

## WARRANTIES ON HIGHWAY CONSTRUCTION PROJECTS

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**House Bill 5460 (Substitute S-3)**

**Sponsor: Rep. Dan Lauwers**

**Committee: Transportation and Infrastructure**

**Complete to 9-12-14**

## A SUMMARY OF HOUSE BILL 5460 (S-3) AS PASSED BY THE SENATE 6-11-14

House Bill 5460 (S-3) would amend four sections of Public Act 51 of 1951, the act that directs the distribution of state transportation revenue. The bill would establish new warranty provisions for the Michigan Department of Transportation (MDOT), county road commissions, and cities and villages for pavement and other construction and reconstruction projects. The bill would also establish new reporting requirements with respect to these warranty provisions.

In addition, the bill would amend a subdivision within Section 11 regarding the department's authority to enter into agreements with county road commissions, cities, and villages.

The bill is tie-barred to House Bill 5477, a bill to amend the Motor Fuel Tax Act.

MCL 247.661, 247.662, 247.663, and 247.664.

## BACKGROUND INFORMATION AND DETAILED ANALYSIS

### *Provisions Dealing with MDOT Contracting Authority – Section 11(1)(g)*

Section 11 of 1951 PA 51 establishes the State Trunkline Fund (STF) and directs the priority order of appropriations from the STF. As provided in Section 11, the STF is appropriated for the construction and preservation of state trunkline roads and bridges and for MDOT administration.

Section 11 also contains provisions not directly related to STF appropriations: the section establishes a rail grade crossing program; authorizes the use of STF money and STF note or bond proceeds for loans to county road commissions, cities, and villages; and, in Subdivision (1)(g), authorizes the department to enter into agreements with county road commissions, cities, and villages "to perform work on a highway, road, or street." The subdivision authorizes such agreements to provide for "the performance by any of the contracting parties of any of the work contemplated by the contract including engineering services, and the acquisition of right of way [...]." Under provisions of this subdivision, these agreements may also provide for joint participation in costs.

It is our understanding that this subdivision currently provides authority for MDOT to enter into agreements with county road commissions, cities, and villages related to local federal aid projects and transportation economic development projects. Further, it is our understanding that this subdivision provides authority for the department to enter into cost-sharing agreements with road commissions, cities, and villages related state trunkline construction contracts.

House Bill 5460 (S-3) would substitute the term "local road agency" for county road commissions, cities, and villages, and would add "a private sector company" to the entities which whom the department could enter into agreements. The bill would also specifically include *maintenance* in the work for which the department may enter agreements. As a result, the proposed amendments to Section 11(1)(g) would authorize the department to enter into agreements with *a local road agency* or a *private sector company* to perform work on a highway, road, or street, including *maintenance*, engineering services, and the acquisition of right of way.

House Bill 5460 (S-3) would add a new Subsection (15) to define "local road agency" to mean what that term means under Section 9a of Act 51, i.e., "a county road commission or designated county road agency or city or village that is responsible for the construction or maintenance of public roads within the state under this act."

***Provisions Dealing with Highway Construction Warranties – Section 11(2), Section 11(14), Sections 12, 13, and 14***

Section 11, Subsection (2) currently includes provisions directing MDOT, where possible, to secure pavement warranties on certain state trunkline projects. House Bill 5460 (S-3) would amend this subsection to require MDOT, with respect to state trunkline projects, where possible, to "secure pavement warranties for full replacement or appropriate repair guarantee for contracted construction work on pavement projects whose cost exceeds \$1 million and projects for new construction or reconstruction undertaken after the effective date [of the enacted bill]."

The bill would also add a new Subsection (14) to Section 11 to establish reporting requirements with respect to these warranty provisions. Specifically, the bill would require an annual report listing all warranties secured under Subsection (2), and indicating whether any of those warranties were redeemed. The report, which would be available upon request and posted on the department's website, would include the following information: the type of project, the cost or estimated cost of the project, the expected lifespan of the project.

The bill would add similar requirements to Section 12 with regard to county road commission projects and to Section 13 with regard to city and village projects. However, the warranty provisions dealing with county road commissions and cities and villages would only apply if allowed by the federal highway administration and the department. The amendments to Sections 12 and 13 would require county road commissions and cities and villages, respectively, to submit a proposed warranty program to the

department no later than September 30, 2015. The bill indicates that if approved the proposed warranty program of a county road commission or city or village would be implemented no later than one year after approval.

The warranty reporting requirements for country road commissions, cities, and villages would be identical to those established under Section 11 for the department. However, the vehicle for the report would be the annual report already required of local road agencies under Section 14 of Act 51.

