

SURETY & FIDELITY ASSOCIATION OF AMERICA

MEMORANDUM

TO: Government Affairs Advisory Committee
Contract Bonds Advisory Committee

FROM: Lenore S. Marema

DATE: October 30, 2007

SUBJECT: 2007 Overview of the State Legislative Sessions—Contract Surety

Only five states still are in their regular session: **Massachusetts, Michigan, Ohio, Pennsylvania** and **Wisconsin**. **Illinois** remains in extraordinary session. The legislature has not adjourned due to continuing budget issues and is engaged in a bitter battle on several issues with the Governor. Four states have convened a special session. **Arkansas** and **Florida** have specific tax issues on the agenda, and **Hawaii** is considering a ferry transportation project. **Maryland** is in special session to address a budget deficit. There are no contract surety issues in any of the special sessions. Pre-filing for the 2008 sessions has begun in a half dozen states.

The following summarizes key state legislation affecting contract surety that SFAA has been working on most recently with AIA and the NASBP. This report updates the September 2007 overview report, which can be accessed on the SFAA website for reference.

State Bond Thresholds

--Recent Introductions. **Ohio** SB 234 was introduced on October 4, and was heard in committee recently. The surety industry was successful in raising substantial problems with the bill and it will be held in committee this year, but most likely will be reintroduced in 2008. The bill would have permitted bonds to be waived in all public projects under \$500,000. The bill did not apply to Department of Transportation (DOT) projects, which are addressed in a different section of Ohio law.

The surety industry was well represented at the recent hearing through the Cincinnati Insurance Company, the Westfield Group and state counsel for the Ohio Surety Federation, among others. When the bill was presented, a number of questions were raised, which showed that the ramifications of the legislation needed to be studied more carefully. Committee members were particularly concerned about the burden that could be imposed on taxpayers if contractors defaulted and no bond was in place.

In introducing the bill, the sponsor made some familiar arguments against bonding. The bill was introduced at the request of commissioners from Cuyahoga (Cleveland) County because there are several ongoing and upcoming projects there. Small and minority

contractors argue that they cannot participate in these projects because they cannot obtain the required bonding. It was noted that there have been few, if any, defaults on the bid and final bonds. This ignores one of the primary purposes of the bond, which is to pre-qualify the contractors that will complete the job. The absence of any defaults also may be misleading in that it would not show efforts of sureties to assist contractors during the job to prevent a default. While it was argued that the contractor would still be liable to the public entity in case of default, realistically, the burden to complete the project would fall to the taxpayers in the absence of bonding, and workers and suppliers would be left with claims against a defaulting contractor to get paid for their work.

Ohio has a new state bond guarantee program. SFAA worked with its members and the former Lieutenant Governor of Ohio to develop the Encouraging Diversity, Growth and Equity (EDGE) program, which is designed to encourage surety companies to increase bonding activity with Ohio's socially and economically disadvantaged businesses. The program enables the Ohio Department of Development to guarantee up to 90% of the losses incurred by participating sureties. Most recently, SFAA was contacted by the Greater Cleveland Partnership for a meeting of all stakeholders to implement the education modules of the SFAA's Model Contractor Development Program (MCDP) in Ohio in early 2008.

Bad Faith

On November 6, voters in **Washington** will decide whether to retain or reject the new insurance bad faith law enacted this year. The insurance industry and business community have worked together since June on a referendum to reverse Washington SB 5726, which enacted the lowest standard for insurance bad faith in the country. The industry and business coalition obtained the necessary signatures to qualify for a referendum to put this issue on the November ballot after negotiations with the Governor and the trial bar for a meaningful corrective bill in 2008 proved to be impossible.

Currently, the effective date of the new bad faith law is stayed until after the November election. If retained, the new law creates a first party bad faith action, but defines a first party claimant as "anyone asserting a right to payment as a covered person under an insurance policy." Treble damages and attorneys' fees can be awarded in bad faith suits against insurers and also for violations of the state insurance unfair claims settlement practices act and regulations. Unlike other states, Washington does not exclude surety from regulation under its unfair claims settlement practices law.

The industry and business coalition has fought the trial bar in an ad campaign designed to put the issues before the voters. There is not strong opinion about this issue in the general public in Washington so that the situation is fluid and the outcome is hard to predict from the polls. The trial bar has run emotional ads in an effort to swing back the soft support that exists for the industry's referendum.

Small and Emerging Contractor Issues in New York

The New York Insurance Department plans to conduct hearings in early December to gather information on the parameters of the small and minority contractor issue in New

York. There likely will be a meeting with all stakeholders, including sureties, prior to any hearings. SFAA last met with the Deputy for Property Casualty Insurance on October 26 to continue to address this issue with the Department and to provide information on a wide range of surety topics in general, and on statistics and the New York market for bonding in particular. Following that meeting, the same Deputy talked with two producers recommended by the SFAA, Bill Maroney and David Caymitte. SFAA hopes to avoid public hearings and to have the Insurance Department join as a partner with the contractor education and bonding assistance program that the SFAA initiated by way of a Memorandum of Understanding (MOU) with the New York State Division of Minority and Women Business Development. The New York Lieutenant Governor was a signatory to the MOU.

