

Written Testimony of
The National Association of Surety Bond Producers, Inc.

Before the Nevada General Assembly
Committee on Government Affairs

In Opposition to
AB 345 (Neal)



March 23, 2015

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The National Association of Surety Bond Producers (NASBP) is a national trade organization of professional surety bond producers, whose membership includes businesses employing licensed surety bond producers placing bid, performance, and payment bonds in Nevada and elsewhere in the United States. NASBP appreciates the opportunity to provide written testimony in strong opposition to A.B. 345 before the Assembly Committee on Government Affairs.

A.B. 345 Removes Essential Protections from Nevada Taxpayers and Businesses

NASBP lauds Representative Neal and Senator Ford for recognizing the importance of providing opportunities to small and emerging contractors, so they may participate on state, local or municipal construction contracts. Unfortunately, there may be unintended consequences if A.B. 345 were enacted into law. Those same constituents, which Representative Neal and Senator Ford are attempting to help, may fall victim to those unscrupulous individual sureties who prey on such small businesses. There are well-documented situations, which include Nevada (see below) where assets pledged by individual sureties have proven to be illusory or insufficient, causing significant financial harm to taxpayers, contractors, subcontractors and suppliers, many of whom are small businesses wholly reliant on the protections of payment bonds to safeguard their businesses.

Following is a summary of our concerns:

- NASBP strongly opposes any measure that would exempt a surety insurer conducting business in Nevada from being subject to the oversight and control of the Insurance Commissioner.
- It is vital for purposes of protecting consumers and taxpayers that all sureties, whether natural persons or corporations, be subject to adequate oversight and control in the jurisdiction in which they conduct business.
- Under A.B. 345, any individual, regardless of character, experience, financial wherewithal, or commitment to pay claims, could write surety bonds on public contracts in Nevada and would be able to sidestep any state insurance grievance or recourse process.
- Individuals acting as surety insurers in the state would be outside the protections of the Nevada insurance code, and those purchasing or relying on the protection of individual surety bonds would exist in a continual market state of “no rules.”
- With no oversight and control in place, Nevada residents would have no governmental safeguards, placing them at the mercy of individuals who may lawfully conduct surety business without any verified ability to do so. Under A.B. 345, no requirements exist for any Nevada authority to examine whether individuals acting as sureties have criminal, tax lien, or personal insolvency histories.
- Nevada businesses mistakenly may assume that individual sureties, as surety insurers, are being regulated and audited by the Insurance Commissioner and may not perform the higher level of due diligence required in the “no rules” environment.
- Surety bond producers, have vested interests in assisting construction firms of all types and sizes, including small, emerging, and disadvantaged businesses, to qualify for surety credit and to earn their bond commissions. Bond producers welcome vibrant surety markets for their clients, but the sureties operating within those markets must be adequately regulated. What confidence can a bond producer possibly have in placing his or her clients with an unregulated surety insurer, when his or her reputation and his or her business liability will be on the line?

For these and the expanded reasons following, we urge you not to support A.B. 345!

Regulation is necessary for public protection

NASBP believes that it is vital for purposes of protecting consumers and taxpayers that all insurers, whether natural persons or corporations, be subject to adequate oversight and control in

the jurisdiction in which they conduct business. The state's interest in regulating and imposing certain minimum requirements, such as capital and financial reporting requirements, on those who conduct surety business in the State of Nevada is paramount to protect the state's and taxpayer resources, its citizens, and the businesses that rely upon the protection of the surety bond product. Thus, NASBP opposes any measure that would exempt a surety insurer conducting business in the state of Nevada from being subject to the oversight and control of the Insurance Commissioner.

The Importance of Surety Bonds: Sound Public Policy

Surety bonds are three-party contract agreements by which one party (a surety) guarantees or promises a second party (the obligee-e.g. state or local contracting authority) the successful performance of an obligation by a third party (the principal). In deciding to grant surety credit, the surety underwriter conducts an-depth analysis, also known as prequalification, of the capital, capacity and character of the firm during the underwriting process to determine the firm's ability to fulfill contractual commitments. Surety bonds are an essential means to discern qualified construction companies and to guarantee contracts and payments, ensuring that vital public projects are completed, subcontracting entities are paid, and jobs are preserved.

