

AK LEGISLATURE FINANCE COMMITTEES FILES 2007-2008 3269

151

1 (b) If an adult has a research or other lawful purpose to access Internet sites
2 that depict the items described in AS 11.61.128(1)(A) - (F), a public library may
3 disable the technology measure for the adult.

4 (c) In this section,

5 (1) "adult" means an individual who is 18 years of age or older;

6 (2) "public library" means a library that is open to members of the
7 public.

SW

WITADANUN

25-LS1356E.1
Bannister
4/1/08

AMENDMENT |

Kelly

OFFERED IN THE HOUSE

TO: HB 353

1 Page 2, lines 6 - 7:

2 Delete all material and insert:

3 (2) "public library" means a library that

4 (A) provides the following services free of charge to members
5 of the public:

6 (i) establishment and maintenance of a collection of
7 books and other materials for loaning;

8 (ii) access to interlibrary loan services;

9 (iii) reading or other educational programs for children;

10 (iv) reference information; and

11 (B) is not operated by or affiliated with the University of
12 Alaska."

FAILED

AMENDMENT 2

OFFERED IN THE HOUSE

BY Gara

TO: HB353

1 Page 2, following line 7:

2 Insert a new bill section to read:

3 (d) This section does not apply to a public library that:

4 (1) has a policy prohibiting computer users from viewing internet sites that
5 depict the items described in AS 11.61.128 (1)(A) - (F), and

6 (2) determines that complying with this section would require a cost that
7 materially reduces library services made available to the public.

8

9 Renumber the following bill sections accordingly.

2007 HOUSE FINANCE COMMITTEE VOTE SHEET

#10353

DATE: 4/02/08

Amendment: #2 GARA

MEMBER

Favor

Oppose

KELLY		✓
NEILSON		
STOLTZE		✓
THOMAS		✓
CRAWFORD		
FOSTER		
GARA	✓	
HAWKER		✓
JOULE		
MEYER		✓
CHENAULT		✓

Yea 1

Nay 6

ALASKA STATE LEGISLATURE

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Juneau, Alaska 99801-1182
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REPRESENTATIVE WES KELLER DISTRICT 14 SPONSOR STATEMENT CS HOUSE BILL 353 (STA)

"An Act relating to the blocking of certain Internet sites at public libraries and to library assistance grants."

CS for House E. 353 will encourage public libraries to assure that our young people do not have access to adult internet sites. Presently, there is cost effective software that allows responsible adults to prevent access to sites that could be considered objectionable. Parents and guardians of children use this software to prevent access.

While children are prevented from accessing these sites at home, some public libraries do not use this blocking technology or because of staffing limitations cannot monitor computer use. A simple installation of the software or constant monitoring will prevent children from reaching adult sites.

Because of the concern that denying access might be considered unconstitutional, and because blocking software might block sites that are necessary for research, CSHB 353 includes language that allows adults to request that the software be disabled. The courts have already ruled this is an acceptable compromise.

CSHB 353 is also reactive in its approach should a library refuse to purchase and install the software or provide monitoring. The bill would restrict state and local grant money to the library for refusal.

In this high tech, instant access world we live in, what was once on the shelves of stores under plastic wraps is now just a click away. Passage of CSHB 353 will assure that public libraries are serving all of their customers in a responsible manner.

E-Mail: Representative_Wes_Keller@legis.state.ak.us
Call Juneau Toll free: (800) 468-2186
Website: www.akRepublicans.org/keller/

2007 HOUSE FINANCE COMMITTEE VOTE SHEET

DATE: 4/1/08

Amendment: _____

MEMBER

Favor

Oppose

MEMBER	Favor	Oppose
██████ HARRIS FOSM	—	
GARA		✓
HAWKER	✓	
JOULE	—	
KELLY	✓	
NELSON	—	
STOLTZE	✓	
THOMAS	✓	
CRAWFORD	✓	
MEYER	✓	
CHENAULT	✓	

Yea 7

Nay 1

LEGAL SERVICES

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STATE OF ALASKA

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
State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM

March 20, 2008

SUBJECT: CSHB 353(STA) relating to the blocking or monitoring of certain Internet sites at public libraries and to library assistance grants (Work Order No. 25-LS1356\K)

TO: Representative Bob Lynn
Chair of the House State Affairs Committee
Attn: Nancy Manly

FROM:  Theresa Bannister
Legislative Counsel

This memo accompanies the bill described above.

Free speech. The bill raises an issue under the First Amendment of the United States Constitution and art. I, sec. 5 of Alaska's constitution,¹ which limit the state's ability to impose restrictions on forms of speech based on the content of the speech involved. Internet site filtering by a library in order to protect children has been upheld by the U.S. Supreme Court in one case ("decision").² However, there were different concurring opinions, as well as dissenting opinions, and it is difficult to predict whether the specifics of this bill will satisfy the requirements of that case.

If I may be of further assistance, please advise.

TLB:med
08-208.med

Enclosure

¹ The state's provision is meant to be at least as protective of free expression as the federal provision. See Mickens v. City of Kodiak, 640 P.2d 818, 820 (Alaska 1982), citing the Proceedings of the Alaska Constitutional Convention 1305-07 (Jan. 5, 1956).

² United States v. American Library Association, Inc., 539 U.S. 194 (2003).

Fact Sheet Web Filtering

Prepared For HB 353: *Act relating to the blocking of certain Internet sites at public libraries and to library assistance grants:*

State URL filtering background:

Web filtering is accomplished by placing a device in between a user and the internet within the State's Executive Branch networking infrastructure. The device, when configured, will categorize all website requests and determine, via established policy, whether to allow or deny the web requests to the end user. Web use policy can be customized to allow diverse agency business needs. Currently, the State network uses Uniform Resource Locator (URL) filtering via an enterprise-wide software solution called Blue Coat.

In general, URL filtering at the State level is used for a number of reasons, including:

Employee Productivity:

With unmanaged internet access, employees can be distracted by non-work related or unproductive activities. URL filtering helps manage employee access to websites, minimizing lost time on the internet, and lowering operating costs by minimizing bandwidth use to State business purposes.

Legal Liability:

Personal internet use can expose organizations to legal liability when employees engage in illegal or inappropriate activities. URL filtering helps manage employee internet access and enforce personal use policies to mitigate legal liability up-front.

Internet Bandwidth usage:

Depending on network capacity, the use of bandwidth-intensive applications such as streaming media or the downloading of music or videos by even a few employees can slow or shut down entire networks. URL filtering helps enforce internet usage policies based on bandwidth needs to prevent business losses and other issues that result from limited access to mission-critical applications.

Website security filtering:

Web filtering solutions protect against: malicious websites, spyware, phishing and other frauds, potentially unwanted software, bot networks, keyloggers and other potentially harmful internet content.

URL Filtering Options:

HB 353 contemplates securing independent internet connectivity in libraries throughout the State. With such independent connections, an end-point home solution, such as **NetNanny, Norton Internet Security or WebWatcher for \$60-\$100 per station** would accomplish the goals sought in HB 353. These various solutions offer different filtering settings per authenticated user, and obtain automatic updates from the manufacturer as new websites come online. This type of software is easy to install and maintain on an individual workstation basis.

In response to the committee's request for information regarding the cost of implementing filtering I am supplying the following. These are estimates of possible costs, as well as some actual figures as noted.

Unalaska (Actual Cost) 2006 Population 3,940

- Installation cost: \$11,620 which included in-house (on-line) training for one tech.
- Annual subscription maintenance: \$1,162
- Annual Library staff cost to disconnect filters for adults: \$1,999.40

Haines (Estimate): 2006 Population 2,241

- software installation : \$480
- required hardware upgrades: \$3500
- staff time for installation/training: \$3000
- software maintenance (licenses): \$300/year
- technology staff support \$3120/year
- Total installation cost: \$6980
- library staff questions/maintenance/ongoing training (turning off filters and managing use): \$1560/year

Pricing is quoted on the number of stations that will host the software. This makes it difficult to project costs for individual libraries. Vendors generally quote a price based on the size of the network. Pricing for network versions are higher and require more expertise to install and maintain. Network filters restrict wireless users and staff workstations.

Individual station software costs on average \$50 for commercially available filtering software sold to the home market. This cost would be per station. These are designed for home use. Most libraries purchasing the same software would pay a minimum of \$199. Staff time would be required to install and then turn filters on and off.

Only the very largest libraries in the state have in-house IT staff and most libraries operate with volunteers who may not have the expertise to turn filters on and off.

Many libraries also have computers that came to them via the Gates Foundation. These computers have security on them to prevent tampering. In order to turn filters on and off the security would have to be disabled first. This is a very complicated and time consuming task.

Mary Jo Joiner, President, Alaska Library Association

Mary Jo Joiner

AMENDMENT I.

Freedom of religion, of speech, and of the press. Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the government for a redress of grievances.⁹

9. Proposed by Congress on September 25, 1789, and declared ratified on December 15, 1791.

Constitution of the State of Alaska

Art 1 Section 5. Freedom of Speech.

Every person may freely speak, write, and publish on all subjects, being responsible for the abuse of that right.

I. GENERAL CONSIDERATION.

Right is not absolute. - In expressing the rights to free speech and privacy, the framers of the state constitution appear to have recognized a right of universal freedom and a right to be left alone which is rooted in the natural inclination of human beings. But these rights, in a free society such as this, have never been recognized as absolute and without limitations. *Messerli v. State*, 626 P.2d 81 (Alaska 1971).

Precision of regulation must be the touchstone. - Because of the "chilling effect" that overbroad laws have on the exercise of constitutional rights, broad prophylactic rules are suspect and precision of regulation must be the touchstone. *Marks v. City of Anchorage*, 500 P.2d 644 (Alaska 1972).

First amendment freedoms are delicate and vulnerable, as well as supremely precious in American society. The threat of sanctions may deter their exercise almost as potently as the actual application of sanctions. Because first amendment freedoms need breathing space to survive, **government may regulate in the area only with narrow specificity.** *Marks v. City of Anchorage*, 500 P.2d 644 (Alaska 1972).

Speech which is vehicle of crime. - Speech is not constitutionally protected when it is the very vehicle of the crime itself. *Webb v. State*, 580 P.2d 295 (Alaska 1978).

Limited restrictions allowed. - Presumably a state can limit speech or assembly in specific places under limited circumstances. *Marks v. City of Anchorage*, 500 P.2d 644 (Alaska 1972).

It is only in the most limited circumstances that speech may be punished. *Anniskette v. State*, 489 P.2d 1012 (Alaska 1971); *Marks v. City of Anchorage*, 500 P.2d 644 (Alaska 1972).

The category of obscenity, which is unprotected, is very narrowly defined. *Hanby v. State*, 479 P.2d 486 (Alaska 1970).

Erotic speech may be punished as obscenity if the tests promulgated by the U.S. supreme court are met. *Marks v. City of Anchorage*, 500 P.2d 644 (Alaska 1972).

II. VAGUE AND OVERBROAD.

Former delinquency statute. - Former statute which criminalized acts "which cause or tend to cause, encourage or contribute to delinquency" was not overbroad, since only speech which advocated imminent lawless action and which was likely to produce such action was proscribed. *Holton v. State*, 602 P.2d 1228 (Alaska 1979).

Former AS 11.15.134(a) did not implicate constitutional rights of adults. - Since former AS 11.15.134(a), which made it a crime to commit a lewd or lascivious act upon or with the body of a child under 16 years of age, intending to arouse the sexual desires of either the actor or the child, prohibited only lewd and lascivious physical contact with children, that section did not implicate the constitutional right of adults to possess and exhibit literature or the right of adults to privacy in their homes at least insofar as that right protects parents dressing in front of children, those who tell dirty jokes, and adults who are passionately affectionate with other adults in the presence of children. *Anderson v. State*, 562 P.2d 351 (Alaska 1977).

When ordinance is void-for-vagueness. - An ordinance is void-for-vagueness where it fails to give a person or ordinary intelligence fair notice that his contemplated conduct is forbidden by the statute and where it encourages arbitrary and erratic arrests and convictions. *Marks v. City of Anchorage*, 500 P.2d 644 (Alaska 1972).

Those generally implicated by the imprecise terms of a disorderly conduct ordinance poor people, nonconformists, dissenters, idlers - may be required to comport themselves according to the lifestyle deemed appropriate by the police and the courts. *Marks v. City of Anchorage*, 500 P.2d 644 (Alaska 1972).

UNITED STATES et al. v. AMERICAN LIBRARY ASSOCIATION, INC., et al. 539 U.S. 194
(2003)

In 2003

Chief Justice Rehnquist, joined by Justice O'Connor, Justice Scalia, and Justice Thomas, concluded:

1. Because public libraries' use of Internet filtering software does not violate their patrons' First Amendment rights, CIPA does not induce libraries to violate the Constitution, and is a valid exercise of Congress' spending power. Congress has wide latitude to attach conditions to the receipt of federal assistance to further its policy objectives, *South Dakota v. Dole*, 483 U. S. 203, 206, but may not "induce" the recipient "to engage in activities that would themselves be unconstitutional," *Id.*, at 210.

2.

....the public forum principles on which the District Court relied are out of place in the context of this case. Internet access in public libraries is neither a "traditional" nor a "designated" public forum. See, e.g., *Cornelius v. NAACP Legal Defense & Ed. Fund, Inc.*, 473 U. S. 788, 802-803.

SUPREME COURT OF THE UNITED STATES

UNITED STATES et al. v. AMERICAN LIBRARY
ASSOCIATION, INC., et al.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF
PENNSYLVANIA

No. 02—361. Argued March 5, 2003—Decided June 23, 2003

Two forms of federal assistance help public libraries provide patrons with Internet access: discounted rates under the E-rate program and grants under the Library Services and Technology Act (LSTA). Upon discovering that library patrons, including minors, regularly search the Internet for pornography and expose others to pornographic images by leaving them displayed on Internet terminals or printed at library printers, Congress enacted the Children's Internet Protection Act (CIPA), which forbids public libraries to receive federal assistance for Internet access unless they install software to block obscene or pornographic images and to

prevent minors from accessing material harmful to them. Appellees, a group of libraries, patrons, Web site publishers, and related parties, sued the Government, challenging the constitutionality of CIPA's filtering provisions. Ruling that CIPA is facially unconstitutional and enjoining the Government from withholding federal assistance for failure to comply with CIPA, the District Court held, *inter alia*, that Congress had exceeded its authority under the Spending Clause because any public library that complies with CIPA's conditions will necessarily violate the First Amendment; that the CIPA filtering software constitutes a content-based restriction on access to a public forum that is subject to strict scrutiny; and that, although the Government has a compelling interest in preventing the dissemination of obscenity, child pornography, or material harmful to minors, the use of software filters is not narrowly tailored to further that interest.

Held: The judgment is reversed.

201 F. Supp. 2d 401, reversed.

Chief Justice Rehnquist, joined by Justice O'Connor, Justice Scalia, and Justice Thomas, concluded:

1. Because public libraries' use of Internet filtering software does not violate their patrons' First Amendment rights, CIPA does not induce libraries to violate the Constitution, and is a valid exercise of Congress' spending power. Congress has wide latitude to attach conditions to the receipt of federal assistance to further its policy objectives, *South Dakota v. Dole*, 483 U.S. 203, 206, but may not "induce" the recipient "to engage in activities that would themselves be unconstitutional," *id.*, at 210. To determine whether libraries would violate the First Amendment by employing the CIPA filtering software, the Court first examines their societal role. To fulfill their traditional missions of facilitating learning and cultural enrichment, public libraries must have broad discretion to decide what material to provide to their patrons. This Court has held in two analogous contexts that the Government has broad discretion to make content-based judgments in deciding what private speech to make available to the public. *Arkansas Ed. Television Comm'n v. Forbes*, 523 U.S. 666, 672—674; *National Endowment for Arts v. Finley*, 524 U.S. 569, 585—586. Just as forum analysis and heightened judicial scrutiny were incompatible with the role of public television stations in the former case and the role of the

National Endowment for the Arts in the latter, so are they incompatible with the broad discretion that public libraries must have to consider content in making collection decisions. Thus, the public forum principles on which the District Court relied are out of place in the context of this case. **Internet access in public libraries is neither a “traditional” nor a “designated” public forum. See, e.g., *Cornelius v. NAACP Legal Defense & Ed. Fund, Inc.*, 473 U.S. 788, 802—803. Unlike the “Student Activity Fund” at issue in *Rosenberger v. Rector and Visitors of Univ. of Va.*, 515 U.S. 819, 834, Internet terminals are not acquired by a library in order to create a public forum for Web publishers to express themselves. Rather, a library provides such access for the same reasons it offers other library resources: to facilitate research, learning, and recreational pursuits by furnishing materials of requisite and appropriate quality. The fact that a library reviews and affirmatively chooses to acquire every book in its collection, but does not review every Web site that it makes available, is not a constitutionally relevant distinction. The decisions by most libraries to exclude pornography from their print collections are not subjected to heightened scrutiny; it would make little sense to treat libraries’ judgments to block online pornography any differently. Moreover, because of the vast quantity of material on the Internet and the rapid pace at which it changes, libraries cannot possibly segregate, item by item, all the Internet material that is appropriate for inclusion from all that is not. While a library could limit its Internet collection to just those sites it found worthwhile, it could do so only at the cost of excluding an enormous amount of valuable information that it lacks the capacity to review. Given that tradeoff, it is entirely reasonable for public libraries to reject that approach and instead exclude certain categories of content, without making individualized judgments that everything made available has requisite and appropriate quality. Concerns over filtering software’s tendency to erroneously “overblock” access to constitutionally protected speech that falls outside the categories software users intend to block are dispelled by the case with which patrons may have the filtering software disabled. Pp. 6—13.**

2. CIPA does not impose an unconstitutional condition on libraries that receive E&nbhyph;rate and LSTA subsidies by requiring them, as a condition on that receipt, to surrender their First Amendment right to provide the public with access to constitutionally protected speech. Assuming that appellees may assert an “unconstitutional conditions” claim,

that claim would fail on the merits. **When the Government appropriates public funds to establish a program, it is entitled to broadly define that program's limits.** *Rust v. Sullivan*, 500 U.S. 173, 194. As in *Rust*, the Government here is not denying a benefit to anyone, but is instead simply insisting that public funds be spent for the purpose for which they are authorized: helping public libraries fulfill their traditional role of obtaining material of requisite and appropriate quality for educational and informational purposes. **Especially because public libraries have traditionally excluded pornographic material from their other collections, Congress could reasonably impose a parallel limitation on its Internet assistance programs.** As the use of filtering software helps to carry out these programs, it is a permissible condition under *Rust*. Appellees mistakenly contend, in reliance on *Legal Services Corporation v. Velazquez*, 531 U.S. 533, 542—543, that CIPA's filtering conditions distort the usual functioning of public libraries. In contrast to the lawyers who furnished legal aid to the indigent under the program at issue in *Velazquez*, public libraries have no role that pits them against the Government, and there is no assumption, as there was in that case, that they must be free of any conditions that their benefactors might attach to the use of donated funds. Pp. 13—17.

