

PAVEMENT WARRANTIES

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Senate Bill 520 (S-2) as passed by the Senate
Sponsor: Sen. Rick Outman
House Committee: Transportation
Senate Committee: Transportation and Infrastructure
Complete to 6-8-20

Analysis available at
<http://www.legislature.mi.gov>

SUMMARY:

Senate Bill 520 would amend 1951 PA 51 (“Act 51”) to change requirements regarding pavement warranties for state, county, and municipal construction projects.

State pavement warranties

Currently, with regard to state trunkline highways, Act 51 requires the Michigan Department of Transportation (MDOT) to secure, when possible, pavement warranties for full replacement or appropriate repair for contracted construction work on pavement projects that cost more than \$2.0 million and projects for new construction or reconstruction. MDOT must report to the public all pavement projects costing over \$2.0 million for which a warranty was not secured.

The bill would increase the threshold cost that requires securing a warranty for a pavement project. Under the bill, MDOT would have to secure, when possible, a warranty for those projects costing more than \$5.0 million, rather than those costing more than \$2.0 million.

The bill would also eliminate the current language that effectively requires a pavement warranty for all new construction or reconstruction. Additionally, the bill would eliminate the requirement that a public report be made of projects for which a warranty was not secured. (MDOT would still have to report annually on warranties that were secured.)

Prequalified status as security

The bill would add a definition for the term “warranty” with regard to state trunkline projects that would allow a contractor to pledge its prequalified status¹ as security against the required replacement or repair of contracted construction work. Specifically, the bill would define “warranty” to mean either of the following:

- A surety bond in the amount of full replacement or appropriate repair for the contracted construction work, as determined by MDOT.
- If the construction contractor has prequalified status and MDOT consents, a contractual agreement for the construction contractor to fully replace or make appropriate repairs to the contracted construction work as determined by MDOT secured by the construction contractor’s voluntarily agreeing to surrender its prequalified status as a bidder on subsequent contracts with MDOT until all repairs are completed, as determined by MDOT.

¹ “Anyone seeking to bid on and/or perform work on MDOT projects must be prequalified. This work includes road and bridge construction/repair, concrete or hot mix asphalt paving, concrete curb and gutter/sidewalks, street/traffic lighting, sewer/watermain installation, sodding/seeding/landscaping, guardrail and fencing.”

See https://www.michigan.gov/mdot/0,4616,7-151-9625_21539_21545---,00.html

Under the bill, if a contractor placed its prequalified status as security for replacement or repairs and lost that status because of a warranty claim, MDOT would have to consider the warranty claim and loss of prequalified status in reviewing subsequent applications for prequalified status from the construction contractor or any associated individual or business entity. MDOT could deny applications for prequalified status on the basis of a previous warranty claim that resulted in the loss of prequalified status by the applicant and any individual or business entity associated with that applicant.

The bill would also require MDOT to include in its annual report on pavement warranties an indication of whether a contractor posted a surety bond or warrantied the construction work by voluntarily placing its prequalified status as security for replacement or repairs.

County pavement warranties

Currently, with regard to county primary or local road systems, Act 51 requires a county road commission to secure, if allowed by the Federal Highway Administration (FHWA) and MDOT, pavement warranties for full replacement or appropriate repair for contracted construction work on pavement projects that cost more than \$2.0 million and projects for new construction or reconstruction. The county road commission must report to the public all pavement projects costing over \$2.0 million for which a warranty was not secured.

The bill would increase (from \$2.0 million to \$5.0 million) the threshold cost requiring a warranty for a pavement project and would also modify the description of projects to which the requirement would apply. Under the bill, a county road commission would have to secure, if allowed by FHWA and MDOT, a warranty for contracted construction work projects where the cost of pavement-related items as defined by the county's warranty program is more than \$5.0 million. The county road commission would have to report to the public all such projects for which a warranty was not secured.

The bill would also eliminate the current language that effectively requires a pavement warranty for all new construction or reconstruction.

Municipal pavement warranties

Currently, with regard to city or village major or local street systems, Act 51 requires a city or village to secure, if allowed by FHWA and MDOT, pavement warranties for full replacement or appropriate repair for contracted construction work on pavement projects that cost more than \$2.0 million and projects for new construction or reconstruction. The city or village must report to the public all pavement projects costing over \$2.0 million for which a warranty was not secured.

The bill would eliminate the current language that effectively requires a pavement warranty for all new construction or reconstruction and would modify the description of projects to which the warranty requirement would apply. Under the bill, a city or village would have to secure, if allowed by FHWA and MDOT, a warranty for contracted construction work projects where the cost of pavement-related items as defined by the municipality's warranty program is more than \$2.0 million. The city or village would have to report to the public all such projects for which a warranty was not secured.

