H.R. 3032, CONSTRUCTION SUBCONTRACTORS PAYMENT PROTECTION ENHANCEMENT ACT OF 1998

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY

OF THE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

AND THE

SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

OF THE

COMMITTEE ON THE JUDICIARY

HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

ON

H.R. 3032

TO AMEND THE OFFICE OF FEDERAL PROCUREMENT POLICY ACT AND RELATED ACTS TO ENHANCE THE PAYMENTS PROTECTIONS FOR SUBCONTRACTORS AND SUPPLIERS ON FEDERAL CONSTRUCTION PROJECTS, AND FOR OTHER PURPOSES

SEPTEMBER 11, 1998

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H.R. 3032, CONSTRUCTION SUBCONTRACTORS PAYMENT PROTECTION ENHANCEMENT ACT OF 1998

FRIDAY, SEPTEMBER 11, 1998

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY, COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT, JOINT WITH SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW, COMMITTEE ON THE JUDICIARY,

Washington, DC.

The subcommittees met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Stephen Horn (chairman of the Subcommittee on Government Management, Information, and Technology) presiding.

Present from the Subcommittee on Government Management, Information, and Technology: Representatives Horn, Sessions, Kucinich, and Maloney.

Present from the Subcommittee on Commercial and Administrative Law: Representatives Gekas, Inglis, and Bryant.

Staff present from the Committee on Government Management, Information, and Technology: J. Russell George, staff director and chief counsel; Mark Brasher, senior policy director; Matthew Ebert, clerk; and Mark Stephenson, minority professional staff member.

Staff present from the Subcommittee on Commercial and Administrative Law: Raymond Smietanka, chief counsel; James W. Harper, counsel; Audray Clement, staff assistant; David Lachmann, minority professional staff member; and Bill Montalto, special counsel.

Mr. HORN. Good morning. Our hearing today will examine H.R. 3032, the Construction Subcontractors Payment Protection Enhancement Act of 1998. This legislation was proposed by Representative Carolyn Maloney, a distinguished member of our subcommittee from the State of New York, in response to a situation which occurred in the city of New York about which we will hear more today. And I suspect similar situations you could hear in almost every city in the United States.

For over 60 years, the Miller act has governed bonding requirements for Federal construction projects. The act provides payment protection to certain subcontractors and suppliers supplying labor and material for the performance of such construction contracts.

Under the act, payment protection is only extended to a firm with a subcontract directly with the prime contractor, a firm with a subcontract with any first-tier subcontractor, and any direct supplier to either a first- or a second-tier subcontractor. Any lower-tier subcontractor or any supplier to such subcontractor is not currently afforded any payment protection under the Miller act. This is the situation which H.R. 3032 seeks to redress.

We all realize this is a very complex issue, and there are a variety of positions that our witnesses may take, and we look forward to the testimony.

[The text of H.R. 3032 and the prepared statement of Hon. Stephen Horn follow:]

105TH CONGRESS
1ST SESSION

H. R. 3032

To amend the Office of Federal Procurement Policy Act and related acts to enhance the payments protections for subcontractors and suppliers on Federal construction projects, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 12, 1997

MRS. MALONEY of New York introduced the following bill; which was referred to the Committee on the Judiciary, and in addition to the Committee on Government Reform and Oversight, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

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A BILL

To amend the Office of Federal Procurement Policy Act and related acts to enhance the payments protections for subcontractors and suppliers on Federal construction projects, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Construction Subcontractors Payment Protection Enhancement Act of 1998".

SEC. 2. ADDITIONAL RESPONSIBILITIES OF THE ADMINISTRATOR FOR FEDERAL PROCUREMENT POLICY.

Section 6(d) of the Office of Federal Procurement Policy Act (41 U.S.C. 405(d)) is amended—

(1) by redesignating paragraphs (9), (10), (11), (12), and (13), as paragraphs (10), (11), (12), (13), and (14), respectively; and

(2) by inserting after paragraph (8) the following new paragraph:

"(9) establishing appropriate Government-wide policies and assuring Government-wide implementation through the Federal Acquisition Regulation of statutes and policies assuring the timely payment of contractors, subcontractors, and suppliers, including chapter 39 of title 31, United States Code (commonly known as the "Prompt Payment Act"), the Miller Act (40 U.S.C. 270a–270d–1), and section 2091 of the Federal Acquisition Streamlining Act of 1994 (Pub. Law 103–355; 108 Stat. 3306);".

SEC. 3. IMPLEMENTATION THROUGH THE GOVERNMENT-WIDE PROCUREMENT REGULATIONS.

(a) PROPOSED REGULATIONS.—Proposed revisions to the Government-wide Federal Acquisition Regulation to implement the amendments made by this Act shall be published not later than 120 days after the date of the enactment of this Act and provide not less than 60 days for public comment.

(b) FINAL REGULATIONS.—Final regulations shall be published not less than 180 days after the date of the enactment of this Act and shall be effective on the date that is 30 days after the date of publication.

SEC. 4. RELATED AMENDMENTS TO THE MILLER ACT.

(a) IMPROVEMENT OF PAYMENT BOND PROTECTION.—Subsection (a)(2) of the first section of the Miller Act (40 U.S.C. 270a(2)) is amended by striking the second, third, and fourth sentences and inserting in lieu thereof the following new sentence: "The amount of the payment bond shall be equal to the amount of the performance bond.".

(b) PAYMENT BOND PROTECTION FOR PROGRESS PAYMENTS.—Section 2(a) of the Miller Act (40 U.S.C. 270b(a)) is amended in the first sentence by striking "who has not been paid in full therefor" and inserting in lieu thereof the following: "(1) who has not been paid in full for a progress payment before the expiration of a period of seven days after the due date of the progress payment, or (2) who has not been paid in full for the labor or material".

(c) EXTENSION OF PAYMENT BOND PROTECTION TO ALL SUBCONTRACTORS AND SUPPLIERS.—Section 2(a) of the Miller Act (40 U.S.C. 270b(a)) is further amended—

(1) by striking "performed by him" and inserting "performed by the person";

(2) by striking "supplied by him" and inserting in lieu thereof "supplied by the person"; and

(3) by striking "him: *Provided, however,*" and all that follows through "within ninety days from" and inserting in lieu thereof "the person. Any person who institutes such a suit shall give notice of such suit to the contractor who furnished such payment bond not later than 90 days after".

(d) PRESERVATION OF PAYMENT BOND PROTECTION.—The first section of the Miller Act (40 U.S.C. 270a) is further amended by adding at the end the following new subsection:

"(e) No waiver of any protection afforded to a person by a payment bond required by this Act shall be valid unless the waiver is in writing and is made after the date such person may institute a suit under section 2 with respect to such bond.".

(e) MODERNIZATION OF SERVICE OF PAYMENT BOND CLAIMS.—Section 2(a) of the Miller Act (40 U.S.C. 270b(a)) is further amended in the sentence beginning with "Such notice" by striking "by mailing" and all that follows through "or his residence" and inserting in lieu thereof "to the contractor at any place the contractor conducts business through any delivery service that provides proof of receipt, including the United States Postal Service, a private express delivery service, or delivery by any form of electronic means,".

(f) ELIMINATION OF DELAYS IN PAYMENT BOND PROTECTION.—Section 2 of the Miller Act (40 U.S.C. 270b) is further amended—

(1) in the second paragraph, by inserting "(b)" before "Every suit instituted"; and

(2) by adding at the end the following new subsection:

"(c) A suit instituted under this section shall not be dismissed on the grounds that it was filed before the expiration of a period of ninety days after the date on which the last of the labor was done or performed or material was furnished or supplied if the person who instituted the suit has received from the contractor who furnished the bond a denial in writing that payment is due, in whole or in part.".

(g) DISCOURAGEMENT OF FRIVOLOUS PAYMENT BOND LITIGATION.—Section 2 of the Miller Act is further amended by adding at the end the following new subsection:

"(d)(1) A court may award the prevailing party in a suit instituted under this section court costs, attorneys' fees, and interest, if the court determines that such an award is appropriate and that—

"(A) the suit is frivolous or a defense that is asserted in the suit is groundless; or

"(B) such an award is needed to preserve the protections of this Act with respect to a small claim, in an amount not exceeding the simplified acquisition threshold (as defined in section 4(11) of the Office of Federal Procurement Policy Act; 41 U.S.C. 403(11)).".

"(2) Interest awarded under this subsection shall be calculated for the period beginning on the date the claim is made and ending on the date of payment, using the interest rates applicable to late payment interest penalties pursuant to section 3902 of title 31, United States Code (commonly referred to as the "Prompt Payment Act").".

(h) ACCOUNTABILITY OF CONTRACTING OFFICERS.—The first section of the Miller Act (40 U.S.C. 270a) is further amended by adding at the end the following new subsection:

"(f)(1) The contracting officer for a contract shall be responsible for—

"(A) obtaining from the contractor the payment bond required under subsection (a); and

"(B) ensuring that the payment bond remains in effect during the administration of the contract.

"(2) In any case in which a person brings suit pursuant to section 2 and the court determines that the required payment bond is not in effect because the contracting officer has failed to perform the responsibilities required by paragraph (1), upon petition of the person who brought the suit the court may authorize such person to bring suit against the United States for the amount that the person would have sued for under section 2.".

○

ONE HUNDRED FIFTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

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Legislative Hearing on H.R. 3032,
the Construction Subcontractors Payment
Protection Enhancement Act of 1998

September 11, 1998

OPENING STATEMENT
REPRESENTATIVE STEPHEN HORN (R-CA)

Chairman, Subcommittee on Government Management,
Information, and Technology

Our hearing today will examine H.R. 3032, the Construction Subcontractors Payment Protection Enhancement Act of 1998. This legislation was proposed by Representative Carolyn Maloney, a distinguished member of our subcommittee from the State of New York, in response to a situation which occurred in the City of New York, about which we will hear more about today.

For over 60 years, the Miller Act has governed bonding requirements for Federal construction projects. The Act provides payment protection to certain subcontractors and suppliers supplying labor and material for the performance of such construction contracts. Under the Act, payment protection is only extended to a firm with a subcontract directly with the prime contractor, a firm with a subcontract with any first-tier subcontractor, and any direct supplier to either a first or second tier subcontractor. Any lower-tier subcontractor or any supplier to such subcontractor is not currently afforded any payment protection under the Miller Act. This is the situation which H.R. 3032 seeks to redress.

We all realize that this is a very complex issue, and there are a variety of positions that our witnesses may have. With that, I look forward to hearing their testimony.

Mr. HORN. This is a joint hearing of the Subcommittee on Government Management, Information, and Technology of the full Committee on Government Reform and Oversight, which I chair in that subcommittee, and Mr. Gekas, the gentleman from Pennsylvania, is chairman from the Subcommittee on Commercial and Administrative Law of the Judiciary Committee, and I believe Mr. Gekas is on his way.

But I might ask, would the gentlewoman from New York who is the author of the bill wish to have an opening statement?

Mrs. MALONEY. Absolutely, Chairman Horn, and Chairman Gekas who is on his way. I would like to thank both of you for calling a joint hearing on H.R. 3032, the Construction Subcontractors Payment Protection Enhancement Act of 1998. I also express my gratitude for the interest and support of the ranking Democratic members of both subcommittees: my friend and neighbor from the great State of New York, Gerald Nadler, who is on the House floor as we speak, and he will be here later; and my good friend from Ohio, Dennis Kucinich.

Like many issues in the government procurement arena, this topic is unlikely to capture virtually any public attention outside of the groups affected, the small construction subcontractors and suppliers from whom we will be hearing today. Payment issues are very real and practicable, determining whether a fully performed job will bring a profit or a loss. For some the very existence of the small firm may literally be at stake.

My legislation is designed to modernize the Miller act, which was enacted in 1935 for the express purpose of providing improved payment protections for subcontractors and suppliers on Federal construction projects. The Miller act was itself a replacement for the Heard act of 1894, which was designed to use the ability to get a surety bond as a means of prequalifying Federal construction contractors and of guaranteeing completion of a Federal construction project in the event the contractor defaulted.

Except for two increases in the act's application threshold, one in 1978 from $2,000 to $25,000 and the other in 1994 from $25,000 to $100,000, the Miller act has remained unchanged for more than 60 years. During the same period Federal construction projects covered by the Miller act have become larger and more technically complex, involving computerized systems simply unheard of in 1935.

Modern construction requires the expertise of much deeper teams of specialized subcontractors and suppliers. The Miller act includes a $2.5 million cap on the maximum size of the payment bond available for any construction contract over $5 million.

As the key witness at the House Judiciary Committee hearing on what became the 1935 Miller act stated, a $2.5 million payment bond, "would be adequate on a job of $10 million." It is wholly inadequate today when major construction projects can cost literally hundreds of millions of dollars. Yet some of today's witnesses are adamantly opposed to any statutory adjustment.

While such a position is not unexpected from the representatives of the surety industry, it is unexpected, if not troubling, coming from the representatives of an administration. Working with Congress in a bipartisan manner, the administration and the Office of

Federal Procurement Policy can take much justifiable pride in adjusting virtually every aspect of the Federal procurement process. I look forward and I need to understand the rationale for leaving undisturbed this clearly out-of-date Miller act threshold like some prized artifact.

Some of today's witnesses are also against extending the reach of the Miller act's payment bond protections to lower-tier subcontractors and their direct suppliers. Again, the legislative history of the Miller act is devoid of any rationale for limiting the payment bond protections to first-tier and second-tier subcontractors and their direct suppliers. That may have covered virtually all of the players on a typical construction team in 1935. It no longer does, and probably hasn't for many years, yet the administration wants to permit the situation into the 21st century.

Mr. Chairman and members of the committee, at this point, time simply does not permit me to march through each provision of my bill and raise similar questions about other objections to propose statutory changes to modernize the Miller act. With your assistance, I will try to do so during questioning.

With that, I too, would like to extend a very warm welcome to Deidre Lee, the new Administrator for Federal Procurement Policy. I look forward to working with her on this and other initiatives to improve the Federal procurement process and its work force.

I also want to welcome one of my constituents from my district in New York, Fred Levinson, who caused me to focus on this issue of modernizing the Miller act because of his own personal experiences, which he brought to my attention. I expect this to be an informative hearing, and may well be a lively one, given the divergence of positions concerning H.R. 3032.

I would just like to add, on a personal note, many people find this silly, but I find procurement absolutely fascinating. And I enjoy very much working with my colleague Mr. Horn, as I have on many aspects, and really his predecessor Mr. Clinger on procurement reform.

Now, many people find all of this technicality very boring, but to me it is literally very important because if it is done well, it can literally mean more police officers on the street, more teachers in the classrooms, because we are running government better, making sure that the dollars are not tied up in litigation, not tied up in efforts that waste money as opposed to getting it out to people.

So procurement, especially since the Federal Government has such a large procurement budget, it is tremendously important to the economy of our country. And it is really the model by which, having come from a State and city legislature, they follow what we do. So our procurement policies are tremendously important. And on this, I guess, we should just go forward.

I had a wonderful relationship with your predecessor. We worked on the procurement, Reinventing Government bill of Vice President Gore, with Mr. Clinger and others, and we worked on many important things.

This I think is an important bill. Many people get bored with it. But if you are not getting paid for the work you're doing and you're left holding the bag, then the cost of Federal jobs goes up, because nobody wants to do it because they know they're not going to be paid.

And I think this is a simple situation. If you're doing a job, you've got to be guaranteed you're going to be paid for it. Otherwise, why should you do it? And by modernizing the Miller act, we will improve in my opinion the efficiency of government, the ability to lower the cost of our contracts for the Federal Government, for Federal services, and really take care of what Mr. Horn always likes to talk about, which is the hard-working American men and women, many of whom are not the big guy running the multimillion dollar corporation, but the guy running the small business who gets that contract and often is left holding the bag when the big guy just decides, "I'm not going to pay. The Feds are going to pay me. I'm going to forget about you."

So to me this bill makes common sense. It's outdated. It should be updated. And I believe if I stop talking, Mr. Horn will be on to passage in this committee, on to passage, to the floor.

Mr. HORN. Not quite. If we don't introduce the chairman of the other subcommittee, we'll be here for three more Congresses. So thank you. It's always are a pleasure to work with the distinguished gentlewoman from New York.

As I mentioned in my opening statement, this is a joint hearing, and the other part of the jointness is the Subcommittee on Commercial and Administrative Law of the Judiciary Committee which is chaired by Mr. George Gekas, the gentleman from Pennsylvania, and he will preside over panel two.

Mr. GEKAS. I thank the gentleman, not just for the introduction but for adhering to our request to conduct this hearing on a joint committee basis, which I believe, for instance, over the years has proved to be very satisfactory for Members and also very effective, because the notions of more than one committee would be blended into a final product that would eventually find its way to the floor. And we hope that that pathway has already been shown in this particular piece of legislation.

I also want to thank the gentleman because he has helped me fulfill a promise I helped make to my constituents in Pennsylvania, that I would strive mightily to convene such a meeting or such a hearing or to urge that one be called. And the gentleman from California has very prudently acquiesced to my request.

As has been stated by the lady from New York, the subject matter here is not such that will cause the media to pound to the doors to find out what's going on in this hearing room. But we know for many, many different people, and for the economy and for the jobs and for simple good business tactics and good business practices, we must address this particular problem. And I'm looking forward to the testimony of the representatives of the administration and others so that we can resolve what we can on this gigantic problem.

I thank the gentleman.

Mr. HORN. I thank you, and we're delighted to have you here.

Let me explain some of the ground rules of this hearing, because it's part of the Government Reform and Oversight Subcommittee, and that is the following: A lot of you as individuals or representatives of groups have statements you would like to have in the hearing record. If you will file them with the recorder or with the staff director, Russell George, on the Government Management side, we will have them all put in the printed hearing. And we appreciate you taking the time to draft these very statements.

All witnesses before the subcommittee, because we're an investigating subcommittee, will take an oath of testimony, to tell the truth. And we will swear in each witness as a group with panel two, and when we get to panel one, we will swear in the new administrator.

Before Ms. Lee makes her statement, I would like to express the opportunity of the high expectations and the hopes we have for you in this very important position within the administration. I believe you were sworn in last month, and you come to your position as a career procurement executive, and I think that's one of the few OFPP administrators to have actually purchased something on behalf of the Federal Government.

So you know how the system works, and we're counting on you to help us make some improvements and recommendations. And we would be glad to work with you on all the relevant committees that get into procurement, which is billions of the taxpayers' dollars. And you're in a crucial position to make sure that process moves smoothly and that it's done right and there's fairness that occurs.

There's a great deal of work to be done on implementing procurement reform in both the civilian agencies of the government as well as the Department of Defense. For example, implementation of the long-expected rewrite of FAR Part 15 and improvements in the professionalism of the procurement work force should be a part of that agenda. It moved out of the House; it didn't quite move out of the other body.

We look forward to your testimony, and we hope that your tenure will be as distinguished as that of your predecessor. If you would now stand and just affirm the oath.

[Witness sworn.]

Mr. HORN. We thank you very much. I might add, our panel two is a good cross section that is coming after you, and it would be appreciated if you could spend the time, we're going to be out of here before lunch, but we would like to have you listen to panel two. And if you have some reaction, we would like to get that in the record.

Usually I put the administrators last because I want them to hear from the grassroots, what's going on in America, and you're new at it, and I suspect you would enjoy that experience. We found it's very pleasant. OK? And it gets things done because we can get closure on some things.

So I'm delighted to introduce the Honorable Deidre Lee, newly sworn-in Administrator, Office of Federal Procurement Policy, Office of Management and Budget. Thank you for coming.

STATEMENT OF DEIDRE LEE, ADMINISTRATOR, OFFICE OF FEDERAL PROCUREMENT POLICY, OFFICE OF MANAGEMENT AND BUDGET

Ms. DEIDRE LEE. Well, thank you very much, Chairman Horn. It's a start, and I'm anxious to get going. So, Chairman Horn, Chairman Gekas, Congresswoman Maloney and other members of the subcommittees, I really appreciate the opportunity to appear before you here today, my first hearing as the OFPP Administrator.

And Congresswoman Maloney, I can't tell you how much it is music to my ears to hear someone say they think procurement is fascinating. I obviously think it is. I have been spending many, many years to that, and I don't often hear that expressed so eloquently. Thank you, and I look forward to working with you.

