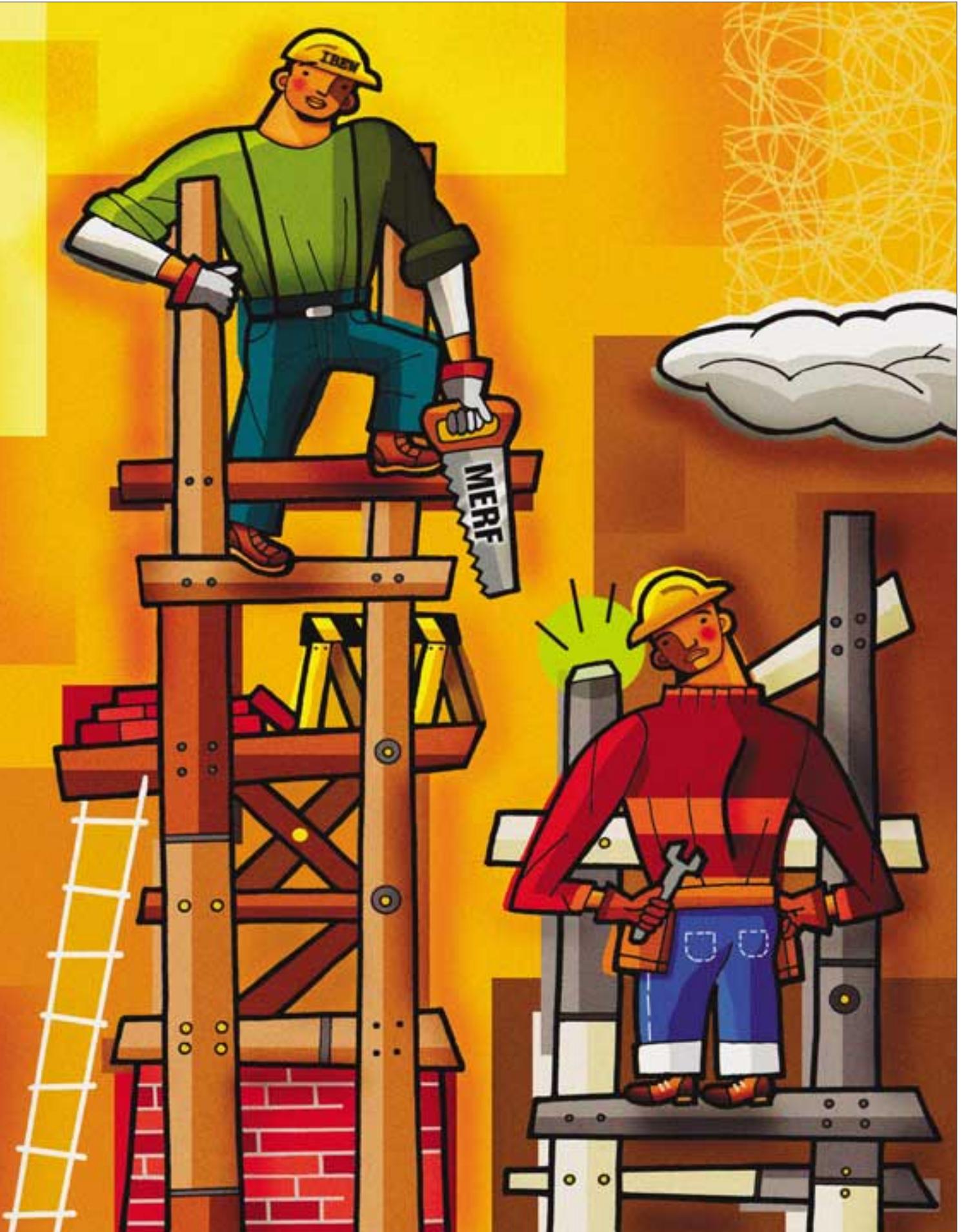


How a controversial
union practice threatens
the construction
industry's competitive
bidding system.

BY JOEL THOMPSON

The Problem with MERFing

ILLUSTRATION BY SYLVIE B O U R B O N N I È R E



SUBMITTING A bid for a construction job is a complex and risky proposition. With every bid, you literally bet the company. Do it well and you can obtain work at a good price that enables your company to prosper. Make a mistake estimating materials or find yourself unable to execute the work at the expected cost, and the impact could put your company under.

