

NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS

Written Testimony of Mark H. McCallum
Chief Executive Officer

Before the U.S. House of Representatives
Committee on Small Business
Subcommittee on Contracting and Workforce

In Support of

H.R. 776
The Security in Bonding Act of 2013



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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 firms employing licensed surety bond producers placing bid, performance, and payment bonds throughout the United States and its territories. NASBP wishes to extend its appreciation to Chairman Hanna, Ranking Member Meng, and to the members of the Subcommittee on Contracting and Workforce of the U.S. House of Representatives' Committee on Small Business for the opportunity to provide written and oral testimony in strong support of H.R. 776, the "Security in Bonding Act of 2013."

By way of background, our testimony will begin with a brief description of the important role surety bonds play in the federal procurement arena.

The Importance of Surety Bonds: Sound Public Policy

Corporate surety bonds are three-party contract agreements by which one party (a surety company) guarantees or promises a second party (the obligee/federal government) the successful performance of an obligation by a third party (the principal/contractor). In deciding to grant surety credit, the surety underwriter conducts in-depth analysis, also known as prequalification, of the capital, capacity and character of the construction firm during the underwriting process to determine the contractor'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 federal government has relied on surety bonds for prequalification of construction contractors and for performance and payment assurances since the late nineteenth century. In 1894, the U.S. Congress passed the Heard Act which codified the requirement for surety on U.S. government contracts and institutionalized the business of surety. In 1935, the Heard Act was superseded by the Miller Act, which required the continuation of these vital assurances so that U.S. taxpayer funds were protected and subcontractors and suppliers would receive payment for their labor and materials. Today, the Miller Act and applicable regulations require that, before any contract exceeding \$150,000 is awarded for a federal construction contract, the prime contractor must furnish a performance bond and a payment bond to the contracting agency.

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 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 federal 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.

Role of the Bond Producer

The bond producer plays a vital role in the federal construction process. The bond producer stands as the “bridge” between the construction firm and the surety company. The bond producer works closely with the construction business as an advisor, educator, and matchmaker to position the business to meet underwriting requirements in order to obtain surety credit.

The objective of the producer is not only to assist the contractor with obtaining surety credit for each contract requiring surety credit but to ensure that the contractor’s business remains viable and thrives for years to come. To that end, bond producers assist construction firms of all sizes with creating networks of knowledgeable professional service providers, such as construction attorneys, certified public accountants familiar with construction business practices, and construction lenders, and may assist construction firms with market intelligence and even strategic and succession planning.

H.R. 776 Supporters

NASBP, along with the Associated Builders and Contractors, Inc. (ABC), the Associated General Contractors of America (AGC), the American Subcontractors Association (ASA), the Mechanical Contractors Association of America (MCAA), the Mid America Government Industry Coalition, Inc. (MAGIC), the Sheet Metal and Air Conditioning Contractors' National Association (SMACNA), the Construction Financial Management Association (CFMA), the Surety & Fidelity Association of America (SFAA) and the American Insurance Association (AIA) view H.R. 776 as a critical means to protect taxpayers, federal contracting entities, and construction businesses of all sizes by assuring the integrity of surety bonds on federal contracts when issued by individuals using a pledge of assets.

Engineering News Record (ENR), a prominent construction industry trade magazine published by McGraw-Hill Construction, with a circulation exceeding 250,000 subscribers, recently endorsed H.R. 776 after examining the practices and assets of individual sureties in a recent special report titled, “A Bold Individual Surety Claims His Coal-Backed Bonds are Rock Solid.”¹ ENR stated in its editorial that an overhaul of individual surety asset rules is now needed. An important public benefit of the bill, according to ENR, will be the clear view it provides of the individual surety’s assets.² Moreover, “being able to see clearly the asset backing the bond will allow contractors and federal contracting officers to know the guarantees promised on paper are backed by honest companies pledging real assets.”³

¹ Korman, Richard. “A Bold Individual Surety Claims His Coal-Backed Bonds are Rock Solid”. *Engineering News Record (ENR)*. February 21, 2013.

² “Clarity Needed on Individual Surety Assets”. Editorial. *ENR*. March 4, 2013.

³ *Ibid*.

**H.R. 776 Enhances Protection of Federal Contracting Agencies,
Taxpayer Funds, and Construction Firms
Furnishing Labor & Materials on Federal Projects**

As noted earlier, the Federal Miller Act requires contractors to furnish surety bonds on federal construction projects to ensure that prospective contractors are qualified to undertake federal construction contracts and that bonded contracts will be completed in the event of a contractor default, thereby protecting precious U.S. taxpayer dollars and subcontractors and suppliers, many of which are small businesses. The financial strength and stability of the surety is the key to the success of the surety bonding system.

Presently, there are three methods construction firms may use to furnish security on a federal construction project:

1. By securing a bond written by a corporate surety, that is vetted, approved, and audited by the U.S. Department of Treasury and listed in its Circular 570;
2. By using their own assets to post an “eligible obligation,” i.e. a U.S.-backed security, in lieu of a surety bond. The security is pledged directly and deposited with the federal government until the contract is complete; or
3. By securing a bond from an unlicensed individual, if the bond is secured by an “acceptable asset,” which includes stocks, bonds, and real property owned in fee simple.

It is this third alternative that has proven consistently problematic to the financial detriment of contracting authorities and of subcontractors and suppliers performing on federal projects. NASBP, along with the other organizations supporting H.R. 776, believe that the current regulations pertaining to use of individual sureties on federal construction projects are fundamentally flawed, allowing gamesmanship by unlicensed persons acting as sureties. Such existing requirements need to be superseded by the statutory approach delineated in H.R. 776.

Federal Acquisition Regulation (FAR) 28.203-2(b)(3) permits federal contracting officers to accept bonds from natural persons, not companies, if the bond is secured by an “acceptable asset,” which includes stocks, bonds, and real property. These individuals neither are subject to the same scrutiny and vetting given to corporate sureties nor are they required to provide physical custody of the asset to the government that they pledge to secure their bonds to the contracting authority.

This lack of thorough scrutiny of individual sureties and control over their pledged assets has resulted in a number of documented situations where assets pledged by individual sureties have proven to be illusory or insufficient, causing significant financial harm to the federal government, to taxpayers, and to subcontractors and suppliers, many of whom are small businesses wholly reliant on the protections of payment bonds to safeguard their businesses.

Federal requirements do mandate a level of documentation and information from individual sureties. Individual sureties are required to complete, sign, and have notarized an affidavit of individual surety (SF 28), which is a standardized form for the purpose of eliciting a description of the assets pledged and the contracts on which they are pledged. SF 28, however, does not elicit other pertinent information, such as that about the character or fitness of the individual acting as surety, like criminal convictions, state insurance commissioner cease and desist orders, outstanding tax liens, or personal bankruptcies.

