HB 689

Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

House Bill 689 (Delegate Frick)
Economic Matters Finance

Procurement - Prevailing Wage - Liquidated Damages

This bill requires a contractor who knew, or reasonably should have known, of the obligation to pay the prevailing wage on a public work project and deliberately failed or refused to pay the prevailing wage to pay liquidated damages of $250 (per laborer or employee) to the public body for each day that a laborer or employee is paid less than the required prevailing wage.

Fiscal Summary

State Effect: General fund expenditures by the Department of Labor, Licensing, and Regulation (DLLR) increase by $109,000 in FY 2017 to adjudicate the increased volume of liquidated damage penalty cases that are likely to be appealed. Out-year expenditures reflect annualization, inflation, increased compliance with the law, and the termination of the contractual position. State revenues (all funds) increase by an estimated $184,200 in FY 2017, which accounts for the bill's effective date, due to the higher liquidated damage penalty in the bill. Out-year revenues reflect annualization and a gradual decrease in the number of knowing violations.

(in dollars)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
GF/SF/FF Rev.	$184,200	$212,200	$145,500	$78,700	$78,700
GF Expenditure	$109,000	$109,000	$96,600	$21,600	$21,600
Net Effect	$75,200	$103,200	$48,900	$57,100	$57,100

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local revenues increase by $61,400 in FY 2017 due to the higher liquidated damage penalty in the bill. Out-year revenues increase slightly due to annualization and then decline gradually due to a gradual reduction in the number of knowing violations.

Small Business Effect: Potential meaningful.

Analysis

Current Law: For a complete description of the State's prevailing wage statute, please see the **Appendix – Maryland's Prevailing Wage Law.**

Background: DLLR advises that, over the last four calendar years, a total of 176 contractors were assessed liquidated damages for failing to pay the appropriate prevailing wage, of which 30 were repeat violators. This translates to an average of 44 contractors per year, of which 8 are repeat offenders and would likely meet the bill's criteria for knowing violations. DLLR further advises that total liquidated damages assessed in the last five calendar years were $783,023, for an annual average of $156,605. DLLR has previously advised that roughly 75% of liquidated damages are paid to the State and the remaining 25% are paid to local public bodies.

State Revenues: For this analysis, the Department of Legislative Service (DLS) uses the annual averages given above to determine the likely increase in revenues for fiscal 2017 resulting from the higher liquidated damage penalty assessed for knowing violations, after adjusting for a partial-year effect due to the bill's October 1, 2016 effective date. DLS also assumes that each violation equates to 178 days (the combined effect of the number of laborers affected and the duration of the violation), the per-violation average based on the information provided by DLLR. In succeeding years, it is assumed that compliance with the prevailing wage requirement increases due to fewer repeat offenders who are subject to the more severe penalty. This results in lower annual increases in liquidated damage revenues until they plateau in fiscal 2021. The analysis also assumes that the State receives 75% of liquidated damages assessed under the bill.

Based on these assumptions, State revenues (all funds) increase by $184,189 in fiscal 2017 and by $212,218 in fiscal 2018, which accounts for a full year of revenues as well as fewer repeat offenders. Out-year revenues reflect continuing increased awareness of the more severe penalty for repeat offenders for two more years, until revenues even out in the fifth year.

State Expenditures: The bill does not increase the number of prevailing wage projects that are subject to DLLR oversight, so there is no need for additional enforcement resources. However, the bill does create a new offense for knowing violations of prevailing wage requirements with a more severe penalty. Although that penalty is assessed by existing investigators, it is assumed that all of the knowing violations will be appealed and require adjudication by the Office of Administrative Hearings (OAH).

Therefore, general fund expenditures increase by $108,964 in fiscal 2017, which accounts for the bill's October 1, 2016 effective date. This estimate reflects the cost of hiring one contractual assistant Attorney General to adjudicate appeals at OAH for three years.

After that, it is assumed that the number of violations subsides due to increased awareness of the more severe penalty for knowing violations. It includes a salary, fringe benefits, OAH fees, and operating expenses.

Contractual Position	1.0
Salary and Fringe Benefits	$46,549
OAH Hearings	57,600
Operating Expenses	4,815
Total FY 2017 State Expenditures	**$108,964**

Future year expenditures reflect a full salary with annual increases and employee turnover as well as annual increases in ongoing operating expenses. They also reflect a reduced number of OAH hearings each year and the termination of the contractual position after three years.

