

THE SURETY & FIDELITY ASSOCIATION OF AMERICA

MEMORANDUM

TO: Government Affairs Advisory Committee

FROM: Daniel Wanke
Associate Analyst, Government and Regulatory Affairs

RE: September State Legislative Report—Recent Enactments in Contract Surety

DATE: October 2, 2006

The following is a list of laws affecting contract surety that were enacted into law in September 2006.

CALIFORNIA

HB 372: *Design Build Contracts* – Effective January 1, 2007

HB 372 extends the sunset date of existing law that allows transit operators to enter into design build contracts to January 1, 2011. The existing law would expire on January 1, 2007. Existing law requires that the contractor submit certain information, which includes all required payment and performance bonding, liability insurance, and errors and omissions insurance. Information on any work that a surety has completed also must be submitted. The new law requires project costs to exceed \$25,000,000 for the transit operator to use design-build entities. Note that the bill number has been corrected from the September Contract Surety Report when it was sent to the Governor, where it was listed as HB 378.

MASSACHUSETTS

HB 5253: *Economic Development Plans* – Effective Immediately

HB 5353 enacts a new emergency law that contains procedures for the submission and approval of proposals for economic development of the Commonwealth. Among the many requirements in the new law, approval of an economic development project is conditioned on the developer obtaining a blanket performance bond or other security that is satisfactory to the Secretary of State and payable to the Massachusetts Development Finance Agency. The bond or security posted is for securing the developer's obligation to complete the construction of the proposed economic development project and public infrastructure improvements included in the proposal. The bond or security must be in an amount equal to or greater than the outstanding principal sum of any revenue bonds that the Agency issued to finance the costs of the public infrastructure improvements.

MICHIGAN

SB 435: *Supplier's Bond* – Effective Immediately

SB 435 amends existing law to raise the maximum amount of the performance bond required in connection with licensure for suppliers who are authorized to sell charity game tickets, numeral game tickets, or both, to organizations. Existing law sets the maximum amount at \$500,000, whereas the new law provides for a maximum performance bond of \$1,000,000.

NEW JERSEY

SB 1726: *ADR for Construction* – Effective Immediately

SB 1726 as originally drafted would have required that all construction payment disputes go to arbitration with the American Arbitration Association (AAA). SFAA opposed the bill, and it was amended in the House to require all construction contracts in New Jersey to provide that payment disputes may be sent to alternative dispute resolution. To the extent that such disputes are litigated, the bill provides that the case must be heard in New Jersey; and attorney's fees are awarded to the prevailing party. The bill also contains prompt pay provisions that give general contractors the same "prompt pay" rights against owners that the existing law gives to subcontractors. The prime should have the same rights to payment from the owner and SFAA supports this provision. To that extent, SB 1726 improves existing law.

The following is a list of laws affecting commercial surety that were enacted into law in September 2006.

FEDERAL

HR 1442: *Suits in Admiralty and Public Vessels Acts* – Effective Immediately

HR 1442 would prohibit a person from acting as an ocean transportation intermediary unless the person furnishes a bond, proof of insurance or other surety. In addition, the bill would require the purchaser of a vessel from the Maritime Administration to post a surety bond to ensure that the vessel will not be operated in foreign trade with the United States in competition with a vessel owned by a citizen of the United States and documented under the laws of the United States for a period of 10 years after the sale. Furthermore, the Secretary of Transportation shall require a charterer of a vessel from the Secretary to deposit with the Secretary an undertaking, with approved sureties, in such amount as the Secretary may require as security for the faithful performance of the terms of the charter, including indemnity against liens on the chartered vessel.

CALIFORNIA

HB 339: *Uniform Limited Partnership Act of 2008* - Effective January 1, 2008

HB 339 enacts the Uniform Limited Partnership Act. The new law contains procedures for the dissolution of a limited partnership; some partners may purchase the interests of other partners with cash for their "fair market value." If the partners cannot reach an agreement on "fair market value," the new law provides that the court may stay dissolution proceedings so long as a surety bond is posted. The bond must be sufficient to cover the estimated "reasonable expenses" plus attorney's fees of the moving parties. Three neutral appraisers are then selected to determine the value of the interests. After the

value is determined, the purchasing parties must make payment for the partnership interests within the time limits that are specified in the decree. If payment is not made, then the court is to enter a judgment against the purchasing parties and the surety or sureties on the bond for the amount of the expenses plus attorney's fees of the moving parties.