Under FAR requirements, the pledged assets also are supposed to be placed in an escrow arrangement by the individual surety, subject to the approval of the contracting officer. The individual surety, however, is not required to turn the assets over to the physical custody of the contracting authority. Each contracting officer, not the Department of Treasury, shoulders the entire burden of determining the acceptability of the individual surety, its documentation, the escrow or security arrangement, and the value and adequacy of pledged assets, and must do so in relatively short order to progress the contract procurement. A missed, incorrect, or forsaken step may mean the acceptance of a fraudulent or insufficient bond, rendering its apparent and much needed protection worthless.

This burden of assessing individual sureties is added to the already considerable responsibilities of contracting officers. They are required to determine the authenticity of the documentation of the assets pledged to support the individual surety's bond obligations and to verify that the pledged assets actually exist, are sufficient, and are available to the federal government. They have to know that a particular financial document is what it purports to be and to understand and to assess the different types of collateral, such as stocks and real estate located anywhere in the United States.

It is not clear if and how often federal contracting officers receive specific training to understand and to perform the needed tasks of examination concerning individual sureties. Documents of federal agencies suggest that there are occasions when federal contracting officers may not have a complete understanding of what is required of them to safeguard taxpayers and small businesses from individual surety fraud. The Financial Management Service of the U.S. Department of Treasury issued a "Special Informational Notice to All Bond-Approving (Contracting) Officers"⁴ on February 3, 2006, still posted on the web site for the Financial Management Service at http://www.fms.treas.gov/c570/special_notice.pdf. This informational notice was directed to federal contracting officers to remind them of the applicable FAR requirements governing individual sureties. Specifically, the notice, a copy of which is attached to this testimony, states in part:

"Although FMS is not substantively responsible for approving individual sureties, we believe it prudent to issue this Special Informational Notice

⁴ United States. Treasury Department. Financial Management Service. "Special Informational Notice to All Bond-Approving (Contracting) Officers". February 3, 2006.

on a FYI basis to Agency Bond-Approving (Contracting) Officers who do have that responsibility under the FAR.

Recently, FMS has been made aware of instances where individual sureties are listing corporate debenture notes and other questionable assets on their 'Affidavit of Individual Surety', Standard Form 28. In some instances, the individual sureties used a form other than the Standard Form 28 as their affidavit."

Likewise, the U.S. Department of the Interior issued a notice to its contracting officers in 2009 to remind them of FAR requirements associated with acceptance of individual surety bonds. This notice, titled "Department of the Interior Acquisition Policy Release (DIAPR) 2009-15," states that the Department of the Interior Office of Inspector General conducted an investigation of contracting personnel practices concerning individual sureties and found concerns.⁵ Specifically, the release, a copy of which is attached to this testimony, states in part:

"The investigation identified several areas of concern that require our attention. There is concern that Contracting Officers (COs) are: (1) unfamiliar with the FAR requirements for individual surety; (2) accepting individual surety bonds without knowing or verifying the assets backing the bonds; (3) not vetting questions about individual surety bonds through the DOI Office of the Solicitor; and (4) not verifying individual sureties against the General Services Administration's Excluded Parties List System."

If a contracting officer fails to perform adequately the necessary investigation of an individual surety, and the individual surety pledges assets that do not exist, are insufficient, or are not readily convertible into cash to pay the obligations of the defaulted general contractor, everyone on the project from the contracting agency on down is left unprotected and at risk for financial loss. If the assets pledged to support the bonds are uncollectible, unpaid subcontractors and suppliers protected by the bond, many of which typically are small businesses, will suffer financial hardship and could, in turn, default and become insolvent.

Examples of Improper Individual Surety Activity

Little statistical data on individual surety problems is available, because individual sureties typically operate outside of state insurance regulatory structures, despite the fact that they are required under almost all state insurance codes to obtain certificates of authority to act as a surety insurer from state insurance commissioners. Moreover, the federal government does not require individual sureties writing bonds on federal contracts to furnish proof of licensure or authority to operate in a state jurisdiction as an surety insurer. Nonetheless, in recent years, illustrations of individual surety problems abound. These situations usually involve individual surety bond assets that turned out to

⁵ United States. Department of the Interior. "Department of the Interior Acquisition Policy Release (DIAPR) 2009-15". September 8, 2009.

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 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 testimony⁶ about this situation during a hearing on H.R. 3534, a predecessor bill to H.R. 776, 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.”⁷ 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 nondischargeable. His false statements then formed the basis of a criminal indictment against Sears, who currently is undergoing criminal prosecution in the U.S. District Court for the South District of Alabama.

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.⁸ 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.⁹ It is alleged that Black repeatedly pledged the same small piece of real property to insure multi-million dollar state and federal construction contracts. Mr. Black currently awaits criminal sentencing in June by the U.S. District Court for the Southern District of Texas, Houston Division.

Mr. Robert Joe Hanson, aka Robert Joe Lyon, aka Dennis Joe Lyon, aka “Chief Joe Blue Eyes” has acted as an individual surety and as an unauthorized surety company on private and public contracts, including federal contracts, under such names as Global Bonding,

⁶ Wellers, Jeanette. Written Testimony before U.S. House Committee on the Judiciary Subcommittee on Courts, Commercial and Administrative Law. March 5, 2012.

⁷ 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.

⁸ 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.

⁹ 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.

Millennium Bonding Enterprises, Shonto Surety, Southwest Surety, or Navajo All Risk, Inc. and Native American Funds Management Services. Lyon/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 \$645,561¹⁰ for supplying bid and performance bonds without a license and without verifiable assets to support these bonds. In October 2012, Lyon 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 Lyon's unlicensed individual surety company, Native American Funds Management Services¹¹. 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 Lyon/Hanson from continuing to issue worthless bonds by changing aliases and jurisdictions.

The above individuals operated nationally and across state boundaries, victimizing public and private entities, small construction businesses, and businesses of all sizes. These examples, unfortunately, are not isolated instances. Other examples exist, both past and present, showing where individual surety bond assets proved illusory, uncollectible, or deficient. More businesses, many of whom are likely to be small businesses, will be victimized unless Congress acts to correct these flawed requirements, which permit unscrupulous individuals, many with criminal, personal insolvency, and tax lien histories, to issue worthless surety bonds on taxpayer-funded federal construction contracts.

Common-Sense Legislative Solution

H.R. 776, the "Security in Bonding Act of 2013," is a simple, common-sense legislative solution that will eliminate opportunities for fraud by mandating that real assets be placed in the care and custody of the contracting authority. The bill requires individual sureties to pledge solely those assets defined as eligible obligations by the Secretary of the Treasury. An eligible obligation is a public debt obligation of the U.S. Government and an obligation whose principal and interest is unconditionally guaranteed by the U.S. Government, such as U.S. Treasury bills, notes, and bonds, certain HUD government guaranteed notes and certificates, and certain Ginnie Mae securities, among other federally guaranteed securities. These safe and stable assets then are provided to the federal contracting authority, which will deposit them in a federal depository designated by the Secretary of the Treasury, ensuring that pledged assets are real, sufficient, convertible, and in the physical custody and control of the federal government. This is nothing more than what now is statutorily required of contractors who wish to pledge collateral as security on a federal contract in lieu of a surety bond.

