process is that those businesses that may be most affected have the least ability to monitor the broad range of state rulemaking entities, recommend appropriate alternative implementation models, or engage meaningfully in the often complex and highly technical rule making proceedings.

These challenges can result in small businesses inadvertently breaking laws and being fined, sometimes significant amounts of money. While ignorance of the law is no excuse, the state bears some level of responsibility for assisting the state’s smallest businesses. This bill proposes a method used in federal law for mediating fines and penalties when a small business has taken the corrective action and the violation was not willful, criminal, or posed an imminent health, safety, or environmental threat.

The policy analysis includes information on the California small business economy, reforms to state rulemaking practices, studies on the cost of federal and state regulations, and background on the federal small business regulatory program being proposed in this bill. Suggested amendments are included in Comment 6.

SUMMARY: AB 1545 requires a state agency, as defined, to assist small businesses in complying with statutes and regulations and to establish policies that would allow small businesses, under certain specified circumstances, to have the total amount of civil penalties reduced for noncompliance. Specifically, this bill:

- 1) Requires a state agency to assist small businesses in complying with statutes and regulations by the agency.
- 2) Requires the state agency to assist a small business during an enforcement action by the agency.
- 3) Requires the state agency to establish a policy by December 31, 2020, to provide for the reduction of civil penalties for violations of regulatory or statutory requirements by a small business, under the following circumstances:
 - a) To qualify for a penalty reduction:
 - i) The violation was not willful or criminal.
 - ii) The violation did not pose an imminent threat to health, safety, or environmental threat.
 - iii) The small business had a low degree of culpability when judged in light of its size, length of operation, and the sophistication of its owners or managers.

- b) If all three of the circumstances described above are met, the policy is to provide for a range of penalty reductions, based on the degree to which certain factors apply, including, but not limited to:
 - i) The degree to which the small business cooperated with the investigation.
 - ii) The degree to which the small business made corrective actions.
 - iii) The prior history of the small business in meeting regulatory requirements of the agency.
 - iv) The degree to which the level of the penalty would impede the small business from continuing to conduct business.
- 4) Authorizes a state agency to amend the policy from time to time to reflect current issues and conditions affecting small businesses and the economy.
- 5) Requires public posting of the policies and annual reports about civil penalty reductions to allow for transparency of the new policy.
- 6) Requires the state agency to notify the Office of the Small Business Advocate within 15 working days of the policy being adopted or amended and the policy and the annual reports, as specified, being posted on the state agency's website.
- 7) Defines "state agency" to include any state agency, department, board, or commission that has significant rulemaking authority over small businesses while excluding the Franchise Tax Board and the Department of Tax and Fee Administration.
- 8) Defines "small business" as a business that is independently owned and operated, not dominant in its field, has fewer than 100 employees, and has average annual gross receipts of \$10 million or less over the previous three years.

EXISTING FEDERAL LAW: The federal Small Business Regulatory Enforcement Fairness Act requires that a federal agency must have a penalty reduction policy for small businesses, involve small businesses in the development of proposed rules through Small Business Advocacy Review Panels, produce Small Entity Compliance Guides for certain rules, and be responsive to small business inquiries about compliance with the agency's regulations.

EXISTING STATE LAW:

- 1) Finds and declares that there has been an unprecedented growth in the number of administrative regulations in recent years and that correcting the resulting problems requires the direct involvement of the Legislature, as well as that of the executive branch of the 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.
- 2) Establishes the Office of the Small Business Advocate (OSBA) within the Governor's Office of Business and Economic Development (GO-Biz), to serve, among other things, as the principal advocate in the state on behalf of small businesses, including, but not limited to, advisory participation in the consideration of all legislation and administrative regulations that affect small businesses. The OSBA is also charged with, among other duties:
 - a) Representing the views and interests of small businesses before other state agencies whose policies and activities may affect small business.

- b) Receiving and responding to complaints from small businesses concerning the actions of state agencies and the operative effects of state laws and regulations adversely affecting those businesses.
 - c) Counseling small businesses on how to resolve questions and problems concerning the relationship of small business to state government.
- 3) Establishes the position of the small business liaison within each state agency that significantly regulates small business or that significantly impacts small business. While a small business liaison is available to assist small businesses in understanding and meeting to designate at least one person to serve as a small business liaison. A small business liaison is prohibited from advocating for or against the adoption or amendment or repeal of any regulation or intervene in any pending investigation or enforcement action.

