"LOOK WHO'S BRINGING HOME THE BACON" -- HOW RECENT DECISIONS INTERPRETING THE DAVIS-BACON ACT CAN NEGATIVELY AFFECT THE SURETY

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Is the citadel of the surety's right to equitable subrogation under attack? Recent decisions from the Court of Federal Claims, Eleventh Circuit and Department of Labor have taken the view that Davis-Bacon Act claims have priority over the surety's right to equitable subrogation in remaining contract funds, even a performance bond surety. Properly determining the remaining amount of contract funds which can be recovered by the surety can have significant impact on the surety's decision making process with respect to determining the course of action upon default of the principal. Evaluation of the surety's options upon default must be made in light of the remaining money under the contract which potentially can be available to fund completion or provide salvage. Accordingly, this paper will explore the Davis-Bacon Act and the federal regulations implementing the requirements of the Act, as well as the surety's right to equitable subrogation and the parameters of the priority of that right. The paper will then examine the conflict between the surety's right to equitable subrogation and the Davis-Bacon Act in the context of the impact on availability to the surety of remaining contract funds. Finally, some practical pointers for addressing Davis-Bacon Act issues will be offered.

I. THE DAVIS-BACON ACT

A. HISTORICAL PERSPECTIVE

The Davis-Bacon Act, 40 U.S.C. §3142 *et seq.* (2003)(formerly 40 U.S.C. §276a) was enacted into law in 1931. Simply summarized, the Davis-Bacon Act requires that laborers and mechanics be paid not less than the "prevailing wage," as determined by the Secretary of Labor, on all federal construction contracts and federally funded construction contracts over $2,000.00.[1] The Act's formative roots go back to the late 1800's with the rise of organized labor and state efforts to enact prevailing wage legislation.

In 1890, Samuel Gompers, the head of the American Federation of Labor, lobbying in Kansas, stated that his organization's top priorities were to seek prevailing wage legislation, end prison labor and child labor.[2] In 1891, Kansas enacted the first prevailing wage law in the country. Kansas was soon followed by New York (1894), Oklahoma (1909), Idaho (1911), Arizona (1912), New Jersey (1913) and Massachusetts (1914). Between 1891 and 1969, forty one states and the District of Columbia enacted some form of prevailing wage legislation.

The Congressional debate on prevailing wage legislation did not begin, however, until 1927. The legislative history pinpoints the impetus for what would later become the Davis-Bacon Act as the construction of a Veteran's Bureau hospital in Long Island, New York;

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1 *See* University Research Assn., Inc. v. Coutu, 450 U.S. 754, 756, 101 S.Ct. 1451, 67 L.Ed.2d 662 (1981).
2 *See* Northwest Fair Contracting Association, *A Brief History of Prevailing Wage Laws* (2003).

Representative Robert Bacon's district.[3] The hospital contract was awarded to a contractor from Alabama who promptly brought in "cheap" labor from the South to build the project, much to the disappointment of local labor.[4] Over the next four years, Representative Bacon introduced a total of thirteen bills in Congress attempting to establish some form of regulation over labor on federal projects.[5] The goal of the legislation was to allow local contractors, who presumably would utilize local labor, to compete on an equal footing by requiring that the same prevailing local wages be paid on the project, regardless of whether the awardee of the contract was local.[6] The economic conditions of the early 1930's quickly gave rise to an oversupply of "cheap" labor and increased the importance of federal building programs, as unemployment rose and private construction became increasingly limited.[7] The Great Depression focused congressional attention more squarely on the economic impact of federal construction. Accordingly, in 1931, a prevailing wage bill submitted by Representative Bacon and Senator James J. Davis of Pennsylvania, with the support of the American Federation of Labor, was passed by Congress.[8] The Davis-Bacon Act was signed into law by President Herbert Hoover.

However, the Act, as originally passed, did not provide for the predetermination of wages and there were no penalty or enforcement provisions to compel compliance.[9] As originally enacted, the Secretary of Labor could not make a prevailing wage determination unless a dispute arose during the course of construction.[10] Further, the wage determinations were held not to be retroactive to the beginning of the project.[11] Thus, the practice quickly developed that general contractors would ignore the contracting officer's directive to pay prevailing wages on a project until there was a prevailing wage determination by the Department of Labor. This left laborers and mechanics under-paid for a substantial part, if not the entire project.[12] Accordingly, in 1935, the Davis-Bacon Act was amended to provide for predetermination of prevailing wages and for enforcement/penalty provisions.[13] The Davis-Bacon Act was followed by similar legislation in the manufacturing and service industries. *See* Walsh-Healy Public Contracts Act 1936 (Manufacturing) and Service Contracts Act 1965. Moreover, at the present time, there are in excess of 60 federal laws related to the Davis-Bacon prevailing wages.[14]

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[3] U.S. Congress. House. Committee on Labor, Hearings on H.R. 7995 & H.R. 9232, 71st Cong., 2d Sess., March 6, 1930, p. 17.