Mr. HORN. When you say it's a pleasure to appear, I've got to remind you, you did take an oath to tell the truth.

Ms. DEIDRE LEE. Remember this is my first appearance, so this is a pleasure. I am here officially, of course, to discuss this bill. I briefly mentioned to Chairman Horn that, if I may digress just a moment as the new Administrator for OFPP and briefly say what my general goals are, I thought they might be of interest to this committee, and then I would certainly go into discussion of the bill.

Mr. HORN. They would be.

Ms. DEIDRE LEE. I think it was clearly stated that so much has been done. We certainly have had the support of the Congress and the administration in getting FARA, FASA, Clinger, Cohen, and Congresswoman Maloney, I still call it the Maloney bill, which is certainly the piece of legislation that gave us so much assistance in bringing about better education and more focus on the civilian side of the work force. I think it's very important, and I think there's more to be done.

So just very quickly from a goal standpoint, my goals are just that we have gotten so much change in statute, regulation and operating principles, but they are not yet fully implemented. If you go around and check the different agencies, it's spotty at best. Some are very excellent with some initiatives; some have differing levels of achievement. So my goal is to really get out and meet with the people, work with the people and ensure that we implement the excellent changes that we have right here before us.

Additionally, I will be the first to admit we will probably have some operational tweaks where we have found things and we will say, we need to turn it a little this way, we need to adjust it a little that way. And one of my goals throughout this implementation process is to work closely and directly with the Congress and also work for measurement, do some sanity checks: How are we doing? Are we making progress? Where do we need to refocus, where do we need to reemphasize? My agenda is to really go out and implement and meet with the people and make sure that we spread these acquisition reforms and reap the benefits, and I think there is yet much to do.

So if I may, I will go to the purpose of our hearing here today, and I have to refer to my notes to make sure I get the correct title. I'm certainly here to discuss the administration views on H.R. 3032, the Construction Subcontractors Payment Protection Enhancement Act of 1998, and I would like to prepare some very informal remarks on that.

Back in February, the administration provided comments of H.R. 3032, and I included a copy of those, attached to my testimony. It is my understanding that we are also considering an amendment to that bill. Therefore, as my comments today I would like to address not only the bill as introduced but the comments, to the best of my knowledge and the way I understand them. I would like to submit my formal testimony for the record and speak——

Mr. HORN. I should say, without objection, all statements are automatically put in the record the minute we introduce you. That's all of those of you on panel two. We would like you to summarize it as best as you can. We don't want you to miss key points, however. There's no time pressure on that. But we would like to have the summary, and then we can have more of an opportunity for questions in a dialog.

Ms. DEIDRE LEE. OK. Thank you.

Mr. HORN. And the Administrator has graciously agreed to sit through with panel two, and we would like that kind of interaction to also occur.

Ms. DEIDRE LEE. I would like to start on my discussion of H.R. 3032 with a commitment, and that is that the administration and I share the subcommittees' concerns and the subcontractors' concerns that subcontractors and suppliers working on Federal construction contracts should—again, I will reiterate the commitment. We would like to express that the administration does share the concern that subcontractors and contractors working on Federal construction contracts ought to get paid for the work they perform.

And I think we do see reducing the risk of nonpayment helps to ensure the likelihood of successful and timely completion of construction contracts and, therefore, effective use of taxpayers' dollars. So certainly we think this is an important and laudatory goal and we need to work toward that.

I'm going to briefly go through five main points of the bill. The first and foremost, what I believe probably the most significant part of the bill is regarding the increased payment bond protection. As Congresswoman Maloney outlined, the current Miller act in 1935 established both performance bonds and payment bonds. Performance bonds were to protect the government. Payment bonds protect the subcontractors, first and second tier. And that was established because of the solvency of the government, so those contractors would have an avenue of redress to address nonpayment procedures.

For payment, of course, there's a sliding scale, but the point, the number we seem to be discussing here today is the $2.5 million that is required on contracts over $5 million; again, set some number of years ago. However, the Miller act also states that the contracting officer can require additional security, and there have been a few instances we believe that has been done.

In practice, though, let's talk about what really happens. The payment bond is generally set at 100 percent of the contract price. That is kind of, I think, industry practice standard, and you will find the majority of the government construction contracts do do that. The progress payment is at a sliding scale. Again, here we focus on that $2.5 million, but remembering that the law clearly states that the CO could, if they believe it's necessary, require additional security.

The bill as introduced originally set the payment bond to the performance bond amount or a contract value, and now we have an amendment that says let's talk about perhaps identifying just the subcontracting piece and setting the bond at that activity. And I'm looking forward to the next panel, because I think they will go into more detail on how a surety bond is set and how it's priced.

But basically the comments we have here is two things to be sure we address in this legislation, and that is in the case, albeit rare, where the government self insures; and in which case there I want to be careful there we don't link payments and performance, because we could unintentionally leave a subcontractor with no coverage because the government has elected to insure, and we have a linkage there. We need to address that. Also the amount of the bond.

We ought to be having payment bonds for a reasonable amount to ensure that they meet their goal, which is to ensure compliance or payment to subcontractors. To that extent, Congresswoman Maloney and Chairman Horn and Chairman Gekas, what I have done already is sent a letter over to the Civilian Agency Council and asked them to open a FAR case, to add to the FAR language that reminds contracting officers that they have this ability and that they have this responsibility and that they ought to ensure, on these large construction contracts, that they are obtaining the appropriate amount of security.

And I think by adding some guidance there to remind people of that responsibility, we will see immediate improvement. We will continue to work with you on this bill, and actually I would like to work with you as that regulation unfolds. So that has been done, and I think we're addressing that particular issue.

Another point in the bill is talking about authorizing suit for nonpayment, nontimely payment of progress payments. And we have concerns from that standpoint, I have concerns, again thinking about the person in the field. Right now we have the Prompt Payment Act, and the Prompt Payment Act recognizes that before you are entitled to progress payment, you must have made satisfactory performance.

I think our bill doesn't quite capture that as clearly, and puts a time line that may in fact make a subcontractor feel that they are entitled to sue for progress payment when, in fact, the first point should be, have you properly and completely performed the work? So that retains quality control from the prime standpoint, and I think that's an important facet for us to focus on in making sure, if we decide to do this kind of activity. As it currently stands we don't recommend it. We need that focus.

Also, under the Prompt Payment Act interest is charged. I mean it's charged both ways. In other words, if a prime does not make timely payment for an invalid reason, he owes the subcontractor interest; by the same token, if the prime collects interest from the government and it makes nontimely payment, they actually owe interest back to the government.

So we think we've got a pretty good system there. Let's make sure, if we make adjustments, that we don't, in fact, I think impact what works quite well as a Prompt Payment Act, and it's an important provision.

The third provision talks about expanding protection to all subcontractors and suppliers. And there is currently, I call it first-tier, second-tier coverage, the bill as introduced covers everybody. The amendment talks about onsite. And I think the goal is a good one, but it's going to be, I believe, difficult and perhaps add some litigation complication of who was onsite. When were they onsite? Is a supplier that made a delivery covered? Are they not covered?

Also, we're kind of concerned, or I'm concerned about the normal business transaction. The government cannot and should not indemnify everybody at every tier. So I think we need to focus as to who has that great deal of risk. And we still need to leave industry to establish some good, sound business relationships and principles among themselves, and I think that we need to be very cautious about that.

So for that reason, we do not support this specific. We need to look at it in a little more focus.

Holding contractors liable. That was in the original bill; it has been deleted. And I want to thank you, I think that is very positive, due to our comments; and working together, we deleted that portion. Thank you very much. I think that's a good thing to do.

And one of the other things, a comment that's covered under here is providing payment for attorneys' fees. Certainly, we all, I think, have the goal of discouraging frivolous litigation; that's a good thing, and we need to focus on that. But the United States generally employs the American rule. I'm looking at Jim; he's nodding his head there. Prevailing parties are not awarded attorneys' fees succinctly, although there are other methods for them to recover should—for some reason or another, in whatever litigation that it be deemed appropriate, so that was as introduced.

As amended, the bill closes that gap and says, let's focus on some businesses and let's focus at $50,000. We certainly think that's a significant improvement and could work with those issues. But I think we as a whole need to look at do we want to set a precedent here in moving off of the American rule and what precedent does this set and where is that going to flow into other government activities, particularly in the procurement arena. And I am somewhat concerned about that because of the litigious impact.

There are a couple of other provisions in the bill. Talking about updating the mailing provisions, I think we certainly can work with that. There's some discussion about whether that is covered elsewhere and whether we need to specifically address that here.

Allowing suit in less than 90 days, that is premised on the fact that it is after denial of the claim, which I think is a very important point.

And there's also some talk about the ability to waive some payment provisions. And I think we can certainly work with those activities. I think I've covered the major portions of the bill there. And so I would just like to summarize that as we stated earlier, during the past several years, Congress and the administration have worked together in a magnificent way to make significant improvements in the Federal procurement process. We have had some statutes, and again, I said I'm particularly fond of the Maloney bill, although, I would like to work on some more things.

And along with these regulatory and process initiatives and policy initiatives, for example, performance-based contracting, servicing contracting, the introduction of additional education requirements and guidance, I think we're going to help agencies do more effective procurement. And the point again is to save the taxpayer dollars where we can reemploy and use it in other areas.

So I am confident that we can continue the bipartisan support that will enable us to make progress. We have much yet left to do. I'm anxious to go out and implement these activities. I look forward to working with you to provide a better level of protection in this activity and to provide an overall better procurement system in many of the other activities that we're working on.

Thank you very much for this opportunity. And I would be happy to answer questions.

[The prepared statement of Ms. Lee follows:]

STATEMENT OF
DEIDRE A. LEE
ADMINISTRATOR FOR FEDERAL PROCUREMENT POLICY
BEFORE THE
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION
AND TECHNOLOGY
AND THE
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW
UNITED STATES HOUSE OF REPRESENTATIVES

September 11, 1998

Chairman Horn, Chairman Gekas, Congressman Kucinich, Congressman Nadler and members of the Subcommittees, I appreciate the opportunity to appear before you today at this joint hearing to discuss the Administration's views on H.R. 3032, the "Construction Subcontractors Payment Protection Enhancement Act of 1998." Back in February, the Administration provided comments on H.R. 3032. I am including a copy of those comments as an attachment to my testimony. It is my understanding that you are considering an amendment to the bill. Therefore, in addition to providing comments on the major features of the bill as introduced, I will also attempt to reflect those changes, as I understand them, in my comments today.

At the outset, let me state that the Administration shares the Subcommittees' concern that subcontractors and suppliers working on Federal construction contracts receive payment for the work they perform. Reducing the risk of non-payment helps to improve the likelihood of successful and timely completion of our construction projects and the effective use of taxpayer dollars.

As introduced, H.R. 3032 would seek to reduce the risk of non-payment to construction subcontractors and suppliers by reinforcing the Miller Act in a variety of ways. Among other things, the bill would: (1) increase payment bond protection; (2) allow suit for non-timely payment of progress payments; (3) expand the scope of the Miller Act to cover all levels of subcontractors and suppliers; (4) hold contracting officers liable if a mistake occurs in obtaining or keeping an effective bond; and (5) provide for the recovery of attorneys' fees in an attempt to discourage frivolous litigation.

The Administration appreciates the intent behind H.R. 3032, and believes that some of its provisions are worthy of consideration. However, the Administration is concerned that the overall impact of the bill in its present form (even with the changes we understand are under consideration) will be more costly than beneficial. Although we still have concerns with H.R. 3032, we believe our overall shared goal of reducing the risk of non-payment to subcontractors and suppliers can be effectively furthered without legislation through the pursuit of regulatory changes.

To better understand the Administration's position, let me now briefly share with you our views on what we believe are the bill's five key provisions.

Increased payment bond protection.

First, and perhaps foremost, H.R. 3032 would increase payment bond protection from their present levels. Such an effort can help to reduce the risk of non-payment. It is unclear, however, whether the language under consideration will achieve the desired result.

As introduced, section 4(a) of H.R. 3032 would require payment bonds to be equal to the amount of performance bonds. Admittedly, the government typically specifies an amount for the performance bond (which is designed to protect the government's interest) that is equal to the contract price. However, the Miller Act and the Federal Acquisition Regulation (FAR) permit the government to specify a performance bond of a lesser amount as appropriate. Such would be the case if the contracting officer believed it would be beneficial for the government to self insure. If payment bonds were equal in amount to performance bonds, subcontractors and suppliers would be left without protection.

I understand that consideration is being given to a revision that would specify that the payment bond amount shall instead be equivalent to the value of the subcontracted contracts under the award. I am concerned that this amount may be difficult to determine, could change during contract administration, and thereby be costly and burdensome to administer.

Although these statutory fixes proposed at section 4(a) are problematic, I appreciate the underlying concern the Subcommittees are attempting to address. While the Miller Act allows contracting officers to require a higher level of payment bond protection, there is no central guidance to encourage and assist contracting officers in achieving this result. For this reason, I have asked the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council to initiate a FAR case. My desire is to see strengthened FAR coverage that results in contracting officers providing additional protection in the form of increased payment bonds.

With respect to my office's role in ensuring the issuance of regulations or publishing appropriate policies on these matters, I note that section 2 of H.R. 3032, as introduced, would amend the Office of Federal Procurement Policy Act to specify that the Administrator delineate policies for subcontractor protection, and assure publication of these policies in the FAR. The Administrator of OFPP already has sufficient authority to issue policies to ensure payment protections for subcontractors and suppliers, and to work with and through the other procuring agencies to publish such guidance in the FAR. Therefore, I do not believe this provision is necessary. I understand that consideration is being given to deleting this provision and I support this change.

Authorizing suit for non-timely payment of progress payments.

Second, section 4(b) of H.R. 3032, as introduced, would apply the Miller Act to progress payments and allow suit for non-timely payment of progress payments. We strongly oppose this provision. The Prompt Payment Act already provides an effective mechanism for ensuring timely payments on construction contracts by imposing interest penalties when bills for contract-compliant work are not paid on time. Creating a new mechanism to achieve this result will simply encourage litigation, which is time-consuming and expensive without adding benefit. Also of concern, the proposed mechanism, unlike the Prompt Payment Act, fails to recognize that satisfactory performance is a necessary prerequisite to payment. The Administration strongly encourages deletion of this provision in its entirety, and I understand such a change is under consideration.

Expanding protection to all subcontractors and suppliers.

Third, section 4(c) of H.R. 3032, as introduced, would amend the Miller Act to extend payment bond protection to all levels of subcontractors and suppliers, regardless of the tier. I do not believe that expanding the scope of protection to additional subcontractors and suppliers would be beneficial. The costs of extended coverage are likely to be substantial. As the surety industry exposure to risk increases, they will charge more for bonds, and these costs will be passed through to the Federal government. Subcontractors and suppliers have a duty to inquire as to the financial responsibility of their business partners. The government simply cannot indemnify, or be a part of, every private sector business arrangement. Nor should it be asked to serve as a substitute for responsible business decisions on the part of the contracting parties themselves.

I understand that an amendment to this provision is being considered to limit the expanded coverage only to those subcontractors on site. Unfortunately, this change will not improve construction contracting significantly and will likely result in costly litigation concerning, among other things, the definition of site, which subcontractors were on site, and for how long. Accordingly, I urge exclusion of this provision.

Holding contracting officers liable.

Fourth, section 4(h) of H.R. 3032, as introduced, would provide for contracting officer liability if a mistake occurs in obtaining or keeping an effective bond. As emphasized in our letter from this past February, the Administration strongly opposes this provision. The government should not be liable for a matter that can be easily verified by the subcontractor or supplier either before entering into a subcontract or any time during performance. It is my understanding that consideration is being given to deleting this provision. We strongly support such deletion.

Providing for payment of attorneys' fees.

Finally, section 4(g) of H.R. 3032, as introduced, would provide for the recovery of attorneys' fees in an attempt to discourage frivolous litigation. While the Administration appreciates the value in discouraging frivolous litigation, we would note that courts in the United States generally employ the "American rule" for civil private sector lawsuits, whereby attorneys' fees are not awarded to the prevailing party.

We understand that H.R. 3032 may be revised to require that only prevailing small claims -- those of fifty thousand dollars or less -- of small businesses be eligible for award of attorneys' fees. If an attorney's fee provision is deemed essential, this approach would at least be more equitably and narrowly tailored to providing relief to the small businessperson, who may be at a disadvantage in pursuing a claim.

Conclusion.

Over the past several years, the Administration and the Congress, working together, have made significant progress in improving the Federal procurement process. Statutes such as the Federal Acquisition Streamlining Act and the Clinger-Cohen Act -- along with regulatory and policy initiatives, such as those emphasizing the use of performance-based service contracting and the consideration of a contractor's past performance -- are helping agencies to make more effective use of our taxpayer dollars. I am confident that our continued bipartisan efforts in acquisition reform will enable us to build on this impressive progress. In this spirit, I welcome the opportunity to work with you to address the Administration's concerns with H.R. 3032 and to discuss the new regulatory efforts we are planning to undertake to provide subcontractors and suppliers with a better level of protection – a level that will ensure even more effectively that our taxpayer dollars for construction are spent on projects performed and completed in a fully successful and timely manner.

This concludes my prepared remarks. I would be pleased to answer any questions you or any members of the subcommittees might have.

Mr. HORN. We thank you for your opening statement, and I yield 10 minutes to the gentleman from Pennsylvania, Mr. Gekas, for the purpose of questioning.

Mr. GEKAS. I thank the Chair.

In your written statement and pursuant to your testimony here today, you indicated you intend to strengthen FAR coverage by, what, notifying the agencies that they should provide additional protection on payment bonds?

Ms. DEIDRE LEE. I have sent a letter over to the Civilian Agency Acquisition Council, and what the council will do is open a Federal Acquisition Regulation case on this. They will, I hope—and this is the guidance we will give them—work on adding language right into the Federal Acquisition Regulation, which is kind of the procurement bible, as you know, when you're issuing a construction contract, how you should think through, what is the appropriate amount of security, and should I increase beyond the two-and-a-half.

If you have a couple hundred million dollar construction contract, you ought to think through and say, hey, should I provide more security, and—in which case, what we would like to do is put some guidance right in there that kind of reminds the contracting officer, here's the things you ought to think about in determining the appropriate amount of security.

Mr. GEKAS. The letter would not amount to a proposed, propounded regulation; is that correct?

Ms. DEIDRE LEE. No, it would ask that a case be opened. And a case would be opened, and it would be published for public comment.

Mr. GEKAS. That will not guarantee the agency to act to promulgate a regulation pursuant to the suggestions in the letter; is that correct?

Ms. DEIDRE LEE. No, sir.

Mr. GEKAS. It's not correct?

Ms. DEIDRE LEE. It is correct, they will open a case; and then we will work through it, and there will be public comment to determine what exactly has changed.

Mr. GEKAS. I understand. But that does not guarantee that eventually a regulation pursuant to the spirit and letter of your letter would be promulgated; isn't that correct?

Ms. DEIDRE LEE. It does not guarantee it.

Mr. GEKAS. Yes.

Ms. DEIDRE LEE. I anticipate it.

Mr. GEKAS. Then you would have no objection if we took the spirit and letter of your letter and what you intended to complete through the regulatory process and simply insert into the bill, pass the bill, then your successor in office and the agency's successors would have a statute which they could follow in this regard? Wouldn't the purpose of your letter then be fully implemented that way?

Ms. DEIDRE LEE. Yes. And we could address some of these other issues.

After the statute is passed, we would write the case that would implement it into the Federal Acquisition Regulation.

Mr. GEKAS. Let the record indicate that the bill or language that we would incorporate reflecting the spirit and letter of the letter being interpolated into the bill would solve the problem at least as to that portion of the payment bond situation.

As a matter of fact, throughout your statement, you have indicated in different ways a sprinkling here and a sprinkling there, that you believe that some of the problems that we see can be met through the regulatory process. And I simply throw that back at you and say, if it can be cured by the regulatory process, we're willing to adopt the very language that you believe should be found in regulations for permanence in a statute.

So I want to make that clear, and I would ask you then to provide for us your version of what regulations should be adopted to meet these problems, which you say you want to work with us to try to solve, so that we would have the option then of simply incorporating the administration's language into a bill and then everybody would be in agreement and we would have a permanent set of rules that everyone can live with.

