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FINAL

ANALYSIS OF BONDING REQUIREMENTS
ON SERVICE CONTRACTS



DECEMBER 1977

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13. ABSTRACT

Although bonding requirements do preclude some small business firms from submitting bids on housekeeping service contracts, the Government is still able to get adequate price competition from small business firms on such procurements.

There is a valid need to include bonds on housekeeping service contracts such as K. P., garbage, and hospital custodial/janitorial, when continuity of performance is critical to mission capability or to the health, welfare, and morale of the troops. Although bonds do not insure performance, they do increase the probability of continued performance since: (1) sureties may elect to: (a) assume performance using the existing work force; (b) provide financial and managerial aid to contractors experiencing performance problems; (2) suppliers and laborers (employees) are more willing to extend credit to a bonded contractor experiencing financial problems.

ASPR 10-104.2(a), which implies that a bond is justified if the contract provides both for the usage and specified manner of handling Government property, material and funds, is being erroneously interpreted as bond justification when contractor has access to Government property during contract performance.

Bond premium costs, which are based on contract value in lieu of the bond's penal sum, are normally not greater than 1 percent of the contract price. Permitting the PCO to rely on a contractor's ability to get a bond as a factor in determining the contractor's responsibility would eliminate duplication of effort currently expended by the surety and PCO.

Recommendations include proposed changes to ASPR and DA guidance regarding bond usage.

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ON SERVICE CONTRACTS

by

Harold F. Candy

DECEMBER 1977

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US ARMY PROCUREMENT RESEARCH OFFICE
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Fort Lee, Virginia 23801

EXECUTIVE SUMMARY

A. BACKGROUND

The Special Assistant for Small Business and Economic Utilization Policy, ASA(I&L) has recently received a number of protests from small business firms charging that Army contracting officers have imposed arbitrary and capricious bonding requirements on service contracts for housekeeping services. The protestors allege that these requirements are unnecessary and restrictive of competition. A preliminary survey has shown that bonding has been a requirement for some Army housekeeping service contracts, and that the penal sum percentages specified vary widely from installation to installation.

B. OBJECTIVE

The objectives of this study are to: (1) develop criteria for contracting officers to use in making application of bid and performance bond requirements on housekeeping service contracts; (2) if bonding is required, determine the penal sum needed to protect the Government's interest; (3) recommend any changes needed for ASPR.

C. RESEARCH METHOD

The research method utilized included: (1) questionnaire solicitation of 32 Army procurement activities, including specific information regarding a 10-percent random sample of awards during FY 76 and FY 77; (2) field visits to selected DOD activities, an SBA regional office, and a commercial surety; (3) evaluation of data obtained.

D. FINDINGS AND RECOMMENDATIONS

Bonds were required for procurements involving the following six classes of services: (1) food; (2) garbage collection; (3) landscape; (4) custodial/janitorial; (5) guard; and (6) installation bus.

Although bonding requirements do preclude some small business firms from submitting bids on housekeeping service contracts, the Government is still able to get adequate price competition from small business firms on such procurements.

There is a valid need to include bonds on housekeeping service contracts such as K.P., garbage, and hospital custodial/janitorial, when continuity of performance is critical to mission capability or to the health, welfare, and morale of the troops. Although bonds do not insure performance, they do increase the probability of continued performance since: (1) sureties may elect to: (a) assume performance using the existing work force; (b) provide financial and managerial aid to contractors experiencing performance problems; (2) suppliers and laborers (employees) are more willing to extend credit to a bonded contractor experiencing financial problems.

ASPR 10-104.2(a), which implies that a bond is justified if the contract provides both for the usage and specified manner of handling Government property, material and funds, is being erroneously interpreted as bond justification when contractor has access to Government property during contract performance.

Bond premium costs, which are based on contract value in lieu of the bond's penal sum, are normally not greater than 1 percent of the contract price. Permitting the PCO to rely on a contractor's ability to get a bond as a factor in determining the contractor's responsibility would eliminate duplication of effort currently expended by the surety and PCO.

Recommendations include proposed changes to ASPR and DA guidance regarding bond usage.

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CHAPTER I

INTRODUCTION

A. BACKGROUND/PROBLEM

The Special Assistant for Small Business and Economic Utilization Policy, ASA(I&L) has recently received a number of protests from small business firms charging that Army contracting officers have imposed arbitrary and capricious bonding requirements on service contracts for housekeeping services. The protestors allege that these requirements are unnecessary and restrictive of competition. A preliminary survey has shown that bonding has been a requirement for some Army housekeeping service contracts, and that the penal sum percentages specified vary widely from installation to installation.

Although a bond does protect the Government's interest in the event of contractor default, the question is posed whether such benefits are outweighed by the cost of bond requirements, which may include: (1) higher procurement costs as a result of some bidders being precluded from submitting a bid; (2) discouraging small business firms unable to obtain bonds, from progressing to larger value contracts and developing their full potential, etc. Thus, there is a need to reassess the principal benefits versus costs to the Government from bonding requirements.

B. OBJECTIVES

An evaluation of the effectiveness of bond requirements must be based on current practices, procedures, policies, attitudes, and experience relating to the procurement of similar housekeeping services both with and without bonds. Thus, the objectives of this study are to:

1. Develop criteria for contracting officers to use in making decisions regarding application of bid and performance bond requirements on housekeeping service contracts.
2. If bonding is required, determine the methodology for developing the penal sum needed to protect the Government's interest.

3. Recommend that the criteria developed in 1 and 2 be included in the ASPR.

C. SCOPE AND METHODOLOGY

Initially, various data sources were queried to obtain current guidance and literature regarding bonding requirements. These data sources included the Defense Logistics Studies Information Exchange (DLSIE), Defense Documentation Center (DDC), and the Federal Legal Information Through Electronics (FLITE) System.

The next step was to determine the extent of and reasons for variation in the use of bonding requirements in the Army. Initial research revealed that there was no available data base from which to obtain this information. Thus, it was decided to obtain this and other information regarding bond usage through a questionnaire to selected Army Purchasing Offices. A random sample of 64 housekeeping service contracts, which is approximately 10 percent of such contracts awarded during FY 76 and FY 76T, was selected and the questionnaire was sent to the 32 procurement activities who issued these contracts. Field visits were then made to six procurement activities, plus Headquarters United States (U.S.) Training and Doctrine Command (TRADOC)/U.S. Army Forces Command (FORSCOM) to gain further insight into bond usage and to verify the questionnaire responses. Additionally, telephone interviews were conducted with personnel at 10 additional activities.

Furthermore, the Small Business Administration (SBA) was visited to gain information regarding their guaranteed bond program which enables some bidders who normally would not qualify for a bond from a commercial surety to be issued a bond. Additionally, a commercial surety was interviewed to gain his perspective regarding bonds.

The information obtained was then analyzed and evaluated to formulate an Army policy for use of bonds on housekeeping service contracts. Additionally, proposed changes to ASPR were developed.

D. ORGANIZATION OF REPORT

Chapter II initially defines the type and purposes of bonds covered in this report. It then analyzes the impact of bonding requirements on small business firms, including

evidence of exclusion of small business firms on procurements because of such requirements. Chapter III addresses the need for bonding requirements. Then, an analysis of the cost effectiveness of bonds is presented. Chapter IV covers the adequacy of current bond policy and guidance for housekeeping service contracts. Chapter V investigates the impact of SBA programs such as the guaranteed bond program and 8(a) contracts on bond requirements. Chapter VI contains the findings and recommendations.

CHAPTER II

APPLICATION OF BOND REQUIREMENTS

A. INTRODUCTION

Contractors are frequently required for certain types of contracts to furnish protection to the Government against the contractor's failure to perform or deliver, or to those supplying labor and materiel to the contractor against nonpayment. Normally, such protection is provided through bonds which indemnify the Government for any losses sustained as a result of the contractor's failure to perform in accordance with the contract provisions or to properly account for public funds.

Prior to the presentation and analysis of information obtained during this study, a brief description of types and purposes of bonds and other securities covered in this report will be given for the reader's review.

1. Bid Guarantee

A bid guarantee is a form of security furnished by the contractor with his bid or proposal which provides assurance that the bidder: (a) will not withdraw his bid within the specified bid acceptance period; (b) will execute a written contract and furnish the final bonds (performance, payment, etc.) required by the bid within the specified contract period. Prerequisites for usage are that the contract will exceed \$2,000 and that either performance or performance and payments bonds are required. Failure by a contractor to furnish the required performance or payment bonds in accordance with the contract requirements may result in termination for default. The bid guarantee is then used to offset any additional costs associated with the reprourement.

If a bidder fails to submit the required bid guarantee with his offer, his bid will normally be rejected. In view of such bid rejection, those unable to get the necessary bonds normally will not expend the time and costs associated with bid preparation efforts. Thus, the inability of a bidder to provide the necessary bid guarantee usually results in his failure to submit a bid.

However, such bid rejections are not required in the following situations: (a) when only a single bid is received, (b) late receipt of a bid guarantee may be waived under the same rules established for consideration of late bids. Additionally, bid guarantees which are less than the amount required by the solicitation will result in rejection of the bid unless: (a) the price differential between low and second low bidder is equal to or less than the amount of the bid guarantee submitted; (b) it is sufficient for the quantity for which bidder is eligible for award (in such event award would be limited to the quantity covered by the bid guarantee). Finally, if an otherwise adequate bid guarantee becomes inadequate as a result of the correction of mistake in bid, the bidder will be given the opportunity to increase his bid guarantee accordingly.

Bid guarantees must be in the form of a firm commitment. Although bidders normally furnish a bid bond, such guarantees may be in the form of postal money orders, certified checks, cashier's checks, irrevocable letters of credit, or in accordance with Treasury Department regulations, certain bonds or notes of the United States.

2. Performance Bonds

A performance bond is defined in ASPR 10-101.12 as a bond which "secures the performance and fulfillment of all the undertakings, covenants, terms, conditions, and agreements contained in the contract." Such bonds thus provide protection to the Government in the event of contractor's failure to satisfactorily perform the contract. If a contract is defaulted, the surety generally can: (a) enter into a takeover agreement where it agrees to carry out the contract and the agency agrees to pay the surety for the remaining work at the contract price; (b) secure another contractor, acceptable to the Government to complete the work; (c) let the Government determine how to complete the work. If the surety does not take over performance, it is liable under the performance bond, for the difference between the original contract money available under the contract and the Government's additional cost to complete the work.

3. Payment Bonds

Payment bonds originated under the Heard Act of 1894 and were primarily intended as a substitute for the mechanics or material men's lien laws. The property liens

that a mechanic or material man acquired supplied security of payment for the labor or material supplied on a private project. However, no lien can be attached to Federal property and the mechanics and material men could not take any action to receive payments against the Government because of lack of privity of contract. The Heard Act originally required that the performance bond obtained for the Government's protection also include a provision for payment of labor and material claims. The Miller Act of 1935 replaced the requirement for one inclusive performance bond with a requirement for two separate bonds, the performance and payment bond.

Payment bonds are defined by ASPR 10-101.10 as those "which secure the payment of all persons supplying labor and material in the prosecution of the work provided by the contract." The protection afforded by payment bonds has been liberally interpreted to include consumable items, such as food, gas, and post transportation charges; equipment repair and maintenance, etc.

4. Fidelity Bonds

Although they are not generally required for procurements, there are a few instances where fidelity bonds are required for service contracts. These bonds provide protection against financial loss due to the dishonesty of an employee.

B. ANALYSIS OF PROCUREMENT STATISTICS AND EXPERIENCE

As the initial step of this project, procurement statistics were examined to ascertain if a large proportion of service contracts were awarded to small business firms. This would tend to refute the proposition that indiscriminate use of bond requirements on service contracts had precluded small business firms from obtaining a substantial portion of such awards. Additionally, a questionnaire was developed and administered to assess experience of procurement activities with application of bonds.

1. DD 350 Procurement Statistics for FY 76

Table I, "FY 76 Procurement of Nonpersonal Services," presents information regarding the awards of the services being studied to small business and minority 8(a) enterprises. Initially, the total procurement dollars were adjusted to exclude intragovernmental, overseas, and sole-source awards. The resulting figure (column c) represents the total competitive base of those services procured within the Continental United States for which more than one offeror could compete for the award. However, many of these services are set aside under the 8(a) program for minority firms. As seen on Table I (columns d and e), such set-asides to minority firms are very prevalent for the four classes of services: (a) food services (56 percent)¹; (b) custodial/janitorial (48 percent)¹; (c) installation housekeeping services (38 percent)¹; (d) guard services (27 percent)¹. Since such contracts are awarded to the Small Business Administration without competition, the value of such procurements must be subtracted from the total competitive base to derive those awards resulting from competitive procurements (Table I, column f).

As can be seen on Table I (columns g and h), over 93 percent of the competitive awards for these service categories were to small business firms. In fact, for the following nine categories, 100 percent of the competitive awards were made to small business firms:

- (a) Installation bus service.
- (b) Custodial/janitorial.
- (c) Insect and rodent control.
- (d) Packing and crating.
- (e) Food service.
- (f) Fueling service.

¹Percentages of total competitive base.

(g) Fire protection.

(h) Landscaping.

(i) Surveillance services.

Furthermore, for three of the remaining five categories of services, over 85 percent of the awards were made to small business firms (installation housekeeping services, 97 percent; garbage collection, 94 percent; guard services, 86 percent). Finally, a substantial portion of the competitive awards were to small business for procurements of laundry and drycleaning services (72 percent) and recruiting services for civilians including meals and lodging (56 percent).

Finally, an analysis of Table I (columns i and j) reveals that approximately 83 percent of all services procured competitively were the result of 100-percent small business set-asides with between 90 percent and 100 percent of the competitive procurements being so awarded for the following eight categories of services:

(a) Installation bus service (100 percent).

(b) Insect and rodent control (100 percent).

(c) Fueling services (100 percent).

(d) Fire protection (100 percent).

(e) Surveillance services (100 percent).

(f) Food service (99 percent).

(g) Custodial/janitorial (99 percent).

(h) Installation housekeeping services (91 percent).

TABLE I - FY 76 PROCUREMENT OF NONPERSONAL SERVICES

Service	a Total	b Less Intra-governmental Overseas & Sole Source	c Total Competitive Base	d Minority from (8a)	e AwarDED to Minority Firms (d + c)	f Procured Competitively	g Small Business 1	h % Small Business (g + f)	i Total Small Business Set Asides	j % Total Set Asides	k Total % Set Aside For Sm Business or Minority Firms [(g + i) + c]
Instl Bus Svc	1,757	1,191	566			566	566	100	566	100	100
Dry & Dry Cleaning	939	229	710			710	510	72	471	66	66
Custodial- Janitorial	36,232	7,538	28,694	13,907	48	14,787	14,787	100	14,488	98	99
Insect & Ro- dent Con	124		124			124	124	100	124	100	100
Packing & Crating	822	12	810			810	810	100	78	10	10
Garbage Collection	10,344	2,584	7,760	89	1	7,671	7,184	94	6,239	81	82
Food Svc	47,574	2,594	44,980	25,319	56	19,661	19,661	100	19,549	99	99
Fueling Svc	3,170	2,218	952	57	6	895	895	100	895	100	100
Fire Pro- tection	1,835	1,362	473			473	473	100	473	100	100
Land- scaping	2,860	184	2,676			2,676	2,676	100	1,887	71	71
Rctg Svc for Civ Incl Meals & Lodging	7,269	722	6,547			6,547	3,658	56	1,547	24	24
Surv Svc	78		78			78	78	100	78	100	100
Guard Svc	12,073	6,958	5,115	1,375	27	3,740	3,201	86	2,054	55	67
Instl Hskpg Svc	6,079	2,825	3,254	1,241	38	2,013	1,945	97	1,828	91	95
TOTAL	131,156	28,417	102,739	41,988	41	60,751	56,568	93	50,277	83	90

1 Of procured competitively

In conclusion, the analysis of DD 350 information for FY 76 reveals that the competitive procurement of the various categories of services being reviewed in the study is usually made to small business firms, most likely as the result of a 100-percent small business set-aside. Furthermore, a substantial portion of the awards are made to minority firms under the 8(a) program. For instance, during FY 76 the combined total 8(a) and 100-percent small business set-asides for these services were \$92,265,000 out of the total competitive base of \$102,739,000, or approximately 90 percent.

The FY 76 data was subjected to further analysis to gain insight into the reasons why for five of the classes of services being studied, small business firms did not receive 100 percent of the competitive awards.

Analysis of Table II, "Rationale for Awards to Large Business," reveals that failure of small business to submit the low bid was the most often cited reason for making the award to other than small business for the following four classes of services:

- (a) Laundry and drycleaning (100 percent)².
- (b) Garbage collection (93 percent)².
- (c) Installation housekeeping services (81 percent)².
- (d) Guard services (73 percent)².

²Percentages represent amount of awards to large business because bids from small firms not low.

TABLE II - RATIONALE FOR AWARDS TO LARGE BUSINESSES

Service	SMALL BUSINESS VS. LARGE BUSINESS		REASONS WHY NOT AWARDED TO SMALL BUSINESS				% of Svc Procured Competitively Not Awarded to Sm Business for Reasons Other Than Failure To Submit Low Bid
	% Small Business ¹	% Large Business ¹	Not Solicited ²	Solicited No Bid ²	Bid Not Low ²	Not Accepted Other Reasons ²	
Ldry & Dry Cleaning	72	28			100		0
Garbage Collection	94	6			93	7	0.4
Rctg Svc for Civ Incl Meals & Lodging	56	44	5	49	44	2	25
Guard Svc	86	14		8	73	19	4
Instl Hskpg Svc	97	3		19	81		0.6

¹Percentages based on percent of services procured competitively.

²Percentage of awards to large business firms.

