

## **Fraudulent Bonds: Is Your Surety Secure?**

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Financial hard times can mean good news and bad news for municipalities.

- The good news: builders are flocking towards public construction, increasing competition and giving cities more construction for their money.
- The bad news: fewer projects lead to tighter margins and tougher credit.

This environment will drive some to unscrupulous measures. In tough economic times, we expect to see more reports of fraudulent surety bonds. The American Subcontractors Association, for example, estimates that losses from surety bond fraud may be as high as \$800 million annually.

Public owners can be hurt by fraudulent performance and payment bonds. If a financially weak contractor can't complete a project, a fraudulent performance bond will provide no protection, which may lead to an expensive and embarrassing loss.

Fraudulent surety bond risk can be divided into three general categories. Fortunately, each risk can be managed relatively simply.

- The first category of risk is the bond from the non-existent surety. In past construction recessions, we have seen bonds issued by companies whose names sounded familiar (or close to familiar). Some of these bonds even boast addresses or phone numbers that are similar to that of an actual registered insurance company. But, upon further investigation, the company may not actually exist.
- A second theme is the company that exists and sounds like a surety, but really isn't an insurance company registered with the Texas Department of Insurance. Those firms can call themselves "cooperatives," or boast "alternative financial security." But, when it comes time to cover a loss, they aren't around to help.
- A third theme is a bond that bears the name of an actual registered surety, but was never authorized by that surety. Those forged (or "photoshopped") bonds are similarly worthless.

How can you guard against these risks? Take three simple steps:

1. Make sure you do more than simply require a bond. Make sure that your bond is executed by a “corporate surety” in accordance with the Texas Insurance Code, as required by Government Code Sec. 2253.021(d).
2. Check the amount of the bond. Texas sureties may write bonds in amounts up to ten percent of their “capital and surplus.” A surety should be proud to tell you about how they compute this number. And your insurance agent can help you double-check the surety’s capacity. (Private owners can go one step further, by specifying certain financial capacity. For example, a private owner might require a minimum A.M. Best rating. Texas cities cannot discriminate in this way according to the Attorney General. See, e.g., Letter Opinion 92-61, and Attorney General Opinion No. DM-165.)
3. Make sure the bond is authentic. Sureties will even help! The Surety & Fidelity Association of America publishes a guide to help “obligees” (owners) check bond authenticity. Download their “Bond Obligee Guide” at [www.surety.org](http://www.surety.org).

Performance and payment bonds can be valuable protection for both public owners and local subcontractors and suppliers. But ensure that you remain vigilant by investigating whether performance and payment bonds are worth more than the paper they’re written on.