Construction Bills: Recent Changes to Construction Laws

By Asha A. Echeverria and Brian R. Zimmerman

Asha A. Echeverria

Brian R. Zimmerman

Maryland Individual Surety Law Set to Sunset in 2014

With its individual surety law scheduled to expire September 30, 2014, Maryland will join the remainder of the continental 48[1] states in barring "individual sureties" from writing bonds on public works projects. Under a law enacted in 2006,[2] Maryland allowed prime contractors to submit bonds written by individuals who do not hold a certificate of authority from the Maryland Insurance Commissioner (MIA) for bid, performance, and payment bonds required on public works projects, provided certain circumstances were met. To submit such a bond, the contractor had to show that it had been denied credit by a surety company within the past three years, that the individual surety was a US citizen and had transacted business through an insurance agency licensed by the MIA, and that the individual had pledged one or more authorized assets. The law mandated that when the prime contractor met those conditions, the bonds were required to be accepted by the public owner.

Ordinarily any compensated corporate surety in Maryland must be licensed by the MIA[3] and individual sureties are prohibited from soliciting or issuing surety bonds.[4] Beyond the preconditions in the law allowing individual sureties on public works projects, the individual surety market for public projects was largely unregulated. These individual sureties avoided monitoring by the MIA for financial stability and solvency because they are not subject to the state's financial and capital reporting regulations.[5] Unlike state-licensed sureties and insurers, there was no state oversight of an individual surety's contract forms or rates.[6] In addition, as they were not licensed insurers or sureties, in the event an individual surety became insolvent and was unable to pay on its bond, a project owner or prime contractor could not avail itself of protection afforded by Maryland's insurance guaranty fund, which was set up to insure against surety and insurer insolvency.[7]

Originally, the individual surety law had a sunset date of September 30, 2009; however, in 2008, Maryland extended the sunset date to September 30, 2014.[8] In 2011, opponents of the individual surety market testified before the legislature and successfully lobbied[9] for a law that made the solicitation and issuance of surety bonds by individuals a criminal act of fraud,[10] except under the limited conditions of the existing law permitting individual sureties on public works projects.[11] This testimony included parties that claimed they had been injured when they were unable to collect on bonds issued by individual sureties on private contracts.[12] One such party was the Korean Seventh-Day Adventist Church, who alleged that the construction of their new church was halted indefinitely when an individual surety failed to pay out on its bond after a contractor's default.[13] Despite the individual surety's alleged defenses that the progress of the work had been misrepresented,[14] the dispute underscored what many believed was a need for regulation of all sureties to ensure that when called upon, a bond will provide the security for which it was written.

In 2013, legislation was introduced to the Maryland General Assembly expanding the right to submit individual surety bonds on public projects to subcontractors.[15] Although proponents of the law argued that it created more contracting opportunities for small businesses with the state, opponents including the National Association of Surety Bond Producers (NASBP), The Surety & Fidelity Association of America, and the American Subcontractor's Association (ASA) of Metro Washington argued that risks posed to owners and subcontractors by the unregulated individual surety market were too high in comparison to any benefits.[16] In a jointly written article advocating on behalf of subcontractors and suppliers, NASBP and ASA of Metro Washington addressed these risks, stating that "if there is no security in the way of a bond with actual financial backing to protect our member subcontractors and suppliers, our members face

Asha A. Echeverria is an associate at Bernstein Shur in Portland, Maine. Brian R. Zimmerman is a shareholder of Hurtado, S.C. in Miluakee, Wisconsin.

the prospect of having to pay their labor and material suppliers out of pocket and possibly put our members' businesses in jeopardy of failing."[17] Despite the opposition, the legislation passed and was signed into law, subjecting such subcontractor bonds to the same preconditions as prime contractor's bonds, and as a result the same sunset date of September 30, 2014.

Under a law enacted in 2012, the MIA conducted an analysis of the practices of corporate sureties and individual sureties and issued a report regarding its findings in late November 2013.[18] The MIA reported that after the individual surety law was enacted in 2006, contractors on public projects attempted to submit a bond from an individual surety on only six occasions. Of these six projects, two were ultimately awarded based upon the individual surety bond; two of the bonds were rejected due to the individual surety bond's failure to meet regulatory criteria; one bid was voluntarily withdrawn by the contractor; and one bid was withdrawn due to a rebidding of the entire project.[19] The MIA's report concluded that it found no evidence that corporate sureties were unable to meet market needs and recommended that the current law authorizing unregulated sureties on projects expire as scheduled.

Whether proponents of the individual surety market seek to extend the individual surety law or the legislature follows the recommendations of the MIA by allowing the law to sunset as scheduled will remain to be seen. The overwhelming consensus among the states for regulation of the surety market suggests that Maryland should allow the law to terminate. Moreover, as evidenced by the very rare instances where contractors have attempted to avail themselves of the law since it was enacted, an unregulated surety market does not appear to represent an essential means to ensure contractors have access to bonding for public works projects.

Endnotes

1. Alaska and Hawaii are the only two states that allow individual sureties. Alaska allows individual surety bonds on public works projects and Hawaii allows the use of individual sureties for "commercial concession leases on public property." Md. Ins. Admin., Final Report on the Analysis of the Practices of Corporate Sureties and Individual Sureties in Maryland, MSAR No. 9319 (2013).
2. Md. Code Ann., State Fin. & Proc. § 13-207 (LexisNexis 2013); 2006 Md. Laws. ch. 299.
3. Md. Code Ann., State Fin. & Proc. § 4-101 (LexisNexis 2013).
4. Md. Code Ann., Ins. §§ 1-201, 27-406.1 (LexisNexis 2013)
5. *See* Md. Ins. Admin., *supra* note 37.
6. *Id.*
7. *Id.*
8. 2008 Md. Laws ch. 266.
9. *Fraudulent Insurance Acts—Individual Sureties—Contracts of Surety Insurance: Hearing on S.B. 764 Before the Maryland Legislature* (Mar. 13, 2012).
10. *Md. S.B. 764 Hearing* (Mar. 13, 2012).
11. Md. Code Ann., Ins. § 27-406.1 (LexisNexis 2013).
12. *Fraudulent Insurance Acts*, *supra* note 45.
13. Jay Hancock, *Church Woes Show Need for Insurance Oversight*, Baltimore Sun, Mar. 21, 2011.
14. *Id.*
15. 2013 Md. Laws ch. 504.
16. Mark McCallum, Larry Leclair & Ed Hershon, *Arrivederci: MD Individual Surety Law Needs to Ride into the Sunset in 2014*, Early Cassidy & Schilling, Inc. Blog (July 22, 2013), http://ecsinsure.wordpress.com/2013/07/22/arrivederci-md-individual-surety-law-needs-to-ride-into-the-sunset-in-2014/; Nat'l Ass'n of Sur. Bond Producers, *NASBP Strongly Opposes HB 595/SB599 "The Subcontractor Equal Access to Bonding Act of 2013,"* http://higherlogicdownload.s3.amazonaws.com/NASBP/536b23f9-dfa6-4bc2-9d7c-be8e7854e61c/UploadedImages/2-13/MD%20HB585_SB599_%20NASBPLtr.pdf; *Maryland Insurance Administration Recommends That the Individual Surety Law Should Sunset in 2014*, Sur. & Fid. Ass'n of Am. (Dec. 6, 2013), http://www.surety.org/news/149205/Maryland-Insurance-Administration-Recommends-that-the-Individual-Surety-Law-Should-Sunset-in-2014.htm.
17. McCallum, Leclair & Hershon, *supra* note 52.
18. *See* Md. Ins. Admin., *supra* note 37.
19. *See id.*

