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Los Angeles County
Metropolitan Transportation Authority

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REVISED
CONSTRUCTION COMMITTEE
OCTOBER 16, 2014

**SUBJECT: CONSTRUCTION CHANGE ORDER STREAMLINING INITIATIVE -
PHASE I**

**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)

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 focus on the means

~~of encouraging the contractor to submit a fully defined efficiency of change order scope of work and completed a cost and schedule proposal. development, and its impact on the entire change order and dispute resolution processes. This second 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. acted upon quickly by both parties.~~

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 and unwieldy 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 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. Phase I of this initiative concentrates on the actions that occur after the cost and schedule proposal is properly submitted by the contractor. Phase II of our

initiative will focus on ways of improving the timely and adequate delivery of scopes of work and cost and schedule proposals by our contracting community.

To reform the Construction Change Order Process, 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 ~~that go before the Board for CMA approval~~ 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. ~~and legal experts, regardless of value. By streamlining legal review to only those changes that present complex issues and high dollar values, time will be saved on all routine change orders that present very little doubt concerning merit or risk.~~
- 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. Phase I of 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. Phase II of the initiative will require partnering with our construction contractors and Metro Project Managers to improve scope of work definition and timeliness.

- Another feature of the new process is that if a change order is not fully negotiated within 60 days, Metro will ~~has the option to~~ issue a unilateral change order, as allowed by the contract, based on Metro's ICE. This feature ~~option~~ 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.

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.

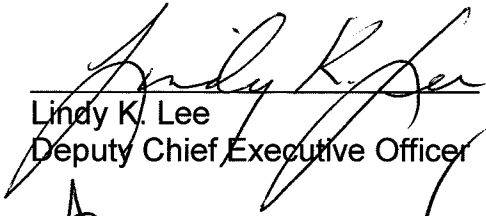
NEXT STEPS

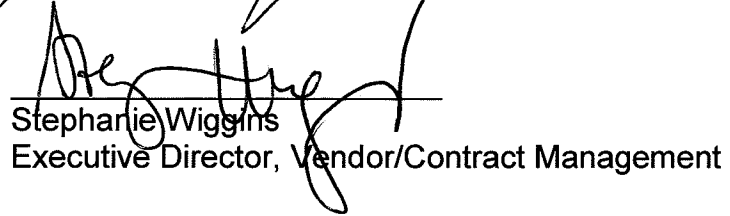
Once Board approval is granted for the recommendations above, training will begin for all affected Business Units. Metro will also transmit the process flow charts to existing and new construction contractors to begin the application of the new process goals. Further, Vendor/Contract Management Staff, 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. 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 with the results of the Phase 2 effort.

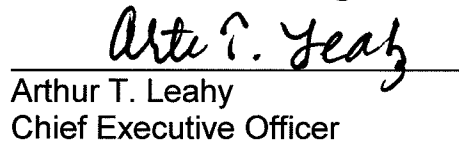
ATTACHMENTS

- 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.

1. If the MTA determines that the cost to complete the work described in the change notice can be determined based upon an evaluation of the scope of the work set forth in the change notice and without the need for detailed plans and specification, the total price for the proposed change, including both design and construction, will be included in a single change order. The actual price to be paid for the change order work will be determined in accordance with paragraphs C, D, E and F.

2. If the cost to complete the work described in the change notice cannot reasonably be determined without detailed plans and specifications, the price for the design of the proposed work and the price to fully complete the work as set forth in the design will each be set forth in separate change orders. The actual price to be paid for each change order will be determined in accordance with paragraphs C, D, E and F.

B. If the contract was awarded as a design-bid-build contract the MTA shall submit to the contractor a change notice describing the scope of the proposed change which shall include plans and specifications describing the specific work to be done under the proposed change order in sufficient detail to reasonably permit the contractor to evaluate the cost of the additional work and to complete it if approved. The actual price to be paid for the change order will be determined in accordance with paragraphs C, D, E and F.

