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13 ARNOLD SCHWARZENEGGER and DAVID GILB

**Exempted from Fees  
(Gov. Code § 6103)**

14  
15 SUPERIOR COURT OF CALIFORNIA  
16 CITY AND COUNTY OF SAN FRANCISCO

17 CALIFORNIA ATTORNEYS,  
18 ADMINISTRATIVE LAW JUDGES AND  
HEARING OFFICERS IN STATE  
19 EMPLOYMENT, GLEN GROSSMAN,  
20 MARK HENDERSON, GEOFFREY SIMS,  
and DOES 1-500,

21 Petitioners/Plaintiffs,

22 v.

23 ARNOLD SCHWARZENEGGER as,  
Governor of the State of California; DAVID  
24 GILB as Director of the Department of  
Personnel Administration; JOHN CHIANG,  
25 Controller of the State of California; JAN  
FRANK, as President of STATE  
26 COMPENSATION INSURANCE FUND, and  
DOES 1-50,

27 Defendants/Respondents.  
28

CASE NO. CPF-09-509205

**DECLARATION OF DAVID W. TYRA IN  
SUPPORT OF RESPONDENTS GOVERNOR  
ARNOLD SCHWARZENEGGER AND DAVID  
GILB'S OPPOSITION ON THE MERITS OF  
PETITIONERS' PETITION FOR WRIT OF  
MANDATE**

**Date: March 20, 2009  
Time: 9:30 a.m.  
Dept.: 301**

**Action Filed: February 10, 2009**

911468.1

- 1 -

DECL. OF DAVID W. TYRA IN SUPPORT OF RESPONDENTS GOVERNOR ARNOLD SCHWARZENEGGER AND DAVID GILB'S  
OPPOSITION ON THE MERITS OF PETITIONERS' PETITION FOR WRIT OF MANDATE

1 I, David W. Tyra, declare as follows:

2 1. I am an attorney at law licensed to practice before the Courts of the State of  
3 California, am a shareholder in the firm of Kronick, Moskovitz, Tiedemann & Girard, and am  
4 counsel of record for Respondents/Defendants ARNOLD SCHWARZENEGGER, as Governor of  
5 the State of California, and DAVID GILB, as Director of the Department of Personnel  
6 Administration (hereinafter referred to as "Respondents") in the above-captioned matter.

7 2. I make this declaration in support of Respondents' Opposition on the  
8 Merits. If called upon as a witness, I would be competent to testify to the following of my own  
9 personal knowledge.

10 3. A true and correct copy of the January 30, 2009 final order issued by the  
11 Sacramento County Superior Court, in case nos. 2009-800000134, 2008-80000126, 2009-  
12 80000135, is attached herein as **Exhibit A**.

13 4. A true and correct copy of CASE's February 3, 2009 notice of appeal from  
14 the judgment and order denying the Petition for Writ of Mandate and Complaint for Declaratory  
15 Relief in case no. 2009-80000134 is attached herein as **Exhibit B**.

16 5. A true and correct copy of Governor Schwarzenegger's Executive Order S-  
17 09-08, dated July 31, 2008 is attached herein as **Exhibit C**.

18 6. A true and correct copy of Governor Schwarzenegger's  
19 September 23, 2008's press release is attached herein as **Exhibit D**.

20 7. A true and correct copy of the Governor's Budget for Special Session 08-  
21 09 is attached herein as **Exhibit E**.

22 8. A true and correct copy of the California Department of Finance's October  
23 2008 Finance Bulletin is attached herein as **Exhibit F**.

24 9. A true and correct copy of the Governor's November 6, 2008 Special  
25 Session Proclamation is attached herein as **Exhibit G**.

26 10. A true and correct copy of the Governor's November 6, 2008 letter to all  
27 state employees is attached herein as **Exhibit H**.

28 ///

911468.1

- 2 -

1                    11.     A true and correct copy of the Governor's December 1, 2008 Proclamation  
2 is attached herein as **Exhibit I**.

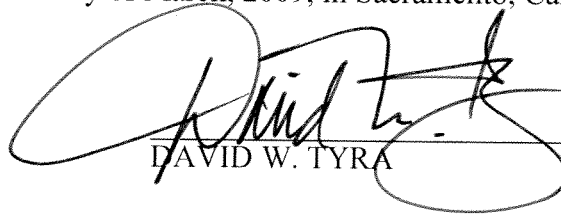
3                    12.     A true and correct copy of the Governor's Executive Order s-16-08, dated  
4 December 19, 2008 is attached herein as **Exhibit J**.

5                    13.     A true and correct copy of the December 19, 2008 press release from  
6 Controller John Chiang is attached herein as **Exhibit K**.

7                    14.     A true and correct copy of the December 22, 2008 letter from Controller  
8 John Chiang to the Governor is attached herein as **Exhibit L**.

9                    15.     A true and correct copy of the January 13, 2009 special report titled,  
10 "California at the Brink of Disaster," authored by Michael Genest, Director of the California  
11 Department of Finance is attached herein as **Exhibit M**.

12                    I declare under penalty of perjury that the foregoing is true and correct and that  
13 this declaration was executed this 9<sup>th</sup> day of March, 2009, in Sacramento, California.

14  
15   
16 DAVID W. TYRA

# **EXHIBIT A**

**SUPERIOR COURT OF CALIFORNIA  
COUNTY OF SACRAMENTO**

**DATE/TIME : 01/30/09**  
**JUDGE : P. MARLETTE**  
**REPORTER : none**

**DEPT. NO : 19**  
**CLERK : D. RIOS, SR.**  
**BAILIFF : none**

**PRESENT:**

**Professional Engineers in California Government;\California  
Association of Professional Scientists,  
Plaintiff,**

**VS. Case No.: 2008-80000126**

**Arnold Schwarzenegger, Governor, State of  
California\Department of Personnel Administration\State  
Controller John Chiang\and Does 1 through 20 inclusive,  
Defendant.**

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**Nature of Proceedings: Amended Minute Order**

The Court is issuing a revised version of its final ruling in these matters. The revision makes no substantive changes in the ruling, but corrects an editing error in the last sentence of the third paragraph from the end of the ruling, regarding the State Controller, by deleting the word "incidental". The revised final ruling which follows shall be the final ruling of the Court.

PROFESSIONAL ENGINEERS IN CALIFORNIA GOVERNMENT, et al., v. GOVERNOR ARNOLD SCHWARZENEGGER, et al., Case No. 2008-80000126;

CALIFORNIA ATTORNEYS, ADMINISTRATIVE LAW JUDGES AND HEARING OFFICERS IN STATE EMPLOYMENT, v. GOVERNOR ARNOLD SCHWARZENEGGER, et al., Case No. 2009-80000134;

SERVICE EMPLOYEES INTERNATIONAL UNION, LOCAL 1000, v. GOVERNOR ARNOLD SCHWARZENEGGER, et al., Case No. 2009-80000135.

The following shall constitute the Court's final rulings on the demurrers and petitions for writ of mandate and complaints for declaratory relief in the above-captioned matters:

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**DATE : 01/30/09**  
**CASE NO. : 2008-80000126**  
**CASE TITLE : PECG; CAPS v.  
SCHWARZENEGGER**

**SUPERIOR COURT OF CALIFORNIA,  
COUNTY OF SACRAMENTO**

**BY: D. RIOS, SR.,**  
**Deputy Clerk**

**CASE NUMBER: 2008-80000126**

**DEPARTMENT: 19**

**CASE TITLE: PEGC; CAPS v. SCHWARZENEGGER**

**PROCEEDINGS: Amended Minute Order**

Introduction and Background:

On December 19, 2008, in a response to the current State budget crisis, Governor Arnold Schwarzenegger issued Executive Order S-16-08. As relevant to this action, the Executive Order directed the Department of Personnel Administration, effective February 1, 2009 through June 30, 2010, to adopt a plan to implement a furlough of represented state employees and supervisors for two days per month, and to adopt a plan to implement an equivalent furlough or salary reduction for all state managers, including exempt state employees.

Several organizations representing state employees affected by the Executive Order have filed three separate petitions for writ of mandate and complaints for declaratory relief challenging the provisions of the Order imposing the furloughs, and seeking to overturn them.

The first such action, Case No. 2008-80000126, was filed by petitioners Professional Engineers in California Government ("PEGC") and California Association of Professional Scientists ("CAPS") on December 22, 2008. That action initially was assigned to Department 33 of this Court, Judge Lloyd Connelly, presiding; it was reassigned to this Department after respondents filed a peremptory challenge to Judge Connelly pursuant to Code of Civil Procedure section 170.6 on January 7, 2009.

The second such action, Case No. 2009-80000134, was filed by petitioner California Attorneys, Administrative Law Judges and Hearing Officers in State Employment ("CASE") on January 5, 2009. That action was assigned to Department 33 of this Court, Judge Lloyd Connelly, presiding. Petitioner simultaneously filed a Notice of Related Case in that action, stating that it was related to Case No. 2008-80000126.

The third such action, Case No. 2009-80000135, was filed by petitioner Service Employees International Union, Local 1000 ("SEIU"), on January 7, 2009. The action was assigned to Department 29 of this Court, Judge Timothy M. Frawley, presiding. Petitioner simultaneously filed a Notice of Related Case in that action, stating that it was related to Cases Nos. 2008-80000126 and 2008-80000134.

On January 9, 2009, the Court heard simultaneous ex parte applications by the petitioners and respondents in Case No. 2008-80000126 for orders shortening time that would have the effect of setting a hearing on respondents' demurrer to the petition and the hearing on the merits of the petition itself for a date prior to February 1, 2009, when the furloughs would go into effect.

At the hearing on January 9, 2009, counsel for the petitioners in Cases Nos. 2009-80000134 and 2009-80000135 appeared and stipulated on the record that those cases would be treated as related to Case No. 2008-

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**SCHWARZENEGGER**

**SUPERIOR COURT OF CALIFORNIA,**  
**COUNTY OF SACRAMENTO**

**BY: D. RIOS, SR.,**  
**Deputy Clerk**

**CASE NUMBER: 2008-80000126**

**DEPARTMENT: 19**

**CASE TITLE: PECG; CAPS v. SCHWARZENEGGER**

**PROCEEDINGS: Amended Minute Order**

80000126, and that those cases would be transferred to this Department for hearing pursuant to Rule of Court 3.300(h)(1)(a). Counsel for respondents in Case No. 2008-80000126 also stated on the record that he represented the respondents in one of the other two cases, and most likely would represent the respondents in the other (although at that time, the petition had not formally been served on the respondents), and also stipulated on the record that the three cases would be heard in this Department as provided above. The parties further agreed to a briefing schedule and to a combined hearing on the respondents' demurrers to, and the merits of, the three petitions. The parties to all three actions have filed their briefs and other papers according to the agreed-upon schedule and the Court heard oral argument on the matter on Thursday, January 29, 2009.

On January 12, 2009, a fourth action was filed challenging the Governor's Executive Order, entitled *California Correctional Peace Officers Association v. Governor Arnold Schwarzenegger, et al.*, Case No. 2008-80000137. The Court issued an order finding that case to be related to the three cases captioned above and further ordered that case assigned to this Department. That case has been set for hearing on Friday, February 5, 2009.

**Ruling on Preliminary Evidentiary Issues:**

Respondents<sup>1</sup> have made two requests for judicial notice, filed January 9, 2009 and January 13, 2009, along with an Amended Request for Judicial Notice on January 23, 2009 in response to the Court's order directing them to submit complete copies of the Memoranda of Understanding ("MOUs") involved in these actions. No objections to the requests have been filed. The Court has reviewed the requests and the documents attached thereto and finds that all such documents are proper subjects for judicial notice. Respondents' requests for judicial notice are therefore granted.

Respondents' evidentiary objection to the Declaration of Peter Flores, Jr. is overruled on the ground that the lack of a signature on the declaration has been remedied by the filing of an amended declaration, unchanged in substance, which bears Mr. Flores' signature.

**Ruling on Respondents' Demurrers to the Petitions:**

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<sup>1</sup> In using the terms "respondents" or "defendants" in this ruling, the Court is referring to Governor Arnold Schwarzenegger and the Department of Personnel Administration. Although State Controller John Chiang also has been named as a respondent in these actions, the Controller has filed an Opposition to the Respondents'/Defendants' Demurrer stating that his interests are actually aligned with the petitioners and that, but for the short time frame, he would have filed a formal motion to realign the parties, seeking to be redesignated as a petitioner/plaintiff. The Controller's position in these actions will be discussed further below. In this ruling, the Court also has treated the terms "the Governor", "the Department of Personnel Administration" (or "the department" or "DPA") and "the State" as being essentially interchangeable.

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**SUPERIOR COURT OF CALIFORNIA,  
COUNTY OF SACRAMENTO**

**BY: D. RIOS, SR.,**  
**Deputy Clerk**

**CASE NUMBER: 2008-80000126**

**DEPARTMENT: 19**

**CASE TITLE: PECG; CAPS v. SCHWARZENEGGER**

**PROCEEDINGS: Amended Minute Order**

Respondents' demurrers are overruled on the following basis:

The petitions and complaints allege generally that the provisions of the Governor's Executive Order S-16-08 that implement a furlough of represented state employees and supervisors for two days per month, and an equivalent furlough or salary reduction for state managers, effective February 1, 2009 through June 30, 2010, are invalid in that such action on the part of the Governor is not authorized by law, and moreover is forbidden by certain provisions of law, in particular, Government Code section 19826(b).

The Court finds that such allegations are sufficient to state a cause of action for issuance of a writ of mandate or for declaratory relief, regardless of whether Government Code section 19826(b) is superseded by the terms of the MOUs petitioners have entered into with the State (as respondents argue), because the petitions and complaints allege, in essence, that the Governor lacks the positive authority to make the challenged order in the first instance, irrespective of any statutory prohibition that may or may not apply. The allegation that the Governor lacks any authority to make the challenged order is sufficient to state a cause of action on its own.

The Court further finds that the issue of the Governor's authority to make the challenged order is not an issue within the exclusive initial jurisdiction of the Public Employment Relations Board, because it involves issues of statutory interpretation and separation of powers between the Governor and the Legislature, which are matters properly within the jurisdiction of the courts, and not issues of unfair practices under the Ralph C. Dills Act, which are matters properly within the jurisdiction of the Board. (See, e.g., *California School Employees Association v. Azusa Unified School District* (1984) 152 Cal. App. 3<sup>rd</sup> 580, 592-593; *California Teachers' Association v. Livingston School District* (1990) 219 Cal. App. 3<sup>rd</sup> 1503, 1519.) Moreover, the petitions and complaints in effect allege that the Governor's Executive Order regarding an employee furlough violates the provisions of the petitioners' MOUs with the State governing wages and hours. The Board does not have the authority to enforce agreements between the parties. (Government Code section 3514.5(b); see also, *San Lorenzo Education Association v. Wilson* (1982) 32 Cal. 3<sup>rd</sup> 841.)

Moreover, even if this Court were to conclude that the Board did have jurisdiction over this matter, it would conclude that the normal policy reasons requiring parties to exhaust available administrative remedies do not apply in this case for many of the reasons stated by the Third District Court of Appeal in a case arising out of an earlier state budget crisis: namely, that the facts are undisputed, so there is no need for administrative development of the record; judicial intervention will not interfere with the expertise of the agency or create problems of judicial economy, given that the underlying issues are within the expertise of the courts and undoubtedly would be resolved ultimately by the courts even if initial jurisdiction were found in the Board; and, given that this case raises questions of first impression which most likely are bound for ultimate determination in the appellate courts, there is little concern of conflicting decisions between the Board and the courts. (See, *Department of Personnel Administration v. Superior Court (Greene)* (1992) 5 Cal. App. 4<sup>th</sup> 155, 168-169.)

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**SUPERIOR COURT OF CALIFORNIA,**  
**COUNTY OF SACRAMENTO**

**BY: D. RIOS, SR.,**  
**Deputy Clerk**



**CASE NUMBER: 2008-80000126**

**DEPARTMENT: 19**

**CASE TITLE: PECG; CAPS v. SCHWARZENEGGER**

**PROCEEDINGS: Amended Minute Order**

In addition, even if this Court were to conclude that the Board did have jurisdiction over this matter, it would conclude that exhaustion of administrative remedies by resort to the Board should be excused on the ground that requiring exhaustion under the particular circumstances of this case would cause both the State and its employees to suffer irreparable injury, again, for many of the reasons stated in the 1992 *Greene* case: specifically, that the extremely grave nature of the fiscal crisis faced by the state, and the urgent need for resolution of these issues in as expeditious a manner as possible, create a great potential for irreparable harm in the nature of layoffs of state employees, with a concomitant reduction in the nature of state services, all of which are amply demonstrated by the declarations and documents that have been filed by parties in this matter (many of them by respondents). Even if, as the Court of Appeal stated in the *Greene* case, there is a possibility that the Board could order the same relief that petitioners seek here, it is extremely unlikely that the entire process of Board adjudication followed by judicial review as provided by law would be completed in a sufficiently timely manner to address the immediate crisis. (See, *Department of Personnel Administration v. Superior Court (Greene)* (1992) 5 Cal. App. 4<sup>th</sup> 155, 170-171.)