Justice Kennedy concluded that if, as the Government represents, a librarian will unblock filtered material or disable the Internet software filter without significant delay on an adult user's request, there is little to this case. There are substantial Government interests at stake here: The interest in protecting young library users from material inappropriate for minors is legitimate, and even compelling, as all Members of the Court appear to agree. Given this interest, and the failure to show that adult library users' access to the material is burdened in any significant degree, the statute is not unconstitutional on its face. If some libraries do not have the capacity to unblock specific Web sites or to disable the filter or if it is shown that an adult user's election to view constitutionally protected Internet material is burdened in some other substantial way, that would be the subject for an as-applied challenge, not this facial challenge. Pp. 1—2.

Justice Breyer agreed that the "public forum" doctrine is inapplicable here and that the statute's filtering software provisions do not violate the First Amendment, but would reach that ultimate conclusion through a different approach. Because the statute raises special First Amendment concerns, he would not require only a "rational basis" for the statute's restrictions.

At the same time, "strict scrutiny" is not warranted, for such a limiting and rigid test would unreasonably interfere with the discretion inherent in the "selection" of a library's collection. Rather, he would examine the constitutionality of the statute's restrictions as the Court has examined speech-related restrictions in other contexts where circumstances call for heightened, but not "strict," scrutiny—where, for example, complex, competing constitutional interests are potentially at issue or speech-related harm is potentially justified by unusually strong governmental interests. The key question in such instances is one of proper fit. The Court has asked whether the harm to speech-related interests is disproportionate in light of both the justifications and the potential alternatives. It has considered the legitimacy of the statute's objective, the extent to which the statute will tend to achieve that objective, whether there are other, less restrictive ways of achieving that objective, and ultimately whether the statute works speech-related harm that is out of proportion to that objective. The statute's restrictions satisfy these constitutional demands. **Its objectives—of restricting access to obscenity, child pornography, and material that is comparably harmful to minors—are "legitimate," and indeed often "compelling."** No clearly superior or better fitting alternative to Internet software filters has been presented. Moreover, the statute contains an important exception that limits the speech-related harm: **It allows libraries to permit any adult patron access to an "overblocked" Web site or to disable the software filter entirely upon request.** Given the comparatively small burden imposed upon library patrons seeking legitimate Internet materials, it cannot be said that any speech-related harm that the statute may cause is disproportionate when considered in relation to the statute's legitimate objectives. Pp. 1—6.

Rehnquist, C. J., announced the judgment of the Court and delivered an opinion, in which O'Connor, Scalia, and Thomas, JJ., joined. Kennedy, J., and Breyer, J., filed opinions concurring in the judgment. Stevens, J., filed a dissenting opinion. Souter, J., filed a dissenting opinion, in which Ginsburg, J., joined.

There were questions in the committee about the federal funding (E-rate) that libraries receive to subsidize telecommunications and internet access. These following may clarify some points:

Federal E-rate funding is a reimbursement program.

- o The E-rate is a discount on telecommunications and internet access charges. Libraries do not receive direct federal cash payments under E-rate for either internet access or telecommunications.
- o Telecommunications and internet service providers (ISP's) receive payment. ISP's and telecoms pass on a discounted rate to libraries either:
 - o By discounting bills throughout the year, or
 - o By paying a lump sum reimbursement after the end of the E-rate fiscal year in June. Libraries must apply for this reimbursement in July and usually do not receive payment until fall.
- o The dollar amount of the E-rate discounts for individual libraries is not predictable from year to year and is not announced until after the beginning of the July-June fiscal year followed by most libraries.
- o Because libraries cannot know either the amount or time of payment, libraries must budget to have funds on hand for both telecommunications and internet access as though the E-rate did not exist. E-rate does not substitute for state grants, which are a predictable, budgeted funding source on which libraries rely for day-to-day operation.

Communities may make the decision to opt out of portions of the E-rate that are governed by CIPA for a variety of reasons in addition to the technical difficulties and costs associated with implementing filtering software.

- o E-rate subsidies cannot be applied to CIPA implementation or filtering software purchases.
- o Applying for the E-rate is complex and time consuming. This is especially true for internet access under the E-rate that is governed by CIPA.

School districts and larger public libraries generally have one administrative position that does little else but work on E-rate applications and compliance for several months of the year. Applying only for the telecommunications portion of E-rate requires the time a professional librarian at larger public libraries for several weeks a year. Adding internet and CIPA compliance would at least double this workload. In all-volunteer libraries, the administrative burden of complying with E-rate and CIPA can make it impossible to apply for these funds.

- o The amount of the subsidy received through E-rate is tied to the poverty rate of the community and determined by enrollment in the school lunch program.

In communities where the discount is 50% or less, as responsible administrators, librarians need to weigh the staff cost of the application process against the rate reimbursed by the discount. In some cases, the discount available through the E-rate for internet access is less than discounts offered by the ISP's for bandwidth upgrades.

- o Lower-tech, lower-cost solutions for internet use control, such as internet use policies, machine placement and staff oversight offer not only a locally appropriate approach, but an affordable solution for many libraries.

LEGISLATIVE RESEARCH REPORT

FEBRUARY 14, 2008



REPORT NUMBER 08.150

INTERNET ACCESS IN ALASKA'S PUBLIC LIBRARIES

PREPARED FOR REPRESENTATIVE WES KELLER

BY ROGER WITHINGTON, LEGISLATIVE ANALYST

You asked for information regarding Alaska's public libraries. Specifically, you wished to know the number of public libraries in Alaska that allow the public to access the internet. In addition, you asked how many such libraries have filtering software installed that restricts access to websites that provide adult content.

According to the Alaska Department of Education and Early Development (DEED), approximately 89 libraries received a Public Library Assistance Grant (PLAG) in 2005.¹ According to Patience Frederiksen, Grants Administrator with the DEED, PLAG recipients represent all but three or four public libraries in Alaska.² As part of the grant process, Ms. Frederiksen surveys the public libraries regarding their activity. Of the 89 libraries that received a PLAG in 2005, two libraries did not offer internet access, three libraries did not report whether or not they offered internet access, and 84 libraries offered public internet access.³ These 84 libraries provided 549 computer terminals that allowed the public to access internet. The annual number of times patrons used electronic resources in these 84 libraries for 2005 was 1,147,461. We include, as Attachment A, the General Information section and the FY2005 section of the report *Statistics of Alaska Public Libraries*, which you may find helpful.

Ms. Frederiksen also collects information on the number of libraries allowing the public to access the internet that have placed filtering software on their computer terminals. In 2007, 87 libraries responded to Ms. Frederiksen's queries regarding filtering software. Three libraries reported that they did not offer internet access to the public, five libraries did not respond to Ms. Frederiksen's

¹ The Library Assistance Grant Fund is set forth in Alaska Statute 14.56.300. The statute states that, subject to legislative appropriations, the Department of Education and Early Development shall provide grants to eligible libraries for public library operations, for interlibrary cooperation, or for regional library services.

² Patience Frederiksen, Grants Administrator, Alaska Department of Education and Early Development, can be contacted at 907-269-6566.

³ Please note that 26 of the 89 public libraries are "dual purpose" and are located in either a public K-12 school or college or university campus.

queries, 35 libraries (40.2%) reported that they have not installed filtering software, and 44 libraries (50.6%) reported that they have installed filtering software on their computers that provide internet access to the public.

Of the 44 libraries with filtering software installed on computers that provide internet access to the public, 36 reported that they have the capacity to turn the filtering software off upon request. Of those 36 libraries, 32 reported that they were asked by a patron to turn off the filter during the previous year; 25 libraries (69.4%) were asked ten times or fewer to turn off the filter while seven (19.5%) reported being asked 11 or more times.⁴

I hope you find this information to be useful. Please do not hesitate to contact us if you have questions or need additional information.

⁴ Ms. Frederiksen did not provide details regarding the parameters of precisely what each library filters. The filtering criteria may differ for each library. As such, some libraries may "filter-out" adult content internet sites such as those that provide pornography or gambling as well as sites that provide medical information.

ALA American Library Association

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MEETING CIPA REQUIREMENTS WITH TECHNOLOGY

By Richard W. Boss

Public libraries have been concerned with the issue of access control versus access management for a number of years. While some public libraries have sought to deny access by children to some Web sites, a larger number have focused on managing access, including authenticating patrons, providing links to selected Web sites, metering of use, and compiling of reports. As recently as 2002, fewer than 25 percent of public libraries had blocking or filtering products on all public Internet workstations and 17 percent had blocking or filtering products on only some. More than 58 percent used nothing at all. With the adoption of the Children's Internet Protection Act (CIPA), the issue has become financial as well as philosophical because schools and libraries will lose federal funds if they do not control access by minors to sites that are proscribed by the legislation.

Despite the fact that the terms "blocking" and "filtering" are often used interchangeably, including by legislators, they do have different meanings. "Blocking" refers to stopping access to something based on its URL; "filtering" refers to stopping access to something based on its content. Almost all of the available products do blocking, but not all do filtering. Nevertheless, vendors may refer to a product that does only blocking as a "filter."

CIPA compliance is required when using funds for particular purposes from three federal programs: E-rate, ESEA Title II D, and LSTA. When a school or library receives discounts from the E-rate program and either or both of the other programs, its CIPA requirements take precedence over the requirements in the ESEA or LSTA programs. A related act known as the Neighborhood Children's Internet Protection Act (NCIPA) focuses on what has to be included in a school or library's Internet safety policy.

There are two basic requirements in the CIPA legislation:

1. A school or library must have some type of blocking or filtering technology on all of its computers from which there is access to the Internet. Both patron and staff computers are affected. The technology must protect against access to visual depictions described as obscene, child pornography, or harmful to minors in the Act. CIPA does not require the blocking or filtering of text. The law does not address the question of laptops brought in by staff and patrons, but a consensus has emerged that these need not be blocked or filtered.
2. A school or library must have an Internet safety policy and hold a public

meeting to review the policy. The policy must incorporate the criteria described in NCIPA.

Whether a school or library blocks and filters content other than the visual depictions defined in the law is a local decision.

The FCC has ruled that if a member of a consortium is not in compliance with the law, only the non-compliant members will be penalized.

The law states that any authorized school or library staff member may disable the blocking or filtering product to allow an adult to have unrestricted Internet access for any lawful purpose. Adults are defined as persons 17 years of age or older. A strict reading of the law would preclude coding the status of a patron in the library card and automatically turning off the blocking or filtering when the I.D. was entered.

The Federal Communications Commission (FCC) is charged with enforcement of CIPA/NCIPA for the E-rate program. The Department of Education (DOE) and the Institute for Museum and Library Services (IMLS) are charged with ESEA and LSTA enforcement respectively, but a school or library receiving E-rate discounts and ESEA or LSTA funding needs to comply with CIPA's E-rate requirements to obtain funding from any of the programs. Schools not receiving E-rate discounts, must certify that they have an Internet Safety Policy in place in order to receive ESEA funding that will be used for Internet access; public libraries not receiving E-rate discounts must certify that they have an Internet Safety Policy in place in order to receive LSTA funding that will be used for Internet access.

It is not possible to discuss all of the available blocking and filtering products in this TechNote. The eight that appear to have been most widely adopted by libraries are discussed herein. For additional objective evaluation of blocking and filtering products, consult a report by Australia's CSIRO for NetAlert and the Australian Broadcasting Authority at www.aba.gov.au/Internet/research/filtering/filtereffectiveness.pdf

All of the products were developed before CIPA, either as products for home use or for organizations seeking to control the activities of employees. They, therefore, block and filter words as well as images. All of the products contain a list of URLs that are blocked, but the list is often not available for review. Some also contain content analysis tools that filter. Only two use object analysis. For example, a graphic image with a great deal of flesh tones will be filtered. All of the products are password controlled. Online and telephone technical support is available for all of the products.

The products developed for home use are client-based; those developed for organizations are server based. However, two vendors of client-based products introduced a server option after CIPA was passed.

Blocking and Filtering Products

Best N2H2 is a server-based blocking product that can be run on a wide variety of platforms, including firewall servers and network servers. The company targets corporate and institutional users. Best employs a full-time staff to categorize Web content. The 45 categories include adults only, drugs, lingerie, nudity, personals, sex, swimsuits, and violence. More than 150,000 sites that are blocked. A purchaser can select the categories to be blocked. The product may be used to block e-mail and chat rooms. There is a 30-day free evaluation period, however,

the time and effort required to configure the product on a server make it a good idea to undertake careful screening by consulting reviewing media before undertaking a trial.

A study by eTesting Labs for the U.S. Department of Justice in 2001 determined that N2H2 had the highest accuracy rate of any product it tested. It blocked 98 percent of the inappropriate sites used in the test. The study report does not appear to be available.

The author's own experience with N2H2 is that it blocks a lower percentage of non-pornographic sites than others.

CyberPatrol 6.1 is a client-based blocking and filtering product developed to be run on Windows 98/Me/NT/2000/XP PCs. While it targets home users, it has been purchased by a number of small libraries because it is relatively inexpensive. Its list price is \$39 for a one-year subscription. The price includes software updates to CyberList, a "blacklist" of unacceptable sites, and online or telephone support. A 14-day free trial is available for evaluation.

The CyberList sorts sites into a number of content categories, including partial nudity, full nudity, sexual acts/text, gross depictions/texts, sex education, and drugs/drug culture. All categories are blocked by default, but a purchaser can select the categories that are to be accessible without blocking. There are also settings that restrict access to e-mail, chat rooms, and newsgroups. The product also does filtering using keyword analysis in content. It is also possible to enter specific words that are to be filtered.

A server based option is now available to larger libraries. Prices are quoted on request.

CyberSitter 2003 is a client-based blocking and filtering product designed to be run on a PC with Windows 95/98/Me/NT/2000/XP. While it targets home users, it has been purchased by a number of small libraries because it is inexpensive, takes very little disk space, and easy to install. The list price is \$39.95 for a single computer license, \$59.95 for two, \$74.95 for three, \$99.95 for five, and \$199.00 for ten licenses. There are free list updates for one year. A two-year subscription to program upgrades is \$20. The program takes just 3.0 MB of disk space. Even though there are 30 categories of filtering, the menus are simple.

The subscription service not only uses a list of sites that deal with sex, drugs, hate, and violence, but also uses a content recognition system on sites that are not on the list. It filters access or will allow access after deleting words and phrases that appear to be objectionable. This can make a page impossible to read. The content recognition also results in a somewhat higher error rate than with a list of sites that have been examined by a vendor's staff. There is a way to add sites to block and there is a mechanism for overriding blocked sites. It can be set to filter out words in newsgroups, mail, chat, or messaging programs. URLs that have been blocked, but that are deemed suitable for minors, can be added to a "white list" so that they will not be blocked in the future. There is a simple on/off switch that can be accessed by someone with the appropriate password.

CyberSitter has won *PC Magazine's* Editor's Choice award for several years in a row.

