

Bond Waivers Hurt More than Help in a Bad Economy

In an economy that is slowly recovering, contractors continually are looking for work to keep their businesses going, their workers employed and their equipment fully utilized. In particular, contractors have been looking to be awarded the public projects that are being funded through the \$787 billion economic stimulus that Congress enacted early in 2009. In some cases, the contractors looking for public projects have left the residential construction market are looking for public work for the first time. Legislators at the state and federal level have tried to help contractors, especially small and emerging contractors, get public jobs in the current economy by waiving the bonding and other requirements for public procurement.

There was an attempt in the U.S. Senate that failed this year to permit surety bonds to be waived for any public project funded by the economic stimulus package. Shortly thereafter, the Oregon Department of Administrative Services (the Department) adopted temporary emergency procurement rules that permitted state procurement officers to waive performance bond or payment bond requirements for projects funded under the 2009 "Go Oregon!" economic stimulus package. The temporary rules will expire in August, and legislation was defeated later in the session that would have allowed the emergency rules to be extended to January 2012.

Legislation was introduced late in the session in New York that would have created a small business mentoring program under which the Metropolitan Transportation Authority (MTA) would have been able to waive many state procurement requirements. Small businesses would have been partnered with an MTA-selected construction manager mentors for four years, during which that they could have been awarded MTA public works projects with the mentor in amounts not to exceed \$1 million. The MTA would have been permitted to waive requirements for bid, payment and performance bonds, competitive bidding, awards to the lowest responsible bidder and the anti-directed insurance and surety provisions for small businesses participating in this mentoring program. In the first year of the program, the aggregate amount of contracts let under this program could not be less than \$10 million or more than \$100 million. The legislation was defeated in the New York Senate.

Ohio enacted a bond waiver program as part of its state budget. Contractors now will be permitted to do four state projects without bonding. The first project done without bonding may be up to \$25,000, after which a contractor can obtain a contract of up to \$50,000 without providing the bonds required by law. The third contract without bonding is for a project up to \$100,000, and the fourth is for a project of up \$300,000. The bond amounts for unbonded work for contracts with local governmental entities are \$25,000, \$50,000, \$100,000 and \$200,000.

Contractors must be participating in a contractor assistance program for the first two unbonded projects and must have successfully completed such a program in order to obtain the last two

unbonded projects. A contractor has to successfully complete one unbonded job in order to be awarded another one.

While these were well-intended efforts this year to help contractors obtain public work, all such legislation could have hurt contractors and taxpayers far more than helped them. Since mechanics liens cannot be asserted against public property, laborers, subcontractors and suppliers on public projects must rely on the general contractor's payment bond for protection. If this bond is waived, these parties are left with no means to collect for their services and supplies if the contractor is unable or unwilling to pay them. Small and emerging contractors are more likely to start as subcontractors. If no bonds are in place, such subcontractors and suppliers will either have to risk losses from non-payment that they cannot afford, or not work on the public jobs for which they are qualified. In the current economy, contractors need payment protection all the more.

The performance bond ensures that the project is completed with the state and local taxpayers paying only the contract price. If a performance bond is not provided, the taxpayers take on the risk that the contractor will default. If no bonds are in place and a default occurs, the state and local contracting entities will bear the burden of re-letting work and paying any excess completion costs. Those costs ultimately are borne by the taxpayers. Most state and local budgets currently have little or no leeway to absorb the extra completion costs from a contractor default.

Since waiving bond requirements permits contractors to bid on public projects without being required to provide payment and performance bonds, the result can be that financially unstable contractors, who cannot otherwise obtain bonding and are not pre-qualified by sureties, will be bidding and obtaining public construction projects. This increases the risk of nonpayment for subcontractors and the risk of default to the state and its taxpayers.

In Oregon, state procurement officers have not used their temporary powers to waive bonds. In Ohio, state and local procurement agencies face the difficult task of implementing their new law. Will state and local government have to let contracts for which some of the bidders have to provide bid security and others do not? How many jobs can a small and emerging contractor bid in order to get that first unbonded job? Who will keep track of how many times a small and emerging contractor bids to obtain a contract, and who will know if the contractor is on their first, second, third or twentieth contract without bonds? Contractors are going to be bidding without bonds to various state and local entities. What mechanism exists to detect and prevent a contractor from doing four unbonded jobs and then starting all over under a different company name and/or a change in ownership? If contractors are bidding on a job without bonds against other bonded contractors, in the absence of the surety, who will review the unbonded contractors to see if they can complete the job and when in the process will such qualification be done?

Letting a job in Ohio which the bids of small and emerging contractors do not have to include bid and final bonds, and in which the bids of other contractors must include bonding, may well increase bid protests in Ohio. Under the Ohio procurement laws, the state is required to accept the "lowest responsible and responsive bidder." For the State's political subdivisions, it's the "lowest and best" bidder. What if an unbonded small contractor is the low bidder? Do the public

contracting entities in Ohio have enough authority under the statutory standards of “responsible and responsive” bidders and “best” bidders to award the contract to a bonded contractor? The new law may turn Ohio’s procurement process into a contentious and litigious one.

There is good public policy for the universal requirement of surety bonds on public works projects. These bonds guarantee that the project will be completed and that subcontractors, suppliers and laborers on the project get paid. If the surety backs a contractor that defaults on the project, the full amount of the surety bond is available to complete the work and to pay those who performed work on the job. It makes even less sense in a weak economy to waive the protections of the pay and performance bonds required by state and federal law.