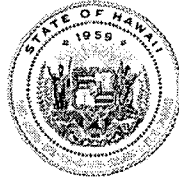


**SB 1062**



LINDA LINGLE  
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**PRESENTATION OF THE  
PROFESSIONAL AND VOCATIONAL LICENSING DIVISION**

TO THE SENATE COMMITTEE ON COMMERCE AND  
CONSUMER PROTECTION

TWENTY-FIFTH STATE LEGISLATURE  
REGULAR SESSION of 2010

Thursday, February 18, 2010  
9:00 a.m.

**TESTIMONY ON SENATE BILL NO. 1062, RELATING TO PROFESSIONAL  
EMPLOYER ORGANIZATIONS.**

TO THE HONORABLE ROSALYN H. BAKER, CHAIR,  
AND MEMBERS OF THE COMMITTEE:

My name is Celia Suzuki, Acting Licensing Administrator of the Professional and Vocational Licensing Division ("PVLD"), Department of Commerce and Consumer Affairs ("DCCA"). The DCCA appreciates the opportunity to testify on Senate Bill No. 1062, Relating to Professional Employer Organizations.

Senate Bill No. 1062 creates a new chapter to regulate professional employer organizations (PEOs) by having them register with DCCA. Section 26H-6, Hawaii Revised Statutes, currently requires that new regulatory measures being considered for enactment be referred to the Auditor for a sunrise analysis. Referral shall be by

concurrent resolution that identifies a specific legislative bill to be analyzed. The statute further requires that the analysis shall set forth the probable effects of regulation, assess whether its enactment is consistent with the legislative policies of the Hawaii Regulatory Licensing Reform Act, and assess alternative forms of regulation.

The DCCA strongly supports a sunrise study on this measure, as mandated by law, before regulating professional employer organizations.

If, however, the regulation of professional employer organizations is enacted, we offer the following concerns. Our overall impression of this bill is that it contains conflicting and cumbersome text. It is not only very difficult to understand, it will be impossible to enforce. It is also lacking substantive pieces commonly found in PVLD regulations, which leaves this proposal substantially deficient in affording protection as PVLD-type regulatory laws do.

We would also like to share three points as follows:

- Designating DCCA to administer the regulation of PEOs is questionable. Of the 35 states that regulate PEOs, 17 place oversight under their departments of labor, eight under their insurance division, two under the secretary of state, one under the department of taxation, one under the commissioner of securities, and one under business registration. Five states place oversight under departments of commerce and consumer affairs.
- We understand that this bill may be based on a model act. A model act is not designed to be a one-size-fits-all regulation. A model act is only a starting point from which the act is changed to provide clear direction on what the state has chosen to protect and what is required of the provider of the service to achieve that goal. Who is responsible for oversight has a lot to do with how the regulation is structured. Given the variations of who regulates/oversees PEOs among the 35 states might explain why this PEO bill contains many inappropriate and questionable provisions for a PVLD-type regulation and instead contains provisions applicable to the interest of different governmental agencies. This makes us question if the

purpose for regulation is clear, what is being regulated, and whose interest is being protected.

- Legislative proposals to regulate a new profession need careful review. The sunrise process provides that opportunity with a neutral third party's assessment. The sunrise provides suggestions on who would be the appropriate regulator (the implementing agency), points out flaws with a proposal, what provisions are inappropriate for regulation, and what improvements are needed to the proposal. Despite the Auditor's ultimate recommendation on whether an industry should be regulated, valuable analysis and suggestions provided through the sunrise review assists the legislature, the proponents, and the designated implementing agency to improve the bill for effective regulation.

