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MDOT ROAD CONTRACTS: ALLOW COUNTY ROAD COMMISSION BIDS

House Bill 5524 with committee and House floor amendments
First Analysis (2-5-98)

Sponsor: Rep. Thomas Kelly
Committee: House Oversight and Ethics

THE APPARENT PROBLEM:

As a January 1998 Senate Fiscal Agency Issue Paper (*PERM Studies and the Use of Private Contractors in State Government* by Philip W. Alderfer, Fiscal Analyst) notes, in July 1992, Governor Engler created the Michigan Public-Private Partnership Commission (Executive Order No. 1992-17), a seven-member commission to study, and make recommendations to the governor on, how to develop ways to provide efficient state services by "introducing competition into the public sector." The commission released its final report in December 1992, and made two recommendations, one to expand the scope of the study and the other a four-item scale to evaluate activities within state departments. The scale, and the reporting process developed around it, was known by the acronym "PERM," which referred to a process by which state departments would analyze ongoing activities and recommend whether the activities should be "privatized, eliminated, retained, or modified." The PERM framework, though recommended by the commission, actually was developed by the Privatization Division of the Department of Management and Budget, a division which was, itself, an evolution from the department's Purchasing Reform Task Force. Consequently, administrative responsibility for the compilation of PERM reports was given to the department's Privatization Division after the commission issued its final report. The Privatization Division was assigned to help state departments to complete PERM reports, as well as to evaluate PERM reports as they were submitted, and to independently assess state functions not examined by state departments. The division began this task on January 1993, and was abolished as an independent unit within the department in September 1997.

According to a second January 1998 Senate Fiscal Agency Issue Paper (*The ABCs of Michigan Highways: The Privatization of Maintenance Contracting in the Department of Transportation* by Philip W. Alderfer), one of the Department of Transportation's privatization initiatives was the "Pilot Program in Highway Maintenance," an effort to shift trunkline maintenance responsibilities to private sector contractors. The first open bidding process, however, resulted in the contract being granted in October 1992 to the Wayne County Road Commission, which was named low bidder on a contract for a contract involving maintenance services on a 27-mile section of I-94 from Detroit to the Washtenaw County line previously maintained by the county road commission. The second attempt to privatize highway maintenance took place in early 1994, when the state solicited bids for a highway contract maintenance contract covering maintenance activities on 20 miles (121 lane miles) of I-496 and US 27 near Lansing, in Ingham, Clinton, and Eaton Counties. The Eaton County Road Commission expressed an interest in submitting a bid for this project, but its efforts were refused by the department. However, in April 1994, the department rejected all three bids eventually submitted by three different private companies because the lowest bid still was more than 50 percent higher than the department's own confidential estimate ($2,147,945 compared with a departmental engineer's estimate of $1,430,229). The department re-released the proposed contract in September 1994, and four private companies submitted new proposals. The low bid was submitted by ABC Paving Company of Trenton, Michigan, and although the ABC contract price still was $266,581 (14.8 percent) higher than the departmental engineer's upwardly revised estimate, ABC was awarded the contract in October 1994. (The ABC $2,065,375 two-year contract price also did not reflect the fact that for the first year of the two-year contract the department provided ABC Paving with a salt storage building, including utility and maintenance costs, worth $344,014.)

According to the Senate Fiscal Agency Issue Paper, maintenance costs under this ABC contract were 96 percent higher than those of the Department of Transportation ($17,211 per "Equivalent-mile" compared with $8,823) and 80 percent more than the average maintenance cost of county road commissions ($9,561 per "E-mile"). Within the specific area covered by the ABC contract, however, ABC Paving maintenance costs were $9,156 (114 percent) more per E-mile than the cost of departmental maintenance garages, and $10,148 (144 percent) more per mile than the costs to contract county road commissions in that area. (The Senate Fiscal Agency report notes that in order to compare costs, the areas under question -- approximately 20 miles of state trunkline -- are translated into maintenance "E-miles," where one E-mile is roughly equivalent to 16 feet of highway surface. The roads maintained by ABC were all two-lane highways, each of which was 12 feet wide, which is equal to 48 feet of road surface per mile, or three E-miles per mile. Since the contract covers approximately 20 route miles of state trunkline, one can use this calculation to approximate the 60 E-mile figure used in the report.)

