

Department of Legislative Services  
Maryland General Assembly  
2015 Session

FISCAL AND POLICY NOTE  
Revised

House Bill 119 (Delegate Morhaim, *et al.*)  
Health and Government Operations Education, Health, and Environmental Affairs

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Construction Contracts - Change Orders (State Procurement Change Order  
Fairness Act)

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This bill changes the process by which State agencies may issue a change order under a construction contract and the requirements for compensating contractors for work performed under a change order. The changes apply to most procurement units that are otherwise exempt from State procurement law, but not to the State's public institutions of higher education or public-private partnerships (P3s). Likewise, the bill does not apply to State procurement contracts for public school construction or public school capital improvements. The bill also requires the Secretary of Transportation, in conjunction with specified entities, to convene a workgroup to develop recommendations on specified issues related to State procurement of construction contracts. Any provision of the bill is valid only to the extent that it does not conflict with federal law.

The bill takes effect June 1, 2015, except that the provisions related to the issuance of change orders and compensation for work performed under change orders take effect January 1, 2016.

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Fiscal Summary

**State Effect:** The Maryland Department of Transportation (MDOT), Department of General Services (DGS), and other State agencies that procure construction contracts can carry out the bill's requirements with existing resources. However, the bill's requirements may have operational effects on these agencies to the extent that they must change and/or accelerate their process for issuing change orders and compensating contractors for work performed under change orders. MDOT can also manage the workgroup with existing resources. No effect on revenues.

**Local Effect:** None. The bill applies only to State construction contracts.

**Small Business Effect:** Meaningful.

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## Analysis

**Bill Summary:** A procurement unit may not require a prime contractor on a construction contract to begin work under a change order until the procurement officer issues a written change order that specifies the basis under which the contractor is to be paid, in compliance with the terms of the contract. Prime contractors may not require subcontractors to begin work on a change order until the same conditions are met. Within five days of receiving a written change order, the prime contractor must provide a subcontractor with a copy of the order and the amount to be paid to the subcontractor based on its share of the work under the change order.

If the amount to be paid under an approved change order does not exceed \$50,000, the procurement unit must pay an invoice for work performed and accepted under a change order within 30 days of receipt of the invoice and in accordance with current law regarding payment of invoices. By January 1, 2017, the Board of Public Works must adopt regulations that provide for an expedited change order process for change orders valued at more than \$50,000. Each procurement unit must issue guidelines related to its change order process by December 31, 2015, and must update those guidelines when changes are made to the process.

The workgroup required by the bill must report its policy, regulatory, and legislative recommendations to specified committees of the General Assembly by December 31, 2015.

### Current Law:

#### *Procurement Exemptions*

The University System of Maryland, Morgan State University, and St. Mary's College of Maryland are exempt from most provisions of State procurement law. Likewise, P3s authorized by State law are exempted from most State procurement law. State law also exempts other agencies, in whole or in part, from State procurement law, including:

- Blind Industries and Services of Maryland;
- Maryland State Arts Council;
- Maryland Health and Higher Educational Facilities Authority;
- Department of Business and Economic Development;
- Maryland Food Center Authority;
- Maryland Public Broadcasting Commission;

- Maryland State Planning Council on Developmental Disabilities;
- Maryland Historical Trust;
- Rural Maryland Council;
- Maryland Health Insurance Plan;
- Maryland Energy Administration;
- Maryland Developmental Disabilities Administration;
- Maryland Stadium Authority;
- Maryland State Lottery and Gaming Control Agency;
- State Retirement and Pension System;
- the Department of General Services, for renovation of historical structures;
- the Department of Natural Resources, for negotiating with nonprofit entities for projects related to conservation service opportunities;
- College Savings Plan of Maryland; and
- Chesapeake Bay Trust.

However, each exempt entity is subject to specified provisions of State procurement law; the bill makes them all subject to the bill's requirements, except for the public institutions of higher education, the State Retirement and Pension System, the College Savings Plan of Maryland, and the Chesapeake Bay Trust.

### *Change Orders*

A "change order" is defined as a written order signed by a State procurement officer that directs a contractor to make changes that the contract authorizes the procurement officer to make without the consent of the contractor. The Code of Maryland Regulations requires construction contracts to contain a provision giving the State the unilateral right to order in writing changes in the work within the scope of the contract. A change order differs from a "contract modification," which changes the terms of a contract and requires mutual agreement by the parties.

Each State construction contract must include a clause that makes each contract modification or change order that affects the price of the contract subject to (1) prior written approval from the procurement unit and any other responsible party and (2) prior certification by the responsible fiscal authority regarding the availability of funds and the effect of the change order or modification on the contract's costs. The clause must also prohibit the execution of any contract modification or change order if the fiscal authority discloses that it will increase the cost beyond the amount budgeted, unless additional funds are made available or the scope of the project is adjusted to allow it to be completed within the budgeted amount.

It is the policy of the State to make payment under a procurement contract within 30 days after the day on which the payment becomes due under the contract, or, if later, within 30 days after receipt of an invoice.

### *Public-private Partnerships (P3s)*

Chapter 5 of 2013 defined a “public-private partnership” as a method for delivering public infrastructure assets using a long-term, performance-based agreement between specified State “reporting” agencies and a private entity where appropriate risks and benefits can be allocated in a cost-effective manner between the contract partners, in which:

- a private entity performs functions normally undertaken by the government, but the reporting agency remains ultimately accountable for the public infrastructure asset and its public function; and
- the State may retain ownership of the public infrastructure asset and the private entity may be given additional decision making rights in determining how the asset is financed, developed, constructed, operated, and maintained over its life cycle.

A “public infrastructure asset” is a capital facility or structure, including systems and equipment related to the facility or structure intended for public use.

Only reporting agencies identified by Chapter 5 may establish a P3. Reporting agencies include DGS which oversees building purchases and leases for most of State government, MDOT, the Maryland Transportation Authority, and specified State higher education institutions. However, P3s do not include agreements entered into by the University System of Maryland, St. Mary’s College of Maryland, Morgan State University, and Baltimore City Community College in which State funds are not used to fund or finance any portion of the project. Specified revenue-producing transportation facilities are also not considered P3s.

**Background:** Although terminologies differ, the concept of a unilateral change order as specified in State law and regulations is common in the construction industry. Many change orders have no effect on project cost, but others can involve additional cost to the contractor or subcontractor. If the change being sought is within the scope of the original contract, the State can issue a change order unilaterally. If it affects cost, the State procurement unit must follow the process and meet the conditions established in statute, as described above. Settlement on cost with the contractor is typically done after the fact, subject to legal challenge if agreement cannot be reached. For instance, both the Maryland Transit Administration and the Maryland Transportation Authority include “force account” provisions in their construction contracts, which allow payment for time and materials plus a profit markup once work related to a change order has been completed and billed.

**Small Business Effect:** The bill requires that small construction companies be paid in a timely fashion for work performed under a change order on State construction contracts.

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### **Additional Information**

**Prior Introductions:** None.

**Cross File:** SB 708 (Senator Conway) – Education, Health, and Environmental Affairs.

**Information Source(s):** Board of Public Works, Department of Budget and Management, Department of General Services, American Institute of Architects, Maryland Department of Transportation, Department of Legislative Services

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