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BACKGROUND PAPER

SENATE BILL 414 AND SURETY BONDING OPTIONS

by Ira Winograd  
March 1, 1982

Senate Bill 414, an Act Establishing a State Operated Small Contractor Surety Bonding Corporation

The rationale for S.B. 414 is contained in the Legislative finding that many competent small contractors, whether minority or otherwise, experience difficulty or are totally unable to obtain at a reasonable cost the surety bonds necessary to bid on both public and private construction projects. This finding contains a minor factual error and it rests on an undefined concept of 'competency'. The error occurs in the implication that bonds are necessary to bid on private construction projects. Private obligees, parties requesting bids, may request bonding but they often forego bonding, especially on smaller projects. They are less likely than public obligees to solicit bids from unfamiliar contractors and they are not bound to accept the lowest bid. The private sector has less need for the prequalification services provided by sureties and surety bonding. On occasion, even a large private sector obligee will forego surety bonding. For example, the TAPS oil pipeline obligees did not require surety bonding. Surety bonds are primarily a requirement of public sector obligees. S.B. 414 would not necessarily improve the prospects of emerging contractors competing for private sector projects.

SB 414 is designed to assist contractors who are denied bonds for reasons other than lack of competence. Testimony presented to the State Affairs Committee in support of S.B. 414 asserts that many competent contractors cannot obtain bonds. The surety industry denies this assertion. This difference of opinion might be explained, at least in part, by the working definition of 'competency' used by sureties.

The low bid method of choosing contractors demands a very stringent definition of competency. A surety bond is a guarantee to the obligee that the contractor is competent to perform according to contract specifications. A surety bond is not issued as an insurance policy to be drawn upon in the event of incompetency. The obligee wants to be certain that all bonded contractors, especially the low bidder, will perform according to contract. From the obligees perspective, execution of the contract is more desirable than collecting financial compensation for failure to perform. The insurance aspect of surety bonding is only used as a last resort. It is used so infrequently that surety rates are not high enough to generate a loss paying insurance fund.

Under normal market conditions, sureties provide bonds only when they conclude that there is a very minimal chance that their own assets will be called upon as a result of a combination of two factors: contractor incompetency and insufficient 'net quick'. If there is the slightest doubt about competency, the contractor must demonstrate a satisfactory cash position, 'net quick'. Net quick cash is a sureties term for the ratio of net working capital to the current and expected work load of the contractor. Net working capital is the value of current assets less liabilities. Traditionally, sureties have looked for a net quick ratio of at least 10% of the total work load on bid upon work.

An emerging contractor has to show an unusually strong balance sheet in order to obtain a surety bond. The sureter wants to be certain that,

in the event of breach of contract, the contractor has adequate assets to cover liability. The surety demands competency in ability to perform and ability to provide financial compensation for nonperformance. The working definition of competency within the surety industry is far more stringent than the common definition of competency.

Senate Bill 414 is proposed as a means of providing bonds to competent contractors who have been denied bonding. It is not evident from the hearings held before the Senate State Affairs Committee that sureties are denying bonds to contractors on the basis of criteria which are irrelevant to their definition of competency. Federal experience with the Surety Bond Guarantee Program of the Small Business Administration indicates that recipients of public sector financed bonds tend to be less competent than recipients of private sector bonds. Insurance reports filed with the State of Alaska show a surety loss to premium ratio of 32.3% between 1975 and 1978. Premium average about 1% of the bond amount, so the loss to bond amount was approximately .32%. Over the life of the S.B.A. Surety Bonding program in the Pacific Northwest, the average loss has been 1.25% of the bond and current losses are 1.37%. This rough comparison shows that the S.B.A. bonding program produces losses at a rate which is four times greater than that incurred by the private sector surety market. The Federal experience indicates that S.B. 414 might increase bonding of fully competent contractors although it would tend to increase bonding of less competent contractors. Some competent contractors might benefit from S.B. 414, while the majority of competent contractors might be harmed by increased competition from less competent competitors.

The Administration of the S.B.A. evaluated their own Surety Bond Guarantee Program and concluded that it results in a net savings to government. Net savings is defined as the difference between obligee accepted low bids presented by S.B.A. bonded contractors and the next highest bid, less program expenses and losses. For every one million dollars in S.B.A. backed bonds accepted by public sector obligees the government saves \$23,000. The S.B.A. estimates that the average difference between S.B.A. backed low bids which are accepted by government agencies and the next highest bid is almost 10% of the low bid.

The income statement of the Surety Bond Guarantee program shows a net loss. Since the 1971 inception of the National program losses plus expenses exceed income by 455%. Using the conservative estimate that 1.25% of each S.B.A. backed bond in Alaska is defaulted, then losses (excluding operating expenses) exceed income by between 200% and 235%.<sup>9</sup>

Due to the similarities of S.B. 414 and the S.B.A. Surety Guarantee Program it is reasonable to expect that S.B. 414 would require a government subsidy. A subsidized Surety Guarantee Program might produce an overall government savings and it might aid some emerging contractors. It would also tend to lower competency standards. In order to evaluate the desirability of S.B. 414, it should be compared to other programs designed to alleviate problems facing emerging contractors. The remainder of this paper reviews the range of problems

which may be encountered by emerging contractors and specific programs designed to alleviate them.

### Problems for Emerging Contractors

Small contractors have trouble obtaining bonds, but a wide variety of reasons can contribute to denials. An overriding problem results from the required qualification aspect of surety bonding. In addition, surety bonds might be denied because a contractor is not fully competent, is being discriminated against, or is hindered by market distortions. A detailed discussion of S.B. 414 is contained under the subheading of Competency problems.

### Required Qualification

In Alaska, a contractor is not qualified to submit a bid above \$50,000, to a State Government obligee, unless a surety bond is obtained. A surety bond is a required qualification and there is no alternative way to provide the necessary pre-bid qualification. The surety has life and death control over contractors seeking State contracts. There are two classes of remedies to alleviate the importance of required qualification via surety bonding: 1) raise the contract size below which no bonding is required, 2) create an optional bonding category.

The \$50,000 upper limit for non-bonded contractors was established in 1976. Since establishment of this limit the Anchorage consumer price index has increased 51%.<sup>1</sup> The current \$50,000 limit can be raised 50% to \$75,000, and the original real dollar value of the original exemption would be maintained. If the 1976 limit were raised by 1/3 in real dollars, the current limit would be \$100,000 in today's dollars.

It appears that a \$100,000 limit may meet the average bond requests of emerging contractors. The average contract size of S.B.A. guaranteed contracts is between \$90,000 and \$100,000.<sup>2</sup> Furthermore, a \$100,000 limit is not apt to cause extensive State liabilities. This limit is low enough to limit State liability on any one project and it is reasonable to assume that public agencies would be very cautious before hiring a non-bonded emerging contractor who had failed on previous contracts.

An optional bonding category could provide another alternative to existing surety requirements. Within a fixed dollar category, non-bonded contractors might be allowed to compete with bonded contractors. In order to avoid penalizing bonded contractors and to preserve an incentive to obtain bonding, non-bonded contractors could receive a penalty equal to a fixed percentage of their bid. For example, if a bonded and a non-bonded contractor submit identical bids, the bonded contractor would receive the contract because the non-bonded contractor would have his bid raised by a penalty, equal to x%, for the purpose of bid evaluation. Although a non-bonded contractor would be at a severe disadvantage over the long-run, an optional bonding category provides an opportunity for an emerging contractor to demonstrate competency so that

bonding might be obtained in the future.

The category might extend from the upper limit of the 'no bond' category to an amount which is high enough to allow an emerging contractor to demonstrate competency on mid-size projects. The upper limit could be set low enough for the State to avoid excessive liabilities. The upper limit might be set equal to the new limit for the S.B.A. surety bonding program, \$250,000, or the traditional S.B.A. limit of \$1,000,000.

The penalty might relate to the provisions of SB 415 which provide that minorities and women shall be awarded contracts if, "the bid is not more than 15% higher than the bid of the lowest bidder; and the bidder agrees to lower his bid by 5%".<sup>13</sup> The following chart illustrates the effect of various penalties in conjunction with the provisions of SB 415, and without SB 415. Each contractor is assumed to submit an identical \$1 bid, and figures are rounded for ease of comparison.