Other substantive concerns regarding this bill are as follows:

- This bill proposes a registration regulatory scheme. PVLD follows the definition of a "registration" scheme as outlined by the Legislative Auditor, namely that it simply involve having the affected industry enroll with the State so that a registry is created to provide basic information for the public. This translates to providing information on name, address, phone contact information, and an affirmation that some minimum threshold requirement has been met. This proposal does contain a public registry requirement (although its contents are not defined). However, it goes far beyond simply having the Professional Employer Organization ("PEO") enroll with the State; it requires the furnishing of a substantial amount of information and documentation for registration and renewal. Such information and documentation are not for purposes of providing information to the public since the bill deems information filed with the department to be confidential and shall not to be published or made available for public inspection. This would make this bill an obvious contradiction of a public registry registration regulatory scheme. If there is a desire to make this bill a true registration scheme, then the bill should be re-written to require only basic information required for a registry and that documents filed for registration become public information.
- We note that PVLD currently has a regulatory program similar to that of a PEO, the regulatory program for Employment Agencies ("EA"). The EA law is structured to protect the person utilizing the services of the EA for referral to an employer. In the case of a PEO, the bill is not structured to protect the "covered employee", but instead appears to protect the PEO and the client using the PEO's services, which is another business. The proposal goes to extensive lengths to codify such business relationships with expectations and the responsibilities shared between the two spelled

out, but does little to codify protections to the covered employee. Laws under PVLD are not to protect business relationships, or for that matter, a business. The focus of the bill is not a fit with DCCA/PVLD. If there is a desire to make it a fit with PVLD, then the bill should be re-written to parallel the EA law and protect the interests of the covered employee and all provisions relating to protecting the business relationship between the PEO and client be removed.

- Presuming this bill was intended to provide some protection or benefit for the covered employee, it clearly falls short. Items related to the covered employee consist of the requirement that the employee be furnished with the agreement between the PEO and its client and worker's compensation insurance, and one section in the bill is dedicated to describing the responsibilities of the PEO to the covered employee. On the issue of the PEO agreement, the provisions in the bill simply describe the relationship between the PEO and its business client. There is nothing that speaks to the relationship and protections offered to the covered employee in this tri-party employment arrangement. On the matter of worker's compensation insurance, the proposal leaves unanswered the question of who will provide this insurance? In one section of the bill it would appear the PEO is to provide it, yet another part of the bill states "... irrespective of which co-employer obtains the workers compensation coverage." Such lack of clarity could negatively impact the covered employee. It is also interesting to note that the section in the bill on worker's compensation goes far beyond coverage for the covered employee. It extends to employees of the PEO's client. This reinforces our belief that this proposal is being geared towards protecting the business relationship between the PEO and client. In fact, the one section that speaks to the responsibilities of the PEO to the covered employee is only 1/2 a page of this 19-page bill. Finally, for the prohibited conduct described in the bill (in the "Enforcement" section), it would be expected to cover conduct detrimental to the covered employee. However, only a short list related to filing issues with the department is contained. One questions whether there is any harm or injury to protect against that warrant regulation of PEOs.
- This bill appears to reflect a misunderstanding of how a state regulator, such as PVLD, carries out its regulatory function. This bill requires the PEO to file information and documentation for registration and renewal of registration. This includes reporting all other state jurisdictions that the PEO has conducted business, business experience of the persons who own or control the PEO, business experience of persons who will run the company, and an audited financial statement of the PEO. What is unapparent to PVLD is that the bill does not provide that the substance of such information is to be at an acceptable threshold level as a condition

for registration (which is the basis of all PVLD's regulatory laws). PVLD appears to be simply a depository for such information. However, when information and documentation are filed with PVLD, there is an expectation, whether clearly stated in the law or implied, that we are to review the documents to determine the appropriateness of granting the privilege and status of being state recognized. If the bill were to be re-written to make it a fit with PVLD so that we are more than a depository of information, the bill then becomes something much more than a registration scheme. If intended to simply be a process to file documentation with a depository to register a business, then we are not the candidate for implementation.

