SB 372 Civil Action - Surety Insurance - Failure t
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Position: FAV

SB 372
Civil Action - Surety Insurance - Failure to Act in Good Faith
Education, Health, and Environmental Affairs Committee
Position: Favorable

Maryland AGC, the Maryland Chapter of the Associated General Contractors of America, provides professional education, business development, and advocacy for commercial construction companies and vendors, both open shop and union. AGC of America is the nation's largest and oldest trade association for the construction industry. AGC of America represents more than 26,000 firms, including over 6,500 of America's leading general contractors, and over 9,000 specialty-contracting firms, all through a nationwide network of chapters. Maryland AGC supports SB 372 and respectfully urges the bill be given a favorable report.

This bill adds obligee claims under surety insurance policies to statutory provisions authorizing the recovery of actual damages, expenses, litigation costs, and interest in first-party claims against insurers if the insurer failed to act in good faith under certain circumstances. The bill also expands the application of provisions regarding unfair claim settlement practices to surety insurance and obligee claims. With the sponsor's amendments, the bill addresses a surety's obligation to act in good faith with respect to performance bonds or performance under a surety insurance policy where the principal has become insolvent, has filed a petition for relief under the bankruptcy laws, has had an involuntary petition filed against it, or has made a general assignment for the benefit of its creditors.

State Finance and Procurement Article, §17-103 requires successful bidders on State construction projects to provide payment and performance bonds. Moreover, §13-225 provides that retainage is limited to 5% if a contractor has provided 100% payment and performance bonds covering the project, so that it is common practice to provide such bonds. While not required in the private sector as a matter of statute, many owners require payment and performance bonds, and general contractors require the same of subcontractors on many projects.

The bottom line is that such bonds are commonplace in the construction industry. As a consequence, unfair claim practices or failures to act in good faith by sureties can affect many construction projects. In the most common case, a general contractor is the obligee under a subcontractor's payment or performance bond, and the subcontractor fails to perform as required by contract or, in the worst case, simply walks off the job or goes out of business. The general contractor as the obligee files a claim with the surety and expects prompt action. Failure of a subcontractor has significant ripple effects on the entire project, since the critical path and schedule have many interdependencies – if subcontractor A fails to perform, other subcontractors dependent on subcontractor A's performance are thrown off their schedules, etc. Prompt attention and steady action by the surety are essential and a reasonable expectation of the contractor-obligee under a performance surety bond. Unfortunately, that is not always the case.

SB 372 simply extends non-controversial provisions in current law governing the performance of insurers under regular insurance policies to sureties and surety bonding, limited to performance bonds and a specific set of failures to perform. These requirements under regular insurance policies are of long-standing and are well understood by insurers and the courts. Good faith and fair surety claim settlement practices are a rational and reasonable expectation of obligees and principals under surety performance bonds. Delays in processing – or even acknowledging – claims and evasive or misleading handling of claims put general contractor-obligees at risk under the prime contract of failing to meet their own contract obligations. This behavior by a surety is unacceptable and should be subject to the good faith and fair claims settlement requirements applicable to other forms of insurance.

Accordingly, Maryland AGC respectfully urges the Committee to give SB 372 with the sponsor's amendments a favorable report.

Champe C. McCulloch
McCulloch Government Relations, Inc.
Lobbyist for Maryland AGC.

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Position: UNF

SFAA Testimony Opposing SB 372
Senate Finance Committee
February 3, 2021

Honorable Committee Members,

The Surety & Fidelity Association of America ("SFAA") is a non-profit corporation whose member companies collectively write the vast majority of surety and fidelity bonds in the United States. SFAA is a licensed rating/ advisory organization in all states and is designated by state insurance departments as a statistical agent for the reporting of fidelity and surety experience.

Respectfully, SFAA strongly encourages policymakers to oppose MD SB 372, legislation that would apply bad faith standards to writers of surety bonds for the reasons below.

Bad Faith Actions are Inappropriate for Surety Claims
The factors that lead many states to impose bad faith damages on insurers do not apply to surety bonds. There are no contracts of adhesion, individual claimants unable to protect themselves, or unequal bargaining power in the surety bond landscape. In recognition of this fact, most states that impose bad faith liability on insurers appropriately exempt surety bonds.

Judicial Exemptions for Surety
In some states bad faith is imposed on insurers by judicial decision, and the exemption of surety is often articulated by the courts. For example, in Cates Construction, Inc. v. Talbot Partners, 980 P.2d 407 (Cal. 1999), the California Supreme Court stated at 980 P.2d 427:

A construction performance bond is not an insurance policy. Nor is it a contract otherwise marked by elements of adhesion, public interest or fiduciary responsibility, such that an extracontractual remedy is necessitated in the interests of social policy.

