Appeal Bonds 101

For Insurers and Insureds

By Dan Huckabay

Staying enforcement of a judgment using appeal bonds is a topic most practitioners only have vague familiarity with, but the implications are often significant. This article provides a primer on the basics that will arm attorneys with the knowledge and tools they need to serve their clients that are faced with a judgment.

Many civil defense attorneys only have a vague idea of what appeal bonds are, and they're not something you hope to deal with often. After all, no one wants to lose a case, and even in those rare circumstances when there is a judgment rendered that a client wants to appeal, the insurers may handle procuring the appeal bond themselves. Despite the infrequency with which civil defense attorneys need to deal with appeal bonds, knowing the basics is extremely important, because what's at stake is usually very significant. Much like an emergency kit for a natural disaster, you need to have this information in hand before the event strikes in order for it to have value. This article will provide that emergency kit while addressing the key unique elements relating to insurers and insureds applying for such a bond.

What Are Appeal Bonds?

In almost all state and federal courts the filing of an appeal of a monetary judgment does not in and of itself stay enforcement of the judgment. Many jurisdictions, but not all, have some form of automatic stay after a judgment is entered, but the timeframe is relatively short. For example, Federal Rule 62 stays enforcement for "30 days after entry, unless the court orders otherwise." In order for appellants to stay enforcement during the course of the appeal, almost all state and federal courts require the appellant to post security with the court for the protection of the judgment creditor. This stops the collection efforts by the judgment creditor, thereby benefiting the appellant, and it protects the judgment creditor by providing them a source of payment for the judgment if it is upheld on appeal.

Appeal bonds, also called supersedeas bonds, are the most common form of security used, and they are provided by surety companies (also referred to as bond companies). Surety or bond companies are insurers, some of which are monoline specialty carriers, meaning they only provide the one product. Other providers are divisions of large multiline insurance companies that provide a variety of insurance products. Like many insurance products, surety bonds are primarily written through insurance agents.

When issuing an appeal bond, the surety company is issuing a guarantee on behalf of the appellant to the judgment creditor, stating that if the judgment is affirmed and the appellant doesn't satisfy the judgment, the surety will pay up to the bond amount.

The Amount of the Appeal Bond

Each state and federal district court has their own rules for setting the bond amount. Some states, like California, Michigan, and New Mexico, use a fixed number that the judgment is multiplied against. The multiplier used in California is 1.5 times the judgment amount (CCP 917.1), Michigan is 1.25 times (Mich. Ct. R. 7.108), and New Mexico is 2 times (New Mexico Statues Chapter 39, Article, 3, Section 39-33-22).

Other jurisdictions like Illinois (Rule 305 - Stay of Judgments Pending Appeal) require the bond amount to be for the judgment plus costs and post-judgment interest that is estimated to accrue during the course of the appeal. It is important to confirm the appropriate interest rate to be used as specified by the rules; in some instances where there is ambiguity as to the interest rate or length of time that the interest should be applied, it can be best to file a motion to the court to approve the bond amount.

In terms of the judgment amount, it is also necessary to review the local rules to determine whether the entire judgment

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needs to be bonded. Some jurisdictions, such as Texas (Rule 24.2 Amount of Bond, Deposit, or Security), only require bonding for compensatory damages and exclude punitive damages.

Many states have caps on the appeal bond amounts that appellants are required to file, regardless of the judgment amount. Kansas (Supersedeas Bonds; SB 199) and Georgia (Georgia Code Title 5. Appeal and Error § 5-6-46 b), for example, require a maximum bond amount of $25 million.

Difference between Appeal Bonds and Insurance

There are three main differences that distinguish surety bonds from most insurance products:

1) The appellant applying for the surety bond derives no direct benefit. Instead, the bond provides a benefit to a third party, the judgment creditor.
2) Unlike insurance, where losses are expected and actuarily priced in, appeal bonds are underwritten and priced to theoretically not have losses. Therefore, they are underwritten conservatively since the premiums are generally not sufficient to make up for losses.
3) Sureties require the appellant to indemnify and reimburse the surety against losses under the bonds, a feature that does not exist in typical insurance policies.

How Appeal Bonds Are Underwritten

Since appeal bonds are underwritten to theoretically not have losses, sureties must evaluate whether the appellant will have the financial resources to satisfy the judgment at some unknown point in the future when the appeal is concluded. Given that appeals can take many years and the bonds cannot be canceled, the surety must be very confident in the appellant's financial capabilities. If the surety believes the appellant will have the means to satisfy the judgment if upheld on appeal, they will provide the bond based on the indemnity of the appellant without any collateral being required.

