



NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS

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Sent via US mail and e-mail at sdarling@ksdot.org.

Ms. Susan Darling
Assistant Bureau Chief, Bureau of Construction & Maintenance
Kansas Department of Transportation
Eisenhower State Office Building
700 SW Harrison St.
Topeka, KS 66603-3754

Re: Proposed Division 100 Sections for KDOT 2007 Standard Specifications (Scheduled to go into effect in July 2007)

Dear Ms. Darling:

On behalf of the National Association of Surety Bond Producers (NASBP), a national trade association of surety bond producers, whose membership includes licensed bond producers placing bid, payment, and performance bonds with contractors performing public transportation work in Kansas, I am contacting you to express our concerns regarding proposed requirements in Section 107.10d(4), which, when read with other proposed sections, specifically, the provision on indemnity, may act as significant deterrents to sureties wishing to write surety bonds for transportation projects in Kansas. Specifically, proposed Section 107.10d(4) reads as follows:

"Surety Liability. The insurance requirements under this subsection 107.10 and subsection 107.11 are performance obligations under the Contract and Contract Bond. If the Contractor fails to maintain the required insurance, the Secretary will declare the Contractor in breach of contract under subsection 108.9 and prevent the Contractor from performing any work until such insurance is in place. If the Contractor fails to maintain the required insurance, the Surety shall be liable for any damages that the required insurance would have covered."

The last sentence of that provision, in effect, turns the surety into a liability insurer for the project, ignoring fundamental distinctions between surety bonds and insurance policies.

Surety bonds are not insurance policies. Although surety bonds often are furnished by insurance companies who are regulated under applicable state insurance codes, a majority of courts recognize that the nature of surety bonds is distinct and different from insurance. Surety bonds are in the nature of credit arrangements in which sureties extend surety credit to qualified contractors in return for premium payments. A contract of suretyship is a three-party contract under which the surety expects no losses,

since the contractor has been carefully qualified as to its ability to perform the obligations of the construction contract, and the liability for incurred losses, if any, remains with the contractor. By the nature of the bonds they provide, sureties seek to avoid defaults by examining all facets of the contractors operations, especially its experience, capabilities, and financial soundness. As a result, the fee payable to the surety is more in the nature of a fee for the qualification process undertaken and the surety credit extended.

Insurance, on the other hand, is a two-party contract on which the insurer expects losses. Insurance premiums are actuarially computed on the assumption that certain losses will occur, based on averages. Unlike sureties which write bonds only for contractors qualified in relation to specific projects, insurers generally write policies, spreading the risks of losses over the entire pool of insureds. Understanding these critical distinctions is important in understanding that sureties do not write contract bonds or calculate surety premiums with the assumption of being a liability insurer for such purposes as third-party tort liability or property damage. Rather, sureties issuing contract bonds are guaranteeing the contractor's ability to perform and to pay subcontractors and suppliers.

Performance and payment assurances, not recovery of tort claims, are the statutory purposes behind the bonding requirements for public work in Kansas. Such requirements were enacted to ensure that public contracting agencies would have bond protection assuring performance of public construction contracts and payment of certain subcontractors and suppliers performing work on such projects. Such requirements do not require bonds to act as de facto insurance policies for such risks as tort claims by third parties. *Yet, the proposed KDOT specification sections go well beyond the statutory purposes of public works bonds, imposing on them risks that they were never intended to cover or to address.* The proposed sections specifically require the surety to be "liable for any damages that the required insurance would have covered." Moreover, the indemnity requirement in Section 107.10c makes the contractor liable for "personal injury claims, property damage claims, and associated expenses" without respect to the fault or negligence of the contractor, in turn making the contractor and its surety the insurers for such claims even if the contractor is without fault. Such risks are the province of liability insurance policies, not bonds. Moreover, the indemnity requirement likely is against public policy as it conflicts with the Kansas anti-indemnity statute (KS ST § 16-121), prohibiting indemnity agreements in construction contracts which require indemnification of a party for its negligence.

It also is worth noting that jurisdictions, such as New Jersey, Washington and Louisiana, even have enacted statutes to preclude public owners from imposing liability on performance bond sureties for property damage and personal injury resulting from the negligence of bond principals.

Expanding the liability of sureties writing bonds on state transportation projects clearly is not in the best interests of the State or of taxpayers. Such expansion not only serves as a significant deterrent to sureties interested in the Kansas public works market, since sureties will not be able to account for such risks in their premium calculations, but serves to frustrate the statutory purpose of public performance bond requirements—that is, to assure funds for the completion of transportation projects in the event of contractor default. Sureties only will respond up to the bond limit, known as the penal sum, of the bond.

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If the penal sum is exhausted as a result of third-party tort claims, no funds will be available to the State for the completion of the transportation project, necessitating, in turn, additional taxpayer dollars to complete the project.

For these reasons, NASBP respectfully requests your reconsideration and removal of requirements in the proposed specifications that impose liability on sureties that is beyond statutory requirements.

Please feel free to contact me at (202) 464-1173 should you have questions or require further information.

Sincerely,

A handwritten signature in black ink, reading "Mark H. McCallum". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Mark H. McCallum
General Counsel & Director of Government Relations

cc: Richard Foss, EVP, NASBP