

SECURITY IN BONDING ACT OF 2012

APRIL 27, 2012.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. SMITH of Texas, from the Committee on the Judiciary, submitted the following

R E P O R T

[To accompany H.R. 3534]

[Including cost estimate of the Congressional Budget Office]

The Committee on the Judiciary, to whom was referred the bill (H.R. 3534) to amend title 31, United States Code, to revise requirements related to assets pledged by a surety, and for other purposes, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

CONTENTS

	Page
The Amendment	1
Purpose and Summary	2
Background and Need for the Legislation	2
Hearings	4
Committee Consideration	4
Committee Votes	4
Committee Oversight Findings	5
New Budget Authority and Tax Expenditures	5
Congressional Budget Office Cost Estimate	5
Performance Goals and Objectives	6
Advisory on Earmarks	6
Section-by-Section Analysis	6
Changes in Existing Law Made by the Bill, as Reported	7

The Amendment

The amendment is as follows:
Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the “Security in Bonding Act of 2012”.

SEC. 2. SURETY BOND REQUIREMENTS.

Chapter 93 of subtitle VI of title 31, United States Code, is amended—
(1) 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

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

“9310. Individual sureties.”.

SEC. 3. GAO STUDY.

(a) STUDY.—The Comptroller General of the United States shall carry out a study on the following:

(1) All instances during the 10-year period prior to the date of the enactment of this Act in which a surety bond proposed or issued by a surety in connection with a Federal project was—

(A) rejected by a Federal contracting officer; or

(B) accepted by a Federal contracting officer, but was later found to have been backed by insufficient collateral or to be otherwise deficient or with respect to which the surety did not perform.

(2) The consequences to the Federal Government, subcontractors, and suppliers of the instances described under paragraph (1).

(3) The percentages of all Federal contracts that were awarded to small disadvantaged businesses (as defined under section 124.1002(b) of title 13, Code of Federal Regulations) and disadvantaged business enterprises (as defined under section 26.5 of title 49, Code of Federal Regulations) as prime contractors in the 2-year period prior to and the 2-year period following the date of enactment of this Act, and an assessment of the impact of this Act and the amendments made by this Act upon such percentages.

(b) REPORT.—Not later than the end of the 3-year period beginning on the date of the enactment of this Act, the Comptroller General shall issue a report to the Committee on the Judiciary of the House of Representatives and the Committee on Homeland Security and Government Affairs of the Senate containing all findings and determinations made in carrying out the study required under subsection (a).

Purpose and Summary

H.R. 3534, the Security in Bonding Act of 2011, amends the requirements that an entity must satisfy in order to bid on or perform work for the United States government under a Federal contract. Specifically, the bill requires that, to secure a contractor’s obligation to complete a project, an individual surety must post collateral in a manner and of a nature that is consistent with what would be required of a contractor electing to bypass the requirement that it secure a surety bond from an entity approved by the U.S. Department of Treasury. Such heightened collateral requirements will ensure that taxpayers, subcontractors, and suppliers will be better protected.

Background and Need for the Legislation

A surety bond refers generically to any one of the bonds that provides security to another party in a contracting relationship. When the Federal Government needs construction services, it solicits bids from contractors. Each bidding contractor posts a bid bond to assure the government that the contractor is willing to accept the bid if it is the winning bidder. Without skin in the game, a bidder may be inclined to lowball several government contracts, get one or two, and walk away from the others, leaving the government to re-budget or look again for another contractor to perform the job. Once a bid is won, the contractor posts a payment bond to guarantee pay-

ment to downstream subcontractors, and a performance bond to assure the United States that it will perform the contract according to its terms. Without a performance bond, the contractor could, for example, perform half the project and then take up another more lucrative project, leaving the government in the lurch.

The Miller Act, 40 U.S.C. §§ 3131–34, requires contractors on Federal projects to give security to subcontractors and to the Federal Government in connection with a Federal contract. Under the Federal Acquisition Regulation, there are three methods by which security can be furnished. A contractor may supply a bond by a reliable corporate surety.¹ Corporate sureties are vetted by the Treasury Department to ensure they are sufficiently capitalized and are listed on Treasury Circular 570.² Alternatively, a contractor may individually provide to the government a possessory security interest in low-risk assets, such as U.S. bonds or notes, or furnish to the government a letter of credit or other right to draw on cash or cash equivalents upon default.³ Finally, a contractor may secure a bond from an individual surety.⁴ Individual sureties are not listed on Circular 570 and are not vetted by the Treasury Department.

