

Date of Hearing: April 5, 2016

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Eduardo Garcia, Chair

AB 2270 (Bonta) – As Introduced February 18, 2016

SUBJECT: Statewide bonding and contractor assistance program

SUMMARY: Establishes a statewide contractor assistance program for the purpose of helping participating contractors to meet applicable bid, payment, and performance bonding requirements for public contracts with state agencies, as specified. Specifically, **this bill:**

- 1) Establishes the Statewide Contractor Bonding Program (Program) for the purpose of assisting participating contractors to meet applicable bid, payment, or performance bonding requirements for public contracts with state agencies.
- 2) Specifies that the program will be administered through the Office of the Small Business and Disabled Veteran Business Enterprise Services (Office), located within the Department of General Services (DGS).
- 3) Authorizes the Office to act as a guarantor on a surety bond for a participating contractor on a contract with a state agency.
- 4) Requires the Office to establish a request for proposals process by which contractors may participate in the Program and requires a preference to be given to any of the following:
 - a) A disadvantaged business enterprise, as defined;
 - b) A certified small business enterprise; and
 - c) A certified disabled veteran business enterprise (DVBE), as defined.
- 5) Authorizes the Office to terminate a contractor's participation in the program after a reasonable period of time if the contractor is no longer in compliance with the requirements of the Program.
- 6) Authorizes the Office to suspend a participating contractor that defaults on a bond from transacting any business with the state either directly as a prime contractor or indirectly as a subcontractor, for a period of not less than three years and not more than 10 years. A suspended contractor is required to receive Office approval before resuming participation in the Program.
- 7) Authorizes the Office to provide technical assistance to a participating contractor. Required technical assistance includes, but is not limited to, all of the following:
 - a) Assessment and identification of the particular barriers facing the participating contractor and development of solutions to those barriers. Activities may include the following:
 - i) Assessments by surety and construction experts;
 - ii) Development of a business plan;
 - iii) Project field support; and
 - iv) Workshops addressing the following topics:

- (1) Basic information pertaining to contractor bonding;
 - (2) Understanding the surety process and underwriting;
 - (3) The process for bidding on state projects;
 - (4) Addressing stop notices;
 - (5) Strategies for accessing capital;
 - (6) Prevailing wages;
 - (7) Job safety and the Occupational Safety and Health Administration;
 - (8) Certification; and
 - (9) Any other topics that would be beneficial to the participating contractor.
- b) Identification of and assistance in obtaining other financial support and resources. Activities may include the following:
- i) Linkages with accountants, brokers, and surety companies committed to helping contractors build bonding and organizational capacity;
 - ii) Pre-qualifications for additional assistance; and
 - iii) Collateral guarantees.
- c) Monitoring and reporting on the progress of the participating contractor to the Office, including reporting on the following:
- i) Collaboration with other programs;
 - ii) Progress on any project for which a bond is issued pursuant to this article;
 - iii) Defaults on a bond issued pursuant to this article; and
 - iv) Funds administration. The bill prohibits the Office from charging a fee for services related to monitoring and reporting on funds administration.
- 8) Requires DGS to adopt the rules and regulations necessary to implement this Program.
- 9) Authorizes the Office to charge a participation fee to cover the costs of administering the Program, excluding the funds of administration monitoring and reporting, as noted above.
- 10) Authorizes a contractor to use the surety bond issued by the Office as proof of having performance and payment bonds.

EXISTING LAW:

- 1) Declares it is state policy that small business and microbusiness receive a fair portion of the total purchases and contracts or subcontracts for state goods, services, information technology, and construction.
- 2) Establishes the Office within DGS for the purpose of:

