ALASKA STATE LEGISLATURE
HOUSE LABOR AND COMMERCE STANDING COMMITTEE
February 11, 2008
3:03 p.m.

MEMBERS PRESENT

Representative Kurt Olson, Chair
Representative Mark Neuman, Vice Chair
Representative Carl Gatto
Representative Gabrielle LeDoux
Representative Jay Ramras
Representative Robert L. "Bob" Buch
Representative Berta Gardner

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

HOUSE BILL NO. 357
"An Act requiring errors and omissions insurance for real estate licensees; renaming the real estate surety fund as the real estate recovery fund and relating to that fund, and redefining the procedures and criteria used by the Real Estate Commission to make an award from the fund to a person suffering a loss caused by certain misconduct of real estate licensees; requiring a real estate licensee to maintain an office in the state; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 357
SHORT TITLE: CLAIMS AGAINST REAL ESTATE LICENSEES
SPONSOR(s): LABOR & COMMERCE BY REQUEST

02/06/08	(H)	READ THE FIRST TIME - REFERRALS
02/06/08	(H)	L&C, FIN
02/11/08	(H)	L&C AT 3:00 PM CAPITOL 17

WITNESS REGISTER

Eleanor Wolfe, Staff

to Representative Kurt Olson
Alaska State Legislature
Juneau, Alaska
POSITION STATEMENT: Presented HB 357 on behalf of the prime sponsor, Representative Kurt Olson.

DAVE FEEKAN, Legislative Chair
Alaska Association of Realtors
Kenai, Alaska
POSITION STATEMENT: Testified and answered questions on HB 357.

JENNIFER STRICKLER, Chief
Professional Licensing
Juneau Office
Division of Corporations, Business, and Professional Licensing
Department of Commerce, Community, & Economic Development (DCCED)
Juneau, Alaska
POSITION STATEMENT: Testified and answered questions on HB 357.

JEFFREY TROUTT, Deputy Director
Juneau Office
Division of Insurance
Department of Commerce, Community, & Economic Development (DCCED)
Juneau, Alaska
POSITION STATEMENT: Testified and answered questions on HB 357.

SHARON WALSH, Administrator
Real Estate Commission
Anchorage Office
Division of Corporations, Business, and Professional Licensing
Department of Commerce, Community, & Economic Development (DCCED)
Anchorage, Alaska
POSITION STATEMENT: Answered questions on HB 357.

ACTION NARRATIVE

CHAIR KURT OLSON called the House Labor and Commerce Standing Committee meeting to order at 3:03:45 PM. Representatives Buch, Gardner, Neuman, and Olson were present at the call to order. Representatives Gatto, LeDoux, and Ramras arrived as the meeting was in progress.

HB 357-CLAIMS AGAINST REAL ESTATE LICENSEES

3:03:59 PM

CHAIR OLSON announced that the only order of business would be HOUSE BILL NO. 357, "An Act requiring errors and omissions insurance for real estate licensees; renaming the real estate surety fund as the real estate recovery fund and relating to that fund, and redefining the procedures and criteria used by the Real Estate Commission to make an award from the fund to a person suffering a loss caused by certain misconduct of real estate licensees; requiring a real estate licensee to maintain an office in the state; and providing for an effective date."

ELEANOR WOLFE, Staff to Representative Kurt Olson, Alaska State Legislature, said that HB 357 was introduced at the request of the Alaska Association of Realtors. She introduced Dave Feekan of the Alaska Association of Realtors to present HB 357 in more detail.

DAVE FEEKAN, Legislative Chair, Alaska Association of Realtors, explained that HB 357 would enact mandatory errors and omissions insurance (E&O) for all real estate licensees and brokers. This bill would also change the current surety fund to a recovery fund. The E&O insurance that would be required is similar to professional liability insurance in that it covers clients in the event of honest mistakes and negligent errors in a real estate transaction. Currently, voluntary E&O coverage covers licensees and brokers that have purchased insurance. In all other cases, claims are made against the surety fund administered by the Alaska Real Estate Commission (AREC). The surety fund system has been in place for 25 years with little modification, except that in 2004 the limit for claims increased from $10,000 to $15,000. The real estate industry and the Legislative Budget and Audit Division (LB&A) have analyzed how the surety fund system works. The $15,000 limit needs to be increased due to the cost of repairs that have risen along with property values, he opined. Additionally, the high cost of administrative hearings, along with legal expenses for brokers and licensees, has resulted in many frivolous claims being settled unnecessarily. The purpose of HB 357 is to help protect the public by requiring every real estate transaction be covered, not just those instances in which the agent has voluntarily purchased E&O insurance.