FISCAL EFFECT: Unknown

COMMENTS & CONTEXT:

- 1) **The Role of Small Businesses within the California Economy:** California's dominance in many economic areas is based, in part, on the significant role small businesses play in the state's \$2.7 trillion economy. Two separate studies, one by the U.S. Census Bureau and another by the Kaufman Foundation, found that net job growth was strongest among businesses with less than 20 employees. Among other advantages, small businesses are crucial in the state's international competitiveness and are an important means for dispersing the positive economic impacts of trade within the California economy.

In 2016 (most recent data), of the 4.2 million establishments in California, there were 3.2 million nonemployer establishments as compared to 922,000 employer establishments. The top three industry sectors with the largest number of nonemployer sole proprietorships included professional, scientific, and technical services (507,000 establishments); transportation and warehousing (297,000); and real estate and rentals (271,000). Total establishments revenues for nonemployer sole proprietorships, across all industry sectors, were \$113 billion in receipts in 2016. As these non-employer businesses grow, they continue to serve as an important component of California's dynamic economy.

Excluding sole proprietorships, businesses with less than 20 employees comprise over 88.3% of all businesses and employ approximately 18.2% of all workers. Businesses with less than 100 employees represent 97.3% of all businesses and employ 35.8% of the workforce. These non-employer and small employer firms create jobs, generate taxes, support important industry sectors, and revitalize communities. Since the recession, these businesses have become increasingly important because they are more flexible and well-suited to meet niche foreign and domestic market needs.

Reflective of their important role within the economy, the JEDE Committee Members regularly hear about the challenges small businesses face meeting the implementation requirements of state, local, and federal regulations. While opponents of regulatory reform accuse small businesses of trying to avert their responsibilities, businesses that have testified before the Committee have repeatedly stated that their goal is to achieve a regulatory environment that encourages small businesses development, while still maintaining public health and safety standards.

- 2) **Cost of Regulations on Business:** There are two major sources of data on the cost of regulatory compliance on businesses, the federal small business administration and the OSBA. For the last 10

years, the federal SBA has conducted a peer reviewed study that analyzes the cost of federal government regulations on different size businesses. This research shows that small businesses continue to bear a disproportionate share of the federal regulatory burden. On a per employee basis, it costs about \$2,400, or 45% more, for small firms to comply with federal regulations than their larger counterparts.

The first study on the impact of California regulations on small businesses was released by the OSBA in 2009. This first in-the-nation study found that the total cost of regulations to small businesses averaged about \$134,000 per business in 2007. Of course, no one would advocate that there should be no regulations in the state. The report, however, importantly identifies that the cost of regulations can provide a significant cost to the everyday operations of California businesses and should therefore be a consideration among the state's economic development policies.

Regulatory costs are driven by a number of factors including multiple definitions of small business in state and federal law, the lack of e-commerce solutions to address outdated paperwork requirements, procurement requirements that favor larger size bidders, and the lack of technical assistance to alleviate such obstacles that inhibit small business success.

- 3) **State Small Business Liaison:** The small business liaison was established in 2006 to assist small businesses in complying with state regulations. Existing state law requires each agency that significantly regulates or impacts small businesses to designate a small business liaison, who is responsible for receiving and responding to complaints submitted by small businesses, providing technical assistance, and assisting small businesses in resolving problems and questions regarding compliance with the agency's regulations.

While outreach and technical assistance is useful, the state small business liaison is, however, prohibited from advocating for or against any regulation or intervening in any pending investigation or enforcement action. Once an enforcement action is initiated, the small business is left to their own devices.

At the federal level, a small business involved in regulatory investigation may call on the Small Business Administration's Ombudsman or the regional Small Business Regulatory Fairness Board. AB 1545 would move California closer to the federal model.

