SECURITY IN BONDING ACT OF 2011

HEARING

BEFORE THE

SUBCOMMITTEE ON COURTS, COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

ON

H.R. 3534

MARCH 5, 2012

Serial No. 112–93

Printed for the use of the Committee on the Judiciary

Available via the World Wide Web: http://judiciary.house.gov

U.S. GOVERNMENT PRINTING OFFICE

73–211 PDF WASHINGTON : 2012

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON THE JUDICIARY

LAMAR SMITH, Texas, *Chairman*

F. JAMES SENSENBRENNER, JR., Wisconsin
HOWARD COBLE, North Carolina
ELTON GALLEGLY, California
BOB GOODLATTE, Virginia
DANIEL E. LUNGREN, California
STEVE CHABOT, Ohio
DARRELL E. ISSA, California
MIKE PENCE, Indiana
J. RANDY FORBES, Virginia
STEVE KING, Iowa
TRENT FRANKS, Arizona
LOUIE GOHMERT, Texas
JIM JORDAN, Ohio
TED POE, Texas
JASON CHAFFETZ, Utah
TIM GRIFFIN, Arkansas
TOM MARINO, Pennsylvania
TREY GOWDY, South Carolina
DENNIS ROSS, Florida
SANDY ADAMS, Florida
BEN QUAYLE, Arizona
MARK AMODEI, Nevada

JOHN CONYERS, JR., Michigan
HOWARD L. BERMAN, California
JERROLD NADLER, New York
ROBERT C. "BOBBY" SCOTT, Virginia
MELVIN L. WATT, North Carolina
ZOE LOFGREN, California
SHEILA JACKSON LEE, Texas
MAXINE WATERS, California
STEVE COHEN, Tennessee
HENRY C. "HANK" JOHNSON, JR., Georgia
PEDRO R. PIERLUISI, Puerto Rico
MIKE QUIGLEY, Illinois
JUDY CHU, California
TED DEUTCH, Florida
LINDA T. SÁNCHEZ, California
JARED POLIS, Colorado

RICHARD HERTLING, *Staff Director and Chief Counsel*
PERRY APELBAUM, *Minority Staff Director and Chief Counsel*

SUBCOMMITTEE ON COURTS, COMMERCIAL AND ADMINISTRATIVE LAW

HOWARD COBLE, North Carolina, *Chairman*
TREY GOWDY, South Carolina, *Vice-Chairman*

ELTON GALLEGLY, California
TRENT FRANKS, Arizona
DENNIS ROSS, Florida
BEN QUAYLE, Arizona

STEVE COHEN, Tennessee
HENRY C. "HANK" JOHNSON, JR., Georgia
MELVIN L. WATT, North Carolina
JARED POLIS, Colorado

DANIEL FLORES, *Chief Counsel*
JAMES PARK, *Minority Counsel*

CONTENTS

MARCH 5, 2012

SECURITY IN BONDING ACT OF 2011

MONDAY, MARCH 5, 2012

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COURTS,
COMMERCIAL AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to call, at 4 p.m., in room 2141, Rayburn House Office Building, the Honorable Howard Coble (Chairman of the Subcommittee) presiding.

Present: Representatives Coble and Gowdy.

Also Present: Representative Hanna.

Staff Present: (Majority) Travis Norton, Counsel; Ashley Lewis, Clerk; and (Minority) James Park, Subcommittee Chief Counsel.

Mr. COBLE. The witnesses will please take your places, if you will, and the Subcommittee will come to order. We have other people who are on their way, I am told, so we will move along initially. Good to have you all with us, by the way.

I will give my opening statement at this time.

Surety bonds are financial instruments used to provide the national security for large construction contracts. For example, prime contractors typically post payment bonds to assure subcontractors that they will be paid for their work. Prime contractors may also bid, and post performance bonds to guarantee the owner that the work will be performed according to the contract.

The Federal Government regularly contracts with privately owned businesses to complete construction projects. In doing so, the government requires contractors to obtain surety bonds, but the security provided to the government by a surety bond is only as good as the Capital R assets that stand behind the bond.

There are currently three ways a contractor can satisfy the Federal Government's requirement for adequate assurance of performance and payment. First, the contractor can obtain a bond from a corporate surety approved by the Treasury Department. These sureties are vetted by Treasury to ensure that they have adequate capital to make good on the bond, if necessary.

Alternatively, the individual contractor can give the United States the possessory security interest in low-risk liquid assets such as T-bills, cash, or cash equivalents. If a contractor does not perform, the government seizes the assets with ease and finds another contractor to complete the work without suffering monetary loss.

A third option, a contractor may secure a bond from an individual surety. Under the Federal Acquisition Regulation, however, an individual with surety needs only to pledge assets to the government. It does not need to allow the government to hold the assets. In addition, an individual surety may pledge more volatile assets such as stocks and bonds traded on an exchange or rights in real property.

In recent years, there have been a number of instances in which individual surety bonds have not provided the security that they purport to offer. In some cases this was because the value of the pledged assets had decreased significantly, like when the stock market suddenly dropped or real estate values plummeted.

H.R. 3534, by Congressman Hanna of New York, is intended to give the Federal Government and subcontractors true security when they contract to perform construction work on a Federal project. The bill allows Federal contracting officials to require a bond from a Treasury-regulated surety. It does not foreclose individual sureties from the bonding market, but it does require them to pledge in the same manner the same kind of low-risk assets that an individual contractor would be required to pledge in lieu of a surety bond.

It should also be noted that H.R. 3534 is supported by the American Subcontractors Association and the National Association of Minority Contractors. I hope to work with Ranking Member Cohen and Congressman Hanna to ensure that the Federal Government does not suffer monetary loss on construction projects at a time when it can least afford to do so.

I look forward to hearing the testimony from our witnesses subsequently.

[The bill, H.R. 3534, follows:]

I

112TH CONGRESS
1ST SESSION

H. R. 3534

To amend title 31, United States Code, to revise requirements related to assets pledged by a surety, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

DECEMBER 1, 2011

Mr. HANNA (for himself and Mr. MULVANEY) introduced the following bill; which was referred to the Committee on the Judiciary

A BILL

To amend title 31, United States Code, to revise requirements related to assets pledged by a surety, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Security in Bonding Act of 2011".

SEC. 2. SURETY BOND REQUIREMENTS.

Chapter 93 of subtitle VI of title 31, United States Code, is amended—

(1) in section 9304(b)—

(A) by striking "may not require" and inserting "may require"; and

(B) by striking "or through" and inserting ", but not through";

(2) by adding at the end the following:

"§ 9310. Individual sureties

"If another applicable law or regulation permits the acceptance of a bond from a surety that is not subject to sections 9305 and 9306 and is based on a pledge of assets by the surety, the assets pledged by such surety shall—

"(1) consist of eligible obligations described under section 9303(a); and

"(2) be submitted to the official of the Government required to approve or accept the bond, who shall deposit the assets with a depository described under section 9303(b)."; and

(3) in the table of contents for such chapter, by adding at the end the following:

○

Mr. COBLE. Mr. Richard Hanna of New York is recognized. Mr. Hanna, glad to have you sit on the podium. You won't be able to speak, however, since you are not a Member of the select Committee, if you will. It is good to have you with us, nonetheless.

Mr. HANNA. Thank you, sir.

Mr. COBLE. And I am still a little reluctant to start. Let me introduce the witnesses, and by then we should be in a position to move forward.

Where is my witnesses list here, Steve? Mr. Mark McCallum is the Chief Executive Officer of the National Association of Surety Bond Producers. NASBP is an international association of companies employing professional surety bond producers and brokers. Prior to his service there, Mr. McCallum held a seated position at the Association of General Contractors of America, and before that at the American Institute of Architects. Mr. McCallum earned his law degree from Tulane School of Law in New Orleans and his Bachelor's Degree from Vanderbilt University in Nashville—one of May favorite towns, by the way, Mr. McCallum. I am a country music enthusiast. So when I think country music, I synonymously think Nashville, knowing that there is more to Nashville than that.

Mr. MCCALLUM. It is a great town.

Mr. COBLE. It is a great town.

Jean Blanco Wellers is the Executive Officer of JBlanco Enterprises, Inc., a construction and real estate management firm in Sheridan, Colorado. Ms. Wellers emigrated to the United States as a child to escape the civil war in El Salvador. Through hard work and education, she became corporate safety director for the largest residential roofing contractor in the Southwest before forming JBlanco Enterprises in 2004.

JBlanco Enterprises participates in the Small Business Administration's 8(a) development program. In 2008, Ms. Wellers' firm was recognized by the SBA as 8(a) contractor of the year and was featured in 2010 as the second fastest growing minority-owned business in Colorado.

Mr. Robert Little, Jr. is an attorney with more than 37 years in public service and private practice. Currently he is of counsel in the law firm of Cohen Seglias Pallas Greenhall & Furman, PC. Prior to that he served as a senior associate counsel to the headquarters of the Naval Facilities Engineering Command for service, supply, and construction contracts worldwide. In that capacity, he had a substantial experience with reviewing surety bond applications. Mr. Little holds a law degree from the College of William & Mary, and a Bachelor's Degree in philosophy from the Virginia Polytechnic Institute.

Finally, Miss Karen Barbour is the owner and founder of the Barbour Group, a Maryland-based independent insurance agency with a focus on construction bonding and commercial insurance. Prior to starting the Barbour Group, Ms. Barbour was a partner of Barbour Construction Corp for 10 years. The Governor of Maryland has appointed Ms. Barbour to his Commission on Small Business. She also serves as vice chair on the advisory board for the Small Business Development Center for the State of Maryland. Ms. Barbour attended Loyola University in Maryland where she earned her Bachelor's Degree in political science and history. She earned her business degree from the University of Baltimore.

It is good to have each of you with us, and I am still in a reluctant hold right now. I hate to start before a member of the Democrat Party shows up, but we may do that because I don't want to penalize you all for having been here in a timely way.

James, I have your assurance that I won't be keel-hauled. But for the moment, folks, if you all would just hang loose, I need to get another Member here if we can. And if not, we will go ahead and proceed. So be at ease for the time being, and pardon my gravelly voice, folks. I am trying to come down with my annual early March cold, but sounds irritable, I know.

[Brief recess.]

Mr. COBLE. I appreciate the presence of the witnesses here, and hopefully we will get some action momentarily. Let's roll. Folks, we are going to go ahead and proceed according to plan. Again, thank you for your patience, and I apologize for the delay.

Mr. McCallum, we will start with you, and folks, we try to comply with the 5-minute rule. There is a timer on your desk, and when the green light turns amber, that is your wake-up call that you have a minute at that point, and then when the red light appears, that is the 5-minute termination. You will not be physically punished if you violate that, but if you can wrap it up as soon as possible. Mr. McCallum, we will start with you. You are recognized for 5 minutes. Get your mike on, please, Mr. McCallum.

TESTIMONY OF MARK H. McCALLUM, CEO, NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS

Mr. MCCALLUM. Mr. Chairman, thank you for the opportunity to speak to you this afternoon.

NASBP members are companies employing licensed bond producers who assist businesses of all sizes to obtain surety credit and to grow as competitive businesses. Bond producers often are asked by construction firms to help them assess the strength and reputation of a surety furnishing a bond to which the firm is a beneficiary. A surety that is not sound financially cannot add to the credit standing of the firm to which it is bonded. Moreover, such a surety will not supply the protection promised by the bond. As a result, bond producers advocate for well-regulated and stable surety markets.

The Security and Bonding Act of 2011, House Resolution 3534, is a critical and commonsense measure that will assure the integrity of surety bonds on Federal construction contracts when issued by individuals using a pledge of assets. Bonds furnished by unlicensed individual sureties have an unfortunate track record of problems on Federal construction projects.

In fact, financial loss to subcontractors and to contracting agencies from individual surety bond fraud was the catalyst for changes in the Federal Acquisition Regulation in 1990. Recent events involving individual sureties, however, have made clear that these changes have not proven sufficient to ameliorate the problem. It is time to do so, and NASBP, along with 10 other national construction and surety organizations view the proposed statutory changes in H.R. 3534 as the solution.

Mr. Chairman, as you mentioned earlier today, construction firms may use one of three methods to furnish security on a Federal construction project. They may secure a bond written by a corporate surety listed on Treasury Circular 570; they may use their own assets to purchase and pledge an eligible obligation in lieu of a surety bond or they may obtain a bond from an individual if the bond is secured by an acceptable asset, which includes stock, bonds, and real property.

Corporate sureties writing on Federal projects must possess a certificate of authority from the Department of the Treasury, which conducts a financial review of the surety and sets a single bond size limit for the surety. Corporate sureties are licensed in the States in which they conduct surety business and they must obtain certificates of authority from State insurance departments. They are regularly audited and file financial reports with State regulators. They must file the rates they intend to charge for their bonds and are subject to market conduct investigations. They are also rated by private rating organizations, such as A.M. Best, which publicize their financial strength and size.

Individual sureties are not subject to the same level of scrutiny and oversight as corporate sureties and are vetted solely by Federal contracting officers who often are overburdened and under resourced for the complex tasked required of them. Federal regulations do not require individual sureties to possess a certificate of authority as an insurer in any State.

They are not required to furnish character information such as information about criminal convictions, State or Federal tax liens, prior bankruptcies, or State cease and desist orders. No third-party rating information is available on individual sureties. If a contracting officer fails to performed adequately, the necessary investigation of the individual surety and the assets backing the individual surety bond proves insufficient or nonexistent, unpaid subs and suppliers are denied their statutory payment remedy and contracting agencies are denied their guarantee of contract performance.

H.R. 3534 solves this problem. It requires individual sureties to pledge solely those assets defined as eligible obligations by the Secretary of the Treasury. Eligible obligations are public debt obligations of the U.S. Government and obligations whose principal and interest is unconditionally guaranteed by the U.S. Government.

These assets then are given to the Federal contracting authority, which in turn deposits them in a Federal depository, such as the Federal Reserve Bank, St. Louis, ensuring that pledged assets are real, sufficient, convertible to cash, and in the physical custody and control of the Federal Government. This is nothing more than what now is statutorily required of construction firms that wish to pledge assets as security on a Federal contract in lieu of a surety bond.

Firms working on Federal construction projects, either as subs or suppliers, have no control over the prime contractor's choice of security provided to the Federal Government, but they suffer the most harm financially if the provided security proves illusory. H.R. 3534 will give them the confidence that on all Federal projects adequate and reliable security is in place to guarantee that they will be paid.

Thank you for your time and attention today. I am happy to answer questions that you may have.

[The prepared statement of Mr. McCallum follows:]

NATIONAL ASSOCATION OF SURETY BOND PRODUCERS

Written Testimony of Mark H. McCallum
Chief Executive Officer

Before the U.S. House of Representatives
Committee on the Judiciary
Subcommittee on Courts, Commercial and Administrative Law

In Support of

H.R. 3534
The Security in Bonding Act of 2011

WWW.NASBP.ORG

March 5, 2012

1140 19th Street, NW, Suite 800
Washington, DC 20036
Phone: 202-686-3700; Fax: 202-686-3656
Website: www.nasbp.org

The National Association of Surety Bond Producers (NASBP) is a national trade organization of professional surety bond producers, whose membership includes firms employing licensed surety bond producers placing bid, performance, and payment bonds throughout the United States and its territories. NASBP wishes to extend its appreciation to Chairman Coble, Vice Chairman Gowdy, Ranking Member Cohen, and to the members of the Subcommittee on Courts, Commercial and Administrative Law of the U.S. House of Representatives' Committee on the Judiciary for the opportunity to provide written and oral testimony in strong support of H.R. 3534, the Security in Bonding Act of 2011.

By way of background, our testimony will begin with a brief description of the important role surety bonds play in the federal procurement arena.

The Importance of Surety Bonds: Sound Public Policy

Corporate surety bonds are three-party contract agreements by which one party (a surety company) guarantees or promises a second party (the obligee/federal government) the successful performance of an obligation by a third party (the principal/contractor). In deciding to grant surety credit, the surety underwriter conducts in-depth analysis, also known as prequalification, of the capital, capacity and character of the construction firm during the underwriting process to determine the contractor's ability to fulfill contractual commitments. *Surety bonds are an essential means to discern qualified construction companies and to guarantee contracts and payments, ensuring that vital public projects are completed, subcontracting entities are paid, and jobs are preserved.*

The federal government has relied on surety bonds for prequalification of construction contractors and for performance and payment assurances since the late nineteenth century. In 1894, the U.S. Congress passed the Heard Act which codified the requirement for surety on U.S. government contracts and institutionalized the business of surety. In 1935, the Heard Act was superseded by the Miller Act, which required the continuation of these vital assurances so that U.S. taxpayer funds were protected and subcontractors and suppliers would receive payment for their labor and materials. Today, the Miller Act and applicable regulations require that, before any contract exceeding $150,000 is awarded for a federal construction contract, the prime contractor must furnish a performance bond and a payment bond to the contracting agency.

Types of Surety Bonds

The bid bond assures that the bid has been submitted in good faith and the contractor will enter into the contract at the bid price and provide the required performance and payment bonds. A performance bond protects the project owner from financial loss should the contractor fail to perform the contract in accordance with its terms and conditions. The payment bond protects subcontractors and suppliers, which do not have direct contractual agreements with the public owner and which would be unable to recover lost wages or expenses should the contractor be unable to pay its financial obligations. Often, small construction businesses must access the federal procurement marketplace at subcontractor and supplier levels, and the payment bond is their primary recourse and protection in the event of prime contractor nonpayment or insolvency.

Role of the Bond Producer

The bond producer plays a vital role in the federal construction process. The bond producer stands as the "bridge" between the construction firm and the surety company. The bond producer works closely with the construction business as an advisor, educator, and matchmaker to position the business to meet underwriting requirements in order to obtain surety credit.

The objective of the producer is not only to assist the contractor with obtaining surety credit for each contract requiring surety credit but to ensure that the contractor's business remains viable and thrives for years to come. To that end, bond producers assist construction firms of all sizes with creating networks of knowledgeable professional services providers, such as construction attorneys, certified public accountants familiar with construction business practices, and construction lenders, and may assist construction firms with market intelligence and even strategic and succession planning.

H.R. 3534 Enhances Protection of Federal Contracting Agencies, Taxpayer Funds and Construction Firms Furnishing Labor & Materials on Federal Projects

NASBP, along with ten other national construction and surety industry organizations (see attached letter to Representatives Hanna and Mulvaney), support H.R. 3534, the "Security in Bonding Act of 2011" as a critical means to protect construction businesses and to assure the integrity of surety bonds on federal contracts when issued by individuals using a pledge of assets. As noted earlier, the Federal Miller Act requires contractors to furnish surety bonds on federal construction projects to ensure that bonded contracts will be completed in the event of a contractor default, thereby protecting precious U.S. taxpayer dollars and subcontractors and suppliers, many of which are small businesses. The financial strength and stability of the surety is the key to the success of the surety bonding system.

Presently, there are three methods construction firms may use to furnish security on a federal construction project:

1. By securing a bond written by a corporate surety, that is vetted, approved, and audited by the U.S. Department of Treasury and listed in its Circular 570;
2. By using their own assets to post an "eligible obligation," i.e. a U.S.-backed security, in lieu of a surety bond. The security is pledged directly and deposited with the federal government until the contract is complete; or
3. By securing a bond from an individual, if the bond is secured by an "acceptable asset," which includes stocks, bonds, and real property.

It is this third alternative that has proven consistently problematic, to the financial detriment of contracting authorities and of subcontractors and suppliers performing on federal projects. NASBP believes that the current regulations pertaining to use of individual sureties on federal construction projects are fundamentally flawed, allowing gamesmanship by unlicensed persons acting as sureties. Such existing requirements need to be superseded by the statutory approach delineated in H.R. 3534.

Federal Acquisition Regulation (FAR) 28.203-2(b)(3) permits federal contracting officers to accept bonds from natural persons, not companies, if the bond is secured by an "acceptable asset," which includes stocks, bonds, and real property. These individuals neither are subject to the same scrutiny and vetting given to corporate sureties nor are they required to provide physical custody of the asset to the government that they pledge to secure their bonds to the contracting authority.

This lack of thorough scrutiny of individual sureties and control over their pledged assets has resulted in a number of documented situations where assets pledged by individual sureties have proven to be illusory or insufficient, causing significant financial harm to the federal government, to taxpayers, and to subcontractors and suppliers, many of whom are small businesses wholly reliant on the protections of payment bonds to safeguard their businesses.

Federal requirements do mandate a level of documentation and information from individual sureties. Individual sureties are required to complete, sign, and have notarized an affidavit of individual surety (SF 28), which is a standardized form for the purpose of eliciting a description of the assets pledged and the contracts on which they are pledged. SF 28, however, does not elicit other pertinent information, such as that about the character or fitness of the individual acting as surety, like criminal convictions, state insurance commissioner cease and desist orders, outstanding tax liens, or personal bankruptcies.

Under FAR requirements, the pledged assets also are supposed to be placed in an escrow arrangement by the individual surety, subject to the approval of the contracting officer. The individual surety, however, is not required to turn the assets over to the physical custody of the contracting authority. Each contracting officer, not the Department of Treasury, shoulders the entire burden of determining the acceptability of the individual surety, its documentation, the escrow or security arrangement, and the value and adequacy of pledged assets, and must do so in relatively short order to progress the contract procurement. A missed, incorrect, or forsaken step may mean the acceptance of a fraudulent or insufficient bond, rendering its apparent and much needed protection worthless.

This burden of assessing individual sureties is added to the already considerable responsibilities of contracting officers. They are required to determine the authenticity of the documentation of the assets pledged to support the individual surety's bond obligations and to verify that the pledged assets actually exist, are sufficient, and are available to the federal government. They have to know that a particular financial document is what it purports to be and to understand and to assess the different types of collateral, such as stocks and real estate located anywhere in the United States.

