# Legislative Analysis

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## WARRANTIES ON ROAD REPAIRS

**House Bill 5460 (Substitute H-3)**
**Sponsor: Rep. Dan Lauwers**
**Committee: Transportation and Infrastructure**

**Complete to 5-8-14**

## A SUMMARY OF HOUSE BILL 5460 (H-3) AS REPORTED BY COMMITTEE 5-7-14

House Bill 5460 (H-3) would amend Public Act 51 of 1951, the statute that governs the distribution of Michigan Transportation Fund (MTF) revenue. The bill would require the Michigan Department of Transportation, county road commissions, and cities and villages to "secure warranties for full replacement guarantee or appropriate repair for contracted construction work on projects whose cost exceeds $1 million, projects for new construction or reconstruction undertaken after the effective date [of the enacted bill], and all other projects where possible." The bill would establish new reporting requirements with respect to these warranty requirements.

The H-3 substitute would also amend Section 14 of Act 51, a section that currently requires separate accounting by local road agencies of MTF 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." The bill would require a local road agency post its annual report on its website, if it has a website.

MCL 247.611, 247.612, 247.613, and 247.614.

## BACKGROUND INFORMATION:

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, 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.

**FISCAL IMPACT:**

<u>House Bill 5460 (H-3)</u> would require the department to "secure warranties for full replacement guarantee or appropriate repair for contracted construction work on projects whose cost exceeds $1 million, projects for new construction or reconstruction undertaken after the effective date [of the enacted bill], and all other projects where possible." The bill would add almost identical language to Section 12 with respect to county road commissions, and Section 13 with respect to cities and villages. [The proposed amending language for Section 12 would establish the warrant 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 requirements.

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 all new construction or reconstruction projects.

Requiring *performance warranties* for all new construction and reconstruction work could increase the cost of construction and preservation work. In a performance warranty contract, the contractor is 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 –

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 would be 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 would have diminished bonding capacity. Contractors, particularly smaller contractors, may find it hard to obtain sufficient additional bonding to bid on new jobs. Small contractors may simply be unable to obtain bonding needed to secure performance warranties.

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