Claims Against Sureties Under The Unfair Trade Practices Act And The Unfair Claims Settlement Practices Act

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Bad faith claims are the bane of every surety's existence. They are sometimes asserted by overzealous attorneys based upon the misguided notion that such claims will provide their clients with leverage in negotiations with sureties. Although allegations of bad faith do not actually lend any additional weight to the merits of a bond claim, they can and often do create headaches for surety claims professionals.

In addition to common law bad faith, claimants will occasionally assert claims against sureties under the statutory unfair trade practice and unfair claims settlement practices acts enacted in almost every state. Although these statutes generally do not provide for a private right of action, claimants sometimes point to these statutes to support their allegations of bad faith. This article briefly examines the history of the model unfair trade practice and unfair claims settlement practice acts (the "Acts"), highlights certain key provisions of the Acts, and evaluates issues that sureties are often required to address under the Acts.

Background

In 1868, in the case of Paul v. Virginia,[1] the United States Supreme Court held that contracts of insurance did not affect interstate commerce, and therefore were not subject to federal regulation.[2] Instead, it was up to the states to regulate insurance.[3] Shortly after, in 1871, the National Association of Insurance Commissioners ("NAIC") was formed[4] to coordinate insurance standards/regulations among the states.[5] The goal was to establish uniformity.[6]

In 1944, the Supreme Court narrowed its ruling in *Paul*, 75 U.S. 168,[7] holding that insurance companies which conduct their activities across state lines are within the regulatory power of Congress under the Commerce Clause.[8] In response to the

1 *Paul v. State of Virginia*, 75 U.S. 168, 19 L. Ed. 357 (1868), *overruled in part by United States v. S.-E. Underwriters Ass›n*, 322 U.S. 533, 64 S. Ct. 1162, 88 L. Ed. 1440 (1944).

2 *Id.* at 183.

3 *See id.* at 183-84.

4 Technically, the entity formed in 1871 was named the National Convention of Insurance Commissioners, which name was changed in 1936 to NAIC. David G. Stebing, David G. Stebing, *Insurance Regulation in Alaska: Healthy Exercise of A State Prerogative*, 10 Alaska L. Rev. 279, 288 (1993).

5 National Association of Insurance Commissioners, https://content.naic.org/index_about.htm (last visited August 16, 2020).

6 *Id.*

7 *South-Eastern Underwriters Ass'n*, 322 U.S. 533.

8 *Id.* at 553.

S.-E. Underwriters ruling, in 1945, Congress passed the McCarran-Ferguson Act,[9] which returned the regulation of insurance back to the states except in the limited circumstance where federal law specifically related to the business of insurance, in which case federal law would preempt state law.[10]

In an effort to retain their restored regulatory powers over insurance companies, states responded promptly to the McCarran-Ferguson Act.[11] Two years after it was passed, in 1947, the NAIC promulgated the Unfair Trade Practices Act ("UTPA"),[12] which was adopted by almost every state that same year.[13] The UTPA prohibited certain conduct of insurance companies, and specifically included a section addressing unfair claims handling practices.[14]

In 1990, the NAIC revised the UTPA, removing the unfair claims handling practices provisions and creating a free-standing act titled Unfair Claims Settlement Practices Act ("UCSPA").[15] Some states followed suit and removed their unfair claims handling provisions from the UTPA.[16] Other states continue to regulate claims handling practices under the UTPA.[17]

Model UTPA and UCSPA Provisions

The UTPA applies to insurers and prohibits, among other things:

- Misrepresentations of the benefits, advantages, conditions or terms of any policy.
- Using any name or title of any policy or class of policies misrepresenting the true nature thereof.

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9 15 U.S.C.A. § 1011 (West)-1015.

10 15 U.S.C.A. § 1012 (West).

11 Gary A. Wilson, *The 1990s – Can the Surety Industry Survive the Evolving Scrutiny of the Law?*, Fidelity and Surety Law Committee Section of Tort and Insurance Practice - American Bar Association 5 (1990).

12 Unfair Trade Practices Act at Chronological Summary of Actions (Nat. Ass. of Ins. Comm'rs 1997), https://www.naic.org/store/free/MDL-880.pdf (hereinafter "UTPA").

13 Wilson, *supra* note 11 at 5.

14 *Compare* the 1989 version of the UTPA, *with* the UTPA.

15 *See* UTPA at Prefatory Note.