If enacted, H.R. 776 will eliminate the gamesmanship and opportunities for fraud endemic in the current regulatory system governing individual surety bonds and pledged assets and will remove a considerable administrative burden from federal contracting officers. Federal contracting officers no longer will need to assess a range of pledged

¹⁰ Richey, Erin. "Montana Adds to Fines Against Alleged Surety Con Artist". *ENR*. December 4, 2012.

¹¹ *Ibid*.

assets, as all pledged assets will be limited to assets unconditionally guaranteed by the federal government; they simply will need to gain custody over the asset to deposit the asset in a federal depository, such as the Federal Reserve Bank, St. Louis. The asset will be released upon successful performance of the bonded obligation, with any accrued interest inuring to the benefit of the individual surety pledging the government-backed asset.

Construction businesses working on a construction project—either as subcontractors, suppliers, or workers on the job—have no control over the prime contractor’s choice of security provided to the federal government, but they suffer the most harm financially if the provided security proves illusory. The impact is particularly acute on small construction businesses, which may not have the strength to weather a significant disruption to their cash flow. Passage of H.R. 776 will mean that contracting agencies and the numerous subcontractors and suppliers on federal construction projects, in the event of a performance or payment default will know that adequate and reliable security is in place to guarantee that they will be paid for their valid claims.

Enhance the SBA Surety Bond Guarantee Program: Increase the Guarantee to 90% for Surety Companies

The SBA Surety Bond Guarantee Program (Program) was created decades ago to ensure that small and emerging contractors have the opportunity to bid on public construction work, grow their businesses and remain a viable part of the U.S. economy. The Program was created with the goal of providing surety bonds to small and emerging contractors that may not otherwise qualify for bonds in the standard surety market. Under the direction of Frank Lalumiere, the Program’s Director, the Program has undertaken important efforts to improve its functioning, for example, by streamlining its application processes, implementing a “fast track” application for bonds under \$250,000, quickly responding to claims, and expanding the Program’s reach to include design-build contracts. This year, significant enhancements were made to the Program to assist small and emerging contractors by increasing the contract size amount guaranteed by the SBA from \$2 million to \$6.5 million. These changes are expected provide greater access to private and public contracts and secure larger contracts vital to small business growth.

These recent SBA efforts have improved surety company participation, but NASBP believes that greater surety company participation could be realized by offering a higher guarantee percentage, such as a guarantee of 90 percent, which is contemplated in Section 3 of H.R. 776. Increasing the guarantee would permit more sureties to make the internal business case for underwriting emerging businesses through the Program. The increase in guarantees likely will stimulate greater corporate surety participation, providing more regulated surety markets to small businesses which otherwise do not qualify for surety credit in the standard market. These small businesses, which typically have very little working capital, are often the ones that are tempted by unscrupulous individual sureties that seek vulnerable businesses, offering surety credit to anyone, regardless of the firm’s qualifications, financial wherewithal, or experience, and at rates many times higher than corporate surety markets.

Conclusion

NASBP appreciates the opportunity to provide the Subcommittee with information about the compelling need to enact H.R. 776: (1) to protect taxpayer funds and construction businesses performing as subcontractors and suppliers on federal construction contracts and (2) to raise awareness about important issues and enhancements made to the SBA Surety Bond Guarantees Program. NASBP hopes its testimony proves beneficial and welcomes any inquiries from the Subcommittee on the points raised in this written testimony or on other matters pertinent to small businesses and surety bonding.

A Bold Individual Surety Claims His Coal-Backed Bonds are Rock Solid | ENR: Engineering News Record | McGraw-Hill Construction

http://enr.construction.com/business_management/ethics_corruption/2013/0225-a-bold-individual-surety-claims-his-coal-backed-bonds-are-rock-solid.asp

February 21, 2013

Richard Korman

Slide Show

photo by lundy bailey

Coal Controversy Scarborough has pledged coal waste at this West Virginia tract as the asset backing his bonds.

----- Advertising -----

Special Investigative Report Individual surety has had plenty of shady dealings. One of the regulars in the field, Robert Joe Hanson, has received cease-and-desist orders for insurance-related violations in at least 10 states in as many years. His latest scrape with the law came last year in Montana, where state regulators accused him of selling bogus surety bonds to Native American contractors under a new alias, Chief Joe Blue Eyes. Created by federal regulations for small contractors as an alternative to more risk-averse corporate sureties, individual sureties are people willing to provide payment and performance bonds—guarantees made in exchange for a premium based on a small percentage of the contract—to small firms that would otherwise fail to qualify for public-works projects.

Corporate sureties and brokers view these individuals with disdain, calling their practices a taint on the industry and citing examples such as Hanson, who has pledged assets of questionable value that may not exist at all. The corporate sureties want to tighten the rules on assets via legislation in a way that would knock most individual sureties out of business—including an antagonist who claims he is providing a service for an underserved market that corporate sureties avoid.

Unlike individual sureties who have stayed in the shadows, Edmund C. Scarborough is the founder and chairman of the U.S. Individual Surety Association. The website of Scarborough's Charlottesville, Va.-based company, IBCS Fidelity, boasts of being capable of providing bonds as high as \$50 million, "far surpassing most other sureties," as the website says.



"If you or your clients have been told NO by traditional sureties, try one of our many services," the website proclaims.

A burly former Florida contractor who claims to have written 6,000 to 7,000 bonds for small federal, state and local contractors, Scarborough says he has developed a business with revenue from bond premiums of \$5 million to \$6 million a year. He says he backs his bonds with about 15 million tons of Kentucky and West Virginia usable coal waste. He also says the bonds are as solid as those provided by A.M. Best-rated insurance companies, such as Travelers and Liberty Mutual.



Scarborough has a gift for hitting the corporate surety world, deploying a narrative in which he plays a noble, unbending David struggling valiantly against corporate surety's imposing Goliath—all for the benefit of small and minority contractors.

"We've had hundreds of bonds accepted by the federal government—and hundreds also rejected—and the only common denominator among the rejected bonds is that they were all minority contractors," he says. If Congress adopts the proposed asset rule changes, eliminating coal products and requiring a federal Treasury bond or something similar, corporate sureties would have "won their battle at the expense of the overwhelming majority of small, up-and-coming or independent contractors, who would no longer exist."

In Scarborough's view, the surety playing field tilts steeply to the corporate side. Everything works against the individual surety providers and their clients. For one thing, corporate sureties can leverage the assets backing their bonds, while an individual surety must back them on a dollar-for-dollar basis. Furthermore, in Scarborough's case, corporate sureties nitpick over whether coal is more like a speculative asset (such as antiques) forbidden under federal rules or more like a share of an actively traded stock, which is allowed.

For accounting purposes, corporate surety is covered by detailed rules for risk-based capital; any bond requires a certain amount of risk-based capital behind it. Even accounting rules for sureties are rigged, he claims. "The surety world is the only entity that [generally accepted accounting

principles] say you don't have to report the liability on your books because it's a third-party guarantee," says Scarborough. "And they call me a crook."

