

Senator Jim Beall, Chair
Senator Jim Nielsen
Senator Hannah-Beth Jackson



Thursday, April 10, 2014
9:30 a.m. or Upon Adjournment of Session
Hearing Room 112

Consultant: Catherine Freeman

Items Proposed for Discussion

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Items Proposed for Discussion

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Resources—Environmental Protection—Energy—Transportation

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DEPARTMENTS PROPOSED FOR VOTE ONLY

3980 Office of Environmental Health Hazard Assessment

- 1. Proposition 65 Limited-Term Positions.** Request for \$785,000 (Safe Drinking Water and Toxic Enforcement Fund) and four, limited-term positions, to revise Proposition 65 regulations and develop a website that provides information to the public on exposure to listed chemicals. The proposed reforms are intended to inform the public about their exposures to chemicals that cause cancer or reproductive harm, pursuant to the original proposition. There is no trailer bill language associated with this request.

Staff Recommendation: Approve Item 1.

3900 California Air Resources Board

The Air Resources Board has primary responsibility for the protection of air quality in California, as well as implementation of the California Global Warming Solutions Act of 2006 (AB 32). This responsibility includes establishing ambient air quality standards for specific pollutants, administering air pollution research studies, evaluating standards adopted by the US Environmental Protection Agency and developing and implementing plans to attain and maintain these standards. These plans include emission limitations for vehicular and industrial sources established by the Board and local air pollution control districts.

The Governor's budget proposes \$801 million and 1,344 positions for support of the board. This is an increase of 45 percent over current year expenditures. The significant increase is due both to the implementation of greenhouse gas reduction programs and continued implementation of Proposition 1B bond programs.

Items Proposed for Vote-Only*

- 1. Advanced Clean Cars Program.** Request for \$577,000 and 3.5 positions (Motor Vehicle Account) to implement the Advanced Clean Cars (ACC) program and enhance the evaporative regulation portion of the ACC program due to proposed changes by the US Environmental Protection Agency.
- 2. Continuation of the Implementation of Proposition 1B.** Request for a three-year appropriation of \$240 million from reverted bond authority for the Goods Movement Emission Reduction Program established in the bond measure.
- 3. Funding Shift—Portable Equipment Registration Program.** Request to realign funding from reimbursement authority to the Air Pollution Control Fund for the Portable Equipment and Registration program (net zero cost to the state).
- 4. Heavy-Duty Trucks: On-Board Diagnostics Implementation and Enforcement.** Request for \$1.23 million (Motor Vehicle Account) and seven positions to implement the heavy-duty, on-board diagnostic regulation in order to meet both state and federal emission requirements.

Recommendation: Approve Items 1-4.

**Note: Proposals related to Cap and Trade expenditures, regulation and administration will be held until May Revision.*

Item Proposed for Discussion**Implementation of SB 4—Hydraulic Fracturing**

Background. As discussed at the March 20 hearing under the Department of Conservation (DOC) budget item, SB 4 (Pavley), Chapter 313, Statutes of 2013, requires the regulation of oil and gas well stimulation treatments such as hydraulic fracturing. The legislation requires, among other things, the development of regulations (which we discuss in more detail below), a permitting process, and public notification and disclosure of wells that will undergo hydraulic fracturing and acid matrix stimulation and the types of chemicals used for these processes. The legislation also states that workload associated with its implementation can be funded by the Oil, Gas, and Geothermal Administrative Fund (OGGAF). The OGGAF is funded through a fee administered by the Division of Oil, Gas, and Geothermal Resources (DOGGR), within the Department of Conservation. The fee is designed to recover the division's costs to regulate oil and gas extraction in the state. The fee is currently assessed at \$0.14 per barrel of oil produced or 10,000 cubic feet of natural gas produced in the state.

Budget Proposal. The budget requests \$300,000 in contract funding and six positions (OGGAF) for the Air Resources Board (ARB) to develop regulations to control and mitigate GHG emissions, "criteria pollutants," and toxic air contaminants resulting from well stimulation.

LAO Analysis. "The Administration's proposal to provide ARB with positions and contract funding to develop regulations to control and mitigate GHG emissions, criteria pollutants, and toxic air contaminants related to well stimulation raises questions regarding legislative intent and workload justification. Senate Bill 4 only requires monitoring of air quality in areas where well stimulation occurs. The legislation does not explicitly direct ARB or any other agency to develop regulations to control or mitigate emissions resulting from well stimulation. Thus, it is unclear if the proposed funding and positions for ARB are consistent with the intent of SB 4. We also note that, under state and federal authority, local air districts currently regulate emissions from wells. In fact, it appears that some air districts are already monitoring emissions that occur with well stimulation, potentially resulting in some duplication of effort between ARB and local boards. In addition, it is unclear why the Governor's budget is proposing to provide ARB with ongoing resources for activities that primarily constitute one-time workload in developing regulations." The LAO does not provide a recommendation to approve or deny the budget proposal.

Staff Comments. The ARB collects fees from all stationary sources and is charged with the monitoring and regulation of all air emissions in the state pursuant current law. This includes GHG emissions, "criteria pollutants," and toxic air contaminants. The ARB, under its current authority, should be providing all monitoring and assessment necessary for all current industries. Additional resources would be appropriate from current permitting fees. Therefore, staff recommends denying the funding proposal.

Staff Recommendation: Deny.

Item Proposed for Discussion**Diesel Emission-Related Proposals**

Background. In 1998, California identified diesel exhaust particulate matter (PM) as a toxic air contaminant based on its potential to cause cancer, premature death, and other health problems. Diesel engines also contribute to California's fine particulate matter (PM 2.5) air quality problems. Those most vulnerable are children whose lungs are still developing and the elderly who may have other serious health problems.

The ARB is statutorily charged with regulating air pollution from mobile and stationary sources within the state to meet both state and federal clean air standards. Mobile sources include on-road vehicles (trucks, buses, etc.), off-road vehicles and equipment (locomotives, tractors, cargo handling equipment, construction equipment, etc.), and marine vessels (recreational watercraft, commercial harbor craft, and ocean-going vessels). Stationary engines are used in emergency-standby generators, prime generators, and agricultural irrigation pumps.

Budget Proposals. The budget includes three proposals related to diesel engines, emission regulations, and enforcement.

- 1. Enforcement of Diesel Emissions Reduction Regulations.** Request for \$1.2 million (Motor Vehicle Account) to support increasing workload related to both state and federal diesel emission enforcement requirements. These enforcement rules ensure a level playing field among the regulated community. Industry groups are assisting the ARB to ensure their investments are protected from those who are not in compliance.
- 2. Diesel Emission Regulation Implementation Support.** Request for \$682,000 (Motor Vehicle Account) and four positions to meet regulatory implementation and outreach needs related to the phase-in of diesel regulations affecting trucks, trailers, and small fleet owner/operators. This would allow the affected industry timely responses to questions and enforcement actions, and would provide education opportunities for those affected by the rules.
- 3. Verification Regulations for Diesel Retrofits.** Request for \$187,000 (Motor Vehicle Account) and one position to implement the requirements for in-use strategies to control emissions from diesel engines. The rule strengthens the deployment of retrofits by adding new installation reporting, enhanced product warranty reporting for retrofit manufacturers and recall provisions.

Staff Comments. Staff concurs with the need for the proposals based on current and federal emission rules. The department should be prepared to discuss how these proposals create a level playing field for emission regulations, in particular with trucks arriving from out of country.

Staff Recommendation: Approve Items 1-3.

3940 State Water Resources Control Board

The State Water Resources Control Board (SWRCB) and the nine Regional Water Quality Control Boards (Regional Boards or Water Boards) preserve and enhance the quality of California's water resources and ensure proper allocation and effective use. These objectives are achieved through the Water Quality and Water Rights programs.

Governor's Budget. The Governor's budget includes \$1 billion and 1,864 positions for support of the SWRCB. Increases are largely due to the Governor's proposed consolidation of the drinking water program from the Department of Public Health to the State Water Board.