In September 1997, the Department of Transportation awarded ABC Paving (one of only two private contractors to submit bids) a second, 43-month trunkline maintenance contract for the same section of I-496, though the contract bid of $3,247,466 was $794,056 (32 percent) more than the departmental engineer's estimate of $2,453,410. Both the Eaton and Ingham County Road Commissions expressed an interest in submitting bids for this project, but they were prevented from doing so because neither road commission was on the department's list of "pre-qualified" contractors. ABC Paving's average cost per maintained mile decreased under the second contract, from $17,211 under the first contract to $15,038 in the second contract, though per mile maintenance costs under the second contract with ABC are still 87 percent more than departmental costs within this area and 113 percent more than the cost of contract road commissions within the same area. Part of both the first and second contracts were up-front "mobilization" payments, which are usually used to provide companies with capital to buy equipment and materials necessary to begin work. The 1994 ABC Paving contract included a $270,000 mobilization payment, equivalent to 13.1 percent of the $2,065,375 contract price. Despite the fact that ABC had been performing identical maintenance tasks for three years on the same section of state trunkline, the second ABC Paving contract had a "mobilization" payment of $793,000, equivalent to 24 percent of the total $3.2 million contract.

In addition to the contracts the Senate Fiscal Agency Issue Paper discusses, county road commissions testified that they have been excluded from bidding for Department of Transportation contracts for state highway maintenance, sometimes even in cases where the department has asked a county road commission to provide such services until a private contractor acceptable to the department has been found. For example, although Ingham and Eaton Counties wanted to bid on the US 27/I-496 road project, the department did not allow them to do so. And, in fact, the private contractor who won that contract, ABC Paving, reportedly asked the department whether or not counties would be allowed to bid on the I-496 contract for 1998 should the department decide to let it again. ABC reportedly said (according to a June 21, 1996, memorandum from a departmental maintenance superintendent to the departmental contract engineer) that if counties were allowed to bid, ABC would not because it couldn't compete with the counties and there would be no point in wasting their time in putting together proposals. Similarly, Wayne and Oakland counties were not allowed to bid on a five-mile section of I-275 in Wayne and Oakland counties (two of the five miles were in Oakland County, from Eight Mile Road to Ten Mile Road), even though the first round of private bids came in so high that the department rejected all of them. The department reportedly asked Wayne and Oakland counties to provide maintenance on the five-mile segment of I-275 until the project could go out for bids again, but when the counties asked as to the possibility of bidding on that maintenance work they were advised by the department that they were ineligible to bid because they were not "prequalified." (The Wayne County bid package request was returned with unattributed, handwritten comments from the department saying "You must be prequalified to receive bid documents on this project.") The department then informed Wayne County that new bid documents would be revised for bidding, but since the department was now four weeks before the end of the current contract with no option for extension within the contract, it asked Wayne County to "make the necessary adjustments within your organization to resume trunkline maintenance on the section [of I-275] effective 12:01 a.m. on January 1, 1998." On January 22, 1998, Wayne County filed a lawsuit in Wayne County Circuit Court to demand the opportunity to bid for a standard state maintenance contract on I-275, seeking a declaratory judgment to allow public road agencies to bid on all state maintenance contracts if they choose to do so.

Counties believe that they can provide the maintenance services called for in these department contracts, often at substantially lower costs than have been bid by private contractors, and that they should not be excluded from such bidding. Legislation has been introduced that would address this issue.

THE CONTENT OF THE BILL:

The bill would add a new section to the Management and Budget Act to require the Department of Transportation to allow county road commission to bid on any departmental contracts for the maintenance, repair, or resurfacing of a state highway over which the department has jurisdiction. (For purposes of the bill, "maintenance, repair, or resurfacing" would not include reconstruction.) Any county road commission receiving funds from the Michigan Transportation Fund for performing highway maintenance, repair, or resurfacing work would be considered prequalified to bid on such contracts.

As a condition of bidding on such contracts, a county road commission would have to both (a) declare in writing that any other county road commission in Michigan was eligible to bid on any road project offered by that road commission and (b) certify in writing that the county road commission would not bid less than its incremental costs for the work being contracted.

[Note: According to the House Fiscal Agency, the floor amendment that changed the reference in subsection (2) of the bill from "state" funds to funds "from the Michigan Transportation Fund" substantially changes this subsection, since currently no county receives Michigan Transportation Fund money for performing highway maintenance, repair, or resurfacing work on state trunklines (instead, counties receive contracted state funds for such maintenance, if they do such work on state trunklines). Thus, with the change in language, no counties would be "prequalified" under the bill. However, because subsection (1) still would prohibit the department from preventing a county road commission from bidding on department contracts for the maintenance, repair, or resurfacing of a state trunkline, the issue of prequalification would be moot anyway.]