Scarborough's adversaries may agree with that quote but keep quiet because they fear what they call his litigious streak. Scarborough has kept several lawyers skilled in the art of litigation quite busy.

Does Scarborough deserve a place in a small-business Hall of Fame or in a rogues' gallery with figures such as Robert Joe Hanson? The answer may depend on the value of Scarborough's hard-to-verify coal holdings and his opponents' will to outlast him in court battles.

For eight years, Scarborough has engaged the U.S. government and the corporate surety industry in the judicial equivalent of trench warfare. In 2005, he sued the U.S. Army and the National Association of Surety Bond Producers (NASBP) over their disclosure of information about an Army investigation of individual sureties and possible fraud. Although he and NASBP settled long ago, on Jan. 15 Scarborough filed an amended complaint in his claim against the U.S. Army. The complaint alleges the Army violated the federal Privacy Act in divulging details of Scarborough's business publicly.

A separate matter carried the bond battle from federal court to Capitol Hill. In 2011, surety bond brokers, insurers and major contracting associations threw their support behind H.R. 3534, the Security in Bonding Act, which passed the House of Representatives last year but died in the Senate. It would have tightened asset rules, requiring U.S. Treasury bonds or related debt securities to be placed in escrow and held by the obligee. Rep. Richard Hanna (R-N.Y.) reintroduced the measure this year on Feb. 15. It included an expansion of the Small Business Administration's surety loan guarantees.

Data Lacking at Federal Agencies

In an effort to gauge the impact of individual sureties, ENR sent Freedom of Information Act requests to eight federal agencies to determine how many are in use on federal projects. Most had no data about how often individual surety bonds have been accepted.

Scarborough has never been charged or convicted of a surety-related criminal offense. But state regulators have ordered him not to do business in Iowa and Virginia, and he has been embroiled in numerous lawsuits. Civil court and state regulatory records provide a glimpse into the controversies that have flared over Scarborough's business dealings. As part of its investigation, ENR reviewed thousands of pages of court pleadings, evidence and cease-and-desist orders and interviewed a number of Scarborough's business associates, clients and adversaries.

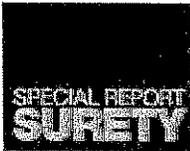
Under payment and performance surety guarantees, the surety promises to finish work or make payments on behalf of the contractor if the contractor defaults. Scarborough presents a real alternative to corporate sureties that stick to rigorous underwriting designed to avert losses. "I respect the man," says Wayne Frazier, president of the Maryland–Washington Minority Contractors Association. "He is a maverick and tough to deal with, and most successful business people are that way."

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February 21, 2013

Richard Korman



BONDS

What is less clear is the way Scarborough appears to have evaded the risks typically undertaken by a surety, such as transferring the risk to owners and contractors via contract terms or artful phrases in bond agreements.

For example, Scarborough's bond agreements previously stated that the premium or fee was "fully earned" on execution of his bond agreement. However, in several instances in which the project was canceled or the bond rejected, he refused to give back the six-figure premiums. He says he has since changed his policy, and now will give the money back or provide a credit. When faced with a claim, Scarborough also appears at times to rely on contractual terms in the small print of the bond agreements. That and the now-changed fee policy has led to litigation (see box).

Steven Golia, president of Scarborough's IBCS Fidelity, says lawsuits aren't necessarily a sign that anything is wrong. "When wrongly accused and taken advantage of, we stand up. We fight the good fight."

Another way Scarborough reduces his risk, his critics claim, has been by apparently inflating the value of the assets backing some of his bonds. To fully understand the issue, one needs to review the bond-related documents, visit coal country, the hills and impoundment ponds of places such as Nicholas County, W.Va., and learn a bit more about Scarborough.

Early Career and Starting an Individual Surety

A 1980 graduate of Hillsborough High School in Tampa, Fla., Scarborough started as a rod man on a survey crew, loading equipment and laying out stakes, according to his 2007 sworn deposition testimony given in his lawsuit against NASBP. Scarborough says he was trying to start his own business in Tampa in the mid-1980s when, while only 20 years old, he inadvertently wrote numerous worthless checks, most of which were for small amounts. He eventually served part of a one-year jail sentence for fraud.

The total amount owed was \$330,000. "I paid everybody every penny," Scarborough said in the

NASBP deposition. In 2008, former Florida Gov. Charlie Crist issued Scarborough a pardon, helping to wipe a grand theft conviction from his record.

Scarborough returned to construction and worked for a New Jersey-based contractor, Megan Group, reaching the position of executive vice president, according to Scarborough's deposition. Late in 2003, he says he left Megan Group, but by this time he was also operating his own company, Scarborough Civil Corp.

A disaster struck in July 2000, when an unsupported trench caved in and killed two Scarborough Civil employees. Federal safety officials proposed a penalty against the firm. While Scarborough says he was devastated by the loss of the two employees, the families of the two workers sought additional restitution beyond what was covered by insurance. Scarborough sold his company, and the year after the accident he and his wife and business partner, Yvonne, filed for Chapter 13 bankruptcy protection in federal court.

A turn of fortune was not far off. Scarborough set himself up in a new individual surety business in late 2003. In April 2004, he signed a memorandum of understanding under which bonds he wrote would be backed with collateral or reinsured by Larry J. Wright, whom a Baltimore jury had convicted of surety fraud in 1992. As it turned out, Wright also backed bonds for Hanson, who sold them to Montana contractors, according to orders filed by the Montana state auditor in 2007 banning Hanson from insurance activity. For those Montana bonds, Wright's company, Underwriters Reinsurance, stated that it had a balance sheet rich with cash and equivalents worth half a billion dollars and another half billion in gold and precious metals, according to the Montana state auditor.

Scarborough said in the 2007 NASBP deposition that he didn't have reasons to question the asset pledged by Wright and relied on Underwriters Reinsurance's balance sheet.

The same year that Scarborough started as an individual surety, Special Agent Christopher Hamblen of the Army's Criminal Investigation Division began looking into fraudulent surety bonds on federal projects. The investigation centered on Hanson but also encompassed Scarborough, Wright and George Gowen, who provided trust receipts that appeared to back Scarborough's bond assets. Hanson could not be reached for comment.

Hamblen created and issued a so-called criminal alert notice, a government document whose aim was to advise [Dept. of Defense] officials of possible fraudulent activity and collect information for the investigation. NASBP, in the April-May 2005 issue of its newsletter, the Pipeline, reproduced the text of the criminal alert notice. The results were far-reaching and costly, fouling up potentially profitable bond placements with important construction contractors, Scarborough said in the deposition.

Scarborough, Wright and Gowen retaliated by suing the Army and the association. The three plaintiffs alleged that the criminal alert notice contained "personal and confidential information about them" and implicated them in "the alleged fraudulent and criminal activities of Hanson." Much of the information was inaccurate and misleading, the plaintiffs argued, and "in no way relates to their current businesses or Scarborough's issuance of bonds."