16 *See, e.g.*, Del. Code Ann. tit. 18, §§ 2301 to 2314 and 18 Del. Admin. Code § 902; Neb. Rev. Stat. Ann. § 44-1522 to 44-1535 and 44-1536 to 44-1544 (West); N.Y. Ins. Law § 2401 to 2409 and 2601 (McKinney); Okla. Stat. Ann. tit. 36, § 1201 to 1220 and 1250.1 to 1250.6 (West); 27 R.I. Gen. Laws Ann. § 27-9.1-1 to 27-9.1-9 and 27-29-1 to 27-29-13 (West).

17 *See, e.g.*, Haw. Rev. Stat. Ann. § 431:13-101 to 431:13-204 (West); Kan. Stat. Ann. § 40-2401 to 40-2421 (West); Mont. Code Ann. § 33-18-101 to 33-18-1006 (West); N.J. Stat. Ann. § 17:29B-1 to 17:29B-14 (West); Vt. Stat. Ann. tit. 8, § 4721 to 4726 (West); W. Va. Code Ann. § 33-11-1 to 33-11-10 (West).

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- Making any statements with respect to the business of insurance which are untrue, deceptive or misleading.
- Making misrepresentations on any application for insurance.[18]

The UCSPA applies to insurers and prohibits, among other things:

- Knowingly misrepresenting to claimants and insureds relevant facts or policy provisions relating to coverages at issue.
- Failing to acknowledge with reasonable promptness pertinent communications with respect to claims arising under an insurer's policies.
- Failing to adopt and implement reasonable standards for the prompt investigation and settlement of claims under policies.
- Not attempting in good faith to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear.
- Compelling insureds or beneficiaries to institute suits to recover amounts due under policies by offering substantially less than the amounts ultimately recovered in a suit brought by them.
- Refusing to pay claims without conducting a reasonable investigation.
- Failing to affirm or deny coverage within a reasonable time after completing its investigation of claims.[19]

For a violation of any of the foregoing, the UTPA and UCSPA provide the state's insurance commissioner with authority to impose fines and/or suspend or revoke an insurer's license.[20]

Do the UTPA and UCSPA Apply to Sureties?

Sureties are expressly included in the UTPA's scope. Specifically, the model UTPA defines the term "policy" as "a contract of . . . suretyship."[21] In contrast, the model UCSPA expressly states that it "is not intended to cover claims involving . . . suretyship."[22]

States, however, vary widely in their adoption of the various UTPA and UCSPA provisions. The vast majority of states follow the UTPA's inclusion of sureties within

18 § 4. [Trustee›s Office not Transferable]., Unif.Trustees› Powers Act § 4.

19 Unfair Claims Settlement Practices Act § 4. [Trustee's Office not Transferable]., Unif.Trustees' Powers Act § 4 (Nat. Ass. of Ins. Comm'rs 1997), https://www.naic.org/store/free/MDL-900.pdf (hereinafter "UCSPA").

20 § 8. [Application of Act]., Unif.Trustees› Powers Act § 8; UCSPA §§ 6-7.

21 § 2. [Powers of Trustee Conferred by Trust or by Law]., Unif.Trustees› Powers Act § 2.

22 UCSPA § 1.

its scope. However, only a handful of states follow the UCSPA's exclusion of sureties from its ambit.[23]

To determine whether a surety is subject to a specific state's UTPA or UCSPA, the state's statutes must be analyzed to determine if sureties and/or surety policies are expressly included within their provisions. Sometimes, the word "surety" or "suretyship" is not specifically used; rather, some statutes utilize broad terms such as "insurance company" or "insurer,"[24] in which case the relevant state's insurance code must be analyzed to determine whether a surety is defined therein as an insurance company. If a surety is included within the state's insurance code, an argument can be made that it is an "insurance company" or "insurer" within the meaning of the state's UTPA or UCSPA provisions, and therefore subject to those statutes. Some states have already addressed these issues.[25] Accordingly, reviewing a specific state's case law is critical to determining whether a surety is subject to a state's UTPA or UCSPA provisions.

Do the UTPA and UCSPA Permit Private Causes of Action?

