



[This is an English version of the decision originally submitted in French to  
Montréal's City Council on January 28, 2019]

## **Recommendation Report Regarding the Expansion and Renovation of the Pierrefonds Library (Call for Tenders 5887)**

(s. 57.1.23 of the *Charter of Ville de Montréal, metropolis of Québec*)

January 28, 2019

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## SUMMARY

*The Office of Inspector General conducted an investigation after receiving a denunciation that Les Constructions Lavacon Inc. demanded a discount from its subcontractors for change orders regarding the expansion and renovation of the Pierrefonds Library. The work was part of a program set up several years ago to increase and improve library services in Montréal.*

*Following the call for tenders issued on January 11, 2017, Les Constructions Lavacon Inc. was declared the lowest compliant bidder with an amount of \$20,350,614.02. Work began in spring 2017 and ended in fall 2018 during which thirty (30) subcontractors worked on the project under the responsibility of Les Constructions Lavacon Inc.*

*As part of its investigation, the Office of Inspector General interviewed ten (10) subcontractors who worked on the Pierrefonds Library project. The investigation revealed that Les Constructions Lavacon Inc. concluded an agreement with each subcontractor under which they undertook to give the company a discount (a “cut”) of 5 to 15% on the value of their work for each change order.*

*The investigation showed that the procedure for paying the discount was the same for all the subcontractors. When a change order was issued, the subcontractors would send their estimate to Les Constructions Lavacon Inc., which would then submit it to the City’s project managers. Once the estimate was accepted, Lavacon would send the purchase order to the subcontractors less an amount equal to the discount included in the agreement. On completion of the work, the subcontractors would send their invoices for the same amount as listed in the purchase order.*

*At no time were the City’s project managers aware of such an agreement and it would have been impossible for them to know about it since the subcontractors were under the responsibility of the general contractor. What’s more, when change orders were received, Les Constructions Lavacon Inc. was required to enter the amount submitted by the subcontractor for the change order on the form provided for this purpose in the contract. The contract thus provided a mechanism for Ville de Montréal to see the amount that the subcontractor would be paid. The method of payment for the discounts received by Les Constructions Lavacon Inc. allowed the company to avoid paying the full value of the work performed by the subcontractors while collecting full payment from Ville de Montréal.*

*The investigation also showed that each subcontractor interviewed concluded such an agreement shortly after the contract was awarded to Les Constructions Lavacon Inc. by Ville de Montréal and that these agreements remained in effect for the duration of the work on the library.*

*Testimony gathered from the subcontractors during the investigation showed that Les Constructions Lavacon Inc. had incorporated the agreement in its contract with subcontractors. Four (4) subcontractors confirmed that this agreement was imposed on them, even though two (2) did not sign the agreement in their contract. For example, a subcontractor explained that an employee of Les Constructions Lavacon Inc. told him that*



*the discount would be applied to the purchase orders even if he refused to sign the agreement. This scheme is unacceptable and should be publicly denounced.*

*Four (4) subcontractors confirmed that they raised the prices of their estimates for change orders to offset the discount they had to give Les Constructions Lavacon Inc. They specified that they increased the price of their estimate by the same amount as the discount they had to give Les Constructions Lavacon Inc.*

*From a contractual standpoint, the Inspector General concluded that because of the agreements, Ville de Montréal did not pay a fair price for subcontracting work arising from change orders. The contractor's actions increased Ville de Montréal's costs for change orders. As one subcontractor explained, almost all his profit was wiped out because of the discount he had to give the general contractor. These losses were impossible for his business to absorb, forcing him to raise the price of his estimates.*

*Two (2) of the four (4) subcontractors mentioned above indicated that it was an employee of Les Constructions Lavacon Inc. who told them to increase the amount of the estimates to offset the discount. A subcontractor confirmed to the Office of Inspector General that he produced two estimates for change orders: a higher estimate including the discount and another excluding the discount, which he kept for his files.*

*Lastly, by having these agreements with its subcontractors, Les Constructions Lavacon Inc. did not fulfill its duty to act in its client's best interests. These agreements placed the company in a conflict of interest between its own interests and those of Ville de Montréal since it stood to gain financially by having the change orders carried out at the highest possible price due to the proportional discount.*

*In conclusion, the Inspector General is of the opinion that such a situation cannot be tolerated at Ville de Montréal and that the actions of Les Constructions Lavacon Inc. during management of the contract constitute a fraudulent practice under the City's bylaw on contract management and recommends that the company be listed in the Register of Ineligible Persons for a period of five (5) years pursuant to such bylaw.*



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## 1. Preliminary remarks

### 1.1 Clarifications

Under section 57.1.8 of the *Charter of Ville de Montréal, metropolis of Québec* (CQLR c C-11.4) (hereinafter *Charter of Ville de Montréal*), the Inspector General has the mandate to oversee contracting processes and the carrying out of contracts by the City or by a related legal person.

The Inspector General decided to avail herself of section 57.1.23 par. 2 of the *Charter of Ville de Montréal*, which states that the Inspector General may, at any time, send a report to the Ville de Montréal Council presenting findings or recommendations that warrant being brought to its attention.

### 1.2 Warning

The Inspector General does not conduct criminal investigations, but investigations of an administrative nature. In this report, each time the term “investigation” is used, this refers to an administrative investigation and should in no way be interpreted as referring to a criminal investigation.

### 1.3 Applicable standard of proof

The Inspector General has a duty to deliver quality reports that are timely, objective, accurate and presented in a manner to ensure that the individuals and organizations under her jurisdiction are able to act on the information provided.

Consequently, in support of her opinions, reports and recommendations, the Inspector General imposes upon herself the burden of proof of the civil standard of the balance of probabilities.<sup>1</sup>

### 1.4 Terminology used in the report

For the sake of simplicity, the Inspector General considers it useful to list the recurring terms in this report. Thus, whenever reference is made to Luigi Pallotta, it will be for actions taken as president of Lavacon. Similarly, any reference to Lavacon's president or head of Lavacon refers only to Luigi Pallotta and no other person. Lastly, when the term “Agreement” is used in this report, it specifically refers to the “Cost-Sharing Agreement” between Lavacon and its subcontractors.

### 1.5 Identification of subcontractors

In order to carry out the investigation, the Office of Inspector general had to meet with ten (10) heads of subcontracting companies hired by Lavacon for the work on the Pierrefonds

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<sup>1</sup> Evidence is sufficient if it renders the existence of a fact more probable than its non-existence (see article 2804 of the *Civil Code of Québec*).



Library. Their testimonies and cooperation during the investigation were essential to uncovering the discounts and their consequences during the work.

Consequently, as provided by law,<sup>2</sup> the Inspector General will protect the anonymity of these witnesses who cooperated during the investigation and none will be identified in this report.

To facilitate reading and comprehension of the investigation and the report, the ten (10) subcontractors will be identified alphabetically from A to J, in bold uppercase letters. Only the Inspector General and authorized staff know their true identities, which under no circumstances have been revealed to Luigi Pallotta, Lavacon and Ville de Montreal's business units.