S.B. 415, 15% Advantage to Minorities and Women

| Penalty        | non-bonded<br>non-minority | non-bonded<br>minority | bonded<br>non-minority | bonded<br>minority |
|----------------|----------------------------|------------------------|------------------------|--------------------|
| 5%             | 1.05                       | .90                    | 1.00                   | .85                |
| 10%            | 1.10                       | .95                    | 1.00                   | .85                |
| 15%            | 1.15                       | 1.00                   | 1.00                   | .85                |
| 20%            | 1.20                       | 1.05                   | 1.00                   | .85                |
| Without SB 415 |                            |                        |                        |                    |
| 5%             | 1.05                       | 1.05                   | 1.00                   | 1.00               |
| 10%            | 1.10                       | 1.10                   | 1.00                   | 1.00               |
| 15%            | 1.15                       | 1.15                   | 1.00                   | 1.00               |
| 20%            | 1.20                       | 1.20                   | 1.00                   | 1.00               |

If SB 415 is in effect, any penalty below 15% would give an advantage to a non-bonded minority compared to a bonded non-minority. Any penalty above 15% would give an advantage to a bonded non-minority over a non-bonded minority. In both cases, the maximum advantage accrues to bonded minorities or women. This arrangement provides maximum growth incentive for bonded minority/woman contractors. Additional minority members could be employed by expanding minority firms and additional minority members might thereby obtain the necessary experience for successful development of new minority firms.

If S.B. 415 is not passed, all non-bonded contractors would be treated equally. As the penalty increases they become less competitive with bonded contractors.

## Competency

A non-profit surety could bond contractors who do not meet general surety competency standards. The non-profit S.B.A. Surety Guarantee program has approved 94.7% of all applications received since inception of the program in 1971. In December 1981, the S.B.A. approved 88.7% of all applications and in fiscal year 1981 the S.B.A. approved 93% of all applications in the Pacific Northwest.<sup>14</sup> The high approval rate, and high loss ratio, which is four times greater than the private sector, indicate that the S.B.A. program has liberal competency standards.

The rate structure of the S.B.A. Program encourages relatively higher competency standards to obtain bonds over \$250,000 than for bonds under \$250,000. The S.B.A. program operates in conjunction with private specialty sureties. Most sureties are general sureties who do not participate in the S.B.A. program.<sup>15</sup> The S.B.A. retains 10% of the premium (20% on bonds over \$250,000), and the specialty surety retains 90% of the premium (80% for bonds over \$250,000). In return, the S.B.A. assumes 80% of the risk of default (90% if the bond is less than \$250,000) and the specialty surety assumes 20% of the risk of default (10% if the bond is less than \$250,000). Specialty sureties have less incentive to underwrite bonds over \$250,000 and this could explain why some contractors have had trouble obtaining bonds over \$250,000. (The S.B.A. has issued notification that a \$250,000 upper limit shall be in effect on individual bonds as of January 18, 1982.)

S.B. 414 would transfer 100% of the risk and premium to a State Small Contractor Surety Bonding Corporation. The Corporation could underwrite bonds without being constrained to match private sector competency standards. The benefit of increased bond availability to the emerging contractor should be weighed against net direct losses to the program, operations cost, indirect cost of contract failures, and any harm which might accrue to bonded contractors.

Net direct losses are dependent on the contract failure rate and the premium collected. If the State maintains a premium structure and competency standards similar to S.B.A. standards it would incur a loss to premium ratio of 75% to 100% on bonds between \$250,000 and \$1,000,000.<sup>16</sup> This estimate assumes a conservative loss rate of 1.25% of guaranteed bonds. This same 1.25% default rate would yield a loss to premium ratio of 200% to 235% for the S.B.A. Surety Guarantee Program because 80% to 90% of the premium is transferred to specialty sureties and 80% to 90% of losses are absorbed by the S.B.A. The State program would not share losses and premiums with private sureties. If the State decreased rates below S.B.A. rates, to match private sector surety rates, the loss to premium ratio would increase.

S.B. 414 operations costs are apt to exceed S.B.A. costs. In return for giving a large percentage of premiums, 80% to 90%, to specialty sureties the S.B.A. program relies on the specialty sureties to perform administrative tasks associated with the program including preparation of application forms. The S.B.A. Surety Bond Guarantee Program requires

only 16 people to issue 1.5 billion dollars worth of surety bonds per year.<sup>18</sup> The S.B.A. administrative overhead is only 20% of income or .1% of guaranteed bonds.<sup>19</sup> Private sector surety expenses average about 55% of earnings.<sup>20</sup> If a 55% operations cost is assumed for a State Surety Guarantee Program, and added to net direct losses, of 75% to 100%, the combined expected cost is between 130% and 155% of premiums.<sup>21</sup> This analysis indicates that a State operated Surety Guarantee Program would incur a net loss.

The net annual loss could be between \$50,000 and \$150,000, assuming that the State Contractor Surety Bonding Corporation underwrites the same value of bonds, at the same rate structure, as the S.B.A. currently underwrites in Alaska. This estimate assumes that the State would incur a loss rate of 1.25%. The 1981 S.B.A. loss ratio was 1.34% of the total bonded amount in Alaska. In fiscal year 1981 the S.B.A. sponsored 145 active bonds in Alaska for \$20,224,281. Since the S.B.A. absorbs between 80% and 90% of loss, the total loss on these bonds was between \$301,117 and \$338,757, [ $.0134(\$20,224,281)/.8=\$338,757$ ,  $.0134(20,224,281)/.9=\$301,117$ ]. A maximum premium of \$260,582 is derived by assuming a low loss/premium ratio of 130% applied to the maximum total loss ( $\$338,757/1.3=\$260,582$ ), and a minimum premium of \$194,269 is derived by assuming a high loss/premium ratio of 155% applied to the minimum total loss ( $\$301,117/1.55=\$194,269$ ). The minimum net loss of \$40,535 is derived by subtracting the maximum premium from the minimum total loss ( $\$301,117-260,582=\$40,535$ ) and the maximum net loss of \$144,488 is derived by subtracting the minimum premium from the maximum total loss ( $\$338,757-194,269=\$144,488$ .) These costs might underestimate actual costs because they assume that all costs are variable, when in fact, surety bonding might require large fixed costs in relation to the size of the Alaska emerging contractor surety market. Fixed costs are the minimum costs needed to initiate and operate the program. Losses would increase in proportion to the total value of issued bonds.

The remaining factors to be considered are too subjective to be evaluated in dollar amounts. These factors include benefits to emerging contractors in need of an opportunity to demonstrate competency, indirect costs of contract failures which are borne by the obligee, and any harm which might accrue to bonded contractors who might be forced to compete with less qualified contractors. In addition, an excessively lenient system could harm the viability of the low bid system of contractor evaluation. These factors have a direct bearing on an evaluation of public surety bonding but they do not lend themselves to monetary evaluation.

Only one State has passed legislation to provide surety bonding. The State of Connecticut has passed legislation enabling the Commissioner of Economic Development to issue surety bonds.<sup>22</sup> Regulations have not been promulgated at this time. There is a great deal of concern about establishing regulations to prevent large contractors from establishing subsidiaries to take advantage of the program. The proposed regulations establish a \$25,000 limit and this gives the program an extremely limited scope.

An alternative approach to the problem of stringent competency standards is to raise the competency of emerging contractors. Competency is in large part determined by a review of past performance. Programs which provide experience for emerging contractors allow them to improve their competency. S.B. 415, which provides an advantage to minority and woman contractors, would tend to improve the competency of these contractors. A raise in the rate below which bonding is not required, and creation of an optional bonding category, would also tend to provide work experience and increase the competency of small contractors.

### Discrimination

The State might provide an alternative bonding system, as proposed by SB 414, which would offer an alternative for competent contractors who were denied contracts because of private sector discrimination. The State could avoid excessive losses by maintaining competency standards comparable to private sector standards. An alternative public system might be justified if there is discrimination in the private sector and legal remedies are inappropriate.