Items Proposed for Vote-Only

- 1. 401 Water Quality Certification Program Compliance Monitoring.** Request for \$983,000 (Waste Discharge Permit Fund) and ten positions, to address recommendations made by the California State Auditor regarding the need for more consistent compliance monitoring and improved project record keeping.
- 2. Department of Defense Fund Shift from Federal Fund Authority to Reimbursement.** Request to shift \$3.9 million and 19.1 positions (including \$500,000 contract authority) from federal trust fund spending authority to reimbursement spending authority to continue the ongoing oversight of cleanup activities at US Department of Navy facilities.
- 3. Technical Bond Adjustments.** The budget proposes several technical bond adjustments in Propositions 13, 40, 50, and 84, to ensure expenditures and reappropriations are allocated for the purposes specified in the bond.
- 4. Fund Shift for the State Water Pollution Control Revolving Fund (SWPCRF).** The budget requests a permanent fund shift of \$3.6 million in state operation authority and seven existing positions from the Federal Capitalization Grant to the SWPCRF-Administrative Fund.
- 5. Underground Storage Tank Cleanup Fund (USTF)—Expiration of the Temporary Fee Increase and Orphan Site Cleanup Fund Technical Adjustments.** The budget proposes a decrease of \$48 million in state operations from the USTF due to the expiration of the temporary storage fee increase. The budget requests technical adjustments to revert unencumbered funds, and appropriate these funds pursuant to the original statute.
- 6. Technical Adjustment—Surface Water Ambient Water Monitoring Program (SWAMP) Administration.** The budget proposes 12 positions (federal funds) from the US Environmental Protection Agency Clean Water Act, Section 106 Grant) to manage the SWAMP activities. This proposal does not require additional funding as it redirects existing contract funds currently used for this purpose.

7. **April Finance Letters and Drought Actions—Technical Budget Adjustments for Drought-Related Activities.** SB 103 (Committee on Budget), Chapter 2, Statutes of 2014, accelerated several of the Governor's proposals related to groundwater and water quality. The Finance Letter requests technical adjustments to provide the continuing funds for the programs previously approved.
8. **Leviathan Mine Combined Treatment—Spring Finance Letter.** The Governor's budget requests \$789,577 (General Fund) and 1.5 positions to conduct treatment activities needed to respond to ongoing federal obligations. This will implement a more effective interim solution at the Leviathan Mine Superfund site owned by the State of California. This proposal is consistent with the long-term obligation of the state at the mine.

Staff Comments. These proposals are consistent with statute and the direction the board has taken over previous years.

Recommendation: Approve Items 1-8.

ITEMS PROPOSED FOR DISCUSSION**Reorganization of the Drinking Water Program****CURRENT REGULATION OF DRINKING WATER**

Department of Public Health Drinking Water Program. The Department of Public Health (DPH) administers the federal Safe Drinking Water Act (and the parallel state statute). The DPH's overall programs are involved in a broad range of health-related activities, such as chronic disease prevention, communicable disease control, regulation of environmental health (including drinking water quality), and inspection of health facilities. The department's drinking water program (DWP) regulates 5,700 public water systems serving more than 15 service connections or 25 people. The department also oversees water-recycling projects, permits water treatment devices, and provides various technical assistance and financial assistance programs for water system operators—including bond and federally-funded programs for infrastructure improvements in public water systems—to meet state and federal safe drinking water standards. The department administers a revolving loan fund for water treatment infrastructure improvements that is funded by the US Environmental Protection Agency (US EPA). The department responds to drinking water emergencies and provides oversight, technical assistance, and training for local water agencies.

State Water Resources Control Board. The State Water Resources Control Board (SWRCB or board) and the nine semi-autonomous regional boards, administer the federal Clean Water Act (and the parallel state statute). Specifically, the board regulates the overall quality of the state's waters, including groundwater, to protect the beneficial uses of water by permitting waste discharges into water and enforcing water quality standards. The board administers the state's system of water rights and provides financial assistance to fund wastewater system improvements, underground storage cleanups, and other improvements to water quality. The board also administers a similar revolving loan fund for wastewater infrastructure improvements that is funded by the US EPA.

Other State Agencies Involved with Water Supply and Drinking Water. Seven state governmental departments have responsibility over the quality of the state's water; however, the DPH is the only state agency responsible for the quality of the state's *drinking* water. For example, the California Environmental Protection Agency (Cal-EPA) coordinates regulatory functions guiding environmental quality and public health. These entities generally focus on setting allowable concentrations of pollutants, issuing permits, and ensuring compliance with relevant statutes. A summary of state agency responsibilities is shown in the following table.

State Agencies Involved with Water Supply/Drinking Water

Department	Key Water Quality Responsibilities
Department of Public Health	<ul style="list-style-type: none"> • Enforces the federal and state safe drinking-water acts. • Ensures the quality of the state's drinking water from the point where water is pumped from a drinking water well or surface water intake point.
California State Water Resources Control Board and Regional Water Quality Control Boards	<ul style="list-style-type: none"> • Protects the quality of surface water and groundwater to the point where the water enters a drinking water well or surface water intake point.
California Department of Pesticide Regulation	<ul style="list-style-type: none"> • Develops mitigation measures to prevent pesticide contamination of groundwater and surface water.
California Department of Toxic Substances Control	<ul style="list-style-type: none"> • Ensures that groundwater and surface water at toxic sites is monitored and remediated.
Office of Environmental Health Hazard Assessment	<ul style="list-style-type: none"> • Performs health risk assessments related to setting drinking water standards.
California Public Utilities Commission	<ul style="list-style-type: none"> • Ensures that customers of regulated water utilities receive reliable service.
Delta Stewardship Council	<ul style="list-style-type: none"> • Improves Sacramento-San Joaquin Delta water quality for drinking, agriculture, the environment, and Delta species.

Source: Senate Office of Research, 2011

CONCERNS RAISED ABOUT THE CURRENT DRINKING WATER PROGRAM

LAO Concerns with the Drinking Water Program (DWP). According to the LAO, several concerns with the DWP were raised by stakeholders and others, prompting an evaluation of the current governance structure of the state's drinking water programs. These concerns include:

- The current location of the DWP within in DPH results in a lack of integration with overall water quality management.
- The DWP's slow rulemaking process has delayed progress in meeting legislative goals, such as developing regulatory criteria for the use of recycled water, and distributing financial assistance.
- The level of fees assessed by the DWP may not be sufficient to generate adequate administrative resources.
- The current structure of decision-making in the DWP may not be sufficiently transparent.

US EPA is Critical of DPH Financial Assistance Programs. There has been a slow distribution of financial assistance by DPH, for projects that enable public water systems to comply with safe drinking water standards. Specifically, the US EPA issued a notice to DPH for non-compliance with the Safe Drinking Water Act, its implementing regulations, and the terms and conditions of the department's revolving loan fund grant agreements funded by US EPA for federal fiscal years 2009 and 2011. In the spring of 2013, the US EPA determined that the department had not expended the funds in the revolving fund, in a timely or efficient manner, nor employed adequate financial resources to operate the fund in a sound financial manner, in violation of the terms and conditions of the grant agreements. The US EPA approved the department's corrective action plan in July 2013, and has been working with the department on allocating these funds in a more timely manner.

GOVERNOR'S PROPOSAL

Proposal to Shift Drinking Water Program to Water Board. The Administration proposes to transfer the Drinking Water Program (DWP) from DPH to the SWRCB. As a precursor to this proposal, the Administration hosted a series of stakeholder meetings and convened a reorganization task force to solicit feedback on the proposal. The Administration plans to prepare a transition plan in February 2014, that will take into account the efforts to date. The proposal includes:

- **Drinking Water Program Reorganization.** The budget proposes to shift 291 positions and \$202 million (\$5 million General Fund) from DPH to the SWRCB, and includes an additional \$1.8 million (General Fund) for one-time funds for technology and facility costs. The proposal shifts all programs (described below) and combines certain financial assistance programs.
- **Local Assistance Programs.** The proposal also includes a request for \$110.3 million local assistance appropriation, and \$209,000 state operations appropriation for a two-year extension of two limited-term positions due to expire on June 30, 2014.

- **AB 21 Implementation.** The budget requests \$93,000 (General Fund) and one position to promulgate rulemaking packages and develop other guidance documents related to AB 21 (Alejo), Chapter 628, Statutes of 2013. AB 21 authorizes the department to assess a fee in lieu of interest on loans for water projects made pursuant to the Safe Drinking Water State Revolving Fund. AB 21 authorizes the department to expend the money for grants for specified water projects that serve disadvantaged and severely disadvantaged communities, thereby making an appropriation.

