



# The State Bar *of California*

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## **OPEN SESSION AGENDA ITEM 704 MARCH 2019**

**DATE:** March 15, 2019

**TO:** Members, Board of Trustees

**FROM:** Leah Wilson, Executive Director  
John Adams, Chief Financial Officer

**SUBJECT:** Report on Fee Increase Need

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### **EXECUTIVE SUMMARY**

This agenda item provides an update on the State Bar's Five Year Forecast based on the 2019 Adopted Budget. It also provides the Board with an update on State Bar funding needs as related to ongoing and one-time General Fund licensing fee increases and a one-time increase to the Client Security Fund. Lastly, the item provides the Board with options for enhanced fee scaling to be applied should a sizeable fee increase be authorized by the Legislature.

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### **BACKGROUND**

In May 2018, staff began the process of developing a Five Year Forecast (Forecast) for the General Fund, an effort which was completed in October 2018. The initial Forecast reflected a comprehensive assessment of the State Bar's funding needs from 2020 to 2024. The forecast started with using the 2018 Adopted Budget as its baseline; historical trends and growth assumptions in key strategic initiatives, and the Bar's long-term capital and information technology needs, were applied to that baseline to create a multi-year funding model reflecting the true needs of the State Bar. In addition to the Forecast, a similar model was created for identifying Client Security Fund (CSF) funding needs. Together these analyses identified needs of a \$100 ongoing licensing fee increase, a \$250 one-time assessment, and an \$80 one-time CSF assessment.

Subsequent to the completion of the October Forecast, the Board adopted a final 2019 budget which impacted the projections. In addition, as staff began discussing the possibility of a licensing fee increase with various stakeholders, the question of the applicability of any increase to low-to-moderate income attorneys has been repeatedly raised. In light of these two

developments, this agenda item provides an update to the October Forecast and seeks the Board’s approval to pursue on-going and one-time General Fund licensing fee increases reflecting that update. . In addition, this agenda item presents the Board with various options for modifying the State Bar’s current scaling procedures to address concerns about the impact of a fee increase on certain segments of the attorney population. The Board will be asked to determine whether one or more of these options can be incorporated into the Bar’s fee increase methodology and advocacy.

## DISCUSSION

### I. Initial Five Year General Fund Forecast – October 2018 Forecast

**Table 1: October 2018 – Five Year General Fund Forecast (2020-2024)**

	2020 Projection	2021 Projection	2022 Projection	2023 Projection	2024 Projection
<b>Revenues</b>					
Mandatory Licensee Fees	67,442,000	68,375,000	69,320,000	70,280,000	71,255,000
Other Revenues	12,349,776	12,617,066	12,890,507	13,184,097	13,513,837
<b>Total Revenues:</b>	<b>79,791,776</b>	<b>80,992,066</b>	<b>82,210,507</b>	<b>83,464,097</b>	<b>84,768,837</b>
<b>Expenditures</b>					
Personnel	89,081,000	94,042,000	98,083,000	101,204,000	103,758,000
Building Operations	5,762,000	5,937,000	6,116,000	6,300,000	6,490,000
Services	4,892,000	5,026,000	4,940,000	5,087,000	5,407,000
Supplies & Equipment (inc. CIP)	18,452,000	14,922,000	10,355,000	10,286,000	25,055,000
Other Expenses	1,798,000	2,577,000	2,616,000	2,656,000	2,696,000
Indirect Costs/Chargebacks	(8,262,000)	(8,510,000)	(8,766,000)	(9,030,000)	(9,301,000)
<b>Total Expenses:</b>	<b>111,723,000</b>	<b>113,994,000</b>	<b>113,344,000</b>	<b>116,503,000</b>	<b>134,105,000</b>
<b>Projected excess of revenues over (under) expenses:</b>	<b><i>\$(31,931,224)</i></b>	<b><i>\$(33,001,934)</i></b>	<b><i>\$(31,133,493)</i></b>	<b><i>\$(33,038,903)</i></b>	<b><i>\$(49,336,163)</i></b>

The October 2018 Forecast is summarized in the above table; it included the following major assumptions:

1. Mandatory Fee revenue to grow by 1.4 percent.
2. Rental Income to increase by \$1.5 million in 2020.
3. Personnel expenses:
  - a. An additional 58 positions in OCTC beginning in 2020 based on the 2018 Workload Study and designed to ensure that the State Bar is able to meet statutory case processing timelines.
  - b. Per a negotiated labor agreement, SEIU salary adjustment of 3.5 percent in 2020, retroactive to 2019
  - c. Providing parity for retiree health benefits for all employees.
  - d. No other staffing increases.
4. Traditional on-going expenses (utilities, maintenance, etc.) to grow at a 3.0 percent.

