

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

B-1251

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 12, 1940.



SUBJECT: Surety Bond Requirements--
Army and Navy Contracts.

Dear Sir:

Recently a representative of one of the Federal Reserve Banks requested information as to requirements of the Army and Navy with respect to surety bonds. The requested information was obtained informally from representatives of the Army and Navy and is reflected by the attached copies of letters, with enclosures, replying to the specific inquiry.

You will understand that this information, which is furnished to you for your assistance in answering inquiries, was obtained on an informal basis and is not to be considered as formal commitments of the War or Navy Department; and, in so far as the information covers administrative practices, these may, of course, be changed from time to time.

Very truly yours,

A handwritten signature in cursive script, reading "E. L. Smead".

E. L. Smead, Chief,
Division of Bank Operations.

Enclosures

TO OFFICERS AT FEDERAL RESERVE BANKS AND BRANCHES DESIGNATED
AS FIELD REPRESENTATIVES IN CONNECTION WITH NATIONAL DEFENSE
PROGRAM.

B-1251-a

C O P Y

December 4, 1940

Mr. _____,
 _____,
 _____,
 _____.

Dear Mr. _____:

This refers to your telegram of November 29 requesting advice as to requirements of the Army and Navy with respect to surety bonds. In this connection, the following advice has been obtained from the Navy Department:

"1. Replying to your request for information on questions raised by _____ in his telegram of 29 November, the following information is furnished.

"(A) Under Emergency Plant Facilities Contract:

If reference is here made to the "Emergency Plant Facilities Contract" form gotten up by the Advisory Commission to the Council of National Defense the Navy treats each case on its own merits and has as yet arrived at no standard schedule to apply to all facilities contracts. Where the emergency facilities constitute a minor portion of the total cost of a supply contract, such facilities are covered by the supply contract and the bond requirements therefor are as covered under B.

"(B) Under Supplies Contract:

I am enclosing a copy of a memorandum of October 17th covering this situation in full detail.

"(C) When advance is made:

This subject is also covered by the above referred to memorandum of October 17th.

- 2 -

Mr. _____

"2. The Navy Department does not possess the discretionary authority granted to the War Department for waiving of bond requirements. Each contract in excess of \$500.00 entered into by the Navy must therefore be bonded.

"3. The statute requiring bonds on Navy Contracts is R.S. 3719."

A copy of the memorandum of October 17 referred to in the above quotation is enclosed.

We are advised by representatives of the War Department that information with respect to War Department requirements will be furnished to us as soon as possible and we will forward it to you as soon as it can be obtained.

Very truly yours,

(Signed) E. L. Smead

E. L. Smead,
Chief, Division of Bank Operations

Enclosure

NAVY DEPARTMENT
BUREAU OF SUPPLIES & ACCOUNTS
WASHINGTON, D.C.

L13-1(1)/L1-1(5) (SPC)
L10-6/L6-2(2)

17 October 1940

NOTICE TO PROSPECTIVE BIDDERS

SUBJECT: Change in bond requirements for supply and facilities contracts

Bonds will be required on supply contracts awarded on bids submitted on and after this date, as follows:

(a) When no advance or progress payments are to be made:

Contract over \$500 up to and including \$50,000. - 25 per cent of the amount of the contract (but not more than \$10,000).

Contract over \$50,000 up to and including \$100,000. - 20 per cent of the amount of the contract (but not more than \$15,000).

Contract over \$100,000 up to and including \$200,000. - 15 per cent of the amount of the contract (but not more than \$20,000).

Contract over \$200,000 up to and including \$1,000,000. - 5 per cent of the amount of the contract (but not more than \$50,000).

Contracts over \$1,000,000. - 5 per cent of the amount of the contract (but not more than \$1,000,000).

(b) When progress payments are to be made, but no advance payments:

The bond shall be in an amount calculated in accordance with paragraph (a) above, plus the following:

Contracts up to and including \$1,000,000. - 15 per cent of the amount of the contract (but not more than \$50,000).

Contracts over \$1,000,000. - 5 per cent of the amount of the contract (but not more than \$1,500,000).

NOTE: The amount of the bond thus calculated is the sum of paragraphs (a) and (b), as applicable.

(c) When advance payments are to be made:

The applicable amount of paragraphs (a) and (b) plus the full amount of the advance payment.

NOTE: The total amount of the bond thus calculated is the sum of paragraphs (a), (b), and (c), as applicable.

"Progress payment" means a partial payment on the material while the work is in progress and before the material passes into the possession of the Government.

"Advance payment" means an advance of funds under the authority of Section 1 of Public No. 671, 76th Congress, Third Session, H. R. 9822, approved 28 June 1910.

When the bond is a combination of paragraphs (a) and (b) and/or (c), and the contract imposes upon the contractor obligations in the form of maintenance and/or performance guarantees and other covenants for fulfillment subsequent to the delivery and acceptance of the material, equipment, etc., and the contractor so requests, the bond may be executed in the amount thus prescribed to run until the delivery and acceptance of the material, equipment, etc., and another bond calculated in accordance with paragraph (a) only, conditioned upon the faithful performance of all maintenance and/or other guarantees and all other covenants not fully fulfilled or performed prior to delivery and acceptance of the material, the second bond to take effect upon the delivery and acceptance of the material and to continue in full force and effect until all covenants and obligations of the original contract are fulfilled.