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MR. FEEKAN explained that HB 357 would require the Alaska Real Estate Commission (AREC) to make certain that E&O insurance is

available at a reasonable rate to all licensees. Licensees can obtain their own insurance so long as the E&O insurance meets the minimum threshold amount set by the commission. Errors and omissions insurance does not provide protection against criminal acts such as fraud or conversion of trust. Thus, HB 357 would convert the existing surety fund to a recovery fund and require claims be processed through the recovery fund. According to a 2004 National Association of Realtors study, 13 states have already adopted mandatory E&O insurance with a 68 percent approval by licensees and a 89 percent approval of regulators in those states.

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MR. FEEKAN, in response to Representative Neuman, answered that approximately 25 percent of the brokerage firms do not currently have E&O insurance. The average cost of E&O insurance premiums written on a per broker basis range from $1,000 to $2,000 per licensee, he said. The reason some firms do not carry the E&O insurance is because it is expensive. Of the 13 states that require mandatory E&O insurance, most set limits for insurance coverage at $100,000 with a $1,000 deductible. Premiums range from $135 to $243 per year for a $100,000 policy. His brokerage firm pays $2,000 for $1,000,000 insurance policy coverage for its policy, which is comparable to paying $200 for $100,000 in coverage, he noted. One company provides the E&O insurance to all 13 states surveyed. Brokers can upgrade their policies to provide coverage for other items such as protection from discrimination suits. The primary goal of mandatory E&O insurance is to ensure that all licensees are insured to provide consumer protection.

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MR. FEEKAN, in response to Chair Olson, answered that adding items to the E&O insurance policy generally increases the deductible amount.

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MR. FEEKAN, in response to Representative Gardner, explained that insurance is written to the broker. This bill would allow licensees to form a group and purchase a group policy for E&O insurance in order to reduce the premium. This bill still would allow an individual licensee the option of purchasing his/her own policy. In further response to Representative Gardner, Mr. Feekan noted that the terminology has been changed from “agent”

to “licensee”. This bill was patterned after Idaho’s law. In Idaho, 25 percent of the brokers have decided to maintain their current E&O insurance policies, he noted. Under HB 357, brokers could continue with their insurance and provide a certificate of insurance for any licensee in the firm so that all licensees within the brokerage firm are covered.

3:12:50 PM

REPRESENTATIVE GARDNER inquired as to whether HB 357 would shift the burden to purchase and maintain insurance from the brokerage firm to the individual licensee.

MR. FEEKAN said that currently, brokers acquire the E&O insurance, but pass the cost on to the licensees as part of their monthly realtor fees. He reported that most of the brokers he polled advised they would not use the proposed AREC E&O insurance unless the policy offers $1 million in insurance coverage. He explained that the difference between a surety fund and a recovery fund is that a surety fund does not cover acts of crime such as fraud, deceit, or misrepresentation. The most common conversion of trust claim is due to broker theft from the trust account, he noted. The surety fund requires the parties submit to an administrative hearing process. Alaska currently has a high number of frivolous claims in the process of administrative hearings. Other states have gone to a recovery fund for similar reasons, he opined. Under HB 357, an individual must have a court ordered judgment in order to make a claim for reimbursement from the recovery fund which would eliminate administrative hearings for those matters, he said. The bill also requires that the judgment must be uncollectible, which means the court found the action constituted a crime. Finally, in order to qualify to use the recovery fund under HB 357, the person must be licensed by the board as a real estate licensee, which means there was a license violation involved.

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REPRESENTATIVE LEDOUX noted her agreement that the $15,000 claim limit is set too low in proposed AS 08.88.465(a). She inquired as to whether the amount in the surety or recovery fund should also be increased.

