Contractors' Bonds on Federal Construction Projects

Edward H. Cushman
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BY EDWARD H. CUSHMAN

A public body has a moral obligation to see that the persons who furnished labor and material required in the construction of a public improvement are paid in full. Prior to the passage of the Act of 1894, the United States endeavored to fulfill this obligation and to protect unpaid subcontractors, materialmen, and laborers by various methods. Congress, by the Act of August 13, 1894, commonly called the Heard Act, required any person entering into a formal contract with the United States for the construction or repair of any public building or public work to execute "the usual penal bond, with good and sufficient sureties, with the additional obligation that such contractor or contractors shall promptly make payments to all persons supplying him or them with labor and materials in the prosecution of the work provided for in such contract."

The Heard Act failed to protect the United States. A few subcontractors instituted suit thereunder before the completion of the building and the payment of their claims tended to exhaust the penal sum of the bond and thus prejudice

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the United States. Jurisdictional problems also arose. Whereupon Congress, by an amendment of 1905, sought to remedy these defects by assuring to the United States adequate opportunity to enforce its demands against the contractor's surety and the priority of such demands. This purpose was accomplished by requiring other creditors to refrain from suit on the bond for a period of six months after completion of the contract and final settlement thereunder, and providing that, if the United States had a claim on the bond, it should have priority in distribution over all other claimants.

The Budget and Accounting Act of 1921 provides that all claims and demands whatever by the Government of the United States or against it should be settled and adjusted in the General Accounting Office. Thereafter, a contractor defaulted and the administrative department failed to make such a final settlement but referred the matter to the General Accounting Office for direct settlement. It was held final settlement took place when the Comptroller General of the United States made such settlement. In another case, a constructing quartermaster (not the Secretary of War), who was not a member of the finance corps of the Army and without authority to direct officers of that corps, prepared and approved a voucher and transmitted it to the disbursing officer of the finance corps for payment. The appellate court held that final settlement had taken place when the Comptroller General of the United States made such settlement. In 1905, the Treasury Department was not only in charge of a considerable portion of the Federal building projects but was in charge of the auditing of accounts thereof. The official in charge of construction would certify that the building was completed, a letter would be prepared setting forth the contract price, the additions and deductions, if any, and payments on account, and recommending that a final voucher for the sum therein specified be drawn to the order of the contractor. The date of the administrative approval of this "final settlement letter" by the Treasury Department was held to be the date of final settlement within the meaning of the Heard Act. Illinois Surety Co. vs. U.S. to use Peeler, supra.

While this amendment of 1905 is somewhat ambiguous, the courts should so construe it as to give full effect to its obvious purpose and avoid injustice or absurd results, London, etc., Indemnity Co. vs. Smoot, 287 Fed. 952 (1923).


place on the date the constructing quartermaster prepared and approved the voucher for payment.\textsuperscript{13}

These cases were reconciled in \textit{Globe Indemnity Co. vs. U. S. to use of Steacy-Schmidt Mfg. Co.}.\textsuperscript{14} This case points out that the policy of the statute to afford protection to the interests of labor and materialmen would not be effected unless they were allowed to bring suit with reasonable promptness after the United States had determined that it will have no claim on the bond, or unless the date of final settlement which fixes the time within which suit could be permitted could be ascertained with reasonable certainty and finality. A determination made and recorded in accordance with established administrative practice by the administrative officer or department having the contract in charge that the contract has been completed and the final payment is due fulfills these requirements. The fact that the final settlement letter directed by the administrative department to the General Accounting Office began "I am enclosing herewith for direct settlement claim of" the contractor, and enclosed for the consideration of the General Accounting Office correspondence relative to delays and extensions requested, was held not to affect the decision. The court pointed out that a different question would arise if the department concerned declined to settle the claim and referred it to the General Accounting Office for settlement.

With the advent of the depression, many public works contractors failed, and more and more the administrative departments refused to make final settlement but referred the transaction to the General Accounting Office for direct settlement. Such action not only subjected unpaid labor and materialmen to additional delay, but frequently made it a serious legal question when final settlement took place.\textsuperscript{15}

This uncertainty has been rendered relatively unimportant by the Act of August 24, 1935.\textsuperscript{16} This new statute provides that, before any contract exceeding $2,000.00 in amount for the construction, alteration or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States (a) a performance bond for the protection of the United States, and (b) a payment bond for the protection of persons supplying labor and material in the prosecution of said public work, which separate bond is substantially similar to the additional bond required under existing Pennsylvania statutes.\textsuperscript{17} This new statute has become known as the "Miller Act," since

\textsuperscript{13}Consolidated Indemnity & Ins. Co. vs. Smoot, 57 Fed. (2d) 995 (1932), certiorari denied, 287 U. S. 613.

\textsuperscript{14}291 U. S. 476 (1933), reversing 66 Fed. (2d) 302.


\textsuperscript{16}49 Stats. 793, c. 642. The statute is set forth in the appendix hereto.

\textsuperscript{17}See article by the writer in Dickinson Law Review, January, 1932, Vol. XXXVI, No. 2, p.69.
it was introduced in the House of Representatives by Congressman John T. Miller, of Arkansas.

The Miller Act provides that persons who have furnished labor or material in the prosecution of the public work and have not been paid in full therefor before the expiration of the period of ninety days from the date on which the last of the labor was done or performed or the materials furnished or supplied by such person for which such claim is made, shall have a right immediately thereafter to sue on the payment bond. As a consequence, a creditor who institutes a premature or defective suit injures only himself. His unfortunate act will not defeat the claims of innocent labor and materialmen or subject them to the necessity of settling a bona fide claim at a substantial discount rather than risk their rights upon the determination of a technical issue which they did not create.

Opposition to the provision giving unpaid claimants the right to sue prior to the completion of the public improvement, on the ground that it would result in suits at such an early date as to harass the contractor, has proved to be unfounded. Experience under the Miller Act is the same as in the various states where an unpaid labor or materialman has the right to sue prior to the completion of the building. Unpaid materialmen first exhaust every effort to obtain a reasonable settlement in order to avoid the expense of litigation. It is a rare case where suit is instituted prior to the completion of the building.

Since a reasonable, certain terminal date is essential, the statute provides that no suit shall be commenced on the bond after the expiration of one year from the date of final settlement under the principal contract. Therefore the decisions pertaining to final settlement are still material. To avoid the consequences which might arise where some departmental official, as a result of misunderstanding of the law or a mistake as to the facts, may furnish to a subcontractor erroneous data as to the date of final settlement, the new statute provides that the Comptroller General of the United States is authorized and directed to furnish to any person making application therefor, who submits an affidavit that he has supplied labor or materials for such work and payment therefor has not been made or that he is being sued on any such bond, a certified copy of such bond and


19 This is an improvement over the old law. The Heard Act provided that a person furnishing an affidavit to the department under the direction of which said work was being or had been prosecuted that labor or materials for the prosecution of such work had been supplied by him or them and that payment therefor had not been made should be furnished with a certified copy of said contract and bond, but failed to contain a provision that the contractor or the surety should be furnished with a certified copy of such bond. As a result, the Office of the Comptroller General refused to furnish such certified copies to the defendants in Heard Act suits. The provision in the Miller Act that such certified copy of the contract and bond shall be prima facie evidence of the contents, execution and delivery of the original will simplify the proof required at the trial of such cases.
of the principal contract, together with a certified statement of the date of such settlement, which shall be conclusive as to such date upon the parties. In view of the object sought to be accomplished by the provision that such certified statement from the Comptroller General of the United States shall be conclusive as to the date of final settlement, it is obvious that Congress did not intend either to enlarge the powers of the Comptroller General of the United States or delay the date of making final settlement. 20

The courts have recognized that the obligation of performance and the obligation of payment of labor and material claims contained in Heard Act bonds are two separate and distinct obligations. 21 The new law preserves all existing rights of priority in favor of the United States. The limitations pertaining to suit on the payment bond do not apply to the United States. 22

The simple expedient of separating the two distinct obligations of performance and payment not only confers upon unpaid labor and materialmen the desired speedy and certain remedy, 23 but also permits the elimination of the provision for intervention, required under the Heard Act, which has received considerable warranted criticism. 24 The requirement that all parties must intervene in the suit first brought subjected many an innocent labor and materialman to the necessity of compromising an admitted claim at a substantial discount rather than run the risk of intervening in a defective or premature suit instituted by another creditor.

