

**Department of Legislative Services**  
Maryland General Assembly  
2018 Session

**FISCAL AND POLICY NOTE**  
**First Reader**

Senate Bill 778 (Senators Hershey and Ready)  
Education, Health, and Environmental Affairs

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**Procurement - Payment Security - Construction Contracts**

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This bill requires contractors to provide payment security for at least 100% of the total amount payable under a construction contract valued at more than \$100,000, up from at least 50%.

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**Fiscal Summary**

**State Effect:** No direct effect on State expenditures for construction. The bill conforms statute to current practice for the Department of General Services (DGS) and the Maryland Transportation Authority (MDTA), but the State Highway Administration (SHA) benefits from having greater protection against contractors defaulting on specified construction contracts. However, higher security requirements may reduce participation in SHA construction contracting if smaller companies cannot afford to pay higher security premiums.

**Local Effect:** No direct effect on local governmental finances. To the extent that local governments currently require less than 100% payment security, they benefit from having greater protection against a contractor defaulting on a construction contract. However, higher security requirements may reduce participation in local construction contracting if smaller companies cannot afford to pay higher security premiums.

**Small Business Effect:** Potential meaningful.

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## Analysis

**Current Law/Background:** Depending on the size and type of a procurement contract, there are three types of security that the State must or may require:

- bid security protects the State against a bidder withdrawing a bid before a contract is awarded or refusing to sign a contract if the bid is awarded;
- performance security guarantees the performance of a contract by a contractor; and
- payment security guarantees that a contractor will pay all of its suppliers and subcontractors for labor and materials, leaving the project free of any liens.

Security is usually provided in the form of a surety bond, which 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.

In general, performance and payment bonds may not be required for procurements valued at \$100,000 or less, unless required by federal law or a condition of federal assistance. However, a procurement officer *may* require *bid* security on contracts for services, supplies, or construction-related services valued at \$50,000 or more.

Bid, performance, and payment security are all required on *construction* contracts valued at more than \$100,000 or if federal law or a condition of federal assistance requires security. The bid security must be at least 5% of the bid price or proposal or as determined by the procurement officer if the contract does not have a total price. The amount of the performance security is determined by the procurement officer. *The amount of payment security must be at least 50% of the total amount payable under the contract.*

For contracts other than for construction exceeding \$100,000 in cost, a procurement officer *may* require performance and payment security.

**Small Business Effect:** There is no effect on small businesses that participate in construction contracts with either DGS or MDTA because those agencies already require 100% payment security for the affected construction contracts. However, small businesses may find it more difficult to participate in large construction projects for SHA because they must pay higher premiums for payment security.

## **Additional Information**

**Prior Introductions:** None.

**Cross File:** None.

**Information Source(s):** University System of Maryland; Department of General Services; Board of Public Works; Maryland Department of Transportation; Department of Legislative Services

**Fiscal Note History:** First Reader - February 25, 2018  
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Analysis by: Michael C. Rubenstein

Direct Inquiries to:  
(410) 946-5510  
(301) 970-5510