When evaluating a business in need of an appeal bond, surety companies will generally consider the overall economic environment, how long the business has been in operation, the specific market(s) the company provides its product or services to, and the financial strength of the company, including that of any parent companies or affiliates that are able and willing to indemnify the surety company.

For sureties to determine whether the financial strength of a company is adequate to provide the necessary confidence that the business will be able to satisfy the judgment, sureties study the company's financial statements for the past several years. They look for the consistency and level of profitability in past financials, as well as whether those profits are likely to remain in the future during the course of the appeal. From a balance sheet perspective, sureties will look at the company's liquidity, including cash balances and available lines of credit. Sureties generally want a company's cash and cash equivalents along with availability under lines of credit to be well in excess of the bond amount required. Further, sureties want the lines of credit to have expiration dates of at least a year, or preferably two years in the future, to raise the surety's confidence of the line's availability. Sureties will also look at long-term debt to evaluate whether the company's cash flow is adequate to cover the ongoing debt obligations.

Surety companies will also review corporate debt ratings from third-party rating agencies, such as Standard & Poor's, Moody's, and Fitch. They will typically only provide bonds on an uncollateralized basis to companies rated as investment-grade by the rating agencies. Companies that are noninvestment grade are considered to be a much higher risk of default on their loan obligations, which directly impacts the value of the indemnity provided to a surety company.

Let's look at an example: If a company needed an appeal bond for $1 million and it had $1 million in cash, a surety company would require collateral, because there is a great amount of uncertainty whether that $1 million in cash would be available in 2 years to pay the judgment when the appeal was concluded. If on the other hand, the same company had $20 million in cash and all other things about the company's performance were positive, the surety would have much greater certainty that the company would be able to satisfy the judgment on their own. While there are no ratios set in stone and there are many variables considered, this generally gives a sense of the surety company's considerations.

When Collateral is Required by Sureties

When an appellant doesn't meet the surety's qualifications, the surety company will require collateral to secure the appeal bond. While there are times when a surety company will accept collateral for a percentage of the appeal bond amount, generally they require collateral in the full amount of the bond. Similar to jumping out of the plane to go skydiving, the skydiver wants to be 100% confident their parachute is packed correctly, because the consequences are so severe. As a result, if someone were told beforehand that there was only an 80% chance their parachute was packed correctly, they would probably choose not to jump. Surety companies approach appeal bonds needing the same level of certainty.

On rare occasions, surety companies will approve less than 100% collateral when the appellant is very qualified but is lacking slightly in one or two small areas. In these circumstances, the surety company has a very high degree of confidence that the appellant will be able to satisfy the judgment, but there is something causing a twinge of uncertainty. For example, perhaps a company is very strong and has a good track record, but the economic environment is impacting their particular marketplace, and it is hard to see how that will play out over the next couple of years during the appeal. Generally, if a surety agrees to accept partial collateral, they will charge a higher premium rate for the appeal bond to compensate for the additional risk they believe they are taking on.

Types of Collateral That Sureties Accept

Surety companies will accept four different types of collateral to secure appeal bonds.

Cash

While cash is one of the most well-known forms of collateral that can be used to secure appeal bonds, it is also one of the least understood in terms of its benefits. Part of the confusion arises because some courts will actually accept cash directly in lieu of an appeal bond, which makes people wonder why they would purchase an appeal bond and pay a premium rather than just pay cash into the court directly.

The first main advantage is that some sureties will pay interest on the cash deposits, whereas the courts often pay little to no interest. There are even some courts that charge for the cash deposit. The amount of interest paid by sureties changes depending on the interest rate environment in the overall economy. These interest rates often equal or exceed the premium rate for the bond, leaving the client in a neutral or a net positive position.

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For larger cash deposits, some sureties offer options that allow appellants to invest in short-term U.S. Treasuries. Again, the interest rate for U.S. Treasuries fluctuates, but as of the writing of this article, the 12-month U.S. Treasury rate is in excess of 4%.

Bank Letters of Credit

Letters of credit are provided by banks and are essentially a promise to pay on demand to the surety up to a certain dollar amount (usually equal to the bond amount). Letters of credit are viewed similar to cash by surety companies due to their liquid nature. The surety company must approve the bank, because essentially, the risk the surety undertakes in these scenarios is the bank failing and the surety not being able to draw under the letter of credit. The sureties also have their own letter of credit format that needs to be provided to the bank.

