

Department of Legislative Services
Maryland General Assembly
2023 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

Senate Bill 358

(Senator Salling, *et al.*)

Budget and Taxation

Health and Government Operations

Procurement - Construction Contracts - Contract Modification Clause

This bill requires that each State construction contract include a clause requiring a contract modification when, based on prevailing average market prices, there is a substantial increase or decrease in the price of materials, up to 10%, due to specified causes, including *force majeure* events (acts of God) such as an epidemic or pandemic. The requirement is subject to specified limitations in current law and applies only prospectively to construction contracts executed on or after the bill's effective date.

Fiscal Summary

State Effect: No effect on total general obligation (GO) bond or Transportation Trust Fund (TTF) capital expenditures, but the number of projects in the capital budget and *Consolidated Transportation Program* that receive funding in a given year may increase or decrease to the extent that project costs decrease or increase due to required contract modifications, as discussed below. No effect on revenues.

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

Small Business Effect: Meaningful.

Analysis

Bill Summary: “Substantial” is defined as large in amount, size, or number.

The required clause must require a contract modification when there is a substantial increase or decrease in the price of materials, up to 10%, due to:

- delayed notice of commencement by the State agency, for any reason;
- acts or omissions by the State agency;
- changes in the work or sequencing of the work ordered by the State agency or arising from decisions by the agency that impact the time or performance of the work;
- encountering hazardous materials or concealed or unknown conditions;
- a delay authorized by the State agency pending dispute resolution or suspension by the agency; or
- *force majeure* events, including an epidemic or a pandemic.

Current Law: “Contract modification” is defined as a written alteration that (1) affects specifications, delivery point, date of delivery, period of performance, price, quantity, or other provisions of a procurement contract and (2) is accomplished by mutual action of the parties to the contract.

Procurement law specifies numerous required clauses for all State procurement contracts, and the following required clauses for construction contracts:

- a clause requiring a contract modification if the condition of the site differs from the condition described in the solicitation; and
- a clause covering the requirements for notice of contract claims, submission of contract claims, and resolution of contract claims under current law.

A required clause for a contract modification or change order must make any change that affects the price of the contract subject to (1) prior written approval from the contracting agency and any other person responsible for the contract and (2) prior certification by the responsible fiscal authority about the availability of money and the effect of the change on the project budget or the total construction cost. The required clause must prohibit the change if the certification discloses that the change will increase the cost beyond the budgeted and available money, unless additional sufficient money is made available, or the scope of the project is adjusted to allow completion using available funds.

Mandated Study

Chapter 516 of 2022 required the Secretary of Transportation and the Secretary of General Services, by December 1, 2022, to each report to the General Assembly on (1) the number and percentage of State construction procurements using a fixed-price contract with price adjustment and (2) for price adjustments executed under those contracts, the material types affected and the average price adjustment for each material type. The reports were required to include data from fiscal 2019 through 2021.

In response to Chapter 516, the Department of General Services advised that it had no fixed-price construction contracts with price adjustments for the reporting period. For the Maryland Department of Transportation (MDOT), **Exhibit 1** summarizes the data on construction contracts for the reporting period.

Exhibit 1
Maryland Department of Transportation Fixed-Price Construction Contracts
Fiscal 2019-2021

	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>
Total Construction Contracts	144	99	71
Fixed-Price Contracts with Price Adjustment	83	54	37
No. of Contracts with Adjustments Made	83	54	37

Source: Maryland Department of Transportation

State Expenditures: In general, State agencies that contract for construction indicate that they negotiate contract modifications with construction contractors for many of the reasons encompassed in the bill, including, in some cases, for *force majeure* events. Data from MDOT confirms that such adjustments are made for more than one-half of its construction contracts, even before the COVID-19 pandemic. These contract modifications, however, are generally negotiated in a manner that shares the risk between the State and the contractor.

The bill essentially requires agencies to accept a contract modification for the required reasons, subject to the limitations in current law. In some instances, the State is required to make modifications even if the fault lies with the contractor. For instance, if the price increase is due to a delayed notice of commencement *for any reason*, the State must modify the contract even if the contractor is responsible for the delay. Conversely, the State may benefit from required contract modifications for projects in which the cost of materials decreases.

In shifting the risk for *force majeure* events that increase costs entirely to the State, the bill (1) severely limits the State's ability to negotiate the terms of the modification, including whether an increase in material costs is attributable at all or in part to a specific event; (2) eliminates any incentive for contractors to help mitigate costs resulting from the event; and (3) may, as a result, cause project costs to escalate more than they otherwise would. A reliable estimate of the bill's potential effects on project costs is not feasible as it depends on the terms of the contract and the specific conditions that give rise to a price increase. It

also depends on the extent to which the modifications exceed project budgets and additional funds are available.

In general, however, the bill has no effect on total GO bond or TTF expenditures for capital projects. MDOT's capital program is fully subscribed and GO bond funding levels are established annually by the Governor and the General Assembly through the capital budget process. To the extent that individual project costs increase due to contract modifications required by the bill, fewer projects receive funding in any given year and some projects may be delayed. However, to the extent that individual project costs decrease in a given year, additional projects may receive funding, or some projects may be accelerated.

Small Business Effect: Small businesses working on State construction contracts may benefit from contract modifications that increase their compensation for materials purchased for the contract when the cost of those materials increases by up to 10%. Conversely, they may be subject to mandated contract modifications that reduce their payments from the State when the cost of materials decreases by up to 10%.

Additional Information

Prior Introductions: Similar legislation has been introduced within the last three years. See SB 507 of 2022.

Designated Cross File: None.

Information Source(s): Department of General Services; Board of Public Works; Maryland Department of Transportation; Department of Public Safety and Correctional Services; Department of Legislative Services

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