- a) Compiling and maintaining a comprehensive bidders list of qualified small businesses and disabled veteran business enterprises;
 - b) Coordinating with the Federal Small Business Administration, the Minority Business Development Agency, and the Office of Small Business Development of the Department of Economic and Business Development;
 - c) Providing technical and managerial aids to small businesses, microbusinesses, and disabled veteran business enterprises, by conducting workshops on matters in connection with government procurement and contracting;
 - d) Assisting small businesses, microbusinesses, and DVBEs, in complying with the procedures for bidding on state contracts; and
 - e) Working with appropriate state, federal, local, and private organizations and business enterprises in disseminating information on bidding procedures and opportunities available to small businesses, microbusinesses, and disabled veteran business enterprises.
- 3) Defines a small business, for the purpose of being eligible for state small business procurement contract bid preferences, as independently owned, not dominant in its field of operation, domiciled in California, employing 100 or fewer employees, and earning \$10 million or less in average annual gross revenues for the three previous years.
- 4) Defines a DVBE, for the purpose of being eligible for state procurement, as an entity meeting all of the following requirements:
- i) The legal structure of the business is a:
 - (1) Sole proprietorship with at least 51% owned by one or more disabled veterans;
 - (2) Publicly owned business with at least 51% of its stock unconditionally owned by one or more disabled veterans;
 - (3) Subsidiary that is wholly owned by a parent corporation, but only if at least 51% of the voting stock of the parent corporation is unconditionally owned by one or more disabled veterans; or
 - (4) Joint venture in which at least 51% of the joint venture's management, control, and earnings are held by one or more disabled veterans.
 - ii) A disabled veteran is a veteran of the military, naval, or air service of the U.S. who has a service-connected disability of at least 10% and who is domiciled in the state.
 - iii) The management and control of the daily business operations are by one or more disabled veterans. The disabled veterans who exercise management and control are not required to be the same disabled veterans as the owners of the business.
 - iv) It has a home office located in the United States, which is not a branch or subsidiary of a foreign corporation, foreign firm, or other foreign-based business.
- 5) Establishes the I-Bank within the Governor's Office of Business and Economic Development (GO-Biz) and authorizes it to undertake a variety of financial activities including, but not limited to, the administration of a revolving loan fund, oversight of the Small Business Finance Center, and the issuance of tax-exempt and taxable revenue bonds.
- 6) Establishes the Small Business Finance Center within the I-Bank for the purpose of assisting businesses seeking capital resources not otherwise available in the private markets including:

- a) Loan guarantees and other credit enhancements;
- b) Direct loans and other debt instruments;
- c) Disaster loan guarantees; and
- d) Surety bond guarantees.

FISCAL EFFECT: Unknown

POLICY ISSUE FRAME

Small businesses play an essential role within the California economy, contributing the most net new jobs, offering an alternative to un- and underemployment, and helping to disburse the financial advantages of the state's globally connected economy. State procurement opportunities represent an important economic tool to support small business development. In the last 15 report periods, the state has met the 25% small business procurement participation goal only five times including the 2013-14 fiscal year.

This measure proposes the establishment of a contractor development program to assist businesses in accessing surety bonds. With enhanced technical assistance, and the option of utilizing a surety bond guarantee, small businesses, DVBEs, and disadvantaged businesses should be able to more successfully compete for state infrastructure-related contracts. The analysis includes background on surety bonds, small businesses role in the California economy, small business and DVBE participation in state contracting, and a former state small business contractor program, which addressed similar needs. Amendments are discussed in Comment #7.

COMMENTS:

- 1) **Small and Emerging Contractor Challenges:** Small and emerging contractors face a variety of challenges in participating in state procurement opportunities. This bill addresses one of small businesses' key challenges, that of being able to obtain a surety bond; a basic requirement for construction-related contracts with public entities.

Other challenges include the high cost of purchasing liability insurance, limited opportunities to develop new relationships with experienced prime contractors, and having the in-house technical and administrative skills to comply with state and federal accounting and reporting practices. The increasing practice by state agencies to issue contracts that exceed \$1 million in value, particularly in the area of state highway construction, also places a unique burden on small contractors.

- 2) **Removing Contracting Impediments:** The Miller Act, under federal law, and the Little Miller Act, under state law, require contractors on most public works construction projects to post bonds guaranteeing both the performance of their contractual duties and the payment of their subcontractors, workers, and material suppliers. These types of bonds serve as a safeguard to the public entity by ensuring compensation and/or the completion of a project. In some cases, the surety company is obligated to find another contractor to complete the contract or compensate the project owner for the financial loss incurred.

