

ANALYSIS OF THE NEW JERSEY FISCAL YEAR 2002 - 2003 BUDGET



BOARD OF PUBLIC UTILITIES AND DIVISION OF THE RATEPAYER ADVOCATE

PREPARED BY

OFFICE OF LEGISLATIVE SERVICES

NEW JERSEY LEGISLATURE

MAY 2002

NEW JERSEY STATE LEGISLATURE

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BOARD OF PUBLIC UTILITIES AND DIVISION OF THE RATEPAYER ADVOCATE

Budget Pages..... C-19: D-468 to D-472

Fiscal Summary (\$000)

	Expended FY 2001	Adjusted. Appropriation FY 2002	Recommended FY 2003	Percent Change 2002-03
State Budgeted	\$25,019	\$25,267	\$25,267	0.0%
Federal Funds	2,129	2,625	2,625	0.0%
<u>Other</u>	<u>20</u>	<u>0</u>	<u>0</u>	<u>—</u>
Grand Total	\$27,168	\$27,892	\$27,892	0.0%

Personnel Summary - Positions By Funding Source

	Actual FY 2001	Revised FY 2002	Funded FY 2003	Percent Change 2002-03
State	273	293	312	6.5%
Federal	16	11	20	81.8%
<u>Other</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>—</u>
Total Positions	289	304	332	9.2%

FY 2001 (as of December) and revised FY 2002 (as of September) personnel data reflect actual payroll counts. FY 2003 data reflect the number of positions funded.

Introduction

The **Board of Public Utilities** (BPU) is a regulatory authority with a statutory mandate (R.S.48:2-1 et. seq.) to ensure safe, adequate, and proper public utility services at reasonable rates for customers in New Jersey. The critical services regulated by the BPU include natural gas, electricity, water, sewer, and telecommunications including cable television. The BPU, which is funded through assessments on the industries it regulates, is currently organized "in but not of" the Department of the Treasury pursuant to a 1994 Reorganization Plan (Executive Order No. 001-94).

As part of the 1994 reorganization, the Department of the Public Advocate was also eliminated and a residual **Division of the Ratepayer Advocate** (RPA) was transferred to the BPU. The Division of the Ratepayer Advocate was created to represent, protect, and advance the interests

Introduction (Cont'd)

of all consumers of regulated utility services, including residential, small business, commercial and industrial ratepayers. The RPA represents the interests of ratepayers before the BPU and other decision-making bodies, and negotiates with utilities on behalf of ratepayers in order to avoid litigation.

While technically within the BPU, the RPA is an independent entity not subject to control or supervision by the Board. While the Governor's FY 2003 budget recommends restoring the Department of the Public Advocate, funding for the Ratepayer Advocate remains within the BPU's budget. Subject to enactment of enabling legislation (e.g., A-345/2341 ACS of 2002), it is anticipated that the RPA will be transferred to the department and restored to its full function.

Key Points

- The Governor's FY 2003 budget recommends \$25.3 million in State funds for Economic Regulation, unchanged from the FY 2002 adjusted appropriation. No programs are scheduled for increased appropriations. This program class includes the BPU (\$20.8 million) and the RPA (\$4.5 million), both of which are fully funded by assessments levied on utilities conducting business within the State.
- The budget appropriates \$2.6 million in federal funds for FY 2003, the same amount as in the current year. The federal monies are for the State Energy Conservation Program.
- The recommended budget provides funding for 332 positions, an increase of 28 positions from the revised FY 2002 authorization (304 positions). Of the total, 45 positions are attributable to the Division of Ratepayer Advocate, an increase of 4 positions. Positions attributable to the BPU itself total 287, an increase of 24 positions above FY 2002.
- The recommended budget continues to include the Division of the Ratepayer Advocate within the BPU's budget. If the proposed re-establishment of the Department of the Public Advocate is approved, it is anticipated that the RPA would return to its original position as a division of that department.

