

**NORTH CAROLINA GENERAL ASSEMBLY
LEGISLATIVE FISCAL NOTE
(INCARCERATION NOTE G.S. 120-36.7)**

BILL NUMBER: SB 925 3rd Edition
SHORT TITLE: Strengthen Security Fraud Enforcement Laws.
SPONSOR(S): Senators Rand and Hartsell

FISCAL IMPACT					
	Yes (X)	No ()	No Estimate Available ()		
	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>FY 2005-06</u>	<u>FY 2006-07</u>	<u>FY 2007-08</u>
EXPENDITURES					
Correction	Exact amount cannot be determined; some impact anticipated.				
Judicial	Exact amount cannot be determined; impact anticipated.				
Secretary of State	Funds were appropriated in 2002. No additional funds are needed.				
ADDITIONAL PRISON BEDS*	Exact amount cannot be determined; some impact anticipated.				
POSITIONS:	3 already-established positions in Secretary of State will be devoted to enforcing the provisions in this bill; unknown number in Correction.				
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Correction (DOC); Judicial Branch; Department of the Secretary of State; State Treasurer					
EFFECTIVE DATE: Sections 11, 12, 25, and 26 of this act become effective December 1, 2003. Section 28 of this act becomes effective October 1, 2003. The remainder of this act is effective when it becomes law.					
<i>*This fiscal analysis is independent of the impact of other criminal penalty bills being considered by the General Assembly, which could also increase the projected prison population and thus the availability of prison beds in future years. The Fiscal Research Division is tracking the cumulative effect of all criminal penalty bills on the prison system as well as the Judicial Department.</i>					

BILL SUMMARY: (Summary provided by the Research Division of the NC General Assembly.) Securities fraud committed in North Carolina by any person or any company is subject to both criminal and civil actions, whether or not the company is chartered in North Carolina, and whether or not the security is registered in North Carolina. Criminal violations of the securities fraud laws are punished as Class H felonies, regardless of the amount involved. In civil actions, the statute of limitations for securities fraud is two years and punitive damages are not allowed to be imposed. Senate Bill 925 would strengthen various laws prohibiting fraud in securities transactions and

dealings by increasing criminal punishment for large-scale securities fraud, expanding civil remedies to recover damages arising from securities fraud, strengthening administrative and criminal powers of securities administrators, and authorizing additional securities investigators.

Additionally, the bill would amend language in G.S. 143-59.1 to prohibit the State from contracting with vendors that incorporate *or reincorporate* in a tax haven country after December 31, 2001, but the United States is the principal market for the public trading of the stock of the corporation *incorporated in the tax haven country*. The bill also deletes Cyprus and Lichtenstein from the definition of a tax haven country.

ASSUMPTIONS AND METHODOLOGY: In 2002, the sixth edition of SB 1455 (Securities Fraud Protections and Study) was ratified. Previous editions of that bill included the substance of SB 925. The fourth edition of SB 1455 included provisions equivalent to those in SB 925 to strengthen various laws prohibiting fraud in securities transactions and dealings by increasing criminal punishment for large-scale securities fraud, expanding civil remedies to recover damages arising from securities fraud, and strengthening administrative and criminal powers of securities administrators. The sixth edition directed the General Statutes Commission to study those provisions.

In addition, the sixth edition increased several securities-related registration and renewal fees and funded three additional investigative positions in the Securities Division of the Office of the Secretary of State. Those positions were identified by the Secretary of State as necessary to enforce the provisions contained in the fourth edition (also contained in this bill, SB 925).