[4] Representative Bacon described the practice of "certain itinerant, irresponsible contractors, with itinerant, cheap, bootleg labor, [who] have been going around throughout the country 'picking' off a contract here and a contract there." 74 Cong. Rec. 6510.

[5] Stuart Schulman, *The Case Against the Davis-Bacon Act*, Government-Union Review, Winter 1983, p.23.

[6] Representative Bacon stated in support of the legislation "I think that it is a fair proposition where the Government is building these post offices and public buildings throughout the country that the local contractor and local labor may have a 'fair break' in getting the contract. If the local contractor is successful in obtaining the bid, it means that local labor will be employed, because that local contractor is going to continue in business in that community after the work is done." 74 Cong. Rec. 6510 (1931).

[7] *See* Coutu, 450 U.S. at 774.

[8] Armand J. Thieblot, Jr., *The Davis Bacon Act*, University of Pennsylvania Press (1975), pp. 8-9.

[9] Id.

[10] S. Rep. No. 1155, 74th Cong., 1st Sess., p.2-3 (1935) and H. R. Rep. No. 1756, 74th Cong., 1st Sess., p. 2-3 (1935).

[11] Id.

[12] Id.

[13] Congress actually passed an amendment to the Act in 1932, but it was vetoed. *See* S. 3847, 72d Cong., 1st Sess. (1932) and Veto Message, S. Doc. No. 134, 72d Cong., 1st Sess. (1932).

[14] *See* 29 CFR Part 1 Appendix A.

However, between 1979 and the present, there have been widespread efforts to repeal prevailing wage statutes, including the Davis-Bacon Act. Nine states have repealed their statutes and legislation has been introduced in Congress for the past several years to repeal or limit the Davis-Bacon Act.[15] Indeed, in 1987, Kansas, the first state to enact prevailing wage legislation, repealed its law. Such repeal legislation is broadly supported by the U.S. General Accounting Office, American Society of Civil Engineers, National Center for Policy Analysis, Associated Builders & Contractors, U.S. Chamber of Commerce and others. Most, arguing in favor of repeal, cite inflated costs for government projects, excess administrative costs to the government and contractors, as well as adverse impact on small and minority firms and unskilled laborers. Further, since 1931, a plethora of labor regulatory legislation has been enacted, which has substantially changed the character of the construction industry to the point where it can be argued that the Davis-Bacon protections are no longer needed. Despite these challenges, the Davis-Bacon Act continues to be applicable to hundreds of millions of dollars in public construction projects.

B. THE ACT

The Davis-Bacon Act was originally codified at 40 U.S.C. §276a *et seq*.; however in 2002, it was re-codified to 40 U.S.C. §3141 *et seq*. and now provides as follows:[16]

§3142 Rate of Wages for laborers and mechanics

> (a) Application. The advertised specifications for every contract in excess of $2,000, to which the Federal Government or the District of Columbia is a party, for construction, alteration, or repair, including painting and decorating, of public buildings and public works of the Government or the District of Columbia that are located in a State or the District of Columbia and which requires or involves the employment of mechanics or laborers shall contain a provision stating the minimum wages to be paid various classes of laborers and mechanics.
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> (b) Based on prevailing wage. The minimum wages shall be based on the wages the Secretary of Labor determines to be prevailing for the corresponding classes of laborers and mechanics employed on projects of a character similar to the contract work in the civil subdivision of the State in which the work is to be performed, or in the District of Columbia if the work is to be performed there.
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> (c) Stipulations required in contract. Every contract based upon the specifications referred to in subsection (a) must contain stipulations that—
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> (1) the contractor or subcontractor shall pay all mechanics and laborers employed directly on the site of the work, unconditionally and at least once a week, and without subsequent deduction or rebate on any account, the full amounts accrued at time of payment, computed at wage rates not less than those stated in the advertised specifications, regardless of any contractual relationship which may be alleged to exist between the contractor or subcontractor and the laborers and mechanics;

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[15] States that repealed Little Davis-Bacon Acts: Florida (1979), Alabama (1980), Utah, Arizona (1984), Idaho (1985), Colorado (1985), New Hampshire (1985), Kansas (1987), Louisiana (1988). Oklahoma's law was struck down judicially.

[16] P. L. 107 – 217, §1, 116 Stat. 1150, August 21, 2002.

(2) the contractor will post the scale of wages to be paid in a prominent and easily accessible place at the site of the work; and

(3) there may be withheld from the contractor so much of accrued payments as the contracting officer considers necessary to pay to laborers and mechanics employed by the contractor or any subcontractor on the work the difference between the rates of wages required by the contract to be paid laborers and mechanics on the work and the rates of wages received by the laborers and mechanics and not refunded to the contractor or subcontractors or their agents.