Discrimination is difficult to prove in the current surety market. A surety is not required to inform the contractor of the reasons for denial. Legislation might be passed requiring, as a condition of doing business with contractors operating in Alaska, that each surety furnish, in writing upon request by a bond applicant, a detailed statement of the reasons which led the surety to refuse bonding to the applicant on a particular contract. Any statutes and regulations governing this requirement should be sufficiently flexible so as to avoid the danger that sureties will develop the practice of responding to bond applicants with a set of routine, meaningless formulations of the reasons for refusal.

Provision might be made to protect sureties from lawsuits arising out of a candid statement of the underwriting decision. Alternative legislation might require rejection reasons to be filed with the Department of Commerce and Economic Development, Division of Insurance. Sureties are already required to file financial statements with the Division. This option would be less burdensome to sureties than public disclosure requirements and it would still provide anti-discrimination benefits.

If one must give reasons for a decision, it is a discipline of the decision making process itself. This will tend to remove subjective prejudices from underwriting. The simple process of having to explain forestalls too much subjectivity by well meaning people. An additional benefit of written reasons is that the emerging contractor can gain a better understanding of bond requirements.

A surety under this proposal could decide on one ground, and give entirely different written reasons. However, this kind of dishonesty is even more difficult to police in the absence of written reasons. In

their presence patterns emerge and can be monitored. A particular pattern with respect to particular sureties and contractors should arise, and this information could prove useful in determining if discrimination has occurred. A consistent pattern of written reasons might provide investigative evidence of suspected discrimination.

The surety business is almost exclusively conducted by insurance companies operating through specialized independent surety agents. These agents are located in centralized market areas. There are a limited number of active agents in Alaska and most Alaskan business is underwritten by Seattle sureties. An Alaska disclosure requirement would have to be constructed in conformance with the Federal Interstate Commerce Clause so as to avoid an illegal restraint of trade.

### Market Distortions

An emerging contractor can be hindered by a shortage of bonds created by inadequate competition among sureties. In monopolistic, or limited competition markets, the supplier can reduce output, in this case bonds, while maintaining profit by charging more per bond. However, bond rates are based on the Rating Manual of the Surety Association of America, and there is little room for sureties to manipulate rates. Inadequate competition might be manifested in a tendency to only accept overqualified contractors and this might produce excessive profits.

Prior to enactment of the S.B.A. Surety Guarantee Program, the Department of Housing and Urban Development commissioned a study of surety bond adequacy and availability which included an analysis of surety profitability.<sup>23</sup> The study reviewed the period between 1958 and 1967, and concluded that, "Ownership of the surety enterprise, overall, received probably a 10-15% return on ownership equity for acting as construction bond sureties during the ten year period."<sup>24</sup> It is possible that the Alaska experience is quite different. The Legislature might conduct a study, or direct the Department of Commerce and Economic Development, Division of Insurance, to study the return on ownership within the surety industry. The study could indicate the degree of competitiveness among sureties involved in Alaska and the kinds of data which might be monitored for an ongoing evaluation of surety bonding.

An emerging contractor might also be hindered by a market structure which is fully competitive but which is not scaled to the needs of small contractors. It is possible that emerging contractors are hindered because the size of available contracts is too large for their capacity. The Department of Transportation and Public Facilities does not maintain a record of contracts by size classification. However, this data could be tabulated and if the percentage devoted to small contracts appears to be too small, larger contracts might be broken down into smaller contracts. Successful completion of a number of smaller contracts would also help emerging contractors to establish the kind of track record for successful performance that could ultimately enable them to obtain bonds on successively larger projects.

The factoring of larger projects runs counter to the desire for greater efficiency by letting contracts in large aggregate amounts. This should be balanced against the benefit to emerging contractors.

### Summary

The following chart summarizes four problem areas facing emerging contractors and programs designed to alleviate these problems.\*

| <u>Problem</u>         | <u>Program</u>  | <u>Precedent</u>   | <u>Expense</u>                             |
|------------------------|---|--|--|
| Required Qualification | No-bonding category<br>Optional bonding.                            | AS 36.25.010.<br>none.   | moderate<br>moderate                       |
| Competency             | S.B. 414.<br>No-bonding category.<br>Optional bonding.<br>S.B. 415. | S.B.A.<br>AS 36.25.010.<br>none.<br>State bidder<br>preference,<br>AS 37.05.230. | maximum<br>moderate<br>moderate<br>maximum |
| Discrimination         | S.B. 414.<br>Reporting<br>requirements.                             | S.B.A.<br>none.  | maximum<br>minimum                         |
| Market Distortions     | Market study.<br>Factoring of<br>larger projects.                   | H.U.D.<br>none.  | minimum<br>moderate                        |

\* There is overlap between problem areas which is not shown in the chart.

The expense estimates are divided into three general categories: maximum, moderate and minimum. The maximum category contains programs which require operating costs or for which costs are not limited to contracts having a specified monetary size. The moderate cost programs are limited to contracts having a specified monetary size. The minimum category applies to programs which do not require continuing government subsidies.

In all problem areas facing the emerging contractor, except one, there is a moderate or minimum cost alternative. The one exception is the problem of stringent competency requirements. The only viable short-run solution is a lowering of qualifications and this would require a State financed surety bond guarantee program. The competency problem can be avoided, within selected contract classifications, by enacting programs to alleviate the required qualification burden of surety bonding. From the obligee's point of view, stringent competency standards are not a problem. Stringent competency standards are the key to the surety

system that enables the owner to have confidence that the lowest bidder can successfully perform on contract on time.

#### FOOTNOTES

1. (SB 414, Section 1, Legislative Findings, [1]).
2. (State Affairs Committee, April 16, 1981)
3. ("Construction Surety Bonds: Their Adequacy and Availability, by David Dykhouse, p.58.)
4. (Insurance Reports for 1977-1979, issued by the Department of Commerce and Economic Development, Division of Insurance)
5. (Availability of Contract Bonding, Anne DeVries, House Research Agency, p.12.)
6. (Ibid. A. DeVries, p.15, and telephone conversation with Tom Sault, Director of S.B.A. Regional Office, Seattle)
7. (See appendix A)
8. (Ibid, Appendix A)
9. (Op. cit. A. DeVries, Table 3.)
10. (AS 36.25.010.)
11. (Wage & Clerical C.P.I. increased from 164.9 in July 1976 to 249.3 in Nov. 1981.)
12. (Op. Cit. Appendix A., Average size in Dec. 1981 is \$91,800, National S.B.A. average).
13. (Sec 10. 37.05.230.iii,iv as proposed by SB 415)
14. (Op. Cit. A. DeVries, p.16.)
15. (Op. Cit. Appendix A and conversation with Tom Sault, Region X Director of S.B.A. Surety Guarantee Program)
16. (see Appendix B table 3 DeVries, S.B.A. premium schedule is 1.5% of first \$250,000 or less, (until recently, 1% on amounts over \$250,000 up to \$1 million), plus a .2% service fee on the entire bond.)
17. (Standard surety premiums equal 1.2% for the first \$500,000 and .725% on the next \$2,000,000 in bonds.
18. (conversation with H. Huegel, Chief, Surety Bond Guarantee Branch, S.B.A.)
19. (Appendix A.)
20. (Op. Cit. Dykhouse, p. 74.)
21. (Operations cost could equal more than 55% of SB 414 premiums because State premium rates could be less than private surety rates.)
22. (Connecticut Public Act 79-611)
23. (Op. Cit, Dykhouse)
24. (Op. Cit Dykhouse p. 77.).