Secretary of State

General Fund Operating Budget. Fiscal Research estimates that the Securities Division with the Department of the Secretary of State would need three unsworn securities investigators at a pay grade of 71 with annual salary of \$33,284 to investigate complaints and to significantly enhance the enforcement of the securities fraud provisions. The positions were authorized by previous legislation (SB 1455, S.L. 2002-189), effective November 1, 2002, with a cost the first year per investigator as follows:

Cost per Securities Investigator (Unsworn)			
Recurring		Nonrecurring	
Salary	\$22,189	Furniture/Equipment	\$2,130
Benefits	\$4,762	Computers	\$3,200
Travel	\$19,090		
Communication	\$867		
Education/Other Expenses	\$3,467		
Total Recurring	\$50,375	Total Nonrecurring	\$5,330

The total recurring cost for the three investigators is expected to be \$151,125. The nonrecurring cost is expected to be \$15,990.

Correction

To project the impact of a bill on the prison population, the Sentencing Commission uses data based on offense codes from the Administrative Office of the Courts (AOC).¹ Offenses that are infrequently charged or infrequently result in convictions are not assigned offense codes. Most violations of the statutes amended in this bill [G.S. 78A-8 through G.S. 78A-14, G.S. 78C-8(a)(1), G.S. 78C-8(a)(2), and G.S. 78C-8(b)] are not assigned offense codes. This is an indication that violations or convictions are relatively rare. Without offense codes and prior conviction rates, the Sentencing Commission cannot project the impact of this bill.

Sections 11 and 25 of the proposed legislation would increase the penalty for securities fraud (in the above statutes) from a Class H felony to a Class C felony in instances where the value of the consideration or losses was \$100,000 or more. If, for example, there were three convictions reclassified from Class H to Class C, there would be the need for two additional prison beds in the first year and four additional prison beds in the second year, due to active sentences and probation revocations.

These sections would also increase the punishment for willful violation of G.S. 78A-9 or G.S. 78C-9 from a Class I felony to a Class H felony if the person violating the statute knows the statement made to be false or misleading. If, for example, there were 10 convictions reclassified from Class I to Class H, there would be the need for two additional prison beds in the first year and three additional prison beds in the second year.

Also included in these sections as new offenses, other willful violations of G.S. 78A-9 and G.S. 78C-9 are punishable as Class 2 misdemeanors. The Sentencing Commission does not have any historical data from which to estimate the potential impact of this proposal on the prison population. It is not known how many offenders might be sentenced for this offense. In FY 2001-02, 12.6 percent of Class 2 misdemeanor convictions resulted in active sentences. The average estimated time served was 15.1 days. Offenders serving active sentences of 90 days or less are housed in county jails; the Department of Correction (DOC) reimburses county jails for the cost of housing offenders serving active sentences of 30 to 90 days. Therefore, Class 2 misdemeanor convictions that result from the broadening of this statute are not expected to have a significant impact on the prison population.

Sections 12 and 25 also create new Class H felony offenses. The Sentencing Commission does not have historical data from which to estimate the potential impact of this proposal on the prison population. If, for example, there were three Class H felony convictions for these offenses per year, this bill would result in the need for one additional prison bed the first year and two additional prison beds the second year due to active sentences and probation revocations.

¹ The Sentencing and Policy Advisory Commission prepares inmate population projections annually. The projections used for incarceration fiscal notes are based on January 2003 projections. These projections are based on historical information on incarceration and release rates under Structured Sentencing, crime rate forecasts by a technical advisory board, probation and revocation rates, and the decline (parole and maxouts) of the stock prison population sentenced under previous sentencing acts.

Section 26 of the bill amends G.S. 78D-24 to punish (upon conviction) any person who willfully violates any provision of Chapter 78D (Commodities Act) as a Class H felon if the actual losses caused by the violation are less than \$100,000 and as a Class C felon if the actual losses caused by the violation are \$100,000 or more. Under current law, such a person is punished as a Class I felon. Every 10 convictions reclassified from Class I to Class H would result in the need for two additional prison beds in the first year and three additional prison beds in the second year. If, for example, there were 10 convictions reclassified from Class I to Class C, there would be the need for nine additional prison beds in the first year and 17 additional prison beds in the second year.