C. Regardless of whether a proposed change is to be added to the contract under a single change order as described in paragraphs A.1 or B., or two change orders as described in paragraph A.2., the MTA and the contractor will separately determine the appropriate value of each proposed change. The MTA independent estimate of the value of the proposed change shall be made by its estimating unit, which shall be organizationally independent of the MTA administrative head of construction. The MTA independent estimate shall be a determination of the estimated cost to the contractor to complete any necessary design work and the actual construction work for the proposed change, plus any contractor markup allowed by the base construction contract. The cost of design and cost of construction may be determined through

separate change orders as described in paragraph A.2. If separate change orders are issued, the change order for the construction work shall not be issued until sufficient design work has been completed to enable a reasonable estimate of the cost of the construction work. To the extent federal cost principles are applicable to the change order, the separate cost elements that comprise the estimate shall be consistent with federal cost principles. The MTA independent estimate of the value of the proposed change shall be audited for accuracy, completeness and consistency with federal cost principles, if applicable, by the MTA management audit services unit if the amount of the independent estimate exceeds \$100,000. The MTA independent estimate of the value of the proposed change shall be provided to the MTA contract administrator, but shall be kept confidential and not provided to the contractor.

D. The contractor shall submit to the MTA contract administrator the contractor's proposed price to perform all of the work under the proposed change. The contractor's price shall include a submittal of certified cost and pricing data in the form of the separate cost elements, including profit, which make up the contractor's proposed price. The contractor's proposed price may be for the cost of construction as described in paragraph B for a design-bid-build contract, or, in the case of a design-build contract, may be for the cost of design, the cost of construction, or the cost of both, depending upon whether the MTA selects, at its sole discretion, to issue one change order for both design and construction as described in paragraph A.1., or separate change orders for design and construction, respectively, as described in paragraph A.2. The MTA contract administrator shall conduct an analysis which compares the separate cost elements in the contractor's proposal with the separate cost elements in the MTA independent estimate. If the contract administrator finds that the contractor's and the MTA's separate cost elements are reasonably consistent and that the contractor's total price for the change does not exceed by more than five percent the MTA independent estimate determined pursuant to paragraph C., the change order(s) shall be issued, or recommended to the Board of Directors if beyond the approval authority of MTA staff, at the price proposed by the contractor.

E. If the contract administrator finds that the contractor's separate cost elements are not reasonably consistent with those in the MTA independent estimate, or that the contractor's proposed price for the change exceeds by more than five percent the MTA independent estimate determined pursuant to paragraph C., the contractor shall be offered the opportunity to execute a change order to do the work in the proposed change for a price equal to, and consistent with the cost elements in, the MTA independent estimate. If the contractor rejects this offer and demands a higher price for the change, the contractor shall submit to the MTA such additional cost and pricing data to support the contractor's price as is reasonably required by the contract administrator to support the contractor's price. Any such additional cost and pricing data submitted by the contractor must be certified by the contractor as current, complete and accurate. If the contractor's proposed price exceeds \$100,000, the MTA's management audit services unit shall conduct an audit of the cost and pricing data required by the contract administrator and submitted by the contractor. If upon review and audit, if required, of the contractor's certified cost and pricing data, the MTA determines that the contractor's proposed value for the change is reasonable, the change order shall be issued, or recommended to the Board of Directors if beyond the approval authority of MTA staff, at the value proposed by the contractor.

F. If after the completion of the procedures set forth above, the MTA and the contractor are not able to agree on the price for the change, the price shall be determined through further negotiations or, if necessary, through legal action or any alternative dispute resolution process which the parties have agreed to utilize. In order to allow continuation of work under the construction contract during any period where a dispute as to the value of the change is being resolved, the MTA may issue a unilateral change order in the amount of the MTA independent estimate of the value of the proposed change as determined pursuant to paragraph C.

G. Nothing in this chapter shall prevent the MTA from using any alternative method allowed by law for pricing a proposed change order, if the MTA, in its sole discretion, determines that such alternative method is in the best interest of the MTA, will produce a price

which reasonably reflects the actual value of the work, and the method of valuation set forth in this chapter is impractical under the circumstances.