Similarly, in Great American Ins. Co. v. North Austin Municipal Utility District No. 1,908 S.W.2d 415, 418 (Tex. 1995), the Texas Supreme Court stated:

Second, concerns that a surety may take advantage of a bond obligee in the claims resolution process ignore the fundamental differences between a liability insurance contract and a surety bond. While a liability insurance contract involves only two parties, the insurer and the insured, suretyship involves a tripartite relationship between a surety, its principal, and the bond obligee, in which the obligation of the surety is intended to supplement an obligation of the principal owed to the bond obligee.

Statutory Exemptions for Surety

In states 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)"

In Pennsylvania, 42 Pa. Cons. Stat. Ann. §8371 provides remedies for bad faith by an insurer toward an insured. Courts in Pennsylvania have consistently held that there is no cause of action against a surety under section 8371. See, for example, Superior Precost, Inc. v. Safeco Ins. Co. of America, 71 F. Supp.2d 438, 448-454 (E.D. Pa. 1999).

Practical Application

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, those costs will increase.

Summary

Legislation that does not recognize that the bond principal 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.

Respectfully,

Adam Brackemyre
Vice President of Government Affairs
Surety & Fidelity Association of America

SB 372 APCIA Oppose Feb 3 2021 FINAL.pdf
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Position: UNF

American Property Casualty Insurance Association
INSURING AMERICA apci.org
Nancy J. Egan, State Government Relations Counsel
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Testimony of American Property Casualty Insurance Association (APCIA)

Senate Finance Committee

Senate Bill 372- Civil Action - Surety Insurance - Failure to Act in Good Faith

February 3, 2021

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 and 77% of the surety market in Maryland. APCIA appreciates the opportunity to provide written comments in opposition to Senate Bill 372.

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 372 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 372.

SB 372_bfp on behalf of MAMIC_UNF.pdf
Uploaded by: Popham, Bryson
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February 1, 2021

The Honorable Delores G. Kelley
3 East, Miller Senate Office Building
Annapolis, MD 21401

RE: Senate Bill 372 - Civil Action - Surety Insurance - Failure to Act in Good Faith – UNF

Dear Chair Kelley and Members of the Senate Finance Committee,

I am writing on behalf of the Maryland Association of Mutual Insurance Companies (MAMIC) in opposition to SB 372 - Insurance - Claim Payment – Clarification.

MAMIC is comprised of 12 mutual insurance companies that are headquartered in Maryland and neighboring states. Approximately one-half of MAMIC members are domiciled in Maryland and are key contributors and employers in their local communities. Together, MAMIC members offer a wide variety of insurance products and services and provide coverage for thousands of Maryland citizens.

MAMIC notes that similar legislation was introduced in 2020, in the form of Senate Bill 801, and that both SB 801 and this year's SB 372 have been opposed by the insurance industry. SB 801 was likewise opposed by the Maryland Insurance Administration.

MAMIC joins that opposition, on the principle that expansion of a sureties duty to act in good faith for the benefit of a claimant who is not party to the surety contract is unwarranted. Furthermore, we note that there is no compelling factual predicate to justify such an expansion. Accordingly, MAMIC respectfully requests an unfavorable report of Senate Bill 272.

Very truly yours,

Bryson F. Popham

cc: Members of the Senate Finance Committee
Jill Showalter, President – MAMIC
Andrew Kirkner, NAMIC

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Position: INFO

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Governor

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TESTIMONY OF
THE
MARYLAND INSURANCE ADMINISTRATION
BEFORE THE
SENATE FINANCE COMMITTEE
FEBRUARY 3, 2021

SENATE BILL 372 – CIVIL ACTION – SURETY INSURANCE - FAILURE TO ACT IN GOOD FAITH

LETTER OF INFORMATION

Thank you for the opportunity to provide written testimony in regards to Senate Bill 372. Senate Bill 372 will expand the scope of Section 27 subtitle 3 (*Unfair Claim Settlement Practices*) and subtitle 10 (*Property and Casualty Insurance – First Party Claims*) to include claims under surety agreements. With respect to subtitle 3, Senate Bill 372 removes the exclusion of surety contracts from the scope of the Unfair Claim Settlement Practices Act (UCSPA) and makes that line of business subject to the UCSPA. With respect to subtitle 10, Senate Bill 372 extends to surety contracts the statutorily imposed obligation of insurers to act in good faith when evaluating certain kinds of first-party claims, notwithstanding that surety contracts are not contracts of indemnity, but financial instruments by which the surety guarantees to pay the contractual obligation of the purchaser to a third-party, subject to the right of the surety to be reimbursed by the purchaser of the surety contract.

