

SURETY TODAY PRESENTATION

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THE SURETY AND THE DAVIS-BACON ACT

In this presentation we will explore the Davis-Bacon Act, its history, the federal regulations implementing the Act, as well as some practical pointers for addressing Davis-Bacon Act issues. Finally, we will address the conflict between the surety's right to equitable subrogation and the Davis-Bacon set-off. Simply summarized, the 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.

I. THE DAVIS-BACON ACT

A. HISTORICAL PERSPECTIVE

The Davis-Bacon Act, 40 U.S.C. §3141 *et seq.* (2006)(formerly 40 U.S.C. §276a) was enacted into law in 1931. However, the Congressional debate on prevailing wage legislation in general began in 1927. The legislative history pinpoints the impetus for what would later become the Davis-Bacon Act as the construction of a federal Veteran's Bureau hospital in Long Island, New York; the congressional district of Representative Robert Bacon.¹ The federal government 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.²

¹ U.S. Congress. House. Committee on Labor, Hearings on H.R. 7995 & H.R. 9232, 71st Cong., 2d Sess., March 6, 1930, p. 17.

² 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.

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.³ 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 or from out-of-town.⁴ The economic conditions of the early 1930's quickly gave rise to an oversupply of labor and increased the importance of federal building programs, as unemployment rose and private construction became increasingly limited during the Great Depression.⁵ Accordingly, in 1931, a prevailing wage bill submitted by Representative Bacon and Senator James Davis of Pennsylvania, was passed by Congress.⁶ 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.⁷ Accordingly, in 1935, the Davis-Bacon Act was amended to provide for predetermination of prevailing wages and for enforcement/penalty provisions.⁸ The Davis-Bacon Act was followed by similar legislation in the manufacturing and service industries. At the present time, there are in excess of 60 federal laws related to the Davis-Bacon prevailing wages.⁹ Most states have also enacted Little Davis-Bacon prevailing wage legislation.

³ Stuart Schulman, *The Case Against the Davis-Bacon Act*, Government-Union Review, Winter 1983, p.23.

⁴ 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).

⁵ See *Coutu*, 450 U.S. at 774.

⁶ Armand J. Thieblot, Jr., *The Davis Bacon Act*, University of Pennsylvania Press (1975), pp. 8-9.

⁷ *Id.*

⁸ 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).

⁹ 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.¹⁰ Such repeal legislation is broadly supported by the U.S. General Accounting Office, 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 is fairly short and not overly complicated. Initially, the Act establishes that it applies to every contract over \$2,000 for construction, alteration, or repair of public buildings and public works to which the federal government is a party or for which federal funding is provided, Pursuant to the Act all applicable contracts must have a provision stating the minimum wages to be paid. The “minimum wages” are to be established by the Secretary of Labor based on the determination of the prevailing wages for the classes of labor employed on projects of a similar character in a similar location in which the work is to be performed. The statute further provides that every applicable contract must have a provision requiring payment of laborers and mechanics at least once a week, at the wage rates stated in the specifications and

¹⁰ 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

that the contractor will post the scale of wages in a prominent place at the site of the work. If a contractor fails to pay the established minimum wages, the statute authorizes the contracting officer to withhold contract funds from the contractor an amount considered necessary to pay to laborers and mechanics the difference between the prevailing wage rates and the wages actually paid to the laborers and mechanics.

In addition to the authority to withhold contract funds the Act also provides for termination of the contractor if the contracting officer finds that any laborer or mechanic employed by the contractor has been paid at rates below the determined prevailing wage rate. 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.”¹¹ 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.¹² 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 and intervene against the contractor and the contractor's sureties as is conferred by law on persons furnishing labor or materials.¹³ 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 violated the Act.¹⁴ The Act states “[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

down judicially.

¹¹ 40 U.S.C. §3143.

¹² 40 U.S.C. §3144(a)(1).

¹³ 40 U.S.C. §3144(a)(2).

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 and punish violators.

To implement the requirements of the Davis-Bacon Act, the Secretary of Labor has been given the exclusive authority to prescribe regulations.¹⁵ 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 Title 29 of the Code of Federal Regulations (CFR), Subtitle A, Parts 1 through 7. Part 1 provides procedures for predetermining the prevailing wage rate, Part 3, 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 Labor¹⁶ or by requesting a “Project Specific Wage Determination.”¹⁷ “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.”¹⁸ Any interested person may seek reconsideration of a wage determination or a

¹⁴ 40 U.S.C. §3144(b)(1).

