

ALERT

VOLUME 35, NUMBER 19 • JUNE 12, 2009



Budget Solution Hard Task for California Policymakers



“The expenditure of vast sums of public money to meet the demands of our social problems cannot be continued indefinitely unless a sound fiscal policy is adopted to balance budgets.”

These words of warning were spoken by the State Controller—not this year, but in 1934 in the depths of the Great Depression. Our state’s economy has not

collapsed to that extent, but our budget policy may be in even worse disarray.

The California Legislature met the recession and its past fiscal mismanagement head-on this week as it struggled to fix its deeply imbalanced budget and avoid running out of cash sometime this summer.

Legislative leaders and members of the legislative budget conference committee worked this week to devise alternatives to the Governor’s proposal to resolve \$24 billion in budget shortfalls through June 2010.

See Budget: Page 4

Tripling of UI Tax Boosts Hiring Costs for State Employers



The California Chamber of Commerce has identified a new “job killer” bill that would make hiring new employees more expensive for California employers.

CalChamber-opposed **SB 222 (Ducheny; D-San Diego)** creates a disincentive to hire new employees by tripling the already-high unemployment insurance (UI) taxes on California employers without a proper analysis of what is needed to reform California’s broken UI system.

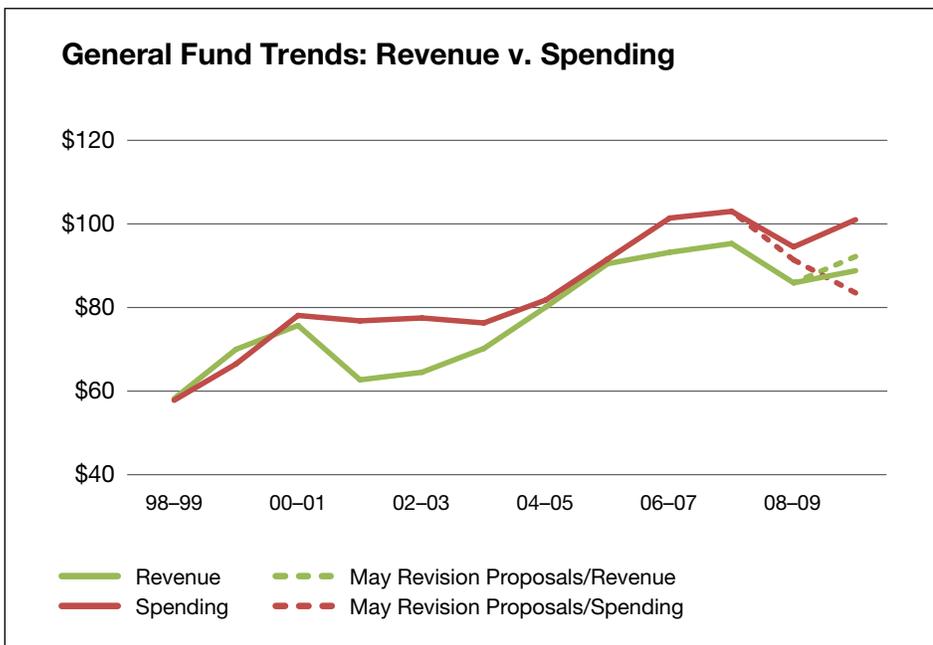
California’s struggling economy and 11 percent unemployment rate have caused the state’s employer-funded UI Trust Fund to run out of money and rely on federal loans to pay ongoing benefits to unemployed Californians.

SB 222 assumes the UI Trust Fund insolvency should be resolved solely through tax increases on employers.

Higher than Other States

Compared to competitors in other states, California employers already pay higher-than-average UI taxes. For instance, the UI tax on California employers raises \$399 per covered employee, compared to \$255 per covered employee in other states.

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Evolution of budget problem: When state revenues have increased, spending has increased, but when revenues decline, spending has remained the same or increased, and the state has borrowed money to fill the gap.

Inside

Employers Paying \$10+ Billion More: Page 3

Labor Law Corner

I-9 Form Changes Mean Employers Need to Adjust Hiring Practices



Sunny Lee
Senior Helpline
Consultant

• What do I need to know about the new I-9 form?

All employers are required to verify that every new hire is either a U.S. citizen or authorized to work in the United States. Changes have occurred in the I-9 form and acceptable documents that establish both the employee's identity and employment eligibility.

Employers need to be aware of these

changes and adjust hiring practices to conform to these new requirements.