- 4) **Different Approaches to Regulatory Reform:** In general, the Legislature's engagement on regulatory streamlining has taken two basic approaches. One set of policies have addressed specific regulatory challenges on a case-by-case basis. The second approach calls for systemic change to the way in which rules are adopted. A review of systemic change recommendations have included:
 - a) **Dynamic Fiscal Analysis in Appropriations Committee:** These bills required an analysis of bills before the Legislature on their impact on business and the economy. The current review by the fiscal committees in the California Legislature focus on the bill's direct impact on state funds, and most specifically on the General Fund. The committee's fiscal analysis is not intended to assess the legislations' potential economic impact on the state.
 - b) **Substantive Administrative Review:** These bills proposed to fundamentally shift the basis of the Office of Administrative Law's (OAL's) review. While current law specifies a procedural review of the regulation package, these bills would have OAL undertaking a substantive review of its impact on business and the economy, including the sufficiency of the assessment of alternatives. Alternatively, legislation has proposed that another state entity, such as the State Auditor or

Legislative Analyst's Office, could undertake this level of substantive assessment of proposed regulations.

- c) ***Enhanced Analysis of Alternatives***: These bills required a more meaningful consideration of alternative implementation models, which could lower costs or reduce the implementation burden on small businesses. Given that small businesses do not generally have the time and regulatory knowledge to successfully participate in the state rule making process, these bills placed a greater responsibility on state agencies to develop and/or seek out those that can recommend appropriate alternative implementation methods better suited to smaller size businesses.
- d) ***Post Implementation Analysis and Sunset Dates***: These bills required a review of a regulation's impact five-years after its implementation. Alternatively, legislation has been suggested that all regulations have a sunset date, which would allow for full review once the actual impacts could be identified. Currently, licensing boards use this model with the Assembly Committee on Business, Professions and the Senate Committee on Business, Professions, and Economic Development, taking the lead.
- e) ***Appeal Boards***: These bills authorize a small business to request a lessening of fines for minor and inadvertent violations. On an ad hoc basis, a business could request a review of its penalty package and, based on mitigating circumstances, have some or all of their fines waived.

Until now, the first approach has been the most successful. Addressing regulatory impacts on a case-by-case basis, however, has had very limited overall impact on California's regulatory business climate. Due to their potential implementation costs, a majority of the bills advancing the systemic approach to regulatory reform have failed to move from the fiscal committees - as illustrated in the comment on related legislation.

The most significant systemic change in recent years was approved in SB 617 (Calderon), Chapter 496, Statutes of 2011, which required an enhanced economic impact analysis for regulations anticipated to have an impact of \$50 million or more. The SB 617 process follows some elements of the federal regulatory model. It should be noted, however, that the state process has resulted in few regulatory accommodations for size of business.

AB 1545 proposes the Appeals Board model. The bill does not propose to lower standards, but does provide the small business with an opportunity to fix the violation and have their fines reduced.

- 5) **Federal Regulatory Flexibility Act**: The federal Regulatory Flexibility Act (RFA) requires federal agencies to take specific steps to collect feedback from small businesses, including nonprofits, on proposed regulations and to determine whether a rule is expected to have a significant economic impact on a substantial number of small entities.

Federal agencies are also required to identify alternative regulatory approaches for small businesses, small governmental jurisdictions, and non-profit organizations. While California law contains similar language, some state agencies too often defer to another portion of the law that states that the "agency is not required to artificially construct alternatives." With most small businesses not in a position to attend public hearings and write letters offering an alternative to the technical requirements of the state regulation, few regulations have special provisions for small business compliance.

Fourteen years after the implementation of RFA, the federal government adopted the Small Business Regulatory Enforcement Fairness Act (SBREFA). Among other changes, the SBREFA permits the

judicial review of an agency's compliance with the RFA. Now, a small business may ask a court to review a federal agency's rulemaking process to ensure that it is in line with the requirements of the RFA. When this judicial review occurs, a further provision of the SBREFA allows the federal Office of Advocacy within the Small Business Administration (SBA) to file an amicus brief to support the claims of the small business. The following issues are subject to judicial review under the SBREFA:

- The final regulatory flexibility analysis including the agency's efforts to evaluate alternative regulatory approaches and reasons for rejecting or accepting them;
- The agency's effort to collect comments from small entities through a variety of mechanisms;
- The agency's decision to certify that a rule will not have a significant impact on a substantial number of small entities, and the factual basis for the certification;
- The agency's compliance with a requirement for periodic reviews at the 10-year anniversary of every rule or the enactment of the 1980 law, whichever is first.

