ALTRES®

February 23, 2012

The Honorable David Y. Ige, Chair
The Honorable Michelle N. Kidani, Vice Chair
Committee on Ways and Means
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: SB2424 Relating to Professional Employer Organizations
February 24, 2012, 9:00 a.m., CR 211

Dear Senators Ige and Kidani:

I would like to thank you and your committee for your efforts to implement PEO registration. My name is Barron Guss, President and second-generation owner of ALTRES, Inc., a 43-year old Hawaii company and Hawaii's oldest Professional Employer Organization. I am here today to provide testimony in support of SB2424 with modification

By way of background information, recently our industry representatives have worked hand in hand with legislators, the DLIR, DCCA and other government leaders to create the framework of the draft in its current form. Although it's not perfect, I feel we are making positive headway towards a bill with which we all can live.

Because of the complexity of the subject matter, I am submitting my comments in topic format so they may be easily followed and referred to during the legislative process.

Responsibilities

In recent discussions with various parties, we have brought up the concern that PEOs cannot assume all of the responsibilities associated with being the employer; i.e., payment of wages, taxes and insurances, unless their clients provide the funds to do so. Additionally, the way the draft law is written, if the PEO were made specifically responsible for the provision of workers' compensation, would there be a question as to whether the exclusive remedy provisions apply, even though the Hawaii Supreme Court ruled affirmatively on this very matter in Peter Frank vs. Hawaii Planing Mill Foundation?

For purposes of clarity, may I suggest that Section 373-L-F be revised to read as follows:

Section 373-L-F - **Professional employer agreements.** The agreement between a professional employer organization and its client company shall state that the professional employer organization shall be deemed the employer for purposes of unemployment insurance, workers' compensation (and the exclusive remedies provision of Chapter 386 shall apply to both the client and the professional employer organization with respect to workers' compensation coverage secured by the professional employer organization), temporary disability

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insurance, and prepaid health care coverage, providing the client company meets its obligations under the Professional Employer Organization agreement.

Bond Requirements

In previously submitted testimony, I suggested the use of the State's form UC-B6, Quarterly Wage, Contribution and Employment and Training Assessment Report for a basis of calculation regarding registration fees as well as bonding level requirements.

By using the information contained in UC-B6, the DLIR will have in hand a simplified way to gather and calculate the information necessary to establish the appropriate schedules for payment of fees and bond level, versus the current draft of the law, which requests information that must be gathered from various sources and, in some cases, is not applicable, i.e., a self-insured PEO that does not pay workers' compensation premiums to a third party carrier.

In light of the above, may I suggest that the following language be inserted in 373L-3 Paragraph (2):

"All other professional employer organizations shall post a bond in an amount equal to one percent of the organization's prior year's total wages or a bond amount of $1,000,000, whichever is less; provided that the amount of the bond shall be no less than $500,000. The bond amount, for the purposes of this section, shall be calculated based on the total gross payroll as reported on the professional employer organization's fourth quarter form UC-B6: Quarterly Wage, Contribution and Employment and Training Assessment Report filed with the department of the preceding year, annualized."

Assurance Organization and Bonding Language

Under separate testimony from ESAC, you will hear that the draft language is not in conformity with standard practices and protocol currently used in the financial industry as well as other states that have enacted registration. I ask that you please take their comments into consideration as you move this bill forward.

Thank you for this opportunity to provide testimony and comment on this proposed legislation.

Sincerely,

Barron L. Guss
President and CEO

BLG:lo

The Twenty-Sixth Legislature
Regular Session of 2012

THE SENATE
Committee on Ways and Means
Senator David Y. Ige, Chair
Senator Michelle N. Kidani, Vice Chair
State Capitol, Conference Room 211
Friday, February 24, 2012; 9:00 a.m.

STATEMENT OF THE ILWU LOCAL 142 ON S.B. 2424, SD1
RELATING TO PROFESSIONAL EMPLOYER ORGANIZATIONS

The ILWU Local 142 supports S.B. 2424, SD1, which adds powers and duties to the Director of Labor and Industrial Relations regarding the registration and regulation of professional employer organizations (PEO's) and authorizes various penalties for noncompliance.

Professional employer organizations fulfill a definite need for smaller employers who seek the advantage of numbers in negotiating for health plans and other insurance-based benefits. However, the ILWU is opposed to the use of PEO's when there is a collective bargaining agreement in place as employers tend to use PEO's as a buffer between themselves and unions representing their employees. PEO's are also often used to muddy the waters when labor unions attempt to organize workers, raising the question of who the employer really is.

