

Report to the

Governor of the State of Maryland

and

**Senate Education, Health, and
Environmental Affairs Committee**

and

**House Health and Government
Operations Committee**

on

Individual Surety Bonds

Fiscal Year 2007

As required by Chapter 299, Laws of 2006

Submitted by:

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EXECUTIVE SUMMARY

State Procurement Law requires bid, performance, and payment security for construction contracts expected to exceed \$100,000.¹ State Procurement Law authorizes – but does not require – bid security for non-construction contracts expected to exceed \$50,000.² State law authorizes – but does not require – performance and payment security on non-construction procurement contracts if the contract is expected to exceed \$100,000.³ One traditional form of security is a bond issued by a surety company authorized to do business in the State (corporate surety).⁴ The General Assembly enacted legislation that permitted *individuals* to issue bonds (individual surety).⁵ An individual surety bond differs from a corporate surety bond in that it is secured by assets from an individual in contrast to being secured by the assets of a corporate surety company. The law became effective October 1, 2006.

The Procurement Advisor of the Board of Public Works is tasked with reporting to the Governor; the Senate Education, Health, and Environmental Affairs Committee; and the House Health and Government Operations Committee regarding the implementation of this law including its impact on small and minority businesses.

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¹ State Finance and Procurement Article, §§13-207 and 17-103, Annotated Code of Maryland

² COMAR 21.06.07.02

³ State Finance and Procurement Article, §§13-207 and 17-104

⁴ State Finance and Procurement Article, §§13-207 and 17-104

⁵ Chapter 299, Laws of 2006

I. Background

Bid, performance, and payment security is required for construction contracts over \$100,000. Security is discretionary for other types of contracts regardless of dollar amount. Typically, in response to State solicitations, bidders submit bonds issued by surety companies.⁶ But State law authorizes bid, payment, and performance security in other forms⁷ including:

- Cash or bank-certified check
- Pledge of securities
- Irrevocable letters of credit
- Bonds issued by individual sureties

The 2006 General Assembly added the latter category of bonds issued by an *individual surety* to provide more State contracting opportunities for businesses unable to obtain corporate bonding.⁸

Although State Procurement Regulations provide discretion to procurement agencies to reject any type of security (including individual surety bonds)⁹, the Board of Public Works has instructed agencies that “*all* acceptable security should be permitted if the procurement officer requires bid, performance, or payment security.”¹⁰ Agencies must consider the following before excluding any acceptable forms of security:

- Impact on small and minority businesses participation
- Whether setting guidelines for the category of security is possible rather than excluding the security altogether
- Degree of risk to the State if all acceptable security is permitted

The Board of Public Works adopted regulations on an emergency basis to quickly implement the individual surety law in Spring 2007.¹¹ The Board has adopted those regulations as final.¹² The Board also issued an Advisory to guide State procurement officers and their assistant attorneys general.¹³

⁶ The surety company must be authorized to do business in the State. State Finance and Procurement Article, §§13-207(d) and 17-104(a)(1)

⁷ COMAR 21.06.07.01(B)

State Finance and Procurement Article, §§13-207, 13-216, and 17-104

⁸ Chapter 299, Laws of 2006

⁹ COMAR 21.06.07.01(F)

¹⁰ Board of Public Works Advisory 1996-3 (www.bpw.state.md.us/procurement/advisories.asp)

¹¹ 34 *Maryland Register* 824 April 27-2007) (AELR grants emergency status: 3/31/07-9/27/07)

¹² COMAR 21.06.07

¹³ Board of Public Works Advisory 2006-4 (www.bpw.state.md.us/procurement/advisories.asp)

Scope of Report. The General Assembly tasked the Procurement Advisor of the Board of Public Works with reporting to the Governor; the Senate Education, Health, and Environmental Affairs Committee; and the House Health and Government Operations Committee regarding the implementation of the Law during the immediately preceding fiscal year, including the impact on small and minority business enterprises.

II. Requirements For Acceptable Individual Surety Bonds

To be an individual surety bond acceptable to a State procurement agency, the following must be demonstrated:

1. The contractor has been denied bonding by a corporate surety;
2. The individual surety only transacts business through an insurance agency licensed by the Maryland Insurance Administration;
3. The individual surety attaches an Affidavit of Individual Surety (template included in Board Advisory);
4. The individual surety is a U.S. citizen (corporations and partnerships cannot act as individual sureties);
5. The individual surety pledges one or more of the following assets in an amount equal to or greater than the total penal amount of the bond.
 - (i) Cash or certificates of deposit;
 - (ii) Cash equivalents held with a federally-insured financial institution;
 - (iii) Certain assets evidenced by a security interest including irrevocable trust receipts;
 - (iv) U.S. Government securities at market value;
 - (v) Stocks and bonds that meet certain criteria;
 - (vi) Real property that meets certain criteria; or
 - (vii) Irrevocable letters of credit that meet certain criteria.