For the other class of service, recruiting services for civilians including meals and lodging, the most often cited reason was that small businesses were not solicited (49 percent),^{2,3} with failure of their bid to be low being the second most cited reason. Furthermore, the overall percentage of competitive awards to large businesses for these four categories of services for reasons other than failure of a small business to submit the low bid was nonexistent or very low (as noted by percentage following service) as noted below:

- (a) Laundry and drycleaning (0 percent).
- (b) Garbage collection (.4 percent).
- (c) Installation housekeeping services (.6 percent).
- (d) Guard services (4 percent).

This additional analysis of the data has revealed that for the few instances that large business firms are awarded service contracts, it normally can be attributed to the failure of small business to submit the low bid. Furthermore, instances of awards to large business firms with no competition from small businesses or rejection of small business firms are extremely low.

Thus, based on the foregoing analysis, it can be concluded that even for the relatively few service contracts awarded to large business firms, small business firms were able to submit competitive bids for nearly all procurements, except for those involving recruiting services.

2. Information Required by Questionnaire

a. Rationale for Questionnaire

³The failure of small businesses to bid on a large proportion of these procurements is partially attributed to their reluctance to tie up a substantial portion of these facilities on a requirements contract. For instance, assume 30 rooms are required to be available under a lodging requirements contract. A large hotel with 500 rooms would probably be willing to reserve these rooms for the contract period since normal vacancy rate would probably be greater than 30 rooms. However, a small motel with 40 units probably would not be willing to reserve 30 units during the contract period.

A review of existing information sources revealed that there was no data base regarding bond usage on service contracts. It was then decided that the most effective way to acquire information regarding the Army's overall experience in bond usage was through a questionnaire.

A review of DD 350 information revealed that there were 632 contract initial award actions issued by Department of the Army activities during FY 76 and FY 76T⁴ for the 14 classes of services being studied. To keep the study within manageable level considering the resources allocated to the study and to obtain significant statistical data, it was decided to obtain information regarding a 10-percent random sample of all initial awards issued during FY 76 and FY 76T. The random sample consisted of 64 contracts issued by 32 Army procurement activities. Specific information was asked in the questionnaire (Appendix A, Incl 3) regarding the individual contracts which were identified (Appendix A, Incl 2). The questionnaire responses were verified during field visits to five of the procurement activities.⁵ No discrepancies in questionnaire responses were found for the 12 contracts reviewed. Based on the favorable verification results, it is concluded that the questionnaire responses are reflective of overall Army experience.

b. Bond Usage

Table III, "Bond Usage by Service Contracts," compares the dollar value of the 64 sample contracts which were awarded with and without bonds. Analysis of Table III reveals that bonds were included in contracts for only five out of the 11 classes of services covered by the random sample. These services along with the value (in percentage) of contracts awarded with bonding requirements were as follows:

- (1) Food services (95 percent).
- (2) Garbage collection (58 percent).
- (3) Landscape services (lawn mowing) (53 percent).

⁴Excludes overseas and intergovernmental awards.

⁵One of the six procurement activities visited was not included in the random sample.

TABLE III - BOND USAGE BY SERVICE CATEGORY¹

SERVICE	COMPETITIVE			NONCOMPETITIVE 8(a) AND SOLE SOURCE	
	BONDS REQUIRED ²	%	NO BONDS REQUIRED ²	%	NO BONDS REQUIRED ²
Installation					
Bus Service			512	100	
Laundry & Dry					
Cleaning			100	100	
Custodial-					
Janitorial	1,183	23	3,977	77	2,634
Insect & Rodent					
Control			19	100	
Garbage					
Collection	1,151	58	829	42	10
Food					
Service	6,610	95	307	5	
Fueling					
Service			998	100	
Landscaping					
Rctg Svc for Civ	332	53	291	47	46
Incl Meals & Lodging			1,959	100	
Guard					
Service	88	4	2,006	96	56
Installation					
Houskeeping Svc			53	100	

¹Three categories of services were not selected in the random sample due to low probability of occurrence (approximately 4 out of 632 for packing and crating services and 3 out of 632 for fire protection and surveillance service).

²In dollar figures, (000) omitted.

(4) Custodial/janitorial services (23 percent).

(5) Guard services (4 percent).

The wide disparity in bond usage between the various service categories tends to support the position that bonds are being inserted in service contracts based on the discretionary judgment of contracting officers in lieu of being indiscriminately used as has been alleged.

During the field visits conducted to six procurement activities and HQ TRADOC and FORSCOM, along with telephone calls to an additional 10 procurement activities,⁶ personnel were asked to identify the type of service contracts for which bonds were required. The only additional type of service contract cited as requiring a bond was one for installation bus services.

To substantiate the ability of procurement personnel to identify contracts with bonding requirements, field personnel interviewed were asked to identify contracts with bonding requirements awarded since FY 76. Then a review of both contracts alleged to have bonds and not have bonds was undertaken. Of the 28 additional contracts reviewed during such field visits, five were correctly identified as having bond requirements and the remaining 23 as not having a bond requirement. Thus, based on the responses to the questionnaire along with the field visits and followup telephone conversations, it can reasonably be concluded that bond requirements are primarily required in the previously six noted classes of services (i.e., food, custodial/janitorial, installation bus, garbage, landscape, and guard). This fact takes on increased importance when coupled with the information in Table I which reveals:

⁶One of the 10 activities telephoned was not included in original random sample.

**TABLE IV—SMALL BUSINESS AWARDS FOR CLASS OF SERVICE
WITH BONDING REQUIREMENTS**

Service	Value (in %) of Bonded Contracts ⁷	Small Business Awards ⁸	100% Small Business Set-Asides ⁸
Food service	95	100	99
Garbage collection	58	94	81
Landscaping	53	100	71
Custodial/janitorial	23	100	98
Guard service	4	86	55
Installation Bus	0 ⁹	100	100

Analysis of Table IV shows an extremely high portion of procurements for these six classes of services with bond requirements were awarded to small business firms usually as a result of a 100-percent small business set-aside procedures. Furthermore, all of the contracts included in the random sample plus the additional contracts reviewed during field visits, which contained a bond requirement were awarded as a result of 100-percent small business set-asides for five of the six classes of services with the exception being garbage services.

In conclusion, it has been shown in this section of the report that bonds were only found to be required for six classes of service contracts procured by the Army. Procurements of these service categories are predominately set aside for small business firms. All of the randomly selected, plus the additional contracts reviewed during field visits which contained bond requirements, were awarded as a result of small business set-asides for all classes of services, except garbage services. Only one contract with a bonding requirement was found to be awarded to a large business firm. Thus, the proposition that bonding requirements have precluded small business firms from receiving a substantial portion of the awards must be rejected. Furthermore, analysis of this data suggests that increasing or decreasing bonding requirements for the classes of services studied probably will have little

⁷Percentage based on random sample.

⁸Percentage based on competitive base for FY 76.

⁹No random sample contract had a bond requirement.

impact on the proportion of awards made to small business firms. Additionally, the widely varying usage of bond requirements for the various classes of services tend to support the proposition that contracting officers use discretionary judgment in deciding whether or not to include a bond requirement.

C. EVIDENCE OF EXCLUSION OF SMALL BUSINESS FIRMS BY BONDING REQUIREMENTS

The next question to be investigated was, "Do bonding requirements preclude a certain segment of the small business community from bidding on service contracts?"

1. Questionnaire Responses

Several questions on the questionnaire were designed to gain insight regarding small bidders' inability to bid because of their inability to obtain bonds. Responses to these questions will now be analyzed.

a. How do bonding requirements impact the Government's ability to obtain full and free competition; i.e., do bonds impose a hardship on a sizable portion of prospective bidders?

Overall, the general consensus of opinion was that bonding requirements do reduce the number of bidders competing for a service contract. Ten of the 32 responding procurement activities felt that bonding requirements had no impact on the Government's ability to obtain full and free competition versus 17 activities who indicated that requirements did preclude some bidders from competing for awards.¹⁰ However, 11 of the later 17 agencies indicated that the Government was still able to achieve its objective of obtaining full and free competition. Their responses indicated that bonding requirements did not impose a hardship on responsible bidders. Typical of such responses were: (i) bonding requirements would impose a hardship on a sizable portion of prospective bidders for low dollar procurements. Some firms competing for such contracts

¹⁰Five agencies did not offer comments due to their lack of experience with bonds.

are often very small firms, with limited resources and experience, who would encounter difficulty in obtaining their initial bond from a surety company; (ii) bond requirements on high dollar value procurements do not impose a hardship on responsible offerors, who possess necessary financial resources and experience to perform the job; (iii) bonding requirements can eliminate "fly-by-night" or marginal firms who lack the necessary experience and financial backing to perform. Such firms frequently "buy in" realizing they have little to lose if the contract is subsequently terminated for default.

b. How many times during FY 75 and FY 76 has your activity rejected a low apparent bidder or terminated a contract for default based on the contractor's failure to furnish the required bond?

Instances of an apparent low bidder being rejected for failure to submit a bid bond are very infrequent. This is substantiated by the fact that only two of 27 activities reported such rejection. At each of these activities they had only rejected one bidder during the 2-year period of FY 75 and FY 76 for failure to submit a bond.

Followup interviews, made to obtain additional data concerning these rejections, revealed: (i) at one activity the low apparent bidder was the only bidder out of 16 bidders who failed to submit a bond. This bidder would have been rejected even if he had submitted the bid guarantee because he was nonresponsive to the solicitation requirement because of his failure to bid on all items in the schedule; (ii) the second activity reported that the low bidder was nonresponsive based on his failure to furnish a bid bond and the second low bidder was rejected for stating he would furnish only 20-percent performance and payment bonds in lieu of the IFB required 100-percent and 50-percent performance and payment bonds respectively. However, after bid opening, the second low bidder indicated the ability to get the required bond, thus, suggesting that a reason such as insufficient time or reluctance to furnish the required bond was responsible for his statement regarding furnishing the 20-percent bonds. There was a total of six bidders for this procurement.

Although few apparent low bidders were rejected for failure to submit bid bonds, questionnaire responses, as revealed in Table V, Bidders' Inability to Obtain Bonds, indicated that bidders, other than the low offeror, were unable to obtain the

necessary bid bond for seven additional contracts with bonding requirements. Furthermore, potential bidders indicated that they were unable to bid because of bond requirements on three additional procurements. In summation, bond requirements impacted the ability of some small businesses to submit a responsive offer for: (i) nine of the 17 (approximately 53 percent) of the contracts included in the random sample; (ii) three of the five additional contracts reviewed during field visits. The reasons given and the number of actual or potential bidders unable to submit bid guarantees is given in Table V. Review of this table reveals that although some bidders are apparently precluded from submitting responsive bids because of bonding requirements, the Government still was able to obtain price competition for all the contracts listed thereon.¹¹ Since all the procurements were 100-percent small business set-asides, it is concluded that bonding requirements do not preclude the Government's ability to obtain adequate price competition from small business service contractors. Also, the fact that four bidders on the procurement of guard services cited that there was insufficient time to obtain a bond, points out the need to insure the adequacy of bid preparation time.

Although procurement personnel were not certain of the reason that bidders were unable to obtain the bid bonds, the consensus of opinion was that the firms were marginal contractors who probably would not be determined to be responsible by the procurement contracting officer. This opinion was usually based on their past experience and knowledge of contractors who compete for contracts in this area. Furthermore, a question was posed during personal interviews whether bond requirements discourage small business and minority firms from progressing to larger value contracts and developing full potential. It was noted that small business firms frequently encounter problems by bidding on a large value service contract too soon. It was contended that it takes time for a new firm to gain the necessary experience, financial backing, etc., to perform on such contracts. The inability of very small firms to compete for such contracts because they were unable to obtain the necessary bonds, was viewed as protecting such bidders from biting off more than they could chew.

¹¹ASPR 3-807.1(b)(1)a states that adequate price competition exists if offers are solicited and (i) at least two responsible offerors, (ii) who can satisfy the Government's requirements, (iii) independently contend for a contract to be awarded to the responsive, responsible offeror submitting the lowest evaluated price (iv) by submitting price offers responsive to the expressed requirements of the solicitation.

TABLE V - BIDDERS' INABILITY TO OBTAIN BONDS

Service	Value (000 Omitted)	Total No. of Bidders	No. of Bidders Failing to Sub- mit Bid Guar- antee	Reasons
1. Custodial	135	9	5	Unknown, but first four low bidders furnished bid guarantees.
2. Custodial ^{1,2}	217	16	1	Rejected low apparent bidders also nonresponsive to other solicitation requirements.
3. Custodial	418	10	1	Insufficient time for SBA to process bond guarantee.
4. Custodial	509	8	1	Unknown
5. Custodial (Hospital) ¹	600	6	2	Two low apparent bidders rejected. Reason: low apparent bidder also nonresponsive.
1. Food	722	19	1	Unknown
2. Food ²	1205	12	1	Unknown
3. Food	1370	16	0	Two potential bidders questioned bond requirement. PCO gave rationale. Both failed to submit bids.
4. Food ^{2,3}	1554	12	0	Potential bidder failed to bid after protest denied.
5. Food	3989	9	1	Unknown
1. Landscape	209	2	0	One potential bidder indicated he did not bid since he could not get bond.
1. Guard	88	9	7	Four of seven indicated insufficient time to obtain bond.

¹Procurement previously noted in text.

²Not included in original random sample.

³Protest discussed later in text.

Interestingly, the SBA has found that the primary reason for default of contractors involving bonded contractors were "insufficient capitalization to carry them over when they ran into trouble, and going beyond their capacity."¹²

An examination of the Building Service Contractors Association (BSCA) Long-Range Planning Council study of bonding offers insight into the reasons why small business firms encounter difficulties in obtaining bonds. The primary reasons for the difficulties were categorized as follows: (i) ignorance of bonding agents about the financial makeup of a successful contracting firm; (ii) inadequate preparation of financial data presented by contractors. Similarly, the SBA found that the three primary reasons cited by sureties for declining to issue a bond without an SBA guarantee (the SBA program is discussed in detail in Chapter V) are: (i) financial package is inadequately prepared; (ii) lack of sufficient work capital; (iii) lack of sufficient technical and/or managerial skills to perform the contract or to handle the extra managerial and financial load of one more contract in addition to his work in progress.¹³

Interviews with personnel who approve bonds for the SBA guarantee bond program and for sureties, revealed that bonding companies often want contractors to project financial statements (such as balance sheets, cash flow statements) during the period covered by the bond. Furnishing acceptable information is often a major, or even impossible, task for very small contractors who, it was alleged, often lack the financial expertise to provide adequate financial information.

Additionally, it is noted in Table V that some of the actual bidders were unable to submit bid guarantees on a high proportion of solicitations with such requirements for custodial/janitorial services (five out of seven procurements) and food services (four out of seven). Furthermore, this occurred on all four of the custodial/janitorial contracts received which were valued over \$100,000.

¹²US Small Business Administration Letter of 2 Jul 74, "Report to the Congress, Use of Surety Bonds on Federal Construction Should Be Improved," Comp. Gen., 17 Jan 1975, p. 60.

¹³Report to Congress, Use of Surety Bonds in Federal Construction Should Be Improved, Comp. Gen. of US, 17 Jan 75, p. 59.

Another question in the questionnaire designed to obtain information regarding the exclusion of small business firms on service contracts asked if the activity had been involved in any solicitation protests (informal or formal) revolving around the inclusion of bonds. Replies from the five of the 32 agencies which indicated such protests will now be fully discussed. One activity indicated that because of the urgent need to get the services, the PCO deleted the bond requirement rather than undergo the delay associated with a bid protest. However, the PCO indicated that he did have sufficient justification for the bond. A second activity reported that only one potential bidder out of 71 solicited had informally protested a bond requirement but dropped his protest after the PCO furnished him justification for the requirement. Formal protests were submitted at the other three agencies. Two of the protests noted that bonding requirements preclude some small business or minority firms from bidding on contracts. An SBA letter involving one of these protests noted: "For the past year or more, this office has received numerous complaints from both 8(a) and non-8(a) small business firms that indicate sureties are becoming increasingly more conservative and unwilling to bond service-oriented companies. This problem has, on occasion, been relieved in the past when several sureties participated in SBA's surety bond guarantee program. However, more recently, even these sureties have begun refusing bonds . . . Numerous 8(a) firms who have under their 8(a) contracts established themselves as excellent performers . . . will be prevented from bidding on requirements they are eminently qualified to perform which, of course, will render all previous and ongoing 8(a) assistance useless as an instrument for becoming competitive."¹⁴ The third protest questioned the PCO's ability to provide the justification needed for the bond. The PCO's were upheld in including bonds on these solicitations based on the supporting documentation justifying bond usage. However, these protests again substantiate the fact that bond requirements do prevent small business, especially 8(a) firms, from bidding.

Finally, Table VI, Number of Bidders on Solicitations With and Without Bonds, lists for the various service categories the dollar value and number of bidders for solicitations with and without bond requirements. A review of this table reveals that the number of bidders for the custodial/janitorial solicitations was somewhat lower for solicitations with bond requirements, as evidenced by the following comparison.

¹⁴ US Small Business Administration Letter to Procurement Division, Fort Hood, 27 July 76, Subject: Solicitation No. DAKF48-76-b-0066.

TABLE VI - NUMBER OF BIDDERS ON SOLICITATIONS WITH AND WITHOUT BONDS*

DOLLAR VALUE	SERVICE	Custodial-Janitorial				Garbage				Food				Landscape				Guard			
		With Bonds		No Bonds		With Bonds		No Bonds		With Bonds		No Bonds		With Bonds		No Bonds		With Bonds		No Bonds	
Sample Data		Proc \$	# of Bidders	Proc \$	# of Bidders	Proc \$	# of Bidders	Proc \$	# of Bidders	Proc \$	# of Bidders	Proc \$	# of Bidders	Proc \$	# of Bidders	Proc \$	# of Bidders	Proc \$	# of Bidders	Proc \$	# of Bidders
10,000 - 100,000		43	3	12	8			(26)	(5)	49	2	55	12			(11)	(6)	88	9	(23)	(7)
		77	3	25	13			(29)	(7)			66	10			37	9				
				31	16							72	18			(40)	(20)				
												87	18			42	5				
												97	3			(49)	(5)				
100,000 - 1,000,000		135	9	109	20	146	5	124	1	477	11			122	1	(102)	(5)			187	4
		(217)	(16)	(123)	(7)	165	2	(224)	(4)	722	19			209	2	142	8			392	9
		418	10	(286)	(26)	380	4	693	2							(160)	(8)			446	8
		509	8	351	13	458	7													879	14
		(600)	(6)	623	21	(600)	(4)														
1,000,000 -				1148	7					(1205)	(12)										
				1674	12					1370	16										
										(1554)	(9)										
										3989	9										

*Includes contracts included in original sample plus additional contracts reviewed during field visits. Contracts not included in original random sample are identified by brackets ().