MR. FEEKAN answered that the majority of claims are for property conditions and not fraud, deceit, or conversion of trust so the $100,000 limit is adequate to cover most claims. He related that most claims average from $7,000-$10,000 for items such as a

leaky roof that had not been disclosed. The surety fund covers issues of conversion of trust such as not refunding security deposits, or theft from the trust account, which typically fall well within the $15,000 limit. He offered that no acts of fraud were discovered in his research, although there could be some cases.

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REPRESENTATIVE LEDOUX posed a scenario in which a broker states that a roof was inspected, but the buyer later discovers that the roof leaks. She inquired as to whether that would constitute fraud.

MR. FEEKAN answered that Representative LeDoux's scenario might constitute a case of fraud against the licensee, but in real estate transactions those types of claims constitute negligence, which is covered under E&O insurance.

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REPRESENTATIVE LEDOUX maintained her concern that the surety/recovery fund limits are set too low in HB 357.

MR. FEEKAN answered that the surety fund is funded from licensees' fees. Thus, increasing the fund limits would also increase the real estate licensees' fees to a threshold potentially not affordable by a high percentage of them, he opined.

CHAIR OLSON offered that typically a new program uses an average cost as a starting point. He offered that in the case of the recovery fund proposed in HB 357, the claims have generally been considerably less than $15,000 for the surety fund. If that amount isn't adequate to fund the recovery fund, [the legislature] could increase the limit, he offered.

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MR. FEEKAN, in response to Representative LeDoux, answered that the average surety fund claim has been substantially below $10,000, but occasionally a claim might reach $15,000. He further explained that a surety fund does not provide a form of insurance for the licensee.

REPRESENTATIVE LEDOUX inquired as to whether a surety fund could get insured if claims were to exceed $15,000.

CHAIR OLSON offered that HB 357 sets up an E&O insurance program, but the recovery fund is a collateral program within the bill.

REPRESENTATIVE LEDOUX maintained her concern that since $15,000 is currently not adequate to cover claims in the surety fund, that HB 357 will not rectify the problem.

MR. FEEKAN opined that the insurance industry believes requiring mandatory E&O insurance will remedy many of the issues facing it since most claims are made against the E&O insurance. Thus, requiring a minimum of $100,000 E&O insurance, as other states have done, should remedy the matter. Another approach that the insurance industry could take would be to increase license fees in order to increase the surety/recovery fund. He opined that raising the license fees would cost real estate licensees considerably more than the proposed $200 premium annual fee proposed in HB 357.

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REPRESENTATIVE NEUMAN referred to a committee packet handout titled, "Mandated Program Chart as of January 1, 2008" and inquired as to the amount projected for Alaska as compared to the other states listed.

MR. FEEKAN reiterated the claim limit for most states is set at $100,000 per claim. The aggregate claim amount varies from $300,000 to $500,000, except that Kentucky's aggregate is set at $1 million. Alaska's aggregate would likely be set at $300,000 to $500,000, he opined. He referred to the column labeled "Deductible" and said that $1,000 damages means the deductible is set at $1,000 and "0 defense" means there is a zero-dollar defense. In further response to Representative Neuman, Mr. Feekan pointed out that an individual licensee's premium would cost approximately $200 per year and the broker's premiums would cost $2,000 per year for $1 million of insurance policy coverage.

REPRESENTATIVE NEUMAN offered his understanding that an agent would pay a $200 annual premium to cover unexpected problems that may arise in a real estate transaction. If an issue arose that the agent did not know existed, the repair would be covered under the agent's E&O insurance, he said.

MR. FEEKAN noted his agreement.

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REPRESENTATIVE GATTO inquired as to whether the agent is responsible for repairs such as a cracked foundation if the owner hires a home inspector whose report concludes that the foundation is sound.

MR. FEEKAN answered that the licensee or broker would have to have had knowledge of the cracked foundation. He noted that E&O insurance covers items that the licensee is not aware or matters that the licensee should have known. In further response to Representative Gatto, Mr. Feekan noted that Alaska law does not require real estate agents to perform discovery so it would not be the agent's duty to find the cracked foundation.