S.B. 2424, SD1 will provide more authority to the Department of Labor and Industrial Relations to register and regulate PEO's and ensure that they follow the law. We anticipate that DLIR will assist to ensure that PEO's are not used to circumvent the legal rights of workers who are in collective bargaining arrangements or are seeking to unionize.

The ILWU urges passage of S.B. 2424, SD1. Thank you for considering our views and concerns.

EMPLOYER SERVICES ASSURANCE CORPORATION
E·S·A·C
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Sent February 23, 2012 via Email to CPNtestimony@capitol.hawaii.gov and via US Mail to:

The Honorable Rosalyn H. Baker, Chair
The Honorable Brian T. Taniguchi, Vice Chair
Committee on Commerce and Consumer Protection
Hawaii's Twenty-Sixth Legislature
Regular Session of 2012
State Capitol
415 Beretania Street
Honolulu, HI 96813

Re: Testimony of Employer Services Assurance Corporation concerning the Committee on Commerce and Consumer Protection's February 24, 2012 hearing on SB 2424 relating to Professional Employer Organizations

Dear Senators Baker and Taniguchi,

On behalf of the Employer Services Assurance Corporation ("E·S·A·C"), the only national accrediting entity and assurance organization for Professional Employer Organizations ("PEOs"), we once again appreciate the opportunity to provide testimony with respect to amendments you are considering to Chapter 373L, Hawaii Revised Statutes ("HI's PEO law").

We greatly appreciate the modifications you've recently made to SB 2424 to: (i) reduce some of the unnecessarily burdensome bonding requirements (at least with respect to PEOs accredited by an assurance organization; (ii) give the director of labor and industrial relations access to important additional compliance information; (iii) minimize the cost of administration; and (iv) provide more effective public protection. More specifically, we thank you for adding authority to SB 2424, to enable the director to approve an assurance organization that would provide certification and financial assurance for qualified PEOs and PEO Groups who elect to use an assurance organization as an alternative means of satisfying Hawaii's PEO requirements.

While my previous testimony spoke to some of the value and protections ESAC's program affords which I will not restate today, certainly a part of the financial assurance ESAC provides is with respect to its bonds. Along with ESAC's certification of a PEO's compliance, early warning system and other compliance information and assurances, most states that have approved ESAC as an assurance organization have accepted ESAC's financial assurance, including its bonds in place for ESAC-accredited PEOs, in lieu of otherwise applicable state PEO bonding requirements. This has been done recognizing that the best regulatory protection is to require proven financial reporting and compliance monitoring, such as ESAC has used successfully since 1995, that will allow the agency to identify a developing problem before it happens so preemptive action can be taken to protect the public.

As an overview of our Financial Assurance Program, ESAC provides a $1 million surety bond on each accredited PEO and a $10 million bond to cover any claims in excess of the $1 million specific bonds. All bonds are written by an A-rated surety company licensed in all states and are held in trust for the benefit of participating clients, employees, agencies and insurers at Regions Bank.

ESAC's surety underwriter must approve the bonding of each applicant PEO based on a bond application, indemnity agreement and audited financial statement before ESAC's accreditation committee and board consider accreditation approval. The surety underwriter also reviews the PEO's quarterly financial information and independent CPA verification of timely payment of key employer liabilities.

Although ESAC currently accredits over 130 PEO entities representing over $40 billion in annual employee wages, it has never had a financial default of an accredited PEO or a claim against any surety bond. ESAC's standards and procedures have been carefully established based on over 17 years of accreditation experience to detect developing PEO financial problems and take corrective action before they occur. The surety's understanding and confidence in ESAC's standards and procedures are why the surety is willing to provide millions of dollars of bonding at an affordable cost to ESAC and its accredited PEOs.

In the unlikely event of a financial default by an accredited PEO, ESAC's claims committee composed of three independent directors and ESAC's general counsel, legal advisor and trustee would administer claims in accordance with the terms of the certificate provided by ESAC to each client of an accredited PEO (be they located in Hawaii or another state).