5. New technology investments designed to increase transparency, public access, and customer service of \$16.7 million over five years, including \$5.2 million in computer hardware & equipment and \$2.5 million on a new License Information Management System (LIMS).
6. Implementation of the Five Year Capital Plan addressing structurally under-funded and longstanding capital maintenance needs, with an investment of \$26.4 million.

The October Forecast was initially presented to the Board in November 2018 as part of the 2019 Preliminary Budget discussion and more in-depth at the January 2019 strategic planning session.

## II. Update to Five Year Forecast (2020 – 2024) – March 2019 Forecast

With the adoption of the 2019 General Fund Budget in January, staff updated the Forecast in February to include the 2019 Adopted Budget and the 2020 Baseline Budget as follows:

**Table 2: March 2019 – Updated Five Year General Fund Forecast (2020-2024)**

	2020 Projection	2021 Projection	2022 Projection	2023 Projection	2024 Projection
<b>Revenues</b>					
Mandatory Licensee Fees	66,867,000	67,141,000	67,428,000	67,715,000	68,003,000
Other Revenues	11,880,404	12,561,692	12,879,136	13,582,580	14,152,036
<b>Total Revenues:</b>	<b>78,747,404</b>	<b>79,702,692</b>	<b>80,307,136</b>	<b>81,297,580</b>	<b>82,155,036</b>
<b>Expenditures</b>					
Personnel	87,944,000	92,868,000	96,872,000	99,955,000	102,470,000
Building Operations	6,055,600	6,236,000	6,424,000	6,617,000	6,815,000
Services	7,408,000	7,450,000	7,434,000	7,655,000	8,336,000
Supplies & Equipment (Incl. IT & CIP)	17,328,463	11,717,618	8,484,551	6,517,249	22,630,910
Other Expenses	498,000	512,000	527,000	543,000	558,000
Debt Service	716,000	1,988,000	2,010,000	2,033,000	2,056,000
Indirect Costs/Chargebacks	(8,573,000)	(8,829,000)	(9,093,000)	(9,366,000)	(9,646,000)
<b>Total Expenses:</b>	<b>111,377,063</b>	<b>111,942,618</b>	<b>112,658,551</b>	<b>113,954,249</b>	<b>133,219,910</b>
<b>Projected excess of revenues over (under) expenses:</b>	<b>\$ (32,629,659)</b>	<b>\$ (32,239,926)</b>	<b>\$ (32,351,415)</b>	<b>\$ (32,656,669)</b>	<b>\$ (51,064,874)</b>
<b>Change from October Forecast:</b>	<b>\$ 701,435</b>	<b>\$ (762,008)</b>	<b>\$ 1,217,922</b>	<b>\$ (382,233)</b>	<b>\$ 1,728,711</b>

The updated Forecast in Table 2 above reflects the following significant changes:

1. The change in mandatory fees was updated based on further demographic & admissions information, the new growth projection is 0.48 percent vs. 1.40 percent for Actives.
2. Rental income has been updated based on new leases and projected 3<sup>rd</sup> Floor lease revenue without costs for tenant improvements for the 3<sup>rd</sup> Floor.
3. Building improvement costs were updated as of February 7, 2019 based on deferred projects from 2019 to 2020.
4. Projected Retiree Health (OPEB) Costs are updated based on the new valuation as of March 2019.