Whereas the government and subcontractors have substantial security when they have recourse to a corporate surety bond or to low-risk collateral posted by a contractor individually, the classes of qualifying collateral permitted under the F.A.R. for individual sureties provide relatively little security. First, an individual surety need not provide a possessory security interest in collateral. Under Uniform Commercial Code Articles 8 and 9, a nonpossessory security interest in investment and other intangible property may be trumped by a possessory security interest or by sale to a bona fide purchaser. The government therefore stands to get primed if these assets are pledged subsequent to their use to support an individual surety bond. Moreover, F.A.R. 28.203–2 permits an individual surety to post any exchange-traded security as collateral; F.A.R. 28.203–3 even allows for the pledge of real property. These classes of collateral are far less secure than low risk cash equivalents like T-bills required to be furnished by individual contractors.

The lack of Treasury Department oversight over individual sureties and the relatively relaxed collateral requirements for individual surety bonds has led to some notable instances in which the United States and/or subcontractors on Federal projects have been left without recourse. For example, in March 2010, Federal agents arrested a man in Fort Worth, Texas, in connection with the sale of worthless surety bonds through his company, Infinity Surety. “According to allegations in the complaint, these bonds were used to insure various multi-million dollar construction project [sic] and were purportedly backed up by a single family residence in Tarrant County with a 2008 tax appraisal value of \$130,700.”⁵ In other

¹ Federal Acquisition Regulation (*hereinafter* F.A.R.) 28.201.

² UNITED STATES DEPARTMENT OF TREASURY, Circular 570 (updated Feb. 17, 2012), *available at* <http://www.fms.treas.gov/c570/index.html>.

³ F.A.R. 204–204.4.

⁴ F.A.R. 203.

⁵ Press Release, United States Department of Justice, Forth Worth Man Arrested and Charged in Alleged \$25 Million Nationwide Scheme to Sell Fraudulent Securities, Mar. 26, 2010.

cases, the Federal Government has had the foresight to reject bonds backed by insufficient security.⁶

One legislative solution to improve the security of the United States and subcontractors on Federal jobs would be to eliminate the individual surety market altogether. With a lighter touch, the Security in Bonding Act of 2011 simply requires individual sureties to post collateral of equal security to the collateral that an individual contractor would have to pledge if he or she chose to secure payment or performance individually.

Some small contractors, and particularly disadvantaged business enterprises⁷ (DBE's) and others seeking to enter the Federal contracting industry, may raise some concern about H.R. 3534. While DBE's who serve as subcontractors can benefit from the enhanced collateral requirements for individual sureties contemplated by H.R. 3534, those seeking to be prime contractors may be wary to the extent that the bill makes obtaining bonds more difficult, as the enhanced collateral requirements for individual sureties may drive some individual sureties out of the bonding industry. Emerging contractors already face difficulty in obtaining the necessary surety bonds to bid for and perform Federal contracts because of their lack of sufficient assets, causing a cycle where a lack of assets leads to an inability to obtain bonding, which, in turn, prevents them from obtaining work that allows them to build up their assets. Some emerging contractors are concerned that H.R. 3534 may have the unintentional effect of making their already difficult bonding situation worse by reducing the number of individual sureties available.

Hearings

On March 5, 2012, the Subcommittee on Courts, Commercial and Administrative Law held a legislative hearing on H.R. 3534 and heard testimony from: Mark McCallum, the CEO of the National Association of Surety Bond Producers; Jeanette Wellers, the President and CFO of JBlanco Enterprises, Inc.; Robert Little, Jr., a former government contracting officer; and Karen Barbour, President of The Barbour Group, LLC.

Committee Consideration

On March 20, 2012, the Committee met in open session and ordered the bill H.R. 3534, as amended, favorably reported by voice vote, a quorum being present.

Committee Votes

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the Committee advises that there were

⁶See, e.g., *Tip Top Constr. v. U.S.*, 563 F.3d 1338 (D.C. Cir. 2009) (approving Federal Government's rejection of individual surety bond backed by an "allocated portion of \$191,350,000.00 of previously mined, extracted, stockpiled and marketable coal, located on the property of E.C. Scarborough" because asset was not readily marketable as required by the F.A.R.).