April Finance Letters. The Governor amended his January proposal to include two finance letters related to the reorganization:

- **Regulating Small Water Systems in Merced and Tulare Counties.** The budget request for \$619,000 (Safe Drinking Water Fund) for five positions to perform regulatory oversight of public small water systems in Merced and Tulare counties.
- **Continuation of the Recycled Water Program.** The budget requests \$498,000 (Waste Discharge Permit Fund) to support three two-year, limited-term positions to continue work begun by the Department of Public Health to adopt Phase II of the uniform water recycling criteria for surface water augmentation, and to investigate the feasibility of developing uniform water recycling criteria.

Regulatory Program. The proposal seeks to consolidate all water quality regulation within one state agency. The DWP would be organized as a separate division under the SWRCB. Program regulatory staff would remain in locally-based offices and would not be integrated with the regional boards. The division would be overseen by a deputy director who would be required to have public health expertise and who would report directly to the executive director. The deputy director would have the authority to grant or deny water system permit applications. These decisions would not be subject to board review, nor would permit issuance and enforcement be delegated to the regional water boards. The proposal does not include a proposal to extend statutorily-mandated minimum penalties for waste discharge violations to drinking water violations.

Maximum Contaminant Level (MCL)-Setting. MCLs are currently adopted as regulations by DPH. These are the health protective drinking water standards to be met by public water systems. MCLs take into account chemicals' health risks; factors, such as their detectability and treatability; and, costs of treatment. The MCLs would continue to be established through the regular rulemaking process under the Administrative Procedures Act. The deputy director would follow existing rulemaking procedures and the SWRCB would act on the proposed regulations in a public meeting, after which they would be subject to Office of Administrative Law review.

Recycled Water. As a result of this reorganization, the DPH functions related to recycled water would be coordinated through the SWRCB permit process. The board does not propose to change how these permits are issued, but proposes to seek opportunities for more efficient and effective permitting of recycled water, as required by SB 322 (Hueso), Chapter 637, Statutes of 2013.

Emergency Response. The proposal plans to maintain the existing local emergency response structure of the DWP, including rotating district office duty officers, under the new division. The division would become part of the Cal-EPA Emergency Response Management Committee, which is Cal-EPA's coordinating body that assists in emergencies requiring cross-department or cross-agency solutions. For emergencies affecting water quality, such as sewage or chemical spills, the DWP would coordinate with the regional boards.

Operator Certification. The SWRCB plans to jointly manage both operator certification programs within the Division of Financial Assistance (already existing at SWRCB). This will allow the DWP to take advantage of the SWRCB's new web-based data management system for wastewater operators and would expand this system to include drinking water operators.

Financial Assistance Programs. The proposal plans for the SWRCB to jointly manage the Clean Water and Drinking Water State Revolving Funds (SRFs) and both bond programs (Propositions 50 and 84) within the Division of Financial Assistance. This proposal will likely require statutory and regulatory changes to harmonize the programs. The division would combine the programs to streamline water quality infrastructure financing, in particular for application assistance for disadvantaged communities.

LAO ANALYSIS OF DRINKING WATER PROGRAM SHIFT OPTIONS

In two separate requests from the Legislature, the LAO has analyzed two options for the transfer of the drinking water program away from DPH and to the Cal-EPA. The first option is the possible shift of the program to the State Water Resources Control Board (SWRCB). The LAO was also asked to evaluate a shift of the program to a stand-alone office at Cal-EPA, such as is the case with the Office of Environmental Health Hazard Assessment.

According to the LAO, the Federal Clean Water and Safe Drinking Water acts allow states significant flexibility in how they structure their water management agencies. For example, 30 states have consolidated drinking water and water quality programs in a single entity. Some states have also consolidated their water quality-related revolving loan programs in agencies that focus solely on providing financial assistance. Below, the LAO describes the potential advantages and disadvantages of the two options it was asked to review.

Potential *Advantages* of Shifting the Drinking Water Program to SWRCB. Transferring the DWP to the SWRCB could address several key concerns raised about the current DPH-run program as outlined below.

- **Greater Policy Integration on Water Issues.** Consolidating the functions of the DWP with SWRCB's water quality and water rights regulatory activities could increase the effectiveness of the state's water regulation activities by addressing water issues more comprehensively. For example, there would be a more coordinated focus on the sources of pollution and their effects on drinking water. In addition, there may be opportunities to streamline permitting processes for entities that are currently regulated by both the DWP and SWRCB.

- **Potential for Accelerated Rulemakings.** The SWRCB is authorized to make some changes to rules by updating its policy handbook—an annual process that allows for public participation through board meetings, and that can be faster than making changes to regulations that are subject to the Administrative Procedures Act, such as the DWP’s rulemakings.
- **Potential for Efficiencies and Increased Administrative Capacity.** Consolidation of the SWRCB’s clean water and DPH’s safe drinking water financial assistance programs could increase efficiency and increase administrative capacity through economies of scale. In addition, SWRCB appears to use its existing fee authority to support program administration to a greater extent than DPH. For example, DPH has the authority to bill water systems for the costs associated with processing financial assistance applications, but it does not currently do so. The SWRCB, on the other hand, exercises its authority to assess fees on loan applicants. These factors suggest that a SWRCB-administered drinking water program may be more likely to have the administrative resources required to adequately run the program and get financial assistance out the door in a timely manner.
- **Potential for Increased Transparency and Greater Public Participation.** The SWRCB’s board structure provides regular, structured opportunities for comments on proposed rules or other issues from all interested parties in a public process.

Potential *Disadvantages* of the Shifting Drinking Water Program to SWRCB. The LAO raised concerns about the potential shift relative to other public health programs, costs associated with the reorganization, and possible disruption to certain services as described below:

- **Loss of Some Integration with Public Health Programs.** Transferring the DWP away from DPH may result in a loss of some integration of drinking water activities with other public health programs, such as those that monitor infectious diseases (including waterborne illnesses), and incidences of birth defects and cancer.
- **Temporary Disruption to Activities.** Transferring the DWP to the SWRCB may result in disruptions that temporarily reduce the program’s capacity to perform regulatory activities. For example, the existing relationships between the DWP staff and local primacy agencies may be disrupted.
- **Potentially Increased, Mainly Short-Term, Costs.** These costs could include relocation expenses, increased personnel costs from consolidation of classifications, and costs to integrate information technology systems.

Potential Relative *Advantages* of Shifting the Drinking Water Program to Cal-EPA. Transferring the DWP to a stand-alone entity under Cal-EPA could have several advantages when compared to transferring it to SWRCB, including: (1) less disruption to the current activities of both SWRCB and the DWP, (2) greater focus within the agency on drinking water policy and public health, and (3) potentially greater visibility for drinking water issues, as described below:

- **Less Disruption to Current Activities.** As previously noted, transferring the DWP to SWRCB could result in some temporary disruption to the activities of SWRCB as it integrates the new drinking water activities and related personnel into its existing operations, and some temporary disruption to the DWP activities as DWP staff move from their current location into a new entity. While some disruption to DWP activities would still occur if the DWP were transferred to a stand-alone entity under Cal-EPA, that disruption may be lessened to the extent that the existing the DWP organizational structure remains largely intact.
- **Greater Internal Focus on Drinking Water Policy.** A stand-alone entity would inherently have a greater drinking water and public health focus than if the DWP were to be transferred to SWRCB. A stand-alone entity would focus exclusively on drinking water issues, whereas the SWRCB is required by statute to balance all beneficial uses of water, such as drinking water supply, agricultural supply, and environmental uses.
- **Potentially Greater Visibility for Drinking Water Issues.** Transferring the DWP to a stand-alone entity could increase the visibility of drinking water issues in policy discussions. First, there would be fewer layers of administration between the DWP and the Governor, potentially allowing the new entity to more effectively advance its perspective on policy issues within the Administration. In addition, establishing a stand-alone entity could signal that drinking water policy is a legislative priority.

Potential Relative *Disadvantages* of Transfer of the Drinking Water Program to Cal-EPA.