Ms. DEIDRE LEE. I would be happy to work on that.

Mr. GEKAS. Thank you. I have no further questions.

Mr. HORN. I now yield 10 minutes to the gentlewoman from New York, Mrs. Maloney.

Mrs. MALONEY. Thank you. I appreciate very much your testimony, but first would like to ask Congressmen Gekas and Horn if they would join me in sending the new amendment to you for official comment, the new amendment that we have. You commented on the last one, and we have a new amendment before us today that changes many of these things.

I think the point that you raised on quality control is tremendously important, and absolutely would work and support any efforts to incorporate quality control in this legislation or any legislation affecting procurement for the Federal Government. And the items that you raised on attorney fees and strengthening the onsite definition, you know, I certainly would work with you on that and support the administration's efforts on clarifying these two areas.

But the real, main point of the bill is really the bond, you know, making sure that it is 100 percent of the amount of the performance bond, which is typically 100 percent of the award value of the construction contract. And I really don't see any trouble in doing that, to reinforce what Congressman Gekas said about if you want to make a change through regulations, why don't you just change it in the law so it's clear and people can understand it.

In your statement, you said that you will be initiating a proposed change to the FAR that would permit a contracting over to request a payment bond in excess of $2.5 million. And staff has advised me that the FAR, in its legislative history, has not reflected such an interpretation since it was originally written in the 1970's.

So putting aside the legal question of whether you can change the Miller act's explicit declaration that the award value of the construction contract will exceed $5 million, why don't you just change it statutorily? I think changing it through regulation could be called into question, as Mr. Gekas said. And if everything can be done by regulation, what do you need a Congress for, what do you need laws for?

The Miller act is a law. If you want to change it, let's change the law, not ask someone to write a regulation. The next day that can be changed in another way, so——

Mr. HORN. I want my friend from New York to know that there are dreams of that in all administrations.

Mr. GEKAS. Would the lady yield for just a moment?

Mrs. MALONEY. I will absolutely yield to my good friend, Mr. Gekas.

Mr. GEKAS. To buttress what you said, the very nature of regulations is that they live or die with the existence of the agency that promulgates them. And the letters that are sent in suggestion for changes on the part of one administrator to another does do not survive sometimes the incumbency of the individual who sends the letter or promulgates or tries to promulgate a regulation.

But putting all of these ideas on which we agree into a statute, as the lady has said, as Steve knows, as we are asserting here, would solve everybody's problems for another generation. And, therefore, I support the lady's contention.

Mrs. MALONEY. And I truly believe that a regulation would be challenged, because how can you change the expressed, written law. I mean, it's there? So I think if we're going to change it, it can't be done as regulation as my colleague pointed out, which can be erased with each administration or each director, but we should legislate it.

In reviewing and getting ready for this hearing, I reviewed the legislative record of this legislation, the Miller act. And we could find only one reference to $2.5 million during a hearing before the House Judiciary Committee on March 8th, 1935, Edward H. Cushman of Philadelphia—Mr. Gekas, your State—a renowned construction attorney of the period said, "Personally, I believe that a payment bond of $2.5 million would be adequate on a job of $10 million."

So I think our question today is, is it adequate for a job of $50 million or $150 million or $250 million, or in the case of my constituent, $750 million?

Furthermore, I asked CRS, the legislative research body, to calculate what the $2.5 million threshold would be if simply adjusted for inflation. And they wrote back that it would be $29.3 million as of the end of 1997. And could you comment, you know, personally, I don't see common sense—common sense is $2.5 million in 1935 was adequate for a $10 million job, which was most of what our procurement was, now we're at billions sometimes, $750 million, our Federal buildings oftentimes are well over in the billions sometimes. So could you comment on updating the amount? I mean—well, you comment.

Ms. DEIDRE LEE. OK. I think it's time, we're 60 years down the road. You're right. It's time. But the intricacy of the bill is the fact, when the Miller act was passed in 1935, it cited those amounts. But it also said and the CO can require additional surety coverage. To me, I read that as common sense. Therefore, you should when it's appropriate and necessary.

But then when it turned into the regulation, it became more of a formula than use your good judgment, use your common sense. And so what I am saying, let's put that back in the regulation that says, you're clearly required to have $2.5 million if it's over the $5 million threshold.

However, you're also required to use some common sense and good judgment and say, would it be appropriate to have additional surety coverage on this case, in which case, what are my guidelines or what are my parameters to making that decision, and then go do it.

So that's the kind of change that I have asked for in the regulation. It certainly would not conflict, should we be able to get together and find a point on this legislation that wouldn't conflict, and I would hope we would line them up. But in the meantime, I felt it was so important that I went ahead and asked the committee to start working on what kind of guidance would we give a contracting officer to determine what is the right amount.

If we set a specific amount in legislation, I would like to see us have some flexibility, so we do address, is that the right amount for this job.

Mrs. MALONEY. Well, I think common sense also dictates that the right amount is 100 percent of the amount of the performance bond, which is typically 100 percent of the award value of the construction contract. That's very simple. Then that's not open to manipulation, that's not open to bribery. It's not open to exploitation. And I would argue that in the long run, it will save Federal dollars, because more people will be willing to go forward and give a bid knowing that they're going to get paid.

And so to me, I think common sense, if you're going to argue common sense, let's make it easy for the professionals, 100 percent, 100 percent, that's very simple. As introduced in this bill, it's 100 percent of the amount of the performance bond, which is typically 100 percent of the award value of the construction contract. And, to me, that is the bill; everything else is sort of bells and whistles that don't really matter. What we're trying to do is have it tied to the reality, and that is what I think is the important part of the bill.

Now, the administration and the GSA letter comment opposed this. And it said, "If a performance bond were waived by government, a very rare occurrence, there would be no payment bond, which would only hurt subcontractors and suppliers."

I mean, that was their argument against it, that it's going to be waived, when you and I know it's never waived, and as we amended it, 100 percent of the amount of contract performance which a prime contractor has made the business decision to subcontract. So, in other words, we're protecting the subcontractors.

What we're seeing unfortunately in New York, and possibly in other areas around the country, is because of this "loophole," I will call it, or ability to manipulate it, you will have a general contractor come in and he's secured, and then he will subcontract everything, run off with the money and they don't get paid.

So then you have a problem getting—you understand what I'm saying—which is happening. Mr. Levinson can speak for himself in the second panel; I hope you will stay for it. But that is specifically the problem, and we have tried to go forward.

Now, when we were talking with GSA and OFPP during staff decisions, they accepted this change in the language. But then when the administration statement came, they were opposed to it, and they said, "This amount may be difficult to determine, could change during contract administration and therefore be costly and burdensome to administer."

And so I just may be missing the point because as—my understanding in business, before being able to submit a bid, each general contractor competing for the prime contract will have to have assembled its subcontractor team in order to be able to submit the bid so their team is in place before they're in the competition area. And during performance, the contractor may add subcontractors to undertake work that they don't want to do, or they may fire them for poor performance and undertake the work themselves. But such changes are absolutely normal and, therefore, sort of the general history of what happens on the job.

The language, it appears to me to cover that and not be more of a burden to the administration. It actually would be helpful to the administration.

And last and in closing—the FAR, the Federal Acquisition Regulations, provides guidance to the contractor regarding increasing the amount of the performance bond when the total project has been increased due to unilateral government change orders, and this doesn't seem to present any administrative burden. And what makes it more burdensome to adjust the payment bond, it just seems to be a more efficient way, and one that reflects the reality of how business is conducted now on the site. And actually I think, raising it to 100 percent, as amended to the amount of contract for performance which, a prime contractor has made the decision to subcontract, I would argue would literally lower the cost of government bids or government contracts, because people would know they're going to be paid.

I'm going to take you to lunch, because you are working on something that I like, which is procurement, and we can talk further. But just your comments on that, and I have no other further questions. I have a few more in writing that we may submit to Mr. Horn, and if he likes them he will submit them to you.

Mr. HORN. Automatically, I like them, I will tell the gentlewoman from New York. And those questions will be submitted, and if you would give us the answers, they will be at this place in the record.

I thank the gentlewoman for her usual vigor in pursuing legislation. And we all appreciate that.

Let me just say, the ranking Democrat on the subcommittee came by. He's got unfortunately a number of key commitments that have to occur in the next couple of hours. But I want to put without objection the opening statement of Mr. Kucinich, the ranking Democrat in the record at this point or after the opening statements.

[The prepared statement of Hon. Dennis J. Kucinich follows:]

Statement of Rep. Kucinich
Hearing on H.R. 3032, the "Construction Subcontractors Payment Protection Act of 1998"

September 11, 1998

Thank you Mr. Chairman, and Chairman Gekas, for holding this joint hearing on H.R. 3032, the "Construction Subcontractors Payment Protection Act of 1998." I would also like to commend Rep. Maloney for introducing the legislation before us today, which seems to make a number of useful, modernizing changes to existing law.

This bill makes a number of amendments to the Miller Act, a law enacted in 1935 which requires two types of bonds to be secured by contractors on federal construction projects. Performance bonds protect the government in the event of a default by the prime contractor and are generally for 100 percent of the value of the contract. Payment bonds provide payment protection for subcontractors. Under the Miller Act, the limit of the payment bond is $2.5 million, and protection is only extended to first- and second-tier subcontractors. Construction industry practices have changes substantially since 1935, and the $2.5 million limit on the payment bond is clearly deficient in today's industry.

H.R. 3032 would also strengthen existing law by making some common-sense modernizations of Miller Act procedures for notice, filing claims and pursuing claims, thereby making the Act more consistent with current practice at the state and local government level, as well as in the private sector.

Thank you again Mr. Chairman. And welcome to our witnesses. I look forward to hearing your testimony.

Mr. HORN. And now I will yield 10 minutes for questioning to the gentleman from Texas, who is the vice chairman of this fine subcommittee. And we're glad to have you with us.

Mr. SESSIONS. Thank you, Mr. Chairman. Really, at this time, I have no questions for the witness. I am interested in people who will be on panel two. But I am invigorated once again by my colleague, Mrs. Maloney, and her questioning.

I will, for the record, tell you that Mrs. Maloney cornered me in an elevator one day to discuss this, and it was really an ambush and I was taken advantage of. But I want you to know that I am delighted that we're having this hearing today; and it's because of her, predominantly, that I'm here. And I appreciate the type of the discussion that's ensued, and I'm in support of allowing these rules and the statute to be the same.

Thank you, Mr. Chairman.

Mr. HORN. We thank you.

Mr. Inglis, I believe was here. Mr. Bryant was here. So it looks like we don't have any more questions at this point. And you're going to sit with us through the second panel.

Ms. DEIDRE LEE. Yes, sir.

Mr. HORN. So I'm going to now call the second panel up. Mr. Gekas will preside over that. And Mr. Fred Levinson, president of Levinson & Santoro Electric Corp.; Mr. Robert Lee, president, Lee Masonry, representing the American Subcontractors Association; Ms. Micki Weaver, secretary-treasurer, Weaver's Glass; Mr. Andrew Stevenson, contracts partner, Holland & Knight, representing the Associated General Contractors; Ms. Lynn Schubert, president, Surety Association of America, representing the American Insurance Association, National Association of Surety Bond Producers.

So—Mr. Levinson is going to speak first, so it goes the easiest way, just the way it is in the agenda. And then Mr. Lee, Ms. Weaver, so forth. But it looks like we're going to pick out Mr. Levinson from the middle.

[Witnesses sworn.]

Mr. HORN. The clerk will note that all five witnesses have affirmed, and Mr. Gekas will preside for this panel.

Mr. GEKAS. We thank the gentleman from California for his kind courtesy. And we will begin, as he has indicated, with individuals as they are listed in the agenda starting with Mr. Levinson.

You will be accorded the starting number of 5 minutes to present your testimony. Your written testimony, this applies to all, will automatically become a part of the record, without objection. And we will try to keep each individual within the 5 minutes, but some latitude would be accorded if it be necessary.

So we will begin with Mr. Levinson for 5 minutes.

STATEMENTS OF FRED LEVINSON, PRESIDENT, LEVINSON & SANTORO ELECTRIC CORP.; ROBERT E. LEE, PRESIDENT, LEE MASONRY, REPRESENTING THE AMERICAN SUBCONTRACTORS ASSOCIATION; MICKI WEAVER, SECRETARY-TREASURER, WEAVER'S GLASS; ANDREW STEPHENSON, CONTRACTS PARTNER, HOLLAND & KNIGHT, REPRESENTING THE ASSOCIATED GENERAL CONTRACTORS; AND LYNN SCHUBERT, PRESIDENT, SURETY ASSOCIATION OF AMERICA, ALSO REPRESENTING THE AMERICAN INSURANCE ASSOCIATION AND THE NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS

Mr. LEVINSON. Thank you. Chairman Horn, Chairman Gekas, Congresswoman Maloney, members of the subcommittees, I'm honored to be before you today to discuss H.R. 3032, the Construction Subcontractors Payment Protection Enhancement Act of 1998. I fully support H.R. 3032 and believe it would fix the deficiencies of the Miller act. If this 63-year-old law had been updated with the proposed changes, it could have saved my company from the disasters we experienced because of the act's shortcomings.

I have firsthand knowledge of the defects of the Miller act. I would like to offer my company's story as a testimony as to why the Miller act must be amended.

In 1993, my company, Levinson & Santoro Electric Corp., contracted with Morganti National for $11.8 million worth of electric work on a Federal prison being built in my birthplace, the Borough of Brooklyn, New York. In May 1997, the Federal Bureau of Prisons terminated the contract with Morganti National. Subsequently, I did not receive payment for literally millions of dollars' worth of work done on time and to specifications.

After learning that the contract was being terminated, I discussed using my Miller act bond rights with my attorney, only to learn that, because of the size of the project, more than $103 million, the maximum amount that could be recovered through the bond was $2.5 million. That $2.5 million was the maximum total for all claims on the project. It is my understanding that the claims on the Miller act now total more than $30 million for that entire job.

I had to face the simple fact that my company was not going to be paid for the work it had done. While I have filed civil suit against Morganti National for $9.5 million, I anticipate the legal process taking many years with high legal fees. My only resource in this situation is to receive pennies on the dollar from an inadequate Miller act bond, a bond that, despite the intent of Congress, does not protect the subcontractors.

Because of the multimillion dollar loss, my company faced the real danger of bankruptcy. We had not been paid for work we had done, but we still had to meet payroll every week and pay payroll taxes; supplies still had to be paid for and all of the other expenses involved in running my business still had to be paid on time. In other words, we financed this work for the general contractor and the Federal Government, but we never got paid.

Before the incident, Levinson & Santoro employed more than 120 men and women in the New York City area. Following the prison job, we only had 15 employees. Before the multimillion dollar loss, we did more than $20 million of work annually. The year following the Miller act disaster, we did less than $2 million worth of work.

I am proud to say that while we still face many difficult difficulties, my company has weathered the roughest part of the storm and is working its way back to full strength. We have a long way to go, but I am confident that we will make a full recovery.

While I am proud of the strides we have made, I do not believe that many subcontractors would have had the ability to survive. I am lucky that my company, one that I built up over a 20-year period, was capable of taking this kind of hit and still surviving. If we had not been such a strong and productive company, we would no longer be in business.

I also feel compelled to emphasize how much easier it would have been for me to simply declare bankruptcy, scratch the losses and move on with my life. While this option would have been better for me financially, I chose to work to keep my company alive. Most subcontractors would not have that choice in a similar situation. They would have been forced to declare bankruptcy and put their employees on the street.

I have done Federal work for more than 30 years, and I believe I have offered a valuable service to the government at the lowest price. And at this point I cannot or will not allow my company to bid on Federal projects unless the Miller act is amended to fully protect subcontractors. I cannot afford to risk my company, my livelihood, and the livelihood of my employees and their families because the Miller act fails to protect subcontractors.

I encourage the members of these subcommittees to take the deficiencies of the Miller act seriously. When Congress first enacted the Miller act in 1935, it intended to protect the men and women who were working on public construction. The normal avenues of resource were not available and are still not available when doing public construction. Thus, the Miller act was enacted.

The Miller act no longer offers subcontractors the protection that was originally intended. Today, the construction business is dramatically different than it was in 1935. Perhaps $2.5 million was enough in 1935, but with contracts valid in the hundreds of millions of dollars, it is not enough now. I know because under the Miller act, my company was almost destroyed and the majority of my employees lost their jobs.

The act needs to be amended so that it does protect the men and women who build Federal buildings. Until the Miller act is amended, I will not be one of those men.

Thank you for inviting me to speak to you today. I will be happy to answer any questions that the members of the subcommittee may have regarding my experience.

[The prepared statement of Mr. Levinson follows:]

Chairman Horn, Chairman Gekas, Members of the Subcommittees, I am honored to be before you today to discuss H.R. 3032, the Construction Subcontractors Payment Protection Enhancement Act of 1998. I fully support H.R. 3032 and believe it would fix the deficiencies of the Miller Act. If this 63 year old law had been updated with the proposed changes, it could have saved my company from the disasters we experienced because of the Act's shortcomings.

I have a first hand knowledge of the defects of the Miller Act. I would like to offer my company's story as testament to why the Miller Act must be amended.

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Subsequently, I did not receive payment for literally millions of dollars worth of work done on time and to specifications.

After learning that the contract was being terminated, I discussed using my Miller Act Bond rights with my attorney, only to learn that, because of the size of the project, more than $103 million, the maximum amount that could be recovered through the payment bond was $2.5 million. That $2.5 million was the maximum total for all claims on the project. It is my understanding that claims on the Miller Act now total more than $30 million for the entire job; I had to face the simple fact that my company was not going to be paid for the work it had done.

While I have filed a civil suit against Morganti National for $9.5 million, I anticipate the legal process taking many years with high legal fees. My only recourse in this situation is to receive pennies on the dollar from an inadequate Miller Act bond – a bond that, despite the intent of Congress, does not protect subcontractors.

Because of the multi-million dollar loss, my company faced the very real danger of bankruptcy. We had not been paid for the work we had done, but we still had to meet payroll every week and pay payroll taxes. Suppliers still had to be paid. And all of the other expenses involved in running my business still had to be paid on time. In other words, we financed this work for the general contractor and the federal government, but we never got paid.

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While I am proud of the strides we have made, I do not believe that many subcontractors would have had the ability to survive. I am lucky that my company, one that I built up over a twenty-year period, was capable of taking this kind of hit and still surviving. If we had not been such a strong and productive company, we would no longer be in business.

I also feel compelled to emphasize how much easier it would have been for me to simply declare bankruptcy, scratch the losses and move on with my life. While this option would have been better for me financially, I chose to work to keep my company alive. Most subcontractors would not have that choice in a similar situation; they would have been forced to declare bankruptcy and put their employees on the street.

I have done federal work for more than 30 years, and I believe that I have offered a valuable service to the government at the lowest possible price. I cannot, and will not, allow my company to bid on a federal construction project again unless the Miller Act is amended to fully protect subcontractors. I cannot afford to risk my company, my livelihood, and the livelihood of my employees and their families, because the Miller Act fails to protect subcontractors.

I encourage the Members of these subcommittees to take the deficiencies of the Miller Act seriously. When Congress first enacted the Miller Act in 1935, it intended to protect the men and women who were working on public construction. The normal avenues of recourse were not available, and are still not available, when doing public construction. Thus the Miller Act was enacted. The Miller Act no longer offers subcontractors the protection that was originally intended.

Today, the construction business is dramatically different than it was in 1935. Perhaps $2.5 million was enough in 1935, but with contracts valued in the hundreds of millions of dollars, it is not enough now. I know, because under the current Miller Act my company was almost destroyed, and the majority of my employees lost their jobs.

The Act needs to be amended so that it does protect the men and women who build federal buildings. Until the Miller Act is amended, I will not be one of those men.

Thank you for inviting me to speak to you today. I will be happy to answer any questions that Members of the subcommittees have regarding my experience.

Mr. GEKAS. We thank the gentleman and we return to the second individual listed on the agenda, Robert E. Lee. I'll make no historical comments about his name.

Mr. ROBERT LEE. Thank you. You've put me a little more at ease. It's rather rough on a demo masonry contractor from Tennessee to come up here. I'm a little bit nervous. Some indulgence with the light would be appreciated. Other than that, today I'm here representing the American Subcontractors Association. It's a national association of 6,500 specialty trade contractors that have 69 State and local chapters.