HB 630: *Immigration Consultants* – Effective January 1, 2007

HB 630, as introduced, would have required sureties to give 30 days notice of the cancellation of the bond to either the city attorney or the district attorney in the county of the principal office of an immigration consultant. A violation of these provisions would have resulted in a fine of up to \$10,000. The bill was amended and these provisions were deleted. The new law contains additional regulatory requirements for immigration consultants. The new law makes it a criminal offense to issue any statements purporting to engage in business as an immigration consultant if a bond and a disclosure statement have not been filed with the Secretary of State. The Secretary is required under the new law to post information on the Internet about immigration consultants, and such information may be posted only if the consultant has maintained the \$50,000 surety bond required under existing law.

HB 751: *Financial Aid Purveyors*

VETOED

HB 751 would have required purveyors of private college financial aid services to be licensed and bonded. Such a purveyor would have had to file a bond with the California Student Aid Commission (CSAC) of at least \$50,000, from a corporate surety authorized to do business in the State, before engaging in the business of providing any services. The total aggregate liability on the bond would be limited to \$50,000. The bond would have been in favor of, and payable to, the State of California, for the benefit of any resident of California damaged by financial aid and scholarship fraud that the purveyor committed. The bill contained definitions of persons covered under its provisions, as well as a list of personas and entities excluded from coverage. However, Governor Schwarzenegger vetoed this bill.

In his veto message, the Governor stated that the bill did not provide the appropriate method to address the “unscrupulous behavior of those private purveyors of college student financial aid services that provide fraudulent or useless scholarship and financial aid information.” The Governor based his decision on the fact that the bill charged the CSAC with the responsibility of regulating these purveyors of services and enforcing compliance with all applicable state and federal laws. He rejected this because the expertise of the CSAC relates to financial aid and is not equipped to perform these duties since it is not a regulatory or enforcement body. As such, he refused to sign the bill.

HB 1363: *Omnibus Conservatorship and Guardianship Reform Act of 2006* – Effective January 1, 2007

HB 1363 amends existing law concerning the bond that conservators and guardians of an estate are required to post. Existing determinants of the bond amount include the value of the personal property of the estate, the probable annual gross income of the property of the estate, the sum of the probable annual gross payments from the federal and state

government programs for which the ward or conservatee is eligible, and any other public entitlements of the ward or conservatee. The new law would require that on or after January 1, 2008, the bond amount also will include the amount of reasonable costs of making any recovery from the bond, including attorney's fees and costs. The new law also requires the Judicial Council to adopt a rule of court on or before January 1, 2008, to implement this provision.

HB 2343: *Milk Producers Security Trust Fund* – Effective January 1, 2007

HB 2343 amends existing law concerning the Milk Producers Security Trust Fund (fund), which protects milk producers (producers) against the loss of payment for bulk milk. Under the existing law, the Secretary of State is authorized to collect security charges until the value of the fund is approximately 110% percent of the dollar amount of the total purchases of milk paid for and received in a single month by the milk handler who has the largest payment obligation to producers for that month.

The new law provides that the security charges are only to be collected until January 1, 2007, and requires instead that the fund be maintained at \$30,000,000 and that "acceptable securities" be posted. After January 1, 2007, if the fund falls below \$30,000,000, the Secretary may resume collecting security charges from all handlers making purchases of milk who have posted acceptable securities. The new law defines "acceptable security" as a surety bond from an admitted surety insurer, deposits of government securities, a cash deposit, a letter of credit, escrow account, or other form of performance guarantee acceptable to the Secretary and meeting the requirements as acceptable security. Failure to provide acceptable securities as required disqualifies any shipments to the handlers from coverage under the fund. Also, handlers who fail to post acceptable securities or any required additional acceptable securities also may be subject to cancellation, suspension, nonrenewal, or placement of conditions on the handler's license.