A server-based option is available to larger libraries. The company quotes prices on request.

CybraryN Solutions Libraries that want only the blocking and filtering module and do not have a Dynix or VFLS system should deal directly with Fast Data Technology as that will result in a lower price. Pricing begins at 25 concurrent users and goes to a site license for more than 1,000 concurrent users. There is no published price list. FastTracker is also available as a hosted service.

FastTracker uses not only a URL list, but also a content analysis tool. The company estimates that 75 percent of the sites that are blocked are on its list, and 25 percent are filtered as the result of content analysis. There does not appear to be a word list available, nor is there a way of permitting access to sites that contain words that are objectionable for reasons other than pornography. Its 30 categories are unusually broad, including job search and shopping sites. That is due to the fact that the product was developed for organizations that are concerned about staff time lost due to surfing of the Internet that is not work-related. One of the claimed advantages of FastTracker is that policies for staff users can be set differently than for patrons, and extensive reports are provided on where users went and for how long.

I-Gear 3.5 is a server-based blocking and filtering product that can be run on a Windows NT Server 4.0 or later, Sun Solaris 2.x server or later, or Red Hat Linux server 5.2 or later. It groups Web sites it has examined into 27 categories that can be blocked or not blocked. In addition it uses a Dynamic Document Review (DDR) that examines incoming text using key words and phrase that have both positive and negative weights. The resultant points score for a document is compared with threshold to determine whether the document should be filtered. Updates are available online via a single button click or the updates can be set to download automatically as they are released.

Prices are quoted after a library submits information about its size. They are negotiable.

McAfee Parental Controls 1.0 is a client-based blocking and filtering product that can be used on any PC or Mac. It is priced at \$49.99, but is most often sold as part of McAfee InternetSecurity 5.0, a \$79.99 package that includes antivirus, firewall, and privacy features. The price includes free updates and free technical support for life.

The product has both a blocked-sites list and a word filter for detecting inappropriate content. Each can be locally edited. This gives librarians the opportunity to improve the accuracy of the blocking and filtering. It can filter pop-up ads and file sharing services. A unique feature of the product is object analysis. Unfortunately, it does not differentiate very well between famous paintings and pornography.

NetNanny 5.0 is a client-based blocking and filtering product designed to be run on Windows 98/93SE/ Me/ NT 4.2/XP PCs. It targets home, school, and library users. It is inexpensive at \$39.95 list, but it requires substantially more computer resources than its major competitors. It requires a minimum of 32 MB of RAM and 60 MB of hard drive space. While earlier versions required a tedious manual set-up, the current release is self-installing. It defaults to the most secure setting.

There are built-in lists of URLs and permitted and restricted words that can be modified by someone with an appropriate password. New lists of URLs can be downloaded manually or automatically on a daily, weekly, or monthly basis. It is possible to add URLs locally. Quota-based filtering makes it possible to filter Web pages containing more than a specified number of restricted words from the

complete word list. An option allows access to be limited to sites that have been specifically authorized. A "Can Go" list of 3,000 Website recommended for children is available.

One unique feature is that it includes object analysis. As is the case with McAfee Parental Controls 1.0, it does not reliably differentiate between art and pornography. Another unique feature is that it can prevent family names, addresses, phone numbers and credit card numbers being sent from the PC.

Websense Enterprise is a server-based product that was developed for Fortune 500 companies to enable them to improve productivity and security. It manages Internet access, blocks peer-to-peer file sharing, and blocks undesirable sites using a large database of URLs that is updated daily. There are 88 categories. Particularly useful is the separation of sex and sex education sites. A companion product called Websense Enterprise Reporter has more than 80 pre-defined report templates.

The server can be a Pentium III or greater processor with 512 MB of RAM or a Sun Ultra 10 Processor with 512 MB of RAM. The operating system can be Windows 2000 or 2003 Server, Red Hat Linux 8.0-9.0, or Sun Solaris 2.6-9.

The product is suitable only for libraries that have a large number of workstations because the license fee is \$15,000 a year. A single license covers up to 1,000 workstations.

Questions to Ask of Vendors

The American Library Association's E-rate Task Force has developed a list of questions to ask vendors. There were 70 questions on the list as of March 1, 2004. Each question will not be relevant for all libraries. The list is available at

Related Files

PLA is a division of the American Library Association. Copyright Statement.

PLA Tech Note prepared by Karen Schneider

The ACLU challenged COPA on behalf of a group of plaintiffs who provide, commercial content for the Internet or who received such content. The trial court found the law unconstitutional on First Amendment grounds. ~~The Third Circuit Court of Appeals~~ agreed that the law was unconstitutional, but said it was unconstitutional because of its reliance on "contemporary community standards." This made the law overbroad.

The U.S. Supreme Court reversed the Third Circuit's decision on May 13, 2002, on very narrow grounds. The Supreme Court did not decide on the constitutionality of COPA, finding only that COPA's reliance on "community standards" does not by itself make the law unconstitutional. As a result, the Supreme Court returned the matter to the Third Circuit Court of Appeals for a fuller consideration of the First Amendment issues raised by COPA's restrictions on Internet speech. All nine justices agreed that the injunction preventing any enforcement of COPA must remain in place while the lower courts further examine COPA's constitutionality.

Because COPA addresses only material sent over the Internet for commercial purposes, it does not directly affect libraries. FTRF joined an *amicus curae* brief in support of the parties' First Amendment argument.

ALA v. United States (Children's Internet Protection Act)

The **Children's Internet Protection Act (CIPA)** requires libraries and schools to install filters on their Internet computers to retain federal funding and discounts for computers and computer access. Because this law directly affected libraries and their ability to make legal information freely available to their patrons, the American Library Association and the Freedom to Read Foundation filed a lawsuit to overturn CIPA, but the Supreme Court on June 23, 2003, in a 6-3 decision, upheld the constitutionality of the Children's Internet Protection Act (CIPA). Although it does not make the case easier to bear, the decision in *United States v. American Library Association* was a plurality decision. [According to "The Modern Problem of Supreme Court Plurality Decision: Interpretation in Historical Perspective" by Adam S. Hochschild, "problems arise when there is less than a clear majority speaking for the Court—when the leading opinion of the Court is a plurality opinion. A Supreme Court plurality decision holds ambiguous precedential value. . . . [A] plurality opinion, which represents the rationale of less than half of the Justices, is . . . problematic. A majority opinion may command more authority than a plurality decision, but precisely what authority does a plurality decision command? In other words, how should courts apply a plurality decision to subsequent controversies involving similar issues?]

Justices Kennedy and Breyer, who joined in Rehnquist's conclusion, but not the reasoning behind it, may have given ALA "loopholes" to move forward.

The decision indicates that CIPA is constitutional for children, but not for adults. Kennedy was very specific in his opinion, saying he would not have voted to uphold CIPA if he had not been assured that CIPA does not apply for adults.

During the U.S. Supreme Court argument, Solicitor General Theodore Olsen opened his remarks by saying that anytime an adult patron wants unfiltered access to a computer, he or she may ask a librarian to disable the filter, and the librarian will do so. His statement was contrary to what CIPA states, which is that a librarian "may" disable a filter "for bona fide research or other lawful purpose."

Kennedy also implied it is now incumbent on the filtering companies to develop a disabler that is both easily and quickly applied; he further implied that if the filtering companies do not do this, ALA may have a cause of action against the filtering companies. Kennedy also said that while CIPA may be constitutional on its face, it may not be constitutional in an "as applied" library setting.

Brief History of CIPA

The three-judge panel sitting in the Eastern District of Pennsylvania issued a decision on May 31, 2002, holding that the CIPA statute is facially unconstitutional and violates the First Amendment. They held that "we are constrained to conclude that the library plaintiffs must prevail in their contention that CIPA requires them to violate the First Amendment rights of their patrons, and accordingly is facially invalid"; the three-judge panel ruled Sections 1712(a)(2) and 1721(b) of the Children's Internet Protection Act to be facially invalid under the First Amendment and permanently enjoined the government from enforcing those provisions.

Because the three-judge panel permanently enjoined the FCC and LSTA from withholding funds from public libraries who have chosen not to install filters on all

terminals, public libraries thus are not required to install filters on their computers in order to receive funds from either agency.

The opinion was unanimous. The opinion was written by Chief Judge Becker of the Third Circuit and joined by U.S. District Judges Fullam and Bartle.

The Court held that the CIPA statute is unconstitutional because the mandated use of filtering on all computers will result in blocked access to substantial amounts of constitutionally protected speech.

The Court found that filters both overblock (block access to protected speech) and underblock (allow access to illegal or unconstitutional speech).

The Court held that less restrictive alternatives exist to allow public libraries to protect children from material that is illegal for them to access. The Court found that public libraries can—and indeed that many do—use the following less restrictive alternatives:

1. Filters offered as a choice for families to use for their own children at the public library;
2. Education and Internet training courses;
3. Enforcement of Internet Use policies by library staff; and
4. Placement of terminals, use of privacy screens or utilization of recessed monitors.

According to a Jenner & Block memorandum dated June 18, 2002, the three-judge panel in the CIPA case held that the FCC and IMLS cannot withhold funds on the ground that a public library has failed to install mandatory filters on every computer. The Court held that "[b]ecause of the inherent limitations in filtering technology, public libraries can never comply with CIPA without blocking access to a substantial amount of speech that is both constitutionally protected and fails to meet even the filtering companies' own blocking criteria." While this decision is directly binding only on the agencies and is not a directive to any particular library, the factual findings and legal conclusions of the Court may serve as useful precedents for other lower courts. ALA thus urges any library using mandatory filtering software to consult with legal counsel to reevaluate their Internet Use Policy and assess the risk of future litigation.

The Justice Department, acting on behalf of the Federal Communications Commission and the U.S. Institute of Museum and Library Sciences, formally notified the Supreme Court on June 20 that it would appeal this ruling.

ALA Press Releases on CIPA

Latest Information on CIPA

The Children's Internet Protection Act (CIPA) designates federal funding for libraries that install filters on all its computers. Libraries that do not accept federal funding do not have to install filters. That is, the Supreme Court's opinion has no effect on libraries that are not covered by CIPA (i.e., libraries that do not receive e-rate discounts or LSTA funds for the provision of public Internet access).

Potential Legal Challenges to the Application of the Children's Internet Protection Act (CIPA) in Public Libraries: Strategies and Issues by Paul T. Jaeger and Charles R. McClure

For additional information on CIPA, see ALA's CIPA Web Site, Public Libraries and the Children's Internet Protection Act (CIPA): Legal Sources, CIPA Supreme Court Decision.

See also Filters and Filtering.

Links to non-ALA sites have been provided because these sites may have information of interest. Neither the American Library Association nor the Office for Intellectual Freedom necessarily endorses the views expressed or the facts presented on these sites; and furthermore, ALA and OIF do not endorse any commercial products that may be advertised or available on these sites.

Sec. 11.61.128. Electronic distribution of indecent material to minors.

(a) A person commits the crime of electronic distribution of indecent material to minors if
(1) the person, being 18 years of age or older, knowingly distributes to another person by computer any material that depicts the following actual or simulated conduct:

- (A) sexual penetration;
- (B) the lewd touching of a person's genitals, anus, or female breast;
- (C) masturbation;
- (D) bestiality;
- (E) the lewd exhibition of a person's genitals, anus, or female breast; or
- (F) sexual masochism or sadism; and

(2) either

- (A) the other person is a child under 16 years of age; or
- (B) the person believes that the other person is a child under 16 years of age.

(b) In this section, it is not a defense that the victim was not actually under 16 years of age.

(c) Except as provided in (d) of this section, electronic distribution of indecent material to minors is a class C felony.

(d) Electronic distribution of indecent material to minors is a class B felony if the defendant was, at the time of the offense, required to register as a sex offender or child kidnapper under AS 12.63 or a similar law of another jurisdiction.

((2 ch 97 SLA 2005; am 6 ch 24 SLA 2007))

Effect of amendments. The 2007 amendment, effective July 1, 2007, added the paragraph (a)(1) and (a)(2) designations, substituted "the following actual or simulated conduct:" and paragraphs (a)(1)(A) - (F) for "an act described in AS 11.41.455(a)(1) - (7)" in paragraph (a)(1), and added "either" near the beginning of paragraph (a)(2), and made related changes.

Effective dates. Section 2, ch. 97, SLA 2005, which enacted this section, took effect on November 28, 2005.

Editor's notes. Section 5, ch. 97, SLA 2005, provides that this section applies "to offenses occurring on or after November 28, 2005."

Section 36(b), ch. 24, SLA 2007, provides that the 2007 amendment of (a) of this section applies "to acts committed on or after July 1, 2007."

HB

356

HFIN

FILE

FISCAL NOTE

STATE OF ALASKA
2008 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: C5HB 356(CRA)
(H) Publish Date: 2/29/08

Identifier (file name): HB356-CED-CRA-02-25-08 Dept. Affected: DCCED
Title: Muni Tax Exemptions: Alaska Native Claims Settlement Act RDU: Comm Asst & Ec Dev (405)
Component: Community & Regional Affairs
Sponsor: Stoltze, Thomas
Requester: House Community and Regional Affairs Component Number: 2879

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

	Appropriation Required	Information						
		FY 2009	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
OPERATING EXPENDITURES								
Personal Services								
Travel								
Contractual								
Supplies								
Equipment								
Land & Structures								
Grants & Claims								
Miscellaneous								
TOTAL OPERATING		0.0	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES								
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CHANGE IN REVENUES ()								
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts								
1003 GF Match								
1004 GF								
1005 GF/Program Receipts								
1037 GF/Mental Health								
Other Interagency Receipts								
TOTAL		0.0	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2008) cost: _____

POSITIONS

Full-time								
Part-time								
Temporary								

ANALYSIS: (Attach a separate page if necessary)

This legislation would expand the list of property exempt from municipal taxation to include certain real property of native corporations conveyed under the Alaska Native Claims Settlement Act (ANCSA) when it is exchanged with a municipality and not leased or developed.

While this legislation has no fiscal impact on the operations of the division, it would have the potential of creating a positive economic impact on local municipalities. It would allow municipalities and native corporations to exchange lands without immediate property tax consequences. This exchange of lands could expedite development of lands by the native corporations in exchange for lands which the municipality may need for public uses, such as recreational uses and public schools.

Prepared by: Tara Jollie, Director
Division: Community and Regional Affairs
Approved by: Emil R. Notti, Commissioner
Commerce, Community, and Economic Development

Phone: 907.269.7959
Date/Time: 2/25/08 2:40 PM
Date: 2/25/2008

ALASKA STATE LEGISLATURE

Vice Chair:
House Finance Committee

Chair:
House Finance Subcommittees for:
Department of Public Safety
Department of Law



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BILL STOLTZE

State Representative

Representative_Bill_Stoltze@legis.state.ak.us

House Bill 356

Municipal Property Tax Exemption

"An Act relating to an exemption from the municipal property taxes for certain real property that is exempt from levy and collection of real property taxes when conveyed by the federal government to implement the Alaska Native Claims Settlement Act or when conveyed under a land exchange authorized by that Act involving land or an interest in land that is made exempt from local property taxes by that Act; and providing for an effective date."

Land conveyed under the Alaska Native Settlement Act (ANCSA) is exempt from taxation so long as it is not leased, developed, or sold. However, when ANCSA was amended to include the automatic land bank tax exemptions Alaska's municipal tax exemptions were not updated to include these lands. These lands are currently exempt from federal and state taxation, but not from municipal taxation. This legislation seeks to update

In addition, some municipalities in Alaska have taken the position that land a Native corporation receives in an exchange with a municipality may not stay exempt under state law. Thus, these municipalities have advised Native corporations that exchanged land the corporation receives from the municipality will be subject to real estate taxes.

This legislation will provide benefits for all municipalities in Alaska who wish to enter into land exchanges with Native villages and regional corporations. Many discussions of exchanges have died in the past when the municipality and Native corporations realized that current state law created this real estate tax issue. If this legislation is passed, those exchanges can be revisited by the affected parties, and exchanges benefiting both parties can be made.

DISTRICT 16

BIRCHWOOD • BUTTE • CHUGIAK • EKLUTNA • FAIRVIEW LOOP
KNIK RIVER ROAD • LAZY MOUNTAIN • PALMER • PETERS CREEK



Representative Bill Stoltze
Alaska State Legislature
Attn: Ben Mulligan
State Capital Room 501
Juneau, AK 99801-1182

Re: Letter of Support for HB 356

Dear Representative Stoltze:

I am writing, on behalf of Cook Inlet Region Inc., to express the company's strong support for HB 356, which would extend to municipal land trades the same tax treatment which ANCSA corporations receive in the case of land trades with the state and federal governments. The legislation is not only a basic fairness measure, in terms of creating parity with the state and federal tax schemes, it is also a practical, "win-win" solution which will give municipalities the opportunity to improve the quality of municipal parklands and other public landholding for the benefit of their residents.

