SB 433

Department of Legislative Services

Maryland General Assembly
2019 Session

FISCAL AND POLICY NOTE
Enrolled - Revised

Senate Bill 433 (Senator Zucker, *et al.*)

Education, Health, and Environmental Affairs Health and Government Operations

State Procurement – State Funded Construction Projects – Payment of Employee Health Care Expenses

This bill requires the Board of Public Works (BPW) to adopt regulations that require all bidders, contractors, and subcontractors on State-funded construction projects to pay employee health care expenses, as defined by the bill. The bill does not apply to minority business enterprises (MBEs) or businesses with 30 or fewer employees. The Department of General Services (DGS) and the Maryland Department of Transportation (MDOT) must establish procedures for bidders, contractors, and subcontractors to certify that they pay employee health care expenses. BPW must collect and report on specified information for three years after the bill's enactment. **The bill takes effect July 1, 2019.**

Fiscal Summary

State Effect: General fund expenditures increase by $265,700 and Transportation Trust Fund (TTF) expenditures increase by $250,400 in FY 2020 to administer and enforce the bill's provisions and conduct the required study; out-years reflect ongoing costs. No effect on *total* expenditures for State construction projects, but the cost of individual nonprevailing wage projects may increase, as discussed below. No material effect on revenues from penalty provisions.

(in dollars)	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Revenues	$0	$0	$0	$0	$0
GF Expenditure	265,700	249,300	257,600	250,800	258,000
SF Expenditure	250,400	235,700	243,600	251,900	260,500
Net Effect	($516,100)	($485,000)	($501,100)	($502,700)	($518,500)

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

Local Effect: No effect on total funds in local capital budgets for construction projects, but to the extent that some nonprevailing wage projects experience higher costs, fewer funds are available for other projects. No effect on local revenues.

Small Business Effect: Meaningful.

Analysis

Bill Summary:

Health Care Expenses Defined

"Employee health care expenses" are any costs for health care services, as defined by the bill, paid by a responsible bidder or subcontractor to an employee, unless the employee has coverage under another plan, including:

- contributions made on behalf of an employee to provide specified credible health care coverage that arranges or provides medical, hospital, and surgical coverage that is not designated to supplement other private or governmental plans;
- contributions made on behalf of an employee to a health savings account, as defined under the federal Internal Revenue Code, or any other similar account;
- reimbursements to an employee for health care expenses;
- payments to a third party to provide health care services to an employee;
- payments under a collective bargaining agreement to provide health care services to an employee; and
- costs incurred in the direct delivery of health care services to an employee.

Certification Requirements

A bidder, contractor, or subcontractor on a State-funded construction contract must demonstrate the payment of employee health care expenses by submitting certification or a valid contract to DGS or MDOT that shows that, for employees who will work on the construction project:

- the employer pays aggregate employee health care expenses of at least 5% of the wages paid by the employer; or
- the employer pays 50% or more of the required premium necessary to obtain coverage by a credible health insurance plan.

The bill establishes less stringent requirements for certification before July 1, 2020. A procurement officer may require a responsible bidder or subcontractor to submit records that are sufficient to support the certification required by the bill. DGS, MDOT, and the Department of Labor, Licensing, and Regulation (DLLR) must collaborate on the development of a certification form.

Enforcement

If a contract awardee fails to provide the required documentation in a reasonable period of time, the procurement officer may void the contract. A person who provides false information under the bill is subject to a civil penalty of between $2,500 and $25,000 for each violation. An action for the civil penalty may be brought by the agency that awarded the contract, the Attorney General, or the State's Attorney.

Board of Public Works Study

For three years following the bill's enactment, BPW must collect the following information for all construction-related, competitive sealed bids:

- whether the bidding company and any subcontractor provides employee or family health care coverage on projects that require a prevailing wage;
- for the year preceding the bid, the percentage of total wages and the total amount spent on employee health care;
- the percentage of total health insurance costs paid by the insurance company (instead of the employee), the type and scope of coverage provided, and the average percentage of the monthly premium paid by the bidder or subcontractor; and
- the average percentage of monthly premium paid by the employee and the average per employee deductible for each health care plan offered.

BPW must direct any relevant agency to incorporate the necessary data in requests for competitive sealed bids, and BPW must report the information it collects to specified committees of the General Assembly by August 1 of each of three years (2020 through 2022).