The Nevada Legislature recognized the importance of surety bonds in 1963 by enacting Chapter 339, "Contractors' Bonds on Public Works" for "state, county, city, town, school district, or any public agency of the State or its political subdivisions which has authority to contract for the construction, alteration or repair of any public building or other public work or public improvement."

Types of Surety Bonds

The bid bond assures that the bid has been submitted in good faith and the contractor will enter into the contract at the bid price and provide the required performance and payment bonds. A performance bond protects the project owner (the state of Nevada) and ultimately the taxpayers from financial loss should the contractor fail to perform the contract in accordance with its terms and conditions. The payment bond protects subcontractors and suppliers, which do not have direct contractual agreements with the public owner and which would be unable to recover lost wages or expenses should the contractor be unable to pay its financial obligations. Often, small construction businesses must access the state procurement marketplace at subcontractor and supplier levels, and the payment bond is their primary recourse and protection in the event of prime contractor nonpayment or insolvency

Interest of the Bond Producer RE: A.B. 345

Bond producers are licensed and regulated by the Nevada Insurance Department. They play vital roles in the construction procurement process. They stand as the "bridge" between construction firms and surety companies. The bond producer works closely with construction businesses of all sizes, serving as an advisor, educator, and matchmaker to position these businesses to meet underwriting requirements to obtain surety credit.

The objective of the bond producer is not only to assist the construction firm with obtaining surety credit for each contract requiring surety credit but to ensure that the firm's business remains viable and thrives for years to come. Bond producers often are asked by construction firms to help them assess the strength and reputation of a surety furnishing a bond to which the

firm is a beneficiary. They understand that the financial strength and stability of the surety is the key to the success of the surety bonding system.

A surety that is not sound financially cannot add to the credit standing of the firm to which it has bonded. Moreover, such a surety will not supply the protection promised by the bond. As a result, bond producers advocate for well-regulated surety markets and protection for consumers of surety insurance, thereby protecting taxpayers and businesses from the actions of unscrupulous and financially unsound surety insurers and promoting consumer confidence in the surety marketplace.

The State of Maryland Enacted Similar Legislation in 2006

The Maryland General Assembly passed a law in 2006 permitting use of unlicensed individual sureties to write surety bonds for prime contracts on state projects without obtaining a certificate of authority from the Maryland Insurance Administration (MIA) as an authorized insurer. NASBP opposed the measure since it created an unregulated market, but the bill was enacted presumably for the purpose of providing increased bonding opportunities to small and emerging businesses. As part of the law, state agencies were required to report annually to the General Assembly about the effectiveness of the law in accomplishing that aim. Interestingly, three reports made by the Board of Public Works to the General Assembly indicated that small businesses did not benefit from the law. Originally, the law was set to sunset in 2009 but it was extended until September 30, 2014. Ultimately the law was permitted to sunset but not without legislative attempts from individual surety proponents to extend the sunset.

The MD Insurance Administration Examines Corporate and Individual Sureties

The MIA conducted an analysis of the practices of corporate and individual sureties in the State to determine whether or not it would recommend that the law sunset as scheduled in 2014. Some of the key findings were that MIA did not find any evidence to support a conclusion that corporate sureties are unable to meet the needs of the current construction market and recommended that the laws authorizing the use of unregulated individual sureties on public works contracts in the State be permitted to sunset as scheduled on September 30, 2014. More importantly, the MIA determined that individual sureties had engaged in misleading and harmful conduct in Maryland and in other jurisdictions.

The MIA concluded that: “In order to better safeguard the public against the issuance of fraudulent surety bonds or contracts of surety insurance, all sureties doing business in the State should be required to obtain a certificate of authority issued by the Commissioner and should be subject to the same level of regulatory oversight required for corporate sureties under Maryland law.” A copy of the analysis is submitted along with this testimony.

Individual Sureties: Examples in Nevada

Of particular concern are sureties that exist outside of the current state regulatory structure. Surety companies must possess a certificate of authority to act as a surety insurer in every state within which they conduct surety business. They must file and receive approval of the rates they charge for their bonds. Likewise, all states, except Alaska, do not exempt natural persons acting individuals sureties from obtaining a certificate of authority as a surety insurer.