Is that better? Thank you.

For the record, neither Lee Masonry nor the American Subcontractors Association have received any Federal grants or contracts in the last 3-years. Lee Masonry is a small business in Nashville, TN, very small. I founded Lee Masonry as a new company in 1976. However, I am a second-generation masonry contractor living under the antiquated Miller act.

My father started laying brick in 1921 at the age of 13. At that time he was employed by the architect who was also the general contractor on the job. Until 1954, well after the Miller act was passed, he worked directly for the general contractor on projects such as Oak Ridge and the TVA installations. That year, 1954, for the first time, he worked on the job that was subcontracted to a masonry subcontractor instead of working directly for the general contractor.

The construction industry has changed radically since those times. Today there is often a construction manager who is the prime contractor of record on the job who then subcontracts out various portions of that work to general contractors who then subcontract most, if not all, of the work to specialty trade contractors who often may subcontract out particular areas of the job that they are doing. I believe that comes to four tiers instead of two that we discussed earlier, if my math is right.

Sounds like a different construction world industry from 1935. Believe me, it is.

After 63 years, the Miller act needs to reflect those changes. With all the changes in procurement law, the Miller act has undergone almost no change. The Federal Government has updated many of its business practices regarding construction contracts. Now it's time to update the Miller act. The Federal Government should protect subcontractors at least as well as the majority of the States do and the private sector. It does not.

ASA believes that the Miller act must be modernized and streamlined if it is to live up to its original intent; that is to protect all persons supplying labor and materials on Federal Government construction projects. ASA strongly supported H.R. 3032 and believes it will go a long way toward improving the effectiveness of the Miller act.

There are some in the construction and insurance industries that want to live in the past and use the business practices of my father's era. I would like to take my remaining time to address some of the critics of H.R. 3032.

Some of these critics say the bill will make the prime contractor responsible for payments to all subcontractors and suppliers. Under the current Miller act, the general contractor already is responsible for providing payment bond protection to first-tier and second-tier subcontractors and their suppliers. Clearly, modern construction projects are more complex than in the 1930's. Nevertheless, the general contractor has responsibility for coordinating all tiers of subcontractors' work and safety on the job site, and they should be responsible for seeing that all tiers are paid.

Some suggest the delay required for filing suit under the Miller act has been fully litigated over the last 60 years. They say this change would only serve to increase litigation costs. In fact, H.R. 3032 actually seeks to expedite the resolution of payment claims. The Miller act requires that a subcontractor wait 90 days after last performing work or furnishing materials on the job before bringing suit.

ASA believes that once the general contractor has denied payment, prohibiting a subcontractor from pursuing his right to payment is unjustified. Opponents of the legislation argue that general contractors should be allowed to force subcontractors to waive their payment rights. They conveniently ignored that once the government awards the general contract, the general contractor becomes a monopolist. Some subcontractors have little or no negotiating leverage.

Finally, some groups have even opposed modernizing the way a notice can be delivered to a prime contractor by stating that computer technology is not available that would provide accurate proof of receipt. Of course that's not what H.R. 3032 requires.

Currently, the Miller act requires that notice of prime—notice to the prime contractor of intent to bring suit under the payment bond must be transmitted by registered mail provided by the U.S. Postal Service. H.R. 3032 would simply permit notice by any means which provides proof of receipt such as Certified Mail, Express Mail, Federal Express, UPS, Airborne Express, and even hand delivery, and of course the legislation anticipates the expanded use of electronic commerce. Therefore, H.R. 3032 would recognize a notice provided by electronic means only if such notice—such electronic method can generate proof of receipt. In fact, it's my understanding that you can do that today with e-mail, actually guarantee receipt.

Subcontractors build the buildings, whether it's a Federal courthouse, a local school building, or a bridge over the Cumberland River in Tennessee. To paraphrase from Oldsmobile, it's not my father's construction industry. The Miller act should be modernized to reflect the construction industry of today.

Thank you.

[The prepared statement of Mr. Lee follows:]

STATEMENT ON
H.R. 3032
Construction Subcontractors Payment Protections Enhancement Act of 1998

The American Subcontractors Association is a national trade association with more than 6,500 firms representing all major construction trades in 69 chapters.

ASA is the only national organization that speaks exclusively for the interests of construction subcontractors. ASA is dedicated to improving the general business conditions for subcontractors through unified and cooperative actions.

Many ASA members perform construction for the Federal Government. Sometimes they serve as prime contractors, contracting directly with the Federal Government. More often, they serve as subcontractors, dealing with the Government only through a prime contractor. In both situations, these specialty trade contractors have a direct and real interest in the Federal Government's construction program, particularly their ability to get paid for work properly performed.

In an ASA survey of subcontractors, the overwhelming majority of subcontractors participating reported that the inability to get paid in a timely manner is their most serious problem. Construction subcontractors are very typical of American businesses: They lay out large sums for materials prior to the start of work. They must promptly pay their labor as required by law. Yet they do not have large capital reserves that would permit long, unexpected and unnecessary delays in receiving full payment for work properly performed.

For a big business, a delay in payment may cause some consternation in the bookkeeping department, but otherwise, business would go on as usual. However, for a small firm, the size of most construction subcontractors, one payment, received late or not at all, might mean the difference between survival and disaster.

The fundamental need of subcontractors who furnish labor and materials to a construction project to be paid has long been recognized. In order to protect subcontractors and suppliers, the various states have enacted lien laws that allow a subcontractor to attach the property being improved and to secure a certain priority of payment, thereby aiding in the collection of sums due for services rendered on private construction projects. However, public property, in effect owned by the people and subject to the legal theory of "sovereign immunity" may not be liened.

Congress recognized this dilemma when it enacted the Miller Act in 1935. In addition to requiring a performance bond to guarantee completion of the project, the Miller Act requires a payment bond to be posted in a penal sum determined by the contract amount with the maximum amount on the payment bond being $2.5 million. The main purpose of the Miller Act is to protect all persons supplying labor and material on United States Government construction projects where lien rights are unavailable

At the time of enactment, and as later amended, the Miller Act was considered good legislation and, up to a point, it has been. However, it has fallen short in many areas. Today, its protections for subcontractors are often more perceived than real.

The construction industry has changed dramatically in the more than 60 years since the Miller Act was enacted. Today, most general contractors perform only a small fraction of the job site construction work. On Federal projects, that percentage is usually no more than 20 percent, and frequently much less. Instead, work is subcontracted to firms that specialize in particular fields.

Many subcontractors on Federal work have been forced to operate on borrowed capital, sometimes paying a high rate of interest, while waiting to collect full payment on work completed and accepted. Others have been financially ruined. Yet most subcontractors will not resort to the Miller Act payment bond unless the prime contractor appears to be insolvent.

ASA believes that the Miller Act must be amended in several areas if it is to once again live up to the expectations of Congress and reflect current business practices. We believe it is time for the Miller Act to be modernized and streamlined so that it once again provides protections for subcontractors and suppliers on Federal construction projects.

Making the Miller Act Work for the 21st Century

ASA strongly supports amending the Miller Act to reflect current business practices. We believe the following amendments will go a long way toward improving the Act's effectiveness in dealing with the problems the Act was designed to address. ASA is strongly supports both H.R. 3032 and the amendment offered in the nature of a substitute.

Require the Payment Bond to Equal the Performance Bond

Under the Miller Act, the Government is protected by a performance bond in an amount the contracting officer "deems adequate for the protection of the United States." That amount is usually 100 percent.

Subcontractors, however, are protected by a payment bond which is only one-half of the contract amount if the contract is less than $1 million; 40 percent of the contract amount if the contract is between $1 million and $5 million; and a $2.5 million maximum if the contract is for more than $5 million. Since its enactment in 1935, the maximum dollar protection for a subcontractor under the Miller Act has been severely eroded by inflation. In any event, ASA believes that subcontractors deserve protection in an amount equal to that of the Government.

Thirty-five states have already agreed with this concept. Payment bonds for state public works projects in these states must equal the amount of the performance bond or contract amount. Eight other states provide subcontractors better protections than found in the Miller Act.

ASA supports the provision in H.R. 3032 that would make the payment bond at least equal to the performance bond (section 4(a)).

The proposed amendment in the nature of a substitute would limit that payment bond to the amount of the contract that the general contractor subcontracts. This potentially will be of assistance to subcontractors, but ASA is concerned that unscrupulous general contractors may underreport the subcontracted amount, leaving some subcontractors unprotected.

Prohibit Waiver of Payment Rights

Allowing a general contractor to require its subcontractors to waive their basic right to payment for work performed negates Congressional intent of the Miller Act. Today, some agreements between a general contractor and subcontractor require the subcontractor to waive, directly or indirectly, its rights under the Miller Act. Such subcontract provisions often are designed to protect the general contractor and its surety by providing them with defenses on a bonded job. The proponents of this argument conveniently ignore that most of the leverage in a contract negotiation lies in the hands of the general contractor.

Under H.R. 3032, any waiver must be in writing and may be made only after a subcontractor or supplier has accrued the right to bring suit under the Miller Act payment bond. Today, there is no effective constraint on an unscrupulous general contractor who would extract from a subcontractor or supplier a "voluntary" waiver of its Miller Act payment bond protection as a condition to getting the job.

ASA supports the provision of H.R. 3032 that would nullify any contract provision that would directly or indirectly waive a subcontractor's rights under the Miller Act (section 4 (d)).

Award Attorney's Fees and Interest to Successful Party

Many assume that a general contractor or its surety settles payment claims upon receipt of notice and after investigation of the merits and validity of the claim. However, ASA has received many complaints from unpaid subcontractors that a surety's first response to their claim is "so sue me." The surety's disclaimer, failure to respond, or other act has demonstrated that it is necessary to resort to actual court action in order to secure the satisfaction of the claim.

In some cases, the claimant is reluctant to initiate litigation because it is clear that the legal and court costs will be so high in proportion to the amount that could be recovered as to constitute an effective legal barrier to the very protection that Congress has statutorily prescribed.

Thus, the payment bond protection afforded by the Miller Act has operated unevenly. For large firms that take on sizable subcontracts and whose claims may be sufficiently large to permit litigation, the bonds offer some limited protection. For those whose claims are small, and who most often are very small firms, the protection is not available from a practical standpoint.

ASA supports the provision In H.R. 3032 that would permit an unpaid subcontractor whose claim is valid, and who can litigate successfully, to recover interest and the reasonable cost of legal fees with respect to a small claim ($100,000 or less). (section 4 (g)).

The proposed amendment in the nature of substitute would limit the dollar value of a small claim to $50,000 and would make the attorneys fees only available to a small business. While we are supportive in general of this amendment, we believe the original language in H.R. 3032 provides better protections for subcontractors and will force surety companies to re-evaluate their "so sue-me" approach to settlement of valid claims.

ASA would also support a provision that would allow a court to award attorneys' fees and interest to a successful claimant regardless of the size of the business or Miller Act claim.

End "Premature Notice" Defense

The Miller Act requires certain subcontractors and suppliers -- those who do not have a direct contractual relationship with the general contractor -- to provide written notice to the general contractor within 90 days from the date on which they last performed labor or supplied materials for which their claims are made. Some courts have ruled that notice given before the actual final day of work is premature and therefore dismissed the suit. These court rulings provide the general contractor and its surety with a technical defense to an otherwise recoverable Miller Act suit.

ASA supports the provision in H.R. 3032 that would prohibit a court from dismissing a complaint merely because this notice was filed prematurely (section 4 (f)).

The provision in the proposed amendment in the nature of a substitute is the same provision as found in H.R. 3032.

Allow Notice with Sufficient Proof of Receipt

The Miller Act requires certain subcontractors and suppliers -- those that do not have a direct contractual relationship with the general contractor -- to provide written notice to the general contractor that they intend to institute action under the Miller Act. This notice must be given by "registered mail." Although most courts have excused this requirement when it has been shown that a general contractor actually received notice, it may still provide the general contractor and its surety with a technical defense to an otherwise recoverable Miller Act suit.

ASA supports the provision in H.R. 3032 that would allow a subcontractor to provide notice by any system of delivery that provides sufficient proof of receipt by the general contractor (section4(e)).

The provision in the proposed amendment in the nature of a substitute is the same provision as found in H.R. 3032.

Modify the Waiting Period for Filing Suit

The Miller Act requires a claimant to wait 90 days after he last performing labor or furnishing material on the project before filing suit. Although most courts have excused this requirement, it still may provide a surety with a technical defense to an otherwise recoverable Miller Act suit.

ASA supports the language in H.R. 3032 that would allow a waiver of the 90 day waiting period when the subcontractor receives a written denial of his claim from the prime contractor (section 4(c)(3)). There is no reason to require a subcontractor to wait 90 days when he knows that payment will not be forthcoming during that period.

The provision in the proposed amendment in the nature of a substitute is the same provision as found in H.R. 3032.

Extend the Protections of the Miller Act to Progress Payments

Under the Miller Act, a subcontractor may not file suit under the payment bond until 90 days after the payment is due. A subcontractor has no right under the Miller Act to assure the receipt of periodic progress payments. This problem is exacerbated by terms, frequently found in subcontracts, which prohibit a subcontractor from stopping work because of nonpayment. On a job of lengthy duration, a subcontractor could be forced to work for months or even years without compensation with no recourse until the job is completed.

ASA supports the language in H.R. 3032 that would extend the protections of the payment bond to monthly progress payments.

This provision has been stricken in the proposed amendment in the nature of a substitute, and ASA strongly supports its inclusion in any legislation that moves forward.

Extend the Protections of the Miller Act to Lower Tiers

Coverage under the Miller Act, and hence the right to bring an action under the general contractor's Miller Act payment bond, extends to those persons in direct contractual relationship with the general contractor, and those who have a direct contractual relationship with a first-tier subcontractor but have no direct relationship with the general contractor. Thus, the right to sue and recover under the Miller Act extends no further than the supplier to a subcontractor and a second-tier subcontractor (a sub-subcontractor). Yet there may be multiple tiers of subcontractors on a federal project. This has become increasingly common with the advent of construction management, general contractors that do no part of the actual construction themselves, and increased specialization in construction.

ASA supports the language in H.R. 3032 that would extend the protections of the Act to all subcontractors and their suppliers.

The proposed amendment in the nature of a substitute would limit those covered by the Miller Act to all subcontractors working on the jobsite and their suppliers. ASA believes this change is acceptable because it will still cover a significant number of those subcontractors at greatest risk on a construction project.

Extend Liability to the Government if Its Agent Fails to Assure that a Proper Bond Is In Place

In the event that the general contractor does not post a Miller Act bond, the contract is voidable and can be terminated by the government at its option. If the government does not terminate the contract, and the contractor defaults, the subcontractor claimant has no standing to sue the government for payment since it is not in privity with the government. As stated by the U.S. Court of Appeals for the Seventh Circuit:

> "The result is . . . unjust. A subcontractor who fulfills his part of the bargain should not suffer because the prime contractor defaulted, and the government contracting officer had not insisted on compliance with the Miller Act. We agree that there is a practical problem . . . that is not addressed by the Miller Act, but that is a problem that can only be addressed, and redressed, by Congress."

In recent years, many of the rules for procurement have changed to provide government contracting officers with an unprecedented number of rights, almost dictatorial authority to use their own judgement with little recourse. However, government contracting officers are not held accountable for their actions, and, in many cases, do not even have to keep records of their actions.

The U.S. Court of Appeals for the Ninth Circuit also commented on this failing in the Miller Act. The Ninth Circuit Court ruled in the fall of 1997 that a subcontractor does have standing to sue the Federal Government for failure to ensure that a Miller Act bond is in place.

The U.S. Army entered into a public improvement contract with a general contractor that was incapable of securing the statutorily required Miller Act bond. No bond was in place on the project, and the general contractor was eventually defaulted on the job. The contracting officer knew of the lack of a bond and still awarded the contract to the non-responsive, and seemingly non-responsible, general contractor.

Blue Fox Inc., a small subcontractor working on the project, was not paid for the work it had performed. After learning that there was no Miller Act bond in place, Blue Fox sued the Army claiming that it was not suing for damages, but it was instead suing for exactly what the contract was intended to provide. Blue Fox merely wanted to receive payment for work done properly and in a timely fashion. The Appeals Court agreed and ruled in favor of the subcontractor.

The U.S. Supreme Court will review the case on appeal in its upcoming session.

ASA supports the language found in H.R. 3032 that would place an affirmative obligation on the government to assure general contractor compliance with the Miller Act. Under such a provision, the government would be liable to the subcontractor if the contracting officer fails to assure that the general contractor provided a suitable bond. ASA believes it is wrong -- and an abrogation of Congressional intent -- for a subcontractor to suffer a financial loss because of the government's failure to enforce the Miller Act. A government contracting officer should at the least be held responsible for ensuring that a statutorily required bond is in place before the awarding of a contract.

The proposed amendment in the nature of the substitute removes this provision. ASA believes that the provision should remain in any bill approved by Congress and that contracting officers should be held responsible for their actions.

Define the Notice as Timely if the Subcontractor Sends It Within the 90-Day Notice Period

At least one court has ruled that the subcontractor's notice is timely only if the general contractor *receives* it within the 90-day notice period. However, once the subcontractor turns it over to the U.S. Postal Service for delivery by "registered mail," it no longer can control the timing of delivery. So, no matter how early the subcontractor sends the proper notice, given the statutorily-mandated delivery method, it has no guarantee that it will be received by the general contractor in a timely manner.

ASA supports an amendment to the Miller Act that would define notice as timely if the subcontractor sends it within the 90-day notice period.

Allow the Filing of a Suit up to One-Year after Anyone has Furnished Labor or Material on a Project

The Miller Act requires a subcontractor to file suit within one year from its last date of furnishing labor or material on a project. This is a serious problem, particularly for "early finishing" trades on projects where retainage is held.

For example, a subcontractor whose work may be completed during the first few months of a two or three-year project, may have its final payment delayed for several years beyond its completion date. If the subcontractor files suit within the one-year, the general contractor and the surety may defend on the ground that the money is not yet due. If the subcontractor waits beyond the one year, it loses all rights under the Miller Act.

This is especially problematic when dealing with retainage. Retainage is the holding of funds by a general contractor from a subcontractor contractor until the completion of a contract. A subcontractor might not know whether or not it will get its retainage from the general contractor, and by the time it is determined, Miller Act rights have expired.

On a large federal project such as the Ronald Reagan Building in Washington, DC, or the Pentagon renovation, retained funds can be held for years. Because of retainage, many subcontractors do not receive funds they have already earned for work properly performed. Subcontractors, in effect, are asked to act as bankers by financing the construction of buildings through retainage.

ASA supports an amendment to the Miller Act to allow the filing of suit up to one-year after anyone has furnished labor or material on the project.

STATES PROVIDE BETTER PROTECTION FOR SUBCONTRACTORS WORKING PUBLIC PROJECTS

All 50 states, and the District of Columbia, have adopted their own statutes, which have been referred to as "Little Miller Acts," to protect subcontractors and suppliers involved with state construction projects. In many instances, state legislatures have been more aggressive than the federal government in protecting subcontractor rights on state construction projects. Appendix A includes a chart that compares state laws with the H.R. 3032 and other proposed amendments to the Miller Act.

SUMMARY

The American Subcontractors Association believes that the 1935 Miller Act must be modernized and streamlined if it is to live up to its original intent -- to protect all persons supplying labor and materials on United States Government construction projects.

The American Subcontractors Association supports H.R. 3032, and believes that the Miller Act must be amended in several areas if it is to once again live up to the expectations of Congress -- and more importantly, protect the subcontractor and supplier on federal construction projects. ASA supports amendment to the Miller Act to:

- require the payment bond to equal the performance bond;
- prohibit the waiver of rights under a payment bond;
- allow the award of attorneys' fees and interest to a successful claimant on small claims;
- allow a claimant to provide notice at any time prior to 90 days after furnishing labor or materials;
- allow notice to a prime contractor by any method that provides sufficient proof of receipt;
- allow the filing of suit upon the denial of a claim;
- extend the protections of the Miller Act to progress payments;
- extend the protections of the Miller Act to lower tiers;
- extend liability to the Government if its agent fails to assure that a proper bond is in place;
- define the notice as timely if the subcontractor sends it within the 90-day notice period; and
- allow the filing of a suit up to one-year after anyone has furnished labor or material on a project.