⁷"Disadvantaged business entities" are for-profit small business concerns where socially and economically disadvantaged individuals own at least a 51% interest and also control management and daily business operations. 49 C.F.R. § 26.5 African Americans, Hispanics, Native Americans, Asian-Pacific and Subcontinent Asian Americans, and women are presumed to be socially and economically disadvantaged. United States Dep't of Transp., Office of Small and Disadvantaged Utilization, *Definition of a DBE*, available at <http://osdbu.dot.gov/DBEProgram/definitions.cfm>.

no recorded votes during the Committee's consideration of H.R. 3534. Mr. Cohen offered an amendment striking a provision that would have given contracting officers discretion to require the use of a corporate surety and adding a GAO study requirement. The Committee adopted the amendment by voice vote.

Committee Oversight Findings

In compliance with clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee advises that the findings and recommendations of the Committee, based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

New Budget Authority and Tax Expenditures

Clause 3(c)(2) of rule XIII of the Rules of the House of Representatives is inapplicable because this legislation does not provide new budgetary authority or increased tax expenditures.

Congressional Budget Office Cost Estimate

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the Committee sets forth, with respect to the bill, H.R. 3534, the following estimate and comparison prepared by the Director of the Congressional Budget Office under section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, April 16, 2012.

Hon. LAMAR SMITH, CHAIRMAN,
Committee on the Judiciary,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 3534, the "Security in Bonding Act of 2011."

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Matthew Pickford, who can be reached at 226-2860.

Sincerely,

DOUGLAS W. ELMENDORF,
DIRECTOR.

Enclosure

cc: Honorable John Conyers, Jr.
Ranking Member

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

As ordered reported by the House Committee on the Judiciary on
March 20, 2012.

H.R. 3534 would amend Federal law regarding the use of certain surety bonds by the private sector for work on Federal construction

projects. Specifically, the legislation would strengthen the collateral requirements for individual sureties. H.R. 3534 also would require a report by the Government Accountability Office (GAO) on the use of surety bonds by Federal contractors over the past 10 years.

CBO estimates that implementing H.R. 3534 would cost less than \$500,000 a year, subject to the availability of appropriated funds for GAO to produce the required report. Enacting the bill would not affect direct spending or revenues; therefore, pay-as-you-go procedures do not apply.

Under current law and regulation, contractors on Federal projects are required to insure their performance to subcontractors and the Federal Government in connection with Federal construction projects using surety bonds. Surety bonds provide financial guarantees that contracts will be completed according to mutual terms; if a contract is not completed, the bonds are available to cover the losses. Based on information from the General Services Administration, private contractors, and bond providers, CBO expects that agencies would continue to receive contracts at the lowest price available and the proposed changes to some collateral requirements under H.R. 3534 would not affect the cost of procuring construction services.

H.R. 3534 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would not affect the budgets of State, local, or tribal governments.

The CBO staff contact for this estimate is Matthew Pickford. This estimate was approved by Peter H. Fontaine, Assistant Director for Budget Analysis.

Performance Goals and Objectives

The Committee states that pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, H.R. 3534 amends title 31, United States Code, to improve the financial security of the United States when it contracts on Federal projects.

Advisory on Earmarks

In accordance with clause 9 of rule XXI of the Rules of the House of Representatives, H.R. 3534 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9(e), 9(f), or 9(g) of Rule XXI.

Section-by-Section Analysis

Section 1. Short Title.

Provides the bill may be referred to as the Security in Bonding Act of 2011.

Section 2. Surety Bond Requirements.

Adds new 31 U.S.C. §9310, requiring that, when Federal law permits acceptance of a surety bond from a producer not subject to Federal oversight, the producer give a possessory security interest in low-risk assets to the Federal Government to provide such security.

Section 3. GAO Study.

Requires GAO to study the instances in which an individual surety has been rejected by the U.S. government or accepted and later found to be deficient; the impact of the bill on the Federal Government, subcontractors, and suppliers; and the percentage of Federal contracts awarded to small disadvantaged businesses and disadvantaged business enterprises.

Changes in Existing Law Made by the Bill, as Reported

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (new matter is printed in italics and existing law in which no change is proposed is shown in roman):

TITLE 31, UNITED STATES CODE

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SUBTITLE VI—MISCELLANEOUS

* * * * *

CHAPTER 93—SURETIES AND SURETY BONDS

Sec.

9301. Definitions.

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9310. *Individual sureties.*

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§ 9310. *Individual sureties*

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(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).

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