House
Legislative
Analysis
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CONSTRUCTION CONTRACTS; DIFFERING SITE CONDITIONS

House Bill 4505 as introduced
First Analysis (5-3-01)

Sponsor: Rep. Judson Gilbert
Committee: Local Government and Urban Policy

THE APPARENT PROBLEM:

Sometimes in carrying out construction work, contractors come across circumstances at a site that had not been foreseen, physical conditions that could have an effect on the cost of completing the work and/or on the amount of time needed to complete the work. Contracts often contain a "differing site condition" clause, which allows for the adjustment of a contract when unanticipated conditions or conditions contrary to earlier plans are discovered. Examples that have been cited include the discovery of illegal underground dumps, old foundations, and unexpected soil or rock conditions. Advocates say that such clauses provide for a process whereby a contract can be adjusted, reducing the risks for contractors, leading to better relations among the contracting parties, and reducing litigation. Further, a differing site condition clause may reduce the cost of some projects because contractors do not have to add margins to cover possible unexpected circumstances.

Public Act 57 of 1998 effectively inserts a differing site condition clause into any contract between a contractor and a governmental entity for improvements exceeding $75,000. The 1998 act is set to expire as of December 31, 2001. Proponents of the act suggest that it has accomplished its intended purpose, and advocate eliminating the sunset date.

THE CONTENT OF THE BILL:

House Bill 4505 would repeal the December 31, 2001 'sunset' provision in Public Act 57 of 1998.

The act requires that a contract between a contractor and a governmental entity for improvements exceeding $75,000 contain certain provisions regarding situations in which previously unknown physical conditions are discovered at a work site. The contract must contain the following provisions.

** A contractor must promptly notify the governmental entity if he or she discovers 1) that a subsurface or latent physical condition at the site differs materially from those indicated in the improvement contract, and/or 2) that an unknown physical condition at the site is of an unusual nature differing materially from those ordinarily encountered and generally recognized as inhering in work of the character provided for in the improvement contract.

** If a governmental entity receives such a notice, it must promptly investigate the physical condition.

** If the governmental entity determines that the physical conditions are materially different and will cause an increase or decrease in costs or additional time needed to perform the contract, it must put its determination in writing and an equitable adjustment must be made and the contract modified in writing accordingly.

** The contractor may not make a claim for additional costs or time because of a physical condition unless he or she has provided the required notice to the governmental entity. A governmental entity may extend the time for the notice to be provided.

** The contractor may not make a claim for an adjustment under the contract after having received the final payment under the contract.

If a contract does not contain the provisions cited above, the provisions are incorporated into and considered part of the improvement contract.

If a contractor does not agree with the governmental entity's determination, he or she may, with the consent of the entity, complete performance on the contract. At the option of the governmental agency, the contractor and the entity will arbitrate the

contractor's entitlement to recover the actual increase in contract time and costs incurred because of the physical condition of the improvement site. The arbitration must be conducted in accordance with the rules of the American Arbitration Association and judgment rendered may be entered in any court having jurisdiction.

The law specifies that it does not limit the rights or remedies otherwise available to a contractor or the governmental entity under any other law or statute. The term "contractor" does not apply to a person licensed under Article 20 of the Occupational Code, which applies to architects, professional engineers, and surveyors. Otherwise, the term refers to an individual or entity that contracts with a governmental entity to improve real property or perform or manage construction services. The term "governmental entity" refers to the state, a county, city, township, village, public educational institution, or any political subdivision thereof. The term "improvement" includes but is not limited to all or any part of any building, structure, erection, alteration, demolition, excavation, clearing, grading, filling, landscaping, trees, shrubbery, driveways, and roadways on real property.

MCL 125.1591 to 125.1596

BACKGROUND INFORMATION:

The history of Public Act 57 of 1998 dates back to the 1995-1996 session of the legislature. During that session, two similar bills—House Bill 4957 and House Bill 6197—passed the legislature but were vetoed by the governor. The governor expressed three objections to House Bill 4957: (1) it would have created "a statutory mandate on specific provisions of a contract for persons who have opportunity to freely negotiate the terms of an agreement"; (2) it would have created "a new statutory cause of action for persons who have access to a judicial remedy through principles of general contract law; and (3) it could have encouraged "costly and time consuming litigation" instead of preventing it.

House Bill 6197 eliminated a provision in House Bill 4957 authorizing a contractor to bring a cause of action against a governmental entity when there was a disagreement over a determination of physical conditions. House Bill 6197 replaced this provision with a new provision allowing for the arbitration of disagreements at the option of a governmental entity. In explaining the veto of House Bill 6197, the governor repeated his initial objection to House Bill 4957—that it is inappropriate to mandate provisions that the contracting parties could freely negotiate themselves. The governor further stated that House Bill 6197 would have created the "basis for breach of contract claims," despite its omission of the term "cause of action" and its provision for arbitrating disputes.

Public Act 57 of 1998 is essentially identical to House Bill 6197, except that it includes a sunset provision, according to which the law will expire on December 31, 2001.

FISCAL IMPLICATIONS:

Fiscal information is not available.

ARGUMENTS:

For:

The 1998 law effectively adds, by statute, a differing site condition clause to contracts between governmental entities and contractors carrying out improvement projects under contracts exceeding $75,000. Such clauses protect contractors when they discover that conditions at a site, particularly underground at a site, differ from what was expected when the contract was entered into. Clauses of this kind, said to be common in federal environmental contracts, among others, provide a means of resolving conflicts over unexpected additional costs or work hours. Such clauses reduce litigation and lead to a better bidding process because contractors will not have to build in amounts to cover potential site problems. The language in the law is said by advocates to be similar to that used in federal contracts.

Response:

Some believe that it is unnecessary and inappropriate to mandate the inclusion of a differing site condition clause in a contract, given that a contractor and governmental entity have the opportunity to freely negotiate the terms of the agreement.

For:

Initial concerns that the act would lead to increased litigation appear to have been addressed. There does not appear to have been any significant increase in lawsuits, and in fact the law has probably helped prevent many disputes that would otherwise have gone to court.

Against:

There is no clear evidence that the law has been effective in decreasing the number of lawsuits brought by contractors against government entities, and there is no documentation supporting the claim

that the law has not led to an increase in litigation. Perhaps the sunset provision should be amended to extend the act for another three years so that the law's effect on litigation can be studied more carefully.

POSITIONS:

The Associated Underground Contractors of Michigan supports the bill. (4-26-01)

The Michigan Municipal League supports the bill. (4-26-01)

The Department of Consumer and Industry Services has no official position on the bill. (5-2-01)

Analyst: J. Caver

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