In U. S. to use of Pen Mar Co. vs. Robinson, 25 it was held that the court had no jurisdiction to consider, in the first suit brought under a Heard Act bond, a second suit on the bond by a second creditor and that such second suit could not be regarded as an intervention in the first suit nor could it be consolidated with the first suit, but must be dismissed, since the suit under the Heard Act was a suit at law to which purely equitable principles do not apply.

The District Court in which a proper Heard Act suit was brought was held to lack power to consolidate with that suit another action which was improperly


23 The security afforded by the bond has a substantial tendency to lower the prices at which labor and material will be furnished, because of the assurance that the claims will be paid, as well as to induce a better grade of subcontractors to bid on public work. Equitable Surety Co. vs. McMillan, 234 U. S. 448, 456 (1913). Therefore, a change in the law which gives to the unpaid labor and materialmen a speedy, certain right of action is beneficial to the United States also.


brought on the same bond in a different and wrong district in the same state.\textsuperscript{26} However, where two suits were instituted in the same District Court under the Heard Act, claimants who erroneously filed intervening petitions in the second suit were permitted to amend their petitions so as to intervene in the suit first brought, where the error was caused by clerk’s answer to petitioners’ inquiry as to whether suit had been filed under the statute, and the interventions were filed in time.\textsuperscript{27}

The change in the remedy permits each subcontractor to maintain a separate independent suit in the district court in the district in which the public improvement is situated. When causes of like nature and relative to the same question are pending in such court, the court may consolidate the causes when it appears reasonable so to do.\textsuperscript{28}

The elimination of the provision for intervention in the suit first brought made unnecessary the provision for notice by the instituting creditor, heretofore honored as often by its breach as in the observance. This requirement of personal notice and notice by publication, contained in the amendment of 1905, was held merely directory, so that the suit of the instituting creditor was valid although notice was not given to the other creditors.\textsuperscript{29} Furthermore, a subcontractor could not successfully assign the failure of the instituting creditor to give such notice as a legal excuse for his failure to intervene in the suit first brought.\textsuperscript{30}

The words “labor and material” as used under the Heard Act have been construed to include patterns made for a contractor from which to make castings required in a vessel,\textsuperscript{31} work of quarrying stone and transporting it to place of building a breakwater,\textsuperscript{32} freight or cartage expended by a materialman in transporting material to the site,\textsuperscript{33} groceries and provisions furnished a contractor for use in a boarding house which, on account of the absence of other accommodations, he was obliged to maintain for his laborers,\textsuperscript{34} but not where there were available existing facilities,\textsuperscript{35} coal to heat buildings,\textsuperscript{36} feed furnished mules

\textsuperscript{27}U. S. to use Sargent Co. vs. Century Indemnity Co., 9 Fed. Supp. 809 (1935), which holds that the suit first brought on the bond is the suit in which all other parties in interest are required to intervene, irrespective of the merit or lack of merit of the claim of the instituting creditor.
\textsuperscript{28}28 U. S. C. A., sec. 734.
\textsuperscript{29}U. S. to use Bryant vs. N. Y. Steamfitting Co., 235 U. S. 327 (1914).
\textsuperscript{31}Title Guaranty & Trust Co. vs. Puget Sound Engine Works, 163 Fed. 168 (1908).
\textsuperscript{33}Title Guaranty & Trust Co. vs. Crane Co., 219 U. S. 24 (1910).
\textsuperscript{34}Brogan vs. National Surety Co., 246 U. S. 257 (1917).
used in work of hauling incident to construction of a levee,\textsuperscript{57} tires and tubes worn out in operation of trucks on Government dam project.\textsuperscript{38} 

Since the new law adopts, to a great extent, words used in the statute which it repeals, it is assumed that the words "labor" and "material" will receive the interpretation placed upon like terms in the former statute.\textsuperscript{39}

Congress, in balancing the equities, decided not to limit the kind or character of labor or material for which payment had been allowed under Heard Act bonds, but to restrict the right of recovery under the payment bond to persons who furnish labor or material under an agreement with the contractor or any subcontractor.\textsuperscript{40} It would seem that this legislative intent has been made ineffective by the administrative department which prepared the new bond forms. The payment bond now in use\textsuperscript{41} is conditioned that "the principal shall promptly make payment to all persons supplying labor and material in the prosecution of the work provided for in said contract, and any and all duly authorized modifications of said contract that may hereafter be made." Where a bond is broader than the legislation under which it is given, it will be enforced for the benefit of all who come within its broader terms.\textsuperscript{42}

\textsuperscript{57}U. S. to use Samuel Hastings Co. vs. Lowrance, 232 Fed. 122 (1918).
\textsuperscript{39}C. J. 1061 to 1063, sec. 625.
\textsuperscript{40}The legislative intent appears in the following excerpt from the report of the Committee on the Judiciary:
"A sub-subcontractor may avail himself of the protection of the bond by giving written notice to the contractor, but that is as far as the bill goes. It is not felt that more remote relationships ought to come within the purview of the bond." House of Representatives Report No. 1263, 74th Congress, first session, reporting favorably on H. R. 8519.
\textsuperscript{41}U. S. Standard Form No. 25-A, approved by the Secretary of the Treasury September 16, 1935.

It was first held under the Heard Act that the terms of the bond could not be enlarged by implication and that one who furnished labor or material to a subcontractor had no action on the contractor's bond. U. S. vs. Simon, 98 Fed. 73 (1899); U. S. vs. Farley, 91 Fed. 474 (1899); U. S. to use vs. Burgdorf, 13 App. D. C. 506, 520. However, in 1906, the Supreme Court decided that, since the statute should be liberally construed with an eye to the purpose of protecting all who furnished labor or material for use in the construction or repair of government buildings and works, such persons are protected by the bond even though the labor and material are supplied to a subcontractor and although the bond expressly covers only labor and material furnished to the contractor. U. S. to use Hill vs. American Surety Co., 200 U. S. 197 (1905); Mankin vs. U. S. to use Ludowici-Celadon Co., 215 U. S. 533 (1909). In reaching this decision, the Court pointed out that neither the bond nor the statute indicated or circumscribed the source of the labor or material and that the condition in the bond, read in the light of the statute, worked to the protection of those who supplied the labor or material provided for in the contract, irrespective of the particular contract or engagement under which the labor or material was supplied.