The Alaska Native Claims Settlement Act of 1971 ("ANCSA") distributed 40 million acres of land in Alaska among 12 regional corporations and more than 200 village corporations owned by Alaska Native groups. The Act provided that ANCSA land, so long as it remained undeveloped, was not subject to taxation. From the earliest days of implementation of the Act, it became apparent there was value in permitting, and even encouraging, land trades between ANCSA corporations and public agencies where public ends could be served by such trades. Accordingly, federal law, initially through amendments to ANCSA and later in provisions of the Alaska National Interest Lands Conservation Act (ANILCA), ensured that such trades could occur without altering the basic tax protections afforded under ANCSA. It did so by extending ANCSA's tax protections to land traded with the state or federal government in exchange for ANCSA land. These measures have allowed hundreds of thousands of acres to be added to state and national parks, to highway and road systems and to other public improvements. They have also facilitated responsible development of lands which would not otherwise have been available for development, providing valuable benefits to the state and to the Alaska Native community in the form of jobs, tax revenue and other benefits.

The federal provisions have never expressly addressed municipal land trades, and the state's taxing scheme, while exempting ANCSA land, does not expressly exempt land traded by a municipality in exchange for ANCSA land. As a result, ANCSA corporations may be reluctant to trade land with a municipality, even where valuable public purposes could be achieved by such trade. A case in point is the proposed land trade between Eklutna, Inc. and the Municipality of Anchorage, in which the Municipality hopes to gain

from Eklutna a critical local access route to Chugach State Park. ANCSA corporations such as Eklutna are, understandably, reluctant to trade a parcel which is tax-free under ANCSA for one of equal value that may be immediately subject to taxation. Eklutna is not alone. CIRI, too, is a large holder of ANCSA lands in the Anchorage vicinity and has at various times had discussions with the City about possible land exchanges which could make lands available for parks, recreation and other public uses. The lack of any express provision, like HB 356, which authoritatively addresses the tax question, stands as a substantial barrier to such trades.

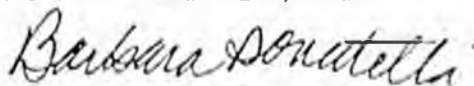
Finally, it is important to keep two additional points in mind. First, this measure does not force any land trade; any such trade would still be required to go through a full public vetting process before it could be completed. Second, the measure creates no net loss of property tax revenue; leaving the current system in place means that ANCSA corporations will simply hold on to their tax-free parcels, with the unfortunate result that the public purposes of proposed land exchanges will not be achieved.

In summary, we believe HB 356 is an important clarification of state tax law related to taxation of ANCSA lands which will serve valuable public purposes. CIRI strongly supports the measure and urges its adoption.

Thank you for the opportunity to comment on this measure.

Sincerely,

COOK INLET REGION, INC.



Barbara A. Donatelli,
Senior Vice President, Administration and Government Relations

Baldy problems might be solved

By GREG DART

Alaska Star

Barricades blocking parking at the Mount Baldy trailhead were to be removed by today, according to city officials.

Robin Ward, director of municipal real estate services, said hikers to Mount Baldy no longer have to trespass across Paula Caywood's land to access the trail, under terms of a lease agreement reached Monday between the Municipality of Anchorage and Caywood. An easement for foot traffic through Caywood's land was also included in the deal, which was to be signed Wednesday.

"It's a win-win situation for everybody," Caywood said Tuesday.

Hikers are still required to have a free permit to cross Eklutna Inc. land. To get to Chugach State Park from the trailhead, hikers cross both Eklutna and Caywood land.

Terms for the six-month lease were not disclosed by press time. The lease also includes an optional six-month extension.

An agreement was reached in principle several months ago, but negotiations ceased between Caywood and the city last month before beginning again last week.

Access to Mount Baldy has been in limbo since October when Caywood applied to rezone 40 acres of land, part of which was the traditional trailhead and parking area, which holds a dozen or so vehicles. Caywood was granted the rezone and given the go-ahead to build six homes.

The deal should give the city and Chugach State Park time to establish a permanent trailhead in the area, said Ward.

That process also took a step forward Friday when the city and Eklutna reached a memorandum of agreement to pursue a land swap. The city is hoping to obtain 80 acres south of the traditional Mount Baldy Trailhead, which would then be acquired by the state to build a permanent parking area.

"Our board voted, approved and signed a memorandum of agreement," said Curtis McQueen, spokesman for Eklutna. "There is a lot that still needs to happen, but we are moving forward and we all have the same goal."

Before a land swap is completed with Eklutna, parcels must be identified and appraisals of all involved land must be completed. The deal may also have to go before voters.

One of the municipal pieces of land that Eklutna is pursuing includes access through designated park land near Mirror Lake Middle School. Any changes that deal with park land must be voter approved.

Ward said it was too early to discuss publicly what land might be swapped with Eklutna. She said as negotiations move forward, more details will be released.

Reach the reporter at greg.dart@alaskastar.com.

This article published in The Alaska Star on Thursday, August 18, 2005.

Mount Baldy agreement signed; access still unclear

By GREG DART
Alaska Star

Barricades blocking the Mount Baldy trailhead and parking lot were removed last week - though it might not seem that way to hikers attempting access to the alpine slopes of Chugach State Park.

The city and a local landowner officially announced Monday that they reached a lease agreement to maintain temporary parking and access over private land.

The traditional Mount Baldy access is at the top of Skyline Drive near where it turns into Wallace Mountain Road.

Those who drive there now will find the dirt parking area. But it may not be completely clear where the trail goes from there, said Anchorage Assemblywoman Debbie Ossiander of Chugiak.

"People still have to go under or around the gate (which blocks the road)," said Ossiander. "If you have never been up there before it might not be clear that is where access is being granted."

That's because people who arrive at the parking lot will find that the two paths that lead to the mountain are both blocked. The bottom path is fenced to help control erosion. The other path is the continuation of Wallace Mountain Road, which is closed off by a locked, metal gate. Although a "Private Property" sign still adorns the gate, officials say access is permitted under or around the other side of the gate.



"I think most people up in the area know where they can go," said John Rodda, director of the Eagle River-Chugiak Department of Parks, Recreation and Community Development.

However, hikers also must obtain permission from another landowner in the area, Eklutna Inc., in the form of a free permit.

Access to the hiking area was put in jeopardy last year when landowner Paula Caywood applied for a rezone of 40 acres for a subdivision. Part of the land has for years been used as the parking lot and trailhead for Mount Baldy.

The city last week reached a lease agreement with Caywood paying her a lump sum of \$3,000 to lease the trailhead land for six months.

Hikers at the Mount Baldy trailhead must go around this gate to gain access to the permitted access in the area.

STAR PHOTO BY GREG DART

The city also reached a memorandum of understanding with Eklutna in regards to a trade that would provide land to the city for a permanent trailhead and parking area. That parking area will likely be built next year above the current trailhead. Caywood has agreed to provide a permanent easement to the parking area.

This article published in The Alaska Star on Thursday, August 25, 2005.

Voters OK Baldy swap Begich wins; most bonds fail

By KATE TRACY
Alaska Star

Voters approved a land swap Tuesday that should restore public access to Mount Baldy.

Also winning easily in the municipal election was Mayor Mark Begich with more than 55 percent of the vote over Jack Frost, Thomas Higgins and Nick Moe.

Voters said "no" to municipal-wide bond propositions with property tax increases attached, including those concerning public safety, parks, the 4th Avenue Theatre and education.

The three percent sales and use tax measure was rejected by more than 70 percent of voters. More than 55 percent voted down the charter amendment authorizing traffic violation enforcement by municipal peace officers.

A precinct-by-precinct tally that would show how Chugiak-Eagle River voted in relation to the rest of the Municipality of Anchorage was not available in time for publication.

Proposition 5 paves the way for the city to trade 20 acres in Edmonds Lake Park to Eklutna for 80 acres adjacent to Chugach State Park to be used for parking and access to the Mount Baldy trailhead.

About 62 percent of voters approved the deal.

John Rodda, Eagle River/Chugiak Parks, Recreation and Community Development director, said voter approval is the initial step in a four-part land exchange driven by Mount Baldy access issues.

Access to Mount Baldy has been in limbo since October 2004 when Paula Caywood applied to rezone 40 acres of her land off of Skyline Drive and was given the go-ahead to build six homes.

A portion of the property has been used for decades as an unofficial, unimproved parking lot to access The Mount Baldy and Chugach State Park.

Last year, barricades came and went as negotiations continued. The city and Caywood have a lease agreement to maintain temporary parking and access over private land, which expires Aug. 21.

The four-part exchange includes trading eight acres of municipal land in the southeast corner of northwest quarter of Section 25 adjacent to Beach Lake Park to Eklutna for about 15 acres in the Powder Reserve development as a future elementary school site.

The city and Eklutna reached a memorandum of agreement last August to pursue the land swap.

Local activists expressed concern that the initial land swap approved by voters, which comes at no cost to taxpayers, is really no deal at all.

Ann Newbury, an active member of the Birchwood Community Council for 28 years, opposed the ballot proposition saying it's a mistake to give away parkland.

"I'm very sad for the community. We're only beginning the battle of what is really going to happen," Newbury said, adding she fears the vote sets a precedent for giving away parkland with little thought to long-term consequences.

Assemblywoman Debbie Ossiander of Chugiak supported the ballot proposition.

"If this hadn't happened it would have been extremely difficult to move forward. This would have stopped all discussion of land trades if it had failed. So, I'm pleased. This is basically an endorsement of that approach we're going," she said.

But the deal isn't done yet.

According to final appraisals, "80 acres of Mount Baldy has fair market value equal to 47 acres of Edmonds Lake Park," Rodda said, adding that municipal land holder Heritage Land Bank will work with Eklutna to make up the 27-acre difference.

"Twenty acres is the maximum that can come out of Edmonds Lake Park," he said.

"We're not done," Ossiander said. "I wrote a resolution that said there would be a five-member advisory group of Chugiak-Eagle River people to weigh in on how this trade finishes up."

That resolution, passed by the Anchorage Assembly March 28, identified other HLB parcels that could make up the appraisal difference.

Ossiander said the assembly will approve final agreements.

Rodda said Parks and Recreation has \$294,000 appropriated for the Mount Baldy trailhead project, which can be used for development.

Nearly 60 percent of voters also approved a long-term lease of the golf course at Russian Jack Park and disposal of 69 acres of parkland for a 38-acre tract adjacent to South Anchorage Ball Fields. Like the Mount Baldy exchange, neither result in property tax increases.

More than 99 percent of voters in the Chugiak Fire Service area elected John Holmquist to fill Board of Supervisors Seat B.

Results of Proposition 26, voted on by citizens residing in the Tablelands Subdivision in Chugiak regarding a new streetlight service in the area, were not available in time for publication.

This article published in The Alaska Star on Thursday, April 6, 2006.

City and Eklutna inch closer to Mount Baldy deal

By DARRELL L. BREESE
Alaska Star

Completion of a land swap deal between Eklutna Inc. and the Municipality of Anchorage to create a public access and parking area at Mount Baldy took a big step toward becoming a reality Feb. 14.

Representatives from the two parties signed a Memorandum of Understanding stating they both will make a mutual effort to reach a binding agreement to complete the land exchange approved by voters in 2006.

But there is a catch, to make up the difference in land values for parcels being traded, Eklutna wants more than \$320,000 cash up front.

Recent appraisals, completed by the municipality, show the fair market value of the 80-acre Eklutna-owned parcel adjacent to Chugach State Park is approximately \$1.4 million. The 20-acre municipal-owned Edmonds Lake Park parcel plus the 7.95-acre access parcel have a fair market value of \$815,218, leaving a \$611,782 difference.

A state legislative grant of \$290,000 for Mount Baldy access eliminates some of the deficit, but it still leaves the municipality \$321,782 short of completing the deal.

Eagle River-Chugiak Parks, Recreation and Community Development director John Rodda said the municipality will have to come up with the difference to satisfy the conditions of the Memorandum of Understanding.

"Basically, both parties have agreed to agree," Rodda said. "Now it is up to the municipality to meet the conditions of the land exchange the Eklutna board of directors has placed on the deal. And that means cash for the difference in property values."

Rodda said Eklutna was offered proceeds from the lease of the Eklutna Radio Tower over the next 30 years to make up the difference, but the Eklutna Board rejected that offer instead requesting the cash up front.

Access to Mount Baldy was limited in 2004, when landowner Paula Caywood applied to rezone 40 acres of land, part of which was the traditional trailhead and parking area. After being granted the rezone, a gate was placed on the property, keeping hikers away from the trails.

Attempts to negotiate a lease with Caywood broke down, leading the city to turn to Eklutna for access to the Mount Baldy trails and into Chugach State Park.

Sen. Fred Dyson praised the cooperative effort of both the parks and rec department and Eklutna in bringing negotiations for the land exchange to this point.

"We have one of the largest state parks in the world right out our back door," Dyson said. "It's a shame that the state hasn't provided better access to it. It's encouraging to see the mayor and Eklutna sitting down to provide the people access to a true treasure of the community."

Dyson and the other local legislators have already secured a \$290,000 grant for the deal, but when asked by Rodda during a Feb. 17 Legislative Town Hall meeting, Dyson wasn't sure if the additional funding would be available.

"I'm not sure we can get it into the budget this year," Dyson asked Rodda. "Could you look to other sources of funding? Maybe sell revenue bonds? I would encourage you look explore other funding options."

The Memorandum of Understanding is binding for one year, then it expires unless both parties can agree to an extension.

"If we can find the money, we have a deal," Rodda said. "The clock is ticking, but Eklutna said that if the money could not come from the state, they would be willing to wait. However, the longer this goes on, the reality of completing the deal fades."

Reach the reporter at darrell.breese@alaskastar.com.

This article published in The Alaska Star on Thursday, March 1, 2007.

Details all that remain for Mount Baldy land swap

\$375,000 state grant secured to complete deal for public access

Aug. 16, 2007

By DARRELL L. BREESE

Alaska Star

Eagle River-Chugiak Parks, Recreation and Community Development Director John Rodda said a \$375,000 state grant puts the Municipality of Anchorage on course to satisfy the conditions of the memorandum of understanding with Eklutna Inc. that will provide access to Mount Baldy, but he cautioned that there are still some things that need to be worked out before the deal becomes final.

"The devil is in the details," Rodda said. "We don't have a final agreement with Eklutna yet, because we are looking for documents that show access to Mount Baldy through the Wallace property beyond the Eklutna land involved in the swap."

Rodda did however say the state grant was a big piece of the puzzle needed to complete the deal.



"We're 95 percent done," he said. "The state funds have been secured and came to the city. Once we iron out the details, we'll have an agreement we can present to the mayor and (Anchorage) Assembly before signing off on the deal.

"We're trying to make the entire process of this deal as transparent as possible," Rodda continued. "We want to keep everything aboveboard and open for review throughout the process."

The Municipality of Anchorage appears to be on track for meeting the conditions of a memorandum of understanding with Eklutna Inc., which will provide access to Mount Baldy. Access to Mount Baldy was limited for outdoor enthusiasts in 2004 when landowner Paula Caywood applied to rezone 40 acres of land adjacent to Chugach State Park, where the established trailhead and parking area was located.

Access to Mount Baldy was limited in 2004 when landowner Paula Caywood applied to rezone 40 acres of land adjacent to Chugach State Park, which was the traditional trailhead and parking area. After being granted the rezone, a gate was placed on the property, keeping hikers away from the trails.

Attempts to negotiate a lease with Caywood broke down, leading the city to turn to Eklutna for access to the Mount Baldy trails.

The \$375,000 state grant is necessary to make up the difference in appraisals for the land being exchanged to provide the public a trailhead and parking area for the popular recreation spot.

Municipal and Eklutna officials signed a memorandum of understanding Feb. 14 stating they will make a mutual effort to reach a binding agreement to complete the land exchange approved by voters in 2006.

Recent appraisals completed by the municipality show the fair market value of the 80-acre Eklutna-owned parcel adjacent to Chugach State Park is approximately \$1.4 million. The 20-acre municipality-owned Edmonds Lake Park parcel plus the 7.95-acre access parcel have a fair market value of \$815,218, leaving a \$611,782 difference.

The remainder, after applying the state grant, will be paid for from the local parks and recreation budget.

"Basically, both parties have agreed to agree in the memorandum," Rodda said. "Now with the state funding, the municipality can meet the conditions of the land exchange the Eklutna board of directors has placed on the deal."

Rodda said while there are still some details to be worked out, the deal is close to being final.

"I anticipate we're probably close to having things ready for approval by mid- to late September," he said. "We have to work through the process on each little detail to make sure we don't leave something out that will come back later and bite us."

Reach the reporter at darrell.breese@alaskastar.com.

Long-awaited Baldy land swap deal signed

City, Eklutna ink agreement for access to Chugach State Park

By DARRELL L. BREESE

Alaska Star

Three years of tension, filled with roadblocks, gates and limited access, came to an end Nov. 17, as the Municipality of Anchorage and Eklutna Inc. finalized a deal for a land swap that will ultimately provide public access to Mount Baldy.