TABLE VII. COMPARISON OF NUMBER OF BIDDERS ON CUSTODIAL/JANITORIAL CONTRACTS

\$ Value of Procurement	With Bond Requirement			No Bond Requirement		
	No. of Procure- ments	Avg \$ Value	Avg No. of Bidders	No. of Procure- ments	Avg \$ Value	Avg No. of Bidders
10,000- 99,999	2	60	3	3	23	12.3
100,000- 999,999	3	354	9	3	361	18.0
1,000,000- over	0	0	0	2	1411	9.5

Approximately nine more bidders submitted bids on such procurements valued under \$1,000,000 which did not require bonds. Coupled with the previously cited fact that for a large proportion of such procurements, some bidders submitted their bids without the required bid guarantee, it is concluded that some bidders are being precluded from submitting competitive bids because of bonding requirements on custodial/janitorial service contracts.

Similarly, Table VI reveals that the number of bidders on procurements involving landscape services is much greater when bonds are not required (an average of 1.5 bids for contracts with bonds with average value of \$165,500 versus eight for contracts of \$72,250 without bonds). However, no conclusion is drawn from this fact based on consideration of the low number (only two) of contracts with bonds.

The last fact drawn from Table VI is that all food service procurements greater than \$100,000 included bond requirement while approximately 83 percent (five out of six) of those under \$100,000 did not require bonds. Three procurements with bond requirements were examined to determine the number of bidders furnishing bid bonds, letter of credit, etc. This revealed:

TABLE VIII. TYPES OF BID GUARANTEE FURNISHED

	Number	%
Bid Bond (20%)	36	85
Letter of Credit	4	10
No Bid Guarantee	2	5
TOTAL	42	100

As can be seen above, only 15 percent of the bidders did not furnish bid bonds. Furthermore, 10 percent of the bidders were able to furnish irrevocable letters of credit, while only 5 percent were unable to furnish any bid guarantee.

2. Conclusions

In conclusion, the evidence indicates that bonding requirements do limit the number of potential bidders capable of submitting bids on service contracts. However, very few apparent low bidders are rejected for their failure to submit bid guarantees. This is substantiated by the fact that questionnaire responses from the 32 Army activities revealed only two instances during FY 75 and FY 76 where the low apparent bidder failed to furnish bid guarantees. Furthermore, one of these bidders was also nonresponsive to other solicitation requirements. On the other hand, bidders who were not the low apparent bidder, were reported to have failed to furnish the required bid guarantee on several procurements. The percentage of such instances was particularly high for procurements involving custodial and food services. However, the Government was able to obtain adequate price competition from small business firms on: (1) all procurements on which a small business was reportedly excluded from submitting a responsive bid because of a bonding requirement; (2) all procurements with bonding requirements, except for one landscaping (lawnmowing) procurement which was awarded to the sole small business bidder as a result of a 100-percent small business set-aside. Additionally, there were some reported cases of potential bidders not submitting bids because of bonding requirements. Finally, the number of bidders on procurements of janitorial and landscape services was lower on procurements involving bonds.

Finally, it was the consensus of opinion of people interviewed that bonding requirements did not impose a hardship on responsible bidders, but probably did preclude marginal bidders, who most likely would be determined to be nonresponsible, from bidding.

CHAPTER III

ANALYSIS OF BOND NEED AND COST EFFECTIVENESS

A. INTRODUCTION

In the previous chapter, it was seen that even though bonding requirements reduce the total number of small business firms who can compete for service contracts, adequate price competition is still available from small business firms on such procurements. Thus, the Army's need for bonds and the cost effectiveness of bonding requirements must be examined carefully to ascertain if the exclusion of some potential bidders is warranted. This chapter will, therefore, examine the need and cost effectiveness of bonds indepth.

B. VERIFICATION OF NEED FOR BOND

1. Need Not as Great as for Construction Contracts

Performance and payment bonds are required by the Miller Act to be included in all contracts over \$2,000 for the construction, alteration, or repair of any public building or public work. The protection afforded the Government by a performance bond is less on a service than on a construction contract. A construction contract requires completion of a project, whereas, a service contract requires performance during a definite period of time. In comparing the increased costs for termination and reprocurement from a new contractor, one must consider factors such as cost differential between the terminated and new contractor (for a job of similar magnitude and percentage of completion) will be greater for a construction contract because of factors such as: (i) higher labor and material costs will be experienced in an inflationary period due to the later period of performance on a construction contract versus performance of the service contract during the original contemplated performance period; (ii) greater phase-in, phase-out costs for a construction contractor who must take over a partially completed project which involves moving costly supplies and equipment to the construction site versus a service contractor who is essentially beginning performance on a new contract and normally has to supply personnel and a limited amount of supplies and equipment. Additionally, a service contract often may be viewed as one with incremental deliveries; i.e., once May 77 is past, the K.P. requirement for

May 77 cannot be repocured. Thus, the sureties liability associated with completion of the remaining performance period actually decreases during the life of a service contract. Similarly, the protection afforded by a payment bond is less on a service versus construction contract. This is caused by the fact that construction contracts require greater expenditures for supplies and equipment than for laborers, whereas, a service contract often involves greater expenditures for labor versus those for equipment and supplies. Nonpayment of a laborer will surface shortly after he failed to receive his paycheck. However, nonpayment of a supplier of equipment or supplies will surface after a longer time period because payment terms usually do not require initial payment for periods of 30 days or greater after acceptance. Thus, the cost liability associated with nonpayment will probably be larger on a construction contract due to longer time periods before it is discovered.

Based on the fact that performance and payment bonding requirements afford the Government less protection on service contracts, specific guidance is provided in ASPR regarding usage of and justification required for such bonds. ASPR 10-104.2(a) provides that performance bonds may be used for contracts other than construction contracts when the procurement contracting officer determines the need for them. Justification must be documented. Consideration should be given to the following factors on determining whether or not to include a bond: (i) if the contract provides both for the usage and specified manner of handling Government materiel, property, and funds: (ii) protection of Government financial interests.

ASPR 10-104.3 provides that a payment bond may be required only if a performance bond is required. Additionally, the bond should be required if it can be obtained at no cost. Thus, in view of the lower level of protection afforded by bonding requirements on service versus construction contracts, the PCO must determine, justify, and document the need for bonds on service contracts. This requirement probably has resulted in the limited bond usage on service contracts previously cited in Chapter II.

2. Criteria for Usage

Several questions on the questionnaire were designed to elicit information regarding the Army's need for bonds on service contracts. For instance, for the sample

contracts which required a bond, the activity was requested to forward the rationale, including a copy of supporting documentation, for use of the bond. Additionally, personnel interviewed were asked to give criteria for bond usage. Analysis of both the responses and supporting documentation furnished revealed several valid reasons for bond usage which will be discussed indepth.

a. Performance Bonds

(1) Criticality of Continuity. One area which must be considered in requiring a bond was the criticality of continuity of the service to either the mission capability or the health, welfare, and morale of the troops. This factor was mentioned as particularly important for services such as K.P., garbage collection where failure to provide the contractual services could not be tolerated even for a short period because of the resulting health (nutritional) and sanitation problems. Custodial/janitorial services bond requirements were also mentioned as being justified based on criticality of continuity of performance. However, there was some question as to the criticality of performance involving office buildings. It was pointed out that normally failure to clean an office for a few days would not present as great a problem as involved with K.P. or garbage services. However, failure to provide hospital custodial/janitorial services on a daily basis was considered serious because the resultant sanitation and general health problems would seriously impede the successful operation of the hospital. Unlike construction contractors, in the event of contractor default or failure to perform on a service contract an alternate method of providing the services would be required immediately. Because of Government administrative lead time to place a new contract, along with the startup time required by the contractor, immediate performance of the services by a new contractor must be ruled out. Documentation supporting the decision to require a bond cited a minimum time period of 45 to 60 days for a new contractor to begin performance. Additional time would probably be required: (i) for large value contracts such as those over \$1,000,000, because of procedural requirements to get approval from higher headquarters, contract award boards, EEO boards, etc.; (ii) if the low offeror required a pre-award survey and was subsequently ruled nonresponsible, etc. Thus, the only alternatives available to the Government are to have the services performed by military troops or civilian employees. Use of military employees would jeopardize mission accomplishment since it would be disruptive to their

scheduled orderly training or jobs. On the other hand, use of civilian employees would take them away from their regularly assigned duties. This could result in the civilian employees losing a prohibitive number of man-hours from their primary duties. In addition, the Government may use civilian labor whose skills exceed those of contractor personnel, causing increased costs to the Government for the performance of the tasks. Thus, it is concluded that the Government does have a definite interest to insure contractual performance on K.P., garbage, and hospital custodial/janitorial and, to a lesser degree, other custodial/janitorial service contracts.

Although it is obvious that a bond does not guarantee performance, it does increase the probability that the Government will obtain uninterrupted performance for services such as K.P., garbage, and hospital custodial/janitorial. For instance, the surety may elect to take over performance of the services using the existing work force; thus, insuring continuity of performance. Yet only one instance was found during the study in which a surety took over performance as a result of contractor's default on performance. This involved a K.P. contract. The original contractor had experienced financial difficulties, including nonpayment to the Internal Revenue Service (IRS) and his employees. When the IRS put a levy on his contract proceeds, he was forced to default on his contracts. The surety took over performance using the contractor's existing work force for approximately a 3-month period. Since continuity of performance was critical for these services, the bond requirement precluded the Government from using less desirable techniques for acquiring these services, such as using the military or civilian employees.

Contrarily, there was one K.P. service contract without a bond requirement that was included in the random sample which was terminated. This contractor also had IRS problems and labor violations which finally resulted in their going out of business. In the interim 16-day period between contract default and placement of a new contract, plus for a couple of days "phase in" period, this activity was forced to use military to perform the K.P. services. It was noted that besides interfering with the normally scheduled training and jobs, use of military in such situations was bad for their morale. Furthermore, the new contract was valued over \$40,000 more than the previous contract despite the fact that the period of performance was 3 months shorter.

Also, sureties frequently find it is to their best interest to aid a contractor experiencing difficulty in contract performance thereby precluding an impending default. This aid may come in the form of financial assistance, such as loan of money to pay creditors, or loan of supervisory personnel or a skilled technician, etc., who can help resolve the performance problem being experienced. Additionally, a potential supplier or laborer will be more willing to extend credit or services to a marginal contractor who is bonded, thus, enabling a contractor to successfully perform.

Since it was beyond the scope of this study to ascertain the number of times a surety provides such aid to a bonded contractor, the full value of this benefit from bonds cannot be assessed. However, the fact that sureties do provide this service must be considered when one is evaluating the cost effectiveness of bonds which is covered later in this chapter.

Sureties often provide other services to a bonded contractor which may preclude default. For instance, they maintain surveillance over contractor's work program to guard against a contractor's overextending his total resources and thus subjecting the surety to a potential financial loss. Although a surety cannot prevent a contractor from submitting a bid, it can refuse to issue bonds on future procurements the contractor is interested in bidding.

Finally, it was found that sureties consider a contractor's previous experience and financial and other resources before issuing a bond. As previously noted, this tends to eliminate "marginal" businesses from bidding. By the very nature of the service industry, a firm having some financial resources, but possessing little or no previous experience and equipment and supplies in a particular service area could submit a bid. It would be very difficult to reject this firm as nonresponsible if he has the ability to obtain the necessary supplies and equipment, which are usually not substantial, and personnel.

Hence, it was contended that a contractor must possess a certain minimum level of financial resources, experience, management, and technical ability to be reasonably expected to perform satisfactorily on a larger value service contract. This minimum level of responsibility has been compared to special standards of responsibility on weapon contracts. Frequently, on weapon contracts, a contractor needs a certain level of technical and

management responsibility to have a good probability of performing satisfactorily. Similarly, it is argued that firms which possess this minimum level of responsibility on service contracts are those who can obtain bonds. Such firms are less likely to default in performance of high valued service contracts. Thus, bonds on service contracts, where continuity of performance is critical, protect the Government interest by increasing the probability of continuous performance of a service or reimbursing the Government for additional costs associated with obtaining alternate performance.

(2) Use of Government Property. The second primary reason cited for bond usage was that contractor's performance required access to Government property. A review of the contracts revealed the bonds were intended to reimburse the Government for damage to the following types of properties for the noted services areas.

TABLE IX. PROTECTION OF GOVERNMENT PROPERTY BY BONDS

Service Area	Property
1. Custodial/janitorial	1a. Office and other Government buildings, including the equipment and supplies therein.
	1b. Supplies, such as toilet paper, soap, etc., given to the contractor as GFP.
2. K.P.	2a. K.P. mess halls, including the equipment and supplies therein.
	2b. GFP, such as meat, milk (which might spoil)
3. Garbage	3a. Dempsey Dumpsters.
	3b. Government-furnished trucks.
4. Landscape (Lawnmowing)	4a. Lawns, trees, shrubs, etc.
5. Installation Bus Service	5a. Building furnished to contractor for parking bus, plus a maintenance shed.
6. Guard	6a. Government property being secured.

Under the Government Property Clause specified in ASPR 7-104.24, the contractor assumes the risk and responsibility for any loss of or damage to Government property provided under the contract except for reasonable wear and tear or consumption of the property in performance in the contract. For competitive procurements, the Government normally relies on the contractor's general liability insurance to cover damage to such property during contract performance. A review of service contracts reveals contractor is frequently required to furnish evidence that he has a minimum amount of liability insurance. Furthermore, the Limitation of Liability--Service Contract Clause, specified in ASPR 7-1912, which is required to be inserted in all the service contracts for which bonding requirements were observed, states that the contractor shall not be liable, by reason of contractor's performance of services for the loss or damage to property of the Government occurring after the Government's acceptance of such services. However, the contractor is liable for damages if he is insured or has established a self-insurance for such damages or if the damage was caused by willful misconduct or lack of good faith by his management.

In view of the Government's policy to either rely on the contractor's liability insurance or to relieve him of liability after acceptance of the services if he does not carry such insurance, a question arose whether the bond justifications based on protection of the property noted in Table IX was justified. An investigation was undertaken to learn the intent of the ASPR provision (10-104.2(a)) which seemingly authorized bond usage on service contracts which provided both for the usage and specified manner of handling Government materiel, property, and funds. It was found that this provision was to cover unusual instances where the Government would incur substantial costs in handling the equipment because of contractor's failure to perform as specified by the contract.¹⁵ For instance, on lease contracts, the contractor may take possession of a large piece of equipment and move it to a different location. If the contractor defaulted in performance, the Government could incur substantial costs in removing, packing, and transporting the equipment back to its storage location.

¹⁵Telecon with W. Gassert, NMAT, ASPR Subcommittee Insurance.

Based on the foregoing analysis, it is concluded that bond justification for protection against damages of the equipment, materiel, and supplies noted in Table IX is not warranted. The justifications had been based on an erroneous interpretation of the ASPR provision which seemingly authorized bond requirement if the contractor was provided Government property and had to handle it in a specified manner. Additionally, the contractor's normal commercial liability should provide protection against damage to the property. The contractor is frequently requested to furnish evidence of a minimum amount of liability insurance prior to the award of both contracts with and without bond requirements.

b. Payment Bonds

Primary reason used to justify payment bonds was that the untimely settlement of equipment and employee expenses would have an adverse effect on performance. Basically, since these bonds protect laborers and suppliers of material to the prime contractor, it was not possible to acquire sufficient evidence to verify such bonds are justified. However, persons interviewed indicated that failure to pay proper wage rates or failure to pay employees was only an occasional problem. Allegations of such instances are referred to the Department of Labor for investigation. Failure to compensate an employee in accordance with the minimum wage determination applicable to the contract, is a violation of the Service Contract Act or the Contract Work Hours and Safety Standards Act if overtime is involved. A review of the Joint Consolidated List of Debarred, Ineligible, and Suspended Contractors as of 1 January 1977 revealed:¹⁶

Reason	No. of Contractors	%
Service Contract Act of 1965	98	43
Contract Work Hours & Safety Standards Act	20	9
Other	108	48
TOTAL	226	100

¹⁶DA Cir 715-1, Joint Consolidated List of Debarred, Ineligible and Suspended Contractors.

In view of the fact that contractors placed on this list represent those performing on all types of DOD contracts (i.e., supp, construction, etc.), the high percentage of contractors placed out for violation of these acts, along with the fact that service contracts constitute slightly less than 10 percent of the total dollar value of Army procurements for FY 76, tends to support the premise that a relatively high proportion of service contractors are marginal businesses. Also, this fact tends to support the need for payment bonds, which will protect the laborer from insufficient compensation for work performed.

The questionnaire responses and review of contract files revealed little information regarding nonpayment of supplies of materiel, equipment, etc., being a problem area. This is partially attributed to the fact that many service contracts, such as these for K.P., custodial/janitorial, landscape (lawnmowing), and guard services, primarily involve furnishing of labor with relatively little equipment and supplies required for contract performance. There were some reported instances of a supplier inquiring whether a contractor had a payment bond. Based on the affirmative reply, the supplier indicated a willingness to extend credit to the prime contractor.