In some circumstances, SBREFA requires federal agencies, such as the Environmental Protection Agency, to convene a special panel to review draft proposed regulations and the related agency analyses under the Regulatory Flexibility Act. In this instance, both the SBA Office of Advocacy, and the Office of Management and Budget attend the panel for the purpose of ensuring compliance. The panel may also independently seek advice from small business representatives and submit a report to the rule making agency.

The SBREFA also provides for congressional review of federal agencies' regulations. Major rules--those with a \$100 million impact on the economy or a major impact on an industry, government or consumers, or those affecting competition, productivity or international trade--cannot go into effect until congressional review is complete. Congress may take up to 60 session days for review and use a variety of mechanisms to delay implementation. Congressional review, however, is subject to a presidential veto.

As a pre-emptive measure, federal agencies are required to publish small business compliance guides for all rules determined to have a significant impact on small businesses. As a means for ensuring that these guides present requirements in a clear and understandable manner, federal law allows these documents to be used in court proceedings as evidence. If a small business is cited for a violation of a regulation, the court may review the content of the small business compliance guide in assessing the reasonableness of the proposed penalty. The court may also review an agency's compliance advice when determining the reasonableness of proposed penalties, fines, or damages assessed against a small business.

Federal law does not always require a small business to take the agency to court in order to access regulatory relief. Under the SBREFA, each agency is also required to establish a policy that provides for the reduction, and under appropriate circumstances, for the waiver of civil penalties for violations of statutory or regulatory requirements by a small business. According to the OSBA, the language in this section was adopted from a statement and Executive memorandum issued by President Clinton in March 1995.

- 6) **Proposed Amendments:** One technical amendment is recommended by staff in order to conform the maximum average income for a small businesses with the income limit set in statute for small businesses participating in state procurement activities.

- 7) **Related Legislation:** Below is a list of bills from the current and prior sessions.
- a) **AB 19 (Chang) Small Business Regulatory Review:** This bill would have required the Governor's Office of Business and Economic Development, in consultation with the Office of the Small Business Advocate, to establish a process for the ongoing review of existing regulations. The bill would have required the review to be primarily focused on regulations affecting small businesses adopted prior to January 1, 2016, to determine whether the regulations could be less administratively burdensome or costly to affected sectors. Status: Held on the Suspense File of the Assembly Committee on Appropriations, 2015.
 - b) **AB 86 (Calderon) Entrepreneurship in Residence:** This bill establishes the Entrepreneurs in Residence Act of 2017 for the purpose of utilizing the expertise of private-sector entrepreneurs to help make state government activities and practices more streamlined and accessible. Status: Pending in the Assembly Committee on Jobs, Economic Development, and the Economy.
 - c) **AB 419 (Kim) Online Regulatory Access:** This bill would have required the Governor's Office of Business and Economic Development to create a Web-access point on its Internet Web site to include information about the state rulemaking process and a web-link to relevant information on the Internet site of the Office of Administrative Law including, but not limited to, information found in the California Code of Regulations, the California Regulatory Notice Register, and the California Code of Regulations Supplement. Status: Held under submission in the Senate Committee on Business, Professions, and Economic Development. These provisions were implemented administratively.
 - d) **AB 582 (Calderon) Entrepreneur-in-Residence Act of 2016:** This bill would have enacted the Entrepreneur-in-Residence (EIR) Act of 2016, including the establishment of a state EIR program within the Government Operations Agency (GOA) for the purpose of utilizing the expertise of private-sector entrepreneurs to help make state governmental activities and practices more streamlined and accessible. Status: Held under Submission in the Senate Committee on Appropriations, 2016.
 - e) **AB 657 (Cunningham) State Government Small Business Liaisons:** This bill requires certain state agencies to prominently display the name and contact information of the small business liaison on the agencies' websites and to notify the Governor's Office of Business and Economic Development and the Department of General Services of liaison position vacancies, as specified. Status: Signed by the Governor, Chapter 81, Statutes of 2017.
 - f) **AB 767 (Quirk-Silva) California Business License Center:** This bill would have formalized the role of the Information Technology Unit within the Governor's Office of Business and Economic Development (GO-Biz), which is responsible for the design and maintenance of an online Internet platform, called the California Business Development Portal. In addition, the bill would have rebranded the state's permit and licensing application as the California Business License Center and provides dedicated staff update and expand the California Business Portal. Status: Vetoed by the Governor, 2018.
 - g) **AB 866 (E. Garcia) Small Business Regulatory Fairness Act of 1996:** As passed by JEDE, this bill would have expanded the duties of the Small Business Advocate to include the provision of known information to state rulemaking agencies on small business stakeholder groups which the rulemaking agency could use when disseminating information about proposed new or amended rules. This bill would have also required a state agency that develops a small business compliance guide in partnership with federal agencies, under the federal Small Business Regulatory Fairness Act of 1996 (Public Law 104-121), to notify and provide specified information to the Small

Business Advocate within 45 days after the guide becomes available to the public. Status: Used for another policy purpose. The measure failed to move from the Senate Floor, 2016.

