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Senate Bill 520 (Substitute S-2 as passed by the Senate)  
Sponsor: Senator Rick Outman  
Committee: Transportation and Infrastructure

Date Completed: 2-28-20

### **RATIONALE**

Until 1995, the Federal Highway Administration restricted the use of pavement warranties for projects using Federal funding, citing concerns that states would employ Federal funding for road maintenance and repair. After those restrictions were eliminated, many states, including Michigan, adopted a warranty program for pavement projects. Public Act 79 of 1997 amended the Michigan Transportation Fund law to require the Michigan Department of Transportation (MDOT) to secure warranties for contracted construction work. Currently, this requirement applies to pavement projects whose costs exceed \$2.0 million. From 1997 to 2018, MDOT reportedly secured 3,800 pavement warranties. Public Act 178 of 2015 extended this requirement to secure warranties to county road commissions, cities, and villages, and many local road agencies have since adopted their own warranty programs. Some have concerns that pavement warranties cost the State and local road agencies a significant amount of money, which reduces available funding to repair or rebuild existing roads and construct new roads. Accordingly, it has been suggested that the Legislature increase the cost threshold for pavement project warranties.

### **CONTENT**

**The bill would amend the Michigan Transportation Fund law to do the following:**

- Require the Michigan Department of Transportation (MDOT) to secure pavement warranties for full replacement or appropriate repair for contracted construction work on pavement projects whose costs exceeded \$5.0 million, instead of \$2.0 million.**
- Require a county road commission to secure pavement warranties for full replacement or appropriate repair for contracted construction work on projects where the cost of pavement-related items as defined by the warranty program exceed \$5.0 million, instead of \$2.0 million.**
- Require MDOT to include in its annual report whether a construction contractor had posted a surety bond or had otherwise warranted the construction work by voluntarily placing its prequalified status as security for replacement or repair.**
- Require MDOT to consider a warranty claim and loss of prequalified status when reviewing subsequent applications for prequalified status from a construction contractor or any associated individual or business entity if a construction contractor warranted construction work by voluntarily placing its prequalified status as security for replacement or repairs.**
- Modify a requirement that a county road commission, city, or village secure pavement warranties for full replacement or appropriate repair for contracted construction work on pavement projects whose cost exceeds \$2.0 million.**

## State Pavement Project Warranties & Reporting

The law establishes the State Trunk Line Fund and requires that money deposited in the Fund be appropriated to MDOT to be used for certain purposes in a particular order of priority.

The law also requires MDOT to spend 90% of State revenue appropriated annually to the State Trunk Line Fund, less amounts for other priorities, for the preservation of highways, roads, streets, and bridges, and for the payment of debt service on bonds, notes, or other obligations. Of the amounts appropriated for State trunk line projects, MDOT must, where possible, 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 undertaken after April 1, 2016.

Instead, under the bill, of the amounts appropriated for State trunk line projects, MDOT would have to secure pavement warranties for full replacement or appropriate repair for contracted construction work on pavement construction or reconstruction and capital preventative maintenance projects whose costs exceed \$5.0 million undertaken after April 1, 2016.

The Department must prepare an annual report listing all warranties that were secured as described above. The report must indicate whether any of those warranties were redeemed and list all pavement projects whose costs exceed \$2.0 million where a warranty was not secured. The bill would eliminate the latter requirement.

The Department must make the report available to the public upon request and must post it on the MDOT website. The report must include the following information:

- The type of project.
- The cost or estimated cost of the project.
- The expected lifespan of the project.
- Whether or not the project met or is currently meeting its expected lifespan.
- If the project failed to meet or is not meeting its expected lifespan, the cause of the failure and replacement or reparation costs.
- The entity responsible for paying the cost of replacing or repairing the project.

The bill would require MDOT to include in the report whether the construction contractor had posted a surety bond or had otherwise warrantied the construction work by voluntarily placing its prequalified status as security for replacement or repair.

In addition, the bill provides that if a construction contractor warrantied construction work by voluntarily placing its prequalified status as security for replacement or repairs, and the construction contractor lost its prequalified status because of a warranty claim, MDOT would have to consider the warranty claim and loss of prequalified status when reviewing subsequent applications for prequalified status from the contractor or any associated individual or business entity. The Department could deny applications for prequalified status based on a previous warranty claim that resulted in the loss of prequalified status by the applicant and any individual or business entity associated with the applicant.

"Warranty" would mean one 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 voluntarily agreeing to surrender its prequalified status as a bidder on subsequent contracts with MDOT until all repairs are completed, as determined by MDOT.

## County, City, & Village Pavement Project Warranties & Reporting

The law extends the requirement to secure pavement warranties for replacement or repair on pavement projects to county road commissions, cities, and villages. Of the amounts appropriated for a county primary or local road system or a city or village major or local street system, where possible, a county road commission, city, or village must 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 undertaken after April 1, 2016, if allowed by the Federal Highway Administration and MDOT.

Under the bill, of the amounts appropriated for a county or local road system, where possible, a county road commission would have to secure pavement warranties or full replacement or appropriate repair for contracted construction work on projects where the cost of pavement-related items as defined by the warranty program exceeded \$5.0 million, undertaken after April 1, 2016, if allowed by the Federal Highway Administration and MDOT. A city or village would have to secure pavement warranties for full replacement or appropriate repair for contracted construction work on projects where the cost of pavement-related items as defined by the warranty program exceeded \$2.0 million undertaken after April 1, 2016, if allowed by the Federal Highway Administration and MDOT.