ASA asks the members of the two subcommittees to seriously consider the issues raised in this statement and urges prompt action on legislation to amend the Miller Act. ASA's members and resources stand ready to assist in this important endeavor.

Appendix A

Public Surety Bonds in the States*

Compared with H.R. 3032 and other proposed Miller Act amendments

State	require the payment bond to equal the performance bond	extend liability to the Government if its agent fails to assure that a proper bond is in place	prohibit the waiver of rights under a payment bond	allow the award of attorneys' fees and interest to a successful claimant on a small claims	allow a claimant to provide notice at any time prior to 90 days after furnishing labor or materials	allow notice to a prime contractor by any method that provides sufficient proof of receipt	define the notice as timely if the subcontractor sends it within the 90-day notice period	allow the filing of suit upon the denial of a claim	allow the filing of a suit up to one-year after anyone has furnished labor or material on a project	extend the protections of the Miller Act to progress payments	extend the protections of the Miller Act to lower tiers.
AL	50%			Yes					Yes		
AK											
AZ	=		L/B	Yes		Yes					
AR	=								Yes		Yes
CA						Yes					
CO	50%								6 mos.		
CT	=			Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
DE	=										Yes
DC											
FL	=		Yes	Yes	Yes		Yes	Yes		Yes	Yes
GA	=	Some				Some Addt'l					Yes
HI	=										Yes

Public Surety Bonds in the States: Compared with H.R. 3032 and other proposed Miller Act amendments –page 2

State	require the payment bond to equal the performance bond	extend liability to the Government if its agent fails to assure that a proper bond is in place	prohibit the waiver of rights under a payment bond	allow the award of attorneys' fees and interest to a successful claimant on a small claims	allow a claimant to provide notice at any time prior to 90 days after furnishing labor or materials	allow notice to a prime contractor by any method that provides sufficient proof of receipt	define the notice as timely if the subcontractor sends it within the 90-day notice period	allow the filing of suit upon the denial of a claim	allow the filing of a suit up to one-year after anyone has furnished labor or material on a project	extend the protections of the Miller Act to progress payments	extend the protections of the Miller Act to lower tiers.
ID	50%	Yes		Yes		Some addt'l					Yes
IL											Yes
IN	=										Yes
IA	75%				Yes						
KS	=										
KY	=										
LA	50%	Yes		Partial		Some addt'l					
ME	=										
MD	50%					Some addt'l	Yes				
MA	=				Similar provision						Yes
MI	=					Yes					Yes
MN	=	Yes	Yes	Yes	Yes 120 days		Yes	Yes		Yes	Yes
MS	=										
MO	=										
MT	=					Some addt'l					

Public Surety Bonds in the States: Compared with H.R. 3032 and other proposed Miller Act amendments –page 3

State	require the payment bond to equal the performance bond	extend liability to the Government if its agent fails to assure that a proper bond is in place	prohibit the waiver of rights under a payment bond	allow the award of attorneys' fees and interest to a successful claimant on a small claims	allow a claimant to provide notice at any time prior to 90 days after furnishing labor or materials	allow notice to a prime contractor by any method that provides sufficient proof of receipt	define the notice as timely if the subcontractor sends it within the 90-day notice period	allow the filing of suit upon the denial of a claim	allow the filing of a suit up to one-year after anyone has furnished labor or material on a project	extend the protections of the Miller Act to progress payments	extend the protections of the Miller Act to lower tiers.
NE						Some addt'l					
NV	50%										
NH	=				Yes – case law						
NJ	=										
NM	=										
NY	=				Yes	Some addt'l		Yes	Yes	Yes	Yes
NC	=			Yes	Yes		Yes	Yes	Yes	Yes	
ND	=	Some									
OH	=		Yes		Yes	Yes	Yes	Yes	Yes	Yes	Yes
OK	=										
OR	=	Yes			Yes 120 days	Some addt'l	Yes	Yes	Yes 2 yrs.		
PA	=					Some addt'l					
RI	50%					Some addt'l			Yes		
SC	=				Yes			Yes			
SD	=								Yes		

Public Surety Bonds in the States: Compared with H.R. 3032 and other proposed Miller Act amendments –page 4

State	require the payment bond to equal the performance bond	extend liability to the Government if its agent fails to assure that a proper bond is in place	prohibit the waiver of rights under a payment bond	allow the award of attorneys' fees and interest to a successful claimant on a small claims	allow a claimant to provide notice at any time prior to 90 days after furnishing labor or materials	allow notice to a prime contractor by any method that provides sufficient proof of receipt	define the notice as timely if the subcontractor sends it within the 90-day notice period	allow the filing of suit upon the denial of a claim	allow the filing of a suit up to one-year after anyone has furnished labor or material on a project	extend the protections of the Miller Act to progress payments	extend the protections of the Miller Act to lower tiers.
TN	=					Some addt'l					
TX	=										
UT	=	Yes		Loser pays					case law retainage		
VT											
VA	=										
WA	=	Yes		Loser pays	Yes	Yes	Yes	Yes	Yes, but 4 mos.		
WV	=										
WI	=										
WY	50%								Yes		Yes

*** Sources:**

Lien and Bond Claims in the 50 States, American Subcontractors Association, Inc., © 1998
Bonds on Public Works, National Association of Surety Bond Producers, © 1997
Attorneys Council of the American Subcontractors Association

Mr. GEKAS. We thank the gentleman and now return to Micki Weaver, who is personally known to this member and who operates a business in my hometown, in our hometown, which has gained an excellent reputation for quality service and a place in the community worthy of the work that is expended by Ms. Weaver in the pursuit of her enterprise. So we ask her to proceed with her testimony.

Ms. WEAVER. Good morning. Thank you, Chairman Gekas, Chairman Horn. It's a pleasure to be here today. I'm the owner of Weaver's Glass, like Chairman Gekas said, located in Harrisburg, PA. My husband and I started Weaver's Glass in 1986. We're a contract glazer. We install glass and aluminum on commercial projects.

We're a small business. We employ 20 people. We do about $3 million worth of work a year. While this changes from year to year, approximately 25 percent of our work is on Federal projects.

There are two specific arguments I would like to address today, made in opposition to H.R. 3032. The first is that the bond costs would increase if the payment bond equals the performance bond. The second is that the construction costs will increase if the payment bond is made equal to the performance bond.

I do not agree with these arguments. While the surety industry could intentionally increase the price of the bonds making this argument come true, I don't believe that making a payment bond equal to the performance bond would cause the actual cost of Federal construction to increase.

In July, Chairman Gekas, when we met, we talked about some of these things, and I'd like to elaborate on that. My belief is that the price of the bonds would not increase. This comes from what I see in the pricing of surety bonds in the various States and on private construction projects. In Pennsylvania, the payment bond must equal the performance bond on all State construction. The price of these bonds is no higher in Pennsylvania than the price of bonds for Federal work in the area.

This is also true when I have to purchase surety bonds for work we do on private projects. The price of a surety bond is based on the value of the contract, the experience rating of the general contractor purchasing that bond, and whether or not that general contractor has ever defaulted on any bonds. If one portion of either of the two bonds is increased or decreased, it does not change the price of that bond.

I asked my surety agent if the bonding costs are increased when the payment bond is increased and he informed me that price does not change. In fact, it is my contention that the government's construction costs will actually decrease if the payment bond is made equal to the performance bond.

With the lack of payment protection afforded to specialty contractors on Federal construction, many subcontractors have decided not to work on a Federal project. Often those best qualified to do the work at the lower price don't even bid the job. We cannot afford risking losing our companies because the Miller act is deficient in its protection of subcontractors.

With specialty contractors deciding not to bid on Federal projects, there is less competition on Federal jobs. When there's a lack of competition, prices increase. Therefore, the government may already be paying too much for construction projects.

Personally, I do not bid on Federal work that I am not capable—or I do not bid on Federal work that I'm capable of doing. I only bid on Federal projects where I know the general contractor, I'm comfortable with working with that contractor, and I know by my experience with him that I'll get paid for that work. Further, I will not do Federal jobs that are so large that a nonpayment could financially ruin the company that I have worked so hard to build. A job like the Federal prison in Brooklyn is a good example of this.

Subcontractors that do not participate on Federal jobs—that do participate on Federal jobs increase their bid prices to cover the additional risk they face because of the limited payment protection. Then the government may ultimately pay inflated construction costs.

If the Miller act is amended along the lines of H.R. 3032 to increase the payment bond and make it equal to the performance bond, I believe that it would cause a reduction in cost to the Federal construction program. I repeat, increased competition with no higher bond costs will decrease the cost to the government.

I would like to commend these two committees for taking the time to investigate this very important issue. If H.R. 3032 is enacted, I do believe that it would be beneficial to the government, as well as offering fair and needed protection for all subcontractors.

Thank you.

[The prepared statement of Ms. Weaver follows:]

Good morning, my name is Micki Weaver. I appreciate having the opportunity to talk to you today about H.R. 3032, the Construction Subcontractors Payment Protection Enhancement Act of 1998. I am the owner of Weaver's Glass, located in Harrisburg, PA.

My husband and I started Weaver's Glass in 1986. We are a contract glazier installing glass and aluminum on commercial projects. We are a small business that employs 20 people and do $3 million worth of work a year. While this changes from year-to-year, approximately 25 percent of that $3 million is from federal work.

There are two specific argument I would like to address today made in opposition to H.R. 3032. The first is that the bond costs would increase if the payment bond equals the performance bond. The second is that construction costs will increase if the payment bond is made to equal the performance bond.

I do not agree with these arguments. While the surety industry could intentionally increase the price of bonds making this argument come true, I do not believe that making the payment bond equal the performance bond would cause the price of construction contracts to increase on federal work.

We discussed this when we met with you in July, Chairman Gekas, and I would like to elaborate. My belief that the price of bonds would not increase comes from what I see with the price of surety bonds in the various states and on private construction projects. In my home state of Pennsylvania, the payment bond must equal the performance bond on all state construction. The price of these bonds is no higher than the price of bonds for federal work in the area. This is also true when I have to purchase surety bonds for work we do on private projects.

On private construction projects, those where the payment bond must equal the performance bond, the price of the bond is not higher than when the bonds are not equal.

The price of a surety bond is based on the value of the contract, the experience rating of the general contractor purchasing the bond, and whether or not the general contractor has defaulted on previous bonds. If one portion of either of the two bonds is either increased or decreased, it does not change the price of the bond. I asked my surety agent if the bonding costs are increased when the payment bond is increased, and he informed that the price does not change.

In fact, it is my contention that the government's construction costs will actually decrease if the payment bond is made to equal the performance bond.

With the lack of payment protection afforded to specialty contractors on federal construction, many subcontractors have decided not to work on federal projects. Often, those best qualified to do the work at lower price don't even bid the job. We cannot afford to risk losing our companies because the Miller Act is deficient in its protection of subcontractors. With specialty contractors deciding not to bid on federal projects, there is less competition for subcontracts on federal construction jobs. When there is a lack of competition, prices increase. Therefore, the government may be paying too much for construction.

Personally, I do not bid all the federal work that I am capable of doing. I will only bid jobs when I know the general contractor and am comfortable with its ability to pay for work properly done. Further, I will not bid federal jobs that are so large that non-payment could financially ruin the company I have worked so hard to build. A job like the federal prison in Brooklyn is a good example of this.

Subcontractors that do participate on federal jobs increase their bid prices to cover the additional risk they face because of the limited payment protection. Then, the government may ultimately pay inflated construction costs.

If the Miller Act is amended along the lines of H.R. 3032 to increase the payment bond to make it equal the performance bond, I believe that it would cause a reduction in the cost of federal construction. I repeat: Increased competition, with no higher bond costs, will decrease the cost to the government.

I would like to commend these two committees for taking the time to investigate this important issue. If H.R. 3032 is enacted, I do believe that it would be beneficial for the government as well as offering fair and needed protections for subcontractors.

Thank you for giving me the opportunity to discuss the Miller Act with you today.

Mr. GEKAS. We thank the lady and we switch to Andrew Stephenson, the next person indicated on the agenda.

Mr. STEPHENSON. Good morning, Mr. Chairman, members of the subcommittee. My name is Andrew Stephenson. That's the truth. I'm the head of the Construction Law Group at the law firm of Holland & Knight. And I have had 22 years to look at the very piece of legislation that you're now looking at. And I've looked at it from about every perspective.

We represent owners. It's been our privilege on occasion to represent the United States on classified projects construction. We represent prime contractors, subcontractors, suppliers, sub-subcontractors, design professionals. So I come to you today in a little bit of a catbird situation. I've seen both sides of this. I've had the privilege to represent the kinds of people you just heard from, and it's been a privilege, as an attorney, to do that.

We have a very serious piece of legislation in front of you. Just like I represent all of these different kinds of people, I'm here speaking today on behalf of the Associated General Contractors. It may be a misconception that the Associated General Contractors also represents general contractors. The fact of the matter is they represent 7,000 general contractors, the 23,000 subcontractors and suppliers. So all of their members will be very affected by what you all decide to do with this legislation.

Let's make no mistake that what we're all contemplating here today with 3032 is a drastic change to the law. That doesn't mean that you as our representatives shouldn't make drastic changes to the law from time to time. That's what you're sent here to do sometimes, but it is a drastic change and it is a very somber, very serious consideration.

What this would do, some aspects of it, would be to create contractual relationships when none now exist, changing the law of privity. It would make contractors responsible for entities that they have no relationship with. It would force multiple payments and multiple lawsuits for the same work. I dare say if the full flower of the legislation, as I understand it, were enacted, that it would be another of their attorney relief acts because of the kind of litigation that it would spawn.

Increases in bond premiums are only one thing that you ought to focus on. My colleague next to me will address that. But that's not the only thing that can happen as a result of this legislation. Because a construction project, as these good people tell you, is risk. And what they try to do, as prudent people, is assess that risk and cover that risk and be compensated for that risk.

And what this legislation does is risk. If H.R. 3032 becomes law, as I understand it, as it's written, it would change the U.S. Supreme Court case of *J.W. Bateson* which goes back to 1978. I have a copy of that opinion with me if counsel would like it, but it's cited in the written materials that were provided to you.

Mr. GEKAS. If there would be no objection, we'll include it in the record.

[The information referred to follows:]

J.W. Bateson Co., Inc., Et Al. v. *United States Ex Rel. Board of Trustees of the National Automatic Sprinkler Industry Pension Fund Et Al.*, 434 U.S. 586, 98 S. Ct. 873 (1978)

Mr. STEPHENSON. Thank you, sir. The case was written by Mr. Justice Marshall, who just left us and there was a dissent by Mr. Justice Brennan and Mr. Justice Blackmun, and I think it's all worth reading.

If I could turn you to the chart that I have and have some assistance, forgive me for doing some show-and-tell, but I think it helps. The mechanics lien laws are what for centuries have protected journeymen, mechanics, subcontractors on private construction projects. Since the United States is a sovereign and we can't lien those projects that the United States builds, the Miller act was enacted and it replaced an even older piece of legislation called the Heard act.

Right now, and I'll take two examples if you look at this chart, in the District of Columbia, someone performing a private construction project can only take a mechanics lien to the tiers you see on that chart. You have the owner at the top. You have the contractor below and you have a first-tier subcontractor. In the District of Columbia I can't, in representing a client, take a mechanics lien unless the person has a contract direct with the owner or has a contract directly with the prime contractor, the general contractor.

In the Commonwealth of Virginia, their legislature decided they would go one tier lower, if you could remove that. So in the Commonwealth of Virginia, I could go one more tier and take the mechanics lien. Beyond that there's no protection in the private sector.

The Miller act, and we've heard the Congresswoman read absolutely correctly and appropriately from the record, was enacted in order to replace the ability of the contractors to take mechanics liens.

In both the jurisdictions I just described, there is another limitation. If the owner has paid the prime contractor and if the prime contractor has paid the next tier, no one, even if they're entitled to a lien can take a lien in any amount greater than what is currently owed to the next tear up. There is no double payment, in other words. If the owner is paid the first tier and the first tier is paid the second tier, there can be no lien for the amounts that are already paid. Therefore, the prime contractor never has a risk of double payment in those jurisdictions.

Under the Miller act, understand a bond is not an insurance policy. An insurance policy—we all have automobile policies—if we get into an accident, unfortunate accident, what then happens is that our insurance company pays. They never come back to us and say, pay me back for what I just paid.

Something I think everyone may be missing here that you need to consider is with a surety bond, and these people also have to get surety bonds, they know the bonding setup and they all go through the same thing. What they go through is the bonding company will issue a bond, yes, indeed, but they require the strongest sort of indemnification imaginable. I don't disagree with them doing it. What that indemnification says, if I pay $1 or I pay $10 million, as long as it's within the penal sum of the bond, you, the contractor, have to pay me back every penny. And it is secured by all the assets of the corporation and most times it's secured even by the homes of the contractors. They even require joint signatures by spouses in order to make sure that their indemnification, which is their risk, is covered.

There's a major difference between insurance and suretyship, and that's underlined, all of the things that you're hearing here. This is not something where I pay a premium and whatever happens after that, I never have to worry about it again. I always have to worry about it because it always comes back to me.

Now, the chart I've put up here also depicts what the *Bateson* case said. Currently, that's as far as the Miller act goes under the *Bateson* case according to the U.S. Supreme Court. If I could describe to you, if I could follow this chart for a minute, the *Bateson* case helps you to understand why the Associated General Contractors is concerned about going beyond these tiers.

In the *Bateson* case, the United States was the owner doing an addition to a hospital. J.W. Bateson was a highly capitalized, highly respected prime contractor and still is. Bateson was paid in full by the government. Bateson paid the first tier sub, Pierce Associates, which also is a very well capitalized, very highly regarded local Virginia mechanical contractor doing all the mechanical work in that particular project, paid in full. Pierce paid its sprinkler contractor, what we call the second-tier sub, in full. Sounds like, why would this case go to the U.S. Supreme Court?

What happened was that the sprinkler contractor was a union contractor. It had not paid its trust funds, amounts that—the trust funds under the collective bargaining agreement that it had with the union were due for pension, health and welfare, et cetera.

Mr. GEKAS. The time of the gentleman has expired. Without objection, you'll be extended time to allow explanation of the chart.

Mr. STEPHENSON. Thank you, Mr. Chairman. If I could remove the rest of it, there's no way that J.W. Bateson, who is going to have to pay back every penny that the pension plan has paid, even though they paid already, is aware of the relationship and the nuances of the relationship between the sprinkler contractor Cullquit in the *Bateson* case and its unions.

What this legislation would do as written is not only have that contractor exposed to that risk, but on a major complicated construction project, what I have depicted here in the chart is not an exaggeration. It's very common that there would be 20 to 30 subcontractors, sub-subcontractors and others operating on a project at the same time.

This is the most complicated industry in the world. One judge has said no place but in the middle of battlefield do people have to make decisions so quickly with so little information, with so unknown consequences, as on a construction project. What this legislation would do is go beyond the site even more remote than the pension funds that I just described.

What the Miller act has tried to do and the Supreme Court has tried to do is strike a balance. Do we all want every sub to be paid on every project? Absolutely we do, and so does the AGC. What you all have to do and what the *Bateson* case tried to do and what for

62 years and 20 years since the *Bateson* case would try to do is strike a balance between what is this going to cost in terms of risk because, believe me, the prime contractor will pass that risk along to the United States. He has to. He has to.

Thank you very much.

[The prepared statement of Mr. Stephenson follows:]

The Associated General Contractors of America (AGC) is the nation's largest and oldest construction trade association, founded in 1918. AGC represents more than 33,000 firms, including 7,500 of America's leading general contracting firms. AGC's general contractor members have more than 25,000 industry firms associated with them through a network of 101 AGC chapters. These 25,000 associate member firms are subcontractors, suppliers, bonding companies and others with construction related specialties. AGC member firms are engaged in the construction of the nation's commercial buildings, factories, warehouses, highways, bridges, airports, waterworks facilities, waste treatment facilities, dams, water conservation projects, defense facilities, multi-family housing projects, site preparation, and utilities installation for housing developments.