Despite the blow from the criminal alert notice, Scarborough's surety business had gross receipts of \$5.8 million in 2006, from which Scarborough and his wife paid themselves \$448,000 in salary, according to discussions of his tax returns in the deposition. Around this time, Scarborough also was looking to expand his influence, hiring Washington, D.C., lobbyist Gilbert Genn and, with others, pushing for new laws to open the doors to individual surety in Florida, New York and other states. A 2006 law in Maryland partly opened that state's public works to individual surety guarantees for public projects.

"I wrote it," Scarborough in the deposition said of the Maryland law.

About this time, Scarborough revamped his bond program, parting ways with Wright and Hanson ("I wasn't crazy about them," Scarborough says). To back his bonds, he started to acquire coal properties, including ones in West Virginia and Kentucky. He also continued to expand his reach and clientele, promising to provide up to \$50 million in surety credit.

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Issue: 03/04/2013

Clarity Needed on Individual Surety Assets

03/04/2013

by the editors of ENR

Text size: **A** **A**

Related Links:

- [ENR's Individual Surety Special Report](#)
- [Editorial: Why Bond Assets Need Scrutiny](#)

ENR's recent special report on individual surety suggests that an overhaul of individual-surety asset rules is needed now more than ever. The Security in Bonding Act, which passed the House last year but died in the Senate, has been resubmitted to the House by Rep. Richard Hanna (R-N.Y.), and Congress soon will have another chance to make certain that surety guarantees pledged on federal projects are backed by legitimate, easy-to-verify assets.

The U.S. has seen enough mystifying complexity in securities in recent years to learn that, in financial matters, transparency is a necessity, not just a virtue.

One part of Rep. Hanna's proposed legislation would increase the federal government's guarantee under the Small Business Administration's surety-bond guarantee program. Recent revisions to the SBA program have tripled the eligible amount, to \$6.5 million from \$2 million, that SBA will guarantee. Any additional flexibility should help make bonds available to more small and minority contractors.

The bill would require any individual surety to pledge very specific assets, such as a Treasury bill or a similar instrument, and place them under the control of a government entity. This pathway would eliminate some of the alleged fraud that has occurred and take the guesswork out of the asset verification process for federal contracting officers.

Reasonable Certainty About Claims

Another important public benefit of the proposed bill concerns the clear view it provides of the individual surety's asset. When the asset is easier to verify, project members who hold payment and performance bonds can reasonably expect that claims will be met.

This area is where last year's House subcommittee hearing on the bill provides important lessons. Past individual-surety frauds have used schemes involving re-insurance, mine securities and precious metals.

The extent of the possible deception can be seen in the June 2003 balance-sheet statement of Underwriters Reinsurance Co. The balance sheet listed assets of \$1 billion, with half the value in "cash equivalents (Gold and Precious Metals)." To demonstrate the rock-solid legitimacy of the pledged assets, Underwriters Reinsurance used a "re-insurance debenture," chosen apparently for its formidable-sounding name, to confirm that the assets on the balance sheet will be available to benefit the project's owner and contractors. This is where contractors and contracting officers must be careful: Financial instruments such as debentures and trust receipts don't necessarily guarantee that the asset's value has been verified. Busy small contractors have little time to sort through it all.

Being able to see clearly the asset backing a bond will allow contractors and federal contracting officers to know the guarantees promised on paper are backed by honest companies pledging real assets.

Keywords: Surety; Individuals; Hanna

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Telephone (202) 874-6850

February 3, 2006

**SPECIAL INFORMATIONAL NOTICE TO ALL BOND-APPROVING
(CONTRACTING) OFFICERS**

Important Information Regarding the Use of Individual Sureties on Federal Bonds

Subchapter E, Part 28 of the Federal Acquisition Regulation (FAR) provides guidance as to the acceptability of sureties and other security for Federal bonds. Acceptable security on Federal bonds include, but are not limited to, both corporate and individual sureties. FAR § 28.201. Acceptable corporate sureties must appear on the Department of Treasury's Circular 570. Treasury's Financial Management Service, Surety Bond Branch (FMS), publishes Department Circular 570 in the Federal Register.

Contracting officers determine the acceptability of individual sureties and ensure that the individual surety's pledged assets are sufficient to cover the bond obligation in accordance with the guidance outlined in the FAR § 28.203.

Although FMS is not substantively responsible for approving individual sureties, we believe it prudent to issue this Special Informational Notice on a FYI basis to Agency Bond-Approving (Contracting) Officers who do have that responsibility under the FAR.

Recently, FMS has been made aware of instances where **individual sureties are listing corporate debenture notes and other questionable assets on their "Affidavit of Individual Surety"**, Standard Form 28. In some instances, the individual sureties used a form other than the Standard Form 28 as their affidavit. **FAR § 28.203(b) specifically requires the use of the Standard Form 28.** In addition, FAR § 28.203-2(a) states that **"the Government will accept only cash, readily marketable assets, or irrevocable letters of credit from a federally insured financial institution from individual sureties to satisfy the underlying bond obligations."**

FAR § 28.203-2(b) includes **examples of acceptable assets**, such as:

- cash, or certificates of deposit, or other cash equivalents with a federally insured financial institution
- United State Government securities
- stocks and bonds actively traded on a national U.S. security exchange
- real property owned fee simple by the surety subject to certain conditions (refer to FAR 28.203-2(b)(4))
- irrevocable letters of credit issued by a federally insured financial institution in the name of the contracting agency and which identify the agency and solicitation or contract number.

Furthermore, FAR § 28.203-2(c) lists **unacceptable assets**, but indicates that the list is not all-inclusive. The following are listed as unacceptable assets:

- notes or account receivable
- foreign securities

- real property located outside the United States, its territories or possessions
- real property used as the principal residence of the surety
- real property owned concurrently
- life estates, leasehold estates, or future interest in real property
- personal property except as listed in FAR 28.203-2(b)
- stocks and bonds of the individual surety in a controlled, affiliated or closely held concern of the offeror/contractor
- corporate assets
- speculative assets
- letters of credit except as provided in FAR 28.203(b)(5)

The FAR also requires that the Government be given a security interest in any acceptable assets pledged by an individual surety. FAR § 28.203-1(a).

Prior to acceptance of an individual surety, FAR guidelines require contracting officers to obtain the opinion of their legal counsel as to the adequacy of the documentation pledging assets. FAR § 28.203(f).

If you have any questions, please feel free to contact this office at the above number.
Sincerely,

/Signed/ Rose Miller

Rose Miller
Manager
Surety Bond Branch



United States Department of the Interior

OFFICE OF THE SECRETARY
Washington, DC 20240

SEP 08 2009



Department of the Interior Acquisition Policy Release (DIAPR) 2009-15

Subject: Individual Surety Bonds

References: Department of the Interior (DOI) Office of Inspector General (OIG) June 29, 2007, memorandum, *Management Advisory of Investigative Results: Individual Surety Bonds*, OIG Case Number OI-NM-06-0174-1; and Federal Acquisition Regulation (FAR) Part 28, *Bonds and Insurance*

1. Purpose:

The purpose of this DIAPR is to remind contracting personnel of key FAR requirements associated with accepting an individual surety bond for a contract to protect the Federal Government from financial losses.