(d) Discharge of obligation. The obligation of a contractor or subcontractor to make payment in accordance with the prevailing wage determinations of the Secretary of Labor, under this subchapter [40 USCS §§3141 et seq.] and other laws incorporating this subchapter [40 USCS §§3141 et seq.] by reference, may be discharged by making payments in cash, by making contributions described in section 3141(2)(B)(i) of this title, by assuming an enforceable commitment to bear the costs of a plan or program referred to in section 3141(2)(B)(ii) of this title, or by any combination of payment, contribution, and assumption, where the aggregate of the payments, contributions, and costs is not less than the basic hourly rate of pay plus the amount referred to in section 3141(2)(B).

(e) Overtime pay. In determining the overtime pay to which a laborer or mechanic is entitled under any federal law, the regular or basic hourly rate of pay (or other alternative rate on which premium rate of overtime compensation is computed) of the laborer or mechanic is deemed to be the rate computed under section 3141(2)(A) of this title, except that where the amount of payments, contributions, or costs incurred with respect to the laborer or mechanic exceeds the applicable prevailing wage, the regular or basic hourly rate of pay (or other alternative rate) is the amount of payments, contributions, or costs actually incurred with respect to the laborer or mechanic minus the greater of the amount of contributions or costs of the types described in section 3141(2)(B) of this title actually incurred with respect to the laborer or mechanic or the amount determined under section 3141(2)(B) but not actually paid.

In addition to the enforcement mechanism set forth in §3142(c)(3)(authority to withhold funds), 40 U.S.C. §3143 of the Act also provides for termination of the contractor if the contracting officer finds that any laborer or mechanic employed by the contractor or any subcontractor directly on the site of the work covered by the contract has been or is being paid a rate of wage less than the rate of wage required by the contract. If the contractor is terminated, the Act states that, "[T]he Government may have the work completed, by contract or otherwise, and the contractor and the contractor's sureties shall be liable to the Government for any excess costs the Government incurs."[17] Congress also provided that the Comptroller General shall pay directly to the laborers and mechanics any accrued payments withheld under the contract which are found to be due under the Davis-Bacon Act.[18] If the funds withheld by the government are not sufficient to satisfy the amounts found to be due to the laborers or mechanics under the Act, such persons have the same right to bring a civil action

[17] 40 U.S.C. §3143.
[18] 40 U.S.C. §3144(a)(1).

and intervene against the contractor and the contractor's sureties as is conferred by law on persons furnishing labor or materials under the Miller Act 40 U.S.C. §3131.[19] Finally, the Davis-Bacon Act provides that the Comptroller General shall maintain and distribute to all departments of the federal government a list of names of persons found to have disregarded the obligations to employees and subcontractors under the Act.[20] "[N]o contract shall be awarded to persons appearing on the list or to any firm, corporation, partnership, or association in which the persons have an interest until three years have elapsed from the date of publication of the list." Far from the original Davis-Bacon Act, which had no enforcement provisions, the current law employs a variety of tools from withholding of contract funds and termination to debarment to coerce compliance.

To implement the requirements of the Davis-Bacon Act, the Secretary of Labor has been given the exclusive authority to prescribe regulations.[21] Pursuant to the Reorganization Plan, the Secretary of Labor has issued regulations designed to assure coordination of administration and consistency of enforcement of the Davis-Bacon Act and the other 60 related statutes. Those regulations are set forth in 29 Code of Federal Regulations (CFR) Parts 1 through 7. 29 CFR Part 1 provides procedures for predetermining the prevailing wage rate, Part 3, issued pursuant to the Copeland Anti-Kickback Act, requires submission of weekly payroll data by contractors, Part 5 provides guidelines for application and enforcement of the Act and Part 7 contains procedures governing the practice before the Department of Labor's Wage Appeals Board.

Under the framework established, the contracting agency has the initial responsibility to determine if the Davis-Bacon Act applies to the project and, if so, to determine the appropriate prevailing wage rate by either referring to an existing general area wage determination from the Department of Labor[22] or by requesting a project specific wage determination.[23] "Prevailing Wage" is defined as "the wage paid to the majority (more than 50 percent) of the laborers or mechanics in the classification on similar projects in the area during the period in question."[24] Any interested person may seek reconsideration of a wage determination or a decision of the Administrator regarding application of a wage determination.[25] If the person is not satisfied with the response of the Administrator on reconsideration, an appeal to the Administrative Review Board may be filed.[26] However, the substantive correctness of the Administrator's wage rate determination is not subject to judicial review.[27] Some courts have taken the view that limited judicial review may be had with respect to issues such as denial of due process or legality of procedures employed by the Department of Labor.[28]

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[19] 40 U.S.C. §3144(a)(2).

[20] 40 U.S.C. §3144(b)(1).

[21] Reorganization Plan No. 14 of 1950 (64 Stat. 1267, 5 U.S.C. App., p. 746). The Secretary also derives authority from the Copeland Anti-Kickback Act, 40 U.S.C. §3145(a).