Since, under the Heard Act, no notice was required, a solvent contractor was occasionally prejudiced by the appearance of a small claim by a remote materialman months after he, in good faith, had paid his subcontractor.
A person who furnishes labor or material under an express or implied agreement with the contractor need not give notice to any one before instituting suit on the payment bond. A person having direct contractual relationship with a subcontractor must give such notice. To so construe the statute as to hold that a person who furnished labor or material to a sub-subcontractor is in the same favored position as a person who deals directly with the principal contractor (i.e., has a status superior to that of one who furnishes labor or material to a subcontractor) would be an unreasonable construction opposed to the intent of Congress, as clearly indicated by the report of the Judiciary Committee of the House of Representatives.⁴³

It is believed that the interpretation of the statutory provision for notice contained in this article accurately sets forth the legislative intent. An earlier bill,⁴⁴ conferred upon every person who had furnished labor and material in the prosecution of the public work the right to sue on the payment bond and provided that any such person who had no contractual relationship, express or implied, with the contractor, should not have a right of action upon said payment bond unless such person gave the ninety days’ written notice to the contractor. The bill reported out by the Judiciary Committee of the House of Representatives and subsequently enacted contained the clause set forth in italics below:

"Every person who has furnished labor or material in the prosecution of the work provided for in such contract . . . . shall have the right to sue on such payment bond . . . . provided, however, that any person having direct contractual relationship with a subcontractor but no contractual relationship express or implied with the contractor furnishing said payment bond shall have a right of action upon the said payment bond upon giving written notice to said contractor . . . ."

The object of this change in language was to eliminate claims by persons more remote than sub-subcontractors. While it might have been better draftsman to indicate the intent to eliminate claims of remote parties by a separate sentence or a separate paragraph, the meaning of the proviso above quoted in

⁴³See footnote (40), supra.
⁴⁴H. R. 6677, 74th Congress, first session. The change in procedure effected by the Miller Act was first urged by the writer on February 20, 1932, before the Committee on the Judiciary of the House of Representatives, 73rd Congress, first session. The suggestion met with the approval of the Committee. Thereafter, a number of separate bills were introduced in Congress which adopted the two-bond system. Following the public hearings of 1935, there was introduced in Congress H. R. 6677, 74th Congress, first session, which combined the best features of all the earlier bills. Several improvements in phraseology were suggested and a new bill embodying these changes (H. R. 8519, 74th Congress, first session) was favorably reported out and was in due course enacted as Public Law No. 321, 49 Stats. 793, c. 642.
italics becomes clear when read in the light of the report of the Judiciary Committee of the House of Representatives. To date, the question whether a claimant more remote than a sub-subcontractor who gives the ninety days' notice may recover under the bond, in view of the broad language of U. S. Standard Form No. 25-A, has not come before a Federal Court for determination. Since such rare and remote claims are relatively small, a liberal interpretation of the statute and bond giving such remote claimants a right of action, provided they have given due written notice within the ninety days, would not work an undue hardship upon any party in interest.

The requirement for notice by persons who furnish labor or material to a subcontractor represents a reasonable compromise between the views of certain materialmen, who contended that since, under the Heard Act, there was no requirement for notice, no such restriction should be imposed by a statute designed to correct procedural defects, and the views of some surety executives, who contended that all claimants should be required to give notice to the contractor and the surety within a short period of time after claimant furnished his labor or material. The subcontractors and materialmen contended that a requirement for notice to anyone within a period less than that which constitutes the usual terms of credit would prove an impracticable requirement nullifying, in most instances, the advantage of the bond. Obviously, a supplier of material would hesitate to offend a customer by giving notice of non-payment of a debt prior to a reasonable period of time after the material was furnished.

No notice is required from persons who deal with the contractor because the contractor knows or should know the nature and character of his indebtedness to the persons with whom he deals. The surety, having access to the records of the principal contractor, can speedily ascertain the status of all subcontracts if it so desires.

Notice is required in order to avoid stale claims and to relieve a responsible contractor and his surety of the possibility of double payment. While Congress, ever considerate of the fact that a laborer or a small claimant might not know or conveniently ascertain the name of the surety, required notice to be given only to the contractor, i.e., a person whose name would be known to all persons at the site, the effect of the new statute is that notice of unpaid claims is brought home to the surety at an early date when it can step in and protect its interests. Persons to whom a substantial sum is due not only notify the contractor but request payment from the surety, especially in the jurisdictions where interest may be claimed from the surety only from the date that payment of the claim is demanded of the surety.

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45 See footnote (40), supra.
46 50 C. J. 90, sec. 147.
The written notice required by the statute is not a formal document. Nevertheless, it must contain sufficient information to enable the contractor to identify the claim with reasonable certainty. The most convenient method of service of such notice is by registered mail directed to the contractor at his office or place of business. However, the notice may be served in any manner in which the United States marshall of the district in which the public improvement is situated is authorized by law to serve summons.

As the premium for the surety bond is based on the contract price and is regulated with most companies by a rating bureau which considers the losses and profits of this phase of the surety business over a period of years, no change has been made in the rate of premium and none should be made merely because the two separate and distinct obligations prescribed by the Heard Act now exist as separate documents which are required to be executed at one and the same time.

Since an additional bond is required in the penal sum of fifty per cent. of the contract price where the contract price is a million dollars or less, it is in a sum which should be adequate to protect all claimants. If the contractor defaults at an early stage of the work of construction, the United States will be protected by its separate performance bond and the amount due labor and materialmen will not in any way approach the penal sum of the payment bond. If the contractor does not default until the public work is substantially completed, obviously laborers will have been paid most, if not all, of the money due them and subcontractors and materialmen will have received a number of progress payments. Consequently, the total of the claims under the payment bond should at all times be less than the penal sum thereof.

II. PWA BONDS SHOULD BE UNIFORM

The rules and regulations of the Federal Emergency Administration of Public Works provide that, on all construction contracts except as otherwise approved by the state director, the applicant shall furnish a performance bond in an amount equal to the contract price, conditioned upon the faithful performance of

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47See footnote (67), post.
49Bulletin No. 2, "Non-Federal Projects," revised March 1, 1935, applicable to PWA non-Federal projects for which allotments were made on or before March 1, 1935, up to and including the time when PWA forms Nos. 188 and 200 were issued. See also rules and regulations relating to applicants and projects under Title II of the National Industrial Recovery Act, issued August 12, 1935, being PWA Form No. 188, applicable to loans and grants, and PWA Form No. 200, applicable to grants, and the rules and regulations relating to applicants and projects under Emergency Relief Appropriation Act of 1935, issued July 22, 1935, being PWA Form No. 166, applicable to loans and grants, and PWA Form No. 179, applicable to grants.
the contract and upon the payment of all persons supplying labor and materials for the construction of the project, except where it is required by local law that protection for labor and materialmen be provided by a bond separate from the performance bond. In the latter case, a performance bond in an amount equal to the contract price, supplemented by a separate labor and materialmen's bond in an amount not less than fifty per cent. of the contract price, is required. In states in which the local law does not require a separate labor and materialmen's bond, the contractor must furnish, in addition to the performance bond conditioned as above, a labor bond in an amount equal to the largest estimated aggregate payroll for any one month during construction. A form of labor bond furnished by the Government must be used in all cases where it is compatible with local law.50

Insofar as the laws of the state in which a construction project is situated permit, there should be uniformity with respect to the scope of PWA bonds and the procedure for recovery thereunder.