¹⁵ 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).

¹⁶ 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

¹⁷ 29 CFR §§1.5, 1.6.

¹⁸ 29 CFR §1.2(a)(1).

decision of the Administrator regarding application of a wage determination.¹⁹ If the person is not satisfied with the response of the Administrator on reconsideration, an appeal to the Administrative Review Board may be filed.²⁰ However, the substantive correctness of the Administrator's wage rate determination is not subject to judicial review.²¹ 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.²²

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.²³ The contractor is also required to retain and maintain its payroll records for a period of three years.²⁴ The contracting agency or the Department of Labor may inspect such records and interview employees to ensure compliance with the Act.²⁵ 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.²⁶

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

¹⁹ 29 CFR §1.8.

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

²¹ 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)..

²² 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).

²³ 29 CFR §3.3 and 29 CFR §5.5(a)(1)(iv)(3)(ii)(A) & (B).

²⁴ 29 CFR §3.4 and 29 CFR §5.5(a)(1)(iv)(3)(i).

²⁵ 29 CFR §3.4(b) and 29 CFR §5.5(a)(1)(iv)(3)(ii)(D).

²⁶ 29 CFR §5.5(a)(1)(iv)(3)(iii) and §5.5(a)(1)(iv)(7).

in the area.²⁷ Further, given the nature of the Act, courts generally hold that the Davis-Bacon Act should be liberally construed to effectuate its purpose.²⁸ Moreover, the protections of the Davis-Bacon Act are not waivable by the contractor, employee or agency.²⁹ However, the Secretary of Labor may make variations, tolerances and exemptions from the regulatory requirements, but not the statutory requirements.³⁰

II. 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.³¹ For example, in one case, 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.³² Aside from the process for setting the wage determination or overall process, 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.

²⁷ 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).

²⁸ Drivers, Salesmen, Warehousemen, etc. v. NLRB, 361 F.2d 547 (D.C. Cir. 1966).

²⁹ International Brotherhood of Elec. Workers, Local 357 v. Brock, 68 F.3d 1194 (9th Cir. 1995).

³⁰ 29 CFR §5.14.

³¹ See note 28.

³² 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).

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, especially those on site, 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.

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, inevitably the surety will be confronted with claims from 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. 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. Who has the superior interest in the contract funds? The limited number of cases that have addressed the priority of the Davis-Bacon Act claim have not established any clear or bright-line rule on this issue, but they are generally not favorable to the surety.

In *National Fire Insurance Co. of Harford v. Fortune Const. Co.*,³³ 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.³⁴ 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.³⁵ 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."³⁶ They were employees of a lower tier sub that did not have a direct contract with the principal as required to be a "claimant" under the bond.

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

³³ 320 F.3d 1260 (11th Cir. 2003).

³⁴ *Id.* at 1272.

³⁵ *Id.* at 1277.

³⁶ *Id.* at 1277, n. 20.

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.

Of course, when the surety performs the obligations under the performance bond it becomes equitably subrogated to the rights of the obligee. In *Westchester Fire Insurance Company v. United States*,³⁷ the Court of Federal Claims addressed the claims of the surety to contract funds that 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.³⁸ 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.³⁹ However, the authority cited by the Court does not support the Court's conclusion.⁴⁰ 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.⁴¹ 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

³⁷ 52 Fed.Cl. 567 (2002).

³⁸ *Id.* at 581.

³⁹ *Id.* at 581-582.

⁴⁰ 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.

directly related to the project like the claims of underpaid laborers' for work on the project.⁴² The Court noted, 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 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 the *Munsey Trust* case.

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 at all. 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. As we all know, 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

⁴¹ *Id.* at 582.

⁴² *Id.* at 583.

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 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*,⁴³ 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 underpaid 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 expired. The Department of Labor instructed the Coast Guard to withhold contract funds for the Davis-Bacon claim, which the Coast Guard did; and the remaining balance of the funds, less the Davis-Bacon withheld 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 and incorrect. Under the Board's theory, 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.

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.

IV. 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.

⁴³ 1999 DOL BCA Lexis 8; 1999-1 B.C.A. (CCH) P30,660