Creating a stand-alone entity to house the DWP could have several disadvantages, relative to moving the program to SWRCB, including: (1) less integration of drinking water policies with other areas of water policy, (2) increased administrative costs and reduced potential for efficiencies, and (3) less effective financial assistance programs. These disadvantages stem, in part, from forgoing potential benefits that could be achieved by transferring the program to SWRCB.

- **Less Integration with Other Areas of Water Policy.** Transferring the DWP to a stand-alone entity in Cal-EPA could increase coordination to some degree among drinking water activities and SWRCB's water quality and water rights activities. This is because both entities would be housed under the same agency that could provide overarching policy guidance. However, the coordination and resulting benefits would be less than if the DWP were integrated into SWRCB. For example, different decision-makers would be setting policy on the quality of water supplies (such as groundwater) and the quality of drinking water. Therefore, some opportunities to recognize problems or develop innovative solutions could be lost.
- **Increased Administrative Costs and Reduced Potential for Efficiencies.** As described above, establishing a stand-alone entity could increase net costs by \$6 million per year because of the need for additional administrative personnel and related operational expenditures. In addition, such an entity might not achieve the same potential efficiencies through economies of scale that could result from consolidating the SWRCB's clean water and DPH's safe drinking water financial assistance programs. Both the DWP and the SWRCB support some of their activities through fees levied on water service providers. Fees charged by a stand-alone entity would likely be higher because additional funding would be required to cover the added administrative costs and lost potential for economies of scale described above.

Issues for Legislative Consideration

Does this Proposal Address the Problem of Poor Drinking Water? Among the many issues raised by stakeholders during the discussion about program reorganization is the ongoing issue of poor drinking water in certain parts of the state. As seen in the figure below, parts of the Central Valley have ongoing water quality problems that result in a complete lack of safe drinking water. These issues have been well-documented but have not been sufficiently addressed. This problem is not isolated to the Central Valley and persists in lower-income and disadvantaged communities. The Legislature should consider whether there are further reforms that the budget or policy committees should consider as part of this reorganization proposal.

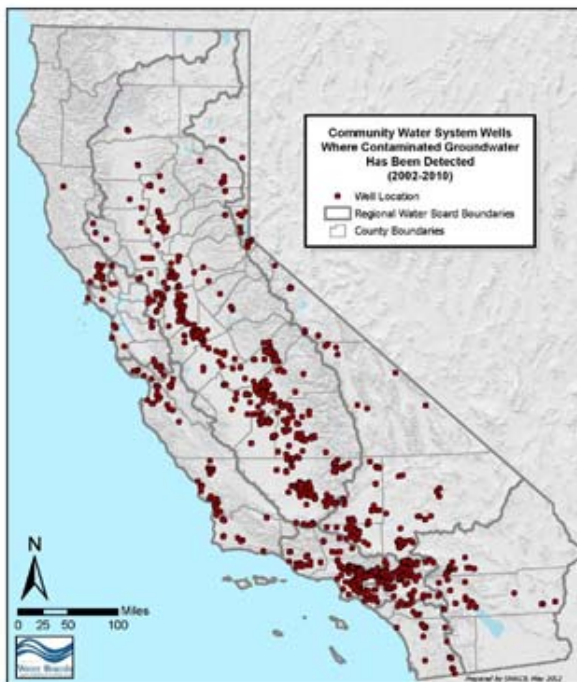


Figure 3: Active Community Water System Wells Where Contaminated Groundwater Has Been Detected Above an MCL Two or More Times between 2002 and 2010 (1,659 Wells / 680 Community Water Systems)

Source: State Water Resource Control Board, 2013.

Should the Other Environmental Health Programs Shift to Cal-EPA? The LAO has laid out a series of potential advantages and disadvantages of shifting the DWP to either the SWRCB or to a stand-alone office at Cal-EPA. While both have merit, a third option may be possible. The Governor's budget proposal attempts to address many of the concerns raised about governance, rulemaking, and public participation. However, it does not suggest further shifts of environmental programs housed in DPH to Cal-EPA. The DWP is currently housed within DPH's Center for Environmental Health, in the Division of Drinking Water and Environmental Management. Within this division are the environmental health programs that regulate the generation, handling, and disposal of medical waste;

oversees the disposal of low-level radioactive waste; and protect and manage food, drug, medical device, and radiation sources. The Legislature may wish to consider both the Governor's proposal, as well as options to shift these other programs to entities within Cal-EPA. For example, shifting the environmental health programs remaining at DPH to the Office of Environmental Health Hazard Assessment (OEHHA) at Cal-EPA may result in efficiencies and would address the concern about splitting up environmental health programs. OEHHA may also be a more appropriate entity to set standards for MCLs and assess emerging contaminants, such as endocrine disrupters.

Transparency and Public Participation. The SWRCB provides regular, structured opportunities for comments on proposed rules or other issues from all interested parties in a public process. The governance structure of a stand-alone drinking water entity would partly determine whether it could achieve the same transparency and opportunities for public participation. For example, if the new entity had a single department head, public participation and transparency could be reduced relative to that which would be achieved if the DWP were transferred to SWRCB; but if it was created to mirror the board structure of SWRCB, the same benefits might be achieved. Alternatively, opportunities for public participation could be built into the new entity, as is done with some other Cal-EPA agencies. The Legislature should evaluate whether or not the budget proposal allows for sufficient transparency and public participation for the drinking water program.

Opportunity for Fee Reform. During the earlier discussion of the proposed shift of the DWP to the SWRCB, concerns were raised about the differences in the way the two entities fund their programs. For the most part, the SWRCB issues permits with a specific up-front cost that is designed to meet regulatory needs. Contrarily, the DPH fee program consists of a mix of up-front fees and payment in arrears for service. While there are advantages to both, it would seem that having surety of an up-front cost might be a better option to fund basic regulatory programs that would allow both the program and the fee-payer assurance of costs annually. The Legislature may wish to consider how the two programs' fee structures should be integrated.

Staff Comments. Staff concurs with the need for the drinking water program reorganization in general. The Administration should be prepared to address the issues for legislative consideration included in the agenda. In particular, concerns have been raised by stakeholders regarding the board's ability to effectively address ongoing water contamination issues in the poorest parts of the state. The subcommittee should consider ensuring that the trailer bill requires the deputy director over the DWP be appointed by the Governor and subject to legislative confirmation. As discussed in numerous legislative hearings, community water systems with contamination are generally clustered in the poorest parts of the state where residents have the least ability to provide improvements to the systems that serve them. Staff are concerned that even with the shift to the SWRCB, the ability of the poorest residents to access clean water will continue to be a problem.

Staff Recommendation. Hold open.

Groundwater Resource Protection

Background. According to the LAO, the potential to use groundwater to increase water supply, either by introducing water from another source into the ground as a storage basin or encouraging the natural refilling of groundwater basins, is a significant option to address water supply needs. However, there are potential barriers to this water reliability strategy. Communities are increasingly discovering that many primary groundwater basins are contaminated. Pollution from industrial activities (such as military facilities), commercial businesses (such as dry cleaners), leaking underground storage tanks (USTs), septic systems, and agricultural activities have reduced or eliminated the availability of usable groundwater in many parts of the state. In some cases, when a contaminant is discovered, it may take decades to remove pollution and bring the water back to usable condition.

Loss of Water Source Can Be Expensive to Locals. Over 43 percent of Californians rely in part on groundwater for their drinking water needs and some communities rely on groundwater for 100 percent of their water needs. As part of routine testing of drinking water, the DPH has sometimes discovered that a source of water (such as groundwater) is contaminated to a level that violates state and/or federal safe drinking water standards. Discovery of contamination in a drinking water well often leads to closure of the well. Users of the well must then find replacement sources of water. In areas where other sources, such as surface water or alternate groundwater resources, are not available, relatively expensive bottled water may be the only available drinking water supply.

The DPH reported that nitrate (a groundwater contaminant) was detected in levels that exceed safe drinking water standards in 921 public drinking water sources, mostly in agricultural areas. In many of these areas, groundwater is the sole source of drinking water for the community.