CHAIR OLSON pointed out that generally an agent will refer owners to a list of home inspectors and the owner can select one to perform the work.

MR. FEEKAN noted his agreement and added that brokers and licensees often recommend home inspectors and engineers be consulted to provide their expertise to the buyer or seller.

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REPRESENTATIVE GARDNER inquired as to whether the shift to a recovery fund, which would require consumers that have been defrauded to seek a court judgment, will also create additional expenses for the consumer.

MR. FEEKAN answered that a consumer is not required to go to court. However, the real estate licensee is required under the E&O policy to notify the E&O insurance company when a client has a problem. The process used is that the client will notify the broker when he/she discovers a problem and the broker notifies the E&O company. The E&O investigator would then investigate the claim. However, the insurance company will often attempt to settle the claim outside of court. In further response to Representative Gardner, Mr. Feekan noted that most E&O claims that consumers consider to be fraud are actually considered negligence in the real estate industry and are covered under the E&O policy. "Fraud is something extremely difficult to prove", he said.

CHAIR OLSON offered that oftentimes it is easier for an insurance company to settle nuisance claims out of court rather than incur legal expenses.

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REPRESENTATIVE GARDNER offered her understanding that the difference between the surety fund and the proposed recovery fund is that a recovery fund requires an uncollectible court judgment that has not been covered by E&O insurance.

MR. FEEKAN responded that many claims allege that a criminal act like fraud has been committed in order to get the claim heard before an administrative law judge. The broker prevails most of the time when they oppose the claim, he opined. He further opined that the surety fund rarely pays out. Thus, to require claims to be uncollectible judgments tends to eliminate frivolous lawsuits.

REPRESENTATIVE GARDNER asked whether the proposed solution would add cost and delay to the consumer with a legitimate claim.

MR. FEEKAN answered that the claim process that the E&O company uses is to first investigate the case and determine that the claim is not covered by the policy since the act constitutes fraud.

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MR. FEEKAN, in response to Representative Gardner, advised that the consumer is made aware from the outset that E&O insurance does not cover claims based on fraud. In further response to Representative Gardner, Mr. Feekan reaffirmed his understanding that the consumer would get a copy of the denial. He offered that the E&O insurance company could decide to pay the claim and then attempt to collect the claim from the licensee.

CHAIR OLSON confirmed that the consumer would receive a copy of the denial in writing from the E&O insurance company because it would constitute bad faith on the part of the insurance company if it did not do so.

MR. FEEKAN noted his agreement that all parties would be notified of the outcome on a claim.

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MR. FEEKAN, in response to Representative Neuman, answered that the findings and recommendations from the Division of Legislative Budget and Audit (LB&A) from the audit of the AREC were incorporated into HB 357. In further response to Representative Neuman, Mr. Feekan offered that the last audit conducted by LB&A in 2004 on the AREC made recommendations which were carried forward to the most recent audit of the AREC. Therefore, the industry is attempting to address the issues raised by LB&A in HB 357.

3:34:10 PM

REPRESENTATIVE LEDOUX expressed concern that a jury trial process would take longer to complete than an administrative hearing.

MR. FEEKAN answered that a claim against the surety fund uses the same process of hiring attorneys in an administrative hearing as a jury trial would.

REPRESENTATIVE LEDOUX maintained her concern, based on her experience, that a trial would take longer from inception to judgment than an administrative hearing. She inquired as to the length of time for an administrative hearing involving a surety fund dispute.

MR. FEEKAN responded that the process is required to be completed in 120 days.

REPRESENTATIVE LEDOUX opined that 120 days is a “drop in the bucket” in terms of a jury trial.

MR. FEEKAN noted that attorneys he polled who practice real estate law said the reason that they do not use the surety fund as a remedy is due to the limit of $15,000 coverage; the damages are generally higher than the limit and there is no settlement process. The purpose of the surety fund is for fraud and deceit, he noted. He further opined that most attorneys prefer to file an E&O insurance claim since legitimate claims generally settle out of court.

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REPRESENTATIVE LEDOUX noted that there is a difference between legitimate claims and small claims actions. She pointed out that it is possible to be defrauded for an amount ranging from $5,000 to $10,000, which may appear to be a nuisance suit, but

actually is legitimate, but of a small nature. She opined that a court case ranging from $5,000 to $10,000 could take up to two years to obtain a judgment. Once the court action is completed, the parties would still need to file with the surety fund.