Current v. New Employees

• Am I required to have all of my employees complete the new I-9?

No, existing employees do not need to complete the new I-9 form if a complete I-9 form is on file. The new I-9 form is required to be used for all employees hired on or after April 3, 2009.

• Where can I find copies of what the documents should look like?

The new U.S. Citizen and Immigration Services **Handbook for Employers** (Rev. 04/03/09) now includes color pictures of the acceptable documents. The guide also contains useful information about I-9 requirements and commonly asked questions and answers. This document may be downloaded directly at www.uscis.gov/files/nativedocuments/m-274.pdf.

• Do we need to track expiration dates on current employees?

No, not for documents that establish identity only. The new requirement of unexpired identity documents applies only to new hires. That change does not affect existing employees.

No Grace Period

• Can we hire an employee who has given us a receipt that he/she has applied

for an initial grant of employment authorization?

Under the old I-9 regulations, new hires were able to work by showing the employer a receipt that they had applied for an initial grant of work authorization. That receipt was then good for 90 days. The new regulations, however, have done away with that provision and the employee must check the box in Section 1 that he/she is already authorized to be employed.

There is no grace period under the new regulations—the employee has to be eligible to work at the time of hire.

Limited Use of Spanish Form

• Can I use the Spanish form for my Spanish-speaking employees?

Although a Spanish version of the I-9 is available, that version may be used only in Puerto Rico. Spanish-speaking employees may be given the Spanish form as a translation guide, but the English form must be completed and retained as the I-9 record.

The Labor Law Helpline is a service to California Chamber of Commerce preferred and executive members. For expert explanations of labor laws and Cal/OSHA regulations, not legal counsel for specific situations, call (800) 348-2262 or submit your question at www.hrcalifornia.com.

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Alert (ISSN 0882-0929) is published weekly during legislative session with exceptions by California Chamber of Commerce, 1215 K Street, Suite 1400, Sacramento, CA 95814-3918. Subscription price is \$50 paid through membership dues. Periodicals Postage Paid at Sacramento, CA.

POSTMASTER: Send address changes to Alert, 1215 K Street, Suite 1400, Sacramento, CA 95814-3918. Publisher: Allan Zarembeg. Executive Editor: Ann Amioka. Associate Editor: Blake Ellington. Art Director: Marcy Wacker. Capitol Correspondent: Christine Haddon. Photographer: Aaron Lambert.

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Russian River Tour. Water Education Foundation. August 6–7, Santa Rosa. (916) 444-6240.

Government Relations

Women's Summit 2009. California State Board of Equalization. June 18, Anaheim. (916) 324-2068.

International Trade

State of the Sea Ports. Northern

California World Trade Center. June 25, West Sacramento. (916) 319-4262.

India Trade Conference. Port of Los Angeles, Southern California Edison, Quanta Consulting. June 26, Irwindale. (949) 480-9466.

Socially Responsible Investing Here and Abroad. Monterey Bay International Trade Association. June 26, Monterey. (831) 335-4780.

Partnering for Compliance. Partnerships International, Inc. August 12–14, San Jose. (321) 952-2978.

Trade Mission to Vancouver, B.C. Sacramento Metro Chamber and Northern California World Trade Center. August 18–19, Vancouver, B.C. (916) 321-9144.



Recap

\$10+ Billion in Tax Hikes, Accelerations for Employers in 2008, 2009 Budget Deals



The California Chamber of Commerce and other employer groups have been pointing out to state decision-makers that the last two state budget compromises

mean a \$10+ billion increase in employer tax payments during the next two budget years.

The increased tax burden is the result of a combination of tax increases, borrowing and acceleration of tax revenues from businesses in the next two years and beyond.

While some economic recovery reforms were also adopted, many companies investing in jobs and operations in California—or attempting to recover from the economic downturn—will suffer permanent harm from these tax increases.

Following is a recap of increased tax liabilities for employers due to tax changes adopted as part of the 2008-09 budget in AB 1452 (Chapter 763, Statutes of 2008) and SBX1 28 (Chapter 1, Statutes of 2007-08), as well as ABX3 3 (Chapter 18, Statutes of 2009-10) for the 2009-10 budget.

September 2008 Tax Increases/Accelerations

1. Strict Liability Penalty that Punishes Reasonable Tax Disputes (SBX1 28): Estimated to raise more than \$2.5 billion from employers as of June 1, 2009.