The forms adopted by the Delaware River Joint Commission of Pennsylvania and New Jersey in 1935 prescribe a surety performance bond and a separate labor and materialman's bond which latter bond follows the standard form.51

The additional bond so required is conditioned that the principal and all subcontractors to whom any portion of the work provided for in the public contract is sub-let and all assignees of said principal and of such subcontractors shall promptly make payment for all labor performed, services rendered and materials furnished in the prosecution of the work provided for in the contract. This bond further provides that all persons who have performed labor, rendered services or

50The standard form of labor bond (now P. W. 26810, formerly P. W. 4408) required to be furnished on PWA non-Federal projects constructed with funds allotted under Title II of the National Industrial Recovery Act provides that the principal contractor and all subcontractors to whom any portion of the work provided for in the principal contract is sublet shall promptly make payment for all labor performed and services rendered in the prosecution of the public work. All persons who have performed labor or rendered services in the prosecution of such work have a direct right of action against the principal contractor and surety on this bond, which action may be maintained at any time up to six months after the complete performance of the contract and final settlement thereof. This bond provides that the surety shall not be liable thereunder for a greater sum than the penalty of the bond or subject to any suit, action or proceeding thereon that is instituted later than six months after such complete performance and final settlement.

The bond further provides that, insofar as permitted by the laws of the state in which such labor was performed or services rendered, such right of action shall be asserted in a proceeding instituted in the name of the obligee to the use and benefit of the person instituting such action and of all other persons having claim under the bond, and any person having a claim under the bond shall have the right to be made a party to such proceeding within said six-month period and to have his claim adjudicated in such action and judgment rendered thereon.

The administration does not require that a labor bond be furnished on PWA non-Federal projects constructed with funds appropriated under the Emergency Relief Appropriation Act of 1935. See footnote (49).

51The condition of the standard form of labor bond was enlarged to cover material furnished to the principal contractor or a sub-contractor. See footnotes (50) and (57) hereof.
furnished materials as aforesaid shall have a direct right of action against the principal and surety on the bond, which right of action shall be asserted in proceedings instituted in the state or any state in which such labor was performed, services rendered or materials furnished; that, insofar as permitted by the laws of such state, such right of action shall be asserted in a proceeding instituted in the name of the obligee, to the use and benefit of the person instituting such action and of any other person having claims thereunder, and any other person having a claim thereunder shall have the right to be made a party to such proceedings (but not later than six months after the complete performance of said contract and final settlement thereof) and to have such claim adjudicated in such action and judgment rendered thereon. The bond further provides that, in no event, shall the surety be subject to any suit, action or proceeding thereon which is instituted later than six months after the complete performance of said contract and final settlement thereof.

The word "person" is defined in the aforesaid bond to mean any person, firm or corporation who has furnished material to be used on or incorporated in the work or the prosecution thereof provided for in said contract and/or to any person engaged in the prosecution of said work who is an agent, servant or employee of the principal or of any subcontractor or of any assignee of said principal or of any subcontractor, and also any one so engaged who performs the work of a laborer or of a mechanic, regardless of any contractual relationship between the principal or any subcontractor or any assignee of said principal or of said subcontractor and such laborer or mechanic, but does not include office employees not regularly stationed at the site of the work.

The School District of Philadelphia recently required a substantially similar form of additional bond limiting suit to such six-month period. However, the School District of Philadelphia now requires a separate labor and materialmen's bond which provides that the right of action shall be asserted in a proceeding instituted in the name of the School District, to the use and benefit of the person instituting such action and of all other persons having claims thereunder, and that any other person having a claim thereunder shall have the right to be made a party to such proceedings within a year after the complete performance of said contract and final settlement thereof. Under the School Code, the additional bond must provide that every person who, whether as subcontractor or otherwise, has furnished material or performed labor in the prosecution of the work, and who has not been paid therefor, may sue in assumpsit on said additional bond in the name of the said School District for his benefit. Each claimant on a school job financed in part by PWA funds should have the beneficent separate right of action prescribed by the Pennsylvania statutes and not be subjected

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to the inconvenience and possible loss which might arise if the instituting creditor started a defective or improper suit, or if a claimant, being ignorant of a suit first brought on the bond, started a second suit thereon. The well established local procedure of separate suits is not prohibited by PWA regulations. The procedure should be the same whether the contract for the construction or repair of the school building is financed entirely by the School District with its own funds or in part by PWA money.

There is no provision for notice to the contractor in these PWA forms. Both the Pennsylvania statutes and the Miller Act require notice by persons who have no contractual relationship, express or implied, with the principal contractor, in order to prevent stale claims by remote claimants and the necessity of double payment.

Under the Miller Act and the Pennsylvania statutes, suit may not be instituted until the expiration of a period of ninety days after the claimant furnished the last of his labor and material. There is no such wise limitation in the PWA form.

The PWA form allows recovery for services rendered. Whether, under this phrase, recovery can be had for the rental value of machinery and equipment has not yet been before our courts. Under the Pennsylvania statutes, recovery may be had for material consumed in operating the machinery and equipment but not for the rental value of the machinery or equipment.

In a recent PWA project for a local university, the contractor was required to execute a bond in the penal sum of $403,192.00, conditioned that he comply with all the terms of the contract and should well and truly pay all persons who had contracts directly with him for materials entering into and becoming a component part of the structure. This bond further provided that the right of any materialman to institute any suit or suits against the surety for materials furnished should not accrue unless and until the university, obligee on the bond, had certified under its seal that the building had been completed to its satisfaction and that it had no cause of action on the bond for the failure of the contractor to complete the same.

This bond contains no limitation of the time for suit, no provision for notice of an unpaid claim to the contractor and denies recovery for materials required in the construction of the improvement, specifically mentioned in the specifications therefor, which were either consumed in the work or rendered worthless as a result of such use therein.

Thus it will be seen that a subcontractor or materialman may not assume

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53 See part I of this article and footnotes (24) to (28) for the problems which arose when all claimants were required to intervene in a single suit instituted under the Heard Act. See also Commonwealth to use vs. Piel Constr. Co., 284 Pa. 64 (1925).

54 Commonwealth to use vs. Ciccone, 316 Pa. 111 (1934); Lancaster to use vs. George, 315 Pa. 235 (1934).
that he is protected by the bond or bonds given in connection with PWA work,\textsuperscript{5} and that it is essential that each bond be examined in order to determine the extent of its coverage and the limitations, if any, to the right of and time for suit.

PWA regulations expressly provide that the requirements of the state law as to form and content of the bonds shall be observed.\textsuperscript{5} In some instances, at the request of the applicant, PWA has approved a labor bond form which also protects materialmen, particularly in those states in which the statutes make no specific provision for rights of action or joinder of parties, but merely make the general requirement that a bond to protect labor and materialmen should be exacted.\textsuperscript{57} Solicitors for the Pennsylvania School Districts have been advised by PWA that they may use any bond form which complies with the statutory requirements of Pennsylvania and, therefore, the impression that standard form P. W. 26810, formerly P. W. 4408, may not be altered is incorrect. Local officials need not hesitate to adopt, with respect to PWA work, bond forms which comply strictly with the requirements of the Pennsylvania statutes.

The Housing Division of the Federal Emergency Administration of Public Works now exacts a performance bond for the protection of the United States and a separate payment bond for the payment of labor and materialmen, using the forms approved by the Secretary of the Treasury following the passage of the Miller Act. It would be well if all other Federal agencies, wherever possible, followed the example of the Housing Division in this connection.

III. INDIVIDUAL SURETIES SHOULD BE ELIMINATED

Whenever any bond conditioned for the faithful performance of any duty or for the doing of any thing is, by the law of the United States, required or permitted to be given with one surety or with two or more sureties, the execution thereof, or the guaranteeing of the performance of the condition thereof, is sufficient when executed or guaranteed solely by a corporation having power to execute such an instrument.\textsuperscript{58} This Act of Congress does not exclude individual sureties.\textsuperscript{59} There is no mandatory requirement either under the Heard Act or any other Federal statute for a bond executed by a corporate surety in connection with

\textsuperscript{58}Szilyagi et al. vs. City of Bethlehem, 312 Pa. 260 (1933).