[22] The authority of the Secretary of Labor has been delegated to the Deputy Under Secretary of Labor for Employment Standards, who in turn has delegated the functions to the Administrator of the Wage and Hour Division of the Department of Labor. 29 CFR §1.1

[23] 29 CFR §§1.5, 1.6.

[24] 29 CFR §1.2(a)(1).

[25] 29 CFR §1.8.

[26] 29 CFR §1.9. The review by the Administrative Review Board will be governed by 29 CFR Part 7.

[27] *See* Coutu, 450 U.S. at 761 n. 10; United States v. Binghamton Constr. Co., 347 U.S. 171, 177 (1954) and Nello L. Teer Co. v. U.S., 348 F.2d 533 (Cl.Ct. 1965)..

[28] *See* U.S. t/u/o Wylie v. W.S. Barstow & Co., 79 F.2d 496 (4th Cir. 1935); Virginia ex rel. Commissioner, Virginia Dep't of Highways & Transportation v. Marshall, 599 F.2d 588 (4th Cir. 1979) and North Georgia Bldg. & Constr. Trades Council v. Goldschmidt, 621 F.2d 697 (5th Cir. 1980).

Once the prevailing wage has been established for a project, the contractor is required to submit weekly payroll statements containing information regarding the wages paid to its employees.[29] The contractor is also required to retain and maintain its payroll records for a period of three years.[30] The contracting agency or the Department of Labor may inspect such records and interview employees to ensure compliance with the Act.[31] Failure to maintain and submit the payroll documentation for inspection and review upon request can result in suspension of further payments on the project and may be grounds for debarment.[32]

C. THE PURPOSE

Consistent with the legislative history of the Davis-Bacon Act, courts have uniformly recognized the Act's dual purpose to give local laborers and contractors a fair opportunity to participate in building programs when federal money is involved and to protect local wage standards by preventing contractors from basing their bids on wages lower than those prevailing in the area.[33] Further, given the nature of the Act, courts generally hold that the Davis-Bacon Act should be liberally construed to effectuate its purpose.[34] Moreover, the protections of the Davis-Bacon Act are not waivable by the contractor, employee or agency.[35] However, the Secretary of Labor may make variations, tolerances and exemptions from the regulatory requirements, but not the statutory requirements.[36]

II. THE SURETY'S RIGHT TO EQUITABLE SUBROGATION

A. HISTORY AND NATURE OF SUBROGATION

The surety's right to equitable subrogation has been well recognized by the courts[37] and thoroughly discussed by commentators.[38] Equitable subrogation is widely regarded as one of the oldest and most venerable equitable doctrines,[39] which is founded upon principles of natural reason and justice.[40] Traditionally, subrogation arises when, "one who has been compelled to pay a debt which ought to have been paid by another is entitled to exercise all the remedies which the creditor possessed against that other."[41] Thus, subrogation has generally been described as, "the substitution of one person (the surety) in place of another (the creditor) with respect to the other's lawful claim or right. The substitution occurs when the

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[29] 29 CFR §3.3 and 29 CFR §5.5(a)(1)(iv)(3)(ii)(A) & (B).
[30] 29 CFR §3.4 and 29 CFR §5.5(a)(1)(iv)(3)(i).
[31] 29 CFR §3.4(b) and 29 CFR §5.5(a)(1)(iv)(3)(ii)(D).
[32] 29 CFR §5.5(a)(1)(iv)(3)(iii) and §5.5(a)(1)(iv)(7).
[33] *See* L. P. Cavett Co. v. U.S. Dept. of Labor, 101 F.3d 1111 (6th Cir. 1996); U.S. f/u/b Glynn v. Capeletti Bros., Inc., 621 F.2d 1309 (5th Cir. 1980); International Union of Operating Engineers v. Arthurs, 355 F.Supp. 7 (W.D. Okla 1973), *aff'd* 480 F.2d 603 (10th Cir. 1973) and In Re Iowa Department of Transportation, WAB Case No. 94-11 (1994).
[34] Drivers, Salesmen, Warehousemen, etc. v. NLRB, 361 F.2d 547 (D.C. Cir. 1966).
[35] International Brotherhood of Elec. Workers, Local 357 v. Brock, 68 F.3d 1194 (9th Cir. 1995).
[36] 29 CFR §5.14.
[37] *See* Prairie National Bank v. United States, 164 U.S. 227 (1896); Henningsen v. United States Fidelity & Guaranty Company, 208 U.S. 404 (1908) and Pearlman v. Reliance Insurance Company, 371 U.S. 132 (1962).
[38] G. Bachrach and J. Burch, *The Surety's Subrogation Rights* in THE LAW OF SURETYSHIP 2d (E. Gallagher ed., 2000) and SUBROGATION RIGHTS OF THE CONTRACT BOND SURETY (G. Bachrach ed., 1990).
[39] *See* American Surety Company of New York v. Bethlehem National Bank, 314 U.S. 314, 317 (1941), *citing* Hampton v. Phipps, 108 U.S. 260, 263 (1883) and Hodgson v. Shaw, 3 Myl. & K. 183, 191 (1834).
[40] Prairie State Bank, 164 U.S. at 231 ("The doctrine of subrogation is a pure unmixed equity, having its foundation in the principles of natural justice. . .").
[41] American Surety, 314 U.S. at 317.