Program Description and Overview

The **Board of Public Utilities** is a regulatory authority with a statutory mandate (R.S.48:2-1 et. seq.) to ensure safe, adequate, and proper public utility services at reasonable rates for customers in New Jersey. Accordingly, the BPU regulates critical services such as natural gas, electricity, water, sewer, and telecommunications including cable television. The Board addresses issues of consumer protection, energy tax reform, deregulation of energy and telecommunications services, and the restructuring of utility rates to encourage energy conservation and competitive pricing in the industry.

To accomplish its mandate, the Board conducts comprehensive reviews to determine the fairness and reasonableness of rates. The Board also has general supervisory responsibility for monitoring utility service, responding to consumer complaints, and investigating utility accidents.

The BPU projects that there will be 5 investor owned electric utilities, 4 gas companies, 104 telephone and telegraph companies, 67 water and sewer companies, 10 municipal water companies and 41 cable TV systems under its jurisdiction in FY 2003. The BPU's budget, which is fully funded through assessments on these regulated industries, consists of five program classes: Utility Regulation, Administration and Support Services, Regulatory Support Services, Cable Television Regulation, and Ratepayer Advocacy. Functionally, however, the BPU is organized primarily by industry.

History of the BPU

The predecessor of the BPU, the Department of Public Utilities, was established in 1911 to address the provision of essential services in this State, which at the time included railroads and interstate commerce in addition to those services under current jurisdiction. From inception, the Board was given broad authority to perform management audits and initiate investigations (based on its own initiative or on consumer complaints), appraise and value the property of utilities and approve rates and institute fees. Its wide-ranging authority was intended to mitigate the effects of monopoly enterprises and avoid disruption of economic activity.

Through periodic reorganizations, the BPU has alternately emphasized its consumer protection and business advocacy functions. In 1977 the BPU was organizationally placed in the Department of Energy, then removed to the Department of the Treasury in 1987, returned to the Department of Environmental Protection and Energy in 1991, and again removed to Treasury in 1994 (where it currently remains).

Current Structure

Pursuant to the 1994 Reorganization Plan (Executive Order No. 001-94), the Board of Regulatory Commissioners (BRC) was redesignated as the Board of Public Utilities (BPU) and reconstituted "in but not of" the Department of the Treasury. As part of the 1994 reorganization, the Department of the Public Advocate was also eliminated and a residual **Division of the Ratepayer Advocate** was transferred to the BPU. However, despite its placement, the Ratepayer Advocate, which represents the interests of ratepayers before the BPU and other decision-making bodies, is not subject to Board control or supervision.

At present, the BPU is in a period of transition as a result of dramatic changes in competitive and environmental regulatory requirements. As summarized in its budget request, "... as the regulatory environment has been undergoing radical changes in recent years, in particular due to

Program Description and Overview (Cont'd)

energy restructuring legislation and the resulting changes to the utilities' corporate structure, we are currently reviewing agency personnel and processes in order to determine the most efficient methods of operation ..."

The challenges of deregulation are shared by public utility commissions nationwide and it may be some time before regulators sort out its full impact on agency operations (particularly with respect to staffing levels, overall mission, skill requirements, and configuration). One example of the changing environment in which the BPU operates concerns out-of-state-entities. The BPU's jurisdiction has always been limited by the state border, and its stakeholder utilities have historically been local as well. This arrangement no longer exists. Under market restructuring, energy utilities have been encouraged to divest their energy transmissions and sales functions over state lines, and to merge wholesale operations at a national level. Increased competition has allowed retail customers to switch from their traditional utility distribution company in order to purchase outside energy generation services from suppliers. Moreover, deregulation enables utilities to seek the most advantageous interstate structure in which to operate (for regulatory and profit purposes), particularly with regard to environmental and tax issues. This erosion of state borders in the face of dynamic ownership structures presents challenges to the agency's mission and its ability to meet its objectives effectively.