\textsuperscript{59}Letter from counsel for the Administrator to the writer, dated November 21, 1935.

\textsuperscript{57}See footnote (49) hereof.

\textsuperscript{58}Act of August 13, 1894, 28 Stat. 279, 6 U. S. C. A. Sec. 6.

\textsuperscript{59}"By the Act of August 13, 1894, c. 282, 28 Stat. 279, Congress has made elaborate provision for the safe use of surety companies as security upon bonds required in court and other proceedings, and while it does not exclude individual sureties, it offers a most convenient and stable means of obtaining indemnity against the default of parties. This is much to be preferred to individual sureties because a properly conducted surety company makes it its business promptly to investigate and to meet its liabilities."

public work contracts. The Miller Act was intended merely to correct pro-
cedural difficulties under the Heard Act, and not to make any material changes in
substantive law.\

A public works contractor should be prohibited from furnishing bonds
executed by individual sureties in connection with Federal public works con-
tracts. Such a change in the law would

(a) not subject a claimant to defenses where the bond was that of an
individual surety, which defenses would be insufficient if a bond of a
paid corporate surety had been furnished;\

(b) eliminate the burdensome task now placed upon Federal officials of
determining whether an individual surety is acceptable. The Federal
officials lack the facilities for a thorough investigation of the state-
ments made by the proposed individual surety;

(c) prevent loss to subcontractors, laborers or materialmen in cases where
the financial standing of the individual surety has changed during
the year or more which elapsed since the date when he executed the
bond and the completion of the public improvement;

(d) assure to the United States a better grade of work. A better grade
of subcontractors will bid on public work and, in normal times, will
reduce their prices if they know the risk of non-payment is shifted
to a paid corporate surety.

An illustration of the hardship which has resulted where the bond of
individual sureties was taken will now be given. Since the case is not yet closed,
the facts will be set forth only in general terms.

By writing dated November 11, 1932, the United States accepted in con-
nection with a contract of $349,500 for the construction of a post office in
Illinois, the bond of three individuals for $175,000. In their affidavits each
individual surety represented that he was worth in real estate and personal prop-
erty, sums aggregating double the penalty of the bond over and above his debts
and liabilities owing and incurred; any property exempt from execution; the
aggregate full penalties on all other bonds on which he was surety; any pecuniary
interest he had in the principal on said bond.

60 The Miller Act provides that the performance bond and payment bond shall be executed
by surety or sureties satisfactory to the officer awarding said contract. See 15 Com. Gen. 188; 15
Com. Gen. 81.

61 The defense of strictissimi juris does not apply to a paid corporate surety. U. S. F. & G. vs.
United States, to use, 191 U. S. 416 (1903); Young vs. American Bonding Company, 228 Pa.
373 (1910).

62 This is the language of the standard form of affidavit by individual sureties.
The contractor was declared in default by the United States on June 7, 1934. A contract to complete the project was awarded November 22, 1934. Final settlement has not yet been authorized. Consequently, the unpaid labor and materialmen do not yet have the right to sue on the bond. A recent mercantile report shows that one of the individual sureties is in the garage business with a bank balance of $200 and is the owner of real estate worth $100,000 on which there is a mortgage of $100,000; that another such surety is a petty employee in a steel mill; that, when this individual executed the bond and made the affidavit, title to the real estate mentioned in his statement was in the name of deponent and his wife as tenants by the entitie. The third individual surety now operates a barber shop. He once owned a building valued at $75,000 subject to a mortgage of $70,000.

Corporate sureties are subject to regulation by the United States and, of course, to examination by the Insurance Departments of the various states.

A bill introduced in the last session of Congress was a step in the right direction. This bill provided that all Federal agencies should require bids for the construction, alteration or repair of any public building or public work to be accompanied either by a bid bond executed by a surety company, by a certified check or by obligations of the United States. This bill failed to pass but no doubt a similar measure will be re-introduced next year.

Wherever by the laws of the United States a person is required to furnish a bond with surety or sureties, such person may in lieu of such surety or sureties deposit as security with the official having authority to approve such bond, United States Liberty Bonds or other bonds or notes of the United States, or other obligations which are unconditionally guaranteed as to both interest and principal by the United States, in a sum equal at their par value to the amount of such penal bond required to be furnished, together with agreement authorizing said official to collect or sell such bonds or notes so deposited in the case of any default in the performance of any of the conditions or stipulations of such penal bonds. Where a person supplying a contractor with labor and material on any public building or public work files with the United States at any time after a default in the performance of any such public work contract an affidavit that claimant has not been paid for the labor or material which he furnished to said

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63It is the duty of such corporate surety to file quarterly statements with the Secretary of the Treasury and that official is empowered to recall the authority of any such surety company to transact any new business under the act whenever in his judgment such company is not solvent or is conducting its business in violation of the statute. This provision applies to corporate sureties seeking to execute bonds under the provisions of the Miller Act. Section 4, Act of August 13, 1894 as amended, March 23, 1910, 36 Stat. 241 Ch. 109, 6 U. S. C. A. Sec. 9.

64H. R. 12260, 74th Congress, second session. The Committee on the Judiciary of the House of Representatives reported this bill favorably to the House, with a minor change. See report No. 2497, House of Representatives, 74th Congress, second session.
public improvement and requests a certified copy of the contract and bond, the
United States may not deliver to the obligee the deposited bonds or notes nor
any surplus or proceeds thereof until the expiration of the time limit for the
institution of suit on said public works bond, and, in case suit is instituted thereon
within a year after completion and final settlement, the United States is required
to hold such notes or bonds, or proceeds thereof, subject to the order of the court
having jurisdiction of said suit. 65

IV. CORPORATE SURETY BONDS BENEFIT THE PUBLIC

Forty-six States of the Union, as well as the United States now require con-
tractors on public works to furnish a bond for the protection of labor and material-
men. 66 Notwithstanding this fact, the suggestion has been made that all public
works surety bonds should be abolished and the public body protect itself against
loss by a special fund. Protagonists of this change start with the assumption
that the bond premium is reflected in the bid of the contractor. They tabulate
public contracts in a city or other political unit for a limited period of time, often
including a period of falling markets. The bond premiums on such contracts, com-
puted at the standard rates 67 are compared with the actual loss incurred by the
public body in the given territory during the period under consideration, and
when the actual pecuniary loss to the public body itself is less than the amount
paid by the contractors for bond premiums, it is assumed that if the bonds had
been eliminated the public body would have saved the difference. 68 This inference
is incorrect. The public benefits in many ways when corporate surety bonds
protecting labor and materialmen are taken.

Where a contractor defaults in the construction of a public improvement,
pecuniary loss is sustained by the persons whose labor and material created the
public improvement as well as by the public body. Not only does there rest

65 Act of June 2, 1924, ch. 234, sections 2, 1029, 43 Stat. 253, 349, as amended by the Act

66 The states without general statutes protecting labor and materialmen by bond are: Ken-
tucky, Maine, New York, South Carolina, Virginia and Vermont. However, as a matter of policy,
a bond protecting labor and materialmen is required by the State Highway Department in Ken-
tucky, Maine, South Carolina and Virginia, and in Kentucky and New York certain political sub-
divisions are required by local acts to exact a bond for the protection of labor and materialmen.