It is not clear if and how often federal contracting officers receive specific training to understand and to perform the needed tasks of examination concerning individual sureties. Documents of federal agencies suggest that there are occasions when federal contracting officers may not have a complete understanding of what is required of them to safeguard taxpayers and small businesses from individual surety fraud. The Financial Management Service of the U.S. Department of Treasury issued a "Special Informational Notice to All Bond-Approving (Contracting) Officers" on February 3, 2006, still posted on the web site for the Financial Management Service at http://www.fms.treas.gov/c570/special_notice.pdf. This informational notice was directed to federal contracting officers to remind them of the applicable FAR requirements governing individual sureties. Specifically, the notice, a copy of which is attached to this testimony, states in part:

> *"Although FMS is not substantively responsible for approving individual sureties, we believe it prudent to issue this Special Informational Notice on a FYI basis to Agency Bond-Approving (Contracting) Officers who do have that responsibility under the FAR.*
>
> *Recently, FMS has been made aware of instances where individual sureties are listing corporate debenture notes and other questionable assets on their 'Affidavit of Individual Surety', Standard Form 28. In some instances, the individual sureties used a form other than the Standard Form 28 as their affidavit."*

Likewise, the U.S. Department of the Interior issued a notice to its contracting officers in 2009 to remind them of FAR requirements associated with acceptance of individual surety bonds. This notice, titled "Department of the Interior Acquisition Policy Release (DIAPR) 2009-15," states that the Department of the Interior Office of Inspector General conducted an investigation of contracting personnel practices concerning individual sureties and found concerns. Specifically, the release, a copy of which is attached to this testimony, states in part:

> *"The investigation identified several areas of concern that require our attention. There is concern that Contracting Officers (COs) are: (1) unfamiliar with the FAR requirements for individual surety; (2) accepting individual surety bonds without knowing or verifying the assets backing the bonds; (3) not vetting questions about individual surety bonds through the DOI Office of the Solicitor; and (4) not verifying individual sureties against the General Services Administration's Excluded Parties List System."*

If a contracting officer fails to perform adequately the necessary investigation of an individual surety, and the individual surety pledges assets that do not exist, are insufficient, or are not readily convertible into cash to pay the obligations of the defaulted general contractor, everyone on the project from the contracting agency on down is left unprotected and at risk for financial loss. If the assets pledged to support the bonds are uncollectible, unpaid subcontractors and suppliers protected by the bond will suffer financial hardship and could, in turn, default and go into bankruptcy.

Improper Individual Surety Activity

Recent situations illustrate where individual surety bond assets have turned out to be inadequate, illusory, or unacceptable. One illustration is *United States ex rel. JBlanco Enterprises Inc. v. ABBA Bonding, Inc,* where, in spite of a March 11, 2005 cease-and-desist order from the Alabama Insurance Department, Mr. Morris Sears was able to submit bonds on a federal contract in Colorado supported by an affidavit (Standard Form 28) stating that ABBA Bonding had assets with a net worth of over $126 million. Although no assets were placed in escrow for the benefit of the government, the U.S. General Services Administration accepted the bonds anyway. Mr. Sears eventually filed for Chapter 11 bankruptcy in the Southern District of Alabama, and it was made clear from the bankruptcy proceeding and legal depositions that most of the $126 million never existed. JBlanco Enterprises, a small business subcontractor performing work on federal contracts, nearly was forced to declare bankruptcy as a result of a deficient individual surety bond placed on a federal project that later proved to have no assets behind it.

Another notable instance surfaced in March 2010, when George Douglas Black, Sr., an individual surety doing business as Infinity Surety, was arrested and charged by the U.S. Department of Justice with mail fraud for allegedly selling more than $25 million of worthless construction bonds to 150 different construction companies on local, state, and federal public works projects, while receiving $2.9 million in fees. Among Black's alleged victims were the U.S.

Department of Navy, the Beaumont Independent School District of Texas, and the Monroe Airport in Monroe, Louisiana. It is alleged that Black repeatedly pledged the same small piece of real property to insure multi-million dollar state and federal construction contracts.

These, unfortunately, are not isolated instances. Other examples exist, both past and present, showing where individual surety bond assets proved illusory, uncollectible, or deficient. Particularly in view of the constrained economy, further instances are likely unless Congress acts to correct the requirements.

Legislative Solution

H.R. 3534, the "Security in Bonding Act of 2011," is a common-sense solution to this problem. The bill requires individual sureties to pledge solely those assets defined as eligible obligations by the Secretary of the Treasury. An eligible obligation is a public debt obligation of the U.S. Government and an obligation whose principal and interest is unconditionally guaranteed by the U.S. Government, such as U.S. Treasury bills, notes, and bonds, certain HUD government guaranteed notes and certificates, and certain Ginnie Mae securities, among other federally guaranteed securities. These safe and stable assets then are provided to the federal contracting authority, which will deposit them in a federal depository designated by the Secretary of the Treasury, ensuring that pledged assets are real, sufficient, convertible, and in the physical custody and control of the federal government. This is nothing more than what now is statutorily required of contractors who wish to pledge collateral as security on a federal contract in lieu of a surety bond.

If enacted, H.R. 3534 will eliminate the gamesmanship inherent in the current regulatory system governing individual surety bonds and pledged assets and will remove a considerable administrative burden from federal contracting officers. Federal contracting officers no longer will need to assess a range of pledged assets, as all pledged assets will be limited to assets unconditionally guaranteed by the federal government; they simply will need to gain custody over the asset to deposit the asset in a federal depository, such as the Federal Reserve Bank, St. Louis. The asset will be released upon successful performance of the bonded obligation, with any accrued interest inuring to the benefit of the individual surety pledging the government-backed asset.

Construction businesses working on a construction project—either as subcontractors, suppliers, or workers on the job—have no control over the prime contractor's choice of security provided to the federal government, but they suffer the most harm financially if the provided security proves illusory. The impact is particularly acute on small construction businesses, which may not have the strength to weather a significant disruption to their cash flow. The result of this bill is that construction businesses, the subcontractors, and suppliers on federal construction projects, will know that adequate and reliable security is in place to guarantee that they will be paid.

NASBP appreciates the opportunity to provide the Subcommittee with information about the compelling need to enact H.R. 3534 to protect taxpayer funds and construction businesses performing as subcontractors and suppliers on federal projects. NASBP would welcome any inquiries from the Subcommittee on the points raised in this written testimony.

ATTACHMENTS

Telephone (202) 874-6850

February 3, 2006

SPECIAL INFORMATIONAL NOTICE TO ALL BOND-APPROVING (CONTRACTING) OFFICERS

Important Information Regarding the Use of Individual Sureties on Federal Bonds

Subchapter E, Part 28 of the Federal Acquisition Regulation (FAR) provides guidance as to the acceptability of sureties and other security for Federal bonds. Acceptable security on Federal bonds include, but are not limited to, both corporate and individual sureties. FAR § 28.201. Acceptable corporate sureties must appear on the Department of Treasury's Circular 570. Treasury's Financial Management Service, Surety Bond Branch (FMS), publishes Department Circular 570 in the Federal Register.

Contracting officers determine the acceptability of individual sureties and ensure that the individual surety's pledged assets are sufficient to cover the bond obligation in accordance with the guidance outlined in the FAR § 28.203.

Although FMS is not substantively responsible for approving individual sureties, we believe it prudent to issue this Special Informational Notice on a FYI basis to Agency Bond-Approving (Contracting) Officers who do have that responsibility under the FAR.

Recently, FMS has been made aware of instances where **individual sureties are listing corporate debenture notes and other questionable assets on their "Affidavit of Individual Surety"**, Standard Form 28. In some instances, the individual sureties used a form other than the Standard Form 28 as their affidavit. **FAR § 28.203(b) specifically requires the use of the Standard Form 28**. In addition, FAR § 28.203-2(a) states that **"the Government will accept only cash, readily marketable assets, or irrevocable letters of credit from a federally insured financial institution from individual sureties to satisfy the underlying bond obligations."**

FAR § 28.203-2(b) includes **examples of acceptable assets**, such as:

- cash, or certificates of deposit, or other cash equivalents with a federally insured financial institution
- United State Government securities
- stocks and bonds actively traded on a national U.S. security exchange
- real property owned fee simple by the surety subject to certain conditions (refer to FAR 28.203-2(b)(4))
- irrevocable letters of credit issued by a federally insured financial institution in the name of the contracting agency and which identify the agency and solicitation or contract number.

Furthermore, FAR § 28.203-2(c) lists **unacceptable assets**, but indicates that the list is not all-inclusive. The following are listed as unacceptable assets:

- notes or account receivable
- foreign securities

- real property located outside the United States, its territories or possessions
- real property used as the principal residence of the surety
- real property owned concurrently
- life estates, leasehold estates, or future interest in real property
- personal property except as listed in FAR 28.203-2(b)
- stocks and bonds of the individual surety in a controlled, affiliated or closely held concern of the offeror/contractor
- corporate assets
- speculative assets
- letters of credit except as provided in FAR 28.203(b)(5)

The FAR also requires that the Government be given a security interest in any acceptable assets pledged by an individual surety. FAR § 28.203-1(a).

Prior to acceptance of an individual surety, FAR guidelines require contracting officers to obtain the opinion of their legal counsel as to the adequacy of the documentation pledging assets. FAR § 28.203(f).

If you have any questions, please feel free to contact this office at the above number.

Sincerely,

/Signed/ Rose Miller

Rose Miller
Manager
Surety Bond Branch

United States Department of the Interior

OFFICE OF THE SECRETARY
Washington, DC 20240

SEP 0 8 2009

TAKE PRIDE IN AMERICA

Department of the Interior Acquisition Policy Release (DIAPR) 2009-15

Subject: Individual Surety Bonds

References: Department of the Interior (DOI) Office of Inspector General (OIG) June 29, 2007, memorandum, *Management Advisory of Investigative Results: Individual Surety Bonds*, OIG Case Number OI-NM-06-0174-I; and Federal Acquisition Regulation (FAR) Part 28, *Bonds and Insurance*

1. Purpose:

The purpose of this DIAPR is to remind contracting personnel of key FAR requirements associated with accepting an individual surety bond for a contract to protect the Federal Government from financial losses.

2. Effective Date: Effective upon signature.

3. Expiration Date:

This DIAPR will remain in effect until superseded or cancelled.

4. Background and Explanation:

The OIG investigated allegations of misuse of individual surety bonds for construction contracts. The investigation identified several areas of concern that require our attention. There is concern that Contracting Officers (COs) are: (1) unfamiliar with the FAR requirements for individual surety; (2) accepting individual surety bonds without knowing or verifying the assets backing the bonds; (3) not vetting questions about the individual surety bonds through the DOI Office of the Solicitor; and (4) not verifying individual sureties against the General Services Administration's Excluded Parties List System.

The Miller Act, 40 U.S.C. 3131, requires performance and payment bonds for any construction contract exceeding $100,000, with some limited exceptions. Agencies must obtain adequate security for bonds with contracts for supplies or services, including construction. Acceptable forms of security include corporate or individual surety bonds, as well as others described in FAR Part 28.204.

The majority of surety bonds for government contracts are supplied by corporate sureties. Corporate sureties are companies approved by the Treasury Department to provide surety bonds. However, the FAR permits a contractor to secure bonds from "individual sureties" if approved by the CO.

FAR Part 28.203, *Acceptability of Individual Sureties,* outlines procedures COs must follow to determine the acceptability of an individual surety.

5. Action Required:

To reduce the risk of financial loss to the Department from contracts backed with individual surety payment and performance bonds, DOI COs must:

- Familiarize themselves with FAR requirements for individual surety bonds.
- Identify and verify assets, backing individual surety payment and performance bonds, prior to accepting them.
- Confirm and ensure that the government has control over pledged assets through the duration of the contract.
- Vet matters involving the acceptance of individual surety bonds with the Office of the Solicitor.
- Verify whether individual sureties are suspended or debarred.

6. Additional Information:

Please disseminate this guidance within your bureau. It will also be available on the web at http://www.doi.gov/pam/diapr.html. Questions may be directed to Brigitte Meffert, Senior Procurement Analyst, Office of Acquisition and Property Management, at (202) 208-3348, or via e-mail at Brigitte_Meffert@ios.doi.gov.

Debra E. Sonderman

Debra E. Sonderman
Director, Office of Acquisition and Property Management
and Senior Procurement Executive

Department of Justice

U.S. Attorney's Office
Southern District of Texas

José Angel Moreno • United States Attorney

FOR IMMEDIATE RELEASE	ANGELA DODGE
March 26, 2010	PUBLIC AFFAIRS OFFICER
WWW.JUSTICE.GOV/USAO/TXS	(713) 567-9388

FORT WORTH MAN ARRESTED AND CHARGED IN ALLEGED $25 MILLION NATIONWIDE SCHEME TO SELL FRAUDULENT SECURITIES

(HOUSTON) – George Douglas Black Sr., 41, of Fort Worth, Texas, was arrested today on mail fraud charges arising from allegedly selling millions of dollars worth of worthless construction bonds for projects across the U.S., United States Attorney José Angel Moreno announced today. Black is scheduled to appear before United States Magistrate Judge John Froeschner in Houston on Monday, March 29, 2010, at 10:00 a.m. It is anticipated the court will consider the issue of Black's possible release on bond at that hearing.

A criminal complaint filed in federal court in Houston on Thursday, March 25, 2010, alleges Black used the United States mail service to sell more than $25 million dollars worth of worthless bonds to numerous victims through his company, Infinity Surety. Black is not licensed or registered to sell securities. According to the allegations in the complaint, these bonds were used to insure various multi-million dollar construction project and were purportedly backed up by a single family residence in Tarrant County with a 2008 tax appraisal value of $130,700.

The bonds represented that the property would fully protect the holder in the event of loss. The bonds were sold to school districts, defense businesses who did work for the military and other companies across the country including a $1.8 million bond sold to a company in the League City, Texas, area. Black's company, the complaint alleges, was being run out of a private mailbox in Saginaw, Texas. The victims paid Black significant fees for these bonds which they believed protected their interests in various construction projects against loss, mailing Black approximately $2.8 million dollars in fees for these bonds from 150 different companies throughout the United States.

In July 2009, Black was enjoined by the state of Texas from selling bonds. Notwithstanding this injunction, the complaint alleges Black sold at least $25 million worth of bonds over a period of a year. Black has been in the business of selling these worthless bonds since 2006 and Black's website claimed these bonds were backed by "United States commercial and residential real estate." The complaint alleges that records obtained by the United States Postal Inspection Service (USPIS) showed this claim was

USAO - 100326 - Black Page 2 of 2

false and that he routinely pledged the same small piece of property to insure multi-million dollar construction projects.

This case was investigated by the USPIS and the Texas Department of Insurance. The case is being prosecuted by Assistant U.S. Attorney Ryan D. McConnell.

A criminal complaint is merely an allegation of criminal conduct, not evidence. A defendant is presumed innocent unless and until proven guilty beyond a reasonable doubt through due process of law.

# # #

http://www.justice.gov/usao/txs/releases/March%202010/032610%20Black_print.htm 4/7/2010

Mr. COBLE. Thank you, Mr. McCallum, and you beat the red light. It illuminated. You get a gold star for that.

Ms. Wellers, I am not trying to put pressure on you, but you are recognized as well.

TESTIMONY OF JEANETTE WELLERS, PRESIDENT & CFO, JBLANCO ENTERPRISES, INC.

Ms. WELLERS. Thank you for having me here. My name is Jeanette Wellers, and I own a roofing, waterproofing, and photovoltaic company located in Sheridan, Colorado. I incorporated my company in 2004 with an SBA loan. I will make this really short, because I only have 5 minutes and I can talk about the subject for hours.

In 2006, we were located in Bloomfield, Colorado, which is now Mr. Jared Polis' district. In 2006, 2 years after I started my business, my company entered into a contract with a general contractor who had contracted to the Federal Government. This was our first Federal job ever. I heard through the grapevine that this general contractor had some financial problems, but after consulting with my staff, we decided that there was minimal risks, and this was a Federal contract and bonding was in place.

After the general contractor failed to pay our progress payment and after we found out that we had no privity with the Federal Government, we consulted an attorney, who after various requests for production of documents found out that the general contractor had obtained and the Federal Government had accepted a fraudulent bond from an individual surety.

We expended thousands of dollars only to learn that the individual surety did nothing to secure the bond principal other than its ability to pay premiums. More detrimental to us was the fact that the assets pledged to back the bond did not exist. So there were no securities pledged and when we went back to talk to the bonding company, they didn't have a claim department. They had pledged all of the assets to different projects, private and Federal.

The fact is that the individual surety could not pay any money due to us, and we ended up getting a second mortgage from our house in $240,000 worth of credit that we owed to credit cards. At this time we owe our attorney a lot of money, and we talked to an attorney, and he ended up telling us that it is okay not to pay what we owed to them. I ended up going to the bank and getting a loan to pay my credit cards, and that is how we ended up getting back on track.

So I am here to support Bill 3534, and I am requesting that you guys hold individual surety and government entities to the same due diligence as contractors are held, and dispel all of us the stresses this has caused to my employees, my family, and my company.

That is it.

[The prepared statement of Ms. Wellers follows:]

Prepared Statement of Jeanette Wellers

JBlanco Enterprises, Inc.

Corporate Headquarters
4065 S. Federal Blvd.
Sheridan, CO 80110
Phone (303)761-0330
Fax (303)761-3359

Dallas
1517 W. N. Carrier Pkwy., Suite 148
Grand Prairie, TX 75050
Phone (972) 602-0800
Fax (972) 602-8677

Las Vegas
7680 W. Sahara Ave., Suite 130
Las Vegas, NV 89117
Phone (702) 942-8337
Fax (702) 967-2373

The Honorable Howard Coble
Chairman, Subcommittee on Court, Commercial and Administrative Law
Committee on the Judiciary
517 Cannon H.O.B.
Washington, D.C. 20515

The Honorable Steve Cohen
Ranking Member, Subcommittee on Court, Commercial and Administrative Law
Committee on the Judiciary
517 Cannon H.O.B.
Washington, D.C. 20515

Dear Chairman and Ranking Member,

I am contacting you about recently introduced legislation, H.R. 3534, titled the "Security in Bonding Act of 2011," which has been referred to the House Judiciary Subcommittee on Courts, Commercial and Administrative Law, of which you are a member. I strongly support passage of this important bill, because it will bolster the integrity of the federal bonding process by making certain that the assets pledged under non-corporate surety bonds are sufficient and in the care of knowledgeable authorities, thereby protecting small businesses and the funds of taxpayers.

I am a Colorado resident and the owner of a small construction business, JBlanco Enterprises, which furnishes labor and materials on federal construction projects. I nearly lost my business as a result of a deficient individual surety bond placed on a federal project that later proved to have no assets behind it. In the spring of 2006, JBlanco Enterprises entered into a contract with a certified 8(a) prime contractor to roof a U.S. Customs House in Denver, Colorado. Because this was a federal project, JBlanco Enterprises felt it could rely on the contracting agency and the federal contracting officer to ensure that a properly executed payment bond was in place to protect subcontractors and suppliers in the event that the prime contractor failed to meet its contractual payment obligations. Sadly, however, this was not the case.

During the course of the project, the prime contractor became in arrears in paying JBlanco Enterprises for its services. As a result, JBlanco Enterprises placed a claim against the payment bond and requested that the federal contracting officer provide the name of the surety company. We did not receive a response from the contracting officer, and the prime contractor promptly terminated our roofing contract. When we filed suit against the prime contractor, the contract officer, upon learning of the lawsuit, then provided the name of the surety to us.

In the course of litigation, our attorney learned the true nature of the payment bond. The prime contractor had secured a bond from a non-corporate individual surety, not from a certified corporate surety approved and listed on Treasury Circular 570. Moreover, the assets pledged to back the payment bond apparently did not exist. We later learned that this non-corporate individual surety had proffered other bonds on multiple federal and non-federal construction projects. Apart from expensive and time-consuming litigation with the prime contractor, the payment bond was our only recourse for payment—we have no lien rights against federal real property. The inability to recover our payment bond claim was a severe financial hardship for JBlanco Enterprises, endangering our business viability.

Passage of H.R. 3534 will ensure that other small businesses relying on payment bonds on federal projects will not have to experience what JBlanco Enterprises experienced; rather, they can have

JBlanco Enterprises, Inc.

Corporate Headquarters
4065 S. Federal Blvd.
Sheridan, CO 80110
Phone (303)761-0330
Fax (303)761-3359

Dallas
1517 W. N. Carrier Pkwy., Suite 148
Grand Prairie, TX 75050
Phone (972) 602-0800
Fax (972) 602-8677

Las Vegas
7680 W. Sahara Ave., Suite 130
Las Vegas, NV 89117
Phone (702) 942-6337
Fax (702) 967-2373

confidence that adequate and reliable security is in place to guarantee that they will be paid for their labor and materials in the event a prime contactor will not be able to fulfill its financial obligations.

Under current law, construction contractors have three options for securing their obligations under their contracts with the federal government. They can obtain a surety bond from a surety company, which is vetted and approved by the U.S. Department of Treasury. In lieu of a bond, contractors can pledge and deposit assets with the federal government until the contract is complete. In such situations, only assets backed by the federal government can be pledged. The third option permits individuals to serve as sureties for contractors by pledging their assets to back the bonds. These individuals are called "individual sureties." Only individual sureties are permitted to pledge assets not backed by the federal government. In fact, individual sureties are allowed to pledge stocks, bonds, and real property, and are not required to deposit such assets with the federal government for the duration of the contract.

To the extent that individual sureties pledge assets that do not exist, are difficult to verify, or are not readily convertible into cash to pay the obligations of the contractor in case of default, subcontractors and suppliers are left unprotected. Experience has shown that if the assets pledged are uncollectible, subcontractors, suppliers, and workers on the job are left with no payment remedy if they are not paid. The federal government is left with unfunded expenses to complete the construction projects. Yet, under federal law and regulations, a contractor pledging assets directly to the federal government to guarantee a contract obligation is subject to far more stringent rules than an individual, acting as a surety for profit, who pledges his or her own assets to guarantee a contract obligation.