Electric Discount and Energy Competition Act (EDECA)

As discussed generally above, the Electric Discount and Energy Competition Act (P.L.1999, c.23) established the framework and the necessary time schedules for the deregulation and restructuring of the electric and natural gas utilities in this State, with the goal of providing all New Jersey consumers with access to uncapped prices for electricity, natural gas, and other energy related services previously available only through the State's regulated public utilities. EDECA also required all electric public utilities to reduce their rates by at least 5 percent no later than August 1, 1999 and by at least 10 percent on or before the end of the third year following enactment. Rate caps are scheduled to be eliminated at the end of the third year, or in 2003, at which time ratepayers will be subject to the volatility of market-based prices.

The profound changes in the way in which electricity will be regulated and sold is expected to have significant impact on various groups of consumers and taxpayers and will have diverse effects on State revenues. Many of these effects are, however, conjectural and dependent upon the ways in which various market forces may interact. As previously noted by the Office of Legislative Services in its fiscal note for EDECA, possible effects which may impact state revenues include:

- Business enterprises may enter or leave the New Jersey electricity sales marketplace and become taxpayers and employers in this State, transfer assets to other states through mergers, or leave the State entirely.
- Corporate consumers of electricity may have profit fluctuations because of operating cost changes from the electricity rate movement. State energy costs may fluctuate as well, introducing volatility to budget implementation.
- Consumers may seek to aggregate their purchasing power to seek better terms on their electricity prices.
- Local production companies may either merge or compete with companies in other states with different regulatory, taxation, or environmental responsibility requirements.
- Increased market share for companies in other states, who transmit power to this market, may increase ambient pollution received by this State.
- Differential electricity rates in and out of State may affect decisions about business location

Program Description and Overview (Cont'd)

and expansion and thereby produce changes in corporation business tax, sales tax and gross income tax revenues.

Federal Telecommunications Act of 1996 (Telco Act)

The telecommunications industry has also undergone substantial structural, technological and regulatory changes in recent years which have presented enormous workload challenges to the BPU.

In particular, the Federal Telecommunications Act of 1996, also known as "Telco" made sweeping revisions to communications laws which had been in existence since 1934. The Telco Act gave individual states a broad blueprint to establish rules and rates for "Competitive Local Exchange Carriers" (including AT&T, MCI, and Sprint among others) to compete against the "Incumbent Local Exchange Carriers," notably Verizon-New Jersey, in the residential and business local landline telephone markets. Verizon-New Jersey is required to file a plan for alternative regulation concerning its local telephone service.

Pursuant to Section 271 of Telco, Verizon has filed an application before the Federal Communication Commission (FCC) to enter the long distance market. BPU has supported this filing, issuing their opinion that Verizon is in compliance with the requirements of the federal act.

The FY 2003 Budget Recommendation

Excluding Ratepayer Advocacy, the Governor's FY 2003 budget recommends \$20.7 million from State sources for the BPU, equal to the FY 2002 adjusted appropriation. The BPU is entirely supported by assessments on the public utility and cable television industries, whose revenues are obtained through customer purchases.

Federal Funds

The balance of \$2.6 million in proposed FY 2003 funding for the BPU comprises federal funds for the State Energy Conservation Program, the same as the FY 2002 adjusted appropriation.

Staffing

Position data in the budget recommendation indicates that BPU's appropriation will support 332 positions compared to 263 filled FY 2002 positions. At present, four of the five authorized board commissioners have been appointed. As in prior years, the BPU faces difficulty in attracting and retaining key personnel, primarily due to salary constraints and competition from the regulated industries.

In addition to hindering the agency's day-to-day operations, on-going vacancies and staff turnover has contributed to the delay or incompleteness of several major tasks mandated pursuant to EDECA. Perhaps most critically, the BPU has not yet given final approval to deregulation plans for certain utilities. As a result, certain companies effectively operate under temporary orders that cannot be challenged by ratepayers. The agency has established on an interim, but not final, basis the so-called "universal" fund to subsidize ratepayers who cannot afford to pay their bills in full.