**AGENCY-WIDE SURETY BOND GUARANTEE PROGRAM STATISTICS**  
**Inception (January 1971) through December 1981**

|  | <u>December 1981</u> | <u>1/71 - 1/1/82</u> |
|--|----------------------|----------------------|
| <u>Net Profit/Savings to Government</u><br>(Federal, State, Local)     |                      |                      |
| Public Sector Savings due to SRG Contracts<br>(see attached Analysis*) |                      | 382,667,040          |
| Net SBG Program Loss to Date   |                      | <u>136,888,443</u>   |
| Net Profit/Savings to Government to Date                               |                      | 245,778,597          |
| <br><u>Surety Bond Guaranty Activity</u>                               |                      |                      |
| Applications for Guarantee Received                                    | 2,224                | 288,360              |
| Applications Approved  | 1,973                | 273,016              |
| Actual Contracts Awarded (low bids, etc.)                              | 725                  | 141,089              |
| Contract Totals (actually obtained)                                    | \$66,591,586         | \$10,689,770,335     |
| Average Contract Size  | \$91,850             | \$75,764             |
| Number of Contractors Assisted   | 169                  | 24,672               |
| Minority Contractors Assisted  | 25                   | 3,492                |
| Defaults Recorded  | 77                   | 8,225                |
| Percentage of Defaults   | 6.9                  | 5.8                  |
| <br><u>Income</u>  |                      |                      |
| Application Fees   |                      | \$2,097,552          |
| Contractor Fees  |                      | \$21,695,464         |
| Surety Premiums/Fees   |                      | <u>\$25,467,354</u>  |
|  |                      | \$49,260,370         |
| <br><u>Expenses</u>  |                      |                      |
| Administrative (SBA Overhead)  |                      | \$3,632,401          |
| Interest to Treasury   |                      | <u>\$5,791,248</u>   |
|  |                      | \$9,423,649          |
| <br><u>SBG Claims Losses</u>   |                      |                      |
| Claims Incurred  |                      | \$238,869,586        |
| Recoveries, Refunds, etc.  |                      | <u>\$24,181,440</u>  |
| Net Claims Incurred  |                      | \$214,688,146        |
| Bulk Reserve (Established by P.F.M.)                                   |                      | \$38,163,072         |
| Net Claims Paid  |                      | <u>\$176,525,074</u> |
| Expenses (SBA Administrative Overhead)                                 |                      | \$9,623,739          |
| Total Loss and Expenses  |                      | <u>\$186,148,813</u> |
| Less Income (Premiums, Fees)   |                      | \$49,260,370         |
| Net SBG Program Loss - Paid Claims To Date                             |                      | \$136,888,443        |

## ATTACHMENT TO SBG PROGRAM STATISTICS

### \*Analysis of Public Sector Savings due to SBG Contracts

The estimate of public sector savings from program inception in 1971 through December 31, 1981, was calculated as follows:

|  |                      |
|--|----------------------|
| Total Awards through the SBG Program               | 10,689,770,335       |
| Percent from Public Sector                         | x 38.7               |
| Awards from Public Sector through SBA Program      | <u>4,136,940,990</u> |
| Bid Spread Factor (bid spread - 9.25 percent)**    | x 1.0925             |
| Projected Public Sector Awards - if no SBG Program | <u>4,519,008,030</u> |
| Less Awards through SBG Program                    | <u>4,136,940,990</u> |
| Savings to the Public Sector                       | <u>382,667,040</u>   |

\*\*These factors were developed from the 11/77 Study of the SBG program by PPED/O&RD. It is estimated that both are significantly higher at this time, but have been held at the 1977 levels in this exhibit for conservative analysis.

TABLE 3

COMPARISON OF LOSS/PREMIUM RATIOS FOR THE SPECIALTY SURETY AND THE SBA

|                                | <u>BOND AMOUNTS</u> |                  |                  |                  |                    |
|--------------------------------|---------------------|------------------|------------------|------------------|--------------------|
|                                | <u>\$249,999</u>    | <u>\$250,000</u> | <u>\$500,000</u> | <u>\$750,000</u> | <u>\$1,000,000</u> |
| <u>SPECIALTY SURETY</u>        |                     |                  |                  |                  |                    |
| -Loss                          | 312                 | 625              | 1,250            | 1,875            | 2,500              |
| -Premium                       | 3,000               | 3,000            | 5,000            | 7,000            | 9,000              |
| -Loss/Premium                  | 10.4%               | 20.8%            | 25.0%            | 26.8%            | 27.8%              |
| <u>SBA</u>                     |                     |                  |                  |                  |                    |
| -Loss                          | 2,812               | 2,500            | 5,000            | 7,500            | 10,000             |
| -Premium                       | 750                 | 750              | 1,250            | 1,750            | 2,250              |
| -Service Charge                | <u>500</u>          | <u>500</u>       | <u>1,000</u>     | <u>1,500</u>     | <u>2,000</u>       |
| -Premium + Service Charge      | 1,250               | 1,250            | 2,250            | 3,250            | 4,250              |
| -Loss/Premium + Service Charge | 225.0%              | 200.0%           | 222.2%           | 230.8%           | 235.3%             |
| <u>OVERALL</u>                 |                     |                  |                  |                  |                    |
| -Loss/Premium + Service Charge | 73.5%               | 73.5%            | 86.2%            | 91.5%            | 94.3%              |

House Research Agency

July 1, 1980



# Alaska State Legislature

## Senate Committee on State Affairs

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Official Business

### HIGHLIGHTS OF CS FOR SENATE BILL NO 414 (State Affairs)

An Act establishing a Small Contractor Surety Bonding Corporation

• Section 1. Establishes a Small Contractor Surety Bonding Corporation

Sec. 45.71.070. CONDITIONS FOR ISSUANCE OF GUARANTEE. The corporation may guarantee and enter into commitments to guarantee a surety against loss from the breach of a bid bond, payment bond, or performance bond by a principal on a contract up to \$1,000,000 for work on public construction...

The bond principal cannot exceed \$1,000,000 and bonds will only be issued for public projects. The S.B.A. Surety Bond Guarantee Assistance Program has had a \$1,000,000 limit. In February, 1982, the limit was reduced to \$250,000. In 1981, DOTPF issued 362 contracts in the \$1,000,000 or less category. Of those, 66 percent (231) were less than \$250,000 and 33 percent (131) were between \$250,000 and \$1,000,000.

(1) The person who would be the principal on the bond is a contractor or subcontractor whose gross revenue for the most recently completed fiscal year was not in excess of \$1,000,000.

This section limits eligibility to small contractors whose annual gross revenues are less than \$1,000,000.

Sec. 45.71.080 EXTENT OF LIABILITY (a) A guarantee under this section shall obligate the corporation to pay to the surety for a breach of contract a sum not to exceed 90 percent of the loss incurred and paid by the surety as a result of the breach.

A private surety would have to agree to accept 10 percent of the liability before the surety bonding corporation issues a bond. This is modeled after the S.B.A. Surety Bond Guarantee Assistance Program. In return for the 10 percent private surety liability, the private surety receives 90 percent of the fees and the S.B.A. receives the remaining 10 percent plus a service charge.

•Section 4. This Act takes effect upon elimination of the United States Small Business Administration surety bond guarantee assistance program.

C.S. for S.B. 414 creates a back-up program to avoid costly delays for small contractors in the event that the S.B.A. program is eliminated.

SB 414

Testimony by the Alaska Division of Insurance  
Before the Senate State Affairs Committee

We are not in favor of SB 414. The bill places the State directly in the business of insurance and does so in a way to deny the public the protection of the insurance code (AS 21).

In Section 1 of the bill, an assumption appears to be made which is the basis for establishing the corporation and which is not the principal reason for any bond availability problem. The section suggests that competence is the prime consideration in providing a bond, but it is only a part of the consideration.

First it should be understood that the bond is not a risk-shifting device for its purchaser. It has another purpose. Its purpose is to secure the interests of the party with whom the contractor wishes to deal. This interest is secured in two ways. First, the surety assumes the owner's financial risks of nonperformance by the contractor; and, second, the suretyship mechanism prescreens or prequalifies contractors and only issues bonds to those who, in the surety's judgment, will be able successfully to perform a given contract.

The surety is concerned with a number of factors when considering the issuance of a bond to a contractor including:

- What is the financial condition of the contractor?
- Has he done jobs of this magnitude before?
- Were they successfully completed according to contract specs?
- Are there factors to make this contract more difficult to perform than his past contracts?
- What's his travel record on past contracts?
- Is he capable of doing the work?
- Is he capable of accurately identifying his costs?

