

THE SURETY & FIDELITY ASSOCIATION OF AMERICA

MEMORANDUM

**TO: Government Affairs Advisory Committee
Contract Bonds Advisory Committee**

FROM: Lenore S. Marema

DATE: November 30, 2007

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

Only five states and the **District of Columbia** still are in their regular session: **Massachusetts, Michigan, Ohio, Pennsylvania** and **Wisconsin**. **Illinois** remains in perfunctory session having never adjourned due to continuing budget issues. Pre-filing for the 2008 sessions has begun in fifteen states.

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

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The two most significant changes in the state chambers were the **Mississippi** and **Virginia** state senates both turning over to Democratic control. Both states have been consistently conservative. Another significant development was Republican Mike Chaney's victory over Democratic trial lawyer Gary Anderson for the Mississippi Insurance Commissioner. Mississippi Attorney General Jim Hood, who initiated much of the coverage litigation against the industry, was re-elected.

Washington Bad Faith Ballot Issue

On November 6, voters in Washington decided to retain the new insurance bad faith law, enacted earlier this year. The vote was 57% to 43%. The new bad faith law becomes effective 30 days from the ballot issue, which is December 6.

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.

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 fought the trial bar in an ad campaign designed to place the issues before the voters. The trial bar ran emotional ads in an effort to sway support for the bad faith law. The fact remains that bad faith was high on the agenda of the trial lawyers and the Democrats in the legislature, which was a strong base of support that became impossible to defeat. The Governor and the insurance commissioner were active in support for the bill and spoke against the industry’s referendum to overturn it. The insurance commissioner appeared on television ads urging voters to reject the industry referendum. The industry did not get the same kind of strong support base from Republicans in the legislature.

We fear that the decisive loss for the industry will energize the trial bar even more. It is possible that they will be back in 2008 with a third party bad faith bill or other anti-tort reform efforts.

Recent Contract Surety Legislation

Small and Emerging Contractors--Enactment

Michigan SB 240 instructs the Department of Transportation (DOT) to continue its program to increase the use of women- and minority-owned businesses for state and local road construction projects. The new law requires at a minimum that the program must consist of education and outreach efforts to these businesses to inform them of DOT competitive bidding requirements and processes. Of note, the DOT will be conducting an assessment of the availability of surety to women and minority owned businesses. The new law instructs the DOT to report to the House and Senate Appropriations Subcommittees on Transportation, and the House and Senate fiscal agencies of its progress each year by September 30th.

Earlier this year, SFAA reported that MDOT issued a report that its Office of Business Development (OBD) conducted many seminars and workshops, working together with numerous business groups and government agencies. During 2006, MDOT held 16 training sessions, which also included training on bonding. Other notable topics included credit management, financial statements, business plan development and business marketing. The report also noted that MDOT held its 26th Annual DBE Conference in March 2006, at which a workshop on construction project estimation, surety, bonding, and accounting was offered, among several others.

Bond Thresholds/Anti-Directed Surety

Pennsylvania HB 2016 was introduced on November 14. The bill would establish bid, performance and payment bond requirements for municipal contracts for supplies, services and construction.

The bill would authorize municipal contracting officers to require bidders on contracts for supplies, services and construction contracts to provide bid security in the form of a certified or bank check, a bond from by a surety company licensed in the Commonwealth, or another form of security as specified in the bid solicitation. The amount of the bond or security would have to be at least the amount that was specified in the advertisement, invitation for bids or request for proposals.

The bill provides that contractors for services and supplies may be required to provide a performance bond executed by a surety company licensed Commonwealth, or such other security that the municipal authority (Authority) requires. The performance bond or other required security shall be in an amount determined by the Authority, and would be conditioned upon the faithful performance of the contract.

The bill provides that for construction contracts in amounts between \$25,000 and \$100,000, the Authority must require performance security in an amount equal to at least 50% of the contract price, as the Authority in its discretion determines necessary to protect its interest. For construction contracts that are in excess of \$100,000, performance and payment bonds would be required from a surety company licensed in the Commonwealth in an amount equal to 100% of the contract price. In lieu of the performance bond, other performance security shall be provided as required by the Authority. The Authority would determine what alternative forms would be acceptable. The Authority would be able to require additional performance bonds, payment bonds or other security.

The bill also contains an anti-directed surety provision, which would make it a misdemeanor offense for any employee to require bonds from any particular surety company or any agent or broker in connection with an invitation to bid or a request for proposal.

We are working with the AIA to see if this bill has any chance of moving this late in the session. If so, the bill needs to be amended to require 100% bonding. Pennsylvania

currently has low state bond thresholds, ranging from \$5,000 to \$25,000 for various different public entities. There is no reason that bonding for municipal projects should be any less.

Contractor Registration

Wisconsin SB 228 is an enforcement measure that would require all contractors and subcontractors to register with the Department of Commerce (Department). The bill would require the Department to establish a website that has contact information for all contractors and subcontractors that have registered with the Department and that shows whether or not such contractors and subcontractors have obtained a performance bond or other financial assurance to ensure their work. The bill passed the Senate and is now in the Assembly.

Bid Shopping

Illinois SB 1176 would prohibit the termination of any subcontractor identified in a bid proposal in a construction contract in excess of \$250,000 once the contract had been entered into with the Capital Development Board unless the Board gives written consent for the termination. The bill has not moved this session, but is expected to be reintroduced next year.

Co-Sureties

Massachusetts SB 2020 authorizes the use of co-sureties on a bond. The sureties would be jointly and severally liable. The bill recently has begun to move in the Senate.