Petitioners SEIU and CASE raise additional claims for declaratory relief regarding the effect of the furlough on the exempt status of employees under the federal Fair Labor Standards Act ("FLSA"). The SEIU complaint alleges that a significant number of its employees will be required to work in excess of 40 hours during furlough weeks, that such employees will no longer be considered exempt employees as a matter of law during those weeks, that such workers will be entitled to overtime pay during such weeks, and that respondents lack any mechanism or systems in place to move employees from exempt to non-exempt status from week-to-week, with the result being that such employees will not receive the overtime pay to which they are entitled under the FLSA. Such facts are sufficient to state a cause of action in declaratory relief based on the theory that respondents are not willing and able to comply with their obligations under the FLSA, at least for the purpose of withstanding a demurrer. Respondents' contention that the complaint on its face shows that petitioner's FLSA claim is not ripe for review, and seeks only an advisory opinion, because there is no allegation that respondents actually have failed to pay any overtime that is due, is unpersuasive.<sup>2</sup>

The CASE complaint alleges the same facts regarding the effect of the furloughs on its employees' exempt status under the FLSA. The complaint lacks the specific allegations present in the SEIU complaint regarding respondents' lack of willingness and ability to comply with the FLSA, but alleges in general terms that respondents' actions will result in denial of the protection of the laws regarding overtime compensation. In essence, this complaint is identical in substance to the SEIU complaint; the Court concludes that it also states a cause of action for declaratory relief.

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<sup>2</sup> This is, of course, distinct from the issue of whether there is any proof tending to demonstrate that FLSA violations actually will occur. This issue is dealt with in the Court's ruling on the merits, below.

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**SCHWARZENEGGER**

**SUPERIOR COURT OF CALIFORNIA,**  
**COUNTY OF SACRAMENTO**

**BY: D. RIOS, SR.,**  
**Deputy Clerk**

**CASE NUMBER: 2008-80000126**

**DEPARTMENT: 19**

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**PROCEEDINGS: Amended Minute Order**

Respondents' demurrers are therefore overruled.

**Ruling on the Petitions and Complaints:**

The petitions for writ of mandate and complaints for declaratory relief challenging the provisions of the Governor's Executive Order imposing furloughs on state employees are based on twin contentions: that the Governor lacks any authority, statutory or otherwise, to take such action; and that applicable statutory law expressly forbids him from taking such action. For the reasons stated below, the Court finds that these contentions are unpersuasive.

The facts regarding the implementation of the furlough are essentially undisputed, as is the fact that the State faces an extremely urgent fiscal crisis.<sup>3</sup> According to documents submitted to the Court, the Governor, through the Department of Personnel Administration, has developed a furlough plan that will result in the closing of general government operations on the first and third Fridays of each month, beginning on Friday, February 6, 2009. The unpaid furlough days are not work days and employees shall not report to work. For state operations that cannot close, a "self-directed" furlough will be used that will result in state employees either taking two furlough days each month on days chosen by the employees and approved by their supervisors, or accruing two furlough days per month to be taken when feasible. Salaries will be adjusted to reflect the unpaid furlough days, but benefits will remain the same.<sup>4</sup>

The Governor's Executive Order thus reduces the normal work hours of state employees for a temporary period due to the state's current fiscal crisis. The emergency measure will result in an accompanying deduction from pay for the hours not worked, but the order does not change established salary ranges. The Governor's authority for this action is found in statutes in the Government Code and in the employment contracts of the unions challenging the order.

The Governor has the statutory authority to reduce the hours of state employees pursuant to Government Code section 19851 and 19849.

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<sup>3</sup> There do appear to be disputes of fact over whether the implementation of the furlough will result in violations of the federal FLSA. This issue will be discussed separately below.

<sup>4</sup> See, Memorandum dated January 9, 2009 from David A. Gilb, Director of the Department of Personnel Administration, to Agency Secretaries, et al., regarding "State Employee Furlough per Governor's Executive Order S-16-08", attached to the Amended Declaration of Peter Flores, Jr. as Exhibit H.

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**SCHWARZENEGGER**

**SUPERIOR COURT OF CALIFORNIA,**  
**COUNTY OF SACRAMENTO**

**BY: D. RIOS, SR.,**  
**Deputy Clerk**

**CASE NUMBER: 2008-80000126**

**DEPARTMENT: 19**

**CASE TITLE: PEGG; CAPS v. SCHWARZENEGGER**

**PROCEEDINGS: Amended Minute Order**

Section 19851(a) provides: "It is the policy of the state that the workweek of the state employee shall be 40 hours, and the workday of the state employee eight hours, except that workweeks and workdays of a different number of hours may be established in order to meet the varying needs of the different state agencies."

Section 19849(a) provides that the Department of Personnel Administration "...shall adopt rules governing hours of work and overtime compensation and the keeping of records related thereto, including time and attendance records. Each appointing power shall administer and enforce such rules."

The Court finds that these two statutes, taken together, provide the Governor with authority to reduce the workweek of state employees to meet the needs of state agencies, and to do so by adopting a rule. The provisions of the Executive Order regarding the furlough are a rule in that they establish a standard of general application to state employees. Under the circumstances of the current fiscal crisis, the reduction in the workweek of state employees under the furlough order is indisputably related to the needs of the various state agencies, which, from the evidence respondents have submitted to the Court, run the imminent risk of running out of money and thus being unable to carry out their missions, if immediate action is not taken to reduce expenditures.

The Court further finds, on two separate bases, that the Governor has authority to reduce the work hours of the state employees represented by the petitioners in these actions pursuant to the terms of the MOUs the State entered into with the petitioner employee organizations, which remain in effect, although technically expired, pursuant to Government Code section 3517.8(a).

First, each of the petitioners' MOUs expressly incorporates the terms of sections 18949 and 19851 into the agreement between the parties<sup>5</sup>, and the terms of the MOU do not conflict with these statutes, notwithstanding that the MOUs call for a normal work week of 40 hours. Thus, these provisions of law are not superseded by the MOUs, and the Governor retains the authority, pursuant to law and contract, to take any actions he would be permitted to take pursuant to Government Code sections 19849 and 19851 as described above.

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<sup>5</sup> See, Respondents' Request for Judicial Notice, filed January 9, 2009, Exhibit A, p. 80 (PEGG MOU); Exhibit B, p. 75 (CAPS MOU); Respondents' Amended Request for Judicial Notice, filed January 23, 2009, Exhibit A, p. 16 (CASE MOU); Exhibit B, p. 20 (SEIU MOU for Bargaining Unit 1); Exhibit C, p. 22 (SEIU MOU for Bargaining Unit 3); Exhibit D, p. 21 (SEIU MOU for Bargaining Unit 4); Exhibit E, p. 21 (SEIU MOU for Bargaining Unit 11); Exhibit F, pp. 22-23 (SEIU MOU for Bargaining Unit 14); Exhibit G, p. 21 (SEIU MOU for Bargaining Unit 15); Exhibit H, p. 21 (SEIU MOU for Bargaining Unit 17); Exhibit I, p. 21 (SEIU MOU for Bargaining Unit 20); Exhibit J, p. 19 (SEIU MOU for Bargaining Unit 21). In addition, the PEGG MOU provides, in Article 17.1, which appears under the heading "State Rights", that: "All the functions, rights, powers and authority not specifically abridged by this MOU are retained by the employer." (See, Respondents' Request for Judicial Notice, filed January 9, 2009, Exhibit A, p. 72.)

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**SUPERIOR COURT OF CALIFORNIA,**  
**COUNTY OF SACRAMENTO**

**BY: D. RIOS, SR.,**  
**Deputy Clerk**

**CASE NUMBER: 2008-80000126**

**DEPARTMENT: 19**

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**PROCEEDINGS: Amended Minute Order**

Second, the specific terms of certain of the petitioners' MOUs expressly permit the State either to reduce hours in case of lack of funds or to take all necessary action to carry out its mission in emergencies.

For example, Article 3.1.B of the MOU between the State and petitioner CASE, which appears under the heading "State Rights", provides that "[t]o the extent consistent with law and this MOU, the rights of the State include, but are not limited to, the exclusive right to...relieve its employees from duty because of lack of work, lack of funds, or for other legitimate reasons...[and to] take all necessary actions to carry out its mission in emergencies."<sup>6</sup>

Article 10.3 of the CASE MOU, which appears under the heading "Layoff", further provides: "The State may propose to reduce the number of hours an employee works as an alternative to layoff. Prior to implementation of this alternative to a layoff, the State will notify and meet and confer with the Union to seek concurrence of the usage of this alternative."<sup>7</sup>

Article 12.1.B of the CAPS MOU, which appears under the heading "State Rights", provides that: "Consistent with this Agreement, the rights of the State shall include, but not be limited to, the right...to take all necessary action to carry out its mission in emergencies."<sup>8</sup>

Article 4.B of each of the SEIU MOUs similarly provides that: "Consistent with this Contract, the rights of the State shall include, but not be limited to, the right...to take all necessary action to carry out its mission in emergencies."<sup>9</sup>

The Court finds that the current fiscal emergency, which is amply documented in the evidence respondents have submitted, authorizes the Governor to reduce the work hours of state employees under these

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<sup>6</sup> See, respondents' Amended Request for Judicial Notice, filed January 23, 2009, Exhibit A, p. 11.

<sup>7</sup> See, Respondents' Amended Request for Judicial Notice, filed January 23, 2009, Exhibit A, p. 59.

<sup>8</sup> See, Respondents' Request for Judicial Notice, filed January 9, 2009, Exhibit B, p. 71.

<sup>9</sup> See, Respondents' Amended Request for Judicial Notice, filed January 23, 2009, Exhibit B, p. 16 (Bargaining Unit 1); Exhibit C, p. 17 (Bargaining Unit 3); Exhibit D, p. 17 (Bargaining Unit 4); Exhibit E, p. 17 (Bargaining Unit 11); Exhibit F, p. 18 (Bargaining Unit 14); Exhibit G, p. 17 (Bargaining Unit 15); Exhibit H, p. 17 (Bargaining Unit 17); Exhibit I, p. 16 (Bargaining Unit 20); Exhibit J, p. 15 (Bargaining Unit 21).

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**DATE : 01/30/09**  
**CASE NO. : 2008-80000126**  
**CASE TITLE : PECG; CAPS v.**  
**SCHWARZENEGGER**

**SUPERIOR COURT OF CALIFORNIA,**  
**COUNTY OF SACRAMENTO**

**BY: D. RIOS, SR.,**  
**Deputy Clerk**

**CASE NUMBER: 2008-80000126**

**DEPARTMENT: 19**

**CASE TITLE: PECG; CAPS v. SCHWARZENEGGER**

**PROCEEDINGS: Amended Minute Order**

cited terms of the various MOUs. The nature of the fiscal emergency is such that the state employee furloughs imposed by the Governor's Executive Order are both necessary and reasonable under the circumstances.<sup>10</sup>

The existence of the current emergency also authorized the Governor to make his order without first meeting and conferring with state employee organizations pursuant to Government Code section 3516.5.

The Court accordingly finds that both statutory law and the provisions of the petitioners' MOUs authorized the Governor to reduce the work hours of state employees through a furlough in the current fiscal emergency.

The Court finds that Government Code section 19826(b) does not preclude the Governor from taking such action.

Section 19826(b) states that the Department of Personnel Administration shall not establish, adjust or recommend a salary range for any employees in an appropriate unit where an employee organization has been chosen as the exclusive representative pursuant to Government Code section 3520.5, which is the case for all of the petitioners in these actions.

This case, however, does not involve the establishment, adjustment or recommendation of a salary range for represented state employees. This case involves a temporary reduction in the hours worked by certain state employees, which will result in a loss of pay for the hours not worked. The order does not change established salary ranges at all: state employees will continue to receive their normal pay according to established ranges in weeks that do not include a furlough day. In essence, state employees are subject to a temporary deduction from their total pay under the established ranges, and not to being paid under a new or adjusted salary range.

The present case is therefore distinguishable from *Department of Personnel Administration v. Superior Court (Greene)* (1992) 5 Cal. App. 4<sup>th</sup> 155, which involved an across-the-board salary cut of 5% with no furlough or reduction in work hours. *Greene* also involved the issue of what the State was entitled to do in the bargaining process under the Ralph C. Dills Act, specifically, whether the State could unilaterally impose the salary cut as part of its "last, best and final offer" when it was officially at impasse with the state employee organizations. The present case does not involve bargaining issues in that the parties are not at impasse, and petitioners' pleadings have raised issues regarding the Governor's positive authority to make the challenged

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<sup>10</sup> At oral argument on these matters, counsel for CASE and PECG argued that many of their members work in so-called "special fund" agencies, and that the Governor's order, which was designed to deal with a looming General Fund deficit, was not reasonably related to the fiscal emergency insofar as it orders furloughs for those employees. (CASE also raised this issue in its reply brief.) This contention was not raised in any of the petitions or complaints for declaratory relief, and petitioners did not submit any evidence to support it. The Court therefore makes no findings on it.

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**SCHWARZENEGGER**

**SUPERIOR COURT OF CALIFORNIA,**  
**COUNTY OF SACRAMENTO**

**BY: D. RIOS, SR.,**  
**Deputy Clerk**

**CASE NUMBER: 2008-80000126**

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**PROCEEDINGS: Amended Minute Order**

order rather than issues regarding any failure to comply with his collective bargaining obligations under the Dills Act.

Moreover, the *Greene* case did not address any provisions of the employee organizations' MOUs that might have authorized the salary reduction in that case, on the basis of an emergency or otherwise, because the case technically involved a situation in which there was an absence of a MOU, as is the case when an existing MOU has expired and the parties have bargained to impasse. (See, *Department of Personnel Administration v. Superior Court (Greene)* (1992) 5 Cal. App. 4<sup>th</sup> 155, 174.) As noted above, the petitioners' MOUs in this case remain in effect pursuant to Government Code section 3517.8(a), and contain provisions authorizing the Governor's order reducing work hours. The *Greene* case therefore is not controlling here.

The Court accordingly rules that, with regard to the issues raised by all petitioners regarding the Governor's authority to make the challenged order, the petitions for writ of mandate are denied and judgment shall be entered for the defendants (respondents) on the complaints for declaratory relief. This ruling applies to both state employees represented by all of the petitioners under the Dills Act and to those state employees represented by petitioners PECG and CAPS who are excluded from the Dills Act by law, as the authorities on which the Court has relied in finding that the Governor has the authority to take the challenged action apply to both classes of employees.<sup>11</sup>

With regard to the causes of action for declaratory relief raised by SEIU and CASE raising issues involving possible non-compliance with the FLSA, the Court finds that as a matter of proof, as distinguished from a matter of pleading, petitioners' claims that implementation of the Governor's order will actually result in employees formerly considered to be exempt from the Act's provisions working overtime within the meaning of the Act during a furlough week, and that the State will not comply with the Act with regard to employees who do so, are entirely hypothetical and speculative prior to implementation of the furloughs, and thus not ripe for decision.

As respondents point out, under applicable federal regulations, employees may be furloughed for budget-related reasons without affecting their exempt status, except for the workweek in which the furlough occurs.<sup>12</sup> The viability of petitioners' FLSA claims therefore depends upon proof that there will be, as a matter of fact,

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<sup>11</sup> At oral argument, counsel for petitioner SEIU raised the contention that the Governor's order amounted to an unconstitutional impairment of contracts. This contention was not raised in any of the petitions, and was not briefed by the parties. Petitioner SEIU did cite several out-of-state cases in its reply brief in which government employee furloughs were challenged on this basis. Those cases were cited, however, for the proposition that a furlough is equivalent to a reduction in employee salary, and not in support of the contention that the Governor's action impaired the petitioner's contracts with the State. Because such contention was not raised by the petitions or briefed by the parties, the Court makes no finding on it.

<sup>12</sup> See, Title 29, Code of Federal Regulations, section 541.710.

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**SUPERIOR COURT OF CALIFORNIA,**  
**COUNTY OF SACRAMENTO**

**BY: D. RIOS, SR.,**  
**Deputy Clerk**

**CASE NUMBER: 2008-80000126**

**DEPARTMENT: 19**

**CASE TITLE: PECG; CAPS v. SCHWARZENEGGER**

**PROCEEDINGS: Amended Minute Order**

employees who work more than 40 hours during a furlough week. At this point, before the furlough actually has been implemented, there is no evidence before the Court regarding any employee actually doing this, let alone any evidence that this will be the case with large numbers of state employees. Petitioners' allegations that this will happen are merely hypothetical.

Similarly, the evidence that petitioner CASE has submitted demonstrating that the State's payroll system is antiquated and lacks the flexibility and reliability to be able to cope with the kind of week-to-week changes in an employee's exempt status that will occur when furloughs are implemented<sup>13</sup>, is not necessarily proof that the State will not be able to cope with paying overtime pay to those to whom it is entitled. Once again, petitioners' proposition that the FLSA will be violated depends upon proof that employees actually will be entitled to overtime, and that there will be sufficient numbers of them that the State will not be able to comply with the FLSA. Such proof is lacking at this point.