When the bond is issued, the surety is in effect contracting with the owner for completion of the contract. If the contractor gets in trouble, the surety has three choices. First, he can contract with the same contractor to complete the contract; second, he can contract with someone else to complete the contract; or third, he can let it default and pay on the court's decision of what the surety penalty should be.

The surety binds itself to the contractor for performance of a contract. If you were so bound, what would you want to know about the contractor?

The surety "premium" does not contemplate loss. It has some loss paying capacity but it is not the chief source out of which losses are intended to be paid.

Competence is a factor, but the phrase is not confined to work skills. Other skills would include managing and controlling costs, skill in competitive bidding, and skill in collecting receivables. These are major causes of contractor failures.

It appears that the real problem falls into other areas such as availability of work and thin financial resources of the contractor.

The response for availability of work is to strengthen the contractor. This can be done by raising the size of contracts requiring bonds and making jobs available in reasonably small jobs.

The response for thin financial resources is to develop a program of facultative reinsurance or indemnity to help availability. Here, care should be exercised to permit the surety to administer the bond and adjust the loss with the State's role limited to finance and setting the conditions of reinsurance or indemnity. This could be accomplished with direction similar to that on page 3, lines 20-23.

#### APPARENT CAUSES OF CONTRACTOR FAILURES

|  |       |
|--|-------|
| Heavy operating expenses<br>(lack of skill in managing and<br>and controlling costs) | 26.4% |
| Inadequate sales<br>(lack of skill in competitive bidding)                           | 25.2% |
| Competitive weakness   | 23.8% |
| Receivables difficulties   | 14.6% |

#### UNDERLYING CAUSES OF CONTRACTORS FAILURES

|                               |       |
|-------------------------------|-------|
| Incompetence                  | 45.4% |
| Unbalanced experience         | 18.6% |
| Lack of managerial experience | 18.5% |

SOURCE: Dunn & Bradstreet, Inc. - 1968

THE LEGISLATURE OF THE STATE OF ALASKA  
TWELFTH LEGISLATURE

FISCAL NOTE

I. REQUEST

Bill/Resolution No. SB 414 "An Act establishing a state-  
Title operated Small Contractor Surety Bonding Corp, and providing for an effective date.  
Requested by Fischer Date 4-21-81

II. FISCAL DETAIL

Agency Affected Department of Commerce & Economic Development  
Program Category Affected Public Protection  
BRU, Program, or Subprogram(s) Affected Regulation & licensing of professions - admn.  
(Note: if more than one budget component is affected, separate line-item amounts and funding for each component in the analysis section.)

EXPENDITURES (Thousands of Dollars)

|                          | FY 81 | FY 82        | FY 83        | FY 84        | FY 85        | FY 86        |
|--------------------------|-------|--------------|--------------|--------------|--------------|--------------|
| 100 PERSONAL SERVICES    |       | 147.4        | 157.7        | 168.7        | 180.5        | 193.1        |
| 200 TRAVEL               |       | 8.0          | 8.9          | 9.8          | 10.9         | 12.2         |
| 300 CONTRACTUAL          |       | 182.3        | 195.1        | 208.8        | 223.0        | 239.0        |
| 400 COMMODITIES          |       | 6.2          | 6.2          | 6.2          | 6.0          | 6.2          |
| 500 EQUIPMENT            |       | 7.3          | .0           | .0           | .0           | .0           |
| 600 LAND & STRUCTURES    |       | 8.1          | 8.1          | 8.1          | 8.1          | 8.1          |
| 700 GRANTS, CLAIMS, ETC. |       |              |              |              |              |              |
| <b>TOTAL</b>             |       | <b>359.3</b> | <b>376.0</b> | <b>401.6</b> | <b>429.1</b> | <b>458.6</b> |

FUNDING (Thousands of Dollars)

|                             |  |       |       |       |       |       |
|-----------------------------|--|-------|-------|-------|-------|-------|
| GENERAL FUND                |  | 359.3 | 376.0 | 401.6 | 429.1 | 458.6 |
| FEDERAL FUNDS               |  |       |       |       |       |       |
| OTHER (Specify Fund Source) |  |       |       |       |       |       |

POSITIONS

|           |  |   |   |   |   |   |
|-----------|--|---|---|---|---|---|
| FULL TIME |  | 3 | 3 | 3 | 3 | 3 |
| PART TIME |  | 1 | 1 | 1 | 1 | 1 |
| TEMPORARY |  |   |   |   |   |   |

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III)

PERSONAL SERVICES - FY'82 salary schedule; exempt. 7% inflation factor projected.

|  |                      |
|--|----------------------|
| 1 Executive Director, range 22, 12 mos       | \$ 50,791.00         |
| 1 Secretary I, range 10, 12 mos.             | 22,735.00            |
| 1 Accountant III, range 16, 12 mos.          | 33,303.00            |
| 1 Assistant Attorney General, 1/2 time       | 20,620.00            |
| Additional support staff (full or part-time) | 20,000.00            |
|  | <u>\$ 147,449.00</u> |

TRAVEL - 12% inflation factor projected.

|   |          |
|---|----------|
| Minimum of 3 meetings per year, 3 days ea., 5 members | 5,000.00 |
| Executive Director                                    | 1,000.00 |
| Assistant Attorney General                            | 1,000.00 |
| Additional staff as necessary                         | 1,000.00 |

IV. DATE 4-21-81 PREPARED BY Theresa J. Edlund \$ 8,000.00  
AGENCY Division of Occupational Licensing  
PHONE 465-2535

Original: Legislative Finance  
cc: Budget and Management  
Prime Sponsor (First Legislator Named)

CONTRACTUAL - 7% inflation factor projected.

|  |                      |
|--|----------------------|
| Consultants: Financial, Investment, Bond Underwriting and<br>Investigative | \$ 160,000.00        |
| Word Processing lease  | 8,500.00             |
| Phone hook-up  | 1,800.00             |
| Long Distance Telephone  | 6,000.00             |
| Copier rental  | 1,000.00             |
| Postage meter  | 1,000.00             |
| Printing and duplication   | 3,000.00             |
| Publications (various)   | 1,000.00             |
|  | <u>\$ 182,300.00</u> |

COMMODITIES

|                           |                    |
|---------------------------|--------------------|
| Postage                   | 4,000.00           |
| Paper stock               | 2,000.00           |
| Tapes for lanier recorder | 180.00             |
|                           | <u>\$ 6,180.00</u> |

EQUIPMENT - one time expense in FY'82.

|   |                    |
|---|--------------------|
| 2 desks, double pedestal, 60x30"              | 704.64             |
| 1 desk, single pedestal with typing extension | 432.83             |
| 2 credenzas, 19x62"                           | 706.36             |
| 2 tables, 72x35"                              | 395.70             |
| 4 file cabinets, 4 drawer legal with lock     | 863.96             |
| 1 bookcase, 3 shelves                         | 102.64             |
| 1 storage cabinet                             | 184.71             |
| 1 chair, exec. swivel with arms               | 176.83             |
| 2 chairs, posture without arms                | 232.54             |
| 3 side chairs                                 | 224.70             |
| 1 typewriter mat                              | 35.46              |
| 1 typewriter, correcting selectric, IBM       | 1,028.83           |
| 3 calculators, desk, printing 10 digit        | 534.78             |
| 1 Lanier                                      | 1,000.00           |
| 2 brief cases                                 | 180.00             |
| 2 file tubs                                   | 363.00             |
| mail baskets                                  | 30.00              |
| waste baskets                                 | 40.00              |
| form racks                                    | 50.00              |
|   | <u>\$ 7,286.98</u> |

LAND & STRUCTURES

150 sq.ft. X 1.50 X 3 X 12 mos. = 8,100.00

# MINORITY BUSINESS ASSISTANCE CENTER

BUSINESS OFFICE:  
836 E. 15th Ave., Suites 3 & 4  
Anchorage, Alaska 99501  
Phone: 907-274-3689/3680

MAILING ADDRESS:  
P.O. Box 3315  
Anchorage, Alaska 99510

April 17, 1981

Senator Vic Fischer  
Chairman  
Senate State Affairs  
Alaska State Legislature  
Pouch V  
Juneau, AK 99811

RE: Senate Bills 45,414 and 415

Dear Senator Fischer

Herein capsulated are the comments we provided at this past Thursday's Tele-conference.