## **2. Contract covered by the investigation**

### **2.1 Denunciation received**

The Office of Inspector General received a denunciation regarding the Pierrefonds Library expansion and renovation project. Two things were mentioned in the denunciation: first, that Lavacon would not provide the cost associated with its subcontractors' work and second, that Lavacon would demand that its subcontractors pay a "premium" of approximately 15% for work resulting from change orders.

Following receipt of this information, the investigating officers interviewed some of the subcontractors to obtain more details on these allegations and Lavacon's actions during the work.

### **2.2 History of the contract**

In 2007, Ville de Montreal implemented a library renovation, expansion and construction program (RAC) to "increase and improve library services while enriching the cultural quality of Montrealers' living environment."<sup>3</sup> Several projects were targeted by this initiative and in October 2012, the City's Executive Committee approved the expansion and renovation project for the Pierrefonds Library.

On September 26, 2016, a first public call for tenders was issued but then cancelled because the price of the lowest compliant bid exceeded the amount of Ville de Montréal's control estimate, which is mandatory under the *Cities and Towns Act*. Lavacon submitted a bid in this call for tenders but was not the lowest compliant bidder.

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<sup>2</sup> *Charter of Ville de Montréal, metropolis of Québec*, chapter C-11.4., s. 57.1.14.

<sup>3</sup> Ville de Montréal, Les bibliothèques, Programmes RAC.,

[http://ville.montreal.qc.ca/portal/page?\\_pageid=4276,118637577&\\_dad=portal&\\_schema=PORTAL](http://ville.montreal.qc.ca/portal/page?_pageid=4276,118637577&_dad=portal&_schema=PORTAL)



Ville de Montréal re-examined the cost of the project and found ways to reduce it. Thus, a second public call for tenders was issued on January 11, 2017 and fourteen (14) companies obtained the specifications. Ten (10) companies ultimately participated and Lavacon won with the lowest compliant bid of \$20,350,614.02 (taxes, contingencies and incidentals included).

### **2.3 Call for tenders 5887 – Expansion and renovation of the Pierrefonds Library**

On March 27, 2017, the City Council awarded the contract to Lavacon for a construction period from April 2017 to August 2018. Among other things, the work required the contractor to respect the main sustainable development principles for Ville de Montréal buildings by aiming for a LEED-NC Gold certification, make changes to the structure, perform demolition work and remove the existing brick for reuse.

## **3. Scope and extent of the investigation**

### **3.1 Scope of the investigation**

The Office of Inspector General's investigation revolved around the agreements Lavacon would have concluded with its subcontractors, whereby they undertook to pay a “cut” of 5% to 15% of the value of each change order.

To verify the accuracy of the denunciation, more than fifty (50) change orders were analyzed from August 2017 to May 2018. As part of the inquiry, the investigating officers interviewed sixteen (16) witnesses and analyzed more than five thousand one hundred (5,100) pages of documents.

They also interviewed ten (10) of the thirty (30) subcontractors who worked on the library project. Of these, only one subcontractor had not yet performed work resulting from change orders when he met with the investigating officers. The Office of Inspector General's analysis of the change orders therefore deals with nine (9) subcontractors who had performed work stemming from change orders when they were interviewed by the investigating officers. However, the analysis of the *Agreements* and the circumstances surrounding their conclusion relates to the ten (10) subcontractors interviewed.

The investigation showed that Lavacon did in fact have an *Agreement* with its subcontractors whereby it obtained a discount ranging from 5% to 15% on the value of the change orders. By seeking to obtain benefits inconsistent with its contractual obligations, Lavacon failed to act in the best interests of its client and was ultimately disloyal to Ville de Montréal.

#### **3.1.1 Distinction between discount and payment discount**

It is important to distinguish between the discounts discussed in this report and the payment discounts that are a recognized practice in the construction industry. According to the tendering code of the Québec bid depository, a payment discount is defined as “a discount freely granted for prompt payment at the conclusion of a contract between the



lowest compliant bidder and the contractor.”<sup>4</sup> A payment discount is a discount that the subcontractor grants the contractor for paying promptly and is related to the payment method. A payment discount is completely different from the type of discounts discussed in this report, which are related to the subcontractors’ work in response to change orders. The Inspector General would like to emphasize that the discounts mentioned in this report never mean a payment discount between Lavacon and its subcontractors but rather what is commonly referred to as a “cut.”

### **3.2 Notices to interested parties**

Before releasing the results of her investigation, the Inspector General sent each of the parties concerned a Notice to Interested Parties (hereinafter the Notice), in accordance with her duty of procedural fairness. On November 20, 2018, the successful bidder of call for tenders 5887, Les Constructions Lavacon Inc. (hereinafter Lavacon), and its president Luigi Pallotta, each received a Notice apprising them of the relevant facts obtained during the Inspector General's investigation and giving them the opportunity to make their comments and representations in writing to the Office of Inspector General.

On that same day, and for the same purpose, an identical Notice was sent to the business unit of Ville de Montréal involved in the file, the Real Estate Management and Planning Department. In the days following the dispatch of the Notices, the Inspector General received responses to the Notices from their recipients. The facts and arguments submitted were considered by the Inspector General and will be addressed in this report.

## **4. Lavacon’s obligations**

The tender specifications impose on Lavacon a number of obligations, of which the following are relevant to the Office of Inspector General's investigation.

### **4.1 Outsourcing**

Under the *General Conditions* resulting from call for tenders 5887 and reproduced below, outsourcing is permitted for the work, but the contractor must submit to the Director a list of selected subcontractors and a description of the work they will perform.

#### **2.3.3 Sous-traitance**

**Si l'entrepreneur fait exécuter des travaux par des sous-entrepreneurs, il doit :**

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<sup>4</sup> *Code de soumission.*, Bureau des soumissions déposées du Québec., chapitre J., s. 1.1 para. 1.

- 2.3.3.1 soumettre au Directeur, dès l'adjudication du contrat, une liste complète et détaillée précisant le nom des sous-entrepreneurs et les travaux qu'ils doivent exécuter, et aviser le Directeur de toute modification apportée à cette liste après l'adjudication du contrat. Il doit joindre à cette liste et à tout avis de modification de cette liste, le cas échéant, une photocopie de la licence délivrée par la Régie du bâtiment du Québec à chaque sous-entrepreneur; il doit également fournir, en temps opportun, une copie du renouvellement de toute licence venant à expiration avant la fin du contrat;
- 2.3.3.2 fournir, en tout temps, à la demande du Directeur, tout renseignement ou document supplémentaire concernant ces sous-entrepreneurs;
- 2.3.3.3 assumer l'entière coordination des travaux qu'ils exécutent et la responsabilité de leurs actes ou omissions;
- 2.3.3.4 communiquer le contenu du contrat aux sous-entrepreneurs concernés, faire respecter par ces derniers toutes les dispositions du contrat qui les concernent et leur remettre, le cas échéant, une copie du cautionnement des obligations de l'entrepreneur pour gages, biens et services.