H.R. 3534 is just good common sense. The security that stands behind every federal contractor's obligations to the federal government should be governed by the same rules. There should be either a corporate surety bond in place from a company approved by the U.S. Treasury or assets with readily identifiable value pledged and relinquished to the federal government while the construction project is ongoing. The same rules that apply to the security that a federal contractor pledges as collateral should also apply to the security proffered by an individual acting as a surety for a contractor.

I urge you to support H.R. 3534. Please do not let another small business owner fall victim to that of a individual surety bond backed with illusory or worthless assets.

Sincerely,

Jeanette Wellers
JBlanco Enterprises Inc.

Mr. COBLE. Thank you, Ms. Wellers. By the way, folks, for your information, your entire statements will be made part of the record. Thank you, Ms. Wellers. You too beat the illuminated red light.

Mr. Little, the pressure is on you now. Good to have you, Mr. Little.

TESTIMONY OF ROBERT E. LITTLE, JR., OF COUNSEL, COHEN SEGLIAS PALLAS GREENHALL & FURMAN PC

Mr. LITTLE. Thank you for the opportunity to testify today on H.R. 3534, Security Bonding Act of 2011. These views are my own and do not necessarily represent the views of Cohen Seglias or the Naval Facilities Engineering Command, my former employer, and my remarks will be brief.

The bill will provide much needed certainty to a very contentious area of Federal construction contracts, acceptability of bid, performance and payment bonds issued by individual sureties. A little bit of background. To address rampant fraud problems encountered with individual sureties in the late 1980's, the regulations, that is the Federal Acquisition Regulation, was modified in 1990 to require individual sureties to pledge certain highly liquid assets. The intent was to make the wealth or solvency of the surety largely irrelevant.

The result was that for about 12 years individual sureties all but disappeared. Their disappearance, by the way, had no apparent ill effects on the small or small disadvantaged business community. When they reappeared, they were convincing to a few people because the people that saw individual sureties initially had never seen them before. As it turns out, most individual surety bonds were rejected.

As I began to look at them in 2004, I noticed that as they were rejected they seemed to be modified to account for each prior rejection. It was as if there were some central clearinghouse that was learning based on the rejections, then issuing the learned information to the individual surety community. And the one thing that they all had and, in my experience at least still have in common, was that all of the assets were unacceptable. All of them.

One of my favorite assets was shares of penny stock based on already mined gold abiding in the tailings of a placer mine valued by a CPA at around a billion dollars that was in a trust, held in another trust, that lived in an escrow account at a Wells Fargo Bank.

When I called the escrow official at the bank to see what was actually in the account, the surety threatened to sue me for violation of an obscure banking privacy act that did not remotely apply.

While that example may seem laughable, it is indicative and very, very serious. H.R. 3534 would end that kind of bullying behavior and those kinds of assets from being proffered.

It could be that individual sureties do have extensive commodities at their disposal, valued in billions of dollars. The fact that I have seen no evidence of it is hardly determinative. But it does make me wary, and I only hope it makes others wary as well.

One final point. If H.R. 3534 becomes law, there will be absolutely no incentive for contracting officers to preclude individual surety bonds. They will literally become the gold standard. Why would any contracting officer prefer arguing with a corporate surety when he or she can execute against what is essentially a cash asset? Indeed, one might expect agencies to find ways to get individual sureties preferential treatment.

Thank you.

[The prepared statement of Mr. Little follows:]

Written Testimony of Robert E. Little, Jr.

Of Counsel, Cohen Seglias Pallas Greenhall & Furman PC

Before the U.S. House of Representatives
Committee on the Judiciary
Subcommittee on Courts, Commercial and Administrative Law

In Support of

H.R. 3534
The Security in Bonding Act of 2011
March 5, 2012

30 South 17th Street
Philadelphia, PA 19103
Phone: 267-238-4759
Email: blittle@cohenseglias.com

Thank you for the opportunity to present my personal views on the necessity for the proposed legislation. These views are my own and do not necessarily represent the views of CohenSeglias or the Naval Facilities Engineering Command, my former employer.

The bill will provide much needed certainty to a very contentious area of federal construction contracts: the acceptability of bid, performance and payment bonds issued by individual sureties.

The issue is the validity of pledged assets and I have not seen even one.

The issue is the validity of assets pledged by individual sureties to secure their obligations under bid, performance, and payment bonds. Without valid assets the bonds are worthless. Since December of 2004 when this problem first came to my attention, I have reviewed and provided opinions on more than several dozen assets pledged by individual sureties. I have not seen a valid asset. Not one. Based on conversations with colleagues, including many contracting professionals, I would have no hesitancy in inferring that virtually no contracting officer during this same period saw a valid asset, even though they have—on more than one occasion—accepted them.

The legislation would the remove the uncertainty associated with individual sureties' pledged assets.

The proposed legislation addresses the problem of uncertainty surrounding assets pledged by individual sureties by requiring that easily verifiable assets be presented directly to the Contracting Officer.

The acceptability of individual sureties has been addressed previously.

In 1990 the Federal Acquisition Regulation (FAR) was modified to eliminate a serious problem: pervasive fraud and misrepresentation by individual sureties in government construction contracting. Rather than eliminate the use of such sureties, the FAR Council shifted the emphasis from ascertaining the estimated net worth of two or more individual sureties to requiring pledges of liquid assets by one or more sureties in order to assure their obligations under bid, performance, and payment bonds.

The solution worked for about 12 years.

There are no direct statistics as to the efficacy of that solution. In my experience and that of my colleagues, the individual surety problem simply went away—for about twelve years. It's easy to understand why. It is one thing to allege you own assets worth, say, two hundred million dollars to induce your acceptance as a surety. It is a wholly different thing to subject those assets to potential liquidation to meet your obligations as a surety. Moreover, the burden was shifted to the surety to demonstrate the asset's value. Prior to 1990, the principal individual surety asset was real estate, since it was not placed under the government's control, but its value contributed to net worth. After 1990, the government required a paramount lien on the entire property and could require its complete liquidation in order to satisfy the government's or subcontractor's and materialmen's claims. As a result, real estate virtually disappeared as an asset.

The solution worked because individual sureties largely disappeared.

When I say the problems went away, let me be clear—it was the individual sureties that went away. A GAO report from 1989 on proliferation of problems with individual sureties noted that there had been a marked increase in bid protests primarily regarding the rejection of individual sureties. In 1987 there were 6 such decisions, by 1988 there were 21 and in the first half of 1989, 23. The ultimate total for 1989 was 62. The year the rules changed, 1990, there were 30 protests involving individual sureties. In the 20 years between January 1991 and December 2011, there were a total of 21 cases using the term "individual surety" and, of those, only 13 were decided under the new rules. Again, the experience of my colleagues was that the new rules did not eliminate the protests so much as the source of the problems, individual sureties themselves.

Then personnel changed, as did the acquisition rules, and the corporate memory waned.

With a few exceptions, something equally dramatic happened during that 20-year period: almost everyone who had ever seen or dealt with an individual surety retired or was placed in a position where the size of the construction projects was too large to be bonded by even the most aggressive individual sureties. Perhaps more important, by the year 2000 most construction contracts were awarded in relative opacity as compared to the process used prior to 1995 when the competitive bidding rules changed. In the late 1980s when individual sureties were most problematical, the almost exclusive methodology for awarding contracts was public opening and inspection of sealed bids, including the bonds. By 2000, virtually all of the contracts that would be attractive to firms unable to obtain corporate sureties—were awarded by negotiation, many non-competitively under the 8(a) program. This, coupled with the fact that smaller contracts had been devolved to field activities without counsel, created the conditions for a "perfect storm". Thus, contracting personnel without any experience dealing with individual surety issues, without benefit of legal counsel, with deadlines to meet, with no competitors looking over their shoulders, and with a new crop of individual sureties have had to make decisions about individual sureties they are ill-equipped to make.

Pledged assets were as varied as they were deficient.

As we began noticing the higher influx of individual sureties around 2004, it became abundantly clear that the pledged assets were as varied as they were deficient. Because of my interest and growing—by default—expertise, I was asked by the Department of Treasury's Financial Management Service to be a person to whom they referred inquirers on individual surety questions. In that role, I had the opportunity to advise contracting officers and attorneys at the Departments of Justice, Treasury, State, Transportation, Veterans Affairs, the EPA, Federal Bureau of Prisons, GSA, NASA, the Corps of Engineers, Air Force and several state government officials. Even with this exposure, I have yet to see a valid asset supporting an individual surety bond.

After 1990, the "individual" in "individual surety" became superfluous.

Almost without exception, the problem has been the pledged assets. As I mentioned earlier, the 1990 changes to the rules shifted the emphasis to the pledge in escrow of liquid assets and paramount liens on pledged real estate. The individual of "individual surety" in effect became superfluous. Or at least that was the intent. When confronted with the discrepancies between the asset pledged and the assets that are allowable, individual sureties usually argue that the list of acceptable assets is inclusive, not exclusive. They argue that as long as the asset does not fall into the category of one of the listed, expressly excluded assets, the Contracting Officer has the discretion to find it acceptable. Accordingly, the argument goes, any asset that can be dreamed up is worth a shot. If the contracting officer in his or her discretion disagrees, well, the bidder/contractor, usually a small business, loses without any real recourse and the individual surety walks away—sometimes with the bond premium.

The Court of Appeals for the Federal Circuit underscored the uncertainty problem.

In a sense, the Court of Appeals for the Federal Circuit underscored the uncertainty problem in a case called Tip Top Construction v. U.S. In that case the Court found that the Contacting Officer reasonably determined that the pledged asset was--on a continuum between acceptable and unacceptable--"less like cash, stocks or bonds [acceptable assets] and more akin to jewelry, furs and antiques [unacceptable assets]." That analysis is not helpful in the long run. The individual sureties will simply argue that they lost a close call and that any and every subsequent situation is different. Conversely, the Contracting Officer is placed in the position the Court seeks for him or her to avoid when it said: "A contracting officer should not have to be an expert on the market for particular commodities in order to evaluate the value and liquidity of a pledged asset."

Certainty matters and it takes time, but not too much.

Contracting Officers are required to exercise discretion in these cases to allow offerors to remedy minor defects in submitted bonds, time permitting. Moreover, where the matter involves small businesses who may not be as familiar with Federal contracting as they should be, Contracting Officers are rightfully reluctant to reject a bond that at the bidding stage would eliminate the small business from consideration or at the performance stage would require termination for default. At the Naval Facilities Engineering Command (NAVFAC), the typical response to a deficient bond was to prepare a comprehensive analysis, mark those areas where changes or additional information was required, and allow the offeror/contractor to make the corrections. We would do this despite the fact that offerors/contractors are required to submit legally sufficient and correct information with the bid or proposal itself. There is also a legal requirement that such matters be treated as "responsibility" issues such that informalities are not to be treated as disqualifying unless there no time left to correct them.

Individual sureties regularly assert that they are awash in assets in hundreds of millions of dollars in assets; its time to convert them to eligible obligations.

Those who disagree that there is a problem would still have no argument that the solution—requiring the individual sureties to liquidate their assets in order to acquire the requisite amount of eligible obligations—would impose a hardship. The individual sureties would have otherwise had to put the assets at risk of liquidation under any circumstances. Change of asset form would not seem to be an undue burden.

***Tip Top*, still the best example of what happens when unacceptable assets are pledged.**

The individual surety is required to complete an affidavit. One thing the affidavit requires is describing "...the assets, the details of the escrow account" and attaching "...certified evidence thereof." That seems reasonable enough; the surety's submittal should be totally self-contained and answer all possible questions. In response, the surety attached a "Certificate of pledged assets". The certificate described the asset as "... previously mined, extracted, stockpiled and marketable coal ..." located on the surety's property also known as Permit No. R-707. The amount of coal pledged was in terms of dollars, $1,800,000. That was about 0.1% of the alleged value of the coal, again in terms of dollars. Imagine now, if you will, what $191,350,000 worth of coal looks like. Hold that picture.

The contracting officer rejected the coal, and the bid, on the basis that the surety's asset was speculative citing to the FAR provision that makes speculative assets unacceptable.

Numerous interchanges ensued. Ultimately, the surety offered to provide quality, quantity and market price information--for the first time. The contracting officer refused to budge and sent another letter reaffirming that the asset was speculative. The bidder protested to the Government Accountability Office (GAO) basically arguing that the agency had the burden to show why the asset was unacceptable. The agency responded that the certified coal lacked quality information so that any estimate of its value or how much effort it would take to liquidate was purely speculative.

The surety provided quality information pertaining to the coal that indicated that the coal was actually "coal refuse," i.e., a mixture of coal and dirt thrown away as part of a deep mining operation on nearby land. Indeed, a consulting firm had prepared a "Limited Scope Estimation of Recoverable Sewell Coal Tonnage From the Coal Refuse Facility Identified As Permit No. R-707" but specifically did not analyze any material from that site, but from a site which might or might not have been indicative (consultant's characterization) of the material at site R-707. So, assuming a recovery of 24%; and assuming the coal is of an assumed quality; assuming that reprocessing is economical; assuming the estimate of coal tonnage at the site was correct; and assuming that a processing facility was constructed; then the assumed output would be worth $79 per ton. If any of those assumptions are wrong, then it wouldn't be.

And there were other problems. The surety had no mining permit to mine (remember, it's underground again) or process the coal refuse. The only permit applicable to R-707 was for final reclamation of the land by spreading the grass seed over the soil already covering what the surety had characterized as a mountain of coal.

So, to revisit your image of the pledged coal, who among you envisioned grassy fields with new growth timber showing no signs of mined, extracted, and stockpiled coal?

This process took from February 19, 2008 when Tip Top's bid was rejected, through February 29, 2008 when the protest was filed at GAO, through May 5, 2008 when GAO issued its expedited decision, through May 15, 2008 when the complaint was filed at the COFC, and finally to April 29, 2009 when the CAFC decided the case.

One would have thought that it would be clear to everyone that coal was a speculative asset and would not be proffered again—at least by anyone who had read the Tip Top case. Even if the regulations were no real deterrent to asset experimentation, a determination that coal and other commodities were speculative as a matter of law would seem to have ended the discussion.

In 2010, a few months before I left government, I got a query regarding certain performance and payment bonds submitted to the Architect of the Capitol. I asked for a copy and saw that the surety in the Tip Top case was being used by the awardee for performance and payment bonds. I saw the "normal" devices listed in the Affidavit that this particular surety used: trust receipts, trust indentures and--a new twist--"a copy of a bill of sale to the asset to be deposited in escrow" that would be "provided on request."

The next page contained a document headed Irrevocable Trust Receipt (ITR). The ITR referenced an agreement between IBCS Mining, a company owned by the surety, and Wells Fargo Bank, NA. The agreement provided that Wells Fargo would issue ITRs that would represent Wells Fargo had been made Trustee (holding a "first priority security interest" in whatever ownership rights the surety has in "property described in Schedule A") for the benefit of the AOC.

The property described in Schedule A was "surface, previously mined, coal" which appeared to be "coal refuse". Perhaps "asset uncertainty" isn't the real problem with individual sureties, but just the real problem's most gentle characterization.

Mr. COBLE. I don't know that I can recall any hearing when all of the first three witnesses, all three, beat the red light. I am not trying to impose pressure on you, Ms. Barbour, but good to have you with us.

KAREN PECORA-BARBOUR, PRESIDENT, THE BARBOUR GROUP, LLC

Ms. BARBOUR. Thank you. Thank you, Chairman Coble, and thanks for listening to me on my views of suretyship and the benefits of individual sureties.

I, too, think H.R. 3534's intent is noble. I think individual sureties will or should have to prove that their assets are real and tangible, but I think that this bill has unintentional flaws, I am sure, that would eviscerate individual sureties.

According to General Zafros, who is past Director of Contract Policy Division, Chief Acquisition Officer, General Services Administration, this bill essentially is a jobs creation killer. He says if this bill is passed, a change to the FAR would need to be proposed, and it would effectively kill individual sureties on FAR contracts. Right now, the current language in the Code prohibits a contracting officer from requiring the bond issued by a corporate surety. The proposed change would give the contracting officers the authority to require the use of a corporate surety. So it would be easier for them just to simply look up on a T list and say okay, fine, that is the corporate surety rather than to try to vet the assets.

So what happens when a minority or small business owner tries to get corporate surety credit and is declined because of their stringent guidelines? They are not going to have anyplace to go.

Individual surety bonds have helped many. There are over 7,000 success stories, and while I can't readily dispute what Mr. Little is saying, I can say that the assets supporting those bonds were just fine and accepted by legal counsel in review. They weren't with NAVFAC, however.

The contractor right now can seek advise from U.S. Treasury and even their own legal counsel, and as Mark McCallum has pointed out in that letter from U.S. Treasury in his testimony, they are required to do so. So they are not overburdened by any stretch.

In fact, one veteran recently I provided an individual surety bond for, he was a graduate—he is a graduate from the Naval Academy and he came back home and he had financial problems. His house was foreclosed on, and the Army gave him a $1 million bond, and he was denied corporate surety credit. So we provided an individual surety bond. He is doing fabulously well. He is going to heal himself with this one job, and he is doing so well they want to award him another $1 million job. Where would he be without this product?

So there are many interpretations of the FAR. It varies with contracting officer and/or agency, and it is very difficult to predict predictability and assurance to contractors that the individual surety bonds will be accepted, so I agree with H.R. 3534. I think that sureties should be preapproved, either by FAR counsel or by U.S. Treasury, and those that pass the FAR requirement should be enrolled on a list of acceptable individual sureties, and that these sureties are able to provide their data and have their attorneys present to address any legal issues with regard to FAR compliance. There should also be an appeal process if the individual surety believes that they were not treated fairly. And this will alleviate concerns for general contractors and for agents like me. I don't see that in this bill.

But if such a system is adopted, how long would that process take and would time be of the essence? I would hope so. We are hearing all of these things about individual sureties. Well, let's talk about First Sealord Surety, a corporate surety that went defunct 3 weeks ago. They were T listed. They were A.M. Best A-minus one day, and literally the next day, they were rated C-plus. The next day they declared bankruptcy. And then the regulators found out they walked away with $8 million of contractors' collateral. They were a small corporate surety themselves, so to hedge their losses they took collateral from contractors. Where is the collateral? Now the contractors are in breach of their contracts. They have to go and secure a new bond, pay for that premium, and they can't get paid on their contracts because they don't have a valid bond. So that surety alone has caused more damage than any individual sureties I know.

So I think we should support legislation for Federal contracting officers to disclose what type of security was provided by the general contractor. Moreover, I have done consulting for the Corps, and I can tell you that sub-guard was taken in lieu of a bond on a mega project. This job could not get a surety bond, a corporate surety bond, so Zurich puts out this product called sub-guard. The Army accepted sub-guard because it affords subcontractor failure on the job. Now, those subcontractors, I am sure, don't realize that there is not a surety bond in place. They don't have any Miller Act claims on a bond, I don't believe, on that job, because the GCs don't have a bond. I have also seen it where on the mega projects, too, that are over a billion dollars where the contractors have put up a corporate guarantee. That is not afforded small business, but it has afforded big business.

So individual surety is a great tool to bring contractors, and the Miller Act hasn't been updated since 1934. Well, $100,000 it was back then. That was a huge sum of money. It is $150,000 now. That is not a big jump. That probably wouldn't even build a McDonald's. So here you are having $150,000 Miller Act requirement that has its tentacles all through small business and preventing them from getting bonding. And then you want to—well, and also States, by the way, there is like 30 pieces of legislation out there where States want to up the Miller Act requirements in their States to a million.

But I just wanted to end this and say in terms of the Tip Top case, that there is a—his name is, excuse me, Professor Nash, the Grand Poohbah of government contracts law, who started the George Washington University Law School's program on government contract law, in his article says: "One of the best aspects of government contracting is that sometimes it gives us a good laugh." And this is regarding the Tip Top case.

The humor is found in the FAR—am I done? There is no red light.

Mr. COBLE. Go ahead and finish.

Ms. BARBOUR. Okay. I didn't see any red light, I apologize—oh, I am sorry.

The humor is found in the FAR, not the decision. Under the FAR stocks traded on specific exchanges in real property are good, acceptable assets, while under FAR 28-203 personal property such as jewelry, furs, antiques are bad, unacceptable assets. Since the mined coal was personal property, it arguably fell within the FAR definition of bad assets. On the other hand, General Motors' stock could have been pledged last year and would have been counted as security at 90 percent of its value. Similarly, the surety's house could have been pledged and counted at 100 percent of its tax assessment value, which are all upside down in this market. But the value of coal can't be predicted, so it doesn't count.

So this gentleman says, well, I would take the coal. All that Tip Top proves is that FAR was written before we got our recent lesson in modern economics. And those good assets turned out to be bad assets—I have just one sentence left—and that coal still has quite a large amount of value without regards to FAR, and maybe someone should try to pledge a retirement account. So this is an esteemed professor who disagreed with the Tip Top case.

[The prepared statement of Ms. Barbour follows:]

THE Barbour Group LLC

Surety Bonds & Commercial Insurance

H.R 3534 – "Security in Bonding Act of 2011"

TESTIMONY OF
KAREN PECORA-BARBOUR

PRESIDENT, THE BARBOUR GROUP, LLC
A SMALL BUSINESS – WOMAN OWNED FIRM

U.S. SBA SMALL BUSINESS PERSON OF THE YEAR (MD) 2008

SERVICING CONTRACTORS IN NEED OF CONSTRUCTION BONDS
AND COMMERCIAL INSURANCE

BEFORE THE
HOUSE JUDICIARY SUBCOMMITTEE ON
COURTS, COMMERCIAL AND ADMINISTRATIVE LAW

March 5, 2012

10 YEAR ANNIVERSARY
2002-2012

20 Liberty Street
Suite 2D
Westminster
Maryland 21157
thebarbourgroup.com
410.876.9610 p
866.876.9610 t
410.876.5954 f

Chairman Coble, Ranking Member Cohen and distinguished Members of the House Judiciary subcommittee, thank you for the opportunity to present my views on suretyship and the benefits of individual sureties.