surety discharges an obligation of the principal to the creditor. The surety then acquires the lawful claims or rights of the creditor."[42]

Distilling the case law regarding equitable subrogation leads to the recognition of several "essential elements," which must be present for subrogation to arise.[43] Those elements are:

1. The existence of an obligation of the principal to the obligee;
2. The failure of the principal to perform that obligation;
3. Rights in the obligee arising from the principal's failure to perform; and
4. The performance by the surety, pursuant to the suretyship, of the obligation that the principal failed to perform.[44]

Once the surety has performed an obligation of its principal, in a manner that satisfies the foregoing elements, and it acquires the right of subrogation, the issues become to whom and what is the surety subrogated and to what extent will its rights to subrogation prevail over other claimants?

B. SCOPE OF SUBROGATION RIGHTS IN GENERAL

In the context of this discussion, we will limit our inquiry to the circumstances that are relevant to the issue of the priority between the surety's right to subrogation and claims under the Davis-Bacon Act on federal construction projects. The distinction between subrogation rights arising from satisfaction of obligations under the performance bond and satisfaction of obligations arising under the payment bond is critical to the analysis.[45] The surety will acquire different subrogation rights depending on which obligations it satisfies.

When the surety completes the performance of a contract under its performance bond, it steps into the shoes of not only the principal, but the government obligee as well.[46] It is said that a performing surety confers a benefit upon the government/obligee by relieving the government of the burden of completing the construction.[47] In contrast, where the surety merely satisfies obligations under the payment bond, it becomes subrogated to the rights of the principal and the laborers and materialmen.[48] The significance of the distinction becomes clear when one considers the relative rights of the parties. If a contractor fails to complete a project, the government is entitled to apply the retained funds and any remaining progress money to the costs of completing the job.[49] Further, the government possesses the right to set off claims against the defaulting contractor from the contract funds remaining in its hands.

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[42] G. Bachrach and J. Burch, *The Surety's Subrogation Rights* in THE LAW OF SURETYSHIP 2d (E. Gallagher ed., 2000) at p. 419. *See* Covenant Mutual Insurance Company v. Able Concrete Pump, 609 F.Supp. 27, 30 (N.D.CA 1984)("Under the theory of equitable subrogation, one who pays the debts or fulfills the duties of another steps into the shoes of that party and is entitled to the securities and remedies of that party."

[43] Id. at 422.

[44] Id.

[45] Trinity Universal Ins. Co. v. United States, 382 F.2d 317 (5th Cir. 1967); Dependable Ins. Co. v. United States, 846 F.2d 65 (Fed. Cir. 1988) and Aetna Cas. & Surety Co. v. United States, 435 F.2d 1082, 1083-1084 (5th Cir. 1970).

[46] Id.

[47] Id.

[48] United States v. Munsey Trust Co., 332 U.S. 234 (1947).

[49] Pearlman, 371 U.S. 142.

"The government has the same right which belongs to every creditor to apply the unappropriated moneys of his debtor in his hands, in extinguishment of the debts due to him."[50] Upon completion of a bonded project pursuant to the performance bond, the surety becomes subrogated to the government's rights in the remaining contract funds as well as the right to set off.[51] These rights stand ahead of creditors of the contractor/principal.

When the surety satisfies obligations pursuant to its payment bond, the benefit conferred upon the government is greatly reduced. The payment bond surety is only subrogated to the rights of the defaulting principal and the laborers and materialmen who are satisfied. However, it should be noted that the subrogation rights under the payment bond generally do not even arise unless the surety has satisfied all claimants first.[52] In American Surety Co. v. Westinghouse Elec. Manuf. Co., *supra.*, the Supreme Court addressed a circumstance where the surety paid the full amount of its payment bond to claimants, but the sum was not sufficient to satisfy all claimants. The Court held that the surety was not entitled to priority ahead of the unpaid laborers and materialmen in the remaining contract funds.[53] Even when the surety satisfies all claimants under the payment bond, it is only entitled to subrogation in the amount of valid claims paid *after* the government's reasonable costs to complete construction are deducted from the contract balance.[54] The Court in Munsey, *supra.*, recognized that laborers and materialmen have no legal rights against the government directly and the government is entitled to set off claims it has against the defaulting contractor before the surety may recover as subrogee to the rights of laborers and materialmen.[55]

It is against this back-drop of suretyship and subrogation that the claims of the Department of Labor to remaining contract balances on federal projects based upon the Davis-Bacon Act must be considered.