Mayor Mark Begich and Eagle River-Chugiak Parks, Recreation and Community Development Director John Rodda attended the Eklutna Inc. Shareholders' Lunch Nov. 17 at the Downtown Marriott Hotel, where they signed off on the deal to trade 80 acres adjacent to the traditional Mount Baldy trailhead for nearly 28 acres near Edmonds Lake.

Eklutna Inc. CEO Curtis McQueen called the occasion of the signing a significant moment in the relationship between the municipality and Eklutna, adding that the Shareholders' Lunch was the perfect place to complete the deal.

"The setting was a wonderful backdrop to celebrate the cooperation between Eklutna (Inc.) and the municipality necessary to complete this deal," McQueen said.

In addition to Eklutna Inc. shareholders, Cook Inlet Regional Inc. (CIRI) President and CEO Margaret Brown attended the lunch.

"The synergy of the regional Native corporation and village corporation working with Anchorage is exciting," McQueen said. "They say Anchorage is the largest Native village, and the partnerships we've developed working together are a fine example of that."

Talks of the land trade began in 2006, when voters were asked to approve the trade of 20 acres of city land in Edmonds Lake Park to Eklutna for 80 acres adjacent to Chugach State Park to be used for parking and access to the Mount Baldy trailhead. During the April 2006 municipal election, 65 percent of voters approved the deal.

According to Rodda, the signing of the final agreement doesn't bring an end to the process.

"We still have a lot of work to do before we can formally close," he said. "Each of us has things to do. We have to formally survey and subdivide the Edmonds Lake parcel and identify the public easement so Eklutna can access the property through Edmonds Lake Park."

Rodda added Eklutna must also survey and identify existing public use easements on their Mount Baldy parcel.

"Another interesting thing about the Eklutna parcel is that CIRI owns the subsurface rights," he continued. "So we're asking that an agreement not to develop can be reached prior to closing. It'd be awful for us to have improved access and then have CIRI come in and start a mining operation."

Rodda said, a key element to making the deal possible has been the help from the State of Alaska and the efforts of the local legislative delegation, which secured \$375,000 to satisfy the conditions of the trade, making it an exchange of equal value for both parties.

The state grant is necessary to make up the difference in appraisals for the land being exchanged. The fair market value of the 80-acre Eklutna-owned parcel adjacent to Chugach State Park is approximately \$1.4 million. The 20-acre municipality-owned Edmonds Lake Park parcel, plus the 7.95 acres needed to access the parcel has a fair market value of \$815,218, leaving a \$611,782 difference.

Money from the local parks and rec budget will pay the remaining \$237,000 after the state grant money is applied to the deal.

Access to Mount Baldy was limited in 2004 when the owner of land adjacent to Chugach State Park applied to rezone the property, which had been used as the traditional trailhead and parking area. After a barricade was constructed blocking access to the portion of the property used for trail access, the municipality turned to voters to approve the land swap.

According to Rodda, there is still a long way to go before the deal is done, and that is delaying any major renovations to the trailhead by the parks and rec department.

"We're targeting June 28 for the final closing," he said. "That will give both sides the time necessary to get approval by the planning commission and tie up any loopholes. This process took much longer than anticipated, but we're nearing the end of the road."

As for Eklutna's plans for the property, McQueen said nothing is in the works.

"We have no immediate plans for the property," he said. "It will likely sit there for future generations to determine what to do with it 20 or 50 years from now."

McQueen did say Eklutna would get the parcel rezoned before adding it to their inventory of property.

Reach the reporter at darrell.breese@alaskastar.com.

This article published in The Alaska Star on Thursday, November 29, 2007.



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www.eklutnainc.com

February 12, 2008

Representative Bill Stoltze
Alaska State Legislature
Attn: Ben Mulligan
State Capitol Room 501
Juneau, AK 99801-1182

Re: Letter of support for HB 356

Dear Representative Bill Stoltze:

Eklutna, Inc. (Eklutna) supports the proposed House Bill 356. This proposed legislation will clear the way for land exchanges between Native corporations and Alaska Municipalities (all of the State's political subdivisions) to occur while maintaining the ANCSA real property tax exempt status for the Native corporations when the lands exchanged are similarly undeveloped.

Under the present statutory framework, when a Native corporation exchanges its ANCSA protected tax exempt undeveloped lands with a political subdivision of the state, there is no statutory provision that allows for the exemption to carry through to the land(s) received by the Native corporation in the exchange. This legislation will provide an exemption from real property taxation in such cases until said lands are developed.

In the case of the ongoing exchange of Eklutna's undeveloped Mt. Baldy land for a portion of the Municipality of Anchorage's (MOA) undeveloped Edmonds Lake Park land, Eklutna will be giving up ANCSA tax exempt land and receiving land that would be subject to real estate taxes. Both parties are frustrated by a lack of statutory authority to provide for a non-taxable status on the undeveloped lands Eklutna will receive in the exchange.

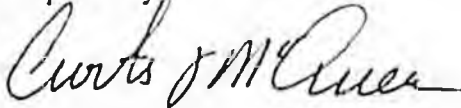
Eklutna has been approached by various municipal entities in the past, such as the Anchorage School District, Anchorage Police Department, Anchorage Fire Department and others looking to exchange MOA Heritage Land Bank lands with ours. There is a real strong disincentive for Eklutna to consider any exchange under these circumstances. This disincentive will negatively affect many potential exchanges of land between Native corporations and municipalities all over Alaska.

Eklutna believes that there are numerous opportunities for exchanges of land to take place between Alaskan Native corporations and political subdivisions of the State of Alaska. However, without the requisite statutory authority in place, some exchanges will never take place or be frustrated by the lack of ability to maintain the ANCSA tax exempt status the undeveloped Native lands provide.

Eklutna fully supports the efforts of the legislature to address and correct this important issue with the proposed legislation. The legislation will provide positive incentive for exchanges to occur between municipalities and Alaska Native corporations and provide benefits for all Alaska.

Thank you in advance for your consideration. If there are any questions, please contact us.

Respectfully,

A handwritten signature in cursive script, appearing to read "Curtis J. McQueen".

Curtis J. McQueen
Chief Executive Officer
Eklutna, Inc.

cc: Jim Arnesen, Corporate Lands and Regulatory Manager
Eklutna, Inc. Board of Directors
Keith Sanders, CIRI Legal Department

HB

357

HFIN

FILE

FISCAL NOTE

STATE OF ALASKA
2008 LEGISLATIVE SESSION

Fiscal Note Number: 2
Bill Version: C3HB 357(L&C)
(H) Publish Date: 3/4/08

Identifier (file name): HB357CS(L&C)-CED-INS-03-03-08 Dept. Affected: DCCED
Title Claims Against Real Estate Licensees RDU Insurance (116)
Component Insurance Operations
Sponsor Labor and Commerce
Requester House Labor and Commerce Component Number 354

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

	Appropriation Required	Information						
		FY 2009	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
OPERATING EXPENDITURES								
Personal Services								
Travel								
Contractual								
Supplies								
Equipment								
Land & Structures								
Grants & Claims								
Miscellaneous								
TOTAL OPERATING		0.0	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES								
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CHANGE IN REVENUES ()								
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FUND SOURCE (Thousands of Dollars)

	FY 2009	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
1002 Federal Receipts							
1003 GF Match							
1004 GF							
1005 GF/Program Receipts							
1037 GF/Mental Health							
Other Interagency Receipts							
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2008) cost: 0.0

POSITIONS

Full-time							
Part-time							
Temporary							

ANALYSIS: *(Attach a separate page if necessary)*

This legislation would require mandatory errors and omissions insurance coverage for real estate licensees. It would not impact the operations of the division.

Prepared by: Linda Hall, Director
Division: Insurance
Approved by: Emil R. Notti, Commissioner
Agency: Commerce, Community, and Economic Development

Phone: (907) 269-7900
Date/Time: 3/3/08 12:00 PM
Date: 3/3/2008

FISCAL NOTE

STATE OF ALASKA
2008 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: CSHB 357(L&C)
(H) Publish Date: 3/4/08

Identifier (file name): HB357CS(L&C)-CED-OL-03-03-08 Dept. Affected: DCCED
Title Claims Against Real Estate Licensees RDU Corp, Bus & Prof Licensing (117)
Component Corp, Bus & Prof Licensing
Sponsor Labor and Commerce
Requester House Labor and Commerce Component Number 2360

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

	Appropriation Required	Information						
		FY 2009	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
OPERATING EXPENDITURES								
Personal Services								
Travel								
Contractual								
Supplies								
Equipment								
Land & Structures								
Grants & Claims								
Miscellaneous								
TOTAL OPERATING		0.0	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES								
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CHANGE IN REVENUES (1156)								
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FUND SOURCE (Thousands of Dollars)

	FY 2009	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
1002 Federal Receipts							
1003 GF Match							
1004 GF							
1005 GF/Program Receipts							
1037 GF/Mental Health							
1156 Receipt Supported Services							
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2008) cost: 0.0

POSITIONS

	FY 2009	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Full-time							
Part-time							
Temporary							

ANALYSIS: *(Attach a separate page if necessary)*

This legislation amends AS 08.88 Real Estate Commission by requiring errors and omissions insurance for real estate licensees; renaming the real estate surety fund as the real estate recovery 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; and requiring a real estate licensee to maintain an office in the state.

This legislation allows the division to charge administrative costs to licensees for any administrative costs associated with the E&O insurance. Costs to be charged to licensees is unknown at this time; however, in accordance with AS 08.01.065 these costs will be recovered through the licensing fees collected.

Prepared by: Chris Wyatt, Administrative Officer
Division: Corporations, Business, and Professional Licensing
Approved by: Emil R. Notti, Commissioner
Agency: Commerce, Community, and Economic Development

Phone: (907) 269-7900
Date/Time: 3/3/08 12:14 PM
Date: 3/3/2008



ALASKA STATE LEGISLATURE

HOUSE LABOR & COMMERCE COMMITTEE

REP. KURT OLSON

Chairman
State Capitol, Room 17
Juneau, AK 99801-1182
(907) 465-2693 FAX 465-3835

Rep. Mark Neuman, V-Chair Rep. Carl Galto
Rep. Jay Ramras Rep. Berta Gardner
Rep. Gabrielle LeDoux Rep. Bob Buch

SPONSOR STATEMENT

CSHB 357 (L&C) Claims Against Real Estate Licensees

HB 357 enacts mandatory errors and omissions insurance for all real estate licensees and brokers, and changes the current surety fund system to a recovery fund. E & O Insurance is similar to professional liability insurance of other professions, as it covers the clients and customers in the event of an honest mistake or negligent error in a real estate transaction.

Currently there are two kinds of E & O remedies available: The first is voluntary E & O that covers brokers and licensees who choose to purchase the insurance; the second is the Surety Fund administered by the Real Estate Commission. Neither remedy offers the type of consumer protection necessary to protect the public in a transaction as large as purchasing a property. The Surety Fund system has been in place for 25+ years with very little modification. The industry has taken a good look at the current system and both licensee and agents agree the current Surety Fund system is broken. With the continual increase in property values and the high costs associated with home repairs the current limit of \$15,000 per claim is far too low. Most major home repairs today far exceed this \$15,000 limit. E & O Insurance would cover claims involving honest mistakes or negligent errors.

The purpose of this bill is to help protect the public by requiring every transaction to be covered, not just those where the agent has voluntarily purchased E & O insurance. As many of you are aware E & O insurance does not cover crimes such as fraud and conversion of trust, therefore, HB 357 converts the existing Surety Fund to a Recovery Fund and requires claims to be uncollectible judgments for acts requiring a license.

Mandatory E & O has been adopted by 13 other states. This bill requires the Real Estate Commission to make basic E & O insurance available at a reasonable rate to all licensees. Licensees may obtain their own E & O insurance provided it meets the minimum threshold amounts set by the Commission.

The Commission is responsible to ensure that applicants have the required E & O insurance in place before being issued a license.

Additionally, this act clarifies the requirement for a real estate office in Alaska to actually be in Alaska, as there are issues of regulatory supervision of licensees and consumer protection with cyber offices.



STATE OF ALASKA
DEPARTMENT OF
COMMERCE
COMMUNITY AND
ECONOMIC DEVELOPMENT

Sarah Palin, Governor
Emil Natt, Commissioner

Division of Corporations, Business and Professional Licensing

HB 357 – Real Estate E & O. Recovery Fund

Testimony given by Jennifer Strickler, Chief

Division of Corporations, Business and Professional Licensing on 2-11-08

The Division of Corporations, Business and Professional Licensing generally supports the reform of the surety fund.

The Division concurs with the recommendations of the September 7, 2007 report by Legislative Audit that the Alaska Real Estate Commission should continue until 2016 and that certain aspects of the surety fund should be changed.

However, the division would note that the bill as drafted would establish a mandatory errors and omission insurance program for all licensees as procured by the Real Estate Commission.

The division has worked with the Division of Insurance on the issues of E&O coverage as set out in the bill and would agree the bill needs to be amended.

1. Section 1, page 3, line 31, addition of item #11: requiring the AREC to establish the requirements of the errors and omissions coverage, including coverage requirements, limits of coverage, deductible amounts, and limitations on cancellation terms as a concern.

The AREC is a regulatory licensing entity, not equipped to establish insurance coverage. Alaska's Division of Insurance would be more knowledgeable in establishing insurance coverage's. Other professional licensing programs that require insurance coverage have parameters identified in statute (contractors, collection agencies, hearing aid dealers, etc.)

2. Item #12 that requires the AREC to procure and make available an errors and omissions insurance policy through the bidding process may not be the appropriate entity to procure and administer coverage.

The AREC should not be engaged in promoting the sales of insurance.

3. Section 5, page 6, Line 8, item (c) allows an individual to independently obtain an errors and omissions insurance coverage is appropriate, but should not be subject to parameters established by the AREC.

4. By mandating E & O insurance, there is no provision in this bill that would cover licensees who are unable to obtain E & O insurance. The point we raise is, should the Recovery Fund still be made available to those who are unable to obtain E & O insurance?

5. We are mindful that this type of system is in place in other states and we have contacted the State of Idaho with respect to their program. We stand ready to work with Insurance and others to effectuate meaningful revision to the current surety system.

MANDATED PROGRAM CHART as of January 1, 2008

STATE	COVERAGE REQUIRED FOR FIRM LICENSE	PER CLAIM LIMIT	AGGREGATE LIMIT	DEDUCTIBLE	POLICY PERIOD	GROUP PREMIUM Per Licensee	WHO COLLECTS
Colorado	Yes	\$100,000	\$300,000	\$0 defense \$1,000 damages	1 year 1/1/08 - 1/1/09	\$243	Company
Idaho	Yes	\$100,000	\$300,000	\$0 defense \$1,000 damages	1 year 10/1/07 - 10/1/08	\$165	Company
Iowa	Yes	\$100,000	\$100,000	None	1 year 1/1/08 - 1/1/09	\$150	Company
Kentucky	No	\$100,000	\$1,000,000	None	1 year 4/1/08 - 4/1/09	\$140	Commission
Louisiana	Yes	\$100,000	\$300,000	0 defense \$1,000 damages	1 year 1/1/08 - 1/1/09	\$184	Commission
Mississippi	No	\$100,000	\$500,000	\$1,000 defense \$1,000 damages	1 year 7/1/07 - 7/1/08	\$205	Company
Nebraska	No	\$100,000	\$300,000	0 defense \$1,000 damages	1 year 1/1/08 - 1/1/09	\$135	Company
New Mexico	No	\$100,000	\$500,000	0 defense \$1,000 damages	1 year 1/1/08 - 1/1/09	\$200	Company
North Dakota	No	\$100,000	\$500,000	\$1,000 defense \$1,000 damages	1 year 1/1/08 - 1/1/09	\$140	Company
Rhode Island	No	\$100,000	\$500,000	\$1,000 defense \$1,000 damages	2 years 4/30/08 - 4/30/08	\$160/2 year	Company
South Dakota	No	\$100,000	\$500,000	\$500 defense \$1,000 damages	1 year 1/1/08 - 1/1/09	\$130	Commission
Tennessee	No	\$100,000	\$300,000	\$0 defense \$1,000 damages	2 years 1/1/07 - 1/1/09	\$256/2 year	Company
Wyoming	No	\$100,000	\$500,000	\$1,000 defense \$1,000 damages	1 year 1/1/08 - 1/1/09	\$150	Company

**Real Estate Errors and Omissions Program
Mandatory State Programs
Maximum Annual Premium and Current Group Program Premium
December 6, 2007**

<u>State</u>	<u>Maximum Annual Premium</u>	<u>Group Premium as of 1/1/2008</u>
Colorado	Not Applicable	\$243
Idaho	\$200	\$165
Iowa	Not Applicable	\$150
Kentucky	\$200	\$140
Louisiana	\$500	\$184
Mississippi	\$250	\$205
Nebraska	\$500	\$135 (WUG)
New Mexico	\$200	\$200
North Dakota	"reasonable" as determined by Real Estate Commission	\$140
Rhode Island	Not Applicable	\$160 (2-year premium)
South Dakota	Not Applicable	\$130
Tennessee	"reasonable" as determined by Real Estate Commission	\$256 (2-year premium)
Wyoming	\$300	\$150



Idaho Statutes

TITLE 54
PROFESSIONS, VOCATIONS, AND BUSINESSES
CHAPTER 20

IDAHO REAL ESTATE LICENSE LAW

54-2013. ERRORS AND OMISSIONS INSURANCE. (1) Each licensee who is actively licensed under this chapter shall, as a condition to licensing, carry and maintain errors and omissions insurance to cover all licensed activities under the provisions of this chapter.

