

2013 DEC 10 P 2:37

Richard H. DIC  
Patricia L. Fishman  
Chief Administrative Officer

*In re the Matter of:*

**EDMUND C. SCARBOROUGH and  
WALTER W. WOLF,**

*Respondents.*

) Docket No. 13-0084  
)  
) **OFFICE OF THE INSURANCE**  
) **COMMISSIONER'S REPLY**  
) **IN SUPPORT OF MOTION**  
) **TO COMPEL**

The Washington State Office of the Insurance Commissioner ("OIC") has learned that Respondent Edmund C. Scarborough ("Respondent") has engaged in bond-issuing activities, and based on what it knew, it issued an order to cease and desist and a notice of intent to impose fines. Respondent has demanded that OIC hold a hearing over the matter. As OIC staff clarified in its November 1, 2013 letter to Respondent, the hearing concern Respondent's bond-issuing activities. Respondent has demanded a hearing, but refuses to comply with his discovery obligations now that he has demanded a hearing. He now asserts he *did* answer discovery, although he thinks it should be limited so that he needn't fulfill the discovery obligations that he is already legally obligated to fulfill. Each of these arguments fails and should be rejected.

First, Respondent did not answer the discovery, as even a cursory review reveals. Yes, he did provide non-responsive sets of purported "answers" and "responses" flanked by boilerplate objections, and he did so within the 30 days that discovery is supposed to normally be supplied. But timely providing the functional equivalent of nothing is not the same as reasonably and meaningfully fulfilling discovery obligations in a cooperative manner.

Second, the discovery is appropriate and is relevant to the issues in this case. Each question relates directly to Respondent's bond-issuing activity which will be at issue at the hearing he has demanded. Respondent cannot demand a hearing that includes only his own version of what he wishes everyone to believe to be true without revealing all of the true and relevant facts. The discovery here

squarely addresses the relevant issues and facts. The discovery is carefully tailored to each of the relevant issues in Respondent's complex bond-issuing activities. By demanding a hearing, Respondent is subject to such reasonable discovery requests.

Respondent also points to interrogatories 7, 17, 18, 19, and 31 as "examples" of discovery he objects to. Yet, each specifically meets the facts and issues in this matter:

- Interrogatory 7 squarely addresses a core issue: whether Mr. Scarborough has assets sufficient to meet his extensive bond obligations. Upon information and belief, Respondent claims to have written 6,000 to 7,000 bonds for small federal, state and local contractors, in a business deriving revenue from bond premiums of \$5 million to \$6 million a year. If true, the scope of Respondent's bond-issuing activity is staggering. His bonds indicate that his purported coal is the sole asset that will be available to pay bond claims, yet, in the one interrogatory his lawyers did answer, the answer states that no coal sale has *ever* been made to satisfy a bond or financial guarantee claim. Either he has never paid a claim or he ignores his bonds and pays out of his pocket. This gives rise to the question of how are consumers truly protected under his bonds, if they say only coal sale proceeds will pay claims and he has not ever sold coal for that purpose? The website of his Charlottesville, Virginia-based company, IBCS Fidelity, boasts of being capable of providing bonds as high as \$50 million, "far surpassing most other sureties," as the website says. Respondent's assets are thus squarely at issue. And if his assets are not sufficient to cover all pending bonds, are consumers under his bonds truly protected? In addition, since 13 or so corporations Mr. Scarborough and his wife have created relate to his bond-issuing activities, his wife is also a principal, apparently. Other interrogatory questions have asked about his wife's part in his bond-issuing activities, but that question was not responded to. If she is, as she appears to be, a principal and his spouse, then her assets too are squarely at issue. And since, upon

information and belief, Respondent and his wife have also filed for and received bankruptcy protection, how did he and his wife so quickly come into possession of the incredibly lucrative assets he now claims to have required to underwrite the thousands of bonds he issues? Interrogatory 7 relates to all of this. It is completely appropriate.

- Interrogatory 17 and 18, again, also goes to the issue of Respondent's assets that supposedly "fully collateralize" his thousands of bonds – specifically the coal assets he claims he has to pay claims on the bonds he has issued. Upon information and belief, Respondent says he backs his bonds with about 15 million tons of Kentucky and West Virginia usable coal waste. His bonds say the coal is supposedly "surface, previously mined, coal" with values in the millions of dollars. Which is true? And who says his coal is truly worth the amount he claims it is to back his bonds? Does he even have this coal? Is his coal worth anything? And says who? How can he claim to be able to liquidate coal promptly to pay claims if he has never done it before? Such questions are highly relevant here. Interrogatory 17 and 18 address these questions. Both are completely appropriate.
- Likewise, interrogatory 19 gets to a core question: the value of coal that supposedly "fully collateralizes" Respondent's bonds. Some have suggested Respondent's coal may not have the value he claims it has. And these valuations are necessary to support or refute his and his bonds' assertion that they are "fully collateralized." Are the bonds fully collateralized if the coal is really worthless or cannot be mined and liquidated quickly to promptly pay claims? If not, consumers are at risk. Interrogatory 19 is completely appropriate.
- And likewise, interrogatory 31 is squarely relevant. Without knowing how many bonds are active and in force at once pledging the same asset for "fully collateralized" bonds, how can we know whether Respondent's bonds are truly "fully collateralized," or are

