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**State Senate**

**State Assembly**

**Department of  
Insurance**

## Effort to Prohibit Tax Deductions for Punitive Damages Costs Resurfaces; And Other Tax Measure to Be on the Lookout For

On Wednesday, the Senate Governance and Finance Committee voted 5-2 to approve SB 66, which disallows a personal income tax deduction and a corporate tax deduction for money paid or incurred for punitive damages. The author, Senator Bob Wieckowski (D-Fremont), contends tax deductions are intended to incentivize good behavior. A deduction for punitive damages works in the opposite direction – it rewards and subsidizes the worst behavior by irresponsible corporate citizens.

The bill is harmful to large corporations that are frequent targets of lawsuits, and often settle cases even though they are not culpable, in order to save legal costs and maintain focus on their business operations.

Senator Robert Hertzberg (D-Van Nuys) raised the alternative of tax aware jurors. Tax-aware juries would adjust the amount of punitive damages to impose the desired after tax cost on the defendant. The author did not reject the idea, but predicted companies would consider this worse than the bill as it could enlarge plaintiff windfalls.

SB 66's predecessors would have abolished tax deductions for punitive damages. The two most recent failed to pass the Assembly Floor or were held on the Senate inactive file. SB 66 moves to the Senate Appropriations Committee. Legislative Counsel has assigned a two-thirds vote key, as the measure may lead to a tax increase on any taxpayer under Section 3 of Article XIII A of the California Constitution.

Last year the California Taxpayers Association was able to get one or two Democrats to vote against similar legislation, which led to its demise. The same strategy is in play this year, and through backchannel sources, we have learned that a couple Democrats are similarly unwilling to vote for it. Should the bill appear to be approaching Senate Floor consideration, a CalTax coalition is in place, of which Norwood Associates is a member. This coalition is prepared to actively lead the resistance.

In other tax news, SB 567, authored by Senator Ricardo Lara (D-Long Beach), eliminates the water's edge tax election, requiring US companies with foreign affiliates to report and pay

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taxes on overseas income. This would be a huge windfall in state revenue that CalTax and its large coalition of business interests across all sectors of the economy are ready to act on, should it get any momentum. Norwood Associates would be involved in the fight on this bill. Fortunately, there really is no indication it has any future. But, industry representatives report a positive meeting with the author who is aware of its controversial nature, and is not wedded to every provision of the bill.

With regard to SB 2, introduced by Senator Toni Atkins (D-San Diego), this imposes a \$75 per real estate transaction instrument / document filing charge to build affordable housing. A group of businesses is working to defeat this bill. In terms of a split roll tax target, lobbyists with deep knowledge of what nascent tax legislation looks like are concerned that is what SB 18 by Senator Richard Pan (D-Elk Grove) could become. Right now it is intent language too broad to understand the meaning, but sets on a path a wide ranging children's program encompassing everything from healthcare to education.

Last but not least important, AB 600, Senator Jim Cooper (D-Sacramento), provides a sales and use tax exemption for manufacturing and research and development equipment that has 20 coauthors. The amendments will be processed on Monday.

### Looks Like Legislature Will Call for Audit of Insurance Department Work Comp Fraud Programs

Assembly Insurance Committee Chair Tom Daly, D-Anaheim, has requested the Joint Legislative Audit Committee undertake an audit of the workers' compensation anti-fraud efforts. Chair Daly wants a better understanding the level of coordination among multiple state government agencies that investigate workers' compensation fraud and whether fraud assessment funds, paid insurers, are being put to their best use. Last budget year, the fraud assessment amounted to \$58.86 million.

This legislative session there is renewed focus on provider fraud, which is driven by the Department of Industrial Relations January report that catalogued current efforts and set forth an aggressive agenda for anti-fraud enforcement for the future.

Also, Assembly Member Adam Gray, D-Merced, has introduced AB 221 – Workers Compensation Liability for Payment, which provides that for claims of occupational disease or cumulative injury the employee and the employer would have no liability for payment for medical treatment unless the treatment was authorized by the employer and the amount of the compromise and release, exclusive of the cost of medical treatment, is \$25,000 or more.

AB 221 attempts to curtail circumstances when attorneys contact workers to inquire whether they have an injury. The lawyer never meets them in person; in fact, there are cases when the attorney is located in Mexico, for example. If the worker claims to have an injury, such as a sore back which may or not be related to work (or even exists if the doctor is corrupt), the attorney files a small claim which insurance companies often pay without much review because it is less costly to do so. AB 221 is follow up legislation to last year's anti-work comp fraud effort, AB 1244 (enacted), which removes from the system anyone who is convicted of fraudulently filing a claim.

## Key Jurisdictional Panel Takes Pharmacy Benefit Manager Testimony; PBM Business Activity Scrutinized by Influential Committee Chair

On Monday, the Senate Business and Professions Committee held a hearing on pharmacy benefit managers (PBM). Committee Chair Jerry Hill (D-San Mateo) convened the meeting because the Legislature has long questioned the business practices of PBMs. The Chair expressed the view that it is unclear what PBMs do, making some question whether they are adequately regulated to protect consumers.