MCL 18.1255

BACKGROUND INFORMATION:

The ABCs of Michigan Highways says, in background information on the Department of Transportation's "Pilot Program in Highway Maintenance," that *"Currently, both the State and local road authorities maintain the 9,606-mile State trunkline highway system. The MDOT [Michigan Department of Transportation] is directly responsible for approximately 3,600 miles of this network. The remainder is maintained by county road commissions, as well as city and village governments, which work under a standard maintenance contract with the MDOT. . . . Highway maintenance encompasses a wide variety of activities including: pothole patching, grass mowing, culvert cleaning, sign and guardrail repair, and winter snow removal."* (The paper notes that it is limited to a comparison of highway maintenance performed by the state and county authorities, and that city and village trunkline maintenance contracts are not included in the discussion.)

According to the Department of Transportation, 62 of the state's 83 counties currently provide routine maintenance of some portion of state highways under standard contracts that are not let for bids. However, the department also notes that there is a significant difference between routine maintenance and road improvements such as resurfacing and (at least in some cases) repair of roads, depending on how extensive the resurfacing or repair is.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, the net effect of the bill on state costs would be indeterminate. Though the bill could reduce state costs on departmental maintenance projects from which county road commission currently may be excluded bidding on, the bill's requirement that road commissions not bid less than their incremental costs for projects also could lead to higher bids from road commissions on such projects. (2-4-98)

ARGUMENTS:

For:

The cost of the Department of Transportation's effort to privatize state trunkline maintenance services in the Lansing metropolitan area, as described in the January 1998 Senate Fiscal Agency Issue Paper, raises some serious questions about the privatization of at least certain state services. If the goal of privatizing state services is to provide quality services at lowered costs to the state and not just to achieve privatization for the sake of privatization, then, as the issue paper points out, not only have "many county road commissions [been] able to provide comprehensive highway maintenance services at a much lower cost than the [Department of Transportation]", but "private maintenance contracting has not yet resulted in a cost saving when compared with the services provided by either the State or county road commissions." Moreover, given the governor's proposal last year to have the state take over control and responsibility for all roads in the state, not just state trunklines, if all roads in the state were placed under the Department of Transportation, the kinds of increased maintenance costs described in the Senate Fiscal Agency issue paper might result in significantly increased costs to the state -- through contracts with private sector companies -- to maintain all the roads in the state.

As the Senate Fiscal Agency paper points out, under ABC's first contract (from October 1994 through, with the extension, September 1997) the costs of the private contractor for the maintenance of the 20 miles of state trunkline in Ingham, Eaton, and Clinton counties was 114 percent ($9,156 per mile) more than the Department of Transportation's average cost of $8,055 per mile in this region of the state, and a whopping 144 percent (or $10,148) more than the comparable county road commission cost of $7,063 per mile for this region. And while this same contractor's average costs per mile have fallen by $2,173 (to $15,038 per mile), these costs still are 87 percent higher than comparable costs for maintenance provided by the Department of Transportation in this area and 113 percent more than comparable costs for those services as provided by county road commissions within the same area.

In addition, as testimony regarding the five-mile section of I-275 contract suggests, even though the Department of Transportation clearly believes that Wayne and Oakland counties are qualified to maintain the section of state highway in question -- at least until the state can find an acceptable private contractor -- the department would not let the counties bid on the actual contract because they had not "prequalified." But surely if the counties were qualified to maintain I-275 while the department looked for a private bid that was not outrageously expensive then they should be qualified to perform the work required by the contract with or without "prequalification." In fact, the counties are alleging that the department's "prequalification" requirement is a ploy to protect private contractors at taxpayers' expense. State officials reportedly also have said that the I-275 project involves federal money, which makes county road commissions ineligible under the Federal Code of Regulations to do the work. However, federal regulations only prohibit public agencies from bidding for road construction contracts involving federal funds (23 CFR 635.112), but do not prohibit public agencies from bidding on road maintenance contracts involving federal money. In any case, as of January 28, 1998, the U.S. Department of Transportation Office of Project Data and Fund Specification reportedly has said that there were no federal funds designated for the I-275 maintenance project in question.

The issue paper concludes that "county road commissions are, at the present time, able to offer highway maintenance services to the State at a significantly lower cost than either the State or private contractors can provide, including the costs of State-provided materials such as salt, sand, and chloride. Based on this finding the SFA [Senate Fiscal Agency] recommends that the State open bidding to allow all interested parties, including both private contractors and local municipalities, to compete for future highway maintenance contracts." This recommendation should be followed.