#### Senate Bill 45

Two brief points: It is recommended that the act waiver limits reflect an appreciation for the yearly increases in the Construction Cost Index. This can be accomplished by either attaching an automatic yearly or periodic multiplier to the limit.

The waiver provision should clearly state it applies to both general contracts and bids submitted by subcontractors to prime contractors on larger jobs.

#### Senate Bill 414

##### General Overview:

The introduction of this bill is very timely and you are to be commended for your efforts.

Under existing state statute companies writing bonds are not required to give the applicant a reason (verbal or written) why their request was denied. This practice effectively denies a contractor an opportunity to correct any deficiencies in future applications. However a more likely situation is the local bonding agent is not brothing to "work" the applicant's package. The proposed bill would certainly correct this situation. Alternately, informal reasons given for not writing bonds in the range being suggested is the profit margin is not substantial enough and the only way they would consider writing bonds in this range was if the contractor was placing his more profitable insurance coverage needs with the company.

Briefly discussed below are specific points on SP 414:

Section 45.71.020, (Board of Directors), pge. 2. Consideration should be given to having the director of insurance serve on the board in place of the Commissioner of Commerce. He or she should have more working knowledge of the problems.

Section 45.71.070, (Eligible Contractors), pge 4. Mechanics of how a contractor could be pre-qualified should be addressed. This would minimize the possibility of the contractors being caught in a time squeeze by going through the process of being turned down (which can be a drawn out process) by a private insurer and then applying to the state at the same time he must be satisfying other conditions of contract award i.e. mobilizing.

Section 45.71.110, (Contractor Surety Funds), pge 5. It would be helpful if a determination could be made as to whether the proposed capitalization is of a sufficient magnitude to meet possible demand.

Concluding discussion should be included on how long a contractor is eligible to participate in the program and what are the penalties for a contractor who does not perform?

#### Senate Bill 415

Section 1 AS 19.10.190 (Advertisement, etc), pge 1. The ending sentence should be more specific in terms of how informal bids will be solicited.

Section 10 AS 37.05.230(1), (no title), pge 5. point(II) How is data for this section to be developed and verified?

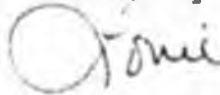
Section 16 AS 37.05.230 (Amended), pge 7. point (10) It may be that DOTPF or Commerce are more capable of providing this function. Alternately if the thinking was the office of EEO could assume the duties, it should be clearly understood that these functions are not necessarily compatible for administrative purposes.

Concluding discussion on SB415, Section 17 is very strong and good and we were pleased to see the University of Alaska brought under the guidelines of this act.

Hopefully these bills will be enacted to the ultimate benefit of all Alaskans.

Finally we requested support of the center from Mr. Putman of your staff by placing in the state budget an amount that will allow us to continue operating the center in FY82, your support of this request will be sincerely appreciated.

Yours truly



E. Louis Overstreet

KDT

THE LEGISLATURE OF THE STATE OF ALASKA  
TWELFTH LEGISLATURE

FISCAL NOTE

I. REQUEST

Bill/Resolution No. SB 414

Title An Act establishing a state-operated Small Contractor Surety Bonding Corporation.

Requested by \_\_\_\_\_ Date April 14, 1981

II. FISCAL DETAIL

Agency Affected Department of Community and Regional Affairs

Program Category Affected Development

BRU, Program, or Subprogram(s) Affected Local Government Assistance

(Note: If more than one budget component is affected, separate line-item amounts and funding for each component in the analysis section.)

EXPENDITURES (Thousands of Dollars)

|                          | FY 81 | FY 82      | FY 83 | FY 84 | FY 85 | FY 86 |
|--------------------------|-------|------------|-------|-------|-------|-------|
| 100 PERSONAL SERVICES    |       | -0-        |       |       |       |       |
| 200 TRAVEL               |       | -0-        |       |       |       |       |
| 300 CONTRACTUAL          |       | -0-        |       |       |       |       |
| 400 COMMODITIES          |       | -0-        |       |       |       |       |
| 500 EQUIPMENT            |       | -0-        |       |       |       |       |
| 600 LAND & STRUCTURES    |       | -0-        |       |       |       |       |
| 700 GRANTS, CLAIMS, ETC. |       | -0-        |       |       |       |       |
| <b>TOTAL</b>             |       | <b>-0-</b> |       |       |       |       |

FUNDING (Thousands of Dollars)

|                             |  |     |  |  |  |  |
|-----------------------------|--|-----|--|--|--|--|
| GENERAL FUND                |  | -0- |  |  |  |  |
| FEDERAL FUNDS               |  | -0- |  |  |  |  |
| OTHER (Specify Fund Source) |  | -0- |  |  |  |  |
|                             |  |     |  |  |  |  |
|                             |  |     |  |  |  |  |

POSITIONS

|           |  |     |  |  |  |  |
|-----------|--|-----|--|--|--|--|
| FULL TIME |  | -0- |  |  |  |  |
| PART TIME |  |     |  |  |  |  |
| TEMPORARY |  |     |  |  |  |  |

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III)

No fiscal impact on this agency.

IV. DATE April 14, 1981 PREPARED BY Terry L. Earley

AGENCY Department of Community & Regional Affairs

Original: Legislative Finance

PHONE 465-4730

cc: Budget and Management

Prime Sponsor (First Legislator Named)



CORROON & BLACK/DAWSON & CO., INC.

4220 "B" Street  
Anchorage, Alaska 99503  
007-278-3471 Telex: 25-109  
April 21, 1981

Senator Vic Fischer, Chairman  
Senate State Affairs  
Alaska State Legislature  
Pouch V  
Juneau, Alaska 99811

RE: Senate Bills No's. 45, 414 and 415

Dear Senator Fischer:

Thank you very much for allowing me to participate in the Teleconference Hearing on the above referenced bills held on Thursday, April 16th throughout the State. At that point in time you had asked for written in-put either pro or con concerning the referenced Senate Bills. I realize that my in-put may not be very welcome as you are one of the sponsors of the bills, but I must submit my comments both as a businessman and as a concerned citizen relating to my opposition to all three of these bills.

First of all, I feel it is only proper that I identify myself as being the manager in charge of surety operations for the State of Alaska for Corroon and Black/Dawson & Co., which position I have held in excess of thirteen years. This means that I devote my full working hours to assisting contractors in obtaining bonding. In addition to this I am also a member of the National Legislative Committee of the National Association of Surety Bond Producers. I am using this method of identifying myself to show that I have had experience in the bonding industry and can therefore speak from a position of some authority.

I should, at this time, clear up a common misconception. That is that bonding and insurance are the same. As you are quite aware, they are not. Simply stated, surety is an extension of unsecured credit on the part of one party to guarantee the acts and/or omissions of another party. Insurance, on the other hand, is where, for a fee, a company will allow an individual into a pool of risk and agree to indemnify him against loss due to his or others' negligence. Most people feel that surety and insurance are one and the same because most surety companies are also insurance companies. This is not true. The only reason that insurance companies write surety is because they have the necessary financial reserves to enable them to do so.

I'm sure that one of the reasons for the introduction of this bill is because you and other State representatives have received information

Senator Vic Fischer

Page Two

4/21/81

from constituents stating that they were unable to obtain the necessary bonding to bid on State, Federal and private projects. The major reason for this is probably because of the lack of people qualified to assist contractors in obtaining surety in this state. Most insurance brokerage firms in Alaska have no thorough knowledge of how to obtain surety credit for their clients. I can liken this to shopping at a drug store in order to obtain a commercial loan. For the lack of skilled personnel in the surety field in this state, I do apologize, however the few of us that are available are doing our best.

