

STATE OF MARYLAND  
*Board of Public Works*

GOVERNOR • TREASURER • COMPTROLLER

# Individual Surety Bonds Report

to the

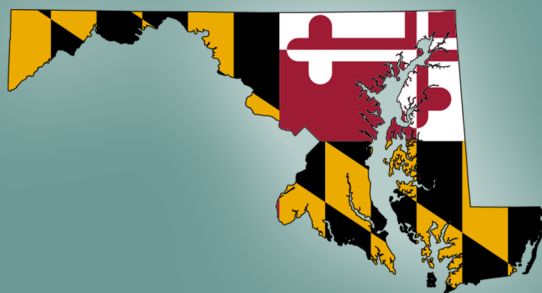
Governor of the State of Maryland

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Senate Education, Health, and  
Environmental Affairs Committee

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House Health and Government  
Operations Committee



Chapter 299, Laws of 2006 as amended by CHapter 266, Laws of 2008

## Fiscal Year 2012-2013

**Board of Public Works**

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# EXECUTIVE SUMMARY

State Procurement Law requires bid, performance, and payment security for construction contracts expected to exceed \$100,000.<sup>1</sup> State Procurement Law authorizes – but does not require – bid security for non-construction contracts expected to exceed \$50,000.<sup>2</sup> 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.<sup>3</sup> One traditional form of security is a bond issued by a surety company authorized to do business in the State (corporate surety).<sup>4</sup> The General Assembly enacted legislation that authorized *individuals* to issue bonds (individual surety).<sup>5</sup> 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 individual surety bond program sunsets on September 30, 2014.<sup>6</sup>

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.

One individual surety bond was submitted to a State agency during the FY 2012 - FY 2013 reporting period. The bond was rejected by the agency because the bidder failed to demonstrate that it had been denied credit by a corporate surety as required by State procurement law.<sup>7</sup> In the seven years since agencies began reporting to the Board, only one other individual surety bond has been submitted to the State<sup>8</sup>.

## BOARD OF PUBLIC WORKS

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**April 14, 2014**

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<sup>1</sup> State Finance and Procurement Article, §§13-207 and 17-103, Annotated Code of Maryland.

<sup>2</sup> COMAR 21.06.07.02

<sup>3</sup> State Finance and Procurement Article, §§13-207 and 17-104

<sup>4</sup> State Finance and Procurement Article, §§13-207 and 17-104

<sup>5</sup> Chapter 299, Laws of 2006

<sup>6</sup> Chapter 266, Laws of 2008

<sup>7</sup> COMAR 21.06.07.02.

<sup>8</sup> A bond submitted in 2007 was ultimately rejected by the State Highway Administration.

## I. Background

State Procurement Law requires bid, performance, and payment security for construction contracts expected to exceed \$100,000.<sup>9</sup> State Procurement Law authorizes – but does not require – bid security for non-construction contracts expected to exceed \$50,000.<sup>10</sup> 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.<sup>11</sup> 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.<sup>12</sup> Typically in response to State solicitations, bidders submit bonds issued by surety companies.<sup>13</sup> But State law authorizes bid, payment, and performance security in other forms<sup>14</sup> 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.<sup>15</sup> In FY 2013, the General Assembly passed the Subcontractor Equal Access to Bonding Act to further improve the bonding environment for small businesses.<sup>16</sup> The Law prevents prime contractors who require subcontractors to provide bid, performance, or payment security on State procurements from imposing more stringent bonding requirements than the State imposes on prime contractors.

Although State agencies have discretion on which types of security they will accept<sup>17</sup>, 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.”<sup>18</sup> 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

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<sup>9</sup> State Finance and Procurement Article, §§13-207 and 17-103, Annotated Code of Maryland

<sup>10</sup> COMAR 21.06.07.02

<sup>11</sup> State Finance and Procurement Article, §§13-207 and 17-104

<sup>12</sup> MDOT may require bonds for certain maintenance projects, but agencies typically do not impose bonding requirements on projects other than construction.