HB 2914: *Architecture Services* – Effective January 1, 2007

HB 2914 amends existing law, which requires limited liability partnerships providing architectural services to maintain insurance policies or securities for payment of any liabilities that arise from claims based on acts, errors, or omissions of the partnership. The securities may be in a trust or bank escrow, cash, bank certificates of deposit, United States Treasury obligations, bank letters of credit, or bonds of insurance or surety companies. The amount must be sufficient for a claim of at least \$100,000, multiplied by the number of licensees performing professional services on behalf of the partnership. The total aggregate limit of liability under the insurance policy or the amount of security for partnerships with five or fewer licensees performing professional services must be a minimum of \$500,000 and cannot exceed \$5,000,000 for all partnerships under existing law. The new law provides, however, that after January 1, 2008, the total aggregate limit of liability under the insurance policy or the amount of security for those partnerships with five or fewer licensees is increased to \$1,000,000. For partnerships with more than five licensees, the policy or securities increase to an additional \$100,000 for each additional licensee, up to the \$5,000,000 maximum. The bill also extends the repeal date of this law from January 1, 2007, to January 1, 2012.

HB 3020: *Time Share Developments* – Effective Immediately

HB 3020 amends existing law concerning bonding for timeshare developments. Currently, developers must furnish a surety bond, cash deposit, letter of credit, or alternate assurance acceptable to the Real Estate Commissioner (Commissioner) in order to assure the fulfillment of the developer's obligations. The new law authorizes the Commissioner to determine the amount of assurance necessary, but that amount is still subject to the maximum amount set in existing law, which limits the amount of the assurance to the "lesser of 50% of the anticipated cost of operation and maintenance of the time-share plan for an operational period of one year or 100% of the assessments attributed to the total amount of unsold time-share interests owned by the developer under the law. The new law provides that the amount of assurance may be adjusted annually, as approved by the Commissioner, but not by more than the "lesser of 50% of the anticipated cost of operation and maintenance of the time-share plan for an operational period of one year or 100% of the assessments attributed to the total amount of unsold time-share interests owned by the developer.

SB 1475 and 1476: *Dangerous Drug Wholesalers* – Effective January 1, 2007

SB 1475 would amend existing law that requires both resident and non-resident applicants for a license as a wholesaler of dangerous drugs to post a bond for \$100,000 to secure any administrative fines. The new law would exempt wholesalers that are government owned and operated from the bonding and other requirements of resident wholesalers. SB 1476 amends the same provisions for both resident and non-resident wholesalers, such that the law, which would have expired on January 1, 2011, would not expire until January 1, 2015.

SB 1481: *Uniform Commercial Code* – Effective January 1, 2007

SB 148 amends California's existing Commercial Code to conform to the Uniform Commercial Code of the National Conference of Commissioners on Uniform State Law. Among the several general revisions, a surety has been further defined to include any "other secondary obligor" in addition to the existing definition as a guarantor.

SB 1758: *Adoption Facilitators* – Effective January 1, 2007

SB 1758 originally would have increased the bond required of adoption facilitators from \$10,000 to \$50,000, but as amended and enacted, the bill will raise the bond to \$25,000. The new law also will require that the bond be from a corporate surety admitted to do business in the State, and be payable to the State of California, whereas prior law did not make such specifications. Adoption facilitators will be required to replenish the bond when there is a recovery made from it, or file a new bond if the existing bond cannot be replenished. Either of these actions would have to be taken before the adoption facilitator would be able to conduct any further business. The new law also will require the adoption facilitator to notify the State Department of Social Services (Department) within 30 days if the bond is renewed, and of any change of name, address, telephone number, or agent for service of process. The new law will require the Department to post on its Internet Web site information that shows if an adoption facilitator is in compliance with the registration and bond requirements. The law will require the Department to establish and

adopt regulations to create a statewide registration process for adoption facilitators and to require adoption facilitators to post a bond.