Finally, even if petitioners were able to prove that the State was likely to fail to comply with the FLSA with regard to some number of state employees, it would not necessarily follow that they would be entitled to the relief they seek, which is the invalidation of the furlough order itself. Any actual violation of the FLSA would give rise to remedies arising under the FLSA, i.e., for recovery of the unpaid overtime compensation<sup>14</sup>, but the failure to comply with the FLSA in that situation would be a separate issue from the validity of the furlough. Notwithstanding this Court's ruling upholding the Governor's order, any affected employee retains his or her rights and remedies under FLSA, and the Court's ruling that petitioners have not proven an actual violation of the FLSA at this point does not preclude them, or their individual members, from exercising those remedies once an actual violation can be proven. Thus, FLSA compliance issues, hypothetical or otherwise, do not serve as a basis for overturning the Governor's Executive Order regarding furloughs.

The Court therefore finds in favor of defendants (respondents) on the SEIU and CASE complaints for declaratory relief regarding alleged non-compliance with the FLSA.

A final issue remains with regard to the State Controller. As noted in footnote 1 above, the Controller, although named as a respondent/defendant, has taken a position in these actions in alignment with the petitioners, specifically stating that his office "...has no intention of implementing the reduction in pay as contemplated in the Governor's Order, unless determined otherwise by a court of law."<sup>15</sup> In *Tirapelle v. Davis*

<sup>13</sup> See, Declaration of Don Scheppmann, chief of Personnel/Payroll Services Division of the Office of the California State Controller, dated October 14, 2008 and filed in the case entitled *David A. Gilb, California Department of Personnel Administration v John Chiang, Office of State Controller, et al.*, which is pending in the United States District Court for the Eastern District of California, attached to CASE's opposition to respondents' demurrer as Exhibit A.

<sup>14</sup> See, e.g., 29 U.S.C. Section 216.

<sup>15</sup> See, Controller's Opposition to Respondents' Demurrer, p. 2:15-17.

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**SCHWARZENEGGER**

**SUPERIOR COURT OF CALIFORNIA,**  
**COUNTY OF SACRAMENTO**

**BY: D. RIOS, SR.,**  
**Deputy Clerk**

**CASE NUMBER: 2008-80000126**

**DEPARTMENT: 19**

**CASE TITLE: PEGG; CAPS v. SCHWARZENEGGER**

**PROCEEDINGS: Amended Minute Order**

(1993) 20 Cal. App. 4<sup>th</sup> 1317, the Third District Court of Appeal held that the Controller may not refuse to implement an executive action affecting state employees' pay that is authorized by law. In this case, the Court has ruled that the provisions of the Governor's Executive Order reducing the work hours of state employees through a furlough, and thereby affecting their pay during the furlough weeks, is authorized by law. The Controller therefore lacks authority to refuse to implement the Governor's Executive Order. The Court's judgment in this matter therefore shall include an order directing the Controller to take all necessary and appropriate steps to implement the provisions of the Governor's Executive Order imposing furloughs on state employees, including the reduction in such employees' pay.

At the close of the hearing, counsel for CASE made an oral motion on the record that the Court stay its ruling pending appellate review. The Court denied the motion.

////////////////////////////////////

Counsel for respondents is directed to prepare the orders and judgments in accordance with this ruling under the procedures set forth in Rule of Court 3.1312.

Certificate of Service by Mailing attached.

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**SUPERIOR COURT OF CALIFORNIA,**  
**COUNTY OF SACRAMENTO**

**BY: D. RIOS, SR.,**  
**Deputy Clerk**



**CASE NUMBER: 2008-80000126**

**DEPARTMENT: 19**

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**CERTIFICATE OF SERVICE BY MAILING**

**C.C.P. Sec. 1013a(4))**

I, the undersigned deputy clerk of the Superior Court of California, County of Sacramento, do declare under penalty of perjury that I did this date place a copy of the above entitled notice in envelopes addressed to each of the parties, or their counsel of record as stated below, with sufficient postage affixed thereto and deposited the same in the United States Post Office at Sacramento, California.

Gerald James  
Attorney at Law  
660 J Street, Suite 445  
Sacramento, CA 95814

David W. Tyra  
KRONICK, MOSKOVITZ, TIEDEMANN  
& GIRARD  
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Brooke D. Pierman, Staff Attorney  
S.E.I.U.  
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Sacramento, CA 95811

J. Felix DeLa Torre, Staff Attorney  
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Will M. Yamada  
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RICHARD CHIVARO, Chief Counsel  
Ronald V. Placet,  
Sr. Staff Counsel  
Office of the State Controller  
300 Capitol Mall, Ste 1850  
Sacramento, CA 95814

Dated: 1/30/09

Superior Court of California,  
County of Sacramento

By: D. RIOS, SR.,  
Deputy Clerk

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**SUPERIOR COURT OF CALIFORNIA,**  
**COUNTY OF SACRAMENTO**

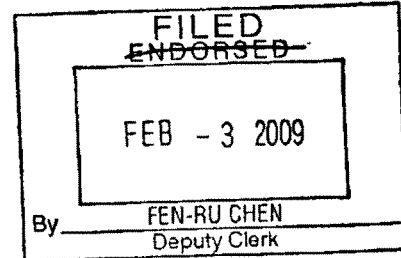
**BY: D. RIOS, SR.,**  
**Deputy Clerk**

# **EXHIBIT B**

ORIGINAL

BROOKS ELLISON  
State Bar No. 122705  
PATRICK J. WHALEN  
State Bar No. 173489  
THE LAW OFFICE OF BROOKS ELLISON  
1725 Capitol Ave.  
Sacramento, CA 95814  
Telephone: (916) 448-2187  
Facsimile: (916) 448-5346  
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Attorneys for Petitioners  
California Attorneys, Administrative Law Judges,  
And Hearing Officers in State Employment



SUPERIOR COURT OF CALIFORNIA  
COUNTY OF SACRAMENTO

CALIFORNIA ATTORNEYS,  
ADMINISTRATIVE LAW JUDGES AND  
HEARING OFFICERS IN STATE  
EMPLOYMENT,

Case No.34-2009-80000134

NOTICE OF APPEAL

Petitioners,  
vs.

ARNOLD SCHWARZENEGGER as Governor  
of the State of California; DAVID GILB as  
Director of the Department of Personnel  
Administration; JOHN CHIANG, Controller of  
the State of California; and DOES 1 through 10,

Date: January 29, 2009  
Time: 9:00 a.m.  
Dept.: 19

Respondents.

PROFESSIONAL ENGINEERS IN  
CALIFORNIA GOVERNMENT;  
CALIFORNIA ASSOCIATION OF  
PROFESSIONAL SCIENTISTS,

Case No.34-2008-80000126 (Related Case)

Petitioners,  
vs.

ARNOLD SCHWARZENEGGER, Governor,  
State of California; DEPARTMENT OF  
PERSONNEL ADMINISTRATION; STATE

1 CONTROLLER JOHN CHIANG; and DOES 1  
2 through 20 INCLUSIVE,

3 Respondents.

4 SERVICE EMPLOYEES INTERNATIONAL  
5 UNION, LOCAL 1000,

6 Petitioners,

7 vs.

8 ARNOLD SCHWARZENEGGER, Governor,  
9 State of California; DEPARTMENT OF  
10 PERSONNEL ADMINISTRATION; STATE  
11 CONTROLLER JOHN CHIANG; and DOES 1  
12 through 20 INCLUSIVE,

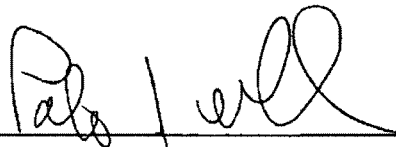
13 Respondents.

Case No.34-2009-80000135 (Related Case)

14 PLEASE TAKE NOTICE that petitioner CALIFORNIA ATTORNEYS,  
15 ADMINISITRATIVE LAW JUDGES AND HEARING OFFICERS IN STATE EMPLOYMENT  
16 ("CASE"), appeals from the judgment and order denying the Petition for Writ of Mandate and  
17 Complaint for Declaratory Relief entered on January 29, 2009.

18  
19 THE LAW OFFICE OF BROOKS ELLISON

20  
21 Dated: Feb 3, 2009

22 

23 PATRICK J. WHALEN

24 Attorneys for Plaintiff  
25 CALIFORNIA ATTORNEYS,  
26 ADMINISTRATIVE LAW JUDGES AND  
27 HEARING OFFICERS IN STATE  
28 EMPLOYMENT

# **EXHIBIT C**



## Office of the Governor

ARNOLD SCHWARZENEGGER  
THE PEOPLE'S GOVERNOR

## EXECUTIVE ORDER S-09-08

07/31/2008

**WHEREAS** the constitutional deadline for enacting a state budget for Fiscal Year 2008-09 has passed without the enactment of a budget, and

**WHEREAS** in the absence of a budget, State government is constitutionally prohibited from making payments that are not compelled by either the State Constitution or federal law; and

**WHEREAS** until there is a state budget, the State has no authority to pay the following payments: (1) Vendors and Contractors for goods and services chargeable to Fiscal Year 2008-09; (2) Payroll for legislative staff, appointees, and exempt employees; (3) Payroll for other state employees beyond that required by federal labor law; (4) Highway User Taxes that are apportioned to the state, cities and counties for highway and road improvement projects; (5) Cal Grants to students in higher education; (6) Transfers to the Trial Courts; (7) Transfers to University of California, California State University, and Community Colleges; (8) Transportation Revolving Fund disbursements; (9) Non-revenue limit school payments; and (10) Payments for non-federally mandated social services programs such as Community Care Licensing, Adult Protective Services, State Only Foster Care, State Only Adoptions Assistance, and Cash Assistance Program for Immigrants; and (11) tax relief payments to low income seniors and disabled persons; and

**WHEREAS** on May 1, 2003, the California Supreme Court, in *White v Davis*, issued a decision that, in conjunction with other pre-existing court orders, clarified that during a period that there is no state budget in place, federal labor laws require the State to pay its nonexempt FLSA employees either federal minimum wage or, for those employees that work overtime, their full salaries plus overtime; and

**WHEREAS** it is not known when a budget will be adopted for Fiscal Year 2008-09, and

**WHEREAS** as a result of the late budget, there is a real and substantial risk that the State will have insufficient cash to pay for state expenditures; and

**WHEREAS** since June 2008, the unprecedented number and size of fires in California has created states of emergency that have required additional and substantial expenditures of cash to ensure that there are sufficient resources to effectively fight these fires and save lives and homes; and

**WHEREAS** it is critical that the State be able to meet any unforeseen emergency such as fire, flood or public health emergency and to continue to make timely payments on constitutionally and federally-mandated obligations and existing obligations to pay holders of state bonds, and

**WHEREAS** due to the impending cash crisis and budget delay, the State may be forced to consider a Revenue Anticipation Warrant (RAW) at an exorbitant cost to the State, including hundreds of millions of dollars in credit enhancements, in order to make sure there is sufficient cash to pay for state expenditures, and

**WHEREAS** after the late adoption of a budget, there will be additional cash demands because all of the deferred payments that were not permitted to be made during the budget impasse will become due and payable, and

**WHEREAS** the late budget has resulted in loss of savings to the State in the amount of \$164 million for July, and failure to enact a budget in August will result in additional loss of savings in the amount of \$323 million; and

**WHEREAS** as a result of the late budget, additional mitigation measures must be implemented to offset the loss of savings and to ensure that there is sufficient cash to make the State's payments; and

**WHEREAS** the State employs nearly 22,000 retired annuitants, permanent intermittent employees, and seasonal employees and the State hires new employees at the rate of approximately 1,700 per month; and

**WHEREAS** except for services and functions of state government deemed critical by this Order, additional mitigation measures need to be taken to immediately reduce expenditures and preserve cash, including the following (1) halting all hiring, transfers and promotions of employees, and contracting for individuals to perform services; (2) prohibition of overtime; (3) termination of the services of retired annuitants, permanent intermittent employees, seasonal employees, temporary help workers and, student assistants; and (4) suspension of personal services contracts

**NOW, THEREFORE, I, ARNOLD SCHWARZENEGGER**, Governor of the State of California, in accordance with the authority vested in me by the Constitution and the statutes of the State of California, do hereby issue the following orders to become effective immediately.

**IT IS ORDERED** that the services and functions of state government directly related to the preservation and protection of human life and safety, including but not limited to emergency and disaster response activities and the provision of 24-hour medical care, shall be deemed critical and exempt from this Order

**IT IS FURTHER ORDERED** that except for services and functions of state government deemed critical and exempt by this Order, all State agencies and departments under my direct executive authority take immediate action effective July 31, 2008 to cease and desist hiring of employees (except in instances in which there is a bona fide offer and acceptance prior to the effective date of this Order), transferring employees between State agencies and departments, promoting employees, and contracting for individuals to perform services.

**IT IS FURTHER ORDERED** that except for services and functions of state government deemed critical and exempt by this Order and emergent situations to preserve and protect human life and safety, all State agencies and departments under my direct executive authority take immediate action to cease and desist authorization of all overtime for employees effective July 31, 2008

**IT IS FURTHER ORDERED** that except for services and functions of state government deemed critical and exempt by this Order, all State agencies and departments under my direct executive authority take immediate action to terminate the services of the following five categories of employees and individuals effective July 31, 2008. (1) Retired Annuitants, (2) Permanent Intermittent Employees, (3) Seasonal Employees; (4) Temporary Help Workers; and (5) Student Assistants

**IT IS FURTHER ORDERED** that except for services and functions of state government deemed critical and exempt by this Order and except for services provided pursuant to multi-year contracts for Information Technology systems and services, all State agencies and departments under my direct executive authority take immediate action to suspend all personal services contracts effective July 31, 2008.

**IT IS FURTHER ORDERED** that all Agency Secretaries and Department Directors shall take immediate action to implement this Order, and any other action that will reduce state expenditures.

**IT IS FURTHER ORDERED** that the Director of the Department of Finance shall establish an exemption process that Agency Secretaries shall utilize to determine if an exemption is justified based on critical services and functions, which may include either cost-reducing or revenue-producing services and functions that will help ensure that there is sufficient cash for the State to make its payments.

**IT IS FURTHER ORDERED** that Agency Secretaries and Cabinet-level Directors shall report their exemptions to the Cabinet Secretary and the Director of the Department of Finance within 24 hours of approving an exemption.

**IT IS FURTHER ORDERED** that the Director of the Department of Finance and Director of the Department of Personnel Administration shall work with the State Controller to develop and implement the necessary mechanisms, including but not limited to pay letters and computer programs, to comply with the California Supreme Court's *White v. Davis* opinion to pay federal minimum wage to those nonexempt FLSA employees who did not work any overtime.

**IT IS FURTHER ORDERED** that the necessary mechanisms to ensure compliance with the *White v. Davis* opinion must be in place to be effective for the August 2008 payroll

**IT IS HEREBY REQUESTED** that during this budget impasse, the State Treasurer shall take all actions necessary to maintain the State's ability to pay its bond obligations, including payment of principal and interest with funds in the State Treasury, and shall take all actions that are necessary to protect the State's funds and investments

**IT IS FURTHER REQUESTED** that other entities of State government not under my direct executive authority, including the California Public Utilities Commission, the University of California, the California State University, California Community Colleges, constitutional officers, the legislative branch (including the Legislative Counsel Bureau), and judicial branch, assist in the implementation of this Order and implement similar mitigation measures that will help to preserve the State's cash supply during this budget impasse.

**IT IS FURTHER ORDERED** that this Order shall remain in effect until such time as both a Fiscal Year 2008-09 Budget is adopted and the Director of the Department of Finance confirms an adequate cash balance exists to meet the State's fiscal obligations.

**I FURTHER DIRECT** that as soon as hereafter possible, this Order be filed in the Office of the Secretary of State and that widespread publicity and notice be given to this Order.



**IN WITNESS WHEREOF** I have hereunto set my hand and caused the Great Seal of the State of California to be affixed this 31st day of July 2008.

**ARNOLD SCHWARZENEGGER**  
Governor of California

**ATTEST:**

**DEBRA BOWEN**  
Secretary of State



# **EXHIBIT D**



# Office of the Governor

ARNOLD SCHWARZENEGGER  
THE PEOPLE'S GOVERNOR

## PRESS RELEASE

09/23/2008 GAAS.650 08 FOR IMMEDIATE RELEASE

### Governor Schwarzenegger Signs State Budget with Budget Reform

Governor Arnold Schwarzenegger today signed the 2008-09 state budget, concluding a very difficult budget year and delivering a real win for Californians with a proposal to achieve meaningful budget reform. It addresses California's \$15.2 billion budget shortfall with a combination of cuts and increased revenues. It fully funds education's Proposition 98 guarantee and does not borrow funding from voter-approved local government or transportation funds. The historic budget reform package includes a strong rainy-day fund aimed at helping smooth out the unpredictable highs and lows in revenues that plague our state and create massive deficits.

