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REVISED
CONSTRUCTION COMMITTEE
NOVEMBER 6, 2014

SUBJECT: CONSTRUCTION CHANGE ORDER STREAMLINING INITIATIVE

**ACTION: AUTHORIZE CHANGES TO METRO'S ADMINISTRATIVE CODE AND
ADOPT A NEW CONSTRUCTION CHANGE ORDER POLICY**

RECOMMENDATION

- A. Repeal Metro's Administrative Code Section 4-15, Processing of Construction Change Orders, also known as the Construction Change Order Ordinance, (Attachment A)
- B. Adopt a new Construction Change Order Policy, (Attachment B)
- C. Establish Construction Contract Modification Authority (CMA) thresholds (Attachment C)
- D. Implement the Construction Change Order Prompt Payment Reform initiative to lead to more timely payments to prime contractors and subcontractors.

ISSUE

Market analysis and peer reviews (both internal and external) of Metro's Construction Change Order process identify schedule impacts that create risk for the contractors and DBE/SBE subcontractors; all of which contributes to higher project costs and schedule delays. In order to accelerate delivery of Measure R and other major capital projects, it is essential to reform Metro's existing construction change order process to make it more effective and easier for everyone to understand. The repeal of the existing Administrative code, the introduction of a new Board Policy to streamline construction change orders and the corresponding Contract Modification Authority will allow staff to implement Phase I of a streamlined construction change order process. Approval of the staff recommendation streamlines the process to allow for most construction change orders to be negotiated within 60 days of receipt of a fully defined scope of work and cost and schedule proposal from the Contractor. If staff can achieve its goal of completing negotiations within 60 days, it would result in an improvement of at least thirty days over the current average processing duration; which amounts to a 30% reduction.

Phase I of Metro's change order initiative focuses on Metro's internal processes to maximize the efficiency of those tasks where Metro Core Support Units

(Vendor/Contract Management, Management Audit Services, Project Management Office, & County Counsel), have direct role and responsibility in the change order review process. ~~Phase II of~~ The streamline initiative will then turn its also focus on the means and methods of encouraging the contractor to submit a fully defined scope of work and completed cost and schedule proposal to further improve the total time needed to process the change. In response to the feedback received at the Metro Construction Committee meeting on October 16th, the initiative will also include a parallel effort to implement prompt payment reform measures to address the negative impacts that the current change order process has on small and disadvantaged businesses. These second reforms phase will require Vendor/Contract Management staff to partner with the construction contractor community and Metro Project Managers to find ways of improving the time needed to develop clear and timely change order scopes of work that can then be negotiated by the parties into a change order. The reforms will also require Metro to establish contractual incentives and performance measurements to effect timely payments from prime contractors to subcontractors.

BACKGROUND

In December 2010, the Board directed the CEO to evaluate, among other things, procurement policies and procedures to ensure the agency can deliver Measure R projects in the fastest possible time. The result was the Measure R Strategic Advisor report submitted to the Board in June 2010, authored by Parson Brinkerhoff.

One of the key areas cited in the report was a need to streamline the construction change order process and as a start, the CEO directed staff to ensure that Metro was no more restricted by law or regulation than other California public agencies.

On September 28, 2012, the Governor signed into law AB 2440, sponsored by Metro which achieved this end. One section repealed the construction change order statute, PUC 130243, which imposed specific restrictions on Metro alone; and which, in conjunction with Administrative Code Section 4-15, has over the years resulted in delays in change order processing.

More recently, the Los Angeles Construction Market Analysis report, produced by Leland Saylor Associates in September 2013 cited industry concerns that risks associated with change order resolution and related delays in payment have significant impact on construction costs on Metro projects. These risks fall disproportionately on small and disadvantaged businesses that rely on uninterrupted cash flows to meet payrolls and sustain their businesses.

DISCUSSION

The construction change order process begins with a request for change or change notice being issued by the either the contractor or Metro following the recognition of a need to modify the project scope of work to address a differing site condition, previously unidentified requirement, or a betterment. The contractor is then required by contract to

provide a fully defined scope of work as part of a cost and schedule proposal within 30 days of the change notice.

The negotiation of a construction change order cannot begin until the contractor provides their cost and schedule proposal. Unfortunately, this is often the root cause of many delays. This initiative not only concentrates on the actions that occur after a cost and schedule proposal is properly submitted by the contractor, but also focuses on ways of improving the timely and adequate delivery of scopes of work and cost and schedule proposals and prompt payment by our contracting community.