There are examples where individual sureties have conducted business in Nevada outside of legal requirements. For example, the Nevada Insurance Department, in 2004, issued a cease and desist

order against Robert Joe Hanson for conducting business as Global Bonding without a license. Subsequently, Hanson received a substantial fine from the Department. Hanson, who as acted under a number of alias, aka Robert Joe Lyon, aka Dennis Joe Lyon, aka “Chief Joe Blue Eyes” has issued bonds as an individual surety and through unauthorized surety companies (e.g., Global Bonding, Millennium Bonding Enterprises, Shonto Surety, Southwest Surety, or Navajo All Risk, Inc. and Native American Funds Management Services) on numerous private and public contracts, including federal contracts. Hanson has a long history of issuing fraudulent bonds that continues to the present. From 2004 to 2010 the Montana Commissioner of Securities and Insurance fined Dennis Lyon \$645,561¹ for supplying bid and performance bonds without a license and without verifiable assets to support these bonds. In October 2012, Hanson was fined an additional \$155,000 by the Montana Commissioner, which includes \$148,000 in restitution for Fort Belknap Tribal Construction on the Fort Belknap Indian Reservation for Hanson’s unlicensed individual surety company, Native American Funds Management Services². A number of state insurance commissioners have issued cease and desist orders against Hanson, including those in California, Connecticut, Florida, Georgia, Montana, **Nevada**, Ohio, Texas and Washington. These orders, however, have not deterred Hanson from continuing to issue worthless bonds by changing aliases and jurisdictions

Examples of Improper Individual Surety Activity

Even though little statistical data on individual surety problems is available, because individual sureties operate outside of state insurance regulatory structures, these situations usually involve individual surety bond assets that turned out to be inadequate, illusory, or unacceptable.

One illustration is *United States ex rel. JBlanco Enterprises Inc. v. ABBA Bonding, Inc.*, where, in spite of a March 11, 2005 cease and desist order from the Alabama Insurance Department, Mr. Morris Sears, doing business as ABBA Bonding, was able to submit bonds on a federal contract in Colorado supported by an affidavit (Standard Form 28) stating that ABBA Bonding had assets with a net worth of over \$126 million. Although no assets were placed in escrow for the benefit of the federal government, the U.S. General Services Administration accepted the bonds anyway. JBlanco Enterprises, a small business 8a subcontractor performing work on federal contracts, nearly was forced to declare bankruptcy as a result of a deficient individual surety bond placed by Mr. Sears on a federal project that later proved to have no assets to support the bond. Ms. Jeanette Wellers, a principal of JBlanco Enterprises, provided oral and written testimony³ about this situation during a hearing on March 5, 2012 before the U.S. House Committee on the Judiciary Subcommittee on Courts, Commercial and Administrative Law.

Sears eventually sought bankruptcy protection against numerous creditors (100+) arising from defaulted bond obligations, including protection against bond debts owed to three federal contracting agencies. Chief Bankruptcy Judge Margaret A. Mahoney, U.S. Bankruptcy Court, Southern District of Alabama held that Sears had “knowingly made misrepresentations regarding collateral he pledged in support of surety bonds.”⁴ Judge Mahoney also found that Sears falsely stated that the real estate had not been pledged to any other bond contract within three years prior to the execution of any Affidavit and that Sears made misrepresentations to numerous agencies. Thus, the Bankruptcy Court determined that that Sears’ debts to the government were

¹ Richey, Erin. “Montana Adds to Fines Against Alleged Surety Con Artist”. *ENR*. December 4, 2012.

² *Ibid*.

³ Wellers, Jeanette. Written Testimony before U.S. House Committee on the Judiciary Subcommittee on Courts, Commercial and Administrative Law. March 5, 2012.

⁴ United States. Department of Justice. US Attorney’s Office. Southern District of Alabama. “Pensacola Man Indicted in Government Contract Surety Bond Fraud Scheme”. June 28, 2012.

nondischargeable. His false statements then formed the basis of a criminal indictment against Sears, who underwent criminal prosecution in the U.S. District Court for the South District of Alabama and subsequently died before sentencing.