Retainage

--Enactments. **New Jersey** AB 3649 extends the 2005 retainage law for DOT projects to the construction and maintenance projects of the New Jersey Turnpike Authority. The new law sets retainage at 2% until substantial completion, after which 1% of a payment could be withheld. The Authority may withhold 4% if the project is not progressing according to specifications. The Governor signed the bill into law on September 29, 2007.

Preferences for Veterans

--Bills on the Move. **Michigan** SB 751 would increase the participation goal for qualified disabled veterans from 3% to 5% for contracts with the Department of Management and Budget for construction, goods and services. Current law defines a qualified disabled veteran business entity as one that is 51% or more owned by one or more veterans with a service connected disability. The bill has passed the Senate committee on Senior Citizens and Veterans Affairs.

RE: 2007 Overview of the State Legislative Session—Commercial Surety

Only five states still are in their regular session: **Massachusetts, Michigan, Ohio, Pennsylvania** and **Wisconsin**. **Illinois** remains in extraordinary session. The legislature has not adjourned due to continuing budget issues and is engaged in a bitter battle on several issues with the Governor. Four states have convened a special session. **Arkansas** and **Florida** have specific tax issues on the agenda, and **Hawaii** is considering a ferry transportation project. **Maryland** is in special session to address a budget deficit. Pre-filing for the 2008 sessions has begun in a half dozen states.

The following summarizes key state legislation affecting commercial surety that SFAA has been working on most recently with AIA. This report updates the September 2007 overview report, which can be accessed on the SFAA website for reference.

Bad Faith

On November 6, voters in **Washington** will decide whether to retain or reject the new insurance bad faith law enacted this year. The insurance industry and business community have worked together since June on a referendum to reverse Washington SB

5726, which enacted the lowest standard for insurance bad faith in the country. The industry and business coalition obtained the necessary signatures to qualify for a referendum to put this issue on the November ballot after negotiations with the Governor and the trial bar for a meaningful corrective bill in 2008 proved to be impossible.

Currently, the effective date of the new bad faith law is stayed until after the November election. If retained, the new law creates a first party bad faith action, but defines a first party claimant as “as anyone asserting a right to payment as a covered person under an insurance policy.” Treble damages and attorneys’ fees can be awarded in bad faith suits against insurers and also for violations of the state insurance unfair claims settlement practices act and regulations. Unlike other states, Washington does not exclude surety from regulation under its unfair claims settlement practices law.

The industry and business coalition has fought the trial bar in an ad campaign designed to place the issues before the voters. There is not strong opinion about this issue in the general public in Washington so that the situation is fluid and the outcome is hard to predict from the polls. The trial bar has run emotional ads in an effort to swing back the soft support that exists for the industry’s referendum.

LICENSE BONDS

Contractors License Bonds

Florida SB 404, enacted this year, requires the Construction Industry Licensing Board (CILB) to promulgate rules for determining the financial stability of contractors subject to certification and registration, which may include minimum requirements for net worth, cash and bonding. For Division I certificate holders, this must be no more than \$20,000; and for Division II certificate holders, this must be no more than \$10,000. Fifty percent of the financial requirements may be met by completing a 14-hour financial responsibility course approved by the Board. Division I certificate holders are general contractors, residential contractors and building contractors. Division II contractors are the following: roofers, sheet metal, air conditioning, mechanical, pool, plumbing, underground utility and excavation.

SFAA recently received a report from the Florida Surety Association that the CILB conducted a rules workshop to obtain input on regulations to implement SB 404. The CILB was considering a license bond requirement based on the contractor’s credit score. A bond would be required only from contractors with a credit score of between 600 and 660. Any applicant with a score of less than 600 would be denied a license, and those with credit scores in excess of 660 would not have to post a bond. The license bond amount could be cut in half if the contractor completed the 14 hour education course. The FSA told the CILB that such an approach was adverse selection against the surety and that such license bonds may not be widely available. The FSA suggested instead that the CILB consider a universal license bond applicable to all contractors.

Most recently, however, the CILB has said that it needs legislation in 2008 to create a universal contractors license bond in Florida and that it has found a bill sponsor. SFAA

has suggested the California law with some modifications for Florida as a model for drafting a new Florida law.

Other New License Bonds

--Enactments. **Illinois** SB 1366/ HB 1292 requires the Commerce Commission to establish license requirements, including bonding, for agents, brokers or consultants engaged in the procurement or sale of retail electricity. The Governor signed the bill on October 11.