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REPRESENTATIVE GARDNER pointed out that the proposed statute requires that a case must be filed within two years of the knowledge of the fraud.

MR. FEEKAN noted his agreement that the surety fund or recovery fund both would have a two-year statute of limitations. He said he could not recollect any instance in which a broker took a case to small claims court. Instead, these cases are claims brought against the E&O insurance company, he specified.

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MR. FEEKAN, in response to Representative LeDoux, agreed that there are numerous cases brought against the surety fund that claim fraud. However, the majority of these cases stem from problems with the property that were not disclosed by the seller.

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JENNIFER STRICKLER, Chief, Professional Licensing, Division of Corporations, Business, and Professional Licensing, Juneau Office, Department of Commerce, Community, & Economic Development (DCCED), said that the division generally supports reform of the surety fund and concurs with the recommendation of the September 7, 2007, LB&A audit that the AREC should be extended until 2016. The division also agrees that certain aspects of the surety fund should be changed. This bill, as currently drafted, would establish mandatory E&O insurance for all real estate licensees. The Division of Corporations, Business, and Professional Licensing has worked with the Division of Insurance on the issues of requiring mandatory E&O coverage for real estate licensees and recommends that HB 357 be amended.

MS. STRICKLER referred to proposed AS 08.88.071(a)(11), which read:

> establish the minimum terms and conditions of errors and omissions coverage required by licensees to comply

with the insurance requirements of AS 08.88.172, including coverage requirements, limits of coverage, deductible amounts, and limitations on cancellation terms;

MS. STRICKLER expressed concern that AREC is a regulatory licensing entity not equipped to establish insurance coverage. Instead, she offered that the Division of Insurance would be a more appropriate entity. Other professional licensing programs that require insurance coverage have parameters identified in statute, such as construction contractors. Ms. Strickler pointed out that proposed AS 08.88.071(a)(12) would require the AREC to procure and make available E&O insurance policies to licensees through the bidding process. However, the AREC may not be the appropriate entity to procure and administer coverage and the AREC should not be engaged in promoting the sales of insurance. Proposed AS 08.88.172(c) would allow an individual to independently obtain E&O insurance coverage that the division deems is appropriate. However, the licensees E&O insurance coverage should not be subject to the parameters established by AREC. She pointed out that HB 357 does not provide any alternative for licensees who are unable to obtain E&O insurance. Further, she questioned whether the recovery fund should be made available to those unable to obtain E&O insurance. She acknowledged that this type of system is currently used by other states. Thus, the division has contacted Idaho with respect to the program. She offered to work with industry and the legislature to address the concerns the division has with HB 357. In response to a request by Representative Gardner, Ms. Strickler offered to make her written testimony available to committee members.

3:43:30 PM

JEFFREY TROUTT, Deputy Director, Juneau Office, Division of Insurance, Department of Commerce, Community, & Economic Development (DCCED), for the record, disclosed that he is married to a realtor. He related that the division has no objection to mandatory E&O for licensees. However, the division is concerned that mandatory E&O insurance may not be available at the rate stated for premiums of $200 annually. The division would like the opportunity to examine E&O policy rates and whether the proposed policy limit of $100,000 is set too low. He noted that the remedy for repairs such as a cracked foundation may be more costly than the limit. The division has concern about the availability of an insurance carrier to provide affordable E&O insurance. Even if a company were to

offer E&O insurance, the division is concerned whether that company will always do business in the state. He pointed out that the division can solicit for companies to provide the E&O insurance, but the division cannot force a company to provide E&O insurance to all licensees. If mandatory E&O insurance isn't affordable, a real estate licensee may not be able to renew his/her real estate license. He offered his understanding that an amendment may be under consideration that will address that issue. He questioned whether the AREC would also need to obtain a license in order to procure insurance. He closed by noting the division's intent to perform due diligence and garner enough information to provide answers to some of the issues the division currently has with HB 357.