For appellants with established banking relationships, these often prove to be a good option, and a letter of credit can be obtained within a week or two. For those appellants that do not have established banking relationships, the process with their bank is akin to applying for a loan and can take several weeks. In some instances, a bank might require the letter of credit to be secured by cash, and in those cases, it can often be better for the appellant to obtain a bond by directly providing the cash to the surety to avoid paying the letter of credit fee.

Insurance companies often require appeal bonds, and there are several nuances in the process that are unique to insurers.

Real Estate

Many are unaware that real estate is even an option to secure an appeal bond. Presently, there are only two surety companies in the marketplace that will accept real estate as collateral for appeal bonds. The sureties will primarily consider residential real estate (single and multi-family) and commercial properties (office, industrial and retail). In some limited instances, they will accept the raw land in very well-developed and high-demand areas.

Generally, the sureties will require an appraisal of the property (there can be exceptions) and title insurance, which the appellant is responsible for paying. The sureties discount the value of the property to account for potential market fluctuations, similar to how banks don't loan up to the full value of a property.

Marketable Securities

As with real estate, marketable securities are one of the lesser-known options available. Marketable securities are defined as money market funds, stock and bond investments, mutual funds, and exchange-traded funds (ETF's) held in a brokerage account. To be considered by a surety, the assets must contain high-quality stocks and bonds and be held in a non-retirement account. The first step in the process is to provide the surety company with the most recent account statement, so they can review the holdings. The value of the account typically needs to be more than the bond amount. The exact amount that the marketable securities need to exceed the bond amount by depends on the type of investments; for example, the value of a stock account will have to be much higher than a low-risk investment like short-term U.S. Treasuries.

After the surety determines that the assets are acceptable to secure the bond, they will need to enter into an account control or pledge agreement with the brokerage firm. Many brokerage firms have their own format, but the surety also has a standard form that can be used. This can take several weeks to get in place if there are aspects of the agreements that the surety and brokerage firm need to negotiate. If they cannot agree on a mutually acceptable format, the client is generally able to transfer their account to another brokerage firm that has an agreement acceptable to the surety.

When the client uses a brokerage firm owned by a bank, we often advise that they look into having the bank affiliate issue a letter of credit secured by their brokerage account. This can sometimes be the quicker and less costly option for the client.

Appeal Bond Costs

The premiums for appeal bonds are charged annually during the course of the appeal. The first year's premium is fully earned once the bond is issued, and any renewal premiums are prorated if the bond is exonerated midterm.

The premiums are based on three factors:

1) The financial strength of the appellant;
2) The size of the bond;
3) The type of collateral provided, if required.

The average premium rate is around 1% of the bond amount. The rates for financially strong appellants needing large bonds can go as low as 0.35%, and the highest rate is usually when real estate is used due to the illiquid nature, which costs 4%.

Appeal Bonds for Insurers

Insurance companies often require appeal bonds, and there are several nuances in the process that are unique to insurers. The first question that always needs to be addressed is whether the insurer has the obligation to post the appeal bond, or whether that lies with the insured. If the insurer does determine that they need to provide the appeal bond, then they must decide the amount they are obligated to bond. In most instances insurers will bond only up to their policy limits, because providing a bond in excess creates an additional liability if the judgment is affirmed. However, there are times when insurers will bond judgments in excess of their policy limits-- Susan Knell Bumbalo's article for DRI's For the Defense in October 2017 titled *Examining Insurers' Obligations to the Insureds Post-Verdict* does an excellent job of reviewing this topic in great detail.

Can Insurers Provide Their Own Appeal Bonds?

Yes, some insurers can provide their own appeal bonds, but contrary to popular belief, most insurers do not have the ability. As of 2023 there are 3,708 property-casualty insurers in the United States, according to IBISWorld. However, there are only 259 companies licensed to transact surety and approved by the Department of Treasury to provide bonds to the United States federal government or courts.

The Treasury Department assigns each approved surety an underwriting limitation, and when a surety issues a bond in excess of the assigned underwriting limitation, "the excess must be protected by coinsurance, reinsurance, or other methods in accordance with 31 CFR Section 223.10, Section 223.11."

Of the 259 surety companies that are approved by the Department of the Treasury, some still decide to go to an outside source. There are probably a variety of reasons for this, but one is that in large companies it can sometimes be easier to go to an outside source than to coordinate between intercompany departments.