This imposed a new, 20 percent strict liability penalty in addition to all existing penalties, which applies to “understatements” of tax liability of \$1 million or more. It applied retroactively to tax year 2003, with a May 31, 2009 deadline, and, prospectively, is permanent. No other state has this penalty. It applies even to reasonable taxpayer behavior where there is no culpability, forcing companies

to overpay their taxes every year, to take into account amounts reasonably in dispute or outside of their control, in order to ensure no 20 percent penalty is imposed. Overpayments will eventually be partially refunded, but the state will have received a low-interest loan from businesses, with no deadline for refunds.

2. Limit on Research and Development Tax Credit and Enterprise Zone Program Credits (AB 1452): Estimated to raise \$900 million from employers.

This bill imposed a two-year limit on the use of all business tax credits, including research and development and enterprise zone credits, California’s only remaining statewide investment incentive tax credits. For tax years 2008 and 2009, these credits are capped at one-half of the taxpayer’s liability, with only very small businesses exempted. This limitation will result in a mid-stream change and tax increase for companies that made investment decisions and plans in reliance upon them. Credits that could have been used during the limitation period are permitted to be carried over, but the lost time-value of money to companies is permanent.

Offsetting Improvement: Effective January 2010, tax credits (but not enterprise zone credits per SBX1 28) may be shared among a related group of affiliate or subsidiary companies, referred to as “unitary utilization.” This will help some but not all companies, due to individual circumstances.

3. Suspension of Net Operating Loss (AB 1452): Estimated to raise \$1.6 billion over two years.

This bill suspends for two years, tax years 2008 and 2009, the ability of businesses and individuals to deduct net operating losses (NOL). Very small businesses are exempted. The NOL deduction gives businesses more flexibility to manage losses they experience within timeframes and cycles that differ from the arbitrary and rigid government tax filing deadlines. The suspension will have a direct impact on marginally profitable businesses attempting to emerge from losses due to

increased tax liability and reduced cash flow.

Offsetting Improvement: After the two-year suspension period, treatment of losses will partially conform to federal carryover and carryback, which benefits some but not all companies, due to individual circumstances.

4. Accelerated Estimated Tax Payments (SBX1 28): Estimated to raise \$2.3 billion over two years

Beginning January 2009 and ongoing, business and individual taxpayers must pay more of their estimated taxes earlier in the year. The bill imposes a new 100 percent accuracy requirement on taxpayers with incomes over \$1 million. Instead of four payments of 25 percent, the first two payments will be 30 percent and the last two 20 percent. This will reduce cash flow for independent contractors and other businesses, small and large.

5. Accelerated Limited Liability Company Fee (AB 1452): Estimated to raise \$360 million from employers.

Limited liability companies (LLCs) must pay their annual fees during the first six months of the current tax year, beginning January 2009 and permanently thereafter. A 10 percent penalty will be assessed if businesses underestimate. The new fee deadline will result in a double payment of the fee in the early part of 2009—the prior year’s LLC fee and the current year’s fee are due. This will pose a hardship for small companies with limited cash flow. Also, LLCs must accurately estimate the following year’s fee liability, or be subject to a 10 percent penalty.

February 2009 Tax Increases

The February 19, 2009 state budget included \$12.5 billion in tax increases in ABX3 3, including more than \$3.5 billion having an impact on the California business community.

1. Sales and Use Tax Rate Increase (ABX3 3): Estimated to raise more than \$2.4 billion from employers.

Businesses in California pay more

See Employers: Page 6

Budget Solution Hard Task for California Policymakers



From Page 1

Daunting Task

The task is daunting for several reasons.

- The budget emergency has actually been years in the making. Even

before taking account of the effects of the current recession, California's fiscal health has been severely damaged.

The chart on Page 1 shows that when revenues have increased, spending has increased, but when revenues decline, spending has

remained the same or increased and the state has borrowed money to fill the gap.

● Between 1998 and 2007—before the recession hit California—revenues increased on average by 64 percent, while spending increased by 77 percent. The recession only exacerbated this.

● California voters in May rejected some short-term budget solutions, as well as an extension of some of the tax increases by one or two years. Voters rejected the key measure, Proposition 1A, by a two-to-one margin.

Voters Oppose Tax Hikes

According to a survey just released by the non-partisan think tank California Forward, the top reasons voters defeated Proposition 1A were:

- Against tax increases: 32 percent;
- Won't solve the problem: 20 percent;
- Need to cut spending/increase accountability: 15 percent;
- State legislators are not doing their job: 14 percent.