The greatest variable in bids is estimating labour costs. For all bidders, the final product and materials are the same, as set out in the drawings and specifications. What separates one contractor from another is the way the pieces are assembled, the processes used and the employees that will implement them.

So imagine your reaction if some players no longer played by the same rules and were able to eliminate their risk. Despite the time, effort and expense you put into preparing bids, you are now losing tenders to a competitor whose labour is subsidized by a third party. That is what union Market Enhancement Recovery Funds, or MERFs, are doing to the construction industry.

History

THE ORIGINS OF what are known as Market Enhancement Recovery Funds and the practice of MERFing can be traced back to the U.S. as far back as the early 1980s. There, construction unions such as the International Brotherhood of Electrical Workers (IBEW) developed a tactic called job-targeting whereby different union locals and unionized contractors' associations would agree on concessions, usually wage reductions, in order to submit a more competitive bid when it was known that non-union contractors would be bidding.

This formalized process differed little from what had often occurred informally in the past: union business agents offering to supply manpower during bad economic times for less than the collective agreement wage rates, or looking the other way when employers did not meet collective agreement requirements. The unions had also commonly used project

agreements to accomplish the same thing on a larger scale. They were a means to offer wage and condition concessions in order to secure deals that would designate major projects as union-only closed shops.

Working for less than collective agreement rates has always proved unpalatable for union members and has been a source of internal strife. While project agreements may win grudging support from the rank and file because the large projects they applied to often employed the majority of a local's membership, job targeting or enabling provisions were usually directed at smaller projects. As a result, some members would be working at full scale

WHILE UNIONS DEFEND MERFING AS A BENIGN FORM OF WAGE STABILIZATION, THEY PRESENT IT DIFFERENTLY TO THEIR OWN MEMBERSHIP. HERE, MERFS ARE SOLD AGGRESSIVELY AS A MEANS OF REGAINING MARKET SHARE AND DRIVING NON-UNION COMPETITION FROM THE MARKET

while others would be receiving lesser amounts. This created problems within the membership which were further aggravated by hiring hall processes which arbitrarily determined who would be assigned to full wage projects and who would be dispatched to projects where job targeting resulted in lower wages. As a result of the internal dissension, the original job targeting programs gave way to funded job targeting plans.

Funded job targeting involves agreements between union locals and unionized contractor groups to create funds that are used to subsidize collective agreement rates on specific projects. Money for the funds comes from two sources: special dues paid by members, or through employer-paid assessments added to collective agreements. These additional assessments are paid by employers as another part of the gross wage package which also includes remittances for benefit plans,

training trusts and pensions. These funds are then used to top up the wages of union members working on job-targeted projects, thus giving union contractors a substantial reduction on the labour component of their bids without requiring individual union members to work at less than the full rate.

Initially, the union paid out wage top-ups from the fund directly to employees working on targeted jobs. Because this required considerable administrative effort, the process was soon abandoned in favour of making direct payments from the fund to the contractor on the targeted project. Under this arrangement, the subsidized contractor pays wages at full collective agreement rates and is then reimbursed for the agreed wage subsidy by payment from the fund.

Now, nearly 20 years after their appearance south of the border, many Canadian locals of the international construction unions have market recovery funds as part of their collective agreements. In the current agreement between the IBEW and the unionized electrical contractors in Alberta, for example, 80 to 96 cents per hour is directed into a MERF. In keeping with the idea that funded job-targeting means no union member works at a lower wage rate, the agreement states that "such contributions are to be made solely by the Employer and no Employer shall deduct such contributions or any portion thereof from an Employee's wages." Other unions employing MERF funds in Alberta include the Plumbers and Pipefitters, and the Insulators.

The debate

IF A UNION contractor expects there will be non-union competition in a bid for a particular job, the contractor applies to the union for a subsidy, indicating the amount required to be the lowest bidder and the estimated total hours for the project. If the union approves the application, the contractor is then able to submit a bid virtually risk-free. If the bid is won, cash payments from MERF funds are made to the contractor based on the per hour rate of subsidy multiplied by the number of hours worked by the contractor's crew.