Although the contract allows outsourcing, Lavacon's use of subcontractors does not create a contractual relationship between them and Ville de Montréal. Clauses 2.3.3.5 and 2.3.3.6 of the contract are clear and explicit in this regard:

- 2.3.3.5 Le Directeur peut, en tout temps, exiger le remplacement d'un sous-entrepreneur qui n'exécute pas les travaux conformément aux exigences des documents; un tel remplacement ne peut avoir pour effet de créer un lien contractuel entre la Ville et le sous-entrepreneur et ne peut en aucun cas augmenter les obligations de la Ville aux termes du contrat.
- 2.3.3.6 La modification de cette liste n'a pas pour effet de modifier le contrat, ni de créer aucun lien contractuel entre la Ville et les sous-entrepreneurs, ni de relever l'entrepreneur des obligations découlant du contrat.

If the contractor decides to use subcontractors, it is considered to be the general contractor and remains Ville de Montréal's respondent while the work is being performed.

## 4.2 *Change orders*

A change order – or an extra, according to the text of the *Agreements* concluded by Lavacon – is accessory to the main contract and does not change the nature of the main



contract.<sup>5</sup> In other words, the work related to a change order must not change the nature of the main work provided for in the initial contract between Ville de Montréal and the contractor. This work may be carried out by the general contractor or a subcontractor once Ville de Montréal approves the authorized personnel. This distinction is important because it changes the value of the *administration cost* that the general contractor can claim for the work related to the change order.

#### 4.2.1 Administration costs

*Administration costs* are used to cover the general contractor's and subcontractor's profits and general administrative expenses for carrying out a change order.

As provided for in clause 5.1.7.12 of the *Special Conditions*, when the work related to a change order is performed by a subcontractor, the latter may add 12% to the price of the work to cover *administration costs*. Then, the general contractor may add 6% to the amount obtained from the subcontractor to cover its *administration costs* on the subcontractor's work.

Where work related to a change order is performed by the general contractor and not by a subcontractor, the general contractor may add 12% of the value of the work to cover the associated *administration costs*.

Clauses 5.1.7.11 and 5.1.7.12 of the *Special Conditions* state the following:

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<sup>5</sup> *Cities and Towns Act* (CQLR, c. C-19), s. 573.3.0.4.

- 5.1.7.11 Sous réserve de l'article 5.1.7.12, une majoration de 12%, indiquée dans le formulaire 7.1 sous l'appellation « frais d'administration », est ajoutée au montant obtenu selon l'article 5.1.7.9 (A ou B ou C) ou selon l'article 5.1.7.10 (D et E et F), selon le cas, pour couvrir les profits et les frais généraux d'administration, de financement, d'intérêts, d'exécution, de coordination et de surveillance, y compris les frais du chargé de projet et du surintendant.
- 5.1.7.12 Lorsque des travaux additionnels sont exécutés en régie par un sous-entrepreneur spécialisé dans la matière, dont il est fait mention, à ce titre, dans la liste des sous-entrepreneurs approuvée par le Directeur, la majoration de 12 % dont il est fait mention dans l'article 5.1.7.11 s'applique au sous-entrepreneur exécutant. Dans ce cas, pour couvrir ses « frais d'administration », il est payé à l'entrepreneur 6% de la valeur après majoration de 12 % des travaux supplémentaires exécutés par son sous-entrepreneur.

It should be noted that Lavacon is challenging Ville de Montréal's interpretation of clause 5.1.7.12, claiming that it is entitled to 12% in *administration costs* for the change orders, regardless of whether the work was performed by the company or a subcontractor. Although relevant to Lavacon and Ville de Montréal, this matter is beyond the scope of this investigation and was not addressed in this report since it is not related to the subject matter, which is the *Cost-Sharing Agreements*.

#### 4.2.2 Form 7.1

In addition, the contract resulting from call for tenders 5887 provides in the *Special Conditions for Form 7.1* (hereinafter the *Form*) that the City manager or executive and the contractor must use to have a change order approved. This *Form* is used to detail in 10 points the amount claimed for the work performed by the contractor or his subcontractors for extras.

When approving a change order, the general contractor provides a breakdown of the value of the work performed by the subcontractor(s) involved. The *Form* makes it possible to see what work was performed by the subcontractor (line 4) and by the general contractor (line 1). Line 4 also shows that the amount indicated for the value of subcontracted work must include the subcontractor's 12% in *administration costs*. Line 6 indicates the 6% that the contractor can add for its own *administration costs* on the subcontractor's work.

Page 2 of *Form 7.1*, as it appears in the specifications is reproduced below:



1. Valeur des travaux exécutés par l'entrepreneur <input type="checkbox"/> voir ventilation en annexe	(débit)	\$ (1)
2. Frais d'administration selon le c.a.s. article 5.1.7.11 et 5.1.7.12	0.12 % de 1	0.00 \$ (2)
3. Valeur des travaux non exécutés par l'entrepreneur	(crédit)	\$ (3)
4. Valeur des travaux exécutés par un (des) sous-entrepreneurs incluant des frais d'administration de 12.00 % qui lui (leur) sont accordés selon le C.A.S. article 5.1.7.11 et 5.1.7.12		\$ (4)
5. Valeur des travaux non exécutés par un (des) sous-entrepreneurs (crédit)		\$ (5)
6. Frais d'administration	0.00 % de 4	0.00 \$ (6)
<b>7. sous-total</b>	<b>1+2+3+4+5+6</b>	<b>0.00 \$ (7)</b>
8. T.P.S.	0,000 % de 7	0.00 \$ (8)
9. T.V.Q.	0,000 % de 7	0.00 \$ (9)
<b>10. montant total</b>	<b>7 + 8 + 9</b>	<b>0.00 \$ (10)</b>

#### Approbation

n.b. L'approbation de cette directive de changement établit également qu'à la date de son émission le déroulement des travaux s'effectue à l'intérieur de l'échéancier tel que modifié par la présente. En conséquence, la présente directive constitue une transaction au sens du Code civil du Québec quant à la valeur des travaux concernés et établissant que les parties n'ont aucune réclamation à faire valoir concernant le déroulement des travaux jusqu'au jour de l'émission.

Signatures	a	m	j
Architecte <input type="checkbox"/> n/a	:	_____	date : ____-____-____
Ingénieur <input type="checkbox"/> n/a	:	_____	date : ____-____-____
Autre <input type="checkbox"/>	:	_____	date : ____-____-____
Entrepreneur	:	_____	date : ____-____-____
Ville de Montréal			
<input type="radio"/> gestionnaire du contrat	:	_____	date : ____-____-____
<input type="radio"/> cadre autorisé	:	_____	date : ____-____-____

The *Form* therefore requires the contractor to disclose the value of the work performed by its subcontractor as part of a change order. This form ensures transparency between the contracting parties concerning payments and work related to change orders. In addition, we can see at the bottom of the form that Ville de Montréal representatives sign and approve the work based on the value presented in lines 1 to 10. What is not apparent from the form is whether the subcontractors receive the entire amount approved for the work.