Program Description and Overview (Cont'd)

THE DIVISION OF THE RATEPAYER ADVOCATE

Pursuant to N.J.S.A. 52:27E-50 et seq., the statutory mission of the **Division of the Ratepayer Advocate** is to ensure that essential services are available to all New Jersey residents, businesses, and industries at affordable rates. The Ratepayer Advocate represents utility consumers in administrative and court proceedings and at legislative hearings to advocate the interests of all State consumers of regulated services whenever the utilities under the jurisdiction of the BPU seek changes in rates and services and whenever statewide utility policy is being decided. The Ratepayer Advocate also negotiates with utilities on behalf of ratepayers in order to avoid litigation.

To accomplish its mandate, the Ratepayer Advocate investigates all aspects of a utility's request to alter rates or services. In the course of an investigation, the Ratepayer Advocate's staff attorneys, along with consulting economists, accountants, and engineers, will develop independent conclusions regarding the reasonableness of a request and prepare and file testimony that supports its conclusions and protects ratepayers' interests. Later, as a party to evidentiary hearings, the Ratepayer Advocate cross-examines the utility's witnesses and submits evidence to support the Division's position. Subsequently, if necessary, the Ratepayer Advocate will seek a specific outcome for ratepayers through litigation in the appropriate State or federal court.

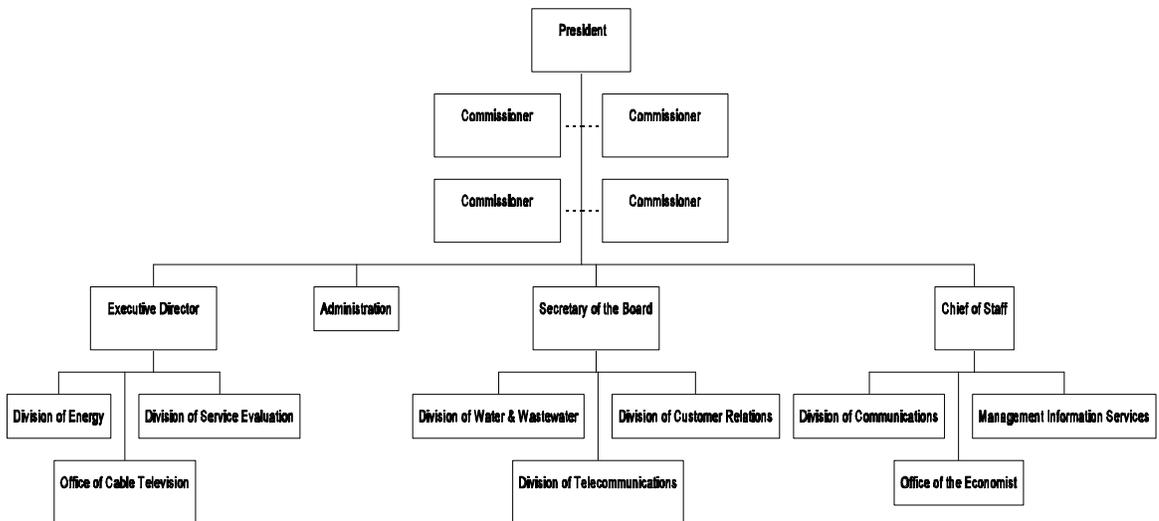
As previously noted, Executive Order 001-1994 established the Division of Ratepayer Advocate organizationally within the BPU; however, the division functions independently of the BPU and is not subject to its control or supervision. Like the BPU, the Ratepayer Advocate is fully funded by assessments imposed on regulated utilities.

The FY 2003 Budget Recommendation

The Governor's FY 2003 budget recommends \$4.5 million in State funds for the Ratepayer Advocacy Program, equal to the FY2002 adjusted appropriation, which will provide funding for 45 positions. This is an increase of 4 positions from the FY2002 adjusted appropriation.