Non-union contractors feel this practice is akin to buying jobs. If there is a high profile job that the union wishes to be manned by

union forces, the union can provide a level of subsidy to the labour component of the bid that will virtually guarantee low bidder status for the selected union contractor.

Even the strongest opponents of MERFing concede that the unionized sector has the need, and the right, to compete on price. However, they feel the manner in which MERFs are being employed distorts the market and should be declared an unfair bidding practice. The unions' own description of its MERF strategy tends to support that argument. The term job-targeting indicates the selective nature of the process. The availability of MERF money gives unions the ability to target specific projects, geographic areas or market sectors – even individual contractors they might want to drive out of business.

In responding to criticism, unions and unionized contractors claim MERFing is simply a way to level the playing field. That argument is difficult to support given the level of subsidy MERFed bids seem to contain. In the commercial sector – the arena where MERFing has caused the biggest controversy – union and non-union hourly wage rates are nearly identical. However, MERF payments are commonly in the area of \$8 per hour and may be as high as \$15 per hour.

While unions defend MERFing as a benign form of wage stabilization, they present it differently to their own membership. Here, MERFs are sold aggressively as a means of regaining market share and driving non-union

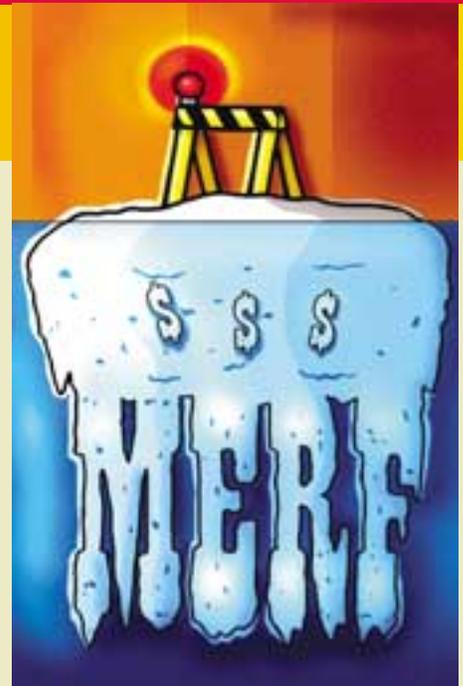
MERFing and the Iceberg Effect

How much unethical bidding activity goes on through the use of Market Enhancement Recovery Funds (MERFs)? Getting information on the devious ways the funds are applied is difficult since, like an iceberg, most of the mass remains below the surface, undetected. Even those not directly affected by bid subsidies believe MERFs threaten the construction industry's carefully nurtured tendering system – a system that relies on integrity and ethical behaviour by bidders.

The following examples illustrate what many players in the construction industry would consider to be the unethical side of MERFing:

1) A major retail facility with a large electrical renovation component is tendered and the electrical prices submitted to the general contractor. The union bidder obtains the prices submitted by each of the competitors and finds his bid is considerably higher than the others. Before awarding the contract, the owner issues an addendum to install additional electrical fixtures so the union bidder approaches the union and tells them how much higher they were on the original tender. The union provides a MERF subsidy on the addendum that bridges the gap in the original bid and the contract is awarded to the union contractor.

2) The sprinkler system component is generally considered a sub price to the mechanical contractor. In preparing a bid on a mechanical package, a mechanical contractor will receive prices for the sprinkler portion from specialists in that field. Although an open shop contractor had the lowest bid, the unionized mechanical contractor is encouraged to take the higher union contractor sprinkler price because the union will sub-



sidise the difference between the two bids. This undermines the competitive bidding system.

3) A union feels a certain general contractor is not carrying enough union bidders in the pre-tender process so, when a project is tendered, the union instructs the unionized electrical contractors bidding not to provide that contractor with the MERF-subsidised price. As a result, the general contractor loses the work by a small margin to another contractor that received the lower, MERF-subsidized rates for the electrical work.

4) A union contractor loses a project and is curious how a unionized competitor submitted a much lower price. Upon further investigation, the contractor discovers that the union provided the competitor with a MERF subsidy. MERF subsidies are largely controlled by the union which allows them to play favourites. Why are certain projects subsidized and others not? Why is it that, in some cases, not all union bidders are given access to a MERF subsidy on the same project? Only the union knows.