Thus, payment bonds on service contracts apparently are needed for the protection of laborers. Nonpayment of laborers is not a major problem to procurement activities because such complaints are forwarded to the Department of Labor. However, the large number of contractors who have been placed on the Joint Consolidated List of Debarred, Ineligible, and Suspended Contractors for violation of the Service Contract Act and the Contract Work Hours and Safety Standards Act tends to support the premise that there is a need for payment bonds.

c. Fidelity Bonds—Handling of Cash

In some type of service contracts, such as K.P. or laundry, the contractor's employees are frequently paid money for the service being rendered. In such instances, a fidelity bond is required for such employees.

3. Adequacy of Current Level of Usage

Another question posed in the questionnaire asked whether the use of bonding requirements should be increased or decreased. This question was designed in part to determine if the current authorized bond usage level satisfied the need for bonds.

Responses to this question varied greatly as evidenced by the fact that out of 30 procurement activities: (i) eight, or approximately 27 percent, favored increased bond usage; (ii) five, or approximately 17 percent, favored decreased usage; (iii) 17, or approximately 56 percent, favored no change in the usage level. Those who favored increased usage generally replied that bonds help insure continuity of performance and decrease the number of marginal firms, who often are inexperienced, are overextending themselves from bidding. Those who favored decreased usage indicated that they were unaware of any problems encountered on service contracts which would be resolved by requiring a bond. The majority of agencies who favored no change stated either that current guidance was adequate or that the PCO should have the discretion to insert a bond based on his analysis of the procurement situation.

Thus, analysis of the responses to this question revealed that current guidance and procedures apparently permit the PCO sufficient latitude to require a bond when he deems it necessary. Based on the fact that approximately only 26 percent of the activities favored increased usage versus 56 percent favoring no change in usage level, it is concluded that the current usage rate is generally fulfilling the Army's needs for such requirements.

Additionally, for those contracts requiring bonds in the original sample, the procurement activities were asked if the bond could be excluded on the next procurement. Replies are as indicated in Table X.

TABLE X. WAIVER OF BOND ON NEXT PROCUREMENT

Type Service	Can Be Excluded	Cannot Be Excluded	Cannot Predict
Custodial	3	2	
Garbage		3	1
Food		4	1
Landscape	1		1
Guard	1		

It is seen above that procurements where continuity of performance was deemed critical (K.P. and garbage), the consensus of opinion was that a bond would be required. For custodial/janitorial, the opinion was fairly evenly divided regarding its need on the next procurement. Finally, for landscape and guard services, the responses indicated that bonds could be eliminated. This supports the premise that guidance should permit bond usage where continuity of performance is critical.

C. COST EFFECTIVENESS OF BONDS

In the previous section of this chapter the Army's need for bonds was verified. The next question which will be addressed is the costs versus the benefits derived as a result of bond requirements.

1. Cost

a. Premium Rates Structure

(1) Governed by States

Public Law 79-15 (15 U.S.C. 1011, 1012) gives the various States, in lieu of the Federal Government, the right to regulate and tax the insurance industry. Each State has established departments which regulate the rates charged for bonds. There are two

types of rates approved by the States: (i) file and use rates are effective once reported to the State; (ii) file and approval rates require State approval before they become effective. Common requirements for both types of rates are such rates: (i) cannot be discriminating; (ii) must be set at a level which will not produce unreasonable profit margins; (iii) must not be excessively high.

(2) Surety Premium Rates

The premium rates paid to sureties for the required bonds vary depending on several factors. First, the rates are based on the contract value in lieu of the penal sum of the bond. Thus, varying the penal sum of a bond does not increase the cost of a bond. Second, in some States the premium rate does not vary with contract value. For instance, the premium rate in Pennsylvania and North Carolina is 1 percent of the contract value. Another factor which governs the cost of bonds is the surety's assessment of the potential risk associated with issuing the bond to the contractor. Certain insurance companies are willing to issue bonds to higher risk contractors. For instance, two contractors in Virginia might pay the following rates for a bond:

TABLE XI. TYPICAL PREMIUM BOND RATES

Dollar Value of Contract	Rate (Based on Face Value of Contract)	
	A	B
Under \$250,000	1.5%	1.0%
\$250,000—\$1,000,000	1.0%	0.75%
Over \$1,000,000	0.075%	0.58%

On one of the service contracts reviewed at the field, the bid bond information furnished by the contractor included data regarding the bond cost. The costs which were considerably higher than those previously mentioned, were: \$5 per thousand plus \$200 processing cost, or \$7,973 for a \$1,554,718 value contract. These rates are the same as those charged class A construction contractor in some States. Although they appear to be based on an erroneous classification of the work performed, the contractor's bid price probably includes a cost factor reflective of the bond cost.

Normally, performance and payment bonds are sold as a package. The premium for a performance bond will be the same as it will be for both a performance and payment bond. Thus, there is no cost advantage gained by the Government in obtaining only a performance bond.

The foregoing analysis has revealed that the premium costs for a bond vary based on factors such as the contract value assessment of risk associated with issuing the bond to the contractor and the State in which the bond is issued. Generally, the cost paid to the surety will not be greater than 1 percent of the contract value.

(3) Additional Costs for SBA Guaranteed Loans

As will be discussed in detail in Chapter V, some small business firms, which cannot normally qualify for a surety issued bond, will apply for and be issued a bond under the SBA guarantee loan program. This increases the cost of the bonding requirement to the contractor by the following amount—a \$10 (nonrefundable) processing fee plus: (i) \$2 per thousand of .002 times the contract price if a 100-percent performance bond is required, or (ii) the smaller of (i) above or an amount equal to 20 percent of the total bond premium charged by the surety company of the contractor. This additional cost would also be reflected in the contractor's bid price.

(4) Government Personnel Not Familiar With Rates

Interviews with various Government personnel indicated a lack of knowledge regarding the cost of bonds. Such information should be disseminated to personnel to aid in their decision regarding a bond requirement.

b. Other Costs

One of the questions posed on the questionnaire was what are the most important detriments to the Government because of bonding requirements. Responses from the 30 procurement activities were as follows:

TABLE XII. ADDITIONAL BOND COSTS

Detriment	No. of Agencies ¹⁷	%
Preclude maximum competition	17	57
Increased contract price	11	36
There are none	5	16
Administrative expense of handling bond	1	3
False sense of security regarding contractor's responsibility	1	3

Analysis of this table reveals that primary detriment was judged to be inability to obtain maximum competition. As previously noted, the contractors excluded from bidding were believed to be marginal firms, who had a strong likelihood of encountering performance problems. The second detriment was higher procurement costs resulting from exclusion of some bidders, plus the premium cost of the bond and the administrative expense of handling the bond. The other reason, false sense of security regarding contractor's responsibility could also lead to increased administrative expense if award was made to a firm requiring close administration to obtain required performance.

2. Benefits

a. Questionnaire Responses

The following table lists responses by the 30 procurement activities to the questionnaire inquiry regarding the most important benefits accruing to the Government because of bonding requirements:

¹⁷Number of responses greater than 30 since some agencies listed two areas.

Benefit	No. of Agencies ¹⁸	%
Increased assurance of performance	17	57
Better contractors (sureties can require rigid experience and finance requirements)	6	20
Protection for administrative expenses and higher reprocurment costs if terminated.	5	17
Protection of Government property	5	17
Insured payment of laborers and suppliers	4	13

The first three reasons, which were previously discussed, are related to increased assurance of performance through: (1) better contractors who are less likely to default on performance; (2) the sureties: (a) assumption of performance; (b) action, such as providing managerial or financial aid to a contractor, which may preclude an impending default; or protection of the Government rights in the event of a default.

As previously noted in this chapter, protection of Government property is being erroneously used as a justification for bond usage. Finally, the last reason, insured payment of laborers and suppliers, was only cited by 13 percent of the activities. This is not surprising since payment bonds are not primarily for the protection of the Government but for laborers and suppliers of equipment and materiel. However, this again points out that there is some need being fulfilled by such bonds, but it is not as great as that fulfilled by performance bonds.

b. Analysis of Benefits

An analysis of the benefits which have not been previously discussed in detail will now be presented.

(1) Reimbursement of Additional Costs Associated with Reprocurment

¹⁸Benefits cited by only one agency not listed. Several agencies listed more than one benefit.

A surety is liable for the excess and reprourement costs associated with contract termination. Additionally, the surety would have to pay additional performance costs incurred during the period of contract termination and assumption of performance by a new contractor. No instances were found in the contracts reviewed where a surety was assessed such costs. As previously noted, the reprourement of a defaulted K.P. contract, without a bond, was \$40,000 more than the previous contract despite the fact that the period of performance was 3 months shorter.

Additionally, in answering a bid protest involving a bonding requirement on another K.P. service contract reviewed, it was noted that the procurement activity had to terminate two K.P. contracts for default in a 5-year period. Additional reprourement costs were listed as \$3,000 and \$1,600 for contracts valued at \$96,000 and \$10,000, respectively.

If a bond had been required in the above instance, the Government would have been protected against the financial losses it suffered as a result of nonperformance.

(2) Reduced Administrative Expense

(a) Pre-award

One of the problem areas reported in the service contract area is the administrative expense and time delay associated with processing mistakes in bids and nonresponsibility determination. Several instances were noted during field review of contracts in which considerable time and administrative effort were required to process such actions. For instance, at one procurement activity the bid for a K.P. contract which did not contain a bond requirement was opened 27 days prior to the required date for initiation of services. However, contract award was delayed until 65 days after the required initial performance date because one bidder had to be rejected for nonresponsibility and the second bidder had to be processed for a mistake in bid. The activity was forced to extend its previous contract for these services. Award of another contract, involving refuse services, was delayed 50 days beyond required initial performance date because of the mistakes in

bids by the two low bidders. For another contract involving custodial services, rationale for including the bond included the fact that over 57 days were required on the previous contract to reject two bidders for lack of responsibility. The emergency procurement of the services from the incumbent contractor resulted in a monthly price increase of approximately \$19,000.

However, it must not be concluded from the foregoing that only responsible contractors submit bids on service contracts with bonding requirements. Two instances were noted where the low bidder was rejected as nonresponsible based on lack of sufficient capacity and credit even though he was able to furnish the bid bond.

Conversely, it was previously shown that bonding requirements do preclude some firms who cannot get bonds from bidding. Such firms are those which the sureties consider to be a high risk of subsequent default based on the sureties assessment and evaluation of the firm's previous experience, technical expertise, and its financial resources. It can also be concluded that a higher percentage of those firms unable to get bonds would be rejected as nonresponsible when compared to firms who got bonds. Considering the administrative effort and time to process a nonresponsibility determination for a small business firm, it is determined that bonding requirements do reduce the Government's administrative effort and lead time associated with award of service contracts.

(b) Post-award

Additionally, the Government incurs additional administrative burden and expense if it is forced to terminate a contract. The Government may be relieved of most of the foregoing administrative effort if the surety elects to take over contract performance. Next, the Government incurs costs associated with the: (i) effort to place a new contract, often on an emergency basis; (ii) determining the amount of damages or excess costs which are to be assessed; (iii) legal sanctions against the defaulting contractor, such as attachment and subsequent liquidation of the contractor's equipment and assets, to protect the Government's interest in the event the contractor's assets are insufficient to pay all creditors. Additionally, a surety will normally take the legal sanctions against the defaulting contractor and is liable for the damages thus relieving the Government of such

effort. Thus, it is seen that bonding requirements do reduce the administrative burden associated with default.

(c) Improved Contract Performance

It was repeatedly noted in field interviews that a bonding requirement makes a contractor more likely to perform satisfactorily. This is attributed to the fact that a contractor does not want to get "blackballed" by a surety because of a bad performance record. Contractor's performance usually improved immeasurably when a surety was informed of bad performance.

3. Duplication of Effort Impedes Maximum Benefit

a. Similar Data Obtained by PCO and Sureties

As previously mentioned prior to issuance of a bond to a contractor, the surety gathers information regarding the contractor's financial, experience, technical, and other qualifications necessary to perform on the pending contract. Typical information obtained from the contractor's previous customers, suppliers, and bankers are contained in Appendixes B, C, and D, respectively. Since service contractors are performing at many differing locations, they are not administered by one DCAS office as is the case for supply contractors. In fact, the contracts are frequently administered by local personnel. Thus, there is no central office which has previous performance information regarding a service contractor. Hence, the PCO requests information from the contractor for the responsibility determination.

A review of contract files at the various agencies revealed that determination of responsibilities by the PCO are often based on analysis of identical or similar data used by the surety. Typically, the IFB requires that the bidder furnish the following types of information:

1 Length of time in this type of service.

2 Location of office or plant.

3 Name and location of bank account.

4 Places, dates, and areas service was previously awarded within last 5 years, including any terminated for default.

5 Names, addresses, and resumes of work experience of supervisory personnel.

6 Statement contractor has adequate personnel and equipment available to perform.

7 Names of previous creditors.

This information is frequently used by the PCO in determining contractor's responsibility. Additional information is frequently obtained from previous customers, including both Government agencies and commercial businesses, regarding his previous performance. This information is similar to that identified in Appendix B. Frequently, the firm's bank and previous suppliers will be contacted to verify his line of credit. Such information is similar to that required by Appendixes C and D. Interviews with procurement personnel revealed it is difficult to get good information on which to base the nonresponsibility determination. It was alleged that inspectors frequently do not initially inspect in accordance with the contract specifications. Thus, the resultant performance problems may not be solely the contractor's fault. Also, the PCO frequently lives with a marginal contractor rather than terminate the contract. This was attributed partially to problems in getting good inspection information. Additionally, there is a tendency to let a marginal contractor complete performance rather than terminate if the deficiencies surface during the final few months of the contractor's performance period. Since the contract was not terminated, contractor's performance is normally rated as satisfactory when another procuring agency requests performance information.

b. Interpretation of ASPR Provision

ASPR 10-104.2 specifies that performance bonds shall not be used as a substitute for determination of responsibilities. In compliance with the provision, PCO's

are currently not attaching any weight to the contractor's ability to obtain a bond in their responsibility determination. Thus, both the surety and PCO are duplicating effort in obtaining and analyzing similar or identical information regarding the contractor's ability to perform. Since the Government is paying for the sureties service by virtue of the bond premium, this duplication of effort is reducing the cost effectiveness of bond requirements.

Based on the foregoing, it is contended that the PCO should be able to place some reliance on the contractor's ability to obtain a bond in the responsibility determination. However, complete reliance is not advocated. The need for additional analysis on contractor's responsibility was supported by the fact that of the contract reviewed, two bidders were rejected for lack of capacity or credit despite the fact that they had furnished bid guarantees. Additionally, the Government PCO, not a commercial surety, should have final discretionary authority to determine a contractor's responsibility.

c. Comptroller General Report

It must be pointed out that the Comptroller General recommended for bonding requirements on construction contracts that "the ASPR and FPR be amended to allow the contracting officer to determine responsibility on the basis of the contractor's ability to obtain performance and payment bonds from surety companies on the Treasury's approved list, except: (i) when the project involves unique construction experience; or (ii) when the contracting officer has information indicating the low bidder may not be quite responsible."¹⁹ In reply to the recommendation, by letter signed by the Assistant Secretary of Defense (I&L), (now ASD Manpower, Reserve Affairs, and Logistics) Arthur I. Mendolia, it was noted, "We do not concur with the recommendation . . . that the ASPR and FPR be amended to allow the contracting officer to base his determination of responsibility on the contractor's ability to obtain performance and payment bond from surety companies. However, we are in accord with the thrust of the recommendation which is to eliminate unnecessary duplicative effort."²⁰ The proposed approach of permitting the PCO to partially base his responsibility determination on the contractor's ability to obtain a performance and payment bond should eliminate some of the duplicative effort.

¹⁹Report to the Congress, Use of Surety Bonds in Federal Construction, Comp. Gen. of the U.S., 17 Jan 75. p. 24.

²⁰*Ibid.* p. 25

D. SUMMARY

It has been seen in this chapter that the Army does have a need for bonding requirements on service contracts where continuity of performance is critical. Bonding requirements do increase contract costs by approximately 1 percent of the contract price. Additionally, they do preclude certain contractors from bidding, thus, possibly increasing initial procurement prices. Such contractors were usually viewed as "marginal firms" who have a higher probability of experiencing performance problems. On the benefit side, the primary benefit of bonds is an increased assurance that the Government will get its required performance on a continual basis. Additionally, sureties frequently aid a contractor, thereby precluding a pending default. Also, bonds reduce certain Government administrative expense incurred in contract placement and administration. Finally, the cost effectiveness of bonds can be increased if duplicative efforts being expended by both the PCO and surety are eliminated. Part of the duplicative effort would be eliminated if PCO's were permitted to partially base responsibility determinations on contractor's ability to obtain bonds.

CHAPTER IV

POLICY AND GUIDANCE

A. INTRODUCTION

In this chapter, policy and guidance regarding bond usage will be examined to determine if any changes are required to improve effective usage of bonds in service contracts.

B. LACK OF UNIFORM GUIDANCE AND PROCEDURES FOR BOND APPROVAL REQUIREMENTS

1. Lack of Uniform Interpretation of DA Policy.

Surprisingly, opinions expressed by personnel interviewed at the procurement activities were nearly equally divided regarding DA attitudes toward bond usage. Generally, those who viewed DA as looking favorably on bond usage stated that this response was valid only if the PCO was able to justify the bond requirement. Contrarily, several indicated that even though they felt that bonds were required on a particular service contract, they did not include it in the contract because of unfavorable DA attitude. In several instances, the appearance of DA unfavorable attitude was generated by factors such as: (1) previous higher headquarters disapproval of bonding requirement for the same type of services; (2) guidance which cautioned procurement activities against bond usage, and required higher level approval for bond usage. For instance, one command sent guidance stating that, "pursuant to ASPR 10-104.1(b), 10-104.2, and 10-104.3, performance and payment bonds shall not be required in connection with service contracts other than construction contracts. . . . ASPR Section I, Part 9 prescribes the proper procedures for determining contractor responsibility. An effective method of dealing with a contractor's unsatisfactory performance under service type contracts is use of the "Inspection of Services" Clause (ASPR 7-1902.4).²¹ This guidance then required approval to use bonds by the subordinate commands' Principal Assistant for Procurement or the HPA.