- Regarding the audit requirement for registration and renewal that is covered quite extensively in the bill, we presume the proponents saw some value with requiring audits as a financial integrity piece to register the PEO. However, the bill undercuts the value of audits by forgiving a PEO operating in the State prior to 1/1/2010, from filing an initial audit. The PEO is instead allowed to belatedly file the audit 24 months later, long after the PEO enjoys the full privilege and status of being state registered, and potentially injuring parties because they did not have the financial wherewithal to provide the services. This is of great concern to PVLD. Also, the bill provides that in lieu of filing an audit, the PEO may post alternative security (bond, letter of credit, securities). PVLD's regulatory laws require alternative security to supplement an audit, not replace it. On the matter of the alternative security of a bond, PVLD's regulatory laws provide specific parameters on the bond (i.e., that the surety be licensed to do business in this state, the amount of the bond, what is covered under the bond, and who the bond runs to). This bill however provides nothing along those lines. In fact, although in relation to perceived abilities for the registrant to arrange electronic filing of its bond by an assurance organization (which we take to mean the surety) with the department, the bill provides that the use of an approved assurance organization shall be optional rather than mandatory. In the absence of language that defines the parameter for the surety/assurance organization, this simple statement leaves it up to the registrant to choose 'any kind' surety when securing a bond. PVLD believes such an arrangement would provide no enforceable protection to any party.
- While the proposal implies it is for registration and oversight of a PEO, the bill also infers a "PEO group" is a covered entity. What should be a simple straightforward registration scheme of a specific business, becomes complicated by recognizing different formations of such business arrangements. PVLD regulatory laws are not structured to do that.

- Regarding the definition portion of the bill and the numerous terms defined, the focus is on defining the parties in the PEO and client relationship. This, again we believe, is regulation geared towards regulating the business relationship between the two parties. There is also an exemption from registering as a PEO for temporary help services. However, the parameters of such services are so ill-defined and confusing that DCCA cannot determine who would or would not fit into such an exemption. Left as is, this would create a loophole allowing most, if not all, entities to escape regulation, which then begs the question, why have registration?
- In cases where PVLD laws regulate a business, a person is held responsible for managing the business and responsible for all business transactions and actions of that business. Our regulatory laws commonly refer to this person as a responsible managing employee or principal agent. Such person is also required to meet requirements set forth in the law, to be recognized. Both the business and the responsible managing employee are tied together and for the business to be recognized, it must have a responsible managing employee. In cases of discipline because of harm to persons utilizing the services of the business, both the business and the responsible managing employee are held accountable. This bill contains no such provisions.

Other concerns with the proposal, less significant but nevertheless problematic, are as follows:

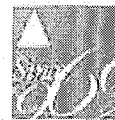
- The proposal sets forth a renewal period tied to the PEO's fiscal year. PVLD regulatory laws do not tie renewals to activities of the business, rather they are set in accordance with renewal timetables we establish. If the purpose was to coincide renewal with the audit required for renewal, that need not be a factor. The bill also lacks standard provisions relating to renewals that are used by PVLD regulatory authorities that set forth consequences for failure to renew.
- The bill sets forth fees for registration and renewal. It is premature to designate fee amounts until after there is an analysis of the costs related to start-up and maintaining this new regulatory program. PVLD registration fees are based on all expenses to regulate an area, to be borne by the registrants.
- The bill has a provision which attempts to address an anticipated conflict with the PVLD Employment Agency ("EA") law. The solution offered is to simply have this new PEO law supersede the EA law in situations of conflict. This provision brings into question what kinds of conflicts would

exist between the two laws? Do practices of the businesses overlap or cross over in some degree that a PEO could be considered acting as an EA? The practices of an EA and PEO should be significantly distinct or if a business provides more than ancillary services which falls under the other law, then they should fall under two laws (with one governing the PEO activities, and the other governing the EA activities). Not knowing why supremacy is afforded the PEO law over the EA law, DCCA is unsure of the reasons for such a provision. We would request that this provision be examined carefully to ensure it does not negate the applicability of the EA law when warranted.

- The effective date of the Act is shown as January 1, 2010. No specific date should be included until all substantive issues with this proposal are resolved.
- Depending on how this bill may advance, PVLD must have a place holder in the bill to address resource needs for implementation and oversight depending on what workload impact we will face.

Thank you for the opportunity to provide testimony on Senate Bill No. 1062.