I am Karen Barbour, owner and founder of The Barbour Group. Established in 2002 as an independent insurance agency, our focus is on construction bonding and commercial insurance. The Barbour Group primarily services the surety needs of a wide range of construction clientele, from startups to medium-sized companies ($50M - $100M) to large firms with more than $100M in annual gross revenue, including Fortune 1000 companies. We are nationally known as one of the most knowledgeable and creative brokers in the business, providing a comprehensive suite of surety bonds for the construction industry, from Alaska to Puerto Rico.

Prior to starting my agency, I was a partner of Barbour Construction Corp. (trading as Specialized Metals) for 10 years. The company performed work throughout the Mid-Atlantic region as a steel erection and metal fabrication subcontractor. I am proud to state that we fabricated and installed all the metal work in the Washington Monument, including the steel casings to house the glass membrane.

Serving as an underwriter for two leading carriers for 9 years, an agent for 8 years for two brokerage firms in the DC Metropolitan Area, my experience developed relationships with key strategic partners and industry leaders. At times the Army Corps of Engineers has asked for my consultation on small business issues. In 1998, I formed the Professional Council of General Construction – a forum, lasting two years, consisting of key personnel of the Baltimore Army Corps of Engineers and key members of various construction trade associations to openly discuss and resolve issues surrounding certain procurement models negatively impacting small businesses.

My insurance agency has received numerous awards and distinctions for our contributions to the success of contractors in the building industry, including selection as one of nine women entrepreneurs to participate in the 2009 Ernst & Young Entrepreneurial Winning Women™ program. I was named 2008 Maryland Small Business Person of the Year by the U.S. Small Business Administration (SBA) – the first surety agent to receive this SBA top honor. I was also honored as one of The Daily Record's 2010 Innovators of the Year for enabling success for small businesses nationwide.

The Governor of Maryland has appointed me his Co-Chair for The Governor's Commission on Small Business. I also serve as Vice Chair on the Adviosry Board for the Small Business Development Center (SBDC) for the State of Maryland, while representing my community as a Board Member for the Economic Development Commission for Carroll County, Maryland.

2002-2012

20 Liberty Street
Suite 2D
Westminster
Maryland 21157
thebarbourgroup.com
410.876.9610 p
866.876.9610 t
410.876.9954 f

TESTIMONY:

HR 3534's intent is notable. As the National Association of Surety Producers has stated in their media release: "Individual sureties will have to prove that the assets which back their bonds are real, tangible assets and submit those assets to the care and custody of the federal government until the completion of the obligation."

However, HR 3534 may have flaws, unintentional I am sure, that would eviscerate individual sureties. According to Gerald Zaffros, past Director of the Contract Policy Division, Chief Acquisition Officer, General Services Administration:

"...if this bill is passed, a change to the FAR (Federal Acquistion Regulation) requirements for individual surety (FAR 28.203) would need to be proposed. Assuming a change is implemented, it would effectively kill individual sureties on FAR contracts. As it stands now, the current language in the code prohibits a contracting officer from requiring a bond issued by a corporate surety. The proposed change would give contracting officers the authority to require the use of a corporate surety bond. Because it is easier for a contracting officer to simply determine if the corporate surety is listed on the Treasury Circular than to investigate the existence and value of the assets being proposed by an individual surety, it would be to the benefit of the contracting officer to simply require the corporate surety.

The problem would be that the corporate sureties, unintentionally, would control who can get a construction contract when they deny bonds to small and minority and veteran owned businesses who do not meet their more stringent qualification requirements."

(See attached FAR 28.203.)

That is the effect of H.R. 3534 --- So where would those small businesses turn to for a bond?

Individual surety has helped many. In fact, there are over 7,000 success stories. Individual surety as allowed by FAR 28.203 gives contractors an option. However, it is interesting to note that many individual surety bonds were not accepted by contracting officers where the contractor was a minority or women owned firm. No such bond was denied to a non-minority firm.

FAR 28.203 states that a contractor can seek advice from the U.S. Treasury and even their own legal counsel before they elect to accept an individual surety bond. In fact, I have attached a letter from the US Treasury providing guidance to contracting officers for your review.

I recently provided an individual surety bond to a veteran owned company. The owner had poor credit with his house foreclosed on; he was denied corporate surety credit.

10 YEAR ANNIVERSARY
2002-2012

20 Liberty Street
Suite 2D
Westminster
Maryland 21157
thebarbourgroup.com
410.876.9610 p
866.876.9610 t
410.876.9954 f

Many veterans returning home have poor credit due to absence from the country to manage domestic financial affairs or inability to find work. On the million dollar contract that the individual surety bonded, the veteran will be making enough money to heal him financially and gain back a notable reputation. This bill will effectively end that opportunity to get back into the U.S. economy after serving our country.

You may hear that individual sureties charge exuberant fees for their bonds. The fees that I have seen ranged in the 3 to 4% of the contract value. I have corporate sureties that charge up to 5%. Not all surety companies are members of the Surety Fidelity Association of America. Also, corporate sureties that are AM Best rated and Treasury listed have not returned premiums even when a replacement bond was provided. I contacted the Maryland Insurance Administration about this and their reply was that a bond premium is an underwriting fee and fully earned. While this is a state agency, I don't know what the Federal Government guidelines are with regard to return premiums. There needs to be specific rules for premium returns noted in the FAR regulation.

There are many interpretations of the FAR and they vary with every contracting officer and/or agency. This makes it very difficult to provide predictability and assurance to contractors that the individual surety bonds will be accepted. So, I agree that Individual Sureties should be pre-approved by either a FAR council or the U.S. Treasury. Those that pass the FAR requirements should be enrolled on a list of acceptable individual sureties. The individual surety should be able to provide their data and have their attorneys present to address any legal issues with regard to FAR compliance. There should also be an appeal process if the individual surety believes that they were not treated fairly. This will also alleviate any concerns that bonding agents will have with regard to FAR compliance.

But if such a system is adopted, how long will the process take? Would time be of the essence?

Regulation does not guaranty against insolvency: A-

In the summer of 2005, five corporate sureties closed down their bond operations within 30 days of each other. Those sureties were Atlantic Mutual, Harleysville, Frontier, XL Surety, and Crum and Foster. Roughly three weeks ago, a corporate surety who focused on serving small business declared bankruptcy. One day is it was rated ~~A+~~ by AM Best and nearly the next day it was rated C+. The company is now in bankruptcy. Since most sureties who service small business contractors are small themselves in comparison to the top ten sureties, they often require collateral and/or funds control to hedge bond losses. Today, many agents and contractors can't get information on how to get their collateral back from First Sealord Surety, the recently bankrupt corporate surety. Total missing is roughly $8 million. And, owners of the projects are requesting new replacement bonds as the surety no longer meets the contractual requirements, an additional premium that the contractor and/or its agent may have to absorb and many cannot afford. Today, many contractors are in breach of their contracts as they no longer have valid bonds. And, they are unable to get paid on current invoices for work performed and accepted until a replacement bond is provided.

10 YEAR ANNIVERSARY
2002-2012

20 Liberty Street
Suite 2D
Westminster
Maryland 21157
thebarbourgroup.com
410.876.9610 p
866.876.9610 t
410.876.9954 f

Surety Bonds are waived for mega projects:

It may be important to note that for contracts in excess of $300,000,000, a federal agency allowed the bonds to be phased during the duration of the project, or incremental phasing. On one project exceeding $650,000,000, the contractor's surety would not provide a bond even though initially it said it would. The contractor asked the federal agency to accept sub-guard in lieu of a bond. Sub-guard is a product of Zurich Insurance. It provides protection to General Contractors against subcontractor failure. However, it offers no protection for the subcontractors against non-performance of the General Contractor. However some owners will waive the General Contractor's bond if they feel comfortable with the blanket protection against subcontractor failure afforded by sub-guard. Additionally, it is not uncommon to hear in my industry that the federal agency took the contractor's corporate guaranty in lieu of a bond on mega projects ($1 billion or more). Here there is no Miller Act protection for small business contractors.

- Support legislation for federal contracting officers to disclose what type of security was provided by the General Contractor and accepted by the contracting officer in support of the contract award: performance and payment bond, performance bond only, payment bond only, letter of credit, corporate guarantee or sub-guard.

Individual surety is a tool to groom contractors back into corporate surety credit. Those who have "graduated" from individual surety bonds now enjoy preferred rates from leading surety companies. With the harsh economic times that we are in, small business contractors' financial conditions will not be stellar. For those that can weather the storm, an excess lines market for bonding needs to exist—individual surety. It is the only method to keep small businesses that have credit issues, often because of no fault of their own, in business.

. Due to the Miller Act limits, surety bonding often has broad reach in becoming a barrier to small construction businesses obtaining work. The Miller Act requires bonds for projects $150,000 and higher. This limit has been adopted by many states. However, many states are now raising the threshold so more contractors can gain access to work. The Miller Act limit of $100,000 was set in 1934 when $100,000 was a significant sum of money. Today, that number would most likely be $1,000,000 (most likely more) given inflation. But it has only increased to $150,000.

Mr. Chairman and Member of the Committee, this concludes my testimony. I thank you for your time and consideration. I have provided in my submitted testimony other great ideas for small business legislative reform.

Thank you.

10 YEAR ANNIVERSARY
2002-2012

20 Liberty Street
Suite 2D
Westminster
Maryland 21157
thebarbourgroup.com
410.876.9610 p
866.876.9610 t
410.876.9954 f

Small Business Administration's (SBA) Bond Guaranty Program:

The American Recovery Reinvestment Act when passed included an amendment that increased the ability of the SBA to guaranty up to 90% of performance and payment bond for a participating surety company for construction projects having a contract value of $2 million to projects having a contract value of $5 million, with discretionary authority to cover individual contracts up to $10 million. ARRA also increased the SBA bond program eligibility standards from $7 million in sales (average over three years) to that of the NAICS codes for small business. With the sunset of ARRA, the project cap for SBA is back to $2 million. Thankfully, however, the sales cap under ARRA remains.

SBA Sales Cap is a Disconnect with Set Aside Programs

Much of the set aside contracts for 8(a)s, WOSBs, SDBs, HUB Zone, VOBs and/or SDVOBs are too large for SBA consideration now. Currently, The Veterans First Contracting Program, Department of Veterans Affairs (VA), is the only sole-source contract acquisition program that enables non-competitively bid contracts for Veterans. **This program authorizes VA contracting officers to sole-source projects up to $5 million to VOB and SDVOBs** (http://www1.va.gov/oamm/_bf/oa/il07-08.pdf).

However, many veterans coming back from Iraq are not in the best financial health and have credit scores that are below the comfort level of many corporate sureties. Unless the ceiling cap for SBA is raised to at least $5 million, bonding capacity will not be enabled for the sole source projects above as the current SBA cap is set at $2 million. As for the 8(a) program, the Federal Government can sole source projects up to $4 million. However, few 8(a) contractors can obtain bonding at this level without SBA assistance and SBA currently cannot help due to its current $2 million contract ceiling price.

- Reinstate the bond limits for the SBA Bond Program under ARRA to enable SBA to consider projects up to $5 million with discretionary authority to consider individual projects up to $10 million.

Understanding MATOC and shortcomings of SBA

MATOC, Multiple Award Task Order Contract, is a common contract delivery vehicle used by Department of Defense agencies. It is established for small business contractors. Here, the Government will typically make 1 to 7 contract awards to separate contractors based on the agency's "best interests." Such contracts typically have a base year and 4 options years to be exercised unilaterally by the Government. Winning such a contract at the end of fifth term as an 8(A) contractor can maintain an 8(A) contractor for an additional five years in the program.

Under the MATOC, each contractor could receive up to $10 million in awards annually. The timing of and amount of the awards are not certain and subject to the ongoing needs of the agency. The contractor is not guaranteed any task orders under the MATOC. The problem arises when the contractor's surety treats the full $10 million contract award as

10 YEAR ANNIVERSARY
2002-2012
20 Liberty Street
Suite 2D
Westminster
Maryland 21157
thebarbourgroup.com
410.876.9610 p
866.876.9610 t
410.876.9954 f

committed-project- backlog, irrespective of actual MATOC awards. This underwriting approach significantly reduces a contractor's capacity for additional bonding.

Many MATOC vehicles require that the contractor need only post a $1 million bond each year at the onset of each term. If the contractor performs more that $1 million in projects for the year, then additional bond premium is billed against any additional work.

The $1 million bond is not an issue for many small businesses. **The issue is that MATOCs require the following:**

"Contractor shall furnish proof in writing from their certified bonding company that they can obtain $10,000,000 dollars' worth of bonds each year. The Contractor's proposal shall include a letter from his/her bonding company, which certifies the contractor's ability to obtain bonding up to the Maximum Award Amount of $10,000,000 each year. Failure to provide said letter with the contractor's proposal will make the offeror ineligible for award."

The SBA cannot help. They cannot provide such a $10 million bond support letter even though the initial bond is for $1 million as stated above.

AGAIN, REINSTATE THE BOND LIMITS FOR SBA BOND PROGRAM UNDER ARRA TO ALLOW SBA TO PROVIDE $10 MILLION BOND CAPACITY LETTERS

- If SBA could have discretionary authority to consider projects up to $10 million as they did under ARRA, they could approve bond support letters for MATOCs and avoid the need of the disadvantaged contractor from partnering with big business and foregoing 50% or more of the profit.

One SBA Program – Don't Consolidate – Allow Only Plan A

At present, there are two programs/plans for bonding with the SBA:

- Prior Approval Program (Sec 411 (a) Small Business Investment Act) – Plan A
- Preferred Program (Sec 411 (a) (3) Small Business Investment Act) – Plan B

PLAN A requires that each contract bond submission is reviewed and approved either by the Denver or Seattle Office of the SBA and simultaneously with the participating surety. (Office location is determined by physical location of the contractor.) I work with both offices of SBA.

10 YEAR ANNIVERSARY
2002-2012

PLAN B allows a surety company to authorize and issue bonds and pay claims without SBA's prior approval and review. The SBA will perform audits of the surety underwriting and bond files at least once every three years.

Unlike Plan A, Under PLAN B, it is typical for the corporate sureties not to implement all of the underwriting caveats the SBA Bond Guaranty Program has to offer. For example, the SBA will include the unused portion of a contractor's bank line of credit as a current asset to the current financial statement and often extend up to 10 times working capital (current assets minus current

20 Liberty Street
Suite 2D
Westminster
Maryland 21157
thebarbourgroup.com
410.876.9610 p
866.876.9610 t
410.876.9954 f

liabilities) to compute the contractors aggregate bond limit. Working capital is key to setting bonding capacity limits for a contractor. **For example, if a contractor only has $10,000 in working capital but a $100,000 unused line of credit, the contractor can receive under SBA $1,100,000 in bond capacity versus $100,000!!**

As an industry standard, corporate sureties will not consider a line of credit as additional working capital.

Under PLAN A, the bonding agent has direct access to the SBA offices. The SBA offices will go above and beyond to help agents and contractors in the program succeed and will provide guidance to the agent on enabling more capacity for the contractor.

Further, the differences between PLAN A and PLAN B, as addressed in this letter, are not clearly evident to contractors. Contractors are not aware that PLAN B may not provide as much bonding capacity as Plan A. (Plan B typically does not weigh in the unused portion of the bank line to increase working capital). When a contractor is declined surety credit under PLAN B, he or she may not know that they can resubmit their bond request under PLAN A. Having one SBA Plan would eliminate this precarious issue.

SBA and the hindering of Joint Ventures

The SBA can consider joint ventures (JV) but the new ceiling cap for annual sales cannot breach the NAICs limitation. While the sales cap is generous, the SBA will add in the sales of the non-SBA JV partner which could be in the hundreds of millions. This add-in will preclude the bonding for the JV entity with SBA. As an aside, few corporate sureties will support JV relationships for small business. Also, with a project cap of $2 million, the pluses to JV make no sense.

- Change the regulation to only bond the small business contractor under the SBA and have the larger JV partner provide a bond from their surety (co-surety relationship).
- Allow regulation to only consider the sales of the SBA bond client so as not to disallow the JV's total sales of the two parties from exceeding the size standards.
- Again, reinstate the limits provided by ARRA for SBA - $5 million single with discretionary authority to consider $10 million projects – as anything less would not be conducive to JV.

SBA and Teaming Agreements

The SBA Bond Guaranty Program cannot accept teaming agreements, such as those found at www.sba.gov. Such agreements delineate the responsibilities of each partner and outline their working relationship per project. Here, the small business contractor is the prime or general contractor and typically partners or teams with a major (big business) subcontractor. The subcontractor can indemnify the prime contractor against any and all loss or provide subcontractor performance and payment bonds to the prime contractor.

Current regulation prohibits the SBA from discounting the teaming partner's sales and amount of work they are performing as a subcontractor to the small business contractor. Unlike joint ventures agreements, there is no joint and several liability with a teaming agreement if the big

10 YEAR ANNIVERSARY
2002-2012

20 Liberty Street
Suite 2D
Westminster
Maryland 21157
thebarbourgroup.com
410.876.9610 p
866.876.9610 t
410.876.9954 f

business teaming partner bonds back their portion of work (typically 80%) in lieu of joint indemnification.

Example: Small Business Prime has a $5 million project but needs support in performing the work. He/She teams with a larger business and subcontracts out 80% of the work to the subcontractor. The subcontractor provides a bond back to the small business prime. Small Business prime is self -performing $1 million dollars or work. This $1 million is under the current bond cap of $2 million. With such an arrangement in place, an exception could be made to consider larger work outside the current SBA limits.

Reducing Cost and Increasing Efficiencies for Surety Agents

The SBA Bond Program is an expensive program for agents to utilize. It is primarily the small, independent bonding agencies that broker SBA bonds. And, such agents have limited resources. It takes 1.0 to 1.5 hours to input an underwriting file into the SBA's electronic system by experienced personnel. A hard copy of the file must be sent to the SBA and to the surety. More often than not, we are given last minute notification from the contractor that a bond is needed. The federal government requires that performance and payment bonds be supplied within 10 days after contract award.

- It would be more cost effective if the SBA forms could be scanned and emailed with acceptance of electronic signatures.

Moreover, an approval for a performance and payment bond cannot be obtained without the SBA having a check made payable to the SBA in the amount of $7.29 per thousand of the contract value.

- It would be more cost effective to have the contractor to "pay by fax." This process of payment is common and used by my agency as an option for payment on non SBA accounts. The check is received via fax and sent to our bank electronically. Another option would be to wire the money to SBA.

De-Bundling/De-Consolidation of Federal Contracts

Much of the stimulus funds received for federal construction contracts from the eyes of a small business contractor fueled large construction projects, such as hospitals and new construction ranging from $450,000,000 to over $1 billion in value. Very little **meaningful** work trickled down to small businesses. By the time the large general contractors had their out-reach sessions for small business, most all of the major sub-trade work was already under contract, leaving just "crumbs" for minority and small business firms.

One such small business emailed me the following:

"Please see the item regarding bundling for Federal Contracts. This is very important for our small construction businesses to respond to as for the past eight years almost all jobs in this marketplace have been bundled. When this happens small business does not have a chance and the larger contractors bid (price) shop the projects again and again. In addition, they are only required to give out 27% of the jobs to small business by law. . Since the majority of the companies in this country are small and because small business employs more people than large businesses, this has been very unfairly skewed and our small business community has gotten largely nothing. Senator Cardin sponsored a bill a year ago to ask Contracting Officers for reasoning for doing this when letting out projects. I think now their reasoning is

10 YEAR ANNIVERSARY
2002-2012
20 Liberty Street
Suite 2D
Westminster
Maryland 21157
thebarbourgroup.com
410.876.9610 p
866.876.9610 t
410.876.9954 f

that they can save 10% overall on the contracts. We must fight this as a group. The General Contractors mark up their jobs a few percentage points after they have covered all expenses on the jobs. This is the same thing that the smaller companies do. There is less need for Federal Contracting Officers when the jobs are bundled but the overhead is shifted to the General Contractors as they need personnel to run the jobs for them. The Largest General Contractors that get these bundled contracts may not even have offices in this area and then take the revenues earned out of this market place and spend it elsewhere even though our taxes support their initiatives. We need to employ our local workforce in this time of recession and support our small business community. This must now be responded to timely as our businesses in this marketplace have not been given the opportunities that are available. I have counted 67 billion dollars in construction bundled jobs in this region this year alone. Almost nothing has been given to the small business community in construction per Federal Biz Ops. Imagine how we could grow with these opportunities as a group. Bundling has been done by the Army Corp of Engineers in two large Contracts that have tied up the majority of repair and small construction work in the next three years to only one or two General Contractors. This involves work in virtually every trade. If work is needed on these bases, it goes through the General Contractor or perhaps they will self-perform only. The largest companies get bigger and bigger and the small ones go out of business. With numbers, we may be successful. Thank you for your time and help. It was good seeing you last week at another successful function. Cheryl London Chereco Co., Inc."

(Chereco is a woman owned firm in Maryland that performs glass and glazing work)

Above is just one example of the many emails I received regarding bundling. The new term small business contractors are hearing is consolidation in lieu of bundling. The effect is nonetheless the same. Bundling or consolidating contracts is an obstacle for small businesses.

- Support legislation that will prevent unnecessary bundling/consolidation of federal construction projects to allow more small business participation at the prime level.

