

The Surety & Fidelity Association of America

1101 CONNECTICUT AVENUE, NW, SUITE 800, WASHINGTON, DC 20036 TEL: (202) 463-0600 – FAX: (202) 463-0606
website: <http://www.surety.org>
E-mail: information@surety.org

July 9, 2010

Via Federal eRulemaking Portal

Docket Management Facility
U.S. Department of Transportation
1200 New Jersey Avenue, SE
West Building, Ground Floor
Room W12-140
Washington, DC 20590-0001

**Re: Notice of Proposed Rulemaking
Office of the Secretary, Department of Transportation (“DOT”)
Disadvantaged Business Enterprise: Program Improvements
Docket No. OST-2010-0118**

The Surety & Fidelity Association of America (SFAA) is a trade association of approximately 450 companies that are licensed to provide surety and fidelity bonds. SFAA members collectively provide the vast majority of payment and performance bonds on federal and state construction projects. We appreciate the opportunity to submit comments regarding the captioned Rulemaking. In particular, our comments address the Rulemaking’s invitation to suggest strategies for fostering small business participation. 75 Fed. Reg. 25815, 25820. In addition, our comments address the Rulemaking’s request for comments regarding “discriminatory or excessive bonding practices,” such as the requirement of allegedly duplicative subcontractor bonding. *Id.* at 25820-21.

Strategies to improve access to contracts

A performance bond secures a contractor’s obligation to perform fully the contract. A payment bond secures the contractor’s obligation to pay its subcontractors and suppliers. The federal government and all states have statutes that require a performance bond and payment bond on public construction projects. The federal government’s bond requirements are set forth in 40 U.S.C. 3131 *et seq.* Thus, sureties have a close relationship with contractors and have a strong interest in developments that affect contractors’ access to contract opportunities. In particular, SFAA has a

keen interest in policies and programs that provide access for small contractors to contracting opportunities.

Proposed 26 CFR 26.39 requires recipients to include in their DBE programs an element to “facilitate competition by small business concerns” and to eliminate obstacles to participation, “including unnecessary and unjustified bundling of contract requirements.” Although necessary in certain cases, bundling and the size of contracts are significant obstacles to small business access to contracting opportunities. Because bundled contracts have significant durations and encompass a sizeable scope, they reduce the number and frequency of opportunities for small businesses to bid on and be awarded public work. These larger procurements are at odds with the goal to enhance contracting opportunities for small businesses. SFAA agrees that the unnecessary and unjustified bundling of contracts is a significant obstacle to small contractor access. The decision to bundle a contract, particularly a contract receiving DOT funds, should be transparent and subject to restrictions setting forth when a bundling decision is appropriate. Further, bundling decisions should be subject to scrutiny by DOT, thereby providing more small construction firms with the opportunity to participate as prime contractors on public construction projects.

In addition to controlling the frequency of contract opportunities that are bundled, recipients should consider other strategies for improving small contractor access. First, mentor/protégé programs and joint ventures with larger contractors could provide a means for small contractors to participate in public construction projects. With the involvement of a larger contractor, the small contractor can take advantage of the expertise and experience (and perhaps the financial support) of the larger contractor.

Second, teaming agreements provide a means for a small contractor to undertake a larger project, short of entering into a joint venture. The larger contractor, often acting as a subcontractor, lends its resources and expertise to the project. In many cases, the small contractor is able to obtain the required performance and payment bonds because the larger contractor has agreed to provide the surety its financial backing, with the necessary disclosures to the government agency.

Third, technical assistance programs provide a complimentary benefit of assisting the contractor’s development of skills and resources, thereby facilitating access to surety bonds. For a public project, providing a performance bond and a payment bond is a condition of contract award. Therefore, access to surety bonding is an integral component of facilitating access to contract opportunities. However, this close connection between access to bonding and access to contracting opportunities often leads to a false conclusion that the bond requirement alone stands as the obstacle to a small contractor’s access to contract opportunities. The starting point on which all agree is that it is in the government’s and the public’s interest that projects are awarded to qualified contractors. One of the services of a surety bond is prequalification. Before providing a bond, a surety reviews the capabilities and capacity of the contractor and makes an assessment of that contractor’s qualification. So, by focusing on enhancing the contractor’s qualifications, access to contract

opportunities and access to bonding will follow. In other words, enhancing the contractor's qualifications, not waiving or reducing the bond requirement on a particular project, is the key to facilitating access. For this reason, SFAA maintains that technical assistance is the most effective means to facilitate a contractor's access to bonding.