simply using the same re-pledged coal assets over and over and over extending the same asset as collateral in every one of many bonds all pending at once? If all the bonds have claims but the same asset to back them, how can he pay them all? Interrogatory 31 is crucial to understanding whether Respondent's "fully collateralized" assertion is reliable.

These and OIC's other discovery questions do not in any way plow strange, foreign fields far from the farm as Respondent complains. All of the same questions OIC now asks in its discovery have long existed over Respondent's bond program – see

[http://enr.construction.com/business\\_management/ethics\\_corruption/2013/0225-A-Bold-Individual-Surety-Claims-His-Coal-Backed-Bonds-are-Rock-Solid.asp?page=1](http://enr.construction.com/business_management/ethics_corruption/2013/0225-A-Bold-Individual-Surety-Claims-His-Coal-Backed-Bonds-are-Rock-Solid.asp?page=1) (hard copy attached).

Finally, in opposing sanctions, Respondent writes that "[i]nterrogatories may be answered by reference to business records," citing CR 33(c). In this case, Respondent's reliance on this notion is fully misplaced. Here, at best, some of the documents Respondent provided were provided in batch fashion, on one disc, and without reference to which document referred to which answer. Taking the approach of inviting a party to dive into the pile of hay to find the needle reeks of gamesmanship, and it is an approach that has been rejected by courts in Washington before. In *Davis v. Fendler*, 650 F.2d 1154, 1158 fn. 3, (9th Cir. 1981), for example, the court strongly rejected such a tactic, and in finding it improper, held:

Appellant, relying on FRCivP 33 (c), specified five places where appellees could find portions of the information requested: (a) the Arizona Corporation Commission, 2222 W. Encanto, Phoenix, Arizona; (b) the Arizona Department of Insurance, 1601 W. Jefferson, Phoenix, Arizona; (c) the Arizona Banking Department, 1601 W. Jefferson, Phoenix, Arizona; (d) the Arizona Attorney General's Office, 1700 W. Washington, Phoenix, Arizona; (e) the Boards of Trustees for Lincoln Thrift Association, its affiliates and subsidiaries, 3130 N. 3rd Avenue, Phoenix, Arizona. It is apparent that the records of the first four of these places do not qualify as appellant's "business records". A party cannot, under the guise of Rule 33(c) resort to such tactics. This is the sort of behavior which undoubtedly caused the trial judge to have legitimate doubts about appellant's blanket assertion of privilege.

Similarly, in calling one party's use of the federal equivalent of CR 33(c) "inadequate," the United

States District Court for the Western District of Washington's Hon. Barbara Rothstein has observed in *Calhoun v. Liberty Mutual Ins. Corp.*, 789 F. Supp. 1540, 1549-50 (W.D. Wash. 1992):

[...] *Rule 33(c)* applies only where the answers to interrogatories may be found in the business records of the party upon whom the interrogatories have been served. Plaintiff however, claims that the answers may be found in defendants own documents -- the documents of the serving party, not the documents upon whom the interrogatories have been served. Furthermore, *Rule 33(c)* mandates that plaintiff do more than merely make a broad statement that the information is available from documents. See *Budget Rent-A-Car of Missouri, Inc. V. Hertz Corp.*, 55 F.R.D. 354, 357 (D. Mo. 1972). Rather, under *Rule 33(c)*, a party must specify the records from which the answers can be ascertained in sufficient detail to permit the interrogating party to locate and identify the records. *Rainbow Pioneer No. 44-18-04 A v. Hawaii-Nevada Inc. Corp.*, 711 F.2d 902 (9th Cir. 1983). Plaintiff states only that "as to the employees (who have made statements in support of plaintiff's claims), the answers to all five Interrogatories may be derived from the business records already revealed to Defendants in response to their first set of Interrogatories." Response to Defendants' Motion for Sanctions at 3. This response falls far short of what is required under *Rule 33(c)*.

The court concurs with defendants that plaintiff's discovery responses were inadequate. [...] Should Respondent later fulfill discovery questions, OIC staff asks that Respondent be reminded to avoid such tactics.