<sup>13</sup> 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)

<sup>14</sup> COMAR 21.06.07.01(B)

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

<sup>15</sup> Chapter 299, Laws of 2006

<sup>16</sup> Chapters 504 and 505, Laws of 2013

<sup>17</sup> COMAR 21.06.07.01(F)

<sup>18</sup> Board of Public Works Advisory 1996-3 ([www.bpw.state.md.us/procurement/advisories.asp](http://www.bpw.state.md.us/procurement/advisories.asp))

- Degree of risk to the State if all acceptable security is permitted

## II. Surety Basics

A surety bond is a contract among an obligee (State), a principal (Contractor) and a surety (individual or corporate). The obligee owns the project and is the recipient of the contractual obligation; the principal is the party performing the contractual obligation; and the surety promises to cover any losses incurred by the State if the principal cannot fulfill the contractual obligation. Individual sureties are natural persons –as opposed to corporations – who offer to bind themselves on bid, performance and payment bonds.

**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 every two years regarding the implementation of the Law during the immediately, including the impact on small and minority business enterprises.

## III. Requirements For Acceptable Individual Surety Bonds

To submit an individual surety bond acceptable to a State procurement agency, the bidder or offeror must demonstrate that:

- a) It has been denied bonding by a corporate surety;
- b) The individual surety transacts business only through an insurance agency licensed by the Maryland Insurance Administration;
- c) The individual surety attaches an Affidavit of Individual Surety;
- d) The individual surety is a U.S. citizen (corporations and partnerships cannot act as individual sureties);
- e) 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:
  - 1) Cash or certificates of deposit;
  - 2) Cash equivalents held with a federally-insured financial institution;
  - 3) Certain assets evidenced by a security interest including irrevocable trust receipts;
  - 4) U.S. Government securities at market value;
  - 5) Stocks and bonds that meet certain criteria;
  - 6) Real property that meets certain criteria; or
  - 7) 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.<sup>19</sup>

*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.

#### **IV. Use of Individual Surety Bonds**

The Maryland Transportation Authority received one individual surety bond during the reporting period. No other State agency reported receiving a bond. MdTA ultimately rejected the individual surety bond citing several factors including: (1) failure to execute a bond equal to or exceeding the penal amount of 5% of the bid amount submitted; (2) failure to provide any documentation that the contractor had been denied credit by a corporate surety; (3) failure to submit an executed State individual surety affidavit; (4) failure to provide evidence of the individual surety transacting business through an insurance agency licensed by the MIA; and (5) failure to provide evidence that the individual surety was a United States citizen.<sup>20</sup>

The Maryland Small Business Development Financing Authority, which offers bonding to small businesses through its surety bond program, received only four surety bond applications in FY 2013.<sup>21</sup> Although bonds are required for most construction projects, agencies reported an overall decrease in the number of procurements requiring bonding.

The Maryland Insurance Administration took a comprehensive look at the practices of corporate and individual sureties in the State. In its report titled, *Final Report on the Analysis of the Practices of Corporate Sureties and Individual Sureties in Maryland*, MIA confirmed that use of individual surety bonds has been limited over the past seven years - not only in State projects - but in county and municipal projects as well.<sup>22</sup> They recommended that the laws authorizing the use of individual sureties in the State be permitted to sunset, restoring the Commissioner's regulatory authority

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<sup>19</sup> The pledge asset requirements are important because they provide guidelines to procurement officers for assessing the risk to the State in accepting individual surety bonds.

<sup>20</sup> MdTA report to the Board dated

<sup>21</sup> MSBDF A FY 2013 Annual Report

<http://www.choosemaryland.org/aboutdbed/Documents/ProgramReports/2013/MSBDF A Annual Report FY13.pdf>

<sup>22</sup> 2013 Final Report on the Analysis of the Practices of Corporate Sureties and Individual Sureties in Maryland.

<http://www.mdinsurance.state.md.us/sa/docs/documents/news-center/legislative-information/corporate-sureties-and-individual-sureties-final-report-2013.pdf>

over all persons issuing surety bonds or contracts of surety insurers in the State.<sup>23</sup> The Law will sunset on September 30, 2014.

## **V. Recommendation**

Even though the individual surety bond program will sunset in a few months, agencies should continue their efforts in ensuring that bonding requirements are not unduly restrictive on competition. Agencies should include information on bonding assistance, like the MSB DFA program, in all solicitations with a bonding requirement.

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<sup>23</sup> MIA Report at p. 14.