Credit Inquiries and Impact on Bonding

Owners and spouses of small businesses are required to provide personal and corporate indemnity to surety companies in order to be extended any form of bonding credit. Surety is not insurance. If a contractor defaults and the surety makes any payments to suppliers and/or the project owner, the surety will seek subrogation against the owners, spouses and principal on the bond (the small business) to be made whole. This is why you will often hear surety companies say that they underwrite risks based on a zero loss ratio. As I am sure you are aware, sureties have losses and often there is very little left to recoup of the small business and its owners.

Before a small business can be considered for bonding, the surety company will pull a credit report on the owners and spouses. If the corporate surety for some reason does not find this contractor a fit for their company, the surety broker will send the contract file to another market, which in turn, will also pull credit. In some cases, several tries may be needed before a solid proposal can be provided by the broker. In the meantime, for every report pulled, the credit scoring companies will deduct points, anywhere from 4 to 10 points, for each credit inquiry.

2002-2012
20 Liberty Street
Suite 2D
Westminster
Maryland 21157
thebarbourgroup.com
410.876.9610 p
866.876.9610 t
410.876.9954 f

Not only do corporate sureties pull credit reports on owners and spouses of small businesses, but so do vendors and banks. While owners and spouses may have fair credit, hovering around 700, by the time outside parties pull credit, the inquiries alone could drop the score to unfavorable levels.

Each time a personal credit is pulled, the company making the inquiry is listed. So, if I, as the broker, send a small business account to Surety A and they decline, the next surety, Surety B will see that Surety A pulled credit and wonder why Surety A did not approve the account. Disclosing the name of the company making the inquiry on the credit report is a Privacy Act issue. Disclosing the inquirer should be made only to the individual under credit investigation, no one else.

Big business does not have this issue. Most large companies do not personally indemnify. Sureties here rely on the credit reports such as Dunn and Bradstreet.

- Support legislation to stop credit reporting authorities from deducting any points for inquiries from personal credit scores when the inquiry was made for the risk evaluation of the small business.
- Support legislation not to openly disclose and name the entity making the inquiry on the personal credit report for any individual/consumer.

Retention Reform for FAR

At present there are three FAR clauses found that address retention. 32.102 gives reason why retention can be withheld from general contractors by contracting officers, 52.232-5 provides the amount that can be withheld by the contracting officer for poor performance, and 52-232-27 that allows a flow down to subcontractors to allow subcontractors to withhold retention form their subcontractors. See below

32.103 Progress payments under construction contracts.

When satisfactory progress has not been achieved by a contractor during any period for which a progress payment is to be made, a percentage of the progress payment may be retained. **Retainage should not be used as a substitute for good contract management, and the contracting officer should not withhold funds without cause. Determinations to retain and the specific amount to be withheld shall be made by the contracting officers on a case-by-case basis. Such decisions will be based on the contracting officer's assessment of past performance and the likelihood that such performance will continue.** The amount of retainage withheld shall not exceed 10 percent of the approved estimated amount in accordance with the terms of the contract and may be adjusted as the contract approaches completion to recognize better than expected performance, the ability to rely on alternative safeguards, and other factors. Upon completion of all contract requirements, retained amounts shall be paid promptly.

2002-2012
20 Liberty Street
Suite 2D
Westminster
Maryland 21157
thebarbourgroup.com
410.876.9610 p
866.876.9610 t
410.876.9954 f

52.232-5 Payments under Fixed-Price Construction Contracts.

(e) *Retainage.* If the Contracting Officer finds that satisfactory progress was achieved during any period for which a progress payment is to be made, the Contracting Officer shall authorize payment to be made in full. **However, if satisfactory progress has not been made, the Contracting Officer may retain a maximum of 10 percent of the amount of the payment until satisfactory progress is achieved.** When the work is substantially complete, the Contracting Officer may retain from previously withheld funds and future progress payments that amount the Contracting Officer considers adequate for protection of the Government and shall release to the Contractor all the remaining withheld funds. Also, on completion and acceptance of each separate building, public work, or other division of the contract, for which the price is stated separately in the contract, payment shall be made for the completed work without retention of a percentage.

52.232-27 Prompt Payment for Construction Contracts.

(1) *Retainage permitted.* Permit the Contractor or a subcontractor to retain (without cause) a specified percentage of each progress payment otherwise due to a subcontractor for satisfactory performance under the subcontract without incurring any obligation to pay a late payment interest penalty, in accordance with terms and conditions agreed to by the parties to the subcontract, giving such recognition as the parties deem appropriate to the ability of a subcontractor to furnish a performance bond and a payment bond.

While general contractors may not have any retention withheld by the contracting officer, they will nonetheless hold retention from their subcontractor's payments, up to 10% without cause. And, the general contractors will not release any retention to the subcontractor until all the work is completed. Given the extreme size of many federal projects, the subcontractors may not see that retention (profit) for several years.

- Support legislation to change FAR retention clauses to disallow any retention to be withheld from the subcontractor (if performing satisfactorily) by the general contractor if no retention was withheld from the general contractor by the contracting officer or if the subcontractor has posted a bond.
- Support legislation to mandate that the general contractor must release the subcontractors' retention upon successful completion of the subcontractor's work.

Very truly yours,

Karen Pecora-Barbour
President

2002-2012

20 Liberty Street
Suite 2D
Westminster
Maryland 21157
thebarbourgroup.com
410.876.9610 p
866.876.9610 t
410.876.9954 f

ATTACHMENT

Telephone (202) 874-6850

February 3, 2006

SPECIAL INFORMATIONAL NOTICE TO ALL BOND-APPROVING (CONTRACTING) OFFICERS

Important Information Regarding the Use of Individual Sureties on Federal Bonds

Subchapter E, Part 28 of the Federal Acquisition Regulation (FAR) provides guidance as to the acceptability of sureties and other security for Federal bonds. Acceptable security on Federal bonds include, but are not limited to, both corporate and individual sureties. FAR § 28.201. Acceptable corporate sureties must appear on the Department of Treasury's Circular 570. Treasury's Financial Management Service, Surety Bond Branch (FMS), publishes Department Circular 570 in the Federal Register.

Contracting officers determine the acceptability of individual sureties and ensure that the individual surety's pledged assets are sufficient to cover the bond obligation in accordance with the guidance outlined in the FAR § 28.203.

Although FMS is not substantively responsible for approving individual sureties, we believe it prudent to issue this Special Informational Notice on a FYI basis to Agency Bond-Approving (Contracting) Officers who do have that responsibility under the FAR.

Recently, FMS has been made aware of instances where **individual sureties are listing corporate debenture notes and other questionable assets on their "Affidavit of Individual Surety"**, Standard Form 28. In some instances, the individual sureties used a form other than the Standard Form 28 as their affidavit. **FAR § 28.203(b) specifically requires the use of the Standard Form 28.** In addition, FAR § 28.203-2(a) states that **"the Government will accept only cash, readily marketable assets, or irrevocable letters of credit from a federally insured financial institution from individual sureties to satisfy the underlying bond obligations."**

FAR § 28.203-2(b) includes **examples of acceptable assets**, such as:

- cash, or certificates of deposit, or other cash equivalents with a federally insured financial institution
- United State Government securities
- stocks and bonds actively traded on a national U.S. security exchange
- real property owned fee simple by the surety subject to certain conditions (refer to FAR 28.203-2(b)(4))
- irrevocable letters of credit issued by a federally insured financial institution in the name of the contracting agency and which identify the agency and solicitation or contract number.

Furthermore, FAR § 28.203-2(c) lists **unacceptable assets**, but indicates that the list is not all-inclusive. The following are listed as unacceptable assets:

- notes or account receivable
- foreign securities

- real property located outside the United States, its territories or possessions
- real property used as the principal residence of the surety
- real property owned concurrently
- life estates, leasehold estates, or future interest in real property
- personal property except as listed in FAR 28.203-2(b)
- stocks and bonds of the individual surety in a controlled, affiliated or closely held concern of the offeror/contractor
- corporate assets
- speculative assets
- letters of credit except as provided in FAR 28.203(b)(5)

The FAR also requires that the Government be given a security interest in any acceptable assets pledged by an individual surety. FAR § 28.203-1(a).

Prior to acceptance of an individual surety, FAR guidelines require contracting officers to obtain the opinion of their legal counsel as to the adequacy of the documentation pledging assets. FAR § 28.203(f).

If you have any questions, please feel free to contact this office at the above number.

Sincerely,

/Signed/ Rose Miller

Rose Miller
Manager
Surety Bond Branch

Subpart 28.2—Sureties and Other Security for Bonds

28.200 Scope of subpart.

This subpart prescribes procedures for the use of sureties and other security to protect the Government from financial losses.

28.201 Requirements for security.

(a) Agencies shall obtain adequate security for bonds (including coinsurance and reinsurance agreements) required or used with a contract for supplies or services (including construction). Acceptable forms of security include—

(1) Corporate or individual sureties; or

(2) Any of the types of security authorized in lieu of sureties by 28.204.

(b) Solicitations shall not preclude offerors from using the types of surety or other security permitted by this subpart, unless prohibited by law or regulation.

28.202 Acceptability of corporate sureties.

(a)(1) Corporate sureties offered for bonds furnished with contracts performed in the United States or its outlying areas must appear on the list contained in the Department of Treasury Circular 570, "Companies Holding Certificates of Authority as Acceptable Sureties on Federal Bonds and Acceptable Reinsuring Companies."

(2) The penal amount of the bond should not exceed the surety's underwriting limit stated in the Department of the Treasury circular. If the penal amount exceeds the underwriting limit, the bond will be acceptable only if—

(i) The amount which exceeds the specified limit is coinsured or reinsured; and

(ii) The amount of coinsurance or reinsurance does not exceed the underwriting limit of each coinsurer or reinsurer.

(3) Coinsurance or reinsurance agreements shall conform to the Department of the Treasury regulations in 31 CFR 223.10 and 223.11. When reinsurance is contemplated, the contracting office generally shall require reinsurance agreements to be executed and submitted with the bonds before making a final determination on the bonds.

(4) When specified in the solicitation, the contracting officer may accept a bond from the direct writing company in satisfaction of the total bond requirement of the contract. This is permissible until necessary reinsurance agreements are executed, even though the total bond requirement may exceed the insurer's underwriting limitation. The contractor shall execute and submit necessary reinsurance agreements to the contracting officer within the time specified on the bid form, which may not exceed 45 calendar days after the execution of the bond. The contractor shall use Standard Form 273, Reinsurance Agreement for a Miller Act Performance Bond, and Standard Form 274, Reinsurance Agreement for a Miller Act Payment Bond, when reinsurance is furnished with Miller Act bonds. Standard Form 275, Reinsurance Agreement in Favor of the United States, is used when reinsurance is furnished with bonds for other purposes.

(b) For contracts performed in a foreign country, sureties not appearing on Treasury Department Circular 570 are acceptable if the contracting officer determines that it is impracticable for the contractor to use Treasury listed sureties.

(c) The Department of the Treasury issues supplements to Circular 570, notifying all Federal agencies of (1) new approved corporate surety companies and (2) the termination of the authority of any specific corporate surety to qualify as a surety on Federal bonds. Upon receipt of notification of termination of a company's authority to qualify as a surety on Federal bonds, the contracting officer shall review the outstanding contracts and take action necessary to protect the Government, including, where appropriate, securing new bonds with acceptable sureties in lieu of outstanding bonds with the named company.

(d) The Department of the Treasury Circular 570 may be obtained from the—

U.S. Department of the Treasury
Financial Management Service
Surety Bond Branch
3700 East West Highway, Room 6F01
Hyattsville, MD 20782.
Or via the Internet at http://www.fms.treas.gov/c570/.

28.203 Acceptability of individual sureties.

(a) An individual surety is acceptable for all types of bonds except position schedule bonds. The contracting officer shall determine the acceptability of individuals proposed as sureties, and shall ensure that the surety's pledged assets are sufficient to cover the bond obligation. (See 28.203-7 for information on excluded individual sureties.)

(b) An individual surety must execute the bond, and the unencumbered value of the assets (exclusive of all outstanding pledges for other bond obligations) pledged by the individual surety, must equal or exceed the penal amount of each bond. The individual surety shall execute the Standard Form 28 and provide a security interest in accordance with 28.203-1. One individual surety is adequate support for a bond, provided the unencumbered value of the assets pledged by that individual surety equal or exceed the amount of the bond. An offeror may submit up to three individual sureties for each bond, in which case the pledged assets, when combined, must equal or exceed the penal amount of the bond. Each individual surety must accept both joint and several liability to the extent of the penal amount of the bond.

(c) If the contracting officer determines that no individual surety in support of a bid guarantee is acceptable, the offeror utilizing the individual surety shall be rejected as nonresponsible, except as provided in 28.101-4. A finding of nonresponsibility based on unacceptability of an individual surety, need not be referred to the Small Business Administration for a competency review. (See 19.602-1(a)(2)(i) and 61 Comp. Gen. 456 (1982).)

(d) A contractor submitting an unacceptable individual surety in satisfaction of a performance or payment bond requirement may be permitted a reasonable time, as deter-mined by the contracting officer, to substitute an acceptable surety for a surety previously determined to be unacceptable.

(e) When evaluating individual sureties, contracting officers may obtain assistance from the office identified in 28.202(d).

(f) Contracting officers shall obtain the opinion of legal counsel as to the adequacy of the documents pledging the assets prior to accepting the bid guarantee and payment and performance bonds.

(g) Evidence of possible criminal or fraudulent activities by an individual surety shall be referred to the appropriate agency official in accordance with agency procedures.

28.203-1 Security interests by an individual surety.

(a) An individual surety may be accepted only if a security interest in assets acceptable under 28.203-2 is provided to the Government by the individual surety. The security interest shall be furnished with the bond.

(b) The value at which the contracting officer accepts the assets pledged must be equal to or greater than the aggregate penal amounts of the bonds required by the solicitation and may be provided by one or a combination of the following methods:

(1) An escrow account with a federally insured financial institution in the name of the contracting agency. (See 28.203-2(b)(2) with respect to Government securities in book entry form.) Acceptable

securities for deposit in escrow are discussed in 28.203-2. While the offeror is responsible for establishing the escrow account, the terms and conditions must be acceptable to the contracting officer. At a minimum, the escrow account shall provide for the following:

(i) The account must provide the contracting officer the sole and unrestricted right to draw upon all or any part of the funds deposited in the account. A written demand for withdrawal shall be sent to the financial institution, after obtaining the concurrence of legal counsel, by the contracting officer with a copy to the offeror/contractor and to the surety. Within the time period specified in the demand, the financial institution would pay the Government the amount demanded up to the amount on deposit. If any dispute should arise between the Government and the offeror/contractor, the surety, or the subcontractors or suppliers with respect to the offer or contract, the financial institution would be required, unless precluded by order of a court of competent jurisdiction, to disburse monies to the Government as directed by the contracting officer.

(ii) The financial institution would be authorized to release to the individual surety all or part of the balance of the escrow account, including any accrued interest, upon receipt of written authorization from the contracting officer.

(iii) The Government would not be responsible for any costs attributable to the establishment, maintenance, administration, or any other aspect of the account.

(iv) The financial institution would not be liable or responsible for the interpretation of any provisions or terms and conditions of the solicitation or contract.

(v) The financial institution would provide periodic account statements to the contracting officer.

(vi) The terms of the escrow account could not be amended without the consent of the contracting officer.

(2) A lien on real property, subject to the restrictions in 28.203-2 and 28.203-3.

28.203-2 Acceptability of assets.

(a) The Government will accept only cash, readily marketable assets, or irrevocable letters of credit from a federally insured financial institution from individual sureties to satisfy the underlying bond obligations.

(b) Acceptable assets include—

(1) Cash, or certificates of deposit, or other cash equivalents with a federally insured financial institution;

(2) United States Government securities at market value. (An escrow account is not required if an individual surety offers Government securities held in book entry form at a depository institution. In lieu thereof, the individual shall provide evidence that the depository institution has—

(i) Placed a notation against the individual's book entry account indicating that the security has been pledged in favor of the respective agency;

(ii) Agreed to notify the agency prior to maturity of the security; and

(iii) Agreed to hold the proceeds of the security subject to the pledge in favor of the agency until a substitution of securities is made or the security interest is formally released by the agency.);

(3) Stocks and bonds actively traded on a national U.S. security exchange with certificates issued in the name of the individual surety. National security exchanges are—(i) the New York Stock Exchange; (ii) the American Stock Exchange; (iii) the Boston Stock Exchange; (iv) the Cincinnati Stock Exchange; (v) the Midwest Stock Exchange; (vi) the Philadelphia Stock Exchange; (vii) the Pacific Stock Exchange; and (viii) the Spokane Stock Exchange. These assets will be accepted at 90 percent of their 52-week low, as reflected at the time of submission of the bond. Stock options and stocks on the over-the-counter (OTC) market or NASDQ Exchanges will not be accepted. Assistance in evaluating the acceptability of securities may be obtained from the—

Securities and Exchange Commission
Division of Enforcement
450 Fifth Street NW
Washington, DC 20549.

(4) Real property owned in fee simple by the surety without any form of concurrent ownership, except as provided in paragraph (c)(3)(iii) of this subsection, and located in the United States or its outlying areas. These assets will be accepted at 100 percent of the most current tax assessment value (exclusive of encumbrances) or 75 percent of the properties' unencumbered market value provided a current appraisal is furnished (see 28.203-3).

(5) Irrevocable letters of credit (ILC) issued by a federally insured financial institution in the name of the contracting agency and which identify the agency and solicitation or contract number for which the ILC is provided.

(c) Unacceptable assets include but are not limited to—

(1) Notes or accounts receivable;

(2) Foreign securities;

(3) Real property as follows:

(i) Real property located outside the United States and its outlying areas.

(ii) Real property which is a principal residence of the surety.

(iii) Real property owned concurrently regardless of the form of co-tenancy (including joint tenancy, tenancy by the entirety, and tenancy in common) except where all co-tenants agree to act jointly.

(iv) Life estates, leasehold estates, or future interests in real property.

(4) Personal property other than that listed in paragraph (b) of this subsection (*e.g.,* jewelry, furs, antiques);

(5) Stocks and bonds of the individual surety in a controlled, affiliated, or closely held concern of the offeror/contractor;

(6) Corporate assets (*e.g.,* plant and equipment);

(7) Speculative assets (*e.g.,* mineral rights);

(8) Letters of credit, except as provided in 28.203-2(b)(5).

28.203-3 Acceptance of real property.

(a) Whenever a bond with a security interest in real property is submitted, the individual surety shall provide—

(1) A mortgagee title insurance policy, in an insurance amount equal to the amount of the lien, or other evidence of title that is consistent with the requirements of Section 2 of the United States Department of Justice Title Standards at http://www.usdoj.gov/enrd/2001_Title_Standards.html. This title evidence must show fee simple title vested in the surety along with any concurrent owners; whether any real estate taxes are due and payable; and any recorded encumbrances against the property, including the lien filed in favor of the Government under paragraph (d) of this subsection. Agency contracting officers should request the assistance of their designated agency legal counsel in determining if the title evidence is consistent with the Department of Justice standards;

(2) Evidence of the amount due under any encumbrance shown in the evidence of title;

(3) A copy of the current real estate tax assessment of the property or a current appraisal dated no earlier than 6 months prior to the date of the bond, prepared by a professional appraiser who certifies that the appraisal has been conducted in accordance with the generally accepted appraisal standards as reflected in the Uniform Standards of Professional Appraisal Practice as promulgated by the—

Appraisal Foundation
1029 Vermont Avenue, NW
Washington, DC 20005.

(b) Failure to provide evidence that the lien has been properly recorded will render the offeror nonresponsible.

(c) The individual surety is liable for the payment of all administrative costs of the Government, including legal fees, associated with the liquidation of pledged real estate.

(d) The following format, or any document substantially the same, shall be signed by all owners of the property and used by the surety and recorded in the local recorder's office when a surety pledges real estate on Standard Form 28, Affidavit of Individual Surety.

LIEN ON REAL ESTATE

I/we agree that this instrument constitutes a lien in the amount of $________ on the property described in this lien. The rights of the United States Government shall take precedence over any subsequent lien or encumbrance until the lien is formally released by a duly authorized representative of the United States. I/we hereby grant the United States the power of sale of subject property, including the right to satisfy its reasonable administrative costs, including legal fees associated with any sale of subject property, in the event of contractor default if I/we otherwise fail to satisfy the underlying ( ) bid guarantee, ( ) performance bond, ( ) or payment bond obligations as an individual surety on solicitation/contract number ______________. The lien is upon the real estate now owned by me/us described as follows:

(legal description, street address and other identifying description)

In witness hereof, I/we have hereunto affixed my/our hand(s) and seal(s) this ___ Day of _____20 __.

Witness:

____________________ __________(Seal)

____________________ __________(Seal)

I, ________________, a Notary Public in and for the (City) ___________, (State) ______, do hereby certify that ____________, a party or parties to a certain Agreement bearing the date ____ day of ________ 20 __, and hereunto annexed, personally appeared before me, the said ____________ being personally well known to me as the person(s) who executed said lien, and acknowledged the same to be his/her heir act and deed.

Given under my hand and seal this ___ day of ___20 __.

____
Notary Public, State

My commission expires:

28.203-4 Substitution of assets.

An individual surety may request the Government to accept a substitute asset for that currently pledged by submitting a written request to the responsible contracting officer. The contracting officer may agree to the substitution of assets upon determining, after consultation with legal counsel, that the substitute assets to be pledged are adequate to protect the outstanding bond or guarantee obligations. If acceptable, the substitute assets shall be pledged as provided for in Subpart 28.2.

28.203-5 Release of lien.

(a) After consultation with legal counsel, the contracting officer shall release the security interest on the individual surety's assets using the Optional Form 90, Release of Lien on Real Property, or Optional

Form 91, Release of Personal Property from Escrow, or a similar release as soon as possible consistent with the conditions in paragraphs (a)(1) and (2) of this subsection. A surety's assets pledged in support of a payment bond may be released to a subcontractor or supplier upon Government receipt of a Federal district court judgment, or a sworn statement by the subcontractor or supplier that the claim is correct along with a notarized authorization of the release by the surety stating that it approves of such release.