OIC submits that Respondent should be ordered to submit full, complete, executed and attested answers and responses to OIC's discovery, that Respondent should provide all requested answers, responses, and responsive documents by a date certain, and that any further objections to OIC's discovery be deemed waived. OIC requests a prehearing conference to review OIC's discovery and Respondent's answers, responses and objections. In addition, OIC staff continues to request a continuance commensurate with the delay Respondent caused, measuring the amount of time for the continuance from the date when the Respondent eventually produces full, complete, executed and attested answers and responses to OIC's discovery, with all responsive documents; Respondent's opposition notes no objection with this request.

Respectfully submitted this 10<sup>th</sup> day of December, 2013.



Alan Michael Singer  
OIC Staff Attorney

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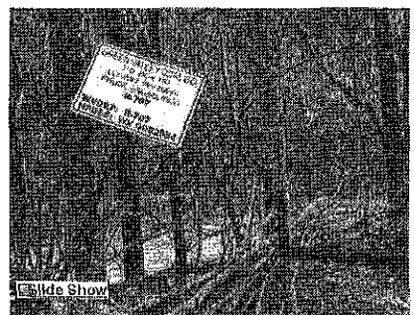
## A Bold Individual Surety Claims His Coal-Backed Bonds are Rock Solid

02/27/2013

By [Richard Korman](#)

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Slide Show  
Photo by Lundy Bailey

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

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**Special Investigative Report** Individual surety has had plenty of shady dealings. One of the regulars in the field, Robert Joe Hanson, has received cease-and-desist orders for insurance-related violations in at least 10 states in as many years. His latest scrape with the law came last year in Montana, where state regulators accused him of selling bogus surety bonds to Native American contractors under a new alias, Chief Joe Blue Eyes.

Created by federal regulations for small contractors as an alternative to more risk-averse corporate sureties, individual sureties are people willing to provide payment and performance bonds—guarantees made in exchange for a premium based on a small percentage of the contract—to small firms that would otherwise fail to qualify for public-works projects.

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

Unlike individual sureties who have stayed in the shadows, Edmund C. Scarborough is the founder and chairman of the U.S. Individual Surety Association. The website of Scarborough's Charlottesville, Va.-based company, **IBCS Fidelity**, boasts of being capable of

providing bonds as high as \$50 million, "far surpassing most other sureties," as the website says.

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

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



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

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

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

For accounting purposes, corporate surety is covered by detailed rules for risk-based capital, any bond requires a certain amount of risk-based capital behind it. Even accounting rules for sureties are rigged, he claims. "The surety world is the only entity that [generally accepted accounting principles] say you don't have to report the liability on your books because it's a third-party guarantee," says Scarborough. "And they call me a crook."

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



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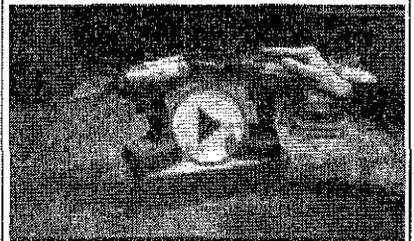
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Does Scarborough deserve a place in a small-business Hall of Fame or in a rogues' gallery with figures such as Robert Joe Hanson? The answer may depend on the value of Scarborough's hard-to-verify coal holdings and his opponents' will to outlast him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

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

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

**Data Lacking at Federal Agencies**

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

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

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

**Keywords:** Surety; Contractors; Congress; Scarborough; IBCS; NASBP

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**scimore** wrote:  
Oh good grief.

You lose all credibility, Karen, by throwing Reliance in there. Did Reliance Surety "blow up" or were they sold? Reliance Surety was the #1 writer of surety in the US, and defaulted on NO performance bonds. None.

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**karen** wrote:

Why not talk about First Sealord Surety. Several key officers of that company walked away with nearly \$8 million in money belonging to contractors that was in escrow accounts and pledged as collateral. The PA Ins Dept did not shut them down until the company had only \$5 million in capital surplus to pay tens of millions in claims. PA has no bond guaranty fund. And, the PA Ins Dept said the bond issued by First Sealord Surety are no longer valid. Even First Sealord's co-surety partner, Great American, was excused of any liability. The PA Ins Dept said that since Great American was excess to the underlying coverage, and since there technically is no underlying coverage, that there is no excess coverage for Great American to pay. I am still digesting that one. So contractors performing their work under contract were now in default of their contracts with General Contractors/Owners. As a result, contractors could not get paid for work performed and had to obtain a new bond at their cost. Some could, many could not. Months leading up to this company's bankruptcy, the surety company raised commission for agents to 35% as a means to entice them to keep sending business. The agents had to know. The surety companies I deal with all had something say about First Sealord that was indicative of doom for this company. Where was regulation here? This surety was licensed throughout the US and was Treasury Listed and AmBest Rated. This is not the first corporate surety that blew up. Reliance, AmWest, Midwest Indemnity, Eastern Indemnity all blew up. Others collapsed such as Frontier, Atlantic Mutual, Crum & Foster, Kemper, etc. There are more.