III. EQUITABLE SUBROGATION AND THE DAVIS-BACON ACT

Given the broad enforcement rights of the government under the Davis-Bacon Act and the wide-ranging applicability of the Act to federal and federally funded construction projects, it is not too difficult to imagine that the surety will be confronted with claims of the Department of Labor to remaining contract funds. Surprisingly, however, there is very little case law addressing the competing claims of the surety and the Department of Labor under the Davis-Bacon Act.

At the outset, the threshold question that must be asked is how should a Davis-Bacon Act claim be categorized? Is it a cost of completion as some courts have concluded, is it simply a claim for labor, is it the government's claim or is it the laborer's claim? The answers to these questions can impact on the analysis of what priority the claim should be accorded.

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[50] National Fire Ins. Co. of Hartford v. Fortune Const., 320 F.3d 1260 (11th Cir. 2003) *quoting* Munsey, *supra.* at 239. *See also* Merritt Commercial Sav. & Loan, Inc. v. Guinee, 766 F.2d 850 (4th Cir. 1985).

[51] Pearlman, 371 U.S. at 138 and Trinity Universal, 382 F.2d at 320.("The surety who undertakes to complete the project is entitled to the funds in the hands of the government not as a creditor and subject to set off, but as a subrogee having the same rights to the funds as the government.")

[52] American Surety Co. v. Westinghouse Elec. Manuf. Co., 296 U.S. 133 (1935).

[53] Id. at 137 ("A surety who has undertaken to pay the creditors of the principal, though not beyond a stated limit, may not share in the assets of the principal by reason of such payment until the debts thus partially protected have been satisfied in full.").

[54] National Fire, 320 F.3d at 1271.

[55] Munsey, 332 U.S. at 234 and U.S. ex rel. P. J. Keating Co. v. Warren Corp., 805 F.2d 449, 452 (1st Cir. 1986).

Ordinarily, the government's claims are to recover for its own damages or losses or to recover funds that are owed to the government, such as taxes, fines or penalties. The Davis-Bacon claim is for wages due laborers and mechanics on a project; it is not the government's money and the money is not "owed" to the government. While the government is entitled to collect the back wages, they ultimately must be paid to the laborer or mechanic. Should the fact that the government is designated as the vehicle through which enforcement is handled be the determinative factor as to the nature of the claim? The government itself has no direct legal liability to the laborer or mechanic. However, the government does have a statutory obligation to enforce the Davis-Bacon Act. The limited number of cases that have addressed the priority of the Davis-Bacon Act claim have not shed much light on this issue.

In National Fire Insurance Co. of Harford v. Fortune Const. Co.,[56] the Eleventh Circuit held that a surety satisfying obligations under its payment bond did ***not*** have priority over the obligee's claim based upon the Department of Labor's Davis-Bacon Act claim.[57] In this case, the obligee, the general contractor, paid the Department of Labor's assessment. The Court concluded that the Davis-Bacon Act assessment was part of the obligee's reasonable costs of completion of the construction and the obligee was therefore entitled to apply the remaining contract funds to satisfy that claim, ahead of the surety's payment bond subrogation rights.[58] The Court observed that the Davis-Bacon Act claim could have been considered as being within the surety's payment bond obligation; however, because of the specific language of the bond, the particular laborers in question could not have been "claimants."[59] As will be discussed in greater detail herein, had the Court treated the Davis-Bacon Act claimants as payment bond claimants, the surety may not have had any equitable subrogation rights at all.[60] If the laborers and mechanics had not been fully paid as required under the Davis-Bacon Act, the surety's rights to equitable subrogation may not have arisen, because all of the payment bond claimants would not have been fully satisfied.[61]

Regardless of the analytical approach, in the context of a surety claiming equitable subrogation rights through its satisfaction of payment bond obligations only, under traditional subrogation law the surety will not be in a position to assert a priority claim to the remaining contract balances ahead of the Davis-Bacon Act claim. The obligee will generally always have the superior right to set off, if the claim is treated as the government's, and to complete the project with the remaining funds, which will take priority over the surety claiming through the principal and/or laborers.