AGC opposes the proposed changes to the Miller Act, in the so-called Subcontractor Payment Protection Act, H.R. 3032. This bill will have a detrimental impact on the construction industry. In today's growing construction industry, AGC contractors can be prime contractors on one-project and specialty subcontractors on another. While AGC supports the goal of faster payment, H.R. 3032 will not achieve that goal. Rather, this legislation will potentially lengthen the payment process with litigation. Most importantly, this legislation will take away one of the only safeguards available to general contractors and to the government to ensure that work completed by subcontractors complies with building codes, project plans and specifications, completion schedules and project schematics. The general contractor on the jobsite is the government's quality control mechanism. The contractor ensures that quality components go into a federal project.

The Miller Act was enacted in 1935 to provide for a two-fold purpose: (1) secure completion of projects through a performance bond, and (2) establish security for payment of subcontractors as a substitute for mechanic's liens. This legislation was amended in 1995 to increase the Miller Act threshold for bonds. Prior to the enactment of the Federal Acquisition Streamlining Act (FASA), any project over $25,000 had to have a Miller Act bond. Under FASA, any project over $100,000 must have a Miller Act bond. Miller Act bonds secure subcontractor payment for completed and acceptable work if the general contractor defaults.

In the private sector, only certain claimants, as provided for by state law, are able to place a mechanic's lien on real property. Such a lien is simply a note on a land record indicating that work has been performed by a mechanic who has not been paid. A mechanic's lien can only be enforced (by selling the underlying property to obtain a source of funds to pay the mechanic) if no other means is available to pay the mechanic for its work.

For a variety of reasons, it is not possible to place a mechanic's lien on property which is owned by the Federal Government. By enacting the Miller Act, Congress substituted a payment bond for a mechanic's lien. The enforcement mechanisms under the Miller Act are similar to mechanic's lien statutes to the extent that payment under the bond is only required if no other source of funds is available to pay a mechanic who has performed work on a federal construction project. The Miller Act ensures the payment of legitimate claims of first tier subcontractors and their suppliers.

To understand our specific comments regarding H.R. 3032, we feel that it is important to clarify the common misconception that a Miller Act bond is similar to an insurance policy or guarantee contract. A Miller Act bond is not an insurance policy and a bonding company does not guarantee that every subcontractor will be paid regardless of the quality of work performed or materials delivered. A Miller Act payment bond is a three-party contract between the general contractor, surety and the government which provides a source of funds which will satisfy the general contractor's payment obligations if the general contractor is unable -- or unwilling -- to make such payment. In this regard, the surety's obligations under a Miller Act bond are subject to the terms of the agreement between the general contractor and the subcontractor seeking payment. Stated differently, the general contractor must be contractually obligated to pay a subcontractor or material supplier before a Miller Act surety has a duty to pay the subcontractor. If there is a dispute over whether the amount is due, or the subcontractor failed to fulfill its contractual obligations, the surety has no obligation to pay.

There are sound business reasons for this arrangement. Prime contractors bid work at profit margins as low as 2%-3%. In this business environment, contractors cannot afford to finance construction or guarantee payment -- especially if a dispute exists between the prime contractor and the government concerning a subcontractor's work. If the government refuses to pay a general contractor because the subcontractor's work was deficient, the subcontractor cannot look at a Miller Act bond as an unrestricted source of funds. It must first establish that it is entitled to be paid the amount it claims it is owed.

It should be remembered that most sureties require the principal owners of a construction business to provide a broad personal indemnity to secure the contractor's bond obligations. Typically, these indemnity agreements require the principal to reimburse the surety for anything the surety pays to a subcontractor. As elaborated below, to secure compliance with this indemnity obligation, the owners of the business (and their spouses) are frequently required to pledge personal assets, including their homes and businesses, as collateral. Therefore, it is fair to assume that a surety only pays a Miller Act bond claim if a general contractor -- and its principal owners -- have no assets. This is very similar to the mechanic's lien remedy the Miller Act was intended to replace. The Miller Act works because it forces general contractors and subcontractors alike to stand behind their work and live up to their commitments.

With regard to the proposed legislation, the most onerous provision of H.R. 3032 is the attempt to require general contractors to be responsible for debts to all lower-tier subcontractors and suppliers on a jobsite. The Miller Act and the U.S. Supreme Court decision in *J.W. Bateson Co. v. U.S. ex rel. Board of Trustees of the Nat'l Automatic Sprinklers Indus. Pension Fund*, 434 U.S. 586 (1978), make general contractors and their Miller Act sureties responsible for subcontractors, sub-subcontractors and suppliers in direct privity of contract—that is, general contractors are responsible to each person or entity with whom they have negotiated and signed a contract and for the "second" tier sub-subcontractors and suppliers who have directly contracted with "first" tier subcontractors.

This is sound policy because it respects the contracting parties' abilities to control their own business and legal relationships. Going beyond that sound parameter will wrest away the parties' autonomy to fashion and adequately police the terms which govern their business affairs. It also forces the owners of a business who have pledged their personal assets to assume a risk over which they have no control. The Supreme Court recognized the inherent unfairness of extending the Miller Act to lower tier subcontractors in the *Bateson* decision. H.R. 3032 would abrogate the Court's reasoning and substitute instead an unnecessary and financially devastating "ripple" effect through unlimited tiers of subcontractors and suppliers.

On today's larger construction sites there can be literally dozens of subcontractors and suppliers simultaneously performing work which the general contractor will seldom encounter. There are often dozens more suppliers and materialmen working off-site who the general contractor has no knowledge of and only indirect control over. H.R. 3032 would require general contractors to undertake direct exposure for the debts of another company with whom it has no contractual relationship and in contravention of the law of privity of contract. In short, H.R. 3032 will force general contractors into positions where they will not be able to account for or control financial risks.

Further, H.R. 3032 fails to recognize that the subcontractor—then, in turn, the sub-subcontractors—are the parties having direct contractual relationships with each subsequent tier. Under the current law, the general contractor is responsible for debts incurred by each subcontractor with whom it is in direct privity of contract and for such subcontractor's debts their own first-tier subcontractors and suppliers. These subcontractors that are not burdened with financial risk to secure bonding or shoulder similar Miller Act responsibility for their own debts. H.R. 3032 would increase the general contractor's exposure to the debts of **everyone** related to a construction project without any ability to ensure their jobs were faithfully executed. This would constitute an unfair financial burden to general contractors, one that likely would spell financial hardship or ruin for many and increase the costs of construction to the government.

This is an important point—one that bears repeating. Under the current Miller Act requirements, which have amply protected subcontractors and suppliers for over 60 years, contractors potentially pay twice if a subcontractor defaults. If a subcontractor fails to pay his suppliers, the general contractor must pay those bills, even though he has already paid the subcontractor for those supplies. The subcontractor is not required to post a bond so there is no bond for the general contractor to place a claim against. This liability is borne by the general contractor alone. There is no reservoir of cash from which to draw. H.R. 3032 will change the Miller Act and Supreme Court precedent and force the general contractor to be responsible for everyone on or off a jobsite. This could force a general contractor to pay 3 or 4 times for the same product which could bankrupt many companies because of the inability to control the contractual obligations of the lower tiers. Since many subcontractors and suppliers are large multi-national organizations, the change proposed by H.R. 3032 will also require small general contractors to be responsible for the debts of companies many times their size.

Contractors holding a bond undertake huge liability. As noted above, sureties issuing bonds require corporate and personal indemnification from the general contractor. Generally, the surety or bondholder does not pay a bond claim out of its own pocket, but from the contractor's resources. A small general contractor must put his or her house, equipment, and other resources up as part of the indemnification agreement between the general contractor and the surety. If a general contractor defaults on a job, that contractor stands to lose the family's house and the business. Those are powerful incentives to perform well. Let us not make the present bonding requirements unfair and inequitable by having the general contractor assume financial responsibility for everyone related to the project. At best, the Federal government only pays the general contractor once; the general contractor should not be exposed to many multiples of payment.

H.R. 3032 would also make the amount of the payment bond equal the amount of the performance bond. Payment bonds are secured by a contractor to guarantee payment to certain laborers, subcontractors and suppliers for the labor and material under a contract (i.e. the delivery of a specific project, built correctly and delivered on time). Performance bonds guarantee performance of the terms of a written contract. The Miller Act provides that the Contracting Officer with discretion to require any additional security that is deemed necessary. The Act states that on projects over $5 million a payment bond must be secured for $2.5 million. The legislation does not limit this amount nor state that it is a maximum amount. To make the performance and payment bonds equal implies that subcontractors are performing all the work. This is simply not the case. In fact, on many contracts, contractors are required to self-perform a specified percentage of any contract. They are also required to subcontract out a specific amount to small or disadvantaged businesses. A set rule mandating performance and payment bonds in equal amounts also will increase the premiums paid by general contractors for such bonds and likewise increase project costs to the taxpayer.

H.R. 3032 would extend the Miller Act's payment protections to progress payments. Progress payments ensure subcontractors get paid for work performed. The Prompt Payment Act already determines the timing and amount of progress payments. Under the Prompt Pay Act, a contractor must pay a subcontractor at least monthly. The amount and time of this payment is a negotiated term of the subcontract. H.R. 3032 would force general contractors to make progress payments even if the work is not performed. Placing Miller Act protections on monthly progress payments will serve to engender litigation over disputed payments. The only enforcement method available to general contractors is withholding payment if subcontractors do not perform the work. We must not abrogate the general contractor's legitimate right to withhold payments in the event that the subcontractor failed to meet his contractual obligations. The government consistently retains and exercises the right to withhold payment to general contractors, often times due to the failure of the subcontractor to perform.

Another proposed change to the claim process would be allowing claims to be filed before the subcontractors work is completed. H.R. 3032 amends the Miller Act by allowing a suit to be filed:

"...before the expiration of a period of ninety days after the date on which the last

> of the labor was done <u>or performed</u> or material was furnished <u>or supplied</u> if the person who instituted the suit has received from the contractor who furnished the bond a denial in writing that payment is due..." (emphasis added)

Final payments are awarded when the general contractor is satisfied that the work has been completed. If the work is not completed there is no claim. If a subcontractor is paid on work that has yet to be completed, what avenues does the general contractor have to ensure that the work will be completed safely, on time, and to the contract specifications? Withholding payment may be the only way to ensure that the subcontractor finishes the job. In many of today's construction contracts, an owner may impose liquidated damages for failure to finish a project on time. These damages can be in the amount of $20,000 or more a day. Is there any doubt that the general contractor must be able to ensure that the subcontractors uphold their contractual obligations? Would the federal government like to be forced to pay contractors before their work has been fully completed and inspected for quality?

H.R. 3032 would prohibit contractual agreements between general contractors and subcontractors that are currently negotiable. Claim waivers are negotiated along with other contractual obligations prior to the commencement of a project. These waivers are commonly used to prevent a lien for work completed after progress payments are paid. They are also used to waive lien rights after a final payment is issued. These waivers protect general contractors from being forced to pay twice for the work of subcontractors.

Changes made by H.R. 3032 could also hurt subcontractors by changing current construction practices. By exposing general contractors to all the debts of their subcontractors, the subcontractor's subcontractors, their suppliers, and the raw material providers, general contractors would be forced to eliminate subcontracts in order to limit their exposure. They would self perform work that would normally be subcontracted. This would eliminate the opportunities for small businesses. In addition, changes made by H.R. 3032 to the common law surrounding the Miller Act will likely increase litigation. Sixty years of case law has settled many of the issues surrounding payment, timely notice, and who has claim to a bond. AGC's subcontractors could be exposed to increased, costly litigation regarding the changes to current practices. This will not speed payment to our subcontractors or suppliers. The long-term ramifications of H.R. 3032 are unknown.

AGC is concerned about allowing the notice of a claim to be delivered through any service that provides proof of receipt. While the Miller Act states that notice must be sent by registered mail, the Courts have ruled that other methods are acceptable. AGC does not believe computer technology is available that would provide accurate proof of receipt. Simply because an e-mail has been sent, does not mean it has been delivered in a readable format. In addition, the federal government and contractors alike are susceptible to problems of the Year 2000 (Y2K) computer glitch. Registered mail or similar notice procedures should be required.

H.R. 3032 would make payment of attorney's fees mandatory. The issue of attorney's fees is properly the subject of contract negotiations between the parties not the government. Such an issue should be an explicit part of the negotiations between the contracting parties, and not a term imposed on the parties by legislative mandate. AGC believes that the proper course for the government is to respect and preserve the parties' freedom to contract.

You should note that AGC, almost from its inception, has supported alternative dispute resolution (ADR) processes, not litigation, to resolve disagreements. AGC is currently a member of the National Construction Disputes Resolution Committee, of the American Arbitration Association, devoted to fostering information about the ADR process and its administration. AGC encourages ADR, not litigation, through our materials and products as well as providing for ADR in our standard contract forms. Most importantly, AGC members feel strongly about dispute avoidance and encourage partnering on which AGC developed and published a guide for all construction industry participants.

AGC members strive to construct the nation's infrastructure on time, with quality workmanship, and under budget. AGC members have secured Miller Act bonds since the legislation's passage. Over sixty years of case law has evolved around the Miller Act and its implementation. While there have been isolated incidences of problems, the Act has been a success and usually produces the intended results.

The Miller Act works because it forces general contractors and subcontractors to stand behind their work and live up to commitments. It encourages payment of legitimate claims of first tier subcontractors and suppliers. It protects the government interest by ensuring the timely delivery of a quality project. H.R. 3032 could change all that. It will hurt general contractors, cost the government money, and would have harmful results to AGC's subcontractors. Today, the government spends approximately $16 billion constructing courthouses, federal buildings, and military installations. Subcontractors are paid when they fulfill their contractual obligations to the general contractor and the ultimate owner: The United States Government. AGC members strive as prime contractors and subcontractors to meet those obligations as well. H.R. 3032 will undermine the efforts of construction contractors to ensure a quality, long-term structure by forcing subcontractors who fail to complete work to be paid. H.R. 3032 will force general contractors to pay the debts of subcontractors. The proposed changes to the Miller Act are harmful to the entire construction industry because they will increase litigation and increase federal construction costs.

Mr. GEKAS. We thank the gentleman, and we turn to the final witness on this second panel, Ms. Schubert.

Ms. SCHUBERT. Thank you, Chairman Gekas, Chairman Horn, Representatives Maloney and Sessions, for being here today. I'm Lynn Schubert, president of the Surety Association of America. I'm also here speaking on behalf of the National Association of Surety Bond Producers and the American Insurance Association.

SAA is a trade association of surety companies and fidelity bond companies. Our members—we have over 650 members who write the vast majority of surety bonds for Miller act projects. NASBP is a national trade association of independent agents and brokers. Their members specialize in surety bonds, and they write 70 percent of all surety bonds written—contract surety bonds written in the United States. The AIA is a national trade association of general property casualty insurers. Many of its members also write surety bonds. And I'm here speaking for all of our organizations today to address the bill before the joint committees, as well as maybe touch a little bit on the substitute.

You've heard a lot today already about the specifics in each of the provisions in the proposed bill and the substitutes. I wanted to compliment Representative Maloney, on her comment that procurement is fascinating. Surprising as it may be, I also find procurement fascinating.

I've been in the construction business for a very, very long time. I hesitate to say actually how many years I've been around in this business, but it is a fascinating business and an important business. And procurement reform is very important, and we in the surety industry support procurement reform.

Where we disagree is on the effect of this bill. I am concerned and our organizations are concerned that the effect of this bill will not be to free up additional moneys for additional teachers and programs that we need, but instead to increase the cost of construction to the Federal Government and we are concerned about that.

I am not going to spend the limited time we have today to go through each and every one of these provisions. What I'd like to do is to just boil our comments down to basically one principle and that principle is fundamental fairness.

Absolutely, we believe that everyone who provides work on a construction project, whether it be Federal, State, or private, ought to be paid for the work that they perform. There's no question about that; that is certainly a principle of fundamental fairness. In fact, when the Heard act was first instituted, it also was instituted for the purpose of fairness. You had general contractors that were not performing their projects, but were being paid by the Federal Government. There's something wrong with that. They instituted the Heard act to create the performance bond requirement.

Because the surety stands behind the contractor, as Mr. Stephenson has described it, the surety then, if the contractor does not perform, performs that work. The government pays for the work. The government gets a project. That is fair. If the surety makes the payment, then the general contractor is responsible to repay the surety. That is fair. But the Heard act left the subcontractors and the suppliers out in the cold, and so when the Miller act was enacted, they created a payment bond requirement to do the same thing, to ensure that people perform their jobs and get paid for their jobs, and that's what the payment bond is there to do, again, an example of fundamental fairness.

The problem is, as Mr. Stephenson described it, there has to be a balance. There must be a balance, and therefore, when the Miller act was created, they created protections for the general contractor in the Miller act. The 90-day waiting period that we've heard about today, the 90-day notice requirement for second-tier subcontractors. The limit of liability to certain tiers, those tiers that were originally protected by a mechanics lien and therefore you need that same kind of protection on Federal or State procurement. The notice by Registered Mail, all of those things were put into place to ensure that the general contractor, that they only paid for work that was properly due and that they didn't have to pay someone five tiers down the road where they had already paid in full.

Now, when these things have, over the last 60 years, and there is a lot of—a lot of litigation and certainly a lot of court decisions on the Miller act, but when it has appeared that the Miller act is not working in a particular area, such as the notice being required by Registered Mail, the courts have stepped in.

The existing case law is much better than what's proposed in the bill here. The existing case law does not require—and it's a Supreme Court case, I might add, which has been followed, of course, by all the lower jurisdictions, it requires that the subcontractor, if the subcontractor can show receipt or the general admits that receipt was made of the claim, then that's good enough. It doesn't have to be by Registered Mail. And again, that's a court stepping in to ensure fundamental fairness of the construction and the contracting process.

Sixty years of case law has made the Miller act work. The proposed changes that we're talking about today, we are concerned would disrupt that case law. In other instances besides the Registered Mail, the proposal is even more restrictive than what is in the existing case law, and we go into this in detail in our written statement, which I know will be a part of the record, and I'd be happy to answer any questions on each of those various provisions.

The one place where we are concerned that perhaps the Miller act may not be working is the size of the payment bond. There may be an instance, Mr. Levinson is certainly a good example, although honestly we have not heard of any other examples, where a contractor may not be paid because the size of the payment bond is not adequate. That is something that concerns us. That is something that we think we should address. We were very pleased to see OFPP take a proactive approach on this and state that they would like to see that changed.

The Miller act is very clear on its face that the size of the payment bond is not limited to $2.5 million. It's very clear. A contracting officer can and should require additional security where necessary. And we hope to see that happen, and we'd be happy to work with OFPP or the joint committees to make that happen.

Representative Maloney spoke about the fact that that is really the guts of this bill. That is really what this is all about, and the rest is bells and whistles. Our problem is that the bells and whistles are going to cause a lot of problems. We truly believe things such as extending the tiers down is going to increase the cost of construction. I think I was prepared to do, I thought, a wonderful description of why that would happen, but Mr. Stephenson did I think the best we could ever hear on why the cost of construction is going to go up.

Mr. GEKAS. The time of the lady has expired. We will accord her enough time to complete her statement.

Ms. SCHUBERT. Thank you very much. If I could just wrap up, obviously the cost of construction is based on risk. I just want to address a comment that was made earlier.

Certainly, Mr. Stephenson has explained why the risk to the general contractor would be increased by some of these proposals and therefore the general contractor's price would go up. We, as an association, have never said that the price of a surety bond would increase because of the increased size of the payment bond. I don't know where that statement came from, but we have never made that allegation.

The price of the bond will increase because the price of the contract will increase and because the risk to the surety will increase by extending the tiers all the way down, not because of the size of the bond itself. And we would look forward to working with OFPP on the new regulations, providing information to contracting officers, or these joint committees to try and make this work.

[The prepared statement of Ms. Schubert follows:]

H.R. 3032
Construction Subcontractors Payment Protection Enhancement Act of 1998

Statement of
The Surety Association of America,
The American Insurance Association and
National Association of Surety Bond Producers
to the
United States House of Representatives
Committee on Government Reform and Oversight
Subcommittee on Government Management, Information and Technology
and
Committee on the Judiciary
Subcommittee on Commercial and Administrative Law

September 11, 1998

The Surety Association of America ("SAA") is a voluntary, non-profit unincorporated association of companies engaged in the business of suretyship. It has approximately six hundred-fifty member companies, which collectively underwrite the overwhelming majority of surety bonds issued in the United States. The American Insurance Association ("AIA") is a non-profit national trade association currently representing over three-hundred major insurance companies, most of which write surety bonds, along with property and casualty insurance. The National Association of Surety Bond Producers ("NASBP") is a national trade association of independent agencies and brokerage firms that specialize in surety bonding for business and industry. NASBP member firms are responsible for producing seventy percent of the contract surety bonds underwritten in the United States annually.

