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The Use of Surety Bonds in Health Care – Part I

[Part II of this article](#) will go into detail on surety bond requirements that may be imposed on providers of durable medical equipment, prosthetics, orthotics and supplies (DMEPOS), on pharmacies and pharmaceutical dealers and suppliers, as well as specific requirements imposed by certain states.

What is a Surety Bond?

Most people have little understanding of what a surety bond covers, how it is structured, how it operates, or why it is used instead of insurance. Indeed, the vast majority of experienced attorneys can have lengthy and successful careers and never deal with a surety bond. But surety bonds have been used to facilitate commerce for thousands of years. The concept of suretyship is referenced in the Code of Hammurabi, is found in the Old Testament, was an element of Roman civil law, was included in the English common law, and was even an integral element of the Magna Carta.

Suretyship is not a form of insurance. Instead, suretyship involves no transfer of risk and provides that one party (the surety) agrees to answer for the debts or obligations of another (the principal). The party in whose favor the bond runs is called the obligee. Since under a surety bond the surety agrees to answer for the debts of another, the bond must be in writing to comply with the requirements of the statute of frauds. (The statute of frauds is a legal concept that requires certain types of contracts to be executed in writing. The precise form of the Statute of Frauds varies between jurisdictions.)

Surety bonds are commonly used to provide a second and alternative source of recovery for the failure of one entity to comply with its contractual, statutory or regulatory obligations. Surety bonds are often used in public construction at the federal level under the Miller Act or at the state level in what are known as “Little Miller Acts.” The bonds envisioned by Ohio Auditor Yost, however, would be best characterized as commercial surety bonds. These

bonds are provided to assure that the principal, which typically is engaged in a particular business, fulfills its obligations imposed by governing statutes or applicable regulations. In this context, the federal government and many states impose obligations to provide these surety bonds on certain providers of health care goods and services.

Targeting Medicare and Medicaid Fraud

On January 20, 1998, Sally K. Richardson, Director, Center for Medicaid and State Operations for the Department of Health and Human Services, [issued a letter](#) regarding the implementation of the Balance of Budget Act (BBA) of 1997. The letter was one of a series of communications that targeted fraud and abuse in Medicaid and Medicare programs. A proposed regulation had been published in the federal register in January 1998 as a final rule and the agency solicited comments on the rule. This proposed rule addressed the use of surety bonds and capitalization requirements for Home Health Agencies (HHAs). Under this proposed regulation, HHAs were required to secure surety bonds to participate in Medicare and Medicaid programs, and a separate bond was required for each program. Under the Medicaid program, each HHA had to post a surety bond that was in the penal sum of \$50,000 or 15% of the annual Medicaid payments made to the HHA by the Medicaid agency for services rendered. Under the Medicare program, the surety bond had to be in the penal sum of \$50,000 or 15% of the annual amount paid by the HHA under the Medicare programs. There were also capitalization requirements imposed for participation in the programs.

States also required the posting of surety bonds by entities or individuals who wanted to become providers of goods or services under a variety of Medicaid programs. Those required to post a bond included physician groups, ambulance or transportation providers, home health agencies, and personal care assistance providers. The purpose of the bond is to assure that these providers who are accepting payment through Medicaid programs are operating their business in a proper manner and in full compliance with applicable federal or state statutes and regulations. The

applicable terms of the Medicaid provider bond vary greatly as to the penal sum of the bond as well as regulations surrounding how the bonds are to be administered.

The premiums charged for the issuance of the bonds also vary greatly and may range from a total of 0.5% to 2% of the bond amount. For example, a \$50,000 bond may require a premium as low as \$250 or as high as \$1,000 depending upon the financial stability of the principal seeking the bond.

Issuing the Bond and Determining its Terms

To issue the bonds, the surety typically conducts a financial review of the potential provider of the goods or services. The bond itself provides a financial guarantee that the business will fulfill its obligations according to the terms of the statutes or regulations governing the providers. Under these bonds, the government agency is deemed the obligee, the principal is the business that is providing the goods or services, and the surety is the carrier that underwrites the bond. For example, Florida requires the posting of such bonds under [Florida statute § 409-907\(7\)](#) of the Florida Agency for Healthcare Administration. The penal sum for the bond in Florida is set at \$50,000.

Under the terms of the bond in Florida, the principal pledges that it will satisfy all requirements of the Florida statutes to render the particular services in a proper manner. Typically, the Florida Medicaid Provider Bond remains in effect for a period of one year. The bonds can be terminated by giving the required notice by certified mail, and the cancellation becomes effective sixty (60) days from the mailing of the notice. The surety can also cancel the bond by giving sixty (60) days' notice to the agency identified as the obligee under the bond. The posting of the bond is required for an entity to become eligible to provide the Medicaid services.

Since suretyship is not insurance, the carrier providing the bond typically secures a commitment from the principal and possibly personal indemnitors to indemnify the carrier in the event it must pay a claim under the terms of the bond. The principal is, and remains, the primary obligor to perform the services or provide the

goods, and the surety becomes the secondary obligor. In this instance, suretyship is much more like a financial requirement that obligates the principal, as the primary obligor, to reimburse the surety in the event that any loss is sustained.

For more information on how surety bonds operate in general or how a specific surety bond may apply to claimants, principals or sureties, please contact any member of Frost Brown Todd's [Health Care Industry Team](#) or the author of this article, [David C. Olson](#) (dolson@fbtlaw.com, 513.651.6905.)

See the next part of the series here: [The Use of Surety Bonds in Health Care – Part II](#)

View the original article in its entirety as a Frost Brown Todd Legal Update: [The Use of Surety Bonds in Health Care.](#)

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