67 The contract price measures the exposure and hence is the correct basis for computing the
premium. Time is also an element of exposure. The standard rates are one per cent. of the contract
price on highway contracts and one and one-half per cent. on building contracts. These are the
rates fixed by the Towner Rating Bureau, of New York City, a bureau which makes advisory rates
for fidelity and surety bonds which has been officially designated by the Superintendent of Insurance
of the State of New York as the official bureau to which fidelity, surety, and forgery experience
of all companies writing such bonds must be submitted, whether or not the companies are sub-
scribers to the bureau. Most surety companies writing public works contractors’ bonds are sub-
scribers thereto.

upon the public body a moral obligation founded in a measure upon the equitable doctrine that one who has enhanced the value of property by furnishing thereto labor or material should be compensated to the extent of his contribution but the security afforded by the bond has a substantial tendency to lower the prices at which labor and material will be furnished because of the assurance that the claims will be paid, as well as to induce a better grade of subcontractors and materialmen to bid on public work.

It is axiomatic in the building trades that, given the same project, the same plans and specifications, the same architect and superintendence, nevertheless, the character of the work performed varies with the contractor and subcontractors performing it. The importance of skill, integrity and ability in connection with a subcontractor on a public improvement is obvious. The class of subcontractors and materialmen who bid on public work would not be improved by a change in the law eliminating the requirement of a bond. The reverse would be the case.

The argument that subcontractors and materialmen will not deal with an irresponsible contractor is not borne out by the facts. Any contractor upon whom a public body puts its stamp of approval by awarding to him a contract will find some subcontractor willing to bid to him thereon. The State of New York lacks a state-wide public works bond law, but unpaid labor and materialmen are given a lien upon the unpaid portion of the contract price. Notwithstanding this right of lien, losses from 1931 to 1933 on New York State work alone to laborers total $138,798.21 and to subcontractors and materialmen were $2,067,891.81. These sums fail to take into account the additional loss to labor and materialmen on public projects in New York other than those pertaining to state buildings and state highways.

It was recently proposed in the State of New York that even the performance bond required by the present law be eliminated and that the State Comptroller provide a special fund of one million dollars to meet any excess cost to the state involved in the completion of defaulted public work contracts. The fund was to be created by paying to the Comptroller from moneys in the State Treasury applicable to payment for work specified in every building contract one

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69Piedmont Coal Co. vs. Seaboard Fisheries, 254 U. S. 1 (1920); See the cases in footnote (1) hereof.


71New York lien law, section 5. Laws 1911, chapter 873, as amended by Laws 1916, chapter 507, sec. 3.

72Taken from the detailed records of the Department of Audit and Control, Albany, New York.

73Bill No. 439, Int. 422, introduced in the Senate of New York January 21, 1936. This bill, entitled "An Act to amend the state finance law, the highway law, the public buildings law, the public works law and the lien law, in relation to dispensing with bonds for the performance of contracts awarded by the state for public improvements," was committed to the Committee on Finance. Throughout this article, it will be called the "Greene Bill."
per centum of the contractor's bid. The fund for the insurance of such contracts reached a total of one million dollars, payments thereto were to be discontinued until a loss was sustained in the completion of a state contract, whereupon payments were to be resumed until the fund of one million dollars was restored. This naive plan overlooks the material facts that, based on the present rate of construction, it would require contracts aggregating one hundred million dollars to be awarded and, therefore, an indefinite number of years, to create a million dollar fund, and that frequently the loss sustained by a surety company upon a public contractor's default is substantial. The surety on the contract for the construction of the Bear Mountain Bridge, New York, advanced in connection with the completion of the bridge one million dollars. The loss sustained by the surety as the result of the default of the contractor for the construction of South Office Building No. 2, at Harrisburg, Pennsylvania, following an accidental fire, was approximately $1,250,000. Losses of $100,000 or more to surety companies on public works projects are not uncommon. Thus, a statute which eliminates immediately protection of a surety bond may seriously prejudice the public body.

Recent contracts for work on the various institutions and other public buildings of the Commonwealth of Pennsylvania were as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1933</td>
<td>$837,794.50</td>
</tr>
<tr>
<td>1934</td>
<td>999,676.73</td>
</tr>
<tr>
<td>1935</td>
<td>31,809.00</td>
</tr>
<tr>
<td>1936 to July 1</td>
<td>717,106.17</td>
</tr>
</tbody>
</table>

Public works contracts for 1935 throughout the entire United States were as follows:

<table>
<thead>
<tr>
<th>Region</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>New England States</td>
<td>$78,044</td>
</tr>
<tr>
<td>Middle Atlantic States</td>
<td>302,114</td>
</tr>
<tr>
<td>Southern States</td>
<td>210,627</td>
</tr>
<tr>
<td>Middle Western States</td>
<td>181,551</td>
</tr>
<tr>
<td>States West of Mississippi</td>
<td>255,162</td>
</tr>
<tr>
<td>Far Western States</td>
<td>191,514</td>
</tr>
</tbody>
</table>


An expert dredging contractor agreed to dredge the Ohio River. When this contractor advised the surety he was unable to complete, the surety procured the completion of the contract within the prescribed time at an increased cost of $150,000.

The contractor for the construction of a bridge over the Hackensack River at Hackensack, New Jersey, became financially embarrassed due to local conditions. The surety stepped in, completed the bridge and delivered it to the State at a loss to the surety of approximately $110,000.

The contractor for the construction of Officers' Quarters at Fort Humphreys (now Fort Belvoir) informed the surety that he was about to cease all work. The surety furnished its engineers, advanced the required financial assistance and, upon delivery to the United States of a completed building and paying the labor and material claims, sustained a loss of $94,957.04.

The contractor for the construction of the Baltimore Appraisers' Stores, Baltimore, Md., encountered difficulties with respect to another building project. The surety company sent its exper-
A surety company can take steps to prevent a contractor from defaulting and thus avoid a substantial loss. The State would have no right to use any part of its special fund to bolster up a weak contractor and thus avoid a breach of contract. Public officials may not avoid the delay, inconvenience and damage incident to a breach of building contract by disbursing public money in the manner in which a wise surety company can expend its own funds in order to avoid a contractor's default. Efficient surety companies frequently minimize their losses by prompt action in lending their financial strength to a needy contractor. A public body cannot function in this manner even if it had the legal right so to do without opening the door to fraud or favoritism.

Where it has bonded a contractor on several jobs in different States, and the existence of a default on one job might result in a breach of the other, a surety company may and frequently does assist the contractor by pecuniary advances and technical assistance. Such a course has at times enabled the contractor to remain in business and out of future and profitable contracts reimburse the surety for its advances. Such aid is valuable only if it can be rendered promptly and the work of construction permitted to continue without undue delay. Surety companies have learned by experience that it pays to anticipate trouble rather than wait to be overtaken by it.

Such action has been taken by surety companies where the contractor became embarrassed by the illness or death of a partner, by PWA inspections.

ienced personnel to assist the contractor, procured the completion of the building, advancing to the project several hundred thousand dollars, and sustained a net loss of around $75,000.

The contractor for the construction of a road for Westchester County Park Commission, New York, became unable to proceed. The surety assumed the work of completion and procured the prompt and satisfactory completion of the work at a loss to itself of approximately one-third of the contract price, i.e., $60,000.

For additional illustrations, see tootnotes (77) to (82) hereof.

77The contractor for the construction of a State building at Manteno, Illinois, was one of the most responsible contractors in Illinois, considered responsible from the standpoint of finance, experience and integrity. Due to the illness of the senior partner, unforeseen difficulties arose shortly after the commencement of the work. The surety company advanced approximately $200,000 to complete the work.