We would like to thank the House Committee on Government Reform and Oversight Subcommittee on Government Management, Information and Technology and the Committee on the Judiciary Subcommittee on Commercial and Administrative Law for addressing generally the important issue of Miller Act payment bonds and, in particular, H.R. 3032, the Construction Subcontractors Payment Protection Enhancement Act of 1998.

H.R. 3032 would amend a number of provisions of the Miller Act, 40 U.S.C. § 270a et seq., concerning payment bonds. The Miller Act amendments proposed in H.R. 3032 are neither necessary nor, with one possible exception, would they further the fundamental purpose of the payment bond. The purpose of the Miller Act payment bond is to help the government procure public works projects at a fair cost by providing payment protection to subcontractors and suppliers comparable to mechanics' lien remedies available on private projects.

Sovereign immunity protects public property from mechanics' liens by unpaid subcontractors and material suppliers. Accordingly, Congress enacted the Heard Act in 1894 and its successor, the Miller Act, in 1935 to require prime contractors to obtain bonds to ensure that subcontractors and material suppliers are paid. All states have adopted "Little Miller Acts" that vary from state to state but usually are patterned after the federal statute.

The Miller Act requires a performance bond for one hundred percent of the contract (the "contract price") but a payment bond in the amount set by a sliding scale, up to a maximum payment bond penalty of $2.5 million. Most state Little Miller Acts, and most private procurements for which bonds are used, require one hundred percent bonds for both performance and payment. This distinction between the federal payment bond amount and the states' payment bond amounts has raised concerns, which are reflected in H.R. 3032.

Payment Bond Penal Sum

The Miller Act payment bond amount has historically proven to be adequate in the vast majority of cases. There could, however, be some instances of subcontractors or suppliers that are unpaid because of a depleted payment bond penalty. Certainly, such an event is possible as the price of construction continues to rise and the $2.5 million statutory payment bond amount remains the same. The surety industry supports requiring a payment bond penalty equal to the performance bond, *i.e.*, one hundred percent of the contract price in most cases. We do not, however, think that legislation is needed to make this change.

A review of the practicalities of the payment process on a public construction project might be useful. First, the federal government (the "government") pays the prime contractor, and the prime contractor pays its subcontractors, through monthly progress payments. A subcontractor that is not paid for completed contract work will not continue to work. The entire project, of course, is not subcontracted, and the prime contractor performs a part of the work itself. As the job proceeds and progress payments are made, the percentage of the contract amount for which the subcontractors have not yet been paid is reduced. For contract work, the subcontractors will have claims for at most one or two months of work, and history has shown that the Miller Act payment bond penalty is more than adequate.

Sometimes a subcontractor claims that work is an "extra" or a constructive change order, and the prime contractor will disagree or, more likely, will pass the claim through to the government. Payment can be delayed while the claim is decided, but the Miller Act payment bond is liable only for sums "justly due." Until the claim is decided, the disputed amount is not justly due. The surety on the bond (the "surety") is not a judge, jury or contract appeals board. It provides a financial guarantee assuring that the subcontractor will not go unpaid because the prime contractor is bankrupt. The bond is not a way for the subcontractor to bypass the contract's administrative remedy or the judicial system and be paid for claims that may or may not be valid.

The payment bond is not the subcontractor's only source of payment. If there is a sum justly due, the prime contractor's entire assets are responsible for its payment. In addition, an unpaid subcontractor has an equitable lien on the contract funds. Although sovereign immunity protects the government from suit by the subcontractor,[1] no one else can receive contract funds while the subcontractor is unpaid. In effect, the contract funds are security for payment to the subcontractors. *See* Gallagher, "Unpaid Subcontractor's or Supplier's Right to Payment Out of Contract Funds" in 10 *The Construction Lawyer* 9 (1990); *United States Fidelity & Guaranty Co. v. United States*, 475 F. 2d 1377 (Ct. Cl. 1973); *United Electric Corp. v. United States*, 647 F. 2d 1082 (Ct. Cl. 1981).

The September 1, 1998, proposed draft substitute to H.R. 3032 provides that "[t]he amount of the payment bond shall be equal to the amount of the contract to be subcontracted by the contractor." Such an amendment would be unworkable because a contractor does not necessarily know when it submits its bid to the government how much of that contract it will subcontract. In the context of competitive bidding for federal government projects, different bidders would be offering different payment bond amounts. One prime contractor might subcontract twenty percent of the contract amount, and another prime contractor might subcontract eighty percent of the contract amount. Such a system would have the effect of subverting the competitive bidding laws.

In addition, the Miller Act payment bond protects laborers and suppliers, not just subcontractors. Whether the bidder is going to purchase material and use its own labor to install it or is going to subcontract the work does not change the amount of work to be done. If a statutory change were to be made, the amount of the payment bond should equal the performance bond.

The Miller Act at 40 U.S.C. § 270a(c) states that the contracting officer can require additional security. If there is a project on which there is a perceived risk that the minimum payment bond penalty required by the statute would be inadequate, the contracting officer simply can require a larger payment bond in the

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[1] In the recent case of *Blue Fox, Inc. v. Small Business Administration*, 121 F.3rd 1357 (9th Cir. 1997), the court permitted an unpaid subcontractor to sue the government for specific performance of its duty to pay contract funds to the subcontractor even though the subcontractor could not have sued for a money judgment. The Supreme Court has granted *certiorari* to hear the government's appeal of this decision.

bid documents. Indeed, the Federal Acquisition Regulations could provide for a payment bond equal to the performance bond in all cases. At the request of the surety industry, the Office of Federal Procurement Policy ("OFPP") has such a regulation under consideration. The payment bond penalty mandated by section 270a(b) of the Miller Act is a floor, not a ceiling; and if a larger payment bond is a good idea, it can be obtained administratively.

It is extremely rare for subcontractors on federal public works projects to be unpaid because the Miller Act payment bond penalty has been exhausted. However, if the small chance of that occurring is unacceptable, raising the minimum payment bond penalty should indeed be implemented. We believe that section 270a(c) gives authority to the OFPP to amend the payment bond amount, and that such a change should be effectuated through the regulatory process.

Progress Payment Protection

The Miller Act payment bond covers all sums justly due, including progress payments. The amendment proposed in H.R. 3032 would delete the period of ninety days for which a claimant has to be unpaid before having a right to payment under the bond. Such a provision would wreak havoc on a federal construction site.

It is important to remember that a subcontractor or supplier has an immediate right of action against the contractor (who also is the bond principal). The ninety-day waiting period, therefore, really applies only to claims against the surety. The purpose is to allow the surety time to investigate the claim and to keep the surety and the federal courts out of the day-to-day administration of the project.

There frequently are disputes over the percentage of work performed and amount to be paid on progress payments. The owner, contractor and subcontractors of necessity work them out, and the job proceeds.

Involving the Miller Act payment bond in progress payment disputes would mean that the United States district courts would become referees of each month's requisition. To allow each subcontractor that is dissatisfied with a reduction in its monthly request to sue the Miller Act surety in federal court is not a rational use of judicial resources. The current ninety-day waiting period ensures there is a legitimate dispute, does not preempt the contractor and subcontractor's usual negotiation, and allows the surety time to investigate and settle claims. Only if there is a serious dispute which cannot be settled in the ninety-day period is the subcontractor free to sue the surety in federal court.

The September 1, 1998, draft substitute to amend H.R. 3032 appears to recognize that involving the Miller Act payment bond in progress payment disputes would create unnecessary problems and deletes this provision from the bill.

Extension of Coverage and Elimination of Notice

H.R. 3032 would eliminate the provision in the Miller Act that requires claimants in privity with a subcontractor to give the prime contractor notice of their claims within ninety days of the date they last furnished labor or material for which claim is made. The Miller Act bond now covers anyone in privity with the prime contractor and anyone in privity with a first-tier subcontractor, but the latter group has to give the prime contractor written notice of the claim. Persons more remote than suppliers or sub-subcontractors to first-tier subcontractors are not covered under the Miller Act bond.

Under the existing law, therefore, the prime contractor, as principal on the bond, can incur double liability. It can pay its subcontractor in full and still be liable for the subcontractor's debts. The unfairness of this is ameliorated by the ninety-day notice requirement. After the ninety days has run, the prime contractor can pay its subcontractor in full without exposure to double liability.

The courts consistently have rejected coverage for persons more remote in the contractual chain than those in privity with first-tier subcontractors because of manifest unfairness to the prime contractor. It is bad enough that the prime contractor can be liable for the subcontractor's debts, but the prime contractor can protect himself by choosing a responsible subcontractor, requiring the subcontractor to provide a bond, issuing joint checks to the subcontractor and its supplier or withholding money upon receipt of notice of unpaid claims.

If H.R. 3032 were passed, all of these protections would be eliminated. Notice no longer would be required, and liability would extend to the debts of remote subcontractors and suppliers of whom the prime contractor has no knowledge or control. The Miller Act payment bond covers the following parties: material suppliers and laborers in privity of contract with the prime contractor; subcontractors to the prime contractor; and sub-subcontractors, material suppliers, and laborers under contract with the subcontractor. The prime contractor cannot require bonds or joint checks or withhold money from persons with whom it has no contractual relationship, and the prime contractor cannot dictate from whom remote subcontractors purchase labor and material. It serves no good policy to hold a prime contractor responsible for the failure of a remote subcontractor over which it has no control, and the imposition of triple or quadruple liability on a prime contractor would only increase the cost of federal construction. It is important to remember that the surety's risk is the bankruptcy of its principal, the prime contractor, but that when a statute or bond makes the principal and surety liable for debts beyond those of the principal, it is solvent principals who will usually have to pay. That risk will have to be factored into their bid prices.

The September 1, 1998, proposed draft substitute to H.R. 3032 would permit "a subcontractor at any tier performing at the site of the work" to give the ninety-day notice before making a claim on the payment bond. Such an amendment would not change our discussion as the prime contractor would still have no knowledge or control of payments by remote subcontractors and would face multiple liability if they failed to pay their bills.

Waiver

H.R. 3032 would invalidate a waiver of payment bond protection under the Miller Act, unless the waiver were in writing and made after the date the claimant could sue on the bond. The courts consistently have held that a claimant can waive its rights under the Miller Act payment bond only if the waiver is "clear and explicit." In actual practice, the alleged waiver language almost always has been found not to have met that test. For example, in *United States for the Use of Clark-Fontana Paint Co. v. Glassman Construction Co.*, 397 F.2d 8 (4th Cir. 1968), the court held that an endorsement on a joint check stating that the recipient waived any right to assert any claim on any bond given by the issuer of the check was insufficiently clear to waive the Miller Act rights of the supplier endorsing the check. See also *Warrior Constructors, Inc. v. Harders, Inc.*, 387 F.2d 727 (5th Cir. 1967). Even if the release language is unavoidable, the courts look for another way not to enforce a waiver. See, for example, *United States for the Use of Youngstown Welding and Engineering Co. v. Travelers Indemnity Co.*, 802 F.2d 1164 (9th Cir. 1986), in which the court found there was no consideration for a release of the claimant's bond rights.

When the contractor and subcontractor negotiate the terms of the subcontract, they address price, payment terms and schedule; but they also address such monetary considerations as interest, attorneys' fees, indemnity obligations and waiver of lien or bond rights. These terms are part of the entire package, and the subcontractor sets its price accordingly. There is no reason for Congress to intervene and void one part of this package when there is no showing of any widespread problem.

Registered Mail

H.R. 3032 proposes to delete the requirement that the ninety-day notice of a claimant not in privity of contract with the bond principal be sent by registered mail and instead allow it to be sent in any manner which provides proof of delivery. In 1940 in *Fleisher Engineering & Construction Co. v. United State ex rel. Hallenbeck*, 311 U.S. 15, 61 S. Ct. 81, 85 L. Ed. 12 (1940), the Supreme Court held:

> We think that the purpose of this provision as to manner of service was to assure receipt of the notice, not to make the described method mandatory so as to deny right of

> suit when the required written notice within the specified time had actually been given and received. In the face of such receipt, the reason for a particular mode of service fails. It is not reasonable to suppose that Congress intended to insist upon an idle form. Rather, we think that Congress intended to provide a method which would afford sufficient proof of service when receipt of the required written notice was not shown.

The lower federal courts have, of course, followed the Supreme Court's decision and held that, as long as the notice was actually received, the manner of its delivery is immaterial. See, for example, *United States for the Use of Moody v. American Insurance Co.*, 835 F.2d 745 (10th Cir. 1987).

The proposal in H.R. 3032 may be more restrictive than current law because it would require delivery in a way which would yield a receipt or other proof, whereas current law requires only that the notice actually be received in any manner. Were Congress to enact this more restrictive language in the face of over fifty years of consistent contrary precedent, it would be presumed to have intended to change the precedent and require delivery with a receipt. Regular mail, for example, would no longer suffice even if the contractor admitted receiving it.

Premature Suit

H.R. 3032 proposes that suits filed prior to the expiration of ninety days after the claimant last furnished labor or material not be dismissed on the ground that the suit was "premature" if the contractor already has denied the claim. Under current law, the courts refuse to dismiss a suit on the grounds that it is premature whether the contractor has denied the claim or not. All the claimant need do is file a supplemental complaint after the ninety days has run. For example, in *Security Insurance Co. of New Haven v. United States for the Use of Haydis*, 338 F.2d 444 (9th Cir. 1964), the claimant did everything wrong. He filed suit before the ninety days had run but filed his supplemental complaint after the one-year limitation expired. Nevertheless, the court treated the premature filing as a mere technicality and rejected the argument that the suit should be dismissed. The court stated: "Nothing but the most compelling authority, emanating from the United States Supreme Court itself, would induce us to stay on this legal merry-go-round."

Once again, the proposed amendment actually would be more restrictive than current law since it implies that a suit filed prior to the expiration of the ninety-day period should be dismissed if the contractor has not denied the claim. In addition, the primary purpose of the ninety-day period is to allow the surety to consider and settle the claim. In most cases the contractor already is aware of the subcontractor's position and does not need the ninety days. If a right to sue were to be triggered by a denial, it should be the surety's denial, not the contractor's.

Attorneys' Fees

In *F.D. Rich Co., Inc. v. United States, ex rel. Industrial Lumber Co.*, 417 U.S. 116, 94 S. Ct. 2157, 40 L. Ed. 2d 703 (1974), the Supreme Court examined the entire issue of the American Rule on attorneys' fees as it relates to the Miller Act and concluded that a claimant should not recover its attorneys' fees unless one of several exceptions applied. The most common exception is if the claimant is entitled to fees by contract. When the contractor and subcontractor negotiate the terms of the subcontract, one such term is attorneys' fees should a dispute arise. If the subcontract provides for such fees to the subcontractor or supplier, they become part of the sum "justly due" for labor or material and are awarded under the Miller Act.

The proposed amendment in H.R. 3032 would take the question of attorneys' fees out of the hands of the contracting parties in two circumstances. The first amendment would allow fees if "the suit is frivolous or a defense . . . is groundless," but the American Rule and the *Rich* case already allow fees in that circumstance. In *Rich* the Supreme Court stated:

> We have long recognized that attorneys' fees may be awarded to a successful party when his opponent has acted in bad faith, vexatiously, wantonly, or for oppressive reasons . . . .

Rule 11, Federal Rules of Civil Procedure, which is applicable to every Miller Act suit, allows an award of attorneys' fees as a sanction for asserting unwarranted claims, defenses and other legal contentions.

For truly vexations or frivolous conduct, the courts already have ample authority to award attorneys' fees. The proposed bill would simply encourage every Miller Act litigant to allege that the opponent's claims are frivolous or its defenses groundless. The cases would become more expensive to litigate and harder to settle with no counterbalancing benefit. That is exactly what happened under a former version of Rule 11 which was more liberal in granting sanctions and engendered a subcategory of Rule 11 litigation, the cost of which far outweighed the beneficial effects of the Rule.

The second category for which the proposed amendment would allow attorneys' fees is if they were "needed to preserve the protections of this Act with respect to a small claim . . . ." In *Rich* the Supreme Court stated:

> We recognize that there is some force to the argument that a party who must bear the cost of his attorneys' fees out of his recovery is not made whole. But there are countervailing considerations as well.

The Court ultimately held that there was no basis to distinguish Miller Act cases from other ordinary commercial litigation and that if the American Rule were to be abandoned Congress would have to do it.

Virtually all prime contractors, subcontractors and material suppliers are commercial corporations and are well able to allocate by contract the risk of attorneys' fees in case of a dispute. There is no reason for Congress to make an exception for "small" claims, which, of course, can be asserted by very large corporations. Unless the American Rule is going to be abandoned altogether, it should apply to Miller Act cases.

If a claimant with a "small" claim knows that it will be able to collect attorneys' fees once suit is filed, but not for work in preparing and settling the claim before suit, it will sue first and discuss the claim later. This will simply increase the amount of litigation. Whatever the merits of the English, loser pays, Rule, a unilateral award of fees to one party, with no countervailing risk of paying fees if it loses, encourages litigation.

If a claim truly is so small it does not justify the cost of a suit, under current law that fact is true for both sides. As long as there is a legitimate dispute, both sides have a powerful reason to settle. If that balance is upset by a one-sided fee-shifting statute, the claimant has less reason to compromise or to minimize its expenses. Claims will be decided on the threat of disproportionate fees rather than the merits of the dispute. There is no public benefit in that, and the American Rule, as articulated in the *Rich* case, should remain applicable to Miller Act litigation.

The September 1, 1998, proposed draft substitute for H.R. 3032 would modify this amendment to permit attorneys' fees if the suit or defense is groundless **and** an "award is needed to preserve the protections of this Act with respect to a small claim, filed by a small-business concern." This change would bar the attorneys' fees currently available for bad faith or vexatious claims or defenses unless the victim also met the "small claim" branch of the test. This makes no sense, and the current law which allows the parties to allocate attorneys' fees by contract and protects against bad faith by either side is far preferable to an arbitrary award based on the size of the claim and the claimant.

Interest

Under current law prejudgment interest can be awarded pursuant to the parties' contract or state law. The proposed amendment would supersede both the contract and state law in the case of a groundless defense or a "small" claim in which interest was "needed to preserve the protections of this Act." If such statutory interest were awarded, it would run from the date of the claim and at a rate set by the Prompt Payment Act.

Often, however, the parties' contract, and particularly a supplier's purchase order, will call for interest at a higher rate or running from the date the material is furnished or the date payment is due rather than the date a bond claim is made. In some cases, therefore, a groundless defense or a small claim will reduce the interest otherwise owed.

While interest clearly is not labor or material, it can be part of the negotiated price, and, therefore, of the sum justly due, for such labor and material. There is no reason not to leave interest to the parties' contract and state law.

Accountability of Contracting Officers

H.R. 3032 proposes to allow a court to "authorize" a claimant to sue the Untied States if the contracting officer fails to obtain or maintain a Miller Act bond. The claimant, however, must first have sued "pursuant to section 2," but if there is no bond, it would seem impossible to have filed suit on it. The proposed amendment also does not indicate what criteria a court should consider in deciding whether to "authorize" a suit.

Leaving these problems aside, there was a time when the government allowed the use of individual sureties without requiring them to undergo the financial scrutiny which corporate sureties must pass before being allowed to write federal bonds. This lead to widespread abuse and fraud, and many subcontractors were left unpaid.

The government has corrected this problem administratively, and now it is virtually unheard of for a federal public works contract to be let without corporate surety bonds. Whether the United States should be liable in such a circumstance, or whether the subcontractors' equitable claim on contract funds is sufficient protection, is an interesting but academic point. The "problem" is so unusual it does not justify legislation. The proposed substitute bill apparently recognizes this and drops the provision entirely.

Conclusion

The Miller Act amendments proposed in H.R. 3032 and the September 1, 1998, substitute do not fulfill, with one exception, the purported purpose of the bill, to enhance and "modernize" the payment protections of the Miller Act, or they are just wrong on their merits. The one exception, increasing the amount of the payment bond, should be accomplished through regulation, not unnecessary legislation.

