MEMORANDUM OF LAW

DATE: December 19, 2001

TO: Stephen Haase, Assistant Director
Development Services Department

FROM: City Attorney

SUBJECT: Ratings Requirements for Sureties

QUESTION PRESENTED

Where the Municipal Code requires parties to produce performance bonds for their work, may the City require bonds from sureties with an A.M. Best rating of "A" or better?

SHORT ANSWER

Yes. The City may require bonds from sureties with an A.M. Best rating of "A" or better because such requirements concern a municipal affair.

DISCUSSION

THE CITY MAY REQUIRE THAT PARTIES HAVING TO PRODUCE BONDS UNDER THE MUNICIPAL CODE OBTAIN THEM FROM SURETIES WITH MINIMUM RATINGS

> Under the San Diego Municipal Code [the Code], permitees performing work under different permits, including grading, encroachment, and public improvement permits, must produce bonds to secure their performance. San Diego Municipal Code 62.0111 and 129.0119. Such bonds assure that the City will be able to safely complete the work should the permitee fail to do so, consequently avoiding negative secondary effects like drainage or runoff problems on other property. Because of this goal, it is important to ensure that the bonds the City accepts come from sureties with the financial ability to meet their commitments should a default occur. However, the City rarely has the time or

resources to investigate the surety of every bond given to it. As a consequence, the City relies on evaluations by professional services such as A.M. Best, and requires bonds from sureties with minimum ratings.

State law conflicts with this minimum ratings requirement. In California, the Bond and Undertaking Law creates guidelines for bonds given as security pursuant to a statute or ordinance. Cal. Civ. Proc. Code 995.020. Where a principal posts a bond for security pursuant to a city ordinance, section 995.670 states: "No public agency shall require an admitted surety insurer to comply with any requirements other than those in Section 995.660 whenever an objection is made to the sufficiency of the admitted surety insurer on the bond or if the bond is required to be approved." As long as the surety shows that it is authorized to transact surety insurance in the state, its assets exceed its liabilities in an amount equal to or in excess of the amount of the bond, and no objections against the surety have been lodged with the Department of Insurance, the insurer is sufficient and the local entity must accept the bond. Cal. Civ. Proc. Code 995.660. Because ratings for insurers are not among these minimum requirements, the Bond and Undertaking Law expects the City to accept a bond regardless of the rating the surety receives.

Where there is a conflict between state and local regulations, courts will look to whether the subject matter of the local rule concerns a municipal affair. Under article XI, section 5 of the California Constitution, a charter city has autonomous authority over its municipal affairs. The purpose of this "home rule" is to curtail the state legislature's authority to intrude into matters of local concern, since cities are familiar with their own local problems and can often act more promptly to address problems than the state legislature. *Isaac v. City of Los Angeles*, 66 Cal. App. 4th 586, 589 (1998). As a result, when there is a conflict between the municipal regulation of a charter city and a general state law, the local rule prevails if its subject matter is a municipal affair. *Bishop v. City of San Jose*, 1 Cal.3d 56, 61 (1969); *Vial v. City of San Diego*, 122 Cal. App. 3d 346, 348 (1981). By contrast, charter cities remain subject to a state law where the matter is of statewide concern and the state law indicates an intent to "occupy the field to the exclusion of [the] municipal regulation." *Bishop,* 1 Cal.3d at 61-62; *Vial*, 122 Cal. App. 3d at 348.

Whether something is a municipal affair depends on the facts of each case:

> We have said that the task of determining whether a given activity is a 'municipal affair' or one of statewide concern is an ad hoc inquiry; that the constitutional concept of municipal affairs is not a fixed or static quantity; and that the question must be answered in light of the facts and circumstances surrounding each case.

Cal. Fed. Sav. And Loan Ass'n v. City of Los Angeles, 54 Cal.3d 1, 16 (1991). The courts, not the state Legislature, make the ultimate decision whether a municipal affair exists. *Bishop*, 1 Cal.3d at 63. Relevant factors may include the jurisdictional impact or effect of the law, language in the state law which expresses an intent to preempt local regulations, and whether the subject matter is beyond the exclusive control of a city. *Id.* at 63; *Cal. Fed. Sav. And Loan Ass'n*, 54 Cal.3d at 18; *City and County of San Francisco v. Boss*, 83 Cal.App.2d 445, 448 (1948). In sum, courts will look for reasons grounded on either statewide or local interests before labeling a given

matter as a municipal affair or a statewide concern. *Johnson v. Bradley*, 4 Cal. 4th 389, 405 (1992).

> Specific examples of municipal affairs found in case law include contracts for city improvements, the treatment and disposal of city sewage, and the levying of taxes to support local expenditures. *Loop Lumber Co. v. Van Loben Sels*, 173 Cal. 228, and 232-34 (1916); *City of Santa Clara v. Von Raesfeld*, 3 Cal.3d 239 (1970); *Cal. Fed. Sav. and Loan Ass'n*, 54 Cal.3d 1, and 11-12. Prior City Attorney Memorandums of Law have also found city public works contracts to be municipal affairs because the City Charter provides a complete scheme for setting their terms. 1993 City Att'y MOL 217; 1982 City Att'y MOL 25.

Consequently, the conflict between the Bond and Undertaking Law and the City's surety rating requirements for bonds under the Code will be resolved in favor of the City where a municipal affair exists. Nothing in section 995.670 of the Bond and Undertaking Law indicates an intent to preempt the local regulations of charter cities. At the same time, City surety rating requirements respond to distinctly local needs and concerns. The requirements exist solely for the protection of City interests. Damage from unfinished work may affect drainage and runoff, in turn causing damage to City stormwater and sewage lines. If the City completes the work for an insolvent surety to avoid this damage, funds for the work come from City coffers. Similarly, the City might find itself in a position of liability to unpaid subcontractors where an insolvent surety failed to meet its obligations. This too places an additional risk on City funds. These risks and their significant local consequences show that surety rating requirements for bonds under the Code concern a municipal affair.

If the City cannot protect itself by requiring bonds from sureties with the financial ability to meet their commitments should a default occur, the demand for bonds under the Code is ineffectual. Simply because a surety has met the minimum requirements for state licensing does not guarantee the surety is safely in a position to secure the performance of a permitee. Surety ratings simply allow the City to act like other prudent consumers by relying on the evaluation of experts before securing their assets, and do not regulate how sureties do business in the jurisdiction. Such requirements merely offer another way for the City to sensibly protect its financial interests from risk.

CONCLUSION

The City currently requires minimum ratings for sureties of performance bonds provided under the Code. Rating requirements protect the City from insurers who do not have the financial ability to complete unfinished work left by defaulting permittees. It is reasonable that the City can rely on the expertise of professionals to secure its financial interests from this risk, which, if realized, has an entirely local impact. If a surety cannot meet its commitments, the City must step in and finish the work with public funds to avoid damage to public property. Because of this local impact, surety bond ratings are a municipal affair, and the City may require parties having to produce bonds under the Code obtain them from sureties with an A.M. Best rating of "A" or better. While surety ratings are not blocked by the Bond and Undertaking Law, a Council Policy setting a threshold for acceptable risk given the size of the work and potential for damage to

public property, may help the City judge when surety ratings are most desirable in a particular case.

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