78The contractor for the extension of the Outfall Sewer in Bolling Field, Virginia, encountered difficulties which he claimed were due in part to PWA inspections and notified the surety that he was unable to proceed. If the job had been defaulted, work would have been delayed until the District had an opportunity to prepare new specifications and re-advertise for bids. The surety had confidence in the contractor's integrity, sent an expert engineer to take charge of the work, advanced the necessary funds for payrolls, paid material bills and sustained a loss of approximately $106,000, but delivered to the District a completed improvement in accordance with the provisions of its contract.
the appointment of a receiver, unanticipated difficulties with subcontractors, with adjacent property owners due to blasting, or by encountering unforeseen conditions influencing the contractor to decide to cease work, which cessation of work would seriously prejudice the public interest.

The proposed New York law seeks to protect subcontractors and materialmen by a requirement that, from the amount of all partial payments on all approved estimates payable to the contractor until fifty per cent. of the work is completed, twenty per cent. thereof should be retained with a smaller but substantial retainance thereafter and until the contract is accepted. In event of the cancellation of the contract by the State, this retained fund is to be applied first toward the payment of unpaid labor performed in and about the construction of the public improvement and the balance, if any, toward the payment of unpaid materials incorporated in the project, before any part thereof may be used to complete the contract.

79 A Baltimore contractor for whom a surety had written three bonds, one covering a sewer contract, one a road contract and one a bridge contract, became financially embarrassed and a receiver for the contractor was appointed. The receiver lacked cash with which to complete the three contracts and applied to the surety for assistance. While the surety had no obligation so to do, it advanced to the receiver sufficient funds to enable him to complete all three contracts. This procedure enabled the receiver to collect other assets which would have been dissipated if it had become necessary to re-advertise, with the normal situation of a substantially increased sum bid as the cost of completion.

80 When the contract for the construction of a road on White Face Mountain, near Lake Placid, New York, was approximately half completed, certain subcontractors claimed that they had been illegally defaulted and filed suit against the principal contractor. Before the project was completed, the contractor became financially embarrassed and the surety, under a bond of $100,000, completed the project.

81 Considerable blasting was required in connection with the sewer contract in Bowling Green, Kentucky. A number of claims were filed against the contractor for damage resulting from the blasting. As a result, the contractor left the job. The surety undertook completion and completed the sewer at a substantial loss to itself, without subjecting the municipality to the delay which would have followed a formal default.

82 A constructor building a levee in Louisiana reached the end of his financial resources. The surety was notified that, in the opinion of the Government engineers, an emergency existed and hence the work of completion of the levee could not be delayed. The surety accepted the estimate of the Government engineers that but approximately 300,000 cubic yards of excavation were required and proceeded in reliance on the Government's estimates, which, of course, had been furnished in good faith. Not only were the Government estimates inaccurate as to the quantities of earth required to be placed, but it developed that the base of the levee had been constructed of material which would not withstand the pressure of the completed levee. As thousands of cubic yards of earth were piled on top of the levee, a greater quantity of earth would begin to leave the bottom and slide toward the river. Finally, after pushing all the inferior material into the river and depositing approximately 900,000 cubic yards of earth, instead of the 300,000 estimated, the surety delivered to the United States a completed improvement, it expending, in order to procure prompt completion of the levee, a sum considerably in excess of the penalty of the bond.

83 Greene Bill, section 2.
Realizing that even such a substantial retainance would be insufficient to pay labor and materialmen in full, such unpaid claimants are also to be permitted to share in the special State fund on an equal footing with the State.\textsuperscript{84}

The United States found it essential to amend the Heard Act of 1894, which gave labor and materialmen equality with the United States on the bond.\textsuperscript{85} By the amendment of 1905, Congress provided that the United States Government should be paid in full before there was any disbursement to subcontractors.\textsuperscript{86} Thus, unless the proposed law gave the State priority over labor and materialmen for any loss which the State might sustain whenever a contractor defaulted, the public would be seriously prejudiced.

However, if subcontractors and materialmen are denied equality with the public body, then a loss to the public body on a second job might prejudice the unpaid laborers and materialmen on the first job. The fund would be exhausted to the detriment of the labor and materialmen. Hence, the risk and hazard of non-payment would continue to be reflected in the bids of subcontractors and materialmen. As the bid of a contractor is based primarily upon the sum total of the bids of the subcontractors, the State under the proposed untried law would lose much more than the sum which represents the premium on bonds protecting all parties in interest.

A surety bond reduces construction costs, guarantees free and open competition and consequently prevents collusive bidding on public work. The low bid on a New York subway project\textsuperscript{87} was approximately three million dollars less than the next lowest bid. Other bids were from six to seven million dollars higher than that of the low bid. The public officials delayed the award of the contract several months to give the surety companies an opportunity to go over the low bidder's estimate. The surety bond was written and the contract successfully completed.

A contractor who subsequently became one of the leading subway constructors in the United States was the low bidder by $648,000 on his first subway job.\textsuperscript{88} This bid was approximately one million dollars below the average of all the experienced subway contractors. The low bidder was able to procure a surety bond and the project was successfully completed. Frequently, but for the

\textsuperscript{84}Greene Bill, section 1.
\textsuperscript{85}See footnote (6) hereof.
\textsuperscript{86}See footnote (8) hereof.
\textsuperscript{87}Fulton Street Tunnel, 8th Avenue Subway, New York City.
\textsuperscript{88}St. Nicholas Avenue Subway, New York City, section from 122nd Street to 133rd Street. Every contractor has to have a beginning in the contracting business and every important contract that is let to any one is a new enterprise on which there may be a profit or a loss. Surety companies must bond "inexperienced" contractors because the mortality of the old and experienced firms is great.
fact that a surety bond was furnished, the contract would have been awarded to a higher bidder.

If contracts are awarded only to wealthy contractors who can afford to have substantial portions of the contract price withheld for the duration of extended contracts, the number of contractors able to compete on public work will become so small that open competition will be stifled if not entirely eliminated.

The requirement of a surety bond tends to eliminate contractors' rings and monopolistic practices. An awarding official seeking to assist a favorite could easily defend his action in rejecting the low bid of a new, inexperienced bidder and awarding the contract to that favorite at a higher price. In the absence of a guarantee that a bidder would complete the work for the amount of his bid, there would be an incentive to award the work to a known contractor, notwithstanding his increased bid. The small premium for a surety bond is a cheap price to pay in order to obtain a larger number of bidders on public work. The amount saved by the public through the fact that low bidders were bonded is many times the total premiums paid for the surety bonds.89

A local contractor with knowledge of local conditions of labor, soil, etc., employing for his administrative staff local citizens is often a better man than is a larger contractor without personal knowledge of local conditions, who wherever possible will employ his regular personnel rather than hire local assistance. In many communities local men would not be able to finance a large job if there was kept from them twenty per cent. of the contract price for an extended period. Hence, these men would refrain from bidding on the work.

Substantial losses on contract bonds are not due primarily to the default of weak, inexperienced contractors. On the contrary, such losses are due chiefly to failures by the larger and more experienced contractors. Defaults of experienced contractors on subway construction, the Catskill Aqueduct, the Shoshone Dam, the Galveston Causeway, the Bear Mountain Bridge and other huge projects have caused surety companies not only the largest losses in each particular case, but the largest aggregate of losses.

The larger contractors, with years of experience in the contracting business, with huge plants and substantial equipment, bidding on projects costing many

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89R. H. Towner, President of the Towner Rating Bureau, (see footnote 67), in an address before the Surety Underwriters Association of Massachusetts, stated:

"Taking ordinary moderate-sized contracts as a basis, the surety's premium on the average runs about ten per cent. of the difference between the lowest bidder to whom the contract is awarded and the next lowest bidder."