Section 14 currently requires separate accounting by local road agencies of Michigan Transportation Fund revenue, accurate and uniform records of all road and street work and funds, and annual reports by local road agencies of "the mileage of each road system under their jurisdiction and the receipts and disbursements of road and street funds." House Bill 5460 (S-3) would amend this section to require a local road agency to post its annual report on its website, if it has a website.

#### **ADDITIONAL BACKGROUND INFORMATION ON WARRANTIES:**

There have been several initiatives by the Michigan Legislature regarding the use of warranties on highway construction projects. Boilerplate language was added to the 1996-97 transportation appropriations bill (1996 PA 341, Section 603) to require the use of warranties on state trunkline construction projects "where possible." Subsequent transportation appropriations bills included similar boilerplate language, including language that would have extended warranty requirements to county, city, and village road agencies. In 1997, language regarding warranties was added to 1951 PA 51, the statute that governs the distribution of MTF revenue. Specifically, 1997 PA 79 amended Section 12 of Act 51 to read: "Of the amounts appropriated for state trunk line projects, the department shall, where possible, secure warranties of not less than 5-year full replacement guarantee for contracted construction work." The warranty language did not apply to county road commissions or cities and villages.

In its June 1, 2000, report, the Michigan Act 51 Funding Study Committee recommended that "all road agencies seek warranties from construction contractors, where appropriate." The Michigan Department of Transportation awarded its first pavement warranty contract in 1996. As of June 2009, 626 contracts awarded by the department included pavement warranty provisions; 39 bridge projects included warranty provisions. [We are in the process of obtaining updated warranty figures from the department.] Most of these warranty contracts have been on Capital Preventive Maintenance (CPM) projects. Relatively few of the contracts for pavement rehabilitation, reconstruction, or new pavement construction include warranty provisions.

The department uses two different kinds of construction warranties on paving projects: *materials and workmanship warranties* and *performance warranties*. Under a *materials and workmanship warranty*, the contractor is responsible for correcting defects in work elements within contractor control (materials and workmanship) during the warranty period. Since the owner, i.e., the department, is still responsible for project design, the

contractor assumes no responsibility for defects due to design decisions. Under a *performance warranty*, the contractor assumes full responsibility for pavement performance during the warranty period. In effect, the contractor guarantees that the pavement will perform at a desired quality level.

Under a *performance warranty*, the contractor may assume responsibility for some or all design decisions, e.g., design/build projects.

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

## **FISCAL IMPACT:**

House Bill 5460 (S-3) amendments to Section 11(1)(g) would authorize the department to enter into agreements with *a local road agency* or a *private sector company* to perform work on a highway, road, or street, including *maintenance*, engineering services and the acquisition of right of way. The fiscal impact of the proposed amendments to this subsection cannot be readily determined.

It is not clear how the inclusion of a "private sector company" among those entities with whom the department could enter into agreements, or the inclusion of "maintenance" in the work which could be contemplated by a contract, would affect the department's contracting authority. The department currently has broad authority to contract with both county road commissions, cities, and villages, as well as private contractors, for work on state trunkline roads and bridges under both 1964 PA 286 and 1925 PA 17.

The proposed amendments to Section 11, Subdivision 1(g) do not appear related to the apparent current intention of the subdivision to provide for state/local cost sharing agreements.

House Bill 5460 (S-3) would amend Section 11, Subsection (2), to require MDOT, with respect to state trunkline projects, where possible, to "secure pavement warranties for full replacement or appropriate repair guarantee for contracted construction work on pavement projects whose cost exceeds \$1 million and projects for new construction or reconstruction undertaken after the effective date [of the enacted bill]."

The bill would add almost identical language to Section 12 with respect to county road commissions, and to Section 13 with respect to cities and villages. [The proposed amending language for Sections 12 and 13 would establish the warranty requirement *if allowed by the federal highway administration and the department*.]

The bill would also establish reporting requirements for the department, county road commissions, and cities and villages with respect to these warranty provisions.

The impact of these provisions on the Michigan Department of Transportation and local road agencies would depend on the number and nature of the warranties required under terms of the bill and whether the bill would effectively require a *performance warranty* for construction or reconstruction projects.

Requiring *performance warranties* for construction and reconstruction work could increase the cost of construction and preservation work. In a performance warranty contract, the contractor may be forced to obtain 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. The department's experience with full performance warranties on construction or reconstruction contracts has been limited.

In addition to possible direct cost increases, the bonding requirements of 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.

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