"While California is certain to face a difficult budget situation again next year, this budget does not take money out of people's paychecks or borrow from voter-approved local government or transportation funds, and it includes real budget reform with teeth," Governor Schwarzenegger said. "These budget reforms, when approved by voters, will finally put California's budget on a path toward long-term fiscal stability."

Throughout California's history, numerous attempts have been made to reform our state's broken budget system. When the Governor was elected, he committed to finally end California's feast and famine budget cycle. In 2004, the Governor worked with the legislature to pass Proposition 58, which took the first step toward budget reform. In 2005, the Governor attempted the next step in budget reform with Proposition 76, and while it was defeated, the Governor remained committed to reform.

Today, the Governor delivered on his commitment with reforms to address two major flaws in the state budget system: wildly volatile revenues and over spending. In fact, had these reforms been in place over the past decade, this year's budget problem would have been approximately \$10 billion smaller and California would have benefited from \$8 billion in additional funding available for infrastructure and other one-time purposes. The proposal will now go before voters on the next statewide election ballot.

Over the weekend, the Governor used his veto pen to make an additional \$510 million in General Fund reductions, reflecting the Governor's determination to reduce spending to the maximum extent possible. The state also captured \$340 million in savings due to the delay in enacting the budget and the effect of the Governor's executive order.

#### BUDGET REFORM

##### A Rainy-Day Fund With Teeth

Increases the size of California's Budget Stabilization Account (BSA) from 5 percent of General Fund expenditures to 12.5 percent-or approximately \$13 billion dollars today.

Requires annual transfers to the BSA of 3 percent of General Fund and eliminates the ability to suspend those annual transfers. During economic downturns, when funds can be drawn out of the BSA, the transfer would not occur.

In addition to the annual transfer of 3 percent of General Fund to the BSA, requires that all current-year revenue that is above 5 percent of the amounts included in the Budget Act be transferred to the BSA, after first providing funding to education as required under Proposition 98. This means that unexpected spikes in revenues that occur during the fiscal year - normally recognized in the Governor's May Revision - will be transferred to the BSA or used exclusively for one-time spending.

Funds can only be transferred out from the BSA under the following conditions. 1) actual revenues during the Fiscal Year must be below a specified level: prior year spending adjusted by population growth and per capita personal

income growth; 2) funds transferred from the BSA back into the General Fund must be appropriated in a stand-alone bill. The amount transferred out of the BSA during a fiscal year will be limited to the amount which would bring revenues up to prior year spending adjusted by population and per capita personal income growth

When the balance in the BSA reaches 12.5 percent, any excess revenues acquired mid-year will be available for one-time expenditures only. One-time purposes will include: paying down debt, paying off outstanding General Obligation bonds, investing in infrastructure and capital outlay projects, paying for "settle-up" dollars owed to education, pre-paying health care liability for retired employees (OPEB) and tax relief.

#### **Mid-Year Reduction Authority**

Authorizes the Director of Finance to do the following when s/he determines, mid-year, that revenues have fallen below specified levels.

- Reduce state operations budgets by up to 7 percent without modifying or suspending the law.
- Freeze Cost of Living Adjustments (COLAs), rate increases or increases in state participation in local costs, as designated in the Budget Act, for up to 120 days.
- The governor can submit urgency legislation to permanently suspend COLAs and other rate increases. If the governor fails to act within the 120 days, or the Legislature fails to adopt the suspension, the COLAs and other rate increases are reinstated.

#### **ADDITIONAL BUDGET CUTS**

- This budget holds General Fund spending to virtually no growth this year-\$103.4 billion 2008-09 compared to \$103.3 billion in 2007-08.
- The Budget includes a reduction of \$850 million General Fund spending or one percent below the amounts proposed in the budget bill adopted by the Legislature. This reduction represents \$9.7 billion in spending reductions and is due to:
  - \$510 million-General Fund vetoes. These vetoes reflect the Governor's determination to reduce spending to the maximum extent possible given constitutional, statutory and court-ordered spending requirements.
  - \$340 million-General Fund savings due to the delay in enacting this Budget and the effect of the Governor Executive Order S-09-08. Given the state's fiscal condition, the order will remain in effect for the remainder of the year.

#### **LOTTERY MODERNIZATION AND SECURITIZATION**

- Proposes a ballot measure to modernize the state Lottery and improve the performance of this underperforming state-owned asset.
- If passed by voters, future proceeds of an improved state Lottery would be securitized (estimated to be approximately \$5 billion in 2009-10) with the additional revenues used to pay down debt and fill the rainy-day fund in the out-years.

#### **EDUCATION FUNDING**

Funds the Proposition 98 guarantee at \$58.1 billion - \$1.5 billion higher than the current-year funding. This level of funding eliminates the proposed reductions in the Governor's May Revision and maintains funding to base categorical programs such as class size reduction, special education, child nutrition programs and child care.

#### **BRINGING IN REVENUE**

The budget passed by the Legislature originally included a measure that would have taken more money out of hardworking Californians' paychecks by requiring that they pay 10 percent more state taxes from Californians to balance the state's books in 2009 - for a total of \$1.6 billion. The Governor rejected it, and it was replaced instead with a plan to bring in outstanding tax revenue owed to the state by increasing penalties on corporations that under-report by more than \$1 million what they owe the state.

- Imposes a 20 percent penalty on the under-reporting of tax owed to the state and applies to any corporation that under-reports by more than \$1 million. (Applies to taxable years beginning in 2003 in which the statute of limitations is open and allows taxpayers an opportunity to file an amended return by May 31, 2009, to avoid the penalty.)

- The Franchise Tax Board estimates that the state will bring in \$1.51 billion over the 2007-08 and 2008-09 budget years. California has had success with this kind of tax collection program before. The similar tax amnesty program the state conducted in 2005 brought in an additional \$3.6 billion, according to the Department of Finance.

A two-year suspension of the Net Operating Loss (NOL) tax deduction: Suspends for two years the ability of corporations to reduce their tax liability based on prior losses and phases in conformity to federal law over three years starting in 2010 by allowing losses to offset profits in two prior years; also extends the period for carrying forward losses from 10 to 20 years.

#### **ECONOMIC STIMULUS**

Includes an economic stimulus package that:

- Expedites the allocation and disbursement of existing transportation and housing bond funds to stimulate economic growth and job creation immediately.
- Authorizes new lease revenue bonds to accelerate capital outlay projects for higher education.
- Provides flexibility in overtime laws to exempt high-paid software engineers in the competitive technology industry from overtime rules.

# **EXHIBIT E**

# GOVERNOR'S BUDGET



## SPECIAL SESSION 2008-09

### INTRODUCTION

Economic conditions have deteriorated dramatically since the Governor signed the 2008 Budget Act on September 23. This deterioration was reflected in General Fund revenue collections for the month of September that came in \$923 million below forecast. As a result, California faces a revenue shortfall of \$11.2 billion this year. Specifically, the Department of Finance estimates that General Fund revenues will be approximately \$567 million lower in 2007-08, \$10.7 billion lower in 2008-09, and \$13 billion lower in 2009-10 than earlier projections.

This significant revenue shortfall demands immediate action for the following reasons:

- A revenue reduction of this magnitude will reduce total cash resources below acceptable levels next month. If no action is taken to reduce spending, increase revenues, or a combination of both, the state will run out of cash in February and be unable to meet all of its obligations for the rest of the year.
- The revenue reduction will eliminate the \$1.7 billion reserve adopted in the Budget Act and create a General Fund budget gap of \$9.5 billion.
- Quick action to restore balance to the current year budget will lay the groundwork for balancing the budget for 2009-10.



## INTRODUCTION

- Delays in enacting budgetary solutions will significantly reduce the value of those solutions for this year and next, thereby necessitating even more spending reductions and/or revenue increases

In light of the urgency of the situation, Governor Schwarzenegger has called a special session of the Legislature and is proposing a variety of spending reductions and revenue increases to bring spending closer in line with available revenues. In addition, given the economic downturn and its impact on families and workers, the Governor is proposing numerous measures to help stimulate the economy to help families stay in their homes and to keep Californians employed.

## OVERVIEW OF THE PROPOSALS TO ADDRESS THE SHORTFALL

The Governor's special session proposals include spending reductions totaling \$4.5 billion, or 49 percent of the total proposed solutions, while revenue increases account for \$4.7 billion, or 51 percent of the total solutions. As the figure shows, these proposals are in addition to the \$24.3 billion in solutions enacted in the Budget Act of 2008. When all of the solutions are considered, spending reductions account for 49 percent, revenue increases account for 39 percent and borrowing accounts for 12 percent.

Final spending and revenue projections for the 2009-10 Governor's Budget will not be available until January. Therefore, this special session proposal is based on preliminary projections of the revenue shortfall only and does not reflect the total potential budget gap. The economic situation and the revenue shortfall are so severe that it is clear that there will be a substantial deficit projected for 2009-10. Therefore, the descriptions of the fiscal effects of the special session proposals include estimates of their impact in 2009-10.

# INTRODUCTION

Figure INT-01  
Major Solutions  
(Dollars in Millions)

	As of 2008 Budget Act			2008-09		
	2007-08 & prior	2008-08	Total	Special Session	Total	
<b>Revenue Increases</b>						
Corporate Penalty for Understatement of Tax	\$1,435	\$75	\$1,510		\$1,510	
Net Operating Loss Suspension and Carryback		1,265	1,265		1,265	
Tax Credit Limitation and Usage Modification		615	615		615	
Limited Liability Corporations Payment Date Change		360	360		360	
Accelerate Estimated Payments		1,270	1,270		1,270	
Remove Estimated Payment Option for High Income Taxpayers		1,035	1,035		1,035	
Accrual Change	418	1,440	1,858		1,858	
Additional Tax Revenues (LAQ/DOF) (June)	120	-250	-130		-130	
Additional Tideland Revenues (LAQ/DOF)	24	166	190		190	
Additional Revenues from Tribal Compacts		78	78		78	
FTB/BOE Revenue Options		226	226		226	
Transfers from Special Funds		141	141		141	
Justice Settlement (transfer to GF)		11	11		11	
Temporary (3-year) 1.5 cent Increase in Sales Tax				\$3,540	3,540	
Oil Severance Tax (9.9% tax rate, exception for stripper wells)				530	530	
Expand Sales Tax to Some Services				357	357	
Nickel a Drink Alcohol Tax				293	293	
All Other Changes	63	74	137		137	
<b>Total Revenue Increases</b>	<b>\$2,058</b>	<b>\$6,506</b>	<b>\$8,564</b>	<b>\$4,720</b>	<b>\$13,284</b>	<b>40%</b>
<b>Borrowing</b>						
Economic Recovery Bonds	\$3,313		\$3,313		\$3,313	
Loans from Special Funds		\$714	714		714	
<b>Total Borrowing</b>	<b>\$3,313</b>	<b>\$714</b>	<b>\$4,027</b>	<b>\$0</b>	<b>\$4,027</b>	<b>12%</b>
<b>Expenditure Reductions</b>						
<b>Proposition 98</b>						
Property Tax	\$275	\$423	\$698		\$698	
Redevelopment Agency Pass Through		350	350		350	
Settle-Up Payment	150		150		150	
Base	671	2,643	3,314	\$2,500	5,814	
<b>Non Proposition 98</b>						
Budget Balancing Reductions	113	2,154	2,267		2,267	
<b>Non Budget Balancing Reductions</b>						
Medi-Cal Program Savings	165		165	142	307	
Suspend Prop 56 Transfer		1,509	1,509		1,509	
Use of Public Transportation Account for Home-to-School Transportation		488	488		488	
Use Spillover Monies for Debt Service Payments		250	250		250	
Reimburse of GF for Past Debt Service Payments from TDSF		235	235		235	
Reduce Mandates Funding		53	53		53	
Eliminate Estimated Claims for N98 Mandates		75	75		75	
Defer Third Year Payment of 15-Year Plan for Old N98 Mandates		75	75		75	
Eliminate Funding for CCPOA Last, Best, and Final Offer	260	230	490		490	
Health and Dental Benefits for Annuitants Premium Reductions	23	81	104		104	
State Cash Management Improvement Program		60	60		60	
Reduction (Control Section 4 07)		50	50		50	
Savings Due to Budget Delay and Executive Order S-09-08		340	340		340	
CDCR--Limit Parole Supervision				78	78	
Funding Realignment for Public Safety Grant Programs				250	250	
Reduce UC and CSU budgets to the 10% Across-the-Board Reduction Funding Level				132	132	
Developmental Services Program Savings				34	34	
SSI/SSP Program Savings				391	391	
CalWORKs Program Savings				274	274	
IHSS Program Savings				118	118	
Reduce State Funding for Transit Agencies				230	230	
Eliminate Funding for the Williamson Act				35	35	
Employee Compensation Changes				320	320	
All Other Changes	60	137	197		197	
<b>Total Expenditure Reductions, before vetoes</b>	<b>\$1,717</b>	<b>\$9,153</b>	<b>\$10,870</b>	<b>\$4,504</b>	<b>\$15,374</b>	<b>46%</b>
Vetoes		\$510	\$510		510	<b>2%</b>
Reduce Reserve		\$306	\$306		306	<b>1%</b>
<b>Total Solutions</b>	<b>\$7,088</b>	<b>\$17,189</b>	<b>\$24,277</b>	<b>\$9,224</b>	<b>\$33,501</b>	<b>100%</b>



## **STIMULATE THE ECONOMY/RETAIN AND CREATE JOBS**

Finally, the special session will focus on various proposals to help stimulate the economy, retain and create jobs, and reduce barriers to job creation and retention

The economic stimulus proposals include accelerating the appropriation of \$700 million remaining in Proposition 1B funds for improvements to local streets and roads. These funds will be available for cities and counties that agree to encumber the funds by December 31, 2009, certify that their local fund balances for road maintenance do not exceed three months of their Highway Users Tax Account (HUTA) and Transportation Investment Fund (TIF) revenues, and meet accountability requirements

The economic stimulus proposal also provides an additional \$800 million in Proposition 1B funding in 2008-09 for local transit agencies to accelerate several large local transit projects. Moreover, to create jobs in a sector heavily impacted by the current downturn, some Proposition 1B projects administered by Caltrans totaling \$822 million will be accelerated by waiving some state and federal environmental requirements

The economic stimulus proposal also includes accelerating the implementation of \$147 million of water and flood projects funded by Propositions 84 and 1E. Under existing law, these funds will not be available until March 1, 2009. The Administration believes urgency legislation is necessary to make these Proposition 84 and 1E funds available immediately. In addition, the Governor will seek action by the federal government to move an additional \$57.1 million in water projects forward now.

The special session proposal will also include the reintroduction of the necessary amendments to AB 900 so that needed construction for the Department of Corrections and Rehabilitation can begin as well as to create valuable jobs in the state. The Administration is also looking forward to continuing to work with the Legislature to address the correctional systems' capital needs for medical and mental health services.

The Governor will propose the following in the special session.

- Easing regulations to allow "in the pipeline" hospital construction projects to move forward
- Providing flexibility to employers regarding flex time schedules, meal and rest periods, and overtime rules, to reduce the amount of costly litigation and encourage employers to keep jobs in-state

## INTRODUCTION


- Providing tax incentives to new film and television production locating in California and production that has left the state, to return in-state
- Creating reforms to help homeowners avoid foreclosure and stay in their homes, as well as reforms to the lending process that will help prevent a future mortgage crisis in California

## ECONOMIC OUTLOOK AND REVENUE ESTIMATES

### ECONOMIC OUTLOOK

Less than six weeks after the enactment of the 2008-09 budget, a string of weak economic statistics, arriving during a spreading credit crunch and the bankruptcies and rescues of several financial institutions, has convinced most economists that the national economy is in recession. Most persuasive was a sharp fall in consumer spending in the third quarter of 2008 and a stock market collapse in October. Mounting job losses, falling home prices, plunging equity prices, and tight credit conditions have worn down consumers. One widely followed measure of consumer confidence – The Conference Board Consumer Confidence Index – fell to a record low in October. Slower consumer spending is, in turn, dampening business spending on equipment and structures.

While economic statistics on the California economy are fewer and less timely than those on the national economy, there is no doubt that the California economy is experiencing the same pressures as the national economy. Job losses have grown in recent months. The state's unemployment rate has risen quickly in the last year and is considerably higher than the national rate. Housing prices are falling faster in the state than in the nation. Taxable sales were below year-ago levels in the most recent four quarters of available data. Auto sales have dropped farther in the state than the nation.



## ECONOMIC OUTLOOK AND REVENUE ESTIMATES

The outlook for the national and California economies has deteriorated considerably since the budget enactment. Weaker GDP growth, bigger job losses, and smaller personal income gains are now expected in 2009. Whereas a short, modest economic decline was expected before, a deeper and longer decline is much more likely now. How long and how deep depends largely on how long it takes for credit to become much more available.

