BEWARE OF INADEQUATE OR FRAUDULENT SURETY BONDS

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A surety bond is only as good as the surety issuing it. A surety that is not itself financially sound cannot add to the credit standing of its principal. Surety is regulated as a type of insurance, and to some extent an owner, contractor or subcontractor can depend on the state insurance departments and the United States Department of the Treasury to perform financial due diligence. There are also several private organizations, most prominently A.M. Best Company, that issue financial ratings of insurers. Although the bond is normally legitimate, a prudent owner, contractor or subcontractor should take steps to assure that the bond will, in fact, provide the promised protection.

CORPORATE SURETIES

Regulated insurance companies write the vast majority of surety bonds. Contractors and subcontractors should check with the insurance department of the state where the bond is issued to verify that the surety company is authorized to write surety bonds. Surety companies wishing to write Miller Act bonds on federal construction projects must possess a certificate of authority from the U.S. Department of the Treasury. A list of surety companies approved to write bonds to the United States, Department Circular 570, is available at www.fms.treas.gov/c570/c570_a-z.html. The name of the surety and the name of the insurance company should be an exact match. There are instances in which unlicensed entities used a name that was very similar to a legitimate surety company.

The fact that the surety company is genuine and solvent is not sufficient if the company did not authorize the bond. The easiest way to confirm that the bond was authorized is to contact the surety directly. Treasury Department Circular 570 includes the telephone number of the Treasury Listed sureties, and The Surety & Fidelity Association of America's website has a Bond Obligee's Guide that identifies whom to contact to verify bonds issued by its members.

The danger of relying on just the name of a legitimate surety is illustrated by a recent criminal case in the United States District Court for the Middle District of Florida in which a Maryland resident, William Raymond Miller, pled guilty to mail and wire fraud in furnishing fraudulent bonds that purported to be issued by legitimate sureties. The Department of Justice Press Release of December 11, 2008, describing the guilty plea stated, "On numerous occasions, Miller made it appear that he was issuing bonds in the names of legitimate insurers … Miller issued surety bonds with a face value of over $535 million and received premium payments of over $22.5 million during the course of the fraud." (http://jacksonville.fbi.gov/dojpressrel/pressrel08/bondfraud121108.htm).

INDIVIDUAL OR PERSONAL SURETIES

There is a long history of fraud by individuals claiming to act as sureties on construction contract bonds. For state or private projects, surety is regulated by the states as a type of insurance. Unfortunately, state insurance departments have typically enforced their laws by issuing cease and desist orders, which have not proven to be effective in preventing abuse. See, for example, http://www.dora.state.co.us/Insurance/enforcement/2007/O07-065.pdf (ABBA Bonding/Morris C. Sears) and http://www.insurance.wa.gov/oicfiles/orders/2004orders/D04-189.pdf (Global Bonding/Robert Joe Hanson).

The United States will accept individual surety bonds on federal government construction projects if certain stringent requirements are met. The surety must place cash or cash equivalents equal to the amount of the bonds in escrow with a federally insured financial institution or provide the government with a deed of trust on real property to secure the bond. See Federal Acquisition Regulations (FAR) §28.203, et seq. (48 C.F.R. §§28.203 et seq.).

Prior to amendments effective on February 26, 1990, the FAR permitted acceptance of individual sureties based on a sworn statement from the surety that his or her net worth was sufficient to cover the bond obligations. In many instances, this sworn statement was found to be false and the assets illusory. The FAR amendments required the deposit of cash or cash equivalents, and excluded various types of assets that fraudulent individual sureties often claimed on their sworn statements. The change was comparable to a bank stopping unsecured lending based on the borrower's representations and instituting secured lending based on a security interest in specific, verified assets.

There is no central authority, such as the U.S. Department of the Treasury, to vet proposed individual surety bonds. The contracting officer has to evaluate them during the course of a particular procurement. This places a significant administrative burden on federal contracting officers who possess differing levels of knowledge regarding surety bonds and the kinds of assets required to back individual surety bonds under the FAR. Contracting officers are sometimes fooled by artfully crafted submissions that appear impressive but have no substance. See, U.S. Dept. of Treasury, Financial Management Service, "Special Informational Notice to All Bond-Approving (Contracting) Officers," dated February 3, 2006 at http://fms.treas.gov/c570/special_notice.pdf.

An owner or prime contractor tendered a bid or performance bond, or a subcontractor or supplier asked to provide labor or material in reliance on a payment bond, should not assume that someone else has done its due diligence. Anyone relying on a bond should obtain a copy and verify that there is a legitimate surety that will be financially responsible. If the surety is not a regulated insurer, the assets pledged to back the bond should be verified. An attorney can help check on any criminal record, bankruptcies, or cease and desist orders issued against the purported surety.

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