Department of Legislative Services

Maryland General Assembly
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FISCAL AND POLICY NOTE
Revised

Senate Bill 599 (Senator Conway)

Education, Health, and Environmental Affairs — Health and Government Operations and Economic Matters

Procurement - Subcontractor Equal Access to Bonding Act of 2013

This bill prevents prime contractors who require subcontractors to provide bid, performance, or payment security on specified State procurements from imposing more stringent bonding requirements than the State imposes on prime contractors.

The bill takes effect July 1, 2013.

Fiscal Summary

State Effect: None. Procurement units can implement the bill's requirements with existing budgeted resources. No effect on revenues.

Local Effect: None. The bill applies only to State procurement.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary: The bill applies to most State contracts for supplies, services, or construction-related services.

Bonds provided by subcontractors must be accepted by the prime contractor if the bond would be accepted by the State and provided by either (1) a surety company authorized to do business in the State or (2) the Maryland Small Business Development Financing Authority (MSBDFA).

In a solicitation or pre-bid conference for a State procurement for services, supplies, or construction-related services, the procurement agency must notify bidders that bid security must be (1) a bond provided by a surety company authorized to do business in the State; (2) a bond provided by an individual surety that conforms to State law; (3) cash; or (4) another form of security that is authorized by federal or State regulations or that is satisfactory to the unit.

Current Law: Bid bonds provide assurance that a given bid has been submitted in good faith and that the contractor intends to enter into the contract at the price bid. Bidders or offerors on State construction contracts must provide a bid bond if the contract is greater than $100,000 or if federal law requires it. The bid bond must be for (1) at least 5% of the value of the contract or (2) an amount determined by the procurement officer if the bid or proposal provides only a rate but not a total price. State procurement officers have the option of requiring bidders or offerors on contracts for services, supplies, or construction-related services to provide a bid bond if the contract amount exceeds $50,000. If bid bonds are required, procurement officers determine the value of the required bonds.

Payment and performance bonds protect the State from financial loss if a contractor fails to pay for labor and materials or defaults on a State contract, respectively. They oblige the surety to cover any loss incurred, up to the value of the bond. On State construction contracts that exceed $100,000, prime contractors must purchase a *performance* bond for an amount deemed appropriate by the agency's procurement officer and a *payment* bond for at least 50% of the amount payable under the contract.

MSBDFA provides financing assistance to socially or economically disadvantaged persons in Maryland. MSBDFA's Surety Bond Program assists eligible small businesses in obtaining bid, performance, or payment bonds necessary to perform on local, State, or federal contracts. It may either guarantee a bond from a commercial surety or issue its own surety bonds, but most of its activity involves issuing its own bonds. Chapter 299 of 2006 (HB 169), as amended by Chapter 266 of 2008 (HB 312), increased the limit on the value of surety bonds issued by MSBDFA from $1.0 million to $5.0 million; the cap reverts to $1.0 million on September 30, 2014.

Chapter 299 first allowed bonds issued by individual sureties to be used for bid, payment, or performance security on State contracts, under specified circumstances. Authority for the State to accept individual surety bonds for procurement contracts expires September 30, 2014.

Chapters 299 and 300 of 2012 (SB 764/HB 885) made soliciting or issuing individual sureties a fraudulent insurance act except in specified circumstances. The Office of the Attorney General has advised that individual sureties are not authorized to offer surety bonds in Maryland, except for bid, payment, and performance bonds for State public works projects.

The University System of Maryland, Morgan State University, and St. Mary's College of Maryland are exempt from most provisions of State procurement law. In addition, the following agencies are exempted in whole or in part from most State procurement law. Any of their procurements that are subject to the exemption from State procurement law would not be subject to the bill's requirements.

- Blind Industries and Services of Maryland;
- Maryland State Arts Council;
- Maryland Health and Higher Educational Facilities Authority;
- Department of Business and Economic Development;
- Maryland Food Center Authority;
- Maryland Public Broadcasting Commission;
- Maryland State Planning Council on Developmental Disabilities;
- Maryland Automobile Insurance Fund;
- Maryland Historical Trust;
- Rural Maryland Council;
- Maryland State Lottery and Gaming Control Agency;
- Maryland Health Insurance Plan;
- Maryland Energy Administration;
- Maryland Developmental Disabilities Administration;
- Department of Natural Resources, for conservation service opportunities;
- Maryland Stadium Authority;
- Department of General Services, for the renovation of historic structures;
- State Retirement and Pension System;
- College Savings Plans of Maryland; and
- Chesapeake Bay Trust.

Background: A surety bond is a three-way contract between the State, a contractor, and a surety (typically an insurance company or other established financial company). Surety bonds require the surety to cover any losses incurred by the State if the contractor defaults or otherwise cannot complete a project as promised. Contractors purchase surety bonds in part to assure those seeking their services that they are legitimate businesses and provide reliable services.

Individual sureties have increasingly drawn the attention of state and federal insurance regulators because they generally operate free from state or federal regulation. A 2007 cease and desist order by the Montana State Auditor against an individual surety operating under different names in as many as eight states failed to stop his illegal activity; in 2012, he was found to be selling fraudulent bonds to Native American tribal reservations and fined $168,000 by the Montana Insurance Commissioner. In 2008, the U.S Court of Federal Claims upheld a federal procurement officer's denial of an individual surety bond because it was backed by "speculative" assets. In March 2011, the *Baltimore Sun* reported that a church seeking to build a new facility in the State had reportedly lost millions of dollars due to a dispute with an individual surety. The Board of Public Works advises that, since the enactment of Chapter 299 of 2006, one individual surety bond has been presented for a State procurement (in fiscal 2007), and it was rejected by the procurement officer.

Like Maryland, the federal government accepts individual surety bonds for bid or performance security on federal contracts, but under limited circumstances. In many respects, Maryland's restrictions on the use of individual sureties mirror those of the federal government, but in some respects they are less restrictive. For instance, Maryland statute allows "irrevocable trust receipts" to be pledged as assets backing individual surety bonds, but federal procurement regulations do not.

Since its inception in 1984, MSBDFA's Surety Bond Program has issued or guaranteed security for 107 projects, totaling $56.9 million of financial assistance. Of those, nine projects defaulted, resulting in total payouts of $1.8 million. In fiscal 2012, the program approved four applications for security for a total of $1.8 million. MSBDFA advises that it does not have sufficient resources to issue security up to the $5.0 million cap for a single client, but it expects to be able to approve bonding or bonding guarantees up to $2.0 million.

Small Business Effect: The bill facilitates access to bonding for subcontractors on State procurement contracts and protects them from bonding requirements imposed by prime contractors that are more restrictive than those imposed by the State. It also protects prime contractors and subcontractors from the risks associated with using unregulated individual sureties by not authorizing prime contractors to accept individual surety bonds from subcontractors.

Additional Information

Prior Introductions: None.

Cross File: HB 585 (Delegate Reznik, *et al.*) - Health and Government Operations and Economic Matters.

Information Source(s): Office of the Attorney General, Department of Business and Economic Development, Board of Public Works, Department of Budget and Management, Maryland Insurance Administration, University System of Maryland, Federal Acquisition Regulation, *Baltimore Sun*, Nevada Division of Insurance, Montana Commissioner of Securities and Insurance, Department of Legislative Services

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