Mr. Towner also stated that on six large contracts (i.e., Montague Street Subway—New York; Scituate Dam—Providence; Passiac Valley Sewer; Bedford Avenue Subway—Brooklyn; Brooklyn State Hospital and Arlington Memorial Bridge—Washington, D. C.) the difference between the lowest bid and the next lowest bid was, in the aggregate, over four million dollars; and that the surety's premium for guaranteeing the lowest bid on each of these projects would be a little over $280,000, i.e., about seven per cent. of the amount saved by the public bodies.
millions of dollars, find that frequently their bids are too low, especially with respect to projects which take several years to complete. A contractor's estimate which might have been accurate when the bid was submitted frequently proves to be thirty or forty per cent. too low several years later when the work is not yet completed.

The smaller, inexperienced contractors usually begin with contracts which can be completed in a short period of time and thus they do not face the hazards incident to long-time contracts.

Federal and Pennsylvania contracts require ten per cent. of the value of the work performed each month to be withheld from the contractor until completion and final settlement. A more substantial deduction would drive small contractors out of the field and give the few large contractors a monopoly on public work. Such a substantial retainance would increase the possibility of the contractor's default because it would deprive the contractor, during the progress of the work, of construction funds necessary to pay his subcontractors.

Moreover, if twenty per cent. of the contract price be retained by the public body from the contractor, he will in turn seek to withhold twenty per cent. of the contract price from his subcontractors and materialmen until such time as the contractor has been paid. Such increase in the monthly retainance will increase the cost of construction. Every competent bidder includes in his bid, in normal times, interest on the fund withheld during the time same is withheld.

The proposed plan would put the Government in business in competition with private industry. The political affiliations of a claimant are of no importance when a surety company is presented with a claim.

Unless the million dollar fund were depleted by an excessive overhead, the State would not have the assistance of trained executives experienced in minimizing losses under building contracts. A defaulted contractor is usually indifferent to the disposition of the fund, and his trustee in bankruptcy is ignorant of the facts. Hence unless the public body paid excessive claims without due investigation, the public body would require a trained force to investigate and contest claims. Defaults are usually scattered. Surety companies are able to adjust such scattered claims more economically and more efficiently since the surety companies are able to employ qualified men to go anywhere in the United States on short notice.

Experience is of great importance in determining how best to handle a building construction default. If the State were to employ such an experienced staff at adequate compensation and in any one year there were but few losses, public funds would be squandered. Since such engineers employed by the surety companies can cover a territory greater than a single state, the entire administrative overhead can be divided in a way impossible if the cost of such employees were restricted to losses within any one State.
If, on the other hand, the State employed but a skeleton staff, it might find its personnel insufficient for a sudden emergency. If this skeleton organization attempted to handle such work in such an emergency, payment of claims would be unduly delayed. If a large staff were kept available in anticipation of actual need the million dollar fund would soon be depleted by an unnecessarily large payroll.

Since the State is not in other forms of bonding business, it cannot divide its costs among various departments as bonding companies do. "Less Government in business" is still a good maxim. The public body should not lose sight of the fact that its revenues would be diminished considerably if the surety companies which now pay substantial corporate taxes in the State were forced out of the construction bond business.

Particularly in these days of rising prices neither the State nor the Federal Government should be a laboratory for an experiment so inimical to the interests of the public.

Edward H. Cushman 

APPENDIX

MILLER ACT, 49 STATS. 793, CHAPTER 642:  
[PUBLIC—No. 321—74TH CONGRESS]  
[H. R. 8519]

AN ACT  
Requiring contracts for the construction, alteration, and repair of any public building or public work of the United States to be accompanied by a performance bond protecting the United States and by an additional bond for the protection of persons furnishing material and labor for the construction, alteration, or repair of said public buildings or public work.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) before any contract, exceeding $2,000 in amount, for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as "contractor":

(1) A performance bond with a surety or sureties satisfactory to the officer awarding such contract, and in such amount as he shall deem adequate, for the protection of the United States.

(2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person. Whenever the total amount payable by the terms of the contract shall be not more than $1,000,000 the said payment bond shall be in a sum of one-half the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than $1,000,000 and not more than $5,000,000, the said payment bond shall be in a sum of 40 per centum of the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than $5,000,000 the said payment bond shall be in the sum of $2,500,000.

(b) The contracting officer in respect of any contract is authorized to waive the requirement of a performance bond and payment bond for so much of the work under such contract as is to be
performed in a foreign country if he finds that it is impracticable for the contractor to furnish such bonds.

(c) Nothing in this section shall be construed to limit the authority of any contracting officer to require a performance bond or other security in addition to those, or in cases other than the cases specified in subsection (a) of this section.

Sec. 2. (a) Every person who has furnished labor or material in the prosecution of the work provided for in such contract, in respect of which a payment bond is furnished under this Act and who has not been paid in full therefor before the expiration of a period of ninety days after the day on which the last of the labor was done or performed by him or material was furnished or supplied by him for which such claim is made, shall have the right to sue on such payment bond for the amount, or the balance thereof, unpaid at the time of institution of such suit and to prosecute said action to final execution and judgment for the sum or sums justly due him: Provided, however, That any person having direct contractual relationship with a subcontractor but no contractual relationship express or implied with the contractor furnishing said payment bond shall have a right of action upon the said payment bond upon giving written notice to said contractor within ninety days from the date on which such person did or performed the last of the labor or furnished or supplied the last of the material for which such claim is made, stating with substantial accuracy the amount claimed and the name of the party to whom the material was furnished or supplied or for whom the labor was done or performed. Such notice shall be served by mailing the same by registered mail, postage prepaid, in an envelope addressed to the contractor at any place he maintains an office or conducts his business, or his residence, or in any manner in which the United States marshal of the district in which the public improvement is situated is authorized by law to serve summons.

(b) Every suit instituted under this section shall be brought in the name of the United States for the use of the person suing, in the United States District Court for any district in which the contract was to be performed and executed and not elsewhere, irrespective of the amount in controversy in such suit, but no such suit shall be commenced after the expiration of one year after the date of final settlement of such contract. The United States shall not be liable for the payment of any costs or expenses of any such suit.

Sec. 3. The Comptroller General is authorized and directed to furnish, to any person making application therefor who submits an affidavit that he has supplied labor or materials for such work and payment therefor has not been made or that he is being sued on any such bond, a certified copy of such bond and the contract for which it was given, which copy shall be prima facie evidence of the contents, execution, and delivery of the original, and, in case final settlement of such contract has been made, a certified statement of the date of such settlement, which shall be conclusive as to such date upon the parties. Applicants shall pay for such certified copies and certified statements such fees as the Comptroller General fixes to cover the cost of preparation thereof.

Sec. 4. The term "person" and the masculine pronoun as used throughout this Act shall include all persons whether individuals, associations, copartnerships, or corporations.

Sec. 5. This act shall take effect upon the expiration of sixty days after the date of its enactment, but shall not apply to any contract awarded pursuant to any invitation for bids issued on or before the date it takes effect, or to any persons or bonds in respect of any such contract. The Act entitled "An Act for the protection of persons furnishing materials and labor for the construction of public works", approved August 13, 1894, as amended (U. S. C., title 40, sec. 270), is repealed, except that such Act shall remain in force with respect to contracts for which invitations for bids have been issued on or before the date this Act takes effect, and to persons or bonds in respect of such contracts.

Approved, August 24, 1935.