

**Associated Builders and
Contractors – Virginia
Chapter**

1578 A East Parham Road
Richmond, VA 23228

**DC Metropolitan
Subcontractors
Association**

9105-A Owens Park Dr.,
Suite 102
Manassas Park, VA 20111

**National Association of
Surety Bond Producers**

1140 19th St., NW, Suite
800
Washington, DC 20036

Sent via email to: DelSlaquinto@house.virginia.gov

February 2, 2011

Delegate Salvatore R. Iaquinto
General Assembly Building, Room 420
Capitol Square
Richmond, VA 23219

Re: Concerns with VA HB 1951 and proposed substitute draft bill

Dear Chairman Iaquinto:

As trade associations representing a significant portion of the construction firms and surety bond producers conducting business in Virginia, we are very concerned about the substantial, negative impact that House Bill Number 1951 will engender. H.B. 1951 amends §§ 2.2-4336 and 2.2-4337 of the Code of Virginia, relating to the Virginia Public Procurement Act; bid, performance, and payment bonds, by substantially increasing the minimum contract amount required for bid, performance, or payment bonds. Currently the minimum contract amounts are \$100,000 for non-transportation-related construction contracts and \$250,000 for transportation-related projects partially or wholly funded by the Commonwealth. If Virginia's bonding threshold is increased, it would be among the highest in the nation. In fact, as contemplated in H.B. 1951 as introduced, the Virginia statute would become almost ten times higher than the current bonding threshold of the Federal Government. Even a \$500,000 threshold, which is being considered in a substitute draft bill, is too high, and would still place Virginia as having the highest bond threshold in the nation.

By first enacting a statute requiring the furnishing of payment bonds by contractors performing public construction contracts, the Virginia Legislature recognized the importance of having payment bonds in place to protect the downstream businesses that supply labor and materials on Virginia public construction projects. Often these business entities, the project subcontractors or suppliers, are small businesses whose only viable remedy in the event of nonpayment by the prime contractor is to claim on the payment bond.

If the prime contractor fails to pay subcontractors and suppliers due to bankruptcy or for other reasons, such subcontractors and suppliers do not have an alternative means to

recover their wages, costs, and expenses. They cannot sue the governmental entity, since they do not have a direct contract with the governmental entity, and they cannot place a mechanic's lien against the public property. In *Thomas Somerville Company v. L.R. Broyhill, et al.*, 200 Va. 358, 105 S.E.2d 824 (1958), the Virginia Supreme Court noted the inability of subcontractors and suppliers under Virginia law to place mechanic's liens against Virginia public buildings and other improvements: "Materialmen and subcontractors who furnish supplies or work for the principal who has contracted with the public agency...for the construction of the public buildings and improvements are unable to perfect mechanic's liens against the property for their protection." The Virginia Supreme Court added that the bonding statute "is remedial in character, its language broad and inclusive, and obviously it was enacted to afford protection to materialmen and subcontractors." By raising the bonding threshold to \$1 million or to \$500,000, which is considered in the substitute bill draft, on all public construction contracts, materialmen and subcontractors in Virginia will be without these invaluable payment protections. Having no recourse in the event of nonpayment will be disastrous for those firms, particularly since many of these firms already are struggling to weather the difficult economic environment for construction in the Commonwealth.

As payment bonds protect materialmen and subcontractors, performance bonds protect contracting agencies and precious taxpayer funds. In the absence of a performance bond, additional taxpayer funds will be required to complete projects when prime contractors default in their performance of such contracts. Raising the bonding threshold for contracts exceeding \$1 million or \$500,000, whichever bill is adopted, will mean that many more taxpayer-funded projects will not have performance bonds in place and taxpayers will suffer any losses.

Beyond increasing the bond threshold, H.B. 1951 substitute draft bill also contemplates establishing a qualification process for prospective contractors for contracts in excess of \$100,000 but not to exceed \$500,000. Apparently, contracting authorities would take on the task of qualifying contractors for such contracts. At present, the task of contractor prequalification is handled through the requirement of the bid bond, which would be removed as a result of the increased bond threshold. The bid bond assures that the contractor intends to enter into the contract at the price bid and will provide the required performance and payment bonds. If the contractor fails to do either, the bid bond specifies the amount to be paid as damages.