(2) The commission shall make the insurance required under the provisions of this section available to each licensee by contracting with an insurance provider for errors and omissions insurance coverage for each licensee after competitive, sealed bidding in accordance with chapter 57, title 67, Idaho Code. The exact premium shall be set by the commission by motion.

(3) Any policy obtained by the commission shall be available to each licensee with no right on the part of the insurance provider to cancel coverage for any licensee.

(4) Each licensee shall have the option of obtaining errors and omissions insurance independently, if the coverage contained in an independently obtained policy complies with the minimum requirements established by the commission.

(5) The commission shall determine the terms and conditions of coverage required under the provisions of this section including, but not limited to, the minimum limits of coverage, the permissible deductible and the permissible exemptions.

(6) A licensee seeking to obtain or renew an active license shall certify to the commission that he is in compliance with the insurance requirements of this section. A licensee who elects not to participate in the insurance program administered by the commission shall obtain a certificate of coverage, signed by an authorized agent or employee of the insurance carrier, reflecting proof of insurance meeting the requirements established by the commission. Upon request by the commission the licensee shall produce the certificate for inspection.

(7) If the commission is unable to obtain errors and omissions insurance coverage to insure all licensees who choose to participate in the insurance program at a reasonable premium, not to exceed two hundred dollars (\$200) per year, per licensee, the requirement of insurance coverage as provided in this section shall be void during the applicable contract period.

(8) The commission is also specifically empowered to charge and collect an administrative fee in addition to the premium paid from each licensee who obtains errors and omissions insurance through the commission contract, which fee shall not exceed ten dollars (\$10.00) per licensee. This administrative fee shall be of an amount sufficient to raise that revenue required to administer the provisions of this section. The limit in subsection (7) of this section applies only to premium cost and not to any administrative fee charged.

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Available Reference: [Search Instructions](#).

Louisiana

Added by Acts 1983, No. 381, §§ 1. Acts 1989, No. 655, §§ 1, eff. Jan. 1, 1990; Acts 1995, No. 1207, §§ 1.

* §§1466. Errors and omissions insurance; mandatory for all licensees

A. All active licensees licensed in accordance with the provisions of this Chapter are mandated to carry errors and omissions insurance to cover all activities contemplated under this Chapter.

B. The commission shall make the insurance mandated under this Section available to all licensees by contracting with an insurance provider having a current rating in A.M. Best of A or better for a group policy after competitive, sealed bidding and awarding such contract pursuant to requirements established by the commission. Such issuance and award shall be exempt from the provisions of Chapters 16 and 17 of Title 39 of the Louisiana Revised Statutes of 1950.

C. Any policy obtained by the commission must be available to all licensees with no right on the part of the insurance provider to cancel any licensee.

D. Licensees shall have the option of obtaining errors and omissions insurance independently, provided that the coverage contained in such policy complies with the minimum requirements established by the commission.

E. The commission shall determine the terms and conditions of coverage mandated under this Section, including but not limited to the minimum limits of coverage, the permissible deductible, and permissible exemptions.

F. Each licensee shall be notified of the required terms and conditions of coverage for the annual policy at least thirty days prior to the annual renewal date. A certificate of coverage, showing compliance with the required terms and conditions of coverage, must be filed with the commission by the annual license renewal date by each active licensee who opts not to participate in the group insurance program administered by the commission.

G. Active licensees applying for inactive status and those licensees renewing their license while in an inactive status may do so without the required coverage mandated by this Section.

H. Should the commission be unable to obtain errors and omissions insurance coverage to insure all licensees who chose to participate in the group insurance program at a reasonable cost, not to exceed five hundred dollars for coverage, the insurance requirement mandated by this Section shall be void during the applicable contract year.

Acts 1988, No. 849, §§ 1, eff. Jan. 1, 1990; Acts 1989, No. 655, §§ 1, eff. Jan. 1, 1990; Acts 1995, No. 1207, §§ 1; Acts 1997, No. 845, §§ 1; Acts 2001, No. 924, §§ 1.

§§1467. Agency

A. Licensees shall provide the parties to a real estate transaction with an agency disclosure informational pamphlet, and where applicable, a dual agency disclosure form as mandated under R.S. 9:3897.

B. The commission may prescribe such agency disclosure forms or pamphlets as it deems necessary for the enforcement of this Section.

Acts 1991, No. 354, §§ 1, eff. Jan. 1, 1992; Acts 1997, No. 32, §§ 1.

§§1468. Psychologically impacted property

A. The fact or suspicion that a property might be or is psychologically impacted, such impact being the result of facts or suspicions, including but not limited to:

(1) That an occupant of real property is, or was at any time suspected to be, infected, or has been infected with Human Immunodeficiency Virus or diagnosed with Acquired Immune Deficiency Syndrome, or any other disease which has been determined by medical evidence to be highly unlikely to be transmitted through the occupancy of a dwelling place; or

(2) That the property was, or was at any time suspected to have been, the site of a homicide, or other felony, or a suicide, is not a material fact or material defect regarding the condition of real estate that must be disclosed in a real estate transaction.

B. No cause of action shall arise against an owner of real estate or his or her agent for the failure to disclose to the transferee that the transferred property was psychologically impacted as defined in Subsection A.

Acts 1991, No. 336, §§ 1.

North Dakota

43-23-18. Injunctions authorized to enforce law. If any person or entity has engaged in any act or practice that constitutes or will constitute a violation of this chapter, the commission may commence an action in the district court of the county in which the person or entity resides or in the district court of the county in which the act or practice occurred for an injunction to enforce compliance with this chapter or rules adopted by the commission. The commission is not required to give any bond for commencing this action. Upon a showing that the person or entity has engaged in any act or practice in violation of this chapter or rules adopted by the commission, the district court may enjoin the act or practice and may make any order necessary to conserve, protect, and disburse any funds involved.

* **43-23-19. Errors and omissions insurance required of salespersons and brokers - Rules.** The real estate commission shall adopt rules pursuant to chapter 28-32 requiring as a condition of licensure that, effective January 1, 2002, and thereafter, all real estate salespersons and brokers, except those who hold inactive licenses, carry errors and omissions insurance covering all activities contemplated under this chapter.

43-23-20. Group insurance coverage authorized - Independent errors and omissions coverage. The real estate commission may negotiate by bid with an insurance provider for a group policy under which coverage is available to all licensees with no right on the part of the insurer to cancel coverage provided to any licensee, except as provided by rules adopted by the commission. A licensee may obtain errors and omissions insurance independently if the coverage complies with the minimum requirements established by the commission.

43-23-21. Commission to determine conditions of errors and omissions coverage. The real estate commission shall determine the terms and conditions of errors and omissions coverage required by this chapter, including the minimum limits of coverage, the permissible deductible, and the permissible exceptions.

43-23-22. Notice of terms and conditions of errors and omissions - Certificate of coverage. Each licensee must be notified of the required terms and conditions of coverage at least thirty days before the annual license renewal date. A certificate of coverage, showing compliance with the required terms and conditions of coverage, must be filed annually with the real estate commission by each licensee who elects not to participate in the group insurance program administered by the real estate commission.

43-23-23. Errors and omissions coverage not required if premium limit unobtainable. If the real estate commission is unable to obtain errors and omissions insurance coverage at a reasonable premium, the errors and omissions insurance requirement of this section does not apply during the year for which coverage cannot be obtained.

Wyoming

(g) A broker may be compensated by more than one (1) party for services in a transaction, if those parties have consented in writing to the shared payment prior to seller and buyer entering into a contract to buy or sell.

(h) An agreement authorizing a broker who originally agreed in writing to act as an agent to a buyer or seller with respect to a particular real estate transaction to act instead as an intermediary to that party, shall provide that the party agreeing to the new relationship shall not be liable for any commission greater than the commission the party would have been liable to pay under the initial agreement. Any contract provision in violation of this subsection is void and unenforceable.

33-28-309. Disclosure type.

Any disclosure under W.S. 33-28-306 shall be in a font size of 12 point or greater.



ARTICLE 4 - ERRORS AND OMISSIONS INSURANCE

33-28-401. Errors and omissions insurance; rulemaking authority; commission duties; certificate of coverage; administrative fee.

(a) Beginning January 1, 2008, an applicant for a real estate license pursuant to W.S. 33-28-106, a licensee renewing a license or an inactive licensee activating a license pursuant to W.S. 33-28-118, shall submit proof of insurance coverage through the group plan provided pursuant to this section or through certification of optional coverage.

(b) The commission shall make errors and omissions insurance available to all licensees by contracting with an insurer for a group policy after competitive bidding. Any group policy obtained by the commission shall be available to all licensees and shall prevent the insurer from canceling any licensee. Licensees may obtain errors and omissions insurance independently if the coverage complies with the minimum requirements established by the commission.

(c) The commission shall promulgate rules and regulations necessary to specify the terms and conditions of coverage required under this section, including the minimum limits and terms of the coverage, the permissible deductible and permissible exemptions. Each licensee shall be notified of the required terms and conditions at least thirty (30) days prior to the license renewal date. Each licensee who elects not to participate in the group program administered by the commission shall file a certificate of coverage showing compliance with the required terms and conditions with the commission by the license renewal date.

(d) If the commission is unable to obtain errors and omissions insurance coverage to insure all licensees who elect to participate in the group program, at a reasonable annual premium not to exceed three hundred dollars (\$300.00) per licensee, the errors and omissions insurance requirement of this section shall not apply during the year for which the commission cannot obtain the errors and omissions insurance coverage. The maximum premium amount shall be adjusted annually by the annual rate of inflation in this state for the preceding twelve (12) month period as calculated by the department of administration and information.

(e) The commission shall charge and collect an administrative fee in addition to the premium paid from each licensee who obtains errors and omissions insurance through the commission. This administrative fee shall be of an amount sufficient to cover the administration of this section and shall not exceed ten percent (10%) of the premium. The maximum premium specified in subsection (d) of this section applies only to premium cost and not to any administrative fee charged.

Errors & Omissions Insurance: The Experience of States with Mandatory Programs for Real Estate Licensees

James E. Larsen* and Joseph W. Coleman**

Abstract. Empirical and survey data collected from parties in states that require real estate licensees to have errors and omissions insurance is presented and analyzed. Satisfaction with the mandatory system was expressed by 68% of licensees and 89% of regulators. Variables that are significantly related to licensee satisfaction are identified. Perhaps most importantly, licensees who have operated under both voluntary and mandatory systems are more satisfied than those who have operated exclusively under a mandatory system. Motivations for mandating errors and omissions insurance include the desire to provide consumer and licensee protection, and affordable premiums for licensees. Recommendations for regulators considering mandating E&O insurance are presented.

Introduction

Errors and omissions (E&O) insurance is the functional equivalent of the professional liability insurance carried by physicians, attorneys, architects, and other professionals. This type of insurance provides a means to indemnify clients and customers who are financially damaged by an honest mistake or negligent error made by a real estate licensee, which, in turn, protects the licensee because a claim filed against a licensee without E&O insurance can be both financially and professionally disastrous. Claims filed against real estate licensees run the gambit from failure to negotiate a sale to misrepresentation of a property's physical condition, but according to Evans (2000), 80% of lawsuits against brokers are brought by buyers, and two-thirds of those have to do with the condition of the property.

Currently, real estate licensees in thirty-eight states may voluntarily obtain E&O insurance, but coverage is mandatory in twelve states. Proponents of mandatory coverage assert that a mandatory program helps ensure that consumers will be protected because all, not just some, licensees have coverage. Like other types of insurance, the E&O insurance market has experienced substantial tightening in recent years. Many insurance companies have stopped writing E&O policies or have greatly increased premiums, making it difficult for some licensees to obtain coverage. Some real estate commissioners at the 2003 ARELLO Annual Meeting reported that they could not find an insurance provider willing to quote coverage at any price. However, states that have mandated coverage arrange for a group policy for their licensees, and based on the comments received from licensees and regulators in the present study, it is apparent that the availability of these group programs helps to make E&O insurance available at affordable rates.

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The National Association of REALTORS® (2003) provides evidence that most agents and brokers have an appreciation of E&O insurance. NAR's survey data indicates that nationwide 83% of all agents and 73% of all brokers have coverage. Stitz (2004) provides insights into why some REALTORS are not covered in states where coverage is voluntary. He reports that approximately 8% of all members of the Ohio Association of REALTORS® do not have E&O insurance; 3% indicated coverage was too expensive, 1.8% stated that they did not believe it was necessary, 1.3% indicated that they intended to obtain coverage but had not yet done so and 0.4% stated that they cannot obtain coverage due to previous claims. The relatively low premium available through the group program in mandatory states may be attractive to many licensees in voluntary states who already have coverage, as well as those who claim the reason they lack coverage is due to high premiums. Mandatory coverage would also likely be motivational for licensees who are procrastinating in obtaining coverage, good news for those who assert that they are uninsurable and resisted by those who believe coverage is unnecessary.

The purpose of this study is twofold; the first is to present information that may be useful to state policymakers contemplating a mandatory E&O insurance program for their real estate licensees. To accomplish this objective, the experience of parties in states with existing mandatory programs is investigated using survey data collected from both real estate regulators and licensees operating in mandated states, and empirical data collected from the preeminent mandatory E&O insurance contract administrator. Despite the importance of E&O insurance, a search of both the real estate and insurance literature revealed no published academic papers that address this topic. Therefore, the second purpose of this paper is to start filling this gap in the literature.¹

The remainder of the paper is organized as follows. In the next section, the states that have a mandatory E&O insurance program are identified. Survey data collected from licensees in the mandatory states is presented in the third section and is analyzed in the fourth section. In the fifth section, information obtained from the insurance industry and state real estate regulators is presented. The sixth section contains recommendations for regulators contemplating the implementation of a mandatory E&O insurance program, and a conclusion is presented in the last section.

States with Mandatory E&O Programs

The twelve states listed in the first column of Exhibit 1 currently require their active real estate licensees to have E&O insurance. Examination of the second column of Exhibit 1 reveals that Kentucky, in 1987, was the first to implement a mandatory E&O insurance program, and that New Mexico and North Dakota, in 2002, are the most recent states to do so.² Also shown in Exhibit 1 are data on each state's population, number of real estate licensees and the number of licensees as a percentage of population. The smallest state with a mandatory E&O program in terms of both population and number of licensees is North Dakota. The most populace state with a

Exhibit 1
Twelve States with Mandatory E&O

State	E&O Mandatory Since	2004 Active Licensees	2004 Estimated State Population	% of Active Licensees to Population
Colorado	1-1-1998	31,963	4,550,688	0.70
Idaho	12-31-1993	6,005	1,366,332	0.44
Iowa	7-1-1991	7,899	2,944,062	0.27
Kentucky	4-1-1987	24,848	4,117,827	0.60
Louisiana	1-1-1990	14,324	4,496,334	0.32
Mississippi	7-1-1994	8,005	2,881,281	0.28
Nebraska	1-1-1993	7,363	1,739,291	0.42
New Mexico	1-1-2002	9,650*	1,874,614	0.51
North Dakota	1-1-2002	1,750	633,837	0.28
Rhode Island	7-12-1990	6,223	1,076,164	0.58
South Dakota	8-16-1993	2,649	764,309	0.35
Tennessee	12-31-1990	30,339	5,841,748	0.52

Note:

*Total licensees: the licensing official at the New Mexico REC did not know the number of inactive licensees in this total.

mandatory program is Tennessee and the state with the most licensees is Colorado. Iowa (Colorado) has the lowest (highest) percentage of licensees to population.

The Licensee Survey

A survey was delivered via email to 1,069 REALTORS licensed in one of the twelve states that require E&O insurance.⁴ The names of the licensees to whom the survey was emailed were obtained using a "find a REALTOR" search engine available on the NAR website.⁴ To be eligible to receive the survey, the licensee was required to have an individual (rather than a company) email address. The results should be viewed with some caution because of the relatively small sample size and because it is unclear what bias, if any, the data source and/or the "individual email address" requirement introduces. The results are interesting nonetheless.