This estimate does not include any health insurance costs that could be incurred for specified contractual employees under the State's implementation of the federal Patient Protection and Affordable Care Act.

Small Business Effect: Small businesses that work on prevailing wage projects for State or local public bodies are subject to a higher liquidated damage penalty for knowing failure to pay the proper prevailing wage rates to their employees.

Additional Information

Prior Introductions: None.

Cross File: SB 1009 (Senator Benson, *et al.*) - Finance.

Information Source(s): Department of Labor, Licensing, and Regulation; Department of Legislative Services

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Appendix – Maryland's Prevailing Wage Law

Contractors and subcontractors working on eligible public works projects in Maryland must pay their employees the prevailing wage rate. "Public works" are structures or works, including a bridge, building, ditch, road, alley, waterwork, or sewage disposal plant, that are constructed for public use or benefit or paid for entirely or in part by public money.

Eligible public works projects are:

- those carried out by the State;
- an elementary or secondary school for which at least 25% of the money used for construction is State money; and
- any other public work for which at least 50% of the money used for construction is State money.

Any public works contract valued at less than $500,000 is not required to pay prevailing wages. The State prevailing wage rate also does not apply to (1) any part of a public works contract funded with federal funds for which the contractor must pay the prevailing wage rate determined by the federal government or (2) specified construction projects carried out by public service companies under order of the Public Service Commission.

Prevailing wages are wages paid to at least 50% of workers in a given locality who perform the same or similar work on projects that resemble the proposed public works project. If fewer than 50% of workers in a job category earn the same wage, the prevailing wage is the rate paid to at least 40% of those workers. If fewer than 40% receive the same wage rate, the prevailing wage is calculated using a weighted average of local pay rates. The State Commissioner of Labor and Industry is responsible for determining prevailing wages for each public works project and job category based on annual surveys of contractors and subcontractors working on both public works and private construction projects.

The commissioner has the authority to enforce contractors' compliance with the prevailing wage law. Contractors found to have violated the prevailing wage law must pay restitution to the employees and liquidated damages to the public body in the amount of $20 a day for each laborer who is paid less than the prevailing wage. If an employer fails to comply with an order by the commissioner to pay restitution, either the commissioner or an employee may sue the employer to recover the difference between the prevailing wage and paid wage. The court may order the employer to pay double or triple damages if it finds that the employer withheld wages or fringe benefits willfully and knowingly or with deliberate ignorance or reckless disregard for the law.

The Governor must include at least $385,000 in the budget each year for the Prevailing Wage Unit within the Department of Labor, Licensing, and Regulation (DLLR).

The University System of Maryland, Morgan State University, St. Mary's College of Maryland, and the Maryland Stadium Authority are all exempt from the prevailing wage law.

History of the Prevailing Wage: The federal Davis-Bacon Act, originally enacted in 1931, requires contractors working on federal public works contracts valued at more than $2,000 to pay their employees the prevailing local wage for their labor class, as determined by the U.S. Secretary of Labor. The general intent of the law, and similar state and local laws, is to stabilize local wage rates by preventing unfair bidding practices and wage competition. Thirty-two states and the District of Columbia currently have prevailing wage laws; since 1979, nine states have repealed their prevailing wage laws.

Maryland adopted a prevailing wage law in 1945 (Chapter 999), but it only applied to road projects in Allegany, Garrett, and Washington counties. In 1969, the statute was amended to include State public works contracts of $500,000 or more. There have been periodic changes to the law and the definition of "prevailing wage." In 1983, the law was broadened to include public works projects in which the State funds 50% or more of the total project costs and 75% or more in the case of public schools. Chapter 208 of 2000 reduced the prevailing wage threshold for public schools from 75% to 50% of construction costs, thereby bringing school construction projects in line with prevailing wage requirements for other public works projects. Chapters 281 and 282 of 2014 further lowered the State funding threshold for school construction projects to 25% of total construction costs, making virtually all K-12 school construction projects in the State eligible for payment of prevailing wages, subject to the $500,000 contract value threshold.