²¹HQ DARCOM AMCRP-SP letter dated 7 Nov 75. Subj: Use of Performance and Payment Bonds in Service Type Contract Requirements.

Personnel interviewed at other major command headquarters expressed a favorable attitude toward bond usage. Furthermore, they indicated that the PCO at their procurement activities have discretion in inserting bond requirements, providing he can justify the requirement. Guidance has been given to procurement activities regarding the need to document the bond justification. For instance, one major procurement command issued a telegram to its procurement activities noting that if the PCO determines a bond is required, "files must be documented to support such determination and should also support the percentage of bond requirements."²² Normally, copies of solicitations are forwarded to these headquarters for review if they exceed a \$250,000 value. However, bonding requirements are normally not challenged by headquarters, unless there is a bond protest regarding the requirement.

Thus, it has been seen that there is no uniform guidance regarding DA's attitude toward bond usage in service contracts. Dichotomy of opinion was found between the major procurement commands and within a command regarding attitudes and procedures to be followed for bond approval. Thus, there is a need for uniform guidance from DA.

2. Internal Procurement Activities Procedures.

All of the activities included in the sample reported that they did not have local procedures or guidance regarding bond usage on service contracts.

Although writing a bond justification was not a major problem on most procurements, the PCO did not always have sufficient data on hand to justify the requirement on some procurements. In such situations, the PCO's requested the technical requirement personnel to furnish input to support a bond requirement. Some PCO's noted that it was sometimes difficult to get adequate supporting documentation from the requirements activity. This was partially attributed to the fact that these personnel are usually dealing with construction contracts, which do not require bond justification. Obtaining such information after the PCO receives the Procurement Work Directive (PWD), delays the procurement action. Thus, there is a need for procedures which would make the requirement personnel responsible for including documentation for a bond requirement with the PWD.

²²Cdr TRADOC, Fort Monroe, Telegram R042231ZFeb76, Subject: Payment and Performance Bonds for Contracts Other Than Construction.

A review of contract files reveals that the information forwarded for publication in the Commerce Business Daily did not always list the bond requirements. ASPR 1-1003.9 (f) provides that certain procurements involving specialized requirements should be brought to the attention of prospective bidders in the synopsis of the procurement. Dissemination of such information will help avoid improvident expenditures for bid preparation. Since a contractor's bid will be rejected if he fails to furnish a bid guarantee, a bonding requirement should be identified in the synopsis.

Review of the contract files also shows that when a procurement must be approved at a level higher than the PCO, the review board or chief of the procurement division is normally made aware of a bonding requirement. For instance, activities often have a set of questions regarding the procurement, including is a bond required?

Finally, it was noted that the Judge Advocate General, Washington normally reviewed the bid bonds and determined if they were legally sufficient. The time required to get the JAG approval did not present a problem to PCO's.

3. Difficulty in Writing Justifications

ASPR 10-104.2 requires that justification for a bonding requirement must be completely documented. A review of the documentation for bonding requirements on the contracts reviewed plus interviews with personnel were conducted to ascertain if any problems were being encountered in meeting this requirement.

a. Justification for Need of Bond

A review of the documentation justifying the need for a performance and payment bond revealed that the PCO normally had a rationale basis for the bond requirement. As previously mentioned in Chapter III, performance bonds were normally justified based on: (1) continuity of service performance was critical to the mission capability on the health, welfare, and morale of the troops; (2) Government administrative expenses to place a new contract; (3) protection of Government property, which was found to be based on an erroneous interpretation of ASPR; (4) nature of contractor, citing

that past experience with contractors providing this type of service revealed that many bids will be from inexperienced contractors who overextend themselves and face bankruptcy and default when they experience performance problems. The justification also usually included a statement regarding the purpose of a bond; i.e., assurance of performance and fulfillment of all undertakings required by the contract. The majority of justifications for payment bonds just noted that payment bonds insured payment of those who furnish materials or labor to the contractor. A few justifications for payment bonds noted that the procurement activity had experienced numerous debt complaints from suppliers and laborers on previous contracts for the service. No justification stated that the payment bond was required in accordance with ASPR 10-104.3 which states that these payment bonds should also be required if they can be obtained at no additional cost than would be paid for a performance bond. It was previously found in Chapter III that the premium paid for a performance bond or a performance and payment bond is the same. Since a payment bond may not be used unless a performance bond is required, it is concluded that documentation justifying the need of a performance bond should be sufficient since a payment bond can be acquired at no additional cost.

b. Penal Sums

(1) Contract Data

Table XIII, "Bond Penal Sums," lists the penal sum and potential liability incurred by sureties for the various types of service contracts reviewed during this study. An analysis of this table reveals that there is wide disparity in the penal sum of bonds used for contracts involving the same service. For instance, the total liability a surety incurred on custodial/janitorial contracts ranged from 20 percent to 150 percent of the contract price. Similarly, the range is from 25 percent to 100 percent and 60 percent to 150 percent of the contract price for food and garbage services respectively. Furthermore, the penal sum does not vary directly with the dollar value of the contract. For instance, for the two largest dollar value custodial contracts of \$498,000 and \$510,000 the total liability is 150 percent and 25 percent respectively. Thus, examination of this data seems to indicate that a constant rationale is not being applied in determining penal sums for performance and payment bonds.

(2) Justification of Penal Sum Used

(a) ASPR Guidance

In view of the wide disparity of penal sums being used, a review of existing guidance in this area was initially undertaken. The only guidance in ASPR relative to the amount of the penal sum is for construction contracts. ASPR 10-103.1 specifies that a performance bond should be required in a penal amount deemed adequate by the contracting officer for the protection of the Government. Generally, the penal amount of each performance bond shall be 100 percent of the contract price at the time of award. But where the contracting officer finds that to require a 100-percent performance bond would be disadvantageous to the Government, he may prescribe a lesser penal amount, which should normally not be less than 50 percent of the original contract price and in all cases no less than the payment bond. ASPR 10-103.2 states that the penal sum for a payment bond shall be:

CONTRACT VALUE	% OF CONTRACT PRICE
\$1,000,000 or less	50%
\$1,000,000 to \$5,000,000	40%
over \$5,000,000	\$2,500,000

(b) Review of documentation of justification

A review of the documentation which supported the penal sum used, plus followup personnel interviews were conducted to determine how the PCO determined the penal sum he used. The most often cited reasons for selecting the penal sum were: (1) subjective analysis by PCO of amount of protection needed by Government; (2) consideration of the criteria specified in ASPR for construction contracts; (3) the value of the equipment being protected divided by the contract value, with a maximum 100-percent penal sum for the bond. Subjective analysis by the PCO ranged from those where the PCO stated that the penal sum was the minimum amount deemed necessary to protect the Government interests to those involving analysis of some cost factors associated with nonperformance. In one case where costs were analyzed the

Table XIII Bond Penal Sums

TYPE SERVICE	CONTRACT VALUE	PERFORMANCE BOND	PAYMENT BOND	TOTAL LIABILITY (% OF CONTRACT PRICE)	TOTAL LIABILITY (\$)
1) Custodial	43,590	50%	50%	100%	\$43,590
2) " "	77,525	50%	50%	100%	77,525
3) " "	135,107	\$20,000**	\$10,000**	22%**	30,000
4) " "	217,953	60%	50%	110%	239,749
5) " "	417,801	10%	10%	20%	83,560
6) " "	458,348	100%	50%	150%	687,522
7) " "	509,837	25%	0	25%	127,457
1) Garbage	146,798	50%	50%	100%	146,798
2) " "	165,771	100%	50%	150%	248,656
3) " "	380,006	50%	50%	100%	381,172
4) " "	600,000	30%	30%	60%	360,000
1) Food Service	49,013	25%	25%	50%	24,506
2) " "	477,564	25%	25%	50%	238,782
3) " "	722,386	25%	25%	50%	361,193
4) " "	1,205,500	50%	25%	75%	904,125
5) " "	1,370,886	50%	50%	100%	1,370,886
6) " "	1,554,718	\$500,000**	250,000**	48%	750,000
7) " "	3,989,780	25%	0	25%	997,445
1) Landscape	122,947	20%	20%	40%	49,178
2) " "	209,443	100%	50%	150%	314,164
1) Guard	88,548	25%	25%	50%	44,274
1) Installation* Bus Service	170,513	50%	50%	100%	170,513

*Not included in original random sample

**Expressed as a dollar value in lieu of a percentage

supporting documentation noted that: (1) the \$500,000 penal sum for the performance bond was based primarily on the estimated monthly contract cost of approximately \$166,000 to \$200,000; (2) the \$250,000 payment bond was based on estimated labor costs of \$60,000 per month. Such a justification appears to be faulty since the surety would only be liable for the additional, not the total, costs incurred during the period of nonperformance. Furthermore, the use of bonds for protection of property was previously found to be erroneous. Therefore, review of the documentation and interviews with personnel revealed that there was no consistent standard being used in deriving penal sums to be required on service contracts. Normally, subjective analysis of the protection needed by the Government or use of the criteria specified for construction contracts is being used. This probably accounts for the wide disparity in penal sums previously noted. It also points out that there is a definite need for guidance in this area.

(c) Amount of Government protection needed

An analysis of the amount of protection needed by the Government will now be addressed. First, it was previously determined that bonds on service contracts were needed where continuity of performance was critical. There are three primary categories of additional costs which may be incurred during the period of nonperformance, which are: (1) increased performance costs; (2) higher reprourement costs; (3) Government administrative costs associated with reprourement of the services. Although it was beyond the scope of this project to get cost information to accurately predict each of these costs, interviews with personnel revealed that these costs would not be great. A hypothetical case will now be presented to give an insight regarding additional cost. Initially, the increased performance costs on a \$1,000,000 annual service contract will be considered. First, one must consider that a contractor is expending on the average \$83,333 per month. Although data is not available to accurately determine the time required to reprocure critically needed services and to get a new contractor to commence performance, it is felt that procurement should normally be able to accomplish this task within 60 days. For the contracts reviewed, only one contract involving services, where continuity of performance was critical was terminated. It took the agency 10 days to place a new contract for the K.P. services. Furthermore, documentation supporting bond requirements cited periods to get a new contractor on board ranging from 30 to 60 days. Therefore, even if the

cost of temporary labor performing the service was 50 percent higher than experienced by the defaulted contractor, the additional costs of performance would only be \$83,333 during the 2-month period. (That is, \$83,333 per month x 2 months x .50 price increase.)

The primary second cost is the higher reprourement costs. Even if a contractor were terminated immediately after award, it is doubtful the increased procurement costs would exceed 10 percent of the original contract price or \$100,000 on a million dollar contract. The additional amount expected for the reprourement would decrease after each month of performance. For instance, if a contract were terminated after 4 months and it took 2 months to reprocure the services, the Government would be purchasing 6 months of services on the new contract. The value of services on the terminated contract for a 6-month period is \$500,000. A \$100,000 additional reprourement cost would represent a 20-percent increase in contract price.

The third primary cost is administrative costs incurred by the Government to effect the reprourement. This cost is very hard to determine but is not considered to be great. The Comptroller General recently noted that procurement activities were not pursuing reimbursement for additional costs associated with terminating construction contracts with bonds because (1) ASPR is somewhat vague on the subject; (2) agencies are reluctant to seek recovery; (3) neither ASPR nor FPR describes what constitutes administrative expenses.²³

In the foregoing analysis, additional costs associated with reprourement were examined. It is felt that the additional costs developed in this hypothetical analysis are on the high side. Such figures were used to provide protection to the Government against unforeseen situations. The total additional cost figures on a million dollar contract were: (1) \$183,333 for additional performance and reprourement costs; (2) a small undetermined amount for Government administrative cost. Based on this analysis, it is not felt that the Government needs protection greater than that afforded by a 25-percent performance bond, which provides a liability of \$250,000 on a million dollar contract. Considering the \$183,333 for additional performance and reprourement costs,

²³ Report to the Congress, Use of Surety Bonds in Federal Construction Should Be Improved, Comptroller General, 17 Jan 1975, p. 42.

the Government would have a cushion of \$66,667 to cover additional administrative costs or any other additional costs associated with the default on this hypothetical defaulted contract.

(d) Penal Sum Size Impact on Cost of Bonding Requirement

It was previously noted that the size of the penal sum of a bond does not impact the premium paid for a bond. One may logically ask why the Government should not use the same criteria employed for construction contracts and get the additional protection afforded by a 100-percent performance and 50-percent payment bond at no additional cost.

The answer to the above question is that a bond's penal sum impacts the ability of some bidder to get a bond. It was reported that many small minority firms often are unable to get a bond from a surety company. They, therefore, are relying on individual sureties. ASPR 10-201.2(d) provides that since the individual surety is liable in the event of principle default, the surety must have a net worth equal to total penal sum of the bond. The impact on this requirement was illustrated on one of the contracts reviewed which had an initial award value of \$954,309. The low bidders and one other bidder, submitted a bond by an individual surety. Since the penal sum for the performance and payment bonds were 50 percent and 25 percent respectively, the surety needed a net worth of 75 percent of the contract value or \$715,731. Neither of the two individual sureties listed net worth exceeding that figure. The JAG recommended rejection of the low bid based on insufficient net worth of the surety, which was listed as \$532,068. The surety alleged that the net worth was in error and furnished an affidavit which showed his net worth was actually \$1,088,026. Based on this, the bid was not rejected. However, if 100-percent performance and 50-percent payment bond had been required, the surety would have been required to have a net worth of \$1,431,413. Since the surety did not have assets equal to this amount, the bid would have been rejected.

The foregoing analysis revealed that although the size of the penal sum of a bond does not increase the premium paid, it does impact the ability of smaller firms, who rely on individual sureties, to obtain a sufficient bond. Thus, the Government

should not require a bond's penal sum to be greater than that needed to reasonably protect the Government's interest.

4. Other Revisions to Policy Needed

Finally, the procurement activities included in the random sample were queried as to what revisions (i.e., additions or deletions) to current policies and procedures, as specified in ASPR, APP, etc., are needed to improve effective bond usage on service contracts. Responses were as follows:

REVISION REQUIRED	NO. OF PROCUREMENT ACTIVITIES
No revisions	17
Mandatory usage of bonds, including eliminating bond justification	5
More discretion of PCO	4
Reduce minimal penal sum of bonds	2
Relax DA's antibond attitude	1

Thus, approximately 60 percent of the agencies felt that the current policies and procedures are adequate. The two most cited reasons for revising policies are diametrically opposed. Approximately 18 percent of the agencies felt that housekeeping services which required bonds should be identified and usage of bonds made mandatory for these procurements. This would eliminate the need to justify bonding requirements. Conversely, approximately 14 percent of the agencies felt that the PCO should be given more discretion in determining if a bond was required on a particular contract.

In view of the aforementioned, there does not seem to be a need for revisions to existing policies and procedures except for that previously noted in this chapter.

C. SUMMARY

An examination of the current policies and procedures for bond usage revealed that there is need for uniform guidance and procedures from DA level regarding bond usage on service contracts. Additionally, the lack of local procedures has caused some minor problems such as getting adequate supporting documentation for a bond. The primary problem area in developing justification for a bond is determining the penal sum. An analysis of the amount of protection needed by the Government from a bond revealed it is less on a service contract than for a construction contract. A hypothetical case revealed that a 25-percent performance and payment bond should adequately protect the Government on a services contract compared to the 100-percent performance and 50-percent payment bonds normally used on construction contracts. Although the premium cost of a bond does not vary with penal sum, a higher penal sum was found to preclude certain bidders, who rely on individual sureties, to get a legally sufficient bond.

CHAPTER V

SBA PROGRAMS

A. INTRODUCTION

As noted in Chapter II, the smaller, often minority, small business firm frequently encounters problems in obtaining the required bonds from a surety. The SBA surety bond program, established by Public Law 91-609, (15 U.S.C. 694a-b) allows the SBA to guarantee a surety company for a portion of its losses, resulting from a small business' breach of the terms of a bid, payment, or performance. This program thus helps the minority or smaller business to get a bond for which he normally would be rejected. The ultimate aim of the program is to "graduate" these contractors so they can obtain bonds from the standard surety market, based on their individual proven record of performance. Since this program aids the Government in achieving its goal of obtaining full and free competition on procurements where bonds are required, an analysis of the program will be presented in this chapter. Additionally, the need for bonds on 8(a) contracts will be discussed briefly.

B. SBA GUARANTEED BOND PROGRAM

1. Eligibility Requirements

Any small business firm bidding on a contract valued at \$1,000,000 or less which requires a bid, performance or payment bond, issued by any surety company included on the Treasury Department's list of approved sureties, can apply. Additionally, if a procurement is put out in components and the individual contracts do not exceed \$1,000,000, a contractor can apply for a bond guarantee on each procurement. There is no limit on the number of bonds that can be guaranteed under this program. It is interesting to note that a bill recently passed by the House of Representatives, provides that, "With respect to any work to be performed, the amount of which would exceed the maximum amount of any contract for which a surety may be guaranteed against loss under Section 411 of the Small Business Investment Act of 1958 (U.S.C. 694(b)), the contracting procurement agency shall, to the extent feasible, place contracts so as to allow more than

one small business concern to perform such work."²⁴ This reinforces the intent of Congress to use this bond guarantee program to the maximum extent. If it does become law, it will mean that procurement agencies should split service contracts, when feasible, to several component parts under \$1,000,000. Thus, it is seen that the SBA guarantee bond program only aids a small contractor on contracts under \$1,000,000.

2. Amount SBA Guarantees vs. Surety Costs

The small business administration can guarantee up to 90 percent of the actual loss suffered by a surety on contracts valued under \$250,000. For contracts between \$250,000 to \$1,000,000 the SBA will guarantee 80 percent of the surety losses. For this protection, the surety must pay the SBA 20 percent of the total premiums charged for performance and payment bonds. Thus, the SBA is furnishing 80 percent to 90 percent of the bond protection to another Government agency in the event of contractor's nonperformance for only 20 percent of the bond premium. Although advantageous to the procuring agency, inappropriate and excessive use of bonding requirements in procurements involving the strong likelihood of the issuance of SBA guarantee loans, is not cost effective to the taxpayer.

