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Background—Public Works Performance and Payment Bond Requirements

There is good public policy for the universal requirement of performance bonds and payment bonds on public works projects. These bonds guarantee that the project will be completed and that subcontractors, suppliers and laborers on the project get paid. If the surety backs a contractor that defaults on the project, the full amount of the surety bond is available to complete the work and pay those who performed work on the job. Congress, all states and many municipalities and local governments recognize the value of these bonds.

The Federal Miller Act

In 1894, Congress enacted the Heard Act to codify the existing practice of requiring public works contractors on federal projects to furnish a bond to assure completion of the contract work and payment of subcontractors and suppliers. In 1935, the Miller Act replaced the Heard Act and required separate performance and payment bonds. The minimum amount below which bonds are not required, the "bond threshold," was set at $2,000 in 1935 and raised to $25,000 in 1978. In 1994, the federal law was amended to raise the threshold to $100,000 but to require payment security (bonds or some other form of acceptable security) for the protection of subcontractors and suppliers on contracts between $25,000 and $100,000. The Miller Act was revised again in 1999 and the amount of protection under the payment bond was increased to 100% of the contract price. Notably, Congress did not increase the threshold below which bonds are not required. In 2008, pursuant to a provision in the National Defense Reauthorization Act, an appropriations bill for the federal fiscal year 2005, enacted in 2004, a provision was added requiring adjustment of all acquisition-related thresholds every five years. In 2007, by regulation, the threshold for payment security was increased from $25,000 to $30,000.

State Bonding Requirements on Public Projects

All 50 states and the District of Columbia require surety bonds on state and local public works projects. The state bond thresholds vary. The majority of states have thresholds of $50,000 or less. North Dakota is one of several states that have moved to the $100,000 threshold also used by the federal government. In only a few states does the state bond threshold exceed $100,000 so that North Dakota already is one of the states with the highest bond threshold in the country.

In the 2009 legislative session, North Dakota SB 2401 would have increased the threshold at which performance and payment bonds are required on construction contracts for public improvements from $100,000 to $200,000, but the bill was converted in the Senate into a study bill that requires the legislative council to study procurement issues during the 2009-10 interim. This will include a study of public improvement and capital construction bid requirements, plans and specifications, and the employment of architects and engineers.

The Impact of Increasing State Bond Thresholds

• **Many Small Subcontractors Are Left with Far Less Protection**--Mechanics liens cannot be asserted against public property in North Dakota. Laborers, subcontractors and suppliers on public projects must rely on the general contractor's payment bond for protection. If no bond is required, these parties are left with no means to collect for their services and supplies if the contractor is unable or unwilling to pay them. Small, emerging and minority contractors are more likely to start as subcontractors. This is especially true on smaller projects, and the most vulnerable companies will be the ones deprived of payment protection by this bill. If the bond threshold is raised, such subcontractors and suppliers will either have to risk losses from non-payment that they cannot afford or not work on the public jobs for which they are best qualified.

Experience shows that construction contractors face a high risk of failure. According to BIZ Miner, of the 1,155, 245 general contractors and operative builders, heavy construction contractors and specialty trade contractors operating in 2006, only 919,848 still were in business in 2008—a 20.4% failure rate. Small contractors with fewer than 25 employees had an even higher failure rate of 21%.

Current economic conditions increase the exposure of contractor failure. According to recent statistics released from a survey of the Associated General Contractors' (AGC) membership, construction employment, an indication of construction activity, construction employment declined for the second consecutive year in most states, and unemployment now stands at 17.4%, which is double the national average. The AGC data compared results from September 2007 to 2008 and most recently from September 2008 to September 2009. Contractor bankruptcies also rose 64%, comparing the first half of 2008 to the first half of 2009. North Dakota was one of only three states in the AGC survey that did not report a decline in construction employment between July 2008 and July 2009, but did report a decline this year.

It does not take much imagination to realize that with a high bond threshold, a contractor could bid on and be awarded multiple large state contracts for which no payment and performance bond would be required, and easily could have a significant amount of unbonded construction underway when financial problems force the contractor into bankruptcy. When a contractor goes bankrupt, they usually do not fail on one project, but on all. Workers and suppliers on several jobs could be affected. In the current economy, North Dakota construction workers and suppliers need payment protection all the more.

• **Increasing the Bond Thresholds Puts Taxpayers at Greater Risk**--The performance bond ensures that the project is completed for the contract price. If a performance bond is not provided, the taxpayers take on the risk that the contractor will default. By raising the bond threshold, there will be more contracts on which state and local jurisdictions will bear the burden of re-letting work and paying any excess completion costs.

• **North Dakota Contracting Officials Will Need to Screen and Qualify More Contractors**—Among the benefits provided by a surety bond, of no less importance is the qualification process that the surety puts the contractor through to ensure the contractor is qualified to complete the contract. The surety examines the contractor's expertise and experience in the type of work, character, capabilities and resources, overall management as well as its capital position and financial track record. Without the performance bond or payment bond, such qualification assessment is solely left to the public entity for the projects that are within the contract size threshold. A public entity will be stretched to make such a detailed evaluation of each bidder for a greater number of projects.

• **Increasing the Bond Threshold May Have Unintended Consequences**--Increasing the bond threshold does not necessarily mean that small and/or local North Dakota contractors will obtain more state construction business, but rather that all contractors will be able to bid on much larger state projects without being required to provided payment and performance bonds. The result of increasing the bond threshold may be that financially unstable contractors in the state and from surrounding states who cannot obtain bonding and are not pre-qualified by sureties will be bidding and obtaining larger construction projects in North Dakota.