Structurally, the surety bond is a three party agreement between the contractor, who is mandated to provide the bond; the project owner, the party protected by the bond; and the surety-insurance company, who writes the bond. There are a variety of surety bonds, but each type shares a common purpose of guaranteeing a contractual obligation to the project owner. For example, a performance

bond will guarantee an obligation is met in accordance with the plans and specifications, while a supply bond guarantees that ordered materials will be delivered as agreed upon. Overall, surety bonds can be instrumental in limiting the risk of selecting a bidder; namely the risk of the project not being completed or that a contractor's unpaid creditors might place a lien on the project. Reducing these risks ultimately aids the owner in reducing the cost of borrowing money to finance the project.

Implementation of AB 2270 would assist emerging contractors by providing an early assessment of the firm's strengths and weaknesses. Based on the assessment, a technical assistance provider would work with the contractor to address deficiencies and then assist the contractor in negotiating the terms of the surety bonds. In some cases, a surety guarantee could be used to enhance the position of the business before the surety bond issuer. By providing technical assistance and collateral support for small construction businesses, the proposed program would positively benefit the contractor, as well as the project owner, the prime contractor, and prospective workers.

Over the next five years, the author contends that the state will initiative over \$50 billion in construction projects related to transportation and community services including health care, education, courts, and recreation. These construction projects represent excellent business opportunities for small businesses, DVBEs, and disadvantaged businesses. However, without assistance in obtaining surety bonds, many of these opportunities could go unexplored.

- 3) **The Role of Small Businesses within the California Economy:** California's dominance in many economic areas is based, in part, on the significant role small businesses play in the state's \$2.3 trillion economy. Two separate studies, one by the U.S. Census Bureau and another by the Kaufman Foundation, found that net job growth was strongest among businesses with less than 20 employees. Among other advantages, small businesses are crucial in the state's international competitiveness and are an important means for dispersing the positive economic impacts of trade within the California economy.

Nonemployer firms make up the single largest component of businesses in California, 2.9 million out of an estimated 3.6 million firms in 2012, representing over \$149 billion in revenues with highest number of businesses in the professional, scientific, and technical services industry sector. As these non-employer businesses grow, they continue to serve as an important component of California's dynamic economy. Excluding nonemployer firms, businesses with less than 20 employees comprise nearly 90% of all businesses and employ approximately 18% of all workers. These non-employer and small employer firms create jobs, generate taxes, and revitalize communities.

In hard economic times, smaller size businesses often function as economic engines. In this most recent recession the trend continued, with the number of nonemployer firms increasing from 2.6 million firms (\$137 billion in revenues) for 2008 to 2.8 million firms (\$138 billion in revenues) for 2010. In the post-recession economy, small businesses are expected to become increasingly important due to their ability to be more flexible and better suited to meet niche market needs. Their small size, however, results in certain challenges in meeting regulatory requirements, accessing capital, competing for large-size contracts and marketing their goods and services.

- 4) **Small Business Procurement Act:** The Small Business Procurement Act, administered through DGS, was implemented more than 30 years ago to establish a small business preference within the state's procurement process that would increase the number of contracts between the state and small businesses. A DBVE component was added in 1989. Today, approximately 90% of DVBEs have dual certification as a small business or microbusiness.

The Small Business Procurement Act states that it is the policy of the State of California that the state aid the interests of small businesses in order to preserve free competitive enterprise and to ensure that a fair portion of the total purchases and contracts of the state be placed with these enterprises. The statute further states that DVBE participation is strongly encouraged to address the special needs of disabled veterans seeking rehabilitation and training through entrepreneurship, and to recognize the sacrifices of California's disabled military veterans. Statute sets an annual 3% DVBE participation goal, and a 2010 executive order sets a 25% goal for small businesses and microbusinesses.

The charts below show small business and microbusiness aggregate procurement participation rates for fiscal years 2011-12, 2012-13, and 2013-14 for mandatory reporting agencies (including Caltrans).