With those comments and overview of our bond program in mind, ESAC respectfully recommends:

(1) Section 5 of SB 2424 be further amended, consistent with the recent amendments to Section 6, to clarify that an approved assurance organization may act on behalf of its PEO members in complying with the registration and bonding requirements of the chapter. {While there is presently a reference within the second sentence of subsection (d) to the "other assurance" which an assurance organization approved by the director may provide, the next sentence only speaks of the assurance organization acting on the PEO's behalf in complying with the registration requirements of the chapter.}

(2) Section 6 be further amended to provide that a PEO which is accredited by an approved assurance organization may satisfy the bonding requirements of Section 373L-3 through the $1,000,000 and $10,000,000 excess bonds acquired on each accredited PEO's behalf through the assurance organization's surety underwriter in lieu of the requirements of Section 373L-3 Hawaii Revised Statutes. {Presently, the opening phrase of subsection (c) only addresses a couple of subsections within this bonding section, as opposed to all of the Section, as it reads: "…in lieu of the requirements of subsections (a) and (b)…".

(3) Section 6 be further amended to clarify, that with respect to coverage under these assurance organization bonds, said coverage is "subject to the terms and conditions of the surety bonds issued under the assurance organization's client assurance program". {The closing two lines of subsection (c) read: "…for the benefit of the state…"; and then subsection (g) speaks of the director or any person having actions against the bond short of obtaining any final judgment. The existing ESAC bonds, presently in place principally for the benefit of the businesses and employees which contract with ESAC accredited PEOs, are written with the Employer Services Trust as obligee to cover specifically defined employer liabilities, including wages, state and federal payroll taxes, fully-insured insurance premiums paid in advance of each period of coverage (e.g. monthly, quarterly or annually), and contributions to defined employee retirement plans. ESAC's bonds are written that way because the surety required ESAC to have specific definitions of the various covered liabilities of accredited PEOs. This bond coverage is certainly beneficial to states, but the director is not a named obligee under these bonds.

I hope you find this helpful as you strive to create the best possible PEO law and regulatory structure for Hawaii. If you would like to discuss this further, I and the entire team at ESAC, will be happy to help.

Sincerely,

Jay Morgan
ESAC’s General Counsel and VP of Compliance and Regulatory Services

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Professional employer organizations; special fund

BILL NUMBER: SB 2424, SD-1

INTRODUCED BY: Senate Committees on Commerce and Consumer Protection and Judiciary and Labor

BRIEF SUMMARY: Amends HRS section 237-24.75 to replace the term "professional employment organization" with "professional employer organization" and the term "assigned employees" with "covered employees."

Repeals and merges HRS chapter 373K into chapter 373L. Transfers the statutory language delineating the general excise tax exemption including the requirement that employee benefits required by law be provided to employees of the client company by the client company, from HRS 373K to the chapter 373L and replaces the term "professional employment organization" with "professional employer organization" and term "assigned employees" with "covered employees."

Adds a new section to HRS chapter 373L to establish a professional employer organization special fund to be administered by the department to implement and operate the registration of professional employer organizations established by this chapter. Moneys collected as fees or fines under HRS sections 373L-B, 373L-C, 373L-D, and 373L-G shall be deposited in the fund. The fund may be expended for personnel and operating expenses and staff training.

Allows the director of labor and industrial relations (DLIR) to establish additional positions to carry out the purposes of HRS chapter 373L.

Appropriates $177,500 out of the professional employer organization special fund for fiscal 2013 to DLIR for the purposes of this act, including the hiring of additional staff. The appropriation shall take effect on July 1, 2012.

EFFECTIVE DATE: July 1, 2050

STAFF COMMENTS: In 2007 the legislature by Act 225 established HRS chapter 373K to provide that amounts received by a professional employment organization from a client company in the course of providing professional employment services which are disbursed as employee wages, salaries, payroll taxes, insurance premiums, and benefits are exempt from the general excise tax. While in 2010, the legislature, by Act 129, established registration requirements for the professional employer organizations and established a new HRS chapter 373L, this measure merges HRS chapter 373K into chapter 373L, including the provisions delineating the general excise tax exemption.

While the measure also proposes to establish a professional employer organization special fund, it should be remembered that the 1990 legislature directed the State Auditor to evaluate all special and

revolving funds as of July 1, 1990 and recommend whether they should be continued or eliminated. The Auditor is also to examine any new or proposed special or revolving funds that would decrease general fund revenues. While the Auditor had a completion date of 1995, the review was completed in 1992. The Auditor's report noted that, "Special funds give agencies full control of these unappropriated cash reserves, provide a way to skirt the general fund expenditure ceiling, and over time erode the general fund. Many experts say that special funds are likely to hamper budget administration. And from a legislative perspective, they are less desirable because they are not fully controlled by the appropriation process."