Before accepting a bond from an individual surety, the procurement officer must consult with the Office of the Attorney General to determine whether the requirements for an individual surety bond have been met.

Pledged Assets. Following are further requisites for the assets that the surety pledges.

Personal property. An individual surety must provide a current UCC-1 financing statement at the time the bond is furnished for the personal property assets listed above (not real property). The financing statement is filed to perfect the State's security interest in the property and establishes its priority in case of debtor default or bankruptcy.

Real property. Pledged real property must be located in the State and owned by the contractor or individual surety in fee simple or by cotenants that all agree to act jointly.

III. FY 2007 – Actual Use of Individual Surety Bond

Based upon Board staff research, in FY 2007 only *one* individual surety bond was submitted in response to a State solicitation.¹⁴ A certified small business submitted the individual surety bond.¹⁵

IV. Discussion

In preparation for this Report, Board staff met with representatives from the Governor’s Office of Minority Affairs, the Maryland Washington Minority Contractors Association, and the individual surety bond industry. The following questions were posed:

Do small and minority businesses have difficulty obtaining bonds from corporate sureties?

There is a continuing need for alternative forms of security for small and minority businesses, especially start-up companies that may not have the financial history to qualify for bonds from corporate sureties.

Why aren’t individual surety bonds being used by contractors unable to obtain corporate bonding? As far as we can tell, only one bidder submitted an individual surety bond in the past fiscal year.

- Businesses feel that State agencies will reject individual surety bonds because they are comfortable and familiar only with the format and content of corporate bonds.
- Businesses have alternatives. There are alternatives for businesses unable to obtain corporate bonding. Once a business is denied by a corporate surety, it may be eligible to apply to the surety bond program with the Maryland Small Business Development Authority (MSBDFA). The General Assembly established MSBDFA in 1978 to promote establishing and expanding economically and socially disadvantaged entrepreneurs and small businesses.¹⁶

¹⁴ The bond was subsequently rejected by the State Highway Administration.

¹⁵ Tessa Structures, LLC

¹⁶ In 2001 the client base was expanded to include all small businesses that are not able to obtain financing through more traditional means

MSBDFA reports it approved fifteen bond transactions in FY 2007 for a total of \$12.9 million.¹⁷ All of the transactions were bonding lines of credit that businesses could use for several contracts simultaneously. State Law also authorizes other forms of security such as irrevocable letters of credit.¹⁸

- There is only one Maryland insurance agency serving individual sureties.¹⁹
- Businesses and State procurement officers are unaware of the individual surety bond law.

What can the State do to ensure small and minority businesses successfully use individual surety bonds when they have been denied bonds by corporate sureties?

State agencies and businesses must be trained to increase their confidence in individual surety bonds. For its part, the Board of Public Works has issued an Advisory (available on our Web site) and conducted training at the June 2007 Statewide Procurement Conference. The Board has requested the Office of the Attorney General to train its attorneys in handling individual surety bonds.

The Governor's Office of Minority Affairs has networked with general contractors to apprise them of the State's individual surety bond program and the expanded bonding opportunities for prospective subcontractors. They also briefed MBE liaisons to increase awareness within State agencies.

The Maryland Washington Minority Contractors Association has offered to coordinate an effort to bring together State agencies and minority contractors to train and discuss individual surety bonds and State procurement procedures.

¹⁷ Maryland Department of Business and Economic Development, Summary Report of the Surety Bond Program as of June 30 2007

¹⁸ COMAR 21.06.07.01

¹⁹ The Barbour Group in Westminster, Maryland

V. Recommendations

- **Training.** Although much has been done in the first year the law has been in effect, it is clear that more training is needed. The relatively complex structure of individual surety bonds adds to the training challenges. Each primary procurement unit, in coordination with the Office of the Attorney General, must ensure their procurement officers are familiar with the laws, policies, and forms associated with individual surety bonds. There should be a standardized curriculum so that all procurement officers are assessing individual surety bonds consistently and effectively.
- **Outreach to small and minority businesses.** Training confronts only part of the problem. Small and minority businesses are not yet using individual surety bonds for State procurements. Representatives of the business community indicate that there is not yet a feeling of confidence that State agencies will embrace the use of individual surety bonds. To alleviate some of that concern, procurement agencies should include specific language in each solicitation addressing the acceptability of individual surety bonds. Small and minority business organizations can offer additional training to their members about alternative forms of security (other than corporate bonds), including the use of individual surety bonds.

VI. Conclusion

Because, the State procures billions of dollars annually in goods and services, the State must maximize opportunities for businesses to compete for State dollars. Small and minority businesses, especially start-up businesses, bear the additional burden of accessing bonding in a tight market. An individual surety bond can be an important asset to ensure small and minority businesses are given every chance to participate in State procurement.