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Charbonneau Commission Report

After 261 days of hearings, the Report of the Commission of Inquiry on the Awarding and Management of Public Contracts in the Construction Industry (the “Charbonneau Commission”) was tabled and released to the public on November 24, 2015.

The mandate of the Commission was to inquire into the existence of schemes that could have entailed activities of collusion and corruption over 15 years (1996-2011), including any possible connections with the financing of political parties; to paint a picture of the possible infiltration of organized crime into the construction industry; and to examine potential remedial measures to identify, eliminate and prevent collusion and corruption in the awarding and management of public contracts in the construction industry, as well as its infiltration by organized crime.

In the course of its work, the Commission, at its request, sought and was granted certain additional powers by the Government, including the right to compel production of documents and to carry out seizures.[1] The Commission's work was also extended, owing to the nature and scope of the information obtained and disclosed at that point during its hearings An interim report summarizing the work then completed was deposited on January 13, 2014, in which the Commission stated that it was not able, at that point, to draw any specific conclusions about whether or not any schemes entailing collusive or corrupt activities actually existed, either in connection with political party financing or with the infiltration of organized criminal elements into the construction industry. The interim report also confirmed the need to continue the inquiry, so as to enable the Commission to study potential solutions and make recommendations to expose, eradicate and prevent collusion and corruption in the awarding and management of public contracts.

After completing its additional work, the Commission made public its final report on November 24, 2015.

BLG is pleased to present this brief overview of the Report of the Charbonneau Commission.

The Report of the Charbonneau Commission, which includes 4 volumes and 1,741 pages, sets forth 60 recommendations to prevent collusion and corruption in the awarding and management of public contracts in the construction industry, as well as its infiltration by organized crime.

Those involved in the construction industry will learn with some relief that the problems of collusion and corruption in the industry are not unique to Québec. The Commission admits candidly that it was inspired by solutions put forward in different countries to eradicate corruption and that these problems are not confined to any one player but are the affair of all those involved in the industry-- from the clients, as well as engineers and contractors, down to and including the workers and the labour unions.

The Commission looked and identified various causes for the illegal activities it found to be pervasive throughout the construction industry.

The lawyers of BLG's Construction Law Group are pleased to share with you an overview of a few of the most relevant recommendations for the different players in the industry, as well as a few reflections on the impact of the eventual implementation of these recommendations on major infrastructure projects.

Public Authorities Awarding Contracts

It is not surprising to see that the Commission's first recommendation is that Québec should set up a Procurement Authority that would constitute a centre of expertise for analyzing and

verifying procurement processes, so as to support and oversee all public bodies that award contracts. In the words of the Commission: " *The lack of personnel and the loss of expertise may have created fertile soil for collusion*." The Commission also recommends that the various public authorities be permitted to consolidate their internal expertise in construction matters. Particular emphasis is placed on the case of the MTQ.

The second recommendation is to depart from the rule requiring contracts to be awarded to the lowest conforming bidder, in order to reduce the foreseeability of results in the contract awarding process. There can be no doubt that such a recommendation, if followed, will have a considerable influence on the entire process of awarding public contracts.

One recommendation that will certainly be very well received by contractors is that the delays in payment of construction works be reduced. The Commission recognizes that the prevailing situation, with its overly long payment delays, contributes to restricting competition in the industry, thus promoting the creation and continuation of collusive agreements. Indeed, once they have paid their workers, their suppliers and their sub-contractors, contractors have to bear the financial brunt of any payment delays. The lack of funds that ensues limits the numbers and growth of the contractors, by restricting their ability to undertake new projects. In this regard, in 2013, more than three-quarters of all contractors are said to have refused to respond to at least one call for tenders, on the basis that they viewed the payment clauses as abusive or that they anticipated payment problems. Moreover, delays in payment further penalize small and medium-sized businesses, which do not always have easy access to credit. They are therefore more at risk of experiencing financial difficulties. This situation is unlikely to encourage them to participate in or seek opportunities in any new procurements. Delayed payment by public authorities of the government incites contractors to factor this financial risk into their pricing, with the result that the financing costs are passed on to the authorities and ultimately the taxpayers.