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

The calculation of the prevailing wage rate is required to include a fringe benefit component (which is in addition to the base hourly rate) that reflects the cost of providing medical coverage, retirement benefits, and other fringe benefits. The contractor must pay the fringe benefit rate either to a third party to provide fringe benefits to the employee, or as additional wages directly to the employee.

Competitive sealed bidding is one of several procurement methods authorized by statute. It is most often used for the procurement of commodities and construction. Historically, it has been the most common procurement method used by the State, in large measure because of a statutory preference for its use. However, that preference was repealed by Chapters 588 and 589 of 2017. Nevertheless, competitive sealed bidding is likely to remain a commonly used procurement method.

Under competitive sealed bidding, a contract is awarded to the responsible bidder who submits the responsive bid that (1) is the lowest bid price; (2) if the invitation for bids so provides, the lowest evaluated bid price; or (3) if the procurement generates revenue for the State, the bid that is most favorable to the State. A "responsible bidder" is defined as a person who has the capability in all respects to perform fully the requirements of the contract and who possesses the integrity and reliability that will ensure good faith performance. A responsive bid is one that conforms in all material respects to the invitation for bids.

Mandated Study on Health Care Coverage

Chapter 468 of 2018 required BPW to collect the information listed below for all construction-related contracts awarded by competitive sealed bids in the three months following the enactment of the bill, and submit a report on its findings to specified committees of the General Assembly by November 1, 2018:

- whether the bidder and any subcontractor provide employee health care coverage on projects that require payment of prevailing wages;
- for the year preceding the bid, what the percentage of total Social Security wages was as well as the total amount spent on employee health care;
- the percentage of total health insurance coverage costs paid by an insurance company compared with the percentage paid by an employee;
- the type and scope of coverage as well as the average percentage of monthly premiums paid by the bidder or subcontractor; and
- the average percentage of monthly premium paid by the bidder's or subcontractor's employees and the average deductible in each health care plan offered.

The report included information from more than 300 contractors and subcontractors involved with 48 different procurements. It found that 75% of respondents provided employee health insurance coverage on prevailing wage projects. Coverage levels among those that provided health insurance varied tremendously, but most employers paid at least 50% of plan premiums, and most deductibles were at or below $2,500.

State Expenditures:

Construction Costs

Most, but not all, State construction projects are required to pay prevailing wages. Thus, employers who do not provide health insurance to their employees on prevailing wage projects must pay their employees the fringe benefit rate as additional wages. To the extent that the fringe benefit rate is sufficient to enable these employers to provide health coverage to their employees at a level that complies with the bill's requirements (instead of paying employees directly), the bill should not have a meaningful effect on wages paid under State construction contracts and, thus, should not have a meaningful effect on total project costs. For the relatively small number of construction contracts that do not meet the $500,000 threshold for payment of prevailing wages, project costs may increase due to bidders and contractors passing on to the State the additional cost of providing employee health coverage in the form of higher bids. A reliable estimate of any such increase is not feasible.

Even so, the bill has no effect on total spending for capital construction projects, which is determined annually by the Governor and General Assembly through the capital budget process. However, to the extent that some nonprevailing wage projects are more expensive, fewer funds are available for other projects.

Administrative Costs

The State awarded more than $2.8 billion in construction contracts in fiscal 2017, which is generally consistent with procurement activity in recent years; local governments awarded additional contracts for school construction and other State-funded projects. As each of these contracts likely involved multiple bidders whose provision of employee health coverage must be certified, the workload for DGS and MDOT increases substantially. Specifically, DGS and MDOT must review the payroll and/or health coverage documentation provided by bidders, contractors, and subcontractors to ensure that their payment of health care expenses meets either of the two thresholds in the bill. Although contractors and subcontractors on prevailing wage projects must submit payroll data to DLLR to confirm payment of prevailing wages, bidders on State contracts do not submit payroll data.

MDOT advises that each of its business units requires two or three additional staff (for a total of as many as 21 additional positions) to carry out the bill's requirements. The Department of Legislative Services disagrees and believes that three additional procurement officers can serve the multiple business units.