Given the findings of the Auditor and the current financial crisis, it is quite clear that the creation of numerous special funds has eroded the integrity of state finances. Moneys in special funds are neither subject to the general fund expenditure limitation nor to the close scrutiny that general funds are subject to in the budgeting process. Special funds that earmark general fund revenues cannot be justified as they restrict budget flexibility, create inefficiencies, and lessen accountability. Further, as evidenced by recent legislative sessions, special funds have been raided in the search for additional revenues. The creation of another special fund by this measure cannot be justified.

Digested 2/23/12

Testimony to the Senate Committee on Ways and Means
Friday, February 24, 2012
9:00 a.m.
Conference Room 211

RE: SENATE BILL 2424 SENATE DRAFT 1 RELATING TO PROFESSIONAL EMPLOYER ORGANIZATIONS

Chair Ige, Vice Chair Hidani and Members of the Committee:

ProService Hawaii provides employee administration services to over 1,000 small businesses in Hawaii, representing over 13,000 employees in Hawaii. As a professional employer organization (PEO), we ensure that our clients remain compliant with Federal and State employment and labor laws, while allowing them to focus on their core business, providing needed and valuable services to the people and the economy of the State. In addition, we ensure that our clients' employees receive timely payment of wages, workers' compensation, TDI and benefits coverage. We also provide HR training and services, dispute resolution, and safety services to our clients and our clients' employees.

We support the efforts of this legislative body to regulate the PEO industry, as it is in this state's and our industry's best interests to have well-functioning firms serving the community. We support the intent of ensuring that only compliant and well-managed PEOs operate in Hawaii. However, we ask for balance between the need for regulatory oversight of the industry and PEOs' ability to conduct business in the State. **We offer the following comments on Senate Bill 2424:**

The proposed language for Chapter 373L-F states,

> The agreement between a professional employer organization and its client company shall state that the professional employer organization shall be deemed the employer for purposes of unemployment insurance, workers' compensation,

> temporary disability insurance, and prepaid health care coverage.

This language appears to allow client companies to "contract out" their liabilities and responsibilities as an employer for unemployment insurance, workers' compensation, temporary disability insurance, and prepaid health care coverage. We strongly urge that you revise this provision as is fair, practical and reasonable.

The PEO cannot assume the sole responsibilities to provided mandated benefits to the client company's employees unless the client company has remitted all of its hours and wages to the PEO, along with the associated payroll taxes, premiums, and other funds. We believe this is not good public policy and does not match the way other states and federal agencies have understood the co-employment relationship. For example, both OSHA and EEOC, along with many state agencies, hold the client or "worksite employer" responsible for conduct at the workplace and limit the PEOs responsibility to the scope of their services provided to the client under the client agreement. Under the PEO relationship, the client company is still held responsible for its employer's obligations; the PEO is hired to assist in meeting those obligations under the terms and conditions set forth in the PEO agreement.

We further believe that a complete transfer of liability from the client to the PEO will deteriorate self-enforcement that will negatively affect the worksite employees and their families. It will exacerbate the cash-paying economy, which will negatively impact state taxation revenues, unemployment contributions, and the health of the workers' compensation, temporary disability and health care systems.

We respectfully ask that this be amended to read as follows:

> The agreement between a professional employer organization and its client company shall state that the professional employer organization shall be deemed the employer for purposes of unemployment insurance, workers' compensation, temporary disability insurance, and prepaid health care coverage <u>providing the client company has met its obligations and responsibilities under the agreement</u>.

Under Chapter 373L-D, we note that form UC-B6, "Employer's Quarterly Wage, Contribution and Employment and Training Assessment Report", is used to determine the biennial renewal fees. We respectfully ask that, for sake of consistency, the same form and calculation methodology be used for purposes of calculating the bond requirement under Section 373L-3.

Since PEOs do not "assign employees" to client worksites, but rather enter into co-employment agreements with client companies in which employment responsibilities are shared between parties, we request that the definition of "client company" in Section 373L-1 to read as follows:

> "Client company" means any person that contracts with a professional employer organization and [~~is assigned employees by~~] co-employs employees with the professional employer organization under that contract.

We are also concerned that the language in Section 373L-C(5) may give the Director authority to revoke or deny licenses based on inadvertent, technical and non-material errors on any document. We ask that this committee revise this provision to read as follows:

> (5) "Knowingly makes [~~any~~] a material false statement, representation, or certification in any document or record required to be maintained under this chapter."

Finally, we ask that Section 373L-E (2) be revised to read "Establishing fees and fines in accordance with chapter 91; and Section 373L-E (4) be deleted due to redundancy.

Thank you for the opportunity to submit testimony.