### **The Nation**

Real GDP decreased 0.3 percent in the third quarter of 2008, with the weakness widely spread across major spending categories. A 3.1-percent drop in consumer spending—the largest percentage decline in 28 years—did most of the damage. Business equipment spending and residential construction also fell, and export growth slowed.

The economy ended the third quarter much weaker than it began, and this was before the stock market delivered its greatest drop in 21 years in October with paper losses of \$2.5 trillion. Retailers are expected to report very weak October sales, which will bode poorly for holiday sales. The fourth quarter of 2008 is expected to be considerably weaker than the third quarter.

The Federal Reserve and U.S. Treasury took dramatic steps in September and October to reinvigorate credit markets. On October 29, the Federal Reserve lowered by one-half percentage point its target for the interest rate banks charge one another for short-term loans. This brought the target rate to 1 percent, leaving the central bank very little room to further ease monetary policy. Thus, it appears increasingly likely that Congress will enact another economic stimulus package.

### **California**

California labor markets have weakened as 2008 has progressed. In the first nine months of the year, California lost 78,600 jobs, but in the first five months the average monthly loss was 5,200 jobs, while in the last four months, it was 13,200 jobs. Seven of the 11 major industry sectors have lost jobs since the end of 2007, with construction, retail trade, and financial activities—which includes real estate and mortgage lending services—accounting for the bulk of the job losses. The state's unemployment rate began 2008 at 5.9 percent and quickly rose to 7.7 percent in August and September.

California's housing slump continues to be a significant drag on the economy. But home sales have started to pick up, especially sales of distressed houses. New home sales remain at low levels. Average home prices continue to drop. In September, the median price of existing homes sold, \$316,500, was 41 percent lower than the median price a

## ECONOMIC OUTLOOK AND REVENUE ESTIMATES

year earlier. Some of the decline is due to a changing mix of homes that have sold—more moderately priced homes and fewer expensive homes. Unsold inventories have stabilized at six months of sales at current monthly sales rates. Single-family home building appears to have stabilized at very low rates.

### The Outlook

The outlook for the state and national economies darkened considerably as 2008 progressed and accelerated through the end of October. Economic growth was already expected to be low before the credit and stock market turmoil developed. Recent economic statistics point to considerable economic weakness in the fourth quarter of 2008 and in 2009. It appears that consumers will get little reprieve from job losses, falling home prices, and low equity prices. The state's unemployment rate could exceed 10 percent in some months of 2009 and 2010. The impact of the financial rescue measures enacted by Congress in October is uncertain at this point. The national and California economies will face strong headwinds in 2009 and the first half of 2010.

A new forecast will be prepared for the Governor's Budget that will incorporate new economic data released in November and be informed by events and other forecasts that become available in the next few weeks.

Figure Econ-01 shows selected economic indicators used in the current forecast.

Figure ECON-01  
**Economic Outlook**  
Percentage changes unless otherwise noted

	2008 (Est.)	2009 (Projected)	2010 (Projected)
<b>Selected United States Economic Indicators</b>			
Real gross domestic product	1.4	-0.9	1.6
Personal income	4.3	1.9	2.6
Corporate profits before taxes	-12.2	1.4	6.3
Nonfarm wage and salary employment	-0.1	-1.6	0.2
Unemployment rate (Percent)	5.7	7.6	8.1
Housing starts (1,000s of units)	931	737	1,013
<b>Selected California Economic Indicators</b>			
Personal income	4.0	2.2	2.6
Nonfarm WAS employment	-0.4	-1.2	-0.4
Unemployment rate (Percent)	7.0	9.0	9.7
Housing permits (1,000s of units)	67	64	83

Forecast based on data available as of October 2008  
Percent changes calculated from unrounded data

## REVENUE ESTIMATES

To provide the Governor and the Legislature with the most up-to-date assessment of current year revenues, the Department has taken into account available data and input from economists, including experts outside of the department to provide an updated revenue projection. Developing this preliminary revenue assessment is highly unusual and outside the traditional revenue estimates included in the Governor's Budget or the May Revision. Based on the latest available data, the Department now projects that baseline General Fund revenues are expected to be approximately \$102.4 billion in 2007-08, \$91.3 billion in 2008-09, and \$89.5 billion in 2009-10. New revenues from tax law changes proposed in the special session are estimated to be \$4.7 billion in 2008-09 and \$10.3 billion in 2009-10. Proposed total revenues are \$96.1 billion in 2008-09, and \$99.8 billion in 2009-10.

Expected baseline revenues have been reduced from Budget Act estimates by approximately \$567 million in 2007-08, \$10.7 billion in 2008-09, and \$13 billion in 2009-10. The reductions are primarily due to reductions to the economic forecast for personal income, capital gains and corporate profits, and lower tax collections. Expected baseline revenues for 2009-10 also reflect a \$500 million reduction for the sale of the EdFund, which is no longer expected to be completed in 2009-10.

The \$7.2 billion revenue reduction to 2008-09 baseline Personal Income tax revenues is largely due to lower expected capital gains. Capital gains accounts for \$4.0 billion of the 2008-09 personal income tax revenue loss. The remaining approximately \$3.2 billion reduction is due to a lower forecast for personal income components such as wages and salaries and proprietorship income.

The approximately \$1.6 billion reduction to 2008-09 baseline Sales and Use tax revenues is due to lower collections, and lower expected disposable income, auto sales and less construction of new housing.

The approximately \$1.6 billion reduction to baseline Corporation tax revenues is due to lower third-quarter corporate estimated payments and lower expected corporate profits.

Figure REV-01 displays the forecast changes between Budget Act and Special Session

# ECONOMIC OUTLOOK AND REVENUE ESTIMATES

Figure REV-01  
**2008-09 Special Session**  
**GENERAL FUND REVENUE FORECAST**  
**SUMMARY TABLE**  
**Reconciliation with 2008-09 Budget Act**  
(In millions)

Source	Budget Act	Special Session			
		Baseline	Change between Forecasts	Proposed	Change between Forecasts
<b>Fiscal 07-08</b>					
Personal Income Tax	\$54,380	\$54,289	-\$91	\$54,289	-\$91
Sales & Use Tax	26,813	26,613	-\$200	\$26,613	-\$200
Corporation Tax	11,926	11,690	-\$236	\$11,690	-\$236
Insurance Tax	2,171	2,173	\$2	\$2,173	\$2
Other Revenues	6,525	6,457	-\$68	\$6,457	-\$68
Transfers	<u>1,212</u>	<u>1,238</u>	<u>\$26</u>	<u>\$1,238</u>	<u>\$26</u>
Total	\$103,027	\$102,460	-\$567	\$102,460	-\$567
<b>Fiscal 08-09</b>					
Personal Income Tax	\$55,721	\$48,479	-\$7,242	\$48,479	-\$7,242
Sales & Use Tax **	27,111	25,486	-\$1,625	\$29,383	\$2,272
Corporation Tax	13,073	11,426	-\$1,647	\$11,426	-\$1,647
Insurance Tax	2,029	2,177	\$148	\$2,177	\$148
Other Revenues	3,242	2,967	-\$275	\$3,789	\$547
Transfers	<u>816</u>	<u>798</u>	<u>-\$18</u>	<u>\$798</u>	<u>-\$18</u>
Total	\$101,992	\$91,333	-\$10,659	\$96,053	-\$5,940
Change from Fiscal 07-08	-\$1,035	-\$11,127		-\$6,408	
% Change from Fiscal 07-08	-1.0%	-10.9%		-6.3%	
<b>Fiscal 09-10</b>					
Personal Income Tax	\$55,863	\$48,824	-\$7,039	\$48,824	-\$7,039
Sales & Use Tax **	29,248	25,234	-\$4,014	\$33,709	\$4,461
Corporation Tax	11,982	10,731	-\$1,251	\$10,731	-\$1,251
Insurance Tax	2,135	2,135	\$0	\$2,135	\$0
Other Revenues	3,366	2,603	-\$763	\$4,389	\$1,023
Transfers	<u>15</u>	<u>61</u>	<u>\$46</u>	<u>\$61</u>	<u>\$46</u>
Total	\$102,609	\$89,588	-\$13,021	\$99,849	-\$2,761
Change from Fiscal 08-09	\$617	-\$1,745		\$3,796	
% Change from Fiscal 08-09	0.6%	-1.9%		4.0%	

\*\* Proposed sales and use tax numbers include \$322 million for 2008-09 and \$713 million for 2009-10 that will be transferred under Proposition 42 to the Transportation Investment Fund. Of these amounts, \$676 million will be transferred in 2009-10 and \$359 million in 2010-11.

**Proposed Law Changes**

**Temporary Sales Tax Increase:** Effective January 1, 2009, a temporary rate increase of 1.5 percent is proposed for three years in the General Fund Sales and Use tax. At the end of three years, the Sales and Use tax rate will return to 5 percent. This proposal is expected to generate additional sales tax revenues of \$3.540 billion in 2008-09 and \$7.319 billion in 2009-10 for the General Fund. These amounts include \$322 million for 2008-09 and \$713 million for 2009-10 that will be transferred under Proposition 42 to the Transportation Investment Fund. Of these amounts, \$676 million will be transferred in 2009-10 and \$359 million in 2010-11.

**Broaden the Sales and Use Tax to Include Certain Services:** Effective February 1, 2009, it is proposed to apply the sales and use tax rate to appliance and furniture repair, vehicle repair, golf, and veterinarian services. Effective March 1, 2009, the sales and use tax rate will be applied to amusement parks and sporting events. Assuming a 6.5-percent General Fund tax rate, this proposal is expected to generate additional General Fund sales tax revenue of \$357 million in 2008-09 and \$1.156 billion in 2009-10. These estimates assume initially low collections but significant improvements in collections over time. This proposal will also generate revenues for local government agencies of \$151 million in 2008-09 and \$487 million in 2009-10, including \$27 million for local public safety funds in 2008-09 and \$89 million in 2009-10.

**Oil Severance Tax:** Effective January 1, 2009, it is proposed to impose an oil severance tax upon any oil producer extracting oil from the earth or water in California. The tax shall be applied to the gross value of each barrel of oil at a rate of 9.9 percent. Any oil produced by a stripper well, in which the average value of oil as of January 1 of the prior year is less than fifty dollars (\$50) per barrel, will be exempt from this tax. Also, any oil owned or produced by any political subdivision of California will be exempt from this tax. This proposal is expected to generate additional revenues of \$528 million in 2008-09 and \$1.195 billion in 2009-10.

**Increase Alcohol and Excise Taxes by 5 Cents a Drink:** Alcohol excise taxes are proposed to be raised by five cents per drink beginning on January 1, 2009. A drink is defined as 1.5 ounces of distilled spirits, 12 ounces of beer, or 5 ounces of wine. This increase is estimated to raise \$293 million in 2008-09 and \$585 million in 2009-10. These estimates are adjusted to reflect an estimate of reduced consumption caused by the increase in price. Alcohol taxes were last raised in 1991. See the Funding Realignment portion of Program Reductions for information on uses of these revenues.



## ECONOMIC OUTLOOK AND REVENUE ESTIMATES

**Vehicle Registration Fee Increase:** Effective February 1, 2009, annual vehicle registration fees are proposed to be increased by \$12 to offset a shift of Vehicle License Fee revenue from the support of the Department of Motor Vehicles to support local criminal justice programs. This special fund revenue will provide \$150 million for these programs in 2008-09 and \$359 million in 2009-10 and future years. See the Funding Realignment portion of Program Reductions for information on uses of these revenues.

## PROGRAM REDUCTIONS

The Administration proposes a total of \$4.5 billion of General Fund reductions in 2008-09 program costs. These reductions will generate \$6.1 billion in General Fund savings in 2009-10. The reductions are in addition to the \$11.38 billion in expenditure reductions in the 2008 enacted budget.

### PROPOSITION 98 (K-14)

#### Total Proposition 98

Due to significant declines in anticipated revenues since the budget was enacted, the Administration proposes total Proposition 98 expenditure reductions of \$2.5 billion in 2008-09 in the special session, including eliminating the partial COLA provided to K-12 revenue limits and community college apportionments, Child Care programs savings, and further reducing general purpose funding for all Local Education Agencies, which will be accompanied by dramatic flexibility provisions that will allow LEA's to transfer categorical funds at their discretion to ensure adequate funding for essential classroom instruction and services. Specific savings proposals are summarized below.

#### K-12 Programs

- \$244.3 million is proposed for reduction by eliminating the 0.68-percent COLA provided for school district and county office of education revenue limits.

## PROGRAM REDUCTIONS

- \$1.791 billion is proposed for reduction by further reducing the amount for local education agency (LEA) revenue limits, coupled with flexibility to transfer categorical funds to each LEA's general fund. This strategy is necessary to provide maximum flexibility to local education agencies (LEAs). It is the Administration's expectation that LEAs will maintain as much funding as possible for direct classroom instruction and the most essential support services. Therefore, the Administration proposes to authorize LEAs to transfer any categorical allocations received to their general fund for any purpose up to the amount of their share of the reduction. Districts electing to utilize this flexibility must adopt a transfer plan in a regularly scheduled governing board meeting and agree to report the amounts and categorical programs from which transfers were made and the purposes for which those funds were used.
- \$55 million is proposed for reduction in capped child care programs to reflect the amount of funding that will not be allocated in current year contracts as reported by the Department of Education for General Child Care, Preschool, Alternative Payment and other programs. Because this amount has not been allocated for contracts with providers, it will not result in a reduction of services to families.
- \$42 million is proposed for reduction from Stage 2 and Stage 3 child care programs based on revised estimates for lower than anticipated caseload since the budget was enacted. Stage 2 costs are revised down by \$27 million and Stage 3 costs are revised down by \$15 million.
- It is also proposed that \$108 million in recently identified prior-year child care savings be reappropriated for CalWORKs Stage 2 and 3 programs to offset an estimated shortfall in one-time savings from the After School Safety and Education (ASES) program that was anticipated to fund part of the 2008-09 costs for these caseload-driven programs.
- \$71.2 million in reductions are proposed to specific programs that are currently underutilized. The amounts and programs with recently identified prior-year savings that are proposed for reduction include \$28.6 million for K-3 Class Size Reduction, \$2.6 million for Principal Training, \$3.3 million for Alternative Credentialing, and \$1 million for the Pupil Retention Block Grant. Further, the Administration proposes to reduce the appropriation for the Targeted Instructional Improvement Grant (TIIG) program on a one-time basis and backfill that reduction through reappropriation of the one-time prior-year savings anticipated from the aforementioned programs. The Administration recognizes these savings amounts are subject to refinement and will work with the Legislature to adjust this proposal to conform to any updated information that becomes available.

**Community Colleges (CCC)**

- \$39.8 million is proposed for reduction by eliminating the 0.68-percent COLA for CCC apportionments enacted in the education trailer bill (Section 33 of Chapter 519, Statutes of 2008)
- \$292.4 million is proposed for reduction by further reducing the amount for general purpose apportionments and providing categorical flexibility similar to the proposal for K-12 LEAs. Similarly, it is the Administration's expectation that districts will maintain as much funding as possible to maximize course offerings aligned with the system's highest priorities for transfer, basic skills and vocation/career preparation along with the most essential support services. Thus, it is proposed that community college districts may transfer categorical allocations to the district's general fund for any purpose up to the amount of their share of the \$290.1 million reduction. Districts electing to utilize this flexibility must also adopt plans in public meetings and agree to report the amounts and programs from which transfers were made and the purposes for which those funds were used.

**HIGHER EDUCATION**

\$132 million in ongoing reductions are proposed for the higher education segments, excluding community colleges. Specific amounts are detailed below.

**University of California (UC)**

- A reduction of \$65.5 million is proposed on an unallocated basis. Together with UC's \$33.1 million share of the \$190 million statewide savings requirement for state operations assumed in the enacted 2008 Budget, expenditures for UC will reflect approximately a ten-percent reduction from the workload budget, consistent with the reduction level proposed in the January 2008-09 Governor's Budget.

**California State University (CSU)**

- A reduction of \$66.3 million is proposed on an unallocated basis. Together with CSU's \$31.3 million share of the \$190 million statewide savings requirement for state operations assumed in the enacted 2008 Budget, expenditures for CSU will reflect a ten-percent reduction from the workload budget, consistent with the reduction level proposed in the January 2008-09 Governor's Budget.

## PROGRAM REDUCTIONS

### **Hastings School of Law (HCL)**

- A reduction of \$402,000 is proposed on an unallocated basis. Together with HCL's \$114,000 share of the \$190 million statewide savings requirement for state operations assumed in the enacted 2008 Budget, expenditures for HCL will reflect a ten-percent reduction from the workload budget, consistent with the reduction level proposed in the January 2008-09 Governor's Budget.