Neither the model UTPA nor the model UCSPA permits a private right of action against an insurer for any violations.[26] Rather, the state's insurance commissioner is vested with the sole authority for remedying a violation of the Acts' provisions.[27]

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23 Cynthia E. Rodgers-Waire & Omar J. Harb, *Regulating Ethics – Attempts to Regulate Surety Claims Practices*, Twenty First Annual Northeast Surety and Fidelity Claims Conference 3 (Sept. 2010) (noting that most states have elected not to adopt UCSPA's Section 1 exclusion of sureties); William Schwartzkopf, Practical Guide to Construction Contract Surety Claims (3d ed. 2020) ("[A]lthough each jurisdiction adopting the UCSPA has generally implemented the language of [the] model act, the states almost universally have failed to incorporate the language that excludes the surety."). Some of the states that have adopted the model UCSPA's exclusion of sureties are Georgia, Maryland and Nebraska. *See* Ga. Code Ann. § 33-6-32 (West); Md. Code Ann., Ins. § 27-302 (West); Neb. Rev. Stat. Ann. § 44-1538 (West).

24 *See, e.g.*, Ariz. Rev. Stat. Ann. § 20-441; N.H. Rev. Stat. Ann. § 417:2.

25 *See, e.g.*, *Sonoma Springs Ltd. P'ship v. Fid. & Deposit Co. of Maryland*, 409 F. Supp. 3d 946, 956 (D. Nev. 2019) (holding that a surety was not an "insurer" for purposes of the Unfair Claims Settlement Practices Act); *Great Am. Ins. Co. v. N. Austin Mun. Util. Dist. No. 1*, 908 S.W.2d 415, 420 (Tex. 1995) (holding that sureties are not subject to Unfair Trade Practices Act because the Act only applies to persons in the "business of insurance" and sureties are not in the "business of insurance"); *K-W Indus., a Div. of Associated Techs., Ltd. v. Nat'l Sur. Corp.*, 231 Mont. 461, 754 P.2d 502, 504 (1988) ("[B]y the plain and explicit language, the legislature made suretyship a 'class' of insurance . . . subject to the provisions prohibiting unfair and deceptive trade practices."); *Gen. Ins. Co. v. Mammoth Vista Owners' Assn.*, 174 Cal. App. 3d 810, 220 Cal. Rptr. 291, 298 (Ct. App. 1985) (holding that sureties were classified as insurance companies under the state's insurance code, and therefore subject to unfair and deceptive trade practices statutes); *Fed. Ins. Co. v. Maine Yankee Atomic Power Co.*, 183 F. Supp. 2d 76, 90 (D. Me. 2001) ("The natural reading of [the UCSPA] is that a surety insurance company is not the owner's "own insurer" for either a payment or a performance bond that a general contractor has purchased under the requirements of a contract for a construction project").

26 § 1. [Definitions]., Unif.Trustees› Powers Act § 1; UCSPA § 1. [Definitions]., Unif.Trustees' Powers Act § 1.

27 *See id.*

States again, however, sometimes deviate from the model Acts. Most states follow the UTPA and UCSPA and do not permit a private cause of action for violations.[28] A minority of states, on the other hand, do permit private causes of action with respect to violations of the UTPA and UCSPA.[29] For those states that do not permit private causes of action, there are generally complaint procedures whereby aggrieved individuals/entities can make a formal complaint either to the insurance company, which is then required to report it to the commissioner, or directly to the commissioner.[30]

Additional Considerations

Is a Single Violation Sufficient to Violate the Acts or Must there be a General Business Practice?

Not all violations of the UTPA and UCSPA are subject to the penalties set forth in those Acts. Rather, both Acts provide that they are violated only when it can be shown that the violation:

- Was committed flagrantly and in conscious disregard of the Act or any rules promulgated thereunder; or
- Was committed with such frequency as to indicate a general business practice to engage in that type of conduct.[31]

As with the other provisions of the Acts, there is some deviation among the states. Some jurisdictions follow the model Acts and require either an intentional act or a general business practice to establish a violation of the Acts.[32] Other states have set the bar higher and require evidence of a general business practice in order to establish a violation of the Acts.[33]