To recap, when work related to a change order is performed by a subcontractor, the latter is entitled to add 12% in *administration costs* to the pre-tax amount of his work and the general contractor may then add 6% for its own *administration costs*.

### 4.3 Civil Code of Québec

In addition to its contractual obligations, Lavacon also has general obligations under the *Civil Code of Québec* applicable to contractors who enter into a business contract. Articles 1375 and 2100 of the Civil Code of Quebec require Lavacon to act in good faith and in the best interests of its client in the context of its contractual relationship with Ville de Montréal:

Article 1375: “The parties shall conduct themselves in good faith both at the time the obligation arises and at the time **it is performed** or extinguished.”

Article 2100: “The contractor and the provider of services are bound to act in the best interests of their client, with prudence and diligence. Depending on the nature of the work to be carried out or the service to be supplied, they are also bound to act in accordance with usage and good practice and, where applicable, to ensure that the work carried out or service supplied is in conformity with the contract.

Where they are bound to an obligation of result, they may not be relieved from their liability except by proving superior force.”

## 5. Facts revealed during the investigation

### 5.1 Agreements between Lavacon and its subcontractors

The Office of Inspector General’s investigation revealed a *Cost-Sharing Agreement* between Lavacon and each of the ten (10) subcontractors interviewed by investigating officers. This *Agreement* stipulated that the subcontractors must give Lavacon a 5% to 15% discount on the pre-tax amount of change orders. With respect to the ten (10) subcontractors interviewed, the first *Agreement* was signed in spring 2017, following the contract award by Ville de Montréal to Lavacon.

The Inspector General obtained a copy of the written *Agreement* for nine (9) subcontractors. These subcontractors explained that it was incorporated as a schedule to their outsourcing contracts with Lavacon. Of these, six (6) signed and dated the document while the other three (3) did not sign it even though it appeared in their contract. Although unsigned, the written document evidencing these *Agreements* corroborates these facts. The tenth subcontractor stated that he verbally concluded the *Agreement* with Lavacon and that he did not remember signing an agreement on this matter.




Other than the percentage of the discount they “granted” to Lavacon and the names of the signing parties, the wording of this *Agreement* was the same for all the subcontractors. Among other things, the contract states that the discounts are compensation for Lavacon's representation with the City for certain disputes and changes.

The *Agreement* template is reproduced below:

### Entente relative au partage des frais

Nom du projet : **AGRANDISSEMENT ET RÉAMÉNAGEMENT DE LA BIBLIOTHÈQUE DE  
PIERREFONDS**

Sous-traitant : 

Compte tenu que Les Constructions Lavacon inc. fournit certains services au chantier et au bureau pour le Sous-Entrepreneur et compte tenu que Les Constructions Lavacon inc. défend auprès du propriétaire et ses professionnels la position du Sous-Entrepreneur pour certains litiges et changements, ce qui inclut la correspondance, les rencontres appropriées à cet égard et dans certains circonstances des paiements rapides, le Sous-Entrepreneur en vertu du contrat signé entre Les Constructions Lavacon inc. et le propriétaire pour le projet en titre offre à Les Constructions Lavacon inc. un escompte sur une portion de la valeur des extras. Le Sous-Entrepreneur reconnaît que la valeur de cette compensation est estimée à % avant taxes sur le montant accepté et négocié pour tous les extras. Il est expressément admis par le sous-entrepreneur que le prix soumis n'a pas été augmenté pour tenir compte de l'escompte accordé. Si le prix négocié ne permet pas l'application d'un escompte, le sous-entrepreneur aura le loisir de modifier ou d'éliminer l'escompte, s'il fait la demande à l'intérieur d'un délai de 4 jours ouvrables. Il est noté qu'aucun escompte n'est applicable lorsqu'il s'agit de travaux à créditer.

X   
Signature Sous-Entrepreneur

Date : 

It should be noted that Ville de Montréal was not aware that such an *Agreement* existed between Lavacon and its subcontractors. Moreover, it was impossible for Ville de Montréal to obtain it from the subcontractors as there is no contractual relationship between the City and the subcontractors. This document was obtained pursuant to the powers granted to the Inspector General.



## 5.2 How the Agreements worked

The Office of Inspector General's investigation showed that the procedure for giving the discount was the same for all the subcontractors. The subcontractors interviewed explained that when a change order was received, they submitted an estimate to Lavacon which, as general contractor for this work, submitted a proposal to Ville de Montréal representatives and professionals to approve the price of the change order.

As noted in section 4.2.2, the amount approved on *Form 7.1* was to reflect the 12% mark-up for the subcontractor's *administration costs*, to which Lavacon added a permitted mark-up of 6% for its own *administration costs*.

After approving the change order using *Form 7.1*, Lavacon would send a purchase order reduced by the 5% to 15% discount, as provided for in the *Agreements* with each subcontractor. The subcontractor would then send an invoice corresponding to the purchase order amount, which Lavacon would pay. Using this subterfuge, Ville de Montréal staff could hardly know how much the subcontractors were actually paid, because it was not the amount that appeared on *Form 7.1*.

The discounts given by the subcontractors therefore means that they gave almost all of their *administration costs* away to Lavacon. For example, a subcontractor who gave Lavacon a 10% discount saw his *administration cost and profit* reduced to 2% while subcontractors who gave a 15% discount lost the entire *administration cost* associated with the change order plus another 3%. Note that the *administration costs*, as stipulated in the contract resulting from CT 5887, were to include the subcontractor's profit on a change order.

The Office of Inspector General's investigation clearly showed that there was a *Cost-Sharing Agreement* between Lavacon and its subcontractors for the work on the Pierrefonds Library. The content of this *Agreement* was identical except for the discount rate, which varied among the ten (10) subcontractors interviewed. In addition, the discount was applied in the same way for all the subcontractors, i.e. deducted from the purchase order that Lavacon would send for the change orders.

## 5.3 Inflated change order prices

As presented in section 5.1, the *Agreement* includes a statement by the subcontractors to the effect they did not increase the price of their estimates to offset the discount granted to Lavacon.

During his interview with the investigating officers, Luigi Pallotta reiterated that “the subcontractor does not change his price to offset the discount” and that this discount does not affect the City, because it “has nothing to do with the price.” Similarly, Mr. Pallotta explained that the City is still paying a fair price for the work since this discount comes out of the subcontractor's pocket. Mr. Pallotta added that this discount does not concern the City because this type of agreement is between the subcontractor and him:



“My subcontractor and I agree not to allow the City to benefit from this discount ... .. because it belongs to me and my subcontractor.”<sup>6</sup>

However, the investigation showed that following this *Agreement* with Lavacon, four (4) subcontractors – **A, B, D and E** – raised the price of their estimate for change orders. Moreover, subcontractor **B** said that he increased his price at Lavacon’s request, while subcontractor **C** said that a Lavacon employee asked him to raise his prices but that he refused to do so.

