

August 2005

## PUBLIC IMPROVEMENT CONTRACTS - BACKGROUND MEMORANDUM

House Bill No. 1260 (attached as an appendix) directs a study of public improvement contracts and issues relating to use of multiple bids versus single prime bids, construction management, professional liability and indemnification, and design-build delivery systems. The bill, as introduced, would have prohibited a construction manager from having common ownership with the architect, engineer, or contractor involved in the planning, design, or construction of a public improvement and prohibited the construction manager from constructing any portion of the public improvement or contracting with any subcontractor to construct any portion of the public improvement. Testimony presented to the House Industry, Business and Labor Committee indicated that the bill was supported by contractors and opposed by architects and representatives of political subdivisions and other governmental entities. The bill was amended in the House to remove the substantive provisions and to require this study.

### BACKGROUND North Dakota Law

North Dakota Century Code Chapter 48-01.1 addresses public improvement contracts. The chapter generally applies to the construction, repair, or alteration of a public improvement undertaken by the state or a political subdivision. Section 48-01.1-01 defines a "public improvement" as "any improvement the cost of which is payable from taxes or other funds under the control of a governing body including improvements for which special assessments are levied." Road construction and maintenance and certain Public Service Commission projects are exempted from the definition of a "public improvement" and are thus excluded from the requirements of Chapter 48-01.1.

Section 48-01.1-02 requires the governing body of a state entity or a political subdivision to award a contract for the construction of a public improvement to the lowest responsible bidder. That section also authorizes a governing body to enter a contract without seeking bids when the governing body determines that an emergency exists.

Section 48-01.1-03 requires a governing body to advertise for bids by publishing an advertisement for three consecutive weeks if the public improvement is estimated to cost more than \$100,000. The publication must be in the official newspaper of the political subdivision and in a trade publication of general circulation among contractors, building manufacturers, and dealers in the state. Section 48-01.1-05 requires that the advertisement provide:

1. When and where the plans, drawings, and specifications may be seen and examined.
2. The place, date, and time the bids will be opened.
3. That each bid must be accompanied by a separate envelope containing a bidder's bond in a sum equal to five percent of the full amount of the bid, executed by the bidder as principal and by a surety, conditioned that if the principal's bid is accepted and the contract awarded to the principal, the principal, within ten days after notice of award, shall execute a contract in accordance with the terms of the bid and a contractor's bond as required by law and the regulations and determinations of the governing body.
4. That a bidder, except a bidder on a municipal, rural, and industrial water supply project authorized for funding under Public Law No. 99-294 [100 Stat. 426; 43 U.S.C. 390a], must be licensed for the full amount of the bid, as required by section 43-07-05. For projects authorized for funding under Public Law No. 99-294 [100 Stat. 426; 43 U.S.C. 390a], the advertisement must state that, unless a bidder obtains a contractor's license for the full amount of its bid within twenty days after it is determined the bidder is the lowest and best bidder, the bid must be rejected and the contract awarded to the next lowest, best, and licensed bidder.
5. That no bid may be read or considered if it does not fully comply with the requirements of this section and that any deficient bid submitted must be resealed and returned to the bidder immediately.
6. That the right of the governing body to reject any bid is reserved.

Section 48-01.1-04 requires a governing body, if the project is estimated to cost more than \$100,000, to procure plans, drawings, and specifications for the work from a licensed architect or registered professional engineer. Similar provisions are included in the statutory provisions regulating professional engineers. Section 43-19.1-28 provides that unless otherwise provided by law, the state or a political subdivision may not engage in the construction of public works involving the practice of professional engineering

when the contemplated expenditure for the project exceeds the sum of \$100,000, unless the engineering drawings and specifications and estimates have been prepared by, and the construction administration and construction observation services are executed under the supervision of, a registered professional engineer.

Section 48-01.1-06 provides that multiple prime bids for the general, electrical, and mechanical portions of a project are required when any individual general, electrical, or mechanical contract or any combination of individual contracts is in excess of \$100,000. That section also authorizes a governing body to allow the submission of single prime bids or bids for other portions of the project, but prohibits the governing body from accepting the single prime bid unless that bid is lower than the combined total of the lowest and best multiple bids for the project.

Chapter 43-07, which relates to licensing of contractors, also addresses bids for public improvement projects. Section 43-07-06 allows a governing body having power to enter public contracts to impose reasonable requirements and conditions as conditions precedent to the awarding of a contract for the construction or reconstruction of public works.

Section 43-07-11.1 provides that a contractor is not eligible to enter a public contract with the state or a political subdivision unless the contractor demonstrates that the contractor has paid all delinquent income, sales, or use taxes, if any, owed to the state. Section 43-07-12 requires that bids and proposals for the construction of most public contract projects must contain a copy of the contractor's license or certificate of renewal issued by the Secretary of State enclosed in the required bid bond envelope. That section provides that a contract may not be awarded to any contractor unless the contractor is the holder of a license in the class within which the value of the project falls and that the contractor must be the holder of a license at least 10 days before the date set for receiving bids, to be a qualified bidder. A bid submitted without that information properly enclosed in the bid bond envelope may not be read nor considered and must be returned to the bidder.