3. Ceiling Dollar Value for the Program

The SBA has a maximum dollar value of \$833,000,000 for all the surety bond guarantee outstanding. The fact that there is a ceiling for the aggregate value of bond guarantees means that each time a guaranteed bond is issued, the SBA's ability to issue other guaranteed bonds is decreased. In a prepared statement regarding proposed HR6339 which would have increased the size of SBA guaranteed bonds from \$1,000,000 to \$5,000,000, the Deputy Administrator of SBA noted that, "this legislation may adversely affect agency resources if the contract amount is raised in light of SBA's revolving fund limit, reduced program activity may result."²⁵

²⁴HR 692, Title VI, Section 601, Small Business Set Asides, Report No. 95-1.

²⁵Louis F. Laun, Deputy Administrator, SBA Hearings Before the Subcommittee on SBA and SBIC Legislation of the Committee on Small Business, House of Representative, 94th Congress, p. 323.

4. Applying for an SBA Bond Guarantee

Initially, the contractor applies to the surety of his choice. He must furnish the surety with all of the financial data, work history, and other information the insurance company needs to determine if it will issue a bond. If the contractor does not qualify for the issuance of a bond, the surety will determine that he will be: (i) willing to issue a bond only if it is guaranteed by the SBA; or (ii) not issue a bond under any circumstance.

If the surety determines a willingness to issue a bond, only if it is guaranteed by the SBA, the contractor must furnish the following types of information: (i) Statement of Personal History (Appendix E); (ii) Application of Surety Bond Guarantee (Appendix F); (iii) recent detailed fiscal year Balance Sheet and Profit and Loss Statement; (iv) aging schedules of Accounts Receivable and Accounts Payable; (v) Work in Progress Schedule; (vi) letter from bank of account indicating line of credit; (vii) personal financial statements. If the SBA underwriting review is favorable, the SBA will complete the guarantee agreement and return it to the surety. Thus, it is seen that the SBA does require much information, which relates to a contractor's ability to perform satisfactorily, prior to issuing the bond. Finally, it must be noted that the sureties handle any claims arising against SBA bond guaranteed contractors. SBA authorizes each surety to deal with such claims in their normal manner to mitigate losses and insure satisfactory completion of the contract.

5. Program Experience

The following table lists experience with the program from its inception in 1971 through 30 September 1976.

Table XIV SBA Guaranteed Bond Program Experience		Percent of Total Application
	Number	
Total applications received	91,711 ²⁶	
Guarantee requested by sureties	89,733	97.8
Guarantees approved by SBA	86,113	93.8
Number of contract awards	46,209	50.3
Value of contract awarded	\$3,022,090,371	

Thus, it is seen that high percentage (over 93.8 percent) of all requests are approved by the SBA. This is not surprising since the requests are normally prescreened by the surety. Furthermore, the value of contracts awarded as a result of this program is over \$3 billion, with an average award value of \$65,400. Thus, this program has aided many small business firms in bidding on Government contracts who could not otherwise qualify for a bond.

On the other hand, total losses to the SBA on these contracts resulting from contractor default was estimated at \$66,480,174 (which included \$44,633,502 which were actually paid plus \$21,846,672 which are anticipated), or a rate slightly greater than 2 percent. Furthermore, out of the 46,209 contractors awarded contracts as a result of this program, 2,590, or approximately 5.6 percent of the contractors had been issued default notices. As noted in Chapter II insufficient capitalization and going beyond their capacity is primarily responsible for the very few contractors who have been issued bonds through this program and have subsequently had their contract terminated for default.

An SBA study of this program found it to be overall cost effective. Noting that the contracts would have been awarded at higher acquisition costs if the low bidder had not been issued a bond as a result of this program, they concluded based on a random sample of contracts awarded that when the \$61.7 million estimated savings in total Government procurement costs (\$18.8 million for the Federal Government) is compared to the \$17.5

²⁶Includes some verbal requests during initial program years.

million in SBA program losses, it becomes apparent that a net overall financial benefit to the Government has been realized.²⁷ Additionally, the contractors were queried as to the reasons for obtaining an SBA bond guarantee. Responses revealed four primary reasons as follows: (i) 34 percent stated their working capital was not sufficient for a regular bond; (ii) 30 percent needed a guaranteed bond because the contract amount involved was higher than their usual contract; (iii) 17 percent reported their sole reason was their surety required it; (iv) 14 percent indicated they did not have sufficient experience.²⁸ Additionally, the benefit of the program to minority firms was substantiated by the fact that 15.3 percent of the bonded contracts, involving 13.6 percent of the dollar value, were to such firms during a period from February through May 1975.²⁹ Thus, this study indicates that this program has benefits to both the Government, through lower procurement costs, on contracts where bonds are needed, and to the smaller, especially minority, contractor.

C. SBA 8(a) Program

As previously noted in Chapter II, a large proportion of service contracts for food, custodial/janitorial, installation housekeeping and guard services (56 percent, 48 percent, 38 percent and 27 percent of the competitive base respectively) were awarded to minority firms under Section 8(a) of the Small Business Act. Such contracts are awarded to the SBA which then places a subcontract with the minority firms.

Information obtained from procurement activities via the questionnaire plus from field interviews and review of contract files revealed that bonds are not included on such contracts. The rationale for not including bonds were: (i) another Government agency, the SBA, is contractually liable in the event of contractor default; (ii) the SBA determines the firm's responsibility to perform satisfactorily on the proposed contract; (iii) the SBA often provides management or financial assistance to the firms, thus decreasing the possibility of performance default; (iv) the contracts are negotiated, thereby insuring that the contractor

²⁷ Study of the Small Business Administration Surety Bond Guarantee Program, Office of Advocacy, Planning and Research, US Small Business Administration, 23 Aug 1975. p. 8.

²⁸ Ibid, p. 9.

²⁹ Ibid, p. 10.

understands and has included a price factor for all required contractual performance. In contrast, it was noted that when the services are procured through formal advertising procedures, a contractor's bid may fail to include a price factor for some required work. This lowers the profitability of the contract and may jeopardize performance for a contractor with smaller financial resources, if other unanticipated performance problems increase costs. In view of these factors, it is concluded that bonds should not be required for service contracts awarded to 8(a) minority firms.

D. Summary

In this chapter, it has been seen that the SBA guaranteed bond program does enable some bidders, who cannot normally qualify for a bond from commercial sureties, to obtain the necessary bonds for contracts valued under \$1,000,000. However, there is a ceiling dollar limitation for all bonds issued under this program.

Although advantageous to the procuring activity, the inappropriate and excessive use of bonding requirements is not cost effective to the taxpayer. Despite the fact that the SBA guarantees the surety for 80 to 90 percent of the damages suffered for bond breach for only 20 percent of the surety's bond premium, an SBA study found that the program is cost effective when one considers the cost savings associated with lower award prices of contractors issued guaranteed bonds. However, requiring a bond in a questionable situation which results in an SBA guaranteed bond reduces the amount of available guaranteed bond in view of the dollar ceiling. This will preclude the issuance of guaranteed bonds to bidders on procurements where the Government has a valid interest to protect.

Finally, it was concluded that bonds should not be required on 8(a) service contracts.

CHAPTER VI

FINDINGS AND RECOMMENDATIONS

A. FINDINGS

1. Purpose of Bonds

The four types of bonds included in service contracts are: (i) bid guarantees or bid bonds; (ii) performance bonds; (iii) payment bonds; (iv) fidelity bonds.

The purpose of these bonds is to provide protection: (i) to the Government against contractor's failure to perform or deliver in accordance with the contract terms; (ii) to suppliers of materiel and labor to the contractor against nonpayment; (iii) against financial loss due to dishonesty of contractor's employees. Since a bidder will be rejected if he is unable to furnish the bid guarantee, the inability of potential bidders to obtain a bond will normally preclude them from undertaking the necessary bid preparation effort to submit a bid. This raises the question, "Do bond requirements discriminate unjustly against small contractors who cannot obtain bonds from surety?"

2. Application of Bond Requirements

Responses to a questionnaire requesting information for a random sample of approximately 10 percent of the service contracts issued during FY 76 and FY 76T revealed that bonds were required for five classes of services: (i) food service; (ii) garbage collection; (iii) landscape; (iv) custodial/janitorial; and (v) guard. Additionally, interviews with field personnel at various procurement activities only revealed one additional category of service, installation bus service, for which a bond requirement was included.

An analysis of DD 350 information for FY 76 for competitive procurement of the 14 categories of services being studied, revealed that based on the dollar value of all competitive awards approximately: (i) 93 percent were to small business firms; (ii) 83

percent were 100 percent small business set-asides. More importantly, the percentage of awards (on a dollar basis) to small business firms and by procurements that were 100-percent small business set-asides was very high for all six categories of services requiring bond as noted below.

Service	% of Random Sample Contracts with Bonds	% Small Business Awards	100% Small Business Set-Asides ³⁰
Food Service	95	100	99
Garbage collection	58	94	81
Landscaping (Lawnmowing)	53	100	71
Custodial/janitorial	23	100	98
Guard	4	86	55
Installation bus svc	0 ³¹	100	100

Further analysis of the DD 350 information revealed that the reason cited for 93 percent and 73 percent of the awards to large businesses for garbage and guard services respectively, was the failure of small business to submit the low bid. This means that 100 percent of the competitive awards during FY 76 for four classes of services with bond requirements were to small businesses. For the remaining two classes, 99.6 percent and 96 percent of the competitive awards were made to a small business firm or the low large business firm. Furthermore, all of the random sample contracts, plus the additional contracts reviewed during field visits, were awarded as a result of 100 percent small business set-asides except for one garbage contract.

Thus, the proposition that bonding requirements have precluded small business firms from receiving a substantial portion of awards must be rejected. Similarly, increasing

³⁰Contract not included in random sample with bond requirement.

³¹Source DD 350 Procurements Statistics for FY 76.

or decreasing bonding requirements for the classes of services studied probably will have little impact on the proportion of awards to small business firms. Finally, the widely varying usage rate of bond requirements for the various classes of services, tends to support the proposition that procurement contracting officers tend to use discretionary judgment in lieu of indiscriminate use in deciding if a bond is required.

3. Exclusion of Small Business Firms

The consensus of opinion of people interviewed and questionnaire responses was that bonding requirements did not impose a hardship on responsible bidders, but probably did preclude marginal bidders, who most likely would be determined to be nonresponsive, from bidding. Interestingly, this is partially supported by a finding by the SBA that the primary reasons for default of small business contractors were: (i) insufficient capitalization to carry them over when they ran into trouble; (ii) going beyond their capacity.

A review of the contract files plus questionnaire responses from 32 procurement activities revealed only two instances during FY 75 and FY 76 where a low bidder was rejected for failure to submit a bid guarantee. Furthermore, one of these two bidders would have been rejected even if he furnished a bond because he was nonresponsive to other solicitation requirements.

Contrarily, information supporting the premise that some small business firms are excluded from bidding is as follows: (i) for 9 out of 17, or approximately 53 percent, plus three out of five additional contracts reviewed, some bidders were not able to furnish required bid guarantees; (ii) review of bond protest information revealed some bidders, particularly minority firms, were unable to furnish bid guarantees; (iii) for custodial/janitorial contracts under \$1,000,000, the number of bidders increased on the average by approximately nine when bonds were not required. However, the Government was able to obtain adequate price competition from small business firms on all of these procurements.

The difficulty encountered by small business in obtaining bonds are related to: (i) inadequate preparation of financial data presented by contractor; (ii) lack of sufficient working capital; (iii) lack of sufficient technical and/or managerial skills to perform the contract or to handle the extra managerial and financial load of one more contract in addition to work in progress; (iv) contract amount exceeded contractor's usual contract amount.

Based on the foregoing findings, it is concluded that bonding requirements: (i) exclude some small businesses, which are normally at best marginally qualified, from bidding on service contracts; (ii) do not preclude the Government from obtaining adequate price competition from small businesses.

4. Analysis of Bond Need

The protection afforded by bonds on service contracts was found to be less on service than on construction contracts. In view of this, ASPR 10-104.2(a) requires the PCO to justify and document the need for a bond. A review of bond justification found that bonds are required when criticality of continuity of the service, such as food service, garbage, and hospital custodial/janitorial, was essential to mission capability or the health, welfare, and morale of the troops. Such justifications noted that a minimum of 45 to 60 days would be required for a major procurement (over \$100,000) from date of contract termination until assumption of performance by a new supplier. In the interim period the Government would have to provide the required services via civilian or military personnel, which would disrupt scheduled training, job, etc. Two terminations of K.P. contracts were observed. For the bonded contract, the surety took over performance for a 4-month period by using the existing work force. For the contract with no bonds, military personnel assumed performance in the interim period. Bonds do not insure, but increase, the probability of continued performance since: (i) sureties may elect to assume performance using the existing work force; (ii) sureties sometimes provide financial and managerial aid to a contractor experiencing performance problems; (iii) suppliers or laborers will be more willing to extend credit to a bonded contractor facing financial problems. Additionally, firms issued bonds are less likely to default if unanticipated performance problems are encountered since a surety requires a minimum level of experience, previous performance,

financial, and other resources before issuing a bond. Thus, it is concluded that performance bonds do protect the Government in situations where continuity of performance is critical.

The second primary reason for requiring performance bonds was to protect Government property, such as dempsty dumpsters for garbage collection or office buildings for custodial/janitorial, that the contractor would have access to during contract performance. These justifications are based on an erroneous interpretation of ASPR 10-104.2(a) which infers a bond is justified if the contract provides both for the usage and specified manner of handling Government property, materiel, and funds. The intent of this provision is to cover situations where the Government would incur substantial costs based on the contractor's failure to perform, such as those associated with removing, packing, and transporting a large piece of leased equipment. Thus, this ASPR provision needs clarification.

Fidelity bonds were found to be required on service contracts, such as K.P. or laundry, where contractor employees are paid money for services rendered.

Nonpayment of laborers or suppliers is not a major problem at procurement activities since such complaints are forwarded to the Department of Labor. However, over 50 percent of the contractors on the Joint Consolidated List of Debarred, Ineligible, or Suspended Contractors as of 1 Jan 77 were placed on it for violation of the Service Contract Act of the Contract Work Hours and Safety Standards Act. Since these acts require minimum level of compensation of employees, this tends to support the need for payment bonds.

5. Cost Effectiveness of Bonds

a. Costs

Premium rates charged by sureties are State regulated. Although some States have uniform rates, others permit rates to vary dependent on: (i) sureties assessment of risk of issuing the bond to a contractor, and (ii) value of the contractor premiums are based on the dollar value of the contract, and not the penal sum of the bond. Generally, the cost of a

bond, which is reflected in the contract price, is not greater than 1 percent of the contract price. However, an additional cost of .002 times the contract price will be paid if a 100-percent performance bond is issued as a result of SBA guarantee. This amount will reduce to 20 percent of the surety's premium if less than a 100-percent performance bond is required. Finally, the premium paid for a performance or a performance and payment bond will generally be the same. Finally, procurement personnel are not generally aware of the rate structure.

Other bond costs mentioned are: (i) precluding maximum competition; (ii) administrative costs of handling bonds.

b. Benefits

Primary benefits which have previously been mentioned are: (i) increased assurance of continuity of performance; (ii) reimbursement of additional administrative and reprourement costs in the event of default; (iii) insured payments of laborers and suppliers. Other benefits included: (i) reduced pre-award administrative effort and delay associated with processing mistake in bids and nonresponsibility determinations which are reportedly commonplace for service contracts and frequently force activities to extend performance periods on previous contracts at higher prices; (ii) when the surety assumes performance, elimination of administrative costs associated with the termination and reprourement of a defaulted contract; (iii) reduced administrative costs by assumption by the surety of certain efforts, such as attachment and liquidation of contractor's assets, needed to protect the Government against damages suffered as a result of the default; (iv) better contract performance, since a contractor does not want to get "blackballed" by a surety.

Finally, prior to issuing a bond, the surety obtains information and performs analysis similar to that undertaken by the PCO in determining a contractor's responsibility. Since ASPR 10-104.2 specifies bonds are not to be used as substitutes for determination of responsibility, PCO's do not rely on the contractor's ability to obtain a bond in their responsibility determinations. To eliminate this duplication of effort, the Comptroller General recently recommended for construction contracts that ASPR and the FPR be

amended to permit responsibility determinations based on the contractor's ability to get bonds from surety. Review of the contract files revealed two instances where a bidder was rejected as nonresponsible for lack of capacity and credit, even though the bidder had furnished a bid guarantee. Thus, it is concluded that the PCO should be permitted to rely on the contractor's ability to obtain a bond as one, but not the sole, factor in determining responsibility.

6. Guidance and Procedure

Lack of uniform guidance regarding DA's position toward bond requirements on service contracts was observed. At the procurement activity level, some felt DA looked favorably upon usage providing the PCO had sufficient justification. Others felt DA discouraged usage based on: (i) disapproval at higher headquarters of bond requirements for previous procurements of the same service; (ii) guidance from higher headquarters cautioning against bond usage.

Other major procurement commands required HPA approval, while two other commands gave the PCO discretion to include a bond requirement. However, higher level approval, such as the contract review board, was often required for solicitations issued by activities under these two commands. Additionally, headquarters for these activities were forwarded a copy of all solicitations over \$250,000 for review. However, headquarters personnel reported they did not challenge bond requirements frequently.

Procurement activities do not have any local procedures, policy, or guidance regarding usage of bonds in service contracts. This has caused some difficulties in getting requirement or technical personnel to furnish documentation for a bond since such documentation is not required for construction contracts. Additionally, some activities did not alert prospective bidders in the synopsis information included in the Commerce Business Daily of a bond requirement. ASPR 1-1003.9(f) provides that such specialized requirements should be brought to a bidder's attention to help avoid unnecessary expenditures for bid preparation.