Other Legislation

New Jersey AB 4478 would revoke the construction permit of any contractor indicted for bribing, or attempting to bribe, a municipal construction official unless the permit holder either posts a bond or has the building under construction designated as a "public benefit structure," which is a designation given by the municipality's chief executive officer upon a finding that the building would provide a public benefit. Any bond posted would be in an amount equal to the cost of removing the building, structure, or improvement and the estimated cost of filing legal papers, expert witnesses' fees, search fees, and advertising charges incurred in any proceeding against the contractor. The bill was introduced on November 8 and has not moved.

OF GENERAL INTEREST

SFAA is working with AIA on District of Columbia Bill 17-252, which contains many of the provisions of the Model Producer Licensing Act of the National Association of Insurance Commissioners (NAIC). Under the Model Act, surety is deemed to be a "limited line," which means that the states do not have to implement all the NAIC's requirements for uniformity in agents' licensing for this line of business. Rather, states can retain their individual requirements without being deemed as not in compliance with the NAIC's uniformity requirements. Under the NAIC Model Act, one limited line, credit insurance, is singled out and insurers selling that line of business are required to provide an education program for their agents. Under the DC bill, however, the following

education requirements are applicable to all limited lines, which specifically includes surety:

§ 31-1131.05a. Pre-licensing education.

(b) An insurer that sells, solicits, or negotiates a limited line of insurance in the District shall provide to each individual whose duties will include selling, soliciting, or negotiating the insurer's limited line of insurance in the District a program of instruction that is approved by the Commissioner. The insurer shall provide the program of instruction to the individual prior to the individual's application for licensure as a limited lines insurance producer.

The bill will be heard shortly and we instructed the AIA local counsel to support education for agents, but to eliminate the requirement that the surety must be the vendor of such pre-licensing education. The NASBP and many other vendors in this area offer educational programs for agents. We believe that credit insurance was singled out in the NAIC Model Act because the business directly impacts consumers, and that many insurers offering this line of business have exclusive agents so that it would make sense to require the insurer to conduct the classes. Most surety bond producers, however, are independent agents and can work for many different sureties. It does not make sense for all sureties to be required to train the agents that work for them. The bill should focus on the education required for licensing, rather than specifying the identity of the provider. Any course provided is subject to Insurance Department approval so that the vendor should not make a difference.

2008 SESSIONS

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2007 Overview of the State Legislative Session—Commercial Surety

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The insurance commissioner appeared on television ads urging voters to reject the industry referendum. The industry did not get the same kind of strong support base from Republicans in the legislature.

We fear that the decisive loss for the industry will energize the trial bar even more. It is possible that they will be back in 2008 with a third-party, bad faith bill or other anti-tort reform efforts.

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§ 31-1131.05a. Pre-licensing education.

(b) An insurer that sells, solicits, or negotiates a limited line of insurance in the District shall provide to each individual whose duties will include selling, soliciting, or negotiating the insurer's limited line of insurance in the District a program of instruction that is approved by the Commissioner. The insurer shall provide the program of instruction to the individual prior to the individual's application for licensure as a limited lines insurance producer.

The bill will be heard shortly and we instructed the AIA local counsel to support education for agents, but to eliminate the requirement that the surety must be the vendor of such pre-licensing education. The NASBP and many other vendors in this area offer educational programs for agents. We believe that credit insurance was singled out in the NAIC Model Act because the business directly impacts consumers, and that many insurers offering this line of business have exclusive agents so that it would make sense to require the insurer to conduct the classes. Most surety bond producers, however, are independent agents and can work for many different sureties. It does not make sense for all sureties to be required to train the agents that work for them. The bill should focus on the education required for licensing, rather than specifying the identity of the provider. Any course provided is subject to Insurance Department approval so that the vendor should not make a difference.

LICENSE BONDS

Recent Introductions. **District of Columbia** Bill 476 would require the attorney-in-fact (AIF) for a reciprocal insurer to post a \$250,000 bond in favor of the insurer for the benefit of anyone injured as a result of the AIF breaching the conditions of the bond. The bond would be conditioned on the AIF's faithful account of the reciprocal insurer's funds and that the AIF would not appropriate any of the insurer's funds for its own use. The bill was introduced on October 24 and has not moved. The District of Columbia legislation is based on The National Association of Insurance Commissioners model reciprocal legislation.

Ohio SB 253 would require those who make loans in amounts under \$1,000 to be licensed and bonded. The bill was introduced on November 11.

New Jersey AB 4478 would revoke the construction permit of any contractor indicted for bribing, or attempting to bribe, a municipal construction official unless the permit holder either posts a bond or has the building under construction designated as a "public benefit structure," which is a designation given by the municipality's chief executive officer upon a finding that the building would provide a public benefit. Any bond posted would be in an amount equal to the cost of removing the building, structure, or improvement and the estimated cost of filing legal papers, expert witnesses' fees, search fees, and advertising charges incurred in any proceeding against the contractor. The bill was introduced on November 8 and has not moved.

PUBLIC OFFICIAL

Bills on the Move. **Michigan** SB 368 would require all county treasurers to be covered under a blanket bond in an amount not less than \$1 million or to post an individual bond in the same amount. The bill has passed the Senate.

OTHER RECENT COMMERCIAL SURETY 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.

Bills on the Move. **Pennsylvania** HB 1152 would do the same. The bill has passed the House and is moving in committee in the Senate. **Massachusetts** HB 4301 was introduced on October 10 and is moving in the House.

Private Investigators

Bills on the Move. **Pennsylvania** HB 825 would require private investigators, security professionals and fugitive recovery agents to post a license bond in an amount that would

be determined by regulation. General liability insurance in an amount of not less than \$1 million also would be required. The bill has passed the House and is moving in the Senate.

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2007 Overview of the State Legislative Session—Fidelity

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The following report updates the previous fidelity overview report that was issued in October 2007, which can be accessed on the SFAA website for reference. There have been no new developments in fidelity legislation since the October report.

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