The law requires a county road commission, city, or village to include within an annual report to MDOT a list of all warranties that were secured, and indicate whether any of those warranties were redeemed. The law also requires the report to list all pavement projects whose cost exceeds \$2.0 million for which a warranty was not secured. Under the bill, a county road commission would have to list all projects where the cost of pavement-related items as defined by the warranty program exceeded \$5.0 million for which a warranty was not secured. A city or village would have to list all projects where the cost of pavement-related items as defined by the warranty program exceeded \$2.0 million for which a warranty was not secured.

MCL 247.661 et al.

### **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**

Warranties are intended to guarantee the integrity of a project and to require a contractor to correct any defects at little to no cost to the State. Since the Federal Highway Administration (FHWA) loosened restrictions on the use of warranties, 35 states have adopted a warranty program. However, the FHWA reports that many states have eliminated their programs after studies suggested that warranties did not add significant value to the reliability and longevity of pavement projects, and ultimately cost states more money on these projects. The FHWA reports that warranty requirements can increase the initial construction costs of certain pavement projects by three percent to 15 percent. The initial costs of warranties decrease the State's capacity to fund the maintenance and reconstruction of existing roads and construction of new roads.

In addition to the potential for increased costs on pavement projects, warranties can be difficult to enforce. A pavement warranty often relies on several assumptions and representations, such as traffic count estimates. If MDOT finds errors or premature deterioration in a pavement project, it must negotiate with the contractor for the road's repair. Some states have repealed their warranty requirements because of consistent difficulties with negotiation that led to those states' transportation departments paying for portions of repairs for projects under warranty. Premature deterioration and negotiation difficulties have occurred in Michigan. For example, a 2016 pavement project on a stretch of I-96 near Lansing required repairs to pavement that remained under

warranty. However, the contractor negotiated to repair only half of the necessary fixes, leaving the rest to MDOT. The increased initial costs associated with warranties for pavement projects and the difficulty of enforcing them reduce available funds for road maintenance and construction in the State. By increasing the cost threshold for requiring pavement project warranties, fewer projects would require warranties, and the State could contribute more resources to Michigan's infrastructure needs.

### **Supporting Argument**

Studying the efficacy of warranty requirements for pavement projects would assist in determining the best approach to quality assurance. Many states that have adopted warranty requirements for pavement projects have repealed them, citing studies on the issue that suggest no evidence of a difference in reliability and longevity for roadways with a warranty. Michigan has not established a mechanism for evaluating the efficacy of its warranty program. Furthermore, in 2015, the Office of the Auditor General found among other things that MDOT did not consistently ensure that contractors upheld their contractual warranty obligations for pavement projects. The Department's lack of oversight hinders the evaluation of warranties for pavement projects in the State and undermines the efficacy of current warranties. Requiring MDOT to report publicly information regarding pavement projects with warranties would ensure accountability and would give insight into whether warranty requirements were the best approach for road quality assurance.

### **Supporting Argument**

Warranties for pavement projects increase the direct cost of a contracted pavement project by requiring the contractor to obtain a warranty bond for potential corrective work (the cost of this is priced into the cost of the project). However, warranty requirements can indirectly affect the cost of projects. In the process of choosing a contractor for a pavement project, MDOT receives bids from many construction contractors and then selects the most acceptable bid for the work. By requiring pavement project warranties, smaller contractors often have difficulty securing an adequate warranty bond without increasing their bids on the project by a significant amount. This deters smaller contractors from bidding and decreases the competitiveness of the bidding process, which results in indirect cost increases for projects. Increasing the threshold for pavement projects that require warranties could expand the pool of contractors willing to bid on projects and could result in cost savings on infrastructure projects in the State.

### **Opposing Argument**

Since 1997, MDOT has secured 3,800 warranties for pavement projects. Of these warrantied pavement projects, approximately 13 percent have required the contractor to return and perform corrective work. It is this percentage of projects that have benefitted directly from pavement project warranty requirements. Warranties also deter contractors from performing inadequate or low-quality work, which saves the State money by preventing a higher percentage of callbacks on pavement projects. This deterrent allows MDOT to ensure the quality of work without having to keep staff and oversight personnel on-site at projects. While warranties may increase the cost of the project at the onset, they save money for the State further along in the process with guaranteed, adequate work and lower staffing requirements. Increasing the threshold, from \$2.0 million to \$5.0 million, would restrict MDOT's capacity to ensure a pavement project's quality.

MCL 247.661 et al.

Legislative Analyst: Tyler VanHuyse

### **FISCAL IMPACT**

The bill likely would have a positive fiscal impact on the Department because of slightly reduced costs for road and bridge construction and maintenance contracts. The bill would have no fiscal impact on local government.

According to the most recent warranty report, the MDOT has 235 warrantied contracts ranging in contract amounts from \$438,000 to \$223.4 million with an average warrantied contract amount of \$14.0 million and a median amount of \$4.2 million. Six warrantied contracts exceed \$100.0 million while 12 are below the \$2.0 million threshold requirement for a warranty. Of

the 235 warrantied contracts, 129 would not require a warranty under the proposed language changes. The largest bond amount for warrantied contracts is 5% of the contract or \$1.0 million, whichever is lower. This means that the larger contracts do not automatically require larger bond amounts; a \$100.0 million dollar contract may have the same bond amount (\$1.0 million) as a \$20.0 million dollar contract. It also should not be assumed that a bond will not be included on a contract just because it is not required under MCL 247.661; however, if MDOT stopped requiring a warranty on every contract below \$5.0 million, the potential savings could be as high as \$17.5 million. Reaching the maximum savings amount would be unlikely. A practical estimate would be closer to \$8.0 million to \$10.0 million over a period of several years.

Fiscal Analyst: Michael Siracuse

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.