(1) *Contracts subject to the Miller Act.* The security interest shall be maintained for the later of—

(i) 1 year following final payment;

(ii) Until completion of any warranty period (applicable only to performance bonds); or

(iii) Pending resolution of all claims filed against the payment bond during the 1-year period following final payment.

(2) *Contracts subject to alternative payment protection (28.102-1(b)(1)).* The security interest shall be maintained for the full contract performance period plus one year.

(3) *Other contracts not subject to the Miller Act.* The security interest shall be maintained for 90 days following final payment or until completion of any warranty period (applicable only to performance bonds), whichever is later.

(b) Upon written request, the contracting officer may release the security interest on the individual surety's assets in support of a bid guarantee based upon evidence that the offer supported by the individual surety will not result in contract award.

(c) Upon written request by the individual surety, the contracting officer may release a portion of the security interest on the individual surety's assets based upon substantial performance of the contractor's obligations under its performance bond. Release of the security interest in support of a payment bond must comply with the paragraphs (a)(1) through (3) of this subsection. In making this determination, the contracting officer will give consideration as to whether the unreleased portion of the lien is sufficient to cover the remaining contract obligations, including payments to subcontractors and other potential liabilities. The individual surety shall, as a condition of the partial release, furnish an affidavit agreeing that the release of such assets does not relieve the individual surety of its obligations under the bond(s).

28.203-6 Contract clause.

Insert the clause at 52.228-11 in solicitations and contracts which require the submission of bid guarantees, performance, or payment bonds.

28.203-7 Exclusion of individual sureties.

(a) An individual may be excluded from acting as a surety on bonds submitted by offerors on procurement by the executive branch of the Federal Government, by the acquiring agency's head or designee utilizing the procedures in Subpart 9.4. The exclusion shall be for the purpose of protecting the Government.

(b) An individual may be excluded for any of the following causes:

(1) Failure to fulfill the obligations under any bond.

(2) Failure to disclose all bond obligations.

(3) Misrepresentation of the value of available assets or outstanding liabilities.

(4) Any false or misleading statement, signature or representation on a bond or affidavit of individual suretyship.

(5) Any other cause affecting responsibility as a surety of such serious and compelling nature as may be determined to warrant exclusion.

(c) An individual surety excluded pursuant to this subsection shall be included in the Excluded Parties List System. (See 9.404.)

(d) Contracting officers shall not accept the bonds of individual sureties whose names appear in the Excluded Parties List System (see 9.404) unless the acquiring agency's head or a designee states in writing the compelling reasons justifying acceptance.

(e) An exclusion of an individual surety under this subsection will also preclude such party from acting as a contractor in accordance with Subpart 9.4.

28.204 Alternatives in lieu of corporate or individual sureties.

(a) Any person required to furnish a bond to the Government may furnish any of the types of security listed in 28.204-1 through 28.204-3 instead of a corporate or individual surety for the bond. When any of those types of security are deposited, a statement shall be incorporated in the bond form pledging the security in lieu of execution of the bond form by corporate or individual sureties. The contractor shall execute the bond forms as the principal. Agencies shall establish safeguards to protect against loss of the security and shall return the security or its equivalent to the contractor when the bond obligation has ceased.

(b) Upon written request by any contractor securing a performance or payment bond by any of the types of security listed in 28.204-1 through 28.204-3, the contracting officer may release a portion of the security only when the conditions allowing the partial release of lien in 28.203-5(c) are met. The contractor shall, as a condition of the partial release, furnish an affidavit agreeing that the release of such security does not relieve the contractor of its obligations under the bond(s).

(c) The contractor may satisfy a requirement for bond security by furnishing a combination of the types of security listed in 28.204-1 through 28.204-3 or a combination of bonds supported by these types of security and additional surety bonds under 28.202 or 28.203. During the period for which a bond supported by security is required, the contractor may substitute one type of security listed in 28.204-1 through 28.204-3 for another, or may substitute, in whole or combination, additional surety bonds under 28.202 or 28.203.

28.204-1 United States bonds or notes.

Any person required to furnish a bond to the Government has the option, instead of furnishing a surety or sureties on the bond, of depositing certain United States bonds or notes in an amount equal at their par value to the penal sum of the bond (the Act of February 24, 1919 (31 U.S.C. 9303) and Treasury Department Circular No. 154 dated July 1, 1978 (31 CFR Part 225)). In addition, a duly executed power of attorney and agreement authorizing the collection or sale of such United States bonds or notes in the event of default of the principal on the bond shall accompany the deposited bonds or notes. The contracting officer may—

(a) Turn securities over to the finance or other authorized agency official; or

(b) Deposit them with the Treasurer of the United States, a Federal Reserve Bank (or branch with requisite facilities), or other depository designated for that purpose by the Secretary of the Treasury, under procedures prescribed by the agency concerned and Treasury Department Circular No. 154 (exception: The contracting officer shall deposit all bonds and notes received in the District of Columbia with the Treasurer of the United States).

28.204-2 Certified or cashier's checks, bank drafts, money orders, or currency.

Any person required to furnish a bond has an option to furnish a certified or cashier's check, bank draft, Post Office money order, or currency, in an amount equal to the penal sum of the bond, instead of furnishing surety or sureties on the bonds. Those furnishing checks, drafts, or money orders shall draw them to the order of the appropriate Federal agency.

28.204-3 Irrevocable letter of credit (ILC).

(a) Any person required to furnish a bond has the option to furnish a bond secured by an ILC in an amount equal to the penal sum required to be secured (see 28.204). A separate ILC is required for each bond.

(b) The ILC shall be irrevocable, require presentation of no document other than a written demand and the ILC (and letter of confirmation, if any), expire only as provided in paragraph (f) of this subsection, and be issued/confirmed by an acceptable federally insured financial institution as provided in paragraph (g) of this subsection.

(c) To draw on the ILC, the contracting officer shall use the sight draft set forth in the clause at 52.228-14, and present it with the ILC (including letter of confirmation, if any) to the issuing financial institution or the confirming financial institution (if any).

(d) If the contractor does not furnish an acceptable replacement ILC, or other acceptable substitute, at least 30 days before an ILC's scheduled expiration, the contracting officer shall immediately draw on the ILC.

(e) If, after the period of performance of a contract where ILCs are used to support payment bonds, there are outstanding claims against the payment bond, the contracting officer shall draw on the ILC prior to the expiration date of the ILC to cover these claims.

(f) The period for which financial security is required shall be as follows:

(1) If used as a bid guarantee, the ILC should expire no earlier than 60 days after the close of the bid acceptance period.

(2) If used as an alternative to corporate or individual sureties as security for a performance or payment bond, the offeror/contractor may submit an ILC with an initial expiration date estimated to cover the entire period for which financial security is required or an ILC with an initial expiration date that is a minimum period of one year from the date of issuance. The ILC shall provide that, unless the issuer provides the beneficiary written notice of non-renewal at least 60 days in advance of the current expiration date, the ILC is automatically extended without amendment for one year from the expiration date, or any future expiration date, until the period of required coverage is completed and the contracting officer provides the financial institution with a written statement waiving the right to payment. The period of required coverage shall be:

(i) For contracts subject to the Miller Act, the later of—

(A) One year following the expected date of final payment;

(B) For performance bonds only, until completion of any warranty period; or

(C) For payment bonds only, until resolution of all claims filed against the payment bond during the one-year period following final payment.

(ii) For contracts not subject to the Miller Act, the later of—

(A) 90 days following final payment; or

(B) For performance bonds only, until completion of any warranty period.

(g) Only federally insured financial institutions rated investment grade or higher shall issue or confirm the ILC. Unless the financial institution issuing the ILC had letter of credit business of at least $25 million in the past year, ILCs over $5 million must be confirmed by another acceptable financial institution that had letter of credit business of at least $25 million in the past year.

(1) The offeror/contractor shall provide the contracting officer a credit rating from a recognized commercial rating service as specified in Office of Federal Procurement Policy Pamphlet No. 7 (see 28.204-3(h)) that indicates the financial institution has the required rating(s) as of the date of issuance of the ILC.

(2) If the contracting officer learns that a financial institution's rating has dropped below the required level, the contracting officer shall give the contractor 30 days to substitute an acceptable ILC or shall draw on the ILC using the sight draft in paragraph (g) of the clause at 52.228-14.

(h)(1) Additional information on credit rating services and investment grade ratings is contained within Office of Federal Procurement Policy Pamphlet No. 7, Use of Irrevocable Letters of Credit. This pamphlet may be obtained by calling the Office of Management and Budget's publications office at (202) 395-7332.

(2) A copy of the Uniform Customs and Practice (UCP) for Documentary Credits, 1993 Revision, International Chamber of Commerce Publication No. 500, is available from:

ICC Publishing, Inc.
156 Fifth Avenue
New York NY 10010

Telephone: (212) 206-1150
Telefax: (212) 633-6025
E-mail: iccpub@interport.net.

28.204-4 Contract clause.

Insert the clause at 52.228-14, Irrevocable Letter of Credit, in solicitations and contracts for services, supplies, or construction, when a bid guarantee, or performance bonds, or performance and payment bonds are required.

Mr. COBLE. Thank you, Ms. Barbour. Thanks to each of you for your terse statements. I appreciate that.

Without objection, I want to introduce into the record the letter from the National Association of Surety Bond Producers and the Security & Fidelity Association of America. It features 10 corporations that endorsed the bill, and the Surety & Fidelity Association of America, their statement as well.

Without objection, they will be made part of the record.
[The information referred to follows:]

National Association of
Surety Bond Producers (NASBP)
1140 19th Street, NW, Suite 800
Washington, DC 20036

The Surety & Fidelity
Association of America (SFAA)
1101 Connecticut Ave. NW, Suite 800
Washington, DC 20036

H.R. 3534, the "Security in Bonding Act of 2011"

Dear Congressmen Hanna and Mulvaney:

On behalf of the national trade associations listed below, representing contractor and specialty contractor firms, bonding agencies, and surety and property/casualty insurers, operating throughout the United States, we support legislation to protect small businesses and taxpayer funds with the introduction of H.R. 3534, the "Security in Bonding Act of 2011."

Surety bonds on federal construction projects ensure that such projects will be completed, preserving public funds, and that subcontractors and suppliers, many of which are small businesses, will be paid.

At present, construction firms may furnish security on a federal construction project:

1. By securing a bond written by a corporate surety, that must be vetted and approved by the U.S. Department of Treasury;
2. By posting an "eligible obligation," i.e. a U.S.-backed security, in lieu of a surety bond. The security is pledged directly and deposited with the federal government until the contract is complete; or
3. By securing a bond from an unlicensed individual, if the bond is secured by an "acceptable asset," which includes stocks, bonds, and real property owned in fee simple.

Individual sureties, allowed in item 3 above, neither are subject to the same vetting and scrutiny as corporate sureties, nor are they required to relinquish the custody and control of the assets that they pledge to secure their bonds. This lack of meaningful oversight has resulted in documented cases where assets pledged by individual sureties have proven to be illusory or insufficient, causing substantial financial harm to the federal government, to taxpayers, and to subcontractors and suppliers.

H.R. 3534, the "Security in Bonding Act of 2011," will remedy this significant problem by requiring individual sureties to pledge solely those assets described as "eligible obligations" and to deposit them in the custody and control of the federal government. By doing so, H.R. 3534, eliminates future instances where individual surety bonds are pledged with insufficient or illusory assets. Thus, if an individual surety bond is furnished in the future, the small businesses which provide goods and services on those federal construction contracts will not need to worry about the integrity of their payment bond remedy.

Thank you again for your leadership on this critical issue. We strongly support your legislation.

Yours sincerely,

National Association of Surety Bond Producers
NASBP
1140 19th Street, NW Suite 800
Washington, DC 20036
202-686-3700
Contact: Larry LeClair, Director, Government Relations

The Surety & Fidelity Association of America (SFAA)
1101 Connecticut Avenue, NW, Suite 800
Washington, DC 20036
202-463-0600
Contact: Lenore Marema, Vice President of Government Affairs

Associated Builders and Contractors (ABC)
4250 North Fairfax Drive, 9th Floor
Arlington, VA 22203
703-812-2041
Contact: Liam P. Donovan, Director, Legislative Affairs

American Subcontractors Association, Inc. (ASA)
1004 Duke Street
Alexandria, VA 22314
703-684-3450
Contact: Franklin Davis, Director of Government Relations

American Insurance Association (AIA)
2101 L Street, NW, Suite 400
Washington, DC 20037
202-828-7100
Contact: Melissa W. Shelk , Vice President - Federal Affairs

Associated General Contractors of America (AGC)
2300 Wilson Blvd., Suite 400
Arlington, VA 22201
703-548-3118
Contact: Marco Giamberardino, Senior Director, Federal & Heavy Construction Division and Sean O'Neil, Director Congressional Relations, Infrastructure Advancement

Mechanical Contractors Association of America (MCAA)
1385 Piccard Drive
Rockville, MD 20850
301-869-5800
Contact: John McNerney, General Counsel

National Association of Minority Contractors (NAMC)
The Ronald Reagan House Office Building, Suite 700
1300 Pennsylvania Avenue, NW
Washington, DC 20004
(410) 268-9227
Contact: Hamilton V. Bowser, Sr., P.E.
President Emeritus and
Former Chair, Bonding Committee NAMC

National Electrical Contractors Association (NECA)
3 Bethesda Metro Center, Suite 1100
Bethesda, MD 20814
301-215-4522
Contact: Lake A. Coulson, Executive Director Government Affairs

Property Casualty Insurers Association of America (PCI)
444 North Capitol Street, NW
Suite 801
Washington, D.C. 20001
202-639-0490
Contact: Ben McKay, Senior Vice President, Federal Government Relations

Sheet Metal and Air Conditioning Contractors' National Association (SMACNA)
Capitol Hill Office
305 4th Street, NE
Washington, DC 20002-5815
202-547-8202
Contact: Stanley E. Kolbe, Jr., Director, Legislative Affairs

Statement of

THE SURETY & FIDELITY ASSOCIATION OF AMERICA

Subcommittee on Courts, Commercial and Administrative Law

U.S. House Committee on the Judiciary

March 5, 2012

1101 Connecticut Ave., NW, Suite 800
Washington, DC 20036
Phone: (202) 463-0600; Fax: (202) 463-0606
Website: http://www.surety.org

The Surety & Fidelity Association of America (SFAA) is a District of Columbia non-profit corporation whose members are engaged in the business of suretyship. SFAA member companies collectively write the majority of surety and fidelity bonds in the United States. The SFAA is licensed as a rating or advisory organization in all states, as well as in the District of Columbia and Puerto Rico, and it has been designated by state insurance departments as a statistical agent for the reporting of fidelity and surety experience.

HR 3534 is a key tool in eliminating fraud and increasing efficiency in federal procurement

Over the years what originally may have been a viable option for securing obligations to the federal government has not kept up with the changes in federal procurement and the economy. HR 3534 would ensure that all security pledged to the federal government to secure an obligation is functionally equivalent.

Background on Individual Sureties in the Federal Procurement Process

Under current federal law and regulations, construction contractors for the federal government have three options for securing their obligations. They can obtain a surety bond from an insurance company that is vetted and approved by the U.S. Department of Treasury and licensed by a state insurance regulator. In lieu of a bond, contractors can pledge and deposit assets with the federal government until the contract is complete. Only assets backed by the federal government can be pledged. The third option permits individuals to pledge their assets to back the contractor. These individuals are called "individual sureties." Only individual sureties are permitted to pledge assets not backed by the federal government. In fact, individual sureties are allowed to pledge stocks, bonds, and real property, and also are not required to deposit such assets with the federal government for the duration of the contract. All individual sureties need to give federal contracting officers is a document listing the assets and representing that they are pledged in an escrow account to secure the contractor's obligations.

The original concept of an individual surety was a person with sufficient wealth that was willing to pledge his/her assets as security to the federal government if the contractor was awarded a federal construction project. Such individual sureties knew the contractor that they were backing personally. The individual surety many times was a relative or close acquaintance of the contractor. All the individual surety needed to do was provide a sworn affidavit, verified by another party, that his or her net worth was sufficient to cover the contractor's bond obligations.

As the economy developed, the vast majority of bonds were provided by corporate insurers, and people who were providing individual surety bonds based on sworn affidavits were doing so for profit. They were individuals who were in the business of being an individual surety and were unknown or unrelated to the contractor providing the bond. Increasingly, the affidavits of such individual sureties were backed by insufficient and illusory assets and claims on the bond went unpaid. In 1990, the Federal Acquisition Regulation (FAR) was amended in an attempt to correct these abuses. The FAR now requires that individual sureties pledge specific assets in an escrow account at a federally insured financial institution equal to the penal amount of the bond. The affidavit that individual sureties now provide must include a specific description of the assets pledged, and represent that they are not pledged for other bonds. These rules, however, have not solved the problem of illusory and insufficient assets.

Why H.R. 3534 is Needed

The individual surety concept has evolved over time from an uncompensated individual who was known to the contractor into an independent third party who agrees to post assets for the contractor for profit. While it may have made sense decades ago to permit individual sureties to post a variety of assets—real estate, stocks, bonds—it no longer makes sense in the current context of individual sureties as persons unknown to the contractor who pledge assets that are often non-existent or hard to value, fluctuate in value or are impossible to liquidate to pay claims. As noted above, in 1990, the FAR was amended to tighten the requirements for assets pledged by individual sureties in response to fraud. Those amendments did not solve the problem. The assets that individual sureties can pledge to the federal government continue to be problematic.

Contracting officers today cannot enforce the existing requirements. They are presented lists of assets pledged that include assets that are not in an escrow account, are hard to verify, hard to value, that fluctuate in value, and that would be hard to liquidate if needed upon default. It is often difficult to determine whether the individual surety actually owns the assets, and whether the individual surety is pledging the assets for just the project in question or whether the same assets have been pledged for many projects in different federal agencies. This remains a significant problem in construction projects.

After one individual surety filed for bankruptcy and the United States asked the Court to declare his debts to it non dischargeable, the Court found, "The Debtor knew that he was pledging the same properties as bond collateral multiple times, and yet he patently denied doing so on each Affidavit . . . the Debtor repeatedly pledged property he did not own in support of his surety bonds . . . Moreover the Debtor made those false statements in order to induce the United States to accept him as a surety." (*United States v. Sears (In re Sears)*, Case No. 09-11053, Adv.Proc. No. 09-1070 (Bankr.S.D.Ala. February 16, 2012)).

Under H. R. 3534 federal contracting officers no longer will have to attempt to determine whether the assets that individual sureties pledge exist, are owned by the individual surety, and are worth the actual value claimed. Just like the assets that the contractor would pledge, the assets that individual sureties pledge would have to be eligible obligations as determined by the US Treasury, and handed over to the federal government and held and scrutinized in the same manner. H.R. 3534 makes the government procurement process more effective and efficient in a way that saves government resources and taxpayer dollars, reduces fraud, and will have no additional costs.

Why Congress Should Act Now

The general contractor on federal construction projects is required to provide performance and payment bonds for the protection of the taxpayers and subcontractors, suppliers and workers on the job. If the general contractor's bonds are backed by supposed assets of an individual surety that in fact do not exist, are difficult to verify, or are not readily convertible into cash to pay the obligations of the general contractor in case of default, everyone on the project is left unprotected. Experience has shown that if the assets pledged are uncollectible, subcontractors, suppliers, and workers on the job are left with no payment remedy if the contractor fails to pay them. These potential claimants cannot place a lien on public property or seek redress from the federal government for not obtaining a meaningful bond. The federal government is left with unfunded expenses to complete the construction projects and the persons who furnished labor and materials are left unpaid.

For example, see judgments entered in *U.S. for the use of Fuller v. Zoucha*, C.A. No. 2:05-cv-325 (E.D.Cal.); *U.S. for the use of Norshield Security Products LLC v. Scarborough*, C.A. No. 8:09-cv-1349 (D.Md.); and *United States v. Sears (In re Sears)*, Case No. 09-11053, Adv.Proc. No. 09-1070 (Bankr.S.D.Ala. February 16, 2012).

Yet, under federal law and regulations, a contractor pledging assets directly to the federal government is subject to far more stringent rules than an individual, acting for profit, who pledges his or her own assets to back the contractor for a fee.

All the major contracting groups support H.R. 3534 because it would create clarity and certainty in any collateral given to the federal government. There would be either a surety bond from a corporate surety vetted by the U.S. Treasury Department to do business with the federal government and licensed by a state regulator, or collateral provided to the designee of the Secretary of the Treasury by a contractor or individual surety in a readily identifiable form and value. All such collateral would be deposited with and vetted by the designee of the Secretary of the Treasury (currently the Federal Reserve Bank of St. Louis).

The uncertainty of the current system increases the cost to the federal government. First, individual sureties charge more for bonding than corporate sureties. Corporate surety rates are regulated by state regulators. No one regulates individual sureties. Second, if a contracting officer rejects an individual surety bond the resulting bid protest is costly and delays the project. Of course there also is the cost of attempting to track down and liquidate an asset if a claim must be made on the bond. This holds true for claimants under the payment bonds as well.

Individuals and small businesses working on a federal construction project—either as subcontractors, suppliers, or workers on the job—have no control over the general contractor's choice of security provided to the federal government, but they suffer the most harm financially if the provided security proves illusory. The result of H.R. 3534 is that laborers, subcontractors, and suppliers on federal construction projects will know that adequate and reliable security is in place to guarantee that they will be paid.

Why H.R. 3534 Makes Sense

H.R. 3534 is just common sense. The security that stands behind every federal contractor's obligations to the federal government should be governed by the same rules. There should be either a corporate surety bond in place from a company approved by the U.S. Treasury and licensed by a state regulator, or assets with readily identifiable value pledged and relinquished to the federal government while the construction project is ongoing. The same rules should apply to the individual surety that apply to any federal contractor that is securing obligations to the federal government.