MICHIGAN

HB 6014 and 6016: *Ecclesiastical Corporations* – Effective Immediately

HB 6014 authorizes ecclesiastical corporations to organize and operate a religious college, provided that such corporations meet the criteria set forth in the new law. Among the many requirements, the ecclesiastical corporation is required to provide a surety bond annually to the Department of Labor and Economic Growth (Department). The bond must be conditioned to provide indemnification to any student suffering loss if he or she could not complete an educational program at the religious college because of its closing. Expiration of the bond will be set on June 30 following the date of issuance and the corporation would have to submit proof of renewal for an additional one-year period to the Department before the date of expiration. The amount of the bond will have to be either the number of students enrolled in the religious college multiplied by \$200, or \$5,000 whichever is higher.

The new law's effect was conditioned on the passage of HB 6016, which has been signed by the governor. The bill provides an exemption for such religious colleges in HB 6014 from existing law which authorizes the state Department of Education to provide minimum requirements for non-incorporated privately operated institutions which offer degrees, diplomas or certificates based on education beyond high school.

SB 1290: *Driver Education Provider and Instruction Act* – Effective immediately

SB 1290 requires driver education providers to be licensed and bonded. Under the new law, applicants may be licensed as a driver education provider for one or more of adults, teens, or truck drivers. A surety bond is required for an original or renewal application for certification. The amount of the bond for a driver education provider for teens or adults must be \$20,000 if the provider has 999 or fewer students in a calendar year, and \$40,000, if the provider has 1,000 or more students in a calendar year. In order to provide truck driver education, the surety bond must be for \$50,000. A separate bond is required for each type of certification-- adult, teen or truck driver. The driver education provider also must maintain bodily injury and property damage liability insurance on a motor vehicle used in driver education course instruction in the amount of \$100,000 for bodily injury to or the death of one person in one accident; \$300,000 for bodily injury to or the death of two or more persons in one accident; and \$50,000 for damage to the property of others in one accident.

The surety bond is for the protection of the students' contractual rights, providing indemnification or reimbursement for any student, financing agency, or governmental agency for monetary loss through fraud, cheating, or misrepresentation in the conduct of the provider's business caused by the provider or by an employee, agent, instructor, or salesperson of the provider. The aggregate liability of the surety cannot exceed the penal

sum of the bond. The surety may cancel the bond if it gives 30 days written or electronic notice to the Secretary of State (Secretary), and is not liable for losses after the effective date of the cancellation. When the Secretary receives written or electronic notice that a driver education provider's surety bond or insurance coverage has been canceled, the Secretary must notify the provider that its license will be automatically canceled unless a new surety bond or a new insurance certificate is sent to the Secretary within 30 days. Failure to submit a new surety bond or insurance certificate within 30 days results in the automatic cancellation of the provider's license. Finally, for any change or termination in the surety bond or insurance policy, the provider must send notice to the Secretary before the expiration date of the bond or policy.

The following is a list of laws affecting fidelity bonds that were enacted into law in September 2006.

CALIFORNIA

HB 2038: *Escrow Agents* – Effective January 1, 2007

HB 2038 would amend existing law that requires escrow agents to be licensed and regulated by the Commissioner of Corporations (Commissioner). Existing law requires licensees to apply for membership in the Escrow Agents' Fidelity Corporation, which is a nonprofit mutual benefit corporation, established to indemnify its members against loss of trust obligations. This may be achieved through a fund established by the Corporation, a fidelity bond or insurance policy approved by the Commissioner, or a combination of any of these. The new law would require that the Fidelity Corporation provide a copy of the fidelity bond or insurance policy to all of its members and the Commission of Corporations when such bond or policy is acquired or renewed, and to provide a copy to any member or successor of interest on request.

HB 3020: *Time Share Developments* – Effective Immediately

HB 3020 amends existing law concerning bonding for timeshare developments. In addition to amending provisions concerning a developer's surety bond, the bill also amends the existing provision for the fidelity bond or insurance required for the managing entity of the timeshare plan or component site. The new law provides that the bond or insurance may not be in an amount less than what is required in existing law, but the new law also allows the Real Estate Commissioner to provide a reduction in the required insurance policy or bond amount, as long as it is not below the existing requirement.