Governor's Proposal

Recognizing that voters have lost patience with their elected leaders and have drawn the line at new tax increases, Governor Arnold Schwarzenegger proposed \$24 billion in budget solutions

in late May. The Governor's proposal (dotted line on chart) rejects new taxes, and includes few one-time gimmicks or loans—at least relative to previous budget solutions.

The Governor's proposal also includes a \$4 billion reserve, anticipating that the economy and tax revenues will not quickly recover.

The new deficit reduction proposals will cut deeply into numerous public programs and have raised alarms from public employee unions and other public sector beneficiaries. Some of the highest-profile proposals include:

- Reducing state employee pay and maintain furloughs.

The California Chamber of Commerce has emphasized repeatedly that the long-term fiscal health of the state will be resolved only by turning around the state's economy. A strong economic recovery will add billions to the treasury without increasing taxes.

- Reducing various payments and services in the Medi-Cal program by more than \$1 billion.

- Eliminating the Healthy Families program for non-poverty children.

- Eliminating or reducing various welfare and in-home care programs by more than \$3 billion.

- Reducing public school funding by \$5 billion.

- Reducing higher education funding by \$900 million.

- Selling a wide variety of state properties and assets.

- Increasing income tax withholding and estimated payments by more than \$2 billion.

- Borrowing \$2 billion in property taxes from cities and counties.

Public Union Reactions

The reactions from the public sector unions have been fierce.

- The American Federation of State, County and Municipal Employees (AFSCME) proposed a six-page list of tax increases totaling more than

\$30 billion and demanded Democratic legislators sign a pledge to support it.

- The Service Employees International Union (SEIU) has launched a \$1 million statewide television advertising blitz calling for new taxes to help balance the state budget.

The public employee union strategy is two-fold: gaining support for tax increases this year to offset program cuts and related reductions in government staffs, plus their longtime fiscal policy goal—repealing the requirement that state tax increases win two-thirds approval of the Legislature.

The legislative and political activity are operating under a tight deadline:

likely within no more than six weeks, California will be unable to pay all of its bills, due to a shortage of cash. And each succeeding month, the cash flow situation will worsen, progressively

threatening more and more programs and the state's credit rating.

But legislators and the Governor cannot focus only on the immediate crisis. From 2010 through 2013, tens of billions of dollars in short-term budget solutions will vanish, including federal stimulus, temporary tax increases, local government loans, tax accelerations and asset sales. Some of these solutions must be repaid; others must be accompanied by offsetting spending reductions.

CalChamber Position

The California Chamber of Commerce has emphasized repeatedly that the long-term fiscal health of the state will be resolved only by turning around the state's economy. A strong economic recovery will add billions to the treasury without increasing taxes, but will occur only if the Governor and Legislature are committed to increasing the state's competitiveness and ensuring California is a welcome environment for job creation.

Contact: Loren Kaye

Court Says Federal Agency Must Consider Human Impacts in Plans to Protect Species



A U.S. district court judge has ruled that plans for restoring endangered species must consider the impact of requirements on people and other affected water users.

The May 29 decision by U.S. District Judge Oliver W. Wanger of the Eastern District Court of California affects pumping of water from the Delta, the major source of water for California residents and many agricultural areas throughout the state.

At issue in the case was a plan (“biological opinion”) issued December 15, 2008 by the U.S. Fish and Wildlife Service to protect the Delta smelt, an endangered fish species native to the Sacramento-San Joaquin Delta, which is believed to be threatened by pumping and

water diversion out of the Delta.

That December 15, 2008 plan was the basis of Wanger’s previous court order to reduce pumping of water from the Delta.

Many farmers continue to receive only 10 percent or less of their normal level of water supply.

Wanger’s May 29 ruling said the plan is invalid because it does not take into account the impacts of its recommendations on all parties.

Background

The lawsuit resulting in Wanger’s ruling was filed in March by the State Water Contractors, an association of 27 public water agencies and utilities that purchase water from the State Water Project. The water contractors contended that the U.S. Fish and Wildlife Service ignored various conditions in the Delta that contribute to the declining smelt population in favor of a model that attributes declines in the smelt population to pumping operations alone.

The case, *San Luis and Delta-Mendota Water Authority and the Westlands Water District v. Kenneth Lee Salazar and the U.S. Department of the Interior*, pitted the government and the environmentalist groups—the Natural Resources Defense Council and the Bay Institute—against west side Central Valley water users who lost Delta water as a result of Wanger’s previous decision.

