
February 16, 2022

The Honorable Guy Guzzone
Chairman, Senate Budget and Taxation Committee
3 West Miller Senate Office Building
Annapolis, MD 21401

**Re: Letter of Information – Senate Bill 507 – Procurement-Construction Contracts –
Contract Modification Clause**

Dear Chairman Guzzone and Committee Members:

The Maryland Department of Transportation (MDOT) takes no position on Senate Bill 507 but offers the following information for the Committee's consideration.

Senate Bill 507 requires State construction contracts to include a clause providing for a contract modification when there is a substantial increase in the price of materials required to complete the contract under certain circumstances. This bill creates a significant risk transfer to the State, which has the potential to increase the cost of construction projects considerably.

Every construction project involves the identification and analysis of each project risk. Risks can generally be avoided, accepted, mitigated, or transferred. The responsibility for a risk should generally reside with the party best able to manage the risk at the lowest cost. Senate Bill 507 requires a blanket risk transfer of increases in materials costs to the State from contractors regardless of other ways that the risk could have been addressed.

The MDOT recognizes that increases in the cost of materials may occur during the course of a construction contract and that our private sector partners do not have control over the cost of materials; however, contractors have other ways to mitigate the impact of a cost increase. These mitigation strategies include utilizing a contingency or an allowance in the bid to account for changes in the cost of materials. Contractors can also make purchasing decisions that can mitigate the impact of price changes. This can include changes to the materials used, where those materials are purchased from, and the timing of those purchases. For example, especially for multi-year contracts like many of the MDOT's construction contracts, contractors have flexibility regarding the timing of the purchase of materials. If costs are expected to rise, contractors may purchase all materials early in the contract to mitigate the cost increase. If costs are expected to decrease, contractors may purchase only the materials immediately needed and delay purchase of additional materials until rates decline. If the State is required to pay for all increases in materials costs, contractors have no incentive to take actions like these to attempt to minimize additional costs.

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Senate Bill 507 puts the State in a worse negotiating position by creating a blanket risk transfer without regard for other contract provisions that are negotiated. It also creates the potential for disputes with contractors due to language that is not defined, like what constitutes a “substantial” increase in the price of materials.

It is notable that Senate Bill 507 provides for contract modifications for price increases only and ignores price decreases. This puts all of the downside risk on the State for price changes but does not provide the State any of the upside risk for price changes. If material prices were to fall, that would result in additional profit for the contractor. For example, when the MDOT utilizes allowances to address fuel prices, it adjusts for both cost increases and decreases so that the MDOT may pay more if costs increase, but the MDOT also pays less if costs decrease.

The MDOT looks forward to continued collaboration to ensure that our efforts to provide safe transportation infrastructure are also leveraged to support broader goals of economic development and equity in the State.

The Maryland Department of Transportation respectfully requests the Committee consider this information when deliberating Senate Bill 507.

Respectfully submitted,

Pilar Helm
Director of Government Affairs
Maryland Department of Transportation
419-865-1090