

Department of Legislative Services  
Maryland General Assembly  
2016 Session

FISCAL AND POLICY NOTE  
Third Reader - Revised

House Bill 403

(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 prohibits a State procurement unit from requiring a prime contractor on a State construction contract to begin work on a change order until a written change order is issued that specifies whether the work is to proceed, in compliance with the terms of the contract, on an agreed-to price, force account, construction change directive, or time and materials basis. Similarly, a prime contractor cannot force a subcontractor to begin work unless the same conditions are met. The bill applies to most entities that are otherwise exempt from most State procurement law, including the Maryland Stadium Authority and public four-year universities in the State. These provisions have effect only to the extent that they do not conflict with federal law or regulation. The Secretary of General Services must convene a stakeholder workgroup to develop recommendations on specified issues related to State construction contracts.

The bill takes effect June 1, 2016, but the provisions related to change orders take effect July 1, 2016.

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**Fiscal Summary**

**State Effect:** The bill has no *direct* effect on State construction costs, but it has the potential to cause construction delays if the requirement for written change orders prevents work from being done. To the extent that these delays result in contract claims against the State or invocation of force account contract clauses, project costs increase, but such occurrences are not expected to be frequent. There is no effect on the total amount of the capital budget, which is established annually by the Governor and General Assembly through the capital budget process. If project costs increase, fewer projects may be funded in a given year. The Board of Public Works (BPW) and the Department of General Services (DGS) can implement the bill with existing resources. No effect on revenues.

**Local Effect:** None.

**Small Business Effect:** Meaningful.

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## Analysis

**Bill Summary:** For the purposes of the bill, a written acceptance letter for a State Highway Administration or Maryland Aviation Administration procurement contract for construction has the same force and effect as a change order until either agency issues a written change order.

If a procurement officer and prime contractor do not agree that work required by a change order is included in the original scope and terms of the contract, the bill does not:

- prohibit a procurement officer from issuing an order to the prime contractor to perform the work or furnish labor or materials determined by the procurement officer to be required by the contract;
- authorize refusal to perform work or to furnish labor or materials that the procurement officer has ordered to be performed or furnished under the contract;
- prejudice or impair the right of a prime contractor to submit a claim or dispute to a procurement officer, in accordance with applicable law, seeking compensation.

If a State agency is to pay for a contract or part of a contract using a unit price methodology, a change order may not be required for work to continue and be completed beyond the estimated quantities in the contract. After work is completed, the agency must determine the actual quantity used to complete the contract and, if necessary, issue a final adjustment change order to the contractor.

If the amount to be paid under a change order does not exceed \$50,000, the procurement unit must pay an invoice for work performed within 30 days of receiving the invoice.

Within five days of receiving a written change order, a prime contractor must give a copy to a subcontractor and notify the subcontractor of the amount to be paid based on the work to be performed by the subcontractor.

By January 1, 2017, BPW must propose regulations that provide for an expedited change order process for change orders valued at more than \$50,000. By December 31, 2016, each State procurement unit must issue guidelines for the unit's change order process and then update and reissue the guidelines as necessary.

The workgroup convened by the Secretary of General Services must develop recommendations on eight issues related to State procurement of construction contracts. It must coordinate activities with the One Maryland Blue Ribbon Commission on Procurement, and issue its recommendations to designated committees of the General Assembly by December 31, 2016.

### **Current Law:**

#### *Procurement Exemptions*

The University System of Maryland, Morgan State University, St. Mary's College of Maryland, and public-private partnerships (P3s) authorized by State law are exempt from most provisions of 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 Economic Competitiveness and Commerce;
- 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;
- DGS, for renovation of historical structures;
- Department of Natural Resources, for negotiating with nonprofit entities for projects related to conservation service opportunities;
- College Savings Plans 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 State Retirement and Pension System, the College Savings Plans of Maryland, the Chesapeake Bay Trust, and P3s.

## *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.

**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, the Maryland Transit Administration, Maryland Aviation Administration, and the Maryland Transportation Authority include “force account” provisions in their construction contracts, which allow them to compel contractors to complete work on change orders subject to payment for time and materials plus a profit markup once work related to a change order has been completed and billed. Because of the markup and other factors, force account is viewed as a last resort to keep work proceeding on a project.

**State Fiscal Effect:** The process for obtaining a written and approved change order can take three to five weeks to complete; the process involves several intermediary approvals, with final approval for change orders over \$50,000 given by BPW, which meets only every

two weeks. For this reason, change order work on State construction projects often proceeds based on informal agreements, sometimes in writing, between the State and its contractors until the written change order is completed. Any disputes regarding the cost of the work to be performed are addressed through an extensive dispute resolution process, with final appeals available to the State Board of Contract Appeals.

Although the bill generally indicates that the State may not compel a contractor to perform work until a written change order is provided, it also retains the State's prerogative to compel change order work if the procurement officer determines that the work is required by the underlying contract. For this reason, significant delays are not anticipated in most construction projects. To the extent that such work is performed under "force account" clauses, it may increase the cost of individual projects due to the markup that is required.

The amount of the capital budget is established annually by the Governor and General Assembly. As the amount of the budget is fixed, any increase in project costs on individual projects funded by the capital budget does not increase the overall size of the budget, but it may delay other projects awaiting funding.

**Small Business Effect:** The bill provides some measure of assurance to small construction contractors and subcontractors working on State projects that they will be paid for work performed under change orders.

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### **Additional Information**

**Prior Introductions:** None.

**Cross File:** SB 826 (Senator Conway) - Education, Health, and Environmental Affairs.

**Information Source(s):** University System of Maryland, Department of General Services, Department of Public Safety and Correctional Services, Board of Public Works, Maryland Department of Transportation, Department of Legislative Services

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