Professional prequalification, as done by a surety, involves both qualitative and quantitative analyses of a construction firm in order to gain a complete picture of the contractor's qualifications. Sureties carefully scrutinize each contractor's financial soundness, experience, and qualifications, to ensure that the contractor can meet its payment obligations and perform its construction contracts. Sureties maintain ongoing, long-term relationships with contractors, providing the surety with knowledge of the contractor's complete work program, including private and public work, and performance over time.

Such a depth of understanding is not one that can be approximated by a public contracting authority. Frankly, few, if any, public contracting agencies are well prepared to perform rigorous contractor prequalification. Public contracting agencies have limited resources and expertise with respect to analyzing the qualifications of contractors. Why would state and local contracting authorities want to assume this burden when it already is being done successfully and more efficiently by sureties, which are in the regular business of qualifying construction firms? Realistically, state and local contracting agencies will have to augment their workforces and commit additional resources to perform qualification of construction firms. *Is this the time to grow government when the same function already is being done well by responsible third-parties?*

Moreover, the surety assumes the risk of nonperformance in the event that the qualified contractor defaults in its contractual obligations. If the contracting authority assumes the responsibility of qualifying contractors and no performance and payment bond is required, any losses relating to the default of the contractor will be assumed by the taxpayer!

Further, will the contracting authority mentor and lend assistance to contractors performing public work? Sureties play an active role to ensure that bonded contractors are taking all the necessary steps to fulfill obligations. Such assistance may include providing advice on internal controls, key management decisions, and offering professional references, such as accountants and engineers, while meeting with their contractors on a regular basis for progress reports. Such assistance is provided “behind the scenes” to keep the contractor on track in fulfilling its contractual obligations. Are public contracting agencies prepared to assume such responsibilities to contractors performing their contracts?

The Commonwealth of Virginia should not be seeking to deprive Virginia businesses and taxpayers of payment and performance protections in this difficult economic environment. If the impetus behind the bill is greater inclusion of small and minority businesses as prime contractors on state contracts, better approaches exist that do not involve stripping subcontractors and suppliers and taxpayers of needed protections. The construction and surety industries have existing programs to mentor and educate small and minority businesses so they are positioned for long-term success as businesses, including enhancing their standing to obtain financial and surety credit. Such programs could be put in place quickly.

Please note that established programs exist to assist small and minority contractors with obtaining bonding and business assistance. The Office of Surety Guarantees of the U.S. Small Business Administration offers a bond guarantee program aimed at providing bonds to small and emerging construction businesses. Further, the Office of Small and Disadvantaged Business Utilization of the U.S. Department of Transportation offers lending and other programs specifically designed to benefit small and emerging contractors seeking to perform transportation contracts.

By removing needed protections and transferring the risk of losses to taxpayers, H.B. 1951 and its draft substitute bill are imprudent, if not dangerous, measures. Neither bill can be said to exhibit sound public policy, particularly in view of the nearly \$388 million budget deficit facing the Commonwealth of Virginia. Neither H.B. 1951 as introduced nor its draft substitute serve the interests of the Commonwealth of Virginia, its taxpayers, or its many businesses performing as subcontractors and suppliers on public construction projects.

We strongly request that you consider placing H.B. 1951 or its substitute bill in a study committee similar to the approach that is being considered with S.B. 1126 (Stosch). S.B. 1126 calls for the study committee to consist of representatives from the construction and surety industry appointed by the Department of Transportation's Commissioner to review performance and payment bonding requirements presently in the Code of Virginia. The Senate passed S.B. 1126 unanimously 39-0. We ask that this bill be given similar consideration.

Please feel free to contact us if you have any questions or need additional clarification with any of the points we have raised.

Yours sincerely,

Harold B. Kelly, Vice President
Associated Builders and Contractors – VA Chapter

Mark McCallum, CEO
National Association of Surety Bond Producers

Marla McIntyre, Executive Director
DCMSA

CC: Members of the House General Laws Subcommittee: #2 FOIA/Procurement
Members of the House General Laws Committee