PBMs negotiate drug prices between pharmaceutical manufacturers and health plans, but some industry experts believe these really just process manufacturer-pharmacist transactions. In the process, though, they incorporate in contracts with pharmacists authority to heavily audit the filling of prescriptions according to formulary and impose egregious, punitive chargebacks for what can be physician assistant clerical-type errors. With \$47 billion in market capital, three PBMs control 80% of their business segment, resulting in strong arm tactics to force community pharmacists to limit counsel, such as drugs that may be less expensive but perform equally well, the California Pharmacy Association testified.

Republican Senator Jeff Stone of Riverside, who is a compounding-only pharmacist by profession, was highly critical PBMs, going as far as to say PBMs are one area where regulation of business practices is badly needed. Curtailing their imposition of cost to the broader healthcare system could only reduce costs that get handed down to consumers, Senator Stone contended.

Senator Hill suggested the \$941 savings PBMs claim they save each consumer through their drug pricing negotiation role could be shared with those that struggle to pay for healthcare. Hill also advocated more drug manufacturer production cost transparency. The concerns raised by lawmakers make PBMs an early target for potential legislation, including Board of Pharmacy regulatory oversight, mandating transparency on the manner in which they conduct business and treat pharmacies, and other issues that Hill pointed out would not be overlooked by his committee.

## Changing Landscape for Insurance Commissioner Race

This week has seen two changes to the 2018 race for Insurance Commissioner, with one legislator entering the race and another choosing to stay out of it.

State Senator Ricardo Lara announced early this week that he was running for the position of Insurance Commissioner, timing the announcement to come soon after introducing legislation that would create a single-payer system for healthcare in California. Lara is a progressive voice in the state Senate that has spearheaded other efforts such as multi-lingual education in California schools and granting healthcare to undocumented children in the state. He has also made it clear that he will continue this position as Insurance Commissioner in his announcement, stating that "As California's Insurance Commissioner, I'll work tirelessly

to represent the great people of California, not the corporations, the billionaire class, the pharmaceutical or the insurance companies.”

While Lara is one of four Democrats who have entered the race, he has already been endorsed by both the Senate President Pro Tem Kevin de Leon as well as the Assembly Speaker Anthony Rendon. He has also been endorsed by former Assembly Member Susan Bonilla, who had previously filed fundraising papers for the campaign but announced this week that she would no longer be running. Bonilla made the announcement the same day that Lara introduced his campaign, releasing a statement that said “I’m pleased to endorse my friend State Senator Ricardo Lara for Insurance Commissioner.”

Other candidates who are campaigning for the Commissioner’s seat include former Assembly Member Henry Perea and the leader of a progressive group Paul Song. With the election still well over a year away, it remains to be seen who else will enter the race and who the most likely candidate will be. Stay tuned.

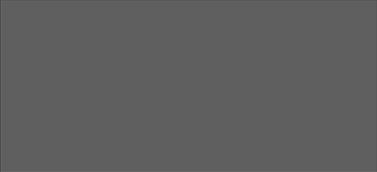
## California Considers Leaving National Flood Insurance Program

After one of the wettest winters in recent history not only eased the worst of California’s multi-year drought but also brought to light severe flood risk throughout the state, California is considering leaving the National Flood Insurance Program. While it may seem a counter-intuitive decision in a state where more than 7 million residents live in flood-prone areas and that just narrowly avoided disaster at one of the nation’s largest dams, proponents say that it would do more to help flood victims than remaining in the program.

The state’s proposal is based on research that was done by Nicholas Pinter and the UC Davis Center for Watershed Sciences that found from 1994 to present day, California has paid over \$3 billion more in premiums than it has received in payouts. Additionally, Pinter found that of the 538 California jurisdictions that pay into the NFIP, only 18 have ever received payouts that exceeded the cost of their premiums. Pinter stated that “That is a massive investment that could have been used for other higher priorities.”

Flood managers in the state have expressed some support for the measure, saying that the federal program does not work for a state like California. In areas like the Central Valley, farmers have often resorted to tearing down buildings that have been damaged by flooding since the premiums have added up to more than the building is worth. Ric Reinhardt, an engineer who is also a member of the state’s Agricultural Floodplain Ordinance Task Force, explained that “FEMA’s flood insurance rates are really developed for riverine systems that don’t have levees. The actuarial process that FEMA uses to develop their rates doesn’t consider the existence of the levee, so while we have frequent floods out here, we don’t have frequent claims.”

The Federal Emergency Management Agency is aware of California’s issues with the program and its thoughts about leaving, and has urged the state to look beyond just thinking in terms of premiums and payouts. Roy Wright, who is in charge of the Federal Insurance and Mitigation Administration within FEMA, said that “Frankly, it takes one event to move you from being a net payer, to a net receiver.” He noted that previously the states of New York and New Jersey were net payers into the system, but after Hurricane Sandy they received



over \$80 billion from the NFIP and became net receivers. Other skeptics of the move to leave the NFIP note that the alternative is creating a state-run program from the ground up, a process that could take a decade or longer.