Cleanup Is Costly. Cleaning up contaminated groundwater can be very expensive. For this reason, the state established an Underground Storage Tank Cleanup Fund in 1989 to provide financial assistance to the owners and operators of USTs containing petroleum. The fund, which is administered by SWRCB and supported by an annual assessment on tank owners, is used to remediate conditions caused by leaking USTs, including the contamination of groundwater supplies. Expenditures from the fund have varied between about \$180 million to \$280 million annually over the last ten years for hundreds of sites. For 2010-11, the Governor's budget proposes expenditures of \$400 million from this fund—the highest level ever.

Most Supply Projections Do Not Account For Groundwater Contamination. In many cases, contamination of a groundwater basin is known to local water managers, who are able to use this information to plan for water supply needs. However, state projections often disregard contamination, particularly where groundwater basins have had historical pollution problems that, when not addressed, remain within that groundwater basin. This situation poses challenges for estimating how much water is available for water supply and the cost to treat contaminated water. In some cases, this is because of a lack of adequate monitoring of water quality in groundwater basins, and in others it is because groundwater monitoring data that is gathered is not shared systematically or comprehensively with state agency officials.

LAO Analysis

The Stakes Are High in Groundwater Management. According to the LAO, the potential to use groundwater to increase water supply, either by introducing water from another source into the ground as a storage basin or by encouraging the natural refilling of groundwater basins, is a significant option to address the state’s water supply needs. However, successful implementation of this solution into the state’s management of water is hampered by the state’s lack of regulation or monitoring of groundwater resources. Management of groundwater supplies—to the extent that it does occur—resides mainly at the local level and thus, by its very nature, does not address water needs from a statewide perspective. As a result, groundwater quality is not protected under state regulation and enforcement as comprehensively as surface water quality. As previously discussed, the consequences of insufficient action to protect these water resources are high. Once contaminated, groundwater loses some of its potential to serve as a water supply source. The situation has already led to costly emergency efforts to clean up contaminated supplies and to provide substitute sources of water to communities dependent upon groundwater.

For the reasons stated above, and to build upon the work the Legislature has already done, the LAO recommends that the Legislature adopt four fundamental changes to the way the state manages groundwater. These recommendations, which are summarized below, represent the first steps that the state could take so that, in the long run, it is in a position to more strongly and effectively manage its groundwater resources. The LAO recommends a shift to a more comprehensive groundwater management regime, similar to those being implemented successfully by other states, in order to avoid future water emergencies from the contamination of groundwater supplies, and to make California’s statewide water supply system more reliable.

LAO Recommendations for Improving Groundwater Management

Problem	Recommendation
Monitoring not comprehensive statewide	Phase in a comprehensive monitoring system to allow the state to focus funding and technical assistance efforts to the areas in greatest need.
Current management efforts not necessarily focused on most challenged groundwater areas	Establish Active Management Areas where groundwater overdraft potential and/or extent of pollution problems are the highest.
Groundwater law does not reflect scientific reality	Bring science and law together by modernizing groundwater law to accurately reflect the physical interconnection of surface water and groundwater.
Groundwater use and rights unclear, leading to distribution and management issues	Consider establishing statewide groundwater permitting over a multiyear period based on data from expanded monitoring requirements. Maintain local control over implementation of state permit granted at either district or basin level to the extent possible.

Strengthen Monitoring Requirements. Finally, the LAO notes that the state needs, but now lacks, comprehensive data on groundwater extraction, groundwater levels, and groundwater quality. For this reason, the LAO recommends that the state phase-in a comprehensive groundwater monitoring program over a period of years modeled after the best such measures adopted by other western states. The LAO analysis of other states finds that while no other single state program is an obvious perfect fit as a model for California, there is much to be learned from the examples of other state programs. Building on recent legislation that strengthens monitoring requirements, the LAO recommends the Legislature further require local water districts to submit standardized extraction data from all groundwater wells, as in Texas and Arizona.

Budget Proposal. The budget requests \$1.9 million (General Fund) and ten positions to begin the implementation of a program to protect groundwater resources from unreasonable diversion and use that causes overdraft conditions or unreasonable effects on public trust resources. The proposal includes trailer bill language authorizing the SWRCB to establish enforceable plans and requirements for basins found in overdraft from unreasonable diversion and/or use that unreasonably affects public trust resources.

SB 103 (Committee on Budget), Chapter 2, Statutes of 2014, appropriated \$800,000 to protect and ensure the sustainability of groundwater in critical basins. The accompanying trailer bill language also provided enhanced water rights enforcement for surface water allocations, which are permitted by the state under its water rights program.

Staff Comments. The Legislature, and in particular the Assembly and Senate budget committees, have raised concerns regarding the cost of maintaining the status quo for groundwater monitoring and enforcement for several years. The LAO has made a compelling argument regarding the costs to the state, the impacts on future water supply development, and localized impacts of the current statewide groundwater management systems. As an example, shown on page 15 of this agenda, groundwater contamination affects numerous local areas of the state, and with this contamination, the amount of water available for supply in these areas is greatly reduced or made more expensive to treat to water standards.

The Governor's proposal is a positive first step in addressing this long-standing problem. Staff recommends the subcommittee approve the proposal, including trailer bill language. This action would be consistent with the Legislature's actions on the recently passed drought package.

Staff Recommendation: Approve budget proposal and trailer bill language.

Implementation of SB 4 - Hydraulic Fracturing

Background. As discussed at the March 20 hearing under the Department of Conservation (DOC) budget item, SB 4 (Pavley), Chapter 313, Statutes of 2013, requires the regulation of oil and gas well stimulation treatments such as hydraulic fracturing. The legislation requires, among other things, the development of regulations (which we discuss in more detail below), a permitting process, and public notification and disclosure of wells that will undergo hydraulic fracturing and acid matrix stimulation and the types of chemicals used for these processes. The legislation also states that workload associated with its implementation can be funded by the Oil, Gas, and Geothermal Administrative Fund (OGGAF). The OGGAF is funded through a fee administered by the Division of Oil, Gas, and Geothermal Resources (DOGGR), within the Department of Conservation. The fee is designed to recover the division's costs to regulate oil and gas extraction in the state. The fee is currently assessed at \$0.14 per barrel of oil produced or 10,000 cubic feet of natural gas produced in the state.

Budget Proposal. The budget requests \$6.2 million and 14 positions in 2014-15 for SWRCB to develop the groundwater monitoring criteria and plan, as well as to evaluate compliance by well owners and operators who develop their own groundwater monitoring plans. It also includes funding for contracts to perform groundwater monitoring. The request for SWRCB would increase to \$9.4 million in 2015-16, which is primarily due to additional costs related to groundwater monitoring contracts.

The Governor also proposes budget trailer language to address what the Administration describes as an inconsistency in SB 4 related to groundwater monitoring. Specifically, sections of SB 4 varied in whether it required SWRCB to "review" or "approve" groundwater monitoring plans developed by well owners and operators. The proposed legislation would specifically require SWRCB to review—rather than approve—monitoring plans. According to the Administration, this change is necessary in order to clarify DOGGR's role as the lead state agency responsible for preparing environmental impact reports. Finally, the Administration states that it may also propose budget trailer language to clarify how the fee increase will be assessed in order to generate the additional revenue reflected in the proposed budget to fund the requested proposals.

LAO Analysis. "It appears that the SWRCB request for contract funding in 2014-15 is premature. As indicated above, SWRCB is not required to complete the development of its criteria and monitoring plan until July 1, 2015. In addition, SWRCB cannot begin monitoring groundwater until the criteria and plan are developed. Thus, funding for groundwater monitoring is not needed until 2015-16.

SWRCB's groundwater monitoring and other activities will vary based on a variety of factors, such as how many wells are stimulated, where the stimulated wells are located, and whether well operators/owners perform monitoring themselves. These factors will depend on the criteria and monitoring plan developed by SWRCB. Thus, while SWRCB will almost certainly have workload associated with monitoring and ensuring compliance by well owners and operators in 2015-16, the extent of that workload is unknown until the criteria and monitoring plan are developed. Thus, the number of positions needed to complete that workload in 2015-16 is currently unknown.

While we (LAO) agree with the Administration's contention that current law regarding SWRCB's role in reviewing or approving monitoring plans is somewhat inconsistent, the proposed trailer bill language is a policy change that would affect which agency is responsible for approving groundwater plans, as well as who is the lead agency for preparing environmental impact reports. Therefore, the Legislature will want to make sure the proposal reflects its intentions for how groundwater monitoring is carried out."

