

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

**BILL NUMBER:** SB 1455 1st Edition  
**SHORT TITLE:** Strengthen Securities Fraud Enforcement Laws  
**SPONSOR(S):** Senators Rand and Dalton

		<b>FISCAL IMPACT</b>				
		<b>Yes (X)</b>	<b>No ( )</b>	<b>No Estimate Available ( )</b>		
		<u><b>FY 2002-03</b></u>	<u><b>FY 2003-04</b></u>	<u><b>FY 2004-05</b></u>	<u><b>FY 2005-06</b></u>	<u><b>FY 2006-07</b></u>
<b>GENERAL FUND</b>						
<b>REVENUE</b>						
<b>Recurring</b>		\$223,350	\$223,350	\$223,350	\$223,350	\$223,350
<b>EXPENDITURES</b>						
<b>Correction</b>	Exact amount cannot be determined; some impact anticipated					
<b>Judicial</b>	Exact amount cannot be determined; impact anticipated					
<b>Secretary of State</b>						
<b>Recurring</b>		\$226,692	\$226,692	\$226,692	\$226,692	\$226,692
<b>Nonrecurring</b>		\$ 15,990				
<b>ADDITIONAL PRISON BEDS*</b>	Exact amount cannot be determined; some impact anticipated					
<b>POSITIONS:</b>	3 positions in Secretary of State; unknown number in Correction					
<b>PRINCIPAL DEPARTMENT(S) &amp; PROGRAM(S) AFFECTED:</b>	Department of Correction; Judicial Branch; Department of the Secretary of State					
<b>EFFECTIVE DATE:</b>	Sections 4, 9, and 10 become effective on December 1, 2002. Sections 5, 6, 7, and 11 become effective on July 1, 2002. The remainder of the act becomes effective when it becomes a 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:** Rewrites G.S. 78A-56(a) and (b) and 78C-38(a) to allow punitive damages in actions for securities or investment fraud under those subsections. Rewrites G.S. 78A-56(f) to change the statute of limitations for actions under the section from two years to five years. Rewrites G.S. 78A-57(a1) and 78C-39(a1) to provide that offenses specified in those subsections are Class C (instead of Class H) felonies if the “total value of consideration,” which the act defines, involved in the violation is \$100,000 or more. Amends various sections of G.S. Ch. 78A to increase certain filing and renewal fees. Rewrites G.S. 78D-24(a) to provide that any violation of the Commodities Act is a Class H (instead of Class I) felony. Appropriates from General Fund for 2002-2003 to the Office of the Secretary of State \$226,692 for recurring expenses and \$15,990 for nonrecurring expenses for three additional unsworn securities investigators in the Securities Division. Provisions that change the classes of offenses are effective Dec. 1, 2002, and apply to acts committed on or after that date. Provisions relating to fees and the appropriation are effective July 1, 2002. Remainder of the act is effective when it becomes law. (Institute of Government Bill Digest)

## **ASSUMPTIONS AND METHODOLOGY:**

### **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).<sup>1</sup> 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.

Sections 4 and 9 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. Each conviction that would be reclassified from Class H to Class C would result in the need for one additional prison bed in the first year and two additional prison beds in the second year, due to active sentences and probation revocations.

Section 10 of the bill amends G.S. 78D-24 to punish any person who willfully violates any provision of Chapter 78D (Commodities Act) as a Class H felon upon conviction. Under current law, such a person is punished as a Class I felon. Every five convictions reclassified from Class I to Class H would result in the need for one additional prison bed in the first year and one additional prison bed in the second year.

**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 AOC and the Securities Division of the Secretary of State’s Office, there is the potential for an increase in prison

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<sup>1</sup> The Sentencing and Policy Advisory Commission prepares inmate population projections annually. The projections used for incarceration fiscal notes are based on December 2001 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.

beds needed under SB 1455. AOC data indicates that as many as 55 convictions in calendar year 2000 might have been affected by the proposed legislation; AOC cannot determine the total number of convictions for these offenses or the proportion of convictions that would have been eligible for the higher felony class under this bill. Securities Division data indicates that only six individuals were charged – and might have been affected by the provisions in SB 1455 – in 2001. In the event that there are 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 2002 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 2003-04. For each additional prison bed needed in that year, the average statewide operating cost is estimated to be \$71.34/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 2003 and 2004; this is based on the assumption that Correction cannot build prisons quickly enough to house additional offenders before 2004-05, 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, 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 Administrative Office of the Courts (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.