With respect to Senate Bill 372's impact on the UCSPA, we note that the specific exemption of surety disputes from the UCSPA has been in place for over 25 years. Maryland's UCSPA closely follows the National Association of Insurance Commissioner's (NAIC) model act, which exempts surety claim matters, workers compensation claims, and reinsurance claims. Each of these lines of business are exempt from the NAIC's model act and from the UCSPA for specific reasons. Workers compensation insurance claims are exempt from the Maryland Insurance Administration's (MIA) oversight under the UCSPA, because the claim by the injured worker is subject to the authority of Maryland's Workers Compensation Commission, which determines the amount due to the injured worker and, thus, the amount compensable under the workers compensation policy. Reinsurance claims are exempt, because reinsurance contracts (i) are complex financial arrangements between insurance companies, which are sophisticated parties of equal bargaining power; (ii) do not impact the consumers' rights under the primary policies (which policy claims are subject to the UCSPA); and disputes under the reinsurance contract are typically subject to mandatory arbitration.

Surety contracts are exempt from the UCSPA, because they are not insurance policies and do not indemnify the purchaser of the surety contract. Rather, surety contracts/bonds are essentially financial instruments through which the surety agrees to advance (not indemnify) the payment of a financial obligation of the purchaser/principal to a third-party/obligee if a specified event/contingency occurs. These instruments exist to substitute the credit of the surety for the credit of the principal, much like a letter of credit or statutory deposit, and provide an easy and direct source of payment to the third-party/obligee from a credit worthy source. The specified contingency that triggers the payment obligation is typically an underlying adjudication or finding of liability, a mandated governmental or statutory requirement, or the happening of an event specified in the contract (e.g. failure to make a payment of a specific date). Payments by the surety are not dependent on the surety's evaluation of the purchaser/principal's liability or negligence, as is the case with claims subject to the UCSPA. Further, surety contracts/bonds are not insurance policies and the surety has not agreed to indemnify the principal. The surety has only agreed to advance the payment of the obligation on the principal's behalf. Hence, unlike insurance, the surety is entitled to recoup any payment made to an obligee from the principal, typically under a related indemnity agreement.

The exemption of surety claims from the scope of the UCSPA does not mean that the MIA lacks regulatory authority over a surety that fails to honor its contractual obligations. If a surety fails to issue payment of a clear (typically adjudicated) obligation, the MIA has existing authority to direct the surety to issue payment in fulfillment of its obligation.

With respect to the impact of Senate Bill 372 on good faith claim evaluation, the MIA has two concerns. First, surety obligations are not first-party claim obligations. As discussed above, surety contracts and bonds are issued to satisfy the obligation of the purchaser/obligee to a *third-party*/principal, subject to the right of the surety to recoup the advancement of that financial obligation. Hence, subjecting surety arrangements to the good faith standard is actually the extension of that standard to third-party claims. While that is a public policy decision for the legislature, from a technical perspective, the MIA wants to make sure that the policy makers are aware that this is the impact of Senate Bill 372.

Second, surety claims are often time sensitive and where there are disputes, those disputes typically involve complex governmental contracting or construction claims where the underlying facts are disputed and resolved only through litigation or mandated arbitration. Given that, to the extent that quick adjudication is a goal of that portion of Senate Bill 372 that would require the submission of a surety claim alleging the failure of the surety to act in good faith to bring that claim before the MIA, that requirement is likely to have the opposite effect. Rather than expediting claim payment by sureties, Senate Bill 372 will impose a new administrative process, with attendant rights of appeal, that may need to be exhausted prior to the final adjudication of a claim, thereby delaying claim payments. The appeals process will further delay the payment of claims and it is unclear what the impact and collateral estoppel effect of any decision of the MIA would be on related third-party claims or the separate indemnity rights of the surety against the contract purchaser/principal. Additionally, the cost to a surety of complying with a new administrative process, which will include the cost of responding to complaints and participating in hearings, could exert upward pressure on the cost of surety bonds in our market.

In addition to these issues, there may be (i) federal preemption issues related to federal contracts and intra-state jurisdictional issues related to state contracts that are raised by Senate Bill 372 and that could impact enforcement by the MIA and (ii) res judicata concerns that are beyond the scope of the MIA's analysis.

Finally, as drafted, the MIA would need to hire one or more additional investigators and have access to third-party vendors to address claims against sureties under the UCSPA and expects to need to engage at least one additional hearing officer to evaluate surety claims for breach, for the absence of good faith, and for the bond amount under §27-1001.