Subcontractors **A, B, D and E** explained that they would raise the value of their estimate by an amount equal to the discount rate stipulated in their *Agreement* with Lavacon. The City therefore did not pay a fair price for these change orders because of the discount Lavacon demanded from its subcontractors. Subcontractor **A** explained that he hid this rate in his estimate because he could not afford to lose 10%:

“For sure we hide it in our estimate [...] we’re not going to lose 10% [...]”<sup>7</sup>

As explained in section 4.2.1, the contract allows subcontractors to add 12% to the amount of their estimate to cover *administration costs*, which include the profits of specialized subcontractors.

However, subcontractor **D** said that once all the different items of the change order are factored in, his price is raised by 10% and that even his employees are not aware of this increase in their estimate. He explained that he has no choice but to increase his price; otherwise, the discount would eat away much of his profit on change orders; his business cannot survive on 2% profit.

Just as for all the other subcontractors, Lavacon paid subcontractor **D** 10% less than the amount of his estimate for change orders.

### 5.3.1 Case of Subcontractor B

Subcontractor **B** explained that he also raised the price of his estimates for change orders by the same amount as the discount rate agreed with Lavacon. He explained that he was “creative” when raising his price but that he never touched the price of labour. An analysis of the documentation showed that he slightly raised the price of almost all the items on his estimate to arrive at a higher price so as to offset the discount.

Subcontractor **B** also explained that it was a Lavacon representative himself who told him to increase his bid price by the same amount as the discount. Subcontractor **B** provided documentation to corroborate the assertion that he raised the price of his estimate for change orders. The documentation consisted of two (2) estimates for a change order, one higher and one at the regular price, which he kept on file.

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<sup>6</sup> Comments by Luigi Pallotta to the investigating officers.

<sup>7</sup> Comment from a representative of subcontractor **A** to the investigating officers.

The investigating officers obtained copies of both (2) estimates. They showed a different amount to reflect the value of the discount. It can be seen that almost all the items are affected, from labour to the cost of the equipment used for the work.

### 5.3.2 *Case of Subcontractor C*

#### 5.3.2.1 *Lavacon's request*

Subcontractor **C** also said that a Lavacon representative asked him to raise the price of his estimate for change orders. During his meeting with the investigating officers, this subcontractor explained that on at least four (4) occasions, a Lavacon representative asked him to raise the price of his estimate for a change order. Each of these Lavacon requests was made verbally and never in writing. Subcontractor **C** emphasized that he refused to do so every time, even though he signed the *Agreement* with Lavacon. In this regard, the subcontractor explained to BIG investigating officers that he quickly signed the document without reading the content of the *Agreement* but maintained that he always refused to raise his prices to offset the discount. Subcontractor **C** said that the Lavacon representative told him that the discount demanded was “Lavacon's profit” and not an amount to defend the subcontractor's interests as stated in the *Agreement*.

#### 5.3.2.2 *Email exchanges*

The Inspector General obtained a copy of an email sent by an employee of subcontractor **C** to the Lavacon project manager that corroborates this subcontractor's assertion. This email was sent well ahead of the original denunciation filed with the Office of Inspector General. The Inspector General notes that Lavacon's project manager's superior had been copied but that Lavacon did not respond to subcontractor **C**'s email.

This e-mail contained the subcontractor's billing items for work done, and as can be seen at the bottom of the e-mail, a statement by the subcontractor to the effect that the amount mentioned in the e-mail was not increased, despite Lavacon's request to do so.

The sentence is easily visible since it is located immediately below the last line indicating the subcontractor's “TOTAL FINAL COST” for the work. In order to ensure confidentiality and protect the identity of the subcontractor, the Inspector General cannot reproduce all the contents of the email without identifying individuals at both Lavacon and at subcontractor **C**. The extract reproduced here therefore does not represent the entire document received:



**Sous-Total :** [REDACTED] = [REDACTED]

**Administration et Profit :** [REDACTED]

**Total frais d'administration et profit :** [REDACTED]

**COÛT TOTAL FINAL :** [REDACTED]

N.B. : Aucun frais supplémentaire de 10% n'a été ajouté aux montants ci-haut mentionnés, pour Lavacon, tel que vous l'aviez demandé.

Merci

The *Nota Bene* states to Lavacon that no additional costs were added. When interviewed by the investigating officers, subcontractor **C** confirmed that his note was intended to indicate to the contractor his refusal to include additional costs because of the latter's request. The rate of 10% is the rate indicated in his *Agreement* with Lavacon, and the "additional charges" refer to the instructions given to the subcontractor to increase the price of his estimate. The Inspector General also notes the subcontractor's use of the term "additional costs" to describe the discounts, thus supporting his assertion that Lavacon asked him to raise the price of his estimate.

In conclusion, four (4) subcontractors (**A, B, D, E**) confirmed that they raised their prices for change orders due to Lavacon's discounts. In addition, two (2) subcontractors (**B** and **C**) explained that it was a Lavacon employee who asked them to increase the amount of the estimates for the change orders. Ville de Montréal therefore did not pay a fair price for these change orders because of the discount these subcontractors had to give Lavacon.

#### **5.4 Incorporation of the Agreement in the outsourcing agreements**

The investigation conducted by the Office of Inspector General also revealed the circumstances surrounding the incorporation of these *Agreements* in Lavacon's outsourcing agreements.

During his interview with the investigating officers, Luigi Pallotta stated that Lavacon did not impose these *Agreements* and that they were reached voluntarily after negotiations. However, the facts show that these *Agreements* were indeed imposed on reluctant subcontractors.

Contrary to Luigi Pallotta's assertions, four (4) subcontractors explained that this *Agreement* was imposed on them, regardless of whether they signed the document in their contract. The facts gathered also show that the *Agreement* was applied to each subcontractor who carried out a change order during the period covered by the investigation.

## 5.4.2 *Signed and unsigned Agreements*

### 5.4.2.1 *Signed Agreements*

The investigation showed that six (6) of the ten (10) subcontractors (**C-F-G-H-I-J**) signed the document and that, of this number, subcontractors **C** and **F** claimed that Lavacon imposed the *Agreement* on them. Subcontractors **G**, **I** and **J** said that they agreed to sign the *Agreement*. Lastly, subcontractor **H** was unable to say whether he had a choice to sign the *Lavacon Agreement*.

During their interviews with the investigating officers, subcontractors **C** and **F** explained the circumstances surrounding the signature of the *Agreement*. For example, subcontractor **C** said that when he met with the Lavacon representative, he was told that the company would take the discount even if subcontractor **C** refused to sign. Subcontractor **F** said that he wanted to refuse to sign this *Agreement*, but that “these are not standard contracts; they’re contracts of adhesion, so everything is imposed [on subcontractors].”

It is important to understand that according to the subcontractors, this *Agreement* was not simply about change orders, it was a condition for securing the main contract. In this regard, subcontractor **G** explained: “We bid on contracts because we’re looking for work, and we’re willing to accept certain irritants in order to land the contract.” Lavacon’s position of strength over the subcontractors and their financial interest in obtaining the outsourcing agreement may also explain why they agreed to give Lavacon the discounts.