Illinois SB 509 requires wholesale drug distributors to post a \$100,000 license bond.

--Bills on the Move. **Pennsylvania** HB 825 has passed the House and is in committee in the Senate. It would require private investigators, security personnel and fugitive recovery agents to be licensed and bonded. The amount of the bond will be determined by regulation. If corporations or other legal entities seek a license, the bonding requirements apply to them as well. In addition, the bill would require \$1 million in liability insurance. The bill would permit other forms of security in lieu of bonds.

--Still Pending. **Massachusetts** HB 931 would require travel agents to post a \$250,000 license bond. This bill has been introduced in previous sessions. SFAA believes that the amount of the bond may make it hard to obtain. **Massachusetts** SB 2335 has been adopted as a substitute for SB 206, which was reported previously. The substitute bill would require credit counselors to post a \$250,000 license bond. The Commissioner of Banks would promulgate the form. The Commissioner and anyone having a cause of action against the licensee could file a claim against the bond. Both of these bills are in committee.

--Recent Introductions. In the current **Maryland** special session to address the budget deficit, the issue of legalized gambling has arisen as a source of revenue. HB 25a would authorize video slot machines in the State and would require a license for gaming facility operators and gaming employees, video slot machine manufacturers, and anyone who manages, operates, supplies, provides security for, or provides service, maintenance, or repairs for video slot machines. The bill would require the newly formed State Gaming Commission to adopt regulations which require all license applicants and licensees to post a bond conditioned on the faithful performance of all requirements of the proposed law and any rules adopted under it. The bill does not specify the form or amount of the bond.

PUBLIC OFFICIAL BONDS

--Recent Introductions. **Ohio** HB 340, introduced on October 3, would create a new State Board for Certified Interior Designers and require the Executive Director and any employees that the Board designates to be bonded in an amount that the Board determines.

APPEAL BONDS

--Recent Introductions. New York SB 6480 would authorize Ulster County to charge a new real estate transfer tax. A court costs bond would be required of anyone who disputed the new tax. The bond could be required for the amount of the taxes, penalties and interest due. The bill is similar to many other bills enacted and still pending in New York this year. SB 6480 was introduced on October 9.

OTHER ISSUES

Amendments to the Uniform Commercial Code

In its Restatement of the Law on Surety, the American Law Institute (ALI) referred to sureties as “secondary obligors” even though ALI restatements generally summarize an existing body of law rather than break new ground. This new terminology has caused states to amend their versions of the Uniform Commercial Code to contain the reference to surety as “any other secondary obligor.” These changes to the law have no substantive impact on surety. **Florida, Iowa, Indiana, Kansas and Utah** enacted such legislation this year. **Pennsylvania** HB 1152 would do the same. The bill has passed the House and its moving in committee in the Senate.

RE: 2007 Overview of the State Legislative Session—Fidelity

Only five states still are in their regular session: **Massachusetts, Michigan, Ohio, Pennsylvania** and **Wisconsin**. **Illinois** remains in extraordinary session. The legislature has not adjourned due to continuing budget issues and is engaged in a bitter battle on several issues with the Governor. Four states have convened a special session. **Arkansas** and **Florida** have specific tax issues on the agenda, and **Hawaii** is considering a ferry transportation project. **Maryland** is in special session to address a budget deficit. There are no fidelity issues in any of the special sessions. Pre-filing for the 2008 sessions has begun in a half dozen states.

The following summarizes key state legislation affecting fidelity that SFAA has been working on most recently with AIA. This report updates the previous fidelity overview report that was issued in August 2007, which can be accessed on the SFAA website for reference.

Bad Faith

On November 6, voters in **Washington** will decide whether to retain or reject the new insurance bad faith law enacted this year. The insurance industry and business community have worked together since June on a referendum to reverse Washington SB 5726, which enacted the lowest standard for insurance bad faith in the country. The industry and business coalition obtained the necessary signatures to qualify for a referendum to put this issue on the November ballot after negotiations with the Governor and the trial bar for a meaningful corrective bill in 2008 proved to be impossible.

Currently, the effective date of the new bad faith law is stayed until after the November election. If retained, the new law creates a first party bad faith action, but defines a first

party claimant as “as anyone asserting a right to payment as a covered person under an insurance policy.” Treble damages and attorneys’ fees can be awarded in bad faith suits against insurers and also for violations of the state insurance unfair claims settlement practices act and regulations. Unlike other states, Washington does not exclude surety from regulation under its unfair claims settlement practices law.

The industry and business coalition has fought the trial bar in an ad campaign designed to put the issues before the voters. There is not strong opinion about this issue in the general public in Washington so that the situation is fluid and the outcome is hard to predict from the polls. The trial bar has run emotional ads in an effort to swing back the soft support that exists for the industry’s referendum.