To reform the Construction Change Order Process internally, contribution and buy-in from multiple Metro business units was requested. A Task Force was formed by the Vendor/Contract Management Business Unit, comprised of Program Management Office, Engineering and Construction, Management Audit Services and County Counsel. The Task Force recommendations are as follows:

- To complete the work started by the repeal of the Metro change order statute, Metro Administrative Code section 4-15 (Attachment A) should also be repealed. This action allows staff to introduce audit requirements that provide added value and reduced project risk. The current procedure requires audits be performed on Metro's Independent Cost Estimates (ICE) \$700,000 or greater. Those audits are not risk based and resources could be better utilized in adding value to this process.

The new procurement and program management procedures will require that audits be performed on all contractor change order proposals valued at \$1,000,000 or greater, or for lower amounts when the Contracting Officer is unable to perform a cost analysis.

- It is recommended that a new Construction Change Order policy be adopted that will allow the agency to meet the challenges of having multiple major projects that are in simultaneous construction, and to mitigate risks associated with a longer process.
- The new Construction Change Order Board Policy (Attachment B) requires that all change requests/notices must be first reviewed by the Contracting Officer and those over \$100,000 by County Counsel to verify that the work constitutes a change to the contract.
- The overall goal is to have change orders completed within 60 days of a fully defined scope of work by the contractor. The full and complete definition of a scope of work is critical to the success in any change order process. The lessons learned from many of the change orders that took a long time to close stem from a lack of scope of work definition. The change order initiative requires Metro staff to apply discipline to the process by holding contractors accountable for providing

timely and proper scope of work definition, and not moving to the initial change order steps without that definition.

- Another feature of the new process is that if a change order is not fully negotiated within 60 days, Metro will issue a unilateral change order, as allowed by the contract, based on Metro's ICE. This feature has three important effects; it places a reasonable goal that is defined in procedure, it reduces the size of any dispute, and lastly it provides important cash flow to the contractor and its subcontractors, including DBEs and SBEs. This aspect of the change order process will attempt to improve the time necessary for disputes of unmerited changes to go to issues to be moving quickly to address.

Construction Change Order Prompt Payment Reform

1. Implement procedures to rigorously enforce the terms of the contract and apply contractual measures to incentivize prompt payment to subcontractors, including non-adherence notices, cure notices and breach letters.
2. Establish a contractor scorecard to assess prompt payment to subcontractors. The scorecard would provide a letter grade illustrating the record of prompt payment of prime contractors and tier 1 subcontractors to all subcontractors. The letter grade would be published quarterly and available on the metro.net website. To promote a culture of accountability, Metro's prompt payment record to prime contractors will also receive a letter grade.
3. Identify means and methods within existing subcontractor prompt payment laws to assist professional services subcontractors to gain timely payments from their prime contractors.
4. Convene an Industry Forum with stakeholders to identify solutions and implement reform measures to improve prompt payment to contractors and subcontractors

The standard terms and conditions of Metro's construction contracts clearly delineate requirements for prompt payment, with flow-down requirements for all subcontractors. However, a renewed focus by Metro's contract administration staff is required to ensure timely enforcement of the prompt payment terms. This action, coupled with the implementation of a contractor scorecard, will promote a culture of accountability when it comes to prompt payment. The scorecard will also help to empower subcontractors, especially small businesses, who today

find it difficult to discuss delayed payment due to fear of not getting repeat business from the prime.

Untimely and ill-defined cost and schedule proposals are a leading cause of disputes and delays in processing construction and design changes. This problem ultimately leads to poor cash flow for both prime contractors and subcontractors. Any real improvement in the process cannot be effective unless Metro addresses the timely and adequate submittal of cost and schedule proposals from contractors. To address this issue a Construction Industry Forum will be convened to find solutions and a common understanding of Metro's change order process.

The Construction Industry Forum must also tackle the difficult dilemma subcontractor's face when disputes occur between the prime contractor and Metro regarding changes that Metro determines do not have merit. This problem is especially acute for professional service subcontractors on Design/Build projects. The forum will include discussions with prime contractors and professional service subcontractors to find a common interpretation and compliance with existing prompt payment requirements.

The new change order process will also carry an emphasis on resolving disputes over unmerited change orders in a timely manner. Unmerited change orders are often the root cause of non-payment to subcontractors. Metro will initiate immediate dispute resolution of unmerited changes and will look to bifurcate all elements of a disputed change order to identify elements of that change order that may have merit.

In conjunction with these process and procedural improvements, staff has defined flow chart process guidelines that intend to define roles and responsibilities for all parties that participate in the change order process, including contractors (Attachment D). This process flow chart establishes time duration goals for each step in the process. By introducing defined steps and roles and responsibilities staff will be able to measure improvement and drive performance.

The streamlined procedures introduce early dispute resolution steps that are intended to first reduce the size of the dispute then to identify ascending levels of Metro management that will be engaged to address disputes before they go to formal Dispute Resolution Boards or mediation.

