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February 15, 2023

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

***RE: Letter of Opposition – Senate Bill 358– Procurement – Construction Contracts –  
Contract Modification Clause***

Dear Chair Guzzone and Committee Members:

The Maryland Department of Transportation (MDOT) respectfully opposes Senate Bill 358, as it would create a significant risk transfer to the State and have the potential to increase the cost of construction projects considerably.

Senate Bill 358 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. 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 358 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 a construction contract and that 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.

Senate Bill 358 puts the State in a detrimental negotiating position by creating a blanket risk transfer without regard for other contract provisions that are negotiated. It also creates potential disputes with contractors regarding what constitutes a “substantial” increase. Responsibility for recognizing price increases would fall to the procurement officer, but this would be difficult to monitor as we know price indices, but not contractors’ pricing.

Senate Bill 358 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.

Senate Bill 358 would allow a contract modification if the substantial increase in the price of materials was caused by “delayed notice of commencement by the unit for any reason.” Without knowing if “notice of commencement” means issuance of a signed contract or issuance of notice to proceed, we are not sure from what point in time the delay would be measured. However, the qualifier “for any reason” could entitle the contractor to additional compensation even when the delayed commencement is caused by the contractor’s fault or failure to comply with contract requirements.

Pursuant to Transportation Business Unit (TBU) procedures, after a contract is signed but before notice to proceed (NTP) is issued, the contractor must submit for review and approval several documents, such as a schedule and a HASP (health and safety plan). If the contractor is late in submitting a plan, or if the plan is deficient and must be revised and resubmitted, the TBU would still be liable for an increase in the price of materials because issuance of NTP was later than contemplated at the time of award.

For delays caused by the State and unreasonably long suspensions of work, contractors are already entitled to additional compensation under current law. Contractors are also already entitled to additional compensation for increased costs caused by the presence of unknown hazardous materials and unknown site or subsurface conditions, since current law mandates that a construction contract contain “a clause providing for contract modification if the condition of a site differs from the condition described in the specifications” [SFP § 13-218(b)(1)].

Providing contract modifications due to force majeure events would be at odds with long-standing Board of Public Works policy that entitles contractors to time extensions but not additional compensation.

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Many of MDOT's current construction contracts are fixed-price with price adjustments to provide for variations in pricing under special conditions defined in the contract. As reported to the General Assembly as a requirement of Senate Bill 507 of 2022, MDOT executed 314 construction contracts during fiscal years 2019 - 2021. Of those contracts, 174 were fixed-price with price adjustments, and all 174 contracts have had price adjustments made for specific materials. A total of 731 adjustments have been made, for a total amount of \$30,792,168.

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.

For these reasons, the Maryland Department of Transportation respectfully requests the Committee grant Senate Bill 358 an unfavorable report.

Respectfully submitted,

Pilar Helm  
Director of Government Affairs  
Maryland Department of Transportation  
410-865-1090