The chart below describes the impact of each new or amended criminal penalty on the prison system in the first year (2004-05). Please note that due to active sentences and probation revocations, convictions of Class C felonies that lead to one new prison bed in 2004-05 will result in the need for two new prison beds in 2005-06. **If, for example, there was one violation of each of the statutes listed (with losses at least \$100,000) – and each violation resulted in a conviction - there would be the need for 9 new prison beds in the first year and 19 new prison beds in the second year.** Each prison bed costs, on average, \$22,787 to operate annually.

Increase in Number of Prison Beds in 2004-05 For Every Conviction			
Section/Statute violated	Current Law	Bed increase under SB 925	
	All losses	Losses less than \$100,000	Losses at least \$100,000
Section 11			
G.S. 78A-8	0.33	no change	+1 bed
G.S. 78A-11	0.33	no change	+1 bed
G.S. 78A-13	0.33	no change	+1 bed
G.S. 78A-14	0.33	no change	+1 bed
G.S. 78A-9 (false/misleading statements)	0.13	+ 0.20 beds	
G.S. 78A-9 (other)	-	+ jail time	
Section 12			
G.S. 78A-58	-	+ 0.33 beds	
Section 25			
G.S. 78C-8(a)(1)	0.33	no change	+1 bed
G.S. 78C-8(a)(2)	0.33	no change	+1 bed
G.S. 78C-8(b)	0.33	no change	+1 bed
G.S. 78C-9 (false/misleading statements)	0.13	+ 0.20 beds	
G.S. 78C-9 (other)	-	+ jail time	
Section 26			
G.S. 78D-24(a)	0.13	+ 0.20 beds	+1 bed

It is impossible to estimate the impact of the proposed legislation on the prison system, and available data indicate a range of possible results. Based on data from the Administrative Office of the Courts (AOC) and the Securities Division of the Secretary of State's office, there is the potential for an increase in prison beds needed under SB 925. Securities Division data indicates that only six individuals were charged – and might have been affected by the provisions

in SB 925 – in 2001. If there were no convictions under the affected statutes, there would be no impact on prison beds.

Based on the most recent population projections and estimated available prison bed capacity, there are no surplus prison beds available for the five year Fiscal Note horizon and beyond. This means that any increase in Class C felony convictions will impact the need for new prison beds. Due to the December 2003 effective date and time it would take for an offender to be convicted and begin serving a prison sentence, the prisons would not see a significant impact from this bill until FY 2004-05. For each additional prison bed needed, the average statewide operating cost is estimated to be \$62.43/day.

Only operating costs of new prison beds, not construction costs, will be included in the fiscal estimate under the following circumstances: (1) when a bill increases the inmate population in the first two years of the fiscal note horizon, FY 2004 and 2005, this assumes that Correction cannot build prisons quickly enough to house additional offenders before 2005-06 and, (2) if the number of beds is anticipated to be less than 400 beds total since it is not practical to assume DOC would construct a general population prison with fewer than 400 beds.

In practice under these circumstances, DOC will have to take all or one of several actions: purchase additional beds out of state or in county jails; pay counties to increase jail backlog; or, establish temporary beds in the State system. For these circumstances, the Fiscal Research Division (FRD) will use the DOC statewide average operating cost, plus 3% annually, to calculate the prison bed cost.

Judicial Branch

For most criminal penalty bills, the AOC provides Fiscal Research with an analysis of the fiscal impact of the specific bill. For these bills, fiscal impact is typically based on the assumption that court time will increase due to an expected increase in trials and a corresponding increase in the hours of work for judges, clerks and prosecutors. This increased court time is also expected to result in greater expenditures for jury fees and indigent defense. The AOC relies on offense code data to project the court costs of a bill; the lack of data for these offenses prevents the AOC from estimating the court impact. However, the AOC does expect SB 925 to have an impact on the court system. Extending the length of time for filing a civil lawsuit would result in more such lawsuits being filed and the availability of punitive damages would increase the complexity, and thus workload, of existing and new cases.