LAO Recommendation. "We recommend that the Legislature deny the request to fund groundwater monitoring contracts (\$3.5 million in 2014-15 and \$7 million in 2015-16) and direct SWRCB to request funding in the 2015-16 budget once its criteria and monitoring plan are complete. In addition, we recommend that the Legislature approve SWRCB's request for 14 positions on a two-year limited-term basis. This would allow SWRCB and the Legislature to reevaluate the need for positions depending on actual workload data following the first year of implementation of the groundwater monitoring plans and other activities."

Staff Comments. Staff appreciates the concern of the LAO regarding the shift of responsibility for groundwater monitoring. However, in order to maintain consistency for CEQA lead agencies, this shift may be necessary. As with other elements of the SB 4 implementation, the trailer bill should be left open for final discussion.

Staff concurs with the funding proposal. This proposal is consistent with the Legislature and Administration's more focused approach to groundwater monitoring in recent years.

Staff Recommendation: Approve budget proposal and hold open trailer bill language for further review.

3950 Department of Resources Recycling and Recovery

The Department of Resources Recycling and Recovery (CalRecycle) protects public health and safety and the environment through the regulation of solid waste facilities, including landfills, and promotes recycling of a variety of materials, including beverage containers, electronic waste, waste tires, used oil, and other materials. CalRecycle also promotes the following waste diversion practices: (1) source reduction, (2) recycling and composting, and (3) reuse. Additional departmental activities include research, permitting, inspection, enforcement, market development to promote recycling industries, and technical assistance to local agencies.

Governor's Budget. The Governor's budget includes \$1.5 billion (no General Fund) and 728 positions for support of the department. Due to the state's high recycling rate and mandated program payments, expenditures from the Beverage Container Recycling Fund (BCRF) exceed revenues by approximately \$100 million. The budget proposes several reforms to support the fiscal reliability of the program. The budget also includes \$30 million for recycling and composting activities that reduce GHG emissions.

Items Proposed for Vote-Only

- 1. Initial Transition for Support of DORIIS.** The budget requests two limited-term positions and \$258,000 (BCRF) to begin transition from contractor staff to state staff support of the Division of Recycling Integrated Information System (DORIIS). This proposal yields an annual savings of approximately \$250,000.
- 2. Increase BCRF Revenue Through Increased Audit Coverage.** The budget requests five, three-year limited-term positions and \$566,000 (BCRF) to increase audit coverage of beverage manufacturers and distributors to better protect the integrity of the BCRF. The emphasis will be on collecting revenues owed to CalRecycle and mitigating risk to the Fund.
- 3. E-Waste Recycling Fund Fraud Investigations.** The budget requests \$500,000 of expenditure authority to establish an Inter-Agency Agreement with the California Department of Food and Agriculture (CDFA), Division of Measurement Standards, to fund auditors and field inspectors to assess operational conformity with applicable recordkeeping requirements and ensure compliance with Weighmaster rules. CDFA is in agreement with this request and will not require additional reimbursement authority to implement this proposal.
- 4. California Tire Recycling Management.** The Governor's budget proposes provisional budget language for new, two-year grant appropriations from the California Tire Recycling Management Fund (Tire Fund) to allow flexibility in the encumbrance of grants and the payment of funds. This request does not include any additional fiscal resources.

- 5. Used Mattress Recovery And Recycling Program.** The budget requests 6.5 positions and \$595,000, on-going, (Used Mattress Recycling Fund) to implement the CalRecycle responsibilities under the mattress stewardship law, pursuant to SB 254 (Hancock), Chapter 388, Statutes of 2013.

- 6. Rubberized Asphalt Concrete Marketing Development Act.** The budget requests \$5.2 million in on-going expenditure authority (Tire Fund) and 1.5 three-year, limited-term positions to allow CalRecycle to increase funding for Rubberized Asphalt Concrete grants in order to spend down an existing Tire Fund balance.

Recommendation: Approve Items 1-6.

1. Beverage Container Recycling Program Reform—Phase II

Background. The Beverage Container Recycling Program (BCRP) is one of the state’s most successful recycling and environmental protection efforts. The state’s recycling rate currently exceeds 85 percent. Because of the state’s high recycling rate and mandated program payments, expenditures from the Beverage Container Recycling Fund (BCRF) now exceed revenues by approximately \$100 million.

Overview of California Redemption Value (CRV) Program. The Division of Recycling (DOR), within CalRecycle, administers the BCRP (commonly referred to as the “bottle bill program”). This program was established more than 25 years ago with the enactment of AB 2020 (Margolin), Chapter 1290, Statutes of 1986. The purpose of the program is to be a self-funding program that encourages consumers to recycle beverage containers. The program accomplishes this goal by guaranteeing consumers a payment—referred to as the CRV—for each eligible container returned to a certified recycler. Only certain beverage containers are part of the CRV program. Whether a particular container is part of the program depends on the material, content, and size of the container.

Unredeemed Deposits Support Supplemental Programs. The CRV redemption rate—the percent of all CRV that is actually collected by consumers from recyclers—is less than 100 percent. This means that distributors pay more CRV into the BCRF than is claimed by consumers. In 2012-13, for example, the BCRF received roughly \$1.2 billion in deposits, but only about \$1 billion was spent in redemption—an 88 percent redemption rate. State law requires that much of the unredeemed CRV be spent on specified recycling-related programs. In total, there are currently ten supplemental programs funded from the BCRF (including program administration), such as programs to subsidize glass and plastic recycling, subsidize supermarket recycling collection sites, and provide grants for market development and other recycling-related activities. These particular programs cost \$254 million in 2012-13.

High Redemption Rates and Supplemental Programs Create Shortfall in BCRF. Over time, redemption rates have increased and are now higher than the target recycling rate defined in statute—80 percent. This leaves less money for the other BCRF expenditures. As a result of the combination of a higher redemption rate and the cost of supplemental programs, the BCRF has been operating under an annual structural deficit averaging about \$100 million since 2008-09.

Based on current expenditure levels, the “break even” recycling rate—the rate at which there is enough unclaimed CRV to support all other program spending—is around 75 percent. Therefore, anytime the recycling rate is above 75 percent, the fund is operating in a deficit. According to CalRecycle’s estimates, the fund is currently forecast to run a deficit of \$110 million in 2014-15, absent any changes made to reduce expenditures or increase revenues. While the BCRF has had operating deficits on several occasions in the past, it was able to absorb the deficits from its large fund balance built up when the CRV redemption rate was low, as well as payments received from loans made to other funds. This balance is now nearly depleted, and the loans are mostly repaid. Thus, the fund no longer has a healthy reserve to help offset the impact of operating shortfalls. CalRecycle projects the BCRF balance to fall below the healthy reserve in September of 2015.

Under current law, if there are insufficient funds available in the BCRF to make all of the required CRV and supplemental payments, the department is required to reduce most supplemental program payments in equal proportions (commonly referred to as “proportional reductions”), in order to keep the fund in balance. The only payments from the fund that are not subject to the proportional reductions are the return of CRV to consumers, as well as program administration. Proportional reductions are problematic because they do not allow for discretion in spending based on priorities or other factors. For example, under proportional reductions, the department cannot prioritize programs that are most effective or central to the BCRP’s overall mission. Additionally, proportional reductions are very disruptive to program participants. Since all payments are reduced equally and quickly, participants can experience a significant cut in funding without much warning to plan accordingly.

In 2009, CalRecycle had to implement proportional reductions to maintain the BCRF’s solvency. This included (1) reduced payments to recyclers of about 70 percent, (2) increased processing fees charged to beverage manufacturers totaling around \$50 million, and (3) elimination of most grant and market development program funding. Based on current revenue and expenditure projections, CalRecycle expects to implement proportional reductions in 2015-16.

Governor’s Proposal. The Governor's budget proposes 12 positions and \$1.48 million, Beverage Container Recycling Fund (BCRF), and \$1.2 million ongoing to develop and implement Phase II of reforms to the Beverage Container Recycling Program (BCRP), including restructuring administrative and handling fees, a phased elimination of the processing fee offset, creating a Recycling Enforcement Grant Program, and changing the funding sources for local conservation corps payments.