Contract Modification Authority

The final key recommendation to complete the reform of the Construction Change Order process is to establish Contract Modification Authority specifically for Construction Change Orders. Currently the Board approved CMA for all construction, professional services and equipment change orders is the greater of \$100,000 or 10% of the original

contract. This threshold applies to the smallest of Metro's capital improvements for bus or rail facilities, or to its largest Measure R projects such as the Crenshaw/LAX Transit Corridor project. The Saylor Report cited that large change orders that are not processed in a timely manner have an effect on contractor and subcontractor cash flows, especially DBEs and SBEs. Specifically, the Report notes:

"Contractors mentioned delay in processing changes to be a significant risk in LACMTA construction. With \$5 billion in work beginning in the 2013-2015 window there will likely be increasing demand on the change management function. Even in the best run projects change orders due to unforeseen conditions are inevitable, and delays in merit determination and payment of approved changes can increase contractor risk and costs."

Current Authorization for individual Contract modification/change order is \$500,000 per change order for all Contract value. Staff's recommendation to further promote streamlining is to scale CMA to reflect project size and complexity as identified in Attachment C.

Although only 5% of all construction change orders and contract modifications currently exceed \$500,000, and the total number of Board actions for construction change orders was only 16 over the last 12 months, these quantities do not reflect the volume of changes that are anticipated once the Crenshaw/LAX, Regional Connector and Westside Subway Extension Transit projects are all simultaneously in construction.

DETERMINATION OF SAFETY IMPACT

This Board action will not have an impact on Safety standards for Metro.

FINANCIAL IMPACT

This Board Action does not require any budgetary funding in order to implement the recommended construction change order streamlining initiatives. All activities will be performed by existing Metro resources.

ALTERNATIVES CONSIDERED

The Board could decide not to adopt the recommendations and maintain the current change order process. This is not recommended as peer reviews and market surveys recommend streamlining the process.

NEXT STEPS


Once Board approval is granted for the recommendations above, training will begin for all affected Business Units. The Industry Forum will be held in January. Metro will also transmit the process flow charts to existing and new construction contractors to begin the application of the new process goals. Further, Vendor/Contract Management Staff,

in partnership with the construction contractor community and Metro Project Managers, will initiate ~~Phase-2~~ process improvements for scope definition and timely submittals of Cost and Schedule Proposals (CSP). The emphasis ~~in Phase-II~~ will be to partner with the contractor community, including the General Association of Contractors (AGC) and the Southern California Contractors Association (SCCA) to improve on the quality and timeliness of CSPs, and to improve the timeliness of payments to prime contractors and small and disadvantaged subcontractors. Staff will apply lessons learned from recent projects to show the contractor community the impact that late and incomplete CSPs have on change order processing, and to improve on the cycle time needed to resolve open change orders and reduce claims. Staff will report back to the Board bi-annually with the results of the change order process improvements and prompt payment reform. ~~Phase-2 effort.~~

ATTACHMENTS

- A. Administrative Code Section 4-15, Processing of Construction Change Orders
- B. New Construction Change Order Board Policy
- C. New Construction Contract Modification Authority (CMA) thresholds
- D. Construction Change Order Process Flow Chart

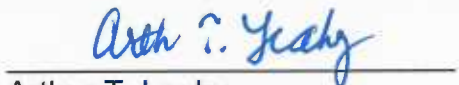
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ATTACHMENT A

Administrative Code Section 4-15, Processing of Construction Change Orders

Chapter 4-15

Construction Change Orders

4-15-010 Purpose and Coverage. The purpose of this Chapter is to adopt a change order procedure as required by Public Utilities Code §130243. The MTA construes the term “change order” as used in §130243 as referring only to a modification of the work to be performed under a contract for construction of a public works project, where the modification of work will result in an increase in the cost to the MTA over the then current base contract amount as modified by any already approved change orders. It is the intent of the MTA that any other contract modification, regardless of how that modification is described or denominated, is not a “change order” as that term is used in Public Utilities Code §130243, and is not subject to this chapter.

4-15-020 Identification of Changes. Whenever any party proposes a change to a construction contract which will involve the expenditure of MTA funds above the amounts contemplated by the existing contract, the MTA contract administrator shall consult with the MTA General Counsel, and technical experts if necessary, to determine whether the proposed change includes work within the scope of the statement of work in the base construction contract as modified by already approved change orders. If it is determined that the proposed change includes work within the scope of the statement of work in the base construction contract as modified by already approved change orders, the requested change order shall be denied. If it is determined that the proposed change includes work which is not covered by the statement of work in the base construction contract as modified by already approved change orders, the change order shall be priced as set forth in this chapter.

4-15-030 Establishing the Price for a Construction Change Order. When a change to a construction contract is identified, as set forth in section 4-15-020, the value for the change shall be established as follows:

A. If the contract was awarded as a design-build contract, the MTA will submit to the contractor a change notice describing the scope of the proposed change.