### III. Funding Need and Fee Increase

Ongoing Increase to Mandatory Licensing Fee: Table 3 below reflects projected revenue and operating costs for the Forecast period. As shown, the ongoing deficit per the Forecast is \$19.5 million in 2020 growing to \$33.3 million by 2024. The last row of the Table shows the percentage of a licensing fee increase that would be needed to address the deficit. For 2020 that amount is approximately 30 percent, or \$100.<sup>1</sup>

**Table 3: Projected Fee Increase Percentage**

	2020 Projection	2021 Projection	2022 Projection	2023 Projection	2024 Projection
Total Revenues:	78,747,404	79,702,692	80,307,136	81,297,580	82,155,036
Total Recurring/On-Going Expenses	(98,290,063)	(104,606,618)	(108,661,551)	(112,124,249)	(115,438,910)
	(19,542,659)	(24,903,926)	(28,354,415)	(30,826,669)	(33,283,874)
Projected Mandatory Licensee Fees	66,867,000	67,141,000	67,428,000	67,715,000	68,003,000
Recurring Deficit	(19,542,659)	(24,903,926)	(28,354,415)	(30,826,669)	(33,283,874)
Percentage Increase to Fee Needed	29.2%	37.1%	42.1%	45.5%	48.9%
Percentage Increase Over PY	29.2%	7.9%	5.0%	3.5%	3.4%

One-Time Special Assessment: Table 5 outlines one-time needs associated with capital and information technology investment as well as the funding needed to replenish State Bar reserves. With future technology investments of \$16.7 million, building investments of \$27.4 million and \$6.9 million for reserves, the estimated one-time special assessment would be \$250 per active licensee.

**Table 4: Special Assessment**

	Investments & Reserve	Assessment Percentage	Special Assessment
<b>5 Year Technology Initiatives</b>	16,673,000	32.7%	82
<b>5 Year Capital Projects</b>	27,358,000	53.7%	134
<b>5 Year Reserve</b>	6,925,000	13.6%	34
	50,956,000	100.0%	250

One-Time Client Security Fund Fee Increase: In addition to a mandatory fee increase to support the General Fund and a special assessment for technology and capital infrastructure, the Client Security Fund would need an additional \$82 per active licensee to provide for sufficient resources to pay all pending applications that are projected to be eligible for payment, an amount which totals approximately \$24.2 million. As shown in the table below, a one-time increase of \$82 for Actives and \$30 for Inactives would be sufficient to fund all projected eligible claims in 2020.

<sup>1</sup> For purposes of fee increase need modeling staff has used \$333 as the base licensing fee; this amount includes the \$315 licensing fee plus the \$25 discipline fee minus opt-outs for legislative activities and elimination of bias.

**Client Security Fund - 4 Year Average Scenario**

4 year average for new applications	19,078,494
Projected payout % 2019	40.16%
Estimated payout added in 2019	<u>7,662,559</u>
Projected payout beginning 2019	<u>21,181,158</u>
Total:	<u>28,843,717</u>
Projected budget application payments 2019	6,900,000
Projected Total estimated applications payout end 2019	<u>21,943,717</u>
Projected Total Outstanding Applications end 2019	54,636,195

**Administrative Costs**

Projected Total estimated applications payout end 2019	21,943,717
Administration Costs (regular staffing)	1,700,000
Administration Costs (temporary inc. 3 Attorneys, 1 Admin)	600,000
<b>Total Amount Needed for Estimated Payout Applications</b>	<u>24,243,717</u>

**2020**

**All estimated payout applications**

Active	193,210	<u>122</u>	23,476,947
Paying inactives	38,010	30	1,140,300
Fee scaling @ 25%	9,915	122	<u>(301,193)</u>
			24,316,054

  

	<u>Current</u>	<u>One-Time</u>	<u>Total</u>
Active	40	82	122
Inactive	10	20	30

**IV. History and Background Fee Scaling**

Business & Professions Code section 6141.1(b) provides that attorneys on active status whose income is less than \$40,000 per year are eligible for a 25 percent reduction in their annual fee. (Bus. & Prof. Code Section 6141.1(b), added by Stats. 1977, c. 58, §6.)

Although staff has sought and received detailed legislative history for this statute, the basis for the selection of \$40,000 as an income limit remains unclear. Committee analyses suggest that it was the result of a compromise, rather than a data-driven decision.