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competition from the market. National publications and local newsletters from the IBEW - perhaps the most prominent proponent of MERFing - unabashedly tell how an Oregon MERFing initiative helped force non-union contractors to capitulate to the union and sign a collective agreement simply to continue to operate.

In Alberta, the IBEW describes MERFing as a means of allowing their contractors to compete. Yet at the same time, the union is using the promise of MERF money as an incentive to persuade non-union contractors to jump to the union side by voluntarily recognizing the union. To date, the IBEW has had few, if any, takers. Consequently, the union has funneled a significant amount of money in southern Alberta to a B.C.-based contractor that the union claims has grown from 10 employees to 400, thanks to MERF support of tenders.

Alberta's unique situation

IN ALBERTA, UNION construction in many trades is almost exclusively limited to the industrial sector - the result of a major re-ordering of the marketplace following the catastrophic crash of the early 1980s.

That market sector became exceptionally robust after many billions of dollars were invested in huge oil sands and petrochemical developments. These mega-projects were mostly built under union-only project agreements. Due to their size, these projects have a major impact on the construction market and the provincial economy as a whole. However, the terms and conditions of the project agreements are only peripherally connected to true market forces. Most work was done cost-plus, which removes incentives for cost-effectiveness. In an additional twist, energy project sponsors also negotiated royalty relief with the provincial government, deferring royalty collection on production until the capital costs of the new facilities have been recovered. This arrangement has further insulated these projects from the market forces that operate in other sectors of the construction market. Perhaps predictably, many of these projects have experienced enormous, multi-billion dollar cost overruns.

The huge volume of industrial construction provided a financial source for Market



SOME CONSTRUCTION OWNERS HAVE ACKNOWLEDGED THE NEGATIVE EFFECT BID SUBSIDIES HAVE ON THE MARKET AND HAVE INSERTED ANTI-MERFING CLAUSES INTO THEIR INSTRUCTIONS TO BIDDERS.

Enhancement Recovery Funds that is disconnected from normal market forces. While costs are certainly not ignored on these projects, their influence is skewed by the arrangements under which the projects proceeded. Consequently, a great deal of money was generated for MERFs - money that is now being used in an attempt to recover the unions' lost market share in the commercial sector. Alberta's MERFing situation could be described as a transfer of wealth from construction purchasers in the industrial sector and also, via foregone royalty revenues, the taxpayers. The recipients are developers and owners in the commercial/institutional sector.

The impact

SURPRISINGLY, EVEN in the construction industry, many people have never heard of MERFs despite the fact the practice has now become commonplace in some market sectors. The Plumbers & Pipefitters in northern Alberta listed some 1,600 MERFed projects between 1993 and 1997, a period when the money available was rather limited compared to the post-1997 period.

This flow of money is affecting the construction market in a number of ways. The most obvious impact is on non-union contractors and their employees in the commercial sector. Many are outraged at what they describe as a legalized bid-rigging scheme and have sought legislated solutions to end this

practice. Contractors who bid against MERF-subsidized bids feel they are in an untenable situation. The bids they submit must cover their costs or they cannot remain in business. Meanwhile, MERFed bids aren't determined by the cost to do the work but by the level of subsidy available from the union. MERFing also removes the issue of worker productivity from the bidding equation since the contractor with the most productive and efficient workforce does not necessarily win a bid against a competitor whose labour cost has been subsidized.

The injection of Market Enhancement Recovery Funds into the market also produces other collateral damage. The most noteworthy is the impact on the carefully nurtured system of competitive tendering by which the construction industry operates. The efficient operation of this mechanism is important to general contractors, project managers, architects, engineers and long-term buyers of construction services. For this group, having non-union contractors refusing to bid on projects they believe will attract MERF subsidies is not a welcome development.

Some construction owners have acknowledged the negative effect bid subsidies have on the market and have inserted anti-MERFing clauses into their instructions to bidders. In at least one instance, union proponents demanded the clause be removed and threatened legal action.

The influence MERFing has on the collective bargaining regime for the union sector of the industry also must be considered. If the union sector is to remain viable, unionized employers need to negotiate collective agreements with their unions that reflect market realities. MERF subsidies shield contractors and union workers from market forces and perpetuate the idea that all is well under the current system.

