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TO: Detroit City Council

FROM: David Whitaker, Director
Legislative Policy Division 

DATE: March 12, 2019

RE: Report on Bonding Insurance for City of Detroit Demolition Contractors

The Legislative Policy Division (LPD) has been requested by Council President Brenda Jones to provide a report on a process to provide a 90-day revocable bonding insurance for contractors that wish to bid on City of Detroit demolition contracts. In addition, LPD has been requested to prepare a resolution urging a change in Michigan law to allow for 90-day revocable bonding.

The bonding insurance relative to the contractors who bid on demolition contracts would be in the form of a performance bond.¹ The State of Michigan requires that contractors who receive public construction contracts over \$50,000 are required to have performance bonds. Public Act 213 of 1963, Contractor's Bond for Public Buildings Works, MCL 129.201, provides in pertinent part:

Before any contract, exceeding \$50,000.00 for the construction, alteration, or repair of any public building or public work or improvement of the state or a county, city, village, township, school district, public educational institution, other political subdivision, public authority, or public agency hereinafter referred to as the "governmental unit", is awarded, the proposed contractor, hereinafter referred to as the "principal contractor", shall furnish at his or her own cost to the governmental unit a performance bond and a payment bond which shall become binding upon the

¹ According to the Business Dictionary a performance bond is: A written guaranty from a third party guarantor (usually a bank or an insurance company) submitted to a principal (client or customer) by a contractor on winning the bid. A performance bond ensures payment of a sum (not exceeding a stated maximum) of money in case the contractor fails in the full performance of the contract. Performance bonds usually cover 100 percent of the contract price and replace the bid bonds on award of the contract. <http://www.businessdictionary.com/definition/performance-bond.html>

award of the contract to the principal contractor.

The State requirement of a performance bond and payment bond for public construction contracts over \$50,000 allows for the governmental unit² to set the amount necessary under the contract but no less than 25% of the total contract amount as set forth under MCL 129.202 which states:

The performance bond shall be in an amount fixed by the governmental unit but not less than 25% of the contract amount, conditioned upon the faithful performance of the contract in accordance with the plans, specifications and terms thereof. The bond shall be solely for the protection of the governmental unit awarding the contract.

As provided by law, the City of Detroit (City) demolition contractors who receive a contract over \$50,000 must provide a performance bond and payment bond that is no less than 25% of the contract amount. The law does not provide for the allowance of a 90-day revocable insurance bond, but does provide that the bond shall be solely for the protection of the City. This requirement is not unusual. The Federal government requires performance and payment bonds on public construction contracts over \$100,000 under 40 U.S. Code § 3131 - *Bonds of contractors of public buildings or works*.³

The general purpose of the performance bonds is the protection of public tax dollars that are being expended on the public construction project, in this instance City demolitions. The use of performance bonds is required, however, according to the state law the amount of the requisite performance bond is no less than 25% of the contract amount. If the City is requiring more than 25% of the contract amount on performance bonds, there may be a need for the City to re-evaluate whether the amount of the performance bond above 25% on City construction contracts is necessary. Is there room for a reduction in the amount of the performance bond required on City demolition contracts?

In addition to the required insurance in the form of a performance bond, the City also requires a certain amount of liability insurance on all demolition contracts. This liability insurance is necessary to protect the City from any claims that may result from injuries or accidents to persons or property caused by the contractor in connection with completing the contract. However, the combination of the two required types of insurance may be placing a heavy burden on smaller contractors, resulting in their inability to compete and bid on contracts. The City may wish to

² As set forth under the Act, the term governmental unit includes a "public authority" and would include the Detroit Land Bank Authority.

³ 40 U.S. Code § 3131(b) *Type of Bonds Required*. Before any contract of more than \$100,000 is awarded for the construction, alteration, or repair of any public building or public work of the Federal Government, a person must furnish to the Government the following bonds, which become binding when the contract is awarded: (1) Performance bond. A performance bond with a surety satisfactory to the officer awarding the contract, and in an amount the officer considers adequate, for the protection of the Government. (2) Payment bond. A payment bond with a surety satisfactory to the officer for the protection of all persons supplying labor and material in carrying out the work provided for in the contract for the use of each person. The amount of the payment bond shall equal the total amount payable by the terms of the contract unless the officer awarding the contract determines, in a writing supported by specific findings, that a payment bond in that amount is impractical, in which case the contracting officer shall set the amount of the payment bond. The amount of the payment bond shall not be less than the amount of the performance bond.

review its insurance requirements to determine if the amount of liability insurance necessary to protect the City is what is being required.

If the types and amount of insurance being requested is necessary to protect the City and the taxpayers, the smaller contractors may need to come up with other ways to meet those requirements. Some smaller contractors have acted as subcontractors to larger contractors who have the resources to meet the requirements. Another possibility is for smaller contractors to enter into joint ventures⁴. While under a joint venture the contractors would have to share the profits and losses, they also share the cost associated with the project.

As stated earlier the bonding insurance is required by law on public construction contracts over \$50,000. Unless the law is changed the requirement to have a performance bond and payment bond on the City's demolition construction contracts will be required as set forth under the Act.

If we can be of further assistance, please call upon us.

⁴ A joint venture is a contractual business undertaking between two or more parties. It is similar to a business partnership, with one key difference: a partnership generally involves an ongoing, long-term business relationship, whereas a joint venture is based on a single business transaction. <https://legal-dictionary.thefreedictionary.com>