Nancy J. Egan, State Government Relations Counsel
Nancy.egan@APCIA.org Cell: 443-841-4174

Testimony of American Property Casualty Insurance Association (APCIA)

Senate Finance Committee

Senate Bill 801- Civil Action - Surety Insurance - Failure to Act in Good Faith

March 3, 2020

Letter of Opposition

The American Property Casualty Insurance Association (APCIA) represents more than 1200 insurers and reinsurers that provide critically important insurance protection throughout the U.S. and world. In combination, our members write 60% of the U.S. property casualty market. APCIA members represent all sizes, structures, and regions—protecting families, communities, and businesses in the U.S. and across the globe. APCIA appreciates the opportunity to provide written comments in opposition to Senate Bill 801.

What is Surety?

A surety bond is a contract among at least three parties: (1) the "obligee" or project owner who initiates, manages or finances a project and is the recipient of the obligation; (2) the "principal" or party who is performing the contractual obligation; and (3) the "surety" or obligor usually an insurance company. Surety bonds require the surety to cover any losses incurred by the obligee if the principal (*i.e.*, contractor) defaults or otherwise cannot complete a contract as promised. Surety bonds provide assurance to the obligee that the principal or contractor providing services is legitimate, financially sound and can reasonably be expected to fulfill its duties, as the surety would not otherwise have issued the bond and assumed the associated risk. The duties of the principal include performance under the contract based on the bid provided, which is covered by a bid bond; completion of the job as contracted, which is covered by a performance bond; and payment of all suppliers and subcontractors, which is covered by a payment bond.

State procurement law requires bid, performance, and payment security for construction contracts that are expected to exceed $100,000. These security requirements for construction contracts apply to "public bodies," including the State; a county, municipal corporation, or other political subdivision; a public instrumentality; or any governmental unit authorized to award a contract. Construction contractors must provide security for an amount deemed appropriate by the agency's procurement officer. On other State contracts for services, supplies, or construction-related services that exceed $100,000, procurement officers have the option of requiring contractors to provide security.

There are a number of programs available to further enhance the availability of surety bonds or contracts of surety insurance for new, emerging and small businesses, including businesses that qualify as minority business enterprises ("MBEs"). Four such programs include the Maryland Small Business Development Financing Authority Surety Bond Program; the U.S. Small Business Administration Bond Guarantee and Lending Program; the Surety & Fidelity Association of America Model Contractor Development Program®; and the U.S. Department of Transportation Bonding Education Program.

Surety is Different than an Insurance Contract

Senate Bill 801 would add surety to the list of civil actions for bad faith under Maryland law. Bad faith actions are inappropriate for surety claims. The factors that lead many states to impose bad faith damages on insurance contracts do not apply to surety bonds. These are not contracts of adhesion in which an insurer dictates the terms and the consumer is unable to protect themselves due to unequal bargaining power such as in a personal auto contract. In recognition of this fact most states that impose bad faith liability on insurers appropriately exempt surety bonds. In states like Maryland that mandate bad faith damages against insurers by statute, sureties are routinely exempted. For example, Section 624.155, Florida Statutes, grants a cause of action against an insurer for bad faith failure to pay, but it specifically exempts surety bonds. Subsection (9) states, "A surety issuing a payment or performance bond on the construction or maintenance of a building or roadway project is not an insurer for purposes of subsection (1)."

Legislation that does not recognize that the bond principal (contractor) is a party to the bond and primarily obligated to pay anything owed under the bond won't benefit the bond holders or the public. The bond principal -- most commonly a construction contractor -- will pay the costs and damages. The surety will be liable as a guarantor if the principal is unable to pay, but the primary obligation is the principal's. That is one of the fundamental differences between bonds and insurance policies -- and one of the many reasons why such legislation is ill-advised as public policy.

A surety is often caught in the middle of a dispute between its principal and the claimant. The principal will have to reimburse the surety in the case of a loss and vehemently argues that the claim is not valid. The claimant equally emphatically argues that the principal owes it the amount claimed and that the claim is valid. Legislation providing for a bad faith cause of action against sureties would force the surety to either pay the claim at the principal's expense or risk bad faith damages.

The impact of such bills becoming law is that one can assume that every surety claim in the state will include an automatic bad faith allegation. Even in cases where the surety ultimately prevails, the bad faith claim will add to the cost of handling the claim and any litigation. Most bonds are required by statute to serve a public purpose. The increased costs resulting from such legislation would ultimately fall on the public in the form of higher costs to the bond principal and the surety. These higher costs would be passed on to the public. For example, many state laws require bonds from contractors on public works. Those contractors would include the cost of the bonds in their bids if the contractor/bond principal and the surety have to pay to defend even invalid bad faith claims.

For these reasons, the APCIA urges the Committee to provide an unfavorable report on Senate Bill 801.