Section 48-01.1-07 requires the governing body to open all bids at the time stated in the notice and award the contract to the lowest and best bidder or reject all bids. That section also directs the governing body to require the contractor to whom the contract is awarded to post a bond. Section 48-02-06.2 provides that a governing body must take a bond from the contractor before permitting any work to be done on the project. The bond must be for an amount equal at least to the price stated in the contract and must be conditioned to be void if the contractor and all subcontractors fully perform all terms, conditions, and provisions of the contract and pay all bills or claims on account of labor and materials used in the performance of the contract. Section 48-02-06.2 provides that the bond is security for all bills, claims, and

demands until fully paid, with preference to labor and material suppliers as to payment. The bond must run to the governing body, but any person having a lawful claim against the contractor or subcontractors may sue on the bond.

Section 48-01.1-08 authorizes a governing body, after competitive bids for the general, electrical, and mechanical work are received as part of the multiple prime bids, to assign the electrical and mechanical contract and any other contracts to the general contractor for the project to facilitate the coordination and management of the work.

Section 48-01.1-09 provides that if the governing body uses a construction manager on a public improvement, the construction manager must be a licensed contractor. That section also requires a construction manager awarded a contract for construction of a public improvement to bond the entire cost of the project through a single bond, or through bonds provided by all bid packages and the construction manager's bond for the full amount of the construction manager's services. The construction manager is required to bond the difference between the total of the bonds and the total project bid if the total of the bonds is less than the total project bid. Section 48-01.1-09 also requires an architect awarded a design contract and a construction manager awarded a construction management contract for a public improvement to carry out their contractual duties as agents to the public improvement entity and prohibits the architect and construction manager from constructing any portion of the public improvement or contracting with any contractor or subcontractor to construct any portion of the work.

Section 48-02-07 requires that at least once in each calendar month during the continuance of work upon any public project, the governing board or a committee authorized by the board shall receive and consider estimates furnished by the supervising architect or the superintendent of construction of the project and allow estimates in an amount of the estimated value of the labor and material furnished upon the contract, and of the material then upon the ground for use in the construction of the project, subject to retentions as follows: 10 percent of each estimate presented until the time the project is 50 percent completed, with no further retainage on estimates during the continuance of the contract. Upon completion of 95 percent of the contract according to the estimates, the governing board may pay to the contractor 95 percent of the amount retained from previous estimates. The remaining amount retained must be paid to the contractor in such amounts and at such times as are approved by the supervising architect or superintendent of construction, with final payment of all money due to the contractor to be made immediately following completion and acceptance of the project. If a supervising architect and/or superintendent of construction is not employed under the contract, the

contractor, at the end of each calendar month during the continuance of work under the contract, may furnish to the governing board the estimates. The board, immediately after considering and allowing any estimate, is required to certify and forward the estimate to the official having the power to draw warrants, who is required to make the payment promptly to the contractor.

### **Construction Management**

Construction management is generally defined as a professional service that applies management techniques to the planning, design, and construction of a project from inception to completion for the purpose of controlling time, cost, and quality. Section 48-01.1-01 defines "construction management" as "the management and supervision of the construction of a public improvement, including the management and supervision of multiple prime contracts." The definition states that the term does not include construction administration performed by a design professional under the terms of a professional services agreement with the governing body. "Construction administration" is defined as "administrative services provided on behalf of the governing body, either by the governing body or a registered design professional, and includes providing clarifications, submittal review, recommendations for payment, preparation of change orders, and other administrative services included in the agreement with the registered design professional." The definition of that term excludes supervision of the construction activities for the construction contracts.

In general, a construction manager will serve as an extension of staff to the owner of the project and manage the entire project with preplanning, design, construction, engineering, and management services. Supporters of this concept argue that the construction manager will provide better onsite coordination of the project because most project owners are unable to maintain the staff resources necessary to pay close, continuing attention to every detail of the project.

### **Design-Build**

The design-build delivery process is generally described as a project delivery method that combines architectural and engineering design services with construction performance under one contract agreement. Under the design-build process, the project owner will typically choose a single entity to design and construct the project in which the selection of the vendor is often based on time schedule and cost. Proponents of this process contend that the process enhances accountability by focusing responsibility on a single entity, reduces costs, and saves time.

## **Professional Liability and Indemnification**

### **Contractors**

Although there are no statutory requirements regarding professional liability insurance for contractors, Section 43-07-04 requires an applicant for a contractor's license to provide proof of liability insurance. That section does not require a specific amount of liability insurance.