AND then there was the article published by the Washing Post's Policy Watch entitled, "Feds to force surety companies to pay up." Here is a caption for you: But apparently, agencies have found that surety companies don't always fork over the amount owed when a contract goes south for whatever reason. According to a proposed rule that was published in the Federal Registrar on March 17, "in a limited number of cases, sureties appear to have simply ignored agency final decisions for extended periods of time." I write very little individual surety bonds. There are agents out there that write many such bonds. I much rather broker corporate surety bonds. The commission is more stable and the rates are better for contractors. Individual surety is akin to a Lloyds of London approach to bonding. But, if you are going to paint a broad brush and squash a needed market for contractors who can't qualify for corporate surety bonds, then let's widen the canvas to show the picture on both sides of the fence. And by the way, every insurance administration of every state says that the premium for a bond is an underwriting fee and fully earned. If the bond is in effect for any length of time, it can be called upon. I have seen several cases where the owner kept the bond for several months. When the contractor was showing positive

performance, they rejected the bond. Even my corporate sureties would not return premium in such cases. The matter with Ed Scarborough occurred when he was in his early twenties. He was pardoned because if the law today was the law then, he would not have been convicted. And, he paid the money back. The officers of First Sealord have not

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Issue: 02/25/2013

## A Bold Individual Surety Claims His Coal-Backed Bonds are Rock Solid

02/27/2013

By [Richard Korman](#)

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

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

[Edmund C. Scarborough's Federal Surety Cases](#)

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

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

### Early Career and Starting an Individual Surety

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

The total amount owed was \$330,000. "I paid everybody every penny," Scarborough said in the NASBP deposition. In 2008, former Florida Gov. Charlie Crist issued Scarborough a pardon, helping to wipe a grand theft conviction from his record.

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

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

A turn of fortune was not far off. Scarborough set himself up in a new individual surety business in late 2003. In April 2004, he signed a memorandum of understanding under which bonds he wrote would be backed with collateral or reinsured by Larry J. Wright, whom a Baltimore jury had convicted of surety fraud in 1992. As it turned out, Wright also backed bonds for Hanson, who sold them to Montana contractors, according to orders filed by the Montana state auditor in 2007 banning Hanson from insurance activity.

For those Montana bonds, Wright's company, Underwriters Reinsurance, stated that it had a balance sheet rich with cash and equivalents worth half a billion dollars and another half billion in gold and precious metals, according to the Montana state auditor.

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

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

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

Scarborough, Wright and Gowen retaliated by suing the Army and the association. The three plaintiffs alleged that the criminal alert notice contained "personal and confidential information about them" and implicated them in "the alleged

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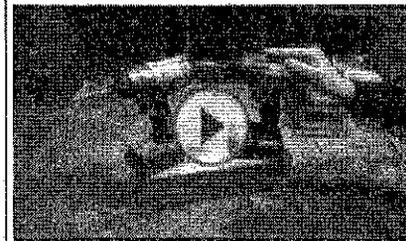
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fraudulent and criminal activities of Hanson." Much of the information was inaccurate and misleading, the plaintiffs argued, and "in no way relates to their current businesses or Scarborough's issuance of bonds."

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

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

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

**Keywords:** Surety; Contractors; Congress; Scarborough; IBCS; NASBP

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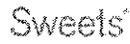
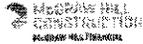
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Issue: 02/25/2013

## A Bold Individual Surety Claims His Coal-Backed Bonds are Rock Solid

02/27/2013

By Richard Korman

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



"Ed's the only one who could write a big bond," notes Karen Barbour, a Maryland-based surety broker.

Another change involved the bank that provided the irrevocable trust receipts related to Scarborough's asset. He switched that part of his business to a trust department of Wells Fargo Bank in Utah.

For some contractors lacking surety credit, individual surety is needed but unwelcome. "If there's something better than dealing with Scarborough, put him out of business," says one of his former clients, who declined to be identified due to the sensitivity of the topic. "Yet, he helped me get work." For others, individual surety was an unqualified godsend. Omar Karim, president of Laurel, Md.-based contractor Banneker Group, was genuinely grateful for the support.

Karim says he and his joint-venture partner needed the bond to qualify for \$10 million worth of building construction work at Ft. Belvoir, Va. He remembered that his bond on the project was "backed by coal."

