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SFA BILL ANALYSIS

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Senate Bill 145 (as reported with amendment)
Sponsor: Senator Glenn D. Steil
Committee: Local, Urban and State Affairs

Date Completed: 3-3-99

RATIONALE

Under current law, before any contract exceeding $50,000 for the construction, alteration, or repair of any public building or public work or improvement of a governmental unit is awarded, the principal contractor must furnish to the governmental unit at his or her own cost a performance bond and a payment bond that will become binding upon the award of the contract to the principal contractor. If the principal contractor is a common carrier or the designated operator of a State subsidized railroad, however, the contractor may provide an irrevocable letter of credit from a State or national bank or a State or Federally chartered savings and loan association instead of the required bonds. (A performance bond guarantees that the contractor will complete the project under the terms, conditions, and specifications of the contract documents. A payment bond guarantees payment of all labor, materials, and subcontractors used on the job by the contractor.)

There has been some concern about situations in which a performance and payment bonds for a public works project were much more expensive to obtain than an irrevocable letter of credit would have been. Some people feel that, if authorized by the governmental unit, an irrevocable letter of credit instead of performance and payment bonds should be sufficient for a principal contractor to enter into a general construction contract for a public works project.

CONTENT

The bill would amend Public Act 213 of 1963, which provides a procedure for bonding contractors for public buildings and public works, to allow a principal contractor to provide an irrevocable letter of credit from a State or national bank or a State or Federally chartered savings and loan association instead of the required bonds if the principal contractor were authorized in writing by the governmental unit. ("Governmental unit" means the State, a county, city, village, township, school district, or public education institution, or any other political subdivision, public authority, or public agency.)

MCL 129.201

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The bill would give local governments flexibility for public works projects by allowing a governmental unit to make the decision that adequate security would be provided by an irrevocable letter of credit instead of performance and payment bonds. An irrevocable letter of credit would provide timely and cost-efficient insurance, which could result in savings on the cost of the project.

Opposing Argument

Performance bonds provide lien protection and insure public property. The bill would not provide adequate protection for subcontractors since they rely on the bonds to collect payment for labor and supplies if a principal contractor fails to make the contract payment. Apparently, current law provides very little understanding of how a subcontractor could collect payment on an irrevocable letter of credit. In addition, banks and savings and loan associations may not be aware of the consequences if a principal contractor went out of business or failed to follow through on the contract.

Response: Irrevocable letters of credit issued by banks and savings and loan associations are standard on private construction jobs. Before issuing any irrevocable letters of credit, the institutions would investigate the principal contractors' financial stability, just as a surety company would investigate the contractor before issuing a performance and payment bond.

Legislative Analyst: N. Nagata

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

Fiscal Analyst: R. Ross