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28 *See, e.g.*, Haw. Rev. Stat. Ann. § 431:13-107 (West); W. Va. Code Ann. § 33-11-4a (West); *Earth Scientists (Petro Servs.) Ltd. v. U.S. Fid. & Guar. Co.*, 619 F. Supp. 1465, 1470 (D. Kan. 1985); *Seeman v. Liberty Mut. Ins. Co.*, 322 N.W.2d 35, 42 (Iowa 1982); *Retail Clerks Welfare Fund, Local No. 1049, AFL-CIO v. Cont'l Cas. Co.*, 71 N.J. Super. 221, 176 A.2d 524, 527 (App. Div. 1961); *Strack v. Westfield Companies*, 33 Ohio App. 3d 336, 515 N.E.2d 1005, 1007 (1986); *Wilder v. Aetna Life & Cas. Ins. Co.*, 140 Vt. 16, 433 A.2d 309, 310 (1981); *Upper Pottsgrove Twp. v. Int'l Fid. Ins. Co.*, 976 F. Supp. 2d 598, 604–605 (E.D. Pa. 2013); *U.S. Sewer & Drain, Inc. v. Earle Asphalt Co.*, No. CIV. 15-1461, 2015 WL 3461087, at *2 (D.N.J. June 1, 2015).

29 *See, e.g.*,Fla. Stat. Ann. § 624.155 (West); Ky. Rev. Stat. Ann. § 446.070 (West); Mont. Code Ann. § 33-18-242 (West); N.M. Stat. Ann. § 59A-16-30 (West).

30 *See, e.g.*, N.J. Stat. Ann. § 17:29B-18 (West); W. Va. Code Ann. § 33-11-4a.

31 § 3. [Powers of Trustees Conferred by This Act]., Unif.Trustees› Powers Act § 3, UCSPA § 3. [Powers of Trustees Conferred by This Act]., Unif.Trustees' Powers Act § 3.

32 *See, e.g.*, Neb. Rev. Stat. Ann. § 44-1539 (West); Okla. Stat. Ann. tit. 36, § 1250.3 (West); 27 27 R.I. Gen. Laws Ann. § 27-9.1-3 (West).

33 *See, e.g.*, Ala. Code § 27-12-24; N.Y. Ins. Law § 2601 (McKinney).

Even if a State Does Not Apply the UTPA and UCSPA to Sureties, or Does Not Permit Private Causes of Action, a Surety Can Still be Liable for Bad Faith at Common Law

Even though most states do not provide for a private cause of action against sureties under the UTPA or UCSPA—either because private causes of action are not permitted in that state or because sureties are not subject to the Acts in that state—sureties should still remain mindful and vigilant with respect to the provisions of the Acts. Claimants may argue that a surety's failure to comply with the provisions of the Acts can support a bad faith claim against a surety in those states that permit common law bad faith claims against sureties.[34]

And in fact, several courts have specifically held that violations of the UTPA or UCSPA by an insurer is admissible evidence of bad faith.[35] At least one court, however, has held to the contrary—that violations of the UTPA or UCSPA are not admissible for purposes of showing bad faith.[36]

The Application of the UTPA and UCSPA to Miller Act Sureties

In states where relevant UTPA and UCSPA statutes apply to sureties and permit private causes of action, at least two courts have held that the Miller Act pre-empts state law remedies with respect to federal construction projects, and thus the UTPA and UCSPA would not apply to those projects.[37] These courts reasoned that when Congress enacted the Miller Act, it did so with the intent of having federal law govern both the rights and remedies available to persons/entities associated with federal projects.[38] Both courts cited to Supreme Court case law holding that pre-emption may be found where there is a "scheme of federal regulation . . . so pervasive as to make reasonable the inference that Congress left no room for the states to

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34 *Compare O.K. Lumber Co. v. Providence Washington Ins. Co.*, 759 P.2d 523, 526 (Alaska 1988)-27 (Alaska 1988) (holding that unfair trade practice statutes do not permit private causes of action), *with Loyal Order of Moose, Lodge 1392 v. Int'l Fid. Ins. Co.*, 797 P.2d 622, 628 (Alaska 1990) (holding that sureties may be liable for bad faith); *Compare Farmer's Union Cent. Exch., Inc. v. Reliance Ins. Co.*, 675 F. Supp. 1534, 1536 (D.N.D. 1987)-37 (D.N.D. 1987) (holding that unfair trade practice statutes do not permit private causes of action), *with Szarkowski v. Reliance Ins. Co.*, 404 N.W.2d 502, 505 (N.D. 1987) (holding that bad faith cause of action was permitted against surety); *Compare Strack*, 515 N.E.2d at 1007 (holding that unfair trade practices statutes do not permit private causes of action), *with Suver v. Pers. Serv. Ins. Co.*, 11 Ohio St. 3d 6, 462 N.E.2d 415, 417 (1984) (holding that bad faith cause of action could be maintained against surety).