### A Contracting Officer Rejects Coal Assets

In 2007, Wanda Peffer reviewed documents she had received from a small contractor on the island of Saint John in the U.S. Virgin Islands and didn't like what she saw. A contracting officer for the Federal Highway Administration (FHWA), Peffer was reviewing the documents for an intersection reconstruction project on which Tip Top Construction submitted a low bid of \$1.8 million.

What held up Peffer's approval was the surety bond Tip Top submitted. She noticed the bond was from an individual and that it was backed by coal assets. The bond documents described the assets behind the bond as an "allocated portion of \$191,350,000 of previously mined, extracted, stockpiled and marketable coal, located on property of E.C. Scarborough."

As far as Peffer was concerned, coal fell outside the guidelines for acceptable assets in her understanding of Federal Acquisition Regulations. She exchanged information about the coal assets with Tip Top and Scarborough but ultimately rejected the bond and declined to accept a substitute asset.

Tip Top filed protests and eventually sued the federal government. Scarborough also sued it. Most of the pleadings concerned Peffer's right to say no to coal.

In his court submissions, Scarborough represented that the asset backing the Tip Top bond was a portion of 166,400 gross tons of previously mined surface coal on an irregularly shaped, 115.5-acre tract in rural Nicholas County, W. Va. The website of a separate Scarborough company, IBCS Mining, says that the company has another coal property in Kentucky and that it had sold coal to utilities and other buyers.

The website describes the material at the properties as waste coal piles. IBCS' team of engineers, geologists and lab technicians had determined the character of each waste pile, the website stated, and the firm planned to use "Green Technology" to reduce the troublesome piles and "America's dependence on foreign oil."

A federal judge eventually ruled in favor of FHWA, bolstering the contracting officer's authority to accept or reject a bond. During the lawsuit, much evidence found its way into the record about the coal properties.

For example, Scarborough's attorneys submitted a report from an engineering-and-mining consultant that provided a limited-scope estimate that the coal refuse on the West Virginia property could produce 3.3-million tons of recoverable coal and that, based on current coal pricing, "this may potentially equate to a gross value of approximately \$261 million following processing." Qualifying their findings, the engineers said they had performed no testing or measuring of the actual, in-place material but had relied on an affidavit of the tract's former owner, a coal engineer.

Scarborough also submitted an affidavit from another coal expert attesting to the fact that coal is indeed a readily marketable asset and that, when already mined, extracted and stockpiled, coal is a very liquid asset. The expert also said it wasn't a mineral right because the material already had been mined.

Although critics claim the Federal Acquisition Regulations don't permit the use of mineral rights to back individual surety bonds, says IBCS Fidelity's Golia, "that's not what we use. Mr. Scarborough uses the actual mined minerals. This is coal you can go over and kick with your foot."

Kicking the coal may not be so easy at the Nicholas County site. Documents attached to the property deeds in West Virginia show a prior owner had been reclaiming the land under the state's direction, covering the coal waste with soil. One question is whether the property's environmental permit, No. R-707, actually allows Scarborough and IBCS Mining to remove the coal waste. The property's ownership chain and regulatory history is long and complex.

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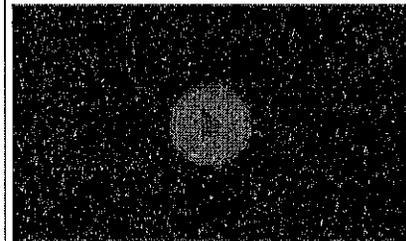
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At a House subcommittee hearing on H.R. 3534, a former attorney with the Naval Facilities Engineering Command, Robert E. Little Jr. took note of these discrepancies related to the Nicholas County coal assets backing the Tip Top bonds.

In his written testimony last March, Little noted that the Tip Top bond's certificate of pledged assets stated that the "previously mined, extracted, stockpiled and marketable coal" was worth \$191,350,000. "Imagine now, if you will, what \$191,350,000 worth of coal looks like," Little stated. He pointed out that "the surety had no mining permit to mine ... or process the coal refuse" and that much of it was covered with soil by a prior owner who was the permit holder for the reclamation obligation.

Keywords: Surety; Contractors: Congress; Scarborough; IBCS; NASBP

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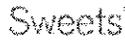
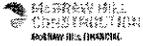
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Issue: 02/25/2013

## A Bold Individual Surety Claims His Coal-Backed Bonds are Rock Solid

02/27/2013

By [Richard Korman](#)

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

"Who among you," Little asked, "envisioned grassy fields with new growth timber showing no signs of mined, extracted and stockpiled coal?"

The IBCS Mining website states that the license for the West Virginia property is "in progress." Eric Rapp, who handles environmental matters for Green Valley Coal Co., says his firm owns the mineral permit for the tract and that Scarborough "can't take anything off."