Finally, the Commission recommends subjecting all para-municipal corporations and non-for-profit organizations (NPOs) controlled or subsidized by a public body or a municipality to the same contractual obligations as the entities to which they are related.

Engineers and Consulting Engineers Firms

The Commission also took a look at the consulting engineering industry in Québec and made a number of significant recommendations which, if implemented, will have a notable impact on the professionals.

The Commission stresses in particular the increased role that the *Ordre des ingénieurs du Québec* should play in preventing and detecting the practices which the Commission has brought to light. The Commission noted that Québec is the only jurisdiction in Canada that does not allow a professional order to impose any disciplinary sanctions on a partnership or a corporation that provides professional engineering services, and which limits the exercise of its supervisory powers to engineers as individuals. Since engineers frequently exercise their profession incorporations or general partnerships, the Commission is concerned about the influence that firms may have with regard to the behaviour of some of their members. As a possible solution, the Commission refers to the rules prevailing in the other provinces and in several American states, where the professional orders take a five-pronged approach to regulating firms, namely:

1. Compulsory registration;
2. Issuance of licences conditional upon compliance with express rules;
3. The obligation to report relevant information;
4. The implementation of compliance systems (including the possibility of audits by the professional order); and

5. The imposition of sanctions.

In this regard, the Commission recommends that the Government amend the Québec Professional Code, so that professional service firms operating within the construction industry be subject to the regulatory power of the professional orders in their sectors of activity.

The Commission also deplores the fact that the *Ministère des Transports du Québec's (MTQ)* internal engineering expertise has eroded over the years. It recommends re-balancing the relationship of power between the internal expertise of the public bodies that award contracts and the consulting engineering firms, in order to restore the public bodies' ability to determine whether certain works should be carried out in-house or outsourced.

The Commission further recommends compulsory training in ethics and professional ethics for all professionals, including engineers, and improved training for the directors of the professional orders, so that they will have the necessary knowledge to fulfill their role adequately.

The Commission stresses the importance of heightening the quality of worksite supervision so as to avoid situations of lackadaisical behaviour that have fostered the proliferation of unjustified "extras" or contract amendments on projects plagued by collusion problems.

Following comments from consulting engineers who work in the municipal field opposed to the use of the "adjusted price" formula in awarding municipal contracts, the Commission recommends developing rules governing the awarding of contracts that are better adapted to the nature of the works concerned.

Construction Companies

In order to render more effective Quebec,s public integrity regime, the Commission recommends lowering the share ownership threshold from 20% to 10%, in order for any shareholder to be considered as one of the officers of a corporation and to take into account in assessing the company's integrity. It also recommends empowering the *Régie du bâtiment du Québec* to assess the integrity of officers who hold shares indirectly in any contracting firm.

Public Procurement

Commissioner Charbonneau traced several causes for the emergence and perpetuation of the various schemes she detected during the inquiry.

A number of those causes are intimately connected with the public procurement of construction projects, since, as the representatives of the OECD testified before the Commission, public procurement is a sector of the economy that is extremely vulnerable to corruption due to the large amounts involved; it constitutes a "fundamental risk" for all G20 countries.

The significant value of public procurement contracts in itself constitutes a risk factor, making the procurement of such contracts a favourite target for collusive and corrupt activities.

The Commissioner enumerated some major failings in procurement strategies, in particular the lack of expertise in the field of procurement, which results in some public bodies being exposed to a high risk of collusive agreements and of contributing inadvertently to their continuation over a long period of time.

For example, reference is made to the process involving non-negotiable tariff contracts, called "rate-setting contracts", by which the MTQ sets, for each of the asphalt plants it designates within a pre-determined or identified geographical area depending on the location of the work, a price for manufacturing and laying asphalt. The effect is that pricing

for an entire territory is predetermined and yet, is considered to be open to competition. This way of proceeding provides the owners of these plants with valuable information, facilitating their tacit conclusion of collusive deals to divide up territories among themselves.

The foreseeability of the criteria for awarding public contracts also fosters collusive agreements, because such agreements are based on the cartel's ability to control effectively the results of calls for tenders. Thus, the repeated use of foreseeable and well known criteria, especially the lowest conforming bidder rule, facilitates the organization of cartels, as the commissioners point out.

