

## PROCUREMENT CONTRACT CLAWBACK PROVISIONS

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**House Bill 5053 as introduced**  
**Sponsor: Rep. Mark E. Huizenga**  
**House Committee: Appropriations**  
**Complete to 2-4-20**

Analysis available at  
<http://www.legislature.mi.gov>

### SUMMARY:

House Bill 5053 would amend the Management and Budget Act (1984 PA 431) to require the Department of Technology, Management, and Budget (DTMB) to develop, by October 1, 2020, policies and procedures that require all state procurement contracts to include “clawback repayment provisions” to recoup any funds paid to a vendor who violates the terms of its contract. The policies and procedures would have to require DTMB, a state agency, or any department that has delegated procurement authority under the Management and Budget Act to enforce the provisions whenever possible.

MCL 18.1261

### BACKGROUND INFORMATION:

The bill reflects boilerplate language included in the FY 2019-20 annual general government budget, 2019 PA 56, as section 838. A clawback is used as a contract mechanism to recover funds that have been paid out but are required to be returned, sometimes with a penalty, in accordance with terms agreed upon in the contract. Clawbacks are most often used in employment contracts and in bankruptcy matters. The Central Procurement Office (CPO) within DTMB uses similar, but different, mechanisms to recoup payments or payment obligations.

According to DTMB, the CPO rarely issues payments to vendors for goods or services in advance and, instead, ties payments to the delivery of specified goods and services or to the vendor’s meeting certain milestones. These conditions on issuing payments to vendors are included in state contracts as a service level agreement (SLA). The CPO may also use performance-related liquidated damages clauses that stipulate in the contract a specific or determinable amount for how much is owed to the state in damages resulting from a breach in the contract or conditions not being met.

The CPO has used SLAs in contracting for many years but has begun including them in contracts more frequently over the last 18 months after the establishment of a Supplier Relationship Management team. According to DTMB, SLAs are included in nearly all contracts that are deemed appropriate for them; however, not all state agencies agree to include SLAs upon the CPO’s recommendation, most often due to the added time necessary to negotiate the contract agreement.

## **FISCAL IMPACT:**

The bill would have an indeterminate fiscal impact on the state, based on several potential cost factors, and no fiscal impact on local units of government. While CPO reports that the term “clawback repayment provision” has no operational definition for procurement purposes, it is unclear whether DTMB will implement the bill in terms of SLAs and performance-related liquidated damages clauses or will develop new procedures to satisfy the bill’s requirements.

The bill could result in cost savings to the state to the extent that provisions in procurement contracts provide a legal basis to the state for reclaiming payments issued to vendors upon establishment of the fact that a vendor has breached its contract. However, the requirement that clawback provisions be required for *all* procurement contracts could add costs as well as prevent the loss of state funds. The requirement would enable CPO to include repayment provisions in contracts where the client agency or department is unwilling to include them, resulting in potential cost savings. But, according to CPO, the inclusion of such provisions would also deter some vendors from submitting bids to the state, thereby decreasing the number of competitive bids, and possibly winning bids, that would bring greater value to the state. Including clawback provisions may also extend the time required to negotiate the terms of contracts, resulting in potential added costs.

The bill would also require DTMB, departments, and agencies to enforce the clawback provisions. This could bring additional indeterminate costs to those departments and agencies. DTMB was appropriated an additional \$892,000 and 6 FTE positions in FY 2018-19 to enhance its contract management and monitoring as well as supplier relations services, through the SRM, and would require no additional funding to enforce the bill’s requirements. However, if a department or agency is the contract owner, it would be responsible for monitoring and enforcing the clawback provisions and may require additional administrative resources and possibly an additional FTE position depending on the volume of contracts under a department. Additionally, the Department of Attorney General (AG) would be responsible for providing any legal and litigation services if enforcement activity reaches that point; however, AG would likely be able to cover the costs with its ongoing appropriations any resulting caseload from the bill.

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