The AOC expects SB 1455 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.

In addition, the AOC expects that Sections 4, 9, and 10 of the bill could have a substantial fiscal impact on the courts because they elevate the offense class that would be charged. Sections 4 and 9 enhance the punishment from a Class H felony to a Class C felony for any person who willfully engages in certain fraudulent practices if the total value of the consideration involved or actual

losses caused in the violation or violations is \$100,000 or more. Section 10 of the bill elevates the punishment under the Commodities Act from a Class I felony to a Class H felony.

Some defendants charged with Class H felonies under current law would be charged with Class C felonies and serve active sentences under the bill. The Securities Unit staff of the Office of the Secretary of State notes that defendants convicted of the Class H felonies now do not typically 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 upgrade from Class H 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.

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. Calendar year 2001 data, for the one offense for which there is presently an offense code (G.S. 78A-8), reveal no defendants charged with that particular offense. Available data for calendar year 2000 reveal 55 convictions under G.S. 78A-8. (These data come from a review of what the clerks entered into what is often referred to as “free text” fields. Since the clerks may enter anything, or nothing, into that field, the data reveal, at best, an order of magnitude. The 55 convictions are a significant number for this field.) AOC data do not reveal how many of those cases involved securities in excess of \$100,000. 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 to Class C felonies would translate into a substantial fiscal impact. These data, moreover, reflect convictions, not charges, and it may be assumed that the number of charges for this or similar offenses (to which G.S. 78A-8 could have been a plea) was significantly greater.

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 percent of the arrests resulting in criminal cases would be elevated 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 indicates 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. However, Section 11 of the bill does appropriate funds to provide the necessary resources (three additional unsworn securities investigators) to the Office of the Secretary of State to investigate complaints. Therefore, there may be significant enforcement of the provisions of the bill and 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.

**Secretary of State**

**General Fund Revenue.** Sections 5, 6, & 7 of this bill would increase certain fees that are now charged by the Securities Division of the Secretary of State's Office. The estimated additional revenue is \$223,350 annually.

Specifically, Section 5 would amend G.S. § 78A-28(b) to increase the public offerings registration/carryover fee from \$100 to \$200. This fee has only been charged once in the last five to six years because the occurrence of registration statements relating to redeemable securities to be offered for a period in excess of one year is rare. Thus, this increase is not expected to generate any significant additional revenue.

Section 6 would amend G.S. § 78A-28(j) to increase the public offering amendment filing fee from \$50 to \$100. For fiscal year 2000-2001, the revenue from this fee was \$50. The proposed increase would generate an additional \$50 annually.

Section 7 would amend G.S. § 78A-31(a)(4) to increase the investment company notice filing renewal fee from \$100 to \$200. For fiscal year 2000-2001, the revenue from this fee was \$218,650. Doubling the fee to \$200 is expected to generate an additional \$218,650 annually.

Section 7 would also amend G.S. § 78A-31(a)(5) to increase the investment company notice filing amendment fee from \$50 to \$100. For fiscal year 2000-2001, the revenue from this fee was \$4,650. Doubling the fee to \$100 is expected to generate an additional \$4,650 annually.

**General Fund Operating Budget.** The Department estimates that the Securities Division would need three additional unsworn securities investigators at a pay grade of 71 to investigate complaints and to significantly enhance the enforcement of the securities fraud provisions. The cost per investigator is as follows:

<b>Cost per Securities Investigator (Unsworn)</b>			
<b>Recurring</b>		<b>Nonrecurring</b>	
Salary	\$33,284	Furniture/Equipment	\$2,130
Benefits	\$7,145	Computers	\$3,200
Travel	\$28,635		
Communication	\$1,300		
Education/Other Expenses	\$5,200		
<b>Total Recurring</b>	<b>\$75,564</b>	<b>Total Nonrecurring</b>	<b>\$5,330</b>

The total recurring cost for the three investigators is expected to be \$226,692. The nonrecurring cost is expected to be \$15,990.

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

**TECHNICAL CONSIDERATIONS:** None

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**DATE:** July 9, 2002



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