## **CORRECTIONS AND REHABILITATION**

### **Parole Reform, Enhanced Credit Earning, and Property Crime Threshold Revisions**

The Administration's special session proposal reflects reductions in the Department of Corrections and Rehabilitation of \$78.1 million in 2008-09 and \$677.6 million in 2009-10, as a result of the following proposals:

- Focus parole efforts on those offenders who have committed serious, violent, or sexual crimes. Under this proposal, offenders without current or previous convictions for serious, violent, or sexual crimes would not receive parole supervision after their release from prison. This would substantially reduce parole costs in the Department, ensure that the highest risk offenders continue to receive full supervision on parole, and reform the current "revolving door" process in which more prison admissions result from parole revocations than court convictions. This proposal is estimated to result in General Fund savings of \$78.7 million in 2008-09 and \$535.9 million in 2009-10.
- Enact statutory changes that would authorize the CDCR to provide up to four months of earned credit for each program successfully completed by an eligible inmate. Incentivizing program participation and completion will reduce inmate violence within the CDCR and will facilitate the inmate's reintegration into society. Additional changes would authorize consistent day-for-day credit for all eligible inmates who comply with institutional rules, continuous day-for-day credits for inmates who are in jail pending transfer to a state prison, and enhanced credits for inmates who are awaiting an assignment at a conservation camp. These proposals result in a cost of \$3.4 million in 2008-09 and a savings of \$90.5 million ongoing beginning in 2009-10, after accounting for savings already included in the 2008-09 Budget Act.
- Implement changes to adjust the statutory threshold values for determining when property crimes are prosecuted as a felony to reflect inflation since 1982. As a result, the special session reflects General Fund savings of \$2.9 million General Fund in 2008-09, growing to \$51.3 million in 2009-10.

## **LEGISLATURE**

- No specific reductions are proposed for the Legislature, however, the 2008-09 Budgets of other constitutional officers including the Governor's Office, the Attorney General, and the Judicial Branch included reductions in the range of ten percent. The Legislature's 2008-09 Budget reflects a reduction of a lesser level. The Administration hopes the Legislature can achieve savings that are more in line with the savings achieved by constitutional executive officers.

## **PUBLIC SAFETY GRANT PROGRAMS**

### **Reductions for Various Public Safety Grants**

- The proposal includes the elimination of a total of \$51.7 million General Fund in 2008-09 and \$103.5 million General Fund in 2009-10 for local public safety funding. This includes the following:
  - o \$14.7 million in 2008-09 and \$29.4 million in 2009-10 that is allocated to counties that operate juvenile camps and ranches. While these funds are available to all counties based on the number of beds occupied, these funds currently support the operation of 29 camps or ranches. These funds are administered by the CDCR.
  - o \$28.7 million in 2008-09 and \$57.4 million in 2009-10 for various local assistance programs administered by the Office of Emergency Services. Included in this reduction is funding for Vertical Prosecution Block Grants, Rural Crime Prevention, California Multi-jurisdictional Methamphetamine Enforcement Teams, the High Technology Theft Apprehension Program, Sexual Assault Felony Enforcement Teams, and various other public safety programs.
  - o \$8.3 million in 2008-09 and \$16.7 million in 2009-10 for grants to county sheriffs of specified small and rural counties for supplemental public safety funding.

## **HEALTH AND HUMAN SERVICES**

To address the budget shortfall, the Administration proposes legislation to implement the following eligibility and benefit changes effective December 1, 2008:

### **Medi-Cal**

- Reduce California benefits to the level of optional benefits provided in most states. Cease to provide the following optional benefits for adult (excluding children): dental,

## PROGRAM REDUCTIONS

chiropractic, incontinence creams and washes, acupuncture, audiology, speech therapy, optometry/optometrists, optician/optical lab services, podiatry, and psychology services. California will still be providing more optional benefits than most states. General Fund savings of \$41 million result in 2008-09 and \$129.9 million in 2009-10.

- Limit benefits for newly qualified immigrants and immigrants who permanently reside under the color of law (PRUCOL) to the same level as currently provided for undocumented immigrants. Benefits retained include emergency services, pregnancy-related services, long-term care in a nursing facility, and breast and cervical cancer treatment. General Fund savings of \$29.7 million result in 2008-09 and \$144.4 million in 2009-10.
- Implement a monthly eligibility determination for emergency services for undocumented immigrants. This population currently receives up to six months of health services after an initial eligibility determination. This proposal would limit services to one month unless and until a subsequent emergency ensues. General Fund savings of \$15.1 million result in 2008-09 and \$73.5 million in 2009-10.
- Reduce the income level for new applicants to the Section 1931 (b) program to the pre-March 2000 standard of an average of approximately 72 percent of the federal poverty level, and define under-employment as the principal wage earner working less than 100 hours a month for persons applying for Section 1931 (b) and for the medically needy program. The Section 1931 (b) program provides Medi-Cal eligibility to families with low incomes who meet eligibility requirements. Parents with higher incomes who meet the resource and status requirements would be eligible for the Medi-Cal medically needy program with a share of cost. General Fund savings result of \$8.6 million in 2008-09, \$109 million in 2009-10, and ultimately \$342.5 million in 2011-12.
- Shift federal Safety Net Care Pool funding from designated public hospitals to portions of the California Children's Services, the Genetically Handicapped Persons, the Medically Indigent Adult Long-Term Care, and Breast and Cervical Cancer Treatment programs, which are eligible for these funds. No net reduction in services to beneficiaries will result from this shift. General Fund savings of \$3.7 million result in 2008-09 and \$54.2 million in 2009-10.
- Reinstate share of cost for Medi-Cal for aged, blind and disabled individuals with incomes over the SSI/SSP limits. Eligibility for Medi-Cal without a share of cost for beneficiaries previously expanded in January of 2001 from 69 percent up to 127 percent of the federal poverty level. This proposal would align eligibility with the SSI/SSP limits, and generate General Fund savings of \$43.8 million in 2008-09, \$203.7 million in 2009-10, and \$212.8 million annually thereafter.

**Three-Percent Reduction to Regional Center Operations and Purchase of Services Payments**

- Discount payments to regional center service providers by three percent effective December 1, 2008. Certain types of payments will be exempt from this reduction, including supplemental rent/lease payments for consumers receiving supported and independent living services, and "usual and customary" rates for services such as bus fares. The department will also consider exemptions necessary to ensure the health and safety of consumers. Payments for supported employment services will not be discounted. Additionally, to assist in the implementation of the reduction to regional center operations funding, the Administration proposes to provide workload relief such as suspension of reporting requirements for staff salary schedules and contract expenditures, and suspension of the 1:66 coordinator-to-consumer ratio. For those consumers who are on the federal Home and Community Based Services Waiver, are three years of age and younger in the Early Start Program, or are consumers moving from a developmental center into the community, the coordinator-to-consumer ratio will not be suspended. These changes are expected to result in General Fund savings of \$34.2 million in 2008-09 and \$59.8 million in 2009-10.

**Supplemental Security Income/State Supplementary Payment (SSI/SSP)**

- Reduce SSI/SSP grants to the federal minimum effective March 1, 2009, which would result in General Fund savings of \$348.9 million in 2008-09 and \$1.1 billion in 2009-10. Currently, the SSI/SSP grant for an aged/disabled individual is \$870 per month and the grant for aged/disabled couples is \$1,524 per month. After provision of a federal cost-of-living adjustment in January, 2009, this proposal would reduce the monthly grants to \$830 and \$1,407 for aged/disabled individuals and couples, respectively.
- Eliminate the Cash Assistance Program for Immigrants effective March 1, 2009, which would result in General Fund savings of \$37.8 million in 2008-09 and \$114.1 million in 2009-10. This state-only program provides benefits to aged, blind, and disabled legal immigrants.

**CalWORKs**

- Modify the Safety Net program, by continuing benefits for families beyond their 60-month time limit only if they meet federal work participation requirements. This would result in General Fund savings of \$80.7 million in 2008-09 and \$242 million in 2009-10, assuming March 1, 2009 implementation.
- Provide cash aid for families receiving child-only benefits in a manner consistent with other CalWORKs families, for General Fund savings of \$76.8 million in 2008-09 and



## PROGRAM REDUCTIONS

\$230.3 million in 2009-10. Under this proposal, aid to some families receiving child-only benefits would be limited to 60 months. These families include parents or caretakers who are undocumented non-citizens or certain types of felons.

- Institute a face-to-face self-sufficiency review every six months with a county worker for CalWORKs families who are not meeting work requirements. This proposal would result in General Fund savings of \$23.3 million in 2008-09 and \$94.8 million in 2009-10, assuming March 1, 2009 implementation. These reviews would assess what services or resources may be necessary to address barriers that are preventing participation and help remove a family's dependence upon public assistance.
- Reduce CalWORKs grants by 10 percent effective March 1, 2009, which would result in General Fund savings of \$93.2 million in 2008-09 and \$279.6 million in 2009-10. This proposal would reduce the maximum monthly grant for a family of three from \$723 to \$651.

### **In-Home Supportive Services (IHSS)**

- Provide IHSS domestic and related services to individuals with the highest levels of need, as measured by a functional index score of 4 or higher. This proposal would result in General Fund savings of \$23.1 million in 2008-09 and \$71.4 million in 2009-10, assuming March 1, 2009 implementation. The provision of other IHSS services to all eligible consumers regardless of their functional index score would not be impacted.
- Focus the state buyout program for IHSS recipients whose Medi-Cal share of cost is higher than their IHSS share of cost on persons with the most severe needs. This proposal would result in General Fund savings of \$12.3 million in 2008-09 and \$37 million in 2009-10, assuming March 1, 2009 implementation. Under this proposal, IHSS recipients with average functional index scores below 4 would be required to pay for more of their services before qualifying for subsidies.
- Limit state participation in the wages of IHSS workers to the state minimum wage plus \$0.60 per hour for health benefits. Assuming March 1, 2009 implementation, this proposal would result in General Fund savings of \$82.9 million in 2008-09 and \$248.8 million in 2009-10.

### **California Food Assistance Program (CFAP)**

- Eliminate the CFAP effective July 1, 2009, which would result in General Fund savings of \$30.3 million in 2009-10. This state-only program provides food benefits to low-income legal non-citizens.

## **STATE TRANSIT ASSISTANCE PROGRAM**

### **Eliminate Local Transit Grants**

- This proposal eliminates the portion of the State Transit Assistance program that is paid from the Public Transportation Account (\$229.9 million in 2008-09 and \$306 million in 2009-10), but retains \$350 million available from Proposition 1B for local transit programs. This program has historically provided between 3 and 5 percent of total funding for local transit agency operations and capital costs associated with local mass transportation programs. The majority of local funding comes from farebox revenues, federal funds, state capital funding, and other local tax revenues.

## **WILLIAMSON ACT**

- This proposal eliminates \$34.7 million in state reimbursements to local taxing agencies that partially defray the loss of property tax revenues from contracts with local landowners who agree to limit the use of their land to agricultural, scenic, or open space purposes in exchange for reduced property taxes. This action does not eliminate the ability of local entities to enter into these agreements.

While local governments can cancel contracts if state funding is eliminated, they cannot begin to collect taxes based on the property's full value until four years have elapsed. After four years the property is annually taxed at an incrementally higher value over a five-year period. In the sixth year, the property is taxed at full value.

## **FUNDING REALIGNMENT**

In an effort to reduce General Fund expenditures and to create permanent, stable funding for certain high-priority programs, the Governor's special session proposal generates additional revenues to fund various public safety programs and drug and alcohol prevention and treatment services. Specifically, the proposal increases revenues by \$442.5 million in 2008-09 and \$944 million in 2009-10 to support these high-priority programs as follows:

### **Local Law Enforcement Grants**

- The proposal provides \$150 million in 2008-09 and \$359 million in 2009-10 in Vehicle License Fee (VLF) funding for specific law enforcement grant programs. The proposal also eliminates General Fund support for these programs, resulting in savings of \$198.8 million in 2008-09 and \$397.5 million in 2009-10. These VLF funds were previously used to support the Department of Motor Vehicles (DMV) operations,

## PROGRAM REDUCTIONS

which will now be funded by increased revenue in the Motor Vehicle Account derived from a \$12 increase in the annual vehicle registration fee. The specific programs that will be funded from the VLF include the following:

- o \$55.7 million in 2008-09 and \$135.9 million in 2009-10 to support a broad spectrum of local juvenile probation activities statewide.

With this funding realignment proposal, overall funding to support juvenile probation activities will be reduced by \$20.2 million in 2008-09 and \$16 million in 2009-10, but the program will receive a permanent, statutory funding stream.

- o \$94.3 million in 2008-09 and \$223.1 million in 2009-10 to support the COPS/JJCPA Programs and the Booking Fees Program. The COPS/JJCPA Programs will receive \$78.6 million in 2008-09 and \$191.6 million in 2009-10. The Booking Fees Program will receive \$15.8 million in 2008-09 and \$31.5 million in 2009-10.

With this funding realignment proposal, overall funding for the COPS/JJCPA Programs will be reduced by \$28.6 million in 2008-09 and \$22.6 million in 2009-10. Overall funding for the Booking Fee Program will not be impacted in either year.

### **Alcohol Excise Tax for Drug and Alcohol Prevention and Treatment**

- Alcohol excise taxes are proposed to be raised by five cents a drink beginning on January 1, 2009. This increase is estimated to raise \$293 million in 2008-09 and \$585.0 million in 2009-10.

Revenues generated from these taxes will be used to fund drug and alcohol abuse prevention and treatment services, thereby generating General Fund savings of \$293 million in 2008-09 and \$585 million in 2009-10 while maintaining program services. Specifically these revenues will provide \$27 million for providing substance abuse services to CalWORKs participants, \$116 million for providing alcohol and drug treatment programs to individuals both in-prison and in parole settings, and \$150 million to the Department of Alcohol and Drug Programs to provide a variety of prevention and treatment services, including services currently provided pursuant to Proposition 36, the Drug Offender Treatment Program, and the Drug Medi-Cal program. By establishing this dedicated revenue source, the state can ensure that these critical programs continue to provide alcohol and drug prevention and treatment to California's most needy citizens.

## **EMPLOYEE COMPENSATION CHANGES**

- Require state employees take a one day furlough each month between December 1, 2008 and June 30, 2010. This would result in a savings of approximately \$263 million General Fund in 2008-09 and \$451 million General Fund in 2009-10.
- Eliminate two state holidays and premium pay for hours worked on all remaining holidays. This would result in a savings of approximately \$39.4 million General Fund in 2008-09 and \$74.5 million General Fund in 2009-10.
- Compute overtime based on actual time worked. This change would result in a savings of approximately \$17.5 million General Fund in 2008-09 and \$30 million General Fund in 2009-10.
- Establish alternative work schedules of ten hours per day, four days per week.

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**Titus Toyama, PE\*\*** (916) 445-8918

\*Program Budget Manager

\*\* Project Executive

# **EXHIBIT F**



# FINANCE BULLETIN

October 2008

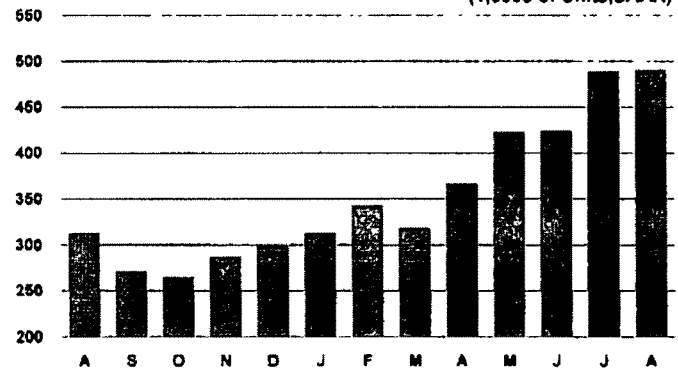
## ECONOMIC UPDATE

The ongoing housing and financial crises continued to roil the California economy in August. The state lost payroll jobs for the sixth consecutive month, and the unemployment rate rose again. Home building slowed, but home sales stabilized.