Court to Provide Oversight

In his latest ruling, Wanger did not tell federal officials how to operate the Central Valley Project, and said it was up to them to manage the massive water pumps in the Delta.

But Wanger said officials must focus not just on protecting the endangered Delta smelt; they also must take into account “the harm being visited upon humans, the community and the environment,” and explain and justify how they reached their water-allocation decisions.

See Court: Page 6

Fisheries Service Still Focuses Solely on Species Impacts

Just a week after a federal court judge ordered the U.S. Fish and Wildlife Service to consider the impact of species protection plans on people, another federal agency released a new plan that focuses solely on what is needed to protect various fish in the Delta.

The plan (“biological opinion”) released June 4 by the National Marine Fisheries Service (NMFS) summarized the harmful impacts of continued Central Valley Project pumping operations to several native species living in the Delta, including a couple of species of salmon, steelhead and green sturgeon.

Contained in the new plan is an alternative proposal to the existing plan that calls for reduced pumping and timed pumping designed out of

sensitivity for the endangered species’ life cycles.

The new plan states that not changing pumping plans will harm native species due to, for example, reduced upstream cold water infusion that harms egg development, ill-timed dam gate closures at the Red Bluff Diversion Dam that impede normal mating behavior, increased exposure to predators resulting from diversion, abnormal and intermittent reverse flows that interfere with normal mating behavior.

The NMFS opinion calls for a reduction of approximately 330,000 acre-feet of water pumped per year and various other mitigation plans with an expected annual cost increase of roughly 5 percent to 7 percent for users of the federal and state water

projects combined. The opinion made it clear that the increase is expected to be over and above the costs associated with any increases due to the U.S. Fish and Wildlife Service plan to protect the Delta smelt.

The NMFS plan considers only the health of the endangered fish species. Similar to the U.S. Fish and Wildlife Service plan for the Delta smelt, the NMFS plan doesn’t contemplate harm to other users of the water, such as people, farming or business enterprises.

The potential cumulative impact of the plans to protect the Delta smelt and other fish on California’s primary water source illustrate again the need for a holistic approach to governing water use in the Delta.

Staff contact: Valerie Nera

Tripling of UI Tax Boosts Hiring Costs for State Employers

From Page 1

California is not alone in experiencing UI fund solvency issues. Fifteen states across the nation have UI solvency problems significant enough to require loans from the federal government.

Those states' UI tax structures, on average, raise more per covered employee than the national average. These 15 states raise an average of \$329 per covered employee, which is 30 percent above the national average of \$255.

In addition, they are not only high UI tax states, but they also have an average unemployment rate (9.4 percent) that is above the average state unemployment rate (8.08 percent).

This data indicates that state UI fund

insolvency is not caused by low employer taxes. If this were the case, then the states with UI fund insolvencies would have lower-than-average tax burdens. What the data does show is that these 15 states have above-average unemployment.

CalChamber Position

The CalChamber believes that California should focus on job creation and economic recovery instead of increasing employment-related taxes that will serve as a disincentive to hire.

Although all stakeholders recognize that the state UI system needs reform, it has not been proven that a tax increase on employment is the most appropriate path. In fact, the data suggests otherwise.

The CalChamber believes that reforming the UI system without adequate empirical data and without appropriate economic modeling of reform concepts could have disastrous economic consequences as California businesses attempt to recover from the recession. The CalChamber has suggested that all concerned parties work together to compile the necessary data and complete the appropriate analyses.

The CalChamber urges policymakers to act cautiously and complete the appropriate economic modeling before moving forward with any efforts to reform the broken UI system.

Staff Contact: Jason Schmelzer

Court Says Agency Must Consider Humans in Plans to Protect Species

From Page 5

Rather than compel the Fish and Wildlife Service, an agency with expertise in biology, to evaluate that harm in terms of economics or sociology, the court said the agency must submit to the court each week a written statement to "explain why alternative less restrictive" water diversion and pumping levels "would not adequately protect the Delta smelt."

Balanced Operation

Governor Arnold Schwarzenegger said Wanger's decision "will likely provide additional balance to the operation of the

state and federal water projects in the Delta; these are just the latest indications that our water crisis is growing. Rather than a piecemeal approach driven by lawsuits and federal courts, we need a comprehensive strategy that upgrades California's water infrastructure to ensure a clean and reliable water supply for our growing state and our environment."

CalChamber Position

The California Chamber of Commerce has repeatedly advocated for a comprehensive water solution for the state that takes into consideration the needs of people, agriculture and business

while safeguarding the environment. The CalChamber also supports multiple species habitat plans as a more efficient method of utilizing scarce natural resources benefiting species as well as societal needs.