Organization Chart

Board of Public Utilities



Fiscal and Personnel Summary

AGENCY FUNDING BY SOURCE OF FUNDS (\$000)

	Expended FY 2001	Adj. Approp. FY 2002	Recom. FY 2003	Percent Change	
				2001-03	2002-03
General Fund					
Direct State Services	\$22,899	\$25,267	\$25,267	10.3%	0.0%
Grants-In-Aid	2,000	0	0	(100.0)%	0.0%
State Aid	0	0	0	0.0%	0.0%
Capital Construction	120	0	0	(100.0)%	0.0%
Debt Service	0	0	0	0.0%	0.0%
Sub-Total	\$25,019	\$25,267	\$25,267	1.0%	0.0%
Property Tax Relief Fund					
Direct State Services	\$0	\$0	\$0	0.0%	0.0%
Grants-In-Aid	0	0	0	0.0%	0.0%
State Aid	0	0	0	0.0%	0.0%
Sub-Total	\$0	\$0	\$0	0.0%	0.0%
Casino Revenue Fund	\$0	\$0	\$0	0.0%	0.0%
Casino Control Fund	\$0	\$0	\$0	0.0%	0.0%
State Total	\$25,019	\$25,267	\$25,267	1.0%	0.0%
Federal Funds	\$2,129	\$2,625	\$2,625	23.3%	0.0%
Other Funds	\$20	\$0	\$0	(100.0)%	0.0%
Grand Total	\$27,168	\$27,892	\$27,892	2.7%	0.0%

PERSONNEL SUMMARY - POSITIONS BY FUNDING SOURCE

	Actual FY 2001	Revised FY 2002	Funded FY 2003	Percent Change	
				2001-03	2002-03
State	273	293	312	14.3%	6.5%
Federal	16	11	20	25.0%	81.8%
All Other	0	0	0	0.0%	0.0%
Total Positions	289	304	332	14.9%	9.2%

FY 2001 (as of December) and revised FY 2002 (as of September) personnel data reflect actual payroll counts. FY 2003 data reflect the number of positions funded.

AFFIRMATIVE ACTION DATA

Total Minority Percent	N/A	N/A	N/A	----	----
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Significant Changes/New Programs (\$000)

<u>Budget Item</u>	<u>Adj. Approp.</u> <u>FY 2002</u>	<u>Recomm.</u> <u>FY 2003</u>	<u>Dollar</u> <u>Change</u>	<u>Percent</u> <u>Change</u>	<u>Budget</u> <u>Page</u>
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The FY 2003 Governor's budget recommends no changes.

Language Provisions

2002 Appropriations Handbook

2003 Budget Recommendations

p. B-195

Receipts derived from fines and penalties in excess of \$300,000 are appropriated for regulatory enforcement activities, subject to the approval of the Director of the Division of Budget and Accounting.

No comparable language.

Explanation

This language provision authorized the BPU to retain for specified operating activities all revenue in excess of \$300,000 collected from fines and penalties. BPU estimates these collections at about \$600,000 per year, of which the first \$300,000 would become revenue for general State use and the balance would augment BPU's operating resources. The deletion of this language will result in the allocation of all fines and penalties collected in FY 2003 for general State use. BPU estimates that this will increase general State revenue by about \$2.4 million in FY 2003, the projected excess over \$300,000 in fines and collections, including a \$2.1 million expected settlement with Verizon.

Discussion Points

1. In 2003, rate caps are scheduled to be removed, pursuant to the Electric Discount and Energy Competition Act (P.L. 1999, c.23). Recent new reports reveal significant differences of opinion as to the impact on consumers and suppliers of deregulation, and note that the Board is already considering various actions in anticipation of expiring rate caps, such as extended rate freezes for small consumers. Also, the Legislature has passed legislation (S-869) allowing for securitization by electric utilities of deferred basic generation service balances.

- **Question:** What activities, studies and analyses will the Board undertake during FY 2003 to prepare New Jersey energy consumers and providers for the transition from rate caps to potentially volatile market-driven energy prices? Does the Board foresee any revisions to its organizational structure or business practices to assure itself the capability of discharging its responsibilities under the Act? What other tools for managing the problems of deregulation, e.g., securitization, does the Board anticipate the need for that require legislative approval?