In addition to the legislatively required 25 percent waiver for those with income under \$40,000, State Bar Rules afford fee waiver and scaling options.<sup>2</sup> State Bar Rule 2.16 (waivers) allows the State Bar secretary to waive 50 percent of the annual fee for licensees with household incomes

<sup>2</sup> The State Bar also provides for 25 percent scaling of licensee fees for attorneys who work at IOLTA-funded legal services organizations. For purposes of this agenda item that population is folded into the \$40,000 income eligibility category.

below \$20,000.<sup>3</sup> A review of the history on the development of the \$20,000 threshold suggests that it was tied to poverty level income for a household of one at the time it was enacted.

Scaling History: Below is a table showing the requested scaling that occurred during the 2018 Billing Year and the four year average for the period 2015 to 2018. Over the past four years, the number in each category has declined.

	4 Year		2018	
	Average	Amount	Amount	Amount
50% scaling (\$20k Total Household Income)	286	(\$49,784)	208	(\$33,206)
25% scaling (\$40k Annually)	10,268	(\$975,646)	9,106	(\$871,900)
Legal Aid Attorney (25% Scaling)	1,107	(\$105,332)	809	(\$77,462)
	11,660	(\$1,080,977)	9,915	(\$949,361)

Scaling Administration: Currently, the rules and application of scaling mandatory fees is straight forward. The State Bar did perform a compliance review in 2015 and plans to do compliance review this summer.

#### **V. Alternatives for Scaling with the Proposed Fee Increase**

Impact of the \$100 Increase on Current Scaled Populations: Assuming an equal 30 percent increase of the General Fund mandatory fee, the table below shows the impact of the increase to Active Licensees across the three current income-based attorney populations.

<b>Standard Scaling</b>	Scaling	Current 2019 Fee	Proposed 2020 Fee	Increase	Percentage Increase
Under \$20,000 (Household)	50%	\$166.50	\$216.50	\$50.00	30.0%
Under \$40,000	75%	\$249.75	\$324.75	\$75.00	30.0%
Above \$40,000	100%	\$333.00	\$433.00	\$100.00	30.0%

Scaling Alternative 1 – Adjust the \$40,000 by the Consumer Price Index (CPI) and impose no increase for those with incomes under that amount (\$64,000): Alternative 1 assumes no increase for any licensee under the new income limit of \$64,000 annually. Approximately 14 percent of the licensees surveyed in 2017 reported annual income under \$60,000. By not increasing the fee for those under the new income limit, in order to be revenue neutral, the increase to the fee for those above the limit is estimated to be 33.6 percent, or \$112.

<b>Alternative 1</b>	Scaling (Effective)	Current 2019 Fee	Proposed 2020 Fee	Increase	Percentage Increase
Under \$20,000 (Household)	63%	\$166.50	\$166.50	\$0.00	0.0%
Under \$40,000	44%	\$249.75	\$249.75	\$0.00	0.0%
\$40,000 to \$64,000	25%	\$333.00	\$333.00	\$0.00	0.0%
Above \$64,000	0%	\$333.00	\$445.00	\$112.00	33.6%

<sup>3</sup> Documentation is required for scaling at the 50 percent level; only an attestation as to income is required for 25 percent scaling.

Scaling Alternative 2 – Impose No Increase For Licensees with Incomes At or Below a “Middle Class” Level. Under Alternative 2, fees would not be increased for licensees with income of less than \$80,000. In order to remain revenue neutral, the increase for those above \$80,000 would need to increase by an estimated 37.8 percent or \$126 annually. For illustration purposes the table below only includes the \$80,000 income threshold; as noted below, staff recommends that household income data would be used to determine scaling levels for either Alternative selected.