3:48:33 PM

REPRESENTATIVE GARDNER inquired as to why a real estate broker or licensee is required to have a principal office in the state.

CHAIR OLSON answered that the provision is in HB 357 so that out-of-state firms will not obtain licensure in the state simply as it would cost less to set up a real estate business or because the agents can no longer work in their home state [due to disciplinary action taken].

REPRESENTATIVE GARDNER further inquired as to whether a real estate licensee must work under a broker since the requirement for licensure is mandatory insurance.

MR. TROUTT answered that under the bill, a real estate agent would be required to obtain E&O insurance. He related that the prospective realtor could begin work in a brokerage firm to become familiar with the real estate laws. He/she could concurrently apply for E&O insurance while his/her real estate application is processed.

3:51:07 PM

REPRESENTATIVE GARDNER expressed concern that a person would be prevented from selling real estate if he/she was denied the E&O insurance.

MR. TROUTT noted his agreement. He offered that the Division of Insurance shares the same concern with HB 357.

3:51:37 PM

REPRESENTATIVE GATTO offered his understanding that mobile homes are considered personal property, but not real property. The LB&A audit findings and recommendations suggested mobile home transactions should be eligible under the Real Estate Surety Fund (RESF).

MS. STRICKLER related that the AREC discussed that specific LB&A recommendation. The AREC maintains that mobile homes are personal property. She acknowledged that the AREC and division are at odds with that specific LB&A recommendation.

3:52:23 PM

SHARON WALSH, Administrator, AREC Anchorage Office, Division of Corporations, Business, and Professional Licensing, Department of Commerce, Community, & Economic Development (DCCED), said that the AREC maintains its position that mobile homes are personal property and disagrees with the LBA recommendation that mobile homes be subject to RESF claims and be considered real property.

REPRESENTATIVE GATTO noted his agreement that mobile homes are personal property. However, he pointed out that the LB&A audit recommends amending statutes to specify mobile home transactions be subject to RESF claims.

MR. TROUTT inquired as to whether a mobile home attached to a foundation is considered real property.

MR. FEEKAN answered that mobile home transactions do not require the involvement of licensed real estate agents unless the sale includes real property.

REPRESENTATIVE NEUMAN agreed that sometimes mobile homes are located on a parcel of land connected to water and sewer.

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REPRESENTATIVE LEDOUX inquired as to whether an office with no staff constitutes a principal office.

MR. TROUTT opined that a principal office for real estate is not in operation unless there is staff.

REPRESENTATIVE LEDOUX further inquired as to the rationale behind requiring a physical office in the state. She pointed out that a Washington lawyer is eligible to practice in Alaska

so long as he/she passes the bar examination and meets the other requirements for licensure.

MR. FEEKAN answered that a real estate broker must have a physical office in the state and not a cyber office. The AREC has established requirements for recordkeeping, trust accounts, and most statutes [for other professions] require a physical office in the state in order to operate, he offered. In further response to Representative LeDoux, Mr. Feekan answered that an office provides a physical place for the public to meet with the licensed broker or realtor.

REPRESENTATIVE GATTO pointed out that otherwise someone could be offering a real estate transaction, but be physically located in other countries such as Pakistan.

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CHAIR OLSON, in response to Representative LeDoux, offered that one added protection to the public is that lawyers must be admitted to the bar.

MR. FEEKAN specified that real estate brokers that employ licensees must have a "brick and stone facility" in the state in order for the broker to operate, the public to visit, and the AREC to inspect records.

3:59:54 PM

MR. TROUTT speculated that an attorney is subject to the jurisdiction of the court in Alaska, but single real estate transactions may not require enough personal contact to warrant personal jurisdiction. However, a building would provide a more solid jurisdictional foundation.

REPRESENTATIVE LEDOUX maintained her concern with the requirement in HB 357 for a broker to maintain a physical office in the state.

MR. FEEKAN, in response to Representative Gardner, answered that a person could obtain a loan on a mobile home, but could not obtain a mortgage on a mobile home unless the transaction was for real property.

[HB 357 was held over.]

4:01:33 PM

ADJOURNMENT

There being no further business before the committee, the House Labor and Commerce Standing Committee meeting was adjourned at 4:01 p.m.