SFAA has worked with several government agencies in implementing its Model Contractor Development Program. This program includes an educational component, which involves up to 10 workshops that provide contractors information in areas such as project management, estimating and construction accounting – issues that are directed toward helping the contractor run a successful business. The program also includes a bond readiness component, which involves on-going counseling sessions with volunteer surety professionals who work with the contractors in assembling the materials necessary for a complete bond application and in addressing any omissions and/or deficiencies that might deter the successful underwriting of a bond. The success and effectiveness of the program has led to DOT and SFAA entering into a Memorandum of Agreement (“MOA”) dated March 16, 2010. Under the MOA, SFAA will assist DOT to “design, develop and implement a component of the DOT OSDBU Bonding Education Program (BEP).” The MOA explained that BEP is a bond assistance program to provide bonding education, placement and technical assistance to small businesses competing for, or awarded, transportation-related contracts.” We suggest that § 26.39 should include technical assistance programs, including DOT's Bonding Education Program, as a strategy to improve access to contracts.

Discriminatory practices

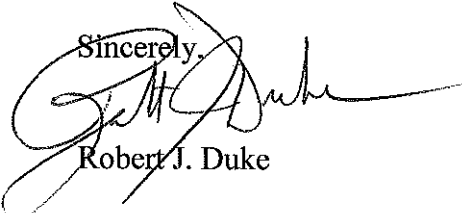
The Rulemaking requests comments regarding “discriminatory or excessive bonding practices,” such as the requirement of allegedly duplicative subcontractor bonding. We are not certain about the intended meaning of the term, “discriminatory or excessive bonding practices.” However, if the term is meant to refer to a surety declining to provide a bond solely on the basis of the contractor's disadvantaged status, we reject the notion. Bonds are written or not written on the basis of the contractor's qualifications and capabilities and not on the basis of the contractor's disadvantaged status. As explained above, SFAA and the industry are focused on facilitating access to bonding for small and emerging contractors. The most effective means to facilitate access is by enhancing the contractor's qualifications through technical assistance programs such as DOT's BEP program. Surety companies are for-profit enterprises and generate revenues by charging premiums for bonds that are written. In addition to the societal benefit in facilitating access for small contractors and DBE contractors, it is in a surety company's economic interest to expand its market to include small and disadvantaged contractors. It is no surprise that SFAA members strongly support the Model Contractor Development Program.

If the term, “excessive bonding practices” is meant to refer to requirements by which the contractor must provide a performance bond and a payment bond in the amount of 100% of the contract price, reducing the required bond amount to an amount less than 100% of the contract price will not

improve access. As noted above, a performance bond secures the contractor's obligation to perform the contract. A payment bond secures the contractor's obligation to pay its subcontractors and suppliers. In determining whether to provide the bonds, a surety company makes an assessment of the contractor's capability and financial strength to perform the obligations of the contract. The surety's assessment must take into account the size and scope of the underlying obligation, the construction contract. The risk to the surety is that the contractor will not be able to complete the contract. If the contractor defaults, the surety's obligations under the bond are triggered. Therefore, the surety's financial and other underwriting thresholds are based on the size of the contract, not the size of the bond. No matter the size of the bond, the bond secures the performance of the whole contract. To a surety underwriter, a bond that is in the amount of 100% of the contract price presents essentially the same risk to the surety as a bond that is in the amount of 50% of the contract. Because the surety's assessment of risk and underwriting thresholds do not change with a lower bond amount, reducing the required amount of the performance and payment bonds will not affect availability to any significant degree.

The Rulemaking referenced an "excessive" practice of requiring that a subcontractor provide bonds that duplicate bonds provided to the project owner. The bonds that must be provided by subcontractors to the prime contractor ("subcontractor bonds") are not duplicative of bonds provided by the prime contractor to the owner ("prime bond"). The beneficiary of the protections differs. The prime bond protects the project owner against the prime contractor's default of the contract. The project owner is the claimant under the performance bond provided by the prime contractor. The subcontractor bonds protect the prime contractor against a subcontractor's default of its subcontract. The prime contractor is the claimant under the performance bond provided by the subcontractor. The decision to require subcontractor bonds is part of the prime contractor's risk management strategy, in the same way the prime contractor may require the subcontractors to obtain other types of insurance. Moreover, the payment bonds provided by a subcontractor may protect subcontractors and suppliers at a lower tier than those protected by the payment bond provided by the prime contractor. Subcontractor bonds and prime bonds serve different purposes and have different scopes of protection.

SFAA shares DOT's interest in enhancing small contractor access to contract opportunities. We would be happy to discuss our comments further. Thank you for your consideration.

Sincerely,

Robert J. Duke