Thus, the only real battle-ground between the surety and the Davis-Bacon Act claim lies in the context of a performing or completing surety under the performance bond. When the surety performs the obligations under the performance bond it becomes equitably subrogated to the rights of the government obligee. In Westchester Fire Insurance Company v. United States,[62] the Court of Federal Claims addressed the claims of the surety to contract funds that

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[56] 320 F.3d 1260 (11th Cir. 2003).
[57] Id. at 1272.
[58] Id. at 1277.
[59] Id. at 1277, n. 20.
[60] The question that is not resolved is whether the Davis-Bacon Act claimants would be considered unsatisfied payment bond claimants for the purpose of determining whether the surety has rights under equitable subrogation. The Supreme Court in American Surety, *supra.*, approached the question in terms of the "class" of creditors the surety has undertaken to protect as opposed to parties who had submitted claims.
[61] *See* notes 52 & 53.
[62] 52 Fed.Cl. 567 (2002).

had been withheld by the Coast Guard at the direction of the Department of Labor to satisfy Davis-Bacon Act violations. The Westchester Court took the view that once the funds were directed to be withheld by the Department of Labor under the Davis-Bacon Act, the funds were no longer available to the Coast Guard, surety or contractor to complete work on the project. [63] The Court stated that the rights of the Department of Labor in the funds were superior to the Coast Guard, contractor and surety and it was therefore "immaterial" whether the surety was subrogated to the rights of the obligee or the contractor.[64] However, the authority cited by the Court does not support the Court's conclusion.[65] The Court in Westchester also rhetorically noted its belief that the surety would be responsible for satisfying the unpaid laborers even if the money was released to the surety instead of being paid to the Department of Labor.[66] Finally, the Court brushed aside the case law holding that the performance bond surety had superior rights to contract funds over the government, stating that tax claims of the contractor were not directly related to the project like the claims of underpaid laborers' for work on the project.[67] The government's claim to the withheld funds was directly connected to the contract and the Department of Labor's claim was not on its own behalf, but on behalf of the laborers.

The Westchester Court does not discuss why the Department of Labor's claim on behalf of laborers should receive any greater priority than claims of laborers generally. As previously noted, the Davis-Bacon Act does not give laborers a private cause of action and laborers have no direct legal claim against the government. While it is true that the Davis-Bacon Act entitles the government to withhold funds, the same is true of other collection and enforcement statutes, yet those claims are inferior to the performing surety. Under subrogation law, the surety is entitled to stand in the shoes of the government and to use the remaining contract funds to complete the project. To say that the set off right of the government renders those funds unavailable, even to the government, and not part of the project, ignores the nature of set off as described in Munsey.

The Davis-Bacon Act provides that "there *may* be withheld from the contractor so much of accrued payments as the contracting officer considers necessary . . ." The use of the word "may" indicates discretion with respect to whether funds will be withheld. Discretion is also given to the contracting officer to withhold such amounts deemed necessary. Further, the funds are to be withheld from the "contractor," not removed from the project for all purposes and beyond reach of even the government to complete the project, or the subrogated surety. Further, upon default of the contractor it can be argued that the funds under the contract are no longer due to the contractor at all, but are for the completion of the project, and thus, should not be subject to withholding for Davis-Bacon claims. The fact that the claim of the laborers directly relates to the project is no different than the government's set off rights which arise directly out of the contract such as liquidated damages, backcharges, and delay damages; and to which the performing surety becomes subrogated. Finally, the Westchester Court's belief

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[63] Id. at 581.
[64] Id. at 581-582.
[65] The Court cited to Unity Bank & Trust Company v. United States, 5 Cl.Ct. 380, 384-385 (1984), *aff'd* 756 F.3d 870 (Fed. Cir. 1984) and Reliance Insurance Co. v. United States, 27 Fed.Cl. 815, 828-829 (1993) to support its holding that the Davis-Bacon Act funds were not available to the surety. Unity Bank involved a claim by an assignee bank, not a surety with subrogation rights. In Reliance Insurance, the court rejected the surety's claim that the government misrepresented the status of the contract funds when the surety entered into a take over agreement. Equitable subrogation is not discussed.
[66] Id. at 582.
[67] Id. at 583.

that the surety would be required to pay the funds to the laborers if the funds were given to the surety ignores the various defenses that the surety may have to the claims of the laborers.

In Liberty Mutual Insurance Company,[68] the Department of Labor Board of Contract Appeals held that the Department of Labor's Davis-Bacon Act claim was superior to a take-over surety's claim for contract funds. The contractor was terminated for default and the surety entered into a takeover agreement with the Coast Guard to complete the project. Subsequently, the Department of Labor, pursuant to an investigation, determined that the contractor had under-paid its workers in violation of the Davis-Bacon Act. The surety did not dispute the findings of the Department of Labor. No payment bond claims were submitted to the surety by the principal's employees and the Miller Act limitations for the employees' claims have expired. The Department of Labor instructed the Coast Guard to withhold contract funds for the Davis-Bacon claim, which the Coast Guard did; the balance of the funds was paid to the surety upon completion. The Labor Board of Contract Appeals decided that the surety did not have priority to the funds withheld because the surety did not pay the laborers who had been underpaid by the principal. The Board concluded that a surety's right of subrogation is dependent on its payment of debts left unpaid by the contractor.