Appeal Bonds with Multiple Insurers

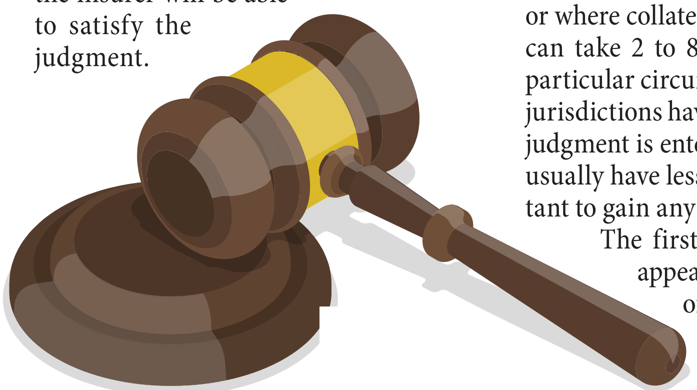
In some cases, there may be multiple insurance policies and insurers involved. In these situations, there are times where there will be a lead insurer appointed to coordinate getting one bond. Generally, each insurer will indemnify the surety for their respective portion of the bond (typically up to their policy limit). However, we have seen cases where a lead insurer makes the guarantee to the surety and coordinates their own agreements with the other insurers in the background. Insurers also sometimes choose to post separate bonds, each for their respective portion.

Setting up an Appeal Bond Facility

Some insurers choose to set up ongoing facilities with surety companies whereby they have signed a general indemnity agreement covering any bonds issued, which allows them to avoid signing an individual indemnity agreement for each bond. This can speed up the process for issuing the bonds, and it may be possible to obtain lower premium rates for the insurer based on the continuing relationship.

What Happens When an Insurer Doesn't Financially Qualify?

Not all insurers are created equal; some are very financially strong while others are not. Even when an insurer is reasonably strong, they may require an appeal bond for a large amount that equals a substantial portion of their surplus. Surety companies evaluate insurers just as they would any other business to determine whether they believe there is certainty that the insurer will be able to satisfy the judgment.



When an insurer is borderline on meeting the surety's qualifications, the surety company may want to ascertain whether there is any reinsurance involved in the case; if there is, getting confirmation of that coverage or possibly the indemnity of the reinsurer can sometimes be an option. Barring those options, there are times when a surety may determine that collateral is required.

Appeal Bonds for Insureds

The first step an insured should take is to determine whether the insurer is providing the bond for any portion of the judgment amount. Once the bond amount is known that the insured must obtain, the surety will evaluate the insured's qualifications.

If the insured is financially qualified, the appeal bond can be written on an uncollateralized basis. This most often occurs with publicly-traded companies, large private entities, and municipalities. When it comes to private entities, they will generally need to provide the surety with an audited financial statement from an outside CPA firm, but there can be exceptions with smaller bonds.

Small businesses and individuals will typically be required to provide collateral to the surety in one of the forms described earlier in this article. There are cases where very high net worth individuals can qualify for an appeal bond without collateral, but there are very few surety companies in the market that will consider it.

When to Start the Process

The general rule of thumb is that it is never too early to start the process for an appeal bond. For a very financially strong insurer or publicly-traded company, the process may only take a few days. For more complex situations involving multiple insurers or where collateral is required, the process can take 2 to 8 weeks depending on the particular circumstances. Given that some jurisdictions have no automatic stay after a judgment is entered, and those that do are usually have less than 30 days, it is important to gain any extra time possible.

The first step is to speak with an appeal bond broker to get a sense of the timing based on the circumstances and preferences of the client. Starting these discussions can happen as early as before the trial even begins, but often occurs before a verdict is rendered or the judgment is entered.

Post-appeal Status of the Bond

Appeals conclude in a variety of ways, and since the bond is tied to the underlying liability of the judgment, it means there is no one answer for how to close out a bond. When the appellate court issues their opinion, it's important to reach out to the surety. If the judgment was affirmed, in whole or part, advise the surety on how the appellant intends to satisfy the judgment or whether they would like the surety to satisfy it using the collateral they may be holding.

If the case is being appealed to a higher court or there are any disagreements over the amount due to the other party, which usually relates to the costs or interest calculation, it's important to communicate that to the surety. We also advise having the surety review any draft settlement agreements before they are finalized to ensure the proper language is included to exonerate the bond and release the surety from all liability.

Conclusion

Law professor Joseph Blocher of the Duke University School of Law was recently quoted in the May 2023 edition of the *ABA Journal* as saying, "The best lawyer isn't always the person who has memorized the most rules." The same is true for the subject of appeal bonds. Appeal bonds can be complex and incredibly nuanced, and attorneys don't need to memorize all the details outlined in this article. However, having at least a vague familiarity with the process for getting a bond in place and a reference to turn to for the details can enable attorneys to be alert to potential issues and allow them to guide their clients through the unchartered waters in an effort to help their clients protect their assets.