The proposed programmatic changes are expected to result in a net increase to the BCRF annual fund balance of \$72.3 million in 2014-15, growing to \$127 million when fully implemented in 2016-17. The proposal also increases processing fee revenues by roughly \$67.4 million. The Administration projects that these changes, described below, would eliminate the program’s structural deficit once fully implemented and avoid the need to implement proportional reductions.

- **Phase Out Processing Fee Subsidy.** The budget phases out processing fee offsets over three years in order to have manufactures cover the full net cost of recycling materials. The projected savings to the BCRF is estimated at \$67 million annually when fully implemented. Currently, the program subsidizes glass and plastic manufacturers by offsetting a portion of the cost to recycle containers.
- **Eliminate Curbside Supplemental Payments.** The budget eliminates supplemental payments to curbside collection programs. Curbside recycling collection programs and neighborhood drop-off programs currently receive supplemental payments to support their operations. The Administration believes that curbside collection programs will likely continue even without the supplemental payment. This change is expected to result in \$15 million in annual savings.
- **Restructure “Administrative Fees.”** The budget eliminates administrative fees paid to processors and recyclers due to declining administrative costs resulting from electronic filing. Distributors will keep their administrative fees, but will have increased reporting requirements

to provide additional data to CalRecycle. Projected savings are \$13 million in 2014-15, with ongoing savings of \$26 million beginning in 2015-16.

- **Eliminate Local Government Payments.** Currently, state law requires a \$10.5 million annual payment to incorporated city and county governments for beverage container recycling and litter reduction activities. This payment is distributed in proportion to the population residing in each jurisdiction. According to the Administration, the CalRecycle has minimal oversight on the use of the funds, which makes it difficult for the department to direct funding to activities that promote its policy goals. Therefore, the Governor's budget proposes to eliminate this payment, though it proposes redirecting the funds to two grant programs. The elimination of the local government payments would result in a savings to the BCRF of \$10.5 million annually.
- **Diversify Local Conservation Corps Funding.** The budget replaces \$15 million of existing BCRF grants to local conservation corps by redirecting a like amount of other special funds to support local corps recycling programs. New funding for local corps programs will be provided by the Tire Recycling Management Fund (\$5 million), the Electronic Waste Recovery and Recycling Account (\$8 million), and the Used Oil Recycling Fund (\$2 million).
- **Restructure Handling Fees.** Handling fees are monthly payments made from the BCRF to recycling centers located in "convenience zones." These payments are intended to offset additional costs a recycler may incur as a result of their location, such as higher rent. CalRecycle audits the convenience zone sites every two years to determine their cost of operations, and uses that to calculate the handling fee amount. The amount of handling fees paid to recyclers is based on volume of material recycled. The Governor's budget proposes to replace the volume-based handling fee with a flat monthly payment of \$1,700 per site. The Administration estimates that a flat payment will result in a savings to the BCRF of approximately \$7 million annually.
- **Recycling Enforcement Grant.** The budget proposes to establish a new competitive grant program, which would provide funding for local enforcement agencies to perform activities targeted toward detecting and deterring fraud. This program would increase expenditures from the BCRF by \$7 million annually.
- **Expand Beverage Container Recycling Competitive Grants.** This grant program provides funding for local recycling and litter reduction projects, such as projects to increase the recycling rates in schools, improve container collection in cities, or reduce litter at public events. The Administration proposes increasing funding for this program by \$3.5 million, resulting in \$5 million in total funding for the program.
- **Public Education and Information.** The proposal includes \$2.5 million for public education in order to inform program participants and the public of recent and proposed changes to the BCRP.

- **Program Administration.** The proposal includes an additional 12 positions and \$1.5 million for increased program administration workload resulting from the above changes, such as the establishment of a new grant program.

LAO Analysis and Comments. The LAO provides the following comments:

“Proposal Is Reasonable Way to Eliminate Structural Deficit. We find that the Governor’s proposal is a reasonable approach to addressing the BCRF structural deficit and avoiding the need for proportional reductions in 2015-16. For example, the proposal eliminates some program elements that are not as central to the mission of the CRV program, such as processing fee offsets. The Governor’s proposal also reduces payments where there is little data on the program’s impact on the overall beverage container recycling rate, such as curbside supplemental payments. We note, however, that there is some level of uncertainty inherent in forecasting BCRF revenues and redemption rates. Therefore, it is possible that even if the Legislature were to adopt all of the Governor’s proposed changes, there could be funding shortfalls in the future.”

“Proposal Could Have Small Impact on Recycling Rates. The proposed program changes would reduce some payments to participants, especially high-volume recyclers in convenience zones (CZ), curbside recyclers, and cities and counties currently receiving payments. Consequently, some recyclers and processors currently operating with a very small profit margin might shut down or operate fewer hours. However, these changes are a small portion of revenue for most participants, and they still receive other payments through the program. For example, while curbside collection programs would no longer receive curbside supplemental payments, they would still receive CRV and processing payments, and are eligible for several grant programs. This is in addition to revenue from their contract with the local government and scrap value of the materials they collect. Therefore, we expect that any impact on recycling to be small.”

“Future Recycling Rate Increases Can Cause Another Structural Deficit. We calculate that the proposed reforms would put the fund balance at the current break even redemption rate of approximately 88 percent. However, if the redemption rate were to increase past this point, it could result in another structural deficit in the future. If that were to occur, CalRecycle anticipates that additional programmatic changes (such as additional spending reductions) would be necessary to support a redemption rate higher than 88 percent. The department states that it expects the rate to stay close to the current rate. The department is currently required to issue quarterly reports on the status of the BCRF to allow the Legislature to monitor revenue and expenditure trends.”

LAO Recommendation. “We recommend that the Legislature adopt the Governor’s proposal. As stated above, we find that the proposal is a reasonable way to ensure the fiscal solvency of the BCRF, which is currently operating with a large structural deficit. We would note, however, that each proposed reduction does come with some trade-offs and would result in a recycling program participant—especially distributors and recyclers—bearing greater costs. Therefore, the Legislature will want to make sure that each of the changes is consistent with policy priorities.”

Staff Comments. The BCRP has achieved great success over the past several years—attaining an overall recycling rate of approximately 84 percent. The BCRF’s ongoing \$100 million structural deficit is, in large part, due to that success. Due to mandated expenditures, the fund cannot sustain a recycling rate that is higher than 72 percent. Up until now, a high fund balance (due to past unclaimed CRV) and fund loan repayments have enabled the BCRP to stay afloat and avoid proportional reduction.

Though the Department conducted seven stakeholder workshops in 2012 in response to the structural deficit, the Administration’s reform proposal lacks stakeholder consensus. And, while some of the proposed reforms have merit, others raise questions. The elimination of the curbside supplemental payment and the local government payment, as well as diversifying local conservation corps funding, makes sense. However, the proposed changes to the processing and handling fees elicit concerns from stakeholders.

Convenience Zones and Handling Fees. The restructuring of the handling fees has raised concerns among stakeholders. Handling fees are monthly payments to recycling centers located in convenience zones (CZ), placed close to supermarkets. The purpose of locating centers in these areas is to increase convenience for consumers seeking to redeem used beverage containers. Seventy-five percent of consumers who recycle at recycling centers choose CZ—these customers account for 61 percent of total transactions.

Currently, handling fees are assessed on a tiered, volume-based system—the higher the volume, the higher the fee. Moving to a flat monthly fee of \$1,700 per site would not guarantee more recycling centers open in currently un-served CZ areas—in fact, creating a flat fee could be a disincentive to establishing new centers. Currently, areas without centers are not served now, due to a lack of profitability.

CZ recycling centers typically operate with relatively low profit margins and relatively high operating expenses. For calendar year 2012, the average CZ payment per site was \$2,701. The proposed flat payment of \$1,700 per month per site would be a 37 percent cut. CalRecycle’s audits show that these sites have an average profit of 5 percent. Thus, cuts of this magnitude would likely eliminate profits, and drive centers to close. The proposed change in handling fees would result in a savings of \$7 million to the BCRF.