Response:

The department points out that in the case of I-275, as their November 26, 1997, letter to the Wayne County Director of Roads (asking Wayne County to resume maintenance of this section of the highway) indicates, it let a "Design, Build, Maintain Contract" three years before with an ending date of December 31, 1997. As the letter states, "The original intent was to have a major reconstruction contract in place by Dec. 31, 1997," but the department "shifted emphasis to another Design, Build, Maintain contract to begin January 1, 1998." Bid opening had taken place, but all of the bids were over the (department's) engineering estimates and so had all been rejected. In other words, the department was not letting a routine maintenance contract, for which the counties presumably are prequalified, but rather was letting a "major reconstruction" contract, for which the counties, who are not in the business of major reconstruction of state trunklines, are not prequalified.

Against:

Spokespeople for the Department of Transportation say that saving money was not the point of the experiment with ABC Paving but rather that the goal was to test ways to bring more competition to road maintenance projects and better learn how to write and negotiate contracts with private companies such as ABC Paving. Thus, the Ingham and Eaton County Road Commissions were excluded from bidding on this contract, not because they were not prequalified to perform routine maintenance on state highways but because the contract was specifically targeted -- and only targeted -- at private sector companies. (The department also pointed out that the Ingham and Eaton County road commissions also wanted to bid only on the parts of the project within their respective jurisdictions, and not on the entire 20 miles, which was not what the contract called for.) As companies gain experience in how to estimate costs, the department reportedly expects the contract costs to come down. As the Senate Fiscal Agency issue paper in fact points out, "[n]either the Department nor ABC had experience with comprehensive contractual highway maintenance projects. Though the MDOT [Michigan Department of Transportation] had long used private contractors for road construction, it had never contracted for comprehensive highway maintenance services with private companies. On the other hand, ABC Paving was a construction firm that had not previously been involved in highway maintenance activities. As a result, the MDOT Director described this effort as an 'experiment . . . to determine the viability of developing private sector involvement in road maintenance.' The Department, he said, would release a 'financial analysis' comparing maintenance costs between the State and the private sector at the conclusion of this pilot project." (*The ABCs of Michigan Highways*, p. 2) The department argues that although it believes that introducing competitive bidding into even routine maintenance contracts will, in the long run, save the state money by holding costs down, competitive bidding has the further benefits of rewarding innovation and ensuring adherence to state-wide performance standards.

Response:

Surely state taxpayers should be able to expect that their tax dollars are being spent in the most efficient way possible, and should not be expected to subsidize the "learning curves" of private companies who want to contract with the state. If municipalities or county road commissions can provide maintenance services more efficiently than private sector companies, they at least should be allowed to bid on contracts and not be excluded simply because they are not within the private sector.

In fact, as one spokesperson for the Oakland County road commission pointed out, because public agencies do not have a profit motive and do not desire a profit margin, they -- unlike private companies -- have no incentive to do extra, unneeded, high-profit work in order to maximize their "return" on their contract costs. The Senate Fiscal Agency issue paper would appear to lend credence to this possibility. For example, a February 1996 memorandum by the Department of Transportation District Contracts Engineer, noted that ABC Paving "tends to concentrate on a few, easy-to-perform, high profit items, especially those that do not require approval of the Contract Administrator. This list included routine patrol patching and the replacement of guardrails with minimal damage or small dents." The issue paper also quotes the District Operations Engineer as saying in his First Summary Report that ABC Paving had "improved, but . . . their overall level of service remained poor." Even in those cases where ABC's performance was "adequate" (such as patrol patching, roadside mowing, curb sweeping, and catch basin cleaning), the District Operations Engineer is further quoted as saying that "the cost is very high." (*The ABCs of Michigan Highways*, p. 2) Despite such comments, the department maintained its commitment to the original contract with ABC Paving, exercising the option for an additional third year in late 1996 so that ABC's first contract ran through September 1997. (The department reportedly granted this extension to have more time to create a more "comprehensive analysis that (would) more accurately compare ABC costs to MDOT [Michigan Department of Transportation] costs," but despite this contract extension, the January 24, 1998, *Lansing State Journal* reported that this was still "underway" and that the department spokesperson could not say when it would be ready. A departmental spokesperson now says that this financial and technical report will be done by the end of the current year.)