Although documentation of bond need does not present a major problem to the PCO, it does require administrative effort to prepare. Elimination of such effort where bonds have been found to be justified would increase the cost effectiveness of bond requirements.

The primary problem area observed in documenting bond requirements was determination and justification of the penal sum. Guidance provided in ASPR 10-103.1 states penal sum for performance bonds should adequately protect the Government. For construction contracts, ASPR 10-103.2 sets minimum level for payment bonds.

Procurement personnel normally determine the penal sum by: (i) subjective analysis of the amount of protection needed; or (ii) consideration of the ASPR criteria for construction contracts. The net result is a wide disparity of bond penal sums for similarly priced contracts of the same service.

A hypothetical example showed that a 25-percent performance and payment bond should adequately protect the Government's interest. Although use of penal sum less than 100 percent for a performance bond will not reduce the premium paid, bidders may be excluded from submitting a valid bond if the penal sum is too high since ASPR 10-201.2(d) requires an individual surety to have a net worth equal to the total penal sum of the bonds. Thus, usage of 25-percent penal sums should adequately protect the Government's interests while not unduly restricting competition.

7. SBA Programs

Finally, it was found that the small business guaranteed loan program enables some small businesses which would not normally qualify for a bond from a commercial surety, to obtain bonds on contracts valued under \$1 million. Under this program, SBA guarantees a surety for 80 to 90 percent of the damages suffered for bond breach. For this protection, the surety must pay the SBA only 20 percent of the surety's bond premium. SBA had found this program to be cost effective based on cost savings associated with lower award prices to contractors issued guaranteed bonds. However, SBA has a ceiling for all guaranteed bonds issued. Thus, use of a bond requirement in a questionable situation will

often result in issuance of an SBA guaranteed bond which will preclude SBA from issuing a guarantee on procurement where the Government has a legitimate interest to protect. Thus, judicious use of bonds by procurement activities is required to maximize the benefit of the SBA guaranteed bond program. Finally, bonds usage on 8(a) contracts was not found to be justified.

B. RECOMMENDATIONS

1. ASPR

Forward to the ASPR committee the following recommended changes. Revise ASPR 10-104.2(a) as follows (change portions underlined): Although performance bonds shall not be used as a substitute for determinations of contractor responsibility as required by Section 1, Part 9, the contractor's ability to obtain a performance bond may be relied upon as one of the factors used in the responsibility determination. Subject to this general policy, performance bonds may be required in individual procurements when, consistent with the following criteria, the contracting officer determines the need therefor. Justification for any such requirement made in accordance with ASPR 10-104.2(a)(i), (ii), and (iii) must be fully documented.

a. When the terms of the contract provide for the contractor to have the use of Government materiel, property, or funds, and further provide for the handling thereof by the contractor in a specified manner, a performance bond shall be required if needed to protect the Government's interests therein. This applies to situations where the Government would incur substantial costs based on the contractor's failure to perform, such as those costs associated with removing, packing, and transporting a large piece of leased equipment. However, performance bonds are not justified on a service contract such as custodial/janitorial solely because a contractor will have access to Government buildings, property, or equipment during contract performance.

b. When the circumstances applicable to a particular procurement are such that for financial reasons a performance bond is necessary to protect the interests of the Government, a performance bond shall be required. (See for example, ASPR 26-402(c)(iii).)

c. When continuity of performance is deemed critical to mission capability, or the health, welfare, or morale of the troops. Justification for requiring performance bonds meeting these criteria must be approved at a level higher than the Procurement Contracting Officer for all services except: (i) food services; (ii) garbage services; (iii) hospital/custodial/janitorial.

d. The penal sum for each performance and payment bond should not normally exceed 25 percent of the contract price. Justifications for the need of a penal sum greater than 25 percent for an individual performance and/or payment bond must be fully documented.

2. Guidance.

Include in DA procurement information circular the following information:

a. The intent of ASPR 10-104.2(a), which states a bond is justified if the contract provides both for the usage and specified manner of handling Government property, materiel, and funds, is to cover situations where the Government would incur substantial costs based on the contractor's failure to perform. For instance, substantial costs would be incurred with the removing, packing, and transportation of a large piece of leased equipment if the contractor defaults.

b. A reminder that the synopsis information included in the Commerce Business Daily should alert a prospective bidder of a bond requirement. This is required by ASPR 1-1003.9(f) which provides that such specialized requirements should be brought to a bidder's attention to help avoid improvident expenditures for bid preparation.

c. The bond premium rate information contained in Chapter III, to alert the contracting officer of the increased contract price associated with a bond. This information should aid in his determination of the cost effectiveness of a bond requirement.

BIBLIOGRAPHY

1. Comptroller General, Report to the Congress Use of Surety Bonds in Federal Construction Should Be Improved, Washington, DC, Jan 75.
2. Department of Army, DA Circular 715-1, Procurement Joint Consolidated List of Debarred, Ineligible, or Suspended Contractors, Jan 77.
3. _____. Letter to Procurement Activities AMCRP-SP, Subject: Use of Performance and Payment Bonds in Service Type Contracts Restricted, HQ, USAMC, Alexandria, VA, Nov 75.
4. _____. Procurement Statistics. Summary Federal Supply Classifications, FY 76, DCSRDA Information Systems Agency, Washington, DC, Undated.
5. _____. Procurement Statistics. Summary Federal Supply Classifications, FY 76T, DCSRDA Information Systems Agency, Washington, DC, Undated.
6. _____. Telegram R042231Z Feb 76, to Procurement Activities, Subject: Payment and Performance Bonds for Contracts Other Than Construction, HQ TRADOC, Fort Monroe, VA, Feb 76.
7. HR 13567, 94th Congress, 2d session, 1976.
8. HR 692, 95th Congress, 1st session, 1977.
9. US Congress, House, Subcommittee on SBA and SBIC Legislation of the Committee on Small Business, Miscellaneous Amendments to Small Business Act and Small Business Investment.
10. US Small Business Administration, Letter to All Eligible Contractors Subject: SBA Surety Bond Guarantee Program, Bala Cynwyd, PA, Undated.

11. _____. Letter to Procurement Division, Fort Hood, Subject: Solicitation No. DA-KF48-76-B-0006, July 76.
12. _____. Study of the Small Business Administration Surety Board Guarantee Program, Aug 75.



APPENDIX A

DEPARTMENT OF THE ARMY
UNITED STATES ARMY LOGISTICS MANAGEMENT CENTER
FORT LEE, VIRGINIA 23801

DRXMC-PRO

10 December 1976

SUBJECT: Analysis of the Army's Bond Requirements in Housekeeping Service Contracts
(RCS DRC(OT)-710)

SEE DISTRIBUTION

1. The Office of the Assistant Secretary of the Army (Installations and Logistics) has recently received numerous questions challenging the use of bonding requirements for Army Housekeeping Service Contracts. Based on these inquiries, the Army Procurement Research Office has been requested by OASA(I&L) to conduct a study to determine if additional policies or procedures are needed regarding contractual bond requirements for housekeeping (as defined in Inclosure 1) service contracts.
2. The specific objectives of the study are to develop criteria for contracting officers to use in making decisions regarding application of bid, performance, and other bond requirements on housekeeping service contracts, and to formulate a uniform Army policy for use of bonds on housekeeping service contracts. The successful completion of the research tasks requires your activity and appropriate field activities (if any) to furnish procurement data as set forth in this letter.
3. It is requested that you furnish specific data on the housekeeping service contracts listed on Inclosure 2. For purposes of this study, information is requested for all types of bonds listed in ASPR 10-101 such as payment, performance, fidelity, and forgery bonds, etc. To permit efficient analysis, it is necessary to use Inclosure 3, Data Regarding Specific Contracts, in compiling and submitting the necessary and most current data regarding the specified contracts.

Appendix A--(Cont'd):

DRXMC-PRO

**SUBJECT: Analysis of the Army's Bond Requirements in Housekeeping Service Contracts
(RCS DRC(OT)-710)**

4. In order to adequately reflect your activity's overall experience and policies/procedures with bonds for housekeeping service contracts, your comments are also required on the questions posed on Inclosure 4, Questionnaire For All Housekeeping Contracts.

5. It is requested that the above information be furnished not later than 7 Jan 77 to:

**Commandant
US Army Logistics Management Center
ATTN: DRXMC-PRO (APRO 614)
Fort Lee, VA 23801**

If you have any questions regarding this requirement, contact Mr. H. Candy of Mr. R. Nick (AUTOVON 687-4381/1395; Comm: 804-734-4381/1395). Please furnish the name and telephone number of your action officer by letter or message upon receipt of this letter.

FOR THE COMMANDANT:

4 Incls

as

**PAUL F. ARVIS, Ph.D.,
Director, US Army
Procurement Research Office**

Appendix A--(Cont'd):

DRXMC-PRO

10 December 1976

SUBJECT: Analysis of the Army's Bond Requirements in Housekeeping Service Contracts (RCS DRC(OT)-710)

DISTRIBUTION:

Commander, White Sands Missile Range, ATTN: DRSTE (Procurement Division), White Sands Missile Range, NM 88002

Commander, Letterkenny Army Depot, ATTN: DRXLE-SP (Procurement Division), Chambersburg, PA 17201

Commander, Red River Army Depot, ATTN: DRXRR-TA (Procurement Division), Texarkana, TX 75501

USAECON, Procurement and Production Directorate, Fort Monmouth, NJ 07703

USASA Central Procurement Activity, Vint Hill Farms Station, Warrenton, VA 22186

USA Engineer District, Fort Worth, P.O. Box 17300, Procurement Division, Fort Worth, TX 76102

Commander, US Army Aviation Center, ATTN: ATZQ-DI-PC (Procurement Division), Fort Rucker, AL 36362

Commander, US Army Infantry Center, Fort Benning, ATTN: ATZB-DI-P (Procurement Division), Fort Benning, GA 31905

Commander, US Army Signal Center, Fort Gordon, ATTN: ATZH-DI-P (Procurement Division), Fort Gordon, GA 30905

Appendix A--(Cont'd):

**Commander, USA Combined Arms Center, ATTN: ATZL-DI-P (Procurement Division),
Fort Leavenworth, KS 66027**

Commander, US Army Armor, Fort Knox, ATTN: ATZK-DI-P, Fort Knox, KY 40121

**Commander, USA Training Center, Engr & Fort Leonard Wood, ATTN: ATZT-DI-P
(Procurement Division), Fort Leonard Wood, MO 65473**

**Commander, US Army Training Center, Fort Dix, ATTN: ATZDGD-G (Procurement
Division), Fort Dix, NJ 08640**

**Commander, US Army Field Artillery, Fort Sill, ATTN: ATZR-DI-PC, Fort Sill,
OK 73503**

**Commander, US Army Training Center, Fort Jackson, ATTN: ATZJ-DIP (Procurement
Division), Fort Jackson, SC 29207**

**Commander, US Air Defense Center, Fort Bliss, ATTN: ATZC-DIP (Procurement Division),
Fort Bliss, El Paso, TX 79916**

**Commander, US Army Transportation Center, Fort Eustis, ATTN: ATZF-PC (Procurement
Division), Fort Eustis, VA 23604**

**Commander, US Army Quartermaster Center, Fort Lee, ATTN: ATZM-DI-P (Procurement
Division), Fort Lee, VA 23801**

HQ Fort Ritchie, ATTN: CCNJ-DIO-PC (Procurement Division), Fort Ritchie, MD 21719

Walter Reed Army Medical Center, ATTN: Procurement Division, Washington, DC 20012

**Commander, Presidio of San Francisco, ATTN: AFZM-PR (Procurement Division), Presidio
of San Francisco, San Francisco, CA 94129**

Appendix A—(Cont'd):

Commander, 7th Infantry Division & Fort Ord, ATTN: AFZW-DI-PC (Procurement Division), Fort Ord, CA 93941

Commander, 24th Infantry Division & Fort Stewart, ATTN: AFZP-DI-P (Procurement Division), Fort Stewart, GA 31313

Commander, Fort Sheridan, ATTN: AFZO-DI-P (Procurement Division), Fort Sheridan, IL 60037

Commander, 1st Infantry Division (M) & Fort Riley, ATTN: AFZN-DI-P (Procurement Division), Fort Riley, KS 66442

Commander, 101st Airborne Division (Air Assault) & Fort Campbell, ATTN: AFZB-DI-PC (Procurement Division), Fort Campbell, KY 42223

Commander, Fort Devens, ATTN: AFZD-DI-P (Procurement Division), Fort Devens, MS 01433

Commander, XVIII Airborne Corps & Fort Bragg, ATTN: AFZA-DI-P (Procurement Division), Fort Bragg, NC 28307

Commander, III Corps & Fort Hood, ATTN: AFZF-PCO (Procurement Division), Fort Hood, TX 76544

Commander, 9th Infantry Division & Fort Lewis, ATTN: AFZH-DIP (Procurement Division), Fort Lewis, WA 98433

Commander, Fort McCoy, ATTN: AFZR-DI-P (Procurement Division), Sparta, WI 54656

Appendix A--(Cont'd):

For this study, housekeeping services are defined as nonconstruction contract for the following service categories:

- a. Gas.**
- b. Electricity.**
- c. Telephone and/or communication service.**
- d. Water.**
- e. Utility other than above.**
- f. Installation bus services.**
- g. Chaplain service.**
- h. Laundry and drycleaning service.**
- i. Custodial/janitorial service.**
- j. Insect and rodent control.**
- k. Packing and crating.**
- l. Garbage collection.**
- m. Food service.**
- n. Fueling service.**

Incl 1

Appendix A—(Cont'd):

- o. Fire protection.**
- p. Landscaping service.**
- q. Recruiting services for civilians (include meals and lodging for recruits).**
- r. Surveillance services.**
- s. Care of remains and/or funeral service.**
- t. Guard services.**
- u. Installations housekeeping service other than above.**

Appendix A--(Cont'd):

The information required by paragraph 3 of this letter to be completed on the questionnaire (Incl 3) are required for the following contracts:

Incl 2

Appendix A—(Cont'd):

**ANALYSIS OF ARMY'S BOND REQUIREMENTS IN
HOUSEKEEPING SERVICE CONTRACTS**

DATA REGARDING SPECIFIC CONTRACTS

TASK 614

1. Contract No. _____ Date: _____
2. Name and phone number of Contracting Officer: _____

3. Contract Type: FFP _____ FPW/EPA _____ Other (Identify)

4. Service description and FSC:
5. Contractor: Large Business _____ Small Business _____
6. Solicitation:
 - a. Competitive _____ Noncompetitive _____
 - b. Total Set-Aside: Yes _____ No _____
 - c. Partial Small Business Set-Aside: Yes _____ No _____
 - d. 8(a) Procurement: Yes _____ No _____

AD-A050 607

ARMY PROCUREMENT RESEARCH OFFICE FORT LEE VA
ANALYSIS OF BONDING REQUIREMENTS ON SERVICE CONTRACTS.(U)
DEC 77 H F CANDY

F/G 5/1

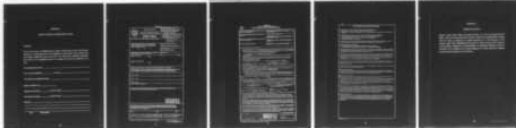
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Appendix A—(Cont'd):

7. Bids Received: a. Total Number _____ b. Small Business _____

8. Performance Period: _____

9. Total Contract Price: a. Basic Contract \$ _____

b. Current Contract \$ _____

10. Was bond included for previous procurement of this service?

Yes _____ No _____

Identify type of bond requirements and percent of contract amount.

_____ Bid Bond _____ %

_____ Performance Bond _____ %

_____ Payment Bond _____ %

_____ Other Bond (Specify) _____ %

11. Basis for determining contract responsibility?

_____ Pre-Award Survey

_____ Contractor's performance on previous contract for identical/similar service

_____ Other (identify)

Appendix A—(Cont'd):

12. Bond requirements included in solicitation: Yes _____ No _____

If no, answers not required on remaining questions.

13. Type of bond requirements and percent of contract amount:

_____ **Bid Bond** _____ **%**

_____ **Performance Bond** _____ **%**

_____ **Payment Bond** _____ **%**

_____ **Other Bond (specify)** _____ **%**

14. Why were the above percentages for each type of bond chosen?

15. Rationale for use of bonds (furnish a copy of any supporting documentation):

Appendix A—(Cont'd):

16. Was bond requirement waived when award was made? Yes _____ No _____ If "yes," rationale.

17. Do you feel the bond requirement contributed to successful performance under the contract? Yes _____ No _____ (If yes, give rationale.)

18. Was any part of penal sum paid by surety? Yes _____ No _____ Don't know _____ If yes, how much?

19. Do you feel the bond requirement could be excluded on next procurement for this service? Yes _____ No _____ Can't predict _____

20. a. Did any bidders fail to obtain/furnish necessary bonds, thus being precluded from award? Yes _____ No _____ Don't know _____ (If yes, give rationale.)

b. How many bidders failed to secure bond? _____

Appendix A--(Cont'd):

c. How many were small business? _____

d. How many were minority businesses? _____

21. a. Did any prospective bidders indicate they could not bid due to inability to obtain bonds? Yes _____ No _____ If "yes": _____

b. How many? _____

c. How many small businesses? _____

d. How many minority businesses? _____

Appendix A--(Cont'd):

ANALYSIS OF ARMY'S BOND REQUIREMENTS IN HOUSEKEEPING SERVICE CONTRACTS

QUESTIONNAIRE FOR ALL HOUSEKEEPING CONTRACTS

1. How do bonding requirements impact the Government's ability to obtain full and free competition; i.e., do bonds impose a hardship on a sizable portion of prospective bidders?

2. What rationale is used to waive a solicitation bond requirement after bid opening?

3. How many times during FY 75 and 76 has your activity rejected a low apparent bidder based on the contractor's failure to furnish the required bonds?

Appendix A—(Cont'd):

4. How many times during FY 75 and 76 has your activity terminated a contract for default based on the contractor's failure to furnish the required bond?