Processing Fees. The processing fee is the difference between the cost of recycling minus the scrap value and is intended to cover recyclers’ costs of collecting a given material. According to the department, the processing fee was never intended to be either an incentive or disincentive for recycling. Further, the department states that the intent of the processing fee is to ensure that the full costs of a container were included in the market’s decision-making about which containers to sell.

While the Administration's rationale for proposing that manufactures cover the full net cost of recycling materials may be desirable, the elimination of the processing fee offsets may lead to beverage manufacture's seeking lower cost, non-recyclable containers for their products. Glass manufacturer's argue that this proposal rewards container types that are not in the program and pay no processing fee.

The phase-out of processing fee offsets will result in a large fee increase (\$67 million) for beverage container manufactures. Glass container manufacturers will absorb \$59 million of the fee increase. Glass container manufacturers maintain that eliminating the processing fee-offset will result in the loss of market share and the closure of plants. The department counters that the glass industry is facing many challenges that threaten the viability of the industry that have nothing to do with the bottle bill, including meeting air quality requirements, the high transportation costs associated with glass, and allegations that the industry is not doing enough to screen leaded glass from entering the recycling stream.

Staff Recommendation. Hold open.

3960 Department of Toxic Substances Control

The Department of Toxic Substances Control (DTSC) regulates hazardous waste management, cleans up or oversees the cleanup of contaminated hazardous waste sites, and promotes the reduction of hazardous waste generation. The department is funded by fees paid by persons that generate, transport, store, treat, or dispose of hazardous wastes; environmental fees levied on most corporations; federal funds; and GF.

Governor's Budget. The Governor's Budget includes \$189 million (including \$21 million GF) and 1,504 positions for support of the DTSC. This is a decrease of \$12 million, or 4 percent, under current year expenditures.

Items Proposed for Discussion

Improving Permitting and Tracking Functions at DTSC

Background. The DTSC regulates hazardous waste management by issuing permits; tracking the generation, transportation, and disposal of hazardous waste; coordinating cleanup of contaminated sites; and seeking recovery of funds from parties responsible for contamination. Concerns have been raised in recent years regarding how DTSC has carried out these responsibilities. For example, due to a backlog in processing applications for hazardous waste permit renewals, many facilities are operating on "continued permits." This means that these facilities have submitted permit renewal applications, but DTSC has not completed its review and approval process, which usually takes several years. While these particular facilities are allowed to continue operations under the terms of their original permit, these are frequently no longer based on up-to-date technologies, practices, and safeguards. Backlogs in continued permits are also problematic because it means that permit holders have not undergone recent assessments of their facilities to determine if they are releasing any hazardous wastes into the environment. These assessments are part of the permit approval process.

In early 2012, the department responded with its "Fixing the Foundation" initiative, which includes more than 30 different activities intended to improve its operations and restore public trust in the department. Activities include increasing cost recovery from those responsible for hazardous waste contamination, reducing permitting backlogs, strengthening enforcement, and improving the financial sustainability of its operating funds.

Governor's Proposal. The Governor's January budget includes four proposals designed to address the above concerns and implement certain aspects of the department's Fixing the Foundation initiative. These proposals include increased funding over the next two years. In total, the budget proposes \$4.6 million in 2014-15 and \$3.2 million in 2015-16 from the Hazardous Waste Control Account and the Toxic Substances Control Account. The Governor also proposed a spring finance letter related to permitting. Specifically, the request includes the following:

- **Cost Recovery.** The budget requests \$1.6 million and 14 two-year limited term positions to reduce a backlog of reimbursements owed to the department for hazardous waste clean-up activities. The Administration estimates that this cost recovery backlog includes around \$26 million in unbilled or uncollected costs that are recoverable.
- **Hazardous Waste Permitting.** The budget requests \$1.2 million and eight two-year limited term positions for two sets of activities. First, the Administration proposes to address the hazardous waste permit renewal backlog. There are currently 24 hazardous waste facilities with continued permits. This number of continued permits is expected to grow to 34 by 2017. Second, the Administration proposes to update cost estimates associated with closing hazardous waste facilities in the future. Cost estimates need to be updated to ensure that there are sufficient funds to pay for the decontamination and decommissioning of hazardous waste facilities.
- **Hazardous Waste Tracking System.** The budget includes \$1.3 million in one-time funding to rebuild the Hazardous Waste Tracking System, an IT system used by the department to track the generation, transportation, and disposal of hazardous waste. The current software used by DTSC was last updated in 2002 and is no longer supported by the developer. Additionally, the capabilities of the system no longer meet the current needs of DTSC and other regulatory agencies.
- **Hazardous Waste Manifest Error Correction.** The budget includes \$381,000 and 3.5 two-year, limited-term positions to correct existing errors in the hazardous waste manifest data. Hazardous waste manifests travel with hazardous waste from the point of generation, through transportation, to the final disposal facility. Each party in the chain of shipping (including the generator), signs and keeps one of the manifest copies, creating a tracking system for the hazardous waste. The manifests are used to verify that the hazardous waste was managed properly and arrived at its intended destination. They are also often used as evidence in criminal enforcement actions. However, according to the department, there are many errors in the system. These errors can occur for various reasons, including handlers of hazardous waste incorrectly, incompletely, or illegibly filling out the handwritten manifests, as well as DTSC staff making mistakes when entering the data into the electronic system. These errors create difficulties for monitoring hazardous waste and prevent DTSC from verifying that hazardous waste is being properly managed.
- **Spring Finance Letter—Hazardous Waste Permitting: Work Plan Implementation.** The budget requests \$699,000 (HWCA) and five three-year, limited-term positions to implement the DTSC Permit Enhancement Work Plan. The plan identifies ten reform goals that will serve as a comprehensive roadmap for implementing a more effective, protective, timely, and equitable permitting system.

LAO Analysis of DTSC Proposals

According to the LAO, the Governor's proposals address documented concerns and would allow the department to make progress toward resolving some key issues, including low rates of cost recovery, inconsistent hazardous waste tracking, and permitting backlogs. Therefore, the Administration's proposals present the Legislature with a reasonable approach to addressing these issues, as part of the 2014-15 budget.

The LAO also finds that, while the Administration's proposals may be reasonable, they will not fully address the identified problems for the long run. For example, while two of these proposals address current backlogs, they rely on limited-term positions that will not address the underlying problems that caused the backlogs to form in the first place. In fact, the Administration does not anticipate that the permitting proposal will eliminate the entire backlog of permit renewals. Consequently, it is unclear whether the backlogs will begin to grow in the future after the limited-term positions expire. The LAO notes, however, that the department reports that it is taking additional actions—such as internal administrative and process changes—that are aimed at addressing some of these problems.

Additionally, while the proposal to correct errors in the manifest data would be beneficial, it would not entirely fix the problems it seeks to address. This is because the proposal does not address the root causes of such errors (such as illegible handwriting or data entry mistakes), thus continuing to allow incorrect data to be entered into the system. Many of the problems associated with the manifest system are due to the paper manifests currently required by the federal government. So, therefore, DTSC is limited in its ability to make certain changes in this area.

LAO Recommendation. “We recommend approval of the Governor's proposals because they should enable the department to make progress in addressing operational deficiencies. We further recommend that the Legislature require the department to report at budget subcommittee hearings this spring on its progress in implementing the Fixing the Foundations initiative. Such a report should include (1) how these four proposals fit into the department's overall strategy, (2) the next steps to be taken—especially regarding aspects of the initiative not proposed for funding, and (3) how each of these steps will be the most cost-effective means of accomplishing all of the initiative's objectives. The department should also provide information on how it will prevent the growth of cost recovery and permitting backlogs in the future.”

Staff Comments. Staff concurs with LAO's analysis. The department should report on its progress in implementing the Fixing the Foundations initiative, as well as the LAO's other concerns in its opening remarks. The department should be prepared to answer the following questions:

- The Hazardous Waste Control Account is the appropriate fund source for many of the reforms proposed by the department. Would repaying the \$10 million loan to the General Fund provide additional resources to the department that could be used to speed up such problems as the manifest tracking system, or specific permitting backlogs?

- The position requests are mostly limited-term. This can create challenges for hiring talented employees. Would making the positions permanent make a difference in the quality of employees hired for this work?

Staff Recommendation: Approve budget requests as proposed.