### 5.4.2.2 *Unsigned Agreements*

Subcontractors **A**, **D** and **E** did not sign the *Agreement* even though the document was incorporated in Lavacon’s outsourcing agreements. Nevertheless, the testimonies and analysis of the change orders showed that Lavacon also applied the discount for these three (3) subcontractors.

Subcontractors **D** and **E** stated that Lavacon imposed the *Agreement* on them. In this regard, subcontractor **E** explained that he didn’t agree with this type of clause but that he had to give in even though he never signed the *Agreement*. During discussions with Lavacon, an employee told him that the company had this type of agreement with all its subcontractors. Yet, subcontractor **E** said that he had never seen nor signed such a clause before despite the fact that his company generated millions of dollars in annual revenue.

As for subcontractor **A**, the Office of Inspector General obtained a copy of the *Agreement*, which was neither signed nor dated. Although he said that he voluntarily concluded the *Agreement*, the subcontractor could not explain why he had not signed it.

### 5.4.2.3 *Verbal Agreement*

Lastly, unlike subcontractors **A**, **D** and **E**, subcontractor **B** verbally concluded the *Agreement* with Lavacon without signing a written document. He said he agreed to apply



the discount but could no longer recall whether he negotiated or signed an agreement in this regard since it's been more than a year since he signed the contract.

Thus, contrary to Lavacon's claims, the Inspector General notes that four (4) of the ten (10) subcontractors interviewed (**C**, **D**, **E** and **F**) stated that the *Agreement* was imposed on them by Lavacon. Furthermore, despite the existence of unsigned documents for subcontractors **D** and **E**, the Inspector General notes that Lavacon still imposed the discounts ("cut") on these two subcontractors, showing that they did not voluntarily conclude the *Agreements*.

Information Sub-contractor	Existence of Written Document	Agreement Signed by Subcontractor	Estimates Increased by Subcontractors	Verbal Request by Lavacon to Increase Estimate Price	Agreement Imposed by Lavacon
A	✓		✓		
B			✓	✓	
C	✓	✓		✓	✓
D	✓		✓		✓
E	✓		✓		✓
F	✓	✓			✓
G	✓	✓			
H	✓	✓			
I	✓	✓			
J	✓	✓			

#### 5.4.3 Negotiation of the discount

The *Agreement* itself was not up for discussion; only the amount of the discount that had to be "given" by the subcontractor to Lavacon was open to negotiation. Of the ten (10) subcontractors interviewed, seven (7) had agreed to a 10% discount on change orders. The other three (3) subcontractors (**B**, **C** and **G**) had an *Agreement* to give discounts of 5% to 15% on change orders.

Subcontractor **G** explained that the rate of 15% was in the contract that he signed and that he could not reduce it. Subcontractor **B** said that Lavacon had simply asked him to add 5% to the value of his estimate and that there was no negotiation in this regard. The facts gathered during the investigation do not shed light on why this subcontractor was able to obtain a lower discount rate than the others in the *Cost-Sharing Agreement*: the discount rate was set at 5% only for him and subcontractor **C**.

Subcontractor **C** agreed to 10% but explained that it was a mistake to have ever signed such an agreement. He said that he subsequently refused to give this discount and that it was only after lengthy discussions and refusals on his part that Lavacon agreed to reduce the discount to 5%.

Subcontractor A stated that this rate is “always 15%” but that he managed to negotiate with a Lavacon representative to bring it down to 10%.

## 5.5 Other specific cases

During the inquiry, the investigating officers discovered facts not related to the *Cost-Sharing Agreements* but that merit being brought to the attention of the City Council in this report. These facts concern two (2) cases involving two (2) different subcontractors where Lavacon claimed amounts on their behalf that were higher than those submitted.

### 5.5.1 Subcontractor C's change order

The investigating officers found that for one change order, Lavacon claimed amounts on behalf of subcontractor **C** that were higher than what he had actually submitted. Investigating officers obtained a copy of the documents related to this change order to identify the amounts in question.

The subcontractor submitted an estimate dated October 4, 2017 to Lavacon for a change order (“CO-X”) totalling \$13,500, including 12% in administration costs and profits to which the subcontractor was contractually entitled. That same day, Lavacon sent the estimate to Ville de Montréal, adding 12% in additional *administration costs* on behalf of the subcontractor, bringing the total to \$15,120.

Although it is possible that Lavacon sent this estimate before receiving the subcontractor's estimate for CO-X, it is unlikely that Lavacon did not receive the estimate already containing the amount for *administration and profit* shortly after.

A purchase order dated October 18, 2017 was sent by Lavacon to the subcontractor in the amount of \$12,150 for the CO-X work. This amount corresponds to the initial amount of \$13,500 less 10%, i.e. the amount of the discount initially agreed between Lavacon and the subcontractor.

At this point, fourteen (14) days after sending the estimate to the City, Lavacon had all the documents in hand to see that the \$15,120 sent to Ville de Montréal was 12% higher than the amount actually submitted by its subcontractor. Lavacon could have informed the City and changed the estimate by eliminating the duplicate 12% *administration cost*.

Nonetheless, on October 24, 2017, Ville de Montréal's contract manager signed the change order that still indicated \$15,120 as the cost of the work performed by the subcontractor (line 4). On November 27, 2017, the subcontractor sent an invoice of \$12,825 to Lavacon for the CO-X work. This price corresponds to the initial amount of \$13,500 less 5%, the amount of the discount ultimately negotiated with subcontractor **C** (see section 5.2.2).

As can be seen in the following document, on December 4, 2017, almost two (2) months after the subcontractor sent his estimate of \$13,500, a Lavacon representative signed the change order that still showed the cost of the subcontractor's work as \$15,120 (line 4). Below is a copy of the change order containing the amounts described in this section.



Identifying information has been redacted to protect the identity of the persons who signed this document.

Ventilation du montant total (case 11)

1. Valeur des travaux exécutés par l'entrepreneur <input type="checkbox"/> voir ventilation en annexe	(débit)	\$ (1)
2. Frais d'administration selon le c.a.s. article 5.1.7.11 et 5.1.7.12	0.12 % de 1	0.00 \$ (2)
3. Valeur des travaux non exécutés par l'entrepreneur	(crédit)	\$ (3)
4. Valeur des travaux exécutés par un (des) sous-entrepreneurs incluant des frais d'administration de 12.00 % qui lui (leur) sont accordés selon le C.A.S. article 5.1.7.11 et 5.1.7.12		15,120.00 \$ (4)
5. Valeur des travaux non exécutés par un (des) sous-entrepreneurs (crédit)		\$ (5)
6. Frais d'administration	6.00 % de 4	907.20 \$ (6)
7. sous-total	1+2+3+4+5+6	16,027.20 \$ (7)
8. T.P.S.	5,000 % de 7	801.36 \$ (8)
9. T.V.Q.	9,975 % de 7	1,598.71 \$ (9)
10. montant total	7 + 8 + 9	18,427.27 \$ (10)

Approbation

Sous réserve de l'avis de différend

n.b. L'approbation de cette directive de changement établit également qu'à la date de son émission le déroulement des travaux s'effectue à l'intérieur de l'échéancier tel que modifié par la présente. En conséquence, la présente directive constitue une transaction au sens du Code civil du Québec quant à la valeur des travaux concernés et établissant que les parties n'ont aucune réclamation à faire valoir concernant le déroulement des travaux jusqu'au jour de l'émission.