Complications and conflicts are likely to continue if a single-species approach to setting Delta water use mandates continues as environmentalists move to expand the list of endangered or threatened species (see related story on National Marine Fisheries Service biological opinion on Page 5).

Staff Contact: Valerie Nera

Employers Paying \$10+ Billion in Tax Hikes, Accelerations

From Page 3

than 40 percent of the sales tax. The budget accord increased the sales tax rate starting April 1 by a full one cent in order to raise almost \$6 billion over the next two years, of which businesses will pay roughly \$2.4 billion.

2. Vehicle License Fee Increase (ABX3 3): Estimated to raise \$425 million from employers.

Businesses in California pay approximately 25 percent of the vehicle license fee (VLF). The budget agreement

increased the VLF rate to 1.15 percent starting May 19 in order to raise about \$1.7 billion on an annual basis, of which businesses will pay about \$425 million annually.

3. Personal Income Tax Rate Increase (ABX3 3): Estimated to raise \$1 billion from employers.

Many businesses in California are organized as limited liability companies, Subchapter S corporations, and partnerships, among others, all of which pay under the Personal Income Tax Law.

Accordingly, these businesses will also pay the increases in the personal income tax rates of .25 percent. Almost all will now pay the highest marginal rate of 9.55 percent for the 2009 and 2010 tax years (which does not include the 1 percent surcharge for mental health funding). As such, the business community will pay more than \$1 billion during this two-year tax increase.

Staff Contact: Kyla Christoffersen

State Supreme Court Ruling Removes Proposition 64 Lid on Frivolous Lawsuits



A recent split decision of the California Supreme Court weakens limits on frivolous lawsuits put in place by a California Chamber of Commerce-

supported and voter-approved ballot initiative in 2004.

Proposition 64, overwhelmingly approved by California voters, required that plaintiffs in lawsuits filed under the state's Unfair Competition Law must actually have suffered harm. This reform was intended to provide companies doing business in California with significant relief from the numerous frivolous lawsuits clogging the court system.

Court Ruling

The state high court's 4-3 decision, however, said that only the named class representative(s) must satisfy the Proposition 64 requirement for being a party to the class action lawsuit. (*In re Tobacco II Cases*, No. S147345, May 18, 2009).

The high court's decision will make it easier for plaintiffs to move forward with the type of meritless lawsuits that were stifling small businesses and led to Proposition 64's passage. Now there is a greater possibility that businesses will be forced to incur high court costs defending meritless claims.

Minority Criticism

The majority's holding was met by strong criticism from the three dissenting

justices. Raising the concern that this decision will invite the very kinds of mischief Proposition 64 was intended to curtail, the dissent characterized the majority's determination as "erroneous," and stated that it "turns class action law upside down and contravenes the initiative measure's plain intent."

Although the court's ruling applies only to class actions, not individual claims, as the dissent points out, it is "contrary to the electorate's clear directive."

Passed in order to bring an end to the loophole that allowed lawyers to file frivolous shakedown lawsuits, the majority's holding will significantly undermine the voters' explicit intention behind approving Proposition 64.

Staff Contact: David Meyerson

CalChamber Saddened by Passing of State/National Leader Jack Henning



The California Chamber of Commerce was greatly saddened to learn of the death of Jack Henning, a state and national leader, who was a pioneer in California's labor movement.

Jack Henning

While Henning, who passed away on June 4 at the age of 93, was often on the opposite side of employers on difficult issues, he was

well-respected and leaves a legacy of dedication to improving the lives of California's workers.

"Jack was a passionate advocate on behalf of the California worker," said CalChamber President and Chief Executive Officer Allan Zaremberg. "He commanded respect and trust from all those who knew him and worked with him."

Henning was executive secretary-treasurer of the California Labor Federation, AFL-CIO, for 26 years and served two U.S. Presidents, first as President John Kennedy's labor secretary and then President Lyndon Johnson's

ambassador to New Zealand. Under California Governor Pat Brown, Henning served as director of the state Department of Industrial Relations.

In a statement released June 4, Governor Arnold Schwarzenegger said that Henning "dedicated his life to improving the lives of others, revolutionized the labor movement and had an enormous impact on California."

Zaremberg recalls Henning as a tough negotiator who worked diligently to get votes lined up and often won on difficult issues. Henning was passionate about education as well, serving as a University of California Regent from 1977-1989.

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