Small Business and Microbusiness Contracting Activity – Mandated Reporters				
Fiscal year	Total Contract Dollars	Total Small Business and Microbusiness Contract Dollars	Total Percent	Total Number of Contracts
2013-14	\$7,101,433,433	\$2,013,377,792	28.35%	90,784
2012-13	\$7,616,142,071	\$1,801,695,547	23.66%	105,617
2011-12	\$7,399,022,425	\$1,796,451,722	24.28%	165,523
Average	\$7,372,199,310	\$1,870,508,354	25.43%	120,641

2013-14 DGS Statewide Consolidated Annual Report

Unfortunately, participation rates have not been as high as desired, with state agencies meeting the 25% small business goal in only five out of the last 15 report years. Further, in comparing year to year numbers, it is important to note that not all of the mandatory reporting agencies provide annual data to DGS for inclusion in the report. As an example, only 80% of the mandatory reporters provided data for 2013-14.

- 5) **Increasing Small Business and DVBE Procurement Participation:** Every year, Members of the Legislature introduce a range of bills to improve outreach and increase targeted preferences to increase small business participation in state contracting. Over the years, direct and innovative approaches have been added including mandating small business and DVBE liaisons at every agency, establishing official state-level Small Business and DVBE Advocates, and requiring the state join a national on-line contracting platform (BidSync), which is soon to be transferred back to a state-only web platform (F\$SCAL).

Among other challenges is the high concentration of contracting within a few departments including several which bid contracts for specialized services. According to the 2013-14 Statewide Consolidated Annual Report, by DGS, the top 10 contracting agencies awarded more than 83% of contract dollars in 2013-14. The data suggests that having department specific strategies to increase small business participation will be required to consistently meet the 25% goal.

In 2013-14, 61% of all state contracts were awarded by the Department of Corrections (SDCR), the Department of Transportation, and the Department of Health Care Services (DHCS). This means that regardless of the efforts of the California School Finance Authority (88.04% of the \$99.677 contracts awarded) and California Transportation Commission (89.44% of the \$14,291 in contracts awarded), the state's largest contracting entities must do a better job of contracting with small businesses and microbusiness if the state is going to consistently meet its mission of offering small businesses

meaningful procurement opportunities. The chart below shows information on the contracting activities of the top 10 contracting departments for 2013-14.

Top 10 Contracting Agencies in 2013-14				
Departments	Total Contact Dollars	Percentage of Statewide Spending	Small Business and Microbusiness Participation Percentage	DVBE Participation Percentage
All Mandatory Reporters	\$7,372,199,310	100%	28.35%	3.67%
Corrections and Rehabilitation	\$2,196,722,703	30.93%	36.03%	3.60%
Transportation	\$1,0174,833,768	15.14%	28.24%	3.70%
Health Care Services (DHCS)	\$1,069,021,018	15.05%	2.36%	0.45%
State Hospitals	\$553,519,167	7.79%	49.17%	2.12%
Water Resources	\$351,102,439	4.94%	19.79%	2.62%
Highway Patrol	\$234,348,394	3.30	12.28	1.72
General Services	135,233,255	1.90%	42.23%	10.49%
Parks and Recreation	123,503,810	1.74%	31.49%	6.76%
Motor Vehicles	111,305,071	1.57%	25.09%	6.55%
Public Utilities Commission	\$99,350,011	1.40	12.34	3.34
Top 10 Total	\$5,975,205,480	83.77%	27.35%	3.02%

Source: 2013-14 Statewide Consolidated Annual Report prepared by DGS

In 2013-14, as shown above, DHCS contracted with small business for only 2.36% of its contracting activities. In fact, the Health and Human Services Agency had the lowest overall small business and microbusiness participation rates (20.285) among all other agencies in the state. If California is going to meet and exceed its small business and DVBE goals, high contract volume agencies like Department of Transportation will need to substantially exceed the 25% and 3% targets.

- 6) **Small and Emerging Contractors Technical Assistance Program:** After several failed attempts to provide assistance to small business in accessing surety bonds, the Legislature successfully passed, and the Governor signed AB 2376 (Price) Chapter 458, Statutes of 2008. This measure established the Small and Emerging Contractors Technical Assistance Program (SECTAP) through the California Department of Transportation. Under the SECTAP, Caltrans offered training and technical assistance to small contractors to improve their ability to secure surety bonds. Collateral support, in the form of a surety guarantee, was provided through the federal Small Business Administration (described below). The SECTAP was repealed under its own terms in January 2013. Statute required annual reporting by the Department of Transportation, but committee staff was unable to locate any report.