NON APPLICABLE

Signatures

Architecte  n/a : \_\_\_\_\_ date: 2017-10-31

Ingénieur  n/a : \_\_\_\_\_ date: \_\_\_\_\_

Autre  : \_\_\_\_\_ date: \_\_\_\_\_

Entrepreneur : \_\_\_\_\_ date: 2017-12-04

Ville de Montréal

o gestionnaire du contrat : \_\_\_\_\_ date: 17-6-24

o cadre autorisé : \_\_\_\_\_ date: \_\_\_\_\_

Line 4 of Form 7.1 still shows \$15,120 as the cost of the work performed by subcontractor C. As the estimate obtained by the investigating officers shows, the cost of this work was \$13,500 including 12% for administration costs. Lavacon therefore managed to collect the extra amount approved by the City as well as apply the discount to subcontractor C's estimate.



### 5.5.2 Subcontractor G's change orders

Of the change orders analyzed, the documents obtained during the Office of Inspector General's investigation also showed that Lavacon submitted inflated estimates to Ville de Montréal for the work of subcontractor **G** for four (4) change orders.

In these cases, the subcontractor emailed his estimate to Lavacon with a price for the work requested in the change order. At this point, Lavacon had all the information concerning its subcontractor's price. Lavacon then sent an estimate to Ville de Montréal for all the work to be performed, increasing the subcontractor's pre-tax price for the work. Although the estimate was reduced by Ville de Montréal's professionals, Lavacon still managed to get the City and its professionals to approve a price that was higher than the subcontractor's estimate. As a result, Lavacon was able to collect, for its own benefit, the difference between the subcontractor's initial estimate and the amount paid by Ville de Montréal for the subcontractor's work.

For example, on October 29, 2017, subcontractor **G** emailed an estimate of \$896 before taxes to Lavacon for its work. On November 16, 2017, Lavacon sent its price to Ville de Montréal for this work, indicating a pre-tax price of \$2,128 for its specialized contractor's work, a difference of \$1,232 between the two estimates. However, on December 7, 2017, the City's professionals recommended that the amount submitted by Lavacon be reduced to \$1,680, still \$784 higher than the price submitted by subcontractor G for this work.

On December 13, 2017, Lavacon sent the subcontractor a purchase order in the amount of \$761.60, which was the subcontractor's initial estimate less the 15% stipulated in the *Agreement* between the two companies. In this way, Lavacon managed to pocket the difference between its subcontractor's initial estimate and the amount paid by the City, plus the 15% discount stipulated in the *Agreement*.

## 6. Analysis

### 6.1 City's bylaw on contract management

In the Inspector General's view, Lavacon's actions during the work, presented in this report, were grievous and cannot be tolerated. The company used tactics at Ville de Montréal's expense to increase its profits on change orders. In this regard, it bears mentioning the provisions of the City's bylaw on contract management, in effect since January 1, 2018, which prohibits and severely punishes this type of tactic.

“ 17. No one may, directly or indirectly, in the context of preparing or presenting a bid or a contract by mutual agreement, participate or attempt to participate in collusion, corruption, or in a fraudulent tactic, or participate or attempt to participate in another illegal act of the same nature which is susceptible to compromise the integrity of the call for tenders process or the choice of a contracting party by mutual agreement, or the management of the resulting contract.



In submitting a bid or agreeing to a contract by mutual agreement with the City, the signatory solemnly declares that the bidder or the party to a contract by mutual agreement did not violate, directly or indirectly, the first paragraph.” (the Inspector General’s emphasis)

Lavacon’s method of operating resulted in financial loss for Ville de Montréal. Imposing such a scheme on subcontractors causes them to inflate their prices to avoid losing the bulk of the *administration costs* charged for change orders.

As an experienced contractor, Lavacon is fully aware that this type of agreement could lead to inflated prices, especially since the *Agreements* stipulate that subcontractors must not increase their cost estimates. Furthermore, it was in a position to financially benefit from estimates being submitted and accepted at the highest possible price due to the proportional discount it could then receive.

The Inspector General therefore concludes that Lavacon’s actions constitute a fraudulent practice within the meaning of the City’s bylaw on contract management.

## **6.2 Act in the customer’s best interests**

As mentioned in 4.3 of this report concerning Lavacon’s duties in a contractual relationship, the contractor is bound to act in the best interests of its client. Article 2100 of the *Civil Code of Québec* is a public policy requirement<sup>8</sup> and the courts have, in the past, sanctioned this type of agreement between a contractor and its subcontractor.<sup>9</sup> The duty to act in the client’s best interests, with prudence and diligence is “very important and even fundamental”<sup>10</sup> in a contractual relationship:

“In addition, due to the presumed relationship of trust in a business contract between the owner and the contractor, in dealing with subcontractors, the contractor must often act as a spokesperson and defend the interests of the owner.”<sup>11</sup>

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<sup>8</sup> KARIM, Vincent, *Contrats d’entreprise (Ouvrages mobiliers et immobiliers : construction et rénovation), contrat de prestation de services et l’hypothèque légale*, 3rd edition, Wilson & Lafleur, 2015., par. 294.

<sup>9</sup> *Développement Tanaka inc. c. Corporation d’hébergement du Québec*, 2009 QCCS 3659, par. 461. (affirmed *Développement Tanaka inc. c. Corporation d’hébergement du Québec*, 2011 QCCA 730) ; *Innovtech Construction inc. c. Centre universitaire de santé McGill (Hôpital de Montréal pour enfants)*, 2010 QCCS 5190.

<sup>10</sup> *Développement Tanaka inc. c. Corporation d’hébergement du Québec*, 2009 QCCS 3659, par. 461.

<sup>11</sup> KARIM, Vincent., cited above in note 8, par. 305.

By signing the *Cost-Sharing Agreements*, Lavacon did not act in the best interests of its client because it encouraged its subcontractors to not offer their best price for change orders. The *Agreements* concluded with the subcontractors put upward pressure on the prices quoted for change orders. The subcontractors interviewed explained that agreeing to the discount without inflating prices is tantamount to losing any profit on a change order. For example, a subcontractor who has to give Lavacon a 15% discount loses any profit stipulated in the contract resulting from the call for tenders. The Inspector General finds it hard to believe that Lavacon acted in good faith by demanding such a discount from its subcontractor.