Against:

A spokesperson for the department reportedly has claimed that the Senate Fiscal Agency Issue Paper demonstrated that the Department of Transportation's performance of routine road maintenance was more efficient than the county road commissions in the state, and further suggested that the fair cost comparisons should be made between the private contractor's costs per mile in the mid-Michigan, Lansing metropolitan area with the road commissions' costs per mile in the Detroit metropolitan area, since all of the roads maintained by the private contractor in the Lansing metropolitan area are high volume, multi-lane freeways. Under this comparison between the two metropolitan areas, the spokesperson is quoted as saying that "ABC Paving is performing maintenance at a cost of $15,038 per e-mile, when the average cost of county road commissions in the [Detroit] metro area is a whopping $17,260 per e-mile, which is 15 percent higher than ABC Paving. Maybe that's where our investigation should be headed. "

Response:

In the first place, the Senate Fiscal Agency paper showed only that the department's state-wide average costs (of $8,823 per mile) are lower than the state-wide average costs (of $9,561) of contract county road commissions. But surely part of what is -- or should be -- at issue is the cost differences among willing providers of maintenance work specifically for the Lansing metropolitan area, whether public (such as the department itself) or private. In the Lansing metropolitan area, however, the department's average costs are almost $1,000 per mile higher (at $8,823) than those of contract county road commissions ($7,063), which would suggest that the paper actually showed that county road commissions not only are cheaper and more efficient in road maintenance in this area than ABC Paving but also than the department itself.

Secondly, however, even though it is true that ABC Paving's costs per mile of state trunkline maintained in mid-Michigan are lower than road commission costs per mile in the Detroit metropolitan area, this is only true for the second contract under which ABC is operating. The ABC Paving average cost under the first contract was $17,211 per E-mile, which was only $49 per mile less than the average contract road commission cost of $17,260 per E-mile in the Detroit metropolitan area. (The Senate Fiscal Agency paper notes that the Detroit metropolitan area has the highest average cost in the state.) It is true that the issue paper notes that ABC Paving's average costs per maintained mile of mid-Michigan state trunkline fell from an average of $17,211 under its first contract (which ran from October 1994 to September 1997) to $15,038 in the new contract (which runs from October 1997 to April 2001). But even so, the paper also points out that ABC's costs still remain 87 percent more than the department's average maintenance costs per mile in this area (of $8,055) and 113 percent more than the average cost of contract road commissions (of $7,063) in this area.

Finally, although both the Lansing and Detroit metropolitan areas are indeed high volume traffic urban areas, Lansing is considerably smaller than Detroit and can be expected to have a smaller volume of traffic (in fact, according to one claim, state statistics reportedly indicate a volume of traffic in the Detroit metropolitan area of over 150,000 vehicles per day, compared with an average of 50,000 to 60,000 vehicles per day in the Lansing metropolitan area). High traffic volumes result in more wear and tear on roads, and thus require higher levels of maintenance and repair, so it stands to reason that higher traffic volume areas would cost more to maintain per mile than lower traffic volume areas.

Reply:

As the department points out, the figure given in the Senate Fiscal Agency issue paper for the average costs to contract county road commissions for the mid-Michigan area -- which are, indeed, more than $10,000 per mile less than ABC's costs -- include not only the 20 miles of multi-lane, high volume traffic highway covered under the ABC contract, but also the unspecified miles of rural county roads in this area as well. Since it could be expected that it is cheaper to maintain low traffic volume, two-land country roads, depending on how many of these kinds of road miles figure into the overall county road commission average, it really would be fairer to compare the miles of state highway maintained by ABC with other, equally urban, high traffic volume, multi-lane highways. Even though the Detroit metropolitan area may not be the perfect match for the ABC contracted highway miles, it still is a better match than the rural roads of Ingham County.

Against:

Because public agencies, such as county road commissions, do not pay taxes, they have an inherent competitive advantage over private sector companies who do. If government entities are to be allowed to compete in the marketplace, then there should at least be a level playing field, which would include somehow compensating for the advantage public agencies have by virtue of their tax exempt status. Every time the state contracts with a public rather than private sector entity, the state loses money in the form of taxes (which, among other things, for example, go to the state's schools).

Against:

The bill would unnecessarily exclude from prequalification county road commissions (like, reportedly, Eaton County Road Commission) that had not previously had contracts with the state. It also would restrict bidding on county road commission road projects to other road commissions only, which would mean that municipalities and counties (such as Wayne County) that did not have road commissions would also be unnecessarily excluded from the bidding process.

Response:

Apparently, the floor amendment to subsection (2) of the bill (see CONTENT above) would mean that no county would prequalify. However, so long as the bill allowed all counties to bid under subsection (1), the issue of prequalification apparently would not matter.

POSITIONS:

The Wayne County executive office supports the bill. (2-4-98)

The Road Commission for Oakland County supports the bill. (2-4-98)

Analyst: S. Ekstrom

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