- California lost 7,700 nonfarm payroll jobs in August—about half of the 15,000 loss in July. The state lost jobs in seven out of the first eight months of 2008, and in 10 out of the last 12. Since nonfarm employment peaked in July 2007, the state has lost 83,700 jobs, or 6,440 per month on average.
- Only three of the state's major industry sectors gained jobs in August. Information added 9,400 jobs, educational and health services, 2,200, and leisure and hospitality, 1,900.
- Seven sectors lost jobs. The big losses were in trade, transportation, and utilities—6,400—and in government, where 6,000 jobs were dropped. Retail trade, the biggest component of trade, transportation, and utilities, lost 7,800. Elsewhere, financial activities lost 2,800 jobs, manufacturing, 2,400, construction, 2,000, professional and business services, 1,500, and other services, 100.
- Still burdened by ongoing housing troubles, California employment also dropped on a year-over-year basis. Nonfarm payroll employment fell by 72,700 jobs (0.5 percent) from August 2007 to August 2008. Six industry sectors gained jobs, led by a 50,200 gain in educational and health services. Employment also rose 26,300 in government, 14,100 in leisure and hospitality, 8,400 in professional and business services, 900 in natural resources and mining, and 500 in other services. Over the year, employment fell by 79,200 in Construction, 33,300 in Financial Activities, 28,800 in Manufacturing, 24,600 in Trade, Transportation, and Utilities; and 7,200 in Information.
- California's unemployment rate rose to 7.7 percent in August, up from a revised 7.4 percent in July, and up from 5.5 percent a year earlier. The 2.2 percentage point increase from August 2007 to August 2008 was the largest year-over-year increase since July 1991. However, as much as a third of that jump may have been due to the U.S. Bureau of Labor Statistics' practice—adopted in January 2005—of adjusting state unemployment estimates so that they add up to the national estimate. This "benchmarking" of states' unemployment estimates has resulted in a huge increase in the variability of California's unemployment statistics.
- Home building slowed considerably in August, with slowdowns in both single and multi-family home building. Residential permits were issued at a seasonally adjusted annual rate of 55,645 units, down over 56.2 percent from a year earlier. Single-family permits were down 55.0 percent, while multi-family permitting was down 57.4 percent. New home permitting during the first eight months of 2008 was down 43.8 percent from the same months of 2007 and down 60 percent from the same period of 2006.
- Nonresidential construction also slowed in August. Nonresidential construction permitting was down 21.9 percent in August from a year earlier. For the first eight months of 2008 as a whole, nonresidential permitting was down 5.5 percent from the same months of 2007.
- In August, California real estate markets basically moved sideways. Existing home sales and home prices were essentially unchanged from July. Sales of existing single-family detached homes totaled 490,850 units at a seasonally adjusted annualized rate, according to the California Association of Realtors. Inventories remained elevated—although much better than at the beginning of the year. The Association's unsold inventory index stood at 6.7 months in August for the second consecutive month. The median price of existing, single-family homes sold in August was \$350,140, essentially unchanged from July, but down 40.5 percent from August 2007.

Home Sales Improve Over the Year

Existing Single-Family Homes Sales  
(1,000s of Units, SAAR)



Source: California Association of Realtors

# MONTHLY CASH REPORT

Preliminary General Fund agency cash for October was \$923 million below the 2009 Budget Act forecast of \$10.667 billion. September's revenues include the third estimated payments for personal income tax filers and calendar-year corporations. Year-to-date revenues are \$1.06 billion below the \$22.58 billion that was expected.

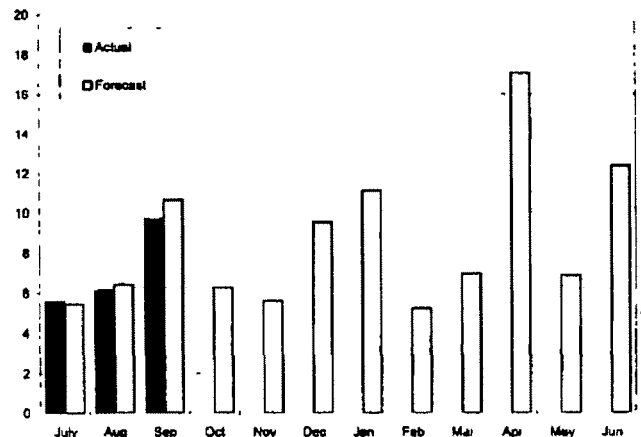
■ Personal income tax revenues to the General Fund were \$289 million below the month's forecast of \$5.836 billion. Withholding was \$23 million above the estimate of \$2.543 billion but estimated payments showed significant weakness coming in \$337 million below the expected level of \$3.267 billion. Other receipts were \$35 million above the forecast of \$305 million and refunds were \$14 million above the projected level of \$175 million. Proposition 63 requires that 1.76 percent of total monthly personal income tax collections be transferred to the Mental Health Services Fund (MHSF). The amount transferred to the MHSF in July was \$4 million below the month's estimate of \$104 million. Year-to-date General Fund income tax revenues are \$98 million below estimate.

■ Sales and use tax receipts were \$212 million below the month's forecast of \$2.249 billion. September represents the second prepayment for third quarter taxable sales. A more complete picture of third quarter sales activity will be available when final payments for the quarter are received in late October and early November. The shortfall in this revenue source can be attributed to the weak economy. Year-to-date, the sales tax cash is \$515 million below forecast.

■ Corporation tax revenues were \$426 million below the month's estimate of \$2.238 billion. The loss was due to sagging prepayments, which were \$468 million lower than the forecast of \$2.095 billion. Other payments were \$18 million above the \$242 million that was expected and refunds were \$24 million below the projected level of \$99 million. Year-to-date revenues are \$428 million below estimate.

■ Revenues from the insurance, estate, alcoholic beverage, and tobacco taxes were \$32 million above the month's estimate of \$185 million. The remaining revenues—pooled money interest income and "other" revenues—were \$28 million below the month's estimate of \$159 million.

General Fund Agency Cash  
2008 Budget Act Forecast  
(Dollars in Billions)



This bulletin reflects revenue receipts under the agency cash basis. Actual General Fund revenue receipts as posted by the State Controller's Office is generally different from the results from the agency cash revenue receipts due to timing. This is due to lags between the time tax agencies record tax payments and refunds, and the time these amounts are reported to and recorded by the Controller's Office accounts. For the month of September, the loss in the major three revenue sources is \$927 million under agency cash basis and \$814 million per the Controller's accounts – a difference of \$113 million. The Personal Income Tax accounts for \$19 million of the difference, the Corporation Income Tax accounts for \$10 million, and the Sales and Use Tax accounts for \$84 million. Sales tax cash numbers are often different because payments are due at the end of the month. In the preliminary Official Statement for the RANs offering, we note that the state's General Fund revenues on a budgetary basis could be adjusted downward by \$3 billion for this fiscal year. This projection is consistent with both the agency cash basis revenue receipts for September reported here as well as with the Controller's cash cited in the preliminary Official Statement.

## 2008-09 Comparison of Actual and Forecast Agency General Fund Revenues (Dollars in Millions)

Revenue Source	SEPTEMBER 2008				2008-09 YEAR-TO-DATE			
	Forecast	Actual	Change	Percent Change	Forecast	Actual	Change	Percent Change
Personal Income	\$5,836	\$5,547	-\$289	-5.0%	\$11,491	\$11,393	-\$98	-0.9%
Sales & Use	2,249	2,037	-212	-9.4%	6,827	6,312	-515	-7.5%
Corporation	2,238	1,812	-426	-19.0%	2,659	2,231	-428	-16.1%
Insurance	145	180	35	24.1%	545	547	2	0.4%
Estate	0	\$0	0	0.0%	0	3	3	n/a
Pooled Money Interest	25	22	-3	-12.0%	75	81	6	8.0%
Alcoholic Beverages	30	27	-3	-10.0%	90	86	-4	-4.4%
Tobacco	10	10	0	0.0%	30	29	-1	-3.3%
Other (a)	134	109	-25	-18.7%	863	838	-25	-2.9%
<b>Total</b>	<b>\$10,667</b>	<b>\$9,744</b>	<b>-\$923</b>	<b>-8.7%</b>	<b>\$22,580</b>	<b>\$21,520</b>	<b>-\$1,060</b>	<b>-4.7%</b>

This is an agency cash report and the data may differ from the Controller's report to the extent that cash received by agencies has not yet been reported to the Controller. Except for estate & "other" revenues, revenues are ranked in descending order of fiscal year magnitude.

Totals may not add due to rounding. The forecast is from the 2008 May Revision updated for the 2008 Budget Act.

(a) The forecast for "other" revenues reflects actual cash for July and August.



# EXHIBIT G



# Office of the Governor

ARNOLD SCHWARZENEGGER  
THE PEOPLE'S GOVERNOR

## PROCLAMATION

11/06/2008

### Special Session Proclamation 11/06/2008

## PROCLAMATION

by the  
Governor of the State of California

**WHEREAS**, an extraordinary occasion has arisen and now exists requiring that the Legislature of the State of California be convened in extraordinary session.

**NOW, THEREFORE, I, ARNOLD SCHWARZENEGGER**, Governor of the State of California, by virtue of the power and authority vested in me by Section 3(b) Article IV of the Constitution of the State of California, do hereby convene the Legislature of the State of California to meet in extraordinary session at Sacramento, California on the 6th day of November 2008, at a time to be determined, for the following purpose and to legislate upon the following subjects

- 1 To consider and act upon legislation to address fiscal and budget-related matters.
- 2 To consider and act upon legislation to address the economy, including but not limited to efforts to stimulate California's economy and create and retain jobs
3. To consider and act upon legislation to address the housing mortgage crisis.
- 4 To consider and act upon legislation to address the solvency of the Unemployment Insurance Fund



**IN WITNESS WHEREOF** I have hereunto set my hand and caused the Great Seal of the State of California to be affixed 6<sup>th</sup> day of November, 2008.

ARNOLD SCHWARZENEGGER  
Governor of California

**ATTEST:**  
DEBRA BOWEN  
Secretary of State

**EXHIBIT 6**



GOVERNOR ARNOLD SCHWARZENEGGER

November 6, 2008

Dear Valued State Worker,

During the six weeks since I signed our state budget, the mortgage crisis has deepened, unemployment has increased and the stock market has dropped significantly. As a result, we are facing a projected \$11 billion revenue shortfall this fiscal year.

These dramatic developments require us to work together and respond immediately. I have called the Legislature into special session to address our fiscal emergency, and I am proposing a combination of economic stimulus measures, programs to keep Californians in their homes, revenue increases and spending reductions to address the real, immediate financial problems facing the state.

If approved by the Legislature, these spending reductions will impact our state workers. Californians rely on you to deliver important services every day, and I am proud of your hard work and dedication to the state. That's why I want you to hear about these impacts from me directly.

To achieve cost savings and protect vital state services, I am proposing the following measures:

- **Furloughs:** All state employees will be furloughed one day each month for the next year and half, a total of 19 days. This will result in a pay cut of about 5 percent. The pay cut will not affect retirement and other benefits for which you are eligible.
- **Holidays:** The Columbus Day holiday will be eliminated, and Lincoln's Birthday and Washington's Birthday will be observed together on Presidents Day. In addition, we will no longer pay time-and-a-half to employees working on holidays. Instead, employees required to work on holidays will receive holiday credit for use at another time, as they do now.
- **Four-day week.** The law will be amended to make it easier for departments to allow employees to work ten hours a day, four days a week.
- **Overtime:** The state will no longer count leave time (including sick leave and vacation time) as time worked for overtime purposes. Instead, employees will only become eligible for overtime pay once actual time worked exceeds the required threshold.

November 6, 2008

Page two

These changes will save the state roughly \$1.4 billion over two years. I know these are not easy proposals, and I assure you we are working closely with union leadership to achieve results in the least painful way possible. All the actions we're proposing must first be approved by the Legislature.

I've always said that California has the most talented and most diligent state employees, and I am confident we will make it through this tough time by working together. Thank you for your cooperation and hard work on behalf of the State of California.

Sincerely,

A handwritten signature in black ink, appearing to read "Arnold Schwarzenegger", written over the printed name.

Arnold Schwarzenegger

# **EXHIBIT H**

## Department of Personnel Administration

### Governor's Open Letter to All State Employees Regarding Impact of Proposed Spending Cuts

November 6, 2008

Dear Valued State Worker,

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These dramatic developments require us to work together and respond immediately. I have called the Legislature into special session to address our fiscal emergency, and I am proposing a combination of economic stimulus measures, programs to keep Californians in their homes, revenue increases and spending reductions to address the real, immediate financial problems facing the state.

If approved by the Legislature, these spending reductions will impact our state workers. Californians rely on you to deliver important services every day, and I am proud of your hard work and dedication to the state. That's why I want you to hear about these impacts from me directly.

To achieve cost savings and protect vital state services, I am proposing the following measures:

- Furloughs: All state employees will be furloughed one day each month for the next year and half, a total of 19 days. This will result in a pay cut of about 5 percent. The pay cut will not affect retirement and other benefits for which you are eligible.
- Holidays: The Columbus Day holiday will be eliminated, and Lincoln's Birthday and Washington's Birthday will be observed together on Presidents Day. In addition, we will no longer pay time-and-a-half to employees working on holidays. Instead, employees required to work on holidays will receive holiday credit for use at another time, as they do now.
- Four-day week: The law will be amended to make it easier for departments to allow employees to work ten hours a day, four days a week.
- Overtime: The state will no longer count leave time (including sick leave and vacation time) as time worked for overtime purposes. Instead, employees will only become eligible for overtime pay once actual time worked exceeds the required threshold.

These changes will save the state roughly \$1.4 billion over two years. I know these are not easy proposals, and I assure you we are working closely with union leadership to achieve results in the least painful way possible. All the actions we're proposing must first be approved by the Legislature.

I've always said that California has the most talented and most diligent state employees, and I am confident we will make it through this tough time by working together. Thank you for your cooperation and hard work on behalf of the State of California.

Sincerely,

Arnold Schwarzenegger

*Updated November 6, 2008 at 12:18 PM.*



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# **EXHIBIT I**





## Office of the Governor

ARNOLD SCHWARZENEGGER  
THE PEOPLE'S GOVERNOR**PROCLAMATION**

12/01/2008

**Fiscal Emergency Proclamation 12/01/2008****PROCLAMATION**by the  
Governor of the State of California

**WHEREAS**, due to developments in the worldwide and national financial markets, and continuing weak performance in the California economy, it is estimated that there will be a General Fund revenue shortfall of at least \$11.2 billion for the 2008-09 fiscal year. Additionally, the weakening economy will increase the expenditures for health and social services beyond what is provided for in the Budget Act; and

**WHEREAS** on November 6, 2008, due to concerns regarding dramatically declining revenues, I issued a Special Session Proclamation and convened the Legislature of the State of California to meet in extraordinary session to address the fiscal crisis that California faces, and

**WHEREAS** the Legislature failed during that Special Session to enact any bills to address the State's significant economic problems; and

**WHEREAS** immediate and comprehensive action is needed to address the revenue shortfall facing the State of California; and

**WHEREAS** within months the State will not be able to meet all of its expenses, outside of debt service, without immediate and comprehensive action; and

**WHEREAS** failure to substantially reduce the deficit carried forward from the current fiscal year into the next fiscal year will likely prevent the State from being able to finance the cashflow shortages of billions of dollars that will occur in July and August, thus making it likely that this fiscal year's deficit will cause the State to miss payroll and school payments at the beginning of 2009; and

**WHEREAS**, according to the Legislative Analyst, next fiscal year's budget will be even more out of balance than the current year budget and balancing the 2009/2010 budget will be immeasurably more difficult if actions to reduce spending trends and increase revenue trends are not put into place immediately,

**NOW, THEREFORE, I, ARNOLD SCHWARZENEGGER**, Governor of the State of California, in accordance with Section 10(f) of Article IV of the Constitution of the State of California, **HEREBY DETERMINE** that General Fund revenues for Fiscal Year 2008-09 will decline substantially below the estimate of General Fund revenues upon which the 2008 Budget Act was based.

**I, ARNOLD SCHWARZENEGGER**, Governor of the State of California, **HEREBY DECLARE** that a fiscal emergency exists

**I, ARNOLD SCHWARZENEGGER**, Governor of the State of California, **HEREBY IDENTIFY THE NATURE OF THIS FISCAL EMERGENCY** to be the projected budget imbalance and insufficient cash reserves for Fiscal Year 2008-09 and the projected insufficient cash reserves and potential budgetary and cash deficit in Fiscal Year 2009-10 which are anticipated to result from the dramatically lower than estimated General Fund revenues in Fiscal Year 2008-09.

**FURTHER**, on this day, as required by Section 10(f) of Article IV of the Constitution of the State of California, I will cause the Legislature to assemble in special session to address this fiscal emergency, and I will submit to the Legislature proposed legislation to address this fiscal emergency



**IN WITNESS WHEREOF** I have hereunto set my hand and caused the Great Seal of the State of California to be affixed this 1st day of December, 2008.