Furthermore, Lavacon put itself in a position to benefit more financially when the work was performed at a higher price, thus placing its own interests above its client's. In doing so, it was no longer in a position to properly advise and inform Ville de Montréal on the performance of the work. In *Tanaka*, the court added that the duty to act in the client's best interests includes the contractor's role to advise and inform:

“The Court has no doubt that for the contractor, “acting in the client’s best interests,” means, among other things, fully assuming its role of advising and informing the client and avoiding conflicts of interest between its own interests and the client’s.”<sup>12</sup>

Worse still, as mentioned earlier, two (2) subcontractors stated that a Lavacon employee told them to increase their prices to factor in the discounts. Such grievous action goes completely against the interests of its client, Ville de Montréal. In this regard, one of the two subcontractors provided a copy of an email corroborating his explanations and to which none of Lavacon's representatives responded to deny, question or challenge the information it contained.

### 6.3 Fair price

The Office of Inspector General's investigation also shows that the work of subcontractors **A**, **B**, **D** and **E** for change orders was not performed at a fair price due to the discounts they had to give Lavacon.

In his response to the Notice, Luigi Pallotta quotes a passage from the *Tanaka* decision mentioned in 6.1 concerning the contractor's duties: “The contractor is usually best placed to effectively evaluate subcontractors' prices.”<sup>13</sup> The Inspector General agrees with Mr. Pallotta's observation, especially since under the contract resulting from CT 5887, “the contractor is required to provide all relevant information concerning execution of the work within its purview.”<sup>14</sup> It is all the more egregious that a general contractor such as Lavacon, benefitting from a key position between the City and subcontractors, concluded *Cost-Sharing Agreements* and asked subcontractors to raise the price of their estimates.

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<sup>12</sup> *Développement Tanaka inc. c. Corporation d'hébergement du Québec*, par. 463.

<sup>13</sup> *Développement Tanaka inc. c. Corporation d'hébergement du Québec*, par. 463.

<sup>14</sup> Clause 5.1.2.4, *General Conditions*



Thus, by concluding or imposing the *Agreements*, Lavacon was no longer in a position to effectively evaluate the prices of its subcontractors given the potential gain it could derive from them:

“The Court must find that a contractor who benefits from a large percentage of the additional costs generated by a change order becomes vulnerable with respect to subcontractors and may tend to accept their requests much more readily given the personal benefit it will derive. At best, it may be much more complacent and understanding; at worst, it may be downright interested in seeing the costs be as high as possible.”<sup>15</sup>

The explanations provided by subcontractor **B** show the situation in which this company was placed due to the discounts and the consequences of the *Agreement* on its estimates. Subcontractor **B** raised the price of his estimates by slightly increasing the cost of each item on the change order. Proceeding in this manner made it difficult to identify the increases and Lavacon collected its discount on the purchase order issued after the work.

The Inspector General concludes that it would be useful for Ville de Montréal to consider implementing measures during the work management process to determine the actual amount paid by a contractor to a subcontractor. For instance, it would be helpful to add a clause in the contract requiring the contractor to provide the City with the subcontractors' purchase orders and invoices for change orders.

#### 6.4 Other specific cases

In addition to applying the *Agreement* and the discounts with the two subcontractors identified in sections 5.5.1 and 5.5.2, Lavacon itself raised the prices of these subcontractors for the change orders. These price increases were in addition to the amounts from the *Cost-Sharing Agreement* and merit a separate analysis by the Inspector General.

Lavacon entered an amount – obviously higher – for its subcontractor's work that was not the real estimate it had received for this work. Whenever Lavacon's representative signed a change order, he or his superior knew that the amount accepted by Ville de Montréal for this subcontractor was higher than the cost of the work performed by the subcontractor.

Although the amounts involved in these change orders are but a few thousand dollars of the project's total value, the fact remains that Lavacon committed a serious breach by claiming from the City amounts that were not submitted by the subcontractors.

## 7. Conclusion

The Inspector General is of the opinion that the methods used by Les Constructions Lavacon Inc. constitute a fraudulent practice under the City's bylaw on contract management and therefore recommends that the company be listed in the Register of

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<sup>15</sup> *Développement Tanaka inc. c. Corporation d'hébergement du Québec*, par. 470.

Ineligible Persons pursuant to the bylaw on contract management. Manipulating a subcontractor to pay a “cut” to be able to work on a project is already unacceptable in itself. Then there is the impact on the amounts entered on the change orders. Lavacon’s actions prevented Ville de Montréal from obtaining fair prices for change orders associated with work on the Pierrefonds Library.

These agreements led to higher prices for change orders due to the discounts demanded by Lavacon. The subcontractors interviewed explained that if they did not raise the prices of their estimates, they would lose most of the profit generated by these change orders. Such actions are unacceptable on the part of a general contractor who, it will be recalled, plays an advisory role to the City during the work.

In so doing, Lavacon placed itself in a conflict of interest between its own interests and those of Ville de Montréal since it gained financially by having subcontractors perform the work at the highest possible cost. In the Inspector General’s view, these actions show that Lavacon was seeking to gain financially at the expense of Ville de Montréal by circumventing its contractual obligations.

Under section 57.1.23 of the *Charter of Ville de Montréal*, the Inspector General may, if a situation so warrants, send a report to the City Council. The Inspector General is of the opinion that the findings of this report are sufficiently grievous not only to send a report but also to make a recommendation to the City Council to list Les Constructions Lavacon Inc. in the Register of Ineligible Persons for five (5) years pursuant to the bylaw on contract management.

As well, in order to better equip Ville de Montréal employees to prevent similar schemes in the future, the Inspector General recommends that additional control measures be developed in tender documents with a view to ensuring billing integrity and transparency.

The Inspector General believes that Les Constructions Lavacon Inc. is not the only company that could use the scheme uncovered by her investigation. For these reasons, the Inspector General reiterates that not only will oversight be increased but that such conduct will be publicly denounced and sanctioned under the City’s bylaw on contract management. The Inspector General invites all persons, particularly subcontractors, who are confronted with such schemes to report them to the Office of Inspector General.

Lastly, as provided by law, given the reprehensible and grievous nature of the actions discovered during her investigation, the Inspector General will send these findings to the Anti-Corruption Commissioner.

## **FOR THESE REASONS,**

The Inspector General



## RECOMMENDS

1. That Les Constructions Lavacon Inc. be listed in the Register of Ineligible Persons for five (5) years pursuant to the City's bylaw on contract management.
2. That the Real Estate Management and Planning Department develop control measures to ensure the integrity and transparency of invoices it receives for contracts of a similar nature;

**REPORTS**, in accordance with section 57.1.18 of the *Charter of Ville de Montréal, metropolis of Québec*, the findings to the Anti-Corruption Commissioner.

**SENDS**, in accordance with section 57.1.18 of the *Charter of Ville de Montréal, metropolis of Québec*, a copy of this decision to the *Autorité des marchés financiers* in light of its mandate under Chapter V.2 of the Act respecting contracting by public bodies.

The Inspector General

Brigitte Bishop

**ORIGINAL SIGNED**