2. Effective Date: Effective upon signature.

3. Expiration Date:

This DIAPR will remain in effect until superseded or cancelled.

4. Background and Explanation:

The OIG investigated allegations of misuse of individual surety bonds for construction contracts. The investigation identified several areas of concern that require our attention. There is concern that Contracting Officers (COs) are: (1) unfamiliar with the FAR requirements for individual surety; (2) accepting individual surety bonds without knowing or verifying the assets backing the bonds; (3) not vetting questions about the individual surety bonds through the DOI Office of the Solicitor; and (4) not verifying individual sureties against the General Services Administration's Excluded Parties List System.

The Miller Act, 40 U.S.C. 3131, requires performance and payment bonds for any construction contract exceeding \$100,000, with some limited exceptions. Agencies must obtain adequate security for bonds with contracts for supplies or services, including construction. Acceptable forms of security include corporate or individual surety bonds, as well as others described in FAR Part 28.204.

The majority of surety bonds for government contracts are supplied by corporate sureties. Corporate sureties are companies approved by the Treasury Department to provide surety bonds. However, the FAR permits a contractor to secure bonds from "individual sureties" if approved by the CO.

FAR Part 28.203, *Acceptability of Individual Sureties*, outlines procedures COs must follow to determine the acceptability of an individual surety.

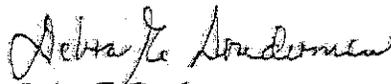
5. Action Required:

To reduce the risk of financial loss to the Department from contracts backed with individual surety payment and performance bonds, DOI COs must:

- Familiarize themselves with FAR requirements for individual surety bonds.
- Identify and verify assets, backing individual surety payment and performance bonds, prior to accepting them.
- Confirm and ensure that the government has control over pledged assets through the duration of the contract.
- Vet matters involving the acceptance of individual surety bonds with the Office of the Solicitor.
- Verify whether individual sureties are suspended or debarred.

6. Additional Information:

Please disseminate this guidance within your bureau. It will also be available on the web at <http://www.doi.gov/pam/diapr.html>. Questions may be directed to Brigitte Meffert, Senior Procurement Analyst, Office of Acquisition and Property Management, at (202) 208-3348, or via e-mail at Brigitte.Meffert@ios.doi.gov.



Debra E. Sonderman
Director, Office of Acquisition and Property Management
and Senior Procurement Executive



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The Honorable Howard Coble
Chairman, Subcommittee on Court, Commercial
and Administrative Law
Committee on the Judiciary
517 Cannon H.O.B.
Washington, D.C. 20515

The Honorable Steve Cohen
Ranking Member, Subcommittee on Court,
Commercial and Administrative Law
Committee on the Judiciary
517 Cannon H.O.B.
Washington, D.C. 20515

Dear Chairman and Ranking Member,

I am contacting you about recently introduced legislation, H.R. 3534, titled the "Security in Bonding Act of 2011," which has been referred to the House Judiciary Subcommittee on Courts, Commercial and Administrative Law, of which you are a member. I strongly support passage of this important bill, because it will bolster the integrity of the federal bonding process by making certain that the assets pledged under non-corporate surety bonds are sufficient and in the care of knowledgeable authorities, thereby protecting small businesses and the funds of taxpayers.

I am a Colorado resident and the owner of a small construction business, JBlanco Enterprises, which furnishes labor and materials on federal construction projects. I nearly lost my business as a result of a deficient individual surety bond placed on a federal project that later proved to have no assets behind it. In the spring of 2006, JBlanco Enterprises entered into a contract with a certified 8(a) prime contractor to roof a U.S. Customs House in Denver, Colorado. Because this was a federal project, JBlanco Enterprises felt it could rely on the contracting agency and the federal contracting officer to ensure that a properly executed payment bond was in place to protect subcontractors and suppliers in the event that the prime contractor failed to meet its contractual payment obligations. Sadly, however, this was not the case.

During the course of the project, the prime contractor became in arrears in paying JBlanco Enterprises for its services. As a result, JBlanco Enterprises placed a claim against the payment bond and requested that the federal contracting officer provide the name of the surety company. We did not receive a response from the contracting officer, and the prime contractor promptly terminated our roofing contract. When we filed suit against the prime contractor, the contract officer, upon learning of the lawsuit, then provided the name of the surety to us.

In the course of litigation, our attorney learned the true nature of the payment bond. The prime contractor had secured a bond from a non-corporate individual surety, not from a certified corporate surety approved and listed on Treasury Circular 570. Moreover, the assets pledged to back the payment bond apparently did not exist. We later learned that this non-corporate individual surety had proffered other bonds on multiple federal and non-federal construction projects. Apart from expensive and time-consuming litigation with the prime contractor, the payment bond was our only recourse for payment—we have no lien rights against federal real property. The inability to recover our payment bond claim was a severe financial hardship for JBlanco Enterprises, endangering our business viability.

Passage of H.R. 3534 will ensure that other small businesses relying on payment bonds on federal projects will not have to experience what JBlanco Enterprises experienced; rather, they can have



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confidence that adequate and reliable security is in place to guarantee that they will be paid for their labor and materials in the event a prime contractor will not be able to fulfill its financial obligations.

Under current law, construction contractors have three options for securing their obligations under their contracts with the federal government. They can obtain a surety bond from a surety company, which is vetted and approved by the U.S. Department of Treasury. In lieu of a bond, contractors can pledge and deposit assets with the federal government until the contract is complete. In such situations, only assets backed by the federal government can be pledged. The third option permits individuals to serve as sureties for contractors by pledging their assets to back the bonds. These individuals are called "individual sureties." Only individual sureties are permitted to pledge assets not backed by the federal government. In fact, individual sureties are allowed to pledge stocks, bonds, and real property, and are not required to deposit such assets with the federal government for the duration of the contract.

To the extent that individual sureties pledge assets that do not exist, are difficult to verify, or are not readily convertible into cash to pay the obligations of the contractor in case of default, subcontractors and suppliers are left unprotected. Experience has shown that if the assets pledged are uncollectible, subcontractors, suppliers, and workers on the job are left with no payment remedy if they are not paid. The federal government is left with unfunded expenses to complete the construction projects. Yet, under federal law and regulations, a contractor pledging assets directly to the federal government to guarantee a contract obligation is subject to far more stringent rules than an individual, acting as a surety for profit, who pledges his or her own assets to guarantee a contract obligation.

H.R. 3534 is just good common sense. The security that stands behind every federal contractor's obligations to the federal government should be governed by the same rules. There should be either a corporate surety bond in place from a company approved by the U.S. Treasury or assets with readily identifiable value pledged and relinquished to the federal government while the construction project is ongoing. The same rules that apply to the security that a federal contractor pledges as collateral should also apply to the security proffered by an individual acting as a surety for a contractor.

I urge you to support H.R. 3534. Please do not let another small business owner fall victim to that of a individual surety bond backed with illusory or worthless assets.

Sincerely,

Jeanette Wellers
JBlanco Enterprises Inc.