MCL 247.661, 247.662, and 247.663

FISCAL IMPACT:

1951 PA 51 (Act 51) is the statute that establishes and governs major state transportation funds and programs. Among other things, Act 51 establishes the Michigan Transportation Fund (MTF); directs the distribution of MTF revenue to other state funds and programs, as well as to local road agencies (county road commissions, and cities and villages); prescribes uses of MTF revenue by local road agencies; establishes the State Trunkline Fund (STF); and prescribes uses of STF revenue.

Senate Bill 520 would amend three sections of Act 51: section 11, governing the use of STF revenue; section 12, governing the use of MTF revenue distributed to county road commissions; and section 13, governing the use of MTF revenue distributed to cities and villages. Specifically, Senate Bill 520 would amend provisions in each of those sections related to the use of warranties. The current warranty language was added to those sections by 2015 PA 175.²

Senate Bill 520 would amend language in section 11 that currently requires MDOT, with respect to state trunkline projects, where possible, to "secure pavement warranties for full replacement or appropriate repair for contracted construction work on pavement projects whose cost exceeds \$2.0 million and projects for new construction or reconstruction..." The bill would increase the warranty requirement threshold to \$5.0 million, would delete language that effectively requires warranties on all new construction, and would streamline a current reporting requirement.

The bill would provide new options for a contractor to provide security for a warranty project: either through a surety bond in the amount of full replacement or appropriate repair for the contracted construction work, as determined by MDOT, or by effectively pledging the contractor's prequalification.

Senate Bill 520 would amend the warranty requirements established in section 12 with respect to county road commission, increasing the warranty threshold from \$2.0 million to \$5.0 million and deleting language that effectively requires warranties on all new construction, and would streamline a current reporting requirement.

Senate Bill 520 would not change the warranty requirement threshold established in section 13 with respect to cities and villages; the threshold would remain at \$2.0 million, although the reference would change from "contracted construction work on pavement projects" to "the cost of pavement-related items as defined by the warranty program." The bill would also delete language that effectively requires warranties on all new construction.

The bill could reduce the number of warranties required of MDOT and local road agencies. The impact on the number of warranties required, and the related impact on state and local costs, cannot be readily estimated at this time.

Warranties may provide additional quality control for highway construction projects. They may also increase project cost. There are a number of variables affecting the effectiveness of warranties in providing additional construction quality, as well as on the impacts on project

² See <http://legislature.mi.gov/doc.aspx?2015-HB-4737>

cost. The most important variable is whether the construction contract requires a materials and workmanship warranty or a full performance warranty.

A warranty could increase project cost if the contractor obtains a warranty bond to ensure that any corrective work will be performed during the warranty period. The warranty bond is a direct cost to the contractor, which would likely be passed on to the owner in higher bid prices. How much bid prices would increase, and whether the owner receives additional value (e.g., increased assurance of a well-built road) for the increased cost, is difficult to determine.

Note that the bill would allow a contractor, in lieu of obtaining a surety bond to guarantee performance of warranty work, to pledge his or her prequalification as a guarantee of warranty work. MDOT's prequalification program is governed by 1933 PA 170,³ which regulates bids and contracts on public work construction.

1933 PA 170 is permissive; it authorizes, but does not require, a prequalification process for public works projects. The act authorizes the prequalification of bidders for construction, maintenance, or repair of the public works, except buildings. The act identifies criteria by which bidders can be prequalified or prevented from bidding, including past performance, financial resources, and construction equipment and facilities.

MDOT uses a prequalification process for insuring that contractors bidding on highway construction contracts have the experience and financial resources to complete the contract. MDOT's prequalification program is established under 1933 PA 170 and the Administrative Procedures Act. MDOT administrative rules concerning the prequalification of contractors are found at R 247.1 et seq. in the Michigan Administrative Code.

In addition to possible direct cost increases, performance warranties may indirectly increase construction bid prices by limiting the number of bidders on some jobs and thus reducing competition. Under a performance warranty, contractors are generally required to secure a warranty bond for the warranty period—which may be as long as 10 years. If the contractor goes out of business, the bonding company guarantees that the warranty will be honored. As long as the warranty bond is outstanding, contractors have diminished bonding capacity. Contractors, particularly smaller contractors, may find it hard to obtain sufficient additional bonding to bid on new jobs. Some small contractors may simply be unable to obtain bonding needed to secure performance warranties.

For additional background information on road construction warranties, see the House Fiscal Agency publication "Transportation: Road Construction Warranties," March 2001, at: <http://www.house.mi.gov/hfa/Archives/PDF/warrant.pdf>

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.

³ See <http://legislature.mi.gov/doc.aspx?mcl-act-170-of-1933>