4-15-040 Administrative Policies. The CEO may develop administrative policies not inconsistent with this chapter, governing the change order review and approval process, which may include, but are not limited to, policies establishing reasonable time deadlines for the completion of the administrative steps set forth in this chapter.

BOARD POLICY - CONSTRUCTION CHANGE ORDERS

1. Purpose and Coverage. This document sets forth the policy of the Los Angeles County Metropolitan Transportation Authority (MTA) concerning the processing and resolution of construction change orders.

Whenever any party proposes to change the value, time of performance or other material terms of the existing contract, within the general scope of the contract, MTA staff and consultants shall follow this Policy

2. Identification of Changes. It is the intent of the MTA that the MTA Contracting Officer will have the responsibility to administer all change orders, and that the Contracting Officer will, ~~as necessary,~~ consult with the MTA General Counsel on all changes over \$100,000, and all appropriate technical experts, to determine whether the proposed change is within the general scope of the contract and that it does not include work already contemplated by the parties in the base contract as modified by already approved change orders. All change orders that require Board approval shall also be reviewed and approved for merit by the MTA General Counsel and the Contracting Officer.

3. Establishing the Price a Construction Change Order. The MTA and the contractor will independently estimate the value of each proposed change. The MTA will independently estimate the value of each proposed change order in accordance with its established estimating procedures. The contractor's price shall be in the form of separate cost and profit elements, as established by the Contracting Officer. The Contracting Officer is responsible for evaluating and determining the reasonableness of the offered prices and may use any available analytical techniques and procedures to make such determination. The Contracting Officer may request the advice and assistance of other experts to ensure that an appropriate analysis is performed.

4. Negotiation of Equitable Adjustments. The Contracting Officer shall negotiate equitable adjustments resulting from change orders in the shortest practicable time. MTA shall ensure accurate identification and prompt resolution of change orders. Contractors shall not be authorized to proceed with changed work until the scope of work is defined and agreed upon and the price for said work is agreed upon unless the Contracting Officer determines the work is required immediately to avoid a serious work stoppage, delay and/or extra costs. In such case, the Contracting Officer shall establish a reasonable, not to exceed, value for the work to be performed prior to resolution of

scope and price, based on the best available MTA estimate, and sufficient to protect the interests of the MTA.

5. Failure to Reach Agreement. If the parties are unable to agree on an equitable adjustment after reasonable attempts at negotiation, or if the Contracting Officer is unable to obtain sufficient information from the contractor to resolve substantial differences, the Contracting Officer shall issue a unilateral change order establishing the price and other terms of the change, based on the best available information. If the unilateral change order exceeds the delegated authority of the Contracting Officer, the unilateral change order must be approved by Board action. If the parties cannot reach agreement on the terms of the change order, the parties may proceed to the disputes resolution process provided for under the contract.

6. Pricing of Change Orders. Nothing in this Policy shall prevent the MTA from using any method allowed by law for pricing a proposed change order, if the MTA, in its sole discretion, determines that such method is in the best interest of the MTA, will produce a price which reasonably reflects the actual value of the work

7. Administrative Procedures. The CEO is authorized to develop administrative procedures consistent with this Policy. The purpose of such procedures is to establish a process for the efficient administrative review and processing of change orders.

ATTACHMENT C

New Construction Contract Modification Authority (CMA) thresholds

The following changes to Metro's Procurement Manual Acquisition 1, Chapter 10.3.1 are recommended for approval. These changes shall only apply to Construction change orders:

Table 1 - Construction Contract Modification Authority (CMA)

The aggregate Contract Modification Authority over the life of Construction Contracts shall increase from \$100,000 to \$250,000, or 10% of the initial contract value, whichever is greater; except in cases where unique authority is granted by Board action.

The Contract Modification /Change Order Authority for individual Contract actions shall be defined by the table below:

Original Contract Value	Authorization per Individual Contract Modification/Change Order
Up to \$25 million	\$500,000
\$25 Million to \$100 Million	\$ 750,000
\$100 Million to \$500 Million	\$1 Million
Greater than \$500 Million	\$1.25 Million

ATTACHMENT D

Construction Change Order Process Flow Chart

Construction Change Order and Dispute Resolution Process