It does not make sense to permit an individual surety to post collateral that the contractor could not post on its own behalf. H.R. 3534 would require the collateral that the contactor can post and that the individual surety can post on its behalf, to be equivalent. If individual sureties have the assets they claim, they could easily provide U.S. debt obligations and turn them over to the contracting officer for deposit for the duration of the construction project. The individual would earn interest on that obligation while it is in the custody of the federal government.

H.R. 3534 makes the government procurement process more effective and efficient in a way that saves government resources and taxpayer dollars, with no additional costs.

5

Mr. COBLE. And we try to comply with the 5-minute rule also. So we will try to do that. We have been joined by the distinguished gentleman from Atlanta, the land of the palmetto, Mr. Trey Gowdy. Trey, good to have you with us.

Mr. McCallum, can you describe in more detail how the government suffers a pecuniary harm when a bid or performance bond proves to be worthless?

Mr. MCCALLUM. Yes, Mr. Chairman. Two different items here. The bid bond is to secure that you have a good-faith bidder who intends to enter into the final contract and supply the final bonds. The bid bond acts to provide the difference between the bid, the lowest bid that was accepted, and the next lowest bidder. And it will pay that amount to the government to help for its reprocurement costs.

The performance bond is guaranteeing the obligation of the awarded prime contractor. If, for whatever reason, that party defaults in their performance, the surety will step in, and they have a variety of actions that they can take, but essentially to guarantee up to the penal sum of the bond any amounts that it needs to pay out to complete that contract obligation.

Typically, there are delays, reprocurement costs, and other costs that the contracting agency and, hence, taxpayers may suffer in the absence of a valid performance guarantee. So that bond is there to secure those debts.

Mr. COBLE. Thank you, sir. Ms. Wellers, opponents of H.R. 3534 have suggested that the bill will harm minority contractors' ability to secure surety bonds. Yet the National Association of Minority Contractors supports the bill. Can you cover that, what appears to be an inconsistency?

Ms. WELLERS. Well, in my opinion, if a contractor doesn't have a good balance sheet, or P&L, they shouldn't get a bond. It is a detriment, I think, to the contractor itself. Because if I go, you know, my business, for example, we know that we can do from $1 million to $10 million projects, and I know I couldn't do a $50 million project. So I wouldn't be looking for a bond that size. Plus, you know, when I got into the struggle with the surety bonds, with the individual surety bond that didn't have any assets, we went back to the SBA, and they have a bond program which I was able to get in. And then I spoke to a regular surety, and 2 years later I was back on my feet.

So, you know, unfortunately, not everybody can be bonded and, you know, if you don't, you know, running a business is tough and you need to know a little bit about money and finances.

Mr. COBLE. I thank you, Ms. Wellers.

Mr. Little, as a former acquisition counselor for the Federal Government, what were some of the assets that you saw individual sureties trying to pledge to support their bonds, and why did you find them unacceptable?

Mr. LITTLE. The assets, many of them we couldn't find. The way they were presented was not unlike the way I described in my statement. That is, it would be an asset hiding in a trust, lurking behind another document or another legal instrument, and as you tried to unravel it and unravel it, you would eventually either give up or you would just reject the bond and say we can't figure out what this asset is. We can't figure out not only what the asset is, we can't figure out how we would ever liquidate it if we could ever figure out what it was and if we could ever get our hands on it.

Mr. COBLE. Yeah.

Mr. LITTLE. That is the biggest problem. Now, we did see some obvious things wrong, like one of my earlier ones was Wachovia Bank stock. Now, when you get Wachovia stock, there is nobody to call to ask what Wachovia stock is valid. What you have to do is you have to start with Wachovia. If you ever did that, you would find that it is very hard to find somebody in Wachovia who knows anything about issuances of Wachovia stock and what it might be worth, and whether the CUSIP numbers that were on those stocks were valid. Couple that way the fact, that very—when somebody comes and tells you that they have got an escrow account full of Wachovia stock—I am preaching to the choir, I am sure—but you probably have never seen a stock certificate from Wachovia stock because they don't print them anymore. So one of the problems is, and there is a fair number of anachronisms involved in the process. But when you get something like a stock certificate, you have no idea—you don't have the stock certificate, by the way. The stock certificate was placed in escrow, so you have to call the escrow office to see whether or not that Wachovia's stock is in there, and so forth.

Mr. COBLE. Yeah.

Mr. LITTLE. So it is difficult. We see instruments that you have never heard of in your life before, and you see them on all sorts of fancy paper. You see debentures. You see gold certificates. You see all sorts of amazing documents that ostensibly, if you were to suspend disbelief and pretend like this was a play, you would be very entertained. But if you actually start trying to pull on the threads of these things, it very soon comes unraveled and there is literally no there, there.

Mr. COBLE. Thank you, Mr. Little.

Ms. Barbour, do you believe that individual sureties ought to be able to leverage the same asset several times over to secure multiple surety bonds, and what happens when that asset needs to be liquidated to support more than one bond?

Ms. BARBOUR. Well, the FAR says that the asset cannot be multiple pledged, that it can only be pledged for that transaction. I don't know. First Sealord Surety when they closed their doors, the Pennsylvania regulators closed it when they had $5 million in assets and $200 million in outstanding bond liability. I don't know why they didn't close them any sooner. I don't know how they could exist with $5 million in net worth or surplus to carry on, you know, to support $200 million in bonds.

I think that is a better question for the regulators, and how they regulate corporate sureties, because individual sureties back dollar for dollar for the bond, and it cannot be multiple pledged.

Mr. COBLE. I thank you, Ms. Barbour.

The distinguished gentleman from South Carolina is recognized for 5 minutes.

Mr. GOWDY. Thank you, Mr. Chairman. I also want to thank the gentleman from New York, Mr. Hanna, and the gentleman from South Carolina, Mr. Mulvaney, for their work on this issue.

Mr. McCallum, I believe that Maryland has recently passed a law that changed how individual sureties are accepted for State construction projects. Are you familiar with that, and do you have any initial——

Mr. McCALLUM. Yes, I am familiar with that.

Mr. GOWDY. What is your assessment on how well it is working and why?

Mr. McCALLUM. That law, the Maryland law was passed in 2006, under the intent to benefit or provide an additional market for small businesses wanting to perform public works contracts in the State of Maryland. There is a requirement that the contracting agencies of the State report every 2 years to the General Assembly on the use of that law in getting individual surety bonds on public works projects.

The next report is due out this month. I don't know what it says, but the first two reports basically have indicated that no small business has benefited from the 2006 law, and you can presume certain things. It is not exactly analogous to the Federal requirements. So the State of Maryland decided that they wanted more information about a potential individual surety, and they created an additional affidavit that the surety would actually have to sign a sworn statement where they would have to provide information about criminal convictions and other matters. And that is a requirement that currently we do not have at the Federal level.

Mr. GOWDY. Thank you.

Ms. Wellers, during the course of your litigation with the individual surety on the Federal project you described in your testimony, what other facts did you learn about the owner of the Federal surety company and his assets, if any?

Ms. WELLERS. Oh, I can tell you a lot about him. He—everything they had pledged, he had a balance sheet, I think he was worth $127 million, but you know, really, he had a house in Texas and his own house. I don't think it was worth more than half a million dollars. He had millions of contracts out there where he pledged the same, you know, the same real estate. We ended up, we were doing a job in Florida, and this company was from Alabama, so we ended up just driving by his house, and his office was just, you know, like a double wide, and stuff—not to say that that is bad, but it was not a real company. He would not return our calls. He didn't have—it was him and his wife, so he didn't have a place where you can make a claim. He was just somebody that claimed to have a surety company, and the GSA accepted it.

Mr. GOWDY. Yes, ma'am.

Mr. Little, some individuals complain, I suppose, that this bill would effectively remove them from the surety market. What do you say to those critics?

Mr. LITTLE. I would say that every representation that I have ever seen by an individual surety indicates that they have assets in the hundreds and hundreds of millions, even billions of dollars. I can't imagine anything happening to those firms that have hundreds and hundreds of millions and billions of dollars.

Mr. GOWDY. Thank you, Mr. Chairman. Again, I thank the gentleman from New York, and the gentleman, Mr. Mulvaney, from South Carolina for their work on this issue, and I yield back.

Mr. COBLE. I thank the gentleman from South Carolina, and I want to reiterate what you said regarding—Mr. Hanna, I appreciate your leadership on this bill.

Folks, again, I want to thank you all for your testimony, for your attendance today. I apologize for any delay that may result unfavorably. Blame me for it, don't hold me harmless, in other words.

Without objection, all Members will have 5 legislative days to submit to the Chair additional written questions for the witnesses, which we will forward and ask the witnesses to respond as promptly as they can, so that their answers may be made a part of record.

With that, again, I want to thank you all for being here, and this hearing stands adjourned.

[Whereupon, at 4:50 p.m., the Subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

Statement of the Honorable John Conyers, Jr. for the Hearing on H.R. 3534, the "Security in Bonding Act of 2011," Before the Subcommittee on Courts, Commercial and Administrative Law

Monday, March 5, 2012, at 4:00 p.m.
2141 Rayburn House Office Building

When the federal government enters into a contract, the American taxpayer as well as those who subcontract with the contractor should be protected.

For example, any Federal construction contract valued at $100,000 or more requires a surety bond as a condition of the contract being awarded.

H.R. 3534, the "Security in Bonding Act," purports to strengthen the protection that surety bonds are intended to provide in two ways: (1) by giving discretion to contracting officers to require contractors to use corporate sureties; and (2) by requiring individual sureties to use federally backed cash assets as collateral.

To provide some perspective about H.R. 3534, I have several thoughts.

To begin with, any entity that provides a surety bond should be held to strong underwriting standards. For instance, we know very well what happens when industries are not closely regulated.

Consider mortgage lenders, for example. In a vacuum of regulation, unscrupulous and predatory lenders engaged in practices that hurt not just their borrowers, but ultimately jeopardized the Nation's economy and the financial well-being of all Americans.

Measures that are intended to mandate more reliable collateral standards are to be commended for seeking to reach that goal. Such strengthened requirements should ensure that American taxpayers are not made to pay for the consequences of under-collateralized obligations.

In addition, this bill will help protect so-called "downstream" subcontractors, who very much depend on the economic vitality and performance of the general contractor and its surety.

But we also need to ensure that measures, such as H.R. 3534, do not result in too much of a good thing, which leads me to my second point.

Particularly during these difficult economic times, our role in Congress should not be to construct unnecessary or overly burdensome hurdles to those who want to enter into a particular business or industry.

Small businesses and entrepreneurs are the backbone of our Nation's economy. As a senior White House policy advisor noted last year:

"small businesses and entrepreneurs employ half of America's workers, and create two out of every three new jobs. America's largest, most iconic companies – from McDonald's to Microsoft, from Ford to Facebook – of course, began as small businesses."

Ensuring that unnecessary or unfair barriers to entering the business world do not exist is particularly crucial for small businesses owned by women, minorities, and the disabled. According to the Commerce Department, minority-owned businesses are an "integral part of local, national and global business communities."

These businesses provide critical services, promote innovation, and create needed jobs that "generate trillions of dollars in economic output."

We need to ensure that these businesses continue to be vital contributors to our Nation's economy.

This explains why I need reassurance that H.R. 3534, in fact, will promote the interests of women-owned and minority-owned businesses.

We need to be sure that this measure, by imposing heightened quality standards for individual surety bond providers, does not have the unintended consequence of freezing out otherwise qualified surety providers.

And, finally, we need to have a greater understanding and appreciation of why the bill changes current law with respect to guaranty corporations.

In pertinent part, H.R. 3534 amends section 9304(b) of title 31, which presently prohibits a government official who approves a surety bond from requiring such bond be given through a guaranty corporation. The bill would now allow him to do so.

At a minimum, this provision gives me pause and will require a thorough explanation.

Accordingly, I look forward to the insights that our witnesses will provide on this issue as well as the others that I have raised.

Statement of the Honorable Steve Cohen
for the Hearing on H.R. 3534, the "Security in Bonding Act of 2011"
Before the Subcommittee on Courts, Commercial and Administrative Law

Monday, March 5, 2012 at 4:00 p.m.

2141 Rayburn House Office Building

It is a little hard to know what to make of H.R. 3534, the "Security in Bonding Act of 2011."

I can support the basic premise of its proponents that good underwriting standards for individual surety bonds in federal contracting protects the federal government, taxpayers, and subcontractors on federal projects, many of which are small businesses owned by members of historically disadvantaged groups.

To that end, H.R. 3534 would require individual sureties to pledge as assets a federal public debt obligation like a Treasury bill, just like contractors who wish to pledge collateral as security must do under current law. The bill would ensure that sufficient assets back an individual surety bond, assuring the government and subcontractors in the event that a contractor fails to pull through on its obligations under a federal contract.

While I can support the goal of ensuring sound underwriting practices, one thing I would like to know from this hearing is the scope of the problem that H.R. 3534 is seeking to address.

Several witnesses offer examples of individual sureties that have issued bonds that are backed by insufficient or non-existent assets. However, I have seen no official reports, academic studies, or other comprehensive data outlining how just widespread a problem this is.

Providing such evidence would help this Subcommittee discern the appropriate scope of any legislative fix.

Another thing that struck me about H.R. 3534 is its repeal of the current prohibition on contracting officers requiring contractors to use a corporate surety. I am not sure why concerns about the assets pledged by some individual sureties warrants repeal of this prohibition. The rationale for this repeal is unclear.

Rather, this provision would seem to have the effect of simply eliminating the use of individual sureties in federal contracting, a result I cannot support.

Finally, I am concerned about any efforts that may result in fewer opportunities for emerging contractors, and particularly those that can be categorized as disadvantaged business enterprises.

It is very difficult for such businesses to obtaining bonding from corporate sureties given their lack of credit history or sufficient assets and the unwillingness of corporate sureties to look beyond these factors in assessing whether to post a bond on behalf of a contractor.

Likewise, such emerging contractors are in no position to post their own collateral as security.

Therefore, emerging contractors rely very heavily on individual sureties in order to be able to bid for federal contracts. Any move that threatens to reduce the availability of bonding from individual sureties should also blunt the potential impact on emerging contractors.

I approach H.R. 3534 with an open mind. I am cognizant of the dangers of lax financial regulation and bad underwriting practices, as we have seen in the form of poorly underwritten mortgages and private student loans, the consequences of which our economy will continue to suffer from for years to come.

I hope, however, that the proponents of H.R. 3534 will respond to the points that I have raised. They are real concerns, and it is in proponents' interest that these issues be thoroughly addressed before moving forward.

National Association of Surety Bond Producers
1140 19th Street, NW. Suite 800. Washington, DC 20036-5104
Phone: (202)686-3700
Fax: (202)686-3656
Web Site: http://www.nasbp.org
E-mail: info@nasbp.org

Responses of Mark McCallum, CEO, NASBP, to
Questions for the Record
For the Hearing on H.R. 3534, the "Security in Bonding Act of 2011"
From Ranking Member Steve Cohen

1. What is the rationale underlying the provision in H.R. 3534 that would give discretion to contracting officers to require the use of a corporate surety and what is your response to Ms. Barbour's testimony that this provision would effectively eliminate the availability of individual surety bonds in federal contracting?

   Response: The referenced provision in H.R. 3534 was struck by amendment, and the amended bill was reported favorably by the Committee.

2. You cite the Department of the Interior Advisory Policy Release 2009-15, which notes a number of problems with contracting officers who are unfamiliar with the Federal Acquisition Regulation (FAR) requirements for individual surety and a general lack of experience in reviewing individual surety bonds.

   Why is better training for contracting officers concerning the FAR's individual surety bond requirements not a better way to address the purported problems with collateral used by individual sureties, rather than amending title 31? Should a provision addressing this concern also be included in H.R. 3534?

   Response: Adequate training of federal contracting officers is critical for a competent and efficient procurement workforce. To that end, additional training on surety bonding requirements and procedures is needed and would benefit federal contracting officers, who already are burdened with considerable administrative and procurement tasks. Such training, however, does not supplant the need for statutory changes to the types of assets that individual sureties can pledge on federal contracts. Following all the procedures correctly and ensuring collection of required documentation cannot eliminate instances where "acceptable" assets are volatile, fluctuating in value, or where such assets were pledged with misleading or mistaken documentation about valuation, such as an inflated or incorrect real estate appraisal. H.R. 3534 ensures that only the safest, most stable assets, public debt instruments guaranteed by the U.S. Government, are pledged as collateral on individual surety bonds. This is the current requirement placed on contractors who wish to pledge collateral in lieu of a corporate surety bond. Individual sureties need only convert their own assets to funds to purchase U.S. Treasury notes and other similar instruments. Their principal will be invested in one of the safest investments available and they also will accrue interest. An investment that is stable and safe for the individual surety also will be stable and safe for the contracting agency and any claimants who are unpaid and seek redress against the payment bond furnished by the individual surety.

3. You and other proponents of H.R. 3534 cite anecdotes concerning inadequate or illusory assets backing individual surety bonds. Can you provide statistics, a study, a GAO or DOJ report, or other macroscopic data that illustrate the scope of this problem beyond individual cases?

Response: NASBP is not aware of a recent government study on individual sureties. Several GAO studies were undertaken before and after the Federal Acquisition Regulation requirements governing individual sureties were amended, effective in February 1990, to address cases of individual surety fraud. Specifically, the GAO published a report in October 1989 titled, "SMALL BUSINESS: Individual Sureties Used to Support Federal Construction Contract Bonds," which provided information about individual surety use and losses and problems resulting from such use during the mid to late 1980s. The GAO gathered information about federal agency fraud investigations and bid protests involving individual sureties and summarized those findings. This information was in part a catalyst for reforms to the FAR requirements governing individual sureties. The reforms were intended to "strengthen procedures governing individual sureties," as federal officials were confronted with "widespread evidence of systematic problems" regarding methods of handling individual sureties (see *53 Federal Register 44564-01 (1988)*) and concerns that problems with individual sureties were compromising payment protections for subcontractors and small businesses providing labor and materials on federal construction projects (see report on Senate Hearing 100-384 before the Subcommittee on Federal Spending, Budget and Accounting of the Committee on Governmental Affairs, entitled *Personal Sureties Under the Miller Act: Inadequate Payment Protection for Small Business Construction Subcontractors*). Legal articles written at that time also echoed these observations and concerns (see, e.g., "Christine S. McCommas, *New Developments in Fighting Individual Surety Bond Fraud* 1990-Jan. Army Law. 56). In the background section of the proposed rule published at 53 Fed. Reg. 44564 on November 3, 1987, it is stated that "[e]xperience has shown that the information contained on the SF 28 [Affidavit of Individual Surety] is inadequate." This section continues: "[t]he frequent result is that bonds submitted by individual sureties are uncollectable to the detriment of the Government and suppliers under Government contracts." The final rule, published on November 28, 1989 at *54 Federal Register 48978*, put in place the following:

> "This final rule is issued to make revisions to the FAR procedures governing the use of individual sureties in support of a bonding requirement. Among other things, the revisions would:
> 1. Require individual sureties to pledge specific assets to support a bond.
> 2. Identify and limit the types of assets which are acceptable for pledge based upon a standard of identifiable value and ready marketability.
> 3. Require objective evidence of asset ownership and unencumbered value.
> 4. Require a Government security interest in the pledged assets by means of a lien or real property or the establishment of an escrow account for acceptable personal property.
> 5. Provide for the Governmentwide suspension or debarment of sureties who commit serious improprieties."

A second GAO study was undertaken after the FAR reforms were put in place. The study, published in April 1992 and titled "CONSTRUCTION CONTRACTS: Individual Sureties Had No Defaults on Fiscal Year 1991 Contracts," assessed individual surety use in Fiscal Year 1991. Among the conclusions of the study were the following:

> "It appears that changes to the Federal Acquisition Regulation (FAR) effective in February 1990 to curtail abuse by individual sureties were a step toward strengthening management controls over individual sureties. However, because many of the contracts in our review span several years, it would be premature to say that no problems with individual sureties will emerge."

In 1998, Michael J. Davidson, author of a thesis titled "Combatting Fraud in the Individual Surety Bond Program" written in support of requirements for a degree of Masters of Law from the George Washington University Law School, posited that the 1990 FAR reforms were inadequate to prevent instances of individual surety fraud. Situations arising from the mid-2000s to the present, in part detailed in the oral and written testimony supplied for the hearing on H.R. 3534, make clear that those changes have not been sufficient to prevent problems with individual surety bonds from continuing to occur, costing precious taxpayer funds and jeopardizing the viability of many businesses. Further information on individual surety problems can be found in "The Importance of Surety Bond Verification," by Edward G. Gallagher and Mark H. McCallum, Public Contract Law Journal, Vol. 39, No. 1 (Winter 2010). Even one unscrupulous individual surety, see e.g., George D. Black, Sr. d/b/a Infinity Surety, can be responsible for fraudulent bonds being placed on projects in multiple U.S. jurisdictions and in the tens of millions of dollars.

4. Would you support the inclusion of a GAO study requirement in H.R. 3534 to determine the scope of the problem of inadequate or non-existent assets backing individual surety bonds?

   Response: As reported in oral and written testimony at the hearing on H.R. 3534, considerable evidence of individual surety problems exists on recent federal construction projects, necessitating a response from Congress to protect taxpayer funds and subcontractors and suppliers reliant on the protections of payment bonds. NASBP would support a GAO study focused on information relating to individual surety use on federal projects.

5. Please respond to Ms. Barbour's testimony that H.R. 3534 could threaten emerging contractors, including minority- and women-owned businesses, who rely on individual sureties to obtain bonds that they could otherwise not obtain from a corporate surety given their lack of credit history or assets.