**ARNOLD SCHWARZENEGGER**  
Governor of California

**ATTEST:**  
**DEBRA BOWEN**  
Secretary of State

# **EXHIBIT J**



## Office of the Governor

ARNOLD SCHWARZENEGGER  
THE PEOPLE'S GOVERNOR**EXECUTIVE ORDER S-16-08**

12/19/2008

**WHEREAS**, due to developments in the worldwide and national financial markets, and continuing weak performance in the California economy, there is an approximately \$15 billion General Fund deficit for the 2008-09 fiscal year, which without effective action, is estimated to grow to a \$42 billion General Fund budget shortfall over the next 18 months; and

**WHEREAS** the cash reserve in the State Treasury is below the amount established by the State Controller to ensure that the cash balance does not reach zero on any day in the month; and

**WHEREAS** without effective action to address the fiscal and cash crisis, the cash reserve in the State Treasury is estimated to be a negative \$5 billion in March 2009, and

**WHEREAS** on November 6, 2008, due to concerns regarding dramatically declining revenues, I issued a Special Session Proclamation and convened the Legislature of the State of California to meet in extraordinary session to address the fiscal crisis that California faces; and

**WHEREAS** the Legislature failed during that Special Session to enact any bills to address the State's significant economic problems; and

**WHEREAS** on December 1, 2008, due to the worsening fiscal crisis, I declared that a fiscal emergency exists and convened the Legislature to meet in extraordinary session to address the fiscal crisis that California faces; and

**WHEREAS** on December 1, 2008, due to the fiscal emergency and the nationwide economic recession, I also issued a Special Session Proclamation and convened the Legislature of the State of California to meet in extraordinary session to address the economic crisis, and

**WHEREAS** on December 17, 2008, the California Pooled Money Investment Board took the unprecedented action to halt lending money for an estimated 2,000 infrastructure projects as a result of the cash crisis, including the substantial risk that California will have insufficient cash to meet its obligations starting in February 2009, and

**WHEREAS** in the December 1, 2008 fiscal emergency extraordinary session, the Legislature failed to effectively address the unprecedented statewide fiscal crisis, and

**WHEREAS** immediate and comprehensive action is needed to address the fiscal and cash crisis facing the State of California; and

**WHEREAS** failure to substantially reduce the deficit carried forward from the current fiscal year into the next fiscal year will likely prevent the State from being able to finance the cashflow shortages of billions of dollars, thus making it likely that the State will miss payroll and other essential services payments at the beginning of 2009, and

**WHEREAS** immediate and comprehensive action to reduce current spending must be taken to ensure, to the maximum extent possible, that the essential services of the State are not jeopardized and the public health and safety is preserved; and

**WHEREAS** State agencies and departments under my direct executive authority have already taken steps to reduce their expenses to achieve budget and cash savings for the current fiscal year, and

**WHEREAS** a furlough will reduce current spending and immediately improve the State's ability to meet its

obligations to pay for essential services of the State so as not to jeopardize its residents' health and safety in the current and next fiscal year

**NOW, THEREFORE, I, ARNOLD SCHWARZENEGGER**, Governor of the State of California, by virtue of the power and authority vested in me by the Constitution and statutes of the State of California, do hereby determine that an emergency pursuant to Government Code section 3516.5 exists and issue this Order to become effective immediately.

**IT IS ORDERED** that effective February 1, 2009 through June 30, 2010, the Department of Personnel Administration shall adopt a plan to implement a furlough of represented state employees and supervisors for two days per month, regardless of funding source. This plan shall include a limited exemption process.

**IT IS FURTHER ORDERED** that effective February 1, 2009 through June 30, 2010, the Department of Personnel Administration shall adopt a plan to implement an equivalent furlough or salary reduction for all state managers, including exempt state employees, regardless of funding source.

**IT IS FURTHER ORDERED** that effective January 1, 2009 through June 30, 2010, the Department of Personnel Administration shall work with all State agencies and departments to initiate layoffs and other position reduction and program efficiency measures to achieve a reduction in General Fund payroll of up to ten percent. A limited exemption process shall be included

**IT IS FURTHER ORDERED** effective January 1, 2009, the Department of Personnel Administration shall place the least senior twenty percent of state employees funded in any amount by General Fund resources on the State Restriction of Appointment (SROA) list.

**IT IS FURTHER ORDERED** that effective January 1, 2009 through June 30, 2010, all State agencies and departments under my direct executive authority, regardless of funding source, are prohibited from entering into any new personal services or consulting contracts to perform work as a result of the furloughs, layoffs or other position reduction measures implemented as a result of this Order.

**IT IS REQUESTED** that other entities of State government not under my direct executive authority, including the California Public Utilities Commission, the University of California, the California State University, California Community Colleges, the legislative branch (including the Legislative Counsel Bureau), and judicial branch, implement similar or other mitigation measures to achieve budget and cash savings for the current and next fiscal year

This Order is not intended to create, and does not create, any rights or benefits, whether substantive or procedural, or enforceable at law or in equity, against the State of California or its agencies, departments, entities, officers, employees, or any other person

**I FURTHER ORDER** that, as soon as hereafter possible, this Order shall be filed in the Office of the Secretary of State and that widespread publicity and notice be given to this Order



**IN WITNESS WHEREOF** I have hereunto set my hand and caused the Great Seal of the State of California to be affixed this 19<sup>th</sup> day of December, 2008

**ARNOLD SCHWARZENEGGER**  
Governor of California

**ATTEST:**  
**DEBRA BOWEN**  
Secretary of State

# **EXHIBIT K**

# **CONTROLLER JOHN CHIANG**

## **STATE OF CALIFORNIA**

300 Capitol Mall  
Sacramento, CA 95814  
916 445.2636  
[www.controller.ca.gov](http://www.controller.ca.gov)

PR08:066  
FOR IMMEDIATE RELEASE:  
DECEMBER 19, 2008

CONTACT: HALLYE JORDAN  
916-445-2636

### **Chiang Issues Statement on Governor's Executive Order Requiring State Employee Furloughs and Layoffs**

**SACRAMENTO** – Controller John Chiang today issued the following statement in response to Governor Schwarzenegger's executive order to implement furloughs and layoffs:

"This is one of many painful results stemming from the inability of the Governor and Legislature to agree on responsible solutions to our chronic fiscal crisis, and more painful realities are on their way. It is clear that the Governor's executive order would hurt public servants, and in turn adversely impact our economy and slow its recovery.

"I await the Department of Personnel Administration's plan on how to implement this executive order. The only hope for reversing our financial course is for the Governor and Legislature to work together to enact a balanced budget that stops us from running out of cash in late February."

###

# **EXHIBIT L**





**JOHN CHIANG**  
**California State Controller**

December 22, 2008

The Honorable Arnold Schwarzenegger  
Governor of California  
State Capitol Building  
Sacramento, CA 95814

The Honorable Darrell Steinberg  
President pro Tem  
California State Senate  
State Capitol, Room 205  
Sacramento, CA 95814

The Honorable Karen Bass  
Speaker of the Assembly  
State Capitol, Room 219  
Sacramento, CA 95814

The Honorable Dave Cogdill  
Senate Republican Leader  
State Capitol, Room 305  
Sacramento, CA 95814

The Honorable Michael Villines  
Assembly Republican Leader  
State Capitol, Room 3104  
Sacramento, CA 95814

Dear Governor Schwarzenegger and Legislative Leaders:

I am writing to underscore the stark reality that, if current projections hold true, the State is less than seventy days from running out of cash. Worse, my office's analyses indicate there will be no shelter from the storm as the State's cash position will remain negative throughout the remainder of the fiscal year.

As I indicated during the recent Joint Legislative Budget Session, the failure of the Governor and the Legislature to quickly arrive at an agreement to responsibly address the State's \$41 billion budget crisis would begin a cascading series of regrettable actions necessary to conserve the State's dwindling cash reserves. However, these cash-preserving options no doubt will have the unintended effect of deepening and prolonging the recession

that has already crippled our State's economy. The first of those actions were made last week:

- The Pooled Money Investment Board was forced to shut off the flow of \$3.8 billion in loans to approximately 2,000 critical infrastructure projects. That action is expected to cost the state 200,000 private sector jobs and the loss of \$12.5 billion to our economy.
- Last Friday, the Governor ordered mass layoffs and unpaid furloughs starting in February for nearly 250,000 state public servants, including nursing home inspectors, peace officers, and auditors charged with identifying fraud, waste, and abuse.

Unless adequate budget and cash solutions are fashioned in the next several weeks, the list of casualties will only multiply in the weeks and months ahead.

Specifically, my office will be forced to pursue the deferral of potentially billions of dollars in payments and/or the issuance of individual registered warrants, commonly referred to as IOUs. In order to ensure that the State can meet its Constitutionally-required obligation to schools and debt service, the Capitol's budget paralysis may leave me no choice but to, in full or in part, withhold payments or to issue IOUs to other individuals and entities entitled to state payments. Given the current financial instability of the banking industry, it is highly unlikely that the banks, if they accept the IOUs at all, will be able to do so for any sustained period of time. Consequently, the recipients of the registered warrants may have no apparent options but to hold them until redemption.

While I hope that reasonable minds and a shared desire to responsibly steer the State away from the worst fiscal crisis since the Great Depression will produce the necessary solutions in the days ahead, I must continue to make preparations for the impending cash crunch. These plans will be outlined for you shortly after the formal release of the Governor's January spending plan.

I also have directed my staff to immediately accelerate the efforts necessary to issue a Revenue Anticipation Warrant (RAW), a rarely-used and extremely costly form of external borrowing. However, given the strained condition of the financial markets, the lack of market liquidity and the current condition of the State's finances, this type of financing may not be possible. A high risk of failure exists even assuming the imposition of high fees and that the Legislature adopts triggered spending reductions and/or tax increases that likely would be necessary to ensure that money is available to allow us to repay a RAW at maturity.

The State's dire cash position not only jeopardizes and places at risk our ability to meet our financial obligations in a timely manner, it threatens our ability to respond to natural disasters and protect our communities from crime. I cannot stress enough the crisis we are

The Honorable Governor Schwarzenegger and Legislative Leaders  
December 22, 2008  
Page 3

facing. Without action by the Legislature and the Governor, we literally are weeks away from a meltdown of State government that threatens the delivery of critical public services our citizens deserve and expect.

Sincerely,

*Original signed by:*

JOHN CHIANG  
California State Controller

Cc: Members of the State Legislature  
Bill Lockyer, California State Treasurer  
Mike Genest, Director, Department of Finance  
Mac Taylor, Legislative Analyst

# **EXHIBIT M**

# California at the Brink of Financial Disaster

Michael C. Genest  
*Director of Finance*  
State of California

# \$41.6 Billion of Budget Deficit

(General Fund in Billions)

Carry Forward Deficit	- \$14.8
Revenues and Transfers	86.3
Total Available Resources	<u>\$71.5</u>
Target Reserve	2.0
Expenditures	111.1
2009-10 Budget Deficit	<u><u>- \$41.6</u></u>

# What Happens When the State "Runs Out of Money"?

(Amounts in Billions)

	Jan	Feb	Mar	Apr	May	Jun	Jul
Beginning Balance With Borrowables	\$3.7	\$3.2	-\$0.5	-\$4.2	-\$3.5	-\$4.4	-\$3.7
Receipts	7.8	5.3	4.9	11.8	5.8	6.9	5.8
Disbursements	8.3	9.0	8.6	11.1	6.7	6.2	12.5
Ending Cash Balance Including Borrowables	3.2	-0.5	-4.2	-3.5	-4.4	-3.7	-10.4
General Fund Cash Balance	-\$11.8	-\$15.6	-\$18.8	-\$18.0	-\$19.2	-\$18.4	-\$26.3

# Who Will and Who Won't Be Paid?

## Will Pay

- Public Schools
- Debt Service, GO and Lease Revenue
- Repayments to Special Funds
- Payroll and Benefits
- Medi-Cal Claims
- RANs Repayment

## Will Not Pay

- Tax Refunds
- Vendors
- Social Services Payments to Counties
- Healthy Families Program
- Developmental Services -  
Regional and Developmental Centers
- Mental Health Programs
- Cal Grants



## **Infrastructure Projects Will Stop**

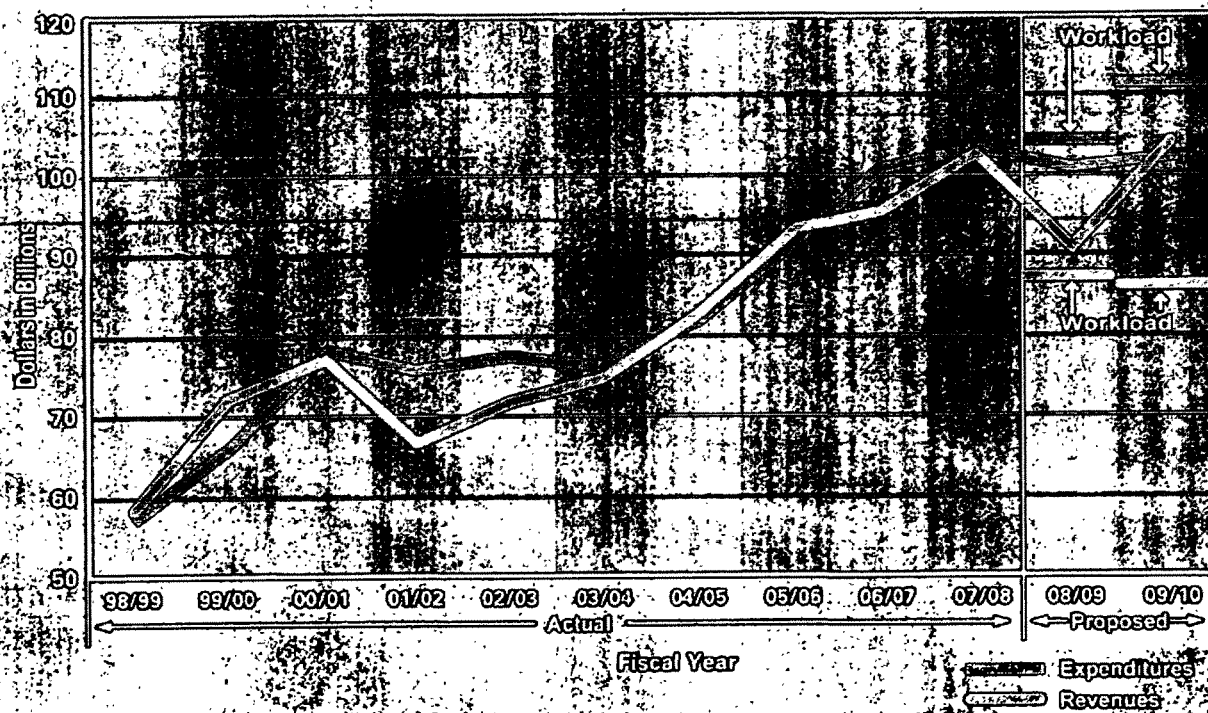
Over 5,700 infrastructure projects are at risk including

- 1,411 K-12, community college and university projects
- 203 transportation projects
- 481 flood control and water projects
- 671 housing projects

The value of all those projects exceeds \$22.5 billion

Shutting down these projects will result in closure costs and penalties that could be hundreds of millions of dollars

# How Did We Get Into This Mess?



# How Did We Get Into This Mess?

Average Annual Growth from 1998-99 to 2009-10 Governor's Budget

Major General Fund Programs	Average Annual Percentage Growth
Prop 98	4.6%
Base	2.7%
VLF Tax Cut	Did not exist in 1998-99
ERB Triple Flip	Did not exist in 1998-99
Corrections	6.3%
Higher Education (excluding Comm. Colleges)	2.5%
Medi-Cal	6.4%
SSI/SSP	1.5%
Developmental Services	13.1%
Mental Health	9.5%
CalWORKs	0.0%
IHSS	11.2%
Other HHS	4.3%
Prop 42	Did not exist in 1998-99
Courts	9.7%
Debt Service/Pension Contribution/Other Non-Discretionary	10.1%
<b>Total</b>	<b>4.7%</b>

# What Do We Propose To Do About It?

(Dollars in Billions)

	December 19 Special Session Proposals		Additional Special Session Proposals		Proposals to be Enacted By July 1		Total	
Expenditure Reductions	\$9,811	44%	\$4,049	87%	\$3,567	24%	\$17,427	42%
Revenues	12,505	56%	236	5%	1,545	10%	14,286	34%
Lottery	0	0%	0	0%	5,001	34%	5,001	12%
Borrowing	0	0%	353	8%	0	0%	353	1%
RAWs	0	0%	0	0%	4,673	32%	4,673	11%
Total	<u>\$22,316</u>	<u>100%</u>	<u>\$4,643</u>	<u>100%</u>	<u>\$14,786</u>	<u>100%</u>	<u>\$41,745</u>	<u>100%</u>

# What Do We Propose To Do About It?

## Cuts

(Dollars in Millions)

Program Area	2008-09 and prior	2009-10	Two-Year Total
Health and Human Services	\$461.8	\$4,332.5	\$4,794.3
Corrections and Rehabilitation	85.1	960.5	1,045.6
K-14 Education	5,027.8	2,683.2	7,711.0
Higher Education	132.2	725.0	857.2
Employee Compensation	414.6	1,288.5	1,703.1
Other	339.4	976.8	1,316.2
<b>Total</b>	<b>\$6,460.9</b>	<b>\$10,966.4</b>	<b>\$17,427.4</b>

# What Do We Propose To Do About It?

## Revenues

(Dollars in Millions)

Program Area	2008-09 and prior	2009-10	Two-Year Total
Temporary 1.5 cent Sales Tax Increase*	\$2,350.0	\$6,758.0	\$9,108.0
Sales Tax on Selected Services*	272.4	1,110.9	1,383.3
Reduce Dependent Exemption Credit	0.0	1,440.0	1,440.0
Oil Severance Tax**	343.2	836.4	1,184.6
Nickel a Drink Alcohol Tax Increase	244.0	585.0	829.0
Special Fund Loans and Transfers	399.0	195.2	594.2
Other	0.0	2.8	2.8
<b>Total</b>	<b>\$3,613.6</b>	<b>\$10,928.3</b>	<b>\$14,541.9</b>

\* Net of Prop 42 revenues

\*\* Net of Costs and Tideland Revenue reduction

## Do The Solutions Hold Up?