Asked about it, Scarborough says his "program has changed dramatically. We have indentured trust agreements where Wells Fargo has a security interest in the properties." He continues, "We haven't used West Virginia in years. West Virginia is ready to go—it's just not going until we get everything together in Kentucky." He sells surface and underground material from his Pike County, Ky., mine, Scarborough adds.



Kentucky may be booming now, but Scarborough backed bonds with the West Virginia property as recently as 2011. According to bond documents attached to lawsuits, for example, Scarborough wrote a bond in December 2009 for a contract of \$1.84 million for contractor Tommy Abbott & Associates Inc. and its work on cottages in Virginia Beach, Va. Another, for a contractor named J. Slagter & Son Construction Co., involved a 2011 road project in Michigan with a \$6.8-million contract.

Scarborough acquired the West Virginia site in 2007 for \$168,500.00, as shown in county records. Scarborough explains, "That's where false information comes in. Do you think Wells Fargo would have issued a trust receipt?" Millions more, he says, will have to be paid to the prior owner in royalties once the coal is sold. A spokeswoman for the bank said it could not comment on "our particular duties to either Scarborough or the parties" with an interest in the trust assets.

### Expertise, Assets, Reform and Ethics

The fog hanging over the value of Scarborough's West Virginia coal holdings is almost as mysterious as the regulatory status of individual surety. Because federal regulations require no license or authority for individual surety, some regard it as wild and wide open for abuses. But this isn't exactly the case. State insurance departments and their investigators require certificates of authority or licenses for anyone working as a broker or insurer. If they receive valid complaints, they issue cease-and-desist orders against individuals operating without authority or a license.

When it comes to the bonds themselves, federal rules place the burden of verifying contractor responsibility on agency contracting officers. "They may not have the specific expertise required in understanding the financial analysis," concedes Michael P. Frischetti, executive director of the National Contract Management Association.

The harm from fraudulent bonds isn't immediately apparent to casual observers. NASBP CEO Mark McCallum says there's plenty of damage when public works and private contracts are backed by shaky or non-existent assets. "It cheats the taxpayers out of rightful guarantees and the subs and suppliers out of payment remedy if the bonds prove worthless," he says. If the sub cannot recover in a suit against the prime, and the prime refuses to pay or is in bankruptcy, says McCallum, "the only recourse is the payment bond. And if that's fake or worthless, it endangers the contractors' businesses."

Corporate sureties' and brokers remain determined to end what they consider fraudulent individual surety. At a time when more government and private owners are trying to save money by allowing contractors to work without payment or performance bonds, the potential for individual surety fraud creates an atmosphere of distrust.

Lynn M. Schubert, president of The Surety and Fidelity Association of America, says her members are tainted when an individual surety doesn't pay on a legitimate claim or refuses to give premium back even though the bond's rejected and not in place. "That has an impact on us," she says.

The small and minority contractors that need help are hurt the most when a fraudulent individual is rejected by the owner during bidding, or worse, when the individual surety fails to return the premium, Schubert says.

If the new rules thin the ranks of individual sureties, any bonds written by individual sureties under those rules will have real assets behind them. Additionally, small contractors still can get bonds through the Small Business Administration's bond guarantee program, she says. Or they can avail themselves of several different programs created to help contractors to qualify for corporate surety bonds and assist them in finding a qualified bond professional.

Scarborough, for his part, also is wary of some individual sureties after being stung by what he learned in 2005 and 2006 about Hanson and Wright.

He testified in the NASBP deposition that he never had reason to suspect Wright. And about whether Hanson should be admitted to the individual surety association, Scarborough said, "He doesn't strike me—from what I've read and from what I heard from others—as being somebody that will step up to the plate and be accountable for whether he did something right or wrong."

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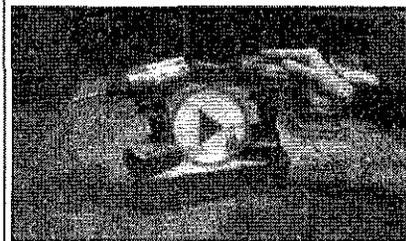
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**karen** wrote:

Why not talk about First Sealord Surety. Several key officers of that company walked away with nearly \$8 million in money belonging to contractors that was in escrow accounts and pledged as collateral. The PA Ins Dept did not shut them down until the company had only \$5 million in capital surplus to pay tens of millions in claims. PA has no bond guaranty fund. And, the PA Ins Dept said the bond issued by First Sealord Surety are no longer valid. Even First Sealord's co-surety partner, Great American, was excused of any liability. The PA Ins Dept said that since Great American was excess to the underlying coverage, and since there technically is no underlying coverage, that there is no excess coverage for Great American to pay. I am still digesting that one. So contractors performing their work under contract were now in default of their contracts with General Contractors/Owners. As a result, contractors could not get paid for work performed and had to obtain a new bond at their cost. Some could, many could not. Months leading up to this company's bankruptcy, the surety company raised commission for agents to 35% as a means to entice them to keep sending business. The agents had to know. The surety companies I deal with all had something say about First Sealord that was indicative of doom for this company. Where was regulation here? This surety was licensed throughout the US and was Treasury Listed and AmBest Rated. This is not the first corporate surety that blew up. Reliance, AmWest, Midwest Indemnity, Eastern Indemnity all blew up. Others collapsed such as Frontier, Atlantic Mutual, Crum & Foster, Kemper, etc. There are more.

AND then there was the article published by the Washing Post's Policy Watch entitled, "Feds to force surety companies to pay up." Here is a caption for you: But apparently, agencies have found that surety companies don't always fork over the amount owed when a contract goes south for whatever reason. According to a proposed rule that was published in the Federal Registrar on March 17, "in a limited number of cases, sureties appear to have simply ignored agency final decisions for extended periods of time." I write very little individual surety bonds. There are agents out there that write many such bonds. I much rather broker corporate surety bonds. The commission is more stable and the rates are better for contractors. Individual surety is akin to a Lloyds of London approach to bonding. But, if you are going to paint a broad brush and squash a needed market for contractors who can't qualify for corporate surety bonds, then let's widen the canvas to show the picture on both sides of the fence. And by the way, every insurance administration of every state says that the premium for a bond is an underwriting fee and fully earned. If the bond is in effect for any length of time, it can be called upon. I have seen several cases where the owner kept the bond for several months. When the contractor was showing positive performance, they rejected the bond. Even my corporate sureties would not return premium in such cases. The matter with Ed Scarborough occurred when he was in his early twenties. He was pardoned because if the law today was the law then, he would not have been convicted. And, he paid the money back. The officers of First Sealord have not.

2/21/2013 4:35 PM CST

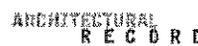
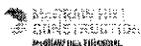
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FILED

2013 DEC 10 P 2:37

Hearing Unit, DIC  
Patricia Peterson  
Chief Hearing Officer

*In re the Matter of:* ) Docket No. 13-0084  
)  
**EDMUND C. SCARBOROUGH and** ) **DECLARATION OF**  
**WALTER W. WOLF,** ) **ALAN MICHAEL SINGER IN REPLY**  
) **TO JASON ANDERSON DECLARATION**  
*Respondents.* )

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I, Alan Michael Singer, state and declare as follows:

1. My name is Alan Michael Singer. I make this Declaration on the basis of first hand personal knowledge. I am over the age of eighteen (18) years. I am competent and authorized to testify to the matters set forth herein.
2. I am employed by the Washington State Office of the Insurance Commissioner (OIC). My title is Staff Attorney within the Legal Affairs Division.
3. On December 10, 2013, I read Jason Anderson's declaration supporting his client's opposition to OIC's motion to compel. It contains misleading statements and inaccuracies. This declaration highlights and corrects some of those misleading statements and inaccuracies.
4. In paragraph 3 of his declaration, Mr. Anderson states "[s]ome, but not all, of the OIC's interrogatories were discussed specifically during the November 13 telephone conference." With all due respect to Mr. Anderson, his characterization of the November 13 telephone conference in this regard is highly misleading and inaccurate. It is highly misleading because at the November 13 conference, very little of the relatively short telephone call was spent discussing OIC's interrogatories and requests for production. In fact, a very large majority of the call was spent discussing the two issues Mr. Parker wished to discuss: trying to reach a

settlement agreement with OIC and the subpoena to Wells Fargo. Toward the end of the call, after those two issues had been discussed at much greater length, OIC's discovery was then only very briefly mentioned. When this discovery was discussed, it was only discussed generally, and in no specific detail. I did make it clear that I believed the purported answers and responses were by and large wholly unacceptable and nonresponsive and that the objections were highly inappropriate. But no time during this conversation was spent carefully reviewing the language in any of the interrogatories and requests for production and comparing them with the purported answers, responses, and extensive objections. In fact, I specifically commented to Mr. Parker and Mr. Anderson that we would require a great deal more time if we were to discuss in any detail all of the many inadequacies in Respondent Edmund Scarborough's purported answers and responses, and the inappropriateness of the extensive objections. The call ended with us agreeing that OIC would need to just file a motion to compel, so that discussion never happened.