2. The Office of Cable Television(OCTV) undertakes regulation of cable television companies in New Jersey, although its authority to regulate rates has been limited in scope by Federal pre-emption to basic service rates and the equipment associated with that service. As of January 1, 2001, there were 41 cable TV systems serving about 2.5 million basic service subscribers in 562 municipalities. This comprised a 1.4 percent increase in basic services subscribers over the previous year and an increase of 11.1 percent since January 1, 1996. Cable television companies pay an annual franchise fee of 2 percent of basic service revenue to municipalities, and also pay an assessment at the rate of about 0.26 percent of gross operating revenue to the OCTV to fund its operating budget.

- **Question:** What was the annual basic service revenue of New Jersey cable television companies for the period 1996-2000? What was the gross operating revenue upon which the OCTV assessment was based, the annual premium service revenue and all other revenue, respectively, for the same period? Please provide in spreadsheet form the amount of franchise fee revenue, by municipality, for the latest three years of available data.

3. In two consecutive investigations by the Office of the State Auditor (1996 and 2001), the auditor noted errors in the Board's management of federal recoverable costs, citing improper cash management (extended receivable delays). Specifically, over \$1 million of federal program expenditures had not been reimbursed during the year incurred.

The most recent audit stated that "We recommend the board's Office of Budget and Finance develop cash management procedures that reduce the time between the disbursement and receipt (drawdown) of federal funds. We further recommend that federally recoverable employee benefit costs be properly charged to the division of Energy Planning and Conservation on the state's accounting system." The board responded that "additional cash management procedures will be implemented."

- **Question:** Has the BPU reduced delays in its recovery of federal reimbursable costs? By addressing this cash management error, has the board affected changes other in receivable procedures?

Discussion Points (Cont'd)

4. The Board of Public Utilities has administrative duties with respect to the Petroleum Overcharge Reimbursement Fund (PORF), and is authorized by budget language (p. D-472) to use the Fund's interest earnings to defray its administrative costs in that regard. The PORF accounts for monies received from federal court settlements with various petroleum companies and distributors that overcharged for petroleum products. Appendix 1A of the Fiscal 2003 budget (p. H-22) estimates the PORF's income in FY 2002 and 2003 at about \$3.8 million, projects expenditures in FY 2003 of about \$3.3 million and a year-end FY 2003 fund balance of \$14.6 million. Recently, Governor McGreevey announced an agreement to acquire 12 percent of state government energy needs from Green Mountain Energy Co., a supplier of electricity generated from "renewable" sources, and to defray the higher costs of this electricity with PORF revenues.

- **Question:** Please describe the Board's administrative duties in connection with the Petroleum Overcharge Reimbursement Fund. What are the specific federal court settlements that will generate the income (other than investment income) the Fund is projected to receive in FY 2002 and 2003? How much of the estimated FY 2002 revenue has been received to date? What are the eligible uses of these funds, and what, if any special restrictions on use apply? What income from these or other settlements is projected for FY 2004 and 2005?

5. The Board is at present conducting public hearings on the Comprehensive Resource Analysis of Energy program (CRA), a four year effort developed by the BPU to address the statewide administration of energy efficiency and customer site renewable energy programs for utility companies. These hearings follow the submission to and acceptance by the Board of a report by a Board consultant, Davies Associates, Inc. on the administration of energy efficiency and renewable energy programs in the State of New Jersey. The Executive Summary of this report states that the \$1 billion of consumers' money the BPU is investing in Energy Efficiency and Renewable Energy programs is unlikely to achieve the BPU's stated objectives and is therefore at risk, but that timely BPU actions, including regulatory change, devoting more resources to the CRA, and assuming administration of the Renewable Energy programs, can avoid this outcome.

- **Question:** Please identify the programs reviewed by the consultant and provide more detail on the conclusions in the Davies report that consumers's investment is at risk. What specific reasons did the consultant cite in observing that the Energy Efficiency and Renewable Energy programs are unlikely to achieve BPU objectives?

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Individuals wishing information and committee schedules on the FY 2003 budget are encouraged to contact:

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