Department of Justice

United States Attorney Kenyen R. Brown
Southern District of Alabama

FOR IMMEDIATE RELEASE
DATE: JUNE 28, 2012
WWW.USDOJ.GOV/USAO/ALS

CONTACT: THOMAS LOFTIS
PH: (251) 441-5845 FX: (251) 441-5277

PENSACOLA MAN INDICTED IN GOVERNMENT CONTRACT SURETY BOND FRAUD SCHEME

MOBILE, AL – United States Attorney Kenyen Brown announces that Morris Sears of Pensacola, Florida was indicted by the Federal Grand Jury in a six count indictment charging Sears with falsifying documents to obstruct the proper administration of Government contracts by the National Park Service and the General Services Administration.

The charges concern bogus “Individual Surety” bonds to guarantee performance of Government contracts and payments to sub-contractors. Sears caused Government contracting officers to accept the bonds by making false statements in sworn Individual Surety Affidavits about the collateral he had to stand behind the bonds. He also repeatedly stated that he had not previously pledged named collateral for other bonds, when he pledged the same collateral to different agencies time after time. Sears operated his bonding business in Lilian, Baldwin County, Alabama.

Sears’s activities came to light in his bankruptcy case. In the bankruptcy case, the National Park Service claimed over a million dollars in losses from Sears’s misconduct. Chief Bankruptcy Judge Mahoney held that Sears “knowingly made misrepresentations regarding collateral he pledged in support of surety bonds” and that [Sears] falsely stated that he owned the pledged property free and clear of liens or mortgages. She found that Sears also 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 numerous times to numerous agencies.... The Debtor’s misrepresentations regarding the pledged collateral were made in sworn affidavits submitted to government agencies”. United States v. Sears, Order of May 22, 2012.

The statutory maximum penalty for the alleged violations is twenty years imprisonment, plus a fine of not more than \$250,000. As in all criminal cases, an Indictment returned by a grand jury is only a charge and the Defendant is presumed innocent.

The case was investigated by agents of the Office of Inspector General, General Services Administration, the Defense Criminal Investigation Service, the Office of Inspector General, United States Department of the Interior, the Office of Inspector General, United States Department of Veterans Affairs, and the Office of Inspector General, United States Department of Agriculture. United States Attorney Kenyen R. Brown stated that the prosecution shows that the Department of Justice will pursue those who defraud the taxpayers by cheating on Government contracts.

Brian D. Miller, Inspector General of the General Services Administration, stated: "There is a kind of an honor system in the federal procurement process. We rely on contractors to tell us the truth in contracting. When they do not, it is important to hold them accountable. Those who deliberately lie and falsify documents should be punished."

The case will be prosecuted by Assistant U.S. Attorney Charles Baer on behalf of the United States Attorney's Office for the Southern District of Alabama. A copy of this press release may be found on the website of the United States Attorney's Office for the Southern District of Alabama at <http://www.justice.gov/usao/als>



Department of Justice

U.S. Attorney's Office
Southern District of Texas

José Angel Moreno • United States Attorney

FOR IMMEDIATE RELEASE

ANGELA DODGE

April 12, 2010

PUBLIC AFFAIRS OFFICER

WWW.JUSTICE.GOV/USAO/TXS

(713) 567-9388

FORT WORTH MAN INDICTED FOR MAIL FRAUD ARISING FROM ALLEGED NATIONWIDE SCHEME TO SELL OVER \$100 MILLION IN FRAUDULENT SECURITIES

(HOUSTON) – A federal grand jury in Houston has indicted George Douglas Black Sr., 41, of Fort Worth, Texas, for mail fraud arising from an alleged scheme to sell more than \$100 million worth of worthless construction bonds for projects across the U.S., United States Attorney José Angel Moreno announced today.

The six-count indictment was returned this afternoon. The court is expected to set a date and to send notice to Black to appear for arraignment on the charges in the near future. Black, originally charged by criminal complaint, was arrested on Monday, March 29, 2010. Following a hearing before U.S. Magistrate Judge John Froeschner, Black was ordered released on bond on March 31, 2010, conditioned upon his discontinuing his bond business and not having any contact with any potential witnesses in the case.

The criminal complaint filed in federal court in Houston on March 25, 2010, alleges Black, not licensed or registered to sell securities, used the United States Mail to sell more than \$25 million worth of bonds backed by a Tarrant County property valued in 2008 at \$130,700 to numerous victims through his company, Infinity Surety. According to the allegations in the complaint, these bonds were used to insure various multi-million dollar construction projects.

The bonds, which allegedly represented that Black's Tarrant County property would fully protect the holder in the event of loss, were sold to school districts and defense businesses who did work for the military and other companies across the country including a \$1.8 million bond sold to a company in the League City, Texas, area. The bonds were required for any public construction project as an insurance policy that is paid out if the contractors default or can't finish the work properly. The complaint alleges that a number of the construction projects in Louisiana dealt with Hurricane Katrina related repairs. A \$19 million bond allegedly sold for repairs to the Beaumont Independent School District was for Hurricane Ike repairs.

Black's company, the complaint alleges, was being run out of a private mailbox in Saginaw, Texas. The victims paid Black significant fees for these bonds which they

believed protected their interests in various construction projects against loss, mailing Black approximately \$2.8 million in fees for these bonds from 150 different companies throughout the United States. Today's indictment alleges more than \$100 million in intended loss associated with these fraudulent bonds. Many of the bonds, according the complaint, were sold through Black's website, Infinitysurety.com.

According to the complaint, in July 2009 Black was enjoined by the state of Texas from selling bonds. Notwithstanding this injunction, Black allegedly sold at least \$25 million worth of bonds over a period of a year. Black has allegedly been in the business of selling these bonds since 2006 and his website claimed these bonds were backed by "United States commercial and residential real estate." The complaint alleges that records obtained by the United States Postal Inspection Service (USPIS) showed this claim was false and that he routinely pledged the same small piece of property to insure multi-million dollar construction projects.

After Black's arrest, the state of Florida instructed Black to cease and desist selling the allegedly worthless bonds.

Each count of mail fraud carries a maximum sentence of 20 years in federal prison and a maximum fine of \$250,000 upon conviction.

The investigation leading the charges was conducted by the USPIS and the Texas Department of Insurance. The case is being prosecuted by Assistant U.S. Attorney Ryan D. McConnell.

*An indictment is a formal accusation of criminal conduct, not evidence.
A defendant is presumed innocent unless and until proven guilty beyond a reasonable
doubt through due process of law.*

###



Everything New Orleans

Houston officials charge George Douglas Black Sr. with mail fraud, alleging he peddled bogus bonds

Published: Tuesday, March 30, 2010, 6:31 PM Updated: Tuesday, March 30, 2010, 7:24 PM



By Rebecca Mowbray, The Times-Picayune

Federal law enforcement officials in Houston have arrested a Fort Worth, Texas, man for allegedly peddling bogus construction bonds on public works projects around the country, including many Hurricane Katrina rebuilding projects in the New Orleans area.