While union contractors may support the goal of driving non-union competition from the marketplace, they recognize the negative long-term implications of a business model that includes bid subsidies. The most important may be the impact on collective bargaining in a market where union contractors must rely on MERF subsidies to win work. Union members who work at full rate on

MERFed projects are insulated from market realities and will not be easily persuaded to vote for a collective agreement that would allow their unionized employers to be competitive – or to vote for a union executive that might tell them such a step is necessary.

Indeed, the “all is well” impression that MERF-funded jobs create among union members may lead them to expect additional improvements in new collective agreements. This will put their employers even further out of touch with the marketplace and lock them into a situation where they have no hope of competing or even being able to exist without subsidization. This scenario is not sustainable even in good market conditions and is vulnerable to collapse in an economic downturn.

While unionized contractors might be seen to benefit substantially from MERF or job-targeting programs, many employers in the union sector are reluctant participants and, at best, view the subsidies as a survival strategy in markets where they cannot compete. One former union contractor compares MERF subsidies to opium, saying that union contractors can't survive without it and need larger and larger hits. Some are dissatisfied with the unions' ability to control who wins which job and, in British Columbia, a union made an out-of-court settlement in a lawsuit brought by a union contractor claiming that the union reneged on its subsidy commitment.

The future of MERFing

WHAT WILL HAPPEN to market recovery schemes in the future? Will the unions succeed in their efforts to regain market domination? Will bid subsidies be banned by regulatory bodies or continue to be a part of the construction market?

MERFing is under attack on many fronts. In Alberta, the provincial government is under pressure to introduce legislation that would make bid subsidies by unions illegal. Well-organized open shop contractors, including the Merit Contractors Association, continue their strenuous opposition to MERFing on the political front. As well, other industry players such as owners, architects, general contractors and construction associations are also being lobbied.

There is also considerable anti-MERFing

sentiment expressed by unionized contractors. Many bitterly resent the control they give up to the union when they become dependent on MERF subsidies. They would much prefer working under a collective agreement that allows them to be competitive. Similarly, some union workers employed in the industrial arena question why they should subsidize members who work in the commercial sector. In B.C., disgruntled union electricians have launched a class action lawsuit against the IBEW seeking the return of money that the union paid out in subsidies to contractors.

While unions have claimed success with MERFing in some U.S. markets, that may not be the case in Canada. Economists suggest that market forces will eventually prevail and construction will be performed by the most efficient provider of the service. How long MERF schemes will be able to ward off those market forces is difficult to predict.

Alberta is currently the main Canadian battleground over MERFing. Industry developments may soon put the system to the test. The run of big industrial projects in northern Alberta that served as the main source of MERF funding is threatening to decrease, perhaps substantially. While there are still new projects pending, uncertainty over the Kyoto Protocol and the huge cost overruns experienced on just-completed projects have prompted some delays as owners re-evaluate their plans. Meanwhile, the cost and productivity problems experienced on the union projects have allowed open shop competition to make new inroads in the industrial market.

This year may prove to be a crucial period for market enhancement recovery schemes. The downturn in the unions' core industrial market will produce substantial unemployment in union ranks for the first time in several years, creating pressure from the membership to increase the use of MERFs to buy jobs. Without the large mega-projects to generate cash, this will quickly deplete the funds but will also increase opposition from anti-MERFing forces in the industry.

The changing market conditions will also coincide with scrutiny of MERFing practices by regulators. Increasing opposition from contractors losing contracts as a result of MERF subsidies now has the attention of MLAs.

MERFING IS UNDER ATTACK ON MANY FRONTS. IN ALBERTA, THE PROVINCIAL GOVERNMENT IS UNDER PRESSURE TO INTRODUCE LEGISLATION THAT WOULD MAKE BID SUBSIDIES BY UNIONS ILLEGAL.

Certainly, awareness of MERFs has increased. Only a few months ago, the terms MERF and MERFing might have been met with puzzled looks. Today, discussion of the practice is widespread within the industry, government and the wider business community. Nonetheless, only time will tell if the attention MERFs are receiving, and the mounting opposition against them, will result in their disappearance from the Canadian construction scene. ☐

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