AB 2270 proposes a similar model to the SECTAP, this time using a state guarantee to help the contractor access surety bonds. The bill proposes establishing a new surety bond guarantee program; the I-Bank, however, has existing surety bond guarantee authority, which is described below.

Federal Surety Bond Guarantee: The Small Business Administration (SBA) offers a surety bond guarantee program for small and emerging contractors that cannot otherwise obtain surety bonds through regular commercial channels. The SBA guarantee covers contracts up to \$2 million.

A surety bond is a three-party financial agreement between a surety, the contractor, and the project owner, in this case the state. The agreement binds the contractor to comply with the terms and

conditions of a contract. If the contractor is unable to successfully perform the contract, the surety institution assumes the contractor's responsibilities and completes the project. The SBA surety guarantee program covers four types of contract bonds:

- Bids – bonds that guarantee that the bidder on a contract will enter into the contract and furnish the required payment and performance bonds;
- Payment – bonds that guarantee the payment of the contractor's workers and materials;
- Performance – bonds that guarantee the contractor will perform the contract in accordance with its terms; and,
- Ancillary – bonds that are incidental and essential to the performance of the contract.

A contractor applying for an SBA surety guarantee must qualify as a small business, in addition to meeting specific eligibility criteria for surety bonding.

State Surety Bond Guarantee Program: Given the importance of surety bonds to small business contractors, including primes and subcontractors, the state also has authority to operate a surety bond guarantee program through the Small Business Center at the I-Bank. Qualifying small business contractors are required to demonstrate to following:

- There is a low probability that the surety bond would be granted by a financial institution or financial company under reasonable terms or conditions, and the beneficiary has demonstrated a reasonable prospect of successful completion of the project.
- The surety bond will be used for a project in this state.
- The beneficiary has a minimum equity interest in the business as determined by the directives and requirements.
- As a result of the surety bond, the jobs generated or retained demonstrate reasonable conformance to the directives and requirements specifying employment criteria.

The Small Business Finance Center is not currently offering surety bond guarantees. With funding for technical assistance and collateral capitalization, the I-Bank provides this new contractor development program.

- 7) **Suggested Amendments:** The Committee may wish to consider whether the state requires another surety bond guarantee program operated by DGS, or whether the existing I-Bank program should be activated.
- 8) **Related Legislation:** Below is a list of the related bills.
 - a) ***AB 1247 (Medina and Bocanegra) Small Business Finance Center:*** This bill establishes the California Small Business Finance Center at the I-Bank, within the Governor's Office and Economic Development, and transfers the authority to administer the small business loan guarantee program, direct disaster loans, surety bond guarantees, and other related programs to the I-Bank. Status: Signed by the Governor, Chapter 537, Statutes of 2013.
 - b) ***AB 1491 (Arambula) Small and Emerging Contractors Technical Assistance Program:*** This bill establishes the Small and Emerging Contractors Technical Assistance Program, administered by the California Department of Transportation, to provide small contractors with technical assistance and training to improve their knowledge and skills necessary to secure surety bonds required for

public works contracting and assist them in participating in state-awarded construction contracts.
Status: JEDE-related content removed, 2007.

- c) **AB 1695 (Bass) Capitalize Surety Bond Guarantee program:** This bill capitalizes and activates the Surety Bond Guarantee Account, administered by the Small Business Loan Guarantee Program, for the purpose of providing surety bond guarantees for small businesses that provide services on state and federally funded transportation projects. Status: Held under submission in the Assembly Committee on Appropriations, 2007.
- d) **AB 2376 (Price): Emerging Contractors Technical Assistance Program:** This bill authorizes the establishment of the Small and Emerging Contractors Technical Assistance Program, administered by the California Department of Transportation, for the purpose of providing small and emerging contractors with the technical assistance necessary to obtain surety bond guarantees offered by the federal Small Business Administration. The program is repealed on January 1, 2013. Status: Signed by the Governor, Chapter 458, Statutes of 2008.

- 9) **Double Referral:** This measure has been double referred to the Assembly Committee on Jobs, Economic Development, and the Economy and the Assembly Committee on Accountability and Administrative Review (AAR). Should this measure pass JEDE, it will be referred to AAR for further policy consideration.

REGISTERED SUPPORT / OPPOSITION:

Support

None Received

Opposition

None Received

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