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February 17, 2010

Senator Rosalyn H. Baker, Chair  
Committee on Commerce and Consumer Protection  
State Capitol  
415 South Beretania Street  
Honolulu, Hawaii 96813

**Re: Support for SB1062 Relating to Professional Employer Organizations  
February 18, 2010, 9:00 a.m., CR 229**

Dear Senator Baker:

My name is Barron Guss, President and second-generation owner of ALTRES, Inc., a 40-year old Hawaii company. I am here today to testify in support of SB1062, Relating to Professional Employer Organizations.

### **Background**

Professional Employer Organizations act as the human resources and administrative arm of over 2,000 of Hawaii's small businesses. In this capacity, a PEO prepares payroll, provides workers' compensation, health insurance and enhanced lifestyle benefits to the employees of the clients they serve, which now number over 20,000.

For more than 30 years, ALTRES has been providing these services and promoting the benefits of the PEO relationship for Hawaii's businesses. Since that time, the industry has grown with a solid list of local providers of these services. In recent years, the Legislature has recognized PEOs with the passing of Act 225, which clarified the manner in which PEOs handle the monies they receive for distribution on behalf of their clients and employees as well as how the General Excise Tax is applied.

### **Why Registration**

Last year, when we began this process, I cited that we were very fortunate that the local PEO providers had been reputable and professional in the manner in which they conducted business, and that the questionable business practices had been limited to the mainland. A year has passed and I am sorry to report that due to the failing economy and desperate measures, new providers have started up and some are simply modifying or interpreting laws to fit their needs.

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PEO failures can have a negative impact on local government, businesses and their employees. It can come in the form of failure to pay taxes, including withholding, social security and retirement benefits, as well as sometimes creating a lapse or gaps in insurance coverage, leaving affected parties to fend for themselves.

Traditionally, an industry asks for licensure and registration to protect its home turf and to provide a competitive advantage for its incumbent businesses. That's not true in this case, as in my 30-year history of promoting these services, I have come across businesses that have subscribed to the services of a mainland PEO, and now local ones as well, only to discover that there has been no adherence to Hawaii State laws, including our pre-paid health act, TDI, as well using non-admitted carriers for workers' compensation insurance. Registration would allow Hawaii authorities to put these businesses on notice for our requirements as well as ensure that Hawaii's businesses and their employees are protected from these bad faith providers.

### **Transparency**

Two sessions ago, there was a working group formed to study the current status of PEOs in the State and their effect, if any, on labor issues, insurance practices and general business issues. At that time, it was agreed that there were no issues with the industry locally, but the establishment of transparency and operational standards would be a prudent measure, given the past problems on the mainland. Currently, there are over 35 states that have adopted PEO registration and the National Association of Professional Employer Organizations (NAPEO) is working to ensure that the other 15 will not have to worry about exposure in this area.

The proposed Legislation calls for declaration of the PEO as well as adherence to certain operational standards, including audited financial statements, positive net worth, and proof of coverage for workers' compensation insurance. I would like to work with the various committees to strengthen the Bill to include proof of coverage for medical insurance, if applicable, as well as TDI.

### **Revenue Positive**

NAPEO, the National Association of Professional Employer Organizations, cites that over 25 of its current members claim to have employment relationships with persons in the State of Hawaii. It is important to note that there are a number of PEOs in the State that currently do not belong to NAPEO, as well as service providers that do not necessarily show up on the radar, bringing the potential number of service providers to more than 50.

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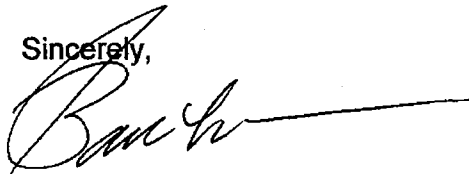
There is currently a proposed \$1,500 service fee for each registration, bringing a positive financial impact of \$75,000 to the State.

**Summary**

Coming from an industry that stresses that its main benefit is to provide simplicity for business owners, it is ironic that I am asking for more government regulation and paperwork. However, I feel it is imperative that our industry and the State move toward creating an environment of transparency and accountability in the PEO industry.

Thank you for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read "Barron L. Guss", with a long horizontal line extending to the right.

Barron L. Guss  
President and CEO

BLG:lo