The number of prevailing wage projects has risen dramatically in recent years. DLLR advises that, in calendar 2015, its prevailing wage unit monitored more than 1,500 projects, compared with 187 in fiscal 2011 and 446 in fiscal 2012. To accommodate the increase in projects, the number of prevailing wage investigators increased in fiscal 2016, from three to six, with each having a caseload of about 200 projects at any given time.

Five Maryland jurisdictions – Allegany, Charles, Montgomery, and Prince George's counties and Baltimore City – have local prevailing wage laws requiring public works projects in the jurisdiction to pay prevailing wages; Montgomery County's prevailing wage ordinance does not apply to school construction projects.

Research on the Effects of Prevailing Wage on Contract Costs: The Department of Legislative Services (DLS) regularly reviews research on the effect of prevailing wage laws on the cost of public works contracts and has found inconsistent and/or unreliable results. The primary challenge confronted by all prevailing wage researchers is identifying an appropriate "control group" consisting of projects of similar type, timing, and location that do not pay the prevailing wage. In most jurisdictions that require a prevailing wage, all projects of a specified type and size are subject to it, so there is no natural control group. Some researchers have compared project costs in states or localities before and after they adopted prevailing wage requirements, but their findings are clouded by the difference in time, during which construction costs changed and other factors were not consistent. Another deficiency in the research is that it almost always relies on project bid prices (*i.e.*, the anticipated cost prior to the beginning of construction) rather than actual final costs. As most construction projects experience change orders or cost overruns affecting their cost, reliance on bid prices negatively affects the validity of the findings. Therefore, research findings related to the effect of the prevailing wage on project costs are inconsistent and often inconclusive. A similar review of research conducted by DLLR for the Task Force to Study the Applicability of the Maryland Prevailing Wage Law also concluded that "data limitations create difficulty for researchers on both sides of the issue."

Early theoretical studies concluded that higher wages under prevailing wage contracts increase contract costs by between 10% and 30%, but many of those studies were flawed, and their findings could not be replicated. For instance, a frequently cited study of 18 projects by the then U.S. General Accounting Office was found to have omitted from its analysis 12 projects in which the prevailing wage was actually lower than the market wage. Empirical studies carried out in the 1990s found much smaller contract cost effects, often in the range of between 2% and 10%, but those studies were hampered by the control group and data quality challenges identified above.

More recent empirical data from several counties yields similar results. Local school systems occasionally solicit side-by-side bids with and without prevailing wages to help them decide whether they want to accept the full State match (and, thus, be subject to the prevailing wage) or a lesser State match without being subject to the prevailing wage. Data provided to the Public School Construction Program by Anne Arundel, Carroll, Frederick, Howard, and Washington counties from 2012-2015 shows that the cost differential between bids with and without prevailing wages for 266 individual bids submitted for 26 different school construction and renovation projects averaged 11.7%, with a range from 0% to 49%. As with other research data, these represent bid prices, not actual construction costs.

These empirical findings have been countered over the past 10 to 15 years by multiple large-scale studies that have found no statistically significant effect of prevailing wages on contract costs. As with the earlier studies that found a project cost effect, control group, and data quality issues may have also affected these studies' findings, but the studies themselves cited the following possible explanations for the absence of a cost effect:

- higher wages are associated with higher productivity, reducing the overall cost of the project;
- contractors may be saving money in other areas, such as using lower-cost supplies and materials; and
- contractors may absorb some of the cost of paying higher prevailing wages in order to remain competitive in government procurement.

One area of the research in which there is a general consensus, and supported by the federal Bureau of Labor Statistics, is that labor costs represent between 20% and 30% of construction costs. Therefore, a 10% gap between prevailing wages and market wages could theoretically increase total contract costs by about 2.5%, and a 40% gap in wages could increase total contract costs by about 10%. That is consistent with the findings of some of the empirical studies that have been conducted, but as noted above, more recent empirical studies have failed to find an effect even of that size. Nevertheless, given the empirical evidence that prevailing wages tend to be higher than nonprevailing wages and that labor costs are a significant portion of overall project costs, DLS believes that it is reasonable to expect that the prevailing wage requirement adds between 2% and 5% to the cost of a public works project. Given the inconsistency and inconclusiveness of the empirical research, however, actual effects may vary by project, with some projects exhibiting higher cost differences and others experiencing negligible differences.