

# The Surety & Fidelity Association of America

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September 15, 2014

Sent via email  
[Seth.sorensen@cityofkilgore.com](mailto:Seth.sorensen@cityofkilgore.com)

Mr. Seth Sorensen  
Director of Public Works  
City of Kilgore  
815 N. Kilgore Street  
Kilgore, TX 75662

## **Re: Kilgore Baseball Complex**

Dear Mr. Sorensen:

The Surety & Fidelity Association of America (SFAA) is a national trade association of companies licensed to write fidelity and surety insurance in the United States. SFAA's approximately 420 members are sureties on the vast majority of contract performance and payment bonds written in the United States and in Texas. It has come to our attention that the City of Kilgore has chosen to waive performance and payment bonds for the captioned project despite the fact they are required under § 2253.021 of the V.T.C.A., Government Code.

As we understand the facts, the City of Kilgore received bids for a project to design and construct buildings as part of the Kilgore Baseball Complex. These bids were rejected because they were well beyond the budget allotted for the projects. As disclosed in recent press reports, you believe that waiving bonding requirements will reduce costs to the City and enable small or local contractors to bid. With the goal of saving money in mind, the City will be assuming the risk and liability to ensure all contractors, subcontractors, equipment rental companies, suppliers, vendors and others are paid for their portion of the project. The City further acknowledges that waiving bonds is illegal but the City is willing to disregard the statutory requirement because there are no apparent repercussions. We ask that you reconsider this opinion and weigh the risks and expense that this decision will have for the citizens of the City of Kilgore, to whom the Council owes a fiduciary duty.

Setting aside the illegality of the action, the premise that waiving bonds presents a cost savings to the City is misguided. The facts are that a waiver of bonding creates greater risk to all parties and shifts undue risk to the City, which is already working under budget restraints, and to the local, small and minority contractors.

The construction business is risky. The surety industry is established to protect taxpayers and subcontractors against the performance and payment risks. The savings in premium pales in comparison to the overwhelming costs to complete a failed project. The City of Harrisburg is illustrative of the risk and impact of failure to bond. In that case, the city was having a difficult time finding a contractor who was bondable to retrofit Harrisburg's incinerator for \$120 mil. The council voted to accept a contractor who was unbondable but provided a bid of \$77 million to perform the project. The low bid enticed the decision makers to accept the contractor. The contractor defaulted and the city was left to finish the project and amassed over \$280 mil in debt to do so. The City of Harrisburg was forced to file bankruptcy in 2011. The entire story can be found at: <http://www.governing.com/topics/transportation-infrastructure/Harrisburgs-failed-infrastructure-project.html>. There are many claim stories that could be discussed, and most of the stories involve the surety coming in and completing the work and paying the subcontractors. A very public recent example of this, in Texas, is Ballenger Construction, a road builder who filed bankruptcy resulting in losses to the surety industry of over \$100 million. While these examples represent large losses, it is very common for sureties to be involved in smaller claims too. In fact, the surety industry 2013 loss experience in Texas, for state and local government contracts alone, was over \$223 million not including expenses.

Accepting bids from contractors without requiring bonds increases the likelihood that an unqualified contractor will present a low bid on a project to get the work. One of the key benefits of bonding is that the surety prequalifies the contractor. The contractor submits itself to a rigorous underwriting process where the surety vets the contractor's creditworthiness, capabilities to perform, and its character. The surety has a wider lens than an owner and is looking at all the work the contractor has underway, not just a single job. Once the surety completes its process, if the contractor is determined to be bondable, the surety then lends its financial support to the project, which is another benefit of bonding – a deep pocket to meet excess costs if the contractor fails. By issuing a bond, the surety provides the public contracting entity with the review of an independent third party that the contractor will be able to complete the construction contract and pay everyone that works on the job. In the event that there is a default, the surety is obligated to remedy the default.

The surety also provides financial protection to subcontractors and suppliers. One of the reasons bonding exists is because the subcontractors and suppliers usually are unable to lien public works projects. If a public entity in Texas fails to require the statutory bonds, that public entity becomes liable just as the payment bond surety would have been liable. V.T.C.A., Government Code § 2253.027. However, unpaid subcontractors and suppliers do not obtain a right to lien the project, merely funds

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unpaid to the contractor. Further, we note the City has not established a claims process, the absence of which will adversely impact the subcontractors, particularly the smaller and more vulnerable emerging and minority contractors. Without a surety bond, this claims process could prove to be cost prohibitive for wronged first tier subcontractors and may be impossible for lower tier subcontractors.

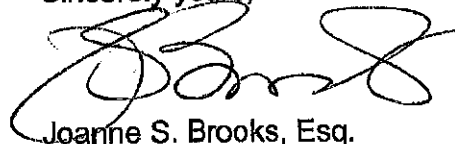
A second consideration in assuming liability for unpaid subcontractors and suppliers is that in Texas, a surety is bound to strict prompt payment laws and procedures set forth in V.T.C.A. Insurance Code §3503-056. What is not clear is how the City will meet those requirements in the absence of bonding. How will the City comply with prompt payment requirements? Ultimately, it does not appear that the City has weighed the expense that will be incurred to set up claim procedures to deal with routine disputes or those that could escalate into a default claim.

Council Member Merlyn Holmes got it right. The City of Kilgore does not want to find itself in a default situation with no performance and payment bond financial protection and without the claim handling expertise that comes with a surety bond. We recommend that performance and payment bonds be required as required by the Texas legislature.

We welcome the opportunity to discuss this matter with you at your convenience.

Since action already has been taken by the City Council, we are copying the Mayor and Council Members for their consideration as well.

Sincerely yours,



Joanne S. Brooks, Esq.  
Vice President & Counsel

R.E. Spradlin III, Mayor (Presiding officer)  
Merlyn Holmes, Council Member, Place 1  
Harvey McClendon, Mayor Pro tem, Council Member, Place 2  
Neil Barr, Council Member, Place 3  
Lori Weatherford, Council Member, Place 4