5. Has your activity been involved in any solicitation protests (informal or formal) revolving around the inclusion of bonds? If yes, give a brief outline of the basis of the protest and the outcome.

Appendix A—(Cont'd):

6. Should the use of bonding requirements be increased or decreased? Why?

7. What are the most important benefits accruing to the Government because of a bonding requirement?

8. What are the most important detriments to the Government because of a bonding requirement?

Appendix A—(Cont'd):

9. Do you have local policies or procedures for inclusion of bond requirements? Please furnish a copy of each.

10. What revisions (i.e., additions or deletions) to current policies and procedures, as specified in ASPR, APP, etc., are needed to improve effective bond usage on service contracts?

APPENDIX B

SURETY LETTER TO CONTRACTOR'S PREVIOUS CUSTOMER

Gentlemen:

RE:

We are in the process of establishing Surety Credit for these people. Your name has been given as a reference since they have previously done work for you. The following questions are an important part of our investigation, so please send an early reply in order that prompt consideration may be given them. Your reply will be *considered strictly confidential* and will devolve no responsibility upon you.

Manager, Bond Department

1. Nature and dollar value of the project? _____

2. Were they cooperative? _____
3. Did they meet schedules promptly? _____
4. Was the job properly supervised and staffed? _____
5. Did they meet obligations to laborers, material houses, and subcontractors as agreed? _____
6. In your professional opinion, do you consider them fully experienced and qualified to handle projects of this class and size? _____

Appendix B—(Cont'd):

Date: _____ **Firm:** _____

By: _____

Title: _____

APPENDIX C

SURETY LETTER TO CONTRACTOR'S PREVIOUS SUPPLIERS

Gentlemen:

We are in the process of establishing Surety Credit for these people. The following questions are an important part of our investigation, so please send an early reply in order that prompt consideration may be given them. Your reply will be considered confidential and will devolve no responsibility upon you.

Account Opened: _____ Credit Limit: _____

Recent High Credit: _____ Last Sold: _____

Amount Owning: _____ Last Paid: _____

Amount Past Due _____ 30 Days _____ 60 Days _____

Terms: _____ 90 Days _____ 120 Days _____

Secured by: _____ Over 120 Days _____

Please Check. _____ Slow but collectable

_____ Discount _____ Unsatisfactory

_____ Anticipates _____ Notes paid at maturity

_____ Pays within terms _____ Turned over for collection

Appendix C—(Cont'd):

____ Pays by postdated
check

____ Cash basis only

COMMENTS: _____

BY _____ **DATE** _____

APPENDIX D

SURETY LETTER TO CONTRACTOR'S BANK

Gentlemen:

We are in the process of establishing Surety Credit for the firm shown above. The following questions are an important part of our investigation, so please send an early reply in order that prompt consideration may be given them. Your reply will be considered confidential and will devolve no responsibility upon you. A postage free envelope is provided for your reply.

Years doing business with? _____

Line of credit established? _____ **Amount?** _____

Amount borrowed against this line? _____

Balance available now? _____

Equipment Financing? _____ **Amount Owning?** _____


Receivable Financing? _____ **Amount Owning?** _____

Remarks: _____

Date

Bank Officer

APPENDIX E Return Executed Copies 1, 2, and 3 to SBA

	<p>United States of America</p> <p>SMALL BUSINESS ADMINISTRATION</p> <p>STATEMENT OF PERSONAL HISTORY</p> <p>NAME CHECK</p>	<p>Please Read Carefully - Print or Type</p> <p>Each member of the small business concern requesting assistance at the development company must submit this form in TRIPPLICATE for filing with the SBA application. This form must be filled out and submitted:</p> <ol style="list-style-type: none"> 1. If a sole proprietorship by the proprietor. 2. If a partnership, by each partner. 3. If a corporation or a development company, by each officer, director, and shareholder, by each holder of 10% or more of the voting stock. 4. Any other person, including a hired manager, who has authority to speak for and commit the borrower in the management of the business.
<p>Name and Address of Applicant (Firm Name)(Street, City, State and ZIP Code)</p>		<p>SBA District Office and City</p>
		<p>Amount Applied for:</p>
<p>1. Personal Statement of: (State name in full, if no middle name, state (MRS/MR), or if initial only, indicate initial). If married include name of spouse. List all former names used, and dates each name was used. Use separate sheet if necessary.</p> <p>First Middle Maiden Last</p>		<p>2. Date of Birth: (Month, day and year)</p>
		<p>3. Place of Birth: (City & State or Foreign Country)</p>
		<p>U.S. Citizen? <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>If no, give alien registration number</p>
<p>4. Give the percentage of ownership or stock owned or to be owned in the small business concern or the Development Company.</p>		<p>Social Security No.</p>
<p>5. Present residence address</p> <p>From To Address City State</p>		
<p>Immediate past residence address</p> <p>From To Address</p>		
<p>BE SURE TO ANSWER THE NEXT 3 QUESTIONS CORRECTLY BECAUSE THEY ARE IMPORTANT.</p> <p>THE FACT THAT YOU HAVE AN ARREST OR CONVICTION RECORD WILL NOT NECESSARILY DISQUALIFY YOU.</p> <p>BUT AN INCORRECT ANSWER WILL PROBABLY CAUSE YOUR APPLICATION TO BE TURNED DOWN.</p>		
<p>6. <input type="checkbox"/> Yes <input type="checkbox"/> No</p>		
<p>7. <input type="checkbox"/> Yes <input type="checkbox"/> No</p>		
<p>8. <input type="checkbox"/> Yes <input type="checkbox"/> No</p>		
<p>9. Name and address of participating bank</p>		
<p>The information on this form will be used in connection with an investigation of your character. Any information you wish to submit, that you feel will expedite this investigation should be set forth.</p>		
<p align="center" style="font-size: 2em; font-weight: bold; opacity: 0.5;">SAMPLE</p>		
<p>Whoever makes any statement knowing it to be false, for the purpose of obtaining for himself or for any applicant, any loan, or loan extension by renewal, deferment or otherwise, or for the purpose of obtaining, or influencing SBA toward, anything of value under the Small Business Act, as amended, shall be punished under Section 1001 of that Act, by a fine of not more than \$5000, or by imprisonment for not more than 3 years, or both.</p>		
<p>Signature</p>	<p>Title</p>	<p>Date</p>
<p><small>It is against SBA's policy to provide assistance to persons not of good character and therefore consideration is given to the qualities and personality traits of a person favorable and unfavorable relating thereto, including behavior, integrity, law and order, and financial soundness. It is also against SBA's policy to provide assistance on the basis of the credit of the United States. The objective of this policy is to ensure that the effort of such assistance will be to encourage or support, directly or indirectly, activities inimical to the security of the United States.</small></p>		



APPENDIX F
U.S. SMALL BUSINESS ADMINISTRATION
APPLICATION FOR SURETY BOND GUARANTEE ASSISTANCE

TO BE COMPLETED BY PRINCIPAL	TO BE COMPLETED BY BROKER/AGENT (Producer)
TRADE NAME OF PRINCIPAL	NAME OF SURETY
PRINCIPAL'S HOME ADDRESS, STREET, CITY AND STATE (Include ZIP)	NAME OF BROKER/AGENT (Producer)
PRINCIPAL'S BUSINESS ADDRESS, STREET, CITY AND STATE (Include COUNTY AND ZIP)	BROKER/AGENT (Producer's) STREET, CITY AND STATE (Include COUNTY AND ZIP)
PRINCIPAL'S EMPLOYER ID NUMBER	BROKER/AGENT (Producer's) TELEPHONE NUMBER (Include Area Code)
	BROKER/AGENT (Producer's) EMPLOYER ID NUMBER

1. Applicant hereby states and affirms the following:

a. The annual gross receipts of my business (including affiliates, as set forth in Part 121 of SBA's Rules and Regulations) during the past fiscal year was \$ _____, or, as annually averaged over the past 3 fiscal years, was \$ _____ (to the nearest hundred). If there are affiliates, attach an explanation sheet, delineating annual gross receipts of each as their interests appear. If there are stockholders, attach an explanation sheet specifying what their share of the organization(s) are.

Type of business: ☐ Proprietorship, ☐ Partnership, ☐ Corporation.
Year Business Formed: _____ Joint Venture ☐ Yes ☐ No

b. A bid, payment or performance bond is required on the following project in order for me to serve as a ☐ primary contractor or ☐ subcontractor thereon.

c. Contractor certifies having attempted (and failed) to obtain the required bonds without the SBA's guarantee; furthermore, the contractor certifies being aware that some sureties charge higher premium rates for bonds than others do, in accordance with premium rate schedules filed in various States.

d. (1) Brief description of this contract work: _____
(2) Estimated time required for completion: _____ (months). Contract has Penalty Clause? ☐ Yes ☐ No.
If "yes", how much? \$ _____ per calendar or wkg. day.

(3) Anticipated project start date: mo. _____ day _____ yr. _____ (4) Projected completion date: mo. _____ day _____ yr. _____
(5) Project Location: _____ (6) Name of ☐ obligee or ☐ Prime Contractor: _____

e. Approximate value of contract: \$ _____

f. Applicant, in consideration of assistance from the SBA, herewith agrees it will comply with the nondiscrimination requirements of Title 13, Code of Federal Regulations, Part 112 and Part 113.

g. SBA is authorized to request this information under Executive Order 11625. It will be used only for statistical purposes. You are not required to disclose this information. Failure to do so will not affect your application.

(1) Principal is a ☐ Veteran ☐ Vietnam-ERA Veteran or ☐ Non Veteran (Check one)
(2) Principal is a ☐ Male ☐ Female
(3) Principal is a (1) ☐ Black, (1) ☐ Puerto Rican, (2) ☐ American Indian, (3) ☐ Hispanic (includes Mexican-American, Cuban, Central or South American or others of Spanish Descent), (4) ☐ Asian (includes persons of Chinese, Japanese, Korean, and Filipino Descent, also, native Hawaiians, Indonesians, Samoans, Polynesians and Micronesians), (5) ☐ Eskimo and Aleuts, (6) ☐ Undetermined, (7) ☐ Others including Caucasians.

2. The date, time and place of the bid opening is as follows: (if applicable):
Date _____ Time _____ Place _____

3. I have read the "Contractor's Processing Fee" section (reverse side) and agree to abide by this fee schedule, PROVIDED I receive the contract sought and SBA extends its bond guarantee. I also agree to pay the contractor's SBA's processing fee to my Agent/Broker in accordance with Paragraph 9 reverse side.

4. I ☐ do not have an SBA Loan. I ☐ had a previous SBA Loan. I ☐ do have an SBA Loan through the SBA Office in _____ with a balance of \$ _____ as of (Date) _____ Loan No. _____

5. I ☐ am ☐ am not an SBA (8)(a) Qualified Contractor (Approved business plan on file).
This bond application ☐ does ☐ does not pertain to an (8)(a) contract.

6. I do ☐ or do not ☐ request Management Assistance.
I have ☐ or have not ☐ previously received SBA Management Assistance.

7. I ☐ have ☐ have not received previous SBA bond guarantee, either under this trade name or another.
If under another trade name, specify: _____
Trade Name: _____
City/State: _____
When? 19 _____ to 19 _____

8. Have you ever defaulted on any previous surety bonds (SBA or other) (either under this contracting concern's trade name or any other concern's of which you have been a principal)? ☐ Yes ☐ No
If "yes", detailed particulars are to be attached to all four (4) copies of this application form. Particulars should include at least the following: (1) Name of Surety; (2) Name of obligee; (3) SBC No. with suffix Number, if applicable; (4) Value of Contract; (5) Date of Default; (6) Status of Default/Claim, i.e., amount of loss to Surety, etc.; (7) Contractor's narrative explanation as to reasons for default and actions taken to meet the obligations to the Surety under term of the bond(s).

9. Applicant hereby authorizes any agent, broker, surety company or financial institution in possession of credit, financial or work experience information concerning the undersigned applicant and the applicant's business to release the same to SBA, in order that SBA may evaluate the same for the purpose of bond guarantee assistance. Applicant certifies that any information he submits to any agent, broker or surety company for their evaluation as to the bondability of this contractor is correct and accurate to the best of the contractor's knowledge.

10. Any intentionally false statement in this application or willful misrepresentation relative thereto is a violation of federal law, which may subject you to criminal and civil prosecution, 18 U.S.C. Sections 287, 371, 1001; 15 U.S.C. Section 645; 31 U.S.C. Section 231, carrying fines up to \$10,000 and imprisonment up to five years.

11. Certification: I hereby certify that all information presented herein is complete and accurate to the best of my knowledge. I further agree to notify SBA, in writing, of any fee(s) paid by me or my designee(s) to the Surety and/or its representatives which are in excess of the fee structure noted in Paragraph 3, above, and specified in Paragraph 9, reverse side. (Attach a separate sheet, detailing amount of such excessive fee(s) and purpose thereof).

Signature (Applicant) _____
Title: _____

WHITE COPY - SBA REGIONAL OFFICE
YELLOW COPY - SBA DISTRICT OFFICE
PINK COPY - SURETY
GOLDENROD COPY - PRODUCER/AGENT/BROKER

DATE REC'D. BY SBA _____
BY: NAME _____
SBA NO. _____

SURETY BOND GUARANTEE OPERATING PROCEDURES

1. Applicant may contact nearest SBA Office which would furnish him the following:
 - a. SBA FORM 994, "Application for Surety Bond Guarantee Assistance."
 - b. SBA FORM 912, "Statement of Personal History," on first application only, or as required. (Good for two calendar years.)
 2. Applicant proceeds to the surety agent of his choice and furnishes that agent with the following:
 - a. Credit information and work experience history normally required by surety underwriters.
 - b. Completed SBA FORM 994, and Contractor Application Fee (non-refundable)
 - c. Completed SBA FORM 912, as required.
 3. Surety agent will forward the original of the SBA FORM 994, and the SBA FORM 912 (all copies) directly to: Small Business Administration, Surety Bond Guarantee, Regional City SBA Office, or as otherwise directed.
 4. Agent will forward to surety company:
 - a. A duplicate copy of the SBA FORM 994, keeping fourth copy for his own records.
 - b. All other information normally required by Surety company to underwrite a bond applicant.
 5. Assuming favorable decision to proceed by the underwriters, the surety will forward a summary of underwriter information and completed Guarantee Agreement (SBA FORM 990) for the case in hand directly to the Small Business Administration, Surety Bond Guarantee, Regional City Office, or as otherwise directed.
 6. The SBA's Surety Bond Guarantee underwriting review staff will make final determinations, as required. Within a reasonable time of receipt of summary underwriting information from the surety, SBA will notify the surety of approval (or disapproval) and return the countersigned Guarantee Agreement to the surety. For those contracts or projects valued at more than \$400,000, the SBA field office's SBG underwriting review staff will make recommendations to the applicable SBG staff for disposition. This procedure will require allowing additional SBA processing time.
 7. Assuming the applicant is low bidder, and before entering into a contract to perform the work, applicant will return to the Surety and/or its representative to request payment and performance bonds as required, and pay the appropriate SBA's Contractor Processing Fee.
 8. SBA FORM 994 shall not be processed by SBA until/unless a surety company or its representative has submitted a bond guarantee request to SBA for this particular contract.
- (a) Contractor Application Fee.**
Each SBA FORM 994, "Application for Surety Bond Guarantee Assistance," must be accompanied by the contractor's \$10.00 application fee. This check is payable to the "Small Business Administration." No application will be processed by SBA unless the \$10.00 fee check is received by SBA. THIS FEE IS NON-REFUNDABLE.
- (b) Contractor's Processing Fee.**
(1) The contractor's processing fee is .2% (\$2/\$1,000) of contract's face value, or, in the case of partial bonds, either .2% of the contract's face value or 20% of the premium charged by the surety, whichever is less.
ALL CONTRACTOR PROCESSING FEES ARE DUE AND PAYABLE NO LATER THAN UPON RECEIPT OF BONDS. SBA will not take final action on any Surety's bond request (SBA FORM 990) for payment, performance bond(s) until and unless the contractor's fee is received by SBA. Each SBA FORM 990, "Guarantee Agreement . . ." pertaining to a final (payment/performance) bond guarantee from a Surety must be accompanied by the appropriate Contractor Processing Fee check, made payable to the "Small Business Administration."
- (2) Each SBA FORM 990, "Guarantee Agreement . . ." pertaining to a bid bond must be confirmed in writing by the Surety as to its ultimate disposition. If the contractor is awarded the subject contract, the Surety must return to SBA a confirmation copy of the SBA FORM 990, and this form must be accompanied by the appropriate Contractor Processing Fee, made payable to the "Small Business Administration". This fee must be paid prior to the surety's issuance of the applicable final (payment/performance) bond(s). Contractor Surety (or its representative) will forward the fee directly to the Small Business Administration, Surety Bond Guarantee, Regional City SBA Office, or as otherwise directed.
- (c) Surety's Guarantee Fee.**
The Surety's guarantee fee is 20% of the premium charged by Surety to the contractor. The surety's premium is to be in compliance with rate schedule filed in and authorized by the applicable State. Under no circumstance will SBA guarantee any bond which the Surety's premium exceeds \$15 per \$1,000 on the first \$250,000 in contract value and \$10 per \$1,000 in contract value over and above the first \$250,000. Contractors are encouraged to seek the lowest available bond premium rate.

APPENDIX G

PROJECT MANAGER

Harold F. Candy, Project Officer, Procurement Analyst, U.S. Army Procurement Research Office, ALMC. BS, Pennsylvania State University, 1962. Prior to joining APRO in August 1969, Mr. Candy was employed as a Contract Specialist for 7 years with the U.S. Navy Aviation Supply Office, Philadelphia, Pennsylvania. Mr. Candy received an MS in Contract and Procurement Management at Florida Institute of Technology, Melbourne, Florida, in September 1974. In addition to his research assignment, Mr. Candy instructs in a graduate level procurement program at a local university.