35 *See Moore v. Am. Family Mut. Ins. Co.*, 576 F.3d 781, 786 (8th Cir. 2009); *Wailua Assocs. v. Aetna Cas. & Sur. Co.*, 27 F. Supp. 2d 1211, 1221 (D. Haw. 1998); *Inland Grp. of Companies, Inc. v. Providence Washington Ins. Co.*, 133 Idaho 249, 985 P.2d 674, 683 (1999).

36 *See Furr v. State Farm Mut. Auto. Ins. Co.*, 128 Ohio App. 3d 607, 716 N.E.2d 250, 257 (1998).

37 *See U.S. For Use of Pensacola Const. Co. v. St. Paul Fire & Marine Ins. Co.*, 710 F. Supp. 638, 639 (W.D. La. 1989)-41 (W.D. La. 1989) (holding that Miller Act preempts state law on federal projects); *Tacon Mech. Contractors, Inc. v. Aetna Cas. & Sur. Co.* 860 F. Supp. 385, 387 (S.D. Tex. 1994), *aff'd,* 65 F.3d 486 (5th Cir. 1995) (same)

38 *U.S. For Use of Pensacola Const. Co.*, 710 F. Supp. at 639-41; *Tacon* Mechanical Contractors, Inc., 860 F. Supp. at 387-88.

supplement it."[39] Both courts further cited to F. D. Rich Co. v. U. S. for Use of Industrial Lumber Co.[40] in which the Supreme Court addressed whether a successful Miller Act claimant could recover attorneys' fees, as permitted by relevant state law. The Supreme Court held that:

The Miller Act provides a federal cause of action, and the scope of the remedy as well as the substance of the rights created thereby is a matter of federal not state law. Neither respondent nor the court below offers any evidence of congressional intent to incorporate state law to govern such an important element of Miller Act litigation as liability for attorneys' fees. Many federal contracts involve construction in more than one State, and often, as here, the parties to Miller Act litigation have little or no contact, other than the contract itself, with the State in which the federal project is located. The reasonable expectations of such potential litigants are better served by a rule of uniform national application.[41]

A few courts, however, have held that state law remedies are available to Miller Act bond claimants.[42] Those courts reasoned that there was nothing in the Miller Act that conflicted with the relevant state law, and that providing claimants on Miller Act projects with additional state remedies only served to further the purpose of the Miller Act in protecting suppliers of goods and services.[43]

Thus, when faced with a claim under the UTPA or UCSPA on a Miller Act project, it is important to consult relevant case law to determine whether there may be an argument for dismissal based upon pre-emption.

39 *U.S. For Use of Pensacola Const. Co.*, 710 F. Supp. at 640; *Tacon* Mechanical Contractors, Inc., 860 F. Supp. at 388.

40 *F. D. Rich Co. v. U. S. for Use of Indus. Lumber Co.*, 417 U.S. 116, 94 S. Ct. 2157, 40 L. Ed. 2d 703 (1974).

41 *Id.* at 127.

42 *See, e.g.*, *K-W Indus., a Div. of Assocs. Techs., Ltd. v. Nat'l Sur. Corp.*, 855 F.2d 640, 642 (9th Cir. 1988)-43 (9th Cir. 1988) (distinguishing *F.D. Rich Co.* and finding that Miller Act did not pre-empt claim under Unfair Claims Settlement Practices Act); *U.S. for Benefit & Use of Ehmcke Sheet Metal Works v. Wausau Ins. Companies*, 755 F. Supp. 906, 908 (E.D. Cal. 1991)-09 (E.D. Cal. 1991) (following *K-W Industries, a Div. of Associates Technologies, Ltd.*, 855 F.2d 640 and finding that Miller Act did not pre-empt state law claim for breach of the covenant of good faith and fair dealing); *Blakeslee Arpaia Chapman, Inc. v. U.S. Fid. & Guar. Co.*, No. 520348, 1994 WL 76383, at *6 (Conn. Super. Ct. Mar. 4, 1994) (holding that the plaintiff's state law claims, including a claim under the Unfair Claims Settlement Practices Act, were not preempted by the Miller Act).

43 *See generally K-W Industries, a Div. of Associates Technologies, Ltd.*, 855 F.2d at 643; *U.S. for Benefit and Use of Ehmcke Sheet Metal Works*, 755 F. Supp. at 909; *Blakeslee Arpaia Chapman, Inc.*, 1994 WL 76383, at *6.