I should now like to list my overall and more specific objections to Senate Bills No's. 414, 415 and 45.

First, I feel that Senate Bill No. 414 would be a duplication of existing bond facilities. At the present time there is, under the State Little Miller Act, a provision for Personal Surety under Section 36.25.010 and Section 36.25.025. I feel that all that is needed is to draft adequate regulations to control personal surety and there would be absolutely no need for Senate Bill No. 414. In addition to this, there is the United States Small Business Administration Surety Guarantee Program, which has been in effect for nearly ten years. You will also find that there are a number of corporate sureties active in Alaska and actively seeking new bonding business. I also feel that Senate Bill 414 would result in increased costs to the State by granting projects to unqualified contractors. Which would result in defaults, rebids, late completion of projects, etc.

Another major objection would be in considering the acceptability of the State as a surety on other than State funded projects. For instance, the Federal Government requires that any surety on Federal projects or Federally funded projects appear on the U. S. Treasury list showing the name, address, assets and single bond capability of the company. This is especially true in light of the fact that in Senate Bill No. 414, under Section B, Page 7, the State would prorate payments if there were inadequate funds in the bonding fund to pay full claims. I'm sure that the Federal Government would object quite strongly to that type of surety.

Another objection is that the primary purpose of bonding is "pre-qualification" of a contractor for performance of a particular contract according to the terms and conditions and timing as laid out in the contract. This means that an independent organization has reviewed the contractor with people who have years of experience in doing just

Senator Vic Fischer

Page Three

4/21/81

that and have then decided to provide a bond.

As a voter and tax payer in Alaska, I take exception to Senate Bill 45, which increases the contract amount that is to be required to bond from \$50,000 to \$100,000. I feel that in this the State is assuming too much of the risk and also putting too much of a burden on the contracting officer in attempting to qualify contractors prior to award. It has been proven by the U. S. General Accounting Office that no other system outside of Corporate Suretyship has been found to appropriately and adequately qualify contractors, to provide an open competitive market place and to bring jobs in on time, while protecting the public. The GAO statement was: "factors that are arguing against the Government becoming a self insured (surety) are the Federal Construction Agency's lack of legal means, administrative machinery and in-house expertise for handling claims submitted by contractors, suppliers, and labor and for providing financial aid to contractors."

Even Dun and Bradstreet recognizes the fact that the contracting business has the distinction of being the industry with the highest failure rate. Their 1980 records indicated contractor failure nationwide at a 15 year high. This failure ratio compared to 1979 showed a 50% increase. In terms of dollars, the liabilities of the failed firms amounted to \$465,000,000. Sub contractor casualties were the highest since 1966.

Dun and Bradstreet study blamed the majority of failures on:

1. Incompetence
2. Financial inadequacies
3. Managerial experience
4. Inflation

Is it the responsibility of the State of Alaska to encourage the under-financed and under-experienced individuals in to competition in an already over populated construction industry? Furthermore it seems unconscionable to expect that the contracting officer underwrite decisions without the benefit of those resources available to a surety. The point is, the taxpayer is going to be asked to pick up the expenses and losses.

Senator Vic Fischer

Page Four

4/21/81

The increase in the size of projects requiring bonds would negate the one main area of expertise that the surety brings to protecting the public. This area is prequalification of the contractor which at the same time provides protection for injured parties. This promotes the reason why a system of proven surety is crucial to the people of Alaska.

Returning to Senate Bill No. 414, I might compare that to the record of the U. S. Small Business Administration which has been in the guarantee business for over nine years. In reviewing the statistics on SBA guarantees you will find that in the past nine years the SBA issued 125,371 guarantees totalling \$13 billion dollars in construction work. These guarantees were issued for 21,393 contractors of which 3,060 were minority contractors. Of this total of 21,393 contractors there were 7,007 defaults resulting in net losses to the program of \$203.5 million dollars. This does not count outstanding bonds upon which claims have been reserved and for which amounts have not yet been established. These are only dollars that have been paid out by the Small Business Administration.

You must recall that these dollars represent 80 to 90 percent of the actual losses as the surety is required to accept 10 to 20 percent of the loss. The surety also cannot receive any payment from the SBA until they can prove a loss has occurred. In any event, these losses have totalled over \$20,000,000 per year for the life of the program. No corporate surety could stand that type of loss.

I'm enclosing for your review several documents among which is a book entitled "The Unseen Services of a Surety." This shows how the corporate surety deals with losses or anticipated losses, not merely by paying out unpaid bills but by also providing engineering, accounting, and financial assistance to contractors who have gotten into trouble, in order that the project may be completed on time to the benefit of the owner. All that is contemplated under Senate Bill No. 414 is that payment be made to either the owner or to unpaid suppliers, sub-contractors, material men etc., this does not insure that the project will be completed.

This letter is becoming quite lengthy and I do have several objections to Senate Bill No. 415, however I must reserve those to a later date.

I would like to make a flat, unqualified statement that an individual or company actively engaged in a construction business, who is qualified from an educational and experience standpoint, who has adequate assets

Senator Vic Fischer

Page Five

4/21/81

to meet job expenses and who has established him/her/itself as a responsible member of society, can obtain corporate surety without State assistance. On the other hand, if a contractor is not qualified, I do not believe the State should assume the responsibility for underwriting this type of contractor. In the age of growing consumer awareness this removal of a proven safeguard could very well prove disastrous to the ongoing building and construction industry and strike a severe blow to the over-all economy of Alaska.

I would be very happy to appear at any hearing or to provide further written testimony concerning these bills upon request.

Thank you very much for your interest.

Sincerely,

A handwritten signature in cursive script, appearing to read "R. L. Richmond".

R. L. Richmond  
Vice-President/Bond Manager

RLR:da

INTRODUCTION OF BILLS (Senate) (cont'd)

Appropriation SENATE BILL NO. 413, by Senators Stimson, Fischer, Sturgulewski and  
(supplemental) Rodey. Makes a supplemental appropriation of \$144,500 from the  
(trans. for general fund for payment as a grant to the Municipality of Anchorage  
handicapped for the expenses of local transportation for the elderly and handi-  
& elderly) capped for the fiscal year ending June 30, 1981. Act provides for an  
immediate effective date.

Introduced April 10 and referred to Community and Regional Affairs,  
then to Finance.

Small Con- SENATE BILL NO. 414, by Senators Fischer and Stimson. States that  
tractor Sure- the legislature finds that many small contractors are unable to  
ty Bonding obtain at reasonable costs surety bonds necessary to bid on both pri-  
Corporation vate and public construction projects. This inability can in effect  
(estab. state reduce competition and contribute to increased costs for such projects.  
operated) Also finds that establishing a state program to provide bonding to  
small contractors at reasonable costs would promote increased competi-  
tion and reduced costs for public and private construction projects  
while maintaining acceptable risk levels for the contracting agency  
or company.

Adds a new chapter to AS 45 (Trade and Commerce). Chapter 71-Small  
Contractor Surety Bonding Corporation. Establishes the corporation  
in the Department of Commerce and Economic Development, but having a  
legal existence independent of and separate from the state. Estab-  
lishes a board of directors consisting of the commissioner of Commerce  
and Economic Development and four members appointed by the Governor  
who serve for a term of four years. Two of the appointed members  
to be small contractors who are licensed in the state and actively  
engaged in a contracting enterprise for the preceding five years. Two  
members shall be public members who may not be contractors and may not  
have a direct financial interest in or be associated by legal contract  
with a licensed contractor except as a consumer of services provided  
by a contractor. Board shall meet not less than once each four months.  
Board shall employ an executive director who may, with approval of the  
board, hire staff as necessary. Employees of the board are in the  
exempt service category. The corporation may contract for outside ser-  
vices as necessary. The attorney general is the legal counsel for the  
corporation.

Act provides for general powers of the corporation and states that it  
has the power to, "issue or participate in the issuance of surety bonds,  
including bid bonds, performance bonds and payment bonds, to eligible  
small contractors, whether as prime contractors or subcontractors,  
if the corporation determines that these bonds are not otherwise avail-  
able, wholly or in part, from a corporate surety upon reasonably equi-  
valent terms and conditions." Also allows the corporation to, "guaran-  
tee or enter into commitments to guarantee corporate sureties against  
loss as the result of a breach of the terms of a bid bond, performance  
bond, or payment bond issued to a contractor as the principal of the  
bond."