Therefore, general fund expenditures by DGS increase by $248,132 and TTF expenditures by MDOT increase by $250,447 in fiscal 2020, which assumes that the additional staff are in place as of the bill's July 1, 2019 effective date. This estimate reflects the cost of DGS hiring a procurement manager, compliance officer, and database manager and MDOT hiring three procurement officers to ensure compliance by bidders, contractors, and subcontractors during the procurement process. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	6.0
Salaries and Fringe Benefits	$465,489
Operating Expenses	33,090
Total FY 2020 DGS and MDOT Expenditures	**$498,579**

Future year expenditures reflect full salaries with annual increases and employee turnover and ongoing operating expenses.

Board of Public Works Study Costs

BPW advises that the three-month study conducted for Chapter 468, though conducted with existing resources, was a bigger drain on staff resources than originally anticipated. Therefore, BPW requires additional staff to collect, compile, and report the information on the provision of health coverage by State contractors from agencies that contract for construction. Accordingly, general fund expenditures increase by $17,548 in fiscal 2020, which accounts for a 90-day start-up delay from the bill's July 1, 2019 effective date. This estimate reflects the cost of hiring a part-time contractual administrative assistant to gather and compile the data on State construction contractors. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Contractual Position	0.5
Salary and Fringe Benefits	$12,423
Operating Expenses	5,125
Total FY 2020 BPW Expenditures	**$17,548**

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.

Future year expenditures reflect a full salary with annual increases and employee turnover, ongoing operating expenses, and the termination of the contractual position in fiscal 2023.

Local Expenditures: The bill requires bidders, contractors, and subcontractors on any State-funded construction project to pay their employees' health care expenses. As the bill does not define what constitutes a State-funded project, this analysis assumes that any construction project that receives State funds is subject to the bill’s requirement. A significant proportion of local school construction projects is required to pay prevailing wages, so the bill likely has little to no effect on the costs of those projects. However, some school construction projects do not meet the 25% State-fund threshold and, therefore, do not pay prevailing wages. Similarly, other local construction projects that receive State funds do not meet the 50% State-fund threshold. For these nonprevailing wage projects, any payments made for employee health insurance coverage by employers who currently do not provide that coverage are likely passed on to local governments in the form of higher bids. To the extent that individual project costs increase, fewer local capital funds are available for other projects.

Local expenditures do not increase to administer the bill as it does not assign any monitoring or enforcement responsibilities to local governments.

Small Business Effect: Businesses with 30 or fewer employees are exempt from the bill’s requirements, but those with between 31 and 50 employees must provide health coverage to their employees if they are involved with bidding on a State-funded construction contract. Only those that work on nonprevailing wage projects are substantially affected by this requirement.

Additional Comments: DGS advises that, with the exception of MBEs, bidders are not required to name subcontractors at the time of bid submission. Therefore, certifying that subcontractors are complying with the bill’s requirement during the procurement process is not feasible. Also, the bill authorizes procurement officers to void a contract due to noncompliance, but procurement officers handle contract formation, not contract management and, thus, are not authorized to void a contract because they have no involvement with the contract once it is signed.

Additional Information

Prior Introductions: SB 492 of 2018, a similar bill as introduced to this bill as introduced, was amended to only require submission of the study by BPW discussed above. It passed both houses as amended and was signed by the Governor as Chapter 468. Its cross file, HB 776 of 2018, was also amended to require a study by BPW. It passed the House and was assigned to the Senate Rules Committee, but no further action was taken.

Cross File: HB 680 (Delegate Cullison, *et al.*) - Health and Government Operations.

Information Source(s): State Board of Contract Appeals; Judiciary (Administrative Office of the Courts); Maryland State's Attorneys' Association; Department of General Services; Maryland Department of Transportation; Department of Labor, Licensing, and Regulation; Board of Public Works; 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, or $250 per laborer per day if the employer knew or reasonably should have known of the obligation to pay 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 almost all public school construction projects in the State required to pay the prevailing wage, subject to the $500,000 contract value threshold.

The number of prevailing wage projects has risen dramatically in recent years. DLLR advises that, during fiscal 2018, its prevailing wage unit monitored 958 active prevailing wage projects, up from 776 projects in fiscal 2016 and 496 in fiscal 2014. To accommodate the increase in projects, the number of prevailing wage investigators increased in fiscal 2016 from three to six; there are currently five investigators.

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) has reviewed 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 through 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. An independent analysis of the Maryland side-by-side bid data concluded that factors other than prevailing wages, including bid timing and the level of competition for the bids, accounted for most of the differences between the prevailing wage and nonprevailing wage bids.

Over the past 10 to 15 years, multiple large-scale studies 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 which is supported by the U.S. 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.