Two hundred one responses were received, an overall response rate of 18.8%.⁵ In an attempt to enhance the response rate, the survey was kept brief (eight questions). The only demographic information collected on the survey was the number of years the respondent had worked in real estate. Respondent gender was identified from a variety of Internet sources.⁶ Approximately 48% of the respondents were female and 52% were male. Examination of the data in Exhibit 2, where respondent tenure in real

Exhibit 2
Licensee Years in Real Estate

State	N	Mean	Low	High	Std. Dev.
Colorado	9	19.8	7	35	9.9
Idaho	26	12.5	1	30	9.3
Iowa	6	17.8	8	35	10.3
Kentucky	12	17.3	6	35	10.2
Louisiana	11	17.3	6	33	9.9
Mississippi	20	18.3	6	32	9.5
Nebraska	7	22.3	7	42	12.6
New Mexico	19	15.3	3	33	11.2
North Dakota	23	15.3	1	34	10.1
Rhode Island	21	13.9	1	33	10.3
South Dakota	21	17.6	1	35	11.0
Tennessee	26	18.5	9	30	8.0
Total	201	16.4	1	42	10.0

estate is detailed, reveals that as a group the respondents have substantial real estate experience; their average tenure in real estate is 16.4 years.⁷

The licensee survey contained (among others) the following three questions:

- Did you obtain your current E&O policy through your state-sponsored program?
- If E&O insurance was not mandatory and you could continue to obtain it at the same premium you are currently paying, would you continue to be covered?
- Who pays your E&O premium? (with the following choices: You, Your broker, and Shared by you and your broker).

Examination of Exhibit 3, where the responses to these questions are detailed, reveals that 72% of respondents obtained their E&O coverage through their state-sponsored provider while 28% obtained their coverage independently.⁸ The majority (92.4%) of the respondents indicated that they would continue to carry insurance even if it were not mandatory while 7.6% indicated that they would not. It is not uncommon for sales associates to shoulder much of the cost of conducting business. Therefore, it is not surprising that 83.1% indicated that they pay for their E&O coverage. However, 11.4% reported that their broker paid the premium and 5.5% indicated that the cost was shared between them and their broker.

Survey participants were also asked: "How many claims have been filed against your E&O policy?" Examination of Exhibit 4, where the results are detailed, reveals that

Exhibit 3
Licensee Response to Three Survey Questions

State	E&O Coverage Thru State Plan		Would Continue Coverage Even if Not Mandatory		Who Pays E&O Premium		
	Yes	No	Yes	No	Licensee	Licensee's Broker	Shared between Licensee and Broker
Colorado	8	1	6	3	9	0	0 ^b
Idaho	17	9	25	1	21	4	1
Iowa	2	4	5	0 ^a	2	3	1
Kentucky	10	2	11	1	12	0	0
Louisiana	8	3	9	2	8	2	1
Mississippi	17	2 ^a	19	0 ^a	18	1	1
Nebraska	6	1	7	0	6	1	0
New Mexico	16	3	18	0 ^a	13	3	3
North Dakota	12	11	23	2 ^a	15	6	2
Rhode Island	8	13	17	4	13	1	2
South Dakota	19	2	20	1	21	0	0
Tennessee	21	5	25	1	24	2	0
Total	144	56	182	15	167	23	11
% of Total	72.0	28.0	92.4	7.6	83.1	11.4	5.5

Notes:

^aOne respondent did not respond to question.^bColorado has a single-class licensee system.

85.1% of the respondents indicated that they had never had an E&O claim filed against them. However, 14.9% indicated that one or more claims had been filed against them. Given information presented later in this paper concerning the total number of claims in each state, it is not surprising that the majority of the respondents have not been involved in a claim. On the other hand, licensees with a claims history may be overrepresented in the sample, but this facilitates a subsequent comparison of the two groups.

Licensees were asked to respond to the following question: "How satisfied are you with your experience with mandatory E&O insurance coverage?" Possible responses included: "very satisfied," "satisfied," "neutral," "dissatisfied" and "very dissatisfied." Examination of Exhibit 5, where the results are detailed, reveals that the mandatory programs have been fairly well received by respondents: 23.5% reported being very satisfied, 44.5% were satisfied, 29% were neutral and 3% were dissatisfied. None indicated that they were very dissatisfied. Note that 68% of the respondents were at least satisfied. This figure is significantly higher than exists in at least one

Exhibit 4
Number of E&O Claims Filed Against Respondents

State	Zero	One	Two	Three	Four or More
Colorado	8	1	0	0	0
Idaho	23	1	1	1	0
Iowa	5	1	0	0	0
Kentucky	11	1	0	0	0
Louisiana	9	1	0	0	1
Mississippi	15	5	0	0	0
Nebraska	6	0	1	0	0
New Mexico	16	3	0	0	0
North Dakota	19	4	0	0	0
Rhode Island	18	3	0	0	0
South Dakota	18	3	0	0	0
Tennessee	23	3	0	0	0
Total	171	26	2	1	1

Exhibit 5
Licensee Satisfaction with Mandatory E&O

State	Very Satisfied	Satisfied	Neutral	Dissatisfied	Very Dissatisfied	Total
Colorado	2	5	1	1	0	9
Idaho	2	11	12	1	0	26
Iowa	0	5	1	0	0	6
Kentucky	7	2	3	0	0	12
Louisiana	4	3	3	1	0	11
Mississippi	5	10	5	0	0	20
Nebraska	2	4	1	0	0	7
New Mexico	4	7	6	1	0	18*
North Dakota	5	14	4	0	0	23
Rhode Island	4	7	8	2	0	21
South Dakota	5	8	5	0	0	21
Tennessee	7	13	5	0	0	26
Total	47	89	58	6	0	200
% of Total	23.5	44.5	29.0	3.0	0	100.0

Note:

*One respondent did not respond to this question.

voluntary state. Overall REALTOR satisfaction with E&O insurance in Ohio was 40.5% as reported by Stitz (2004).

Finally, the survey gave participants the opportunity to make any comments that they wished about E&O insurance; 41 individuals, from 9 states, elected to do so. Examination of their comments, which are available at www.wright.edu/~joseph.coleman, reveals several recurring themes: (1) an appreciation of the low premium due to group purchasing power; (2) concern that claim limits are too low to be effective, (3) concern that having E&O coverage increases the probability that the licensee will be subjected to a frivolous lawsuit (although this would apply whether or not coverage was mandatory); and (4) concern that a good claims record does not result in a reduced premium.⁹

Analysis of Licensee Survey Data

The results of tests conducted to identify variables that are significantly related to licensee satisfaction with mandatory E&O insurance are reported in this section. Two preliminary tests are conducted: one to investigate whether state survey response rates are related to average satisfaction level for licensees in each state, the other to determine if there is a difference in average satisfaction levels by state. It would be problematic if either result is significant. A Pearson correlation test, however, indicates that the former relationship is insignificant (correlation coefficient (r) is .338 with a p value = .28), and ANOVA results indicate the latter relationship is also insignificant (p value = .21). The results of these two preliminary tests indicate that it is appropriate to conduct the following tests on all respondents as a single group.

A t -test is used to determine if satisfaction levels differ significantly for the following seven variables. First: between licensees who pay for their own coverage and those whose broker pays, or shares, the premium cost. A priori, it seems logical that not being responsible for the premium payment might result in greater satisfaction with a mandatory system. Second: between licensees who have, and have not, experienced an E&O insurance claim. A priori, it seems logical that a person who has gone through the claims process might be more favorably inclined toward a mandatory system (although this may depend upon how effectively the claim was handled) because the licensee has first-hand knowledge of the financial protection E&O insurance provides. A licensee who has never had a claim filed against them may view E&O insurance in general as unneeded, and, therefore, consider a mandatory system as a vehicle that forces them to carry the "unneeded" coverage. Third: between licensees who obtained E&O coverage through the state-sponsored provider and those who obtained coverage independently. It is possible that one who opposes a mandated program would signal dissatisfaction by refusing to obtain coverage with the state-sponsored carrier. Fourth: between licensees who would continue to carry E&O insurance even if it were not mandatory and those who would not. It is intuitive that a licensee who indicated that he/she would not carry E&O insurance if it were not required is unlikely to be satisfied with a program that mandates coverage. Fifth: between licensees who have operated under both a voluntary and a mandatory system and those who have only experienced a mandatory program because licensees who have operated under both

systems may be in a better position to evaluate the advantages and disadvantages of a mandatory system (*e.g.*, premiums, claim limits). Licensees in the sample are divided into these two groups by comparing their tenure in real estate to the number of years that coverage had been mandatory in the state in which the licensee operates. Sixth: between licensees located in a state with a real estate recovery fund and those located in a state without a recovery fund. Eight of the mandatory E&O insurance states have a real estate recovery fund, including: Colorado, Idaho, Kentucky, Louisiana, North Dakota, Rhode Island, South Dakota and Tennessee. Recovery funds, normally funded by fees levied on licensees, may provide consumers with additional protection because the funds can be used to indemnify consumers that have been financially damaged in a transaction that is excluded by the E&O policy or a claim that exceeds the E&O policy claim limit. Despite this, it is possible that licensees in a state with a recovery fund view the two programs as redundant, and, therefore, hold E&O insurance in lower regard. Seventh: between male and female licensees. There is little reason to suggest that satisfaction levels should differ by licensee gender, but the gender issue is examined here because other real estate and insurance studies have identified differences based upon this criteria.¹⁰

To address the above issues, the mean satisfaction level for the two groups in each of the seven cases is calculated. The mean value is obtained by assigning a numerical value to each respondent's reported satisfaction level: 1 for very satisfied, 2 for satisfied, 3 for neutral and 4 for dissatisfied (*i.e.*, the lower the mean value, the higher the satisfaction level). Then a two-tailed *t*-test is applied. Finally, both a one-factor ANOVA and a Tukey-Kramer multiple comparison test are employed to test whether licensee tenure in real estate (dependent variable) is significantly related to licensee satisfaction with mandatory E&O insurance. A priori, it is plausible that the more experience a licensee gains the more he/she realizes the importance of E&O insurance and, therefore, the more likely the licensee is to be satisfied with mandatory coverage.

Examination of Exhibit 6, where the results of the *t*-tests are presented, reveals that three variables are highly significantly related to satisfaction. Specifically, satisfaction is higher for licensees with an E&O claims history compared to those with no claims history; for licensees who have worked under both a voluntary and mandatory E&O coverage system compared to those who had worked only under a mandatory system and, not surprisingly, for licensees who stated that they would continue coverage even if E&O insurance were not mandatory compared to those who stated that they would not.

Examination of Exhibit 6 also reveals the four variables found not to be significantly related to satisfaction. Specifically, no difference in satisfaction is discovered between licensees that pay for their own coverage and those who pay only some, or none, of the premium; between licensees who obtained coverage through their state plan and those who obtained coverage independently; between licensees located in states with and without a recovery fund; and no difference in satisfaction levels is discovered between the females and males in the sample.

The ANOVA results indicate a significant difference between satisfaction with mandatory E&O insurance and the number of years of experience possessed by a

Exhibit 6
t-test Results: Licensee Satisfaction

Group	Variable	N	Mean Satisfaction Level: Group 1	Mean Satisfaction Level: Group 2	t-Statistic	p Value
1	Who pays E&O premium					
1	Pay own	166	2.108	2.147	0.25	.797
2	Pay none or share cost	34				
1	E&O claim history					
1	none	170	2.170	1.800	2.38*	.018
2	One or more	30				
1	E&O carrier					
1	State-sponsored	143	2.105	2.140	0.28	.777
2	Independent	57				
1	Would continue coverage					
1	Yes	181	2.044	2.789	4.02**	<.0001
2	No	19				
1	Work experience with					
1	Mandatory & voluntary	137	1.985	2.397	3.49**	.0006
2	Mandatory system only	63				
1	State has recovery fund					
1	Yes	158	2.096	2.062	0.25	.810
2	No	42				
1	Gender					
1	Male	104	2.086	2.146	0.52	.600
2	Female	96				

Notes: In all cases but one, the folded F-test showed the population variances for each subgroup should be assumed to be equal and the pooled t-test was used. For the variable "work experience with," the folded F-test indicated that the population variances should be assumed to be unequal and the Satterthwaite test was used.

*Significant at the 5% confidence level.

**Significance at the 1% confidence level.

licensee ($p < .0001$). In order to more precisely identify the differences, a Tukey-Kramer multiple comparison test was performed. The test results indicate that the mean number of years in business for the respondents who were very satisfied (21.5 years) is significantly higher than both the mean number of years in business for the respondents that are satisfied (16.2 years) and those who are neutral (12.2 years). There is, however, no significant difference in the mean values between the very satisfied respondents and the respondents who are dissatisfied (20.5 years). All other multiple comparisons are not significantly different. Although the difference between the satisfied and neutral groups is not statistically significant, the magnitudes of the length of service tend to support the a priori hypothesis. The magnitude for the dissatisfied group with those of the other groups may be due to confounding variables outside the scope of this study (e.g., negative experience with insurance companies).

The Regulator's Survey

This section presents information gathered by survey from the Real Estate Commission (REC) in nine of the twelve states where E&O insurance is mandatory.¹¹ The responding RECs are almost unanimous in their opinion of mandatory coverage. Eight of nine respondents reported that they were very satisfied with mandatory E&O insurance and one reported being neutral (with possible responses: very satisfied, satisfied, neutral, dissatisfied and very dissatisfied). The results of a two-tailed *t*-test (p value < .0001) verify that the regulator's mean satisfaction level is significantly higher than the licensee's mean satisfaction level. Such a high satisfaction level clearly indicates that regulators believe that the mandatory program has achieved the desired results. The near consensus response, however, prevents statistical analysis of differences in satisfaction levels for RECs as was done for licensees. The RECs response to other survey questions, however, provides a wealth of valuable information. For expository expedience, the information is divided into five groups. First, the motivations behind the implementation of mandatory E&O insurance are reviewed. Next, the advantages and disadvantages of mandatory programs are presented. Third, the focus is on program administrative costs. Fourth, some insurance policy details and related regulations are examined. Finally, data on the recent E&O insurance claims history of each mandatory E&O state is presented.

Motivations for Mandatory E&O

In an open-end question, REC participants were asked to enumerate the motivations for instituting mandatory E&O insurance. Seven of the nine respondents specifically mentioned the need to maintain or increase consumer protection; three mentioned the need to provide affordable insurance coverage to licensees; and three mentioned the need to maintain or increase licensee protection.

The actions of some state legislatures have provided added incentive for real estate officials to recommend mandatory coverage. In Colorado, the REC became concerned about (the recently-passed legislation that empowered the state to transfer money from funds such as the real estate recovery fund into the general fund. The possibility that the public could be left unprotected motivated the Colorado REC to recommend mandatory E&O legislation, which became effective in 1998. Subsequently, in 2003, funds were appropriated from the Colorado recovery fund, dropping the fund balance well below the statutory minimum. This episode may give real estate officials in other states with recovery funds pause for concern.¹²

In most states, regulators initiated the move to mandatory E&O insurance. For example, the REC in Nebraska (which had no real estate recovery fund before, or after, mandating E&O insurance) wanted to provide real estate consumers with some financial protection and was considering establishing a recovery fund. During its investigation the Nebraska regulators learned of the Kentucky E&O program, decided a mandatory E&O program would require less administrative time, and helped develop legislation which was enacted into law. In Iowa, however, the move to mandatory E&O insurance was initiated by the state Association of REALTORS®. According to

the Iowa REC, before E&O insurance was mandated, "coverage was difficult to obtain and the premiums were staggering. Premiums would go up, or the policy would be cancelled without claims or cause leaving the licensee without coverage."

Advantages and Disadvantages of Mandatory E&O

In this section, the advantages and disadvantages of mandatory E&O insurance programs, mentioned by insurance industry officials and state RECs are presented. Some are more subtle than others, and no guarantee is given that either list is complete.¹³

First, the advantages:

Coverage Availability. Many insurance companies have recently stopped writing E&O policies for real estate licensees, or have greatly increased the premiums. This makes it difficult for some real estate practitioners to obtain coverage. The group program in each mandated state helps to make this important insurance available to all licensees at affordable rates.

Affordability. E&O insurance in the voluntary market is costly. Premiums for individuals often range from \$300 to \$500 or more, depending on the type of real estate activities performed. However, policies are generally only sold on a firm basis (*i.e.*, the entire firm must purchase a policy and individual licensees do not have the option to obtain insurance). Minimum premiums for firm policies are in the range of \$1,500 to \$2,000. Many small companies may not be able to afford the minimum premium, so go without any E&O insurance coverage. Group plans under mandatory E&O insurance programs are designed to bring down the cost of coverage (*i.e.*, lower premiums and lower deductibles).

Portable Coverage. Mandatory E&O insurance programs alleviate problems relating to individual coverage. Since E&O policies in voluntary states are generally available to firms only, an individual who changes firms may find that he/she is not covered by the new firm's policy. Also, most firm policies cover claims against members of the firm for acts of a licensee only while the licensee is employed by that firm. For example, if an employee of Firm A is sued for an act that occurred while the licensee was working for Firm B, Firm A's insurance may not cover this act. Many licensees may find themselves in this situation. Larsen and Coleman (2003) report substantial licensee movement between brokerage firms. In addition, because some firms do not carry insurance, a licensee working for an uninsured firm may be unable to obtain individual coverage. Group policies under mandatory programs are designed to provide individual coverage that will follow the licensee even if the individual changes firms.