It is somewhat ironic to note that the legislative and regulatory framework governing the awarding of public contracts in Québec, obliging public authorities to comply strictly with methods and rules regulating the process of awarding public procurement contracts, allows bidders to foresee the results of calls for tenders. For example, when the tenderers know that the contract will be awarded to the lowest conforming bidder, they can easily set up a strategy of collusion, whereby they have only to agree among themselves on the prices to be quoted in the bids they submit in order to determine the outcome of the tendering. The commissioners stress that such a regulatory framework does not prevail in the private sector, where the rules are set by the private clients calling for the tenders. Those clients, if they sense that the process has yielded an abnormal or unsatisfactory result, can attempt to negotiate the outcome with the bidders. This flexibility makes predicting the outcome of a tender process much less certain and reliable.

The Commission believes that the legislation, regulations and consistency of practices of a number of public authorities awarding contracts, over the years, has facilitated the development and continuation of the collusive strategies detected. In the municipal field, although the rules do allow for certain flexibility, permitting the municipal authorities to apply criteria other than price in selecting their contracting parties. Unfortunately few municipalities avail themselves of this flexibility.

A further cause identified is the pressure that can be exerted by the chosen mode of selection of bidders. The lowest conforming bidder rule places the bidder before a difficult dilemma: the higher the profit margin that he desires to achieve, the greater the risk that his bid will be rejected in favour of the tender of a competitor who is prepared to reduce his price. Consequently, in a competitive marketplace, bidders will tend to reduce their profit margins to a minimum in order to improve their chances of winning the call for tenders. The Commission observes that the pressure created by such a system incites contractors to devise schemes to recover their discounted profits, for example by claiming for extras (whether or not justified) or by reducing the quality of the work carried out or by bribing the project supervisor on the worksite. In the longer term, bidders may be tempted to develop a whole system of collusion, designed initially to minimize their losses and then, in the longer term, to guarantee stable, and sometimes highly lucrative, profit margins.

The often insufficient time limits for the filing of bids is also identified as one more cause of collusion. Corrupt public authorities can often impose unreasonably short deadlines for depositing tenders, in order to reduce competition and benefit one bidder that possesses privileged or inside information. Furthermore, substantial and late alterations to a project, often described in addenda, without adjusting the tender filing deadlines accordingly, have the same effect. The case of Montréal's water meters procurement was cited as an example of such a practice, which excluded from the tendering process a consortium formed by SNC-Lavalin, Gaz Métro Plus and Suez Environnement.

Another aspect of tendering that opens the door to abuse relates to selection committees. The Commission demonstrated that the formation of selection committees is largely unregulated, which can open the door to conflicts of interest and problems of undue interference in their decision-making process.

Although since 2010 municipalities have been required to adopt a policy on contract management, which may include provisions governing conflicts of interest arising within selection committees, the Commission notes that use of the regime has been the exception rather than the rule.

Finally, the release of certain information by public authorities can make them vulnerable to illegal schemes. In fact, the disclosure of certain information out of a concern for transparency exposes the authorities to doubtful practices. The release on request of the list of contractors who have obtained or purchased the specifications or tendering documents facilitates the circulation of information within groups of firms wishing to organize collusive agreements. The same holds true for the release of cost estimates for projects. The Commission noted that it was a well-known fact that the amount of the bid bonds that the City of Montréal requires for its tenders equalled 10% of the estimated cost of the work concerned. By disclosing the amount of the bond security required, the City was, in fact, publishing the amount that it expected to pay for the work, which information could obviously be used by any group of firms conspiring to rig the bids.

Conclusion

The report makes for fascinating reading for anybody either interested by or participating in the construction industry. The commission's findings and recommendations will undoubtedly be the subject of much discussion and analysis over the next few weeks and the various construction industry stakeholders will undoubtedly be combing through them to identify those areas or practices which require changes or adaptations.

The extent to which the recommendations will be implemented by the Government with respect to its public procurement regime and process for construction projects remains to be seen but the Commission's revelations, findings and recommendations should provide it with all the motivation and/or justification it may require to act promptly and decisively.

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