Program requires contractors to have been doing business in the state  
for at least one year and to have maintained his principal place of  
business in the state for at least one year before the date of appli-  
cation. Also requires that the person's gross revenue for the most  
recently completed fiscal year was not in excess of \$1,000,000.

SB 414, (cont'd)

The corporation may not issue to a single contractor a bond in excess of \$500,000. If more than one bond is issued to a contractor, the aggregate total of bonds outstanding at one time may not exceed \$500,000.

Act provides for fees and payments by contractors, payment by corporate sureties, and a contractor surety fund which may not exceed \$5,000,000. Outlines claims for payment, consideration of application, findings and payment, order of claim payment and right to subrogation.

The board shall prepare for the Governor and the legislature an annual report of its activities under this chapter including a summary of the amount and type of bonds issued and the disposition of claims filed with the corporation.

Adds the Small Contractor Surety Bonding Corporation to the list of state boards and commissions. Act provides an immediate effective date.

Introduced April 10 and referred to State Affairs, Labor and Commerce, then to Judiciary.

Competitive  
Bidding  
Procedures

SENATE BILL NO. 415, by Senators Fischer and Stinson. Rewrites competitive bidding procedures contained in AS 37.05.230 & 240 and requires the following contracts to be awarded in accordance with new provisions:

--Highway construction contracts for \$50,000 or more (currently only those for \$100,000 or more must solicit competitive bids) and highway maintenance contracts for \$25,000 or more (new provision). (Secs. 1-3 of bill. Amends AS 19.10.190 & 210.)

--Contracts for Local Service Roads & Trails entered into by a local government if the amount of state money is \$50,000 or more and Local Services Roads & Trails maintenance contracts for \$25,000 or more. (Secs. 4-5 of bill. Amends AS 19.30.191(b) and 211(a).)

--State public works construction contracts for \$50,000 or more (currently \$100,000) and maintenance contracts for \$25,000 or more (new provision). (Secs. 6-8 of bill. Amends AS 35.15.030 & 050.)

--Contracts entered into by a municipality or REAA for construction of a public works project if state portion is \$50,000 or more (Sec. 9 of bill. Adds new subsection (g) to AS 35.15.080, "Local Control of State Public Works Projects".)

--Contracts awarded by the University of Alaska if state money is \$50,000 or more. (Sec. 18 of bill.)

--Contracts awarded by a nonprofit corporation if state money is \$50,000 or more. (Sec. 19 of bill.)

--State grants to municipalities and other recipients who propose to award a contract of which \$50,000 or more is financed with the grant or other state money. (Secs. 20-22 of bill. Amends AS 37.05-.315.)

INTRODUCTION OF BILLS (Senate)(cont'd)

SB 415 (cont'd)

Makes the following amendments to AS 37.05.230 (Competitive Bidding):

--Sec. 10 of bill amends (1) to require that competitive bid be awarded to a bidder on the "certified minority bidders list" (created in bill) if the value of contracts awarded during the fiscal year to bidders on the list is less than 20% of the total value of contracts, the bid is not more than 15% higher than the lowest bid, and the bidder agrees to lower the bid by 5%. Subject to the foregoing provision, bids shall be awarded to Alaskan bidders if bidder is on the "certified Alaska bidders list" and bid is not more than 10% higher (currently 5% higher) than the bid of the lowest non-resident bidder. States that competitive bids are not required "(i) for contractual services when no known competition exists; (ii) when rates are fixed by law or ordinance; (iii) for items traded in on like items; or (iv) for professional services." (Existing law also exempts sales involving fair trade items and cases where, in the judgment of a purchasing agent, food, clothing, or medical supplies, or material for use in laboratory and experimental studies may be purchased otherwise to the best advantage of the state.)

--Sec. 11 of bill requires notices to be sent to those on Alaska bidders list and adds provision to (2) which allows state to "limit solicitation of bids" if it finds that it is in the best interests of the state.

--Sec. 12 of bill amends definition of "Alaska bidder" in (5) to add that person must not be delinquent in payment of state taxes and must maintain inventories or facilities in support of business activities in the state.

--Sec. 14 of bill amends (7) to state that the minority and resident bidding preference does not apply to highways & public works contracts of the Dept. of Transportation & Public Fac. estimated to be less than \$50,000 (currently resident preference does apply to contracts estimated to exceed \$5,000).

--Sec. 15 of bill amends (8) to bring contracts for \$50,000 or more for the purchase of products or services manufactured or provided by a sheltered workshop under the competitive bidding requirements.

--Sec. 16 of bill adds new paragraphs (9), (10), & (11) to AS 37.05.230: (9) directs the Dept. of Admin. to compile and update a certified Alaska bidders list; (10) directs the Dept. to compile and update a certified minority bidders list; (11) states that the minority and resident bidding preferences do not apply to purchases and contracts involving federal money received by the state if the application of a bidding preference would violate federal law or program guidelines.

Section 17 of the bill amends AS 37.05.240 relating to bid requirements and award of contracts and purchases. Adds new subsections which require a prime contractor, when submitting a bid, to name the principal subcontractors he intends to use. After bid awarded contractor may change subcontractors only "for cause." Also requires at least 20% of the money from a contract awarded under competitive bidding which is paid to subcontractors to be paid to subcontractors

INTRODUCTION OF BILLS (Senate)(cont'd)

SB 415 (cont'd)

on the certified minority bidders list, unless no subcontractors on the list are available.

Section 23 of bill adds definition of "department" (Dept. of Admin.) to definitions section of AS 37.05.

Section 24 of bill deletes current exceptions granted by AS 44.33.300 to competitive bidding requirements for state public works and highway construction contracts in areas hit by economic disaster.

Does not provide for effective date.

Introduced April 10 and referred to State Affairs, Transportation and Finance.

Appropriation  
(special)  
(Seward Hwy.  
Paving)

SENATE BILL NO. 416, by Senator Fischer. Appropriates \$65,140 from the general fund to the Dept. of Transportation & Public Fac. for payment to the Boysen Investment Corp. for an unanticipated increase in costs of petroleum products used in paving the Seward Highway (O'Malley Interchange-Potter job). Effective immediately.

Introduced April 10 and referred to Transportation and Finance.

State Health  
Insurance  
Program

SENATE BILL NO. 417, by Senators Kerttula, Dankworth, Fischer and Stinson. Directs the Commissioner of Administration to establish a state health insurance program for Alaskan residents. Minimum benefits shall be established by Commissioner by regulation and shall include hospital and medical expense benefits. Program shall not include dental care or eye glasses or hearing aids or their prescription or fitting. Premiums shall be paid by state for any resident enrolled in the program who is not enrolled in a group health insurance plan. Sets limit for annual deductibles under the program at \$100 for each enrolled resident or \$300 for each enrolled family. Copayment amount for each enrolled resident may not exceed 20% of expense covered. Sets maximum cost to enrolled resident at \$2,500 per year. Directs Commissioner of Administration, on the enactment of bill, to immediately undertake the adoption of regulations and the preparation of contracts so that coverage and benefits may begin on July 1, 1982. (New provisions added to AS 18 under Chapter 23, State Health Insurance Program.) Provides for immediate effective date.

Introduced April 10 and referred to Health, Education & Social Services and Finance.

Agricultural  
Development  
Projects

SENATE BILL NO. 418, by Senator Kerttula. Expands the powers of the Commissioner of Natural Resources (in AS 38.05.020), the Director of the Div. of Lands (in AS 36.05.035), and the Alaska Agricultural Action Council (in AS 44.33.470) by adding that those officials & that agency may "require prequalification, including the submission of conservation plans, development plans, or other plans, schedules, or programs, of persons who apply to participate in an agricultural development project." Retroactive to January 1, 1980 and effective immediately.

Introduced April 10 and referred to Resources and Finance.