   Response: H.R. 3534 addresses the types of assets that individual sureties may pledge as collateral, requiring only use of safe investments, that is, public debt instruments guaranteed by the U.S. Government. Individual sureties having real assets should not be impacted by H.R. 3534, as such individuals need only to convert his or her existing assets to assets unconditionally guaranteed by the U.S. Government and place such assets in the safe keeping of a federal depository. The individual surety's investment principal and interest will be guaranteed by the federal government and will only be at risk if the bonded contractor defaults on its contract obligations. Such a system should not impact the availability of surety credit from legitimate individual sureties interested in serving emerging businesses, including minority- and woman-owned businesses. For these reasons, national organizations, such as the National Association of Minority Contractors, Women Construction Owners and Executives, USA, and Vet Force (Veterans Entrepreneurship Task Force), support H.R. 3534.

It is worth noting that many more small and emerging construction businesses serve as subcontractors and suppliers, rather than prime contractors, on federal construction projects. For these businesses, the integrity of the payment bond is of paramount importance. By mandating that individual sureties only pledge assets consisting of public debt instruments guaranteed by the U.S. Government, unpaid subcontractors and suppliers can rest assured that real, stable assets back their payment bond remedy and are available to pay their claims, ensuring their cash flow and the continuation of their businesses.

6. What have your members done to help emerging contractors, and particularly those that are disadvantaged business enterprises, obtain bonds so that they can bid for federal contracts, and what additional efforts do you plan to undertake in that regard?

Response: Bonding agencies, employing licensed bond producers, comprise the regular members of the National Association of Surety Bond Producers. Bond producers have a vested interest in helping businesses of all sizes to qualify for surety credit, as they only make commissions upon the issuance of a surety bond for the bonded construction firm. Bond producers work every day to position construction businesses to qualify for and to maintain surety credit. To that end, they act in many critical roles—guide, educator, adviser, and match-maker. Many NASBP bond producers work with small and disadvantaged businesses daily or weekly so they can pursue federal and other public work that requires surety bonds. Many NASBP bond producers also volunteer locally in their communities to make presentations on obtaining surety credit to local business groups, including those representing minority- and women-owned construction businesses.

As an organization, NASBP has an unparalleled commitment to bring bonding education, assistance, and awareness to all businesses seeking surety credit. NASBP, together with the Surety & Fidelity Association of America, publishes and makes available for free through the Surety Information Office web site (www.sio.org) educational pamphlets and other materials to educate small and emerging businesses on the prerequisites for surety bonding. NASBP has been and continues to participate in and support initiatives undertaken by the U.S. Department of Transportation, the U.S. Small Business Administration, and private industry organizations to educate small and disadvantaged construction businesses on ways in which to qualify for bonding. Last year, NASBP members participated in 11 U.S. DOT-sponsored bonding education and assistance workshops presented across the U.S., and NASBP members are participating in additional U.S. DOT bonding education and assistance workshops occurring in 2012. NASBP works with local jurisdictions to present bonding education programs. For example, NASBP currently is in the process of planning a one-day program on bonding education and assistance for small and disadvantaged businesses to occur in or near Baltimore, Maryland in the fall of 2012. In addition, NASBP members have participated in numerous programs conducted by the Surety & Fidelity Association of America around the country to educate and assist small and emerging contractors that have resulted in over $150 million in bonding for these contractors. These contractors now have a relationship with a surety and will be able to continue to develop and to grow.

7. Ms. Barbour suggests that individual sureties should be pre-approved like corporate sureties either by the U.S. Treasury Department or some other entity, together with an appeal process if the individual sureties if it is not included on such a pre-approved list.

Do you agree with her suggestions? If so, should they be included in H.R. 3534?

Response: Because the simple and common-sense statutory changes of H.R. 3534 would ensure that only safe, stable assets would be used as collateral for individual surety bonds and that such assets would be placed under the care and control of the federal government, a more elaborate, time-consuming, and expensive process such as pre-approval of individual sureties by the U.S. Department of the Treasury is not needed. Such a process, however, would be more desirable than the current situation in the absence of the statutory enhancements of H.R. 3534. It should be noted that, in the past, the U.S. Department of the Treasury has refused to become involved with individual sureties or to review them in any way. As such, the Department of the Treasury should be consulted before consideration of any legislative effort in this direction.

8. Ms. Barbour suggests that the Miller Act threshold for federal contracts requiring surety bonds should be higher than the current level in light of the fact that its original $100,000 limit was set in 1934. She suggests a $1 million threshold.

Do you agree with her suggestions? If so, should they be included in H.R. 3534?

Response: The original Miller Act threshold in 1935 was $2,000 (49 Stat. 793). It was increased to $25,000 in 1978 (92 Stat. 2484). The Federal Acquisition Streamlining Act of 1994 (108 Stat. 3342) increased the threshold to $100,000 and indexed it to inflation. Pursuant to the inflation adjustment, and the fact that any increase is in increments of $50,000, the threshold increased to $150,000 effective on October 1, 2010 (75 FR 53129 (8/30/2010)). The initial $2,000 threshold adjusted for inflation actually would have been $31,433 in 2010 (www.westegg.com/inflation/infl.cgi).

Raising the bonding threshold of the Miller Act to $1 million would put at risk payment protections for countless small businesses serving as subcontractors and suppliers on federal construction projects. Subcontractors and suppliers performing federal construction work do not have mechanic's lien rights against federal property. If the prime contractor fails to pay subcontractors and suppliers due to bankruptcy or for other reasons, such subcontractors and suppliers do not have an alternative means to recover their wages, costs, and expenses—that is, they cannot place a lien against the public property and, as parties without direct privity of contract to the federal contracting agency, do not have any recourse against the federal government for payment. Especially vulnerable to nonpayment are small and disadvantaged construction businesses which operate as subcontractors or suppliers and which usually cannot afford to go unpaid on even one project. It does not make sense to jeopardize their statutory payment remedies by increasing the Miller Act bonding threshold to $1 million. Increasing the

Miller Act threshold would be a decided detriment to subcontractors, suppliers, and small and disadvantaged businesses.

Federal contracting agencies using taxpayer funds also will not have the benefit of performance guarantees on contracts less than $1 million. The federal government will retain the risk of loss on such contracts instead of shifting that risk to a knowledgeable surety in the regular business of assessing and guaranteeing performance of construction obligations. A prime contractor default or insolvency on those contracts will necessitate expenditure of additional public funding to remedy the default.

Response of Karen Pecora-Barbour, President, The Barbour Group, LLC to Questions for the Record from Ranking Member Steve Cohen for the Hearing on H.R. 3534, the "Security in Bonding Act of 2011"

1. Please describe the importance of individual sureties to small business contractors, including many disadvantaged business enterprises that seek to bid on federal projects.

   Unfortunately, the SBA bond provisions that enabled support of projects up to $5 million and certain federally funded projects up to $10 million ceased with the sunset of ARRA. Now, the SBA bond program can only support projects up to $2 million. The set aside and sole source projects under many of the federal set aside programs can be as high as $4 million. SDVOB program can sole source projects as high as $5 million. So a large gap exists within the reaches of the SBA bond program.

   Many such firms (minority and small business) do not have the components for a complete underwriting package to secure bonds from a corporate surety. Individual Surety is perfect here because the individual surety can put other safeguards in place to sure up any underwriting deficiencies and be pro-active with any claims. Corporate sureties will not intervene on a potential claim until the contractor has been declared to be in default. This is not true of Individual sureties, at least from my experience. So minority and small business firms typically get greater hands on support from an individual surety to have a successful project.

   The SBA, while they have examples of teaming agreements on their website, will not consider such teaming agreements for bonding. For example, if ABC Minority Contractor has a $15 million job with the Army and is teaming with Gilbane, SBA will not recognize Gilbane as a teaming partner. They will not approve the bond even though ABC Minority is performing $2 million of the work. The contractors could opt to use a Joint Venture model but that takes approval under the 8(A) program. (And, here too, many corporate sureties will not bond JVs where the majority JV owner is the small business prime.) Corporate sureties will often say no to such teaming agreements and if they approve they will often want to impose strict underwriting requirements that make the job impossible to perform. And for teaming support, the larger General Contractor, who is the teaming partner, will want more profit to be involved in the job.

   An Individual surety approaches these types of project models, for the most part, without any collateral as long as the larger General Contractor provides a bond for their portion of work. I just had a bond declined by several corporate sureties. The contractor is a Naval Academy Graduate. He has poor credit and his house was foreclosed upon. One of his church members is a contractor and became his teaming partner. Even with the teaming partner's support the only surety that would approve the bond was an Individual Surety. I have many such stories. My agency, while a small business too, is unique in that it has over 15 corporate surety markets as its vendors. We have a broad reach and even with that reach could not get a corporate surety to approve the bond.

Also, please note that very large companies use individual sureties when their corporate surety says no. For example, the individual surety I use has provided bonds to national federal contractors when their sureties said no because the contractor reached their capacity. While not a minority firm, the job did feed many minority contractors who were employed as subcontractors on the federal jobs.

Take First Sealord Surety--They were T-Listed and Am Best Rated A- (Excellent). Overnight their rating dropped to C+ and they were dropped from the 570 circular. There was no notice to anyone. Contractors are now in default of their contracts. They no longer have a valid bond. First Sealord bonded small and minority firms. They are on the street now. Many have the only option of Individual Surety. First Sealord's bonds were terminated March 8th and their reinsurer, Great American, was exonerated from any liability. This perplexes many agents and contractors!

With Individual Sureties you have dollar for dollar backing with acceptable assets. I think First Sealord was more fraudulent and caused more collateral damage than all individual sureties combined over several years. It appears that an officer of the company walked away with millions of collateral. I have no idea if the collateral was found and returned to the clients of First Sealord. But a contractor I have helped has seen no recovery from First Sealord as yet. Thankfully, we were able to obtain a replacement bond. However, the contractor had to pay the premium (twice).

There is no excess or surplus lines market for bonds like there is for insurance. Individual Surety is it. It is necessary and has healed many financial hiccups for contractors. It allows contractors to build their financial statement in order to gain corporate surety credit, sometimes at preferred rates.

2. Why do emerging contractors have difficulty obtaining bonds from corporate sureties or posting their own collateral as security for federal contracts?

   Access to capital is the biggest reason. Congress should pass a law that prohibits credit reporting authorities from deducting points of a person's credit score if the report was pulled to support their small business needs. Owners of big business do not get their credit scores pulled, only small businesses. By the time the small business owner takes out credit for a copier, desks, car, office space, they could have started at 700 but now are at 625 due to all the dings. And, then they have to apply for bonding. Bonding companies want to see the contractor having a bank line of credit. Once any agent submits a contractor for bonding credit, the corporate sureties pull personal credit reports, too. And, then the score could drop further. It is impossible for a new company to reach perfection for a creditor. It takes time. Individual Surety can give contractors time to reach the perfection they need for corporate surety.

   With the Federal Miller Act requiring bonds for projects $150,000 and higher, there is no way a small business can avoid bonding. If you could set the limits higher, such as $500,000, then the contractor may have the chance to grab worthwhile jobs and build up their experience and financial base without any bonding constraints. But with the limit set so low, they have no choice but to apply for bonding too early in their development.

3. You noted in your written testimony that one provision of H.R. 3534 that would give federal contracting officers the discretion to require the use of a corporate surety would effectively eviscerate the use of individual sureties.

   Why would this eviscerate individual sureties and what impact would this provision have on emerging contractors?

   The code change as outlined in the original HR 3534 gave the contracting officer the ability to only require a corporate surety bond. At present, the Federal Acquisition Regulation does not permit bias over the acceptance and use of corporate or individual surety bonds. If you allow a contracting officer to only ask for corporate surety bonds then many small businesses will not be able to compete or offer up a competitive proposal. HR 3534 was going to do just that. You will, in essence, drive up the price of projects since you will be eliminating a large pool of small contractors with low overhead to bid your projects. A contracting officer would rather just look up a corporate surety on the 570 Circular, see them there and say, "approve," rather than review the assets of the individual surety and seek general counsel's approval.

   When Bob Little was the lead counsel for the Navy he sanctioned contracting officers when they would opt to accept individual surety bonds. An ethics charge was filed against him. I don't know what happened as this is not public information, but Bob Little is no longer counsel for the Navy. The federal government contracting agencies do not tolerate bias.

4. Your fellow witnesses assert that H.R. 3534's enhanced collateral requirements for bonds issued by individual sureties will protect many small businesses and suppliers that serve as subcontractors.

   What is your response?

   I offer no disrespect, but quite candidly, what person or individual surety is going to liquidate their stocks, bonds, marketable assets into cash and earn nothing at the bank? Answer: None. Making cash the only acceptable asset is a death knoll to individual sureties. So the 8,000 contractors that my individual surety has helped will disappear.

   Allegheny Casualty Insurance Company recently sent me their financial statement. Admitted assets are Unpaid Premiums and Assumed Balances, Receivables from Parent Subsidiaries & Affiliates and Net Deferred Taxes, for example. They are material amounts. See attached. So if a corporate surety can use such tenuous assets, why does an individual surety have to put up cash?

   Why cannot federal agencies be mandated to review all individual sureties, and if accepted, put them on a vetted list so agents and contractors and contracting officers can have better ease in making their decisions? How hard could that be?

If you are going to make it tougher for Individual Sureties, you should re-evaluate your admitted assets allowances for corporate sureties to prevent sureties from evaporating like First Sealord.

5. Would you agree that heightened collateral requirements that weed out bad actors from within the individual surety industry would benefit honest and legitimate individual sureties?

   I believe FAR 28.203 is great as it is. I believe that the assets they are allowed are better than what corporate sureties can use. I think the FAR needs to stop excluding stock on NASDAQ and allow for over the counter commodity trades, if this change has not occurred already.

   The individual surety I use is backed by Wells Fargo. Wells Fargo, on their letter head, assures the contracting officer they will receive CASH if the default cannot be cured. Wells Fargo has in their possession already mined coal and they have a security interest in that coal. They will only pledge 75% of its value and for every bond written, a security interest is filed in the name of the contracting officer/unit. Wells Fargo will sell the coal and provide the cash proceeds. The owner/obligee does not get coal. Coal is a commodity and is priced daily. Corporate sureties invest in coal as well. See write up on program from Jones Day.

(I would like to retract in my testimony that the Miller Act was set at $100,000 in 1934. I erred. It was $2000 and did not increase to $100,000 until 1990s. I had little time to prepare my testimony and failed to note my error. Thank you.)

Statement for the Record

Hearing
on
H.R. 3534, the Security in Bonding Act of 2011

March 5, 2012

before

Subcommittee on Courts, Commercial and Administrative Law
Committee on the Judiciary
U.S. House of Representatives

AMERICAN SUBCONTRACTORS ASSOCIATION, INC.
1004 Duke Street, Alexandria, VA 22314-3588
Phone: (703) 684-3450 Fax: (703) 836-3482
E-mail: ASAOffice@asa-hq.com Web: www.asaonline.com

Chairman Coble, Ranking Member Cohen, and Members of the Subcommittee, the **American Subcontractors Association, Inc.** (ASA) expresses its strong support for H.R. 3534, the **Security in Bonding Act of 2011**.

ASA is a national trade association representing subcontractors, specialty trade contractors, and suppliers in the construction industry. ASA members work in virtually all of the construction trades and on virtually every type of horizontal and vertical construction. ASA members frequently contract directly with the Federal Government. More often, they serve as subcontractors dealing with the Federal Government through a prime contractor. More than 60 percent of ASA members are small businesses.

Congressional action with regard to specifying surety bonds on Federal construction contracts is not new. The first statute was enacted by Congress in 1894. The current statute, the Miller Act, was first enacted in 1935. The statement on behalf of the National Association of Surety Bond Producers (NASBP) provides the historical context of the Miller Act and a full explanation of the types and purposes of the surety bonds required by the Miller Act. The required bid bond and performance bond protect the Government, as steward of the taxpayers' money. The required payment bond provides payment protection, of last resort, for the subcontractors and suppliers who have performed their obligations in furtherance of a Federal construction contract. ASA's Statement for the Record focuses exclusively on the importance of the payment bond and how payment bonds provided by individual sureties are essentially worthless, unless the pledged assets are real, adequate in amount, and readily available to meet the legitimate payment claims of the myriad subcontractors and suppliers performing on a typical modern Federal construction contract.

The statement of Bob Little provides the Subcommittee a comprehensive overview of the participation of individual sureties in Federal construction since the 1980s and the practical challenges faced by Federal contracting officers under the existing regulatory framework. Mr. Little speaks with great authority as a renowned contracting professional who spent his career in public service, most notably his many years with Naval Facilities Engineering Command (NAVFAC), a major buyer of construction within the Department of Defense.

ASA participated actively in the various regulatory efforts to assure that the payment bonds furnished by individual sureties actually provide the real payment protections for subcontractors and suppliers intended by the statutory mandate of the Miller Act. The use, and abuse, of individual sureties have tended to be episodic in nature. Unfortunately, the construction industry, and especially small subcontractors and suppliers, are currently facing another sustained episode. The potential for inadequate or worthless payment bonds to be furnished by individual sureties has been exacerbated by the advent of increasingly convoluted forms of financial instruments and the sustained overload of responsibilities that currently are being required of a deeply understaffed corps of Federal contracting officers and supporting acquisition professionals.

The current coverage of the Government-wide Federal Acquisition Regulation (FAR) Subpart 28.2 (Sureties and Other Security for Bonds) provides the contracting officer very solid guidance, but implementation can be compromised by severe challenges, especially if the individual surety is determined and skilled in gaming the system. The core challenge for the contracting officer relates to assessing the assets being pledged by the individual surety in support of the surety bonds being furnished to the Government. Do the assets being pledged actually exist? What is the real value of the pledged assets? Can the pledged asset, although real and properly valued, be readily liquidated? Claims against a payment bond under the Miller Act are generally paid in cash, not, for example, timber "available" to be harvested for milling.

By training and experience, even the most seasoned contracting officer in the acquisition of construction is likely at a distinct disadvantage in making these determinations with regard to the broad array of assets acceptable under FAR Part 28.203-2. The challenge is presented not only with regard to real property and raw commodities, often in locations remote from the contracting officer's location, but also by increasingly opaque forms of "secure" financial instruments. The determined individual surety has the ability to mount a focused and lengthy effort to get the contracting officer to accept the proffered assets. Today, the typical contracting officer has too many contract award and contract administration actions on-going simultaneously and too few supporting staff resources. To get forward motion on the award of a particular construction contract for the benefit of the ultimate Federal user, the contracting officer may be willing to acquiesce, especially if the exposure to the Government is relatively small due to the small likely contract award value of the contract, especially in this era of contracts valued in hundreds of millions of dollars, if not billions. A payment bond from an individual surety providing only illusory protection can, however, easily result in a catastrophic loss to a small subcontractor or supplier on that "small" contract.

Given the Government's responsibility as steward of the taxpayers' money, as well as the practical limitations of the current FAR-based system for the protection of subcontractors and suppliers, ASA believes that Congress needs to enact remedial legislation to deter those individual sureties who succumb to the temptation to misrepresent the assets being pledged in support of the surety bonds that they are furnishing.

H.R. 3435, the Security in Bonding Act of 2011, is such a targeted Congressional intervention. It simply applies to individual sureties the same standards currently permitted by the Miller Act (31 U.S.C. 9303) for a prime contractor choosing to furnish "eligible obligations" rather than a surety bond. When H.R. 3435 becomes law, Federal contracting officers will be able to have certainty that the assets pledged by an individual surety are real, sufficient in amount, and readily available should any payment claims arise. For ASA, construction subcontractors and suppliers will be able to have confidence that the bonds furnished by the individual surety will provide the payment protection of last resort intended by the Miller Act.

In conclusion, ASA would like to offer its observations on the testimony of another witness who asserted that restrictions on surety bonds provided by individual sureties will be detrimental to emerging small business concerns seeking to grow by becoming prime contractors on Federal construction opportunities. She emphasized that small business concerns, owned and controlled by minorities, women, Service-Disabled Veterans and other Veterans will be among the hardest hit. ASA believes that the hard data suggest that small business concerns of all types are more likely to perform as subcontractors and suppliers on today's typical large-scale Federal construction projects. To these small subcontractors and suppliers, at every tier, it is paramount that the Miller Act payment bond required for their protection is actually backed by assets that are real, adequate in amount, and sufficiently liquid to be available to pay a claim for payment of the amounts due to them for the work that they have fully performed.

In addition, ASA remains a strong supporter of the programs operated by the Small Business Administration (SBA) to facilitate access to surety bonds issued by corporate sureties that have been vetted and approved by the Department of the Treasury. SBA's Surety Bond Guarantee Program has helped many small business concerns to obtain the surety bonds that they needed to compete for Federal prime contract opportunities in construction. ASA was a major participant in the coalition that supported the legislation sponsored by former Senator Sam Nunn of Georgia that provided a statutory basis for the SBA's Preferred Surety Bond Guarantee Program. The Preferred Surety Bond Guarantee Program substantially broadened the pool of corporate sureties willing to participate in the SBA program assisting yet additional numbers of small business concerns. As noted by another witness, the effectiveness of these SBA Surety Bond Guarantee programs has been diminished by the maximum dollar value of an eligible construction contract. The steady increase in the size of Federal construction contracts and the steady decrease in the overall number of prime contract opportunities have further contributed to the reduced utility of these valuable SBA programs. Unfortunately, in ASA's opinion, since the mid-1990s, these programs have not been accorded the appropriate financial resources in the fierce annual competition for increasingly scarce Federal budgetary resources. Addressing both of these limitations would have diminished the current resurgence in demand for surety bonds from bonding sources of last resort, individual sureties, especially those willing to furnish bonds backed by inadequate or simply mythical assets. Unfortunately, neither of these enhancements to the SBA's Surety Bond Guarantee Programs is within the jurisdiction of the Committee on the Judiciary.

Chairman Coble, thank you for so promptly scheduling this legislative hearing. ASA urges equally prompt, and favorable, action by the Full Committee on the Judiciary, under the leadership of Chairman Smith.