LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

STATE OF HAWAII
OFFICE OF THE DIRECTOR
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
335 MERCHANT STREET, ROOM 310
P.O. Box 541
HONOLULU, HAWAII 96809
Phone Number: (808) 586-2850
Fax Number: (808) 586-2856
www.hawaii.gov/dcca

LAWRENCE M. REIFURTH
DIRECTOR

RONALD BOYER
DEPUTY DIRECTOR

TO THE HOUSE COMMITTEE ON FINANCE

TWENTY-FIFTH LEGISLATURE
Regular Session of 2009

Wednesday, February 18, 2009
2:00 p.m.

**TESTIMONY ON HOUSE BILL NO. 1729**
**RELATING TO THE DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS.**

TO THE HONORABLE MARCUS R. OSHIRO, CHAIR, MARILYN B. LEE, VICE CHAIR, AND MEMBERS OF THE COMMITTEE:

My name is Lawrence Reifurth, and I am the Director of the Department of Commerce and Consumer Affairs ("DCCA" or the "Department"). The Department respectfully opposes H.B. No. 1729.

Section 1 of the bill explains the rationale for requiring that the Department pay the interest on the bonds issued to pay for the King Kalakaua Building ("KKB"), which was purchased by the State in 2002:

> The legislature finds that the department of commerce and consumer affairs is a self-sustaining department whose operational costs are funded almost exclusively through special funds. The legislature further finds this principle of self-sustainment should be extended to apply to capital expenditures as well as operational expense, especially during these economically challenging times, during which the State must make efforts to recover all costs for the operations of special-funded departments.

> In particular, the legislature finds that the State issued general obligation bonds in 2002 to assist the department of commerce and consumer affairs in the purchase of a new building.
>
> The purpose of this Act is to require the department of commerce and consumer affairs to be financially obligated to pay all the interest on the principal on the general obligation bonds issued for the purchase of the building for the department.

The Department agrees with much of the underlying principle expressed in section 1 of the bill, and agrees that it is reasonable, if the concept of self-funding is to be meaningful, that DCCA pay the capital costs associated with its operations. We have three concerns with this particular proposal:

1. DCCA, arguably, has already paid for the KKB;
2. If DCCA has already paid for the KKB, the transfer of monies for this purpose may run afoul of the decision in *Hawai'i Insurers Council v. Lingle* (2008); and
3. Even if DCCA did not already pay for the building, the Department has not budgeted for the expense because it was not asked to pay the interest expense since it was first incurred, and paying for it suddenly in the manner proposed here will very seriously and adversely affect customer services thereby undermining the Legislature's purpose in establishing the Department as a self-funded agency.

***DCCA, arguably, has already paid for the building***

By way of Act 177, SLH 2002 (CCA-191, item 2A), the Legislature appropriated $33 million for the acquisition and renovation of the old federal building (aka the United States Post Office Custom House and Court House), now known as the King Kalakaua

Building. The means of financing (MOF) was "C" funds (general obligation bond funds) and not "D" funds (general obligation bond funds with debt service costs to be paid from special funds). KKB houses all but two of DCCA's divisions and the bulk of its employees.

H.B. No. 1729 proposes to require DCCA to pay all the interest on the principal on the GO bonds issued for the purchase of the building. Those familiar with the transaction's history might argue that DCCA has already reimbursed the general fund for the entire cost of the transaction, and that this proposal amounts to DCCA paying twice for the same thing.

DCCA's reimbursement arguably occurred when, simultaneous with the $33 million CIP appropriation for the building in 2002, the Legislature sought to transfer the same amount out of the Compliance Resolution Fund (CRF) and into the general fund (Act 178, SLH 2002, section 39).

Governor Cayetano subsequently reduced the amount transferred to $26 million, but, the next year, the Legislature more than made up the difference when it transferred another $15 million (Act 178, SLH 2003, section 28) from the CRF. As a result, a total of $41 million was transferred from the CRF to the general fund in calendar year 2003.

Neither the 2002 or 2003 transfer bills explicitly tied the CRF transfer to the building purchase. The subject of DCCA's intention to pay for the building purchase, however, was discussed in letters from DCCA to legislative committees in 2001-02, and was mentioned later in legislative hearings. In addition, I have confirmed with former DCCA director Kathy Matayoshi (1994-2002) that DCCA intended, and understood that the Legislature intended, that the 2002 transfer was for the purpose of reimbursing the general fund for the cost of the KKB.

***Is it legal for the Department to make these payments under these circumstances?***

The Department of the Attorney General is looking at the issue, but I believe that causing DCCA to pay the interest on the principal of the GO bonds may be illegal under the Supreme Court's decision in *Hawai'i Insurers Council v. Lingle* (2008) if its purpose is not DCCA-related. I further believe that a court would likely conclude that funds directed for the purpose of paying an expense denominated as the Department's building-related expenses would not be a legitimate DCCA-related expense if the Department has already paid those expenses.

At the same time, it is possible that the AG might also conclude that the legality of the transfer will depend in part on the source of the revenues used to pay the expense, and thus some cash reserves might be available for this purpose, while other cash reserves might not. If so, the Department's divisions may be affected unequally (a lot of one division's reserves might be available for transfer, while little/none of another division's reserves might be available).

***Even if it is legal for DCCA to pay this expense, DCCA has not budgeted for it and cannot readily afford to suddenly assume this responsibility without some planning.***

The Department is already experiencing reduced registration and license renewal revenues and expects that revenues will continue to fall for some time before they rise again.

Whether or not DCCA paid for the KKB, if the Department is caused to pay $8.8 million for historic/current interest expenses as proposed in this measure, the Department will have an FY09 EOY cash balance of less than $20 million, or approximately 5.4 months of reserve (based on Financial Plan numbers). This is significantly below the 9-month cash reserve that the department targets.[1] Using more current and more likely FY09 expense projections, I believe that we are more likely to end the year at closer to $27 million in cash reserves (approximately 7.7 months), which, while still well below the 9-month target, is less alarming.

If the department pays $8.8 million for historic/current interest payments, however, it will likely not be in a position to immediately assume additional future interest-related obligation. Using the Financial Plan projections again, incorporating the additional responsibility for future bond interest payments as currently included in this proposal would leave the department with less than $12 million (3.3 months) in cash reserves EOY FY10 and less than $6 million (1.6 months) in FY11. In light of departmental cash flow needs, the department could not assume this additional responsibility and keep services at the existing levels.

[1] A 9-month cash reserve target was established by the Department in 2003, and was significantly less than the 24-month and, later, the 18-month reserve target adopted by the prior Administration. The Department requires EOY cash reserves because it is responsible for addressing its own (1) cash flow, and (2) rainy day scenarios. Many of the Department's divisions do not receive any/significant revenues until well into the fiscal year (e.g., CATV: all revenues received in January/February; PVL/RICO: largest revenues received in December/June; DFI: revenues not received until the end of the fiscal year; and INS: assessments not usually received until the second half of the fiscal year). As such, the 9-month reserve target is a reasonable one, and it would be irresponsible financial planning on the Department's part if it were to voluntarily begin the year with cash reserves even approaching a 6-month level without simultaneously initiating plans to reduce service levels and, hence, expenses.

***Summary of the Department's position***

In sum, the Department supports the principle of self-sufficiency that underpins the establishment of the CRF, and agrees that it is reasonable that the Department pay its own operation-related expenses. We submit, however, that we have already done that in this case, and that the effect of this proposal would be to cause the Department to pay a portion of those expenses twice. This would be wrong and, may be, illegal.

Thank you for the opportunity to testify, and I would be pleased to address any questions that you might have.