Coverage for Prior Acts. Under mandatory E&O programs, claims made during the policy period resulting from "prior acts" (a claim resulting from a transaction in a previous policy period, but where notice is not received until a subsequent policy period) are covered if the licensee has been in the

group plan continuously from the date of the alleged error to the effective date of the claim.¹⁴ Prior acts coverage is also available in the voluntary market, but would not apply if the licensee switched insurance carriers between the transaction date and the claim date.

Consumer Protection. The purchase of a home is the largest investment most consumers make in a lifetime. An undisclosed problem or misrepresentation will likely have an adverse effect on that consumer and, if the real estate licensee who caused the damages is uninsured, the consumer may be without recourse. Mandatory E&O insurance increases consumer protection from honest mistakes and omissions by licensees because all licensees, not just some, are insured.

And, the disadvantages:

Mistake Prone Licensees Can be Problematic. At least two problems result from the fact that insurance underwriters base the mandatory E&O policy premium upon the weighted average risk of all licensees within the state. First, the inclusion of high risk individuals increases the premium for all licensees and licensees with a good claims record tend to resent the fact that the premium they pay does not reflect their personal claim record. Second, the insurance provider must rely on the REC to police licensees because existing programs require that the state-sponsored policy be offered to every licensee at the same price, with no right on the part of the insurance provider to cancel an individual's coverage. This is true, even if a licensee has a lot of previous claims and cannot obtain coverage on their own outside the group program. Therefore, to protect the financial integrity of the program, the REC may be required to discipline problem licensees (even revoke an individual's license in the event such action is justified) because there are only two ways the insurance provider can stop covering a problem licensee: (1) stop writing the entire group program, or (2) for the problem licensee to no longer qualify as a member of the group (*i.e.*, the individual no longer has a valid license). If the REC does not adequately monitor its licensees, the group program may be put at risk.

Additional REC Administrative Responsibilities. With a mandatory E&O insurance program, the REC will incur some additional administrative responsibilities. In most cases, the REC must devote time and resources to the program to help ensure that it is operated effectively. This effort will involve coordinating the activities of REC officials and staff with members of the state insurance and legal departments, which, in turn, will require these departments to also devote time and resources.

Few Insurance Providers. RECs in mandatory E&O insurance states are concerned by the low number of insurance companies currently underwriting policies. This limits competition and opens the possibility that even with a group plan, premiums may escalate or, at the extreme, threaten the existence of the group program. In 2003, Alabama became the first (and to date only) state to repeal its mandatory E&O requirement. The issue surfaced in 2002

when the Alabama REC conducted a review of their E&O group program and found that it had been four years since an insurance carrier had been under contract (due in part to the high number of E&O claims filed against licensees in the program). Alabama statutes provided that if the REC was unable to contract with an insurer to cover all licensees who choose to participate in the program, the requirement of E&O coverage was void during the applicable contract period. Today, the Alabama REC encourages licensees to seek E&O coverage on the open market.

Program Administration Costs

REC survey participants were asked: "How much does it cost annually to administer the state mandatory E&O program?" The responses suggest that some RECs may either not have a good grasp on this issue, consider administration costs to be too small to measure, or consider these costs to be a part of their overhead (five states gave no response for this question). With few exceptions (*i.e.*, the three states where the REC still collects the E&O premiums) the majority of administrative duties have been transferred to the external program administrator.¹⁵ The primary duties maintained by the states in administering their mandatory E&O insurance program are: (1) issuing requests for proposals (RFP's) for new contracts; (2) reviewing bids; (3) negotiating final contracts; and (4) ensuring licensee compliance.¹⁶ Of those RECs that did respond to the question, the estimated costs of administering the E&O program ranged from zero to \$5,000 annually. One state estimated the annual hours devoted to administering the E&O program to be 350 hours by the staff with an additional 100 hours by management.

Special circumstances may shift administrative costs up or down. For example, in Kentucky there is a tax on insurance premiums that varies by county, so in collecting the E&O premium the REC must verify the licensee's county of residence to ensure that the correct amount of tax is collected. On the other hand, Rhode Island cut administrative costs to bare bones in recent years by operating their program without a contract with an insurance provider. Rhode Island had a contract with Rice Insurance Services Company (RISC) from 1992 through 2000. But, primarily because of the low number of E&O claims filed on licensees in the state, decided in 2000 to let RISC handle almost all of the program administrative details (RISC agreed to do so because Rhode Island's program loss experience was deemed acceptable). This decreased the RECs administrative costs because it removed it from the administrative process, but licensees can still benefit through a low group rate. Of course the Rhode Island REC remains ultimately responsible for ensuring that each of its licensees has E&O coverage.

Policy Terms and Associated Regulations

Examination of the information presented in Exhibit 7 reveals considerable variation between states regarding E&O policy terms and associated requirements. While the maximum coverage per claim, shown in the second column, is \$100,000 in every state; the total claim limit, shown in the third column, ranges from \$100,000 in Iowa

Exhibit 7
Mandated E&O Program Policy Details: November 1, 2004

State	Coverage Limit Per Claim	Total Coverage Limit	Deductible	Maximum Annual Premium	Premium 2004 (2005)	Who Collects Premium
Colorado	\$100,000	\$300,000	\$0 defense \$1,000 damages	None	\$230 (\$215)	RISC
Idaho	\$100,000	\$300,000	\$0 defense \$1,000 damages	\$140	\$135 (\$135)	RISC
Iowa	\$100,000	\$100,000	\$0 defense \$0 damages	None	\$123 (\$134)	RISC
Kentucky	\$100,000	\$1,000,000	\$0 defense \$0 damages	\$125	\$123 (\$123)	REC
Louisiana	\$100,000	\$300,000	\$0 defense \$1,000 damages	\$500	\$217 (\$217)	REC
Mississippi	\$100,000	\$500,000	\$1,000 defense \$1,000 damages	\$150	\$146 (\$148)	RISC
Nebraska	\$100,000	\$300,000	\$0 defense \$1,000 damages	\$500	\$150 (\$150)	RISC
New Mexico	\$100,000	\$500,000	\$0 defense \$1,000 damages	\$150	\$146 (\$146)	RISC
North Dakota	\$100,000	\$500,000	\$1,000 defense \$1,000 damages	\$125	\$125 (\$125)	RISC
Rhode Island	\$100,000	\$500,000	\$1,000 defense \$1,000 damages	None	\$148/2 year (\$160/2 yr.)	RISC
South Dakota	\$100,000	\$500,000	\$500 defense \$1,000 damages	None	\$140 (\$140)	REC
Tennessee	\$100,000	\$300,000	\$0 defense \$1,000 damages	"Reasonable" as determined by Real Estate Commission	\$260/2 year (\$306/2 year)	RISC

Note: The sources are Rice Insurance Services Company and various state RECs.

to \$1,000,000 in Kentucky.¹⁷ The deductible amount per claim, shown in the fourth column, ranges from zero in Iowa and Kentucky to \$2,000 in Mississippi, North Dakota and Rhode Island.

Seven states have statutes or rules, shown in the fifth column of Exhibit 7, which set an upper limit on the annual premium amount. The limit ranges from \$125 in Kentucky and North Dakota to \$500 in Louisiana and Nebraska. In the past, such limits have presented a problem in some states as market conditions drove premiums above the previously set limit. This problem cannot occur in the five states that have not set a premium limit. Actual premiums charged in 2004 and 2005 are shown in the sixth column. The annual premium for 2004 ranges from \$80 in Rhode Island (where claims have been incredibly low, see Exhibit 8) to \$230 in Colorado. The

**Exhibit 8
Annual E&O Claim Information: 2001-2003**

	Colorado	Idaho	Iowa	Kentucky	Louisiana	Mississippi	Nebraska	New Mexico	North Dakota	South Dakota	Rhode Island	Tennessee
2001 Claims												
No payment or reserve	370	7	49	32	NA	29	NA	NM	NM	9	2	87
With payment or reserve	228	11	42	40	NA	35	NA	NM	NM	12	6	84
Total claims	598	18	91	72	NA	64	74	NM	NM	22	8	171
Average claim amount for claims with payment or reserve	\$18,509	\$8,054	\$6,791	\$8,990	NA	\$18,426	\$5,427	NM	NM	\$13,167	\$14,917	\$10,497
2002 Claims												
No payment or reserve	343	23	62	34	NA	32	NA	NA	5	6	8	72
With payment or reserve	238	16	50	42	NA	31	NA	NA	1	10	5	93
Total claims	581	39	112	76	NA	63	61	NA	6	16	13	165
Average claim amount for claims with payment or reserve	\$18,778	\$11,540	\$12,957	\$8,713	NA	\$15,245	\$4,705	NA	\$16,723	\$6,186	\$2,981	\$8,809
2003 Claims												
No payment or reserve	401	19	41	35	63	30	NA	NA	6	2	12	62
With payment or reserve	162	25	61	83	99	38	NA	NA	3	2	11	123
Total claims	563	44	102	118	162	68	43	NA	9	4	23	185
Average claim amount for claims with payment or reserve	\$20,963	\$11,255	\$8,895	\$8,549	\$11,220	\$11,145	\$8,782	NA	\$13,616	\$11,835	\$7,334	\$9,918

Notes: The sources are Rice Insurance Services Company and various state RECs.

NA = Not available

NM = Program not mandated this year

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Total claims	598	18	91	72	NA	64	74	NM	NM	22	8	171
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No payment or reserve	343	23	62	34	NA	32	NA	NA	5	6	9	72
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Total claims	581	39	112	76	NA	63	61	NA	6	16	13	165
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Notes: The sources are Rice Insurance Services Company and various state RECs.

NA = Not available

NM = Program not mandated this year

rightmost column in Exhibit 7 shows that the state REC collects the premium in three states: Kentucky, Louisiana and South Dakota. RISC collects the premium in the other nine states. In all cases, the state REC is responsible for ensuring that each licensee is in compliance with the mandatory E&O insurance requirement.

Policy premiums are a function of a number of variables, including: the number of individuals in the group, loss experience, deductible amounts and exclusions. Exclusions are not shown in Exhibit 7 because there are few (although some) differences between the subject states. Generally, the exclusions in mandatory program policies are similar to those in non-mandatory policies, and include transactions where the licensee had a personal interest, the claim was not submitted by the insured to the insurance company during the coverage period, fraud or a crime was involved, environmental conditions are involved, and where the licensee is alleged to have caused personal injury.

Many states have reciprocity agreements for their licensees with other states. Participants in existing state-sponsored E&O programs can obtain coverage in all states with which their state has reciprocity by paying a single \$15 endorsement. As long as the licensee's home state policy meets the minimum E&O requirements of the other state, the licensee is then covered for E&O claims in the other state.

As previously mentioned, some licensees believe that the E&O claim limits, detailed in Exhibit 7, are too low to be effective. However, the \$100,000 per claim limit that currently applies in all mandated states is more than fivefold the average paid claim amount shown in Exhibit 8.¹⁸ In some problem transactions, more than one licensee is involved. In cases where two (or more) licensees are liable, it is possible that the effective single-claim limit is actually \$200,000 (or higher), at least from the damaged party's perspective (*i.e.*, individual agent's claim limits are additive). In addition, because some licensees believe existing claim limits are too low, it is worth noting that the specified claim limits are minimums, not maximums, and a licensee can obtain additional coverage from the insurance provider. The premium for additional coverage depends on a number of factors including the amount of coverage, whether the applicant is a group or individual, and the claim history of the applicant (*i.e.*, policy details on coverage above state minimums are not covered by mandatory E&O insurance regulations).

Recent State-sponsored Plan Claim Activity

The E&O claim history for state mandated programs for the period 2001 through 2003 is summarized in Exhibit 8. During this period, the number of annual claims ranged from only 4 in South Dakota during 2003 to 598 in Colorado during 2001. The average claim amount paid ranged from \$4,705 in Nebraska during 2002 to \$20,963 in Colorado during 2003. When including all states, there is no clear trend in the number of claims filed over the time period examined or in the average claim amount paid.

Recommendations for Policymakers Considering Mandatory E&O Insurance

In this section, several recommendations for policymakers contemplating a mandatory E&O program are presented. First, it is best to keep statutory requirements as basic as possible because circumstances may change and it is sometimes problematic to amend legislation. To facilitate this effort, legislation from states with mandatory programs (which vary in the amount of detail) should be examined when formulating proposed legislation. Most state statutes provide that the REC shall determine the terms and conditions of coverage, including the minimum policy limits, permissible deductible and permissible exclusions through rules and regulations. This is an effective method that may ease program administration if future changes in these items are required. Rules and regulations tend to be easier to modify compared to statutes.

Second, despite the fact that the statutes of most states with mandatory E&O insurance specify a maximum policy premium (Exhibit 7), such a specification is not recommended. A statutory price limit can create problems in the event the maximum premium amount becomes unrealistic due to changes in market conditions. In fact, this problem has already occurred in more than one state, necessitating an amendment to the statutes. Again, greater flexibility is available when the statute gives the REC the authority to set a maximum price, which can be adjusted to account for inflation or a change in market conditions.

Third, specifying a minimum A.M. Best rating requirement by statute is not recommended. There are often only one or two bidders for mandated E&O insurance programs and restrictive rating requirements in the statute may further limit competition. In an effort to ensure financial stability of its insurance carrier, two states established a minimum A.M. Best rating requirement by statute (as did Alabama). Most states, however, do not include this item in their statutes. Instead their legislation allows the REC to either establish the minimum rating requirement in the RFP specifications or to consider the company's rating as a factor when evaluating bid proposals.

Fourth, if the state has a real estate recovery fund in place, it is recommended that the recovery fund be maintained to protect the public for legitimate claims that either exceed E&O policy limits or claims that are excluded by the E&O policy. However, at the time mandatory E&O insurance is being contemplated, it is important to consider the interaction of allowable claims and claim limits for both the recovery fund and E&O program. Upon implementation of mandatory E&O insurance, several states in the sample modified their recovery fund claim limits or criteria.

Fifth, licensees should be given the option to obtain coverage independently so long as the coverage at least meets state requirements. Sixth, mandatory E&O should only apply to active licensees. All states with mandatory E&O follow both of these prescriptions. Without the latter, licensees considering temporarily leaving the business would have an incentive to drop their license rather than transferring to inactive status.

Seventh, in all phases of the process (*e.g.*, drafting legislation, formulating rules and regulations and drafting RFPs), a good resource is the state's risk manager. As an expert on insurance issues, the risk manager can help establish reasonable coverage terms and conditions, and later assist in an evaluation of the financial strength of bidding companies. Finally, during the program investigation phase, regulators should make it clear to all parties exactly why the change is being contemplated (*e.g.*, lower premiums, consumer protection). In addition, regulators should encourage, and seriously consider, licensee input on the proposal.

Conclusion

E&O insurance provides important financial protection for the public and real estate licensees, but tightening in the insurance market is reflected in increasing premiums. The group insurance policies offered in conjunction with mandatory E&O insurance state programs offer a vehicle to help control these costs. Twelve states currently require their active real estate licensees to have E&O insurance: Colorado, Idaho, Iowa, Kentucky, Louisiana, Mississippi, Nebraska, New Mexico, North Dakota, Rhode Island, South Dakota and Tennessee. An impressive 68% of REALTORS and eight of nine regulators from these states who responded to the survey expressed satisfaction with mandatory E&O insurance. Licensee respondents did, however, express concern that having E&O insurance makes them a target for frivolous lawsuits, and also that policy claim limits are too low. The former concern may (or may not) be true regardless of whether coverage is mandatory. Regarding the latter concern, it was shown that the \$100,000 per claim limit that currently applies in all mandated E&O group policies is livelfold the average amount paid per claim over the 2001–2003 time frame, and additional coverage can be obtained by licensees unwilling to assume the risk that they will not be the subject of a successful claim in excess of the limit.

Analysis of the survey data indicates that licensee satisfaction with mandatory E&O insurance is significantly related to four of eight variables tested. Licensees with a claims history are more satisfied than those with no claims history. Licensees who stated that they would continue coverage even if coverage was not mandatory are more satisfied than those who stated that they would not. Licensee satisfaction is also positively related to the number of years of experience possessed by a licensee. Perhaps most importantly, licensees who have worked under both a voluntary and mandatory E&O system are more satisfied with mandatory E&O insurance compared to those who had worked only under a mandatory system.

Licensee satisfaction with mandatory E&O programs was found to not be related to the other variables tested. No significant difference in satisfaction was discovered between licensees who pay for their own coverage and those who pay only some, or none, of the premium; licensees who obtained coverage through their state-sponsored plan and those who obtained coverage independently; and licensees located in a state with a recovery fund and those located in a state without a recovery fund. In addition, no significant difference in satisfaction was discovered between females and males.

Survey responses from state real estate regulators provide a wealth of valuable information. Motivations for instituting a mandatory E&O insurance program include