RAY SPEAR

Rear Admiral SC U S Navy
Paymaster General of the Navy

December 11, 1910

Mr. _____,

_____.

Dear Mr. _____:

This refers further to your telegram of November 29 requesting advice as to requirements of the Army and Navy with respect to surety bonds. The advice obtained informally from the Navy Department was furnished you with my letter of December 4. We have now received an informal memorandum prepared by a representative of the War Department, and a copy of this memorandum is enclosed for your information and assistance in replying to inquiries. You will understand that the memorandum is merely an informal one describing the practices of the War Department and is not to be considered as a formal commitment of that Department; and, in so far as the memorandum covers administrative practices, these may, of course, be changed from time to time.

Very truly yours,

(Signed) E. L. Smead

E. L. Smead,
Chief, Division of Bank Operations.

Enclosure

C O P Y

SUMMARY STATEMENT AS TO BOND REQUIREMENTS OF THE WAR DEPARTMENT.

A. Emergency Plant Facilities Contracts.

No bid, performance or payment bonds are at present required in connection with Emergency Plant Facilities Contracts.

B. Supply Contracts.

1. Requirements as to bid bonds.--The Army regulations as to when bid bonds are required reads as follows:

"At the discretion of the chief of arm, service, or bureau concerned, bid bonds may be required or waived--

- (1) In special cases, or
- (2) By general instructions issued to purchasing officers, but will be required or waived alike to all bidders."

Chiefs of the arms and service have issued general instructions requiring bid bonds in cases where contracts are let on a competitive basis after the issuance of general invitations to bid but in general do not require bid bonds in cases where the contract is negotiated.

2. Requirements as to performance bonds.

(a) No performance bond is generally required when the amount involved is under \$2,000.00, although the chief of the arm or service concerned has discretionary authority to require such a bond.

(b) In the ordinary supply contract, which is not a "public work", (see (c) below) performance bonds are not generally required, although it is in the discretion of the chief of the arm or service to require a performance bond or waive it in special cases.

(c) The Miller Act, 49 Stat. 793-794, 40 U.S.C. 270, requires payment and performance bonds for contracts for the construction, alteration, or repair of public buildings and public works when the amount involved exceeds \$2,000.00. The Comptroller General has ruled that a contract for work, labor, or manufacture upon articles or property belonging to the United States, including supply contracts, wherein it is provided that partial payments will be made for material and labor as the manufacture of such supplies progresses, title to the work in progress to vest in the United States upon the making of the first such partial payment, is a contract for "public work of the United States". Similarly all contracts for supplies on a cost-plus-a-fixed-fee basis are contracts for public work since title to materials used or to be used in performance of the contract

passes to the Government upon delivery at the site of the work. The ruling is applied even though the contractor retains possession and remains responsible for the care of the property so paid for until finally accepted by the United States.

(1) When the supply contract is also a contract for "public work" the amount of the required Miller Act performance bond will be set by the chief of the arm or service concerned, provided the contract is let on a fixed-price basis.

(2) If the supply contract constitutes a "public work" but was let on a cost-plus-a-fixed-fee basis, Public 781, 76th Congress, as amended by Public 800, 76th Congress (Third Supplemental National Defense Appropriation Act 1941) amends the Miller Act to permit the Secretary of War to waive the compulsory performance bond requirement of the Miller Act, and he has in general done so, leaving discretionary authority with the chief of the arm or service involved to determine whether a performance bond in such case will be required.

(d) In general, the amount of the performance bond for a supply contract (if such bond is required either by statute or administrative action) has been set by the Chiefs of the Arms and Services concerned at 10%; for large airplane contracts the amount of a performance bond required has been set at 5%.

3. Requirements as to payment bonds.

(a) The Miller Act establishes a statutory requirement for payment bonds to protect sub-contractors and material men in all "public work" contracts. As has already been indicated, if the supply contract is also a "public work" contract and has been let on a fixed price basis, this requirement can not be waived.

(b) If the supply contract is on a cost-plus-a-fixed-fee basis, the requirement normally is waived under Public 781, 76th Congress as amended by Public 800, 76th Congress.

(c) The statutory amount of the bond is 50% of the total amount payable by the terms of the contract when the contract is under \$1,000,000.00; 40% when the face of the amount of the contract is between \$1,000,000.00 and \$5,000,000.00; and when the contract is over \$5,000,000.00 the payment bond is in the sum of \$2,500,000.00.

4. It should be noted that if the obtaining of Miller Act bonds is too onerous, the manufacturer under a supply contract may avoid them by nego-

tiating the contract on a cost-plus-a-fixed-fee basis or by eliminating from the contract any provision for partial payments, provided he can also convince the arm or service concerned that such bonds should be waived in his case.

C. Bond Requirements with Respect to
Advance Payments.

When an advance payment is made on a supply contract, Public 703, 76th Congress vests in the Secretary of War discretion as to the adequacy of the Security required. Whether or not an advance payment bond in addition to a performance and payment bond (if they are required because the supply contract is also a contract for a "public work") will be demanded depends upon the recommendation of the Chief of Arm or Service concerned, upon the general financial condition of the Company and upon whether the Secretary of War deems other security furnished (usually in the form of a supplemental agreement) to be adequate.