In another example, Edmund Scarborough, the owner of IBCS Fidelity, who issued numerous bonds across the country as an individual surety using irrevocable trust receipts and other interests, recently filed for personal bankruptcy. In his bankruptcy petition, this individual surety listed \$4.5 million in assets and \$16.2 million in liabilities. Scarborough often pledged a speculative commodity, mined coal waste, which he valued at \$191 million, to back his individual surety bonds. That mined coal waste was valued at \$120,000 in the bankruptcy filing.⁵

Another notable example surfaced in March 2010, when George Douglas Black, Sr., an individual surety doing business as Infinity Surety, was arrested and charged by the U.S. Department of Justice with mail fraud for allegedly selling more than \$100 million of worthless construction bonds to 150 different construction companies on local, state, and federal public works projects, while receiving \$2.8 million in fees.⁶ Among Black's alleged victims were the U.S. Department of Navy, the Beaumont Independent School District of Texas, and the Monroe Airport in Monroe, Louisiana.⁷ It is alleged that Black repeatedly pledged the same small piece of real property, a condominium unit, to insure multi-million dollar local, state and federal construction contracts. Mr. Black was convicted of fraud in the U.S. District Court for the Southern District of Texas, Houston Division.

The above individuals operated nationally and across state boundaries, victimizing public and private entities, small and minority construction businesses, and businesses of all types and sizes. These examples, unfortunately, are not isolated instances. Many other examples exist showing where individual surety bond assets were not what they purported to be and proved illusory, uncollectible, or deficient.

Resources Are Available to Small & Emerging Contractors

While A.B. 345 may be intended to assist small, emerging and disadvantaged firms with surety credit, there are substantial resources available to assist such firms to obtain surety credit through regulated surety markets. Many surety companies offer bonding programs that are specifically designed for qualified small contractors. Those contractors that do not qualify in the standard market can enter bonding programs, such as those offered by the U.S. Small Business Administration, to gain surety credit. Each of these will pair such firms with a regulated surety market. NASBP has created a website, www.suretylearn.org, expressly for the purpose of orienting small, emerging and disadvantaged firms in how to qualify for surety bond credit. NASBP members, as part of their services, regularly educate firms of all types and sizes on the steps leading to surety bond credit relationships.

There are instances, however, when a firm cannot and should not obtain surety credit, because the firm clearly lacks the basic ingredients— the character, capacity and capital—to perform the contract obligation successfully. Otherwise, the essential purpose of bonding, that is, to

⁵ Richard Korman, *Controversial Individual Surety Files for Bankruptcy Protection*, ENGINEERING NEWS-RECORD, August 5, 2014 available at: http://enr.construction.com/business_management/finance/2014/0805-Outspoken-Individual-Surety-Files-for-Bankruptcy-Protection.asp?

⁶ United States. Department of Justice. US Attorney's Office. Southern District of Texas. "Fort Worth Man Indicted for Mail Fraud Arising From Alleged Nationwide Scheme to Sell Over \$100 Million in Fraudulent Securities". April 12, 2010.

⁷ Mowbray, Rebecca. "Houston Officials charge George Douglas Black Sr. with mail fraud, alleging he peddled bogus bonds". *The Times-Picayune (Nola.com)*. March 30, 2010.

demonstrate the qualification of a firm to perform a specific obligation, would be abrogated and meaningless.

Furthermore, NASBP members, professional surety bond producers, have vested interests in assisting construction firms of all sizes, including small, emerging and disadvantaged businesses, to qualify for surety credit. Bond producers are familiar with the surety market and the business strategies and underwriting differences among sureties and act in many critical roles—guide, educator, adviser, and match-maker—to position firms to meet the underwriting requirements for surety credit. Bond producers welcome vibrant surety markets for their clients, but the sureties operating within those markets must be regulated. What confidence can a bond producer possibly have in placing her clients with an unregulated surety insurer, when her reputation and her business liability will be on the line? Simply put, bond producers cannot be confident in surety insurers on whom they have no objective information and who are not subject to the regulatory and market conduct control of the state insurance commissioner.

Please Vote No on A.B. 345!

Recent historical events, such as those surrounding the mortgage industry, have demonstrated quite clearly the dangers of exempting certain kinds of business conduct from meaningful regulations. When governments fail to perform their purpose of regulating market conduct within their jurisdiction, taxpayers and consumers pay a significant price!

A.B. 345 permits state and local contracting authorities to accept bonds from unregulated individual sureties, abrogating effective market oversight and control and therefore subjecting Nevada businesses, taxpayers and citizens to possible harm. For all of the foregoing reasons, NASBP strongly urges you to vote no on A.B. 345.