The AOC anticipates that many sections of the bill could have a substantial fiscal impact on the courts because they create new offenses not currently charged and elevate offense classes for existing offenses. As a result of the enhanced penalties, some defendants charged with Class H or Class I felonies under current law would be charged with Class C or Class H felonies. Moreover, defendants charged with Class C felonies would serve active sentences under the bill.

The AOC reports that Securities Unit staff of the Office of the Secretary of State noted last year that defendants convicted of the Class H or Class I felonies typically do not have the requisite number of prior record level points to ensure that they serve active sentences. With upgrades in

the offenses charged (particularly the more significant upgrades from Class H or Class I felonies to Class C felonies), all defendants would face active sentences (all sentences in Class C are active). More vigorous defense and prosecution, and more time and cost disposing of cases would accompany such enhancement. Trials and pleas would demand more court time and preparation time as a result of the stiffer penalties under the bill.

In addition, the bill expands the definition of “Investment Advisers” (*Section 16* of the bill) to include persons exempt from registration under federal law Section 203(b)(3) of the Investment Advisers Act of 1940. Section 203(b)(3) exempts certain investment advisers from registering in order to use mails or any other means of interstate commerce in connection with his or its business as and investment adviser. *Sections 17 and 18* of the bill further clarify that investment advisers exempt from registration under Section 203(b)(3) (or a representative of such a person) are allowed to transact business in the State as investment advisers or investment adviser representatives respectively. While it is possible that more investment advisers and their representatives could transact business in the State under the bill than before, conversations with Securities Unit staff indicated that any such increase would be insignificant and impossible to quantify. According to the Securities Unit staff, these changes would only move a small number of private investment advisers within the scope of the antifraud provisions in the State.

While the AOC expects these changes to affect the courts, it is unable to provide an estimate. Regarding the impact of the civil liability changes, the AOC expects increased complexity of civil cases and more civil lawsuits as a result of the inclusion of punitive damages and extension of the filing period. No securities cases have been assigned to the Business Court, which could suggest that the civil cases to date have not been so complex that assignment of those cases was warranted.

Regarding the criminal cases, the AOC also does not have offense codes for most of the offenses to which the bill would apply, and does not know how many defendants could be charged with the new offenses (relating to the obstruction of investigations) created under the bill. Calendar year 2002 data for the one offense for which there is presently an offense code (G.S. 78A-8) reveal two defendants charged with that particular offense, for unknown dollar amounts. These data reflect convictions, not charges, and it is possible that the number of charges for this or similar offenses (to which G.S. 78A-8 could have been a plea) was significantly greater. If the crimes selected for prosecution often involve substantial securities, the \$100,000 threshold may be crossed in the majority of cases. Enhancement from Class H or Class I felonies to Class C or Class H felonies would have a substantial fiscal impact.

The Securities Unit estimates that approximately 1,700 to 2,100 complaints are filed and investigated by their office each year. During calendar year 2001, only six arrests resulted from these investigated complaints. The Securities Unit also estimates that 98% of the arrests resulting in criminal cases would be elevated from Class H to Class C felonies under the bill. According to the Securities Unit, not many cases have arisen in the past because the cases are most often referred to individual district attorney’s offices that may not have the necessary expertise or resources to prosecute these types of cases. As such, the Securities Unit staff indicated that it is not unlikely for a district attorney to work out a plea agreement with a defendant before the defendant is charged or indicted. To the extent that there is significant enforcement of the provisions of the bill, the AOC would expect substantial increases in the workload of the courts.

While all these data collectively suggest a significant number of cases, the AOC is unable to estimate a specific number.

SOURCES OF DATA: Department of Correction; Judicial Branch; North Carolina Sentencing and Policy Advisory Commission; Department of the Secretary of State.

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