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SFA BILL ANALYSIS

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Senate Bill 712 (as reported with amendments)
Senate Bill 713 (as reported with amendments)
Sponsor: Senator Walter H. North
Committee: Human Resources, Labor and Veterans Affairs

Date Completed: 11-26-97

RATIONALE

Under current law, before any contract exceeding $50,000 for the construction or repair of a public work of the State or a local unit is awarded, the proposed contractor must furnish to the State or local unit a performance and payment bond that is binding upon the award of the contract. There has been some concern about situations in which payment bonds posted by a contractor working on public projects were invalid or insufficient to protect subcontractors and material suppliers on the same project. When the prime contractor went out of business or simply failed to follow through the contract payment, the subcontractor and supplier did not get paid. (See **BACKGROUND**, below.) Some people feel that legislation is needed to help guarantee the authenticity of contract payment bonds and to establish a governmental unit's duty to require that a contractor's payment bond be sufficient and properly executed.

CONTENT

Senate Bill 712 would amend Public Act 187 of 1905, which insures the payment of subcontractors, laborers, and suppliers used in the construction or repair of public buildings and public works, and Senate Bill 713 would amend the Public Act 213 of 1963, which provides for bonding contractors for public buildings and public works, to provide that contracts between the State or a local unit of government and a contractor for the construction or repair of public buildings or public works, would require a good and sufficient performance and payment bond.

"Good and sufficient performance and payment bond" would mean a bond properly executed by a surety company that was an authorized insurer as defined in the Insurance Code.

The bills provide that if the State or a county, city, village, township, or school district failed to obtain a bond as required, the State or local unit would be liable for the contractor's or other third party's failure to make payment to any person entitled to recover under the bond. The State, county, city, village, township, or school district, however, would not be liable under this provision when a person claiming the right to recover under the bond or letter of credit had not fully performed as required by the contract for construction, alteration, or repair.

Currently, a contractor who is a common carrier operating under the Common Carrier Act, or the operator of a State-subsidized railroad, may provide an irrevocable letter of credit from a State or national bank or a Federally chartered savings and loan, instead of the required bond. The bills also would allow the letter of credit to be provided by a credit union.

Senate Bill 712

Currently, if a public building or other public work is to be built, repaired, or ornamented under contract at the expense of the State or a local unit, it is the duty of the governmental unit to require sufficient bond for the payment by the contractor of all subcontractors who supply labor, contract wages, contract benefits, materials, or equipment. The bill would require a good and sufficient performance and payment bond.

Senate Bill 713

Currently, before any contract exceeding $50,000 for the construction or repair of a public building or public work of the State or local unit is awarded, the proposed contractor must furnish to the State or

local unit a performance bond and a payment bond that is binding upon the award of the contract. The bill would require a good and sufficient performance and payment bond.

The bill also would require the principal contractor to furnish to each subcontractor, before performance on a contract, a copy of the bond or letter of credit required under the Act. The subcontractor could void its contract with the principal contractor if the principal contractor failed to provide a copy of the bond or letter of credit as required under the bill.

Under the bill, the bond would be required to be at least 100% of the contract amount. Currently, the payment bond must be in an amount that is at least 25% of the contract amount.

MCL 570.101 (S.B. 712)
129.201 et al. (S.B. 713)

BACKGROUND

Public Act 213 of 1963 has been the subject of recent court decisions. In 1987 East China Township Schools entered into a general construction contract with Dougherty Construction for construction and renovation of athletic facilities. As required under the Act, Dougherty provided the school district with a performance and payment bond. Dougherty then hired a subcontractor, Kammer Asphalt Paving Co., to perform part of the project. Kammer notified Dougherty and the school district of the work it intended to perform and its reliance upon the payment bond. Though the school district made progress payments to Dougherty, Dougherty did not make complete payments to Kammer. After complaints by Kammer of Dougherty's failure to compensate the subcontractor, the school district found that the bonds furnished by Dougherty were invalid and unenforceable, and it terminated the contract with Dougherty when Dougherty failed to provide a replacement bond. Kammer filed suit against Dougherty and the school district, claiming that the district was liable for damages since it had failed to ensure the validity of the bond. The St. Clair Circuit Court granted the school district's motion for summary disposition, finding that the statute did not require a governmental unit to ensure the validity of the bonds. The Court of Appeals affirmed the decision of the circuit court. In a split decision, *Kammer Asphalt Paving Co., Inc*. v *East China Township Schools* (443 Mich 176 (1993)), the Michigan Supreme Court reversed the lower court, allowing Kammer to proceed with its case against the school district. The Supreme Court found that the Act, examined as a whole, "imposes upon a governmental unit the duty to verify the validity of a payment bond" furnished by a general contractor of a public works project.

In April 1996, the Court of Appeals addressed the issue of a governmental unit's duty to require a contractor to furnish a payment bond. In *ABC Supply Company* v *City of River Rouge* (216 Mich App 396), the Court affirmed a decision of the Wayne Circuit Court, which confirmed a zero dollars arbitration award and an order of summary disposition in favor of the city. The Court of Appeals stated: "We believe the clear language of *Kammer* does not go so far as to construe MCL 129.201...as placing an affirmative duty on the governmental unit to require that the statutory bonds be furnished." (MCL 129.201, which is Section 1 of Public Act 213, provides that before any contract exceeding $50,000 for the construction or repair of a public building or work is awarded, the contractor must furnish to the governmental unit a performance and a payment bond.) The Court of Appeals stated that the Supreme Court's decision was based, rather, on MCL 129.208 (Section 8 of the Act), which requires a governmental unit to furnish a certified copy of the bond *at the request* of the subcontractor, and provides that the copy is prima facie evidence of the contents, execution, and delivery of the original. The Court of Appeals pointed out a footnote in the *Kammer* decision, in which the Supreme Court said that if Kammer had never requested copies of the bond, it would have had no recourse against the school district: "After nonpayment by a general contractor, if subcontractors are willing to work without at least requesting copies of the bonds, then they assume the risk that no bonds (or invalid bonds) exist." The Court of Appeals concluded that the Supreme Court's holding in *Kammer*, then, "does not provide for a broad duty of the government unit to require the bonds or be liable for parties injured by the failure to require the bonds".

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The bills would help avoid disputes between subcontractors and a governmental unit when the general contractor fails to furnish a sufficient or enforceable payment bond, as seen in recent court

cases. It would require governmental units to post bonds on public works projects that were good and sufficient in order to provide adequate protection for all subcontractors who supply labor, contract wages, contract benefits, materials, or equipment. The bills also would ensure that the bonds were properly executed by surety companies that were authorized insurers as defined in the Insurance Code, and specify that if a governmental unit failed to obtain the bond as required, it would be liable for a failure by the contractor to make payments to any person entitled to recover under the bond. This would guarantee that payment bonds were issued properly, and thus give greater assurance to subcontractors that they would be paid for the labor and supplies they provided.

Opposing Argument

The bills would make governmental units liable for the failure of a general contractor's payment bond unless the construction, alteration, or repair required by the contract had not been fully performed. Some people believe that the local units may not be capable of determining whether a contractor's payment bond was a good and sufficient performance and payment bond. The bills also do not specify whether the local governments still would be held liable when a good and sufficient performance and payment bond, which was properly executed by a surety company, had failed to pay subcontractors.

Legislative Analyst: N. Nagata

FISCAL IMPACT

Government entities that do not obtain a bond as required would be liable to ensure payments to contractors or subcontractors. However, government entities would not be liable if contractors and subcontractors do not perform fully as required by the contract for construction, alteration, or repair.

Fiscal Analyst: R. Ross

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