5. Mr. Anderson's paragraph 3 also states "[a]lthough Mr. Singer identified several interrogatories to which he believed a complete answer had not been given, he also acknowledged that some interrogatories were answered completely, including specifically numbers 4, 11, 12, 20, 21, and 24." This account is misleading, because it wrongly suggests that interrogatories and requests for production were discussed individually and carefully considered in detail. They absolutely were not. Mr. Anderson's account is also not accurate. After I pointed out that it was obvious that the vast majority of interrogatories and responses to requests for production were simply not responded to, Mr. Parker asked, "Well, are there any that were answered correctly?" At that point in the conversation, we quickly flipped through the set, and I did indicate that a very small number did appear to have had some

answer, if not a complete answer. One of these was interrogatory number 4, but not 11. I specifically mentioned the answer was not complete, but that it was a somewhat refreshing deviation from the rest that simply included nothing but a laundry list of objections. As to 12, I inquired whether any other complaints were known other than with insurance regulators in Idaho, Virginia, and Iowa, and Mr. Parker did not indicate an understanding of any. However, Mr. Anderson's assertion that I "acknowledged" that this was answered "completely" is inaccurate; I do not know what Respondent Scarborough knows. I only know that I was told in that call that his attorney does not know of any other complaints with state insurance regulators other than the states of Washington, Idaho, Virginia, and Iowa. As to 20 and 21, these were not answered, but were rather evasive. I was certainly glad to see that something other than boilerplate objections coupled with a complete non-response was given, but it is not accurate to state that I "acknowledged" that these were answered "completely." As to 24, however, this does appear to have been answered.

6. Paragraph number 4 in Mr. Anderson's declaration also contains inaccuracies. He inaccurately asserts that I purportedly "stated that a primary concern that [OIC] sought to address through the discovery requests was a lack of confidence that [OIC] knew the full extent of Mr. Scarborough's bond-issuing activities in Washington." It is true that I told Mr. Anderson and Mr. Parker that we certainly needed to know the full extent of Mr. Scarborough's activities in Washington or impacting Washington residents, but Mr. Anderson inaccurately asserts that I purportedly stated that this was "a primary concern that [OIC] sought to address through the discovery requests." After I made clear that one missing but basic piece of information was copies of all bonds and financial guarantees, Mr. Parker did offer, "What if I were to get you copies of the bonds?" But I only responded that that

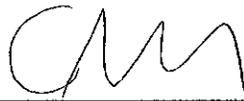
would be “a good start.” Aside from Mr. Parker’s own agreement to provide these bonds, we did not reach any agreement whatsoever as to whether that sole act would satisfy any of the discovery requests. Mr. Anderson also inaccurately asserts that I made some agreement to “deem” unspecified interrogatories and requests for production “satisfied” by Mr. Parker’s volunteering copies of some bonds. No such “deeming” or agreement was made, as evidenced by the lack of *any* writing – let alone a writing signed as agreed to by OIC’s and Respondent’s representatives – to confirm any of these supposed agreements Mr. Anderson only now asserts in opposition to OIC’s motion to compel. As indicated, the only other agreement we did eventually reach, aside from Mr. Parker agreeing to at least provide some of his client’s Washington bonds as a “good start,” was that OIC would need to file a motion to compel.

7. In paragraph 8 of his declaration, Mr. Anderson also makes a misleading and inaccurate statement: “after a specific request by Mr. Singer, I supplemented Mr. Scarborough’s answer to interrogatory number 8.” Mr. Anderson was asked about his client’s financial guarantee activity, as indicated; but this was not asked specifically in reference to interrogatory number 8 or any other interrogatory or discovery request. Rather, it was asked as a follow up on the November 13 conversation. Mr. Anderson’s e-mail reply does not indicate it is supplementing anything, nor does it indicate anything other than Respondent Scarborough’s attorney’s understanding that, at some unspecified point in time, his client apparently did not recall issuing any financial guarantees in Washington. Mr. Anderson’s statement is also misleading by now being used to suggest that OIC’s discovery was somehow being supplemented cooperatively or otherwise, or that a motion to compel was somehow obviated to any degree by Mr. Anderson’s e-mailed commentary.

8. By November 27, when I prepared and submitted my own declaration with OIC's motion to compel, Mr. Parker's associate, Jason Anderson, had provided an e-mail attaching PDF copies of several of the bonds Mr. Parker had promised he would provide. That e-mail is attached to Mr. Anderson's declaration as both "Exhibit C" or "Exhibit 3." I was told a disc containing more bonds was sent in the mail, but prior to preparing and filing OIC's motion to compel, I never saw that disc. After filing that motion, I then first saw Mr. Anderson's letter indicating the bonds were being provided to purportedly "supplement" certain discovery requests.

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

EXECUTED this 10<sup>th</sup> day of December, 2013 at Tumwater, Washington.



\_\_\_\_\_  
Alan Michael Singer