• **Increasing the Bond Threshold May Inhibit the Growth and Financial Stability of Small Contractors**—As a contractor grows and the size of its contracts increases, it likely encounters more and more projects that must be bonded. Therefore, to grow in the arena of public construction, a contractor needs an established relationship with a surety. Increasing the level at which the contractor is required to be bonded delays the inevitable necessity of developing a relationship with a surety. The contractor benefits when it begins a relationship with a surety early in its growth. The surety can provide guidance as to what is required, in terms of financial position, organization and experience, in order to obtain bonding "at the next level." Late entry into the bonding market increases the likelihood that the contractor may not have the financial and operational profile to obtain bonds for larger projects.

In the long run, raising bond thresholds harms small and emerging contractors and suppliers by substantially increasing their risk of non-payment if they are operating as subcontractors and by raising the difficulty of qualifying for their first bonds.

Consider the Consequences of Unbonded Projects:

There are numerous cases in which unpaid subcontractors and suppliers have been left unpaid by the government's failure to obtain statutorily required bonds. See, for example, *U.S. Dept. of the Army* v. *Blue Fox, Inc.*, 525 U.S. 255, 119 S. Ct. 687, 142 L. Ed.2d 718 (1999). *N.V. Heathorn, Inc. v. County of San Mateo*, 2005 WL 419462 (Cal. App. February 23, 2005); and *Electrical Electronic Control, Inc. v. Los Angeles Unified School District*, 24 Cal. Rptr.3d 316 (Cal. App. 2005).

Conclusion

For the reasons listed above, increasing state bond thresholds is contrary to sound public policy. Bonding requirements exist to provide vital safeguards for those who work on public projects and the taxpayers who pay for them.

The Surety & Fidelity Association of America

100 Years of Service: 1908-2008

State Bond Thresholds

The state bond thresholds are the amounts above which bonds are required on state construction projects. In most instances, states may require bonds on contracts below the threshold.

No Threshold	Under $25,000	$25,000	$25,000-$50,000	$50,000	$75,000	$100,000	Other
Delaware	Arkansas ($20,000)	Hawaii	Kentucky ($40,000)	Alabama	Minnesota-13	Alaska California-6 Colorado	Indiana ($200,000)
Idaho	California-6	Iowa	South Carolina ($50,000)	Arizona Illinois-7		Connecticut District of Columbia-11	Florida-1
Ohio	District of Columbia-11	Louisiana-8	Washington ($35,000)	Michigan		Georgia	Maine ($125,00)
Utah	Illinois-7 ($5,000)	Mississippi	New Hampshire ($35,000)	Montana Oklahoma		Kansas	North Carolina ($300,000)
West Virginia	Massachusetts ($5,000) Nebraska-5	Missouri	Oregon-9	Rhode Island		Maryland	Virginia $250,000 for DOT Projects
	Wisconsin ($10,000)	New Mexico		South Dakota		Nebraska-5	
	Wyoming ($7,500)	Texas (payment)-12				Nevada New Jersey-2 New York-3	
						North Dakota	
						Oregon-9 Pennsylvania-10	
						Tennessee	
						Texas (performance)	
						Vermont	
						Virginia-14	

Notes

1. Payment and performance bonds may be waived for contracts under $200,000 for counties, cities, political subdivisions and other public entities. The state Department of Management Services may delegate the authority to any state agency to waive bonds for work in excess of $100,000 but less than $200,000. The threshold for DOT projects is $250,000.
2. Bonds may be waived in certain situations if contracts are under $100,000 (public entities other than state agencies) or $200,000 (state agencies).
3. Bonds may be waived by the head of the state agency or commission if the contracts exceed $100,000 or if it exceeds $200,000 for a contract not subject to state requirements for multiple award requirements. (Wicks Act)

   Certain public authorities in New York that construct medical buildings have individual payment bond thresholds. For the Westchester County Health Care Corporation and the Nassau County Health Care Corporation, the threshold is $1.5 million, not including the costs of medical equipment and devices. The threshold for the Clifton-Fine Health Care Corporation and for the Erie County Health Care Corporation is $500,000, not including the costs of medical equipment and devices.

4. In contracts under $35,000, the state may retain 50% of the contract amount in lieu of bonds.
5. $100,000 is the performance bond threshold for the construction, repair and improvement of buildings. The payment bond threshold, which is broadly applicable to all public projects, is $15,000 for the state and $10,000 for all other public entities.
6. In California, the threshold for a performance bond is $100,000. The payment bond threshold is $25,000.
7. In Illinois, the bond threshold is $50,000 for state agencies, but $5,000 for all other public entities.
8. The threshold is $100,000 for the New Orleans Swage and Water Board
9. Oregon threshold is $100,000 but $50,000 for DOT projects.
10. In Pennsylvania construction projects between $25,000 and $100,000, performance security is required in an amount of 50% of the contract price.
11. In the District of Columbia, bonds are not required in projects under $25,000 and may be waived in projects under $100,000.
12. For municipalities and any joint board created under the Transportation Code in Texas, the payment bond threshold is $50,000. The payment bond threshold is $25,000 for all other governmental entities.
13. For city housing and the city redevelopment authorities the threshold for bonds in Minnesota is $100,000.
14. For Virginia public universities and colleges, as well as Virginia Commonwealth University, the threshold is $1 million for payment and performance bonds for university construction projects.