- h) **AB 912 (Obernolte) California Small Business Regulatory Fairness Act:** This bill would have established the California Small Business Regulatory Fairness Act for the purpose of setting the framework by which a small business could be provided with an opportunity to implementing a policy to allow the reduction of certain penalties and fees. Status: Died in the Assembly Committee on Appropriations, 2018.
- i) **AB 1286 (Mayer) California Regulatory Reform Council:** This bill would have established the California Regulatory Reform Council to make reports and recommendations to the Legislature and the Governor related to the structure, organization, operation, and impact of all levels of state and local regulations on industries operating within the state. Status: Held without further action by the Assembly Committee on Appropriations, 2016.
- j) **AB 1675 (Calderon) Entrepreneurship-in-Residence:** This bill would have established the entrepreneur-in-residence program within the Governor's Office of Business and Economic Development for the purpose of improving outreach and strengthening coordination with the entrepreneur and small business community. Status: Died on the Suspense File in the Senate Committee on Appropriations, 2014.
- k) **AB 2723 (Medina) Small Businesses and Major Regulations:** This bill would have added statutory protections to ensure that the costs of major regulations on the state's smallest size businesses are considered when state agencies undertake their economic impact assessment for major regulations. Status: Vetoed by the Governor, 2014. The veto message reads: "This bill would require the economic analysis for major regulations to include a separate assessment of the impact on sole proprietorships and small businesses. I signed legislation in 2011 to require a comprehensive economic analysis of proposed major regulations. The analysis must assess whether, and to what extent, the proposed regulations will affect all California jobs and businesses. Agencies must also identify alternatives that would lessen any adverse impact on small businesses. I am not convinced that an additional layer of specificity based solely on the legal structure of a business would add value to the comprehensive economic analysis already required."
- l) **SB 606 (Neilson) Small Business Appeals Board:** This bill would have established the Small Business Appeals Board and authorized the board to grant a hearing and review the order, ruling, action, or failure to act of any state agency upon petition of any small business affected and to grant any remedy or impose any penalty authorized under existing law governing administrative procedures. Status: This bill died in the Senate Committee on Governmental Organization, 2015.
- m) **SB 617 (Calderon) State Government and Financial and Administrative Accountability:** This bill revises the state Administrative Procedure Act to require each state agency adopting a major regulation to prepare an economic impact analysis and requires state agencies to implement ongoing monitoring of internal auditing and financial controls and other best practices in financial accounting. Status: Signed by the Governor, Chapter 496, Statutes of 2011.
- n) **SB 828 (Runner) Small Business Appeals Board:** This bill would have established the Small Business Appeals Board and authorized the board to grant a hearing and review the order, ruling, action, or failure to act of any state agency upon petition of any small business affected and to grant any remedy or impose any penalty authorized under existing law governing administrative procedures. Status: Died in the Senate Committee on Business, Professions and Economic Development, 2011.

- o) **SB 1228 (Runner) California Small Business Regulatory Fairness Act:** This bill establishes the California Small Business Regulatory Fairness Act for the purpose of setting the framework by which a small business could be provided with an opportunity to implementing a policy to allow the reduction of certain penalties and fees. Status: Held on Senate Appropriations, 2016.

- 8) **Double Referral:** The Assembly Committee on Rules has referred this measure the Assembly Committee on Jobs, Economic Development, and the Economy and to the Assembly Committee on Accountability and Administrative Review (AAR). Should this measure pass the committee, it will be referred to AAR for further policy consideration.

REGISTERED SUPPORT / OPPOSITION:

Support

None on File

Opposition

None on File

Analysis Prepared by: Toni Symonds / J., E.D., & E. / (916) 319-2090