U.S. Attorney Jose Angel Moreno in Houston charged George Douglas Black Sr. with mail fraud for using the U.S. Postal Service to sell more than \$25 million of worthless construction bonds through his company, Infinity Surety, over a period of one year.

The U.S. Department of Justice for the Southern District of Texas believes that Black sold fraudulent bonds to 150 different companies around the country to enable them to bid on public works projects and pocketed \$2.9 million in fees. The bonds were supposed to protect taxpayers and ensure the proper completion of projects in the event that a construction firm went out of business, walked away from a project or did a lousy job on the work.

The millions of dollars of construction projects secured by Infinity Surety were backed by a home that Black owned in the Fort Worth area that was worth \$130,700 and a few other small properties, meaning that local governmental bodies would have been in a jam had anything gone wrong with the jobs.

Black's victims include the Beaumont Independent School District in Texas and the U.S. Department of the Navy. The criminal complaint also cites a school in St. Tammany Parish and a project to build a new terminal at the Monroe Regional Airport.

In Louisiana, **according to state insurance officials**, projects to rebuild the cabins at Bayou Segnette State Park in Westwego, a community center in Plaquemines Parish, schools throughout the New Orleans area, the bathrooms at the Louis Armstrong International Airport, as well as a project to demolish the former C.J. Peete public housing complex in New Orleans were all affected.

Locally, companies that used Infinity for bonding on jobs include Home Solutions of Louisiana, JRDKS Construction LLC, Benetech LLC, and Envirotech Services LLC, among others.

In some cases, government officials accepted Infinity Surety guarantees even though the company was unlicensed, putting taxpayers at risk and meaning that rival bidders with proper bond documents were unfairly denied work. In other cases, such as the Monroe Airport, low bidders with Infinity bonds were denied jobs, spawning lawsuits.

In July, the Texas Department of Insurance asked Infinity Surety to stop doing business because it was unlicensed. The Louisiana Department followed suit in December, obtaining a preliminary injunction from a Baton Rouge judge. The hearing for a permanent injunction is scheduled for the last week in April.

In the wake of the Infinity Surety scandal, Sen. Conrad Appel, a Republican from Metairie, has introduced Senate Bill 70 requiring public bodies to check with the Louisiana Department of Insurance to verify that companies providing bond insurance are licensed.

Kathy English, a public affairs officer for U.S. Attorney Jim Letten, could not confirm, deny or comment upon whether federal officials in New Orleans are also investigating Infinity Surety because of the local companies and local projects involved.

But an investigation in one district does not preclude an investigation into another, and Insurance Commissioner Jim Donelon said that his office has been working with Letten's office and the Federal Bureau of Investigation in New Orleans on the Infinity matter.

The Louisiana Department of Insurance also worked with federal law enforcement officials in the case of fraudulent bond broker Gwendolyn Moyo, who peddled bogus bonds and laundered the proceeds with former state Sen. Derrick Shepherd. Letten's office prosecuted the case, and Moyo has been sentenced to 20 years in prison, and Shepherd is serving 37 months.

In December, state insurance officials said that the Infinity Surety situation is probably larger than the Moyo situation.

Indeed, the criminal complaint in Texas suggests that Black probably sold more than the \$25 million in bonds noted in the court filing, because the Justice Department only looked at one year's worth of transactions in its investigation. In reality, Black sold construction bonds from February 2006 until November 2009, according to the complaint.

Black listed his business address as a Pack and Ship Store in Saginaw, Texas, according to the criminal complaint.

He has asked for a public defender to represent him, and is being detained. A bail hearing is set for Wednesday. According to the complaint, Black has been arrested in Illinois, Nevada and Minnesota for offenses ranging from forgery to delivery of cocaine and marijuana.

Rebecca Mowbray can be reached at rmowbray@timespicayune.com or 504.826.3417.

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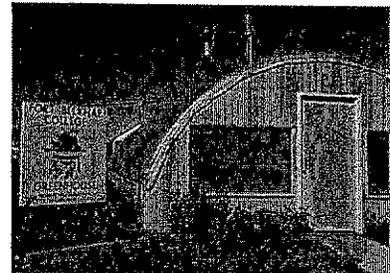
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Montana Adds to Fines Against Alleged Surety Con Artist

12/04/2012

By [Erin Richey](#)

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 A greenhouse in part of the Fort Belknap reservation's college, where Dennis Lyon was the source of a surety bond.

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The Montana Commissioner of Securities and Insurance has added \$155,000 to the tally of fines racked up by an individual surety provider accused of violating insurance statutes in eight states.

Montana had previously fined Dennis Lyon \$645,561 for supplying bid bonds and a performance bond without a license and with unverifiable backing assets, in 2004 and 2010. The state issued a permanent cease-and-desist order against Lyon in 2007. Similar orders prohibiting Lyon from selling bonds also exist in Texas, Oklahoma, Florida, Nevada, Washington, Maryland, and Georgia.

A portion of Montana's most recent fine, levied in October, includes \$148,000 in restitution for Fort Belknap Tribal Construction on the Fort Belknap Indian Reservation, which paid bonding costs and fees to Lyon's unlicensed individual surety, Native American Funds Management Services.

It provided a performance bond on a contract to build an expansion to Fort Belknap College, the Aaniih Nakoda College. The commissioner alleges that Lyon, whose legal name is Robert Joe Hanson, received nearly \$150,000 from the Gros Ventre and Assiniboine Tribes to provide the bonds.

A press release from the commissioner, Monica J. Lindeen, says Dennis Lyon also is known as Chief Joe Blue Eyes.

The college sought payment on the bond in June 2011; state records indicate the surety did not pay.

Lyon has yet to pay any fines in Montana. Neither he nor Fort Belknap Tribal Construction could be reached for comment.

Lucas Hamilton, communications director for the commissioner, says that the fines represent the limit of the state's ability to punish Lyon, since they cannot revoke a license he never had in the first place. Hamilton adds that it is difficult to root out such violations without tips from concerned consumers.

"There's no real proactive way we can get ahead of him," Hamilton says of Lyon.

Individual surety bond fraud on federal contracts has recently regained the attention of the U.S. Congress, where the House of Representatives last May passed the Security in Bonding Act of 2012. Known as H.R. 3534, the

act proposes to set lighter standards for the types of assets that may be used to back an individual surety bond. Action in the Senate could occur in the spring or summer.

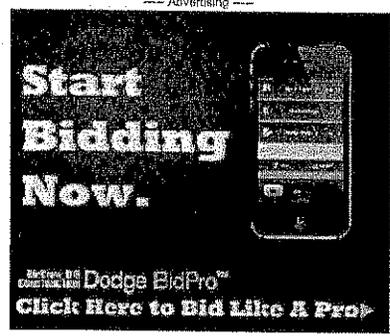
For contractors seeking a surety bond, Hamilton recommends calling a state department of insurance to verify that the person selling the product is licensed.

"It would have made a big difference had we gotten that call before the Fort Belknap reservation went ahead with surety bonds."

Keywords: Individual; Surety; Bond; Montana; Belknap; College; Lyon; Hanson; Reform



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