Permitting suits over progress payments, barring waivers, allowing delivery of the ninety-day notice by other than registered mail, not dismissing premature suits, awarding attorneys' fees for frivolous or groundless claims and suing the government for failure to obtain bonds are solutions in search of a problem. Current law either already accomplishes what the amendments propose or the alleged problem almost never arises.

Eliminating the ninety-day notice, extending coverage below second-tier subcontractors and shifting attorneys' fees for "small" claims are wrong on their merits. It is fundamentally unfair to expose prime contractors to double and triple liability for the debts of project participants whom they neither select nor control. A remote sub-subcontractor or supplier is able to evaluate a transaction's credit risk and protect itself in a normal commercial way before extending credit to a second-tier or lower subcontractor. If the risk of loss were removed, there would be no reason for remote sub-subcontractors or suppliers to evaluate their credit risk, and the prime contractor would not be in a position to do so. Extension of the prime contractor's liability beyond the debts of its own subcontractors is a recipe for fraud, abuse and economic waste.

The one exception to these unnecessary amendments is the provision requiring a payment bond penalty equal to the performance bond. A subcontractor or supplier on a federal construction project almost never goes unpaid because of the prime contractor's insolvency. However, the Miller Act payment bond amount has not been raised since 1935, and the cost of construction has risen. A scenario wherein a subcontractor or a supplier goes unpaid because a payment bond penalty has been exhausted would be imaginable, although extremely rare. Accordingly, the surety industry supports increasing the amount of the Miller Act payment bond to equal that of the performance bond, through the regulatory process.

This bill to amend the Miller Act payment provisions does not achieve its purported purposes, as delineated in the draft substitute to H.R. 3032: "to modernize the Act to reflect modern Federal construction practices, to foster more expeditious resolution of legitimate payment bond claims, to restore the effectiveness of the Act regarding small claims . . . . " The Miller Act payment bond provisions have been extremely successful legislation, which have achieved their purpose of providing protection to subcontractors and material suppliers on federal construction projects comparable to the mechanics' lien protection available on private projects. They do not need to be "modernized," as they are currently remarkably effective. Many of the provisions of the proposed legislation would have the effect of fostering more litigation and illegitimate payment bond claims. The Act is as effective now regarding small claims as it ever was.

The Miller Act has been extensively interpreted, and government contractors, subcontractors, suppliers and sureties are familiar with it. They can order their affairs accordingly, and if a dispute arises, they usually can determine the answer without the expense of litigation. The Miller Act should not be amended, and uncertainties thereby introduced, unless the Act is not working. The fact is that a subcontractor or supplier on a federal construction project almost never goes unpaid because of the prime contractor's insolvency. The Miller Act as it currently stands works well, and it should not be amended.

SAA, AIA and NASBP would like to thank the Subcommittees for allowing us to testify today. The issue of payment protection on federal construction projects through Miller Act bonds is critically important. This issue is, furthermore, complex and fraught with misunderstandings. We would be very pleased to continue to provide expertise and advice to the Congress on Miller Act issues.

Mr. GEKAS. We thank the lady. We thank the entire panel. And now with their permission, we will subject them to some examination by members of the committees, and we'll begin with allotting 10 minutes or whatever he wishes to allot himself, the chairman, Mr. Horn.

Mr. HORN. Thank you very much, Chairman Gekas. We thank each of the witnesses. You've all given us a very good perspective from your background. Let me tell you briefly where I'm coming from on this.

Having been a university president with State contracts for 18 years, I learned a few things, that too many general contractors underbid trying to get the low bid, and when you're dealing with probably the Federal and the State governments, I know for sure, and they then put the squeeze on the subcontractors to make up for their low bid, and it is not a responsible bid. And increasingly States and certainly this government no longer have to take the low bid, but you'll always have somebody sue you on it and tell you how great they are.

And what I want to start on how great some were, Mr. Levinson, obviously we're all bothered by the story you mentioned. Could you tell me, is Morganti National still in business?

Mr. LEVINSON. Yes, they are.

Mr. HORN. Did they have a pattern and practice of underbidding that led to some of this?

Mr. LEVINSON. No, that's not the case here. I'm not sure of the pattern. It was the first job I had ever been on with them.

Mr. HORN. You don't know of any other experiences they had with a subcontractor similar to yours?

Mr. LEVINSON. No. As a matter of fact, I had only heard good things about them from people that had done work with them on another project in Connecticut.

Mr. HORN. Presumably Morganti was the prime contractor; is that correct?

Mr. LEVINSON. That is correct.

Mr. HORN. Your problem with the Miller act is not that it doesn't cover lowered tier or sub-subcontractors, but the amount of the payment bond?

Mr. LEVINSON. That is correct. I am a first-tier subcontractor doing the electrical work. The problem with it is, as I stated, and I don't know the exact dollar value, there are other claims against the bond besides my $9.5 million claim. I am told those numbers reach about $30 million. Two others, quite substantial by the way, three people making the bulk of that $30 million that I'm told about; but there could be as many as 10 or 15 different claims against that bond. And where does that money get spent first? I'm sure everybody's going to get pennies on the dollar.

It just doesn't work. We don't have the proper protection.

Mr. HORN. In Administrator Lee's testimony, she noted that the government simply cannot indemnify every private sector business arrangement. Would you care to respond to that?

Mr. LEVINSON. If I look at it from my personal problem, if the government is not willing to see that a first-tier subcontractor is protected, then maybe they shouldn't be in the contracting business. Let me tell you that I've been doing work for the Federal Government for 30 years as a subcontractor. But I've also done other agency work at that same time.

In New York State and in New York City, the payment bond is equal to the performance bond. I'd always heard the words Miller act, but never bothered to read the boilerplate of the contract, which is very clear; and it does say the bond for payment is $2.5 million.

It's so mind-boggling that on a $103 million job you'd have a $2.5 million payment bond that I'm going to tell you there is no contemplation on the part of the people that enacted this original legislation that this kind of thing would have happened. There would be no sense in even bothering to enact that kind of legislation. It's ridiculous as it stands right now from that particular standpoint, and we have to be protected. We've done our job.

Mr. HORN. You heard Mrs. Maloney cite the update based on inflation of the Congressional Research Service, which went about from $2.5 million, let's say to $29 million. What do you think is the accurate formula we ought to use, and if we do put it into law, what kind of an adjustment do you think we ought to do so we don't have to wait 50 years or 60 years before it's brought up to date?

Mr. LEVINSON. Well, you certainly shouldn't be using a specific dollar value because as inflation occurs, the numbers on the projects go up so that specific number absolutely does not work.

The proper thing to do, in my opinion, would be to do what 34 States have done in many, many municipalities, including the city of New York, and make that payment bond equal to 100 percent of the performance bond and call for a bond in each and every instance, do not allow the government to become a self-insurer. That to me is mind-boggling. But if you do allow them to become a self-insurer, then the government should be well prepared to protect everybody on that job and pay the payment portions of it, too, if they don't ask for that bond. It would be the only fair thing to do.

As I've stated, under the present conditions, I could no longer do a Federal job. It's just mind-boggling that I didn't understand the regulation all these years. But I do now, and I will not perform Federal work.

Mr. HORN. Where I'm coming from on another aspect is, since I'm a strong supporter of the Davis-Bacon act, two good Republicans looked around at the Depression and said, hey, why are we having these people come in and undercut the local wage structure? And the prevailing wage has prevailed and that is automatically updated because of the prevailing wage changes, and the Department of Labor looks at the wage situation in a particular labor market area.

It just seems to me, with small business being the generator of jobs in this country, that we have protected the worker when they get the job and that's largely from small business, but we haven't protected the contractor; and that's what this is sort of all about.

Now, do all of you agree that the performance and payment must be equal, essentially?

Mr. LEVINSON. I certainly do and listening to the way that provision has been modified from possibly being 100 percent of the total contract, it leads the potential fraudulent actions on the part of an unscrupulous general contractor, if in fact he does exist. He can go into that bid, tell his bonding company I'm going to be doing all the work on the job. Does that mean we're going to have no payment bond on the job, and then he goes out and subcontracts the work?

Originally, the Federal Government—and it's disappeared from the regulations—made the general contractor bid list his major subcontractors. Then we would at least have had that protection that the government would be aware that he's absolutely going to be subcontracting the major part of his work. But without that provision in the law anymore, in theory we could have an unscrupulous contractor say, I'm not subcontracting anything, no payment bond on the job, let alone $2.5 million.

I would hope, and I'll be talking to Congresswoman Maloney about this, that we do get some words into that legislation that adequately protects against that kind of problem occurring. We have to be protected. It's only fair and equitable that we are, and we are the people that build the buildings for the Federal Government.

Mr. HORN. Any comment anybody else would like to make to that question?

Ms. SCHUBERT. I have two questions with that.

Mr. HORN. Ms. Schubert.

Ms. SCHUBERT. One is almost a similar concern, and that is as to how much is subcontracted. If you say you want the payment bond to be equal to the performance bond, it's very rare the general contractor is going to subcontract the entire amount, and so the government may be paying for something that they may not need. They may not need that large of a payment bond to protect the subcontractors and suppliers.

My second concern was raised in the first panel, or with the OFPP, and that is, the Miller act does not say that it should be a 100 percent performance bond. So the government can choose the size of the performance bond and then the payment bond will be whatever that is. And that may not always be appropriate. I think that's something that just has to be considered.

Mr. HORN. Maybe when we have a contract with the Federal Government, and obviously they're dealing with the general contractor, not with the subcontractors, that if there's a record of where they do not pay their subs, they're simply disbarred from having a Federal contract. Would that be helpful?

I'm waiting for Mr. Stephenson to go into orbit. I enjoyed your chart, by the way. It reminded me of what was circulated by the Clinton health plan in the fall of 1994.

Mr. STEPHENSON. Then I got the point across I think, sir. Some of the things you're considering have untoward results sometimes. They sound as if they shouldn't, and they should be somewhat simple. Like the equalization of the two kinds of bonds, the two kinds of bonds serve two very different purposes. One probes the United States to make sure the project is completed, and there's a reason for the penal amount of the bond to be in the amount of that project; because theoretically, the contractor could default right out of the ground immediately, and the government would have to complete the entirety of the work.

The payment bond is just for your consideration as to whether it's worth the United States paying for that because they will. The payment bond has this different purpose, and what the payment bond's limitation is is different because—and typically on private projects it's different because—is that hopefully through a variety of mechanisms that we put into place with the contracts, you don't have the entirety of the work at issue against the payment bond. You have progress payments.

Hopefully, the subcontractors stay somewhat close to the prime contractor. They don't have the entirety of their contracts at risk all at once. So that's something for you to consider when you're considering what should be the appropriate amount.

It is true that the subcontractors if you have a whole variety of them in a default situation where the prime contractor actually has defaulted, it could be a variety of them that have built up claims that exceed the penal amount of the bond no matter what you set the bond at.

Mr. HORN. Mr. Chairman, you might want to invite Administrator Lee back. She might wish to reply, try to get closure here one way or the other on some of these issues.

Mr. GEKAS. At this point, although Mr. Lee is chomping at the bit, I cannot accommodate him at the moment. I want to convey the remainder of the time, the next 10 minutes, 8 to 10 minutes to the gentlelady from New York for her examination of the witnesses and, in advance, I thank the members of the panel for their testimony.

Mrs. MALONEY. I thank the chairman for yielding, and I thank Chairman Gekas and Chairman Horn for calling this hearing. The chairman has informed me we will not be returning to this panel. We will be going to a series of votes. Some of my questions I will relate to Chairman Horn, who has worked in a wonderful, bipartisan way; and I would like to make a few very brief points.

I thank all of you for your testimony; Ms. Weaver, I thought yours was particularly moving. And to the point, to respond to Mrs. Schubert's statement, the regulation calls for 100 percent of performance bond, not the law, but the regulation.

And very quickly, Mr. Lee, you said that in 34 States, the payment bond already equals the performance bond. Do you know when most of these States modernized their law? Has it always been that way? Get back to me in writing.

Has equalizing payment and performance bonds in the State had any adverse effects, that some claim it might, such as raising the cost to the government?

Has it had adverse effects, yes or no?

Mr. ROBERT LEE. No.

Mrs. MALONEY. You can elaborate in writing.

I would like to respond to Mr. Stephenson's chart. Our legislation only—and we amended it because of this concern raised by the administration in meetings we had with them, we amended it to be only onsite, and we'll work with the language as Mrs. Lee pointed out, but it's only going to be onsite.

It's not going to go all the way down to everyone who comes to a site and gives a package. It is only onsite. And I would like to very quickly ask Mr. Stephenson—and again get back to me in writing—why should a subcontractor be denied from further pursuing his payment rights by immediately filing suit once a general contractor has been denied his right to payment?

Why should you have to wait 90 days? That seems silly. If you had been wronged, why can't you file suit?

Then I would like to assume for the record that you and in your law practice use Federal Express, UPS, couriers and the like in the normal course of business. I certainly do. And is it appropriate to require that it's insufficient for providing notice under the Miller act?

Under the Miller act, you're stating we have to continue using Registered Mail. I mean, that's silly.

It seems to me, you know, hello, we're going to the 21st century. We're using a lot of types of mail. Why do we have to have Registered Mail? Is it because it's tied to a court case?

Again, we're running out of time, so I want to quickly go ahead.

In your testimony you suggested that a general contractor cannot know everyone on the job site, and it's my understanding, certainly it is in New York, that the general contractor is responsible for coordinating all the activities. In New York, they're responsible for the safety of the work site. And as we've heard repeatedly over the last few years, the general contractor has to perform these key contractual obligations, and yet how can they do that and yet not know everyone that they're working with on the job site? I mean, literally, in New York, you're responsible for the safety of the job site. Again, get back in writing.

I have to really—I want to put into the record with the general OK of the chairman, testimony of Edward H. Cushman of Philadelphia, his State, on the appropriate size of the bond; and also in the hearing on the Miller act, the sureties oppose the Miller act of 1935 because it would disturb 40 years of litigation under the Heard act of 1894. I have a direct quote from that testimony. I'd like to put it into the record.

Mr. GEKAS. Without objection, the entire statement will be made part of the record.

Mrs. MALONEY. I would like to add to it that the sureties opposed the adoption of the Miller act in 1935 because the proponents had failed to adequately document problems with the Heard act of 1894. I'd like to put both of those statements in the record. I would have read them if we weren't being called to a series of votes. And I really—to me, and I have a few more specifics that I'll put in writing, but I've thought oftentimes—I'm often moved very much by the practical experience of people, and I thought Mr. Levinson and Mrs. Weaver really outlined beautifully their situations.

Mrs. Weaver outlined the benefit to the taxpayer and the American citizen of not making it impossible for her to bid on a job unless she can afford to lose the entire company, to paraphrase your words. And for you to say that you would not bid on Federal, or you up the amount you would bid on Federal jobs knowing that the possibility was there that you would not be paid. And Mr. Levinson, too.

[The information referred to follows:]

<u>Excerpts from</u>:

Bonds on Contractors on Public Works

Hearings before the Committee on the Judiciary
U.S. House of Representatives
74th Congress, 1st Session

March 8, 22, April 26, and May 3, 1935

March 8, 1935 Hearing

Testimony of Edward H. Cushman, Sr. of Philadelphia, PA

On the appropriate size of the payment bond -

"Personally, I believe that a bond of $2,500,000 for subcontractors and labor and materialman alone would be adequate <u>on a job of $10,000,000</u>." (at 26, emphasis added)

On whether having a separate payment bond will result in increased surety bond premiums, which the contractor reflects in the price bid to the Government -

No. "... [T]he change has not resulted in any increase in premiums in Pennsylvania." It only motivated bonding companies to due a better job evaluating the capacity of the prime contractor to perform its contractual obligations, including timely payment of subcontractors and suppliers. (at 26)

On when suit under the payment bond should first be permitted -

Permitting suit only 90 days after the subcontractor or supplier last supplied labor or material affords the prime contractor "a reasonable time to investigate the claim". (at 30)

H.R. 3032 permits suit sooner than 90 days, if the claim has been denied (presumably after investigation).

March 22, 1935 Hearing

Sureties opposed the Miller Act in 1935 because it would disturb 40 year of litigation under the Heard Act of 1894

In testimony regarding making changes to the Heard Act of 1894, the predecessor to the 1935 Miller Act, General Washington Bowie, Jr., the representative of the surety companies testified:

> "Now, in that forty-odd years the surety companies and the public generally have spent hundreds of thousands of dollars in finding out just what that act means. As I say, it has been called to the attention of courts hundreds of times and the decisions rendered have cost us lots of money and I do not think there is any other statute on the books that has been so thoroughly analyzed and construed. You might say every clause or every word has been examined by some court, some place, some time. ...
>
> Therefore, in my humble judgment, the Heard Act should be amended as little as possible.

Sureties opposed the adoption of the Miller Act in 1935 because the proponents had failed to adequately document problems with the Heard Act of 1894.

With regard to whether there was a sufficient number of cases to justify any modification to the 1894 Heard Act, a Charles H. McComas, representing several of the large surety firms, said:

> "... I do not think the [Heard] act should be amended in light of one or two inequities or injustices. The fact of the matter is that most adjustments are made without recourse to the law, and in fact the penalty [dollar amount] of the bond is sufficient to take care of all creditors and very seldom is there 13 or 16 months delay in law suits ... ." (at 60)

In arguing against separate payment bonds for the protection of lower-tier subcontractors and suppliers to subcontractors, a Col. Ralph Proctor, representing another large surety firm, said:

> "... a general contractor pays a sum for the work done under the terms of the subcontract and then the sub does not pay his sub for labor or materials, and it has happened and it will happen again that contractor and the surety under such conditions become liable twice for the same bill." (at 62)

The Associated General Contractors of America (AGC) also testified in opposition to legislation that became the Miller Act, to provide a separate payment bond to protect subcontractors and their suppliers.

Mr. W.H. Snow, testifying on behalf AGC, opposed changing the Heard Act of 1894 to provide a separate payment bond, saying:

> "Its [a separate payment bond's] existence will be a grave detriment to the Government in the orderly progress of Federal construction projects, in the quality of construction, and will necessarily increase the cost of construction to the Government ... ." (at 63)

Prepared by the Office of Rep. Carolyn B. Maloney (NY-14th)

Mrs. MALONEY. And I think, since we're running out of time, we all live in America, thank God. We all want to work together. We all want to come up with a just solution, and I think we can try to work this out on personal staff levels. We're not going to rewrite a bill here today, but I really would like to close by giving time to Mr. Levinson, my constituent, who brought this to my attention very eloquently, and Mrs. Weaver to respond to the aspects brought by industries.

They're on the job. They're paying the taxes. They're employing the people. They're the ones that built America and they're the ones that are really out there making it happen.

So I would like to give the remainder of my time to Mr. Levinson and Mrs. Weaver to comment on the objections that were brought by, "professional organizations versus on-the-job," getting the job done.

Mr. LEVINSON. I'll be very brief. Just to put aside this wonderful chart that's been——

Mrs. MALONEY. My staff is going to tell me your brilliant statements. We have 6 minutes left. We're going to miss a vote.

Mr. GEKAS. The lady is excused. I'll listen. And run.

Mr. LEVINSON. The general contractors in almost all cases today on a major subcontractor—and usually that figure is a half a million dollars worth of work or more—are requiring that they provide a payment-of-performance bond to the general contractor, so that risk does not filter down. The subcontractor is now responsible for that, and interestingly so, I have never met a general contractor that will accept my subcontractor bond in the form that the Miller act allows for it. They insist on 100 percent payment bond.

Mr. GEKAS. Ms. Weaver, do you have anything to add?

Ms. WEAVER. My comment would only be to quote what I said in my earlier testimony. Increased competition, which in revising this bill, will happen because small businesses will be more comfortable to bid the work, will decrease the cost to the government.

Mr. GEKAS. We thank the entire panel. I must tell you that just as the purpose of hearings like this is, you have educated and re-educated members of these committees on this very intensely complicated subject. We thank you, and we will hear from you later, I am sure.

I ask unanimous consent that all Members have 5 legislative days to submit statements and questions of the witnesses for the record.

This committee session stands adjourned.

[Whereupon, at 11:56 a.m., the subcommittees were adjourned.]

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