<b>Alternative 2</b>	Scaling (Effective)	Current 2019 Fee	Proposed 2020 Fee	Increase	Percentage Increase
Under \$20,000 (Household)	64%	\$166.50	\$166.50	\$0.00	0.0%
Under \$40,000	46%	\$249.75	\$249.75	\$0.00	0.0%
\$40,000 to \$80,000	27%	\$333.00	\$333.00	\$0.00	0.0%
Above \$80,000	0%	\$333.00	\$459.00	\$126.00	37.8%

The limited attorney income data available to the State Bar is provided below to facilitate the Board’s analysis of these two options. The 2017 licensee survey data indicates that over two-thirds active lawyers who responded make over \$100,000 annually.<sup>4</sup>

	2017 Survey - Income	
	Distribution	Licenses
Under \$40,000	7.5%	14,499
\$40,000 to \$60,000	6.5%	12,403
\$60,000 to \$80,000	9.9%	19,018
\$80,000 to \$100,000	8.7%	16,691
Above \$100,000	67.4%	129,684
	100.0%	192,295

In addition, the [Bureau of Labor Statistics](#) (BLS) estimates that the annual median salary of a lawyer in California in 2017 was \$149,656<sup>5</sup>. In addition, the BLS has \$73,380 for the 10<sup>th</sup> percentile and \$101,160 for the 25<sup>th</sup> percentile.

Household or Individual Income Used for Scaling Determination: Currently, household income is used as the basis for scaling at the \$20,000 income level, while individual income is used for the \$40,000 threshold. Staff recommends that household income be the standard applied for scaling under Alternatives 1 or 2 above.

## **VI. Summary**

<sup>4</sup> The 2017 State Bar Five-Year Attorney Survey, with 17,261 responses, was used to extrapolate projected income distribution of all Active Licenses. <http://www.calbar.ca.gov/About-Us/Who-We-Are/Bar-Numbers>

<sup>5</sup> May 2017 State Occupational Employment & Wage Estimates for California by the United States Department of Labor, Bureau of Labor Statistics for Lawyers (23-1011). [https://www.bls.gov/oes/current/oes\\_ca.htm](https://www.bls.gov/oes/current/oes_ca.htm)

The State Bar funding need is:

- 1. *\$100 average increase to the annual license fee for Active Licensees***
- 2. *\$250 one-time special assessment for capital and technology investments, including reserves, and***
- 3. *\$80 increase to the Client Security fee.***

As a result of no licensing fee increase for almost 20 years, operating revenues are not adequate to address operating needs as well as maintaining capital assets and upgrading technology infrastructure. Even with continued deferrals of capital maintenance, without a fee increase for 2020, significantly reductions in operating costs will need to occur as part of the next budget process without a fee increase in 2020.

### **FISCAL/PERSONNEL IMPACT**

Described above.

### **RULE AMENDMENTS**

None

### **BOARD BOOK AMENDMENTS**

None

### **STRATEGIC PLAN GOALS & OBJECTIVES**

Goal: 3. Improve the fiscal and operational management of the State Bar, emphasizing integrity, transparency, accountability, and excellence.



## RECOMMENDATIONS

**It is recommended that the** Board of Trustees authorize staff to pursue an on-going General Fund licensing fee increase of up to \$100 with an annual CPI adjustment, a one-time General Fund special assessment of up to \$250, and a one-time Client Security Fund assessment of up to \$80, effective January 1, 2020. While these figures do not align with identified need in every instance to the dollar, the variances are de minimis in any given year and certainly over the five-year Forecast period. Further, staff believes that \$100, \$250, and \$80 serve as clear, digestible, and defensible numbers which will easily facilitate stakeholder discussions regarding licensee fee increases. It is also recommended that the Board of Trustees authorize staff to incorporate one or more scaling options into the fee increase methodology and related advocacy.

**Should the Board of Trustees concur with staff's recommendation, the following resolution would be approved:**

**RESOLVED**, that the Board of Trustees hereby authorize staff to pursue an on-going General Fund licensing fee increase of up to \$100 plus an annual CPI adjustment, a one-time General Fund special assessment of up to \$250, and a one-time Client Security Fund assessment of up to \$80, effective January 1, 2020 as presented to the Board this day; and it is

**FURTHER RESOLVED**, that the Board of Trustees hereby authorizes staff to incorporate one or more scaling options into the fee increase methodology and related advocacy for the fee increase request to the Legislature; and it is

Further Resolved, that the Board of Trustees hereby authorizes staff to seek a multi-year fee bill in consultation with legislative and other stakeholders.