The Board's position is illusory. If the surety wants to acquire a priority position the surety must pay the laborers, but when the laborers are paid there will be no need for a priority position. The Board's decision also places requirements on a Miller Act surety that are contrary to the Miller Act, i.e.: payment of claims that have not been asserted against the bond and which are barred by limitations. Thus, under the Labor Board's approach, in order to obtain subrogation rights and priority, the surety must disregard the requirements of its bond and the Miller Act. The Davis-Bacon Act does not require such a result, nor does the law of equitable subrogation. Further, the Board ignores the fact that the surety, by performing under the performance bond is also entitled to be subrogated to the rights of the government, and the government is not required to satisfy claims of laborers to exercise its set off rights or to utilize the contract funds to complete the project.

In Covenant, *supra.*, the United States District Court for the Northern District of California, held that a completing surety under the performance bond was entitled to be subrogated to the rights of the government, notwithstanding the fact that the penal sum of the surety's bond was not sufficient to satisfy all of the claimants. The surety was accorded priority rights in the remaining contract funds over the competing claims of the unpaid laborers. While the case does not involve the Davis-Bacon Act, the basic fundamental subrogation principles should still apply. The case illustrates the flaw in the reasoning of the Labor Board and points out the glaring hole in its analysis.

There are very few cases addressing the issue of the priority rights of the surety in the context of a Davis-Bacon Act claim and the cases that do exist do not provide favorable treatment of the issue. Accordingly, the surety must be aware when it seeks to recover contract funds on a project subject to the Davis-Bacon Act, that the Department of Labor may be able to assert a claim that could be afforded a superior priority right to those funds.

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[68] 1999 DOL BCA Lexis 8; 1999-1 B.C.A. (CCH) P30,660

IV. PRACTICAL POINTS FOR ADDRESSING DAVIS-BACON ACT CLAIMS

As a practical matter, when faced with a Davis-Bacon Act claim from the Department of Labor, the surety will typically not be in a position to challenge the underlying wage determination or project classification, as those determinations will generally have been made long before the surety gets involved and will not be subject to challenge. However, some effort can be given to determining whether the Department of Labor complied with its own regulations and applicable statutes and whether due process was provided to the principal at the various determination stages.[69] For example, the Wage Appeals Board ruled that the Secretary of Labor, in connection with his wage determination powers, improperly relied upon a definition, which was in the nature of a rule that had not been formulated following the rule-making procedures.[70] There are also a number of other issues that the surety should pay close attention to in order to minimize the size of the Davis-Bacon Act claim.

Generally, the slow pace of the Department of Labor investigations and issuance of findings will allow the surety time to get involved with the process and to contest the final decision of the Department with respect to the Davis-Bacon issues. The surety should take advantage of this opportunity because the Department of Labor is typically more than willing to negotiate a settlement of the issues if the case is not egregious. This is particularly true where the contractor has gone out of business or will not be performing government projects in the future. The most immediate task for the surety is to gather the relevant documents and information regarding the principal's payroll practices. While not always the case, often when a project goes into default the project documents seem to "disappear" and the project personnel move on. Thus, the surety must move quickly to obtain copies of or get access to the principal's payroll records and job records; these documents will provide the basis for the Department's claim and your defenses. The next task for the surety is to interview the on-site project managers and/or supervisors to determine what practices were utilized for recording work performed on the project at issue. The surety also needs to obtain a copy of the applicable wage determination and classification as well as any modifications or corrections.

Some issues that can be explored include whether the Department of Labor has correctly identified the work being performed by specific employees or groups of employees. Often the Department of Labor will look at an activity and classify it as all or predominately all skilled work, which should be paid at a higher wage, when in actuality a substantial portion of the work was unskilled and should be paid at a lower wage. The surety should also review the work that was being performed to determine if it is covered by the Davis-Bacon Act. For example, was the employee performing "construction work" on the physical site or dedicated site. Occasionally, the Department of Labor may be over-inclusive in their classification. Attention should also be paid to overtime and fringe benefit payments as these categories are fertile grounds for Davis-Bacon Act claims. Payments or contributions to qualified benefit plans or programs by the principal may be missed or improperly excluded in the Department of Labor findings. Finally, if the principal is working on several projects, some of which are covered by the Davis-Bacon Act and some of which are not, it is not uncommon for workers to go back and forth between projects. Under such circumstances, a worker's activity attributable to the Davis-Bacon Act project may be miscalculated. Using a comprehensive approach to analyzing the Department of Labor's claim can lead to substantial reductions in the claim.

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[69] *See* note 28.

[70] *See* In Matter of Review of Davis-Bacon Wage Decisions 77-TX-4190 through 4207, WAB Case No. 77-23, CCH Labor Law Reporter Transfer Binder (June 1973)-Sept. 1978) P31162 (1977).

V. CONCLUSION

The conflict between the Davis-Bacon Act claim and the surety's right of equitable subrogation is still very much undecided and unexplored by the courts so the surety should be prepared to challenge such claims to protect the surety's claim to contract funds. Alternatively or perhaps simultaneously, the surety should take the necessary steps to administratively challenge such claims and informally negotiate a reduction of the claim.

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