### **Architects**

Section 43-03-23 addresses the liability of an architect. That section provides that an architect is not liable for the safety of persons or property on or about a construction project site or for the construction techniques, procedures, sequences, and schedules or for the conduct, action, errors, or omissions of any construction contractor, subcontractor, or material supplier, their agents or their employees, unless the architect assumes responsibility by contract or by the architect's actual conduct. However, that section further provides that an architect is not relieved from liability from the architect's negligence in the architect's design work or otherwise.

### **Engineers**

Section 43-19.1-24.1 addresses the liability of an engineer. That section provides that an engineer is not liable for the safety of persons or property on or about a construction project site or for the construction techniques, procedures, sequences, and schedules or for the conduct, action, errors, or omissions of any construction contractor, subcontractor, or material supplier, their agents or employees, unless the engineer assumes responsibility by contract or by the engineer's actual conduct. That section further provides that an engineer is not relieved from liability from the engineer's negligence in the engineer's design work or otherwise.

## **2005 LEGISLATION**

Senate Bill No. 2023, which was the state government capital projects bill, included an amendment of the provisions relating to construction managers to provide that an architect awarded a design contract and a construction manager awarded a construction management contract for a public improvement must carry out their contractual duties as agents to the public improvement entity. The bill also provided that an architect and construction manager may not construct any portion of the public improvement and may not contract with any contractor or subcontractor to construct any portion of the work.

## OTHER STATES' LAWS

### South Dakota

South Dakota law requires the state and the governing body of a local government to advertise for bids for construction of a new building or the remodeling of an existing building that is estimated to cost \$50,000 or more and provides that each bid must contain a certified check, a cashier's check, or draft for 5 percent of the bid or a bid bond for 10 percent of the amount of the bid. South Dakota law requires that contracts for the construction of a public improvement be awarded to the lowest responsible bidder.

Under South Dakota law, a person may not act as the architect or engineer and the contractor on a public work if the amount to be expended on the public work exceeds \$100,000.

South Dakota law contains provisions authorizing the state or a local government to enter design-build contracts for public improvements under certain conditions. South Dakota Codified Laws Section 5-18-26 provides that a design-build contract may be entered if the governmental entity, before issuing any request for proposals, establishes and publishes procedures for the solicitation and award of design-build contracts and makes a determination that it is in the best interest of the public to enter a design-build contract to complete the public improvement. The determination to utilize design-build and the basis for the determination must be recorded in the minutes of the meeting of the governing board of the entity. The statute provides that in making the determination, the governing board must find that design-build projects should meet at least one of the following criteria:

1. The entity requires a project design and construction timeline that is faster than the traditional design/bid/build process would allow.
2. The complexity of the project requires close coordination of design and construction expertise or an extreme amount of coordination.
3. The entity requires early cost commitments.
4. The project can be defined at an early stage and the entity is able to specify all requirements.

The governmental entity is required to follow the procedures of other laws governing public improvement construction contracts to the extent those laws are compatible with the use of design-build contracts.

South Dakota law also authorizes the use of a construction manager in the design, construction, or remodeling of a public improvement. Section 5-18-51 provides that unless the construction manager-agent is an employee of the governmental entity, the entity may engage the services of a construction manager only if the entity determines that it is in the public interest to utilize the services of a construction manager and the construction management services would not unreasonably duplicate and be in addition

to the normal scope of separate architect or engineer contracts. In general, a construction manager is prohibited from acting as a contractor on a public improvement.

### Montana

Montana law requires the advertising for bids for the construction or alteration of any state building project that exceeds \$75,000. Except for projects costing less than \$25,000, each bid must be accompanied by bid security in the amount of 10 percent of the bid.

In 2003 the Montana legislature authorized the Department of Transportation to establish and implement a design-build contracting pilot program for highway construction from April 1, 2003, until December 31, 2008.

### Minnesota

Minnesota law provides that contracts for construction and buildings must be established by competitive bids. However, for building, construction, and repair contracts that are estimated to be less than \$50,000, informal bids may be used.

The 2005 Minnesota legislature adopted legislation to allow the state to utilize construction manager at risk or design-build techniques for a limited number of contracts. Under the legislation, which became effective on May 25, 2005, the state Commissioner of Administration may not utilize design-build contracts for more than 5 percent of its total projects let, by number, in each of the fiscal years 2006 and 2007, and 10 percent of its total projects let, by number, in each fiscal year thereafter, that are funded in whole or in part with proceeds from the sale of state general obligation bonds; and the commissioner may not utilize construction manager at risk contracts for more than 5 percent of its total projects let, by number, in each of the fiscal years 2006 and 2007, and 10 percent of its total projects let, by number, in each fiscal year thereafter, that are funded in whole or in part with proceeds from the sale of state general obligation bonds.

## POSSIBLE STUDY APPROACH

In undertaking this study, the committee should seek information from representatives of state agencies, institutions of higher education, and political subdivisions who are responsible for entering public improvement contracts, architects, engineers, contractors, and construction managers. In doing so, the committee can determine whether it would be advantageous to state agencies and political subdivisions to revise the existing public improvement contracting laws to provide for alternative methods for construction of the public improvements.

ATTACH:1